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Response to the Consultation Paper: Commonhold Proposals for Commonhold Regulations

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The full response is divided into three sections. The first section discusses some of the policy issues raised by the Consultation Paper. This is posted below. Two further sections, the detailed response to the 179 questions asked, and a section which discusses issues raised by the proposed provisions to the governing documents are available on request from theresa.mcdonagh@jrf.org.uk .

1. The Success of Commonhold

It is too soon to know the extent of the impact of commonhold law. Based on the experience in Australia and the US commonhold will be preferred over leasehold for reasons stated in the past. Owners have an asset that does not automatically depreciate with time, and they have more control over their homes and management issues. If developers understand the benefits of marketing a commonhold unit, as opposed to a leasehold flat, residential commonhold will be established in England and Wales.

Commonhold is likely to be less successful in mixed-use projects. The inability to layer different commonholds and the requirement that they be attached to the ground poses major problems. For example, in Australia and the U.S. one can create a project with parking on the first two floors, (commonhold or not) commercial space on the next floor (commonhold or not), a medium priced commonhold on the next floor, and a luxury commonhold on the top floor. These can be governed by a master association. Projects can also have several buildings with different uses and each building can be a different commonhold under the umbrella of a master association. In the future, the legislation needs to be amended to include this flexibility.

Having said that, however, if commonhold were currently the only form of ownership available in England and Wales, clever lawyers would figure out ways to make the system work. For example, assume a commonhold project includes commercial space on the ground floor with residential floors above. If the regulations permit different classes of voting in a commonhold then perhaps the documents could be structured to have class A vote on the commercial floor issues, class B on the residential floor issues and both classes on common issues. This example also assumes that the commercial floor could be leased on long term leases if desirable and that the regulations permit flexibility in other areas identified in this paper.

Lawyers are understandably risk adverse, however, so they will be unlikely to change their approach to commercial projects unless their clients see a distinct advantage in doing so. Thus, the regulations must be sufficiently flexible to permit a variety of arrangements.

2. Standardization vs. Flexibility

The regulations state that one of the principal advantages of commonhold over long-term leasehold is the use of standard documents. Commonhold communities, however, are diverse and will need different documentation.

Some commonholds may consist of attached housing; some of detached housing. Some may have 200 units or more; some may have two. Some may be commercial or mixed use; some may be solely residential. Some may be old (conversion to commonhold); some may be new. It is not possible to have the same documents for all of these projects using the English and Welsh companies' law because the companies' law was not created with commonhold associations in mind. The companies' law is more suitable for large for-profit companies.

In New South Wales, Australia there are standard provisions for particular types of projects. Developers can choose add additional provisions from a schedule of provisions. Thus, documents in the same type of commonholds are relatively standardized. It is possible for New South Wales to have this approach because the commonhold statutes were specifically written for commonhold associations. The traditional company's law does not apply.

Because of the way in which the English and Welsh law is written, I do not believe the goal of standardized documents is attainable if developers are to have maximum flexibility in creating projects. Some provisions can be standard, but the goal should not be to have all provisions standard. Flexibility, particularly for commercial projects, also should be a goal. Even if the documents are not standard among all the different types of commonholds, they will be standard within a commonhold community. This is a better situation than that which exists in the leasehold system because one block of flats may have different long-term leases with different provisions.

3. Simplicity and Plain English

When reading the proposed regulations and governing documents, one should try and read them through the eyes of an owner who has no legal background and no formal higher education. The provisions need to be to be put in simpler language.

The owners need to be able to understand their documents. They should not have to hire a solicitor to interpret every provision.

For example, one of the sections identifying the powers of the commonhold association in the Memorandum of Association has 37 subsections, and this is just one of the sections identifying association powers. These could be reduced to "The association has the powers of a company except as listed below". The exceptions would be things that could only be done with the consent of owners, such as terminating the commonhold or changing voting rights. This approach would greatly simply the regulations.

There should not be cross-references to other statutes or standards. If other standards or law are relevant, they should be specifically identified in the regulations or governing documents. Owners should not have to research a variety of areas of law in order to understand how to govern their commoholds.

4. Voting Rights

Regulations relating to voting should be simple. Some of the provisions, particularly those involving polls, are not. In addition the provisions relating to polls are subject to abuse by an owner who wishes to be an obstructionist. Therefore, the provisions relating to polls should be eliminated. Secret ballots and proxy voting should be permitted at a meeting.

As mentioned above, class voting should be permitted at least in mixed-use projects. It may be desirable in other types of commonholds too, for example, where some floors of a building or some areas of a detached commonhold have substantially different needs from other parts of the commonhold.

5. Amending Documents

The documents must be capable of being amended. Few of us are clairvoyant enough to predict what a commonhold will be like 30, 50 or 100 years from now.

The owners must be able to respond to change.

Thus, the question isn't usually whether documents should be amended, but under what conditions. Thought needs to be given to the voting requirements for passing resolutions.

Some provisions should not be capable of amendment, such as a requirement that all associations prepare a budget or fund the operating and reserve account. Other provisions such as voting rights or terminating the commonhold should require a high percentage of the owners, not a percentage of a quorum, to amend. Still other provisions that have less impact, such as requiring the building to be a particular colour should be amendable by a majority of a quorum.

Therefore, it is necessary to go through the proposed regulations and identify those provisions which should not be amended, those which should be difficult to amend, and those which should be relatively easy to amend.

6. Access to Records

Transparency is essential. The proposed regulations give owners the right to inspect records unless the board determines otherwise. Owners should have an absolute right to inspect records at a reasonable location unless there is a valid reason that records should remain confidential. Valid reasons may include records created in connection with litigation, confidential hearings of covenant violations, and personnel records.

Records must be available at a convenient location. In Florida one developer kept the records out of state so that owners would not have access. Transparency is essential.

7. Finances

All associations should be required to create a budget. The proposed regulations speak in terms of estimating income. The amount of income is only relevant in relation to expenses. Both must be estimated. Each owner's share of the assessments should be based on an adopted budget.

The association is obligated to maintain the common parts. Therefore, they must have a general operating account. They are also required, however, to make long- term repairs. Therefore, they must also fund a reserve account. Failure to adequately fund reserve accounts has been a problem in the U.S.

8. Leasing

It is important to keep the provisions regarding leasing simple. When considering the regulations one should keep in mind that these tenants will be short-term tenants. Specific recommendations are made with respect to the leasing provisions in the second part of this paper.

9. Insurance

Insurance experts should review the proposed regulations regarding insurance. Because commonholds can be attached or detached, and residential or commercial, the regulations must be flexible. Insurance, however, should be mandatory.

Insurance should also be required for directors and officers under certain conditions. It will be

easier to get people to volunteer for these positions if they are protected against lawsuits.

10. Dispute Resolution

An association should have an internal system for resolving disputes. The sophistication of the system will depend on the type of comomonhold.

Every effort should be made to avoid unnecessary litigation. The regulations provide for an ombudsman system and external alternative dispute resolution mechanisms. It is important, however, to permit some flexibility in resolving disputes because the commonholds can be so varied.

11. Developer Rights

Developers need to retain rights while they are marketing the commonhold. It is also important, however, that the unit owners know when they purchase exactly what those rights are and when they will terminate.

12. Managing Agents

The regulations treat managing agents differently from other service providers. There appears to be a holdover from the notion from the leasehold system where the “owner – tenants” don’t hire the managing agent. In commonhold they do so managing agents should be treated like any other service provider, and the board should have the authority to enter into contracts with managing agents.

If there is a concern that the developer will enter into a long-term contract with his or her agent to the detriment of the association a regulation could provide that the developer may only enter into one-year renewable contracts while the developer is in control. Obviously, contracts that unreasonably advantage the developer to the detriment of the association could be void.

These are some of the policy issues addressed in this paper. Others appear in the following two sections and in **Commonhold Law: Problems and Potential Solutions** (Joseph Rowntree Foundation, 2000.).