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# FREEHOLD BLOCK MANAGEMENT

**Quick guide: Tenants' right of first refusal**

Part 1 of the Landlord and Tenant Act 1987 (the Act) grants leaseholders of residential buildings, in certain circumstances, the right of first refusal where a freeholder intends to dispose of its interest in the building. If caught by the Act, a freeholder cannot make the disposal unless it has first offered the leaseholders the right to purchase the interest in accordance with the formal procedures set out in the Act.

This guide aims to provide freeholders and managing agents with an overview of the Act, when it applies and what they need to do to comply.

# Quick guide: Tenants' right of first refusal

## WHO HAS TO COMPLY?

Almost all freeholders are obliged to comply with the Act, but there are a few exceptions:

- Local authorities and various other public bodies
- Housing associations
- Development corporations and urban development corporations
- Resident landlords. A freeholder only counts as a resident landlord for the purpose of the Act if:
  - He/she is an individual, not a company;
  - The building is not a purpose-built block of flats (i.e. it is a building or house which has been converted into a number of flats);
  - The landlord occupies a flat in the building as his/her only or principal residence and has done for at least the last 12 months.

## WHICH BUILDINGS?

The Act applies to a building if:

- The building contains two or more flats held by "qualifying tenants". A qualifying tenant means the tenant of a lease which is granted for at least 21 years or more.
- More than half of the flats in the building are held by qualifying tenants.
- If the building is mixed use, the internal floor area of the non-residential parts (not including any common parts) amounts to less than half of the total internal floor area of the Premises.
- If an estate is made up of multiple blocks, each individual building must be dealt with separately under the Act, even though they may share common areas such as car parks, gardens and grounds.

## WHICH TRANSACTIONS?

The Act applies to most transactions the freeholder of a building might want to enter into, including:

- A sale of the whole or part of the freehold
- The grant of a headlease of the whole or part of the freehold
- The grant of a lease over communal areas, such as the roof space or air space
- The grant of an option or right of pre-emption over the freehold
- The grant of a commercial lease of non-residential parts. The Act is unclear on whether the grant of a lease of a commercial unit within a mixed-use building is a "relevant disposal". It seems unlikely that Parliament intended transactions of this kind to fall within the Act; however, there is no specific exemption for such disposals and therefore freeholders should serve offer notices before granting such leases to avoid any risk of liability.

Freeholders should note that a "disposal" for the purpose of the Act takes place when contracts are exchanged, not when the sale or lease is completed. It is not, therefore, possible to enter into a contract which is conditional on the leaseholders not accepting an offer made by the freeholder.

The following transactions are specifically exempted from the Act and offer notices are not required:

- The grant of a lease of a single flat
- Transfers made pursuant to a court order in matrimonial or inheritance proceedings
- The grant of security (e.g. a mortgage or charge over the freehold)
- Transfers/sales made pursuant to a compulsory purchase order or a collective enfranchisement claim by leaseholders
- A gift to a member of the freeholder's family or to charity
- A transfer between members of the same family
- A transfer by a company freeholder to an associated company (provided it has been an associated company for at least two years). The two-year requirement is intended to prevent freeholders from avoiding the Act by transferring ownership to an associated company set up for that very purpose and then selling the shares in the company, rather than the building itself.

## TIMESCALES AND PROCEDURES

If the Act applies, the procedure for serving notices is as follows:

- The freeholder must serve a notice (known as a 'Section 5 notice') on all leaseholders in the building who are "qualifying tenants". Different types of notice are required depending on what sort of interest the freeholder is disposing of (i.e. a sale of the freehold, the grant of a lease, or the grant of an option) and how the transaction will take place (i.e. a normal sale or an auction)
- The notice must state the price for the transaction and any other key terms, and must give the leaseholders a period of at least two months in which they can accept the offer.

The offer can only be accepted collectively by more than half of the qualifying tenants acting together. This is known as the 'requisite majority'.

It is not possible for a single leaseholder – or any number fewer than half – to accept the offer.

### IF THE REQUISITE MAJORITY OF LEASEHOLDERS WISH TO ACCEPT THE OFFER

- The leaseholders must serve an acceptance notice within the two-month acceptance period specified by the notice.
- They then have a further two-month period in which to nominate a purchaser for the interest. Usually, a group of leaseholders will form a limited company to proceed with the transaction.
- The transaction must then be completed within the timescales contained within the Act.

### IF THE REQUISITE MAJORITY OF LEASEHOLDERS DO NOT WISH TO ACCEPT THE OFFER

- After the two-month acceptance period has expired, the freeholder may proceed with the transaction. It is not possible to proceed earlier than this, even if all leaseholders have indicated that they do not wish to accept the offer
- However, if the transaction is not completed within 12 months, the freeholder will have to serve fresh offer notices.
- If the purchase price is reduced, or any of the other key terms of the transaction change, fresh notices will also be required.

- Either party may withdraw from the transaction before contracts are exchanged. The Act gives leaseholders a right of first refusal, but it does not impose an obligation on the freeholder to sell to the leaseholders. However, if the freeholder chooses to withdraw from the transaction because he/she does not wish to sell to the freeholders, it is not possible to dispose of the same interest in the building for another 12 months.
- If it is the leaseholders who choose to withdraw, they may have to pay some of the freeholder's legal costs. This does not apply if they withdraw within the first four weeks after the nomination period has ended.

## CONSEQUENCES OF FAILURE TO COMPLY

Failure to comply with the Act can have serious consequences for both the freeholder and the third-party purchaser they sell to.

1. Firstly, failure to comply is a criminal offence. The penalty for freeholders (including, if the freeholder is a company, their individual directors) is an unlimited fine – there is currently very little guidance on the appropriate fine to be imposed but this is likely to take into account all the circumstances, including whether the contravention of the Act was deliberate or inadvertent.
2. Secondly, if leaseholders become aware that the freeholder is planning to enter into a transaction without complying with the Act, they can serve a "default notice" on the freeholder requiring him/her to comply. If the freeholder does not do so within fourteen days, the leaseholders can apply to court for an order requiring the freeholder to comply with the Act.
3. Finally, if the leaseholders do not become aware of the transaction until after it has been completed, they have the right to obtain information about the transaction from the purchaser and then, if they wish to do so, purchase the building on the same terms – effectively unwinding the sale to the third-party.

## LEGAL SUPPORT

Please contact our property litigation team if you need assistance with:

- Determining whether the Act applies to your building or transaction
- Drafting and serving notices
- Dealing with the consequences of non-compliance


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