LANDMARK CHAMBERS: ROOFTOP DEVELOPMENT SEMINAR

Dealing With Tenants' Statutory Rights

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Landmark Chambers

1. This paper examines the extent to which tenants' statutory rights can affect a landlord's ability to carry out rooftop development. In particular, it considers the impact of:

    a. The tenants' right to manage under the Commonhold and Leasehold Reform Act 2002;

    b. The tenants' rights of first refusal under the Landlord and Tenant Act 1987; and

    c. The tenants' rights of collective enfranchisement under the Leasehold Reform Housing and Urban Development Act 1993

a) Right to Manage

The nature of the right

2. Chapter 1 of Part 2 of the Commonhold and Leasehold Reform Act 2002 ("the 2002 Act") makes provision for certain tenants to acquire the right to manage a self-contained building or part of a building via a right to manage ("RTM") company. The right is acquired from the landlord without compensation and without the tenants needing to prove any shortcomings on the part of the landlord.

3. In order to qualify for this right the building must contain two or more flats, at least two thirds of which must contain qualifying tenants (s72) – that is tenants holding under a long lease (s77).

4. The RTM company must be a private company limited by guarantee whose articles of association state that its object, or one of its objects, is the acquisition and exercise of the right to manage the premises (s73). There is no requirement that the membership of an RTM company must comprise a certain proportion of qualifying tenants, but the company will be unable to give a

claim notice seeking to exercise the right until at least half of the qualifying tenants of flats in the premises are members (s79).

5. Importantly, on the acquisition of the right to manage, the RTM company assumes the *'management functions'* previously exercised by the landlord or other manager under the terms of the lease. These functions are described in ss96-7 of the 2002 Act. In particular, s97(2) states:

> *(2) A person who is—*
>
> *(a) landlord under a lease of the whole or any part of the premises,*
>
> *(b) party to such a lease otherwise than as landlord or tenant, or*
>
> *(c) a manager appointed under Part 2 of the 1987 Act to act in relation to the premises, or any premises containing or contained in the premises,*
>
> *is not entitled to do anything which the RTM company is required or empowered to do under the lease by virtue of section 96 , except in accordance with an agreement made by him and the RTM company.*

Effect on the landlord's right to develop the roof and airspace

6. This issue was considered by James Morgan QC, sitting as a Recorder at Central London County Court, in Francia Properties v Aristou [2017] L&TR 5. In this case the claimant landlord sought a declaration that he was entitled to develop a new flat on the roof space of an existing block. The block was managed by the defendant RTM company. There was no dispute that the RTM company was empowered to manage the roof under the 2002 Act. The defendant argued (at [70]) that s97(2) of the 2002 Act imposed an absolute prohibition on the landlord from developing any part of a building in respect of which an RTM company exercised its function.

7. Recorder Morgan concluded at [76]-[79] (emphasis added):

> *76. Returning to the words of s.97(2), whilst the prohibition is wide, it is not part of the function of the RTM in this case (or generally) to construct new dwellings. In those circumstances, what the claimant is proposing to do is not per se something the Company is "required or empowered to do under the lease". What the Company is required or empowered to do is to manage the roof. True it is that this management will be affected during and by the building work, but that in my judgment is not expressly prohibited by the Act. Further, the Company can continue to exercise management function in relation to the roof by, for example, applying to court for an injunction in the event that the development results in an ingress of the elements through the roof.*

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> *77. My provisional view is that the tension is to be reconciled by permitting a landlord to carry out development works providing it has taken all reasonable steps to minimise the disturbance to the management functions of the RTM both during and after the works.*
>
> *78. The fact that the development works may alter the size and scope of a building and therefore the responsibilities of an RTM does not seem to me to be an absolute bar, although it will clearly be relevant to the reasonableness of the works…*
>
> *79. There may come a point when the development scheme is so significant in its effects on the RTM that it cannot be said that the landlord has taken all reasonable steps. For example, the replacement of a pitched roof with a flat roof that is likely to cost enormous sums to maintain... But that would have to be resolved on a case-by-case basis.*

8. Recorder Morgan went on to consider the impact of the RTM provisions of the 2002 Act on the landlord's Article 1, Protocol 1 right under the European Convention on Human Rights. He found that this supported his view, expressed at [77] above, that the exercise of RTM rights could not impose a blanket ban on development by the landlord, but the landlord had to take reasonable steps to minimise disturbance to the RTM's management functions.

Conclusion

9. **The judgment in Francia is currently on appeal to the Court of Appeal**. Arguments were heard on 22 June 2017 and judgment is therefore due at any time. However, as things currently stand, the fact that an RTM company is responsible for the maintenance of a building is not necessarily a bar to rooftop development by the landlord. However, the landlord is under a duty to take all reasonable steps to minimise the disturbance to the management functions of the RTM.

b) Right of First Refusal

The nature of the right

10. Section 1(1) of the Landlord and Tenant Act ("the 1987 Act") provides that a tenant's immediate landlord shall not make any *'relevant disposal'* affecting any premises to which at the time of the disposal the Act applies unless he has previously served on all the qualifying tenants of the flats contained in those premises a notice conferring on them rights of first refusal.

11. Broadly speaking, according to s1(2), the 1987 Act will apply to premises if they consist of the whole or part of a building, contain two or more flats held by qualifying tenants and the number of flats held by such tenants exceeds 50% of the flats contained in the premises.

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12. According to s1(3), the Act will also apply to mixed-use premises provided that the internal floor area of non-residential parts is 50% or less of the whole (excluding common parts).

13. The right under the 1987 Act will only be available to those occupying under a tenancy (s3). This expressly includes statutory tenancies under the Rent Act 1977 but excludes certain tenancies including assured tenancies under the Housing Act 1988 and business tenancies under the Landlord and Tenant Act 1954. Tenants who do not qualify for protection as shorthold tenants, such as companies, can therefore be qualifying tenants.

Effect on the landlord's right to develop the roof and airspace

Lease of the roof space and/or airspace

14. In order to develop the rooftop of a building, it is common for a landlord to grant a lease of that space and the airspace above to a developer, along with other rights necessary to carry out the development.

15. By s4(1) of the 1987 Act, the disposal of any interest or estate in any such premises to which the Act applies, including *'common parts'*, will, subject to some exceptions, constitute a *'relevant disposal'* for the purposes of s1(1), thus triggering the qualifying tenants' right of first refusal. *'Common parts'* are defined in s60(1) as including the structure and exterior of the building.

16. In Dartmouth Court Blackheath v Berisworth [2008] 2 P&CR 3, Warren J held that a lease of a roof space and the airspace above did constitute a relevant disposal under the 1987 Act. In this case the roof space contained several pipes and chimneys which served the flats beneath and was regarded by Warren J (at [66]) as a part of a building pursuant to s1(2).

17. Warren J further concluded (at [70]) that the airspace necessary to enable maintenance to be carried out should also be regarded as appurtenant to the building, if not part of it, and therefore ought also to fall within s1(2). In this case, this amounted to the airspace up to at least the top of the chimneys. Warren J stated (at [71]) that if he was wrong on this then the airspace was a common part, being part of the exterior of the building pursuant to s4(1) and s60(1).

18. Thus, it would seem where any landlord of qualifying premises wishes to grant a lease of his airspace to a developer, the tenants' right of first refusal may be engaged. This would give tenants the opportunity to block any development by purchasing the lease for themselves.

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What is the "disposal"?

19. By s4(1) a *'relevant disposal'* is the *'disposal of any estate or interest (whether legal or equitable)'*. By s4A(1) a contract to create or transfer an interest or estate in land, whether conditional or unconditional, will constitute a *'relevant disposal'*. Thus the freeholder cannot enter a contract with a developer for the development of the roof and the grant of the necessary leases without serving a s5 Notice on the qualifying tenants.

20. If the landlord carries out the development, it may wish to enter into a contract to sell the lease of newly created rooftop flats off-plan, even before they are completed.

Methods by which landlords can avoid the 1987 Act

21. There are several methods by which landlords can avoid having to give their tenants a right of first refusal under the 1987 Act. These are generally derived from the exclusions to the definition of *'relevant disposal'* contained in s4, since no right of refusal can arise without a such a disposal.

Disposal to associated company/family member

22. If landlord is a body corporate, a disposal to company with which it has been associated for at least two years is not a relevant disposal (s4(2)(l)). Thus if the landlord plans ahead, it can create an associated company, and after 2 years can grant a lease of the roof and airspace to it without engaging the 1987 Act. The developer then has the option of selling the site or development by way of a sale of the shares in the associate company, which would not be a relevant disposal, or by the grant of leases of individual flats: see below.

23. If the landlord is an individual, the grant of a lease of the roof and airspace to a family member by way of a gift is not a relevant disposal (s4(2)(e)).

Lease of a single flat.

24. The grant of a tenancy under which the demised premises consist of a single flat, is expressly excluded from being a 'relevant disposal' by s4(1)(a) of the 1987 Act.

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25. Thus the landlord could carry out the development itself and then grant leases of single flats.

26. The question arises whether the landlord could enter an agreement with a developer allowing it to carry out the development, on the basis that once they are completed the landlord will grant leases of single flats to or at the direction of the developer.

27. The grant of a license is not a 'relevant disposal' for the purposes of the 1987 Act because it does not grant any legal or equitable interest. In theory a developer could therefore be granted a licence sufficient to enable the necessary works to take place.

28. The question would be whether the exception for a grant of a lease of a single flat applies in these circumstances. A "flat" is defined by section 60(1) in the same was as under the 1993 Act, namely

> "flat" means a separate set of premises, whether or not on the same floor, which—
>
> (a) forms part of a building, and
>
> (b) is divided horizontally from some other part of that building, and
>
> (c) is constructed or adapted for use for the purposes of a dwelling"

29. At the time of the contract there is no such "flat", but there will be at the time a lease is granted. In those circumstances, the question is whether the exception in section 4(1) applies. There is no authority on this. A purposive construction would suggest that there is no relevant disposal. It is hard to see why the 1987 Act is not engaged if the landlord develops and then sells leases of each flat, but is engaged if he agrees to grant such leases once the flats are built. On the other hand, an argument could be made that this exception will not apply where a flat is sold off-plan. This is because s1(1) is clearly focused on the state of the premises at the time of the disposal: "*a landlord shall not make a relevant disposal affecting any premises which at the time of the disposal this part applies*". At the time of its disposal by contract an off-plan flat has by its very nature not been completed. Thus, it cannot be a flat under s60(1) of the Act, since this definition does not appear to contemplate incomplete or hypothetical dwellings. Instead it is simply the air and roof space above the existing building, the disposal of which, as stated above, will give rise to a right of first refusal.

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Conclusion

30. Provided the relevant qualifications are met, tenants could invoke this right to prevent a landlord from selling a lease of the roof or airspace of the building containing their flats to a developer, although the tenants would have to purchase the lease themselves.

31. The prudent course, if there is no obvious exception, it to serve a s5 notice in respect of the intended contract with the developer. Assuming this provides for the developer to pay market value, it is unlikely that the tenants will want to exercise their rights. Their aim is usually to stop the development, not to carry it out or pay the value of it.

c) Collective Enfranchisement

The nature of the right

32. The provisions for collective enfranchisement in the Leasehold Reform Housing and Urban Development Act 1993 ("the 1993 Act") confer on *'qualifying tenants'* of flats in *'relevant premises'* the right to have those premises acquired on their behalf by a nominee purchaser. Broadly speaking a *'qualifying tenant'* is a tenant under a long lease (s5) – typically a lease for a term of years certain exceeding 21 years (s7(1)(a)). Under s.3(1) the *'relevant premises'* must consist of a *'self-contained building or part of a building'*, containing one or more flats, and the total number of flats held by qualifying tenants must be at least two thirds of the total number of flats in the premises. Under s.13(2)(b)(ii) the right must be exercised by the tenants of at least half of the flats in the building.

33. The tenants are entitled to acquire the freehold of the relevant premises, including its common parts. *'Common parts'* include the structure and exterior of that building or part and any common facilities within it (s101). In Dartmouth Court Blackheath v Berisworth [2008] 2 P&CR 3, Warren J held that the airspace above a building was part of the building for the purposes of the 1987 Act, at least to the height necessary to build an additional storey. In Panagopoulos v Cadogan [2011] Ch 177, Roth J applied the same principle, again obiter, to the extent of a building under the 1993 Act, holding that a lightwell was part of the building. In Bin Mahfouz v

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Barrie House (Freehold) Limited [2014] UKUT 0390 the Upper Tribunal held [at 148] that the airspace above the building was part of the building.

34. The tenants can also acquire leases of, among other things, *'common parts'*, where acquisition of those is reasonably necessary for the proper management or maintenance of those common parts (s2(3)). Again, it has been held in the same cases referred to above that the airspace is part of common parts.

35. The next question is whether acquisition is reasonable necessary for the management or maintenance of it. In Meadowside v Shellpoint Trustees LON/ENF/1177/04, 2008, the LVT held, without evidence, that acquisition of the airspace was reasonably necessary for maintenance of the roof. In Kintyre v Romeomarch 2005 WL 3804439, a Land Registry Adjudicator (at [24(1)-(2)]) held that a flat roof of a block of flats and the airspace above it could be acquired by tenants under the 1993 Act since control of them was reasonably necessary for the proper management and maintenance of the roof and the premises as a whole. It could not be so managed if a flat or phone masts were placed on it. In Heritage Land v Buttremere Court Freehold Limited LON/00BK/OCE/2006/0312 the LVT held that it was necessary to acquire an airspace lease, because

> "49.The tenants are likely to want to make use of the roof. We have mentioned that laying decking for a sitting out area could be easily effected. Less likely uses of the roof, such as for firework displays on Guy Fawkes night or for launching hot air balloons, might be possible. In all these cases the freeholders will need to manage the whole airspace, so as to prevent, for example, raucous parties or unsupervised fireworks. Insofar as they install decking or barbeques there will be a need for maintenance.
>
> 50.Those matters go beyond the rights which the airspace lease gives the freeholder. Accordingly in our judgment acquisition is reasonably necessary."

36. In each of these cases it was argued that sufficient rights were reserved to the freeholder for maintenance and management, but in each case the argument was rejected. It met with better success in Panagopoulos v Cadogan [2011] Ch 177, where Roth J held that acquisition of a lightwell was not reasonably necessary given the rights reserved to allow access for maintenance and repair of drains and conducting media, as well as of the exterior walls of the structure facing towards the light-well. It was argued that future technological developments

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may change the nature of the cabling or media services, or create the need for new services, so as to render the reserved rights under the lease inadequate. However, Roth J held that

> "in my view such vague speculation about possible future needs is not sufficient. Section 2(3) refers to the case where acquisition "is reasonably necessary for the proper management or maintenance of those common parts". It will almost always be possible to argue a case for the benefit of full control that comes with a freehold in possession, but section 2(3) clearly envisages that in some cases the freeholder's needs will be sufficiently accommodated by the terms of the lease."

37. This stricter approach might give grounds for resisting acquisition of an airspace lease in appropriate circumstances, if lower Tribunals could be persuaded to follow it.

38. By section 36 and Schedule 9 of the 1993 Act, once tenants have made an enfranchisement claim, the landlord is entitled to request a leaseback of certain *'units'*, including flats without qualifying tenants and premises let or intended for letting on a business lease (s38). In Mehrie Bin Mahfouz v Barrie House [2015] L. & T.R. 21, a landlord had granted business leases of storage rooms to two telecommunications companies prior to the tenants' enfranchisement claim. These rooms were connected to mobile phone masts and equipment situated on the roof surface and airspace of a block of flats. The Upper Tribunal held (at [143]-[149]) that the storage units and masts taken together constituted *'units'* under the Act and that, accordingly, the landlord was entitled to lease them back pursuant to s36.

Effect on the landlord's right to develop the roof and airspace

39. Where tenants become aware that their landlord is intending to undertake a rooftop development, they frequently seek to prevent this by making a claim for the freehold of the premises under the 1993 Act.

40. The price the tenants pay for the freehold will have to reflect the development value of the airspace. The relevant valuation date will be the date of the enfranchisement claim. The starting point will be the gross value of the proposed development. From this will be deducted the development costs and developer's profit. This figure will then be adjusted down to reflect the likelihood of planning permission being granted. Any prior planning applications or pre-application advice/indications will clearly be highly relevant to this. The more likely that

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planning permission will be obtained, the less the adjustment. The final total arrived at reflects the development value of the airspace.

41. If the landlord has made no applications by the date of the Notice, it is open to the parties to call evidence from a planning consultant as to the prospects of getting planning permission. The costs of a dispute as to development value can be substantial, as it is often necessary to call an engineer and costs consultant in addition to the planning consultant and valuer. The costs can outweigh the benefit if the development value is low or doubtful.

42. If the landlord's plans are advanced, a collective claim is unlikely to prove a magic bullet to stop it.

43. The problem is illustrated by the decision in Royal Tower Lodge 2013 LON/00BG/OCE/2012/0219. The landlord reached agreement in principle with a developer to grant an airspace lease to enable it to develop on the roof of a block of flats. The price agreed in principle was £748,000. The developer applied for planning consent which was refused, but the grounds for objection meant that a revised application was likely to be successful. The developer engaged with the tenants, and offered some sweeteners such as a new lift. This appeared to be acceptable. The freeholder served a s5 Notice on the tenants in respect of a proposed contract to grant the airspace ease subject to planning. The tenants did not accept. They responded by serving a s13 Notice, offering nothing for the roofspace on the basis that planning permission had been refused. The price could not be agreed and was referred to the FTT. The freeholder called evidence from the developer, from a planning consultant and valuer. The valuer prepared a residual valuation to justify a premium of £862,000 for the airspace. The tenants did not put up a real fight and this figure was accepted. The tenants then withdrew the claim.

44. In a case such as that, the tenants have three choices:

    a. To pay the development value and carry out the development or sell the right to do so to a developer;

    b. To pay the development value and not carry out the development. The problem is that they will not want to pay much, if anything, for it. Preventing a roof development does not usually add to the value of the flats below, so it is money down the drain.

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c. Claim the freehold but let the freeholder retain the airspace or lease of it as the case may be. In Hemphurst Limited v Durrels House Limited [2011] UKUT 6 (LC), a landlord had obtained planning permission for a rooftop development and granted a lease of the airspace above a block of flats. The Upper Tribunal held that the tenants, who had issued an enfranchisement claim, were not required to acquire the whole of the airspace lease (at significant cost). Instead, they could acquire only those parts of the roof that were that were necessary for maintenance and repair.

45. A landlord can claim a leaseback of a *'flat or other unit'*. The definition of *'unit'* in s38 is limited to (a) a flat, (b) premises constructed or adapted for use as a dwelling, or (c) premises let for business use. This will be available if a flat or unit is in existence at the valuation date, but not before.

Conclusion

46. Provided that the necessary qualifications are met, a collective enfranchisement claim is an effective means by which tenants can prevent unwanted rooftop development. However, the tenants must be prepared to compensate the landlord for the loss of development value. The amount of compensation payable will depend upon the value of the airspace once developed and the likelihood of planning permission being granted.

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