

Commonhold or Leasehold?

A Question for Developers

"We are determined to give people a viable and robust alternative to Leasehold, which is why we are re-introducing this Bill at the earliest opportunity in this new Parliament", so said Baroness Scotland (Parliamentary Secretary in LCD – 21/06/01)

The **Commonhold and Leasehold Reform Act 2002** (the Act) received Royal Assent on 1st May 2002 and will probably be fully implemented by late 2003. Developments which are planned now (in 2002), will have the option of using traditional means of ownership (Freehold and/or Leasehold) or the new Commonhold. Property developers should be considering which form of ownership may best suit their purposes.

So what is Commonhold? Within the constraints of this short article it will be impossible to fully explain exactly what the concept of Commonhold ownership is. However, in short, it is a new form of Freehold ownership which has the flexibility of Leasehold so far as the physical division of the property is concerned. In a block of flats the individual flats may be Commonhold, which is a freehold title and not a leasehold for a term of years. The flats will therefore not start to devalue towards the end of their leases. It is possible that developments which are sold "Commonhold" may command a premium over those developments which are sold "Leasehold."

The Commonhold system will work in a very similar way to some current developments where the Freehold is sold to a management company the owners of which are the individual units owners. The difference will be that the structure of the ownership will be regulated by statute (the Act) and not simply by the documentation prepared by the developer at the time of sale. Because of this Commonhold is likely to be popular with Mortgage Lenders since the operation of developments will be substantially the same. Again this is likely to enhance the value of units.

Where a development is to be Commonhold the flat owners will own their units as Commonholders. The common parts of the estate (roads, stairs, lobbies etc) will be owned by the **Commonhold Association** (CA) which will be a company limited by guarantee. The members of the CA will be the individual unit holders on the development. The CA will be responsible for the running of the development and the raising of service charges (called **Commonhold Assessments**). Once the last unit has been sold the developer will play no further part in the running of development.

The development can be mixed use (residential/commercial) and could consist of both houses and flats. The legal structure will certainly assist in the running of estates where there are houses the owners of which have to contribute towards the maintenance of roads and other common services.

However, from a developer's viewpoint the following must be born in mind

- a. If the proposed development is to be sold as Commonhold then the entire site must be Commonhold. A commonhold unit cannot be over or under a part which is not also Commonhold.
- b. There must be at least two units.
- c. Certain types of land cannot be Commonhold (e.g. Flying Freeholds, certain types of agricultural land, places of worship etc)

From a developers position the most important point is item a) above since if a development is to be either mixed use (commercial and residential) or mixed type (houses and flats) then the entire development must be Commonhold. If the development proposal consists of flats above commercial/retail premises, with the commercial/retail premises to be let at commercial rents and the flats to be disposed of at premium values the method of disposal would have to

be carefully considered. The retail units would also have to be Commonhold and disposed of as such (presumably for a premium value) and subsequently let at commercial rents. The Commonhold owners of those units would be members of the Commonhold Association and obligated to contribute to the Commonhold Assessment.

As can be seen the structure of ownership could differ substantially from similar developments structured along traditional Freehold/Leasehold lines. The change in that structure may have an affect on the financing of the project and in the ownership of investment property. For example, will a shopkeeper prefer to own the unit Commonhold (thereby holding a capital asset) or to lease from a superior Commonholder? Will property investors wish to purchase retail premises to lease out where they are unable to control management of the building as Freeholder and only contribute as a Commonholder? It is possible that two markets may develop in the commercial sector with smaller to medium sized businesses opting for Commonhold and larger corporations preferring Leasehold. Of course the same will also apply to office and industrial units.

As is usual with modern legislation the Act provides a legislative framework. How the legislation will operate will depend on regulations made under the Act. In this case most of the regulations remain to be published. Those regulations will deal with such matters as alterations in size of units during building (to cover sales off plan) to how the day to day management of Commonhold estates will be maintained. It is this last point that may provide excellent opportunities for professional property management companies. It is just possible that the Government may include a regulation that if a certain proportion of the unit holders require, a professional management company will have to be appointed. That would cover the situation where the Commonholders are either too busy to run the estate or simply do not wish to.

In conclusion whilst Commonhold does have exciting possibilities for developers we strongly recommend that before a decision is made to market the units as Commonhold legal advice is obtained. Preferably that advice should be obtained at the "idea" stage and not later.