SHARED OWNERSHIP LEASES: QUESTIONS FOR THE LAW COMMISSION

(1) What are your views on shared ownership leases as a product?

1.1 The Law Commission has recently completed three projects on residential leasehold and commonhold, covering enfranchisement, the right to manage and commonhold. Each of these projects considered how the relevant regime might cater for shared ownership leases (in the case of the enfranchisement and commonhold projects, within specific Terms of Reference agreed with Government, as explained further in our response to Question 2 below). However, we did not ask consultees for their views on shared ownership as a product, or form any view of our own on the shared ownership product.

1.2 Shared ownership is often described as "part-buy, part-rent". It is marketed as enabling a purchaser to buy a "share" of a house or flat (usually between 25% and 75%), while paying rent on the remainder of the property. Because the purchaser only needs to secure a mortgage for the share of the property he or she is purchasing, the deposit required will be much lower than that which would be required to purchase the same property in full – and the mortgage sum itself will also be smaller.. The scheme is therefore useful for helping first-time buyers and individuals from low and middle income backgrounds to get onto the property ladder.

1.3 Over time, the purchaser of a shared ownership property can buy additional shares in the property – a process known as "staircasing". Each time a purchaser buys an additional share, the rent payable on the remainder of the property will decrease accordingly. In most cases, it is possible to staircase to 100%.

1.4 We understand that "shared ownership" is a key component of Government's programme of affordable housing provision, and that shared ownership properties today make up a small but important portion of the residential property market. However, we are also aware of several issues relating to the shared ownership product.

1.5 First, it is clear to us from the consultation responses we have received to our consultations on residential leasehold and commonhold, as well as from other anecdotal evidence we have heard, that members of the public do not always understand exactly how shared ownership schemes operate, or the precise nature of the legal arrangement which the purchaser of a shared ownership property is entering into.

1.6 We have endeavoured in our Enfranchisement Report to explain exactly how shared ownership leases work, in a way that we hope is clear and accessible to as many readers as possible: see paragraph 7.6 of the Report, and the large text box which follows (over several pages, pp397-400). In particular, we have pointed out that the term "shared ownership" is itself something of a misnomer. To summarise briefly:

(1) There is in fact no asset which is "shared". Instead, the provider of the shared ownership property grants the purchaser a long lease, which in most respects is no different from any other long lease. It may be because this fact is misunderstood that many shared ownership leaseholders apparently express

surprise that they are required to pay full service charges in respect of their properties.

(2) The degree of "ownership" which a shared ownership lease provides is also widely misunderstood. In legal terms, a shared ownership lease almost always takes the form of an assured or assured shorthold tenancy – since the rent payable on the unpurchased "share" will virtually always exceed the limit for exclusion from the assured tenancy regime under the Housing Act 1988. The purchaser of a shared ownership lease in effect purchases a very long assured or assured shorthold tenancy, with the right to staircase to 100% in accordance with the terms of the lease. At that point, the shared ownership leaseholder will own the property in the same way as any other freeholder (in the case of a house) or leaseholder (in the case of a flat).

The fact that a shared ownership lease is an assured or assured shorthold tenancy means that until the shared ownership leaseholder has fully staircased, he or she has much more limited security of tenure than most ordinary leaseholders.[1] In particular, the shared ownership leaseholder runs the risk of eviction under the Housing Act 1988 on the basis of one of the grounds for possession listed in schedule 2. This includes "Ground 8", which provides that the court must make a possession order when the tenant is in two months' rent arrears. In effect, the shared ownership leaseholder is at risk of losing his or her lease, and the entire purchase price paid for it, for non-payment of rent. There is no relief available from this outcome, such as there is where an ordinary long leaseholder loses their lease through forfeiture. We note that Government has committed to changing the law so that long leaseholders will not be classed as assured tenants simply because they pay a high ground rent.[2] We assume that Government's work in this area will also extend to the rent paid by shared ownership leaseholders on the unacquired share of their home.

1.7 Furthermore, because the shared ownership product is delivered by means of a lease (even where the property in question is a house, so that there is otherwise no good reason for it to be sold as leasehold), shared ownership leaseholders are faced with the same difficulties as all other leaseholders. That is, their interest is a wasting asset because a lease's financial value decreases as the term of the lease expires, and their control over their property will be limited by the terms of the lease.

1.8 These shortcomings of leasehold ownership are addressed by the recommendations we make in our Enfranchisement and Right to Manage Reports (as set out further below). Our Report on commonhold puts forward recommendations so that commonhold is seen as a preferred alternative to leasehold. However, given the

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1 Most long leases contain a low ground rent, by virtue of which they are excluded from the assured tenancy regime in the Housing Act 1988: see s1(1)(c) and (2), and sch 1, Pt 1, paras 3 to 3C. However, some long leaseholders who have particularly high or onerous ground rents (a more common occurrence in leases granted in recent years) may sometimes exceed the limit for exclusion and therefore also fall within the assured tenancy regime.

2 See Department for Communities and Local Government, Tackling Unfair Practices consultation – Summary of consultation responses and Government response (December 2017) p 21, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/670204/Tackling_Unfair_Practices_-_gov_response.pdf.

importance of shared ownership in providing low cost home ownership, and the unavailability of non-lease based shared ownership products, our recommendations would enable shared ownership leases to operate in commonhold schemes.

(2) The Law Commission has noted numerous issues with leasehold property ownership and made a number of recommendations – is there anything that is particularly pertinent for the shared ownership sector?

1.9 In July 2020 we published our final reports, setting out our recommendations for reforms to the law of enfranchisement, the right to manage and commonhold. The reports specifically consider the position of shared ownership leases within each of these regimes.

Enfranchisement

1.10 We consider the position of shared ownership leases in detail at paragraphs 7.6 to 7.93 of our Enfranchisement Report.

1.11 Government's policy position is that all shared ownership leaseholders should be able to extend their leases, so that they have security in their homes and can mortgage or sell their properties. However, they should not be able to carry out an individual freehold acquisition claim or participate in a collective freehold acquisition claim unless they have staircased to 100% ownership. This is because the shared ownership lease is specifically designed to enable those who cannot afford to purchase a property outright to do so in stages, via the staircasing provisions which form part of almost all shared ownership leases. It would not be right if leaseholders were able to circumvent these provisions by relying on statutory enfranchisement rights to acquire the freehold of their house or building.

1.12 This policy position was reflected in the Terms of Reference for the enfranchisement project. We were asked:

> To ensure that shared ownership leaseholders have the right to extend the lease of their house or flat, but not the right to acquire the freehold of their house or participate in a collective enfranchisement of their block of flats prior to having "staircased" their lease to 100%.

1.13 Our recommendations relating to shared ownership are therefore limited to how this policy position should be implemented. In summary:

(1) We recommend that shared ownership leaseholders should be entitled to the same 990-year lease extension as all other leaseholders. When a shared ownership leaseholder extends their lease, their share in the property and the terms of the lease which related to its shared ownership nature should stay the same.[3]

(2) We recommend that the premium payable on the extension of a shared ownership lease should consist of:

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[3] Enfranchisement Report, Recommendation 42, para 7.19. See also Recommendation 2, para 3.62.

(a) the usual cost of buying out any ground rent payable under the lease, but not any rent payable in respect of the unacquired share of the property; and

(b) a proportion of the usual cost of deferring the landlord's reversionary interest in the property, corresponding to the share which the leaseholder holds in the property.[4]

(3) We discuss the issues which can arise where the provider of a shared ownership lease is themselves a lessee, and whether these lessees should also have rights (or obligations) to extend their own head lease, so that a shared ownership leaseholder does not end up with a commercially-motivated landlord in place of their original landlord, which is likely to have been a housing association or other registered provider of social housing.[5] We put forward several possible options, and suggest that Government should carry out further work on these issues, including further engagement with the social housing sector.[6]

(4) We recommend that there should be no relaxation of the qualifying criteria for collective freehold acquisition claims where a building contains units let on shared ownership leases.[7]

(5) We recommend various criteria which a shared ownership lease must satisfy if it is to be excluded from freehold acquisition rights (although we acknowledge that any definition of a shared ownership lease for these purposes will likely also need to align with that used by Government for the purposes of exempting shared ownership leases from the ban on the grant of leases of houses).[8]

1.14 More generally, our Enfranchisement Report contains numerous other recommendations for a new enfranchisement regime, which will make it easier, quicker and cheaper for leaseholders to exercise their enfranchisement rights. Many of these recommendations will benefit shared ownership leaseholders claiming a lease extension in exactly the same way as any other leaseholder making such a claim.

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4 Enfranchisement Report, Recommendation 43, para 7.38.

5 This issue is not unique to buildings containing shared ownership leaseholders. There will be other cases where social landlords who are head lessees have granted long sub-leases with enfranchisement rights. However, we are aware that this kind of structure is common in new developments utilising shared ownership as a form of affordable housing. Further, it may be particularly important for shared ownership leaseholders to retain a social housing provider as their landlord, given the ongoing interaction between a shared ownership leaseholder and their landlord in relation to monthly rental payments and staircasing applications.

6 Enfranchisement Report, paras 7.39 to 7.47.

7 Enfranchisement Report, Recommendation 44, para 7.61.

8 Enfranchisement Report, Recommendation 45, paras 7.92 to 7.93.

Right to manage

1.15 We consider the position of shared ownership leases at paragraphs 4.8 to 4.21 of our Right to Manage Report.

1.16 As with lease extension or collective enfranchisement claims under the Leasehold Reform, Housing and Urban Development Act 1993, there is some uncertainty over whether shared ownership leaseholders who have not staircased to 100% qualify for the right to manage under the current law. We see no reason why shared ownership leaseholders should not be eligible for the right to manage, regardless of the "share" in the property which they own, and we therefore make a recommendation to that effect.[9] This will ensure that shared ownership leaseholders can have greater control over their homes, by taking charge of matters such as services, maintenance, repairs, improvements and insurance.

1.17 Again, shared ownership leaseholders who choose to participate in a right to manage claim will benefit from all of the other recommendations we make to improve the right to manage, in exactly the same way as any other leaseholder. These recommendations will make it easier, quicker and cheaper to exercise the right to manage, and also help to ensure that management by the leaseholders runs smoothly thereafter.

Commonhold

1.18 We consider the position of shared ownership leases at paragraphs 11.4 to 11.110 of our Commonhold Report.

1.19 Within a commonhold, the individual property in a building (such as a flat) is referred to as a commonhold "unit". The unit owner owns their unit on a freehold basis, and is a member of the company (called the "commonhold association) which owns and manages the common parts of the building. The unit owners can vote on decisions affecting the management of the building through their membership of the commonhold association.

1.20 Under the current law, a commonhold unit owner cannot grant a residential lease of their unit which is longer than seven years. Commonhold was designed to offer an alternative to leasehold, which addresses the shortcomings of leasehold ownership. It was therefore not considered appropriate to perpetuate the existence of leasehold within commonhold. However, the prohibition would prevent the grant of shared ownership leases within commonhold, which play a key role in Government's programme of affordable housing. In our Terms of Reference agreed with Government for the commonhold project, we were asked to "consider ways of incorporating shared ownership within commonhold".

1.21 In the commonhold report, we therefore recommend an exception to the ban on residential leases in order to accommodate shared ownership leases within commonhold, provided that the shared ownership lease contains the fundamental

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9 RTM Report, Recommendation 11, para 4.21.

clauses set by Homes England and the Welsh Government.[10] These clauses provide a level of protection, such as standardised rent review provisions, and should prevent some of the same abuses that have been witnessed in the leasehold sector being carried into commonhold.

1.22 We make a number of recommendations to ensure shared ownership leases can be integrated successfully in commonhold, both where the lease is granted in an existing commonhold (for example in a new commonhold development or after an existing leasehold building has converted to commonhold), and where the lease was granted before the decision was taken to convert an existing leasehold building to commonhold. In new commonholds, it is envisaged that the provider of the shared ownership lease will be the commonhold unit owner and will be able to grant a shared ownership lease of their unit. The position is more complicated where a leasehold building converts to commonhold, although our recommendations ensure that the relationship between the provider and shared owner will be preserved following conversion.

1.23 Our recommendations cover:

(1) The exercise of voting rights in the commonhold. Where a shared ownership lease is granted in a new commonhold development (or after an existing leasehold development has converted to commonhold), we recommend that the shared ownership leaseholder (rather than the provider of the shared ownership lease) should exercise the commonhold voting rights. This is because the shared ownership leaseholder ultimately benefits from the outcome of these decisions and pays the commonhold's costs.[11] The position is slightly different in respect of a shared ownership lease granted before a decision to convert. This is because the provider granted the lease before the block converted, so the terms of the lease have not been written with commonhold in mind. The provider may decide to delegate their voting rights to the shared ownership leaseholder, but it is not mandatory.

(2) The position of the shared ownership leaseholder after staircasing to 100%. In the case of a shared ownership lease granted in a new commonhold development (or after a building has converted to commonhold), we recommend that the shared ownership leaseholder should acquire the freehold title to the unit and become a member of the commonhold association.[12] Where the shared ownership lease was granted before the conversion, the shared ownership leaseholder will continue to be a leaseholder, but the provisions of the lease relating to shared ownership will cease to have any effect. The shared ownership leaseholder cannot be transferred the freehold in this scenario as the amount payable on final staircasing would have been calculated on the basis of acquiring the remaining term of the lease, not the freehold. However, we

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10 These fundamental clauses are not necessary in shared ownership leases, but they are relevant to whether a provider of such leases qualify for funding from the government. They include terms on reviewing the rent payable on the remainder of the property and on staircasing.

11 However, the provider and the shared owner should both vote on the termination of the commonhold, as this is a decision which inherently affects both parties: Commonhold Report, Recommendation 48, para 11.50.

12 Commonhold Report, Recommendation 50, para 11.73.

recommend measures that will enable the shared ownership leaseholder to buy the freehold of the commonhold unit in the future.

(3) The ability to challenge costs within the commonhold. Residential leaseholders have statutory rights to challenge the reasonableness of service charges after they have been incurred. These protections are not required within commonhold as the owners control the commonhold association and vote on setting the cost budget. We recommend measures to mitigate the differences between the regime for setting and challenging costs under commonhold legislation and in leasehold legislation. In short, provided that the shared owner is given with the same protections to set and challenge costs as unit owners under commonhold legislation, they should not also retain their rights to challenge costs under leasehold legislation.

(3) Do any particular issues arise relating to service charges, ground rents, lease length or conditions that is particular or more common for shared ownership properties?

1.24 The Law Commission is not best placed to comment on issues which arise in relation to shared ownership leases in practice, as our knowledge of the sector is based almost entirely on what we are told by stakeholders and consultees. In any event, with the exception of lease length, these matters are largely outside the scope of our projects.

1.25 Nevertheless, we make the following points:

(1) As explained in our response to Question 1 above, the rent which is payable on the unacquired "share" of a shared ownership property will virtually always exceed the limit for exclusion from the assured tenancy regime under the Housing Act 1988. In law, shared ownership leases are therefore assured or assured shorthold tenancies, and vulnerable to possession claims under the Housing Act 1988 on the basis of any applicable grounds for possession listed in schedule 2 to that Act – including "Ground 8", which provides that the court must make a possession order when the tenant is in two months' rent arrears. This issue can also arise in respect of other long leases which have a sufficiently high ground rent, although overall this is fairly rare. For shared ownership leaseholders, however, it is virtually unavoidable. We note that Government has committed to changing the law so that long leaseholders will not be classed as assured or assured shorthold tenants simply because they pay a high ground rent, and we assume that this work will also extend to the rent paid by shared ownership leaseholders on the unacquired share of their home.[13]

(2) We note that the Homes England model shared ownership leases suggest that shared ownership leases should not generally contain a more than nominal ground rent, in addition to the rent payable on the unacquired "share". However,

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13 See Department for Communities and Local Government, Tackling Unfair Practices consultation – Summary of consultation responses and Government response (December 2017) p 21, https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/670204/Tackling_Unfair_Practices_-_gov_response.pdf.

responses to the leaseholder survey which we carried out as part of our Enfranchisement consultation suggest that a number of shared ownership providers do charge a significant annual ground rent. Anecdotally we received confirmation from some housing associations that they do charge ground rents above a nominal level in shared ownership leases.

(3) Anecdotally we have heard that some shared ownership leaseholders have experienced difficulties in trying to resolve issues with the quality of new-build developments. As mentioned above, often in such developments the shared ownership provider will be a head lessee, and it will be the freeholder or a third-party management company who is responsible for repairs and maintenance. In this scenario, the shared ownership leaseholder has no contract with the freeholder, and their lease may require the shared ownership provider to do little more than use "best endeavours" to resolve the problem. This problem is not unique to shared ownership, of course, but we understand that it arises more frequently in this context because of the use of section 106 planning agreements which lead to this tri-partite structure of ownership.

(4) What could housing associations do to support your recommendations?

1.26 Shared ownership leases can be useful for first-time buyers. The recommendations we make in our reports will give shared ownership leaseholders greater security of tenure, and the ability to participate in the management of their building, making shared ownership leases more attractive products. Shared ownership leases will also be workable within commonhold, which is important given our aim of ensuring that commonhold can be used as the preferred alternative to leasehold ownership of flats. We hope that housing associations will see the benefits of our recommendations and support them.

1.27 It is now for Government to consider the recommendations we have made, and to decide whether and when to take them forward. Ultimately, for our recommendations to become law, an Act of Parliament will be required. If housing associations have comments on our recommendations or wish to express their support for the recommendations, then these should be passed on to the Ministry of Housing, Communities and Local Government (although the Law Commission is happy to act as a post-box for such correspondence).

1.28 As mentioned in our response to Question 2 above, we have suggested that Government should engage further with the social housing sector in relation to the issues which arise where the provider of a shared ownership lease is themselves a lessee. We would encourage housing associations to engage fully with such discussions.