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LANDLORD AND TENANT ACT 1987

Landlord Disposal – Tenant’s rights of first refusal – mixed-use properties

Possible criminal offence and civil law breach

We are often asked if a disposal of part or the whole of the landlord’s interest in a property with a shop and flats above triggers a problem of falling foul of the tenant’s right of first refusal. Possibly.

If it’s a qualifying building with qualifying tenants, there is a potential problem but, in practice, few tenants and few landlords are aware of it, many transactions take place without following the statutory procedure, and there appears to be no case law to assist. The points of interest are:

1. The premises must comprise the whole or part of a building which must contain two or more flats held by qualifying tenants. The number of flats held by such tenants must exceed 50% of the total number of flats and in mixed-use premises the residential part must comprise at least 50% of the internal floor area of the premises (common parts are disregarded).
2. The landlord must generally be the immediate landlord of the qualifying tenants of the flats and must be neither an exempt landlord (i.e., Local and Police authorities, development corporations, registered housing associations and various other public bodies) nor a resident landlord (i.e., that is the landlord himself a resident in the premises).
3. There is a relevant disposal by the landlord of any legal or equitable estate or interest in the premises, unless one of the statutory exceptions applies. The Act lists certain disposals which are exempt; these include the grant of a tenancy of a single flat and the creation of a mortgage or charge. A transfer from one company to an associated company which has existed for at least 2 years is also exempt.

So, if nobody gets taken to Court, why bother?

Examples from residential buildings (no commercial use) do exist from which some warnings of vulnerable transactions can be suggested.

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In one case of three flats, two sold on long leases and one retained as an investment, the landlord transferred the freehold interest to an associated company for a nominal sum. The two long leaseholders challenged on the basis of failure to have their right of first refusal because the landlord's associated company had not existed for 2 years. The associated company had to transfer the freehold to the two long leaseholders at the same nominal sum it had paid. Ouch!

In another case of a block of flats, planning permission had been granted for two additional flats on the roof and the landlord granted a lease of each flat to be built to himself personally at a nominal sum. The long leaseholders challenged on the grounds that the flats did not yet exist and the new leases were not leases "of a flat". The landlord acknowledged the point, replied that the leases were therefore a nullity, deregistered them at the Land Registry and the situation was saved. Phew!

The foreseeable problems are when a landlord wants to do a deal at something other than full market value for whatever reason: tax, inter-family deal, financial restructuring, etc. The rules must be known and observed.

If the landlord is selling the whole or part of his interest for full market value, then it is difficult to see why it bothers him whether the purchaser is the qualifying leaseholders of the flats or someone else. Except, following the S5 procedure involves delay and risk: what happens if the leaseholders turn out to have no hope of raising the money? The original purchaser might have been lost, the market might have deteriorated, the sale may be pushed into another tax year, or company accounting period, other dependent transactions may be lost.

Of course, if a landlord has a good relationship with the flat leaseholders, go and see them, speed up the process, get early replies, **manage** the process.

If one or more of those relationships are bad – take care. The last thing a landlord wants is to be on the receiving end of a private prosecution over a point of legal principle. The last thing the professional advisers want is to be on the receiving end of a complaint of unprofessional conduct to their regulating Institution.

BRMT
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