

A guide to leasehold homes

As the owner of a leasehold property, it is in your own interest to understand the legal nature of the ownership. What exactly do you own and what are the associated rights and liabilities?

www.switch.law



This guide aims to help you:

- understand residential leasehold
- be clear on your rights
- appreciate your responsibilities

What is leasehold?

Leasehold flats can be in purpose-built blocks, in converted houses or above commercial or retail premises. Owning a leasehold property should not be a concern as long as you know and appreciate your rights and obligations. Maisonettes, apartments, flats and even houses can be sold as leasehold. Typically in leasehold developments there are interdependent relationships that rely on shared areas or services.

The person who owns the freehold and granted the lease is normally known as the landlord. The owner of the leasehold property is known as the tenant.

The landlord can be a person or a company, including a local authority or a housing association. It is also quite common for the tenants to own the freehold of the building collectively, through a residents' management company, effectively

becoming their own landlord. Furthermore, under right to manage, the tenants may not own the freehold, but are able to manage the building as if they were the landlord. In larger developments the landlord may delegate management functions to a management company which may be run by the tenants on a 'not for profit' basis or be run by a professional managing agent.

Glossary of leasehold terms

Landlord	Individual or company who owns the land. Sometimes known as lessor or freeholder in the lease.
Tenant	Current owner of the leasehold property. Sometimes known as a lessee or leaseholder in the lease.
Lease term	The length of the lease.
Residue	The time remaining on the lease.
Ground rent	Regular payment (normally yearly) made to the landlord in accordance with the lease.
Peppercorn ground rent	Some older leases use this term to mean that no rent is actually payable.
Deed of covenant	A contract / deed between the incoming purchaser (buyer) and the management company containing provisions obliging the buyer to comply with covenants and restrictions in the lease.
Forfeiture	The landlord's right to obtain possession if the clauses of the lease are breached, for example non-payment of ground rent or service charges.
Notice of assignment and charge	Where property changes hands, notice must be given to the landlord and/or management company of such change of ownership and any mortgages on the property. A fee is usually payable in this respect.
Compliance certificate	Management companies often put a restriction on the 'deeds' to ensure the provisions of the lease are complied with. A compliance certificate is required to provide to the land registry as evidence the restriction has been complied with. A fee is usually payable in this respect.
Sinking fund	Sinking, or reserve funds, are collected in advance in anticipation of major works. This enables the cost of major works to be spread over regular payments.

What is a management company?

A management company is a third party who has entered into the lease document in addition to the landlord. The management company is usually owned jointly by all the tenants in the building by means of a shareholding or membership in the company. For a tenant-owned management company this means that the responsibility for managing and running the properties vests in the tenants collectively.

If you will become a member or shareholder of the company when you purchase, full details will be included in our lease report.

The advantage to the company being owned by tenants within the building is that the company is run at cost, and not for profit. The downside is that the effectiveness of the company and the tenants' responsibility for it is of great importance. The company must deal effectively with maintenance and insurance, and must make sure that the property complies with all statutory rules, e.g. fire regulations. If the management company ceases to function as an effective unit then it could be struck from the Register of Companies, causing a breakdown in the scheme of management, making your property difficult to sell. It will be in your best interests to take an interest in the performance of the company, its compliance with company legislation and Companies House filing obligations. If your property has a management company, this will be detailed in our full lease report sent to you.

What is a managing agent?

Sometimes the landlord or management company carries out the management of the property themselves. Alternatively a managing agent is appointed to manage and maintain the building on their behalf, in accordance with the terms of the lease. The agent takes instruction from the landlord, not the tenants, but should constantly be aware of the tenants' wishes and requirements.

The agent will receive a fee for day-to-day management which will usually be paid by tenants as part of the service charges. This may be based on a specified percentage of the day-to-day service charges; it is good and common practice for it to be a fixed fee per annum. Where major works are involved, the agent may charge an additional fee, which will normally be a percentage of the total cost of such works.

What is a lease?

A lease is a contract between the landlord and tenant giving conditional ownership for a fixed period of time. It is an important document and you should ensure that you read this carefully and understand it. The wording of leases is usually in legal language and can vary from property to property.

It is difficult to change the conditions of the lease after you buy, so make sure that the services provided for and the obligations imposed in the lease are those that you want or can accept.

The lease sets out the contractual obligations of the two parties: what the tenant has contracted to do, and what the landlord is bound to do.

The term and residue of the leasehold ownership is simply a long tenancy, the right to occupy and use the property for a long period – the 'term' of the lease. The term is typically for 99, 125 or 999 years and the property can usually be bought and sold during that term. The term is fixed at the beginning and decreases in length year by year. The remaining period is known as the residue. If it were not for inflation, the value of the property would diminish over time until the eventual expiry of the lease, when the property returns to the landlord. In practice this is rare as leases can sometimes be extended.

Some mortgage lenders are reluctant to lend on leasehold properties with a shorter lease term remaining. It is important to consider this in contemplation of a future sale as well as your immediate purchase. The landlord may be agreeable to extending the lease provided that they receive appropriate financial compensation for doing so.

Legislation entitles a tenant to request an extension to the lease term for a further 90 years once they have owned it for two years (although the seller may be able to start the process and assign the right to the buyer). The landlord will be entitled to compensation of thousands of pounds for extending the lease. The formula for calculating the landlord's compensation has an added component if the residue is less than 80 years and this can add further thousands of pounds to the amount the landlord will be entitled to. The process to extend using legislation is technically quite complex and can take months to progress. The tenant will be expected to meet both the landlord's and their own costs of valuation and legal advice.

These associated legal and valuation advice costs are also likely to be several thousands of pounds.



What is ground rent?

Because leasehold is a tenancy, leases have typically been payment of a rent to the landlord. Ground rent is a specific requirement of most leases and must be paid on the due date, subject to the issue of a formal and specific demand by the landlord.

Some leases are subject to increasing ground rents, and provisions for any increase in the rent is set out in the lease. If this applies further detail will be sent to you in our lease report. The future ground rents may be known, or may increase in line with inflation.

Where rents are regularly reviewed in line with inflation and the Retail Prices Index (RPI) it is not possible to accurately predict what future ground rent payments will be. Figures for RPI and inflation can be viewed at:

<https://www.ons.gov.uk/economy/inflationandpriceindices>

What are service charges?

Service charges are payments by the tenant for all the services the landlord or management company provides. These usually include maintenance and repairs, insurance of the building and, in some cases, provision of central heating, lifts, estate staff, lighting and cleaning of common areas etc. Usually the charges will also include the costs of management services, either by the landlord or by a professional managing agent.

Service charges will vary from year to year; they can go up or down. Details of what can and cannot be charged by the landlord and the proportion of the charge to be paid is set out in the lease. Service charges are normally paid in advance based on an estimate of what they are likely to be. They are then adjusted in the event of a surplus or shortfall arising at the end of the year, to take account of the actual expenditure incurred.

The landlord or management company can only recover the costs of services which are reasonable. Tenants have powerful rights to challenge service charges they feel are unreasonable at the Leasehold Valuation Tribunal (LVT). When considering the purchase of a leasehold property,

it is important to find out what the current and future service charges are likely to be. It is normal procedure for lease outgoing such as service charges and ground rent to be apportioned on completion. This means that if the seller has paid these outgoing in advance, then he will be entitled to be re-imbursed by you for all money paid in respect of any period after completion.

At this stage we do not know whether it will be necessary for any sums to be apportioned, and no calculations can be made until after a date for completion has been agreed. We will advise you if any apportionments are necessary in our reports to you and include these fees in our financial statement.

An added complication here is that the proposed apportionment made on completion will typically be based upon whatever has been paid against the budgeted service charge only. Ultimately the landlord or management company will produce a set of final accounts, but this may be some considerable time after the end of the accounting year. As the purchaser, if there is a surplus against the budget, then in practice you will most likely benefit from this, although technically any surplus calculated to have been paid by the seller would entitle the seller to recover the surplus from you.

Alternatively, if there was a deficit in terms of actual expenditure against the budget, then this could leave a shortfall covering not only your period of ownership but also that of the seller.

If it is likely that a shortfall will arise following completion, then we will ask the seller to retain a reasonable sum to cover this eventuality. We would be reluctant to negotiate and hold this 'retention' without prior agreement for the further administration costs of monitoring and settling apportionments when the final accounts are available, as this can be many months and in some cases years after completion. We will not accept responsibility for any unforeseen shortfall or service charge demand that we were not made aware of at the time of completion. That is a potential additional cost which you may find yourself exposed to.



What are my obligations?

The tenant's obligations will include payment of the ground rent (if any) and in most cases a contribution to the costs of maintaining and managing the building (service charge). The lease will probably also place certain restrictions on the use and occupation of the property.

Tenants are not necessarily entirely free to do whatever they want; the lease comes with restrictions to protect the rights of everyone with an interest in the building. For example, retirement schemes will usually have restrictions on the age of those who can live there. When a leasehold property changes hands, the seller passes on all the rights and responsibilities of the lease to the purchaser, including any future payments of service charges that have not yet been identified and any existing breaches of the lease conditions and obligations.

What are the landlord's obligations?

The landlord will usually be required to manage and maintain the structure, exterior and common areas of the property, to collect service charges from all the tenants and keep the accounts. The landlord usually will insure the building, subject to the tenants contributing towards the cost.

What's included in my leasehold property?

Leasehold ownership usually includes everything within the four walls of the property, including floorboards and plaster to walls and ceiling, but does not usually include the external or structural walls. The structure and common parts of the building and the land it stands on are usually owned by the freeholder, who is also the landlord. The landlord is usually responsible for the maintenance and repair of the building. The costs of maintenance and repair are normally recoverable through the service charges and billed to the tenants.

What are my rights?

First and foremost, the right of peaceable occupation of the property for the term of the lease, usually referred to as 'quiet enjoyment'. In addition, the tenant usually has the right to expect the landlord to maintain and repair the building and manage the common parts – that is, the parts of the building or grounds not specifically granted to the tenant in the lease but to which there are rights of access, for example, the entrance hall and staircases.

The rights granted to you are set out in the lease. Please see our report to you for further information. It is important to check through the rights contained in your lease to ensure you have the necessary rights to enjoy your property. If there are rights that you anticipated benefitting from that are not listed please raise this with us.

Rights are also granted for others including the landlord and other tenants over your property in some circumstances. These are set out in the lease and will be detailed in our report to you.

What are reserve funds?

Many leases provide for the landlord to collect sums in advance to create a reserve or 'sinking' fund to ensure that sufficient money is available for future scheduled major works, such as roof repairs, external decorations or lift replacement. The lease will set out the arrangements for this and when regular, cyclical maintenance works are due.

Contributions to the reserve fund are not repayable when the property is sold. If there is insufficient money in the reserve fund to deal with major works the costs will be shared between owners in the proportions set out in the individual leases.



How is the building insured?

The lease will normally require the landlord to take out adequate insurance for the building and the common parts, and will give them the right to recover the cost of the premium through the service charges. This policy will not normally cover the personal possessions of individual tenants for which contents insurance should be taken out.

What happens if I don't pay?

It is the tenant's obligation to pay the service charges and ground rent promptly under the terms of the lease. If they are not paid and the landlord is able to satisfy a court that the charges are properly due and reasonable, then he can begin forfeiture proceedings by applying for a court order. The court has wide discretion where forfeiture is concerned, but if forfeiture is approved by a court, this can lead to the landlord repossessing the property. The landlord may also seek a county court judgment for payment which can affect a tenant's ability to obtain credit.

Forfeiture is the landlord's remedy against a tenant who is in breach of covenants within the lease. Such a clause is found in the vast majority of residential property leases. It is the landlord's ultimate sanction to enable the defaulting tenant to be removed from the property and has the effect of bringing the lease to an end. This is therefore a powerful and potentially dangerous remedy.

The good news is that, in our experience, it tends only to be exercised in extreme circumstances and in reality the landlord's right to forfeit the lease has been substantially curtailed for the protection of tenants. Provided you pay your ground rent and service charges on a regular basis, and provided you generally act in a reasonable manner, then you should have nothing to fear from these provisions in the lease. The comfort for you is that the leases are similar for other properties in the building, and the landlord can also enforce this sanction against neighbouring defaulting tenants. If you do encounter any dispute with your landlord or get notice that proceedings may be taken against you, please seek advice as soon as possible.

What other rights do I have and where can I find out more?

Probably more than you think. The rights available to tenants are wide ranging, and advice is readily available. Where a dispute arises, the first step should be to ask the landlord or managing agent for full details and/or an explanation.

Details of all rights that tenants have are not set out in this guide, but further information is available from LEASE, the Leasehold Advisory Service on their website: www.lease-advice.org

All documents should be read and used in accordance with our terms and conditions. This document is for your general information only and is not a detailed statement of the law. It is provided to you free of charge and should not be used as a substitute for specific legal advice.