

RESIDENTIAL LEASES: FEES ON TRANSFER OF TITLE, CHANGE OF OCCUPANCY AND OTHER EVENTS (“EVENT FEES”)

PROGRESS REPORT

INTRODUCTION

- 1.1 Older people who buy a leasehold retirement flat often have to pay more than just the purchase price. When the property is sold, they may be required to pay between 1% and 30% of the resale value to the company that built and/or manages the property (the “landlord”). These fees can also be triggered by other events, such as sub-letting. We therefore call them “event fees”. Event fees are common in specialist housing for older people, but rare in other residential leases.
- 1.2 In 2014, the Department for Communities and Local Government (DCLG) asked the Law Commission to investigate these fees. We published a consultation paper in October 2015 and received 168 responses.
- 1.3 This document is a progress report on the Law Commission’s project. It sets out our initial policy conclusions and recommends the next steps to address the problems. Some work is urgent and we hope to complete it by April 2017. Other work would take longer and is for the next stage of the project.

BACKGROUND

- 1.4 Event fees can help make specialist housing affordable for retired people who are asset-rich but income-poor. But they can also catch people unawares. As a resident said in response to our consultation:

In my own case neither the solicitor nor the estate agent drew my attention to the event fees hidden away in the, belatedly received, very long lease document.

He therefore considered these fees to be unfair and deceptive.

- 1.5 If a court considers a term in a contract between a business and a consumer to be unfair, the term is not binding on the consumer. The law in this area is set out in Part 2 of the Consumer Rights Act 2015.
- 1.6 However, the application of unfair terms law to event fees has several complexities and uncertainties:
 - (1) If event fees are considered to be part of the price, they could be exempt from the courts’ control of unfair terms, provided the contract term imposing the event fee is transparent and prominent.

- (2) Event fee terms are only found in leases, which are a special type of contract. The way the unfair terms regime applies to leases has not yet been fully explored by the courts.

These legal difficulties are a barrier to consumers challenging event fee terms in court.

- 1.7 The Campaign Against Retirement Leasehold Exploitation (CARLEX), working in conjunction with Leasehold Knowledge Partnership (LKP), has campaigned against poor practice in the retirement leasehold sector. CARLEX's campaign led to an investigation by the Office of Fair Trading (OFT).
- 1.8 In 2013, the OFT investigation published its report, finding that transfer fees (one sort of event fee) were potentially unfair contract terms. However, perhaps as a result of the legal difficulties discussed above, the OFT did not challenge transfer fee terms in court. Instead, it obtained a variety of undertakings from landlords not to enforce some fees in some circumstances.

Calls for reform

- 1.9 The OFT investigation resulted in some landlords improving their practices. However, it did not resolve questions over the legality of event fees or achieve universally better disclosure of event fees across the sector.
- 1.10 Complaints from residents have continued. In the past year, the BBC, Daily Mail, Daily Express and Financial Times have all reported the public disquiet over event fees. Although in theory residents may challenge the terms of a lease in court as unfair contract terms, this may not be practicable. Retirement flats are often sold at times of crisis (for example to finance residential care) and sellers will not be able to complete a sale until the fee has been paid. Although variable service charges may be challenged before the First Tier Tribunal, these protections do not apply to event fees.
- 1.11 Uncertainty following the OFT report has also left a black cloud over the industry. Investors have been reluctant to lend on the security of an event fee income stream where such fees may be open to legal challenge. One provider noted:

The uncertainty created by the OFT report was... cited as one of the reasons for a withdrawal of a lender on a syndicated finance package for a major new development. (LifeCare Residences)

- 1.12 This lack of lending is starving developers of the funds that they need to build more specialist housing for older people.
- 1.13 Law reform is needed to restore legal certainty and provide a legal framework that gives vulnerable elderly consumers greater protection while enabling investors to lend, and builders to build, with confidence.

The project

- 1.14 In response to complaints, from both residents and developers, the Law Commission was asked to investigate. In 2014, the Department for Communities and Local Government (DCLG) asked us:

to consider the problems caused by terms in residential leases generally, and in the retirement sector in particular, which require the lessee to pay a fee on a transfer of title or change of occupancy.

- 1.15 In October 2015, we published a consultation paper, supported by extensive background papers, including a survey of residential property solicitors and a mystery shopping report. A summary of the 168 responses has been published alongside this document and is available on the Law Commission website, www.lawcom.gov.uk.
- 1.16 The project was initially funded until March 2016. DCLG has confirmed that it will provide further funding until April 2017 so that the Law Commission can begin to address some of the problems identified. This document sets out in broad terms the Law Commission's view of the steps that should be taken to solve the problems identified by DCLG. It is divided between immediate steps (by April 2017) and longer term work.

IF TRANSPARENT, EVENT FEES CAN BE BENEFICIAL

- 1.17 **Policy conclusion: Event fees can benefit consumers but they must be disclosed to prospective buyers early, clearly and prominently.**
- 1.18 As we explain below, event fees may be a useful way to defer payment, allowing specialist housing to be built and maintained at an affordable cost. This in turn can help realise the benefits of specialist housing and further the government's objective of boosting housing supply. However, urgent action is needed to ensure that event fees are transparent.

Benefits of specialist housing

- 1.19 There is considerable demand among older people for specialist housing. While 39% of over-65s are interested in specialist retirement housing, only 3% live in such a property. One reason for this disparity is a lack of good-quality specialist housing that reflects modern expectations. Another may be the recent negative publicity about problems in the specialist housing sector, such as those surrounding event fees.
- 1.20 Undersupply of specialist housing has a knock-on effect on the wider housing market. Older people who wish to downsize, but are unable to do so, will continue to occupy larger family homes, with implications for the whole housing chain.
- 1.21 Moreover, good-quality specialist housing has been found to improve older people's physical and mental health. Extra-care housing, in particular, has been found to save the NHS £1,115 per resident per year.¹ Specialist housing can also enhance social lives and help combat loneliness.

¹ Shiro Ota, *Housing an Ageing Population (England)*, December 2015, p 20.

Potential for event fees to increase the supply of specialist housing

- 1.22 High quality specialist housing is expensive. For example, schemes may include communal space for residents to undertake a range of activities, provide on-site care, and have accessibility features such as lifts. This increases the costs of both initial development and maintenance. There is also evidence that, in order for properties to continue increasing in value, specialist housing schemes demand significant periodic expenditure on refurbishment and modernisation. The money has to come from somewhere, and unless other arrangements are made, the result will be inflated annual service charges for older leaseholders. The alternative is that the resale value of specialist properties will fail to keep pace with the housing market.
- 1.23 Event fees defer payment until the property is sold, which may be on or shortly before death. In this way people can use some of the capital tied up in their property to fund their retirement. Often the fees go towards reducing annual service charges, making them more predictable and affordable.
- 1.24 In theory developers could borrow money against the future income stream from event fees to finance their projects. This could allow new specialist properties to be sold more cheaply. However, investors in specialist housing have told us that this will only be possible once the legal uncertainty surrounding event fees has been resolved.
- 1.25 The lack of legal certainty means that professional valuers are unable to firmly attribute any value to such income streams. In turn, this means that lenders will not consider this as suitable collateral to support any funding requirement.

The need for transparency

- 1.26 A major problem with event fees is that they are often disclosed too late in the purchase process – after a buyer has made an offer for the property, had it accepted and instructed a solicitor. By this time, the buyer is emotionally committed to the purchase. The buyer has been unable to take account of the fee in their purchasing decision. They did not compare total prices, thereby undermining the competitive process.
- 1.27 The Law Commission's mystery shopper highlighted particular mischief when properties were resold through a conventional estate agent. Estate agents frequently fail to provide information about event fees, as this example illustrates:
- After discussion of the service charge, I asked if there were any other charges I should be aware of. I was categorically told there were no other charges. This was wrong. A lease from this development reveals that there is a 1% transfer fee and 1% contingency fee.
- 1.28 Consumers may also fail to appreciate how large the fees can be. For example, one common fee structure is to charge "1% for each year of residency". A buyer who buys a £250,000 flat they may think that this is a minor concern. They may then be shocked to discover, when they sell for £300,000 ten years later, that they owe £30,000.

- 1.29 Our consultation revealed real anger on the part of residents and their heirs at having to pay unexpected fee. Those to whom the fees came as a surprise were unlikely to appreciate their potential benefits. As one leaseholder put it:

There is no reasonable justification for such fees. Event costs incurred by the landlord should be borne by the landlord from his profits.

We therefore think there is a need for urgent action, as set out below.

IMPROVING ESTATE AGENTS' PRACTICE

- 1.30 Recommendation 1: Estate agents should be given guidance on their existing legal obligation to disclose event fees in any communication to prospective buyers that mentions the price of the property.**

1.31 Estate agents are subject to the Consumer Protection from Unfair Trading Regulations 2008 ("CPRs"). These require agents to disclose the event fee in any marketing communication where the purchase price is stated. However, our research shows that estate agents often fail to do this.

1.32 The Property Ombudsman has agreed in principle to produce guidance for estate agents on the sale of retirement property as to their obligations in relation to such fees. This would highlight the need to find out about the event fee before marketing the property so that it can be disclosed.

1.33 Estate agents who fail to fulfil their obligations under the CPRs commit a criminal offence. They could face prosecution by Trading Standards. In addition, the Property Ombudsman can award compensation for breaches of the CPRs of up to £25,000. Conveyancers who discovered hitherto undisclosed event fees should alert their clients to the availability of compensation for expenses already incurred, such as solicitors' and surveyors' fees. This way, the consumer will not be out of pocket if they do not proceed with the purchase.

CODES OF PRACTICE

- 1.34 Recommendation 2: The industry should work with the Law Commission to create a single set of Code of Practice provisions relating to event fees. These should be approved by the DCLG.**

1.35 There are several codes of practice in the industry, including the Association of Retirement Housing Managers (ARHM) Code, the Associated Retirement Community Operators (ARCO) Code and the Consumer Code for Home Builders (CCHB). Although some of these contain requirements relating to event fees, they do not go far enough. Many code owners have acknowledged the need for clearer and more effective provisions on event fees and expressed a desire to raise standards. ARHM, ARCO and the Secretariat of the CCHB have already worked constructively with the Law Commission to implement Code of Practice provisions relating to event fees. Moving forward, however, a fuller and more standardised solution is needed.

- 1.36 Many, perhaps most, retirement flats are sold “in-house”, with the developer, the landlord’s managing agent or a related company acting as estate agent. Here improving the practices of these organisations will have a direct benefit by providing buyers with more information. In other cases, developers and managing agents need to ensure that information is available promptly to the seller’s estate agent.

Section 87 approval

- 1.37 Over the next nine months, our aim is to work with the industry to draft code provisions that set out stringent requirements relating to event fees. These could then be approved by the DCLG under section 87 of the Leasehold Reform, Housing and Urban Development Act 1993.
- 1.38 This would ensure that the code provisions had a consistent status throughout the many different codes of practice that relate to different parts of the specialist housing industry. It would also give the provisions a higher status than that of purely voluntary self-regulation, as it would require the courts to take the provisions into account in any dispute relating to event fees, even if neither party is a signatory to the code.
- 1.39 The code provisions would be adopted voluntarily by current code owners (who have signalled their willingness to work with the Law Commission) and be incorporated into existing industry codes of practice, either into the main body or as an appendix. As well as current code owners, the Law Commission will work with organisations that represent older people and consumers, such as Age UK, EAC (Elderly Accommodation Counsel) and CARLEX, on the new provisions.

New code provisions

- 1.40 Our aim is that the code provisions would:
- (1) put responsibility on the company that receives the event fee (often the landlord-developer or its managing agent) to provide information about event fees.
 - (a) where the property is sold by the developer or their management company, information would be given directly to buyers at an early stage.
 - (b) in other cases, the landlord, or their management company, would be required to make the information available to estate agents promptly, on request. One possible conduit of information is the information and advice charity, EAC, which maintains an online database of housing schemes and, in its consultation response, offered to host the required information.
 - (2) require that buyers are given realistic worked examples of the potential amount of the fee when the property is sold.
 - (3) ensure that event fees do not normally apply in circumstances other than sale or subletting, such as a change of occupancy.

- (4) where event fees apply on sub-letting, ensure that the fees are proportionate to the lower financial gain a leaseholder makes from a short sub-letting than from an outright sale.

IF THE RULES ARE BROKEN, THE FEE SHOULD NOT BE PAYABLE

Recommendation 3: Event fees in relation to which there has been a breach of the code provisions should be presumptively unfair and unenforceable.

- 1.41 One way of achieving this would be to add an entry to the “grey list” in Schedule 2 of the Consumer Rights Act 2015 for an event fee term in relation to which the relevant code of practice has not been complied with. Schedule 2 provides an indicative and non-exhaustive list of contractual terms in consumer contracts that may be regarded as unfair. Terms on the grey list are assessable for fairness, even if they are part of the contract price and meet the legal requirements for transparency and prominence.
- 1.42 Another option may be to introduce a statutory provision stating that event fees should comply with the relevant code of practice, including in relation to the marketing of properties with event fees, and that an event fee term in relation to which the code of practice has not been complied with shall not be binding on the consumer.
- 1.43 Our aim is to ensure that the consumer has an effective remedy where a landlord breaches the code provisions. Conversely, landlords who comply with the code provisions should have reasonable certainty that their income stream is secure. We look at each point in turn.

An effective remedy for consumers

- 1.44 At present any consumer who challenges an event fee would be faced with the argument that an event fee is a price term, and therefore exempt from review under section 64 of the Consumer Rights Act 2015. However, this exemption does not apply to any term on the “grey list” in Schedule 2.
- 1.45 If following the “grey list” route, we would create an entry on the “grey list” for “an event fee in relation to which the relevant code of practice has not been complied with, by the fault of the landlord or its managing agent”. This means that, when the code of practice has not been complied with, a court would be highly likely to find the event fee to be unfair. As a consequence, the fee would not have to be paid.

Reasonable certainty for developers

- 1.46 Extensive consultation with industry bodies suggests that an addition to the “grey list” for terms which breach codes of practice would give developers a reasonable degree of certainty that terms which comply would not be found to be unfair. We say this for four reasons:
 - (1) A code-compliant event fee may well be exempt from review as a price term;
 - (2) In practice, the regulators and courts have relied heavily on the grey list as an indicator of what is and is not fair;

- (3) The courts would be obliged to take account of the code of practice under section 87;
 - (4) The courts could consider the legislative background to the grey list provision, including the arguments made in the Law Commission report, the introduction to the codes of practice.
- 1.47 We have been told by investors that this change would be sufficient to remove the current black cloud over specialist housing, by allowing further investment on the security of event fees. A representative from the industry commented:

We have consulted with funding partners and investors, and the feedback we have received is that they would be confident that the proposals would satisfy their requirements for lending if enacted and put into effect in full. (Associated Retirement Community Operators)

Mechanics of the “grey list” addition

- 1.48 An addition to the “grey list” may be made by statutory instrument. The Secretary of State for Business has power to make an order by statutory instrument, subject to affirmative resolution.
- 1.49 This power was added in 2015. The Law Commission had advised the Department of Business, Innovation and Skills that certain contractual terms known to exploit consumers’ behavioural biases should be added to the grey list. In discussions after this advice was given, it was decided that the Secretary of State should have the power to expand this list in future, as other terms may come to light which consumers find difficult to take fully into account in their decisions. Event fees are a good example of such terms.

A STATUTORY TRUST FOR SINKING FUNDS

- 1.50 **Recommendation 4: Event fees that are solely for the maintenance, repair, or improvement of the estate should be subject to a statutory trust.**
- 1.51 Some event fees such as “contingency fees” must be used exclusively for the maintenance, repair or improvement of the development. Often, landlords voluntarily hold this money on trust for the benefit of leaseholders. However, this is not a legal requirement. By contrast, the law subjects variable service charges to a statutory trust, under section 42 of the Landlord and Tenant Act 1987. The fact that money from contingency fees is not protected by a statutory trust is therefore something of a legal anomaly.
- 1.52 This recommendation would require primary legislation and would therefore be a more long-term objective.
- 1.53 It is not intended to change the way that event fees are spent. It would only apply where the money is already required to be used exclusively for the benefit of the property. However, it would ensure that the funds are protected in the event of the landlord’s insolvency.

- 1.54 It is important that contingency fees are made fully transparent under the code provisions. However, where contingency fees are held on trust and used solely for the benefit of residents as a group, we think that they should be exempt from the grey list addition, since non-enforceability would harm residents.

CLARIFYING HOW UNFAIR TERMS LAW APPLIES

- 1.55 The Consultation Paper explored several complexities in the way that unfair terms legislation applied to long leases.
- 1.56 One particular problem is that under English law a lease is considered to be a contract only between the first landlord and the first leaseholder. Once Leaseholder 1 has sold the lease to Leaseholder 2, the relationship between the landlord and Leaseholder 2 is said to exist because of “privity of estate” rather than contract. However, for unfair terms purposes, we consider that the courts would take a more European approach. We think the European Court would view the lease as one continuing contract with different parties.
- 1.57 To clarify this issue, we think that the Consumer Rights Act 2015 should be amended to state that, for the purposes of unfair terms legislation, an event fee term should be treated as a term in a contract between the current landlord and current leaseholder. This would apply even where the lease has been assigned to a new leaseholder or landlord.
- 1.58 A related problem is that judges who assess the fairness of a contract term must take into account “all the circumstances existing when the term was agreed”. This leads to questions about when an event fee term was agreed. It is possible that the court would only look at circumstances applying when the lease was first granted.
- 1.59 This would be undesirable. Landlords may adhere scrupulously to good practice in future, yet the event fee may be unenforceable if there had been a lack of transparency at the time the lease was first granted. Similarly, consumers may not be able to challenge the event fee where it was properly disclosed to the first leaseholder by the landlord, but not to subsequent leaseholders.
- 1.60 There is a strong case to amend the Consumer Rights Act 2015 to clarify that the relevant circumstances for the assessment of fairness of an event fee are those at the time of the assignment of the lease (i.e. the most recent sale) rather than the time of the grant (the first sale).
- 1.61 However, as discussed below, this is less urgent than the previous recommendations. These changes mainly affect the assignment of existing leases, not new builds. Therefore, there is not the same pressure to change the law so as to allow new investment in specialist housing.

EXISTING LEASEHOLDERS

- 1.62 There is a genuine sense of grievance on the part of existing leaseholders, many of whom have suffered from poor practices and a lack of transparency in the past when they bought their properties. The reforms described so far are prospective only. They would take effect on the next sale (grant or assignment) of a lease and would not help those who are already obliged to pay an event fee on some future event.
- 1.63 We consulted on the idea that landlords should voluntarily agree with existing leaseholders to vary their approach to charging event fees. Consultees were concerned about the legal status of this proposal, which seems to have been taken by some consultees as an official statement by the Law Commission about what constitutes best practice in relation to existing leases. It was not intended to be taken in this way. Given the response from consultees, the idea will not be taken further. For the avoidance of doubt, the law that applies to current leases is the law that was in force at the time they were created (subject to any retrospective changes made by positive law).
- 1.64 We are considering other avenues of redress for existing leaseholders, including an option to bring their claim in the First-tier Tribunal rather than in the County Court. The Civil Justice Council's working group on property disputes produced an interim report in May 2016 addressing some of the issues arising out of jurisdictional overlap between these two judicial forums. We think it will be best to wait for the group's further report, due in September 2016, before forming a view on what form any redress for existing leaseholders might take. Such redress would only be offered if doing so would not create any further legal uncertainty.

THE WAY FORWARD

- 1.65 Our reforms are split into two stages. The first stage responds to the urgent need to protect purchasers of, and encourage investment in, new housing: our aim would be to have the guidance for estate agents, code of practice and grey list addition in place by April 2017. This would provide investors with the certainty they need to lend on the strength of an event fee income stream.
- 1.66 If approval is given for the next stage, we would hope to provide detailed recommendations to bring in a statutory trust and amend unfair terms law, but we would not draft a Bill. We envisage that we would draft the Bill sometime during the 2017-2018 financial year, if our recommendations have been accepted by DCLG, and there is a good prospect that a Bill slot is available.

The pressing need for reform

- 1.67 The industry is sending a clear message that they will be able to build more specialist housing once reforms have been made. A housing with care provider noted:

Across the sector as a whole removing the current legal uncertainty would... have an immediate and substantial impact on new developments. New participants, both investors and operators, would be attracted into the sector. (Retirement Villages Group)

- 1.68 Discussions with representatives from the industry and lenders have revealed that the first stage of our reforms would give them enough confidence to go ahead and invest in building more specialist housing.
- 1.69 The government has stated that boosting supply of specialist housing for older people is a priority. Our approach will remove one obstacle to this objective.
- 1.70 The public's demand for immediate action to be taken is reflected in press reports:
- Ron [Whittle], a decent, reasonable man, acknowledges the many advantages of retirement properties, but says his experience has put him off ever considering one for him and his wife in future unless there is a change in the law... "The whole process needs to be transparent, no hidden extras," he declares. "If that puts up charges, so be it, at least people will know where they stand from the start."
(Daily Express)
- 1.71 We would hope to meet this demand for action by ensuring that event fees are disclosed early, clearly and prominently.

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28 June 2016