

Law Commission

Consultation Paper No 226

**RESIDENTIAL LEASES: FEES ON
TRANSFER OF TITLE, CHANGE OF
OCCUPANCY AND OTHER EVENTS**

A Consultation Paper

EMBARGOED

THE LAW COMMISSION – HOW WE CONSULT

About the Commission: The Law Commission is the statutory independent body created by the Law Commissions Act 1965 to keep the law under review and to recommend reform where it is needed.

The Law Commissioners are: The Rt Hon Lord Justice Bean (Chairman), Professor Nick Hopkins, Stephen Lewis, Professor David Ormerod QC and Nicholas Paines QC. The Chief Executive is Elaine Lorimer.

Topic of this consultation paper: Residential leases: fees on transfer of title, change of occupancy and other events (“event fees”).

Geographical scope: England and Wales.

Duration of the consultation: 29 October 2015 to 29 January 2016.

How to respond

A response form is available on the project web page for those who wish to use it. It can be found on the project webpage:

<http://www.lawcom.gov.uk/project/transfer-of-title-and-change-of-occupancy-fees-in-leaseholds/>

Please send your responses in any form:

By email to: event_fees@lawcommission.gsi.gov.uk; or

By post to: Max Marenbon, Law Commission, 1st Floor, Tower, Post Point 1.53, 52 Queen Anne’s Gate, London SW1H 9AG
Tel: 0203 334 3603

If you send your comments by post, it would be helpful if, where possible, you also send them to us electronically.

After the consultation: We plan to publish recommendations in 2016 and present them to the Government. It will be for Government and Parliament to decide whether to change the law.

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THE LAW COMMISSION

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EVENTS**

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GLOSSARY

Administration charge	A charge payable by a leaseholder in addition to rent, in connection with (a) the landlord giving approval to something such as internal modifications; (b) the landlord providing information to a third party; or (c) some default by the leaseholder such as breaching one of the terms of the lease.
Age-exclusive housing	The category of specialist housing for older people with fewest special services provided on site. Aside from the housing being designed for the needs of older people, there is likely to be an alarm cord and the lease will set a minimum age for occupiers.
Age-restricted housing	See age-exclusive housing.
Assisted living	Used by providers of specialist housing to refer to accommodation designed for older people who have greater care needs and will require domiciliary care.
Consumer Protection from Unfair Trading Regulations 2008 (CPRs)	The CPRs implement the EU Unfair Commercial Practices Directive 2005. They are designed to protect consumers against misleading or aggressive trade practices.
Contingency fund	See sinking fund.
Domiciliary care	Care (for example, help with washing and dressing) provided in a person's own home.
Extra-care housing	Specialist housing for older people where carers are available to provide domiciliary care on site (care in the resident's own home).
Fixed service charge	A service charge that does not vary according to the costs actually incurred by the landlord or management company in providing services.
Forfeiture	A right of the landlord to bring the lease to an end earlier than it would naturally end if the leaseholder breaches a term of the lease. The result in practice is that the leaseholder loses their property.
Grey list	The Unfair Terms Directive contains an "indicative and non-exhaustive" list of contract terms which may be regarded as unfair. This list is now set out in Schedule 2 to the Consumer Rights Act 2015.

Housing with care	See extra-care housing.
Housing with support	See retirement housing.
Independent living	Used by providers of specialist housing to refer to accommodation designed for older people who are able to live more or less independently with a minimum of support.
Landlord	The owner of the freehold interest in land.
Leaseholder	The owner of a leasehold interest in land where the lease is a long lease, typically granted for an original term of over 80 years.
Operator	The management company of an extra-care housing development.
Retirement housing	<p>Specialist housing for older people where there is a residential or non-residential manager or warden available to provide some support on site.</p> <p>The term is sometimes used more loosely to refer to specialist housing in general. This paper sometimes uses the term in this looser sense and it should be apparent from the context in which sense the term is being used.</p>
Service charge	A payment made by a leaseholder to a landlord or management company towards the cost of providing services such as repairs, insurance or maintenance of communal areas.
Sheltered housing	Similar in most respects to retirement housing, but this term is typically used to refer to social rented housing, whereas the term “retirement housing” is used for private owner-occupied housing.
Sinking fund	A fund held by a landlord or management company to “cover the cost of irregular and expensive works such as external decorations, structural repairs or lift replacement.” (Source: the Leasehold Advisory Service). The fund is paid for out of contributions made by leaseholders.
Specialist housing (for older people)	Housing designed for older people, where the resident owns their own home. Includes age-exclusive housing, retirement housing and extra-care housing. There will be a term in the lease setting a minimum age for occupiers.

Statutory trust	An obligation imposed by statute to hold property in trust for particular purposes and/or for the benefit of particular persons. One example is the statutory trust of service charge monies imposed by section 42 of the Landlord and Tenant Act 1987. Under this statute, the landlord is obliged to hold variable service charge payments for the purpose of defraying “costs incurred in connection with the matters for which the relevant service charges were payable” (e.g. the maintenance of communal areas) and for the benefit of the current leaseholders.
Tenant	The owner of a leasehold interest in land.
Unfair contract term	Defined in the Unfair Terms Directive as “a contractual term which has not been individually negotiated” that “contrary to the requirement of good faith... causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer.”
Unfair terms legislation	Legislation designed to strike out terms in a contract between a business and a consumer if they are unfair to the consumer. For the purposes of this consultation paper, references to unfair terms legislation include the Unfair Terms Directive 1993 and its implementing legislation: the Unfair Terms in Consumer Contracts Regulations 1994, Unfair Terms in Consumer Contracts Regulations 1999 and the Consumer Rights Act 2015.
Variable service charge	A service charge that varies according to the costs actually incurred by the landlord or management company in providing services.

TABLE OF ABBREVIATIONS

APPG	All-Party Parliamentary Group
ARCO	Associated Retirement Community Operators
ARHM	Association of Retirement Housing Managers
ARMA	Association of Residential Managing Agents
ASA	The Advertising Standards Authority
CAP	The Committee of Advertising Practice
CARLEX	Campaign Against Retirement Leasehold Exploitation
CCRC	Continuing Care Retirement Community
CLC	Council for Licensed Conveyancers
CMA	Competition and Markets Authority
CPRs	The Consumer Protection Regulations 2008
DCLG	The Department for Communities and Local Government
EAC	Elderly Accommodation Counsel
FCA	Financial Conduct Authority
LEASE	Leasehold Advisory Service
OFT	Office of Fair Trading
RICS	Royal Institution of Chartered Surveyors
TPO	The Property Ombudsman

CHAPTER 1

INTRODUCTION

- 1.1 When people say they own a home, they may mean one of two things. They may own the freehold - that is, own the property outright. Alternatively, they may own a long lease. Often the two types of ownership are treated as equivalent, with freehold common for houses and leasehold common for flats. They may sell for similar sums. However, in legal terms the owner of a long lease is regarded as tenant of whoever owns the freehold (the landlord).
- 1.2 A lease creates mutual obligations between landlord and tenant. Many of the tenant's obligations in a long lease are familiar. The tenant will be obliged to pay yearly ground rent (often £10 although sometimes hundreds of pounds). Usually, tenants would also be obliged to pay a service charge for the cost of maintaining the building.
- 1.3 This consultation paper deals with a more unusual obligation, which occurs in some long leases. This is where the tenant is required to pay a substantial fee when a defined event happens. Typically, the event is the sale of the property, and the fee payable is a percentage of the sale price. We have seen fees of up to 30% of sale price, although 1% is more usual.
- 1.4 These fees are common in specialist housing for older people. They do appear in other residential leases, but only rarely. They are referred to by a bewildering variety of names, including "transfer fees"; "contingency fees"; "deferred management fees" and "selling service fees". We call these fees by the generic term, "event fees", because they are all payable on the occurrence of an event, typically when the property is transferred from one owner to another.

BACKGROUND TO THE PROJECT

- 1.5 In 2013, the Office of Fair Trading (OFT) investigated the use of one sort of event fee (known as a "transfer fee") in leases of specialist housing for older people.¹ The OFT found that terms imposing this type of event fee in leases were potentially unfair contract terms, contrary to what is now the Consumer Rights Act 2015.² The OFT did not mount a legal challenge, but it secured undertakings from many landlords in this sector not to enforce these terms, or only to enforce them to a limited extent.³
- 1.6 Subsequently, the Department for Communities and Local Government (DCLG) asked the Law Commission to look into this matter.
- 1.7 This consultation paper addresses the problems uncovered by the OFT's investigation. However, it is broader in scope and covers all types of event fee. It describes the nature of the problem; sets out the current law; proposes solutions; and invites comments from all interested parties.

¹ OFT1476 (February 2013): Investigation into retirement home transfer fee terms, a report on the OFT's findings.

² Successor to the Unfair Terms in Consumer Contracts Regulations 1999, then in force.

³ See Appendix B.

- 1.8 This consultation is open to the general public. We seek views and responses to our questions by 29 January 2016. Information about how to respond is set out on page iii.

TERMS OF REFERENCE

- 1.9 On 9 September 2014, the Department for Communities and Local Government (DCLG) asked the Law Commission:

- (1) 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.
- (2) To consider how the current law addresses the problems that are identified.
- (3) Following consultation with relevant stakeholders, to consider whether greater protections are needed to address these problems and what the impact of any greater protections would be. These protections may relate to, though are not limited to:
 - (a) unfair terms legislation;
 - (b) landlord and tenant law; and/or
 - (c) conveyancing procedure.
- (4) To make interim recommendations by March 2016.

SETTING THE CONTEXT

- 1.10 Although this project is concerned with only one issue, it needs to be seen in the broader context. Chapters 2 to 4 therefore set out the nature of the issue in its social and economic context
- 1.11 As event fees are overwhelmingly used in specialist housing for older people, we start with a short description of this market. We are not looking at rented housing in this sector, or at care homes. Instead, this project is about owner-occupied units (such as flats and bungalows) held on long leases and sold for a capital sum. Specialist housing involves varying levels of support or care, and often brings significant benefits to its residents. However, at present there are only around 145,000 such units in England and Wales.
- 1.12 In Chapter 3 we illustrate the variety of event fee terms found in leases of specialist housing. All the terms we consider share the following characteristics:
- (1) They require the tenant to pay a fee on the happening of a defined event.
 - (2) The event is where title to the lease changes hands; where there is a change in the occupancy of the property; or some other event that creates a third party interest in the lease.
 - (3) The fee is calculated in accordance with a formula in the lease (such as a percentage of the purchase, sale price or open market value of the property).

- 1.13 However, if fee provisions were redrafted as fixed amounts (such as £10,000) issues similar to those raised by fees calculated in accordance with a formula might arise.
- 1.14 Chapter 4 then looks at the problems associated with event fees. It draws on four studies carried out for this project.
- (1) We asked Iain Lock, Head of Independent Health at Bilfinger GVA, a property consultancy firm, to produce a report into the retirement property market from a developer's perspective, focusing particularly on extra care housing.
 - (2) We worked with the Law Society Conveyancing and Land Law Committee to send a questionnaire to conveyancing solicitors with experience of event fees. We received 50 responses to the survey, which give a candid view of event fees from the perspective of residential conveyancing solicitors.
 - (3) We asked a mystery shopper to describe the process of buying a retirement property from a consumer perspective. The shopper visited six properties, noting what was said about event fees during the visit and in subsequent follow-up conversations.
 - (4) We also asked our mystery shopper to analyse the websites of eight developers and operators, to see what information was available for potential purchasers.
- 1.15 These four studies are available online as separate background papers.⁴ We are very grateful to the authors of the papers and to the Law Society Conveyancing and Land Law Committee.

THE LAW

- 1.16 Chapters 5 to 8 focus on the law. The law in this area is particularly complex as leases operate both as contracts and as property rights in land. This means that terms in leases are subject to landlord and tenant law, which regulates the relationship between the parties. Residential leases are also subject to consumer protection law, including the law of unfair terms in consumer contracts.
- 1.17 Chapter 5 concentrates on landlord and tenant law. Typically, leases oblige the landlord to maintain common areas and shared facilities and to insure the building, with a corresponding obligation on the tenants to contribute to the cost of such maintenance and insurance as a service charge. Other sums may be charged for administrative acts, for granting consents, or to contribute to the cost of insurance. Disputes over service and other charges arise for many reasons. To resolve these problems, variable service charges, administration charges and charges for granting consent are subject to statutory protections. However, none of these protections apply to the event fees we have seen.

⁴ See Appendix C.

1.18 Chapter 6 looks at the law on unfair terms in consumer contracts. Unfair terms legislation has the potential to control the use of unfair event fee terms. The broad principles are relatively clear – but the application of unfair terms legislation to event fees raises three thorny questions:

- (1) Do event fees fall within the exemption which prevents a court from assessing the appropriateness of the price? We think not, as event fees are rarely in plain English. And even if a court is prevented from looking at the amount of the price compared with the services provided, an event fee may be unfair for other reasons (for example, because it applies in unexpected circumstances). However, the price exemption adds unnecessary complexity, which may deter challenges.
- (2) Leases represent a contract between the first tenant and the landlord. However, English law does not recognise a contractual relationship between subsequent tenants and landlords. We think that under European legal principles, the relationship between subsequent tenants and landlords is contractual in nature, and unfair terms legislation derived from EU law applies to it. However, this point does not emerge sufficiently clearly from the legislation or case law.
- (3) The first regulations on unfair terms in consumer contracts came into force on 1 July 1995.⁵ There are problems in applying unfair terms legislation to leases created before this date.

1.19 Chapter 7 explains the requirement to provide material information under the Consumer Protection from Unfair Trading Regulations 2008. This will include information about the price and any other charges, such as event fees, applying to a property. These Regulations need to be better known, understood and acted upon by developers, managing agents and estate agents involved in selling retirement leases which contain event fees.

CODES OF PRACTICE

1.20 Codes of practice play an increasingly important role in consumer protection. They are intended not only to give guidance to traders about how to comply with the law, but also to set out best practice, which may go further than the law requires.

1.21 In Chapter 8, we consider eight codes of practice, applying to estate agents, managing agents and developers. Until recently, many of these codes did not do enough to ensure that prospective purchasers were told about event fees at a sufficiently early stage. However, many of these codes are now being revised. This provides an important opportunity to strengthen the provisions relating to event fees.

⁵ Unfair Terms in Consumer Contracts Regulations 1994 (SI 1994 No 3159). Although the Unfair Contract Terms Act 1977 has been in force since 1 February 1978, this Act only affects exclusion and limitation clauses and does not apply to event fees.

AN INTERNATIONAL COMPARISON

- 1.22 The market for retirement villages is far more developed in the United States, New Zealand and Australia than in England and Wales. Retirement villages provide substantial services, leading inevitably to high service charges. Most developers use some form of deferred fees to make these charges affordable.
- 1.23 In New Zealand and much of the US and Australia, there is often specific legislation to regulate retirement villages. None of this legislation attempts to ban deferred fees or to regulate their amount. However, it is designed to ensure that such fees are transparent. The New Zealand Retirement Villages Act 2003 for example, is highly specific about when disclosure statements must be given and what they must contain.

PROPOSALS

- 1.24 We seek views on our provisional proposals, set out in Chapters 10 to 12. We do not think that event fees should be banned: often purchasers who are capital rich but income poor may welcome an opportunity to defer fees. Nor do we think that tribunals should have jurisdiction to assess the level of the charges against the services actually provided. That would be an extremely expensive and fact-intensive exercise, which could fail to take account of the risk of over- or under-compensation inherent in the bargain between landlord and leaseholder.
- 1.25 However, we do think that event fees should be much more transparent. There should be a duty on those who benefit from event fees to provide consumers with clear, well-illustrated information about them at an early stage. To this end we propose reform of unfair terms legislation and of existing codes of practice, which should set out detailed, robust requirements.

THANKS

- 1.26 In the course of our work to date we have met or corresponded with the stakeholders listed in Appendix A and learned a great deal from them about the issues. A full list of those we met and corresponded with is set out in Appendix A. We are grateful to them for giving us so much of their time.
- 1.27 We have also drawn heavily on an advisory panel of industry representatives and consumers. The panel has commented on draft proposals and background papers and shared their expertise and experience with us. The members of the advisory panel are listed in Appendix A and we wish to record our particular thanks for the help they gave us.

CHAPTER 2

SPECIALIST HOUSING FOR OLDER PEOPLE

- 2.1 Event fees are a feature of residential leases sold to older people. We therefore start with an introduction to this type of housing. It takes a variety of forms, from flats and bungalows which are almost indistinguishable from general housing, to specialist “retirement villages” offering 24 hour care.
- 2.2 Here we outline the broad categories of owner-occupied specialist housing for older people. Specialist housing brings benefits to its residents and frees family homes for others on the property ladder. Yet very little owner-occupied specialist housing is available in this country, especially when compared with the USA, Australia or New Zealand. Concern has been expressed that the housing stock in England and Wales is no longer meeting the needs of an ageing population - a result of problems with both supply and demand. As we discuss below, policy issues concerned with event fees need to be understood within the context of the broader issues concerning this market.

TYPES OF OWNER-OCCUPIED SPECIALIST HOUSING

- 2.3 This project is concerned with housing in the private sector, where residents own their homes under a long lease, rather than with rented accommodation. There are no agreed classifications or terms used to describe owner-occupied specialist housing, but it is possible to identify three broad categories: “age exclusive housing” (without support); “housing with support”; and “housing with care”. We look briefly at each.

Age exclusive housing

- 2.4 The distinguishing feature of age exclusive housing is that the lease includes a condition that occupiers must be of a minimum age. Beyond this, the housing may be similar to a block of mainstream leasehold flats, or to freehold houses.
- 2.5 As part of this project we commissioned a background paper from Iain Lock, a consultant with experience of this market, which describes age exclusive housing as follows:

An age restriction is placed on occupants... most frequently at a minimum of 55 years of age for one occupant. There are no other defining features beyond the wider housing market and the design largely mirrors the wider market and applies to apartments and houses. This age restricted accommodation is most attractive to the active younger elderly who take the opportunity to live amongst people of a like age and perhaps to downsize from larger less appropriately sized family housing releasing an element of equity in the process.¹

- 2.6 There is likely to be a care alarm system, and some developments have a communal area or shared garden.²

Housing with support

- 2.7 In the social rented sector (provided by local authorities or housing associations), this form of housing is usually called “sheltered housing”. In the owner-occupied sector, the term “sheltered housing” is thought to carry some stigma, and so it is more commonly called “retirement housing”.³ Again, residents live in self-contained units, but a warden or manager is available to offer support. Also, the schemes usually have communal facilities, such as a lounge, and some provide a laundry. However, nursing or personal care is not provided.
- 2.8 Elderly Accommodation Counsel (EAC) defines this category as including “some form of regular on-site ‘warden’ or scheme manager service, however limited”.⁴ It notes that in recent years, many schemes have reconfigured their services, “typically replacing resident scheme managers with full or part time non-resident ones, or with visiting or on-call support staff”.⁵ The EAC definition includes schemes which provide part-time non-resident managers, but excludes those with only an on-call or emergency visiting service.

¹ I Lock, “Age Restricted Housing Models With and Without Care,” 1.1 (Law Commission, October 2015) (available on the project page of the Law Commission website).

² Source: Elderly Accommodation Counsel (meeting with Law Commission on 21 November 2014).

³ See the comments of Andrew Burgess of Churchill Retirement Living to Demos: Claudia Wood, *The Top of the Ladder*, September 2013, p 29. Demos is Britain’s leading cross-party think tank. It specialises in social policy. *The Top of the Ladder* focuses on the chronic undersupply of appropriate housing for older people.

⁴ EAC, Statistics on specialist housing provision for older people in England February 2012, Introduction. See www.housingcare.org/downloads/eac%20stats%20on%20housing%20for%20older%20people%20february%202012.pdf.

⁵ Above.

- 2.9 As before, this form of housing is age restricted. Often the leases state that residents must be over 55 or 60. However, the average age of residents is significantly older: according to one provider it is 79 across its schemes.⁶

Housing with care

- 2.10 This is a newer form of specialist housing for older people. It is referred to by a wide variety of names. The EAC explain that the phrase “housing with care” includes schemes described by their landlord or manager as “extra care”, “assisted living”, “very sheltered”, “close care” or “continuing care”.
- 2.11 Again, the properties are usually self-contained, but the operators provide much greater levels of care and support on site. There are also a broader range of communal facilities, which typically include a restaurant, bar, lounge and laundry – and in upmarket developments may extend to a spa and swimming pool. The average age of residents is older than for housing with support: for one provider it is 83.⁷
- 2.12 Typically, care services are provided and paid for as required: residents may buy more or less care, depending on their current needs. Our consultant, Iain Lock describes the provision of care as follows:

The private sector operators of assisted living are registered as domiciliary care providers and offer the services direct to the residents, who, in the main, will buy their care from the operator although they are at liberty to buy in their care from outside providers if they wish.⁸

- 2.13 He explains that operators can provide care more effectively, as carers can move from one resident to another without travel costs, and on-site staff are there to monitor quality. Schemes will also organise more social events, and may provide a mini bus service to take residents to local shops and facilities. He continues:

⁶ This figure was provided to Demos by McCarthy & Stone: see C Wood, *The Top of the Ladder*, September 2013, p 30.

⁷ Above. Again this figure is provided by McCarthy & Stone. For other schemes, offering more intensive levels of care, the average age may be higher.

⁸ I Lock, “Age Restricted Housing Models With and Without Care,” 1.3 (Law Commission, October 2015) (available on the project page of the Law Commission website).

At single apartment block level the schemes have an appearance much like sheltered housing apartment blocks and at their most modest in terms of additional facilities will have an expanded communal facility to include a restaurant and meeting room where residents can interact and be provided with meals and other daily services. Typically, so that there is a level of economy of scale in operation, such developments have a minimum of 40 apartments and often 60 to 80.⁹

“Retirement villages”

- 2.14 Within the extra care housing sector, many operators provide larger “village” like developments, with 80 to 250 apartments. Such developments can feature a range of on site facilities such as a gym, spa and swimming pool; and perhaps an on site care home.
- 2.15 Retirement villages in England and Wales are close to the US concept of a “Continuing Care Retirement Community” (CCRC). “Continuing Care” refers to the fact that the schemes can provide for the acute needs of residents as they near the end of their lives.

“Continuing Care” is the term used for aging in situ and indicates the scheme is able to provide for the growing needs of aging through to 24 hour care if necessary. In the UK a Retirement Village that includes a care home can be termed a CCRC.¹⁰

THE ADVANTAGES OF SPECIALIST HOUSING

- 2.16 Specialist housing brings benefits to its residents and to others in the housing chain. We summarise these below. We then look at how little specialist housing is available and the reasons for this.

The benefits to residents

- 2.17 There is considerable evidence that good quality specialist housing brings health, social, financial and emotional benefits to its residents. An All Party Parliamentary Group (APPG) on Housing and Care for Older People reported that:

⁹ I Lock, “Age Restricted Housing Models With and Without Care,” 1.3 (Law Commission, October 2015) (available on the project page of the Law Commission website).

¹⁰ Above.

Older people who move to specialist retirement housing enjoy a higher quality of life and improved social networks. Evaluations also show positive outcomes in terms of health, safety and well-being, while moving to smaller, more energy efficient accommodation can help older people to stay warm and save money on energy bills.¹¹

2.18 The Demos report summarises many studies which show that older people who move to specialist housing enjoy a higher quality of life than they did before they moved, and have better health than others in their age group.¹² For example:

- (1) A survey by the University of Reading found that eight out of ten residents reported that they generally felt happier in their new home; and a third felt that their health had improved.¹³
- (2) A review of 19 extra care housing schemes by the Personal Social Services Research Unit found that occupants had considerably lower rates of mortality than a matched sample in care homes, and 40% had improved physical capabilities after moving in.¹⁴
- (3) Two studies found that residents reduce their use of medication after moving into extra care housing.¹⁵

2.19 The Demos report comments that the greatest health benefits come from extra care housing, thanks to the presence of support services and improved social networks. However:

It is clear that simply downsizing into general needs housing that is more efficient to heat and maintain, or perhaps has adaptable bathrooms, or is on one floor, will have a range of health and financial benefits associated with staying warm, avoiding fuel poverty and reducing the risks of falls.¹⁶

¹¹ An Inquiry by the All Party Parliamentary Group on Housing and Care for Older People into the affordability of retirement housing (2014). The Inquiry confined itself to the question of affordability for those who would like to downsize.

¹² C Wood, *The Top of the Ladder*, September 2013, p 41.

¹³ Ball, *Housing Markets and Independence in Old Age* (2011).

¹⁴ A Netten and others, *Improving Housing with Care Choices for Older People: An Evaluation of Extra Care Housing*, PSSRU (2011).

¹⁵ See Extra Care Charitable Trust (2006) and S Biggs and others, "Lifestyles of belief: narrative and culture in a retirement community", *Ageing and Society* (2000) 649.

¹⁶ C Wood, *The Top of the Ladder*, September 2013, p 43.

The benefits to others in the housing chain

- 2.20 As the Demos report shows, England and Wales suffers from a serious shortage of housing stock. Although this shows itself as a particular problem for young would-be first time buyers:

It is not simply a shortage at the bottom of the ladder. It is a shortage across the housing chain, which is preventing families from moving into bigger homes and making space at the bottom of the ladder for first time buyers.¹⁷

- 2.21 Each time an older person leaves a large family home for a smaller retirement flat, it frees up a house for a growing family – which in turn may free a house for a first time buyer. In this way, increased specialist housing benefits all those seeking a home.
- 2.22 A report in June 2015 looked at the housing of those aged over 55. It identified 5.3 million under occupied homes, with 7.7 million spare bedrooms.¹⁸ The report found that almost a third (32%) of home owners aged over 55 said that they had considered moving to a smaller property in the last 5 years, but only 7% had actually done so.¹⁹ There were many deterrents to moving, of which the most common reason was a lack of suitable properties. The report commented on the “chronic undersupply of age-specific housing”, particularly in the mid-market and in urban areas, where older people could remain close to family and friends and within easy reach of healthcare, shops and public transport.

THE SIZE OF THE SPECIALIST HOUSING SECTOR

- 2.23 In 2015, EAC calculated that there were just over 145,000 units of owner-occupied specialist housing in England and Wales: 141,105 in England and 4,334 in Wales. Of these, most are “housing with support” rather than “housing with care”. There are fewer than 14,000 owner-occupied properties in England and Wales which offer domiciliary care facilities.

¹⁷ C Wood, *The Top of the Ladder*, September 2013, p 13.

¹⁸ *Last Time Buyers* – A report by Legal & General, in conjunction with the Centre for Economics and Business Research (CEBR) (June 2015).

¹⁹ Above.

Specialist housing provision for older people in England and Wales 2015

	England	Wales	Total
Age exclusive housing	14,114	577	14,691
Housing with support	113,828	3,648	117,476
Housing with care	13,208	109	13,317
Total	141,150	4,334	145,484

Source: *Elderly Accommodation Counsel*

- 2.24 Many organisations have commented on how small the owner-occupied retirement sector is. As we explain below, it is small in comparison with the rented retirement sector. It is very small in comparison with the population currently over 65. And it is extremely small in comparison with the projections for an ageing population over the next 20 years. There is a growing literature on the reasons for this lack of specialist housing for older people and the problems it is likely to cause.²⁰

The comparison with social rented specialist housing

- 2.25 There is much more specialist housing available for social rent (although there is only a tiny number of specialist properties available for private rent). EAC calculates that in 2015 there were over 513,000 rented units: 486,047 in England and 27,578 in Wales. In other words, 78% of all specialist housing is for rent (almost all of this being social housing) and only 22% for sale.
- 2.26 Yet, for older people generally, those proportions are reversed: 76% are owner-occupiers.²¹

The comparison with the current population

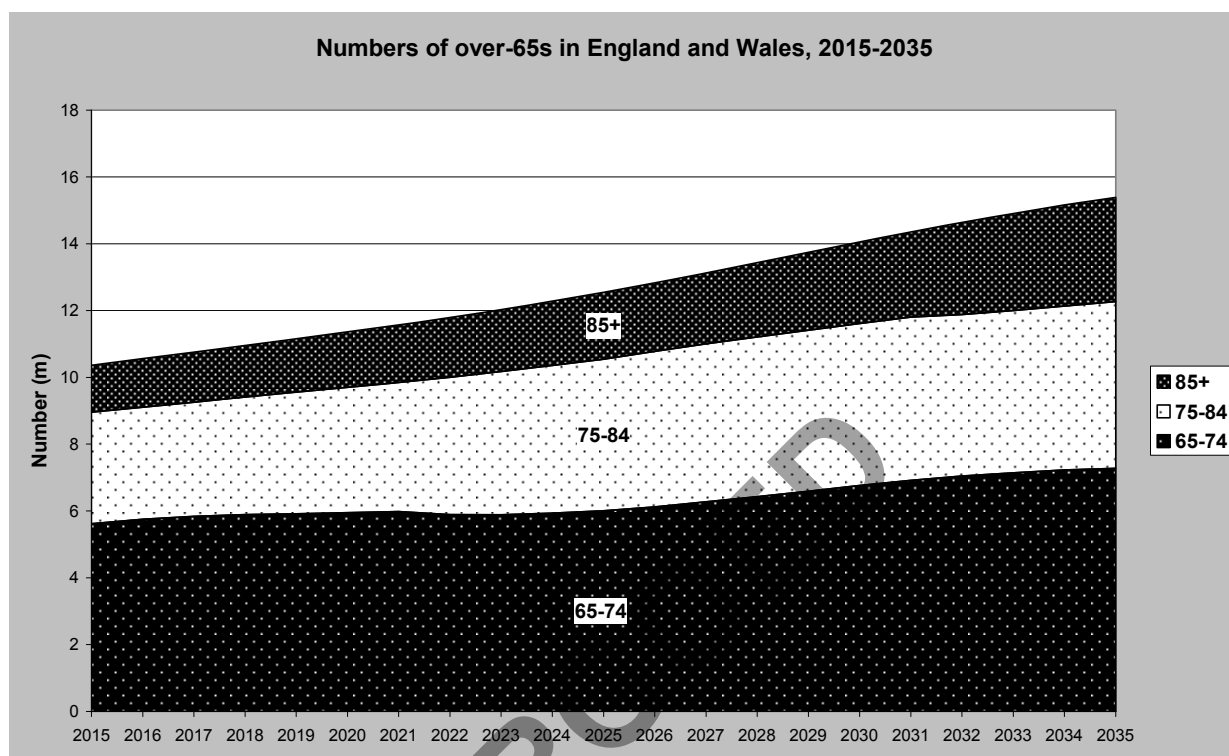
- 2.27 In 2015, there were 10.4 million people aged 65 or over living in England and Wales: less than 2% lived in owner-occupied specialist housing. This compares with 17% of over 60s who live in specialist housing in the USA, and 13% for Australia.

²⁰ C Wood, *The Top of the Ladder*, Demos: 2013; House of Lords Select Committee on Public Service and Demographic Change, *Ready for Ageing?* (2013); All Party Parliamentary Group on Housing and Care for Older People (2014); Shelter, *A Better Fit? Creating housing choices for an ageing population*, (April 2012) p 29.

²¹ J Pannell, H Aldridge and P Kenway, *Older People's Housing: Choice, Quality of Life and Under-Occupation*, Joseph Rowntree Foundation, May 2012.

The comparison with population projections

- 2.28 As the following graph shows, over the next 20 years, the number of those aged over 65 in England and Wales will increase rapidly: from 10.4 million in 2015 to 15.4 million in 2035.²²



- 2.29 The greatest changes will be among the very old, who are most in need of care and support. Over the next 20 years, the number of people aged between 75 and 84 is expected to increase by 50% (from 3.34 million to 4.99 million). The numbers aged 85 or over will more than double (from 1.41 million to 3.12 million).

²² Source: Office for National Statistics, 2012-based subnational population projections for England and 2012-based principal population projections for Wales by single year of age and sex, <http://www.ons.gov.uk/ons/rel/npp/national-population-projections/2012-based-projections/rft-table-z4-zipped-population-data-files---wales.zip> and <http://www.ons.gov.uk/ons/rel/snpp/sub-national-population-projections/2012-based-projections/rft-population-regions.xls>.

- 2.30 The current stock of specialist housing is already insufficient and this deficit will become much more acute over the next two decades. Despite the increase in potential demand, the number of homes built specifically for older people has decreased from the 1980s.²³ A submission by McCarthy & Stone for the Demos report showed that in 2010, only 6,000 units for rent and 1,000 units for ownership were built, compared with 17,500 for rent and 13,000 for ownership in 1989.²⁴
- 2.31 A House of Lords Select Committee concluded that “the Government and our society are woefully underprepared” for these demographic changes.²⁵ Among many changes needed, “sufficient provision of suitable housing, often with linked support, will be essential to sustain independent living by older people”.²⁶
- 2.32 Meanwhile, a Shelter policy report looking at housing choices for older people concluded that:

We need a significant increase in supply and a greater range of housing that is suitable for older people, including private-rented and owner-occupied housing.... Developers are not currently providing enough for this growing market and realising its potential.²⁷

THE REASONS FOR THE LACK OF RETIREMENT HOUSING

- 2.33 There appear to be many interlocking reasons for the lack of specialist housing in England and Wales. The Demos report identified problems with both supply and demand. Below we consider each in turn.

²³ *The Affordability of Retirement Housing*, an inquiry by the All Party Parliamentary Group on Housing and Care for Older People (November 2014).

²⁴ C Wood, *The Top of the Ladder*, Demos: 2013, p 17.

²⁵ House of Lords Select Committee on Public Service and Demographic Change, *Ready for Ageing?* (2013) para 1.

²⁶ Above, para 6.

²⁷ *A Better Fit? Creating housing choices for an ageing population*, (April 2012) p29.

Supply issues

- 2.34 The first problem appears to be difficulties in obtaining planning consent. Developers often struggle to convince local authorities of the value of owner-occupied specialist housing. One major developer reported that two-thirds of its developments were permitted only after appeal: local authorities were often worried about the consequences of increased numbers of older people on local health services.²⁸ It may also be difficult to find the right sort of site. Older people are likely to want homes within easy reach of shops, services and buses – not on green field sites in the “middle of nowhere”.
- 2.35 Developers also point out that specialist housing may be more expensive for them to develop. The presence of communal facilities (such as lounges) adds to the footprint of specialist housing schemes, and must be paid for. Furthermore, it is often difficult to sell specialist housing “off-plan”. Buyers want to see the entire development in operation before committing themselves to a purchase, so developers must carry the cost of working capital for longer.²⁹
- 2.36 Further, retirement property is only attractive if it is in good condition. Often, much of the attraction of moving is not to have to worry about repairs or redecorating. This means that the maintenance costs tend to be greater than for other properties.
- 2.37 Some of the organisations developing owner-occupied housing are housing associations, charities or non-profit making organisations. However, most are commercially orientated. The economics of developing retirement housing depend not only on the initial sale price, but also potential income streams, from domiciliary care provision, ground rents and event fees. It is important not to interfere with these income streams in a way which discourages further supply.

Demand issues

- 2.38 Polls of those over 60 show a considerable interest in moving. For example, in the Demos poll, 58% of people over 60 said that they would consider moving, with 25% saying that they would be interested in buying a purpose built retirement property.³⁰ The attraction of moving was often to find a more suitable property (which was easier to maintain, or with fewer stairs) or to downsize, often from a three or four bedroom house to a two bedroom house.

²⁸ C Wood, *The Top of the Ladder*, Demos: 2013, p 24, based on evidence from McCarthy & Stone.

²⁹ Above, p 27.

³⁰ Above, p 30. As part of its research, Demos polled 1,510 over 60s in July 2013.

- 2.39 However, it is one thing for people to think about moving – and quite another to do it. As we discuss below, there are many barriers to moving, ranging from the cost of specialist housing to psychological considerations. Many people put off a decision until forced to move by a crisis.

The affordability of retirement housing

- 2.40 One of the major attractions of downsizing is to release equity in one's home. For many owner occupiers in London and the South East, moving from a three to four bedroom house to a two bedroom flat offers the prospect of releasing substantial equity. A 2013 study by Policy Exchange suggested that moving from an average detached property in London to an average semi detached property would release nearly £300,000. A similar change in the South East would release £180,000.³¹
- 2.41 As the APPG on Housing and Care for Older People pointed out, others may not be so fortunate. The inquiry found that many people in modest homes, particularly in the North East, have insufficient equity in their homes to purchase a retirement property outright. Unsurprisingly, those over 65 could also have difficulty raising further finance by obtaining a mortgage or other loan. The APPG received evidence from Churchill Retirement, for example, that while 63% of people who bought Churchill specialist housing released equity, 21% paid more for their new retirement flat than the value of the home sold.³² The costs of the move (stamp duty and estate agents, solicitor and surveyor fees) added to the gap.
- 2.42 In addition, older people may be concerned about service charges. As the APPG put it:

Ongoing costs – in the form of service charges to maintain communal areas or services on site (ranging from the presence of a warden through to support services and meals) are also a considerable concern for older people as these have to be paid from any equity released by the sale of their home or, alternatively, from savings or pension income.³³

³¹ See A Morton, *Housing and Intergenerational Fairness*, quoted by the Parliamentary Group on Housing and Care for Older People, "*The Affordability of Retirement Housing*" (November 2014) at p 15.

³² *The Affordability of Retirement Housing*, an inquiry by the All Party Parliamentary Group on Housing and Care for Older People (November 2014) p 18.

³³ Above, p 29.

- 2.43 One particular problem is that these costs may be unpredictable and outside people's control. As one consultant put it, it is "less about 'can I afford to move here?' and more about 'can I afford to stay here?'" , if costs increase faster than income.³⁴ The APPG recommended that:

More sophisticated arrangements – as in some other countries – for deferring some service charges until the property is sold should also be made available more widely.³⁵

Other barriers to moving

- 2.44 It is not just an issue of cost. The Demos survey reported multifaceted barriers to moving, "with a range of practical and emotional factors in play".³⁶ The process of moving is daunting; and people are emotionally attached to their homes.³⁷ Also, the properties available may not be what people are looking for. Often properties are one-bedroom, when most people are looking for two bedrooms; they are too far from shops; or (for older homes) too old fashioned.
- 2.45 There is also a lack of understanding of what retirement housing offers, exacerbated by the lack of consistency in the terminology used. An Age UK survey of residents found that older people want better and more accurate information about a scheme before they move in, so that there is no misunderstanding about what the scheme offers and what is required from the residents.³⁸ The Demos report also notes "a general dearth of information, advice and help for older people to navigate the housing market".³⁹
- 2.46 The result of all these factors is that people rarely move until there is some kind of crisis. As the Demos report puts it:

³⁴ *The Affordability of Retirement Housing*, an inquiry by the All Party Parliamentary Group on Housing and Care for Older People (November 2014) p 30.

³⁵ Above, p 7.

³⁶ C Wood, *The Top of the Ladder*, Demos: 2013, p 34, based on evidence from McCarthy & Stone.

³⁷ A Shelter Policy Report puts this point in the following terms: This stresses that "older people often feel a strong sense of attachment to their space and possessions, or their neighbourhood and local community." See "*A better fit? Creating housing choices for an ageing population*" (2012) p 14.

³⁸ Age UK residents enquiry into sheltered and retirement housing, "*Making it work for us: A residents' inquiry into sheltered and retirement housing*" p 17.

³⁹ C Wood, *The Top of the Ladder*, Demos: 2013, based on evidence from McCarthy & Stone, p 33. Similarly, the APPG enquiry confirmed that conveyancing solicitors do not provide detailed advice on retirement issues. See *The Affordability of Retirement Housing*, an inquiry by the All Party Parliamentary Group on Housing and Care for Older People (November 2014) p 37.

Therefore few people are making a positive choice to move into retirement housing until something forces them to do so – a death of a partner, an accident or fall within the house, burglary or major maintenance problem. A move to retirement housing is more akin to a last resort or ‘distress purchase’, commonly seen in moves to residential care, rather than a preventative or – better yet – aspirational move for a more active retirement.⁴⁰

- 2.47 This has major implications for our project. Many of those buying specialist housing are under conditions of stress; they have little understanding of the various models and terminology associated with this market; and there is a dearth of advice. Furthermore, many people will be moving from owning a freehold on a family house to leasehold, and may have little experience of what leasehold involves.
- 2.48 In this environment, it would not be surprising if people failed to understand the full implications of event fees, even if they were explained clearly. As we see in Chapter 4, in many cases they are not explained clearly.
- 2.49 Also, older people can easily be put off moving, whatever the benefits of specialist housing. Negative publicity which suggests that specialist housing is exploitative, or charges high hidden fees, could have a disproportionate effect on this underdeveloped, nervous and fledgling market.

CONCLUSION

- 2.50 Event fees are a small part of a much larger picture. As we have seen, over the next 20 years, the number of people aged 75 to 84 will increase by 50% and the number aged 85 or over will more than double. Specialist housing has major benefits and is a crucial part of preparing for these demographic changes.
- 2.51 Our aim is to encourage this market sector to develop. So we need to maintain a balance. It is important that developers are given adequate and reliable income streams which encourage them to build more specialist housing. We also recognise that those who are capital rich and income poor may welcome the opportunity to defer some parts of the purchase price or service charges. This is particularly the case if an event fee makes the amount of the service charge more certain and predictable.

⁴⁰ C Wood, *The Top of the Ladder*, Demos: 2013, p 34, based on evidence from McCarthy & Stone.

- 2.52 On the other hand pricing structures must be transparent to buyers, who may be vulnerable through age and stress, and who have a great deal of information to absorb with little specialist advice. Publicity suggesting that pricing structures are exploitative or unfair could set back the whole market, and deter cautious older consumers from making the decision to purchase.

EMBARGOED

CHAPTER 3

WHAT ARE EVENT FEES?

- 3.1 In Chapter 2, we described the market for owner-occupied specialist housing for older people. This form of housing is sold on long leases (typically around 100 to 125 years). It is common for these leases to include an obligation for each leaseholder (or “tenant”) to pay a sum to the landlord when they sell the property. Often, these sums are calculated as a percentage of the sale price, ranging from as little as 1% to as much as 30%. The fee can also be triggered by other events, such as sub-letting, mortgaging or a change in occupation of the property.
- 3.2 Here we draw on a sample of specialist leases sold to older people, obtained from the Land Registry. Event fees appear ubiquitous within this sector. By contrast, we have not seen any event fee terms used in general leases. In our survey of solicitors described in Chapter 4, a few respondents mentioned that they had seen event fees in other leases, for example, for a luxury gated community.¹ However, these were isolated instances. Overall, it appears that event fees are unusual outside the specialist housing market.
- 3.3 Within retirement leases, these fees go by a wide variety of names, including “transfer fee”, “exit fee”, “deferred management fee”, “contingency fee”, “sinking fund fee”, and “assignment fee”. There are differences between those fees which are ring-fenced for maintenance and those which are not. However, many of the differences represented by these labels are presentational rather than substantive. The bewildering range of terms used tends to obscure discussion rather than elucidate it. We have therefore coined a new general term, “event fee”, which refers to any fixed or percentage fee set out in the lease which is triggered by an event such as sale, subletting or change of occupancy.
- 3.4 In this chapter we start by describing the type of terms found in leases within this specialist housing market. Following the Office of Fair Trading (OFT) investigation which commenced in 2009,² some landlords gave voluntary undertakings not to enforce some of these terms in some circumstances.³ We look briefly at these undertakings. We then provide a full definition of “event fees” for the purpose of this project.

VARIATIONS IN DRAFTING EVENT FEES

- 3.5 There is no standard way in which event fee terms are drafted. The terms differ in what, if anything, they say the charge is for. They can also differ as to the circumstances where the money becomes due. As we describe below, we have identified four broad approaches: transfer fees; contingency fees; deferred membership fees; and selling service fees.

¹ With the assistance of the Law Society Land Law and Conveyancing Committee, we sent a questionnaire to conveyancing solicitors with experience of this issue. A full description of the survey is set out in Appendix C (see paras 4.28 – 4.54).

² The report of the investigation was published in 2013. See OFT 1476 (February 2013) *OFT investigation into retirement home transfer fee terms*, a report on the OFT’s findings.

³ The undertakings were given between 2012 and 2014.

- 3.6 Some of the examples we give below are from leases drafted before the OFT investigation, in response to which some developers changed their standard terms. Therefore, an example given from a particular developer does not necessarily reflect the wording used by that developer in its most recent leases. The wording in the older leases remains in place because it reflects the wording agreed between the parties at the time when the lease was first agreed.

Transfer fees

- 3.7 Under this approach, there is no reason given for the obligation to pay and no restriction on how the money will be spent. Nor is it specified that any benefit or service will be provided. Rather, the term simply imposes a fee on the occurrence of a defined triggering event.

- 3.8 In this example, the fee was not given any label at all:

3.11.a On every assignment... the Leaseholder will pay to the Landlord 1% of the sale price of the Premises.⁴

- 3.9 In another example, the term is labelled as a “transfer fee”.

10.4 Not to agree to assign underlet dispose of or to make any other material change in occupation or otherwise part with possession of the premises without first having given at least 28 days prior written notice to the Landlord... and... at completion of any such transaction... to pay to the Landlord a transfer fee of 1% of the gross sale price or unencumbered open market value ... whichever shall be the greater sum.⁵

- 3.10 This term is drafted particularly widely, to apply not simply to a sale but to any “disposition”, subletting or change in occupation. We discuss the implications of this below.⁶

Contingency fees and deferred service charges

- 3.11 In leasehold properties, it is usual for tenants to contribute to a contingency or sinking fund each year as part of their service charge. In some retirement leases, this is replaced or supplemented by an event fee on sale. It may also be triggered by other events such as sub-letting.
- 3.12 In law, simply referring to an event as a contingency or sinking fund fee would not require the money to be held on trust for the benefit of the tenants. As we explain in Chapter 5, event fees have the legal status of fixed service charges. In such circumstances, unlike a sinking fund composed of annual variable service charge contributions, there are no legal restraints on how the money may be used.⁷

⁴ Hanover Lease, November 2008.

⁵ McCarthy & Stone Lease, July 2008.

⁶ See paras 3.35 – 3.40.

⁷ Landlord and Tenant Act 1985 s 18(1); *Arnold v Britton* [2013] EWCA Civ 902; Landlord and Tenant Act 1987 s 42. See paras 5.51 – 5.53.

- 3.13 However, the lease itself may circumscribe the way in which the money is used. This is an example:

10.5 ... the Tenant shall upon completion of every assignment underletting or other material change in occupation or possession of the Premises... pay to the Landlord a contingency fee of 1% of the gross sale price or unencumbered open market value (which in default of agreement shall be determined by the Landlord's Surveyor) whichever shall be the greater sum... ⁸

- 3.14 The ways the fee may be spent are then set out in a schedule:

Schedule 4

10. The sums paid to the Landlord by way of contingency fee under the provisions of the Fifth Schedule shall be dealt with as follows :-

10.1 Such sums shall be used to provide a contingency fund ("the Contingency Fund") for or towards the costs and anticipated costs and expenses of items of capital expenditure...

10.2 The Contingency Fund shall be held by the Landlord or its agent on trust for the tenants of the Building and may be invested by the Landlord at its discretion in any of the investments specified in Part III of the First Schedule to the Trustee Act 2000...

10.3 The Landlord may in its discretion use the Contingency Fund or any part of it... to discharge or reduce the Service Charge.⁹

- 3.15 Where the fees are earmarked for a sinking fund, many leases state that the money should be used for "renewing, upgrading or improving" the estate.
- 3.16 In some extra care housing schemes the cost of long term capital upkeep of the estate is much greater than in conventional retirement housing because of the scale and number of communal facilities. Service charges could be made prohibitively expensive if, as in mainstream residential leasehold, contributions to this fund for this long term maintenance were billed annually.¹⁰
- 3.17 In this example, the deferred service charge is one percent of the market value at the date of acquisition of the dwelling per year lived in the property:

⁸ McCarthy and Stone lease, December 2012.

⁹ Above.

¹⁰ For examples, see "Event fees as deferred service charges" in Ch 4, below.

1.6 “the Deferred Service Charge” means the amount which the Tenant should pay by way of contribution to provide a sinking fund to defray the costs and expenses incurred by Anchor as set out in Part II of the Third Schedule [which deals with major capital expenditure such as replacing the lifts] ... the Deferred Service Charge shall be such sum as is equivalent to the Deferred Service Charge Proportion [i.e. 1%] of the Market Value of the Dwelling as at the Lessee’s acquisition of the Dwelling for each year (apportioned on the basis of complete months) that shall on each occasion have elapsed since the date of his acquisition of the Dwelling.¹¹

- 3.18 In mainstream residential leases, sinking fund contributions are calculated according to a projection of how much money will be needed for major repairs. By contrast, event fees are a rather blunt instrument, as the amount of money received depends on how often properties are sold, and at what value – not the projected costs of capital upkeep. Some operators get around this problem by including a clause which allows them to alter the amount of the deferred service charge at their discretion.¹²

Deferred management and membership fees

- 3.19 Sometimes fees are referred to as deferred management fees, rather than deferred service fees, moving further away from the idea that fees are specifically allocated to maintaining the property.
- 3.20 The deferred management fee may increase incrementally with the time lived in the property. It may also be capped at a certain percentage of the property’s value. In some cases, the operator may offer to fix the annual service charges for the duration of a resident’s tenancy at a set figure, increasing only in line with inflation.¹³ In return, the operator will charge a relatively high fee when the resident leaves. For those on a fixed income, such as a pension, this may be an attractive option.
- 3.21 In this example, the tenant pays 1% a year, up to a maximum of 15%.

39. To pay the Deferred Management Charge to the Management Company on the date of any Change. [...]

“Deferred Management Charge” 1% for each year or part year that the Tenant for the time being has been the Tenant of the greater of any premium payable on a Change and the Open Market Value on the date of the Change to a maximum of 15%

“Change” [means] any change of:

(a) The Tenant or if the Tenant is a limited company the control of that company; or

¹¹ Anchor lease, October 2005.

¹² Above, cl 3.6.4.

¹³ Audley Retirement lease, sch 5, June 2014.

(b) The Occupier.¹⁴

3.22 In some cases, the event fee, whilst described as a deferred service charge is so substantial as to suggest a different sort of arrangement. The term then may be referred to as a deferred membership fee, suggesting that the retirement development is a club with a membership fee.

3.23 In this example, the resident is offered two options. After two years, the choice is between paying 30% of the sale price; or 20% of the purchase price plus 50% of the increase in the property's value.

3.24 The first option is set out in the following terms:

In respect of a Sale within one year of the date of the Effective Date, the aggregate of:

(a) 10% of the Purchase Value; and

(b) 50% of the Increased Value

In respect of a Sale within two years of the Effective Date, the aggregate of:

(a) 15% of the Purchase Value; and

(b) 50% of the Increased Value

In respect of any Sale on or after the second anniversary of the Effective Date the aggregate of:

(a) 20% of the Purchase Value; and

(b) 50% of the Increased Value.

3.25 The second option is:

(a) 10% of the Sale Value if the Sale occurs within one year of the Effective Date;

(b) 20% of the Sale Value if the Sale occurs within two years of the Effective Date

(c) 30% of the Sale Value in respect of any Sale on or after the second anniversary years of the Effective Date

3.26 The lease then provides that "in the absence of election by the Tenant, the Deferred Membership Fee shall be Option 2".¹⁵

¹⁴ Audley Retirement lease, August 2014.

¹⁵ Life Care Residences lease (Battersea Place), p 4-5, 2015.

“Selling service” fees

- 3.27 Some terms are described as payment for the landlord's assistance with resale. At first glance these look like administration charges, but the amounts may be high and bear little relationship to administration costs.
- 3.28 As we discuss in Chapter 5, some “administration charges” may be challenged under landlord and tenant law. Where charges are payable “for or in connection with the provision of information or documents”, tenants may apply to the First-tier Tribunal (Property Chamber) on the grounds that the charge is unreasonable.¹⁶ However, not all “selling service” fees are necessarily administration charges.¹⁷
- 3.29 In this example, the lease requires the leaseholder to pay a Change of Ownership fee charged at the following percentages:
- (1) 5% of the sale price of the Premises (“the premium”)... if the date of the disposal or disposition of the lease is one year or less from the date hereof...
 - (2) 10% of the premium if the date... is two years or less but more than one year from the date hereof ...
 - (3) 12.5% of the premium if the date... is more than two years from the date hereof.¹⁸
- 3.30 This is said to be for a Change of Ownership Service, comprising:
- Access to details of potential purchasers kept by the Landlord;
 - Advice and assistance to the Tenant considering disposal of the Premises;
 - Reasonable efforts to seek a potential purchaser for the Premises;
 - Provision of details of past and anticipated future Village Service Charge, as reasonably required to satisfy prospective purchasers;
 - Reviewing details of prospective purchasers and their fellow occupiers to ensure that they are Qualifying Residents;
 - Provision of village information to potential purchasers.

¹⁶ See Commonhold and Leasehold Reform Act 2002, schedule 11.

¹⁷ See *Decision of the Midland Leasehold Valuation Tribunal as to its Jurisdiction* (23 March 2006) (unreported), discussed in Ch 5, paras 5.77 – 5.80.

¹⁸ Retirement Villages lease, April 2013.

- 3.31 Although the charges are said to be for a service, the charging structure relates to the length of occupation and property value rather than to the service provided. The fees also appear to be excessive: after more than two years, a leaseholder selling a property for £300,000 would pay a fee of £37,500, substantially more than one would expect to pay to an estate agent for a similar service. However it is unlikely that the leaseholder could challenge the fee as unreasonable, as the charge relates to more than just the provision of information or documents.¹⁹
- 3.32 This is another example, where the lease contains a “sales administration fee” of 3%, for the services which an estate agent would normally provide.

Sales Administration Fee a maximum of 3% of the greater of the premium payable on a sale of the Property or the Open Market Value at the time of the sale...

38. To pay the Sales Administration Fee to the Management Company on the date of completion of any sale of the Property...

- 3.33 In this case, a 2% fee is compulsory, but the tenant can choose whether to pay a further 1% for additional estate agency services.²⁰
- 3.34 Where the landlord offers the tenant a choice of whether to use an estate agency service, we would not classify the term as an event fee. The seller is able to evaluate whether the charge offers good value for money at the appropriate time. However, where selling service fees are compulsory, and not challengeable before a tribunal, they appear to be just another form of event fee.

FEES PAYABLE ON WIDER EVENTS

- 3.35 Some terms do not just apply to selling or sub-letting the property. As we have seen, some apply to any “disposition” or to any “material change in occupation”. In other words, the term could potentially apply where the property is inherited or mortgaged, or where a new resident moves in, or an existing resident moves out.²¹
- 3.36 One McCarthy & Stone lease, which lists the 1% contingency fee and 1% transfer fee separately, makes it clear that creating a mortgage or devolution on death does not trigger the contingency fee:

The tenant shall upon completion of every assignment underletting or other material change in occupation or possession (excluding devolution on death and the completion of any mortgage or charge)... pay to the Landlord a contingency fee of 1%...²²

- 3.37 Although these exclusions are set out for the contingency fee, they are not written into the provision for the 1% transfer fee.

¹⁹ For further discussion, see paras 5.77 – 5.82.

²⁰ Audley Retirement lease, August 2014.

²¹ Also potentially upon surrender of the lease or an equity release.

²² McCarthy & Stone Lease, July 2008.

3.38 This is another example :

To pay to Warford Park... on the creation or any devolution of any legal or equitable estate or interest in the Apartment or on a change of occupation a sum equal to 1% of... the open market value... .²³

3.39 In this term, “devolution” would cover the way that property passes to an heir on death. When someone dies, their property vests automatically in their personal representatives (either executors on grant of probate, or administrators on grant of letters of administration). We think that the automatic vesting of the property amounts to “devolution on death”. This raises the possibility that one fee would be payable when the tenant dies and another when the property is sold.

3.40 Moreover, references to creating a legal or equitable estate would include mortgaging the property. A “change of occupation” might occur when one partner dies, or where a carer moves in, or even where the property is left empty (for example, if the owner moves into residential care).

3.41 As we explore below, most landlords have now agreed to charge transfer fees only on sale or sub-letting, and not on the occurrence of wider events.

LANDLORDS’ UNDERTAKINGS FOLLOWING THE OFT REPORT

3.42 The OFT investigation into retirement home transfer fee terms concluded that they were potentially unfair.²⁴ As a result of its investigation,

a number of landlords agreed to either cease enforcing a transfer fee, to replace it with a flat fee, or to make changes – such as enforcing the term on final sale and not in a wide range of other circumstances - that mitigate what we consider to be the most egregious unfairness of the respective transfer fee terms.²⁵

3.43 The businesses involved did not accept that their terms might breach unfair terms legislation. However, nine landlords agreed to engage constructively with the OFT and gave voluntary undertakings or satisfactorily clarified the principles it applied when enforcing transfer fee terms.²⁶ We set out details of these undertakings in Appendix B.

3.44 The industry did not have an agreed position. Instead, each landlord gave a different undertaking. Some undertakings are quite complex, in that they apply only to some but not all event fees, or only in some circumstances. The OFT highlighted in its report why it had not secured uniform outcomes:

²³ The Beeches, Warford Park (Fairhold) lease, 2003.

²⁴ OFT 1476 – February 2013.

²⁵ OFT 1476 – February 2013, para 1.6.

²⁶ <https://www.gov.uk/cma-cases/retirement-homes-hidden-exit-fees-investigation>.

First, the landlords' existing leases and business models are different. Second, we are constrained by the limits to which each firm can voluntarily agree to undertakings – some are either controlled or constrained by finance providers such as funding banks or bondholders. Third, enforcement action where there are differences in circumstances between cases has to be individually targeted and can only be resolved by individual negotiations, which inevitably tend to produce a non-uniform result. Only legislation could deliver a uniform market.²⁷

3.45 Below we highlight five common themes.

No transfer fees on death or change of occupancy

3.46 Landlords have now confirmed that they will not charge fees on death: when a property passes to relatives, landlords will only charge the relatives when they come to sell the property (rather than once on inheritance and again on sale). Furthermore, landlords have agreed not to charge for a change in occupancy that does not involve a sub-letting.

No transfer fees or reduced fees on sub-letting

3.47 Where owners find it difficult to sell, one option is to let the property – but even a fee of 1% of the full market value can prove exorbitant on a short let.

3.48 Some landlords have agreed not to charge a transfer fee on a sub-letting,²⁸ while others have agreed to reduce the scale of the fees. For example, before 2012, in some leases, Fairhold Homes charged two fees on each sub-let:²⁹ a transfer fee of 1% of the market value and a contingency fee (also of 1% of the open market valuation). It has now replaced the transfer fee with a flat fee of £85 (to be adjusted in future years in line with inflation) and, where the terms of the lease give it discretion to do so, has replaced the contingency fee with a fee equivalent to one month's rent.³⁰

3.49 The largest developer, McCarthy & Stone, has published the following explanation about how their contingency fee applies on subletting:

²⁷ OFT 1476 – February 2013, para 6.18.

²⁸ See, for example, the undertakings given by Hart and by Shropshire Leisure Group Ltd in Appendix B.

²⁹ Fairhold had a large number of leases that it had acquired from developers, some of which allowed for this, but not necessarily all. Fairhold gave undertakings on 30 July 2012 in relation to how it would enforce the transfer fee term going forward.

³⁰ This only applies where the terms of an existing lease give Fairhold discretion to waive the contingency fund fee of 1% of the open market value payable upon each sub-letting, and to instead charge a fee equivalent to one month's rent (in accordance with the waiver) for each sub-let by way of an assured shorthold tenancy agreement.

With regard to under letting on leases prior to October 2014, we will charge a concessionary rate (irrespective of the provisions in the lease, which may be higher) of one month's rent for each year that the apartment is underlet (or pro-rata for less than a year).... This concession will apply for a maximum period of two years, after which time we will revert to the terms of the lease.

For leases from October 2014, the underletting contingency fee has been reduced to a contingency fee of 1% of the annual rent (or pro-rata for underletting of less than one year). Where the underletting is for more than a year, the contingency fee is 1% of the annual rent payable annually on the anniversary of the commencement of the term.³¹

Transfer fees charged on purchase price rather than sale price

- 3.50 The OFT argued that at the time of purchase, consumers will not know what the sale price will be. This makes it impossible for consumers to understand or plan for future liabilities.
- 3.51 In response, some (but by no means all) landlords have agreed to base the transfer fee on the purchase price rather than the sale price, if the purchase price is lower.³² Hart agreed to calculate the transfer fee on the basis of the lower of either the sales price or the purchase price updated in line with the Retail Price Index. Basing the transfer fee on the lower value gives tenants certainty over their maximum liability at the time that they purchase the property. It also prevents disputes about what the right level of fee should be.³³

Waiving transfer fees

- 3.52 In some cases, developers agreed to waive fees. However, these undertakings applied only to some of the fees payable, and only to leases the developer continued to own.
- 3.53 The largest developer, McCarthy & Stone, gave an undertaking that it would not enforce transfer fees in existing contracts, subject to two qualifications. First it only applies to transfer fees and not to contingency fees.³⁴ Secondly, a transfer fee is still payable where the freehold has been sold to a third party, even if McCarthy & Stone continue as the sub-landlord.

³¹ <http://www.mccarthyandstone.co.uk/faq/>.

³² Examples are Fairhold Homes Ltd, Goldsbrough Estate Ltd and Shropshire Leisure Group Ltd.

³³ Given the lease typically based the fee on a percentage of the sale price or open market value.

³⁴ Contingency fees are quite distinct, being payments into a contingency or sinking fund as contributions to future service charge liabilities. Therefore, although McCarthy and Stone gave undertakings relating to the enforceability of transfer charge terms, it can still enforce payment of contingency fund contributions without alteration.

- 3.54 Pegasus also agreed not to enforce the 1% transfer fee at the two retirement home sites it continued to own. However, it added the proviso that the 1% fee would be charged once the freehold had been transferred to third parties under existing contractual agreements.³⁵

Removing transfer fees from new leases

- 3.55 Finally, most of the landlords under investigation undertook not to include transfer fees in any new leases unless the fee is for a service and represents its reasonable costs.³⁶ In this context, transfer fee is to be construed relatively narrowly. It does not include contingency fees, for example. Nor was the OFT focussed on the extra care sector, which typically charges deferred management and membership fees.³⁷ Finally, the only service fees which can be challenged before a tribunal³⁸ are those which fall within the narrow statutory definition of an “administration charge”.³⁹ For other service fees, the landlord alone decides whether the fee represents a reasonable cost.

The current position: conclusion

- 3.56 As a result of these undertakings, there have been some clear benefits to consumers. As far as we know, no landlords currently charge one fee on death and another on sale; nor do any impose a fee when a relative or carer moves in. Many people have found it easier to sub-let and more fees have been levied on purchase price rather than sale price.
- 3.57 However, the position is extremely complex. First, not all landlords gave undertakings, and the undertakings which were given had substantial differences.⁴⁰ In many cases, the undertakings relate only to “transfer fees” rather than to those with other labels, such as contingency fees, or service fees. Furthermore, the undertaking only applies where the developer or landlord retains the freehold – not where the developer or landlord has sold the freehold to someone else.
- 3.58 This complexity makes it very difficult for solicitors to advise purchasers on the effect of a fee. We have also been told of cases where developers themselves were confused about the effect of a fee, and demanded substantial sums several months after the property had been sold.

³⁵ OFT, para 6.12.

³⁶ See the undertakings given by Fairhold Homes and Hanover Housing Association. Hart also undertook that it will not include provision for the charging of a transfer fee in any new retirement housing it constructs, unless the fee is for a service and represents its reasonable costs. Previously, McCarthy & Stone had agreed not to include any transfer fees in leases after 1 September 2008.

³⁷ The OFT made clear at para 2.11 of its report that the retirement village type model (which offered extra care facilities) was not the primary focus of its investigation but that the general principles it had set out in Ch 8 of its report might equally apply to this model.

³⁸ This is now the First-tier Tribunal (Property Chamber) and was formerly the Leasehold Valuation Tribunal.

³⁹ Commonhold and Leasehold Reform Act 2002, sch 11 para 1, discussed at paras 5.73 – 5.82.

⁴⁰ The OFT highlighted in its report why it had not secured uniform outcomes, see OFT 1476 – February 2013, para 6.18. See also paras 3.42 – 3.45 above and Appendix B.

- 3.59 Following the OFT report, much of the debate has attempted to distinguish between different forms of event fees, even if some of these differences are a matter of drafting rather than substance. Below we focus on what all the different forms of event fees have in common, before arriving at a definition for the purposes of this project.

WHAT CHARACTERISTICS DO ALL EVENT FEE TERMS SHARE?

- 3.60 Whatever the label used, all the terms we have described above share certain characteristics. The term creates an obligation for the tenant to pay a fee. The fee is triggered by the happening of an event defined in the lease.
- 3.61 The most common triggering event is where title to the lease changes hands, but fees are also triggered by other events. For example, fees may be triggered by sub-letting, by a change in occupation or by granting a mortgage over the property. In the leases we have seen, the fee is calculated according to a formula of which one variable is the sale price, the purchase price or the open market value of the property, and the other is a percentage that may be fixed or may increase in a predictable way according to the length of time lived in the property. On this basis, we can begin to define an event fee for the purposes of our project.
- 3.62 This is a difficult exercise. We are aware that if we draw the boundaries too narrowly, developers may simply employ lawyers to draft new clauses to evade the controls. Although the event fees we have quoted all refer to a percentage of sale or purchase price, many concerns about event fees would apply equally to a high fixed fee, such as a £30,000 fixed fee for assistance with resale.
- 3.63 On the other hand we would not want to include the relatively small administration charges which are common in mainstream residential leases, where (for example) the vendor must pay the landlord £150 to provide information to a purchaser's solicitor. These fees are already subject to review under schedule 11 to the Commonhold and Leasehold Reform Act 2002.⁴¹

Defining an event fee

- 3.64 By an event fee we mean a term in a residential lease with the following characteristics:
- (1) It imposes an obligation for the tenant to pay a fee on the happening of an event, or in connection with an event defined in the lease.
 - (2) The event is where title to the lease changes hands; where there is a change in the occupancy of the property; or where some other event creates a third party interest in the lease.
 - (3) The fee is fixed (such as £10,000) or calculated in accordance with a formula in the lease (such as a percentage of the purchase or sale price of the property).

⁴¹ Commonhold and Leasehold Reform Act 2002, schedule 11 para 1, discussed at paras 5.73 – 5.82.

- (4) The fee is not an administration charge as defined in schedule 11 to the Commonhold and Leasehold Reform Act 2002, such as fees “for or in connection with the provision of information or documents”.
- 3.65 Where the landlord requires the tenant to pay for the landlord’s own estate agency service, this fee is included within the scope of the study, but only if the charge is mandatory.

CONCLUSION

- 3.66 Event fee provisions differ in their drafting and stated purpose, but all share some broad characteristics. Essentially, they are terms in leases which require each leaseholder to pay a significant amount on the happening of a defined event (such as sale or change of occupancy). The fee is typically expressed as a percentage of the purchase or sale price of the property.
- 3.67 In the next chapter we consider the criticisms made about such terms and the justifications given for them.

EMBARGOED

CHAPTER 4

THE PROBLEM WITH EVENT FEES

- 4.1 In this chapter we focus on the criticisms made of event fees and the arguments put in their favour. Event fees have attracted public anger. They have also been criticised by the Office of Fair Trading (OFT) for exploiting consumers' behavioural characteristics (or "biases") to distort competition. We start by illustrating this anger and by summarising the OFT's criticism. We also provide a brief introduction to the literature on behavioural biases.
- 4.2 We then describe three small research studies conducted for this project: a survey of conveyancing solicitors; a mystery shopping exercise; and an analysis of developers' websites. We were particularly interested to see how event fees were presented to prospective purchasers and whether purchasers were able to take the fees into account in their decision-making. Our research shows that consumers may only be told about event fees when they have made an offer, had it accepted and incurred costs. By then, it may be too late.
- 4.3 Despite the problems with event fees, we think that they may be justified in some circumstances. In particular, for consumers who are asset rich and income poor, they can be a way to make service charges more predictable and affordable.
- 4.4 Finally, we draw on all these materials to make an assessment of the advantages and problems of event fees as a way of paying for retirement housing. We do not think that event fees should be banned. However, much more needs to be done to make event fees transparent, so that purchasers understand their effect and build them into their decisions.

PUBLIC ANGER

- 4.5 As the quotes below indicate, event fees have received negative newspaper coverage:

Highly controversial (*The Guardian*);¹

A tax on the elderly (*The Daily Express*);² and

Fees, which can add to the distress of bereaved relatives when elderly residents pass away ... elderly, sick and vulnerable residents feel they are being condemned to worry and misery by the very people they trusted to provide them with a trouble-free home in their old age. (*The Daily Mail*).³

¹ P Collinson, "The Peverel tenants who are fighting back", *The Guardian*, 12 February 2011.

² M Frost, "Exit fee is a 'tax on elderly'", *The Daily Express*, 5 May 2015.

³ This Is Money, "Leasehold fees: the perils exposed by Peverel", *Mail Online (This Is Money)*, 11 May 2011, <http://www.dailymail.co.uk/money/mortgageshome/article-1722738/Leasehold-fees-the-perils-exposed-by-Peverel.html>.

- 4.6 A vocal grassroots activist movement, Carlex (“The Campaign Against Retirement Leasehold Exploitation”) campaigns against event fees, with supporters describing them as “simply a rip-off”, “wrong”, “absurd”,⁴ and a “stealth charge”.⁵

- 4.7 Letters to the Law Commission also reveal anger about these fees:

I just want to register my view that the agreement they are invoking constitutes an unfair contract and that I would be very grateful if you would consider outlawing this practice, which appears to [be] only motivated by the greed of the Landlords and has absolutely no benefit for the home owners and tenants of a retirement home.⁶

- 4.8 Another person sent us a copy of the complaint they made to managing agents:

These 1% charges that we had to pay to the Contingency Fund and for the Transfer are in our view disgusting and morally wrong. What right have you to prey on the elderly during the last few years of their lives, so that if they have to move out into a care home they are fleeced by you?⁷

Lack of clarity about the purpose of event fees

- 4.9 One cause of this anger is that people do not understand what the fees are for, or feel that they have been misled about their purpose. The daughter of a deceased resident said:

I have the original Purchaser Information Pack from [the developer]..... It states that a 1% fee is payable on resale, subletting or change of resident as “an administration fee”.... The PIP further states that “this payment includes the cost of ensuring that the terms and conditions relating to residents taking up occupation are complied with.....”

This is completely untrue and the current freeholder told me it undertook no checks on purchasers (other than age verification). It would not allow that the fee was in any way associated with “administration”, but was merely payable on resale, change of resident etc.⁸

- 4.10 Another lessee told us:

⁴ Carlex, “Sub-letting fees aren’t fair, and I’m not paying”, February 13 2012, <http://www.carlex.org.uk/sub-letting-fees-arent-fair-and-im-not-paying/>.

⁵ Carlex, “Exit fees: second response to Carlex from the OFT,” February 11 2012, <http://www.carlex.org.uk/exit-fees-second-response-to-carlex-from-the-oft/>.

⁶ Complaint received by e-mail, 7/1/15.

⁷ Complaint to Estates & Management Ltd, copied to the Law Commission 9/12/14.

⁸ Email from a member of the public (2015).

I was personally dubious at the time about the reason for the 1% transfer fee so phoned [the developer's] solicitor personally to ascertain the purpose. They confirmed it was for the work of 'checking the suitability of the incoming purchaser for independent living'. This was alluded to in the sales literature.

Following my father's death in 2010, the family sold the flat. By this time, [the developer] had sold the freehold to [another company]. However, [the other company] made no checks on our incoming purchaser, and I was informed the transfer fee was 'just a fee'. It wasn't a fee for a service at all.⁹

Payment on events other than sale

- 4.11 On some schemes event fees are triggered by events other than sale, such as sub-letting and mortgaging. These are a particular source of complaint. One person who contacted us explained that they had decided to let the property as they were unable to sell it.

I have paid one exit fee of over £1500 in order to sub-let and am still responsible for management fees and ground rent.¹⁰

- 4.12 Where sub-letting fees are payable on each sub-let, or are calculated as a percentage of the open market value of the property, the sums involved may appear large and disproportionate.

CRITICISM BY THE OFFICE OF FAIR TRADING (OFT)

- 4.13 In 2013, the OFT reported on its investigation of event fees. The investigation focused on transfer fees, but the OFT's reasoning applies to all event fees:

We consider that transfer fee terms are onerous given that typically they apply in wide ranging and surprising circumstances and there is no obvious advantage that the tenant receives in exchange for the fee, or any service that the landlord provides... Such fees... create a liability that is difficult for consumers to quantify, given that it is a percentage of a future unknown value... Their full effects were not flagged in pre-sale material. These fees therefore have the potential to operate as a trap for consumers, who may enter into the lease transaction without realising their full liability. Even where the consumer is aware of the existence of the transfer fee, we are concerned that behavioural characteristics of consumers may mean that they do not take account of the full cost in calculating the price they are willing to pay to purchase the retirement home property.¹¹

- 4.14 In other words, the following criticisms are made about event fees:

⁹ Email from a member of the public (2015).

¹⁰ Email from a member of the public (2015).

¹¹ OFT 1476 *OFT investigation into retirement home transfer fee terms*, a report on the OFT's findings, (February 2013) p 22.

- (1) The terms often come as a surprise: they may apply in unexpected circumstances and be higher than anticipated.
 - (2) Often the fees are not linked to any service which the landlord provides.
 - (3) The terms are not always transparent to consumers: the full effects may not be given prominence in pre-sale material.
 - (4) Even if consumers become aware of the terms, the terms may exploit consumers' "behavioural biases", which means that consumers do not take the terms into account in their decision-making.
- 4.15 We start by describing the way that terms may exploit behavioural biases. We then look at the evidence from our surveys. We were particularly interested to see how far these terms come as a surprise. How do consumers find out about the terms and how far are they flagged on websites and in pre-sale material?

BEHAVIOURAL BIASES

- 4.16 Traditionally, the law has assumed that consumers are rational economic actors, who, when presented with the right information, make rational decisions about what to buy. The issue, therefore, is one of providing consumers with the right information, in the right way, at the right time.
- 4.17 Over the last ten years, however, a growing body of economic literature suggests that consumers display "behavioural biases", which lead people to make "predictably irrational" decisions.¹² These behaviours apply to all consumers, not just those who are vulnerable through age or ill-health. However, behavioural biases have particular application when consumers make complex decisions under stress. As we saw in Chapter 3, many people only move into specialist housing following a stressful life event, such as a bereavement or accident.
- 4.18 Of all the ways in which humans may be led to make irrational decisions, three particular tendencies are observed in a range of different settings, and are particularly relevant to event fees. These are: an undue focus on the present; over-confidence; and aversion to losing sunk costs. We consider each in turn.

Undue focus on the present

- 4.19 As a study for the OFT puts it, "consumers never like to incur pain immediately but are always keen to have pleasures now".¹³ They therefore put more weight on a price that must be paid immediately, and less weight on a price that need only be paid in the future.

¹² D Ariely, *Predictably Irrational: The Hidden Forces That Shape Our Decisions* (2008). For discussion of how this affects consumer behaviour, see OFT1324 (May 2011): *Consumer Behavioural Biases in Competition*, a report by S Huck, J Zhou and C Duke; M Armstrong and J Vickers, "Consumer Protection and Contingent Charges" (2012) *Journal of Economic Literature* 50:2, 479; DG SANCO (2010): *Consumer Decision-Making in Retail Investment Services: A Behavioural Economics Perspective*, a report by N Chater, R Inderst and S Huck.

¹³ OFT1324 (May 2011): *Consumer Behavioural Biases in Competition*, a report by S Huck, J Zhou and C Duke p 25, para 3.34 citing S DellaVigna and U Malmendier "Paying not to go to the Gym" (2006) *American Economic Review* 96(3) 694.

- 4.20 This is often referred to as “hyperbolic discounting”, or excessive discounting of future costs.¹⁴ Consumers tend to put too much weight on the upfront cost of the property and too little weight on event fees payable when the property is sold. To someone caught up in the process of buying a home, the prospect of selling that home appears a distant event, the costs of which are discounted.

Over-confidence

- 4.21 An insight from behavioural economics is that consumers tend to think that they can handle their lives better than they actually can.¹⁵ This optimism leads them to think that they will go to the gym more often than they actually do, and that they will seek unauthorised overdrafts less often than they do.
- 4.22 Similarly, when consumers move into retirement housing they are likely to imagine a rosy future, in which they remain happily in the property for the rest of their lives. They will find it difficult to envisage (for example) that their health will deteriorate to the point where they might need to move to a care home. Even if this crosses their mind, they may prefer not to dwell on the possibility.
- 4.23 In fact, the evidence suggests that event fees are often triggered while residents are still alive, but need to sell – either because family circumstances change, or because they need to go into residential care. Exact figures are hard to obtain but based on a “reasons for sale” survey by the largest managing agent of retirement housing, the proportion of properties sold while the resident is still alive is somewhere from 32% to over 50%.¹⁶ Natural human confidence means that consumers tend to under-estimate the likelihood of such a move.

Loss aversion to sunk costs

- 4.24 Once consumers have invested time and effort into finding a product, they are often reluctant to walk away if unappealing terms and conditions are revealed late in the buying process. An example is where a consumer is attracted to a cheap airline ticket, which is revealed to be much more expensive by the end of the booking process after the emergence of additional charges. By then, consumers feel committed to the product and will continue to buy, even if the original reasoning behind the purchase has been shown to be inaccurate.

¹⁴ For an introduction to this complex issue, see Ted O'Donoghue and Matthew Rabin (1999) "Doing It Now or Later", *American Economic Review*, 89(1): 103-124.

¹⁵ S DellaVigna and U Malmendier "Paying not to go to the Gym" (2006) *American Economic Review* 96(3) 694.

¹⁶ *Offering Circular of Fairhold Securitisation Limited*, April 2007, 4.10, 83, http://www.ise.ie/debt_documents/FAIRHOLD%20SECURITISATION%20LIMITED_6586.pdf. The lower estimate is the sum of “Nursing care admission” (21%) and “Voluntary” (11%) reasons for sale; higher estimate takes into account “Others” (14%) and the fact that some “Disposals” (34%) may not be related to deaths, although most are. By contrast, “Death or inheritance” is given as the direct reason for just 20% of sales. For extra care housing the figure would be much lower because care provided on site makes it less likely that residents will have to move out before death.

- 4.25 The same disinclination to abandon a purchase may occur during the process of buying a retirement property. Typically, consumers only discover the event fee during the conveyancing process: by then, they feel emotionally and financially committed to the property and will proceed with the purchase, even if the original reasoning behind the purchase (based on the lower headline price) has been shown to be inaccurate.

Behavioural bias: effect on competition

- 4.26 These behavioural biases, taken together, may distort purchasing decisions. A lower upfront price coupled with an event fee may be perceived, wrongly, as a better deal than a slightly higher priced property without an event fee. This may lead to a “race to the bottom”, where all developers use event fees, so as not to be at a competitive disadvantage.
- 4.27 Below, we draw on evidence provided by a survey of conveyancing solicitors to see if these biases have an effect in practice.

OUR SURVEY OF CONVEYANCING SOLICITORS

- 4.28 With the assistance of the Law Society Land Law and Conveyancing Committee, we sent a questionnaire to conveyancing solicitors with experience of this issue. We are very grateful to the Committee for their help.
- 4.29 We received 50 responses. Here, we summarise the main findings. A full description of the survey is set out in Appendix B. For these purposes, we refer to all event fees by their traditional title, “transfer fees”, since it is more familiar to solicitors, even though strictly speaking a transfer fee is only one kind of event fee.

Finding out about the term

- 4.30 Most solicitors (77%) said that purchasers only found out about transfer fees when they were told about them by their conveyancer. Other solicitors (23%) said that clients may be told about them by estate agents or the developers’ sales teams.

Depends on the transaction - for a new build it should be made known from the moment a tenant expressed interest.¹⁷

- 4.31 However, the earlier communication was not always effective:

It is lost in the middle of a glossy brochure if at all; moving on is the last thing they are focusing on when buying.¹⁸

- 4.32 Conveyancers are under a duty to inform purchasers of adverse terms. All the solicitors in our study said that they did this. However, some pointed out that conveyancing is now often a routine on-line process, without face-to-face contact or detailed advice:

¹⁷ Law Society Survey, para 1.19.

¹⁸ Above, para 1.20.

Clearly a solicitor ought to warn clients about the fees. Unfortunately conveyancing is low margin work at many firms, and often carried out by unqualified paralegals.¹⁹

"Factory" (on-line) mass-conveyancing firms are the worst offenders in not providing proper, detailed advice.²⁰

- 4.33 The majority of the solicitors in our study said they would mention the term verbally to their clients (62%); others would highlight it in their written report (21%). However, some would include it in their written reports without necessarily highlighting it (21%).

The effect on decision-making

- 4.34 One problem is that the information may come too late to make any difference to the purchaser's decision. The great majority of respondents (83%) said that the presence of an event fee made no or very little difference to the decision whether to buy. Clients already felt committed to the purchase, having made an offer which was accepted and paid costs (such as surveyors' or solicitors' fees).

- 4.35 By the time the event fee is disclosed, the client is unlikely to allow it to derail the purchase process:

It did not factor particularly highly on the client's decision making.²¹

They take the information on board and proceed with the purchase in any event.²²

- 4.36 Furthermore, clients may not feel that they had an alternative:

Most of them consider they have no choice... they have made a decision to move into sheltered accommodation and payment of the transfer fee is a necessary evil.²³

Almost invariably clients just accept them reluctantly as part of the deal and apparently an endemic abuse in leases of retirement flats.²⁴

- 4.37 Finally, clients discounted the fee on the grounds that they did not anticipate selling during their lifetime:

They usually tell me it is not a problem as they won't be paying the fee because the flat won't be sold until they are dead!²⁵

¹⁹ Law Society Survey, para 1.68.

²⁰ Above, para 1.68.

²¹ Above, para 1.33.

²² Above, para 1.33.

²³ Above, para 1.28.

²⁴ Above, para 1.29.

²⁵ Above, para 1.30.

- 4.38 This suggests that the biases predicted by behavioural economics do have an effect in practice.

Complaints about event fees

- 4.39 The lack of effect on decision-making does not mean that leaseholders accept event fees. The overwhelming majority of solicitors said that their clients complain about them (89%), particularly when they come to sell (73%).
- 4.40 The reaction to an event fee depends on whether the sale is conducted by the leaseholder themselves, or following their incapacity or death.

Mostly clients who are themselves selling remember the explanation given to them. However, typically sales occur after death or incapacity of clients and the personal representatives or attorneys may not know and usually are unhappy about such provisions.²⁶

Complaints from tenants

- 4.41 Most solicitors (68%) thought that original purchasers were not surprised at having to pay a fee. However, purchasers may be surprised by the amount of the fee.

They are usually aware that they will have to pay but in a rising market are often staggered by the amount and the fact that they have not had the benefit of the money.²⁷

- 4.42 Others may have forgotten:

They say that they've forgotten about it. They react with alarm and are unhappy, but normally know about it but have forgotten.²⁸

- 4.43 Even leaseholders who remember being told about the event fee may complain at having to pay the fee. The main complaints were that it was unfair – either because it was excessive; or because it was levied for no reason, or because it affected some more than others:

If [the fee] is genuinely applied towards amenities on the development, it's not so bad, but I have seen cases where it is paid to a company which has no interest in the development whatsoever, which seems to me to be wrong.²⁹

²⁶ Law Society Survey, para 1.44.

²⁷ Above, para 1.41.

²⁸ Above, para 1.43.

²⁹ Law Society Survey, (available on the project page of the Law Commission website). (Unpublished response to Question 8(c)).

If one flat in a retirement block is sold many times more than another flat the first one's owners will have paid much more in transfer fees, yet derived no equivalent benefit, in effect subsidising the other tenants where (if that is the case) the fee is paid into the service charge fund.³⁰

Complaints from the tenant's family

- 4.44 Three quarters (75%) said that family members were usually surprised by event fees. As one solicitor put it:

The client who purchased is usually dead or in hospital or some form of residential care and often being represented by executors, attorneys or family members who because of the circumstances have a lot on their plate. Most will be unaware of the provision and think it unreasonable but accept it because they want the property to be sold.³¹

- 4.45 Family members may see event fees as exploiting a vulnerable group:

It is seen as a particular "rip-off" exploiting elderly clients in retirement flats.³²

- 4.46 More needs to be done to make buyers and their families aware of event fees, so that they can plan their finances accordingly and are not taken unawares by event fees at a vulnerable time.

Challenging event fees

- 4.47 Although it is common for clients to complain about event fees, it is rare for solicitors to challenge or dispute the term. Most solicitors thought that any challenge to an event fee was likely to be futile:

To what end? They are all enforceable and the clients always receive legal advice before they enter into these contracts.³³

They [the landlords] rely on the lease and won't debate the point.³⁴

- 4.48 Even the minority of respondents (21%) who had ventured to dispute an event fee tended to meet with outright rejection from the landlord. This was the case both on sale and prior to purchase.

Only when buying new from the original Lessor, to try to persuade them to remove the provision. I have never succeeded!³⁵

³⁰ Law Society Survey, para 1.51.

³¹ Above, para 1.45.

³² Above, para 1.52.

³³ Above, para 1.54.

³⁴ Above, para 1.54.

³⁵ Above, para 1.56.

I have challenged these fees on several occasions but the landlord has always refused to agree any reduction.³⁶

- 4.49 Where the circumstances of the case were unusual, solicitors had a little more success in disputing the charges. The OFT investigation also seems to provide some assistance when fees are charged on short-term lets:

On behalf of executors who could not sell a retirement flat and wished to let short term. Landlord wanted to charge full transfer fee on each new tenancy agreement. Extracted a concession that a minimal administration fee would be charged (but subsequently discovered that the Office of Fair Trading were putting pressure on the landlord/agents concerned at the time and this is now a routine measure).³⁷

- 4.50 However, in other cases, freeholders have taken a firmer line:

I referred the freeholder to the OFT view that such provisions were unfair, but this was dismissed by the freeholder as not a view they shared and on the basis that they were not a party to any undertakings given to OFT. Elderly clients or their attorneys or personal representatives normally have little taste for litigation or incurring fees in such disputes, so the matter has ended there.³⁸

Solicitors' views on what should be done

- 4.51 Finally, we asked solicitors about how prospective purchasers could be made more aware of event fees. Most (62%) thought that estate agents or developers' sales agents should do more to tell people about the terms.

The estate agents need to up their game on this. We have problems with people never having been told about transfer fees.³⁹

It should be a requirement that any transfer fee is disclosed by the selling agent at the outset - it should be stated in all advertising.⁴⁰

- 4.52 Others suggested that managing agents, landlords or conveyancers could do more. However, a minority of solicitors suggested that event fees should be banned altogether:

The real solution is to make such fees unlawful and to give the right to reclaim any such paid in the last 6 years.⁴¹

³⁶ Law Society Survey, para 1.56.

³⁷ Above, para 1.58.

³⁸ Above, para 1.59.

³⁹ Above, para 1.62.

⁴⁰ Above, para 1.64.

⁴¹ Above, para 1.70.

Conclusion

- 4.53 It is rare for event fees to put purchasers off buying, particularly as many people do not find out about the fee until after they have made an offer, had it accepted and incurred costs. By then, they are emotionally committed to buying and unlikely to focus on problems which will only arise when they come to sell.
- 4.54 Sellers often think that event fees are unfair, but are unlikely to mount a legal challenge. As discussed in Chapters 5 and 6, the law is too complex. Furthermore, sellers are also focused on their immediate problems, such as coping with incapacity or bereavement. They have little appetite for litigation.

OUR MYSTERY SHOPPING EXERCISE

- 4.55 One of the main criticisms about event fees is that consumers find out about them too late to take them into account in their decision-making. We therefore commissioned a small-scale mystery shopping exercise.
- 4.56 The mystery shopper visited six retirement properties, noting what was said about event fees during the visit and in subsequent follow-up conversations. We were interested in what information was given spontaneously; and what information was given when the shopper specifically asked about charges (including event fees). We then checked the information given against a copy of the lease obtained from the Land Registry.

Lack of information from conventional estate agents

- 4.57 New properties are bought from developers and extra-care housing is normally sold through the scheme operator. However, many resales of retirement housing are conducted through conventional estate agents. The research highlights how little information non-specialist estate agents know or pass on to purchasers about retirement housing.
- 4.58 Out of the six properties visited, four were re-sales through conventional estate agents (Properties 3, 4, 5 and 6). In none of the four cases was the mystery shopper given accurate information about the event fees.

Property 3

- 4.59 This was a flat in a block of 44, served by a communal lounge, laundry and guest suite, with a 24 hour alarm system. Although the firm claimed to market a lot of retirement properties, the agent appeared to be seriously under-briefed about many aspects of the property. The shopper reported:

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.

- 4.60 Follow-up calls failed to elicit any more information about event fees:

I rang the estate agent's office and again asked for a copy of the lease, and details of any other charges I thought might have been overlooked. Was there, for example, any ground rent to pay? While I received answers to the specific questions I asked, there was no response to my request for a copy of the lease and no information about any charges payable on resale.

A fortnight later, I rang and again asked to see the lease. The estate agent said, *that's usually held by the solicitor*. The estate agent said there were *no nasty covenants or anything*. *When you have agreed a price your solicitor will want to ask for the lease*.

Property 4

- 4.61 This was a one bedroom apartment in a recently built block of sheltered housing. It was being sold by the current owners who had lived there for about 18 months. By contrast with Property 3, the agent appeared competent and on top of his brief. Nevertheless, the agent also failed to mention anything about event fees.

I was shown around the flat by the estate agent and the current resident.

There was discussion of service charges and ground rent, although there was some confusion over both of these. However, the contingency fee (1% of proceeds of sale of the apartment, payable to the developer, not the service company, on resale) had not been mentioned, so I asked the agent specifically on the way out. He was not sure as to whether there was one, but thought not. I asked him to check....

A woman from the estate agent phoned me after the visit to gauge my interest.... I asked her about the fee which might be payable on resale. She was surprised to hear of such a thing but said she would check. She has not got back to me.

Properties 5 and 6

- 4.62 Our mystery shopper was taken around both these properties by the same estate agent. No information was given spontaneously about event charges. In one, the shopper had the opportunity to talk to the scheme manager, who was well informed about the property generally, but did not mention fees on resale. At the end of the visit, the shopper asked the estate agent specifically about charges.

Having been shown both properties, I stressed to the agent that I was anxious to know all the charges that attached to each property. There had been no mention of a transfer or contingency fee. I asked the agent directly and he said, *no. None*. As an afterthought, he said, *oh, unless [the developer] - not these guys [ie the service company] - I think they may take 10% of what it sells for. I'll check. It's not like that on [the first development] but they may have added it in here*. He said he would check the position for both. This really reflects the lack of information the estate agent had.⁴²

- 4.63 The mystery shopper then followed up on the telephone, and was again misinformed.

When the estate agent did not get back to me about the event fees, I rang to ask. On the line, he told me that there was a 10% transfer fee on Property 6 and none at all on Property 5. According to the leases, he was wrong about both properties. There is in fact a 1% transfer fee (not ring-fenced for anything in particular) and a 1% contingency fee (ring-fenced for service provision and upkeep of the buildings) on both Property 5 and Property 6.⁴³

How far are these experiences typical?

- 4.64 This was a small study and we were keen to understand whether it reflected the market as a whole. We therefore sent the full report to our advisory panel of consumer and industry representatives. Panel members said that these findings chimed with their own understanding of the market:

The mystery shopper exercise appears to confirm some of what we already know about the confusion around exit fees.⁴⁴

Estate agents are not, on the whole, familiar with the concept [of specialist housing] and its offering or of selling to elderly buyers that need more than bricks and mortar.⁴⁵

[This] is, unfortunately, likely to be fairly reflective of the experience that many people face when enquiring about leasehold retirement properties.⁴⁶

- 4.65 One problem is that estate agents act for the vendor, not the developer or operator. The person selling the property may not know about the event fee, or may have forgotten about it. They may be suffering from dementia, or may have died. They are therefore not in a position to provide the estate agent with reliable information. As we discuss in Chapter 8, developers and managing agents are currently under no obligation to give information to estate agents at this stage.

⁴² Mystery Shopping Report, (available on the project page of the Law Commission website).

⁴³ Above.

⁴⁴ Email from panel member, 16.04.15.

⁴⁵ Email, May 2015.

⁴⁶ Email from panel member, 14.04.15.

Sales of retirement property by specialist sales teams

- 4.66 When retirement property is sold by a developer's sales team or a specialist retirement sales agency, more information is made available to consumers. However, even here, the experience is patchy. The mystery shopping exercise found one example of good practice from an extra-care development, where the consumer was both told about the charge and given written materials about it. In the second case, however, a developer appeared to be selling properties off-plan before finalising their fees and charges.

Extra-care housing on sale from the developer

- 4.67 This was an upmarket flat in a retirement village. The event fees were relatively high: between 3% and 18%, depending on the options selected and length of time the resident has lived in the property. In this case, a specialist sales agent was able to explain the event fee and provide written information, including a worked example.

Retirement housing sold off-plan by the developer

- 4.68 Here the development was still being built and details of the charge structure did not appear to have been finalised.

When I asked about service charges, the sales person told me they were not allowed to give the price out at that stage, but did give me an estimate.

Nothing was said about event fees. When I asked, she said she understood that there was a one percent charge though this was not actually laid down. I understood that there were no other charges.⁴⁷

- 4.69 However, the information given by the sales person did not match up with the printed materials the mystery shopper received. The printed material indicated that a fee would be payable on sale as a contribution to the sinking fund, which would be based on a surveyor's annual estimate of what was needed for upkeep of the buildings. Effectively, the amount of the contribution would be calculated and billed each year, but the annual contributions would only become payable all together as an event fee triggered by resale. However, when the mystery shopper rang for clarification, the sales person repeated that there was a 1% fee payable on resale.

- 4.70 To clarify the position, one would need to see the lease, and for this, the purchaser would need to pay a deposit of £1,000:

I rang to chase up about the lease. The sales person said she had enquired about it but still did not have a copy herself. She said it was not generally available until a client had actually reserved. This required a deposit of £1,000. She said that *solicitors don't like giving them out. Our solicitor will talk to your solicitor when you have made the deposit.*

⁴⁷ Mystery Shopping Report, (available on the project page of the Law Commission website).

- 4.71 As no leases had yet been registered, it was not possible to clarify the correct position by obtaining one from the Land Registry. However, a lease from the same developer at another site had two separate event fees. There is both a transfer fee of 1%, which is not ring-fenced, and a sinking fund fee of 1% which is ring-fenced for the provision of services and upkeep of the site.
- 4.72 This experience may not be typical of new developments more generally. It is, however, concerning that a developer can demand a £1,000 deposit before providing full details of their fees and charges.

DEVELOPERS' WEBSITES

- 4.73 Our third research report is an analysis of the websites of eight developers and operators. We asked our mystery shopper to go through these websites to see what information is made available to potential purchasers, and how easily a prospective purchaser could find information about event fees. The report concludes:
- (1) It is quite possible to design a complex website that is attractive, easy to navigate and informative. In this survey, this was best demonstrated by Retirement Villages Group. Churchill / Millstream and Audley were also clear about their charges.
 - (2) Other sites were harder to use because the emphasis was on being a shop window in which the seller did not want high fees to be too prominent.
 - (3) There was often considerable emphasis on the positive aspects of event fees. They were represented as providing security against unexpected costs; as maintaining the value of the property; or as causing no worry to the resident since they would automatically come out of the sale of the property.
 - (4) In many cases, the reader had to be pretty persistent in order to find all the fees, and alert to a tendency to distract from them.
 - (5) Two websites gave such limited information that it was impossible to tell whether there were any event fees or not.
- 4.74 One problem was that event fees went by a variety of names, including Deferred Management Fee, Contingency Fee, Assignment Fee, Sinking Fund Fee, Transfer Fee and Exit Fee. This could be extremely confusing. For example, one website reassured purchasers that it did not charge an assignment fee, only to mention later that "upon resale of the property a 4% fee was paid into the sinking fund". Another site mentioned a "sales administration fee of 2%". This was separate from the description of the deferred management charge of 1% per year of occupation, capped at 15%.

- 4.75 We accept that the money raised by differently named fees may be spent in different ways. For example, the distinction drawn between these fees may aim to reflect the fact that an “assignment fee” would be a pure income stream for the developer and a “sinking fund fee” would go into a trust for long-term upkeep of the buildings. Nevertheless, consumers with no experience of the specialist housing sector are likely to be unaware of these distinctions. Therefore, if a developer states that they do not charge one type of event fee, a consumer could be led to believe that they also do not charge any of the others.
- 4.76 In some cases, leaseholders may be liable to pay one fee to the developer and another to the managing agent. The report comments that the relationship between the developer and the managing agents may be particularly difficult to tease out.
- 4.77 Unfortunately, one developer had a particularly challenging website. Although it included a “list of charges related to sale”, it could take 13 separate clicks to reach this page. Understanding the full picture may involve 17 clicks. The information was not readily accessible to older readers, who may have less experience, stamina or eyesight to contend with such intricate sites.
- 4.78 Some sites give the impression of an industry which is not fully committed to fee transparency. A member of our advisory panel added:

I would be stunned if any lay person were able to keep up without some considerable research... I can see ten different terms for costs that would be incurred or that the resident would be liable to meet.⁴⁸

ARGUMENTS IN FAVOUR OF EVENT FEES

- 4.79 Despite the lack of transparency in the sales process, event fees may have some advantages for older residents who have more capital than income. As we saw in Chapter 2, specialist housing offers many benefits to residents in terms of health and wellbeing. However, some consumers may struggle to afford it. The All Party Parliamentary Group (APPG) on Housing and Care thought that deferred payments may have a role to play in offsetting both the initial purchase price and service charges.

Event fees as a deferred purchase price

- 4.80 In Chapter 3, we saw that “low equity” owner occupiers may struggle to afford a suitable property. There may not be enough money left over from the sale of their old house to buy a specialist property, once the mortgage has been paid off and stamp duty and other moving costs have been met.
- 4.81 The All Party Parliamentary Group (APPG) on Housing and Care concluded:

⁴⁸ Email, 14.04.2015.

Shared ownership, and other ownership options and payment plans – such as lifetime leases, deferred payment plans, shared equity and so on – which enable low equity owner occupiers to purchase retirement properties need to be made more available.⁴⁹

4.82 The Group drew attention to a deferred payment plan offered by Churchill, which enabled older people to pay up to £40,000 of the original purchase price of their retirement home when they sell or die.⁵⁰

4.83 As they are currently used, event fees are not necessarily seen as a form of deferred purchase price. The OFT noted:

We have not seen any convincing evidence to substantiate the contention that purchasers have received an upfront discount on the purchase price.⁵¹

4.84 Furthermore, event fees do not affect only the original leaseholder. Instead, they run with the lease: they must be paid by the first purchaser and all subsequent purchasers. This means that once the first purchaser comes to sell, the lease may be worth less than originally thought. If event fees are part of a deferred purchase price, the first purchaser is effectively forced to offer a deferred purchase price to the subsequent purchaser, who pays an event fee not to the first purchaser but to the landlord.

4.85 However, given the problems with the supply and affordability of specialist retirement housing, we agree that creative solutions are needed. It would be dangerous to impose a blanket ban on payments on sale, which could prevent new and more innovative ways to defer payment of some part of the purchase price until the property is sold.

Event fees as deferred service charges

4.86 Inevitably, specialist retirement housing has high service charges, which must cover not only maintenance of the property but also the cost of cleaning and maintaining the communal amenities. In some cases, it will also pay for a manager or other staff.

4.87 Older residents on fixed incomes may be very concerned about these charges, particularly if they are unpredictable and outside their control. The APPG noted that:

the affordability issue was less about ‘can I afford to move here?’ and more about ‘can I afford to stay here?’⁵²

4.88 The APPG recommended that:

⁴⁹ *The Affordability of Retirement Housing*, an inquiry by the All Party Parliamentary Group on Housing and Care for Older People (November 2014), p 39.

⁵⁰ Above, p 35.

⁵¹ OFT 1476 – OFT *Investigation into retirement home transfer fee terms* (February 2013), para 5.19.

⁵² *The Affordability of Retirement Housing*, an inquiry by the All Party Parliamentary Group on Housing and Care for Older People (November 2014), p 30.

More sophisticated arrangements – as in some other countries – for deferring some service charges until the property is sold should also be made available more widely.⁵³

4.89 They noted that deferred charges were widely used in New Zealand.⁵⁴ In Chapter 9, we look in more detail at the use of deferred charges in retirement communities in the United States, Australia and New Zealand. Deferred charges are common: the amount is not regulated, but many jurisdictions do have regulations to ensure that the charges are transparent.

4.90 In England and Wales, deferred service charges are widely used in the retirement village sector, where the high levels of service would otherwise be unaffordable by people on fixed incomes. In this sector, high event fees are common – sometimes up to 30%. In return, residents are offered the reassurance of a cap on current service charges. On our visits to retirement villages, residents explained that they were fully aware of these fees, which represented an attractive option for them.

4.91 The Associated Retirement Community Operators (ARCO) provided several examples of the way that deferred service charge payments of sale were an effective way of making service charges predictable and affordable. The figures they gave us show that in some cases, without a fee on sale, the service charge would more than double.⁵⁵ For example:

One operator uses an event fee of 30% of the sale price or 20% of the sale price plus a 50/50 split of the equity uplift on sale. The current monthly service charge is £520. However, without an event fee, this would need to increase to £1,461: an increase of 182%.⁵⁶

Another operator charges £375 a month. However, without event fees it would be £701 per month, an increase of 87%.

A third operator uses an event fee of 1% of sale price per year of occupancy. The current service charge is around £700 a month. Without the event fee it would be £1,116, an increase of 59%.⁵⁷

4.92 Those illustrations are at the higher end of the market where the properties are expensive and the service charges high, but another example from a charitable operator provides similar evidence.

⁵³ *The Affordability of Retirement Housing*, an inquiry by the All Party Parliamentary Group on Housing and Care for Older People (November 2014), p 7.

⁵⁴ Above, p 35.

⁵⁵ See para 4.102.

⁵⁶ This is based on an eight year occupancy period.

⁵⁷ Source: ARCO.

For long term maintenance, the charity charges an event fee of 1% of the purchase price per year of residency, capped at 10%. To cover the service charges, there is also a compulsory resale to the operator at the original purchase price, with any equity growth going to the operator. The current service charge is £258 per month. Without these arrangements, the revised monthly charge would be £875, an increase of 239%.

- 4.93 Although these figures can only be regarded as estimates, it is clear that without event fees, the impact on service charges would be substantial. In many cases it would make the housing unaffordable, especially for people of limited means on fixed incomes.

Event fees as an income stream for developers

- 4.94 Even if event fees are not specifically marketed as a form of deferred purchase price, those which are not put into a ring-fenced trust fund still contribute to developers' income stream. Developers of specialist housing find it more difficult to raise funds than mainstream housing developers.

As a restricted sector it is seen as more risky and this has meant development funding has been in short supply and more expensive.⁵⁸

- 4.95 Before the OFT report, many developers used the income stream from event fees to raise finance from banks. For example, one developer (Fairhold) made a public bond issue backed by income streams from its freehold portfolio, including event fees.⁵⁹ Others offered event fees as security to banks and other lenders.
- 4.96 Since the OFT report, this has been more difficult. The legal uncertainties concerning the validity of event fees have made banks unwilling to lend against them.⁶⁰ This has acted as a block on building more retirement housing. However, even if event fees are not used as a vehicle for secured borrowing, they still represent a flow of money into a specialist housing scheme which can be used for capital investment. As a consultant to the industry put it:

The event fee in particular is a mechanism, not entirely specific to this sector, but one that has been adopted to allow an increased return to investors over a long period, for the continual upgrade of facilities and to produce a return to make the sector sufficiently attractive when compared with investing elsewhere.⁶¹

⁵⁸ I Lock, *Age Restricted Housing models with and without Care* (May 2015), para 5.1.

⁵⁹ Above, para 5.1.

⁶⁰ Above, para 5.2.

⁶¹ Above, para 4.6.

- 4.97 Where developers are already operating on the basis of event fees, any retrospective change to these arrangements could be extremely disruptive. It could reduce the money available to maintain and upgrade the development, leading to less attractive housing, which residents find difficult to sell. For future sales, developers would be able to react to controls on event fees by charging in other ways, either by increasing the purchase price or the fees payable during occupancy. A reduction in event fees is likely to lead to higher charges elsewhere.

CONCLUSION

- 4.98 Our view is that event fees are not necessarily unfair. However, as the OFT argued, human behavioural characteristics mean that consumers find it difficult fully to appreciate their effect when they buy a property. Sophisticated consumers might find it difficult to understand the effects of some event fees even if the fees are reasonably transparent. Yet many of those buying retirement properties are not sophisticated: instead they are struggling to take in a great deal of complex information at a highly stressful time. And in many instances, event fees are very far from transparent. Our mystery shopping exercise revealed some shocking examples of failure to tell prospective purchasers about event fees.

Are some event fees more problematic than others?

- 4.99 When we started this project, we had assumed that higher fees would be more problematic than lower ones. This is not necessarily the case. We have seen examples of 30% fees which are explained clearly to purchasers, both in face-to-face discussions and in writing. Purchasers then have the chance to discuss them with their families and make informed decisions. Higher fees are less likely to “slip under the radar”. Any deal which involves parting with 30% of the value of one’s home is so obviously important it tends to focus consumers’ attention.
- 4.100 Much of the public criticism has been aimed at smaller, cumulative charges. Purchasers are unlikely to pay much attention to a 1% transfer fee, or a 2% administration fee, or a 1% contingency fee. However, when they come to sell a flat for £500,000, and are hit by a surprise fee of £10,000 for no reason apparent to them, they may feel misled. They may also fail to appreciate the likely size of a charge fixed at 1% per year of occupancy. On a £500,000 flat, after 15 years, this would amount to £75,000. These charges need to be made much more transparent.
- 4.101 There are also particular problems with fees payable on events other than sale, such as letting or mortgaging. Purchasers who have no intention of letting their home are unlikely to pay any attention to the issue. However, if the purchaser needs to enter residential care, and the property proves difficult to sell, a short-term let may then seem like an obvious solution. It seems wrong to charge fees based on the market value of the property to those who have not realised this market value.

The purpose of the event fees

- 4.102 Much of the discussion about event fees has focused on the justification given for the fee. Faced with criticisms of “pure” transfer fees, paid for no particular purpose, developers have rewritten the terms to link the fee to a service, such as help with sales.
- 4.103 It is true that event fees are easier to explain if they can be linked to a particular service. However, in the end, the totality of the resident’s payments are made in exchange for the totality of services. The justification given for each fee may not necessarily be central to its economic role.

The need to maintain confidence in the sector

- 4.104 Some of the ways in which event fees are used within retirement housing risk bringing the sector into disrepute. They are seen as exploiting vulnerable elderly residents and have been labelled as “wrong” and “a rip-off”. As we saw in Chapter 2, the market for retirement housing is still not fully established, and cautious, older consumers could easily be deterred by negative publicity.
- 4.105 In Chapters 11 and 12, we propose an amendment to the law of unfair terms to curb unfair event fees and detail ways in which the industry can work together to ensure that they are more transparent.

CHAPTER 5

LANDLORD AND TENANT LAW

- 5.1 The previous chapters have set out how event fees work and the problems they cause. The next three chapters look at the law that applies to them.
- 5.2 The law is particularly problematic as leases operate both as contracts and as property rights in land. This means that terms in leases are subject to land law, which regulates the relationship between landlords and tenants. They are also subject to the law applying to consumer contracts. In this chapter, we concentrate on landlord and tenant law. Chapter 6 looks at the law on unfair terms in consumer contracts, and Chapter 7 explains the requirement to provide price information under the Consumer Protection from Unfair Trading Regulations 2008.
- 5.3 Here we start by explaining the nature of a lease. We then look in more detail at how the obligations under a lease may be enforced against the first leaseholder (or “tenant”) and against any subsequent tenant who acquires the property.
- 5.4 Leases often require tenants to pay variable service charges, administration charges and fees for granting consent. These charges have the potential to surprise and disadvantage tenants. Therefore, the law has stepped in to ensure that such charges are reasonable. We provide an introduction to how service charges, administration charges and fees for giving consent (where consent to do something is required by the lease) are regulated. We explain that this regulation does not apply to the majority of event fees.
- 5.5 Finally, the Office of Fair Trading (OFT) suggested that the Scottish controls on “casualties” may be an appropriate model for reforming the law on event fees in England and Wales. We therefore look briefly at the Scottish provisions.

THE LEGAL NATURE OF A LEASE

- 5.6 A long residential lease is usually defined by statute as being one granted for a term in excess of 21 years¹ and for which a premium is paid.²
- 5.7 Many of those who purchase specialist housing will previously have owned freehold property, so becoming a tenant will be a new and unfamiliar experience. The purchase price of a lease can be similar to the cost of buying an equivalent freehold property, and this may encourage a belief that there will be little change. New tenants may not fully appreciate the implications of the fact that they do not acquire absolute ownership and are subject to the terms of the lease.³

¹ For example, in sch 10 of the Local Government and Housing Act 1989, para 2(3).

² The premium is the purchase price. In commercial leases, the terms we are concerned with are regulated by the common law.

³ See para 5.38.

- 5.8 Leases can be complicated legal documents. They set out the express terms that regulate the relationship between landlord and tenant and usually cover a broad range of issues.⁴ The terms in a lease are referred to as covenants.⁵ Event fee terms are one of the covenants in a lease.
- 5.9 Another factor that adds to complexity is that leases have a dual nature. A lease is a contract but it also creates “an estate in land”. This has legal consequences both for the original parties to the lease and for subsequent purchasers or other future owners (such as heirs).⁶

The lease as a contract – “privity of contract”

- 5.10 The original landlord and tenant enter into a contract.⁷ In English law, the parties generally have freedom to contract as they wish, but for residential leases this is subject to a framework of regulatory statutes.
- 5.11 The lease creates a contractual relationship between the landlord and the tenant which continues until the lease expires or is brought to an end. At common law, the original parties remain liable to perform their contractual obligations and can enforce them against each other, even if they dispose of all their interest in the lease to someone else.⁸ However, in English law there is no contractual relationship between successors to the original parties because they were not party to the contract when it was made.
- 5.12 In English contract law, the general principle is that only the original parties to a contract can enforce it against each other, referred to as “privity of contract”. That said, in leases successors in title are entitled to enforce some covenants through the principle of “privity of estate”, explained below.

The lease as an estate – “privity of estate”

- 5.13 A lease is not only a contract; it is also an interest (or “estate”) in land. The parties also have mutual rights and obligations to each other in land law. Unlike the contract, the estate can be conveyed to successors in title of each party, the subsequent owners of the freehold and leasehold of the land. They are entitled to enforce the covenants in the lease between themselves. Lawyers refer to this as “privity of estate”: it exists between whoever stands in the relationship of landlord and tenant for the time being.⁹

⁴ In addition to its express terms, a lease may also have implied terms, including covenants which impose obligations on the parties.

⁵ A covenant is a legal promise in a deed. As most of the statutes we consider in this chapter use that term, we do too.

⁶ See Ch 3, in particular paras 3.35 – 3.41.

⁷ There may also be other parties, such as a managing agent or management company.

⁸ The Law of Property Act 1925, s 141, which applies to leases created before 1 January 1996, modifies the common law position so that where the original lessor has assigned the reversion, the assignee alone may sue the lessee for breaches. We discuss the Landlord and Tenant (Covenants) Act 1995, which applies to leases created after 1 January 1996 and further modifies the law, in paras 5.21 – 5.29.

⁹ This is described as being in a relationship of tenure.

- 5.14 This can be illustrated as follows. A, the landlord and B, the tenant are the original contracting parties to a lease and there is privity of contract and privity of estate between them. If B sells the lease to C, privity of contract remains as between A and B but there is no longer privity of estate between them. Privity of estate now exists between A and C. In the same way if A sells the reversion (freehold) to the lease to D, there will be privity of estate between C and D.

The common law: two classes of covenant

- 5.15 At common law, covenants fall into one of two groups: those that “touch and concern” the land and those that are personal.

Covenants that “touch and concern” the land

- 5.16 Covenants that “touch and concern the land” are those that affect the parties in their capacity as landlord and tenant.¹⁰ Examples are covenants for payment of ground rent or service charge, obligations to insure and repairing obligations.
- 5.17 Where there is privity of estate, covenants that touch and concern the land can be enforced directly between successors to the original parties, notwithstanding that there is no contractual relationship between them.¹¹ Event fees would be held to touch and concern the land and therefore bind successors.

Personal covenants

- 5.18 Personal covenants do not bind successors. They are covenants that are expressed to be personal, or are construed as personal because they affect the parties in some capacity other than as landlord or tenant. Examples are covenants that grant the tenant an option to purchase the landlord’s reversion or that oblige one party not to compete with the other party’s business.¹²

TRANSMITTING A COVENANT TO SUCCESSORS

- 5.19 At common law, the original parties to a lease remain subject to its terms for its entire length even if they have disposed of their interest in it. As a consequence, where a successor to the original party breaches a covenant, the original party could be called upon to perform it instead and can be sued for damages for breach.

¹⁰ See *Breams Property Investment Co Ltd v Stouglar* [1948] 2KB 1.

¹¹ The rule in *Spencer’s Case* [1583] 5 Co Rep 16a.

¹² See *Thomas v Hayward* (1869) LR 4 Ex 311.

- 5.20 This produces harsh results, particularly for tenants, as they tend to be subject to more financial burdens than the landlord. Original tenants may be called upon to pay large sums under a lease long after they have parted with it.¹³ In a 1988 report, the Law Commission criticised the law for being unfair to original tenants because they remained subject to the burdens under the contract without being entitled to the benefits.¹⁴

The Landlord and Tenant (Covenants) Act 1995

- 5.21 The law was subsequently modified by the Landlord and Tenant (Covenants) Act 1995. The Act came into force on 1 January 1996. It distinguishes between leases made before and after that date.

Leases granted before 1 January 1996

- 5.22 For those leases granted before 1996, it remains the case that the contractual liability of the original parties does not end where one or both dispose of their interest in the lease.
- 5.23 However, the Act provides some protection to the original tenant, to moderate the harsh effect of the law. Under section 17 of the 1995 Act, the former tenant is not liable to pay any fixed charge unless the landlord has served a notice within six months of a charge becoming due. Where the full amount is paid, the former tenant may apply for an overriding lease that is equal in length to the remaining term of the original lease plus 3 days. In this way, the former tenant becomes the immediate landlord of the current tenant and can enforce the terms of the lease against the current tenant.¹⁵

Leases granted after 1 January 1996

- 5.24 These are referred to as “new leases”. For new leases, section 3 of the 1995 Act fixes the benefit and burden of all landlord and tenant covenants to the land and each part of it. It no longer matters whether a covenant touches and concerns the land. However, section 3 does not apply where covenants are expressed to be personal. The subject matter of the covenant is no longer relevant: what matters is whether it is expressed to be personal.¹⁶
- 5.25 None of the event fee terms we have seen so far have been expressed to be personal and therefore do not come within this exception. They are therefore subject to the statutory regime.

¹³ Even where the original tenant has died, a claim may be made against their estate in respect of a contingent liability. The Law of Property Act 1925, s 77 implies a term in a lease that an assignee will indemnify the assignor for a breach of a term in the lease. Section 77 does not apply to new leases after 1 January 1996, Landlord and Tenant (Covenants) Act 1995, s 30(3).

¹⁴ See Landlord and Tenant Law Privy of Contract and Estate (1988) Law Com No 174 which resulted in the 1995 Act.

¹⁵ Section 18 of the 1995 Act protects the tenant where the liability under the lease has been varied by the landlord and a subsequent tenant so that it is increased. The former tenant is not liable for that part of the increase that results from the variation.

¹⁶ Section 3(20) of the 1995 Act. In *First Penthouse Ltd v Channel Hotels & Properties (UK) Ltd* [2003] EWHC 2713 (Ch), the covenant was not expressed to be personal but this was implied from the way it was drafted.

- 5.26 Where the leasehold interest is assigned to a purchaser, section 5 of the 1995 Act provides that the original tenant is automatically released from the tenant covenants and is no longer entitled to the benefit of the landlord covenants from the time of the assignment. The tenant will remain liable, however, for any breach committed before the release. The purchasing assignee becomes bound by the tenant covenants from the date of the assignment, but does not acquire any rights or liabilities before this.

The 1995 Act and the problems caused by “privity of contract”

- 5.27 As we have seen, at common law, the doctrine of “privity of contract” had two effects for leases. The first was that the initial tenant and landlord continued to be contractually bound by the lease even after it had been assigned. The second was that subsequent tenants and landlords were not regarded as bound by a contract. Rather, the obligations between them were seen as arising through “privity of estate”.
- 5.28 The policy direction of the 1995 Act was to move away from the principle of privity of contract between the landlord and the first tenant. As one commentator at the time of the Act put it:

This ancient principle... has underpinned leasehold practices and litigation tactics to the present day... But now all this is changing. The Landlord and Tenant (Covenants) Act 1995... will ultimately deny landlords the right to resort to this principle.¹⁷

- 5.29 However, the 1995 Act did not affect the second limb of the doctrine of “privity of contract”, which was that the obligations between subsequent tenants and landlords were to be regarded as non-contractual. We return to this issue in Chapter 6, when we consider whether the Unfair Terms Directive applies to leasehold obligations between the subsequent parties to a lease. We compare the traditional English view that obligations in a lease are non-contractual following assignment with the approach taken in 17 other European jurisdictions. In Chapter 11, we provisionally propose a further move away from the English doctrine of privity of contract, at least for event fees terms.

Forfeiture - a threat against tenants

- 5.30 In some circumstances, a landlord may be entitled to exercise the old and harsh remedy of forfeiture to enforce a covenant against a successor tenant, even where the breach was committed before the successor acquired the lease.

¹⁷ “Former Tenants, Future Liabilities and the Privity of Contract Principle,” S Bridge, (1996) 55 *Cambridge Law Journal* 313.

Leases granted before 1 January 1996

- 5.31 It is standard practice for a landlord to reserve a right of re-entry in a lease that is triggered by the breach of a tenant's covenant. This allows the landlord to bring the tenancy to an end through forfeiture. Forfeiture provides the landlord with a means of enforcing the covenants against a current tenant even though the breach took place during the ownership of a previous tenant.¹⁸

Leases granted after 1 January 1996

- 5.32 For new leases, section 23(1) of the 1995 Act provides that an assignee has no liability "in relation to any time falling before the assignment". However, it appears that a landlord may still exercise a right of forfeiture. This is because there has been a breach of covenant and it does not matter who breached it. The court may grant relief from forfeiture, but this is discretionary.¹⁹ The assignee may come under substantial pressure to remedy the breach – not because of legal liability for it, but to obtain relief from forfeiture.²⁰
- 5.33 In 2006, a Law Commission consultation confirmed that there was a strong case for reform of the law of forfeiture. We recommended that the current law of forfeiture should be abolished and replaced with a simpler, more coherent statutory scheme.²¹ However, this recommendation has yet to be implemented.

The consequences for conveyancing practice

- 5.34 To reduce the risk of forfeiture after assignment, it has become standard practice for a conveyancer acting for a purchaser to insist on confirmation from the landlord that all rents and other sums have been paid and that all other covenants are complied with to the date of assignment. Without this, a purchaser will be advised not to proceed.
- 5.35 This puts vendors of property subject to event fees in a weak position. In practical terms, they will not be able to complete the sale until the event fee has been paid. Where a retirement lease is being sold to realise funds for future care or following a death, the vendor may conclude that the easiest and quickest course is to pay up rather than challenge a landlord's demand for payment.

¹⁸ See Woodfall on Landlord and Tenant at para 16.131 which explains for what breaches the assignee is liable.

¹⁹ See generally Woodfall on Landlord and Tenant, Ch 17 s 7 – relief from forfeiture and, in particular para 17.166 setting out the factors to be considered in the exercise of discretion.

²⁰ If a landlord forfeits the lease after assignment of the tenancy for arrears of a fee, any money judgment for the arrears would be against the first tenant and not the second. Yet the second would have lost a valuable asset.

²¹ Termination of Tenancies for Default (2006) Law Com No 303.

REGULATION OF SERVICE AND ADMINISTRATION CHARGES

- 5.36 Leases often impose substantial charges on tenants. Where there are multiple leasehold properties within a building or development, there will be joint structures (such as the roof) and common parts (such as an entrance hall or lift). With specialist housing, there may be many more shared facilities. Usually, the landlord will be obliged to repair and maintain the common areas, with a corresponding obligation on the tenants to contribute to the cost as a service charge. Other sums may be demanded for administrative acts, for granting consents, or to contribute to the cost of insurance.
- 5.37 Disputes over service and other charges arise for many reasons. Tenants may be asked to foot the bill for work over which they have little control. They may even feel that the work carried out was not necessary at all. The landlord, not being the paying party, may have little incentive to keep costs down or ensure that the work is of a reasonable standard. As a consequence, tenants may feel that they are not getting a good deal or even that an unscrupulous landlord is profiteering.
- 5.38 To resolve these problems, variable service charges, administration charges and charges for granting consent are subject to statutory regulation. Parliament has stepped in where it is felt that the common law offers too little protection for residential lessees.²²
- 5.39 Here we summarise a recent study on the problems associated with leasehold service and administration charges. We then outline the controls on service charges in the Landlord and Tenant Act 1985; on service charge monies in the Landlord and Tenant Act 1987; on administration charges in the Commonhold and Leasehold Reform Act 2002; and on unreasonably withholding consent under the Landlord and Tenant Act 1927. As we explain below, none of these protections would appear to apply to the event fees identified in Chapter 3.

The Competition and Markets Authority 2014 market study

- 5.40 The problems associated with service and administration charges were recently examined by the Competition and Markets Authority. Its study found almost universal agreement that new leaseholders often had little understanding of the implications of purchasing a leasehold property.²³
- 5.41 The study was not concerned with the role of the landlord; nor did it look at event fees. Rather, it concentrated on the provision of services by property managers relating to the communal areas or structure of a building. Although the CMA did not assess the legal framework which underpins leasehold, it looked in depth at leaseholders' experience of property management.

²² The move towards increased regulation of service and other charges began with the Housing Finance Act 1972, ss 90 and 91A. The 1972 Act was introduced in response to the growing establishment of private sector purpose-built leasehold flats. The Act introduced a right for the lessee to demand a summary of service charges and a requirement for the landlord to consult over proposed charges.

²³ *Residential Property Management Services: a market study*, para 4.68. In March 2014, the OFT launched a market study of residential property management services in England and Wales. Responsibility for the study passed to the Competition and Markets Authority (CMA), the successor to OFT, who published their findings in December 2014.

- 5.42 The study produced mixed findings. Although many leaseholders were content with the service they received, some had experienced significant problems, or found the services provided and the value for money to be very poor. There were cases where the costs incurred or the stress and disruption experienced was severe. The CMA concluded that:

The basic leasehold structure, whereby responsibility for appointing and supervising property managers rests with the landlord while leaseholders bear the cost, is a major cause of the problems and discontent experienced.²⁴

- 5.43 The problems were compounded by the fact that many leaseholders have a poor awareness of their obligations. Many leaseholders do not understand how property management arrangements work before they purchase the property, and fail to factor in service charge liabilities when flat-hunting.²⁵ The problems experienced by older leaseholders in specialist housing are part of this larger picture.
- 5.44 The CMA recommended targeted changes, which mostly build on the existing self-regulatory regime. It proposes more pre-purchase information generally; greater disclosure and communication from property managers; and cheaper alternatives to the First-tier Tribunal for the resolution of disputes. We endorse the need for more pre-purchase information, particularly about event fees. We have also been influenced by the CMA's discussion of the problems of dispute resolution in this area, which we summarise at paragraph 5.54.

SERVICE CHARGES

- 5.45 The Landlord and Tenant Act 1985 (the 1985 Act) applies to long residential leases which are granted for a term in excess of 21 years.²⁶ It defines what may be claimed as a service charge and provides a means for the tenant to challenge a service charge demand.²⁷
- 5.46 However in the recent case of *Arnold v Britton* the Supreme Court confirmed that the protections apply only to variable fees, and not to those which are fixed in advance.²⁸ This means that the protections do not apply to event fees, even if the fees are described as deferred service charges.

²⁴ *Residential Property Management Services: a market study*, para 4.103.

²⁵ Above, para 1.25.

²⁶ LTA 1985, s 26(2) as amended. The Act also covers perpetually renewable leases and leases granted under the Housing Act 1985.

²⁷ Under s 27A.

²⁸ [2015] UKSC 36. We discuss the case in greater detail at paras 5.61 – 5.72.

Meaning of service charges

- 5.47 Section 18 of the 1985 Act defines a service charge as an amount payable by the tenant as part of or in addition to the rent that is payable directly or indirectly, for services, repairs, maintenance, improvements or insurance or the landlord's costs of management. For the Act to apply, the service charge or part of it must vary or be capable of varying according to the relevant costs.²⁹

Relevant costs

- 5.48 Whether a particular actual or estimated cost can be included in the charge as a relevant cost is determined by the terms of the lease. The landlord must be obliged or permitted by the lease to do some act or incur some cost before it can be recovered as part of the service charge. Although there is nothing in principle to prevent a landlord from making a profit on providing services, for it to do so there must be clear words of entitlement to a profit in the lease.³⁰

Requirement of reasonableness

- 5.49 Section 19 of the 1985 Act imposes an important qualification on the amount the landlord, managing agent or management company is entitled to recover as service charge. Relevant costs can be taken into account when calculating the service charge:

- (1) only to the extent that they are reasonably incurred; and
- (2) where they are incurred on the provision of services or the carrying out of works, only if the services or works are of a reasonable standard.³¹

Other protections

- 5.50 The 1985 Act provides a variety of other protections relating to variable service charges as defined by the Act.

- (1) There are rights to information. The tenant, or recognised tenants' association, may require the landlord to supply a written summary of the relevant costs incurred in the previous year.³²
- (2) A duty to consult may also arise under section 20 of the 1985 Act where the landlord proposes to carry out large scale works or to enter into a long-term agreement.³³

²⁹ Landlord and Tenant Act 1985, s 18(1)(b).

³⁰ See *Arnold v Britton* [2012] EWHC 3451 (Ch).

³¹ LTA 1985, s 19(1).

³² Other provisions designed to increase transparency were included in the Commonhold and Leasehold Reform Act 2002, but have not been brought into force. The accounts must be either for the previous 12 months or, where the relevant accounts are made up for periods of 12 months, the last such period ending no later than the date of the request LTA 1985, s 21(1).

³³ In broad terms, this applies to agreements lasting for more than a year in respect of which any lessee's contribution is over £100 per year, or work that results in a contribution from any individual lessee of more than £250. See ss 20 and 20ZA of the 1985 Act and the Service Charge (Consultation Requirements) Regs 2003, (SI 2003 No 1987).

- 5.51 Furthermore, the Commonhold and Leasehold Reform Act 2002 increases the rights of lessees to take on the management of their properties and therefore gain control through a company specially set up for that purpose.

Service charge disputes

- 5.52 Where there is a dispute between the landlord and tenant over a service charge, one or both may apply to the First-tier Tribunal (Property Chamber) under section 27. The Tribunal can determine whether a service charge is payable, and if so, by whom, to whom, the amount to be paid and the date and manner for payment. The Tribunal does not have exclusive jurisdiction to hear service charge disputes. Its jurisdiction is concurrent with the courts.³⁴
- 5.53 The Tribunal can also decide issues in advance of work being carried out. It can consider whether, if work were to be done, a service charge would be payable and, if so, who would be liable to pay it, for how much, and when. This allows the parties to find out what their respective liabilities will be before the cost of work has been incurred.
- 5.54 In its market study on residential property management services,³⁵ the CMA commented that the process of taking a claim to the Tribunal could be complex, costly and unpredictable. The system was said to be too daunting, particularly for elderly tenants. The fees can be high: for example, taking a service charge dispute worth over £15,000 to a final hearing costs £630 in England (£500 in Wales), since there is an application fee of £440 and a hearing fee of £190.³⁶ Legal costs may be awarded against a tenant who has acted unreasonably. Furthermore, some leases give the landlord a contractual right to recover legal costs from the tenant, even if the tenant wins.³⁷
- 5.55 These shortcomings are likely to act as strong deterrents for elderly people who feel aggrieved about charges demanded by the landlord. As discussed in Chapter 11, we are wary of reforms which would require residents to bring complex cases before the First-tier Tribunal to assess the reasonableness of event fees.

Protecting service charge funds

- 5.56 In some cases, the landlord may be holding substantial amounts in readiness for the works to be carried out. The law requires some service charge funds to be used for their intended purpose and to be protected against creditors should the landlord become insolvent.

³⁴ This is a consequence of the wording of section 27(1), see also *Phillips v Francis* [2010] EGLR 31. The court may transfer a dispute, or an issue in dispute, to the Tribunal for resolution.

³⁵ December 2014.

³⁶ The current Ministry of Justice consultation on tribunal fees would reduce this to £100 and £200 respectively: http://consult.justice.gov.uk/digital-communications/further-fees-proposal-consultation/supporting_documents/.

³⁷ The right to recover legal costs through the service charge can be challenged under s 20C of the LTA 1985.

- 5.57 Section 42 of the Landlord and Tenant Act 1987 provides that a statutory purpose trust is imposed over money paid in service charges (including for sinking or reserve funds).³⁸ The funds belong to the tenants beneficially on trust to provide the services for which they were paid. Therefore, the money is not available to creditors of the landlord on insolvency. During the currency of the statutory trust, the landlord and its agents are subject to trustees' duties and will be liable for breach of trust if the money is not used for the purposes of the trust or is not properly safeguarded.
- 5.58 The statutory trust does not apply to funds paid under a fixed service charge. In practice, some operators do put money into a voluntary trust, but this is not a legal requirement.

FIXED SERVICE CHARGES: EXCLUDED FROM PROTECTION

- 5.59 The Landlord and Tenant Act 1985 only applies to service charges that vary, or are capable of varying, according to the relevant costs.³⁹ Fixed service charges that are payable regardless of whether any costs are incurred, or that do not vary according to costs incurred or to be incurred, are excluded from the scope of the Act. This important exclusion has implications for many of the event fees that we have seen.
- 5.60 The exclusion of fixed service charges from review can lead to startling results as was recently seen in the case of *Arnold v Britton*.⁴⁰

Arnold v Britton

- 5.61 This case concerned service charge clauses in the leases of 25 holiday chalets in a leisure park. The leases imposed an obligation on the tenant to pay a proportionate part of the expenses and outgoings incurred by the landlord in the repair, maintenance, renewal and provision of services in respect of the park. These obligations varied slightly but required the tenant to pay a fixed annual sum of £90, increasing at a compound rate of 10% every year of the 99 year term, or (for some leases) every three years.
- 5.62 The landlord brought proceedings in the County Court for declarations, including one that the covenants imposed a fixed service charge which meant that the 1985 Act did not apply. The tenants argued that the reference to payment of a proportionate part of the costs imposed a variable charge with caps on the amount that could be claimed; therefore the Act did apply and the service charge could be reviewed for reasonableness. If the landlord's interpretation was correct, then, under a lease for 99 years granted in 1974, which imposed an annual service charge of £3,060 in 2012, the charge for the final year in accordance with the formula would rise to £1,025,005. In other words, some tenants would be required to pay over £1 million a year for service charges on a modest holiday chalet.

³⁸ Service charge has the same meaning as given by LTA 1985, s 18(1).

³⁹ LTA 1985, s 18.

⁴⁰ [2015] UKSC 36, [2013] EWCA Civ 902, [2012] EWHC 3451 (Ch).

- 5.63 The tenants were successful at first instance and the landlord appealed to the High Court.

The High Court judgment: fixed or variable charges?

- 5.64 In his judgment, Mr Justice Morgan analysed the advantages and disadvantages of different types of service charge covenants. He explained that a fixed service charge provides certainty as to future costs and there is no need for prior consultation before costs are incurred. Fixed service charges that are index-linked or subject to a fixed percentage increase ensure ease of calculation.
- 5.65 However, there is a risk that the landlord will be over or under compensated for the provision of services. Variable service charges ensure that the tenant pays a fair amount towards the landlord's costs. On the other hand, variable charges involve more work, introduce uncertainty as to the amount of future charges and leave the door open to more disputes over the calculation of the sum due.
- 5.66 The High Court held that the parties had opted for fixed charges, subject to a percentage increase. The landlord could not disregard the fixed percentage if it proved inadequate to cover costs and, by the same token, the tenant could not disregard it if it turned out to be too high.⁴¹ The tenants unsuccessfully appealed to the Court of Appeal and then to the Supreme Court.⁴²

The Supreme Court: bound by the natural meaning of the term

- 5.67 Lord Neuberger gave the leading judgment in the Supreme Court and reviewed the relevant authorities on the interpretation of contracts. He explained that, when interpreting a written contract, the court must identify the intention of the parties by reference to:

what a reasonable person having all the background knowledge which would have been available to the parties would have understood them to be using the language in the contract to mean.⁴³

- 5.68 The test focuses on the meaning of relevant words in their documentary, factual and commercial context. It disregards subjective evidence of any party's intention. Also, importantly Lord Neuberger said that:

While commercial common sense is a very important factor to take into account when interpreting a contract, a court should be very slow to reject the natural meaning of a provision as correct simply because it appears to be a very imprudent term for one of the parties to have agreed.⁴⁴

⁴¹ [2012] EWHC 3451 at [49].

⁴² [2013] EWCA Civ 902, [2015] UKSC 36.

⁴³ [2015] UKSC 36 at [114].

⁴⁴ Above at [20].

5.69 The majority agreed that while some reliance could be placed on commercial common sense, it could not override the clear language used. Therefore, the court declined to rewrite the contract, confirming that its role was to interpret the terms of the contract and not correct it. The fact that the consequences of the language used worked out badly or even disastrously for one party was not a reason for departing from their natural meaning.

5.70 Lord Carnwath dissented, preferring to interpret the relevant clause to give effect to what he saw as the intended purpose and “to guard against unfair and unintended burdens being placed on the lessees”.⁴⁵ He felt that something had gone wrong with the drafting and that there was an inherent ambiguity which needed to be resolved. He considered that the lessors’ interpretation

would lead over the course of the leases to supposedly “proportionate” service charges becoming wholly disproportionate to the costs of the relevant services, to extreme and arbitrary differences between the different groups of leases within the estate, and to the prospect in the foreseeable future of potentially catastrophic financial consequences for the lessees directly concerned.⁴⁶

5.71 That prospect was not sufficient to convince the majority. On the facts, the tenants had struck a very bad bargain but unfortunately they were bound by it and could not challenge it as being unreasonable.

5.72 We consider the outcome of this case and the impact on event fees further in Chapter 10.

ADMINISTRATION CHARGES

5.73 Administration charges are regulated by schedule 11 to the Commonhold and Leasehold Reform Act 2002. This applies to charges payable by a tenant for or in connection with:

- (1) applications for approvals under the lease;
- (2) the grant of approvals; or
- (3) the provision of information or documents.

5.74 These controls also apply to administration charges in connection with a breach (or alleged breach) of a covenant in the lease, or a failure by the tenant to make a payment by the due date.

5.75 Importantly, schedule 11 extends to administration charges due from the tenant to a party to the lease other than the landlord, such as a managing agent or management company.

⁴⁵ [2015] UKSC 36 at [123].

⁴⁶ Above, at [80].

Assessing the reasonableness of administration charges

- 5.76 Unreasonable administration charges may be challenged before the First-tier Tribunal (Property Chamber).⁴⁷ A variable administrative charge is payable only to the extent that the amount of the charge is reasonable.⁴⁸ For non-variable charges, the tribunal may make an order varying the lease on the grounds that:

(a) any administration charge specified in the lease is unreasonable;
or

(b) any formula specified in the lease in accordance with which any administration charge is calculated is unreasonable.⁴⁹

Are “selling service fees” administration charges?

- 5.77 This raises the question whether any of the “selling service fees” illustrated in Chapter 3 fall within the definition of administration charges under the Act. In 2006, the Midland Leasehold Valuation Tribunal considered an event fee that was described as a “selling service fee” and decided that it was not an administration charge.⁵⁰

- 5.78 The term read as follows:

Not to assign or transfer nor offer to assign or transfer the Flat or otherwise part with possession of the same without first notifying Richardson Managements Limited and then to pay them a selling service fee of 5% of the enhanced value of the Flat... .

- 5.79 The Tribunal held:

With reluctance, but without any doubt, we have come to the conclusion that the “selling service fee” does not fall within any of the four categories in paragraph 1(1) of Part I of Schedule 11. In particular, the approval of Richardson Managements Ltd to the leaseholder’s assignment is not required by the lease... So the fee cannot be categorised as being for or in connection with the grant of any such approval for the purpose of paragraph 1(1)(a). Nor can that fee be categorised as a payment, direct or indirect, in connection with a breach of covenant or condition in the lease for the purpose of paragraph 1(1)(d), because the fee is not referable to any breach. Clearly paragraphs 1(1)(b) [fee for provision of information] and (c) [fee for late payment by the tenant] do not apply.

⁴⁷ CLRA 2002, sch 11, para 5. The court has a concurrent jurisdiction to determine disputes over administration charges.

⁴⁸ Above, sch 11, para 2.

⁴⁹ Above, sch 11, para 3(1).

⁵⁰ *Decision of the Midland Leasehold Valuation Tribunal as to its Jurisdiction* (23 March 2006) (unreported).

- 5.80 This decision confirms that tribunals will assess whether a fee is an administration charge based on whether the drafting of the term imposing the fee brings the fee within the categories in paragraph 1(1) of Part I to schedule 11. Calling the fee an "administration charge" or "selling service fee" is not relevant, nor is the service (if any) provided in exchange for the fee.
- 5.81 It is possible that some event fees we have looked might be considered charges for "the provision of information or documents". In Chapter 3, for example, we considered a fee for a change of ownership service. Some elements of the service related to the provision of information, including "access to details of potential purchasers kept by the landlord"; "provision of details of past and anticipated future village service charge"; and "provision of village information to potential purchasers". However, some elements of the service were not limited to providing information. The change of ownership service also included "advice and assistance to the tenant"; and "reasonable efforts to seek a potential purchaser".
- 5.82 It is likely that, in these circumstances, the fee as a whole would not be regarded as an administration charge.

CHARGES FOR GRANTING CONSENT

- 5.83 It is common for leases to require the tenant to obtain the landlord's consent before taking certain actions in relation to the property. The OFT investigation into retirement home transfer fee terms noted that there are statutory restrictions on the landlord charging fees to give consent under a lease.⁵¹
- 5.84 Section 144 of the Law of Property Act 1925 provides that no fine or sum of money shall be payable for consent to assign, underlet, part with possession or dispose of the property, unless the lease provides express provision to the contrary.⁵² However, as consent is not linked to payment of event fees in the examples that we have seen, this provision is not relevant.
- 5.85 In addition, where a lease requires a tenant to obtain the landlord's consent to a disposal of the lease,⁵³ section 19(1) of the Landlord and Tenant Act 1927 prevents the landlord from unreasonably withholding consent to the disposal. Charging any fee to give consent (other than to cover reasonable costs) may amount to unreasonably withholding consent.⁵⁴
- 5.86 In the leases we have seen, the event fees are payable on the happening of an event and not for the grant of consent to the assignment, sub-letting, change of use or other action. Therefore, this provision do not apply to event fees.

⁵¹ OFT 1476, para 9.1.

⁵² "Fine" includes premium, payment, consideration or benefit, LPA 1925, s205(i)(xxiii). Section 144 also preserves the landlord's right to payment of reasonable legal and other expenses incurred.

⁵³ Which includes assignment, sub-letting, charging or parting with possession of the demised premises or any part.

⁵⁴ For the grounds on which consent can be withheld, see *International Drilling Fluids Ltd v Louisville Investments (Uxbridge) Ltd* [1986] Ch 513.

THE SCOTTISH APPROACH

5.87 The OFT investigation recommended:⁵⁵

Further or alternatively, there could be consideration of whether the model currently in force in Scotland of restricting or prohibiting certain classes of fees would be appropriate.⁵⁶

We therefore conclude this chapter by looking briefly at the Scottish provisions to see if they may be appropriate for England and Wales.

Leasehold casualties in Scotland

5.88 In Scotland, a leasehold casualty is an extra amount, over and above the rent, which must be paid by the tenant to the landlord from time to time if the lease so requires.⁵⁷ There is some similarity between Scottish casualties and the event fees that we have seen. Both casualties and event fees may arise either at stated intervals during the currency of the lease or on the occurrence of a particular event, such as the assignation of the lease by the current tenant. However there are important distinctions between them. One is that casualties are largely historical and

were a largely forgotten relic, which most people regarded as obsolete in practice, until recently reactivated by a few landlords.⁵⁸

5.89 Furthermore, unlike event fees, it appears that casualties were not charged for any discernible purpose and were not expressed to be for service or contribution towards costs of any kind.

5.90 As the OFT explains, the Scottish system of land holding is also quite different:

In general, long residential leases are rare in Scotland. Since 1974 new residential leases have been restricted to 20 years by virtue of the Land Tenure Reform (Scotland) Act 1974. Further, the Long Leases (Scotland) Act 2012 converted (with some exceptions) most remaining ultra-long leases (over 175 years long) to ownership.⁵⁹

5.91 The Land Tenure Reform (Scotland) Act 1974 outlawed casualty provisions in leases executed on or after 1 September 1974. However, leasehold casualties granted in pre-1974 leases survived largely unnoticed until the 1990s when the activities of “title raiders” brought them to public attention. Until then most landlords treated leasehold casualties as archaic and did not claim them. The “title raiders” purchased the landlord’s interests under long leases and exploited the casualties to extract money from tenants.⁶⁰

⁵⁵ OFT 1426 February 2013.

⁵⁶ Para 9.1.

⁵⁷ Report on Leasehold Casualties (Scot Law Com No 165) para 1.2.

⁵⁸ Above, para 4.11.

⁵⁹ Royal Assent 7 August 2012, Commencement Date 28 November 2015.

⁶⁰ Angus McAllister, *Scottish Law of Leases* (4th ed 2013), paras 8.52 – 8.53.

- 5.92 This led to the Leasehold Casualties (Scotland) Act 2001,⁶¹ which applies to all leases granted before 1 September 1974 for a period of 175 years or longer. The Act extinguishes many casualties, but not all. The Act also provides compensation to the landlord for loss of the casualty.⁶² It was decided to apply the Act only to leases longer than 175 years, as virtually all casualty provisions are in longer leases and setting a lower threshold might have inadvertently affected provisions in modern commercial leases.

Title conditions

- 5.93 In Scotland, many provisions which would be leasehold covenants in England and Wales have been written as “title conditions”. Where a title condition imposes an obligation on the homeowner, it is known as a “real burden”. Typically, a “real burden” is a condition imposed by the developer on all the owners of property in the development.
- 5.94 Previously, “real burdens” would generally be enforced by the developer or manager having a “superior interest” of the property. However, since devolution there have been extensive property law reforms in Scotland. As part of these reforms, the Title Conditions (Scotland) Act 2003 aims to transfer the right to enforce burdens from the developer or management company to the unit owners.
- 5.95 However, some burdens are specially protected and cannot be discharged or varied except by compliance with strict statutory conditions. In particular, there are specific provisions for “sheltered and retirement housing” defined as:

a group of dwelling-houses which having regard to their design, size and other features, are particularly suitable for occupation by elderly people (or people who are disabled or infirm or in some other way vulnerable) and which, for the purposes of such occupation, are provided with facilities substantially different from those of ordinary dwelling-houses.⁶³

- 5.96 In this form of housing, the “core burdens” that regulate the provision of services or facilities can only be discharged by a majority of two thirds of the owners of the units, as opposed to a bare majority.

A model for England and Wales?

- 5.97 Although the Scottish model is instructive, we do not think that it would be viable to propose reform for event fees in England and Wales along similar lines. The historical context and development of property law in the two jurisdictions is very different. In Scotland, the reforms were designed to achieve widespread absolute ownership so that the relationship of landlord and tenant no longer applies. In contrast, the event fees that concern us are covenants in long leases governed by a framework of landlord and tenant law, which we would not seek to dismantle.

⁶¹ The 2001 Act implemented the Scottish Law Commission Report on Leasehold Casualties (Scot Law Com No 165, 1998).

⁶² Angus McAllister, *Scottish Law of Leases* (4th ed 2013), para 8.54.

⁶³ Title Conditions (Scotland) Act 2003, s 54(3).

CONCLUSION

- 5.98 The law relating to leases is complex, as they operate both as contracts and as estates in land. There are many statutory controls on leases but they are not designed to deal with event fees.
- 5.99 Although there are ways of disputing service charges under the Landlord and Tenant Act 1985, the Act only applies to variable charges, not charges which are fixed by a formula in the lease. The lack of protection against fixed service charges is starkly illustrated by the case of *Arnold v Britton*. The Supreme Court confirmed that where the term is drafted in clear language there is no reason to depart from its natural meaning. This applied even though the fixed service charge increased at a compound rate, leading to charges of more than £1 million by the end of the 99 year lease.
- 5.100 Secondly, the controls on administration charges only apply to fees which are for applications or grants of approvals under the lease or “the provision of information or documents”. A First-tier Tribunal has found that this does not apply to fees for “selling services” generally.
- 5.101 Thirdly, section 19 of the Landlord and Tenant Act 1927 prevents landlords from unreasonably withholding consent to dispose of the lease. However, this would not apply to the event fees we have seen.
- 5.102 The next chapter considers how leases are regulated as consumer contracts under the law of unfair terms. In Chapter 10 and 11 we consider the need for reform.

CHAPTER 6

UNFAIR TERMS LEGISLATION

- 6.1 The main legal protection against unfair event fees derives not from landlord and tenant law but from consumer law – in particular, the requirement in the Unfair Terms Directive 1993 that terms in consumer contracts must be fair. In this chapter, we outline the law on unfair terms in consumer contracts. We then discuss some of the difficulties in applying this law to event fees in residential leases.

THE UNFAIR TERMS DIRECTIVE 1993 (UTD)

- 6.2 The UTD is an EU directive which requires member states to enact laws to protect consumers against unfair terms.¹ It is based on “minimum harmonisation”, which means that member states may provide more protection to consumers than the UTD requires but may not provide less. Previously, in domestic law, the Unfair Contract Terms Act 1977 provided protection against unfair clauses excluding or limiting liability but did not apply to other terms. By contrast, the UTD covers all terms in consumer contracts, unless a specific exemption applies.
- 6.3 The UTD was first implemented in the UK on 1 July 1995 through the Unfair Terms in Consumer Contracts Regulations 1994.² The 1994 Regulations, however, were found to be in breach of the UTD because they did not allow for enforcement by a sufficient range of organisations. They were replaced by the Unfair Terms in Consumer Contracts Regulations 1999, which stayed close to the wording of the UTD. Essentially, the 1999 Regulations “copied out” the Directive.
- 6.4 On 1 October 2015, the 1999 Regulations were replaced by new legislation: namely, Part 2 of the Consumer Rights Act 2015. Part 2 of the 2015 Act implements recommendations made by the Law Commission and Scottish Law Commission in 2013 to simplify the law and make it more accessible.³ The 2015 Act is written in clearer terms than the 1999 Regulations. In some cases, it goes further than the UTD requires: in particular, the legislation now applies to negotiated as well as non-negotiated terms, and (as explained below) price and main subject matter terms are only exempt if they are both transparent and prominent. In this chapter, we explain the law by referring to the 2015 Act.

¹ Directive 93/13/EEC, OJ 1993 L 95.

² SI 1994 No 3159.

³ Law Commission and Scottish Law Commission, Unfair Terms in Consumer Contracts: Advice to the Department for Business, Innovation and Skills (March 2013).

- 6.5 However, the UTD remains highly relevant because a national court must interpret domestic law in the light of the wording and purpose of the UTD.⁴ Any uncertainty about the meaning of the UTD can only be resolved authoritatively at a European level by the Court of Justice of the European Union (CJEU). Much of the UK case law concerning the 1994 and 1999 Regulations also applies to the 2015 Act, and we draw on that case law below.

A BRIEF SUMMARY OF UNFAIR TERMS LEGISLATION

When does the legislation apply?

- 6.6 Part 2 of the Consumer Rights Act 2015 applies to “a contract between a trader and a consumer”.⁵ A consumer is defined as “an individual acting for purposes that are wholly or mainly outside that individual’s trade, business, craft or profession”.⁶ As discussed below, residential tenancies have been held to be consumer contracts for these purposes.⁷

What does the legislation require?

- 6.7 Part 2 of the 2015 Act subjects consumer contracts to two requirements:

- (1) “transparency”;⁸ and
- (2) “fairness”.⁹

Transparency

- 6.8 The Act states that “a trader must ensure that a written term of a consumer contract... is transparent”.¹⁰ To be transparent, a term must be expressed in plain and intelligible language and legible.¹¹
- 6.9 A term which is not transparent is not necessarily unenforceable, but transparency is relevant in three ways:
- (1) Enforcement bodies may apply for injunctions to stop traders from using non-transparent terms.¹²

⁴ Case 14/83 *Von Colson and Kavann v Land Nordrhein-Westfalen* [1984] ECR 1891, para 26; Case C-106/89 *Marleasing* [1990] ECR I-4135, para 8; see Cabinet Office Legal Advisers, European Division, *European Law in Government* (25 February 2011) at [375]; for example, see the reasoning of the Court of Appeal in *Office of Fair Trading v Foxtons* [2009] EWCA Civ 288 at [42] and House of Lords in *Director General of Fair Trading v First National Bank plc* [2001] UKHL 52 at [31].

⁵ CRA 2015, s 61(1).

⁶ Above, s 2(3).

⁷ See *R (Khatun) v Newham LBC* [2005] QB 37 and the discussion at para 6.71 below.

⁸ CRA 2015, s 68. See also UTD, art 5.

⁹ CRA 2015, s 62.

¹⁰ Above, s 68(1).

¹¹ Above, s 64(3).

¹² Above, sch 3, para 3(5).

- (2) If the term's meaning is in doubt, "the meaning most favourable to the consumer is to prevail".¹³
- (3) As discussed below, even if a term specifies "the main subject matter" or concerns "the appropriateness of the price", it is reviewable for fairness if it is not transparent.

Fairness

- 6.10 A court may assess any term in a consumer contract for fairness, unless the term falls within one of the exemptions. The 2015 Act replicates the language of the UTD by defining unfairness in the following terms:

A term is unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations under the contract to the detriment of the consumer.¹⁴

- 6.11 The Act goes on to state:

Whether a term is fair is to be determined—

(a) taking into account the nature of the subject matter of the contract, and

(b) by reference to all the circumstances existing when the term was agreed and to all of the other terms of the contract or of any other contract on which it depends.¹⁵

- 6.12 In 2002, we noted that there had been considerable debate in the legal literature about the correct interpretation of the fairness test.¹⁶ We concluded that it was a general test, which should be looked at in the round, bearing in mind both the substance of the term and the way it was presented to the consumer.

The effect of an unfair term

- 6.13 The UTD requires Member States to provide that unfair terms shall

not be binding on the consumer and that the contract shall continue to bind the parties upon those terms if it is capable of continuing in existence without the unfair terms.¹⁷

- 6.14 The 2015 Act fulfils this requirement by stating that "an unfair term of a consumer contract is not binding on the consumer".¹⁸ However, "the contract continues, so far as practicable, to have effect in every other respect".¹⁹

¹³ CRA 2015, s 69(1).

¹⁴ Above, s 62(4).

¹⁵ Above, s 64(5).

¹⁶ Unfair Terms in Contracts (2002) Law Commission Consultation Paper No166; Scottish Law Commission Discussion Paper No 119, para 3.57 to 3.69.

¹⁷ UTD, art 6(1).

The “grey list”

- 6.15 The UTD contains an “indicative and non-exhaustive” list of terms which may be regarded as unfair.²⁰ The CJEU has described the list as being of “indicative and illustrative value” which should be readily available to the public in each Member State.²¹
- 6.16 This list is now set out in schedule 2 of the Consumer Rights Act 2015. It is usually referred to as the “grey list”: the terms on it are not necessarily unfair (black) but there is some indication of unfairness (grey). Although it is sometimes suggested that there is a presumption that a term on the grey list is unfair, this is not formally part of the law. In practice, however, regulators draw heavily on the grey list in giving guidance to traders, so it has proved to be of considerable practical importance.
- 6.17 Terms on the grey list which are commonly encountered include:
- (1) penalty clauses;²²
 - (2) cancellation clauses which allow the trader (but not the consumer) to end a contract on a discretionary basis;²³
 - (3) terms which irrevocably bind the consumer to terms which they had no opportunity of reading before the conclusion of the contract;²⁴
 - (4) variation clauses which unilaterally enable the trader to alter the terms of the contract without a valid reason specified in the contract;²⁵ and
 - (5) price escalation clauses which do not give the consumer a corresponding right to cancel the contract.²⁶

¹⁸ CRA 2015, s 62(1).

¹⁹ Above, s 67.

²⁰ These were originally set out in an Annex to the UTD.

²¹ *Commission v Kingdom of Sweden* Case C 478/99 [2002] ECR I-04147 at [22]; [2004] 2 *Common Market Law Reports* 34.

²² CRA 2015, sch 2, para 6.

²³ Above, sch 2, para 7.

²⁴ Above, sch 2, para 10.

²⁵ Above, sch 2, para 11.

²⁶ Above, sch 2, para 15.

- 6.18 Most of the terms in schedule 2 are copied from the Annex to the UTD. However, as the UTD is a “minimum harmonisation” directive, Member States are permitted to add to the grey list if they wish. The Consumer Rights Act 2015 added three new terms to the list. The Act also allows the Secretary of State to add terms to the grey list by statutory instrument.²⁷ In Chapter 11, we consider whether some forms of event fee should be added to the grey list.

Exemptions

- 6.19 There are two main exemptions, where the court may not assess a term for fairness:

- (1) **Terms which reflect the existing law.** The 2015 Act follows the UTD by excluding contract terms which reflect “mandatory statutory or regulatory provisions” or international conventions.²⁸ The Act clarifies that this includes rules which, according to law, would apply between the parties even if in the absence of a contract. As the law would not require an event fee in the absence of a specific term in a contract or lease, this exemption does not apply in this context.
- (2) **Terms relating to the main subject matter or the appropriateness of the price.** This important exception has led to difficult litigation. As it could be argued that event fees are price terms, we discuss this exemption in more detail below.

- 6.20 Before October 2015, there was also an exemption for terms which were individually negotiated. It was interpreted narrowly. In *UK Housing Alliance Ltd v Francis*, the Court of Appeal held that the fact that a consumer had instructed solicitors, who had the opportunity to consider and negotiate terms, did not mean that the terms were individually negotiated.²⁹ This exemption was removed by the Consumer Rights Act 2015.

Enforcement

- 6.21 Importantly, unfair terms legislation may be enforced both by individuals and by regulators. If either the trader or the consumer brings the matter before a court the court must consider whether the term is fair. This applies “even if none of the parties to the proceedings has raised that issue”, provided that the court has “sufficient legal and factual material to enable it to consider the fairness of the term”.³⁰

²⁷ Under s 63(3), “the Secretary of State may by order made by statutory instrument amend schedule 2 so as to add, modify or remove an entry”.

²⁸ CRA 2015, s73(1).

²⁹ [2010] EWCA Civ 117, [2010] Bus LR 1034 at [19] by Longmore LJ.

³⁰ CRA 2015, s 71(2) and (3).

- 6.22 In addition, schedule 3 to the Consumer Rights Act 2015 lists 11 regulators who may prevent unfair terms from being used. These include the Competition and Markets Authority (CMA), the Consumer Association and any local weights and measures authority in Great Britain.³¹ These organisations may apply to court for an injunction³² or may accept undertakings.³³

HOW UNFAIR TERMS LEGISLATION APPLIES TO EVENT FEES

- 6.23 The broad effect of unfair terms legislation is that a court may assess whether the terms of a lease are fair. A tenant may apply to the court for a declaration that a term is unfair, and therefore not binding on them. Alternatively, if the landlord pursues a claim against the tenant for payment, the court may decide that the payment term is unfair whether or not the tenant raised the issue.
- 6.24 In addition, the CMA may apply to a court for an injunction to stop landlords using unfair terms; it may also accept undertakings from landlords that they will not enforce unfair terms – either at all, or not in specific circumstances.
- 6.25 As we have seen, in 2013, the CMA's predecessor, the Office of Fair Trading, published a report which argued that several factors in the way that some event fees were used made them potentially unfair. They commented that the fees may lack transparency, and even if consumers are aware of their existence, "the behavioural characteristics of consumers may mean that they do not take account of the full cost in calculating the price".³⁴ In Chapter 3 we summarise the undertakings given in response to the investigation.

Uncertainties and problems

- 6.26 Unfair terms legislation has the potential to control the use of unfair event fees which consumers fail to take into account in their decision making. The broad principles are relatively clear – but the application of unfair terms legislation in this area raises some difficult legal issues. In particular, we have identified three thorny questions about the application of unfair terms legislation to event fees:
- (1) As event fees appear to be price terms, do they fall within the exemption which prevents a court from assessing the appropriateness of the price?
 - (2) Leases represent a contract between the first consumer tenant (T1) and trader landlord (L1). Does this contract continue after T1 has sold the lease to another tenant (T2), or L1 has sold the freehold to another landlord (L2)? In other words, is there a contractual relationship between subsequent tenants and landlords to which unfair terms legislation applies?

³¹ CRA 2015, sch 3, para 8.

³² Above, sch 3, para 3.

³³ Above, sch 3, para 6.

³⁴ OFT 1476 – *OFT investigation into retirement home transfer fee terms* (February 2013) para 4.2.

- (3) The first regulations on unfair terms in consumer contracts came into force on 1 July 1995.³⁵ Does unfair terms legislation have any retrospective effect on leases created before this date?

6.27 We discuss each of these issues in turn.

THE EXEMPTION RELATING TO MAIN SUBJECT MATTER AND PRICE

The statutory provision

6.28 Section 65 of the Consumer Rights Act 2015 sets out this exemption as follows:

A term of a consumer contract may not be assessed for fairness... to the extent that—

(a) it specifies the main subject matter of the contract, or

(b) the assessment is of the appropriateness of the price payable under the contract by comparison with the goods, digital content or services supplied under it.

6.29 Previous versions of this exemption specified that the exemption applied only so far as the term is in plain, intelligible language. The 2015 Act narrows the scope of the exemption by stating that it applies only if the term is “transparent and prominent”.³⁶

6.30 As we have seen, to be transparent the term must be in plain, intelligible language and legible. In the High Court in *OFT v Abbey National*, Mr Justice Andrew Smith explained that it is not enough for the term to be expressed “as clearly as is reasonably possible given its subject matter” or the supplier to make “a commendable effort” to make the term intelligible.³⁷ It must actually be intelligible to an average consumer, defined as someone “who is reasonably well-informed, observant and circumspect”.³⁸ We think that several of the terms set out in Chapter 3 would fail this test.

6.31 To be prominent, the term must be “brought to the consumer’s attention in such a way that an average consumer would be aware of the term”.³⁹ This is a relatively low level test: as we have seen many leaseholders are aware of the event fees, even if they fail to understand their full implications.

³⁵ Unfair Terms in Consumer Contracts Regulations 1994 (SI 1994 No 3159). Although the Unfair Contract Terms Act 1977 has been in force since 1 February 1978, this Act only affects exclusion and limitation clauses and does not apply to event fees.

³⁶ S 64(2).

³⁷ *OFT v Abbey National* [2008] EWHC 875 at para 121. This was not disputed in the Court of Appeal or Supreme Court.

³⁸ CRA 2015, s 64(5).

³⁹ Above, s 64(4).

The exemption in the UTD

6.32 Section 65 largely reflects the exemption set out in article 4(2) of the UTD, although the UK has taken advantage of the minimum harmonisation status of the Directive to state that the exemption only applies to terms which are prominent.

6.33 Article 4(2) of the UTD states:

Assessment of the unfair nature of the terms shall relate neither to the definition of the main subject matter of the contract nor to the adequacy of the price and remuneration, on the one hand, as against the services or goods supplied in exchange, on the other, in so far as these terms are in plain intelligible language.⁴⁰

6.34 Following the Law Commissions' recommendations, the 2015 Act simplifies some of the terminology. In particular, section 65 refers to the "appropriateness" of the price rather than the "adequacy". The Law Commissions thought that "adequacy" could be confusing: to say that a price is inadequate suggests a price is too low, while consumers would generally complain that a price was too high. The Act also refers simply to price, rather than "price and remuneration": the Law Commissions thought that "remuneration" did not add anything in this context. These differences in terminology are not intended to change the meaning.

6.35 Article 4(2) was inserted into the text of the UTD at a late stage by the European Council following a "particularly influential" article by Professors Brandner and Ulmer.⁴¹ Originally, the European Commission sought to subject every term in a consumer contract to a standard of fairness whether or not they were individually negotiated.⁴² However, Professors Brandner and Ulmer forcefully argued against such wide-reaching controls:

⁴⁰ Council Directive 93/13/EEC, OJ 1993 L 95.

⁴¹ *Office of Fair Trading v Abbey National* [2009] UKSC 6, [2010] 1 AC 696 at [6] by Lord Walker.

⁴² See Michael Schillig, "Directive 93/13 and the 'price term exemption': a comparative analysis in the light of the 'market for lemons rationale'" (2011) *International & Comparative Law Quarterly* 933, p 937.

In a free market economy parties to a contract are free to shape the principal obligations as they see fit. The relationship between the price and the goods or services provided is determined not according to some legal formula but by the mechanisms of the market. Any control by the courts or administrative authorities of the reasonableness or equivalence of this relationship is anathema to the fundamental tenets of a free market economy. It would partially abrogate the laws of the market and hence prevent the offerers of goods or services from acting in accordance with those laws; the consumer would no longer need to shop around for the most favourable offer, but rather could pay any price in view of the possibility of subsequent control of its reasonableness.⁴³

Instead, they argued that consumer protection should be ensured by “improving the transparency in this area”.⁴⁴

- 6.36 The exemption seeks to reconcile consumer rights with free competition. Michael Schillig comments that this “inherent conflict renders a coherent and consistent interpretation very difficult”.⁴⁵ As Lord Steyn stated in *Director General v First National Bank Plc*:

The directive is not an altogether harmonious text. It reflects the pragmatic compromises which were necessary to arrive at practical solutions between member states with divergent legal systems.⁴⁶

The bank charges litigation

- 6.37 The exemption has been the subject of considerable litigation, most notably about bank charges,⁴⁷ culminating in the 2009 Supreme Court decision, *Office of Fair Trading v Abbey National plc*.⁴⁸ This was a test case brought by the Office of Fair Trading (OFT) against seven banks and one building society. The issue before the court was whether charges for unauthorised overdrafts were exempt from an assessment for fairness because they were price terms.
- 6.38 The High Court and Court of Appeal found that the terms were not exempt, because they were not part of the essential bargain between the parties, and a typical consumer would not recognise the charges as part of the price.

⁴³ Professor Brandner and Professor Ulmer, “The Community Directive on Unfair Terms in Consumer Contracts: Some Critical Remarks on the Proposal Submitted by the EC Commission” (1991) 28 *Common Market Law Review* 647, p 656.

⁴⁴ Above.

⁴⁵ Michael Schillig, “Directive 93/13 and the ‘price term exemption’: a comparative analysis in the light of the ‘market for lemons rationale’” (2011) *International & Comparative Law Quarterly* 933, p 936.

⁴⁶ [2001] UKHL 52, [2002] 1 AC 481 at [32].

⁴⁷ For example *Director General of Fair Trading v First National Bank* [2001] UKHL 52, [2002] 1 AC 481; *Office of Fair Trading v Foxtons Ltd* [2009] EWHC 1681 (Ch), [2009] 3 EGLR 133; *Office of Fair Trading v Ashbourne Management Services* [2011] EWHC 1237 (Ch), [2011] ECC 31.

⁴⁸ [2009] UKSC 6, [2010] 1 AC 696.

6.39 Conversely, the Supreme Court rejected the idea that price terms could be divided into those which formed the essential bargain and those which were ancillary. Below we look at three strands of the Supreme Court judgment:

- (1) Whether a term concerned the price should be determined objectively, not by how a typical consumer would perceive the bargain.
- (2) The exclusion relates not to price terms as such, but to the way that price terms are assessed.
- (3) The issue would not be referred to the CJEU.

The price should be determined “objectively”

6.40 The Court rejected a test based on how a typical consumer would regard the bargain. Lord Mance said that it would re-write the legislation to introduce a test based on how far consumers had actually exercised contractual freedom when agreeing upon a price stated in plain and intelligible language.⁴⁹ Instead, the price was a matter of objective interpretation by the court. The Court considered how the banks in fact derived their revenue; it appeared to be swayed by evidence that unauthorised overdraft charges amounted to over 30% of revenue from all personal current account customers.⁵⁰ On this basis it was held that the charges were part of the price of personal banking.

6.41 Applying this reasoning to event fees, it could be argued that if an event fee provides a substantial income stream to the landlord it is part of the price, even if a typical consumer would not think of it in this way.

The exclusion relates to the way that price terms are assessed

6.42 Following the words of the UTD, the legislation does not state that a court cannot review the price. Instead, it states that the court may not assess the “appropriateness of the price” by comparison with the goods, digital content or services supplied.

6.43 In *OFT v Abbey National*, the High Court was asked whether the regulations excluded a price term from any assessment of fairness (the “excluded terms” construction) or whether it excludes only an assessment relating to the adequacy or appropriateness of the price (the “excluded assessment” construction).⁵¹ Mr Justice Andrew Smith decided in favour of the excluded assessment construction. This finding was not challenged on appeal.⁵² Whilst this may initially appear to be an abstract point, the Supreme Court pointed out that this was likely to be of great practical importance.⁵³

⁴⁹ [2010] 1 AC 696 at [112].

⁵⁰ Above, at [47] and [88].

⁵¹ [2008] EWHC 875, [2008] 2 All ER (Comm) 625 at [422].

⁵² So as to distinguish *Director General of Fair Trading v First National Bank Plc* [2001] UKHL 52, [2002] 1 AC 481. See [2009] UKSC 6, [2010] 1 AC 696 at [29].

⁵³ Above at [29] by Lord Walker.

6.44 This prediction has proved to be correct. In *Office of Fair Trading v Ashbourne Management Services*, the High Court considered the application of unfair terms legislation to various gym membership contracts.⁵⁴ The OFT had received many complaints from consumers who had entered into lengthy gym membership contracts; even if consumers cancelled the contract, they were still required to pay for the full period of the contract for services they had not used.

6.45 The High Court found that the terms were unfair. Although the payments following cancellation may have provided the gym with a substantial income stream, the judge held that the term did not fall within the exemption. Even if it was a price term, the assessment did not relate to the appropriateness (or adequacy) of the price. Mr Justice Kitchin commented:

Instead it relates to the obligation upon members to pay monthly subscriptions for the minimum period when they have overestimated the use they will make of their memberships and failed to appreciate that unforeseen circumstances may make their continued use of a gym impractical or their memberships unaffordable. Put another way, it relates to the consequences to members of early termination in light of the minimum membership period.⁵⁵

6.46 Thus the court could find that the terms were unfair. On this basis, event fees could be found to be unfair – not because they are too high – but because consumers failed to appreciate when the charge would apply or the unforeseen circumstances which would lead them to dispose of the property.

No reference to the European Court of Justice

6.47 Finally, the Supreme Court decided not to refer the matter to the Court of Justice of the European Union (CJEU). The Court considered there to be a “strong public interest in resolving the matter without further delay”⁵⁶ due to the “very large”⁵⁷ number of claims stayed pending the decision. This approach to a matter of Community law was “the lesser of two evils”.⁵⁸

⁵⁴ [2011] EWHC 1237 (Ch), [2011] ECC 31.

⁵⁵ Above at [175].

⁵⁶ [2009] UKSC 6, [2010] 1 AC 696 at [50].

⁵⁷ Above at [48].

⁵⁸ Above at [50].

- 6.48 This aspect of the Court's reasoning has been severely criticised by academics.⁵⁹ It is suggested that the CJEU may have taken a different approach to interpreting the exemption, which was less literal and more purposive. For example Phillip Morgan commented that the Court's approach was "distinctly English as opposed to European, in that it is not broad and purposive".⁶⁰
- 6.49 Professor Hein Kötz has highlighted the "striking discrepancy between the decision of the Supreme Court and German case law on the issue in question".⁶¹
- 6.50 The German Federal Supreme Court (*Bundesgerichtshof* – *BGH*) has consistently held that the standard terms of banks may be assessed for fairness if they provide for specific fees to be charged on top of the general current account fees.⁶² For example, the Court assessed the fairness of fees charged to a customer who wished to withdraw cash at the counter rather than from an ATM,⁶³ who was notified by the bank that his account had been seized by his creditors⁶⁴ or who was overdrawn.⁶⁵
- 6.51 That said, however, these German decisions have been made against a different factual and legal background.⁶⁶ They would not necessarily be followed by the CJEU. We consider CJEU decisions on this issue below.

⁵⁹ For example, Paul Davies described the decision not to refer as "dubious": "Bank Charges in the Supreme Court" (2010) 69(1) *Cambridge Law Journal* 21, p 23. Mel Kenny said that the judgment "dramatically recasts" the doctrine of when references should be made: "Orchestrating Sub-prime Consumer Protection in Retail Banking: *Abbey National* in the Context of Europeanized Private Law" *European Review of Private Law* (2011) 43, p 55. Michael Schilling said it was a missed opportunity: "Directive 93/13 and the 'price term exemption': a comparative analysis in the light of the 'market for lemons' rationale", (2011) *International & Comparative Law Quarterly* 933, p 963.

⁶⁰ Phillip Morgan, "Bank charges and the Unfair Terms in Consumer Contracts Regulations 1999: the end of the road for consumers?" [2010] *Lloyd's Maritime and Commercial Law Quarterly* 208, p 212 at p 214. See also Mindy Chen-Wishart, "Transparency and Fairness in Bank Charges" (2010) 126 *Law Quarterly Review* 157, p 161 and Simon Whittaker, "Unfair Contract Terms, Unfair Prices and Bank Charges" (2011) 74(1) *Modern Law Review* 106 at pp 115-116. For a full discussion of academic reactions to the *Abbey National* decision, see Law Commission/Scottish Law Commission, Unfair Terms in Consumer Contracts, Issues Paper (July 2012) Part 6.

⁶¹ Hein Kötz, "Schranken der Inhaltskontrolle bei den Allgemeinen Geschäftsbedingungen der Banken: Entscheidung des britischen Supreme Court vom 25. November 2009", (2012) 20 *Zeitschrift für Europäisches Privatrecht* 332, pp 344 to 346.

⁶² In one case, a bank had instructed all of its branches to charge a fee of €6 if a debit had to be returned due to the customer account being overdrawn. This was held to be unfair BGH 8 March 2005, NJW 2005, 1645, 1647. See also Hugh Beale, Bénédicte Fauvarque-Cosson, Jacobien Rutgers, Denis Tallon and Stefan Vogenauer, *Ius Commune Casebooks for the Common Law of Europe: Cases, Materials and Text on Contract Law* (2nd edn, 2010), pp 818-20.

⁶³ BGH 30 November 1993, BGHZ 124, 254, NJW 1994, 318.

⁶⁴ BGH 19 October 1999, NJW 2000, 651.

⁶⁵ BGH 13 February 2001, BGHZ 146, 377, NJW 2001, 1419.

⁶⁶ The current German price/subject matter exemption in § 307(3) of German Civil Code stems from § 8 Unfair Terms Act 1976 (BGB) which predates the UTD. The German system subjects all standard terms that deviate from, or add to, default rules to an assessment of fairness.

The CJEU approach to the price exemption

6.52 When the Law Commissions examined this issue in 2012 we commented:

There is very little CJEU guidance on the correct interpretation of the article 4(2) exemption. To date, no decision has dealt directly with the types of terms which fall within its scope. Instead, Advocate General Trstenjak has characterised the “price” and “main subject matter” as factual circumstances which fall to a national court to decide.⁶⁷

6.53 We noted however, that the article 4(2) exemption did not apply to price escalation terms.⁶⁸ Advocate General Trstenjak explained that in these cases:

the dispute hinges less on the amount of the cost itself than on the entitlement of the defendant... unilaterally to amend the contract terms for particular services.⁶⁹

6.54 Advocate General Trstenjak also noted that the CJEU still receives a “large number” of references for a preliminary ruling on the interpretation of the UTD.⁷⁰ Since 2012, there has been another case on the price exemption, to which we now turn.

Kásler

FACTS

6.55 This case, from Hungary, concerned extra fees charged in a mortgage contract.⁷¹ Mr and Mrs Kásler took out a mortgage in 2008. The Káslers wanted to deal in Hungarian forints, but the loan was denominated in Swiss francs. As the bank did not take the risk of currency fluctuations, it was able to offer the Káslers a lower rate of interest. However, during the global financial crisis, the Hungarian forint almost halved against the Swiss Franc. The Káslers faced spiralling repayment costs and went to court to challenge the mortgage.

6.56 The case turned on a challenge to one apparently small term of the contract. The amount of the loan was calculated using the exchange rate given by the bank when it was buying Swiss francs from customers on the day the mortgage funds were transferred. However, the Káslers’ monthly instalments were calculated using the bank’s exchange rate when it was *selling* Swiss francs to customers on the day before each instalment was due. This difference between the “buy” and “sell” rate was referred to as the “spread” and represented a profit to the bank.

⁶⁷ Law Commission/Scottish Law Commission, Unfair Terms in Consumer Contracts, Issues Paper (July 2012) para 7.21. The quote refers to Opinion of Advocate General Trstenjak Case C-484/08 *Caja de Ahorros y Monte de Piedad de Madrid v Asociación de Usuarios de Servicios Bancarios (Ausbanc)* [2010] ECR I-04785 at [70].

⁶⁸ Case C-472/10 *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt* (26 April 2012).

⁶⁹ Opinion of Advocate General Trstenjak Case C-472/10 *Nemzeti Fogyasztóvédelmi Hatóság v Invitel Távközlési Zrt* (6 December 2011) at [79].

⁷⁰ Above, at [1].

⁷¹ Case C-26/13 *Árpád Kásler v OTP Jelzálogbank Zrt* [2014] ECR O.

- 6.57 The Káslers said that the term allowing the bank to charge the spread was unfair because it gave a unilateral and unjustified advantage to the bank, contrary to Article 209 of the Hungarian Civil Code, which implemented the Directive. The Káslers won their case in Hungary at first instance. The decision was upheld on appeal. When the case reached the Hungarian Supreme Court (*the Kúria*), it asked the CJEU to consider whether the term about the exchange rate was part of the contract price. The CJEU decided that it was not.

THE CJEU DECISION

- 6.58 The CJEU stressed that article 4(2), as an abridgment of consumer protection, should be interpreted narrowly and strictly.⁷² It held that the term allowing the bank to calculate the repayment amount using its “sell” exchange rate was not part of the contract price. Therefore it was not exempted by article 4(2) from being reviewed for fairness.
- 6.59 The CJEU’s decision seems to have been influenced heavily by its view that the bank was not providing a foreign exchange service. The foreign currency denomination was just a convenient way of ensuring that the bank received stable repayments. The CJEU decided that there was no corresponding service provided by the bank for which the spread was the contract price.
- 6.60 In his advisory opinion, which the CJEU followed in its judgment, Advocate General Wahl said:

If, as seems to be the case in the main proceedings, the bank does not provide the customer with a specific service, but the reference to the foreign currency is merely a standard of value, the view could be taken that that difference between the buying price and the selling price for the foreign currency is not an adequate consideration and that the unfairness of the relevant contractual term may be examined.

- 6.61 Advocate General Wahl also drew attention to the fact that article 4(2) only prevents an assessment of the “adequacy of the price” rather than all elements of a price term:

It must be borne in mind that such an exception does not concern all parts of the price, but only the adequacy of the price and remuneration, on one side, as against the services or goods supplied in exchange, on the other... The terms laying down the manner of calculation and the procedures for altering the price remain entirely subject to the directive.

⁷² Case C-26/13 *Árpád Kásler v OTP Jelzálogbank Zrt* [2014] ECR O at [42].

IMPLICATIONS

- 6.62 The reasoning in *Kásler* differs from the Supreme Court's reasoning in *OFT v Abbey National*. In *Abbey National*, the Supreme Court took a holistic approach: they considered that the whole package of monetary obligations undertaken by the customer was the price of the whole package of services provided by the bank. By contrast, in *Kásler*, the CJEU looked for a connection between a given payment and a particular service rendered. The CJEU decided the foreign exchange fee was not part of the contract price because, it said, the bank was not directly providing a foreign exchange service. This casts doubt over the reasoning in *Abbey National*, suggesting that *Abbey National* may not be a reliable guide to the interpretation of article 4(2).
- 6.63 That said, the decision in *Abbey National* is not necessarily wrong. As Advocate General Trstenjak explained, what is or is not a "price" is a matter of fact for national courts to decide. There are many factual differences between unauthorised overdraft charges and the "spread" charged by the bank in *Kásler*. Most notably, in *Kásler*, the consumers paid interest, which represented the main price of the loan. In *Abbey National*, there was no main price: personal banking was sold as "free if in credit". Therefore, personal banking is more of a package, with less of a link between individual charges and services.
- 6.64 The case law shows the difficulties and uncertainties in this area.

Conclusion

- 6.65 Our overall conclusion is that a court could consider the fairness of some event fees – not because the charges were too high, but because of other aspects of the way that they were structured, presented and applied. However, the law in this area is more complex and uncertain than it should be.
- 6.66 In our 2013 Advice to the Government on Unfair Terms in Consumer Contracts, we explained that the UTD represents a compromise between classical and behavioural economics. The exemption in article 4(2) seeks to exempt price terms which consumers know about, while some paragraphs of the grey list protect consumers against common terms which are known to exploit their behavioural biases.
- 6.67 Our recommendations sought to preserve this compromise. In general, we thought that the courts should not assess the price or main subject matter where the terms were made clear to consumers before they entered into the contract. On the other hand, the legislation was right to recognise well-known ways in which consumers' biases can be exploited, and to include these on the grey list.
- 6.68 Following our recommendations, the Consumer Rights Act 2015 made four changes:
- (1) Price terms are only exempt from review if they are transparent and prominent. However, "prominent" is given a relatively narrow meaning. A term is prominent if a reasonably circumspect consumer would be aware of the term. As discussed in Chapter 4, consumers are often aware of terms but fail to take them into account because of predictable behavioural biases.

- (2) The 2015 Act explicitly states that all terms on the grey list may be reviewed for fairness and do not fall within the exemption relating to main subject matter and price.⁷³
- (3) Three new terms known to exploit behavioural biases were added to the grey list. This includes the sort of term common in gym membership contracts which came under scrutiny in *OFT v Ashbourne*. These are terms which have the object or effect of:

requiring that, where the consumer decides not to conclude or perform the contract, the consumer must pay the trader a disproportionately high sum in compensation or for services which have not been supplied.

- (4) The 2015 Act includes a power allowing the Secretary of State to add terms to the grey list by statutory instrument.⁷⁴

6.69 In Chapter 11, we provisionally propose that the Secretary of State should use this power to expand the grey list to include event fees which fail to abide by a code of practice. We do not think that this will be a substantive change in the law. In our view, event fees are already reviewable for fairness, at least in so far as the alleged unfairness relates to issues other than the amount (such as timing, structure or presentation). It will, however, introduce greater clarity over this issue.

A LEASE AS A CONTRACTUAL RELATIONSHIP

Leases as contracts between the original parties

- 6.70 Residential leases are considered to be consumer contracts for the purposes of unfair terms legislation, at least when made between the original landlord and tenant.
- 6.71 This was confirmed in the case of *R (Khatun) v Newham LBC*.⁷⁵ A homeless woman applied to be housed by the local authority and was offered a private sector periodic tenancy on a take it or leave it basis. One question was whether the lease she signed fell within unfair terms legislation. Counsel for the local authority argued that the UTD did not apply to land. Instead it should be interpreted as only applying to "contracts for goods and services as an English lawyer would understand those terms". Lord Justice Laws commented that this argument placed an "illegitimate reliance on the large divide in the law of England between real and personal property":

⁷³ CRA 2015, s64(6).

⁷⁴ Above, s63(3) – (5).

⁷⁵ [2005] QB 37.

There is plainly no general principle to support such a proposition. Quite the contrary: European legislation has to be read as a single corpus of law binding across the member states.... In our domestic law these distinctions have a long history and a present utility. In the context of a Europe-wide scheme of consumer protection, they could be nothing but an embarrassing eccentricity.⁷⁶

6.72 It is clear, therefore, that the concept of a “consumer contract” has to be applied in a broad, European way and does not depend on the eccentricities of English land law.

6.73 There are several cases in which the terms of periodic tenancies have been found to be unfair. For example in *Peabody Trust Governors v Reeve* a term in a standard tenancy contract used by a registered social landlord was found to be unfair. A variation clause gave the landlord considerable discretion to alter tenancy terms. As the court put it, it sought to reserve:

almost *carte blanche* in the field of variations, apart from the areas of rent and statutory protection, so as to provide in effect that the terms of the tenancy agreement will be whatever the [landlord] says they are to be from time to time.⁷⁷

Is there a contractual relationship between subsequent parties?

6.74 Leases represent a contract between the first consumer tenant (T1) and trader landlord (L1). The more difficult issue is whether this contractual relationship survives an assignment to new parties. Does the contract continue after T1 has sold the lease to another tenant (T2), or L1 has sold the freehold to another landlord (L2)?

6.75 In Chapter 5, we explain that, in English contract law, the general principle is that only the original parties to a contract can directly enforce it against each other. This principle is referred to as “privity of contract”. English law accepts that leases can be assigned from one tenant to another (and from one landlord to another), but the subsequent relationship is not considered to be a contractual one. Traditionally, covenants that touch and concern the land are said to be directly enforceable between successors to the original parties, not through contract law, but through land law concepts. There is said to be “privity of estate” between the parties.

6.76 For leases granted after 1 January 1996, the issue is governed by the Landlord and Tenant (Covenants) Act 1995 (the 1995 Act). The 1995 Act is written entirely in terms of land law concepts, and does not in any way suggest that a contract subsists following an assignment of the lease.⁷⁸

⁷⁶ [2005] QB 37, para 78.

⁷⁷ [2008] EWHC 1432 (Ch), [2009] L&TR 6 at [56].

⁷⁸ For example, s 3(1) begins by stating that “the benefit and burden of all landlord and tenant covenants of a tenancy” shall be “annexed and incident to the whole, and to each and every part, of the premises demised by the tenancy and of the reversion in them”.

- 6.77 In English land law, a lease creates a contract only between the original parties. The relationship between subsequent parties is not seen as contractual in nature.
- 6.78 What implications does this have for unfair terms legislation? As we have seen, the legislation only applies to “a contract between a trader and a consumer”. Could it be argued that unfair terms legislation does not apply to the terms of a lease between subsequent parties, because there is no contract for it to apply to? Alternatively, is the view that a lease ceases to be a contract on assignment simply an “eccentricity” of English law which has no effect on the interpretation of European legislation, such as the UTD?

Previous authority

- 6.79 The OFT reached the view that unfair terms legislation “applied to leases in the same way as to other contracts”:

In particular they apply not only when leases are made between the freeholder and the original leaseholder but also when the lease is assigned, if the assignee is a ‘consumer’ for the purposes of the UTCCR⁷⁹.

- 6.80 The only direct authority we have found on the point is the case of *Levitt v London Borough of Camden*.⁸⁰ Here, an assignee tenant brought a claim under the 1999 Regulations, arguing that the terms of the lease were unfair. The Lands Chamber of the Upper Tribunal decided that the Regulations did apply to the lease in question, citing *R (Khatun) v Newham LBC* as authority. In *Khatun*, however, the dispute was between the original parties so there was, without doubt, a contract between them. The tribunal did not consider whether separate rules might apply to the relationship between subsequent parties to a lease. It is therefore not necessarily a strong authority on the issue.

The Draft Common Frame of Reference (DCFR)

- 6.81 In order to resolve this issue, it is necessary to look beyond English land law concepts, to see whether the relationship between subsequent parties to a lease would be considered to be a contract under general principles of European law.
- 6.82 The best source of information about how other Member States would approach this issue is provided by the Draft Common Frame of Reference (DCFR).⁸¹ The DCFR is an academic text, which has been described as “nothing less than the draft of the central components of a European Civil Code”.⁸² It is a substantial document, in six volumes, containing draft articles, commentary and background notes. It is divided into ten books, covering a wide range of subjects, including a book on sales, lease of goods and service contracts.

⁷⁹ OFT investigation into retirement home transfer fee terms (February 2013) para 3.3.

⁸⁰ [2001] UKUT 366 at [29].

⁸¹ Draft Common Frame of Reference: Principles, Definitions and Model Rules of European Private Law, Full Edition: Christian von Bar, Eric Clive (eds), 2009.

⁸² *Atiyah's Sale of Goods* (12th ed 2010), p 6.

- 6.83 It follows a large body of collaborative work to understand and set out the general principles of European contract law. In 1982, the Lando Commission brought together contract law specialists from different member states. Following comparative studies of Member States' contract laws, the Lando Commission published its "Principles of European Contract Law".⁸³
- 6.84 In 2003 the European Commission built on this work. It set out an action plan to develop a "Common Frame of Reference". The explicit intention was that such a work could be used to interpret directives (such as the UTD). The Commission argued that, by "establishing common principles and terminology", it would help in "ensuring greater coherence of existing and future *acquis* in the area of European contract law".⁸⁴ At present, the DCFR remains an academic draft: it does not yet have an official political stamp to give it authoritative status in interpreting directives. Nevertheless, it is a highly influential text in answering questions of the sort that we have outlined.

Transfer of contractual rights and obligations under the DCFR

- 6.85 Unlike English law, most European countries are happy to accept that contractual rights and obligations can be transferred from one party to another. The transfer of rights is dealt with in Article III-5:101; the transfer of obligations in III-5:201. Meanwhile, III-5:302 deals with "the transfer of the entire contractual position". It states that:

A party to a contractual relationship may agree with a third person, with the consent of the other party to the contractual relationship, that that party is to be substituted as a party to that relationship.

- 6.86 The commentary states that "agreements for the transfer of an entire contractual position are often concluded with regard to tenancy agreements, loan arrangements, labour contracts and other types of contract of long duration". It provides an illustration in which A contracts for the construction of a prefabricated house with Company B, who becomes bankrupt. Provided A agrees, Company C may "step into the contractual relationship" with all the contractual rights and obligations which were previously B's.
- 6.87 The commentary stresses:

⁸³ Published in three volumes between 1995 and 2003 (the second volume subsuming the content of and so replacing the first).

⁸⁴ Communication from the Commission to the European Parliament and the Council – A more coherent European contract law – an Action Plan, COM (2003) 68 (12 February 2003), p 16. The word "*acquis*" refers to the body of EU law as set out in directives regulations and decisions.

The transfer of an entire contractual position must not be confused with novation. Novation implies the extinction of the old contractual relationship and the constitution of a new one with a different object or a different source, whereas in a transfer of the entire contractual position the relationship remains the same. The contractual bond is the same, but it transferred from the first party to the incoming third party.⁸⁵

6.88 The notes show that English law is an exception to this general principle:

English law deals with the transfer of an entire contractual position under the heading of novation.... In theory, however, novation results in a new contract.⁸⁶

6.89 In English contract law the idea that a contract only binds the original parties is so strong that the law does not recognise that the same contractual bond can operate between new parties. Instead, a transfer which other European legal systems would characterise as a transfer of a continuing contract would, in England, be characterised as something else: in the case of a lease, as an estate in land or (in other contexts), as a new contract.

6.90 However, the notes suggest that English law is unique in this respect. All 17 other legal regimes discussed do recognise the transfer of a contractual relationship (including Scotland).

Conclusion

6.91 In the absence of any binding authority on this issue, our conclusions can only be tentative. We think that under European principles, a lease would be regarded as constituting a contractual relationship between the landlord and any subsequent tenants. The English characterisation of this relationship as non-contractual is a mere “eccentricity” which does not affect the application of the UTD. In European law, the original lease is a contract – and it remains a contract through its life, irrespective of any change to the parties. As the DCFR commentary puts it, “the contractual bond is the same, but it transferred from the first party to the incoming third party”.⁸⁷

6.92 We have considered what the effect would be if the lease started as a consumer contract (between a trader landlord and a consumer tenant) but the consumer then assigned the contract to a business. If the contractual bond is the same, does the contract remain a consumer contract, even if neither party is a consumer? We do not think that it is necessary to answer this question as it is clear that only a consumer can take advantage of unfair terms protection. As section 62 of the Consumer Rights Act puts it, “an unfair term of a consumer contract is not binding on the consumer”. An unfair term would, however, be binding on a non-consumer party.

⁸⁵ Communication from the Commission to the European Parliament and the Council – A more coherent European contract law – an Action Plan, COM (2003) 68 (12 February 2003), p 1103.

⁸⁶ Above, p 1106, note 15.

PROBLEMS WITH THE “ONE CONTINUING CONTRACT” ANALYSIS

- 6.93 It is clear from the DCFR that the UTD does apply to leases between subsequent tenants and landlords. However, there are three problems with the concept that a lease is one continuing contract, agreed between the original parties and assigned to others.

The need to look at what each tenant was told

- 6.94 First, the UTD requires the assessment of fairness to refer to the circumstances “at the time of the conclusion of the contract”. Article 4(1) states this specifically:

The unfairness of a contractual term shall be assessed, taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances attending the conclusion of the contract and to all the other terms of the contract or of another contract on which it is dependent.

- 6.95 The CRA 2015 transcribes this requirement by stating that “whether a term is fair is to be determined

....

(b) by reference to all the circumstances existing when the term was agreed and to all of the other terms of the contract or of any other contract on which it depends.⁸⁸

- 6.96 This means that the way the term was presented to the consumer is often crucial. If it was not presented in a clear, transparent way, the term is likely to breach the requirement of good faith and be considered unfair.
- 6.97 We think it is important that steps are taken to inform each new tenant about the terms, especially onerous or unusual terms. Yet if a lease is seen as a single, continuing contract which is passed from one consumer to another, then the only relevant circumstances would be those arising when the lease was agreed with the first tenant. It would suggest that landlords can wash their hands of the need to provide information thereafter. We do not think that is right in policy terms. In Chapter 11 we provisionally propose to change the law in this area.

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⁸⁷ Comments, p 1103.

⁸⁸ CRA 2015, s 64(5).

Where the first tenant is a business

- 6.98 Secondly, we have considered how unfair terms law applies to a lease which was originally agreed between a landlord and a non-consumer tenant. What happens if the “business” tenant (T1) then sells the lease to a consumer (T2)? Clearly, there is a consumer contract between T1 and T2, but is there also a consumer contract between L1 and T2? In other words, can a lease which was not a consumer contract when it was created become a consumer contract when a consumer becomes bound by it?
- 6.99 The DCFR analysis of one continuing contract suggests not. In practice, we have not found this to be a problem in the current market. However, if the “one continuing contract” analysis is applied literally, it could provide an easy way to evade unfair terms law. Landlords could agree a lease initially with a management company, who could then sell the lease to a consumer, meaning that the terms between landlord and tenant were not subject to unfair terms law.

Leases created before 1 July 1995

- 6.100 The normal rule is that a contract must be judged in accordance with the law in force at the time it was agreed. The third problem with the “one contract” analysis is that unfair terms controls would have no effect on a lease created before the introduction of unfair terms legislation on 1 July 1995.
- 6.101 We think that when a lease is extended it becomes a new contract. Similarly, a new contract arises if the lease is varied. However, if the lease continues in its original form and is simply assigned to new parties, it could be argued that it remains as the original contract. On this basis, old leases created before 1 July 1995 would fall outside the protection provided by unfair terms legislation.
- 6.102 The OFT commented on this issue in the following terms:
- How this affects transfer fee clauses in leases drafted before 1 July 1995 is a technical legal question which can only be finally settled by a judgment of the court. However, our view is that the date of the original lease agreement cannot on its own make such terms immune from challenge for as long as the lease remains in force, which may be a matter of decades or even centuries.
- 6.103 Since the OFT report, the issue was considered briefly by the Supreme Court in *Arnold v Britton*.⁸⁹ As we saw in Chapter 5, the case concerned terms in a lease for 99 years granted in 1974. Lord Carnwath noted, in passing, that “no issue arises in the present proceedings as to the possible application of other more general protections relating to unfair contractual terms”. This was because

The 1994 Regulations came into effect on 1 July 1995, and therefore would not it seems apply to contracts concluded before that date.⁹⁰

⁸⁹ [2015] UKSC 36.

⁹⁰ Above, at para 93.

- 6.104 We agree with the OFT that this has the potential to create a serious gap in consumer protection: new consumers could find themselves saddled by unfair terms agreed up to a century earlier. In Chapter 10 we consider how far it is legitimate to impose new controls on existing leases.

CONCLUSION

- 6.105 The law of unfair terms applies to leases, but it does not do so in a seamless way. In Chapter 11 we recommend statutory change in this area.
- 6.106 First, we think that each time a new consumer tenant becomes bound by obligations to a landlord, this should be seen as forming a new contractual relationship for the purpose of unfair terms law. When assessing the fairness of an onerous or unusual term in a lease, the court should look at all the circumstances which applied when the consumer took on the obligation – including how the term was presented to them. We propose that even if the lease was first agreed before 1 July 1995, a term may be considered unfair if, following our reforms, the landlord failed to take appropriate steps to make the term transparent to new consumer tenants.
- 6.107 Secondly, the CRA 2015 states that price terms are only exempt from review if they are transparent and prominent. However, “prominent” is defined narrowly: a term is prominent if a reasonably circumspect consumer would be aware of the term. Event fees are one example where, even if the term is sufficiently prominent for the average consumer to be aware of it, this may not be enough. Those buying specialist housing may be particularly vulnerable. And, even if consumers are aware of the term, they may fail to understand the full implications and may not, as a result, take the term into account in their decisions.
- 6.108 The principle behind the CRA 2015 was that terms known to exploit behavioural biases should be added to the grey list.⁹¹ It therefore includes a power allowing the Secretary of State to add terms to the grey list by statutory instrument.⁹² We think that event fees are particularly likely to exploit behavioural biases. In Chapter 11 we provisionally propose that they should be added to the grey list using this power.

⁹¹ Law Commission and Scottish Law Commission, *Unfair Terms in Consumer Contracts: Advice to the Department for Business, Innovation and Skills* (March 2013), paras 3.52 to 3.58.

⁹² CRA, s 63(3) – (5).

CHAPTER 7

THE CONSUMER PROTECTION FROM UNFAIR TRADING REGULATIONS 2008

- 7.1 If traders give inadequate or misleading information about event fees, they may face public enforcement under the Consumer Protection from Unfair Trading Regulations 2008. These regulations are usually referred to as the Consumer Protection Regulations or “CPRs”. They implement an EU Directive, the Unfair Commercial Practices Directive 2005.¹ They are designed to protect consumers against misleading or aggressive trade practices across the full range of consumer transactions, from buying a sandwich to buying a house.
- 7.2 In particular, the regulations make it a criminal offence for a trader to omit material information which consumers need to make an informed decision about a transaction. Some of the practices encountered in our mystery shopping research would appear to breach this provision.
- 7.3 In the property sector, the CPRs rely on public rather than private enforcement. This means that consumers who purchase long leases may not rely on the CPRs in proceedings before the courts. Instead, they must complain to local authority trading standards services, which may bring a criminal prosecution. The Competition and Markets Authority also has power to take action and focuses on market wide problems.²
- 7.4 However, the CPRs are still relevant to individual consumers. As we describe in Chapter 8, the regulations are incorporated within several industry codes. The Property Ombudsman, for example, will apply its own code and may award compensation of up to £25,000 for a material omission under the CPRs.
- 7.5 A breach of the CPRs may also be a factor in deciding whether a term is fair. The Court of Justice of the European Union (CJEU) has clarified that breach of the Unfair Terms Directive defines the criteria for assessment particularly widely by expressly including “all the circumstances” attending the making of the contract in question:

In those circumstances,... a finding that a commercial practice is unfair [under the Unfair Commercial Practices Directive] is one element among others on which the competent court may base its assessment of the unfairness of contractual terms.³

¹ SI 2008 No 1277.

² Competition and Markets Authority, CMA7: *Consumer Protection: Guidance on the CMA’s approach to use of its consumer powers* (March 2014), 2.

³ Case C-453/10 *Pereničová and another v SOS financ spol. s. r.o.* [2012] 2 CMLR 28, paras 42-43.

WHEN DO THE CONSUMER PROTECTION REGULATIONS APPLY?

7.6 The CPRs, like the Unfair Terms Directive, apply to traders in their dealings with consumers. They do not affect dealings that are purely between businesses (B2B) or purely between consumers (C2C).⁴

7.7 The CPRs stay close to the wording of the Directive, and introduce a number of European definitions. Under regulation 2(1), a trader is defined as:

Any person who in relation to a commercial practice is acting for purposes relating to his business.

7.8 Meanwhile a “commercial practice” is:

Any act, omission, course of conduct, representation or commercial communication (including advertising or marketing) by a trader which is directly connected with the promotion, sale or supply of a product to or from consumers.⁵

7.9 This is a wide concept, covering the whole supply chain.⁶ For example, it covers an estate agent who advertises a property, or makes a representation which is directly connected with the promotion or sale of a property, even if the agent acts for a seller who is a private individual.

7.10 In its turn, a “product” is defined as including immovable property.⁷ It therefore covers the promotion or sale of a lease.

7.11 Previously, estate agents were subject to the Property Misdescriptions Act 1991, which made it a criminal offence to make false or misleading statements about properties offered for sale. However, in 2013 this Act was repealed on the grounds that it was duplicated by the CPRs.

UNFAIR PRACTICES

7.12 The CPRs identify five unfair practices. For the purposes of this project, we concentrate on two: misleading actions and misleading omissions.⁸ In both cases, the action or omission must “cause or be likely to cause the average consumer to take a transactional decision he would not have taken otherwise”.

⁴ See art 3 and recital 6 of the Directive; and European Commission, *Guidance on the Implementation/Application of Directive 2005/29/EC on Unfair Commercial Practices* (December 2009) 1666, p 14, available at http://ec.europa.eu/consumers/rights/docs/Guidance_UCP_Directive_en.pdf. B2B communications are now covered by the Business Protection from Misleading Marketing Regulations 2008.

⁵ The Consumer Protection from Unfair Trading Regulations 2008, reg 2(1).

⁶ Joined Cases C-261/07 and C-299/07 *VTB-VAB NV v Total Belgium NV*; and *Galatea BVBA v Sanoma Magazines Belgium NV* [2009] ECR I – 2949, para 49, [2010] All ER (EC) 694.

⁷ Consumer Protection Regulations 2008, reg 2(1).

⁸ The other three are aggressive practices (reg 7); a blacklist of examples of 31 practices which are always unfair (sch 1); and a safety net of practices “contrary to the requirements of professional diligence” (reg 3(3)).

- 7.13 Below we explain each of these terms: “misleading action”, “misleading omission”, “causes or is likely to cause”; “average consumer”; and “transactional decision”.

Misleading actions

- 7.14 An action by a trader is misleading under regulation 5 if it contains false information, or “its overall presentation in any way deceives or is likely to deceive the average consumer”, even if it is factually correct.⁹
- 7.15 The misleading information must relate to one of the listed matters, set out in regulation 5(4) to (6). The lists include “the price or the manner in which the price is calculated”.
- 7.16 An action will also be “misleading” under the CPRs if the trader signs up to a code of practice and then fails to comply with a commitment in it. Regulation 5(3)(b) states that an action is misleading if:

it concerns any failure by a trader to comply with a commitment contained in a code of conduct which the trader has undertaken to comply with, if—

(i) the trader indicates in a commercial practice that he is bound by that code of conduct, and

(ii) the commitment is firm and capable of being verified and is not aspirational.

Misleading omissions

- 7.17 It is also an offence for a trader to omit material information. Regulation 6 states that a commercial practice is a misleading omission, if in its “factual context” it:

- (a) omits material information;
- (b) hides material information;
- (c) provides material information in a manner which is unclear, unintelligible, ambiguous or untimely; or
- (d) fails to identify its commercial intent, unless this is already apparent from the context.

and as a result it causes or is likely to cause the average consumer to take a transactional decision he would not have taken otherwise.

⁹ The Consumer Protection from Unfair Trading Regulations 2008, reg 5(2).

- 7.18 In general, information is material if the average consumer needs it “to take an informed transactional decision”.¹⁰ The UK courts have stressed that, under this clause, the information must be *necessary* for the consumer’s decision rather than merely relevant. In *OFT v Purely Creative Ltd*, Mr Justice Briggs emphasised that:

The question is not whether the omitted information would assist, or be relevant, but whether its provision is necessary to enable the average consumer to take an informed transactional decision.¹¹

- 7.19 More recently, the Court of Appeal has endorsed this approach, stressing that information may not be needed if it is available elsewhere.¹² However, if an estate agent or developer fails to tell a purchaser about event fees, it is unlikely that the purchaser would be able to find the information elsewhere before making an offer. Our analysis of websites described in Chapter 4 illustrates how difficult it can be for elderly consumers to find information about event fees online.¹³

- 7.20 There are specific requirements for “invitations to purchase”, which describe the product and its price, and enable the consumer to make a purchase.¹⁴ Regulation 6(4) lists information which will be regarded as material in invitations to purchase, This includes the price or:

Where the nature of the product is such that the price cannot reasonably be calculated in advance, the manner in which the price is calculated.¹⁵

- 7.21 This could have particular application to estate agents’ particulars. They would be considered to be an “invitation to purchase” if they describe the property and its price and enable consumers to make purchases. In our view, particulars should not only include the headline price but also details of other significant charges or financial commitments.

“Cause or likely to cause”

- 7.22 It is not necessary to prove that the misleading action or omission actually caused the consumer to make the transactional decision. It is enough if there was a real risk of a hypothetical average consumer making a transactional decision they would not have taken otherwise.¹⁶

¹⁰ The Consumer Protection from Unfair Trading Regulations 2008, reg 6(3)(a).

¹¹ *OFT v Purely Creative Ltd* [2011] EWHC 106 (Ch); [2011] ECC 20 at [74].

¹² *Business Secretary v PLT Anti-Marketing Ltd* [2015] EWCA Civ 76; [2015] ECC 12 at [40] to [43].

¹³ Mystery Shopping Report (available on the project page of the Law Commission website).

¹⁴ For a definition of invitation to purchase, see reg 2(1).

¹⁵ The Consumer Protection from Unfair Trading Regulations 2008, reg 6(4)(d)(ii).

¹⁶ European Commission, *Guidance on the Implementation/Application of Directive 2005/29/EC on Unfair Commercial Practices* (December 2009) 1666, p 24, available at http://ec.europa.eu/consumers/rights/docs/Guidance_UCP_Directive_en.pdf. See also *OFT v Purely Creative Ltd* [2011] EWHC 106 (Ch); [2011] ECC 20 at [71].

“The average consumer”

7.23 The concept of the average consumer is used widely in European law. The CJEU has set a robust standard: one must judge the practice from the viewpoint of a hypothetical consumer who is “reasonably well informed, reasonably observant and circumspect”.¹⁷

7.24 However, the CPRs (unlike UK unfair terms legislation) allow for an alternative and less onerous test. This applies where

- (1) the commercial practice was “directed to a particular group” of consumers;¹⁸ or
- (2) a “clearly identifiable group of consumers is particularly vulnerable ... because of their mental or physical infirmity, age or credulity” and that a trader could be reasonably expected to foresee this.¹⁹

In these circumstances, the average consumer refers to “the average member of that group”.²⁰ In other words, where specialist housing is marketed at older people who are likely to have infirmities and who are seeking support and care, the standard is that of a “reasonably observant” older person with infirmities.

“A transactional decision”

7.25 A “transactional decision” is defined as “any decision taken by a consumer, whether it is to act or to refrain from acting, concerning:

- (1) whether, how and on what terms to purchase, or make payment in whole or in part for, retain or dispose of a product; or
- (2) whether, how and on what terms to exercise a contractual right in relation to a product”.²¹

7.26 This is a broad concept. Importantly, it is much wider than just making a purchase, and covers steps which are preliminary to the purchase. The European Commission’s guidance states:

¹⁷ See reg 2(2), and Case C-210/96 *Gut Springenheide GmbH, Rudolf Tusky v Oberkreisdirektor des Kreises Steinfurt-Amt für Lebensmittelüberwachung and Another* [1998] ECR I-4657.

¹⁸ The Consumer Protection from Unfair Trading Regulations 2008, reg 2(4).

¹⁹ Above, reg 2(5)(a).

²⁰ Above, reg 2(5).

²¹ Above, reg 2(1).

Most common activities which consumers carry out in a "pre-purchase" stage are to be considered transactional decisions. These include, for instance, a decision to travel to a sales outlet or shop, the decision to enter a shop (eg after reading a poster on the shop window or a billboard in the street), the decision to agree to a sales presentation by a trader or his or her representatives and the decision to continue with a web booking process.²²

7.27 In *Purely Creative*, Mr Justice Briggs commented on this as follows:

Although it may be debatable whether the Commission's guidance that this includes a decision to step into a shop after viewing an advertisement in the window goes too far, it was common ground that any decision with an economic consequence was a transactional decision, even if it was only a decision between doing nothing or responding to a promotion by posting a letter, making a premium rate telephone call or sending a text message.²³

7.28 As discussed in Chapter 4, a major problem with event fees is that purchasers are told about them too late in the process, after they have made an offer, had it accepted, incurred costs and instructed a solicitor. By then, they are emotionally and financially committed to the process and are unlikely to drop out.

7.29 The wide definition given to "transactional decision" addresses this concern. Under the test accepted in *Purely Creative*, any decision to spend even a nominal amount of money would be a "transactional decision", including incurring travel costs to visit an estate agency or property, paying to obtain a survey report or to instruct a solicitor.

7.30 We also think that making an offer on a property is a transactional decision. Although these offers are not legally binding, many consumers would consider them to be morally binding. After an offer has been accepted, consumers are naturally reluctant to resile from the deal, even if they later discover hidden charges. In our mystery shopping exercise, one developer asked the shopper to pay a £1,000 deposit before providing full details of costs and charges. Paying a substantial deposit of this type would also be a transactional decision.

7.31 This means that failing to provide material information about event fees before the purchaser incurs costs, makes an offer or pays a deposit can amount to a criminal offence, even if the purchaser would find out about the fees from their solicitor.

²² European Commission, *Guidance on the Implementation/Application of Directive 2005/29/EC on Unfair Commercial Practices* (December 2009), para 2.1.3.

²³ *OFT v Purely Creative Ltd* [2011] EWHC 106 (Ch); [2011] ECC 20 at [68].

THE “DUE DILIGENCE” DEFENCE

- 7.32 Misleading actions and omissions are criminal offences. The maximum penalties are two years’ imprisonment or an unlimited fine.²⁴
- 7.33 Traders have a defence if they can show that the offence was due to a cause beyond their control,²⁵ and that they “took all reasonable precautions and exercised all due diligence” to avoid committing the offence.²⁶ The burden of proof lies on the trader. The standard is high and requires taking *all* reasonable precautions.²⁷

ENFORCEMENT

- 7.34 In England and Wales, the CPRs can only be enforced by local authority trading standards services and (where there is a market-wide issue) by the Competition and Markets Authority. The emphasis is on education, guidance and advice. The formal sanctions are used as a last resort. In addition to criminal prosecutions, enforcers may apply to the courts for a civil enforcement order to stop a business from breaching the legislation, where the breach harms the collective interests of consumers.²⁸
- 7.35 Individual consumers have only limited rights to seek compensation before the courts for breach of these Regulations. In October 2014, the Government amended the Regulations to allow consumers a right to redress for some misleading actions and aggressive practices.²⁹ However, this new right does not apply to sales of immovable property (such as long leases); nor does it apply to misleading omissions. Therefore it is not relevant to this project.
- 7.36 However, as we explore in Chapter 8, consumers do have the right to complain to an approved redress scheme. The largest redress scheme is the Property Ombudsman (TPO), which has a code of practice that follows the CPRs closely.³⁰ Consumers can be awarded compensation by TPO if they have suffered loss owing to a breach of the CPRs by an estate agent.

²⁴ The Consumer Protection from Unfair Trading Regulations 2008, reg 13.

²⁵ Above, reg 17(1)(a).

²⁶ Above, reg 17(1)(b).

²⁷ See also C Twigg-Flesner, D Parry, G Howells, A Nordhausen, *An analysis of the application and scope of the unfair commercial practices directive: Report for the Department of Trade and Industry* (18 May 2005), para 2.10, available at <http://webarchive.nationalarchives.gov.uk/+/http://www.bis.gov.uk/files/file32095.pdf>.

²⁸ Under Part 8 of the Enterprise Act 2002.

²⁹ Consumer Protection (Amendment) Regulations 2014 (SI 2014 No 870). These Regulations implement the recommendations of the Law Commission and Scottish Law Commission, *Consumer Redress for Misleading and Aggressive Practices* (2012) Law Com No 332.

³⁰ See paras 8.27 – 8.32.

HOW DO THE CPRS APPLY TO EVENT FEES?

- 7.37 The CPRs already impose important duties on businesses involved in the sale of retirement properties. They apply to all traders involved in the “promotion, sale or supply” of retirement properties, including developers, managing agents and estate agents.
- 7.38 Those giving price information about retirement properties must not give false information, or present information in a way which is likely to deceive the average consumer. It is a criminal offence to give misleading price information if it is likely to cause an average older consumer to make an offer on the property or incur costs regarding it, which they would not have done otherwise. It is also a criminal offence to omit material information, if it is likely to cause an average older consumer to make one of these transactional decisions.
- 7.39 Some estate agents in our mystery shopping exercise appeared to breach these requirements. In some cases they gave inaccurate information. In other cases they gave no information about event fees, even though these fees would appear to be needed by a reasonably circumspect member of the group of older consumers to make an informed decision about whether to make an offer on the property.
- 7.40 Of course, if prosecuted, estate agents acting for private sellers may have a due diligence defence. They may be able to show that they took all reasonable precautions to find out about the charges but failed to discover them. We accept that at present, estate agents may find it difficult to discover the full extent of event fees which attach to a property. In Chapter 12, we make proposals designed to ease this process.

CONCLUSION

- 7.41 Some of the practices we encountered in this project appear to contravene the CPRs. The CPRs need to be better known and understood by developers, managing agents and estate agents involved in selling retirement leases which contain event fees. If the industry fails to improve the transparency of these terms, it would be open to trading standards services to take enforcement action. Moreover, if a developer fails to disclose an event fee term, in breach of the CPRs, this would be a factor in any assessment of whether a term is unfair.

CHAPTER 8

CODES OF PRACTICE

INTRODUCTION

- 8.1 The law establishes general principles of consumer protection. The details are often left to informal redress schemes and self-regulatory codes. Redress schemes allow consumers to enforce their legal rights without going to court. They may also decide cases according to what is fair and in accordance with best practice, rather than the strict letter of the law. Meanwhile, codes of practice often consolidate the relevant law for a given industry in one place, and give guidance about how it applies. They also sometimes impose additional best practice requirements, giving consumers a greater degree of protection than the law requires.
- 8.2 As we explain below, estate agents and managing agents are now required to be members of one of three approved redress schemes, which can award compensation of up to £25,000 to consumers.

Eight codes

- 8.3 Estate agents, managing agents and developers are also subject to various different codes. We have identified eight separate codes which are relevant to event fees:
- (1) *The UK Code of Non-broadcast Advertising, Sales promotion and Direct Marketing* (the CAP Code) covers misleading marketing communications generally. It is maintained by the Committee of Advertising Practice (CAP) and administered by the Advertising Standards Authority (ASA). It applies to estate agents and the sales teams of developers and operators.
 - (2) *The Property Ombudsman* (TPO) code covers residential estate agents.
 - (3) Two codes apply to developers. All major home builders have joined the *Consumer Code for Home Builders*. This is a general code with no specific requirements about event fees. However, developers registered with the National House Building Council (NHBC) must also conform to the *NHBC Sheltered Housing Code*, which is more specific about event fees. Under current proposals, the NHBC Code will be abolished and the CCHB will incorporate specific rules about event fees instead.
 - (4) Two codes cover agents who manage specialist housing for older people. The *Association of Retirement Housing Managers* (ARHM) has a code designed to promote good practice among those managing private retirement housing. *Associated Retirement Community Operators* (ARCO) has a code for those offering housing with care.

- (5) Finally, general managing agents have self-regulatory codes. The *Association of Residential Managing Agents* (ARMA) requires its members to comply with a “consumer charter”, known as ARMA-Q. Chartered surveyors must be members of their professional body, the *Royal Institution of Chartered Surveyors* (RICS). Where they are involved in managing residential leasehold property with variable service charges, they must abide by the RICS Service Charge Residential Management Code.

Code status

- 8.4 Some of these codes are purely voluntary, and have been developed by the industry to improve standards. However, the ARHM Code has been approved by the Secretary of State.¹ This means that a court or tribunal must take the code into account where it is relevant to the proceedings, even if the managing agent is not a member of the ARHM. The RICS Code has a similar status.
- 8.5 Even voluntary codes may be enforceable against those who have subscribed to them. For example, TPO may require estate agents to compensate consumers who have suffered loss through a breach of the TPO code. As we noted in Chapter 7, it is also a criminal offence for a trader to make a firm commitment to comply with a code of conduct and then fail to do so.²

This chapter

- 8.6 In this chapter, we start by looking at recent events. In Chapter 5, we refer briefly to the Competition and Markets Authority (CMA) market study into residential property management services.³ The CMA recommended substantial revisions to codes of practice, and many trade organisations that publish codes are strengthening their existing codes in the light of this study. There is also new guidance for estate agents on compliance with the Consumer Protection from Unfair Trading Regulations 2008 (CPRs).
- 8.7 We then outline redress schemes for estate agents and managing agents. Next, we consider each of the eight codes, focusing on what information property professionals are required to give to prospective purchasers about event fees.

RECENT DEVELOPMENTS

The CMA market study

- 8.8 The CMA market study looked at general residential property management services by property management companies where there are multiple leasehold flats and some shared facilities or common parts in the building. Although the study did not focus on specialist retirement housing, it was included where it met these criteria.

¹ Under s 87 of the Leasehold Reform, Housing and Urban Development Act 1993.

² Consumer Protection from Unfair Trading Regulations 2008, reg 5(3)(b), see paras 7.14 – 716.

³ Published 2 December 2014.

CMA findings

- 8.9 The CMA's findings in relation to codes of practice for property managers are of particular relevance to this project.⁴ The CMA observed that:

although the existing codes have their limitations, they serve an important function in raising standards across the sector.⁵

- 8.10 In considering what remedies would be appropriate to address the problems in the leasehold sector, the CMA considered that:

The problems that exist in the market are best dealt with through targeted measures to improve the working of the current model, rather than through a fundamental reform of the regulatory framework...⁶

We have decided to build on the existing self-regulatory regime, rather than, at this stage, to recommend major statutory regulation of the sector.... This is because:

Many issues can be addressed by safeguards embedded in codes and property law, although their strength and application might in certain cases need to be improved.

We believe that we should allow time for the various developments in the market to take effect.⁷

Pre-purchase information

- 8.11 Among other things, the CMA recommended that pre-purchase information be improved.

We recommend that when specific enquiries are made about property the estate agent provides a short information sheet providing key information on major facts about leasehold ownership (the information sheet to be produced by LEASE⁸/Law Society).

We recommend that leasehold property particulars prepared by estate agents should state the current level of service charges.

A requirement to provide this information should be incorporated into the approved code of practice followed by estate agents and the associated guidance that supports it.

⁴ CMA market study, paras 1.41-1.44.

⁵ Above, para 1.44.

⁶ Above, para 1.51.

⁷ Above, para 1.53.

⁸ The Leasehold Advisory Service is a non-departmental public body funded by the Department for Communities and Local Government and Welsh Government to provide free legal advice to those affected by the law on residential leases.

- 8.12 Following publication of the CMA market study, many of the codes of practice are in the process of being revised to include a requirement to provide the recommended information.
- 8.13 At the request of Department of Communities and Local Government (DCLG), the Leasehold Advisory Service (known as “LEASE”) is working on a high level key facts sheet to provide basic information about leasehold property to purchasers at an early stage.

Recent changes to conveyancing procedure

- 8.14 The Law Society also revised its Leasehold Property Enquiries form (LPE1) and a second edition came into effect on 1 October 2015. The Law Society has taken this opportunity to include a specific question about event fees. The form now asks about transfer fees, deferred service charges or similar fees expressed as a percentage of the property’s value payable on an event such as resale or subletting.⁹
- 8.15 Another change is that the LPE1 will be used alongside the buyers’ leasehold information summary (LPE2), to give buyers a summary of the important information about their leasehold responsibilities. Amongst the costs and payments to be set out, LPE2 specifically identifies future fees payable on sale or sub-letting.¹⁰ This means that event fees should be highlighted and drawn to the buyer’s attention. We welcome these changes, which will ensure that event fees are less likely to be overlooked at the conveyancing stage.

Guidance for estate agents

- 8.16 There is also new guidance for estate agents on how to comply with the Consumer Protection from Unfair Trading Regulations 2008 (CPRs). The UK’s lead enforcement authority for the Estate Agents Act 1979 is the National Estate Agency Trading Standards Team at Powys County Council. In September 2015 it updated the old OFT guidance on compliance with the CPRs in property sales.
- 8.17 The new Guidance stresses that information about leasehold charges should be provided early in the marketing process. It states:

In the most straightforward property sales, the material information that you should give to consumers may be quite basic.... However, depending on the circumstances of each sale, material facts could include the length of the lease, the level of charges payable under a lease... This information should be provided as early in the marketing process as possible and not left until a potential buyer expresses an interest in a property.¹¹

⁹ LPE1 (second edition) para 4.12.

¹⁰ Form LPE2, (the buyers leasehold information summary), sets out in section C additional payments which are planned, including any future fees payable when the buyer sells or sublets.

¹¹ National Trading Standards Estate Agency Team, Guidance on Property Sales (September 2015), para 2.7.

REDRESS SCHEMES

- 8.18 Since 2007, all estate agents dealing with residential property have been required to join an authorised redress scheme.¹² From October 2014, this requirement has been extended to managing agents in England.¹³ Redress schemes are intended to provide consumers with access to an independent complaints procedure if they are unhappy with how their complaint has been handled by the agent.
- 8.19 There are now three approved schemes, which apply to both estate agents and managing agents.¹⁴ The three schemes are: TPO; “Ombudsman Services: Property”; and the “Property Redress Scheme” (PRS). The great majority of estate agents (95%) are members of TPO.¹⁵ However, those who manage leasehold properties on behalf of landlords (variously called property managers or managing agents) are more evenly divided.¹⁶
- 8.20 All three schemes can require traders to provide an apology, an explanation of what went wrong and practical action to correct the problem. Importantly, the schemes can also require traders to pay compensation of up to £25,000. Compensation can be given for proven financial loss and also “avoidable aggravation, distress and/or inconvenience”.¹⁷ Traders are legally bound by the award but consumers are free to pursue the matter in court if they disagree with the decision.¹⁸
- 8.21 Awards tend to be low: the average award for 2014 was £374 for sales complaints.¹⁹ It is rare for redress schemes to make the maximum award. Furthermore, redress schemes do not award punitive damages.

¹² Estate Agents Act 1979, sch 3 as amended by the Consumers, Estate Agents and Redress Act 2007, s 47 and sch 6. Section 1 of the 1979 Act includes various exemptions (for example for solicitors and credit brokers).

¹³ The Redress Schemes for Lettings Agency Work and Property Management Work (Requirement to Belong to a Scheme etc) (England) Order 2014. Similar arrangements are proposed for Wales.

¹⁴ Source: Department for Communities and Local Government, “Lettings Agents and Property Managers: Which Government approved redress scheme do you belong to?” (October 2014) p 4, available at https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/361556/LettingsAgents_and_Property_Managers_redress_scheme_leaflet.pdf.

¹⁵ The Property Ombudsman, *Advice for Advisors*, <http://www.tpos.co.uk/downloads/TPOE1-6%20Advice%20for%20Advisors.pdf>.

¹⁶ For example, 1,806 offices offering property management services have joined the PRS: Annual Report, p 15.

¹⁷ The Property Ombudsman, *Terms of Reference for the Property Ombudsman*, 10(b), <https://www.tpos.co.uk/images/documents/corporate-reference-policy-and-procedures/tpoe31-1-terms-of-reference.pdf>.

¹⁸ The Property Ombudsman, *Advice for Advisors*, <http://www.tpos.co.uk/downloads/TPOE1-6%20Advice%20for%20Advisors.pdf>.

¹⁹ www.tpos.co.uk.

- 8.22 All three schemes may award compensation for breach of the CPRs. This means that the redress schemes could compensate a leaseholder where an estate agent or property manager failed to provide material information about event fees. However, we are not aware of anyone who has taken action over event fees in this way. Consumers may not realise that it is possible to go back and make a complaint against the agent who originally sold them the property when they discover the full effect of the event fee on resale, many years later.
- 8.23 Under the TPO scheme, a consumer should first make a complaint in writing to the firm of estate agents which sold the property.²⁰ When the firm's internal complaints procedure has been exhausted, the consumer remains dissatisfied with the outcome, or more than eight weeks has elapsed since the complaint was first made in writing, the consumer may ask TPO to intervene.²¹

ADVERTISEMENTS: THE CAP CODE

- 8.24 It is open to individuals to complain to the ASA about misleading advertisements and other marketing communications, such as estate agents' property particulars. The ASA will apply the CAP Code.
- 8.25 The CAP Code sets out the principles in the CPRs and states that the Code should be read in conjunction with them.²² It then gives further guidance on how the rules apply to price information. In particular, it states that "quoted prices must include non-optional taxes, duties, fees and charges that apply to all or most buyers".²³ It goes on to state:
- If a tax, duty, fee or charge cannot be calculated in advance, for example, because it depends on the consumer's circumstances, the marketing communication must make clear that it is excluded from the advertised price and state how it is calculated.²⁴
- 8.26 We interpret this as requiring all marketing communications by estate agents and developers' sales teams to state any event fees that apply to the lease.

²⁰ The time limit on making a complaint to the registered firm is not more than 12 months from the date when the act or omission first occurred or could reasonably have come to the notice of the complainant, *Terms of Reference for the Property Ombudsman* (1 June 2014), Part 3, 12(e).

²¹ TPO can accept a complaint not later than six months after the date of the registered firm's final viewpoint letter, *Terms of Reference for the Property Ombudsman* (1 June 2014), Part 3, 12(d).

²² CAP Code (12 ed), p 116.

²³ Above, rule 3.18.

²⁴ Above, rule 3.19.

THE TPO CODE

- 8.27 TPO has developed a Code of Practice for Residential Estate Agents. This is particularly important within the industry as all members of the National Association of Estate Agents are required to adhere to it. Furthermore, as we have seen, 95% of estate agents are members of TPO's Redress Scheme, which applies to their conduct in general and not just to their marketing communications.²⁵ In deciding a case under the Redress Scheme:

The Ombudsman will have regard to what is generally accepted as good practice in the industry as defined by the TPO Codes of Practice.²⁶

- 8.28 TPO's code summarises the provisions of the CPRs. It provides the following guidance on what may be "material information":

In the most straightforward sales, the material information that you should give to potential buyers may be quite basic. Little more than the asking price, location, number and size of rooms, and whether the property is freehold or leasehold.²⁷

- 8.29 However, more information could be material in some circumstances:

Depending on the circumstances of each sale, material facts could include... the level of charges payable under a lease... .

- 8.30 This would arguably require disclosure of event fees. On the other hand, the code gives the impression that estate agents could leave event fees for conveyancers to investigate:

At the outset of the marketing process, you are not expected to research issues that are outside your line of business, for example, where your business is marketing property and the issues are ones that a surveyor or conveyancer would investigate.

The code continues:

However, should you become aware of such information later on, you cannot ignore or suppress it.²⁸

²⁵ The Property Ombudsman, *Advice for Advisors*, <http://www.tpos.co.uk/downloads/TPOE1-6%20Advice%20for%20Advisors.pdf>.

²⁶ The Property Ombudsman, *General Membership Obligations*.

²⁷ The Property Ombudsman, *Code of Practice for Residential Estate Agents*, 1 August 2014, 18k.

²⁸ Above.

- 8.31 We think that the code could do more to encourage estate agents to find out about event fees and make prospective buyers aware of them in advertisements, in property particulars and at viewings. In discussion with TPO, we were told that estate agents ought to know about event fees and ought to disclose them. It is highly desirable that this point is clarified in the code.
- 8.32 In Chapter 12, we explain that landlords should provide information about this issue and ensure that it is readily accessible to estate agents. We hope that the Code and supplementary guidance will clarify that estate agents should take active steps to research the issue and include information about event fees in their marketing communications.

CODES APPLYING TO DEVELOPERS

The Consumer Code for Home Builders

- 8.33 The Consumer Code for Home Builders (CCHB) came into force in 2010 to provide protection and rights to purchasers of new homes.²⁹ It is sponsored by the main UK builder trade bodies and aims to ensure that all new home buyers are fully informed about their purchase before and after they sign the contract. CCHB deals with new build properties generally, and is not focused on the retirement market. It includes a redress scheme, which can award up to £15,000 against the home builder.³⁰
- 8.34 Adoption of the code is voluntary, but builders must adopt it to register with a Home Warranty Body.³¹ As most purchasers would expect to receive a warranty with a new-build house, the effect is that all major home builders have adopted the code.
- 8.35 The code reminds builders that the CPRs require “all traders to deal fairly with consumers and not to use aggressive or misleading practices”. It then includes specific requirements about disclosing charges to prospective purchasers:

Home Buyers must be given enough pre-purchase information to help them make suitably informed purchasing decisions.

In all cases this information must include: [...]

a description of any management services and organisations to which the Home Buyer will be committed and an estimate of their cost.³²

- 8.36 As part of the latest revision of the CCHB, it is proposed that this requirement is widened to cover:

²⁹ CCHB was reviewed in 2012 and is currently undergoing a further review. A revised draft Code was issued for consultation in September 2015.

³⁰ Consumer Code for Home Builders, 4.5.

³¹ CCHB has applied to Chartered Trading Standards Institute for the new code to be approved under the Consumer Codes Approval Scheme.

³² Consumer Code for Home Builders, 2.1.

any fees that a home buyer may be required to pay including, but not limited to, transfer charges. Such charges typically impose a conditional obligation on the tenant to pay a fee when they sell and the title to the lease changes hands or property is let. The requirement to provide information on other fees would also apply to charges that go into a sinking fund (a fund to help cover any unexpected maintenance or repairs, like replacing the roof), held on trust for the tenants for the upkeep of the building.³³

- 8.37 Question 5a in the consultation on the review of the CCHB asks if consultees agree that all fees as outlined above should form part of the pre-sale information to be provided to home buyers. If it is adopted, this is a welcome development because it spells out that transfer charges (which correspond to our definition of “event fees”) must be disclosed at the pre-purchase stage. We hope that the CCHB will build on this development, for example, to require clear illustrations of how much purchasers will be required to pay when they come to sell.

NHBC Sheltered Housing Code

- 8.38 The National House Building Council (NHBC) sees its role as setting and raising standards of new homes and providing consumer protection for homebuyers. It is best known for its new homes warranty which applies to over 1.6 million new homes, giving it a market share of around 80%.
- 8.39 NHBC has published a code dealing specifically with sheltered housing, with which developers registered with NHBC must comply. The current edition of the code was published in 2005, and therefore predates the CPRs.³⁴
- 8.40 This code is more specific than the present version of the CCHB. It requires developers and their agents to mention event fees in a purchaser’s information pack. It also requires developers to provide some benefit to the leaseholder in exchange for event fees.
- 8.41 The NHBC is currently working on a full programme of changes to its rules, which it plans to implement from April 2016. One of the changes under consideration is whether to remove the Sheltered Housing Code from its rules. This is mainly due to the existence of the CCHB which has some overlapping requirements for the provision of information. The CCHB has a wider application than the NHBC Sheltered Housing Code. It applies to all homes sold to private individuals in the UK (the NHBC Sheltered Housing Code does not extend to Scotland) that are registered with the home warranty bodies that support the code.

Transparency on first purchase

- 8.42 Currently, for new build properties, the Sheltered Housing Code provides that the developer must provide a purchaser’s information pack:

Every Builder or Developer registered with NHBC who builds or sells a Sheltered Dwelling must:

³³ CCHB Consumer Code consultation July 2015, para 5.

³⁴ NHBC is reviewing its Sheltered Housing Code, see para 8.41.

i. ensure that every potential First Purchaser of the Sheltered Dwelling is provided with a Purchaser's Information Pack which contains the information specified in this Code; the Purchaser's Information Pack must be provided when the Purchaser reserves the Dwelling and in good time so that the First Purchaser can properly consider the information which it contains before exchanging contracts to purchase the Dwelling...³⁵

8.43 The pack must include, among other things:

ii. any charges on resale...³⁶

8.44 In other words, event fees must be included in the information pack provided when the purchaser reserves the property. We are concerned that by the time a purchaser reserves a property, the information about event fees may be too late. We hope this issue will be addressed in any forthcoming review of the Sheltered Housing Code.

Transparency on subsequent purchases

8.45 As the Sheltered Housing Code is aimed at house builders, there is less it can do to protect those who purchase the property from another resident. However, where the property is managed by others, the developer is required to reach an agreement with the management company that it will abide by the code. The developer must:

Ensure that the Management Organisation of a Sheltered Dwelling built or sold by him enters into a Management Agreement as required by this Code. The Management Agreement must give each Purchaser of the Sheltered Dwelling the benefit of the legal rights specified in this Code.³⁷

8.46 The code requires landlords and managers to provide the information pack to subsequent purchasers where they have notice of the sale:

A Landlord or Management Organisation which receives notice of a sale or assignment of a Sheltered Dwelling by a Purchaser must provide an up-to-date copy of the Purchaser's Information Pack to the subsequent Purchaser or assignee.³⁸

8.47 However, the duty only applies when the landlord or manager is given notice of the sale, which may be late in the conveyancing process. In fact, the code even envisages that the pack might be provided after purchase:

³⁵ NHBC Sheltered Housing Code, Part 1, 1(i).

³⁶ Above, Part 2, 5, 5.7(ii).

³⁷ Above, Part 1, 1(ii).

³⁸ Above, Part 2, 4.

This copy should be provided, *if possible*, before the sale or assignment is made.³⁹

Substantive provisions about event fees

- 8.48 The developer (referred to as the vendor) must give the following undertaking.

No share in the equity or equity growth of any Sheltered Dwelling has been or will be retained or claimed by the Vendor or on its behalf...⁴⁰

- 8.49 At first sight this appears to prohibit event fees. However, the prohibition is subject to a list of exceptions. Under the code event fees are allowed where the lease provides

(i) for a fixed deduction on re-sale to finance long-term repairs, renewals and improvements to the Sheltered Dwelling Scheme from a sinking fund;

(ii) for a fixed deduction on re-sale as part of a bona fide scheme to provide a Purchaser or resident with:

- a) extra care; or
- b) reduced service charges; or
- c) provision of income; or
- d) some other tangible benefit;

(iii) for a defined share of the equity to be retained on re-sale where the Sheltered Dwelling was originally sold at a discounted price.⁴¹

- 8.50 This would appear to allow all the event fees in this study to be charged, except for simple transfer fees, which are not linked in the lease to a corresponding benefit or service. Even here a developer could argue that a purchaser received a benefit in the form of lower purchase price or better on-site facilities, although this was not specified in the lease. Perhaps surprisingly, there are no prohibitions on charging event fees on death or change of occupation, or on charging fees on sub-letting which are calculated as a percentage of the open market value.

³⁹ NHBC Sheltered Housing Code, Part 2, 4 (emphasis added).

⁴⁰ Above, Part 3, 4.10.

⁴¹ Above, Part 3, 4.10.

Conclusion

- 8.51 We are concerned about certain aspects of the current version of the NHBC Sheltered Housing Code. For example, it does not require developers or managing agents to give information about event fees early enough in the process, or require clear illustrations of how they work. There is also a need to improve the process by which managing agents give information to subsequent purchasers. Finally, we think that event fees should not be charged in circumstances such as a tenant's death or a change of occupation. We hope that these issues will be addressed in any forthcoming review of the code.

CODES APPLYING TO THOSE WHO MANAGE SPECIALIST HOUSING

- 8.52 Two codes apply to those who manage specialist housing: the ARHM Code and the ARCO Code. These codes are therefore particularly relevant to the way that managing agents provide information about event fees.

ARHM Code of Practice

- 8.53 The Association of Retirement Housing Managers (ARHM) has a code to promote good practice among organisations that manage age exclusive or sheltered housing. It is not aimed at managers of extra care housing or retirement villages.

Application of the Code

- 8.54 At first glance, the ARHM Code appears to be pure self-regulation, applying only to ARHM members, with expulsion from ARHM as the only sanction. However, it has been approved by the Secretary of State under section 87 of the Leasehold Reform, Housing and Urban Development Act 1993. This gives it the following legal effect:

A failure on the part of any person to comply with any provision of a code of practice for the time being approved under this section shall not of itself render him liable to any proceedings; but in any proceedings before a court or tribunal—

(a) any code of practice approved under this section shall be admissible in evidence; and

(b) any provision of any such code which appears to the court or tribunal to be relevant to any question arising in the proceedings shall be taken into account in determining that question.⁴²

- 8.55 The ARHM Code can thus be taken into account by a court or tribunal where relevant, even if neither of the parties is a signatory to the code.

Transparency in the ARHM Code

- 8.56 The code requires ARHM members to provide a "Leaseholders' Handbook". It explains how this dovetails with the NHBC Code:

⁴² Leasehold Reform, Housing and Urban Development Act 1993, s 87(7).

The Leaseholders' Handbook... should contain the following information, which should be clearly and fully described using simple language. The handbook as described below should be sufficient to meet the requirements of the Purchaser's Information Pack as set out in the National House Building Council Sheltered Housing Code.

There follows a list of particulars including the following:

A full, clear, complete and unambiguous breakdown of all periodic or one-off charges that the leaseholder will be expected to pay... .

- 8.57 The code may allow the handbook to be provided after purchase. It simply states

Managers should ensure that all purchasers of dwellings that they manage are provided with a Leaseholders' Handbook.⁴³

- 8.58 This requirement is less onerous than the corresponding requirement on managers under the NHBC Code, under which the Purchaser's Information Pack is to be provided before purchase where possible.⁴⁴

- 8.59 The reason for the disparity may be that the ARHM code envisaged prospective purchasers would be provided with a Home Information Pack (HIP). Although HIPs were set out in the Housing Act 2004, they were scrapped because of criticism for being expensive for sellers and largely ignored by house buyers.⁴⁵

Event fees in the ARHM Code

- 8.60 The ARHM Code has a section dealing with charges on resale:

Managers should not make any charge or require any payment on resale except where it is stated or implied in the lease or where a service has been offered and accepted at an agreed fee.⁴⁶

- 8.61 The code goes on to state that "any charge should be reasonable". It also gives a non-exhaustive list of reasons for charges on resale. As well as standard administration charges, these include:

Charges or payments arising on a resale are usually in respect of the following:

For acting as an agent when selling a property [...]

For any service charge or ground rent arrears [...]

For reserve fund contributions payable on resale under the terms of the lease.⁴⁷

⁴³ ARHM Code of Practice, 11.16.

⁴⁴ NHBC Sheltered Housing Code, Part 2, 4.

⁴⁵ The incoming Conservative – Liberal Democrat coalition government suspended the requirement for property sellers to provide HIPs on 20 May 2010:
<http://www.bbc.co.uk/news/10130254>.

⁴⁶ ARHM Code of Practice, 14.3.

- 8.62 These provisions would have little effect on most event fees, which are set out in the lease and not within the discretion of the managing agent.

Conclusion

- 8.63 The current ARHM Code is out of date because it was published in 2005 and so predates the CPRs. The ARHM has recognised the need to update the code and has been engaged in a review process. The new code of practice is due to be implemented in April 2016 and will take steps to address many of the gaps in the old code.

The ARCO Consumer Code

- 8.64 Associated Retirement Community Operators (ARCO) is the trade body for operators of extra care housing schemes.⁴⁸ In September 2014 ARCO members adopted a self-regulatory charter, compliance with which was a condition of membership. The charter has now been superseded by a more stringent consumer code, effective from September 2015.

Transparency

- 8.65 The code requires ARCO members to act in a transparent manner generally.⁴⁹ It also deals with event fees in particular, setting out detailed requirements:

We will provide customers with information on any deferred fees that may be payable when they sell or sublet the property. We will provide this when customers view the site or any property, or otherwise before any deposit is paid to reserve a property. If such deferred fees apply, we will:

(a) Provide information on how and when the deferred fees are payable, and how they are calculated, and explain this information on request.

(b) Provide realistic worked examples of their financial impact, clearly stating the assumptions behind the examples.⁵⁰

- 8.66 “Customers” are defined in the code as

Prospective purchasers who have yet to pay any deposit to reserve a property in a retirement community.⁵¹

- 8.67 Taken together, these two provisions make it clear that ARCO members must provide comprehensive information about event fees to prospective buyers before they pay any deposit to reserve a property.⁵²

⁴⁷ ARHM code of practice, 14.3.

⁴⁸ Operators are those who run the scheme, who may or may not also be the owners.

⁴⁹ ARCO consumer code, 2.3.

⁵⁰ Above, 5.10.

⁵¹ ARCO, *draft working Consumer Code* 2014, 1.5.

- 8.68 The code also covers advertising:

We will ensure that the information provided on our retirement communities and services in our marketing, advertising and sales materials... complies with all relevant advertising codes of practice, and with relevant legislation.⁵³

- 8.69 This reference includes the CAP Code of Practice. We think this means that advertisements must also mention event fees.

Conclusion

- 8.70 Unlike the other codes discussed here,⁵⁴ the ARCO Code clarifies that information must be provided when customers view the site or any property, and before any deposit is paid. We welcome this. We also welcome the commitment to provide realistic worked examples of the impact of event fees.

- 8.71 However, the ARCO Code does not have any governmental or legislative backing. It is purely self-regulatory. The most serious sanction for non-compliance would be expulsion from ARCO membership. According to ARCO, compliance will:

be externally assessed, with up to six assessments per year for the large providers, (and at least every 2 years for single site operators)... compliance with this Code (and having assessments) is a condition of membership.⁵⁵

CODES APPLYING TO AGENTS WHO MANAGE LEASES IN GENERAL

- 8.72 Two codes apply to property managers who deal with residential leases in general: ARMA-Q and the RICS Code. We include them here for completeness, but neither includes specific provisions about event fees.

Arma-Q: Consumer Charter and Standards

- 8.73 The Association of Residential Managing Agents (ARMA) administers the Consumer Charter and Standards (known as ARMA-Q). ARMA-Q is a self-regulatory regime for its members. ARMA estimates that around half of UK long term residential leasehold flats are managed by an ARMA member or affiliate.⁵⁶

- 8.74 ARMA-Q includes a section on pre-sales enquiries. However, members are not required to volunteer information: only to respond to enquiries when they are made. The code states:

⁵² The fees must also be set out clearly in the contract: Arco Consumer Code, 6.3.

⁵³ Arco Consumer Code, 4.1.

⁵⁴ The CCHB, NHBC and ARHM codes are still in the process of revision and are likely to make similar changes.

⁵⁵ Source: ARCO (email, 04.08.2015).

⁵⁶ The dominant managing agent in the retirement sector, First Port (formerly Peverel) has applied for ARMA-Q accreditation.

When dealing with pre-sales enquiries the Managing Agent: [...]

(b) Should supply the Leaseholder, or their representative, with information about the premises that they manage to satisfy the pre-sales enquiries and any other reasonable enquiries that may arise. [...]

(d) Must not knowingly give inaccurate or misleading answers. [...]

- 8.75 ARMA-Q makes no reference to the CPRs or the requirement not to omit material information. Nor are there any specific requirements about event fees. The code is not tailored for the retirement sector, where event fees usually apply.

RICS Code

- 8.76 The Royal Institution of Chartered Surveyors (RICS) regulates chartered surveyors and maintains professional standards. RICS promotes a variety of codes, including the Service Charge Residential Management Code. Like the ARHM Code, it is approved by the Secretary of State,⁵⁷ so it can be taken into account in court and tribunal proceedings.
- 8.77 The RICS Code applies to surveyors who deal with variable service charges in residential leasehold properties. The code contemplates that the surveyor may be called on to give information in the sale process.⁵⁸
- 8.78 The RICS Code has recently been revised and the new edition is awaiting approval from DCLG. The new code states that provision of appropriate information to prospective purchasers is regarded as good practice.⁵⁹ The code makes no specific mention of event fees.

CONCLUSION

- 8.79 We think that redress schemes and codes of practice have an important role to play in preventing some of the problems associated with event fees and in ensuring their transparency. We welcome the increased emphasis now given to pre-purchase information.
- 8.80 In Chapter 12, we make proposals to build on these developments to increase the transparency given to event fees. We wish to see information provided at an early stage with clear illustrations about how much purchasers will be called on to pay when they sell the property. We also propose that the codes should prevent event fees from being applied in unexpected circumstances such as mortgaging the property or a carer moving in.

⁵⁷ Under the Leasehold Reform, Housing and Urban Development Act 1993, s 87.

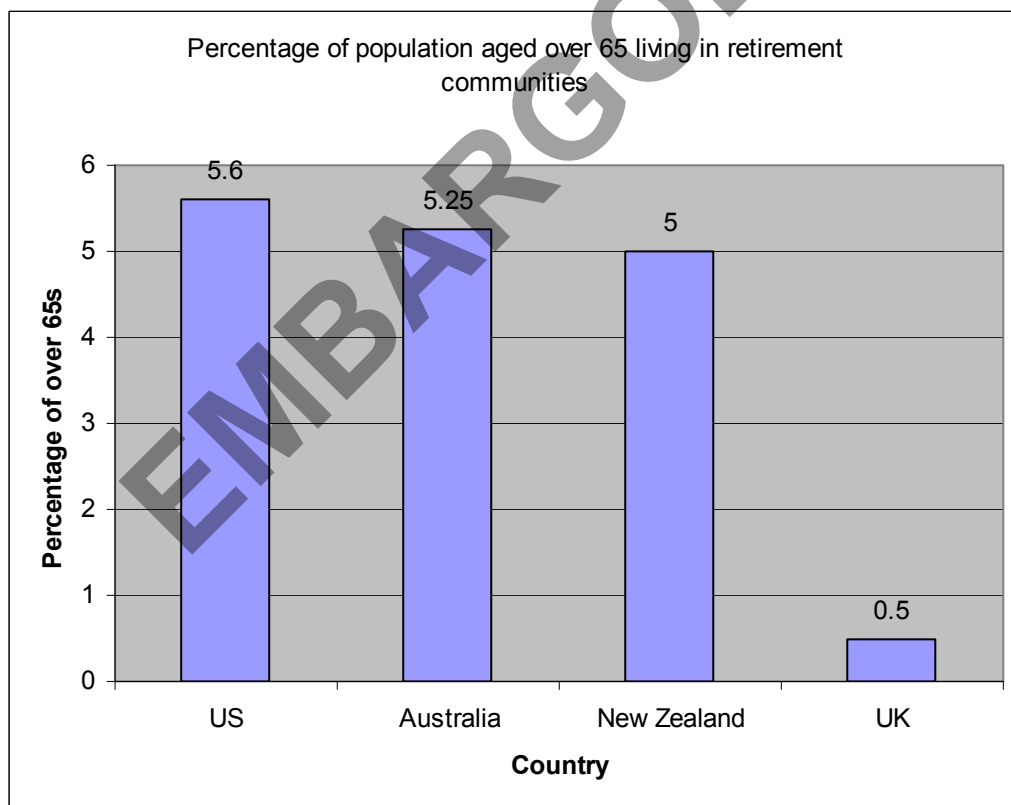
⁵⁸ Currently there is a reference to the now defunct Home Information Packs but this provision will be replaced in the new revised Code.

⁵⁹ Draft RICS Code (3rd Edition).

CHAPTER 9

INTERNATIONAL COMPARISONS

- 9.1 As we saw in Chapter 2, the market for specialist housing is much more developed in the USA, Australia and New Zealand than in Britain. In this chapter we focus on the form of extra care housing in these jurisdictions known as “communities” or “villages”. This sector relies heavily on deferred fees, and we were keen to see how these fees were regulated.
- 9.2 The USA has over 2,000 Continuing Care Retirement Communities (CCRCs). These allow residents to “age in place” by providing for both independent and assisted living, and many have a care home on-site. CCRCs offer a wide range of communal activities and facilities which are included in the overall cost to residents. The idea also spread rapidly in Australia and New Zealand, where “retirement villages” are common.
- 9.3 The Associated Retirement Community Operators (ARCO) estimate that, in the USA, Australia and New Zealand, over 5% of those of those aged over 65 live in retirement villages. This compares with only 0.5% in the UK.



Source: ARCO 2015.

- 9.4 Retirement villages are much less common in Europe. For example, the market for specialist housing in France is at an embryonic stage, with only 250 retirement developments in 2011. However, it appears set to grow.¹
- 9.5 The extensive facilities and services provided by retirement communities must be paid for. As we explore below, it is common for retirement villages or CCRCs to charge substantial deferred fees, payable when the resident leaves in the same way as event fees. In this chapter, we focus on these deferred fees, looking at how they are structured in the USA, Australia and New Zealand.
- 9.6 Although deferred fees have caused some concern, we are not aware of any attempt in these jurisdictions to regulate the amount of the fee. Nor are we aware of any court cases which have held the fees to be unfair. Instead, the emphasis has been on transparency. In all three jurisdictions, specific legislative provisions exist to provide consumers with good quality information about the deferred fees.

THE UNITED STATES

- 9.7 In the USA, the legal background to CCRC is different. In England and Wales, residents usually buy a lease. Many hope to sell the lease to another consumer, benefiting from a capital gain. By contrast, in the USA the capital sum is an “entrance fee”, which does not purchase a right in land. As one guide puts it:

Seniors often use the proceeds from the sale of their home to pay the Entry Fee of the CCRC. However, the resident should be cautioned that in most CCRCs, the payment of the Entry Fee is not the same as the purchase of an apartment or real estate of any kind.²

- 9.8 The entrance fee is typically refundable in whole or in part on the death or exit of the resident, and the percentage which is refundable may decrease according to the duration of residency.

In some CCRC agreements refunds are available on a declining basis after a specified period of residency... . However, some CCRCs give residents the option of paying a higher entry fee, which then remains completely refundable.³

¹ Jean-Bernard Litzler, “Vivre dans une résidence pour seniors, combien ça coûte” (21 March 2012) *Le Figaro*, <http://www.lefigaro.fr/retraite/2012/03/15/05004-20120315ARTFIG00809-vivre-dans-une-residence-pour-seniors-combien-ca-coute.php>.

² Philip Posner, “Continuing Care Retirement Communities” p 3 <http://www.masslandlaw.com/pdfs/CCRC-article.pdf>.

³ Above.

- 9.9 As in the UK, residents also pay monthly service fees. In one common model the community operator agrees to provide more care for the same fee if the resident becomes more infirm (essentially a type of long term care insurance). This results in fairly high monthly fees. Alternatively, residents may have the choice of lower entrance and monthly fees: if additional care becomes necessary it is provided on a pay-as-you-go basis.⁴

Similarities and differences between refunds and event fees

- 9.10 The part-refundable entrance fee bears many similarities to some of the deferred management fees described in Chapter 3. There is a capital sum payable on entry which the resident recoups on departure, minus a deduction of a fixed percentage of the capital value.
- 9.11 An important difference is that, in the USA, the deduction is a percentage of the entrance fee (equivalent to the purchase price) rather than the sale price. In England and Wales, the event fee cannot be calculated in advance as it will fluctuate according to the market. On the other hand, it permits the householder to share in any capital gain. On the US model, the developer takes any capital gain in the value of the property and the resident is left with a proportion of what they paid when moving in.
- 9.12 Another difference is that each resident contracts directly with the operator: residents do not sell rights to each other.

US legislation

- 9.13 As of 2005, 34 US states had adopted legislation regulating CCRCs.⁵ For example, article 46 of the New York Public Health Law is devoted to this purpose. One of its sections is very similar to the Consumer Protection Regulations. It prevents statements or illustrations that are:

untrue, deceptive, misleading, or omit material facts or omit any other information required by regulations appropriate to a continuing care retirement community.⁶

- 9.14 Since the refund amount is a material fact, this requires CCRCs to be transparent about their event fee-type financial structures.

⁴ Paula Span, "CCRC fees: prepare to be bewildered" (3 December 2009) *The New York Times*, <http://newoldage.blogs.nytimes.com/2009/12/03/ccrc-fees-prepare-to-be-bewildered/>

⁵ Pearson, K. C., "Continuing Care Retirement Communities, State Regulation and the Growing Importance of Counsel for Residents and their Families," pp 172-182, *Pennsylvania Bar Association Quarterly* (October 2006), p 175.

⁶ § 4613.

“Community Development District” laws

- 9.15 Other elements of US retirement communities are wholly unlike their counterparts in England and Wales. One of the most famous examples is “The Villages” in Florida, an entire district which had 51,442 residents according to the 2010 census,⁷ and is said to have doubled in population since then.
- 9.16 The Villages was developed under Florida’s special “Community Development District” law, by which private developers take on responsibility for services usually provided by local government. These include roads, water, sewerage, waste collection and public transport. Residents pay for these services through a bond secured on the value of the property. In the UK, these charges would be billed on an ongoing basis, for example as part of council tax and water or sewerage charges.

NEW ZEALAND

- 9.17 In New Zealand, properties in retirement villages are typically sold on a licence to occupy basis. As in the USA, this means that the resident does not own the property, but has a personal right to live there. A government guide explains:

The majority of registered retirement villages in New Zealand offer a licence to occupy. This gives you the right to live in the unit, without ownership rights. It usually means you can’t borrow against the value of your unit, though some villages may offer this option.⁸

- 9.18 A special regime exists to ensure that should the retirement village operator borrow money secured against residents’ homes, the lender cannot evict the residents in the event of a default.⁹

Fees

- 9.19 Residents pay a capital sum on entering the village. When the resident leaves, they can recoup only some of the capital sum, since a “fixed deduction” will have been made:

As a new resident, you’ll pay a capital sum when entering a village... . Typically, up to 30 percent of that capital sum is spent over the following three, four or five years to cover costs such as the use of communal facilities, management or long-term maintenance. This is usually deducted at the end of the occupation right agreement and is commonly called a “fixed deduction.”¹⁰

- 9.20 Again, this is supplemented by regular service charges.

⁷ United States Census Bureau, <http://quickfacts.census.gov/qfd/states/12/1271625.html>.

⁸ New Zealand Ministry of Business, Innovation and Employment, *Thinking of living in a retirement village?* (2014) p 7.

⁹ Above, p 8.

¹⁰ Above, p 9.

- 9.21 The lack of capital gain can be a problem when residents wish to move. A guide from the New Zealand Government provides this salutary example, where a couple were unable to “downsize” from a villa to an apartment:

Alice and Jack purchased the right to live in a village for \$160,000. This was exactly the money they had left over from selling their house. They planned to move to an apartment as their needs changed, and still have money left over.

When the time came to move, their villa was worth \$250,000. However, Alice and Jack found they would only receive \$130,000 from its sale due to deductions, and they wouldn't receive any share in its capital gain.

In addition, the cost of the apartment had risen to \$160,000, so their dream of downsizing as their needs changed was not possible after all.¹¹

- 9.22 Additionally, some developers use a “capital loss” clause, meaning that where a property depreciates in value below the purchase price, the loss is borne by the resident.

Statutory regulation

- 9.23 There is no attempt to regulate the amount of event fees. Instead, the focus is on transparency. The New Zealand Retirement Villages Act 2003 states that “before any occupation right agreement can be entered into, the intending resident must receive a disclosure statement”.¹²

- 9.24 Schedule 2 of the Act specifies in detail what the disclosure statement must contain. As well as having to make disclosure about the ownership, management and finances of the village, village operators must supply extensive information about deferred fees, together with worked examples. Even the yearly intervals to be used for worked examples are prescribed. Thus paragraph 3(e) requires the statement to contain

the estimated financial return that a resident, former resident, or the estate of a former resident, could expect to receive on the sale or other disposal of a vacant residential unit at intervals of 2 years, 5 years, and 10 years after the resident enters into an occupation right agreement.¹³

- 9.25 The effect is that disclosure is standardised. The aim is to allow consumers to make an informed choice between different properties.

¹¹ New Zealand Ministry of Business, Innovation and Employment, *Thinking of living in a retirement village?* (2014).

¹² New Zealand Retirement Villages Act 2003, s 30.

¹³ Above, sch 2, para 3(e).

Challenges before the courts

- 9.26 The “fixed deduction” or event fee itself does not appear to have been subject to serious legal challenge in New Zealand. However, one case suggested that the courts may be prepared to intervene in an extreme case.
- 9.27 In *Culverden Retirement Village Limited v Hill*,¹⁴ Mr and Mrs Hill spent \$153,500 to purchase a unit in a retirement village. The operator, Culverden, had an option to repurchase the unit if the claimants breached a rule relating to the operation of the village. Culverden alleged that there had been such a breach and exercised the option, repurchasing the unit for less than \$11,000.
- 9.28 Mrs Hill claimed that Culverden had an implied duty to exercise the option to repurchase in good faith and that it had breached this duty. Culverden applied to strike out Mrs Hill’s claim, on the ground that the good faith cause of action was so clearly untenable it could not succeed.
- 9.29 The High Court of New Zealand refused to strike out the claim:

There were submissions directed in a variety of ways to the broad issue whether a duty of good faith is, as a matter of law, a duty which might be capable of being implied into an option. A submission was made that “the common law, and the law of New Zealand, do not imply such terms in to commercial contracts”. I do not accept the proposition stated in such general terms. I agree with the conclusion of Judge Singh that this is a developing area of the law, where there are conflicting opinions, such that a claim should not be struck out on an interlocutory application before trial.¹⁵

- 9.30 The case did not reach full trial, so the law remains undeveloped. However, it is possible that the New Zealand courts could require village operators to exercise their contractual rights in good faith. In extreme cases, an operator could be found to breach this requirement.
- 9.31 This does not mean that fixed deductions would be found to be unfair generally. Ten years earlier, the Judicial Committee of the Privy Council had been asked to decide whether the same retirement village should be regulated as issuing investment securities under the New Zealand Securities Act 1978.¹⁶ The court agreed with the Registrar of Companies that residents did make an investment. However, it was not necessarily a bad investment. The court remarked:

¹⁴ *Culverden Retirement Village Limited v Edna May Hill* [2008] NZHC 1843 (25 November 2008).

¹⁵ Above, at para [34].

¹⁶ *Culverden Retirement Village Limited v Registrar of Companies* [1996] UKPC 50.

Their Lordships consider that... buyers of units would say they have invested their money in buying a townhouse in Culverden Retirement Village on terms that they will occupy this, with necessary services provided, for so long as they wish and that they will then get back all or a large part of their outlay. The return from their outlay is to be found in the totality of these benefits, not just the financial repayment at the end.¹⁷

Conclusion

- 9.32 The New Zealand retirement village model bears some similarities to retirement villages in the UK. However, the right which residents purchase is usually a licence to occupy. This means that residents do not own their own home; they merely have the right to live there. At up to 30 percent, event fees are comparable to those of full service retirement villages in England and Wales. However, since the resident gets no share of any capital gain and may be required to reimburse the operator for any capital loss, the New Zealand model eats up a greater proportion of the resident's capital.
- 9.33 There is specific legislation to regulate retirement villages and ensure that charges are transparent. The Government also publishes a consumer guide to alert consumers to the fee structures used, and provide examples of how they work in practice.¹⁸

AUSTRALIA

- 9.34 As we have seen, retirement villages are popular in Australia. Although these villages use a variety of tenure and commercial arrangements, the great majority charge some form of event fee. Estimates suggest that 90% of retirement properties require the resident to pay a "deferred management fee" on departure, in addition to normal service charges.¹⁹
- 9.35 These fees are controversial. As the Sydney Morning Herald put it:
- Changes to legislation covering retirement villages haven't stopped the flow of complaints from residents about contracts that often block their way to any return from what is likely to be their final property transaction... Many retirees get back less than they put in once a village operator has collected various fees and charges and perhaps a cut of the increased value of a unit.²⁰
- 9.36 The article also quoted Andrew Giles, Chief Executive of Australia's Retirement Village Association, arguing that such fees are necessary:

¹⁷ *Culverden Retirement Village Limited v Registrar of Companies* [1996] UKPC 50 at [15]-[17].

¹⁸ New Zealand Ministry of Business, Innovation and Employment, *Thinking of living in a retirement village?* (2014).

¹⁹ Lesley Parker, "Lifestyle's hidden costs" (February 16, 2011) *Sydney Morning Herald*.

²⁰ Above.

Giles defends the departure fee as “the only avenue for an operator to make a return on their investment in a village.” He says monthly service fees are set on a cost-recovery basis only and don’t cover the initial cost of building shared facilities such as swimming pools and emergency call systems.²¹

Statutory regulation

- 9.37 Many states and territories have introduced legislation to regulate retirement communities.
- 9.38 An example is the Australian Capital Territory. From 1999 to 2012, it had a Retirement Villages Industry Code of Practice with legislative backing. This Code has now been replaced by the Retirement Villages Act 2012. Among other things, the Act requires operators to provide a disclosure statement within 14 days of the prospective resident expressing an interest “in particular premises in the village”.²² The disclosure statement must “include fees and charges payable in relation to the premises” and “comply with any requirement prescribed by regulation”.²³

Challenges before the courts

- 9.39 In one retirement village in New South Wales, Fernbank, the relationship between residents and the management company broke down, resulting in disputes and litigation for over a decade. Residents called for a “fair division of charges”; they complained about substantial fees and operating expenses, and alleged that the agreements they had entered into were “at least unfair and perhaps invalid”.²⁴
- 9.40 One of these fees was a “deferred management fee”. On sale, some residents would have to pay 2.5% of the purchase price per year lived in the property, to a maximum of 25%, plus 20% of the increase in the value of the property. Others would pay a flat fee of 3.5% of the resale price of the property per year lived in the property up to a maximum of 35%. The fee drew complaints from residents, who alleged that the management company were accruing something in the order of \$1.5 million per year. The fees were said to be of “no tangible benefit evident to the proprietors, other than an occasional relatively small handout”.²⁵

²¹ Lesley Parker, “Lifestyle’s hidden costs” (February 16, 2011) *Sydney Morning Herald*.

²² Retirement Villages Act 2012, s 24(1).

²³ Above, s 24(3).

²⁴ *Eric & Valerie Coffey & Ors v Fernbank Management Pty Ltd & Anor* [2001] NSWSC 192 at [63] – [68].

²⁵ Above, at [69].

9.41 In *Coffey v Fernbank*,²⁶ the New South Wales Supreme Court found that the entirety of the “Services Agreement”, in which the deferred management fee was to be found, was unenforceable. This did not result from any appraisal of its terms but from the unenforceability of a separate, but related, agreement (the “Management Agreement”) which had previously been found to be invalid in another case.²⁷

9.42 However, the Supreme Court recognised that, by denying the enforceability of the Services Agreement, the management would be left uncompensated for the services they had provided. So it looked separately at the charges for the services to determine a “fair and just remuneration for the benefits provided”.²⁸ The management company provided various methods to decide what was a fair fee, including using a sum equal to the deferred management fee. The court accepted that the deferred management fee was, in the end, the best way to value the services that had been provided:

I am comfortably satisfied that the application of the stipulated “fee” in the unenforceable Services Agreements which each of the plaintiffs agreed to pay to Management at the time of the resale of their units is just and represents fair and reasonable remuneration for Management in the circumstances of this case.²⁹

9.43 In coming to this conclusion, the court was satisfied that the deferred management fee represented the bargain entered into by the residents and the management company, without any need for the “dissection of the minutiae of the costs of the operation” of the retirement village.³⁰ It also found that the residents had been aware of the fee, and their obligation to pay it, at the time they purchased their property.³¹

9.44 One interesting aspect of this case was that the court found it extremely difficult to find any other way to value the range of services provided to the many different residents. As we discuss in Chapter 10, deferred management fees involve some form of transfer of risk. The value of the actual services provided may be more or less than the fee. In these circumstances, attempting to assess the fee against some objective evidence of benefits tends to be expensive, time consuming and likely to lead to prolonged dispute. In some cases, those disputes may be irresolvable.

²⁶ *Eric & Valerie Coffey & Ors v Fernbank Management Pty Ltd & Anor* [2001] NSWSC 192.

²⁷ *Gillett v Halwood Corporation Ltd & Ors* NSWCA, Priestley JA, Handley & Powell JJA, unreported, 26 March 1998.

²⁸ *Eric & Valerie Coffey & Ors v Fernbank Management Pty Ltd & Anor* [2001] NSWSC 192 at [127].

²⁹ Above, at [252].

³⁰ Above, at [234].

³¹ Above, at [244].

Conclusion

- 9.45 Australia permits an event fee-type financial structure, and its retirement village industry makes extensive use of this model. Again, specific legislation has been introduced to regulate retirement villages, which focuses on transparency. For example, in the Australian Capital Territory, the Retirement Villages Act 2012 identifies specific requirements for disclosure. Although deferred management fees have been challenged before the courts, they have been considered fair and reasonable.

LESSONS FOR ENGLAND AND WALES

- 9.46 The market for retirement villages is far more developed in the United States, New Zealand and Australia than in England and Wales. As discussed in Chapter 10, this form of housing brings benefits to both residents and to society – and we wish to encourage it.
- 9.47 The higher level of services provided by retirement villages leads to higher charges. In these jurisdictions, most developers use some form of deferred fees to make these charges affordable. Although the charges may be high, they are regulated rather than banned. We do not think that there is anything wrong with deferred fees as such.
- 9.48 However, it is essential to make these fees transparent to prospective residents. In New Zealand and in much of the USA and Australia, there is specific legislation to regulate retirement villages. This legislation is often highly specific about when disclosure statements must be given and what they must contain. In Chapters 11 and 12, we propose much greater transparency requirements for England and Wales.

CHAPTER 10

OUR APPROACH TO REFORM

- 10.1 There is a need to increase the provision of specialist housing for older people. Yet the way that event fees are currently used risks bringing the sector into disrepute. As we explain below, we think that high event fees may be justified, but only if potential purchasers are able to understand and take account of the fee in their decision-making. This requires fees to be presented at an early stage and in a clear way, so that purchasers know how much they are likely to have to pay, and when they must pay it.
- 10.2 At present, event fees fall into a gap in the law. They are not covered by the statutory protections for residential leases in landlord and tenant law, and there are undue complexities in the way that unfair terms legislation applies to them. To ensure that event fees are fully transparent, we propose amendments to the law of unfair terms (discussed in Chapter 11), coupled with stronger codes of practice (discussed in Chapter 12).
- 10.3 To some extent, considerations of human rights and constitutional principle constrain Parliament's ability to change existing leases. We consider how far it would be legitimate to enact legislation which alters the terms of existing leases. Finally, we discuss possible options which we are not minded to pursue. In particular we explain why we do not propose to ban event fees completely or to bring fixed service charges within section 19 of the Landlord and Tenant Act 1985.

THE NEED FOR TRANSPARENCY

- 10.4 As we highlighted in Chapter 2, people typically move to specialist housing following a crisis, such as the death of a partner or an accident. They are often stressed and therefore vulnerable. Furthermore, purchasers face an array of confusing terminology and a dearth of advice.¹
- 10.5 Even sophisticated consumers may find it difficult to understand the full effect of an event fee, unless they are presented in a clear and transparent way. Many of those buying retirement properties are not sophisticated. Instead, they are struggling to take in a great deal of complex information at a highly stressful time. They find themselves bound by fee obligations which are often very far from transparent, and which can operate in surprising circumstances to impose high charges.
- 10.6 In our view, those who benefit from event fees have a responsibility to ensure their transparency. We believe that developers, operators and managing agents should do more to bring event fees to the attention of prospective purchasers at an early stage. They should do so in a clear and prominent way which allows people to understand how much they are likely to pay and in what circumstances.

¹ See Chs 3 and 4.

Problems with the current law

- 10.7 There are defects in the way that the current legal protections apply to event fees. First, they are excluded from the statutory protections for residential leases. As discussed in Chapter 5, even when event fees are described as deferred service charges, they are not subject to the controls in the Landlord and Tenant Act 1985, because they are fixed rather than variable charges. Most event fees do not fall within the controls on administration charges in the Commonhold and Leasehold Reform Act 2002; nor within the controls on fees for providing consent under the Landlord and Tenant Act 1927.
- 10.8 Event fees are subject to the controls on unfair terms in consumer contracts. However, in Chapter 6 we discuss several complexities in the way that unfair terms law applies to price terms and to leases. Our tentative conclusion is that under European law, a lease would be regarded as a continuing contract between the landlord and any subsequent tenant. But this point is not as clear as it should be. Furthermore, the legislation does not require a court to focus on what each tenant was told about the fee and does not appear to apply to leases created before 1995.
- 10.9 Traders are required to provide material information about the terms of a lease under the Consumer Protection from Unfair Trading Regulations 2008. However, these obligations are insufficiently understood within the sector. As we see in Chapter 8, the various codes of practice applying to estate agents, managing agents and developers do not do enough to ensure that prospective purchasers are given clear information about event fees at an early stage.
- 10.10 Our conclusion is that there is a need to reform the law to ensure that event fees are applied in a way which is fair and reasonable. We ask if consultees agree.

Assessing charges for fairness: two possible models

- 10.11 The law provides two separate models of how charges may be assessed for reasonableness. Under section 19 of the Landlord and Tenant Act 1985, the First-tier Tribunal is asked to assess the amount of the service charge against the costs which were reasonably incurred. The tribunal then looks at whether the services or works were of a reasonable standard. The focus is on the appropriateness of the charge compared with the cost of the services reasonably supplied in exchange.
- 10.12 Under the Consumer Rights Act 2015, the court is also given jurisdiction to decide whether a contract term is fair and reasonable, but the nature of the assessment is different. Where price terms are transparent and prominent, the court is specifically prevented from assessing the amount of the charge by comparison with the services supplied. Instead, the focus is on whether the term meets the requirements of good faith or causes a significant imbalance in the parties' rights and obligations, looking at circumstances existing when the term was agreed. The primary question is whether the consumer was able to understand and take account of the term when the contract was formed: not whether the charge was more or less than the cost of the services supplied.

10.13 As we describe at paragraphs 10.38 to 10.44 below, we do not think it is appropriate for a court or tribunal to attempt to assess the amount of an event fee compared with the services supplied. That would be an extremely expensive and labour-intensive undertaking which would fail to have regard to the nature of the bargain. However, we do think that event fees have the potential to be unfair if they are not presented in a way which allows consumers to understand the term or take it into account.

10.14 We therefore think that there should be statutory reform to ensure that event fees are brought fully within the scope of unfair terms legislation. We look in detail at the nature of these reforms in Chapter 11, and make provisional proposals.

10.15 Do consultees agree that:

(1) **Developers, operators and managing agents should do more to bring event fees to the attention of prospective purchasers at an early stage?**

(2) **There is a need to reform the law to achieve this objective?**

RETROACTIVE LEGISLATION: IS IT LEGITIMATE TO ALTER TERMS IN EXISTING LEASES?

10.16 The terms “retrospective” and “retroactive” are often used interchangeably. However, we think it is helpful to distinguish between them. The term “retroactive” describes a law which applies to events which predate the commencement of the law as though it were the law at the time of those past events.² The term “retrospective”, on the other hand, describes a law which recognises past transactions, but alters the consequences of those actions for the future.

10.17 The Law Commission noted in a recent issues paper on Sentencing Procedure that “there is a strong and ancient common law suspicion of retroactive laws”.³ As Lord Justice Staughton put it in *EWP Ltd v Moore*:

One requirement of justice is that those who have arranged their affairs... in reliance on a decision of these courts which has stood for many years, should not find that their plans have been retrospectively upset.⁴

10.18 Retroactive legislation may go further than simply impacting unfairly on a few individuals: it may undermine the certainty of the law more generally. Lord Diplock saw this as a constitutional principle:

² E.g. C Bobbett, “Retroactive or retrospective? A note on terminology [2006] 1 *British Tax Review* 15-18.

³ <http://www.lawcom.gov.uk/wp-content/uploads/2015/06/Sentencing-Procedure-Issues-Paper-Transition-online.pdf>, p 5.

⁴ [1992] 2 WLR 184, 474.

Acceptance of the rule of law as a constitutional principle requires that a citizen, before committing himself to any course of action, should be able to know in advance what are the legal consequences that will flow from it.⁵

- 10.19 Where there is any doubt on the issue, the courts will therefore apply a strong presumption that a law operates only on future acts. The position was outlined by Lord Justice Buckley in *West v Gwynne*:

As a matter of principle an Act of Parliament is not without sufficient reason taken to be retrospective. There is, so to speak, a presumption that it speaks only as to the future.⁶

- 10.20 This does not prevent Parliament from legislating retroactively, provided that this is made sufficiently clear.⁷ However, as we explore below, retroactive legislation may not be compliant with the European Convention on Human Rights (ECHR).

Article 1 Protocol 1 of the ECHR

- 10.21 Where developers have sold leases on the basis that they will provide a continuing income stream, we think that this right would be interpreted as a “possession”. Possessions have been interpreted widely to include not only property but also some contractual rights.⁸ We think covenants under a lease would be regarded as either a property right or as contractual rights which are treated as a possession for these purposes. This would engage Article 1 Protocol 1 of the Convention (A1P1), which imposes some restrictions on depriving persons of their possessions.

- 10.22 The text of A1P1 reads as follows:

Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by the general principles of international law.

The preceding provisions shall not, however, in any way impair the right of the State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

⁵ *Black-Clawson International Ltd v Papierwerke Waldhof-Aschaffenburg AG* [1975] 2 WLR 513, [1975] AC 591, p 638.

⁶ [1911] 2 Ch 1, 12.

⁷ There are two recent examples of retroactive legislation; the Mental Health (Approval Functions) Act 2012 gave retroactive validation to the faulty approvals; the Job-Seekers (Back to Work Schemes) Act 2013 effectively reversed a court decision that parts of the government’s 2011 Regulations on back to work schemes were unlawful.

⁸ *Wilson v First County Trust (No 2)* [2004] 1 AC 816.

- 10.23 The interplay between retroactive law and A1P1 has been considered recently by the Supreme Court in *Re Recovery of Medical Costs for Asbestos Diseases (Wales) Bill*.⁹ This case concerned a Bill before the National Assembly for Wales. The Bill would have allowed NHS Wales to recover the costs of treating those with asbestos-related diseases from a former employer or other body which was liable to compensate the victim. Under clause 14 of the Bill, if the compensator's liability was covered by an insurance policy then that policy was to be treated as also covering the compensator's liability for NHS treatment. Clause 14 imposed this change on insurance policies regardless of whether they were entered into before or after the date when the Bill was due to come into effect.
- 10.24 The majority of the Supreme Court found that the Bill was outside the Assembly's legislative competence on grounds unrelated to A1P1. However, Lord Mance went on to consider the application of A1P1, outlining a four stage test for determining whether a legislative provision infringed the protocol:¹⁰
- (1) Is there a legitimate aim which could justify restricting a Convention right?
 - (2) Is the measure adopted rationally connected to the aim?
 - (3) Could the aim have been achieved by a less intrusive measure?
 - (4) On a fair balance, do the benefits of achieving the aim by the measure outweigh the disbenefits resulting from restriction of a Convention right?
- 10.25 Lord Mance considered that the court will accept the legislature's determination of what is in the public interest unless it is manifestly without reasonable foundation.¹¹ However, when it comes to assessing the proportionality of the measure at the fourth stage the legislature's judgment is not determinative. As Lord Mance put it:
- [T]he European Court of Human Rights scrutinises with particular circumspection legislation which confiscates property without compensation or operates retrospectively. In the case of confiscation, it will normally be disproportionate not to afford reasonable compensation, and a total lack of compensation will only be justifiable in exceptional circumstances. In the case of retrospective legislation, "special justification" will be required before the court will accept that a fair balance has been struck.¹²

All the judges on the panel expressed agreement with this analysis.

⁹ [2015] UKSC 3; [2015] 2 WLR 481.

¹⁰ Set out at para [45] of the judgment.

¹¹ Para [48], drawing on *James v The UK*, Application Number 8793/79.

¹² [2015] UKSC 3; [2015] 2 WLR 481 at para [53].

- 10.26 In other words, retroactive legislation to deprive landlords of existing rights to an income stream is not necessarily incompatible with human rights. However, it would require special justification. It would be necessary to show that the legitimate aim of protecting consumers could not have been achieved by a less intrusive measure.

Implications for event fees

- 10.27 We do not think that it would be right for our proposals to affect event fees which have already fallen due. To interfere with legal obligations which have crystallised in this way would undermine the certainty of the law.
- 10.28 It might be legitimate to impose controls on existing leases which affect event fees falling due in the future. However, special justification would be needed. Where developers have planned their affairs on the basis of a right to an income, and have a reasonable expectation of that income, the courts would be wary of depriving developers of that income without compensation. It would have to be shown not only that the deprivation was in the public interest, but that the aim could not have been achieved by a less intrusive measure and that the reform was proportionate.
- 10.29 However, we do not think that human rights law prevents Parliament from imposing obligations on landlords to inform future consumers fully about the effect of event fees, or imposing penalties on developers who fail to do this.
- 10.30 Finally, many event fees are already subject to unfair terms law, so questions of retroactivity do not arise. In Chapter 12, we ask landlords to give clearer and stronger undertakings about existing event fees in order to prevent further litigation and to raise consumer confidence in the specialist housing market.

PROPOSALS WE ARE NOT MINDED TO PURSUE

- 10.31 Finally, we discuss four possible options which we are not minded to pursue. These are to ban event fees completely; to bring fixed service charges within section 19 of the Landlord and Tenant Act 1985; to treat selling charges as administration charges under the Commonhold and Leasehold Reform Act 2002, schedule 11; or to extend the controls on the granting of consent under section 19 of the Landlord and Tenant Act 1927. We explain why our initial view is that these options are not appropriate and ask for views.

A ban on event fees?

- 10.32 One possible solution might be to prevent such fees from being levied at all. The Office of Fair Trading effectively suggested this option when it urged “consideration of whether the model currently in force in Scotland of restricting or prohibiting certain classes of fee would be appropriate”.¹³

¹³ OFT report, para 9.9.

- 10.33 We are not minded to pursue this option. Inevitably, specialist retirement housing has high service charges, not only for normal maintenance, but also to pay for communal amenities and staff. This is especially true for retirement communities, where the additional facilities and services may be substantial. For those who are capital rich and income poor the idea of deferring some of these charges is often attractive, especially if it is combined with a clear cap on monthly fees.
- 10.34 In Chapter 4 we gave some illustrations of the effect which banning event fees could have on annual service charges. In one such example a monthly service charge could increase from £520 to £1,461, making it unaffordable.¹⁴ However, the reasonableness of prevailing levels of charge is not something that we can investigate.
- 10.35 Deferred charges are widely used in retirement villages in the United States, Australia and New Zealand. In Chapter 9 we explain that many states and territories in these jurisdictions have statutes to regulate retirement villages, but the emphasis is on ensuring the transparency of deferred charges. We are not aware of any legislation to ban deferred charges or to regulate their amount.
- 10.36 We think that any attempt to ban event fees could reduce the development of more specialist housing for older people or make that housing less affordable. In our view, deferred fees, payable on sale, are not necessarily objectionable if they are explained sufficiently clearly at an early stage.
- 10.37 Do consultees agree that event fees should not be banned completely?**

Should fixed service charges be reviewable?

- 10.38 A second possible option would be to bring fixed service charges within the controls imposed by the Landlord and Tenant Act 1985. Effectively, this would allow the First-tier Tribunal (FTT) to assess the amount of any event fee described as a deferred service charge. The FTT would then have jurisdiction to look at how far the event fee matched the costs reasonably incurred for the services provided and the works carried out, and whether the services or works were of a reasonable standard.¹⁵
- 10.39 In *Arnold v Britton*,¹⁶ Lord Neuberger pointed out that “there are various provisions which protect tenants against unreasonable service charges but none of them apply here.”¹⁷ He suggested that Parliament may wish to change the law:

The present case suggests that there may be a strong case for extending such provisions [which protect tenants]even though they involve a fixed sum payable by way of service charge. But that is a policy issue for Parliament, and there may be arguments either way.¹⁸

¹⁴ See para 4.91.

¹⁵ LTA 1985, s 19(1).

¹⁶ [2015] UKSC 36.

¹⁷ Above, at [65].

¹⁸ Above, at [65].

Lord Hodge added:

My conclusion that the court does not have power to remedy these long term contracts so as to preserve the essential nature of the service charge in changed economic circumstances does not mean that the lessees' predicament is acceptable. If the parties cannot agree an amendment of the leases on a fair basis, the lessees will have to seek a parliamentary intervention.¹⁹

- 10.40 However, we can see strong arguments against giving tribunals jurisdiction to assess the amount of a fixed or deferred service charge by looking at whether the fee paid corresponded to the cost of the services provided.

Problems with trying to assess the fee against the costs

- 10.41 First, tribunal proceedings can be costly and unpredictable, even for reasonably simple disputes. As the Competition and Markets Authority pointed out, the fees can be high. Furthermore, some leases give the landlord a contractual right to recover their legal costs from the tenant, even if the tenant wins.²⁰ These shortcomings act as strong deterrents for elderly people who feel aggrieved about charges demanded by the landlord.
- 10.42 Secondly, any attempt to assess an event fee against the service provided would require an extensive amount of detailed information. In assessing a fee payable after 15 years, for example, it would be necessary to look at all the services provided over that 15 year period. Those services may be provided by firms associated with the landlord or developer, leading to disputes about whether the service provider's charges were or were not reasonable. This would be followed by further argument about the standard of the services supplied and the extent to which residents benefited from them. We note that in *Coffey v Fernbank*, the Supreme Court of New South Wales found it extremely difficult to value the services by looking at past costs.²¹
- 10.43 Furthermore, the exercise of attempting to match event fee to service costs would fail to take account of the parties' bargain. As the High Court judge pointed out in *Arnold v Britton*, by setting a fee in advance, the parties take the risk that the landlord may be over- or under-compensated for the services provided.²² In return, tenants are given greater certainty over how much they will be required to pay. Some tenants will consume more services than they have paid for; others less. In these circumstances, allowing some tenants to reduce their costs undermines the fundamental nature of the bargain struck.

10.44 Do consultees agree that there should not be reform to bring event fees within the ambit of section 19 of the Landlord and Tenant Act 1985?

¹⁹ [2015] UKSC 36 at [79].

²⁰ See para 5.57.

²¹ *Eric & Valerie Coffey & Ors v Fernbank Management Pty Ltd & Anor* [2001] NSWSC 192. See paras 9.41 – 9.44.

²² [2012] EWHC 3451 (Ch) at [46].

Should selling services be classified as administration charges?

- 10.45 In Chapter 5 we explain that administration charges are regulated by the Commonhold and Leasehold Reform Act 2002, schedule 11. This includes charges for “the provision of information or documents”, but not for other selling services such as “advice and assistance to the tenant”; or “reasonable efforts to seek a potential purchaser”. The OFT criticised the narrow definition of administration charges in schedule 11. It recommended that the definition should be widened to give tribunals jurisdiction to assess the reasonableness of a greater range of fees.
- 10.46 Many of the problems with assessing deferred service charges do not apply to assessing charges for “selling services”. It would not necessarily involve a detailed fact-finding exercise. Nor is there the risk of over- or under-compensation central to the bargain. Instead, the tribunal could look at the assistance given to a tenant with selling the property, and could assess the reasonableness of the charge compared with comparable services provided by local estate agents. In some of the terms we have seen, the fees appear as excessive compared with comparable providers.
- 10.47 We can see some arguments for extending the definition of administration charges to include services connected with selling the lease. However, we think it would be difficult to find sufficient justification to apply the new controls to current leases. There could, of course, be no such objection to applying the controls to new leases, but the effect is likely to be limited. Developers would simply avoid the controls by drafting terms in new ways, to avoid coming within the definition of administration charges. The reform may well prove pointless.
- 10.48 Do consultees agree that the controls on administration charges set out in the Commonhold and Leasehold Reform Act 2002, schedule 11 should not be extended to include selling services?**

Charges for granting consent

- 10.49 As we saw in Chapter 5, section 19 of the Landlord and Tenant Act 1927 effectively prohibits fees being charged for obtaining the landlord’s consent to assignment, sub-letting, charging or parting with possession of the property. One possibility would be to amend this section to control all fees on assignment, sub-letting or parting with possession – not simply for granting consent
- 10.50 However, it is not clear how control would be exercised. If landlords could only charge a reasonable sum for legal or other expenses incurred in connection with the change, it would effectively ban high event fees to cover deferred service charges. On the other hand, if courts were asked to assess the amount of the charge against all the services provided, it would lead to the same problems we identified in extending controls of service charges.
- 10.51 Do consultees agree that section 19 of the Landlord and Tenant Act 1927 should not be amended to cover event fees?**

CONCLUSION

- 10.52 We do not think that event fees are necessarily objectionable. They may legitimately reflect an element of deferred purchase price, service charge or contingency fund contribution. However, they can become exploitative if they are not adequately explained to each tenant who becomes bound by them.
- 10.53 We are not minded to impose an outright ban on event fees. Nor do we think that event fees should be assessed against the cost of providing the service. That would be a lengthy and costly process. It would also fail to recognise that event fees offer certainty of payment, and may be more or less than the cost of the services actually consumed. It would be possible to extend controls on selling services and consent fees, but we fear that these controls could be avoided by ingenious drafting of new lease provisions.
- 10.54 Instead, we propose amendments to the law of unfair terms, described in the next Chapter. As we explain, our proposals would require landlords to inform future consumers fully about the effect of fees in current leases. We also think that where money is required to be used exclusively for the maintenance, repair or improvement of the development, it should be held on statutory trust.
- 10.55 These changes are primarily designed to affect future behaviour. Our proposals would only have a minor effect on existing rights. We think this minor effect is justified by the need to protect vulnerable consumers and ensure the competitiveness of the sector.

CHAPTER 11

PROPOSALS FOR STATUTORY REFORM

11.1 In the previous chapter, we argued that event fees need to be disclosed to each incoming tenant at an early stage, clearly and prominently. In this chapter, we make three provisional proposals for statutory reform:

- (1) Event fees should be brought fully within the scope of unfair terms legislation.¹ To do this we propose statutory reform to clarify that, for the purposes of unfair terms legislation, an event fee should be treated as a contract term. The contract should be seen as arising between the tenant and the landlord when the tenant becomes bound by the term.
- (2) The Secretary of State should use the power in the Consumer Rights Act 2015 to add a paragraph to the grey list covering event fee terms which do not comply with a designated code of practice.
- (3) Where the lease requires fees to be used exclusively for the maintenance, repair or improvement of the development, that money should be subject to a statutory trust for the benefit of the tenants.

11.2 We start by setting out the three provisional proposals, and then define what is meant by an event fee for these purposes. In Chapter 12 we look in detail at how the various relevant codes of practice should be amended to ensure transparency.

BRINGING EVENT FEES WITHIN UNFAIR TERMS LEGISLATION

11.3 In Chapter 10 we argue against bringing event fees within section 19 of the Landlord and Tenant Act 1985, which makes service charges payable only to the extent that they are reasonably incurred. However, we think it is important that event fees are used in a way that would be regarded as fair, as defined in the Consumer Rights Act 2015.

11.4 In Chapter 6 we note many legal complexities in the way that unfair terms legislation applies to event fee terms. Our first provisional proposal is designed to remove these complexities. As we discuss below, we have three objectives:

- (1) To put beyond doubt that unfair terms legislation applies to event fee terms, not only as between the initial tenant and the initial landlord but also for subsequent tenants and landlords.
- (2) To ensure that the fairness of an event fee term is assessed by reference to the circumstances when the tenant became bound by the term, including how the term was presented to that particular tenant.

¹ By “unfair terms legislation” we mean the Unfair Terms Directive 1993 and the legislation implementing it, of which the most recent statute is the Consumer Rights Act 2015 (see glossary).

- (3) To apply unfair terms legislation to any event fee in a lease that is assigned to a consumer after the reform comes into effect, irrespective of when the lease was first granted.

Treating event fees as contract terms

- 11.5 A lease is a contract when it is created, but there is some uncertainty over whether it remains a contract after it has been assigned to a new tenant or to a new landlord. In Chapter 6 we discuss the tension between the English approach and that taken in other European jurisdictions.² We think that for the purposes of unfair terms law, the word “contract” should be given a European meaning. On this basis, our tentative conclusion is that when interpreting the Unfair Terms Directive, the Court of Justice of the European Union would treat a lease as a contract throughout its life, irrespective of who the parties to it are.
- 11.6 However, given the debate on this issue, we think that the matter could usefully be clarified. We therefore provisionally propose statutory reform to state that, for the purpose of unfair terms legislation, an event fee should be treated as a contract term. This should apply even if the lease has been assigned to a new tenant or if the freehold has been assigned to a new landlord.

Focusing on how the term was presented to the tenant

- 11.7 Under article 4(1) of the Unfair Terms Directive, whether a term is fair depends on “all the circumstances attending the conclusion of the contract”. In Chapter 6 we explain that unfair terms protection looks not only at the term itself but at how the term is presented to the consumer. A particularly onerous or unusual term may be fair, but only if the trader ensures that the consumer was aware of the term and able to take it into account in their decision-making.
- 11.8 Furthermore, the Consumer Protection from Unfair Trading Regulations 2008 (CPRs) require traders to give consumers the material information they need before making a transactional decision. A breach of the CPRs may be a factor in deciding whether a term is fair.³
- 11.9 We think these general principles should apply to event fees. We see no reason to prevent the use of event fees, even high event fees, if consumers are aware of them at an early stage and are able to take them fully into account in their decisions. However, event fees have the potential to distort competition if consumers are only told about them after they are already emotionally committed to the purchase; or if consumers cannot readily calculate how much they will be; or if they are applied in surprising circumstances.

² The English approach is discussed in Ch 6, paras 6.70 – 6.92. We explain that the Landlord and Tenant (Covenants) Act 1995 was a partial move away from the doctrine of privity of contract, as it applied to leases. This reform could be seen as a further move away from a strict approach to privity of contract, at least for event fees. The European approach is discussed in Ch 6, paras 6.81 – 6.9.

³ Case C-453/10 *Pereničová and Perenia v SOS financ spol sro* [2012] 2 All E.R. (Comm) 907; [2012] 2 CMLR 28 paras 42-43.

- 11.10 We think that, in assessing whether an event fee is fair, the court should focus on the circumstances which exist when the tenant first becomes bound by the term. In Chapter 6 we explain that the current law does not appear to achieve this effect. A lease may be seen as one continuing contract, which is formed when the first tenant agrees to its terms. This suggests that the court should look only at the circumstances of the original sale – not at what the current tenant was told. This position is highly undesirable. Moreover, information on the circumstances of the original sale would rarely be available to the parties many years later.
- 11.11 To resolve this issue, we suggest a further change to unfair terms legislation. We provisionally propose that, for the purposes of unfair terms legislation, an event fee should be treated as if it were a term of a new contract made when the consumer first became bound by the term. This means that any assessment of whether the event fee was fair would look at the circumstances existing when the current tenant became bound by the term, including when and how the tenant was told about the term.

The effect on old leases

- 11.12 The Unfair Terms Directive (UTD) was first implemented into UK law on 1 July 1995. In Chapter 6 we discuss whether it applies to leases created before this date. We note a statement from one of the Justices of the Supreme Court that it does not.⁴ The normal rule is that a contract must be judged in accordance with the law in force at the time it was agreed – and a lease is often seen as a single contract, agreed when it is granted.
- 11.13 The OFT argued that this was wrong in policy terms, as it would “make leasehold terms immune from challenge for as long as the lease remains in force, which may be a matter of decades or even centuries”.⁵ The OFT is right to highlight the long periods involved. Residential leases typically last 99 years or more. Yet if the market for specialist housing for older people is to flourish, developers need to abide by contemporary notions of appropriate consumer protection.
- 11.14 The effect of the UTD is to impose “a requirement of good faith” on traders who benefit from onerous or unusual terms.⁶ If a term contravened the requirement of good faith it is not binding on the consumer. In practice, good faith is largely about openness, including (where appropriate) positive obligations to provide information. In Chapter 12, we consult about the sort of measures which we think that those who benefit from event fees should undertake in the future.

⁴ Lord Carnwath, in *Arnold v Britton* [2015] UKSC 36, at para 93.

⁵ OFT 1476 (February 2013) Investigation into retirement home transfer fee terms, a report on the OFT’s findings, para 3.3.

⁶ To quote the words of the UTD, art 3.1, a term shall be regarded as unfair “if contrary to the requirements of good faith, it causes a significant imbalance in the parties’ rights and obligations”.

11.15 Traders should not be penalised for a failure to carry out these measures in the past. However, we think that landlords who benefit from existing event fees, should be obliged to act in good faith in the future. We therefore provisionally propose that unfair terms law should begin to apply to event fees in leases originally granted before 1995 from the first time the property is sold following our reforms.

11.16 In Chapter 10, we conclude that this policy is compatible with the European Convention on Human Rights.⁷ A term is highly unlikely to be found to be unfair simply on the basis of the term itself. Instead, the emphasis will be on the landlord's conduct in explaining the term to the tenant, so that the tenant fully understands its effect. As the court would focus on how the landlord behaved following the statutory reform coming into force, the law would not be retroactive, although it would be retrospective (see our discussion of this distinction in Chapter 10, above).⁸

Only event fee terms or all covenants in residential leases?

11.17 Finally, we have considered whether these reforms should apply only to event fees, or whether similar principles should be extended to all covenants in residential leases.

11.18 Our terms of reference ask us to look only at event fees, and we have therefore restricted our provisional proposals to apply only to event fee terms. However, we would welcome views on whether similar principles should apply more widely: for the purposes of unfair terms legislation, should the whole lease be treated as if it were a new contract arising when each consumer becomes bound by it? If consultees considered that there were strong arguments to bring all residential leases within the scope of unfair terms legislation, the Law Commission could consider this issue for inclusion in our Thirteenth Programme of Law Reform.

11.19 Do consultees agree that

- (1) Statutory reform should ensure that event fees are fully assessable for fairness under unfair terms legislation (as set out in the Consumer Rights Act 2015)?**
- (2) For the purposes of unfair terms legislation, an event fee term should be treated:**
 - (a) As if it were a contract term?**
 - (b) As if it were a term of a contract made between the landlord and tenant when the current tenant first became bound by the term?**
- (3) This should apply to event fee terms on the next sale of the lease after the reform comes into effect, irrespective of when the lease was first granted?**

⁷ See paras 10.27 – 10.30.

⁸ See para 10.12.

11.20 We welcome views on whether similar principles should apply more generally to all covenants in residential leases.

ADDING EVENT FEES TO THE GREY LIST⁹

11.21 In Chapter 6, we explain that, under section 65 of the Consumer Rights Act 2015, a term of a consumer contract which is transparent and prominent may not be assessed for fairness to the extent that:

the assessment is of the appropriateness of the price payable under the contract by comparison with the goods, digital content or services supplied under it.

11.22 This provision has given rise to considerable debate and uncertainty. It is possible that event fees may be held to be price terms. Although many event fee terms are not transparent, some may be sufficiently prominent to meet the statutory test. The 2015 Act defines “prominent” relatively narrowly: a term is prominent if a reasonably circumspect consumer would be aware of the term.

11.23 The 2015 Act was based on joint advice provided to the Government by the Law Commission and Scottish Law Commission. The advice acknowledged that in some circumstances, the fact that a term is sufficiently prominent for the average consumer to be aware of it may not be enough. Some products are aimed at consumers who are particularly vulnerable. Furthermore, some terms exploit the way that consumers reach decisions so that, even if consumers are aware of the term, they fail to take it into account in their decision-making.

11.24 The two Commissions argued that where a term is known to exploit behavioural biases in this way, it should be added to the “grey list”.¹⁰ As we explain in Chapter 6, the grey list is an “indicative and non-exhaustive” list of terms which may be regarded as unfair, now set out in schedule 2 of the Consumer Rights Act 2015. Terms on the grey list are assessable for fairness, even if they are price terms, and even if they meet the tests for transparency and prominence.¹¹ The 2015 Act therefore includes a power for the Secretary of State to add terms to the grey list by statutory instrument.¹²

11.25 Those buying specialist housing are likely to be particularly vulnerable, as they are often required to absorb a considerable amount of information at a highly stressful time. Furthermore, event fees are a clear example of terms that exploit behavioural biases. Even if consumers are aware of the term, they may fail to understand its full implications.

⁹ The “grey list” is the list of indicatively unfair terms, now set out in Schedule 2 of the Consumer Rights Act 2015.

¹⁰ Law Commission and Scottish Law Commission, *Unfair Terms in Consumer Contracts: Advice to the Department for Business, Innovation and Skills* (March 2013), paras 3.52 to 3.58.

¹¹ CRA, s 64(6).

¹² Above, s 63(3) – (5).

- 11.26 We therefore propose that the Secretary of State should use the power in the 2015 Act to make a new addition to the grey list, for event fees that fail to comply with the relevant provisions in a code of practice.¹³ We discuss the definition of an event fee at the end of this chapter.

The effect on existing leases

- 11.27 As discussed above, following our reforms, each time a new consumer tenant becomes bound to pay an event fee to a landlord, this obligation would be treated as if it were part of a new contract. The effect is that this proposal would apply to any lease which changes hands following the proposal coming into force.

Codes and the need for certainty

- 11.28 The emphasis on compliance with provisions in a code of practice responds to the industry's need for certainty. During pre-consultation discussions, developers stressed that, in order to finance much needed new housing, they need to plan their borrowings and income stream. Legal uncertainty undermines such plans and has the potential to inhibit new developments. The OFT investigation led to doubts about the enforceability of event fees, which made banks reluctant to lend against them. We have been urged to remove this uncertainty.
- 11.29 Developers need to know in detail what they are required to do to make event fees transparent and enforceable. We think that this level of detail would be unsuitable for primary legislation, but that it should be spelled out in industry codes. Meanwhile, developers who comply with stringent and appropriate code provisions should be given a reasonable level of certainty that the fee will be enforceable.
- 11.30 As a member state of the European Union, the UK is constrained in what it may do to give certainty to industry. The Unfair Terms Directive is a minimum harmonisation measure, so the UK cannot legislate to state categorically that event fee terms which comply with the code of practice are necessarily fair.
- 11.31 However, in practice, the courts are heavily influenced by what is on the grey list. Furthermore, if a code is approved under section 87 of the Leasehold Reform, Housing and Urban Development Act 1993 a court is required to take it into account in determining any relevant question. In practice, we think that the courts would put considerable reliance on whether the code provisions had been complied with in determining whether an event fee term was fair.
- 11.32 Furthermore, anyone who attempted to argue that an event fee which complied with the code was unfair would face the argument that transparent and prominent price terms could not be assessed against the goods or services supplied in exchange.¹⁴ It would not be open to consumers to argue that terms in plain English that were brought to their attention and that complied with the code were excessive compared to the services which had been supplied.

¹³ See para 11.42.

¹⁴ CRA, s 65.

- 11.33 Taking these considerations together, the proposal to confine grey list terms to event fees which do not comply with an approved code should give considerable comfort to the industry. If landlords comply with the code, the term is highly likely to be held to be fair. We think this certainty would be valuable in encouraging further development. In Chapter 13 we ask if, following our proposed reforms, lenders would be happy to lend on the income stream provided by event fees which comply with a relevant code of practice.

How would the codes of practice work?

- 11.34 We discuss how the codes would operate in Chapter 12. We think that the primary responsibility for ensuring that an event fee is fair should rest with the person who is claiming an entitlement to receive the fee, usually the landlord. Therefore, the landlord would need to comply with an approved code which sets out good practice in this area. They may do this directly, or delegate the task to managing agents.
- 11.35 Retirement leases may be sold through “ordinary” estate agents, who act for the vendor and have no links to the landlord. Here the landlord’s primary responsibility would be to make the information available to estate agents. If the estate agent failed to include the information in marketing communications, this of itself would not result in the term being on the grey list, since the landlord would have complied with the code. However, a redress scheme could award compensation against the estate agent. The estate agent might also be liable to prosecution under the CPRs.¹⁵

The need for industry action

- 11.36 As we discuss in Chapter 12, this proposal is dependent on the industry taking the lead swiftly to include and implement suitable provisions in their codes of practice. Without appropriate action from the industry, it would not be possible to confine the grey list to event fee terms which failed to comply with a code of practice. More intrusive legal controls would be needed.
- 11.37 **Schedule 2 to the Consumer Rights Act 2015 sets out an “indicative and non-exhaustive” list of terms which may be regarded as unfair (the “grey list”). Do consultees agree that:**
- (1) The Secretary of State should exercise the power in section 63(3) of the Consumer Rights Act 2015 to add a term covering event fees to the grey list?**
 - (2) The addition to the grey list should be confined to event fees where the person claiming the fee fails to comply with the relevant provisions of an approved code of practice?**

¹⁵ See paras 12.75 – 12.80.

A REQUIREMENT FOR A STATUTORY TRUST

11.38 In Chapter 3 we identify some types of event fees which are referred to as contingency fees, deferred service charges or contributions to a sinking fund. In many cases the lease requires the money received to be used exclusively for the maintenance, repair or improvement of the development. Often, landlords hold this money on trust for the benefit of tenants. However, this is not a legal requirement.

11.39 This contrasts with the law regarding variable service charges, described in Chapter 5. Section 42 of the Landlord and Tenant Act 1987 provides that money paid for variable service charges must be held on trust. Section 42(3) states that:

The payee shall hold any trust fund—

(a) on trust to defray costs incurred in connection with the matters for which the relevant service charges were payable (whether incurred by himself or by any other person), and

(b) subject to that, on trust for the persons who are the contributing tenants for the time being...

11.40 Section 42 is an important protection where the landlord becomes insolvent. Without a trust, any service charge monies held by the landlord could be claimed by the landlord's creditors. It also means that, during the currency of the statutory trust, the landlord and its agents are subject to trustees' duties. They will therefore be liable for breach of trust if the money is not used for the purposes of the trust or not properly safeguarded.

11.41 Those owning retirement leases could be particularly vulnerable on a developer's insolvency. Ian Lock's report gives one example of what can happen to residents when an operator goes into administration:

A retirement village in Morecambe Bay, Lancashire, went into Administration part way through development... The Administration left the c 35 residents that had acquired a property at the scheme with little prospect of being provided with the scheme they thought they were buying into, vulnerable and with assets they could not sell.¹⁶

We think that on a developer's insolvency, protection should at least be provided to any money held by the landlord specifically for the benefit of the properties.

¹⁶ I Lock, "Age Restricted Housing With and Without Care", May 2015, 8.0.

Problems with voluntary arrangements

- 11.42 Since the statutory trust in s 42 of the Landlord and Tenant Act 1987 does not apply to sinking funds raised through event fees, “the beneficial ownership of the money will be a question of construction of the lease”.¹⁷ Hence it will be down to the wording of the individual lease whether the sinking fund is held on trust at all, and if there is an attempt to hold the money on trust, whether that trust is valid.
- 11.43 We are aware that many developers already put such money into a voluntary trust. However, this may not be satisfactory for three reasons.
- 11.44 First, some landlords may fail to put the money into a trust. Secondly, where trusts are established on a voluntary basis, they may not be legally watertight. A recent Law Commission consultation paper on protecting consumer prepayments on retailer insolvency noted that it is not enough simply to pay the money into a separate bank account. The trader needs to show a clear intention to establish a trust, preferably (but not necessarily) through a trust deed drawn up by a lawyer.¹⁸ Moreover, directors of a company which is facing insolvency are not permitted to declare a trust over monies they have already received, as this would be to give a preference to one set of existing creditors over another.¹⁹
- 11.45 We commented that if the trust lacks the correct legal formalities, administrators may seek to defeat it.
- Administrators are required to act in the interests of the creditors as a whole. This means that they may be required to recoup money held in an improperly-constituted trust for the benefit of all the creditors. In practice, we were told that on appointment administrators will seek legal advice about whether a trust is valid in law. If it is vulnerable to challenge and the administrators consider that the funds might belong to the company, they are obliged to challenge the trust to maximise return to the general body of creditors.²⁰
- 11.46 Finally, even if a trust has been established correctly, it is possible that in the confusion leading up to insolvency, book-keeping errors will occur, so that payments are not correctly allocated.
- 11.47 A statutory trust removes these difficulties, as a court would find that the money is subject to the statutory trust as soon as it is received.

Our proposal

- 11.48 Our proposal is a relatively modest one. It would not apply to event fees that provide an income stream to the landlord for an undesignated purpose.

¹⁷ Woodfall: Landlord and Tenant, 7.179.1. This paragraph only contemplates s 42 not applying where the lease is not of a dwelling, but its reasoning is valid in other cases where s 42 does not apply, such as here where although the lease is of a dwelling, the money is not “service charge” money as defined in s 18 of the Landlord and Tenant Act 1985.

¹⁸ Consumer Prepayments, para 2.63.

¹⁹ Insolvency Act 1986, s 239. See Consumer Prepayments, para 2.67.

²⁰ Consumer Prepayments, para 2.70.

- 11.49 It would only apply where the terms of the lease require the money paid to be used exclusively for the maintenance, repair or improvement of the development. In these circumstances we propose a new statutory provision that the money should be subject to a trust, equivalent to the trust arrangements set out in section 42 of the 1987 Act.
- 11.50 This proposal is not intended to change the way that the money is spent. It would only apply where the lease provides that the money must already be used for the benefit of the properties. Its main effect would be not on the landlord but on the landlord's creditors following insolvency. For this reason, we think the statutory reform should apply to existing leases, provided that the payment is made after the new statutory provision comes into force.
- 11.51 The main effect of the proposal would be to protect tenants on the landlord's insolvency. A secondary effect would be that event fee terms which are subject to a statutory trust would be less likely to be found to be unfair. As we discuss below, our provisional view is that terms subject to a statutory trust should not fall within our proposed reforms to the law of unfair terms. In particular, they should not be included in the addition to the unfair terms grey list.
- 11.52 Do consultees agree that where the lease requires event fees to be used exclusively for the maintenance, repair or improvement of the development, the fees should be subject to a statutory trust?**

DEFINING EVENT FEE TERMS

- 11.53 Finally, we consider how an event fee term should be defined for the purposes of our proposals. Essentially, an event fee is a fee which the tenant is obliged to pay under a term in a residential lease, where:
- (1) the term requires the tenant to pay the fee on, or in connection with the happening of a defined event;
 - (2) the event is that title to the lease changes hands, a change in the occupancy of the property; or some other event which creates a third party interest in the lease; and
 - (3) the fee is fixed or calculated in accordance with a formula.
- 11.54 However, we are concerned that lawyers may seek to circumvent any legislative controls by finding other ways in which to draft the term. We would need to find language which was sufficiently broad to prevent these possible means of avoidance. We therefore suggest that the definition should include any fee payable "in connection" with a defined event rather than simply on the happening of a defined event.

Exceptions

- 11.55 We think that this definition should be subject to two exceptions:
- (1) It should not include administration charges as defined in schedule 11 of the Commonhold and Leasehold Reform Act 2002.

- (2) It should not include event fees which must be used exclusively for the maintenance, repair or improvement of the development and which are subject to the statutory trust we have proposed.
- 11.56 Administration charges within the meaning of schedule 11 are common in all residential leases and can already be assessed for reasonableness.
- 11.57 Meanwhile, event fees which are subject to a statutory trust must be used for the benefit of the tenants. This means that any finding that the fee was unfair would damage the interests, not only of the landlord but of the other tenants as well. We would not wish to encourage that outcome.
- 11.58 Although event fees subject to our proposed statutory trust would not be included within our proposed reforms to unfair terms legislation, we think that prospective purchasers should still be told about them. They are still material information within the meaning of the Consumer Protection from Unfair Trading Regulations 2008. In Chapter 12 we propose that code provisions should require information about these terms to be included within a disclosure document given to prospective purchasers.
- 11.59 Do consultees agree:**
- (1) **That an event fee term should be defined as a term in a residential lease which imposes an obligation for the tenant to pay a fee on, or in connection with, the happening of a defined event where:**
- (a) **the event is that title to the lease changes hands, a change in the occupancy of the property; or some other event which creates a third party interest in the lease; and**
- (b) **the fee is fixed or calculated in accordance with a formula.**
- (2) **The definition should not include fees which:**
- (a) **fall within the definition of administration charges in schedule 11 to the Commonhold and Leasehold Reform Act 2002?**
- (b) **must be used exclusively for the maintenance, repair or improvement of the development and which are subject to the proposed statutory trust?**

CHAPTER 12

PROPOSALS RELATING TO CODES OF PRACTICE

- 12.1 In Chapter 8 we explain that there are many different codes of practice, covering estate agents, managing agents and home builders. We conclude that codes have an important role to play in preventing the problems associated with event fees and in ensuring their transparency. However, they need to be revised substantially. Here we look at the protections which we think should be included in codes of practice, and ask for views.
- 12.2 In Chapter 11 we propose an addition to the grey list of unfair terms. It would apply to event fees where the person claiming to be entitled to the fee failed to comply with the relevant provisions of a code of practice.¹ Where the fee does not go into a sinking fund, the person who claims the fee is usually the landlord.
- 12.3 In this chapter we put forward a set of provisions about event fees (the “event fee provisions”) that can be annexed to the relevant codes of practice for developers, operators and managing agents. We look first at how the event fee provisions would work and what we think they should be.
- 12.4 Many leases with event fees are sold by individuals through ordinary estate agents. In the next section we discuss how the event fee provisions would mesh with the obligations on estate agents and conveyancers. We provisionally propose additions to the codes applying to estate agents.
- 12.5 Finally, we consider the position of existing tenants. While our provisional proposals for law reform are not retroactive, as a matter of best practice we hope that developers will undertake not to apply event fees to existing tenants in an unfair way.

THE EVENT FEE PROVISIONS

The status of the provisions

- 12.6 Our changes to the grey list would direct a court’s attention to whether the landlord (or their managing agent) had complied with the relevant provisions of a code of practice. We therefore see our proposed event fee provisions as affecting all those who benefit from event fees, and their agents.
- 12.7 We welcome views on which organisations should take responsibility for implementing the provisions. It may be simplest if they operate as replacements or additions to the relevant provisions in existing codes. The provisions could therefore be incorporated within the Consumer Code for Home Builders, the National Housing Building Council (NHBC) Sheltered Housing Code, the Associated Retirement Community Operators (ARCO) Code and the Association of Retirement Housing Managers (ARHM) Code.

¹ The grey list is an “indicative and non-exhaustive” list of terms which may be regarded as unfair, now set out in the Consumer Rights Act 2015, sch 2.

Scope

- 12.8 In some cases, the freehold (and the right to receive the fees) may be sold to others, who are not bound by these codes. Our addition to the grey list would mean that, in assessing the fairness of an event fee term, a court would still consider whether the landlord had complied with the relevant provisions, even if the landlord was not a member of one of these organisations. Unlike in mainstream housing, resales of specialist housing for older people are often conducted by the landlord's managing agent. The managing agent would be bound by the relevant code. Moreover, the landlord would be in a position to require that their managing agent complied with the relevant code of practice.
- 12.9 In Chapter 4 we note that event fees are common in specialist housing, and rare in more general residential leases. However, event fees are not confined to specialist housing, so we think that the relevant event provisions would need to apply more generally. We welcome evidence from consultees on the use of event fees outside specialist housing.
- 12.10 In Chapter 11 we explain that the grey list would not include event fees used exclusively for maintenance, repair or improvement ("sinking fund fees"), which would be subject to our proposed statutory trust. While a breach of code provisions in relation to these fees would not suggest that the fees are unenforceable, we think the codes should nevertheless cover sinking fund fees. It is important that there is proper transparency about sinking fund fees. Sinking fund fees should still be set out in the event fees disclosure document that we propose should be given to prospective buyers (at para. 12.36, below).

Approval

- 12.11 We think that the event fee provisions should be approved by the Department for Communities and Local Government (DCLG) under section 87 of the Leasehold Reform, Housing and Urban Development Act 1993.² This would ensure a consistent, high status for them. It would also require a court to take into account any provision which appears relevant to determining a question in proceedings. This would give greater certainty to developers that, if they have complied with the relevant provisions, the event fee will be enforceable. If the provisions were annexed to a government-approved code, they could be approved separately so that the whole code did not have to go through the approval process again.
- 12.12 In preliminary discussions, code owners in the industry have been receptive to the idea of incorporating our event fee provisions in an annex or schedule to their codes. We welcome their collaboration in driving up standards. Without industry co-operation to add new provisions to their codes, it would not be possible to confine the grey list addition only to those event fee terms which failed to comply with the relevant code provisions. As we discuss in Chapter 11, the alternative would be to add all event fee terms to the grey list, leaving the courts to decide whether the term was fair. This would provide less certainty for developers.

² This section is set out at para 8.54.

- 12.13 Do consultees agree that the codes of practice applying to developers, operators, managing agents and estate agents should be strengthened to ensure that event fees are brought to the attention of prospective purchasers at an early stage?**
- 12.14 We welcome views on which organisations should take responsibility for implementing new code provisions dealing with event fees.**
- 12.15 We welcome evidence on the use of event fees in residential leases outside specialist housing for older people. If possible, please provide specific examples of the term used, together with a description of the property.**
- 12.16 Do consultees agree that the event fee provisions applying to all those with a right to receive event fees should be approved by the Department for Communities and Local Government under section 87 of the Leasehold Reform, Housing and Urban Development Act 1993?**

Event fees on sub-letting

- 12.17** When people buy a property to live in, they may have no intention of sub-letting. They will therefore give little thought to whether an event fee would be charged on sub-letting. However, if later the property proves difficult to sell, sub-letting may be the only way that the leaseholder can raise the money to meet their service charges and other obligations. Event fees have the potential to operate harshly in these circumstances, particularly where a percentage of the open market value (rather than the rent) is payable on each new sub-letting.
- 12.18** We think that, where event fees are payable on sub letting, they should not be expressed as a percentage of the open market value. We welcome views on alternative charging formulas, such as a percentage of the rental income or a fixed fee. The industry should also consider prescribing a maximum amount which may be charged on sub-letting.
- 12.19 Do consultees agree that on sub-letting event fees should not be charged on a percentage of the open market value?**
- 12.20 We welcome consultees' suggestions on fair and proportionate ways to calculate sub-let fees (such as flat fees or a percentage of the rent).**
- 12.21 Should the codes of practice prescribe a maximum amount that may be charged on sub-letting?**

Event fees in unexpected circumstances

- 12.22** As we saw in Chapters 2 and 4, event fees may be charged in unexpected circumstances. We have received evidence of event fees being charged when a property is mortgaged (for example, on an equity release mortgage). Many fees are also drafted in such a way that they could be charged on a change of occupancy, such as a relative or carer moving in. We think that these terms would be considered unfair.
- 12.23** Many landlords have now given undertakings or agreed that they will not charge event fees except on sale or sub-letting. We think that this should be part of the approved provisions on event fees.

12.24 Do consultees agree that event fees should only be charged on sale or sub-letting?

A choice to pay fees up front

- 12.25 In its investigation, the Office of Fair Trading (OFT) pointed out that where an event fee is assessed as a percentage of the sale price, there is a lack of certainty for the consumer:

This means that it is impossible for the consumer to understand or plan for what their future liabilities might be.³

To estimate the fee, a prospective purchaser would need to make speculative assumptions about how long they would live in the property and by how much property prices would increase.

- 12.26 To address this concern, the OFT thought that purchasers should be given one or more of the following options:

- (1) a flat fee;
- (2) a calculation based on the lower of the price the tenant originally paid or the sale price;
- (3) the option to switch to ground rent; or
- (4) the event fee being expressly treated as credit.

- 12.27 The fourth option opens the prospect that landlords could bill a monthly fee, but then treat that fee as a loan to be repaid when the tenant sells. This would tie the event fee more closely to the value of the services provided, but would bring the fee within the scope of consumer credit legislation. Although this has some attractions, it would require landlords to be authorised as credit providers by the Financial Conduct Authority. Given how far this would increase the regulatory burden on landlords, we are not minded to pursue this option at this stage.

- 12.28 Nevertheless, we think that where the event fee is calculated as a percentage of the sale price, there is a strong argument that landlords should give prospective purchasers an alternative option, so that the amount of the fee could be known at the time of purchase. Some providers already do this voluntarily.

- 12.29 On the other hand, those considering buying a retirement property already have a huge amount of information to take in. There is a danger of “option and information overload”. We would not favour providing purchasers with yet more information, unless a reasonable number of people would find the alternative options attractive. We therefore ask for views on this issue.

³ OFT report, para 4.7.

12.30 Where the event fee is calculated as a percentage of the sale price, it can be difficult for prospective purchasers to estimate their future liability upon resale. Should prospective purchasers be given an alternative payment option, so that they can know the amount of the fee at the time of purchase?

12.31 We welcome consultees' suggestions on which alternative payment options might be attractive, and how they should be presented.

Where the landlord sells the property directly

12.32 On sales of new-build properties and where the landlord operates the development, the landlord will advertise the property, sell the property directly to the purchaser, or be responsible for showing round prospective purchasers. In these cases, the event fee provisions should require the landlord to provide material price information in a clear and prominent way early in the process. We explore this in more detail below.

Advertisements

12.33 Any advertisements must comply with the Consumer Protection from Unfair Trading Regulations 2008 (CPRs) as reflected in the UK Code of Non-broadcast Advertising, Sales Promotion and Direct Marketing (the CAP Code). This code is maintained by the Committee of Advertising Practice (CAP) and administered by the Advertising Standards Authority (ASA).

12.34 The CAP code requires that "quoted prices must include non-optional... fees and charges that apply to all or most buyers".⁴ Where the fee cannot be calculated in advance, the "marketing communication must make clear that it is excluded from the advertised price and state how it is calculated".⁵

12.35 In our view, the new code provisions should state that, whenever an advertisement mentions the price of the property, it should also mention the event fee. We think that in a simple case, the advertised price might look like this:

£250,000 + 1% on resale.

12.36 Where the event fee is more complicated (for example, if the percentage fee increases over time), it may be unwieldy to display the full method of calculation in an advert. The CAP indicated to us that they would be happy to work with advertisers and property advertisement portals to find a suitable solution. For example, with previous online advertisements of property, they agreed that a "pop up" window giving details of extra fees would be appropriate.

Disclosure document early in sales process

12.37 When prospective purchasers express an interest in the property, we think they should be supplied with a disclosure document.

⁴ CAP Code rule 3.18.

⁵ Above, rule 3.19.

- 12.38 We think that, where the property already exists, the document should be supplied when the prospective purchaser views the property. If the property is sold off-plan, the document should be supplied when the prospective purchaser visits the site. If a site visit is not possible, the document should be supplied at a sales presentation, or the first significant interaction between the prospective purchaser and sales staff.

Contents of the disclosure document

- 12.39 The purpose of the disclosure document would be to give details of the event fees applying to the property, to illustrate their effect, and (if appropriate) to provide a brief explanation of the alternative options.
- 12.40 A particularly confusing aspect of the current situation is that event fees go by a variety of names and are often referred to separately. In our analysis of websites, for example, one site mentioned a “sales administration fee” in a separate place from the “deferred management charge”.⁶
- 12.41 We think it would be helpful to standardise the terminology, so that all fees which meet our definition are described as event fees. For example, where a fee is described as something else, the words “event fee” could be put in brackets afterwards. If the consensus was that a different standard term should be used rather than “event fee”, alternatives could be explored. What is important is that terminology should be standardised.
- 12.42 We also think that the document should include all the event fees applying to the property in the same place. We do not propose that the grey list should include sinking fund fees if they are subject to our proposed statutory trust. However, we do think that these fees should still be mentioned on the disclosure document, so that prospective purchasers can see all the event fees together.
- 12.43 Finally, we think that the disclosure document should give contact details for organisations that provide free independent advice on event fees.

Illustrative examples

- 12.44 The disclosure document should include worked examples. We see these as crucial to making event fees transparent.
- 12.45 In the course of this project we have come across several worked examples currently being used. We saw one from an extra-care housing operator about how its deferred management charge accrues over time. The example showed a table of charges up to year 8 on an apartment which in year 1 was valued at £295,000. While it is encouraging that operators are already using worked examples, this one was not as clear as it could be.

⁶ See para 4.74.

- 12.46 First, the example was used for a development where the cheapest apartment actually on offer was almost double the price of the one in the example. Secondly, the event fee escalated by 1% per year before being capped at 15% of resale price. The table showed only 8 of these 15 years (although there was a note underneath mentioning this). With the numbers shown, the final charge was just over 10% of the original purchase price. When extended to the 15th year, it was almost 30%.
- 12.47 We think that the codes should set clear parameters about how the examples are calculated. In particular, the codes should provide for the examples to be based on a price which is representative for that development (if not for the actual property).
- 12.48 In Chapter 8 we note that the New Zealand Retirement Villages Act 2003 requires operators to provide a disclosure statement which includes estimates of fees on sale after 2 years, 5 years, and 10 years.⁷ We think that there is something to be said for standardising both the intervals and the range of likely house price increases, to make the disclosure documents more comparable with each other. We also think that any example should be extended to an adequate number of years to show the full effect of the event fee.

Face-to-face discussions

- 12.49 The house-buying process is a complex one, in which consumers are inundated with written information. Where the landlord sells the property directly, the sales staff should be required to mention the event fee in face-to-face discussions. They should draw attention to the fee, explain when it is charged and how it is calculated, offer the alternative option (if appropriate) and mention the illustrative examples.
- 12.50 Again, we would aim for standard terminology. If the term is called something else, the speaker should explain that it is an event fee.
- 12.51 We think it would also be good practice for staff to suggest that the purchaser discusses the fee with their family. This would prevent the family from being taken by surprise when selling the property following the purchaser's death or incapacity.

12.52 Do consultees agree that where the landlord sells the property directly:

- (1) An advertisement which mentions the price of the property should also mention the event fee?**
- (2) When prospective purchasers first visit the property they should receive a disclosure document?**
- (3) Where the property is sold off-plan,⁸ the disclosure document should be supplied on a visit to the site or sales presentation, or at the first significant interaction with sales staff?**

⁷ New Zealand Retirement Villages Act 2003, sch 2, para 3(e).

⁸ Sold on the basis of plans for property that has not yet been built.

- (4) The disclosure document should
 - (a) set out in the same place all the event fees applying to the property (including sinking fund fees subject to a statutory trust); and
 - (b) illustrate their effect, explain alternative options and give contact details for advice organisations?
- (5) The code should specify how illustrative examples are calculated. In particular it should:
 - (a) require that the example is based on a price which is fairly representative for that development; and
 - (b) standardise the intervals and the range of likely house price increases, so that they extend to an adequate number of years (for example, 15 years)?
- (6) The event fee should be mentioned in face-to-face discussions?

Where the property is sold by managing agents

- 12.53 In some cases, the sale of the property will be conducted by the landlord's agent. We have been told that for the majority of resales of retirement homes it is the managing agent, or a connected company, which acts as estate agent. Under the current NHBC Sheltered Housing Code, the developer is required to reach an agreement with the managing agent that it will comply with the Code.⁹ We think that the event fee provisions should place a comparable duty to require the landlord to compel its managing agent to comply with the rules on advertising, disclosure documents and face-to-face discussions.
- 12.54 Under the usual rules of agency, a failure by the agent is treated as a failure by the principal.¹⁰ This means that a managing agent's failure to comply with the rules about disclosing event fees would be treated as a failure by the landlord. Therefore, a breach of the relevant event fee provisions by an agent would mean the event fee term was on the grey list, as an indication of a term which may be unfair. Moreover, it would be open to a redress scheme to require the managing agent to provide compensation to the purchaser.

The ARHM Code

- 12.55 In practice, much of the task of informing purchasers about event fees will fall on members of the Association of Retirement Housing Managers (ARHM). As we have seen, the ARHM Code has ministerial approval. At the time of writing we understand that it is being revised, and a new version of the code will be issued shortly.

⁹ NHBC Sheltered Housing Code, Part 1, 1(ii).

¹⁰ Bowstead and Reynolds, *Agency* (20th ed), paras 8-177 to 8-188.

- 12.56 We think the ARHM code should include the event fee provisions. Where an ARHM member plays a role in selling a property, that member should comply with the requirements on advertising, and should supply copies of the disclosure document at an early stage.
- 12.57 We think that scheme managers employed by ARHM members should also make themselves available to talk to prospective purchasers. Where they do so, they should mention event fees.

Other codes

- 12.58 Other codes in this sector include the Association of Residential Managing Agents (ARMA)'s Consumer Charter and Standards (known as ARMA-Q). Similarly the Royal Institution of Chartered Surveyors (RICS) is responsible for the Service Charge Residential Management Code, which is government approved.
- 12.59 Although members of these organizations are less likely to be directly involved in selling retirement leases, we hope that all the codes applying to estate agents and managing agents would reflect similar principles.
- 12.60 **Do consultees agree that where a property with an event fee is sold through managing agents, the managing agent should:**
- (1) **comply with requirements on advertising;**
 - (2) **supply copies of the disclosure document at an early stage; and**
 - (3) **hold face-to-face discussions with prospective purchasers?**
- 12.61 **We think that, under the current law, breaches of the rules on event fees by the managing agents would be treated as breaches by the landlord. Do consultees agree that:**
- (1) **this interpretation is correct?**
 - (2) **this should continue to be the law?**

Where the property is sold by the leaseholder's agent

- 12.62 In Chapter 4 we describe how some of the most difficult problems arise when the lease is sold by one resident to another, using a conventional estate agent. The leaseholder may not know about the event fee, have forgotten about it, be suffering from dementia, or have died. The family are likely to be recently bereaved or preoccupied with providing care for the outgoing resident. Leaseholders and their heirs are therefore not in a position to provide the estate agent with reliable information.
- 12.63 Developers and managing agents are currently under no obligation to give such information to estate agents at this stage. We think this needs to change, so that estate agents can include information about event fees in their initial advertisements and property particulars. As we saw in Chapter 7, upfront price information is already a legal requirement.

- 12.64 Often, it will be important that the property can be sold swiftly. For example, if the property is being sold to pay for care home fees, these may be unaffordable without money released from the sale. It is crucial that estate agents should be able to access information about the event fees quickly and in an accessible format.
- 12.65 We have two suggestions as to how such information might be provided to the estate agent. We welcome views.

An online database?

- 12.66 One option is that landlords should take responsibility for setting up a database of all properties to which event fees apply. In practice they could delegate the work to their managing agents.
- 12.67 The aim would be to allow all estate agents to go online and type in the address in question. The website would then provide the following information:
- (1) the event fee in the lease;
 - (2) any undertaking the landlord has given about whether and when they will enforce the event fee; and
 - (3) the outline of a disclosure document, which the estate agent could give to prospective purchasers having input the specific data for the property.
- 12.68 The codes applicable to estate agents would require estate agents to visit the website, mention the fee in their advertisements, and hand the disclosure document to prospective purchasers. Although landlords do not benefit directly from sinking fund event fees, we think that these should also be included on the database.
- 12.69 Event fees are not confidential. Leases are public documents which are already available from the Land Registry, although most people without Land Registry accounts would find the process of obtaining a lease difficult and expensive. We see no reason why the database should not also be available to members of the public who may have an interest in purchasing specialist housing. However, as most purchasers would not be aware of the need to search the database, in practice the responsibility for searching would lie with estate agents.

An alternative

- 12.70 In discussions, the Association of Retirement Housing Managers suggested that setting up a database of all event fees in England and Wales would be overly burdensome on the industry. Instead, when an estate agent is asked to market the property, the estate agent should contact the managing agent of the property, who could have a dedicated telephone number or email address for this purpose. The managing agent would then be required to supply the estate agent with a completed event fees disclosure document. We think this would need to be done quickly – within two working days – as the estate agent would not be permitted to advertise the property until the information had been supplied.

- 12.71 There could be difficulties with this system. Where an estate agent contacted a managing agent and did not receive a reply, there would be scope for argument about who was at fault. Any delay at this stage may be particularly frustrating to those trying to sell quickly. However, we welcome views.
- 12.72 **Do consultees agree that landlords should establish an online database to provide information to estate agents about the event fees?**
- 12.73 **Alternatively, would it be sufficient for estate agents to contact managing agents for this information?**
- 12.74 **We welcome other suggestions as to how estate agents can be provided with information about event fees for a property swiftly and in an accessible format.**

CODES APPLYING TO ESTATE AGENTS

- 12.75 As we saw in Chapter 8, estate agents are required to register with an approved redress scheme. The great majority (95%) of sales agents are registered with the Property Ombudsman (TPO) which applies its own code.¹¹ We would wish codes applying to estate agents to mesh with the relevant provisions on event fees which apply to landlords and their agents.
- 12.76 The TPO code already reflects the requirements of the Consumer Protection from Unfair Trading Regulations 2008 (CPRs), which prohibit estate agents from omitting material information.¹² However, the code could usefully give more guidance on how this applies to event fees.
- 12.77 We think that the code should clarify that whenever an advertisement mentions the price of the property, it should also mention the event fee. Furthermore, where a prospective purchaser views a property which is subject to an event fee, the estate agent should supply a copy of the disclosure document outlined above. We would hope that this document could be downloaded easily from the web rather than sent specifically by a managing agent.
- 12.78 We have considered whether estate agents should also be required to discuss event fees face-to-face. We think it may be better if, when selling a retirement property, estate agents encouraged prospective purchasers to talk directly to the agent or manager responsible for the property. Agents should facilitate such a meeting.
- 12.79 A breach of the TPO Code or the CPRs by an estate agent would not result in the event fee being on the grey list and potentially unenforceable. However, a breach of the CPRs is a criminal offence. Trading standards services have power to bring enforcement action, which could include prosecution in egregious cases. Furthermore, where a consumer complains to TPO, TPO has power to award compensation of up to £25,000 for any breach of the CPRs or the code, including a failure to provide material information about event fees.

¹¹ The Property Ombudsman, *Advice for Advisors*, <http://www.tpos.co.uk/downloads/TPOE1-6%20Advice%20for%20Advisors.pdf>.

¹² See discussion in Chs 7 and 8.

12.80 We accept that in practice, breaches of the code may only come to light when the lease is sold, and by then residents and their heirs may find it difficult to remember who the estate agent was, or what the particulars contained. On the other hand, we think that clear rules, coupled with the possibility of regulatory action and individual complaints, will act as a powerful incentive to estate agents to improve practice.

12.81 Do consultees agree that codes which apply to estate agents should reflect similar principles with regard to event fees?

12.82 In particular:

- (1) Should every advertisement which mentions the price of a property subject to event fees also mention the event fee?**
- (2) Should the estate agent supply a copy of the disclosure document when a prospective purchaser views a property which is subject to an event fee?**
- (3) When selling specialist housing, should estate agents encourage prospective purchasers to talk directly to the agent or manager responsible for the property?**

CONVEYANCING PROTOCOLS

12.83 So far, our proposals have aimed to provide prospective purchasers with information at an early stage. However, we think it is important that event fees are also disclosed in the conveyancing process, so that conveyancers can discuss the implications of the fees with their clients.

12.84 In Chapter 8 we note that landlords and managing agents have undertaken to provide a purchaser's information pack when requested to do so by the purchaser's conveyancer. We welcome the new edition of the standard leasehold property enquiry form (LPE1) sent by the purchaser's conveyancer to the vendor's landlord or managing agent. From 1 October 2015, it will include a specific question about transfer fees, deferred service charges or similar fees expressed as a percentage of the property's value payable on an event such as resale or sub-letting.¹³ This means that event fees are less likely to be overlooked at the conveyancing stage.

12.85 We think that it should be part of the standard procedure for conveyancers to talk through event fees and their implications with their clients. We ask consultees if they agree with this principle.

12.86 Do consultees agree that it should be standard procedure for conveyancers to talk through event fees with their clients?

¹³ LPE1 (2nd ed), para 4.12.

EXISTING LEASEHOLDERS

- 12.87 All the proposals we have made so far are designed to protect new purchasers. There is very little to protect existing tenants who are subject to event fees. It is even possible that the process of making event fees clearer to prospective purchasers could have the effect of reducing the price of the lease on resale.
- 12.88 As we discuss in Chapter 10, there are problems in passing new legislation to overturn the terms in existing leases. However, most leases are already subject to unfair terms legislation. Some of the event fee terms we have seen are not in plain English, and therefore do not fall within the price term exemption. The OFT has made a convincing case that many commonly seen event fee terms are unfair.
- 12.89 The way that some event fees currently operate has the potential to reduce confidence in the sector. As a result, cautious older consumers may be less likely to consider specialist housing, while lenders may fear further litigation.
- 12.90 In order to reduce the uncertainty of more litigation and restore the confidence of consumers we think that all landlords should as a matter of best practice expressly agree that in relation to existing leaseholders:
- (1) Event fees will only be applied on sale or sub-letting;
 - (2) Fees on sub-letting will not be calculated as a percentage of the open market value of the property. We think that even sinking fund fees may operate unfairly and disproportionately where a proportion of the value of the property is charged in each short let.¹⁴
 - (3) Fees should only be charged as a percentage of the sale price where the landlord, operator or agent clearly illustrated the effect of such a fee before the tenant bought the property. In other cases, the fee should be charged as a percentage of the lower of the purchase price or the sale price.
- 12.91 Many landlords gave undertakings to this effect to the OFT, but we think that the principles could be applied more consistently across the sector.
- 12.92 In Chapter 3 we also note some confusion about the effect of the various undertakings which have been given. We ask for views on whether landlords should write to current tenants who are subject to event fees explaining how and when the fee will be enforced. At present, we are open-minded on this issue. The advantage is that the effect of the various undertakings would be then better known and understood. The disadvantage is that it would add to costs and could cause confusion.
- 12.93 Do consultees agree that landlords should expressly agree with existing tenants that:**
- (1) Event fees will only be applied on sale or subletting?**

¹⁴ We ask for views on alternatives at para 12.93.

- (2) On subletting, event fees will not be calculated as a percentage of the open market value of the property?
- (3) Except where purchasers are given illustrations on the effect of the fee calculated as a percentage of the sale price, the fee should only be levied as a percentage of the lower of the purchase price or the sale price?

12.94 Should landlords write to current tenants who are subject to event fees, to explain the effect of the undertakings they have given?

CONCLUSION

- 12.95 In Chapter 2 we noted the urgent need to provide more specialist housing to meet the needs of an ageing population. Experience in the USA, New Zealand and Australia suggests that deferred fees are integral to making specialist housing affordable, at least in the extra-care sector. However, it is crucial that people are told about the fees clearly, at an early stage. If not, public confidence will be undermined. In Chapter 4 we noted examples of extremely poor practice, coupled with complaints that event fees are “wrong” or “a rip-off”.
- 12.96 If specialist housing is to grow and flourish, we would encourage all those involved in the sector to build on current initiatives to ensure a full transparent pricing structure. Given the importance of the issue, more is required.

CHAPTER 13

ASSESSING THE IMPACT OF REFORM

- 13.1 In this chapter, we look briefly at the benefits and costs of our proposals and ask for views.

BENEFITS

- 13.2 The way in which event fees are currently used within retirement housing causes two problems: it decreases consumer confidence and it decreases lender confidence. As we explain below, we think the main benefit of our proposals would be to increase confidence among both consumers and lenders, providing a greater supply of housing and a higher level of demand.
- 13.3 There should also be cost savings from the proposal for a statutory trust over fees used exclusively for the maintenance, repair or improvement of the development (often referred to as “contingency fees”). Managing agents would no longer be required to incur the legal costs of establishing voluntary arrangements.

The effect on consumer confidence

- 13.4 As we saw in Chapter 2, the market for retirement housing in England and Wales is far from established. Although many people consider downsizing, far fewer people actually do so. The Demos survey reported multifaceted barriers to moving: the process is daunting; people are emotionally attached to their homes; there is a lack of understanding of what retirement housing offers; and “a general dearth of information, advice and help for older people to navigate the housing market”.¹
- 13.5 In this underdeveloped and nervous market, any negative publicity may have a disproportionate effect. People may be put off exploring a move to specialist housing if they feel that the market is exploitative or charges hidden fees.
- 13.6 Our proposals are designed to encourage consumer confidence by removing hidden fees, and ensuring that transfer fees are fully transparent from the first advertisement or visit.
- 13.7 Do consultees agree that our proposals will increase consumer confidence in the specialist housing market?**
- 13.8 If so, what effect might this have on the market?**

The effect on lender confidence

- 13.9 Secondly the current legal uncertainty over event fees reduces lender confidence. In his background paper, our consultant Iain Lock notes that developers may experience difficulties in obtaining funding to build specialist housing for older people:

¹ C Wood, *The Top of the Ladder*, Demos: 2013, p 33. For the evidence on this issue, see Ch 2 from p 15.

As a restricted sector it is seen as more risky and this has meant development funding has been in short supply and more expensive.

13.10 He continues:

Lenders have not been prepared to take income from transfer charges into account since the Office of Fair Trading investigated the practice. They have considered the security of the income to be below their standards for secured lending. Any continued doubt over the ability to levy transfer charges will restrict funding and investment into the sector.

13.11 There is an urgent need for more legal certainty in this area. Developers want to know what they should do to make event fees acceptable. It is difficult to give absolute certainty, as EU member states may not reduce the level of unfair protection below the minimum required by the Unfair Terms Directive 1993. The aim of our proposals, however, is to grant the maximum certainty with the constraints imposed by the 1993 Directive.

13.12 Our proposals set out the specific steps required to make event fees open and transparent. Where developers have taken these steps, the banks should be sufficiently certain that the fees will be enforceable to meet the standards required for secured lending. The aim is to increase the lending available to developers.

13.13 Do consultees think that following our proposals, event fees which comply with the code of practice will have sufficient legal certainty to meet the standards required for secured lending?

13.14 We welcome evidence on the effect which removing the current legal uncertainty over event fees may have on the volume of lending available.

Saving the cost of setting up express trusts to hold contingency fees

13.15 Under our provisional proposals, managing agents would no longer be required to establish express trusts to hold event fees paid into a sinking or contingency fund. Instead, any fees used exclusively for the maintenance, repair or improvement of the development would be subject to a statutory trust. We think this will save the legal and administrative costs of establishing an express trust.

13.16 We welcome evidence about the legal arrangements by which contingency funds are currently held. Do agents and developers incur legal and other costs in establishing express trusts?

COSTS

13.17 Under our proposals, estate agents, managing agents, operators and developers would be required to comply with the relevant provisions of a code of practice. However, many of the proposed provisions simply clarify the current law. In particular, estate agents are already required to mention all charges which apply to a property, both in their advertisements and in their property particulars.

- 13.18 In assessing the costs of our proposals, we have not included the costs of complying with the current law (for example, by producing disclosure documents). Instead we concentrate on the additional costs resulting from new proposals.
- 13.19 We think the main costs would result from familiarisation; the online database; the proposal to prevent event fees in circumstances which do not involve sale or subletting; and from the need to have face-to-face meetings. We also ask about other possible costs.

Familiarisation costs

- 13.20 Estate agents, managing agents, operators and developers would need to familiarise themselves with the statutory changes and the requirements of the code of practice.
- 13.21 We have been told that there are approximately 45,000 branches of residential estate agents in England and Wales. We welcome evidence about the training estate agents currently receive about the Consumer Protection from Unfair Trading Regulations 2008 (CPRs) and consumer codes of practice. We think the need to give information about event fees could be seen as a small part of this more general training.
- 13.22 Similarly, we welcome evidence about the number of managing agents, operators and developers involved in this area. What current training is provided about the CPRs, and how far would this need to be extended to cover the new provisions?
- 13.23 We welcome evidence on the training currently given to estate agents about the Consumer Protection from Unfair Trading Regulations 2008 and consumer codes of practice. How far would the current proposals add to this cost?**
- 13.24 We welcome evidence about the number of managing agents, operators and developers who would need to familiarise themselves with the proposed changes. How is this likely to be conducted?**

Online database

- 13.25 We provisionally propose that developers should provide information about event fees to an online database. This would clearly entail upfront fees in putting all the relevant information online. However, in the long term we think there would be savings. With all the information accessible in one place it would be easier to respond to queries about event fees.
- 13.26 We welcome evidence on the costs of setting up a new online database to provide information to estate agents about the event fees.**
- 13.27 We would also be interested in the costs of alternative ways of providing this information swiftly and in an accessible format.**

Preventing event fees in circumstances unrelated to sale or sub-letting

- 13.28 As we saw in Chapter 2, some fees are drafted in such a way that they would apply in surprising circumstances: such as when the tenant dies, or the property is mortgaged, or a relative or carer moves in. Some terms would allow the developer to charge one fee when the resident dies and another when the property is sold.
- 13.29 Our understanding is that developers do not charge event fees in this way. Most developers waived fees on death even before the Office of Fair Trading investigation, and many have now given formal undertakings not to charge event fees except on sale or sub-letting.
- 13.30 Given current practice, we do not think that restricting event fees to sale or sub-letting will have significant costs for the industry. However, we welcome evidence on this point.
- 13.31 Do developers collect event fees on death, mortgaging or change of occupancy, in circumstances which do not involve a sale or sub-letting? If so, how much is collected in this way?**

Face-to-face discussions

- 13.32 We make two proposals for face-to-face discussions. First, when a developer sells directly to a consumer, it would be expected to have a face-to-face discussion which mentions the event fee. Our initial view is that this would not add significantly to costs. Developers already hold face-to-face discussions with prospective purchasers, and we think that the CPRs already require developers to mention event fees at this stage.
- 13.33 Secondly, when a retirement lease is sold through the vendor's estate agent, we provisionally propose that estate agents should encourage prospective purchasers to talk directly to the agent or manager responsible for the property. We suggest that estate agents should facilitate such a meeting. We have been told that managers of sheltered accommodation already welcome the chance to talk to prospective purchasers, so we do not think that this would impose a significant burden on them. However, we would welcome evidence on this point.
- 13.34 When a retirement lease is sold through the vendor's estate agent, how far do agents and managers hold face-to-face discussions with prospective purchasers?**
- 13.35 Would the provisional proposal that estate agents should encourage and facilitate such meetings add to costs?**

Other costs

- 13.36 We welcome evidence about other costs which may result from our provisional proposals.**

CHAPTER 14

LIST OF QUESTIONS

This consultation is open to the general public. We ask for responses to the following questions. First we ask about the reforms which we provisionally propose. We then ask about other possible options which we are not minded to pursue at this stage.

PROPOSALS FOR STATUTORY REFORM

The need for reform

14.1 Do consultees agree that:

- (1) developers, operators and managing agents should do more to bring event fees to the attention of prospective purchasers at an early stage?
- (2) there is a need to reform the law to achieve this objective? (10.15)

Bringing event fees within unfair terms legislation

14.2 Do consultees agree that:

- (1) statutory reform should ensure that event fees are fully assessable for fairness under unfair terms legislation (as set out in the Consumer Rights Act 2015)?
- (2) for the purposes of unfair terms legislation, an event fee term should be treated:
 - (a) as if it were a contract term?
 - (b) as if it were a term of a contract made between the landlord and tenant when the current tenant first became bound by the term?
- (3) this should apply to event fee terms on the next sale of the lease after the reform comes into effect, irrespective of when the lease was first granted? (11.19)

14.3 We welcome views on whether similar principles should apply more generally to all covenants in residential leases. (11.20)

The grey list

14.4 Schedule 2 to the Consumer Rights Act 2015 sets out an “indicative and non-exhaustive” list of terms which may be regarded as unfair (the “grey list”). Do consultees agree that:

- (1) the Secretary of State should exercise the power in section 63(3) of the Consumer Rights Act 2015 to add a term covering event fees to the grey list?

- (2) the addition to the grey list should be confined to event fees where the person claiming the fee fails to comply with the relevant provisions of an approved code of practice? (11.37)

A statutory trust for sinking fund event fees

- 14.5 Do consultees agree that where the lease requires event fees to be used exclusively for the maintenance, repair or improvement of the development, the fees should be subject to a statutory trust? (11.52)

Definition of event fees

- 14.6 Do consultees agree that:
 - (1) an event fee term should be defined as a term in a residential lease which imposes an obligation for the tenant to pay a fee on, or in connection with the happening of a defined event where:
 - (a) the event is that title to the lease changes hands, a change in the occupancy of the property; or some other event which creates a third party interest in the lease; and
 - (b) the fee is fixed or calculated in accordance with a formula.
 - (2) the definition should not include fees which:
 - (a) fall within the definition of administration charges in schedule 11 to the Commonhold and Leasehold Reform Act 2002?
 - (b) must be used exclusively for the maintenance, repair or improvement of the development and which are subject to the proposed statutory trust? (11.59)

PROPOSALS RELATING TO CODES OF PRACTICE

- 14.7 Do consultees agree that the codes of practice applying to developers, operators, managing agents and estate agents should be strengthened to ensure that event fees are brought to the attention of prospective purchasers at an early stage? (12.13)

Sponsorship of the event fee provisions

- 14.8 We welcome views on which organisations should take responsibility for implementing new code provisions dealing with event fees. (12.14)

Use of event fees outside of specialist housing

- 14.9 We welcome evidence on the use of event fees in residential leases outside specialist housing for older people. If possible, please provide specific examples of the term used, together with a description of the property. (12.15)

Government approval of the event fee provisions

- 14.10 Do consultees agree that the event fee provisions applying to all those with a right to receive event fees should be approved by the Department for Communities and Local Government under section 87 of the Leasehold Reform, Housing and Urban Development Act 1993? (12.16)

Event fees on sub-letting

- 14.11 Do consultees agree that on sub-letting event fees should not be charged on a percentage of the open market value? (12.19)
- 14.12 We welcome consultees' suggestions on fair and proportionate ways to calculate sub-let fees (such as flat fees or a percentage of the rent). (12.20)
- 14.13 Should the codes of practice prescribe a maximum amount that may be charged on sub-letting? (12.21)

Event fees in unexpected circumstances

- 14.14 Do consultees agree that event fees should only be charged on sale or sub-letting? (12.24)

A choice to pay fees up front

- 14.15 Where the event fee is calculated as a percentage of the sale price, it can be difficult for prospective purchasers to estimate their future liability upon resale. Should prospective purchasers be given an alternative payment option, so that they can know the amount of the fee at the time of purchase? (12.30)
- 14.16 We welcome consultees' suggestions on which alternative payment options might be attractive, and how they should be presented. (12.31)

Disclosure requirements when the landlord sells the property directly

- 14.17 Do consultees agree that where the landlord sells the property directly:
- (1) an advertisement which mentions the price of the property should also mention the event fee?
 - (2) when prospective purchasers first visit the property they should receive a disclosure document?
 - (3) where the property is sold off-plan, the disclosure document should be supplied on a visit to the site or sales presentation, or at the first significant interaction with sales staff?
 - (4) the disclosure document should:
 - (a) set out in the same place all the event fees applying to the property (including sinking fund fees subject to a statutory trust); and
 - (b) illustrate their effect, explain alternative options and give contact details for advice organisations?

- (5) the code should specify how illustrative examples are calculated. In particular it should:
 - (a) require that the example is based on a price which is fairly representative for that development; and
 - (b) standardise the intervals and the range of likely house price increases, so that they extend to an adequate number of years (for example, 15 years)?
- (6) the event fee should be mentioned in face-to-face discussions? (12.52)

Involvement of managing agents in the sale

- 14.18 Do consultees agree that where a property with an event fee is sold through managing agents, the managing agent should:
- (1) comply with requirements on advertising,
 - (2) supply copies of the disclosure document at an early stage; and
 - (3) hold face-to-face discussions with prospective purchasers? (12.60)
- 14.19 We think that, under the current law, breaches of the rules on event fees by the managing agents would be treated as breaches by the landlord. Do consultees agree that:
- (1) this interpretation is correct?
 - (2) this should continue to be the law? (12.61)

Where the property is sold by the leaseholder's estate agent

- 14.20 Do consultees agree that landlords should establish an online database to provide information to estate agents about the event fees? (12.72)
- 14.21 Alternatively, would it be sufficient for estate agents to contact managing agents for this information? (12.73)
- 14.22 We welcome other suggestions as to how estate agents can be provided with information about event fees for a property swiftly and in an accessible format. (12.74)

Codes applying to estate agents

- 14.23 Do consultees agree that codes which apply to estate agents should reflect similar principles with regard to event fees? (12.81)
- 14.24 In particular:
- (1) should every advertisement which mentions the price of a property subject to event fees also mention the event fee?

- (2) should the estate agent supply a copy of the disclosure document when a prospective purchaser views a property which is subject to an event fee?
- (3) when selling specialist housing, should estate agents encourage prospective purchasers to talk directly to the agent or manager responsible for the property? (12.82)

Conveyancing protocols

- 14.25 Do consultees agree that it should be standard procedure for conveyancers to talk through event fees with their clients? (12.86)

UNDERTAKINGS TO EXISTING TENANTS

- 14.26 Do consultees agree that landlords should expressly agree with existing tenants that:
- (1) event fees will only be applied on sale or subletting;
 - (2) on subletting, event fees will not be calculated as a percentage of the open market value of the property;
 - (3) except where purchasers are given illustrations on the effect of the fee calculated as a percentage of the sale price, the fee should only be levied as a percentage of the lower of the purchase price or the sale price? (12.93)
- 14.27 Should landlords write to current tenants who are subject to event fees, to explain the effect of the undertakings they have given? (12.94)

POSSIBLE OPTIONS WHICH WE ARE NOT MINDED TO PURSUE

- 14.28 Chapter 10 discusses other possible options, which we are not minded to propose at this stage.

Rejecting an outright ban

- 14.29 Do consultees agree that event fees should not be banned completely? (10.37)

No assessment against costs reasonably incurred under section 19 of the Landlord and Tenant Act 1985

- 14.30 Do consultees agree that there should not be reform to bring event fees within the ambit of section 19 of the Landlord and Tenant Act 1985? (10.44)

Not extending controls on administration charges

- 14.31 Do consultees agree that the controls on administration charges set out in the Commonhold and Leasehold Reform Act 2002, schedule 11 should not be extended to include selling services? (10.48)

Not extending controls on charges for granting consent

- 14.32 Do consultees agree that section 19 of the Landlord and Tenant Act 1927 should not be amended to cover event fees? (10.51)

ASSESSING THE IMPACT OF REFORM

Effect on consumer confidence

- 14.33 Do consultees agree that our proposals will increase consumer confidence in the specialist housing market? (13.7)
- 14.34 If so, what effect might this have on the market? (13.8)

Effect on lender confidence

- 14.35 Do consultees think that following our proposals, event fees which comply with the code of practice will have sufficient legal certainty to meet the standards required for secured lending? (13.13)
- 14.36 We welcome evidence on the effect which removing the current legal uncertainty over event fees may have on the volume of lending available. (13.14)

Saving the cost of setting up express trusts to hold contingency fees

- 14.37 We welcome evidence about the legal arrangements by which contingency funds are currently held. Do agents and developers incur legal and other costs in establishing express trusts? (13.16)

Familiarisation costs

- 14.38 We welcome evidence on the training currently given to estate agents about the Consumer Protection from Unfair Trading Regulations 2008 and consumer codes of practice. How far would the current proposals add to this cost? (13.23)
- 14.39 We welcome evidence about the number of managing agents, operators and developers who would need to familiarise themselves with the proposed changes. How is this likely to be conducted? (13.24)

Online database

- 14.40 We welcome evidence on the costs of setting up a new online database to provide information to estate agents about the event fees. (13.26)
- 14.41 We would also be interested in the costs of alternative ways of providing this information swiftly and in an accessible format. (13.27)

Preventing event fees in circumstances unrelated to sale or sub-letting

- 14.42 Do developers collect event fees on death, mortgaging or change of occupancy, in circumstances which do not involve a sale or sub-letting? If so, how much is collected in this way? (13.31)

Face-to-face discussions

- 14.43 When a retirement lease is sold through the vendor's estate agent, how far do agents and managers hold face-to-face discussions with prospective purchasers? (13.34)
- 14.44 Would the provisional proposal that estate agents should encourage and facilitate such meetings add to costs? (13.35)

Other costs

- 14.45 We welcome evidence about other costs which may result from our provisional proposals. (13.36)

EMBARGOED

APPENDIX A

ACKNOWLEDGEMENTS

- A.1 The members of our advisory panel reviewed and provided feedback on a number of draft proposals. We should like to thank them for the many hours they devoted to this project.

Michelle Banks, CEO, Association of Residential Managing Agents.

Professor James Driscoll, University of Essex; Judge, First-tier Tribunal (Property Chamber).

Adam Hillier, I&A Development Advisor, Elderly Accommodation Counsel.

Dudley Joiner, Managing Director, Leaseholder Association and Right to Manage Federation.

Sheila Kumar, Chief Executive, Council for Licensed Conveyancers

Debbie Matusевичius, Board member and former Chairman, Association of Retirement Housing Managers; Leasehold Consultant, Anchor.

Siobhan McGrath, President, First-tier Tribunal (Property Chamber).

Joe Oldman, Age UK, Policy Adviser (Housing).

Philip Rainey QC, Tanfield Chambers.

Shula Rich, responsible for leasehold management education, National Federation of Property Professionals.

Martin Rodger QC, Deputy President, Upper Tribunal (Lands Chamber).

Michael Voges, Executive Director, Associated Retirement Community Operators.

Sue Williams, Land Law and Conveyancing Committee, The Law Society; Wolferstans Solicitors.

- A.2 Between September 2014 and October 2015, the Law Commission also met or otherwise corresponded with the following people and organisations with respect to the event fees project. We are extremely grateful for their time and for the information they have provided.

Age UK

Christopher Brooks

Associated Retirement Community Operators (ARCO)

Bill Gair

Michael Voges

The Association of Residential Managing Agents (ARMA)

The Association of Retirement Housing Managers (ARHM)

Cecilia Brodigan

Don Kennedy

Paul Silk

Richard Wheeldon

The Campaign Against Retirement Leasehold Exploitation (CARLEX)

Sebastian O'Kelly

The Campaign for Housing in Later Life

Churchill Retirement

Spencer McCarthy

The Committee of Advertising Practice

James Craig

Rupa Shah

The Competition and Markets Authority (CMA)

Ian Anthony

Gordon Ashworth

Darren Eade

Jason Freeman

Andrew Hadley

Mike Lambourne

The Consumers' Association (Which?)

Paul Davies

Richard Dilks

James Edgar

Jessica Moran

Chris Warner

The Council of Licensed Conveyancers

The Department for Business, Innovation and Skills (BIS)

Marcelle Jansiss

The Department for Communities and Local Government (DCLG)

Saoirse Cowley

Ian Fuell

Paula Hassall

Dee Mapp

Elderly Accommodation Counsel

The ExtraCare Charitable Trust

Nick Abbey

The Home Builders Federation (HBF)

John Slaughter

The Law Society

Members of the Conveyancing and Land Law Committee

Rachel Holland

Diane Latter

The Leasehold Advisory Service (LEASE)

Roger Southam

The Leaseholder Association

Mark Spall

Leasehold Knowledge Partnership (LKP)

Martin Boyd

LifeCare Residences

Richard Davis

Craig Percy

Robin Waterer

McCarthy and Stone

Chris Sommerfelt

Paul Teverson

The National Federation of Property Professionals

The National House Building Council (NHBC)

Ian Davis

The Property Ombudsman (TPO)

Christopher Hamer

Gerry Fitzjohn

The Right to Manage Federation (RTMF)

The Royal Institution of Chartered Surveyors (RICS)

Georgiana Hibberd

The Secretariat of the Consumer Code for Home Builders

Carol Brady

Noel Hunter OBE

Mike Swatton

The Silver Line

Sarah Caplin

Dame Esther Rantzen

Colin Wagman

Iain Lock, GVA Grimley

James Munro, National Trading Standards Estate Agency Team, Powys County Council

Beth Rudolf, the Conveyancing Association

Jassette Sue-Patt, JPS Law

APPENDIX B

UNDERTAKINGS GIVEN TO THE OFFICE OF FAIR TRADING

- B.1 The OFT investigation into retirement home transfer fee terms concluded that they were potentially unfair.¹ As a result of its investigation,

a number of landlords agreed to either cease enforcing a transfer fee, to replace it with a flat fee, or to make changes – such as enforcing the term on final sale and not in a wide range of other circumstances that mitigate the most egregious unfairness of the respective transfer fee terms.

- B.2 Each of the businesses which gave undertakings to the OFT confirmed that, whilst they did not agree with the OFT's views and believed that their transfer fee terms did not breach the Unfair Terms in Consumer Contract Regulations 1999 (UTCCR), they would engage constructively with the OFT during the investigation and voluntarily agreed to sign undertakings to address the OFT concerns, which the OFT accepted.²
- B.3 There is no standard definition of transfer fees and the OFT circumscribed its terms more narrowly than we are doing in our project. The OFT was primarily concerned with the fairness and clarity of terms triggered on the happening of an event in a range of circumstances, such as transfer, sub-letting, other disposal or change of occupation.
- B.4 The OFT excluded those fees which are measured against the provision of costs or services. It did not focus on contingency fund fee terms either but noted that that they were generally drafted in a similar form to transfer fee terms.
- B.5 The OFT believed that the companies which were the subject of active investigations were likely to cover the great majority of properties in the non-assisted retirement home market. Although it sought to improve the position for lessees of existing leases it also maintained the position that it wanted this business model to cease being used in newly built or acquired developments.³

Taking each of the companies investigated in turn:

¹ OFT 1476 – February 2013

² <https://www.gov.uk/cma-cases/retirement-homes-hidden-exit-fees-investigation>.

³ In its report OFT 1476 – February 2013, para 8.14, it said “we consider that landlords should not include or enforce transfer fee terms in newly created or acquired leases, other than in circumstances where the fee is for a service and is no more than the actual costs reasonably and necessarily incurred in providing that service, or where it is presented as a credit facility”.

MCCARTHY AND STONE

- B.6 The OFT market wide investigation was launched following an initial investigation into a transfer fee term used by McCarthy and Stone, which is the largest developer of retirement housing in the UK.⁴ The transfer fee in its leases was 1% of the greater of the gross sale price and open market value payable on assignment, underletting, disposal or any other material change in occupation. There was also a contingency fund fee of 1% payable in the same circumstances.
- B.7 In September 2008 McCarthy and Stone gave an undertaking to the OFT that it would remove the transfer fee from new developments and would not enforce the fee in existing contracts. This undertaking was subject to the qualification that it could only do so in relation to properties where it retains the landlord's interest and not in cases where it has sold its interest to unconnected third parties.
- B.8 It appears that McCarthy and Stone is no longer including a transfer fee in its leases after 1 September 2008 and is not collecting any fees from that date even in leases which provide for its payment.⁵ Further, where the property is sublet, it may waive payment of the 1% contingency fund contribution in certain circumstances. If for example the sub-lease is for a period of six months or less a charge of one month's rent may be levied instead.⁶
- B.9 FAQ 58 on the McCarthy and Stone website now reads:

Are there any fees that are payable on selling or letting?

A contingency fee of 1% of the sale price or open market value (whichever is higher) is payable on resale and, in some cases, when the apartment is under-let. The contingency fees are held in a fund on trust for the residents and so do not go to the landlord or the management company. A transfer fee (sometimes referred to as an exit fee) is payable to the landlord on sale or under-letting but this only applied to leases set up prior to September 2008 and is not applicable in any development where McCarthy & Stone is the landlord.

With regard to under-letting on leases prior to October 2014, we will charge a concessionary rate (irrespective of the provisions in the lease, which may be higher) of one month's rent for each year that the apartment is under-let (or pro-rata for less than a year). This is a concession from the terms of the lease which are in essence one month's rent for each six month under-let period. This concession will apply for a maximum period of two years, after which time we will revert to the terms of the lease.

⁴ <http://www.mccarthyandstone.co.uk>.

⁵ <http://www.mccarthyandstone.co.uk/faq/>.

⁶ Inconsistently with this, Carlex reports that from 1 September 2014 McCarthy and Stone has dropped the 1% contingency fund contribution on sub-letting and replaced it with a one-off payment of £80 plus VAT for the first two years of rental. It also notes that the 1% transfer fee on sub-letting has been replaced with a payment representing one month's rent. <http://www.carlex.org.uk/mccarthy-stone-reform-sublet-fees-discussions-carlex>.

For leases from October 2014, the under-letting contingency fee has been reduced to a contingency fee of 1% of the annual rent (or pro-rata for under-letting of less than one year). Where the under-letting is for more than a year, the contingency fee is 1% of the annual rent payable annually on the anniversary of the commencement of the term.⁷

B.10 McCarthy and Stone makes clear that it:

Supports the removal of transfer fees from all retirement developments and [has] led the way for this to become an industry standard.

FAIRHOLD HOMES LIMITED

- B.11 As a result of the OFT investigation, Fairhold and associated companies agreed to make substantial changes to how they charge and enforce transfer fee terms.⁸ They agreed not to charge a transfer fee in any new leases obtained through the acquisition or development of properties unless the fee is for a service and represents its reasonable costs. They clarified that in existing leases leaseholders will not pay any transfer fee when the lease is passed on through inheritance, is surrendered, or when a relative or carer moves in with the tenant.
- B.12 A flat fee of £85 will be charged for subletting (to be adjusted in future years in line with inflation),⁹ replacing the previous transfer fee of 1% of open market value. Where it has discretion under the lease, Fairhold will also waive the separate contingency fund fee of 1% of the open market value payable on sub-letting. It will instead charge a fee equivalent to one month's rent (in accordance with the waiver) for each sub-let. Contingency fund contributions will be paid into a ring-fenced fund.
- B.13 On sale, a 1% transfer fee will continue to be charged, but it will now be calculated against the lower of the sale price and the original purchase price of the property. In addition, on sale, Fairhold undertook to provide all potential new purchasers with clear information summarising all the amounts payable under the lease.¹⁰

⁷ <http://www.mccarthyandstone.co.uk/faq/>.

⁸ Fairhold was the owner of 53,000 retirement home leases as at 30 July 2012, the date of the undertakings (including those managed by Peverel, now Firstport).

⁹ The undertaking provides that (a) if a sub-lease by way of assured shorthold tenancy continues beyond its fixed term period, a further fixed sub-letting fee (£85) will become payable (even if no further formal shorthold tenancy is entered into) and (b) if a sub-lease by way of assured shorthold tenancy is entered into for a fixed term period of greater than one year, a further fixed sub-letting fee (£85) will become payable at the start of each subsequent year that the assured shorthold tenancy continues.

¹⁰ <https://www.gov.uk/cma-cases/fairhold-leasehold-retirement-properties-transfer-fee-terms>.

HANOVER HOUSING ASSOCIATION

- B.14 Hanover owns over 4,400 freehold interests in a range of leasehold retirement properties. These comprise a large number of different leases with differing event fees. Hanover did not give undertakings, but OFT closed its investigation into it on the basis of the satisfactory clarification by Hanover of the principles it applies when enforcing transfer fee terms. In new leases Hanover proposes to include a transfer fee to recover its reasonable costs in dealing with the transfer.¹¹
- B.15 Hanover confirmed that in all but one of the sample leases reviewed by the OFT, the transfer fee is charged in respect of services undertaken by the landlord (referred to as an 'administration' transfer fee) and is therefore subject to a test of reasonableness under the Commonhold and Leasehold Reform Act 2002 and can be challenged in the First-tier Tribunal (Property Chamber) if they are excessive. As such, where the lease entitled Hanover to an administration transfer fee, stated to cover Hanover's costs, of 'up to' or 'not exceeding' a certain amount (such as a percentage of the sale price or open market value), or to a fixed percentage of the sale price or open market value, Hanover only collected a fee that reflected justified and reasonable administration costs.
- B.16 In relation to those remaining leases that contained transfer fee terms arising from an event, but not related to the provision of services (referred to as a 'non-administration' transfer fee), Hanover addressed a number of the OFT's concerns about how, and in what circumstances, such clauses were enforced in practice. In particular, Hanover confirmed that it will only charge such fees where the tenant is selling the property – where they are sub-letting, Hanover will only charge a reasonable sum to cover the landlord's costs, and where the property is inherited, the fee would generally be charged only when the heir has sold the property. The OFT reserved its position on the remaining concerns.

HART RETIREMENT DEVELOPMENTS (SOUTHERN) LIMITED AND HART RETIREMENT DEVELOPMENTS (THAMESNORTH) LIMITED (COLLECTIVELY REFERRED TO AS 'HART')

- B.17 Hart is the owner of 14 retirement developments. The transfer fee term in its leases requires lessees to pay between 1.5% and 5% (dependent on how long the property was owned) of the higher of the sale price or open market value of the property in a number of circumstances. As part of the OFT investigation, in November 2012, Hart agreed that it would not include provision for the charging of a transfer fee in any new retirement housing it constructs, unless the fee is for a service and represents its reasonable costs.
- B.18 It also agreed that a transfer fee will not be payable upon the tenant's interest first being passed onto a beneficiary under a will or intestacy, when sub-letting or in circumstances where there is otherwise a change in occupation, an equity release or surrender.

¹¹ <https://www.gov.uk/cma-cases/hanover-housing-association-retirement-properties-hidden-transfer-fee-terms>.

- B.19 Although a transfer fee will continue to be charged on sale, it will be calculated against the lower of either the sale price or the original purchase price adjusted by the Retail Price Index. It was previously a percentage of the higher of the sale price or open market value.
- B.20 Existing lessees will also be given the option of switching to pay a quarterly ground rent in place of the transfer fee if they would prefer greater certainty. If they choose to switch to paying a ground rent, they will need to pay a lump sum at the time of switching equivalent to the notional ground rent that they would have paid for the period between the purchase of the property and their decision to switch.
- B.21 Future purchasers will be given the opportunity at the outset to choose between paying a quarterly ground rent and a transfer fee on sale.¹² If they choose the transfer fee option, the fee payable will now be calculated on the sale price (and no longer on the open market value if higher).

PEGASUS RETIREMENT HOMES

- B.22 Pegasus is a developer of retirement housing and sells its freehold interest in the development (at the latest) when all the individual properties are sold. It has included terms in its leases which require the tenant to pay a transfer fee of 1% of the higher of the sale price or open market value of the property in a number of circumstances.
- B.23 During the OFT investigation, in January 2013, Pegasus agreed that it would not tell lessees that the transfer fee is an administration fee or that there is any service or valuable benefit for the fee. For future developments Pegasus has agreed only to require payment of a transfer fee in the event of an assignment or underletting by way of sale.¹³ When it is payable the transfer fee will be calculated on the sale price (and no longer on the open market value if higher). A transfer fee will not be payable on inheritance, sub-letting, surrender, a change in occupation of the property without any change in the legal or beneficial ownership of the lease, mortgage or transfer of the interest in the lease without any payment to a spouse or partner.
- B.24 In relation to existing sites Pegasus agreed not to enforce the 1% transfer fee term in the leases of two retirement home sites where it continues to own the freehold, until such time as the freehold is transferred to third parties under existing contractual agreements. Where Pegasus had already sold the freehold but still had a contractual obligation with the freeholder to sell any remaining unsold properties (for which Pegasus held the leases as a lessee), it undertook to improve the transparency of the transfer fee term in pre-sale documentation.

¹² <https://www.gov.uk/cma-cases/hart-leasehold-retirement-properties-hidden-transfer-fee-terms>.

¹³ The reference to underletting as distinct from sub-letting was intended to cover a very specific circumstance where this had occurred.

BOVIS HOMES LTD

- B.25 Bovis is a general builder which has built some specialist retirement housing in the past. It is not building any new retirement homes at present, although there are properties for resale on its existing developments.¹⁴ There is a transfer fee in its leases of 2.5% of the gross proceeds of sale (plus any VAT if applicable) and from such amount, 1% of the consideration is paid into a service charge reserve fund.
- B.26 Following publication of the OFT report into its investigation in February 2013, Bovis confirmed that in future on final sale it will charge a fee of 1% of the sale price (to be paid into the service charge reserve fund) plus a standard administrative fee of £500 plus VAT (to be increased annually in line with RPI).

GOLDSBOROUGH ESTATE LTD

- B.27 Goldsbrough is part of the BUPA group and a provider of specialist retirement housing with 14 retirement housing and 8 assisted living developments. There is a transfer fee term in its leases of the greater of 1% of the gross sale price and the open market value payable in a number of circumstances. Following publication of the OFT report into its investigation, Goldsbrough agreed that the original purchase price of the property would be used as the basis of calculating the transfer fee payable on sale, and not in any other circumstances such as sub-letting, inheritance, change in occupation, surrender or an equity release.¹⁵

SHROPSHIRE LEISURE GROUP LTD

- B.28 This Group incorporates DW Dulson Ltd, a firm of general builders in Shropshire which progressed into retirement developments and then to leisure complexes.
- B.29 There is a transfer fee in its leases of the higher of 1% of the gross sale price or full market value together with an additional 0.5% for each year or part year of ownership. After being approached by OFT, it confirmed that the transfer fee will now only be charged on sale and will be capped at a maximum of 3%. The fee will be calculated on the basis of the lower of the purchase price and the sale price.

STOCKBROOK INVESTMENTS LTD

- B.30 This company is a freehold owner with links to Hallmark Developments which develops care homes. There is a term in its leases that the lessee will pay to the landlord a reasonable sum, as determined by the landlord, being not more than 1% of the greater of the sale price or the open market value of the property and will be in respect of landlord's costs and expenses relating to specified administrative matters.

¹⁴ <http://www.bovishomes.co.uk/>.

¹⁵ In circumstances where a lease term specifically provides for 1/6 of the transfer fee payment to be credited to the building reserve (akin to a contingency fund fee) this will continue to be payable in other circumstances such as sub-letting (but the remainder of the transfer fee will not be payable in these circumstances).

- B.31 The company agreed with OFT that in future a transfer fee will only be charged on final assignment by way of a sale and will not be payable when a lease is passed on through inheritance or surrendered or when a relative or carer moves into the property. A flat transfer fee of £100 will be payable on sub-letting.

EMBARGOED

APPENDIX C

BACKGROUND PAPERS

Background papers produced for this project (available on the project web page – a link is given on page iii) are as follows:

- (1) *Age Restricted Housing with and Without Care*, Iain Lock;
- (2) Law Society Survey;
- (3) Mystery Shopping Report;
- (4) Websites Report.

EMBARGOED