

A NEW LEASE OF LIFE

A lease that is nearing its term is a diminishing asset. What are the legal ramifications involved in acquiring an extension lease and how should you approach the process?

By Alan Edwards

The Leasehold Reform Housing and Urban Development Act 1993 set out, amongst other aims, to address the issue of leases being a diminishing asset, and by Chapter 2 of Part I of the Act gave certain lessees the right to call upon their landlord to grant a new lease of the flat for a period of 90 years beyond the termination date of the existing lease, at a peppercorn rent. The lessee pays a premium in accordance with a valuation formula laid down by the Act. There is no limit to the number of 90 year extensions which can be granted.

Qualification

In order to be entitled to obtain a new lease, the lease, and the lessee (called the Qualifying Tenant by the Act) must qualify as follows:

1. The lease must have been granted for a term of years certain exceeding 21 years.
2. The lessee must have owned the lease for a period of two years at the date that he serves a notice under section 42 of the Act claiming to exercise the right to receive an extension lease. Since the passing of the Leasehold Reform Act 2002 it is no longer necessary for a lessee to be resident in the flat. The lessee is entitled to an extension lease of not only the flat but also of any property which is enjoyed with the flat, for instance, a parking space demised to the tenant with the flat.

The process of application

1. The lessee serves a notice upon his landlord requiring the landlord to grant a 90 year extension on the terms set out in the notice which will include terms as to price as



well as to the wording of the lease. The price will be as advised by a valuer who will be familiar with the valuation formula laid down in the Act. The terms of the lease will be as advised by the lessee's solicitor. It is often the case that a lease will contain defects and without going into detail of the entitlement to have a defect put right, this is an opportunity to do so.

The notice is served upon the landlord who is able to grant the 90 year extension, which may mean the freeholder, or in a case where there is an intermediate lease of more than 90 years, the intermediate leaseholder. Where there is an intermediate lease which is not long enough to grant a 90 extension then the notice is served upon the freeholder with a copy on the intermediate leaseholder, or leaseholders if there is more than one.

2. The landlord must serve a counter notice on the lessee within two months of the service of the lessee's notice indicating whether the landlord agrees that the lessee is entitled to require an extended lease, and if so, whether the landlord agrees with the terms which are suggested. If the landlord does not agree with the terms suggested then he must set out his counter proposals. If the landlord fails to serve a counter notice within the two-month period, then the lessee is entitled to obtain from the landlord a new lease on the terms which are set out in the lessee's notice. This is a strict timetable and landlord's and their advisers must ensure that the counter notice is served within the time limit.

Because the landlord can be condemned to grant a lease on the terms set out in the

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lessee's notice, case law has held that the figure inserted in the lessee's notice as the figure that the lessee intends to pay for the new lease, must be realistic (justified upon valuation advice) (*Cadogan v Morris* (1999) 1 EGLR59. If the figure is not realistic then the notice is invalid.

3. Following the service of the lessee's notice and the landlord's counter notice, there follows a period of two months in which the Act envisages that the parties will negotiate the price to be paid for, and the terms of, the new lease. If agreement is not reached then either party may within a further period for months apply to the Leasehold Valuation Tribunal to fix the price and the terms, that is a six-month period in total from the service of the counter notice. If an application is not so made in the absence of agreement, then the lessee's notice is deemed as having been withdrawn, and the lessee must wait a further 12 months before he can serve another notice, and must pay the landlord's costs. Lessees and their advisers must therefore be very careful to observe this time limit.

4. Once the application to the Leasehold Valuation Tribunal is made, the Tribunal will give directions for the preparation of the case for Hearing, and will give a date for the Hearing. Currently this is approximately three to five months after the application has been made. However, negotiations continue after the application has been lodged in the Tribunal, and the vast majority of cases settle without the necessity of going to a Hearing. The Tribunal has jurisdiction to award costs only in very limited circumstances. It is normal therefore for each party to pay their own costs in relation to the Tribunal, which is a strong incentive to settle. It is normal for the Tribunal to adjourn the first hearing if the parties are near to an agreement.

5. Once price and terms have been agreed the 93 Act lays down a timetable for the new lease to be completed by the expiration of two months after all the terms have been agreed. If either party fails to complete, an

application can be made to the County Court within a further two months. Lessees must beware as the court may order in the default of the lessee completing that the lessee's notice should be deemed as withdrawn resulting again in the lessee having to wait a further 12 months before another notice can be served, and being liable for the landlord's costs.

There is provision in the Act for the lessee to pay the landlord's valuer's costs (but only for the valuation not for negotiation) and the landlord's solicitors costs in relation to the grant of the lease. There is also provision to enable a lessee to obtain an extension lease even where the landlord cannot be found.

As I have indicated above, the price to be paid for the new lease is calculated in accordance with a number of heads of compensation for the landlord which are laid down by a formula in the Act. One of these is "marriage value". This is normally by far the most expensive part of the compensation package. The Leasehold Reform Act 2002 introduced a new concept whereby if a lease has an unexpired term of more than 80 years at the date when the lessee's notice is served, then no marriage value is payable. This is a considerable saving for lessees and lessees should be astute to ensure that they do not allow the unexpired term of their leases to go down to 80 years or less before serving a notice. The difference in price can be considerable.

When to apply: extension lease or enfranchisement?

A lessee can apply for an extension lease even though the building does not qualify for enfranchisement. For instance, where more than 25% of the building has commercial use. The advantage of applying for an extension lease over participating in a collective enfranchisement, is that the lessee does not have to rely upon the co-operation of other lessees in the building so as to reach the 50% mark of all flats in the building which is a prerequisite for enfranchisement.

Generally speaking the cost of enfranchisement in terms of the premium to be paid is the same or very similar, as for

an extension lease. In both cases normally the lion's share of the price is made up of marriage value. The proportion of the collective enfranchisement price which has to be paid by the lessee in relation to their flat is very similar or identical to the price for the new lease for the flat. There is nothing to prevent a lessee who has obtained a new lease from later participating in an enfranchisement but they will not have to pay marriage value for their flat on the enfranchisement, because they have already done so in the acquisition of the new lease.

Lessees when deciding to acquire a new lease or to participate in an enfranchisement will need to analyse what they wish to achieve. By exercising the right to collective enfranchisement a lessee will acquire, normally through a company of which they will be a shareholder or member, control over the management of the building, together with the ability to obtain a 999 year lease, instead of just a 90 lease. Also, professional costs will be distributed between all those participating in the enfranchisement. If, however, a lessee has no interest in control of the building then they may consider that the route of the extension lease is more attractive. A word of warning, however. It is common where there has been an acquisition of the freehold by collective enfranchisement for any buyer of a flat which has not participated, to require that the seller procures that the buyer becomes a shareholder of the enfranchisement company either to obtain a 999 year lease or to be part of the management of the building, or both. The seller will therefore be in a position of having to negotiate with the enfranchisement company upon the terms upon which a 999 year lease and/or a share/membership in the company will be forthcoming.

It is often the case that the right to acquire a new lease is exercised where it is not possible to organise a sufficient number of lessees in the building to exercise the right to collective enfranchisement.

The above is very much a simplified overview. The legislation is complex and there is a growing body of case law arising out of that complexity. It is a brave lessee or landlord who grapples with this legislation without expert advice.

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