

The Pryors Limited

Consultation Paper on proposed variation to the leases at The Pryors

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1. Purpose

The purpose of this paper is to explain – and to seek an indication of your support for – a proposal by the Board to initiate a consensual process to rectify deficiencies in our leases, including the absence of an express right to collect reserve funds.

The Board is strongly of the view that lease variation along the lines summarised in this paper is in our mutual best interests, and it hopes that this paper will help everyone to reach the same general conclusion. However, we wish to emphasise that you are not being asked to commit to variation of your lease at this stage. The Board simply wishes to summarise what is wrong with our current leases and to gauge support for embarking on the process of variation. In the first instance, that process will involve its instructing solicitors to draw up the requisite documentation for approval by lessees in due course. In short: the Board needs to know whether there is an appropriately high level of support in principle before taking things further and incurring legal costs.

You are strongly encouraged to indicate your support or otherwise for the proposal by completing the attached form and returning it to John Connell at Flat 6 by [] [May] 2009.

2. What is wrong with our current leases?

As many lessees will be aware from papers issued by the previous Board, our leases, which are in substantially the same common form, share certain common deficiencies judged by the standards of modern leases. The principal deficiency lies in the scope of the scope of their service charge provisions. This includes the absence of an express right for The Pryors Limited as the lessor to collect funds for reserve purposes to meet the future costs of carrying out major and possibly unanticipated maintenance works. This is a serious deficiency because it exposes lessees to the risk of very large fluctuations in service charge demands. It also exposes the lessor to the risk of a shortfall in funding to meet those costs when they arise as it may have problems collecting service charges from lessees who are “caught short” financially. The service charge provisions also fail expressly to cover certain matters necessary to facilitate the provision of some of the services that we currently enjoy or require. These deficiencies create risks of disputes and potential major disruption to the smooth-running and maintenance of The Pryors.

The Board proposes that the service charge provisions be varied to rectify these deficiencies –

particularly by the insertion of an express provision for the collection of monies for reserve purposes - as further explained in section 3 below.

The Board also wishes to address some other deficiencies in the leases as mentioned in section 4 below.

The Board reminds lessees, when considering this paper, to bear in mind that they are not only lessees of their individual flats but also co-owners of the entire freehold of The Pryors through their shares in The Pryors Limited. Lessees therefore have dual interests in ensuring the good maintenance and running of The Pryors, and, to that end, in ensuring that all residents' leases are in an appropriate, substantially similar form. The Board also invites lessees to take into account the latent potential for deficiencies in the leases to have a deleterious impact on the appeal of flats and their linked shares in The Pryors Limited to potential purchasers. If such deficiencies lead to dramatically fluctuating service charges, lessor-lessee disputes, delays in works etc., such matters will be disclosed by enquiries made by purchasers' solicitors and might even become public knowledge in the local property market.

The previous Board took legal advice from a firm of solicitors and counsel as to the deficiencies and how these might be rectified by a statutory process requiring the consent of a minimum 75% majority of consenting lessees. **The current Board now wishes essentially to pick up where the last Board left off by instructing solicitors to provide further legal advice and assistance in drafting lease variations with a view to pursuing this statutory, consensual process of variation.**

Further information regarding this consensual process of variation is set out in section 5 below: "How can variations be made?"

3. Proposed variations concerning service charges

3.1 The Service Charge Provisions

3.1.1 This is the principal issue of concern. Any form of flat lease that is designed for use by 59 flats in a common form requires adequate service charge provisions. A correctly drawn service charge mechanism should give the lessor sufficiently wide powers to enable it to manage and administer the land and buildings that it controls. These powers should be expressed in an unambiguous fashion with a view to avoiding uncertainties as to their extent or effect. The Board would like to ensure that service charge provisions adequately cover all the costs of providing the services on which we rely.

3.1.2 Any potential abuse of the right to collect service charges is counterbalanced by the statutory right of each lessee to challenge any expenditure on the grounds that it has not been reasonably incurred or that it is otherwise unreasonable. In a block like The Pryors, the dangers of abuse should be reduced still further by virtue of the fact that the lessor is under the control of the body of lessees in their capacity as shareholders and not some outside landlord.

3.2 The Service Charge Reserve Fund

- 3.2.1** Very commonly, the service charge provisions in leases of flats provide for a service charge reserve – that is: a fund of money collected by the lessor and set aside to meet expenditure that is not programmed for outlay during the current accounting period. Like all service charges, it is held by the lessor as "trust monies" and can only be applied for purposes authorised by the relevant leases.
- 3.2.2** In the case of The Pryors, the original leases, which were granted in the 1970s and 80s, made provision for a reserve fund to be collected. The leases were subject to variation in the 1990s following acquisition of the freehold by The Pryors Limited. The variations had many beneficial effects including the extension of the term of the leases. However, the variations substituted new service charge provisions which did not expressly repeat the provision for a reserve fund that appeared in the original leases, and they did not insert any new reserve provision either. Notwithstanding this omission, and in the belief that such a power existed by implication, contributions towards a reserve fund continued to be collected. The Board felt obliged to discontinue these collections pending a possible variation of our leases.
- 3.2.3** The Board understands that most property professionals would consider a reserve fund to be - at the very least - highly desirable for two lessee controlled mansion blocks comprising 59 flats which are over 100 years old. The age of the buildings increases the frequency of the need to raise significant sums of money, and if 59 units are required to contribute large amounts in a lump sum - possibly without much prior notice- a shortfall could easily arise which will probably result in necessary works being delayed with a consequent increase in costs due to further deterioration as well as a rise in prices in the interim. In addition, the extra administrative work required could lead to additional costs being incurred. Any additional funds required would ultimately have to be paid for by us .
- 3.2.4** The Board proposes a variation of the leases to provide for a reserve fund. This is partly because the Board believes such inclusion to be best practice, and partly because it seems likely that it may never have been intended to abandon the reserve fund when the leases were varied in the 1990s.
- 3.2.5** The Board has given careful thought to the type of reserve fund that we ought to adopt - reserve funds can be either "limited" or "general". A "limited fund" is one that only permits the monies collected to be used for limited purposes such as for periodic major repairs and decoration and/or the replacement or renewal of major plant or equipment. In such a case, the monies collected may not be used for any other purpose. A "general fund" is one that can also be used for other service charge purposes, such as payment for emergency repairs or to cover a shortfall in service charges. Given other controls that will exist over expenditure, and the obvious sense in having the added flexibility offered by a general reserve fund, the Board believes that we should incorporate a provision for a general reserve fund into the revised leases. This would reintroduce the kind of reserve fund that was operated in the past.

4. Other lease provisions requiring variation

It is considered a sensible that, at the same time as altering the leases with respect to service charge provisions, certain other deficiencies in our leases should be rectified to bring the leases into line with modern lease standards. The Board wishes to take legal advice on these matters with a view to appropriate variations being proposed to the leases. They include, for example, the following matters:

4.1 The Gardens

Presently the lease does not make clear that the gardens are for the permanent use of residents, and a small amendments to the lease are required to clarify this and to clarify the lessor and lessees' obligations in relation to the gardens.

4.2 Insurance Provisions

Over the last few years we have paid approx £15,000 each year for insurance cover against the risk of loss caused by terrorism. Many lessees might consider this to be an unnecessary expense but the Board has considered itself prevented by the wording of our leases from discontinuing this type of cover. Variations in the wording of the lease could provide us with greater flexibility in the way we insure.

4.3 Repair Covenants:

The leases contain inadequate obligations on the part of lessees to make good (or to entitle the lessor to make good) damage in their flats which could lead to damage outside those flats. There are standard provisions that could be inserted to bring the leases in line with modern norms.

5. How can variations be made?

5.1 Agreement of every Lessee

As each of our leases is substantially in the same common form, it follows that correction of deficiencies in this common form requires amendment of some 59 leases at the same time to the same effect. As each lease constitutes a separate contract made between a lessor and a lessee, each variation would require the agreement of 60 different parties. The Board is proceeding on the assumption that, in practice, such unanimity on such a range of issues would be very difficult, if not impossible, to achieve.

However (for certain amendments to leases) legislation exists - the Landlord and Tenant Act 1987- to enable leases to be varied even though not every party is in complete agreement, as mentioned below.

5.2 The consensual procedure

Under the Landlord and Tenant Act, there is a "consensual" procedure whereby an application may be made to the Leasehold Valuation Tribunal (LVT) to authorise a variation of the leases. This procedure, in order to be successful, requires:

- (1) the positive agreement of 75% of all lessees to the proposed variations; and
- (2) that no more than 10% of all lessees vote against the proposed variations (as opposed to abstain from voting).

Subject to that requirement for a high level of lessee consent, the procedure is fairly straightforward and allows scope for variation to rectify the deficiencies referred to in this paper.

The Board wishes to gauge the level of support for initiating the process of drawing up variations of leases with a view to following this consensual procedure. That is the purpose of this consultation exercise. Lessees are not being asked to commit now to variations of their leases. They will be asked to do that once those variations have been drafted and submitted to them.

For completeness, the Board notes that there is a non-consensual procedure for lease variation under the Landlord and Tenant Act. This is a procedure whereby certain limited categories of defect in a lease may be rectified without the high level of support required under the consensual procedure. The Board understands that this adversarial procedure could be used in order to rectify many of the deficiencies in the service charge provisions in the leases, though not some of the other modernizing variations that can be made under the consensual procedure. This adversarial procedure would be less straightforward and more costly than the consensual procedure. In any event, the Board has no plans to follow this procedure since it is adamant that it wishes to garner support for the consensual procedure – indeed, this consultation exercise is all about reaching a consensus.

6. Answers to some further questions.

6.1 What happens next?

Assuming this consultation exercise elicits an appropriately high level of support from lessees, the Board proposes to instruct solicitors to prepare revised variations to the leases, updating variations that were previously drafted and circulated to lessees.

6.2 How much will it cost?

The most recent costs estimate given to members for processing a consensual application amounted to approximately £30K.

6.3 How long will the process take?

Subject to ascertaining an appropriate level of support, the Board intends to instruct solicitors by the summer to commence work on preparing lease variations for submission to lessees. Realistically, this may take a month or two. Assuming there is the requisite level of consent to the lease variations, a consensual application will be made to the LVT. The Board understands that the process then takes approximately 6 months.

6.4 Do I need to consult my solicitor?

Our solicitors will be asked to confirm for the benefit of all lessees that the proposed variations when incorporated will give us a lease that is fit for purpose and freely marketable as well as being reasonable from both the standpoint of lessor and lessee. To recap: the lessor in our case is owned by the lessees and we gain no group advantage from any defect in the lessor's powers. Each lessee is free to consult his or her own separate lawyer at his/her own expense if he/she wishes to gain extra assurance.

6.5 Do I need to get my mortgagees involved?

It is anticipated that the LVT may require the lessor to serve (or the lessor may choose to serve) the application on all mortgagees. However, it is not anticipated that the variations will have any material effect on mortgagees' security or that any mortgagee will wish to become involved.

6.6 I am selling my flat - do I need to inform my Purchaser?

This depends on the question that is asked by any proposed purchaser. However, once the procedure starts, it is considered that any seller will need to inform any proposed purchaser of the procedure.

6.7 Will my service charge percentage liability change?

No.

6.8 Why do we not grant ourselves new extended leases?

The consensual procedure outlined above would not allow us to extend the term of our leases or grant new leases to ourselves.

We could grant ourselves new rectified and extended leases outside the procedure, but we would need first to agree the wording of such a new lease which, as mentioned before, would require some 60 parties to agree each amendment.

In practice, it could take a number of years before each lessee would have signed up to a new lease. The Board believes that the priority issue is to rectify defects, especially since most leases have long terms remaining.

It makes more sense to deal with the defects first using the statutory consensual procedure and then to consider lease extensions as a separate issue.

However, every lessee is entitled to apply to the court at any time for a new extended lease.

6.9 When can I see the proposed lease amendments in detail?

Once they have been drafted by our solicitors and approved by the Board. The Board will only instruct solicitors to draft the detailed proposals when it is satisfied that there is a sufficiently high level of support to move forward. We would not wish to incur legal expenses if there is clearly a significant level of objection at the consultation stage.

7. **Next Steps**

7.1 We would ask you to let us have an indication of your support – or otherwise – by returning the attached form to John Connell at Flat 6 by [] May 2009. Remember: this does not commit you to lease variation. You would only be committed to agreeing to the changes at the point when you join in signing the consensual application – once you have seen the detailed changes that are proposed.

7.2 If you have concerns that require further discussion in the meanwhile, please contact the Board via Derek Flack. This whole process is about building consensus.

Thank you for your consideration of this proposal.

PLEASE DETACH AND SUBMIT THIS FORM

To: The Directors
The Pryors Limited
Flat 6
The Pryors
East Heath Road
London
NW3 1BS

I/We refer to the recent Consultant Paper issued by the Board in relation to the proposed variation of leases at The Pryors.

[Please tick the appropriate box below]

In principle, I/we support the proposal to initiate a consensual process to rectify deficiencies in my lease. (I understand that this does not commit me to any variation of my lease at this stage.)

In principle, I/we object to the Board's proposal.

Additional comments [optional]

.....
Signed

.....
Date

.....
Please print NAME and FLAT NUMBER