Briefing note for all-party round table meeting on leasehold issues

Introduction

We are failing to make energy efficiency improvements in private blocks of flats and other leasehold properties, because it is very difficult for different parties with a title to the properties to reach agreement practically and lawfully for improvement works to proceed.

This is directly impacting on delivery of key government targets and programmes to promote energy efficiency. The UK government has a legally binding commitment to achieve an 80% cut in carbon emissions[1]. Energy improvements to homes are recognised as a central part of that strategy. But 20% of English homes are flats. The Committee on Climate Change identifies additional insulation, high efficiency electric heating and district heating as key components of the strategy to decarbonise homes[2]. All of these from a purely technical perspective should be most cost-effectively delivered in flats because of the potential to share heat between dwellings and other economies of scale. But our evidence suggests we are less likely to be retrofitting flats – at least in the private sector - than other types of homes.

The Fuel Poverty Strategy for England[3] legally commits government to bringing fuel poor homes to an energy performance standard of band "C" by 2030, improving[4] homes currently in the bottom F and G bands by 2020. One type of private flat – those in converted houses - are by the far the most likely homes to be in the F and G energy performance bands[5]; these dwellings are also most likely to pose a significant health threat to residents because they are dangerously cold.

Making energy improvements in blocks of flats

There is one big reason for the lack of progress in improving energy efficiency in private blocks of flats. A large number of different parties can have a title to - or responsibility for - any given block: freeholders, leaseholders, short-term tenants, mortgagees and management companies. Under the current system, it is a near impossibility for these parties to reach agreement practically and lawfully for energy improvement works to proceed.

Some of the specific issues are:

- Leases limit what works freeholders can do to the building – and charges they can incur - on behalf of leaseholders. The vast majority of leases make no reference to energy efficiency measures: installing insulation (for example) will therefore constitute an improvement which goes beyond what is authorised under the lease.
- Leases can also limit what changes leaseholders can make within individual flats.
- Leases can vary greatly, even within the same building.
- Varying leases is difficult and is rarely undertaken. The law makes some provision to make this easier in some circumstances, but not in regard to energy efficiency.
- There is a lack of guidance and encouragement for building owners to understand the potential costs and benefits for building level action on energy upgrades.
- It can be difficult to bring parties together - absentee landlords/leaseholders are a problem.

This is particularly an issue in private housing. As social housing providers usually own outright the freehold of a block of flats and directly let most of the units within it, it is easier for them to take action across the building. However, as many buildings also contain leaseholders on long leases who have exercised the right to buy these blocks may also be problematic.

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[1] By 2050, against 1990 levels.
[2] *Committee on Climate Change, 2015 Progress Report: Technical Annex 2: Buildings* https://www.theccc.org.uk/publication/reducing-emissions-and-preparing-for-climate-change-2015-progress-report-to-parliament/
[3] *Cutting the cost of keeping warm: a fuel poverty strategy for England*, DECC 2015 https://www.gov.uk/government/publications/cutting-the-cost-of-keeping-warm
[4] "as far as reasonably practicable"
[5] Based on analysis of 2010/11 English Housing Survey data. The latest 2012/13 data continues to show that flats in converted houses are the least energy efficient property types as well as showing highest risk of dangerous excess cold.

What are the consequences of this issue?

Blocks of flats are being upgraded with insulation and double glazing at a much slower rate than other types of houses. For example, older private blocks make up 8%[6] of all homes, but 19% of the homes with no double glazing.

The oldest flats - notably those in converted houses - are the least energy efficient homes in the housing stock, posing a significant health risk to residents: 26%[7] of flats in converted flats have a serious health and safety hazard, with "serious excess cold risk" being more than twice as prevalent than in the rest of the stock.

Our ideas for proposed legislation

This is a complicated problem. There is no one solution that will resolve this issue for all - or even a majority - of blocks. New primary legislation is likely to be required. Nonetheless given the scale of the problem, unlocking action on even a minority of blocks of flats could lead to major progress on energy efficiency and fuel poverty in the hardest to treat buildings.

In the next section of this document we investigate four possible solutions:

Building –level solutions

- A duty on the freeholder or other party having control of the building to undertake an energy efficiency survey of the whole building to identify where measures could be installed and to provide a cost/benefit analysis.
- An independent right for leaseholders and/or freeholders to improve the energy efficiency of buildings in which they have an interest.
- Changing leases to permit energy efficiency measures to be undertaken and the cost recovered via the service charge

Flat-level solutions

- Where a lease contains a covenant prohibiting a leaseholder from carrying out alterations within a flat, overriding such a provision where the leaseholder intends to undertake energy efficiency measures.

Finally we discuss what can be done to prevent this problem arising in future by ensuring that new leases adequately allow for energy efficiency upgrades to be made.

Building-level Solutions

Solution 1: A building-level energy saving survey

Statute would create a mandatory energy assessment scheme for blocks of residential flats. This would place a duty on the freeholder (or other party having control of the building) (the "*building controller*") to undertake an energy efficiency survey of the whole building to identify where measures could be taken and to provide a cost/benefit analysis. The duty would be owed to, and enforceable by, leaseholders and by a public body such as The Environment Agency/Local Authority. This idea would parallel the recent introduction of mandatory Energy Saving Obligation Surveys (ESOS) in the business sector.

As with ESOS we suggest that there would not be a duty to undertake the improvements but identifying energy efficiency opportunities will provide an impetus for action. Our later recommendations indicate powers that will be made available to undertake energy efficiency improvements. The building controller is the person best placed to undertake this survey and to ensure all parties know what is possible in terms of improvements to the building. If the buildings controller does not already have the necessary ancillary rights to be able to conduct the survey, these would be implied.

[6] English Housing Survey, 2011 data
[7] English Housing Survey, 2013 (latest available) data

Secondary legislation could set out precisely what information the survey would have to contain. This would support the dwelling (flat) level Energy Performance Certificates which are already required at point of sale or rental.

Consideration needs to be given to:

- How frequently the building controller would be required to undertake the survey
- What buildings should constitute "*qualifying buildings*"?
    - The buildings would need to include at least one 'qualifying lease'. A qualifying lease is a lease of a residential flat let for more than 21 years. Should there be a higher minimum number of residential flats in the building? Should there be minimum proportion of the building occupied on a residential basis? Should there be a requirement that a minimum proportion of the building is occupied by qualifying leaseholders?
    - It may be appropriate to exempt certain buildings:
        - Where blocks of flats have been recently constructed or sold as whole buildings and therefore already have a building level EPC.
        - Where two or more of the flats (or a specified proportion of flats) have an energy efficiency above EPC "C".
        - Special provisions may be necessary for listed buildings, e.g. for the survey to incorporate guidance from English Heritage or specialist installers.
        - Are there any categories of freeholder/landlord which should be exempt, for example those in the public sector who may already be under independent duties to improve the energy efficiency buildings (such as local authorities under EU directives)? There is a strong argument to exempt social housing landlords given that social housing is the most energy efficient part of the housing stock.
    - The obligation would also apply to mixed use properties. In principle there is no reason for limiting this requirement to wholly residential properties. Mixed use buildings let to several tenants (a shop on the high street with a flat above it) may well also benefit from energy efficiency measures.
- How would the survey be paid for? Should the cost of the survey be recoverable only from qualifying leaseholders through the service charge, or should the cost be shared amongst all building leaseholders/tenants/freeholders with a special mechanism for recovery? Or is there some other suggestion?
- Enforcement. By making this a statutory duty, the leaseholders would be entitled to bring civil proceedings against the building controller if he fails to comply. Remedies could include:
    - An injunction requiring the building controller to undertake the survey.
    - A prohibition on the building controller:
        - recovering ground rent and/or service charges; and/or
        - on the disposal of the building

      until he has complied. This could be protected for example by registering a unilateral notice at the Land Registry against the building controller's title.
    - Damages (including exemplary damages).
    - A right for the leaseholders to step in and carry out the survey themselves.

- A right to acquire by compulsion the building controller's interest. A building controller who wishes to be released from the statutory duty could do so by agreeing to transfer his interest to the leaseholders.

Should a failure to comply be made a criminal offence? Some areas of landlord and tenant law (for example failing to comply with the right of a tenant to first refusal under the Landlord and Tenant Act 1987) do carry criminal sanctions for non-compliance.

Solution 2: Changing leases to permit energy efficiency measures to be undertaken and the cost recovered via the service charge

A typical long lease of a flat will contain a covenant by the freeholder to maintain and repair the building and then to recover the cost through the service charge. However, unless the lease is drafted to make it clear that the freeholder is also entitled to undertake improvements or the building has deteriorated and the measures are necessary and appropriate to remedy the disrepair, carrying out energy efficiency measures is likely to go beyond the repairing covenant. This means that, however reasonable it may be to undertake the work the freeholder has no right to carry them out, he cannot recover the cost and if he interferes with the leaseholders' use and enjoyment of their flat, he can be sued.

The other barrier is a lease that contains an absolute or unreasonable restrictions on the ability of the leaseholder to undertake energy efficiency measures, which are within the flat and which have no adverse impact on the rest of the building and other leaseholders.

Our proposal

- Where a residential lease contains an obligation to maintain and repair the building and a mechanism to recover the cost through the service charge (a "*qualifying lease*") there is be implied into the lease the right of the freeholder (but without imposing an obligation to do so) to undertake "*qualifying improvements*" and then to recover the cost through the service charge.

- Points to consider:

    - What about a long lease where there is only a short amount of time left to run and the freeholder intends to use the provision to carry out works at the leaseholder's expense and from which the leaseholder will derive no benefit? It would be possible to limit the effect of the implied term. However, this is not a new issue[8] and simply by giving the freeholder the ability to carry out the work does not mean that it is reasonable to incur the cost. There are other forms of protection (see below).

    - Definition of a "*qualifying improvement*". This would be a measure designed to improve the energy efficiency of the building. Should the legislation:

        - Define a qualifying improvement narrowly (e.g. by limiting it to improvements where the return on investment/payback period was reasonably short) (or where the building fails to meet a prescribed minimum standard and the improvement will take it to that minimum standard); or

        - Defined it broadly; or

        - Leave the question to the First Tier Tribunal (see below). If the latter, statutory guidance should be to be issued to which FTT judges must have regard. This guidance could include having regard to the severity of the underlying deficiency, the number of flats, the degree of interference that the improvements would cause, the payback period, the availability of any third party funding, the personal circumstances of occupiers and leaseholders, and whether the improvements are linked to other repairs.

- Note that the Landlord and Tenant Act 1985 already includes various forms of protection for leaseholders that provide that the costs must have been reasonably incurred and the freeholder must

[8] See for example *Fluor Daniel Properties Limited v Shortlands Investments Limited* [2001] 2 E.G.L.R. 103 which concerned whether the landlord was entitled to recover the costs of replacing an air conditioning system from tenants whose leases were shortly to expire.

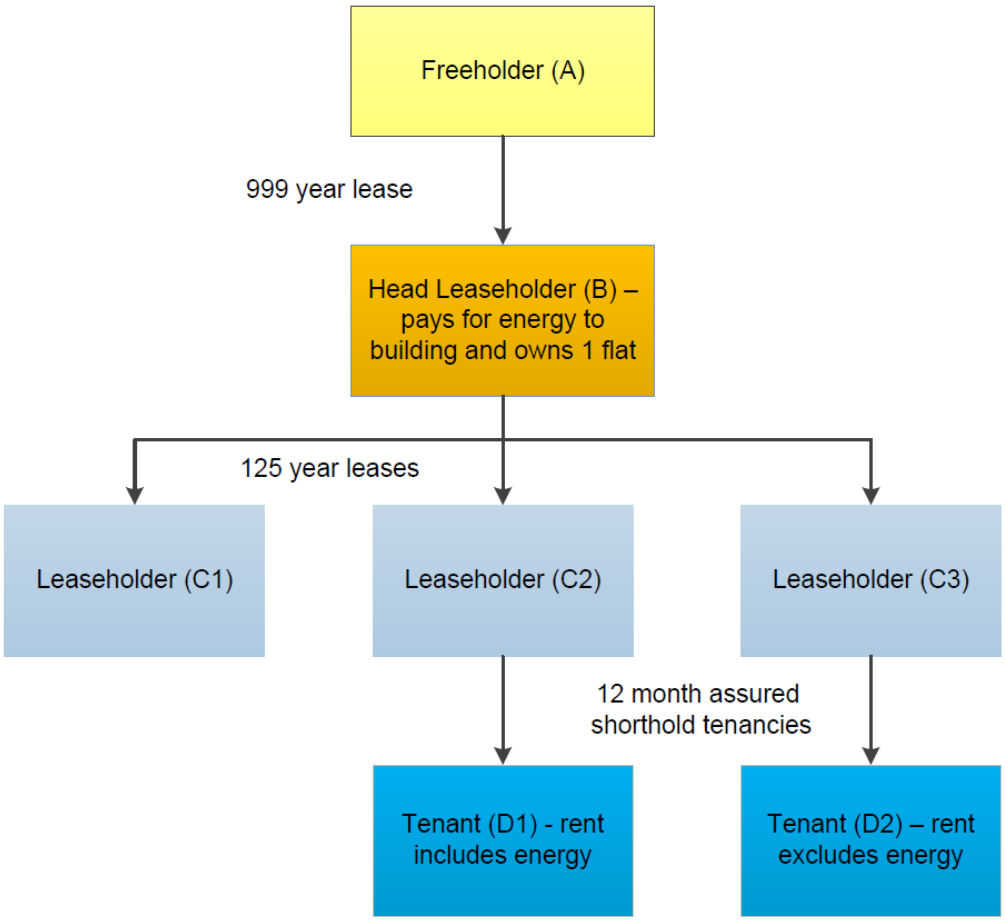
undertake a consultation exercise with the leaseholders. The normal way such costs are challenged is in the FTT.

Solution 3: An independent right for leaseholders and/or freeholders to improve the energy efficiency of buildings in which they have an interest.

This would create a new right for those with an interest in the building to act independently of the leases to carry out improvements to reduce the energy costs that they have to pay.

Points to consider:

- "Q*ualifying improvements"* would be improvements identified in a mandatory survey (perhaps only if meeting certain criteria as to payback periods).
- Should a "*qualifying building*" could have the same meaning as that applicable for energy efficiency surveys? Is it appropriate for this right to extend to mixed use buildings, and to buildings with flats not held under a qualifying lease?
- What about linked buildings? Although technically feasible, it may not be appropriate or aesthetically desirable for example to change the windows or install external wall insulation on only one building in isolation from the others.
- Consent requirements: There would need to be a majority of "*qualifying owners*" before such rights could be exercised.
- How should a qualifying owner be defined? Take the following example.



In this scenario the qualifying owners could be any of the above. We would suggest the qualifying owners are those leaseholders with a lease of more than 21 years and with a financial interest in the energy efficiency of the building because they directly meet the cost of energy to part of the building.

This will include:

- The freeholder (A) if he pays for energy supplied to part of the building that is not recharged to leaseholders (e.g. a flat owned by the freeholder and not leased).
- Any head leaseholder (B) where the same applies.
- Individual flat owners (C) who pay for energy supplied to part of the building that is not separately recharged to someone else. So:
  - C1 would be a qualifying owner as he owns and occupies his flat.
  - C2 would also be a qualifying owner - although the flat is let out, the tenant (D1) pays an all inclusive rent and so he cannot separately recharge for the energy.
  - C3 would not be a qualifying owner as either he passes on the cost of energy supplied to D2 in addition to charging rent or D2 pays the energy supplier directly. This means that C3 who has no immediate incentive to agree to the work cannot scupper the scheme. If the flats in the building are mainly occupied by C3 type leaseholders, the number of qualifying owners could be very few. Does that matter?
- Should D2 have any positive say in whether the scheme proceeds? One option would be that where there is a "*qualifying occupier*" (in this scenario D2)) who pays for the energy, the qualifying occupier can require that leaseholder (C3) is treated as a qualifying owner (whatever the actual views of C3). Alternatively the qualifying occupier could require the leaseholder C3 to agree where there is grant funding to pay for the upgrade or the qualifying occupier D3 is willing to fund the upgrade. This approach would follow the spirit of the 2011 Energy Act private rented sector energy efficiency regulations.

- Consent requirements: what majority is required? Should it be a simple majority (51%) or higher (e.g. 75%)?
- Should the qualifying owners be required to own a "*requisite proportion*" of the building? This could ensure that the votes of those who own/occupy larger flats and who are more likely to benefit from energy savings, carry greater weight.
- Should there be any 'weighting' of votes or should each qualifying owner have one vote?
- If substantial energy costs are incurred in heating/cooling the common parts, the freeholder has a greater interest in improving the building: in these circumstances, should its vote be weighted?
- Procedure
  - The qualifying owners would need to create a specific corporate vehicle (the "*right to improve company*") to undertake the work. The legislation could set out the features of the RTI company (rather like the legislation which created right to manage companies did) and would deal with the rights and obligations of members and how the cost of the improvements is to be met and apportioned.
  - The legislation would need to address how to deal with those qualifying owners who do not form part of the RTI company and who did not vote in favour. It would need to:
    - Create a consultation process akin to that under the Landlord and Tenant Act 1985 to ensure their views on the works and the costs are still taken into account.
    - Provide for the RTI company and/or any qualifying owner to apply to the FTT to determine whether the cost is or will be reasonably incurred.

- Confer a right of entry onto parts of the building not within the control of members (such as the common parts or flats).
- Give the RTI company the right to recover an appropriate proportion of the cost from qualifying owners. The most obvious mechanism would be by way of a debt secured against the flat or freehold by way of a statutory charge.

Flat-level solution

Solution 4: Where a lease contains a covenant prohibiting a leaseholder from carrying out alterations within his flat, overriding such a provision where the leaseholder intends to undertake energy efficiency measures.

This measure is designed to permit a leaseholder to carry out energy improvements within his flat provided that s/he does not need to alter or damage the structure of the building. This would override the absolute prohibition on making any alterations. There is precedent for such a measure in other areas (e.g. the Landlord and Tenant Act 1927 (which applies to improvements to commercial property)).

This measure would:

- Permit the "*qualifying leaseholder*" to undertake a "*qualifying improvement*" provided that the leaseholder had first obtained the freeholder's written consent which cannot be unreasonably withheld or delayed. For these purposes:
    - A "*qualifying leaseholder*" would be the leaseholder under a lease granted for a term of more than 21 years.
    - A "*qualifying improvement*" would be a measure designed to improve the energy efficiency of the flat.
- Impose a statutory duty on the freeholder to give consent unless it is reasonable not to do so and to ensure that any conditions are reasonable. This mirrors similar statutory duties in dealing with the assignment, underletting and charging of leases under the Landlord and Tenant Acts 1927 and 1988. It has the effect of placing the burden on the freeholder to prove that the refusal or conditions are reasonable.
- Only apply where there is no comparable covenant within the lease.
- The legislation could set out the circumstances when it would be reasonable to refuse consent or impose conditions. This could for example:
- Permit the freeholder to:
    - Refuse consent where:
        - the work will adversely affect the structure of the building or substantially interfere with the use and enjoyment by other leaseholders/occupiers of the building.
        - The freeholder is or intends to undertake qualifying improvements to the building and these works would render those works more difficult or more expensive.
    - Impose conditions on any consent e.g. that any work must be undertaken at a specified time and/or in accordance with building regulations, planning and listed building legislation.
- Give the First Tier Tribunal jurisdiction to deal with any dispute in this area.

Future Leases

Up and down the country lawyers are continuing to issue leases which do not contain express provisions allowing for energy efficiency measures to be carried out. Such leases are many and varied and it would be extremely difficult to produce a standard form of long lease of a residential property.

However, is there a case for legislation in this area requiring some express provisions to be included? Or, if the above solutions (2 and 4) are adopted, will familiarity with the implied powers and rights lead to the adoption of express terms in new leases without compulsion?

There is also work that could be done by Government and others with interest and influence in this area to promote the better use of such clauses. And where Government does have a greater degree of control is over the rollout of the right to buy where it would be open to the Government to influence the form of lease to be used by social landlords.

Human Rights Considerations

Article 1 of the First Protocol will apply to the solutions outlined above. This contains three rules:

- There should be no interference with possessions;
- No one should be deprived of property except in the public interest; and
- The state may control people's use of property by law in the general interest.

Article 1 covers all forms of property and includes freehold land, leases and tenancies and interests in land such as easements and restrictive covenants. The right is not an absolute one; it is relative. The role of the Court is to determine whether the interference with a person's property is lawful under domestic law and, if so, whether a fair balance has been struck between the general interest of the community and the need to protect the individual's fundamental rights. This is done using a proportionality test while recognising that national authorities are afforded a wide "margin of appreciation" in determining whether actions can be justified. Where the interference involves the deprivation of property it is more difficult for a public authority to justify the action and compensation is normally required. Conversely, control of property is more readily justified.

In our view the four solutions can all properly be described as fulfilling the general interest of the community. There is a legitimate general interest in ensuring that the energy efficiency of buildings is improved, energy wastage and energy bills are cut. It follows therefore that measures which control the enjoyment of the property (in the widest sense) can be in the general interest of the community.

The issue therefore is whether the measure is a proportionate one. We believe these measures are proportionate, having regard to the extent of the rights and obligations of those with property interests, the conditions to be satisfied before rights can be exercised and procedural safeguards including the role of the FTT.

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