

FREEHOLD BLOCK MANAGEMENT

Tenants taking control –
collective enfranchisement



TENANTS TAKING CONTROL – COLLECTIVE ENFRANCHISEMENT

Leaseholders who are unhappy with the management of their building have a number of options which enable them to take control of this themselves. The two most common options for tenants are:

- Collective enfranchisement in accordance with the Leasehold Reform, Housing and Urban Development Act 1993 (“LRHUDA”); and
- Right to manage in accordance with the Commonhold and Leasehold Reform Act 2002 (‘CLRA’).

This guide aims to provide freeholders and managing agents with a brief overview of the first of these two procedures – collective enfranchisement – including when it applies, how the freehold is valued, and what to do if leaseholders serve notice under the LRHUDA.

WHAT IS COLLECTIVE ENFRANCHISEMENT?

In summary, collective enfranchisement is the right for a group of leaseholders to buy the freehold interest in their building from the existing freeholder. In order to exercise the right, the building must meet the following criteria:

- It must be a self-contained building.
- It must contain two or more flats held by 'qualifying tenants'. A qualifying tenant is one who has a lease which is granted for at least 21 years or more.
- At least two-thirds of the flats in the building must be held by qualifying tenants.
- If the building is mixed use, the internal floor area of the non-residential parts (not including any common parts) must amount to 25% or less of the total internal floor area of the Premises.
- If the freehold is owned by a resident landlord (i.e. one who also lives in the building), the right to enfranchise will not apply if the building contains four flats or fewer; the building is not a purpose-built block but was converted into flats; the same freeholder has owned the building since before it was converted, and the freeholder occupies one of the flats as their only or principal home within the last 12 months.

WHO CAN BRING THE CLAIM?

Assuming the building qualifies for enfranchisement, a claim can be brought by a group of qualifying tenants who, together, own at least half of the total number of flats in the building.

Providing the above criteria are met a freeholder cannot resist a claim for enfranchisement and it is not necessary for the leaseholders to show that the freeholder has been mismanaging the building or is in breach of the leases.

WHAT IS THE PROCEDURE?

If the building qualifies and sufficient numbers of qualifying tenants wish to participate, the procedure for acquiring the freehold is as follows:

- The participating leaseholders must serve an initial notice on the freeholder. This must include details of their 'nominee purchaser' – usually a limited company they set up for this purpose.
- The initial notice must propose a price at which the leaseholders will acquire the freehold.
- The freeholder must respond to the notice by serving a counter-notice by the date specified in the initial notice, which must be at least two months after it is served. The counter-notice must state whether the freeholder admits the leaseholders have the right to enfranchise, and whether the price is accepted.
- The freeholder and leaseholders then have a period of two months in which to try and negotiate the price and any other terms for the acquisition.
- If terms have not been agreed within this time, the leaseholders must apply to the First-Tier Tribunal (Property Chamber) to decide the terms by no later than 6 months from the date of the freeholder's counter-notice.
- Various other time limits apply for completing the acquisition, once terms are agreed or ordered by the Tribunal.

HOW IS THE FREEHOLD VALUED?

The LRHUDA sets out how the freehold should be valued. The price to be paid must take into account the following:

- The income the freeholder would receive from the ground rent for the remainder of the term of the leases;

- The reversionary value of the freehold on the expiry of the terms of the leases;
- 'Marriage value'. If some or all of the leases have terms of 80 years or less remaining, then the freeholder might expect to receive income from granting lease extensions to the affected leaseholders. The LRHUDA provides that this potential profit should be split 50:50 between the freeholder and the acquiring leaseholders.
- The value of any other related interests that may apply to the building e.g. income from commercial properties or garages.
- Any other losses. These may include, for example, loss of access to a neighbouring site; loss of development value if the building has the potential to be extended by way of building on the roof or otherwise redeveloped.

In very broad terms, the longer the term of the leases and the lower the ground rent payable, the lower the value of the freehold – a building with leases let on 999 year terms with ground rent of £10 per annum will command a lower price than a building with leases which have 75 year terms and ground rent of £500 per annum.

WHAT STEPS SHOULD A FREEHOLDER TAKE WHEN SERVED WITH AN INITIAL NOTICE?

- Take early legal advice in order to determine whether the initial notice is valid and whether the building qualifies for collective enfranchisement.
- Ensure that a counter-notice is served by the deadline stated in the leaseholders' initial notice. If no counter-notice is served, the leaseholders will gain the right to purchase the freehold on the terms specified in the initial notice.
- Take valuation advice to determine whether the price proposed by the leaseholders is reasonable.

- Once terms are agreed or ordered by the Tribunal and the transaction completes, co-operate in an orderly handover of management to the leaseholders' nominee purchaser.

WHAT ABOUT COSTS?

Leaseholders who serve an initial notice will be liable for the majority of the freeholder's costs of the claim, including:

- Investigations into whether the building qualifies for collective enfranchisement;
- Investigations into the qualifying tenants' titles to their flats;
- The initial valuation of the freehold; and
- The costs of the transferring the freehold to the leaseholders.

However, freeholders will not ordinarily be able to recover the costs of negotiations over the price to be paid, or the costs of First-Tier Tribunal proceedings to determine the price if agreement cannot be reached. In the First-Tier Tribunal, the usual rule is that parties bear their own costs, unless very unreasonable behaviour on the part of one of the parties can be shown.

LEGAL SUPPORT

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

- Advice on whether the right to collective enfranchisement applies
- Serving notices or counter-notices
- Disputes about valuation



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