UK Finance

# MHCLG Request for Input:

## Implementation Impacts of Commonhold Reform

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# Introduction

UK Finance is a centre of trust, expertise and collaboration at the heart of financial services. We represent 300 firms, including 120 first-charge mortgage lenders. These lenders include banks, building societies and non-bank lenders providing mortgages to all parts of the UK's housing market: owner-occupied, buy-to-let, later-life lending, self-build, shared ownership, social and affordable housing. They also lend and invest to support housing associations and social housing providers as well the wider home-building sector.

## Executive Summary

We welcome the opportunity to respond to the Ministry of Housing Communities, and Local Government (MHCLG)'s request for input on the implementation impacts of commonhold reform. We received responses from members representing a share of over one third of the mortgage market. Some of which already lend on commonhold properties.

In 2022, we last estimated that approximately 40 mortgage lenders, including some large lenders, were able to lend on commonhold. This has been considered a competitive market given that fewer than 20 commonholds had been created between 2002 and 2022.

However, if the government continues with its aim to make commonhold the new default tenure for flats, then we expect the number of commonholds to increase in line with the governments aims to build new homes. The property industry, including the mortgage market will have to undertake significant work to adjust.

Commonhold reform is likely to cost individual firms multi-millions of pounds to implement changes across areas such as policy, legal, training, systems (including documentation) and processes. Members share deep concerns on the risks associated with commonhold which were not addressed in the **Commonhold White Paper.** Our members require more detail on the proposed reforms, including the conversion process, in order to make a meaningful impact assessment. We welcome further engagement with MHCLG on this matter.

Due to the knowledge gap on commonhold across the industry, members are concerned about the impact new commonhold legislation could have on delaying the homebuying and selling process even further. To help minimise delays, our members recommend MHCLG implements its **Home buying and selling reform** proposals before commonhold reform.

# Question 1:

These questions are about the familiarisation costs associated with implementing the new commonhold regime. When answering them, please think about the government's ambitions to reform the commonhold model and make commonhold the default tenure, as well as its commitments to reform the conversion process to make it easier for existing leasehold blocks to voluntarily convert their buildings from leasehold to commonhold:

## 1a. What, if any, one-off or initial activities would you (as an individual or business) / your members need to carry out to familiarise yourself with and adjust to using commonhold instead of leasehold in practice? These could include legal, financial, administrative, training or operational tasks. Please briefly describe the nature of these activities.

## Do these activities relate to reforms to the supply of new commonhold units and making commonhold the default tenure, and/or the conversion process?

## ANSWER:

The following activities relate to reforms to the supply of new commonhold units and making commonhold the default tenure. These activities would be carried out by our members who do not currently lend on commonhold, and by our members who need to update their policies in line with the proposed reform. In 2022 we estimated that approximately two thirds of the mortgage market did not lend on commonhold. Our members will need to undertake significant work to develop a new policy framework including:

- **Policy review**
    - Consult with legal advisers and the Royal Chartered Institute of Surveyors (RICS) to understand associated risks across the whole mortgage journey and determine new lending policy. Considerations include valuation criteria and valuer guidance notes, mortgage servicing processes, building insurance requirements, risk of changes to security during the lifetime of mortgage, risk of customer default on payments due to the commonhold association, and enforcement and repossessions. Members would need to create or update supporting processes.
    - Consideration will need to be given to how commonhold costs will be estimated and factored into the mortgage application and underwriting calculations in line with the FCA's Handbook, MCOB 11.6 Responsible Lending rules. Members will

subsequently need to update their individual scorecards which determine new lending decisions.

- **Technology and systems -** Lenders will face significant cost updating and reconfiguring systems to support commonhold.
  - Amending UK Finance Lender Handbook.
  - Lender criteria website pages.
  - Mortgage application journeys, including mortgage broker portals.
  - APIs with conveyancers.
  - Property information portals.
  - Land registry business service portals.
  - Updating contractual documentation including Mortgage Offers, Terms and Conditions, mortgage deeds etc, to reflect customer commonhold obligations.
  - All impacted customer communications including letters.

**Training** – Whilst we have previously estimated one third of the mortgage market lend on commonhold, it has remained an unpopular tenure. There is limited expertise and experience across the industry.

- there is a huge knowledge gap on commonhold across the industry. Lenders will need to raise awareness, understanding and expertise of commonhold including the lender's new policy with:
  - Internal colleagues (for example: mortgage advisers, underwriters, post-completion support teams, and financial wellbeing and possessions).
  - Guidance for external mortgage brokers.
  - Panelled conveyancers.
  - Panelled surveyors.

A long implementation period will be required to allow lenders to action the changs within their existing tech stack. Implementation of these changes will have to compete with other changes. For example, regulatory changes from the FCA as it feeds back on its Mortgage Rule Review.

- **Conversion**

As the White Paper acknowledged, the concept of conversion is complex and challenging. We welcome further detail on the proposals for conversion in the draft legislation (if not before). This information is vital for members to assess the impact of conversion. There are many areas which remain a concern for lenders.

Generally, members anticipate needing to carry out the above activities to enable a customer to convert a leasehold flat to commonhold. They expect there to be additional new activities such as:

- Developing a customer engagement strategy to address queries including costs, revaluation, documentation and contractional updates.
- Establishing a process to support the conversion of leasehold to commonhold, including lender assessment and communicating the lender's decision. It is unclear whether the lender will have a choice to approve or decline a unit's conversion application where the lender has previously secured a mortgage within the unit based on leasehold terms.

## 1b. Do you have a sense of what these activities would cost in £s? For how long would you/your members face these costs?

### ANSWER:

Based on the large scale of the work involved, as outlined in our response to 1a, members are concerned that it could cost each individual firm multi-millions of pounds.

Members are unable to provide a more accurate estimation as the White Paper does not define the legal framework of commonhold. It is not possible at this stage to accurately quantify how long members would face these costs. However, members anticipate the activities outlined in 1a face costs over a number of years.

## 1c. When, in relation to the implementation of the reforms, would you/your members face these costs? For instance, this could be:

- During the period when legislation is still being developed in Parliament
- Once legislation is passed
- When guidance or regulations are published
- When commonhold developments begin to enter the market
- When clients begin requesting advice or services related to commonhold
- When the rules around the prohibition of leasehold are enforced and commonhold is the default tenure

### ANSWER:

Members expect to incur an on-going cost at each stage of the process. Initially there will be consultation and advisory costs whilst legislation is being developed. Followed implementation costs to support the new changes and ongoing services.

Upfront data sharing between mortgage lenders, conveyancers and managing agents/conveyancing associations will be essential to minimising delays in the homebuying and selling process. Without readily available data and information, delays will be prominent in mortgage application decisions and in the conveyancing process as conveyancers try and advise their buyers. One member suggested delaying Commonhold Reform until MHCLG has implemented its changes to Home buying and selling reform to avoid worsening the time it takes to buy a commonhold flat.

# Question 2

These questions are about the ongoing costs associated with implementing and operating under the new commonhold regime. Please consider how these costs may evolve over time as commonhold becomes the default tenure for new flats, and as the conversion process for existing leasehold buildings is reformed:

## 2a. What, if any, recurring or ongoing costs or activities would you or your members expect to arise from using the new commonhold framework (that would not otherwise have been incurred under leasehold)?

- Please briefly describe the nature of these costs (e.g. legal, administrative, governance).
- Do the costs relate to reforms to the supply of new commonhold units and making commonhold the default tenure and/or to reforms to the conversion process?

### ANSWER:

Members anticipate the activities to be similar to those listed in 1a. As explained in 1c, members expect to incur on-going costs from using the new commonhold framework. The costs will relate to both the supply of new commonhold units and making commonhold the default tenure and reforms to the conversion process.

## 2b. How much do you estimate these costs to be in £s?

### ANSWER:

Please see 1b. Members are unable to provide a meaningful estimate of costs without further detail on the new commonhold framework, including the conversion process.

Members anticipate commonhold reform will result in significant costs from planning, implementation and post-implementation activities.

## 2c. At what point in the implementation of the reforms would you/your members expect to incur these costs? How frequently would these costs arise, and for how long might they continue? For instance, on timing, this could be:

### ANSWER:

Please see 1c.

## 2d. Would you expect the scale of these recurring costs to increase, decrease, or stabilise over time as the market adjusts to commonhold? Why?

### ANSWER:

Based on the anticipated scale of commonhold reform, members expect there will be recurring costs that may persist over a longer-term period. Members anticipate these costs to exist for longer with commonhold conversion.

A member highlighted that Automated Valuation Models (AVMs) which are used to digitally value properties, are expected to take time to develop values for commonhold properties. This means lenders will initially need to rely on physical valuations for new lending decisions on commonhold properties. This is more costly for the lender and could be applied to every commonhold case. The cost of a physical valuation can be passed onto the mortgage applicant. MHCLG are encouraged to engage with providers of AVMs if they have not done so already.

However, members generally expect costs to stabilise once processes are established and the market adjusts to commonhold.

Implementing Homebuying and Selling reforms first could help costs decrease over time at a quicker rate if the availability of data was improved.

## 2e. How many properties or developments do you/your members expect to be involved with annually under the new commonhold framework?

### ANSWER:

This will vary between our members and is difficult for them to determine.

One large member suggested 1000 to 1200 units annually. They estimated their existing leasehold stock for conversion to be around 200,000.

# Question 3

These questions are about the practical costs and activities associated with leasehold, and potential savings that may arise following the implementation of the new commonhold regime, particularly as commonhold becomes the default tenure for new build flats.

## 3a. What, if any, recurring or ongoing costs or activities associated with leasehold would you/your members save on when commonhold becomes the default tenure for new flat supply?

### ANSWER:

With the information available in the White Paper, members anticipate making very limited, if at all, savings when commonhold becomes the default tenure for new flat supply.

One member did suggest some small savings may be made in relation to removing administrative checks on ground rent.

Commonhold is expected to be more costly and time-consuming than leasehold as the industry moves to adapt to a new tenure which it has limited experience with.

## 3b. How much do you estimate these savings to be in £s?

### ANSWER:

It is highly unlikely there will be any savings to offset the significant cost our members face implementing and servicing commonhold reform. It is not possible to quantify any further at this stage.

## 3c. How many properties or developments do you/your members currently incur these leasehold-related costs for annually?

### ANSWER:

Not available.

## 3d. What support, guidance, or tools would help you or your members maximise these savings as you move to commonhold?

## ANSWER:

We recommend MHCLG to first implement its Homebuying and Selling reform proposals to improve the availability of upfront property data.

We recommend MHCLG provides the legal framework of commonhold reform, including the conversion process so that members can consider the proposals in more detail and better understand the risks and costs involved. For example, members require more information on:

- How to navigate commonholder disputes.
- How to navigate the risk of unpaid commonholder costs, which can result in potential forfeiture or sale of the property.
- The conversion process:
    - The threshold for consenting to a conversion from leasehold to commonhold.
    - If the lender can approve/decline the conversion and the implications of the decision.

We encourage the government to lead on raising consumer awareness and education of commonhold. Consumers will need to understand their additional responsibilities and obligations with maintaining their properties with other commonholders including the associated risks and costs.

# Question 4

To support the practical implementation of future reforms, we are seeking to understand how current features of newly delivered blocks of flats (i.e. those delivered since the Leasehold Reform (Ground Rent) Act 2022) may affect readiness for the new regime.

## When you or your members encounter units in new blocks of flats (by which we mean those delivered since the Leasehold Reform (Ground Rent) Act 2022), what proportion of these typically have the following features?

- Please provide an approximate percentage or frequency (e.g. “most”, “some”, “rarely”) for each:
    - 990-year leases as standard
    - A resident management company that owns the freehold
    - Professional managing agents responsible for the upkeep of the building
    - A reserve fund in place from the outset

## ANSWER:

Not all respondents had sufficient time and/or data to respond.

Generally, 990-year leases are most prevalent. Some encounter units where a resident agent company owns the freehold. More encounter units professionally managed by agents responsible for the upkeep of the building. It is not always known if there is a reserve fund in place from outset.

These limitations in data may affect the ability to assess members' readiness for commonhold implementation based on current block features.

Members remain concerned about commonholders understanding and fulfilment of their responsibilities, namely keeping the property in a reasonable state of repair, particularly where vulnerabilities imped can imped ability.

These concerns are illustrated by work RICS has previously reviewed in Scotland (which is under a similar commonhold system) and the challenges it has created for residents in carrying out essential building maintenance works due to the need for unanimity in all decisions. We understand there are building safety issues in Scotland where 80% of buildings need some form of repair, and 50% are in critical disrepair.

These concerns are further illustrated in England. We understand that MHCLG are familiar with the Beech Rise and Willow Rise units in Kirkby and the issues residents including mortgage holders face (and in turn, their mortgage lenders). We understand the units were changed from leasehold to a Resident Management Company (RMC) in 2007. The RMC has not met its responsibilities and obligations. There is a service charge debt of £1 million and the maintenance of the building has fallen into disrepair (with £500,000 relating to fire safety work).

# Question 5

The government has committed to banning the sale of new leasehold flats and is planning to consult later this year. It is keen to seek views on what transitional arrangements may be required to support a smooth transition from use of leasehold to commonhold for new supply as well as consider the case for exemptions. Should there be a transitional period in advance of any leasehold flat ban coming into force, there could be a period where the reformed commonhold model was available yet optional for use, and a later period after a transition where the new commonhold would become the required tenure for new flats, except where exemptions apply. We would be interested in your views on costs or savings associated with the reformed commonhold model being available yet optional, as well as it being mandatory for use.

## Q5. Do you have any views on the costs or savings associated with financing or working with leasehold versus

## commonhold blocks, should the new commonhold model be available for use, but in advance of any future mandate?

## ANSWER:

Members expect it to be highly unlikely that there will be cost savings changing from leasehold to freehold.

Members do not believe there would be successful uptake of the new commonhold model if it was made available for use before a future mandate. They do not expect there to be voluntary demand or supply of the tenure due to the expected risks, challenges and delays it could have on the homebuying and selling process. Members query if developers would have an incentive to choose this tenure over leasehold. Significant work will be involved in implementing a new model and it is unlikely many would be ready ahead of a future mandate.

A phased or optional approach could result in a two-tier market. This will be deepened when some existing units convert to commonhold, and others chose to remain on leasehold.

Please email karina.hutchins@ukfinance.org.uk if you have any questions.