A response to the Government's consultation on: Reforming the leasehold and commonhold systems in England and Wales from Ground Rents Income Fund (GRIF)

About us

1. Your name: Chris Leek (Investment Manager)

2. An email address: chris.leek@schroders.com

Individual: n/a

Organisation:

What is the name of your organisation?

Ground Rents Income Fund (GRIF)

What is your organisation?

d. Investor

Please describe your organisation's purpose in relation to this consultation.
a. Ownership or management of properties

If you answered a. Please answer the following questions

12. Does your organisation own or manage a building(s), with non-residential elements or units such a as a shop, gym or an office?
YES

13. In what region are the majority of properties in your portfolio based?
a. North East

b. North West

c. Yorkshire

14. Please indicate, as an approximation where necessary, how many mixed-use freehold properties your organisation owns or manages.
Approximately 30

About us, Questions 15 to 18 , not able to provide

Accompanying statement

Ground Rents Income Fund plc (GRIF) is a Real Estate Investment Trust that aims to provide consistent long-term performance through investment in UK long-dated ground rents with predefined cash flows. GRIF's shareholders include pension funds, private client fund managers and long-term savings investors.

In the vast majority of cases, the leases GRIF owns exceed 100 years, a length commonly regarded as a long lease. GRIF only acquires pre-existing freehold and long leasehold assets on a secondary basis (GRIF does not develop the assets and instead acquires the stabilised, income producing investment from either the original developer or other third party investors); by this point, the terms (starting ground rent, review type, frequency of review and obligations) and duration of the lease have already been set by the developers of the site.

GRIF currently owns around 19,000 units nationwide across a range of properties including apartments, houses, student accommodation and commercial units. GRIF's average annual ground rent is £111 for houses and around £250 for apartments.

GRIF is a responsible landlord and investor and aims to deliver best-in-class residential asset management for our leaseholders, which currently includes overseeing the resolution of complex building safety issues.

Like other responsible landlords and institutional investors, we support the Government's desire for a well functioning, sustainable, leasehold market and want to ensure that all stakeholders are fairly considered in any proposed legislation.

Question 1. Do you agree or disagree that increasing the non-residential limit for collective enfranchisement from 25% to 50% meets government's aim of addressing the historic imbalance of rights between freeholders and leaseholders?

b. Disagree

The question is couched around a very subjective judgement about any historic imbalance of rights between freeholders and leaseholders. Para 15 of the consultation paper makes clear that the Government's aim is "*to address the historic imbalance…. whilst taking into account the legitimate rights of freeholders*". This latter requirement is conspicuously omitted from the question. The focus should be on more objective questions around:

1. Whether there is a problem with many abuses of the leasehold system in mixed use buildings that are not satisfactorily resolved through existing mechanisms such as the Tribunal?

2. The impact of the Government's reforms on all parties in such buildings: leaseholders, freeholders, and commercial tenants.

There is little evidence of 1., and we have significant concerns about 2. We express our concerns in question 2. below.

The Law Commission posed the right question in their original consultation paper. Compulsory disposition should be limited to buildings that are predominately residential. A 25% limit of non-residential space achieves that.

The evidence on which the Commission then changed its mind is lacking in transparency. There were about 1,000 responses to the Law Commission consultation – 58% were in favour of retaining the 25% limitation. There were 1,500 responses to the Commission's Leaseholder Survey; c. 0.03% of leaseholders. Moreover, the only evidence that has been published to support the increase in the threshold to 50% is that there were 'numerous' leaseholders that cited the 25% threshold as a problem.

Question 2. Do you support or oppose a 50% non-residential limit for collective enfranchisement?

e. Strongly oppose

If response Strongly support or Support - What are the benefits of increasing the non-residential limit for collective enfranchisement from 25% to 50%? (Max 500 words)

If response Strongly oppose or Oppose - What are the challenges or dis-benefits, of a 50% non-residential limit for collective enfranchisement? (Max 500 words)

Our concerns are:

1. In our experience, the primary flashpoint in mixed-use buildings is the apportionment of the service charge between leaseholders and freeholders. Moving ownership will not resolve those challenges and reasons for disagreement.

2. Investor-led management of buildings will be weakened, and if investors cannot protect their assets, and lose their future development rights, they are less likely to invest. Ultimately, it is the public that lose out if investor returns are compromised because their pensions are compromised. The impact is not to great extent on investors, but how that investment supports others.

3. At a time when our town and city centres need significant repurposing, much of which might be mixed-use buildings, the Government's proposals will discourage investment in mixed-use development.

4. On large mixed-use developments place-making and therefore the protection of investors' long-term value will be undermined by buildings electing to opt out of the broader vision for a place.

5. The Levelling-Up White Paper specifically mentions 20 King's Cross style regeneration projects. These will be harder to deliver if investors are not able to protect their long-term interests in the management and future development of such places.

6. To protect their investment from enfranchisement claims, more mixed-use development may be targeted at the residential rental market rather than residential owner-occupied market, with an impact on the Government's desire to support greater homeownership.

7. Freeholders will be concerned about the impact on their commercial development and on commercial tenants. Mismanagement of the common parts by leaseholders could have a damaging impact on a landlord's investment, as the commercial tenants will be on relatively short leases, and able to vote with their feet.

8. At the time of the 2002 Act, mixed-use was less commonplace, but various planning policies have driven its expansion over the past 20 years. The affected buildings may be predominantly residential in the sense of percentage floorspace, but in terms of value to the investor, they will often be generating significantly more value from the commercial parts, and investors through no other reason than protecting their investment will want to control the management of the building. That is one of the reasons why the 25% threshold was chosen back in 2002. It was also not a contentious issue that the Law Commission looked at, and originally in its consultation stakeholders supported no change.

Question 3. If you were to benefit from a new 50% non-residential limit, would you buy your freehold?

d. Not a leaseholder

Question 4. If no/not sure to Q 3, please select all relevant reasons?

Not applicable.

Question 5. Are there any individuals, organisations or types of properties that you believe should be exempt from the proposed increase in the non-residential limit to 50%?

a. Yes

If Yes - Please set out what type of individual, organisation or property should be exempt. Please provide information on the following:

If the Government pursues a threshold of 50%, for the reasons set out in question 2, we suggest an exemption where buildings are part of a wider estate. This would therefore protect the value in placemaking – an important consideration given the Government's work on its planning for quality agenda. Also, the problems currently being faced from collapsing High Streets is a lack of common intent and ownership. These proposals will exacerbate that problem.

Why you think they should be exempt, providing evidence where possible; and the criteria for how an exemption would work in practice.

The exemption could be defined in terms of a number of buildings in close proximity, that are managed as a single estate. Further criteria could be:

- the landlord's historic connection with the area.
- the present character of the area.
- the landlord's management record.

Question 6. Do you support or oppose a 50% non-residential limit for individual freehold acquisitions?

e. Strongly oppose

If response Strongly oppose or Oppose - What are the challenges or dis-benefits, a 50% non-residential limit for individual freehold acquisitions? (Max 500 words)

We can see why this is being proposed if the Government is seeking to be consistent with the proposals addressed in questions 1. to 5., but again would ask Government to consider where the value sits in a flat above a shop, and the owner's intentions in owning both. In most circumstances the greater value will sit in the commercial investment – the shop. That is why many flats above shops sit empty – because they are of secondary importance to the

owner. A position well-recognised by previous administrations, who have had their own ‘living over the shop’ initiatives to bring such space back into use.

The intentions of the owner in most circumstances will be to invest in the commercial unit. Any small amount of income generated by services to the flat will be ancillary. Freeholders will also want to exercise management control over any common parts. If, for example, the shop is a bank there will be security concerns. If it is a supermarket – a smooth delivery process, etc.

If an investor holds a lease of a shop and flat above, lets out the shop on a commercial tenancy and rents out the flat on an Assured Shorthold Tenancy (AST), what possible justification is there for allowing that investor to acquire the freeholder’s interest at a discount?

Question 7. What are the potential impacts of introducing a 50% non-residential limit for individual freehold acquisitions? (Max 500 words)

Please see our comments to Q6 above.

Question 8. Do you agree or disagree that mandatory leasebacks to landlords as part of the collective enfranchisement process will reduce the cost of purchasing a freehold?

a. Agree

It is difficult to understand why this question is being asked as there can be only one answer.

Question 9. Do you support or oppose mandatory leasebacks to landlords as part of the collective enfranchisement process?

e. Strongly oppose

If response Strongly oppose or Oppose - What are the challenges or dis-benefits of mandatory leasebacks as part of the collective enfranchisement process, on the presumption of a 50% non-residential limit? (Max 500 words)

Any person, individual or corporate, should have the option to exit when their property rights are being changed so fundamentally. A long-lease will not come with development rights, nor the other benefits of freehold ownership, which is why the cost is less. Such a policy will discourage future investment in mixed-use owner-occupied buildings and deprive existing freehold owners of their property rights without adequate compensation.

It is worth stressing where value sits in a building. If it is a single floor of commercial and 9 floors of residential the value is likely to be predominantly in the residential parts. In a building with 3 floors, of which one floor is commercial and two residential, most of the value is likely to sit in the commercial use of the building. It is more important for the commercial parts to remain in good condition in order to remain attractive to commercial occupiers(see Question 11, the difference between commercial and residential approaches to repair and maintenance). The presumption in developing and owning an existing building is that there is scope to redevelop as required. What is being proposed, however, is that the owner will no longer be able to adjust their building to commercial needs, but worse, they will be forced to keep it, or sell their long-lease of lower value to the market. Overall, the impact will be that in mixed-use buildings commercial space will not be as responsive to market demands.

As articulated elsewhere in this response, freeholders will also want to ensure that their valuable commercial space sits in a building that is well managed. The Law Commission recognised this concern in its consultation:

> *"With regard to concerns about the loss of control of management, we expect that leaseholders who enfranchise will frequently employ the services of a professional managing agent. We think that they are particularly likely to do so where they are tasked with managing premises which contain commercial units or other property which extends much beyond the participants' own homes. We do not therefore consider that the loss of control will mean that the building is not professionally managed."*

Alas the Law Commission provides no evidence to back its supposition.

It is also well recognised across the sector, including by Government, that there are a lot of unregulated and unprofessional managing agents. Government should be delivering the reforms suggested by Lord Best's ROPA report before handing management control to more leaseholders.

There must also at least be a risk of poorer management standards, as one of the motivations for leaseholders to enfranchise will be to reduce service charges, which will get reflected in the quality of managing agents they instruct.

Question 10. Do you agree or disagree that increasing the non-residential limit for the right to manage from 25% to 50% meets government's aims of addressing the historic imbalance of rights between freeholders and leaseholders?

b. Disagree

Question 11. Do you support or oppose a 50% non-residential limit for right to manage claims?

e. Strongly oppose

If response Strongly support or Support - What are the benefits of increasing the non-residential limit for right to manage from 25% to 50%? (Max 500 words)

If response Strongly oppose or Oppose - What are the challenges or dis-benefits, of a 50% non-residential limit for right to manage? (Max 500 words)

There is a move in the residential development market to make more new-build flats structured with Resident Management Companies; and making Right to Manage more accessible for apartment buildings is generally compatible with this.

This consultation is not focused on apartment buildings, however, but mixed-use buildings, which will often come with added complexity from the different uses, users, and owners of the building. For example, commercial users may want 24/7 security. Residential users may see that as an extravagance. Commercial owners may take a more precautionary approach to repairs and maintenance, conscious of their commercial tenants' needs for business continuity. Residential owners may take more of a 'need to replace' approach.

Where there is a freeholder, they will seek to balance these competing needs. Where management rests with leaseholders, they will understandably pursue their interests.

In a new building you may be able to design out some of these competing needs, wherever possible separating out the commercial and residential and minimising the common parts, but these reforms are aimed at existing buildings.

We can understand the desire from leaseholders for enfranchisement, but that must be balanced against the significant value in the commercial uses which investors will want to protect.

It is often the case the mixed-use flats will particularly appeal to buy-to-let investors, who will then find assured shorthold tenancy tenants for their units. Such small investors will tend to take a shorter-term view, and therefore minimise management costs to the detriment of the building and its environment, impacting on the commercial use(s).

Such concerns are not without foundation and were recognised by the Law Commission:

> *"We suggested in the alternative that leaseholders should be able to acquire the RTM over premises with more than 25% non-residential space but only if they appoint a managing agent. However, later in this Report we conclude that the RTM company should never be under a legal duty to appoint a managing agent."*

The Law Commission also noted that such concerns would be accentuated in complex buildings, but did not really offer any solution in such circumstances beyond conjecture that...

> *"It is likely that they (leaseholders) will appoint professional directors with building management experience, or appoint a managing agent."*

Question 12. Do you agree or disagree that right to manage company voting rights should be amended to ensure leaseholders continue to have effective control of decisions?

b. Disagree

Question 13. Do you support or oppose capping the total votes allocated to landlords in right to manage companies to one-third of the total votes of qualifying tenants (Law Commission's Option 3)?

e. Strongly oppose

If response Strongly support or Support - What are the benefits of capping the total votes allocated to landlords in right to manage companies to one-third of the total votes of qualifying tenants? (Max 500 words)

If response Strongly oppose or Oppose - What are the challenges or dis-benefits, of capping the total votes allocated to landlords in right to manage companies to one-third of the total votes of qualifying tenants? (Max 500 words)

We appreciate the conundrum the Law Commission is seeking to resolve on voting rights, which is created by the proposed change in the non-residential threshold. As set out elsewhere in this response, we strongly oppose the change in the threshold, because of the concerns we have expressed on landlords' loss of control over management of the common parts and their loss of development rights and impacts on investment.

Our strong opposition is therefore against the wider reforms, and not some of the Law Commission's rationale on this specific part of the consultation. Clearly it is no one's interests to have a building where the Right to Manage sits with the leaseholders, but the voting rights of the freeholder to all intents and purposes block that right over the residential parts of the building.

Where the Law Commission rationale breaks down is on the common parts, where landlords' interests and voting rights are just as legitimate as leaseholders.

Because voting rights encompass the common parts the fairest outcome would therefore be the Law Commission's suggested option 1, which would apportion votes based on floor area, rather than option 3.

Question 14. Do you support or oppose that, where Shared Ownership providers are liable for paying for repair and maintenance during the 'Initial Repair Period' of a new Shared Ownership lease, they should have the right to vote on matters relating to these works and their costs?

a. Strongly support

If response Strongly support or Support - What are the benefits of allowing Shared Ownership providers the right to vote on matters relating to the works and costs for which they are responsible during the “Initial Repair Period”? (Max 500 words)

If response Strongly oppose or Oppose - What are the challenges or dis-benefits of allowing Shared Ownership providers the right to vote on matters relating to the works and costs for which they are responsible during the “Initial Repair Period”? (Max 500 words)

Based on the principle of no taxation without representation, this is a fair proposal. Those who are being asked to pay for such works should have the right to vote on them.

Question 15. Do you support or oppose that, where Shared Ownership providers wish to delegate this right over decision-making to the shared owner, they should be able to do so?

a. Strongly Support

If response Strongly support or Support - What are the benefits of allowing Shared Ownership providers to delegate this right over decision-making to the shared owner? (Max 500 words)

If response Strongly oppose or Oppose - What are the challenges or dis-benefits of allowing Shared Ownership providers to delegate this right over decision-making to the shared owner? (Max 500 words)

We think such flexibility makes perfect sense and if shared ownership providers want to delegate their voting powers to the shared owner they should be allowed to do so.

Question 16. What should be the maximum fee (£) for issuing a Commonhold Unit Information Certificate (CUIC)?

No response.

Why do you think your chosen maximum fee (£) is most suitable? (Max 500 words)

n/a

Question 17. Do you support or oppose a sanction on the commonhold association that no fee is payable, if the deadline for the CUIC’s provision is missed?

b. Support

If response Strongly support or Support - What are the benefits of placing a sanction on the commonhold association that no fee is payable, if the deadline for a CUIC is missed? (Max 500 words)

If response Strongly oppose or Oppose - What are the challenges or dis-benefits of placing a sanction on the commonhold association that no fee is payable, if the deadline for a CUIC is missed? (Max 500 words)

This sounds like a good discipline and the proposed sanction seems appropriate bearing in mind the voluntary nature of the position of the commonhold association officers who will run the commonhold association.