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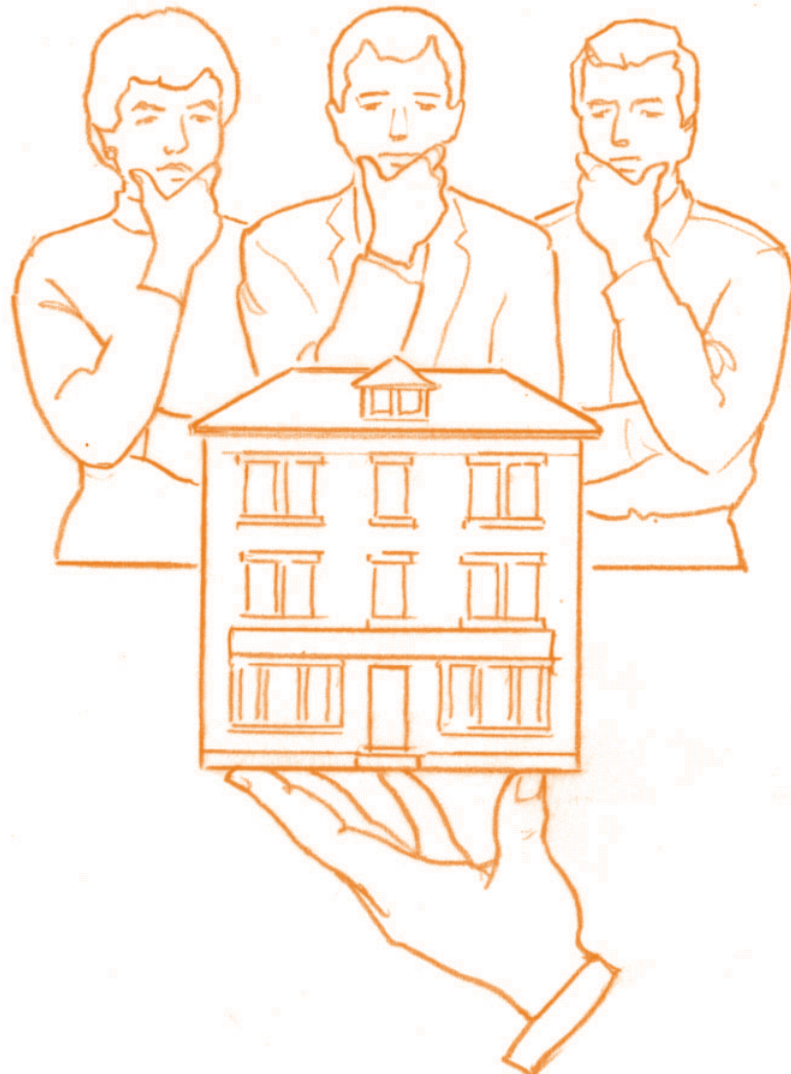
Llywodraeth Cynulliad Cymru
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L E A S E

THE LEASEHOLD
ADVISORY SERVICE

THE RIGHT OF FIRST REFUSAL



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This leaflet is not meant to describe or give a full interpretation of the law; only the courts can do that. Nor does it cover every case. If you are in any doubt about your rights and duties then seek specific advice.

The Right of First Refusal

The Right of First Refusal (RFR) is provided by Part 1 of the Landlord and Tenant Act 1987 (the 1987 Act) as amended by the Housing Act 1996.

Where a landlord is proposing to sell his interest in a building containing flats in relation to which the RFR exists, he must, by law, first offer it to the tenants before offering it on the open market. He must serve formal notices on the tenants telling them what he is intending and must provide time for them to consider the offer; he cannot sell to another party during that time, nor offer the interest to anyone else at a price less than that proposed to the tenants or on different terms. Breach of these legal obligations by the landlord is a criminal offence. If the landlord sells without providing the Right of First Refusal, the tenants can serve a notice on the new owner demanding details of the transaction, including the price paid; they can then take action to force the new owner to sell to them at the price he paid.

It is important to understand certain key principles of the RFR:

- it is not a means of forcing a landlord to sell his freehold interest in a property (this is provided by the enfranchisement provisions of the Leasehold Reform, Housing and Urban Development Act 1993). It is an opportunity for the tenants to purchase that interest before it is offered on the open market or by auction.
- the right follows a landlord's decision to sell and the tenants can only react to the landlord's offer. He can withdraw the offer at any time before the contract is binding.
- the right is available both to leaseholders and regulated (fair rent) tenants but not to houses occupied as single dwellings.
- the price is set by the landlord, or by auction where the landlord decides to sell that way. There is no right for that price to be determined by a Leasehold Valuation Tribunal or anyone else. However the landlord cannot sell or offer the interest to another party on different terms or at a lower price than that originally offered within 12 months of his notice, unless he again offers the Right to the existing tenants on the new terms and/or at the lower figure.
- the price set may, in some circumstances, be lower than that which could be achieved through a collective enfranchisement. However, it could also be higher.
- the requirement to make the offer and the procedure involved is set out in the Act. If a landlord fails to comply with any of these statutory requirements he commits a criminal offence. The requirements also apply where the landlord's interest is being sold by a Receiver, a Trustee in bankruptcy or an Executor following grant of probate.
- the right is not available to tenants of local authorities, housing associations, nor, in some cases, where the landlord lives in the building.

Buildings, landlords and qualifying tenants

For the RFR to exist, the building, the landlord and the tenants have to meet certain requirements.

The building

There are three requirements for the building to be subject to the RFR:

- it must contain at least two flats; and
- no more than 50% of the building to be in non-residential use; and
- more than 50% of the flats in the building must be held by 'qualifying tenants'.

The legislation does not define what is intended as a building, but it is generally understood to mean a separate building or, in some cases, a part of a building which may be divided vertically from another part. In the absence of a legal definition, a common sense approach should apply as to what normally constitutes a building and whether it is capable of development without substantially affecting the rest of the building. So, floors of flats above a shop are not a separate building but one half of a pair of semi-detached houses converted into flats is a separate building from its neighbour.

There must be at least two flats in the building, so the right does not apply to houses occupied as one unit – but will, of course, apply to a house which has been converted into flats.

The building will be excluded from the RFR if more than 50% (excluding the common areas) is not in residential use, say offices or shops. The measurement excludes any common parts of the residential building, such as staircases, landings etc. The Act refers to parts of the premises occupied or intended to be occupied for non-residential purposes. A building could be excluded if it contained empty spaces which made up more than half the building which the landlord intended to use for non-residential purposes, such as storage.

The landlord

The RFR does not apply to the following landlords:

- most housing authorities (local Councils, New Towns and Development Corporations);
- registered social landlords and fully mutual housing associations which are not registered;
- charitable housing trusts; and
- resident landlords who live in the building where the following two conditions apply:
 - the building is not a purpose-built block of flats, that is, it must be a property, a house for example, which has been converted into flats since its original construction; and
 - the landlord genuinely lives in the building as his only or principal residence and has done so for more than 12 months.

Immediate landlord

The RFR only applies when the immediate landlord of the tenants decides to sell. The immediate landlord is the one to whom the rent or ground rent is paid and who will be entitled to vacant possession of the flat when the lease expires. Where a landlord has a lease for less than seven years (or longer, but which is terminable within the first seven years) his landlord is also subject to the RFR in relation to those premises.

For example, a block of flats is owned by a freeholder, Smith. He grants a lease of the whole building to Brown for a term of 100 years. Brown then grants leases of 99 years for each of the separate flats. In this case, Brown is the immediate landlord of the individual leaseholders of the flats and would have to provide the Right of First Refusal where he intended to sell his lease of 100 years (known as a headlease). Smith, as freeholder, is not the immediate landlord of the flats and would be free to dispose of the freehold (even to Brown) without offering it to the flat-owners first.

Qualifying tenants

The RFR is restricted to qualifying tenants. These include leaseholders and most fixed or periodic tenancies, but specifically excludes shorthold or assured tenancies, business and agricultural tenancies, tenancies which are dependant upon employment (and any sub-tenants of any of these).

Someone who is a tenant of three or more flats in the building (as leaseholder or tenant) will not be a qualifying tenant of any of the flats and will not be entitled to the Right of First Refusal.

Disposals

The sale or transfer by the landlord of his interest is termed a disposal. This may be a simple sale of the interest, the freehold or a headlease over all the flats, where the landlord leaves the scene, or it could be a proposal by the landlord to create a new headlease, a new interest in the building. In either case, where the disposal is a relevant disposal and the conditions in relation to the building, the landlord and tenant are fulfilled, the RFR exists and the disposal must first be offered to the tenants.

The majority of disposals will trigger the Right of First Refusal, but some are exempt:

- grant of single tenancies: the disposal must apply to the whole building – the landlord is free to grant tenancies of individual flats.
- grant of a mortgage: where the landlord obtains a mortgage or a loan on the security of his interest.
- disposal to a receiver or trustee in bankruptcy: the transfer of the estate to the receiver, liquidator or trustee in the first instance is an exempt disposal. **However, any subsequent disposal by the receiver, liquidator or trustee will not be exempt and the tenants will need to receive notice of their rights.**
- disposal to an associated company: this is where the interest is transferred as an asset to another company, which has been associated with the parent company for at least two years. Therefore, for example, a landlord which is a company may transfer its freehold of a block of flats to an associated company. Tenants are not able to exercise the RFR in this case, but should investigate, through the Registrar of Companies, that the associated company has been associated for the requisite two years prior to the transfer.
- disposals arising from collective enfranchisement under 1993 Act.
- disposals arising from compulsory purchase orders.
- sales by charities to other charities.
- certain sales in connection with matrimonial and family proceedings.
- a sale by two or more persons of the same family to a different combination of the same family (or a transfer by family members to fewer of their number).
- sales to the Crown or to Government departments.

When the disposal occurs

The time at which the disposal takes place is significant for the service of notices and for prosecutions in the case of a failure to comply with the statutory requirements.

- where the disposal is subject to a contract, then the disposal occurs when contracts are exchanged, not the later date of completion.
- where there is no contract, the disposal will occur on the date of any agreement to sell, or the date of an auction if the landlord chooses to sell this way.

The Offer Notice

The Act requires that notices be served in respect of a separate building and this can sometimes cause confusion in cases of estates comprising a number of separate blocks sharing common grounds. The general interpretation of the legislation is that, in these cases, the landlord should treat the blocks as separate buildings and serve notices in respect of each building. However, the position is not entirely clear and landlords proposing service of notices in these circumstances, or tenants receiving them, should seek further advice.

If all the conditions are satisfied, then a landlord proposing to dispose of his interest must serve a formal notice on the qualifying tenants making the offer of first refusal; this is called the Offer Notice.

Breach of this obligation by the landlord, or his agent, is a criminal offence, punishable by a level 5 fine on conviction (currently £5,000).

There are five different forms of notice, dependant upon the circumstances of the disposal:

Section 5A – simple sale by contract

Section 5B – sale by public auction

Section 5C – a grant of an option or right of pre-emption

Section 5D – sale not pursuant to a contract

Section 5E – sale for a non-monetary consideration

The most common uses of the procedures arise from sales by contract or auction and the details for the S5A and S5B notices are given below.

The other procedures are relatively uncommon and those for the Sections 5C, 5D and 5E are set out in Appendix 2.

Service of the notice

The legislation requires the landlord to serve the notice on the qualifying tenants and that is what he is expected to do. It does, however, provide that the landlord will be considered to have complied with this if he serves notices on *not less than 90% of the qualifying tenants*.

Where there are less than 10 qualifying tenants he may serve on all but one of them. This means that, where there are only two qualifying tenants, the landlord could comply by serving the Offer Notice on only one of them.

The general interpretation of the requirement is that the 90% rule is intended to provide some leeway for a landlord, perhaps unable to trace all the necessary recipients, and should not be taken as a licence to deliberately omit 10% of the qualifying tenants.

If the notice is served on different tenants at different times, resulting in the period for accepting the RFR offer being different, the notice is presumed to have effect for all the tenants as if it provided for the acceptance period to end with the date in the last notice served.

Where a notice has been served, the landlord shall not dispose of the interest during the period specified in the notice (or a longer period if agreed with the tenants) unless it is to the tenants.

The procedures
Section 5A –
where the landlord
intends to dispose
on the open market

1. Where the landlord intends to dispose on the open market, the notice must include the following:
 - i) the terms of the proposed disposal, that is the property and the interest being disposed of (the freehold, a headlease etc), the price and any deposit required;
 - ii) a statement that the notice constitutes an offer by the landlord to enter into a contract on the terms set out in the notice;
 - iii) the date by which the offer may be accepted (the initial period) – this must **not be less than two months from the date of the notice**; and
 - iv) a date for the nomination by the tenants of a purchaser (the nominated person), which must **not be less than a further two months**.
2. If the qualifying tenants wish to take up the offer, **the requisite majority must write to accept**. That majority is more than 50% of the qualifying tenants (counting one vote per flat). Those tenants must serve a notice accepting the landlord's offer within the period set out in the landlord's notice (unless he later agrees a longer period).

If the qualifying tenants do not serve the acceptance notice, or serve it outside the offer period, the landlord is free to dispose of the interest on the open market, **but not on different terms or at a price lower than that proposed to the tenants in the Offer Notice**.
3. Where the qualifying tenants accept the offer they then have a further period of **at least two months** in which to notify the landlord of their **nominated person**. This is the person, or group, or company which the qualifying tenants wish to acquire the interest on offer. *(There is a note on organising the nominated person and formation of a company in Appendix 3).*

If the qualifying tenants are expecting the offer, or are well organised, they can inform the landlord of their nominated person at any time following their acceptance of the offer; they do not need to delay matters until the second two month period at 1(iv) above.

If the qualifying tenants do not notify the landlord of their nominated person within the required period, the landlord is free to dispose of the interest on the open market, **but not on different terms or at a price lower than that proposed to those tenants in the Offer Notice**.
4. Once the landlord has been notified of the nominated person, the nominated person must be sent a contract within **one month** of the notification.
5. The nominated person then has a period of **two months** to sign and return the contract and to pay the deposit (this must not be more than 10% of the price).

6. The landlord has **seven days** from receipt of the signed contract to exchange.

Although the procedures are simple and provide very generous time frames for the tenants, there are certain limitations which must be considered:

- the price in the Offer Notice – this is the price set by the landlord and is not negotiable (unless the landlord is prepared to do so) nor is it challengeable at a Leasehold Valuation Tribunal. It is a ‘take it or leave it’ offer, based by the landlord on what he reasonably expects he could achieve in an open market sale. The protection for the tenants is the prohibition on sales within 12 months on different terms or at a lower price – this should discourage the landlord from setting an artificially high price to the tenants. (*There is a discussion of the pricing/valuation aspects in Appendix 4*)
- the requisite majority – the necessary majority of qualifying tenants must be maintained throughout the process; should it drop below the required number the nominated person must so advise the landlord and the tenants must withdraw. The landlord is then free to sell (but still not at a lower price or on better terms within 12 months).
- either party may withdraw – the landlord may withdraw the offer and the nominated person may withdraw his intention to proceed with the acquisition at any time up to exchange of contracts; neither is bound to proceed.
- either party may be deemed to have withdrawn – if the landlord does not send or exchange contracts (steps 4 and 6 above), or if the nominated person does not return the signed contract (step 5 above) the party is deemed to have withdrawn. In this case the landlord may dispose of his interest during the 12 months following withdrawal but subject to conditions.
- the cost of withdrawal or deemed withdrawal – if a notice of withdrawal is served after the first four weeks of the nomination period specified in the Offer Notice, or if a party is deemed to have withdrawn after this period, the withdrawing party will be liable for the other side’s costs. Withdrawal within the first four weeks means that there is no liability for costs.

Section 5B – where the landlord intends to dispose by auction

1. Where the landlord intends to dispose by auction, the notice must be served between four and six months before the date of the auction.

The notice must include the following:

- i) the principal terms of the proposed disposal, the property and the interest. However, there will be no price or deposit mentioned (nor is the landlord required to divulge the reserve price);
- ii) that the disposal is to be by public auction;
- iii) that the notice is an offer by the landlord for the contract (if any) entered into by the landlord at the auction with the purchaser, to have effect as if the nominated person had entered into it;
- iv) the initial period for acceptance of at least two months. This initial period must end **at least two months before the date of the auction**; and

- v) a further period of **28 days** for the nomination of a purchaser (note, not two months, as in S5A notice). This period must end **at least 28 days before the date of the auction.**
2. The S5B notice is not required to state the date of the auction, although it would be reasonable to do so. If the date is not included then, **at least 28 days before the auction** the landlord must serve a further notice on the **requisite majority** (not all the qualifying tenants), stating the date, time and place of the auction.
 3. If the qualifying tenants wish to accept the offer the requisite majority must do so within the initial period set in the landlord's notice (unless he agrees a longer period).
 4. They must then notify the landlord of their nominated person within the 28-day further period.
 5. The nominated person must send a notice to the landlord at least 28 days before the date of the auction, electing that the remaining stages of the procedure should apply.
This is different from other provisions in that the tenants cannot rely on the procedure continuing, they must formally advise the landlord that they wish it to do so; **failure to serve this notice will result in the tenants' previous acceptance being deemed withdrawn.**
 6. The interest is offered at the auction. The tenants are free to attend or not – they are not required to. Similarly, they are not required to make a bid and would be unwise to do so as this will have the effect of driving up the price. If a successful bid is accepted at the auction the landlord must send a copy of the contract to the nominated person **within seven days of the auction.**
 7. The nominated person then has a period of **28 days** in which to accept the contract and pay any deposit required. This has the effect of the nominated person and not the successful bidder entering into the contract.

Although the procedures are simple and provide generous time frames for the tenants, there are certain matters which must be borne in mind:

- the price is set by the auction and cannot be challenged unless the landlord is prepared to negotiate. Again it is a 'take it or leave it' offer but this time at a figure achieved in an open sale.
- if the landlord withdraws the interest from the auction, or it does not sell, then the interest cannot be sold, by auction or otherwise, without starting the whole procedure afresh with service of a new S5A or S5B notice.
- if the qualifying tenants do not accept the offer made by the landlord or notify him of the nominated person, or if the nominated person withdraws from the acquisition or is deemed to have withdrawn because of a failure to adhere to the time limits, then the landlord is free to sell at auction within the next 12 months, with no further reference to the tenants, but subject to conditions. However, he may not sell privately (other than a sale at a public auction) without a new notice under S5A, or he commits a criminal offence.
- the nominated person must withdraw if there are no longer sufficient tenants to form a requisite majority.
- the nominated person is deemed to have withdrawn where he fails to accept the contract or pay the deposit (*see step 7 above*).

- if either party withdraws, or is deemed to have withdrawn, they will be liable for costs.

The S5A and S5B procedures are the most commonly used and the remaining provisions are relatively rare.

Where the landlord fails to give Notice of First Refusal

Duties of the new landlord to inform the tenants

In cases where the landlord fails to comply with the statutory requirements in relation to the RFR he becomes liable to criminal prosecution and, on conviction, to a level 5 fine on the standard scale (up to £5,000). The qualifying tenants also have rights of remedy; they can demand information on the sale and the price paid, and can force the new landlord to sell to them at that price. This right can be enforced against subsequent purchasers should the new landlord sell on.

Often the tenants will know nothing about a sale until they receive a communication from the new landlord, and this may be some time after the sale took place.

Any 'new' landlord of a property containing at least one dwelling is required by law to inform the tenants of his name and address (Section 3, Landlord and Tenant Act 1985 – a S3 notice). This notice must be served no later than the next day on which rent is due, according to the lease (or, if the next date is within two months of the date of his acquiring the property, the end of the two months). Failure to serve the S3 notice is subject to criminal prosecution and is liable on conviction to a level 4 fine on the standard scale (up to £2,500).

Where the building is one to which the RFR should apply, the new landlord must, as well as the S3 notice, serve a notice under Section 3A of the Landlord and Tenant Act 1985 (a S3A notice), advising each tenant of their rights under the 1987 Act. The S3A notice must be served by the new landlord, irrespective of whether the original landlord had or had not served an offer notice on the qualifying tenants prior to the disposal.

The S3A notice must state:

- that the disposal to the new landlord was one to which Part 1 of the Landlord and Tenant Act 1987 applied
- that the tenant (together with the other qualifying tenants) has the right:
 - to obtain information about the disposal; and
 - to acquire the new landlord's interest in the building;
- the time limits in which these rights may be exercised.

Even if the disposal to the new landlord took place entirely in compliance with the statutory requirements of the RFR, the S3A notice must be served, notwithstanding that the tenants would not, in this case, have the rights set out in the notice, it is simply a procedure that must be followed and breach is subject to criminal prosecution, and on conviction is liable to a level 4 fine on the standard scale (up to £2,500).

The purpose of the S3A notice is to ensure that all qualifying tenants are alerted to the possibility of a breach of their rights and are armed with the necessary information to take action. The time limits for remedial action date from the tenants receipt of the S3A notice, irrespective of the date the actual disposal took place.

The tenants' right to require information

When the tenants find out that they have a new landlord and think that the transfer may have not been in accordance with the RFR, the requisite majority (more than 50%) of the qualifying tenants may serve a notice on the new landlord under section 11A of the 1987 Act. The section 11A notice, which allows the tenants to seek certain information, must be served within **four months** of the date of receipt by the tenants of the section 3A notice or the date on which the tenants having received any other documents indicating that the disposal has taken place.

The new landlord must respond to the notice within one month.

There is no prescribed form for the section 11A notice but it can seek the following information:

- the terms on which the disposal was made, the price, any deposit paid, and the date it took place; and
- where the disposal consisted of entering into a contract, a copy of that contract.

It is possible to obtain some of this information, without the need to serve the notice, through the public access to the Land Registry. All interests registered must show the date of the acquisition by the new owner and the price paid. Access to the Register may be through any regional office of the Land Registry or through the website (www.landregistry.gov.uk).

The tenants' right to acquire the landlord's interest

If the qualifying tenants can show a breach of the statutory requirements in relation to the RFR, they can require the landlord to give effect to the contract for disposal as if it had been entered into with the nominated person rather than the purchaser, or they can compel the new landlord to sell his newly acquired interest to them, on the same terms as he acquired it.

Acquisition procedures

Right to take benefit of a contract (Section 12A)

The procedure to be taken for acquiring the interest will depend on the disposal that has taken place; the rights are:

- under Section 12A – the right to take benefit of a contract
- under Section 12B – the right to compel resale
- under Section 12C – the right to compel grant of a new tenancy

This section applies where the landlord has entered into a contract for disposal but the actual disposal, the sale of the building or grant of an interest, has not yet been completed. The S12A notice is not a 'purchase notice' as it does not compel a sale; it is a notice requiring the landlord to treat the contract as though it had originally been entered into by the tenants' nominated person, putting the nominee into the position of the contracting party.

There is no prescribed form or content for a S12A notice, it simply advises the new landlord of the qualifying tenants' wish to acquire.

A S12A notice must be served within a period of six months beginning:

- where a S11A notice was served, the date on which the new landlord complied with that notice;
- where no S11A notice was served, the date on which the tenants became aware of the transfer (for example, through a S3A notice).

The nominated person is required to pay any deposit and to comply with any other specific provisions of the contract.

A statutory period of 28 days is provided for the nominated person to formally enter into the contract and any contractual periods within the contract will have to be started again from the date the S12A notice is served (for example, the contract may have required the purchaser to make a planning application within three months etc; that three months will run from the date of the new contract).

Right to compel resale (Section 12B)

A S12B notice is the real purchase notice and applies where the disposal has taken place and the building has been transferred to the new landlord. Again, there is no prescribed content to a S12B notice but it is important that it should clearly describe the estate or interest the tenants are requiring.

A S12B notice which must be served within a period of six months beginning:

- where a S11A notice was served, the date on which the new landlord complied with that notice;
- where no S11A notice was served, the date on which the tenants became aware of the transfer (for example, through a S3A notice).

There are no time limits in which the resale to the qualifying tenants must take place. The effect of the notice is that the new landlord is bound to effect the sale and this can be enforced, in the event of any delays, through the county court.

The right provides for the re-sale to be 'on the terms on which it was made'. The price for the tenants is therefore whatever the purchaser paid. This may include other considerations (for example, an additional sum to the landlord to obtain planning consent), any arrears of rent or other charges paid as part of the deal plus the original landlord's conveyancing costs if paid by the purchaser.

There is no provision for re-negotiation of the price, or for its independent determination by an LVT. However, there is a limited role for the LVT relating to other property. For example, where the building was included with other properties in a portfolio sale, it will be difficult for the tenants, and possibly for the landlord, to allocate a price to one property within a large group. The LVT has jurisdiction to apportion the price from the overall sale.

In some cases there may be changes to the property since the original sale (for example, the new landlord may have obtained possession of some of the flats, or obtained planning permission to build additional flats). In this case the price should be whatever it would have been at the date of the sale had the changes applied at that time. This is not a matter within the jurisdiction of the LVT and must be determined by the court.

Right to compel grant of a tenancy (Section 12C)

A S12C notice may be served where the original disposal consisted of the surrender by the landlord of a tenancy held by him, for example, a headlease over all the flats. The notice requires the superior landlord (the landlord to whom the tenancy was surrendered) to grant the qualifying tenants a tenancy on the same terms as that which was surrendered. Again, there is no set form for the notice, nor any time limits for compliance by the landlord.

A S12C notice must be served within a period of six months beginning:

- where a S11A notice was served, the date on which the new landlord complied with that notice;
- where no S11A notice was served, the date on which the tenants became aware of the transfer (for example, through a S3A notice).

The tenancy must be re-granted, to the qualifying tenants' nominated person, on exactly the same terms, and with the same date of expiry as the original tenancy, notwithstanding the passage of time from when it was originally granted to the re-grant to the tenants. Any consideration that was originally paid for the tenancy must be paid to the purchaser by the nominated person.

Disputes

A court will deal with any disputes about a landlord's failure to comply with the 1987 Act. The Leasehold Valuation Tribunal, on the other hand, has jurisdiction to hear and determine any question arising in relation to any matters specified in a notice under sections 12A, 12B or 12C, and also to determine any questions where the landlord proposes a non-monetary disposal under section 5E where it is accepted by the tenants (*see Appendix 2*).

Rights against subsequent purchasers

Qualifying tenants who have been denied the right of first refusal can pursue their rights of remedy even if the new landlord sells the interest on to another.

In a case where the original purchaser has already sold on but receives a S11A notice (request for information) from the qualifying tenants he must:

- send a copy of the notice (and his response to the notice) to the new purchaser; and
- advise the tenants of the name and address of the new purchaser.

He must take similar action if the qualifying tenants have served a notice under S12A, 12B or 12C, by passing it on to the subsequent purchaser and notify the tenants of the new purchaser's name and address.

Where the notice is forwarded to the subsequent purchaser, he (the subsequent purchaser) becomes bound by the requirements of the notice as though he had originally been served with them.

If the qualifying tenants had not served a notice under S12A, 12B or 12C prior to the subsequent transfer, they may still do so by service on the subsequent purchaser by treating him as the original purchaser.

Prospective purchasers

The 1987 Act provides some protection for prospective purchasers of buildings which they know or suspect are subject to the RFR. They can, before proceeding with the purchase, serve notice on the tenants under Section 18 of that Act.

A prudent purchaser of residential accommodation will wish to ensure that he will not subsequently lose the property to qualifying tenants who are entitled to exercise the RFR and S18 provides him a route to make proper enquiries.

There is no provision in the legislation for a prospective purchaser to obtain information about the property or the tenants (other than through the usual routes of the Land Registry or electoral roll), so S18 allows him to approach the tenants directly.

A prospective purchaser may serve a notice under S18 on the current tenants of the building, setting out the proposed terms of the purchase and the price and seeking to know:

- whether the landlord has served a S5 offer notice in respect of the proposed disposal;
- if not, whether the tenant considers himself entitled to receive such an offer (that is, does the tenant think that the RFR should apply to the building?);
- and, if so, whether he would wish to exercise his right if a S5 notice were to be served.

The S18 notice must be served on at least **80%** of the tenants in the building (whether qualifying tenants or not). In this case, each of the flats is regarded as having one tenant. The tenants have **two months** to respond.

If either:

- **no more than 50%** of the tenants who received the notices respond; or
- **more than 50%** have responded to the S18 notice but in each case the tenant responding is of the view that either he is not entitled to exercise the RFR or he does not wish to avail himself of the RFR

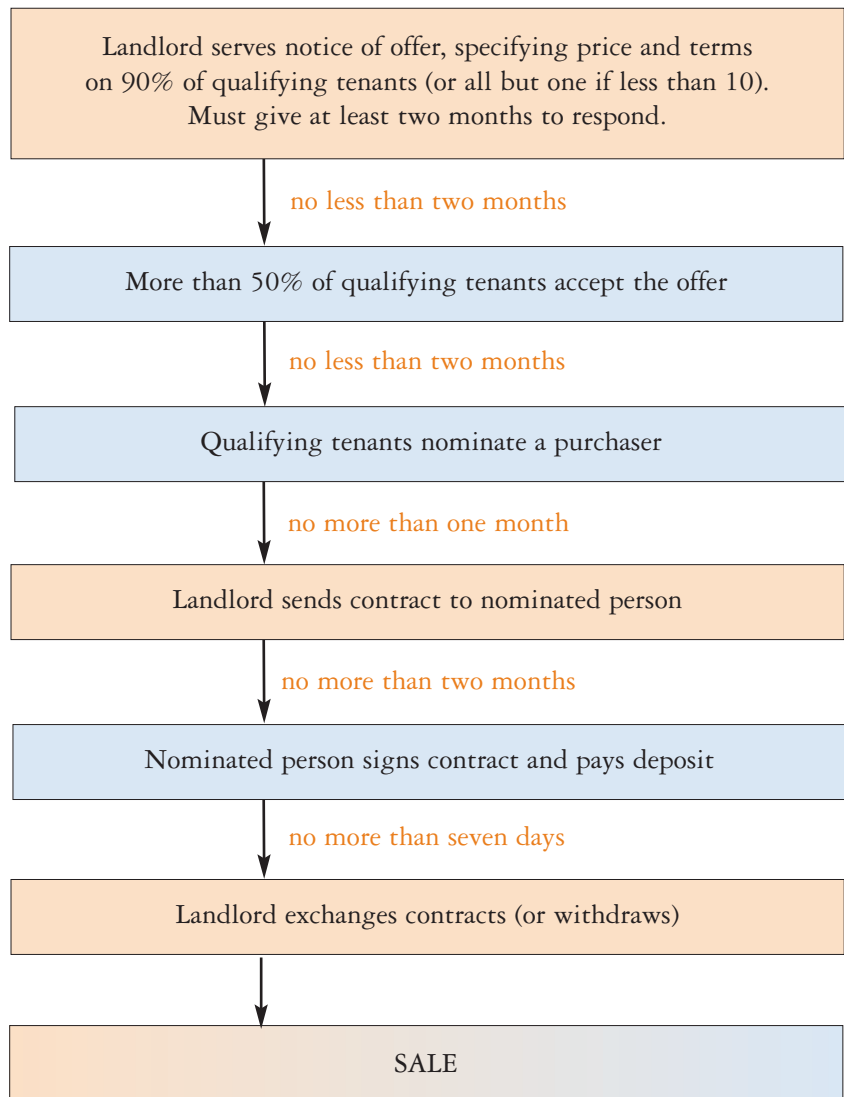
then the prospective purchaser may treat the building as one to which the RFR does not apply. He can then proceed to purchase without the present owner needing to serve the S5 offer notices and with no danger of any subsequent attempt to force him to take action under S12A, 12B or 12C.

It is clear that the S18 procedure is not intended as a substitute for the proper offer to the tenants through the S5 notice, and does not absolve the landlord or vendor from his obligation to serve the notices. It is a permissive power provided to protect an innocent purchaser.

Appendix 1(a)

Procedures and statutory time limits

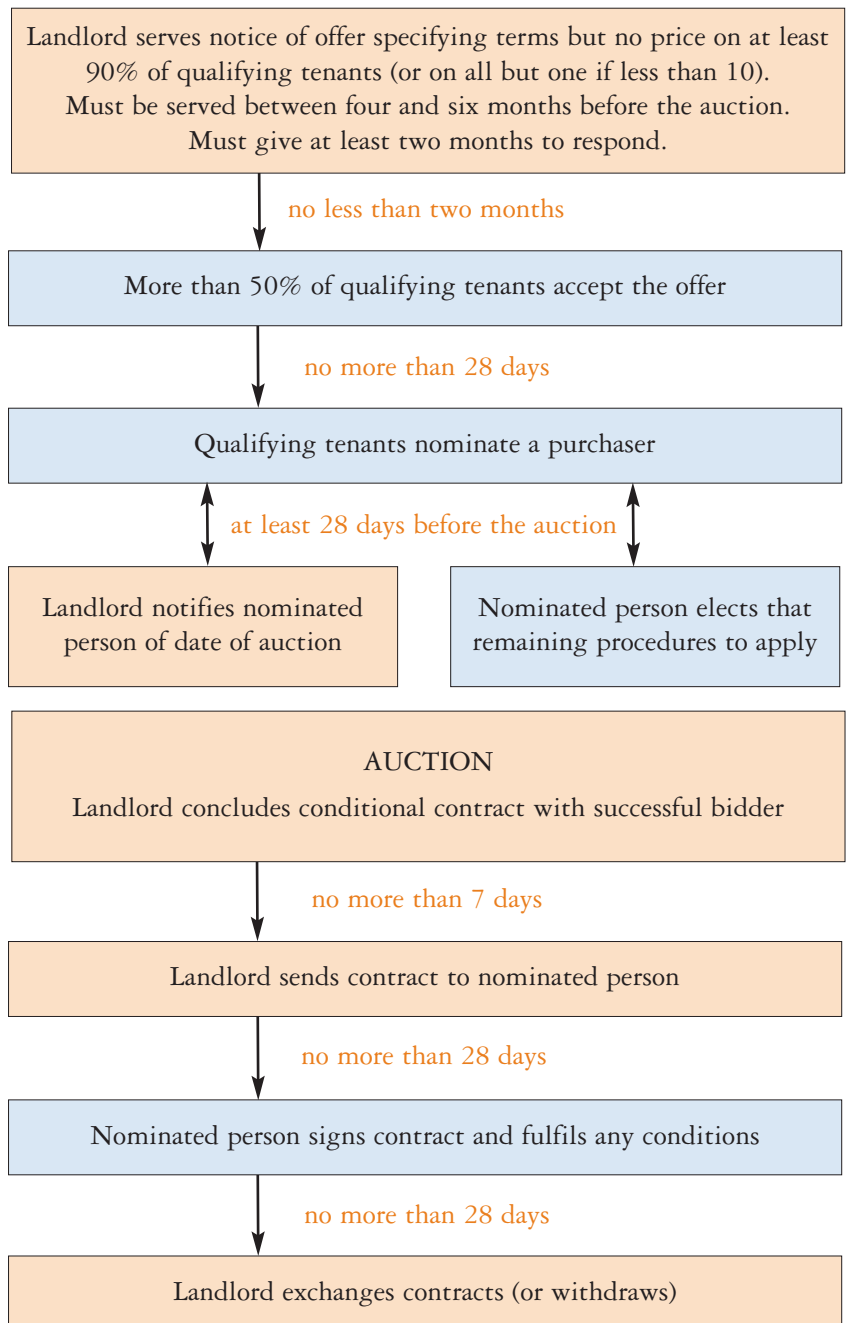
Section 5A – open market disposal



Appendix 1(b)

Procedures and statutory time limits

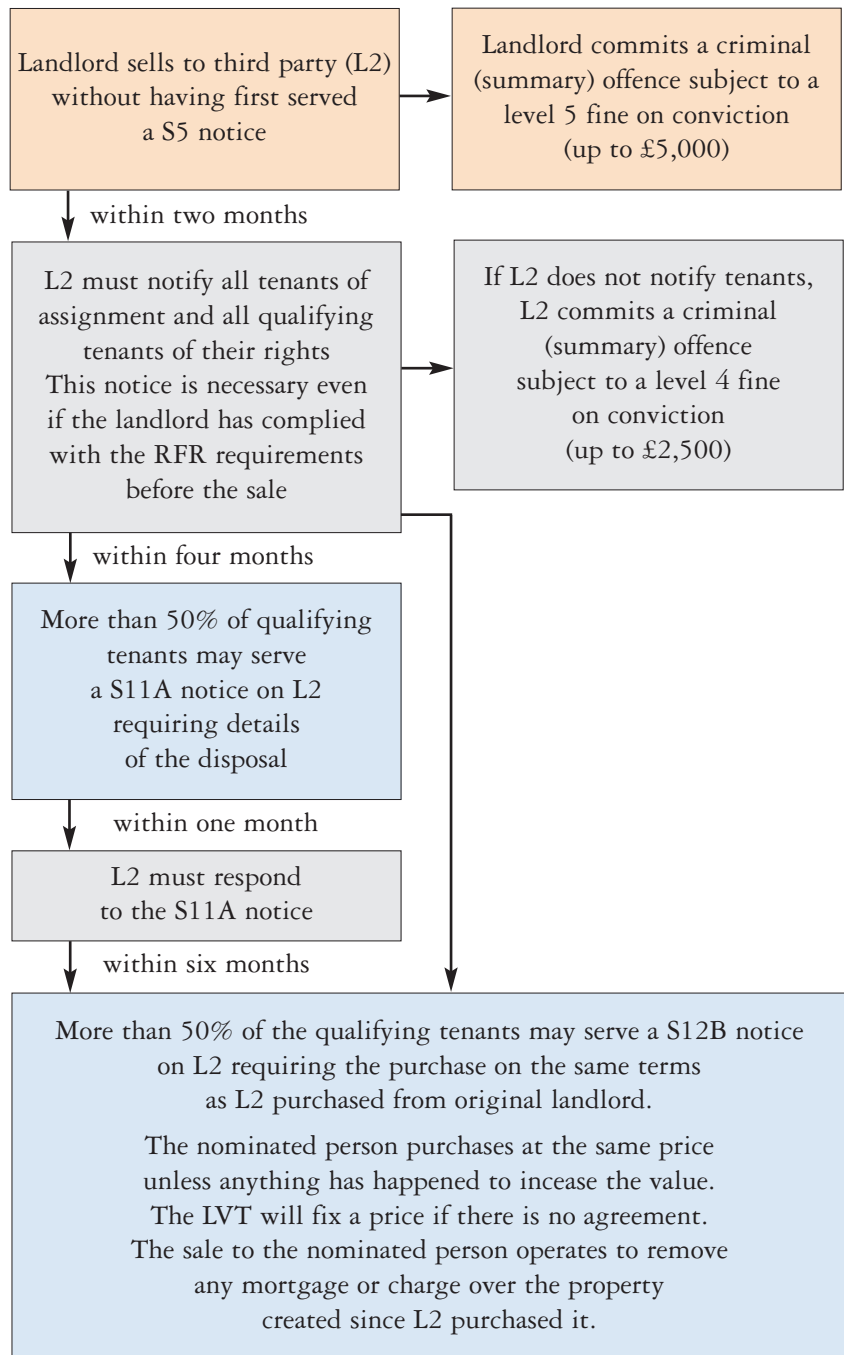
Section 5B – disposal by auction



Appendix 1(c)

Procedures and statutory time limits

Where landlord fails to serve a S5 notice



Appendix 2

Other Offer Notices

Section 5C – where the landlord proposes to grant an option or right of pre-exemption on purchase of his interest.

1. The notice must include the following:
 - i) the terms of the proposed disposal, the property or interest, the price and details of the option or pre-exemption.
 - ii) a statement that the notice constitutes an offer by the landlord to grant the option or right of pre-exemption in the terms proposed.
 - iii) a period in which the offer may be accepted by the requisite majority.

All timeframes and subsequent procedures follow those of S5A.

Section 5D – where the proposed disposal is not subject to a contract or option or right of pre-emption and is proceeding straight to the conveyance.

The notice must include the following:

- i) the terms of the proposed disposal, the property or interest, the price etc.
- ii) a statement that the notice constitutes an offer by the landlord to dispose of the interest on those terms.
- iii) the provisions for acceptance and nomination (as for S5A).

Section 5E – where the landlord proposes a non-monetary disposal. This could be where the landlord's disposal is by way of a gift, or perhaps part of a deal with another landlord including its exchange for other land or rights.

The notice must include the usual details and information on the interest and terms of the disposal as required under sections 5A to 5D, whichever is applicable, but, of course, no price or other consideration unless any part of the disposal consists of money.

In addition it must state:

- i) that the tenants may make an election under Section 8C of the 1987 Act accepting the offer of a non-monetary disposal (and explaining what this is); and
- ii) that the notice constitutes an offer which may be accepted by the requisite majority of qualifying tenants, for a nominated person to acquire the property.

The S8C procedure is rather complex but essentially it provides a right for the requisite majority to acquire the interest from the new owner, after the disposal, as though the landlord had not served the S5 notice. The tenants will have to pay the monetary equivalent of the interest and this is one of the few areas in the right of first refusal where the price may be determined by the LVT.

Tenants receiving a S5E notice should seek further advice.

Appendix 3

The 'nominated person'

The 'nominated person' is the person identified by the requisite majority of the qualifying tenants to the landlord and who will acquire the interest and become the new landlord. The nominee must be decided upon at an early stage because they conduct the later stages of the process and, on completion, will be responsible for the management of the building.

The nominated person can be a person, one of the qualifying tenants, or a corporate person, a trust or, more probably, a company formed by the qualifying tenants for the purpose. There are no controls or qualifications in the legislation governing selection of the nominated person and the qualifying tenants are free to choose whoever they wish, by whatever means of selection.

There is also the ability to invite another company to step in, or perhaps a Housing Association with management experience, but it must be borne in mind throughout the selection process that the nominated person is the person or body the qualifying tenants are putting forward to be their new landlord and to be responsible for the management of the building.

The most common format is a company wholly owned by the tenants and, if this is the vehicle chosen by the participating tenants, the company will need to be in place prior to the landlord being informed. A solicitor, managing agent, accountant or company agent will be able to advise how to establish a company and can produce the Memorandum & Articles of Association necessary to reflect the purpose of the company and to govern voting rights and control of shares.

Appendix 4

The price: the valuation aspects

The Act provides no guidance or limit on the price at which the landlord offers his interest to the qualifying tenants.

It might be assumed that, because the landlord cannot then sell to others at a lower price, this will have to be a price achievable in the open market. However, that may not be the case and sometimes S5 notices are served simply to tempt the tenants into buying at a price slightly higher than that which they would have to pay following a claim under Chapter 1 of the Leasehold Reform, Housing and Urban Development Act 1993 (the 1993 Act).

Tenants often seek valuation advice on receiving S5 notices. The valuer should be asked to give the range of the enfranchisement price under the 1993 Act if the minimum number of lessees participated and to advise whether the price offered should be accepted in that context. It should be remembered that there can be savings in taking up the RFR as compared with mounting an enfranchisement claim under the 1993 Act .

Firstly, under RFR no landlord's costs are payable unless the tenants withdraw. The price quoted is all that is payable to the landlord. He has to meet his own professional costs from the proceeds of sale. Under the 1993 Act, the landlord receives the price for the freehold and his reasonable valuation and legal costs. (In both cases, stamp duty land tax is also payable by the purchaser.)

Next, the costs incurred by the tenants are likely to be less under RFR than under the 1993 Act. The procedures under RFR are less complicated, so the tenants' legal and valuation costs may be lower.

Finally on price, the RFR carries certainty. The offer price is the certain price that will be payable (unless the landlord withdraws the offer). Under a 1993 Act claim, the price is not known for certain until the end of the negotiation, determination and appeal process, which can sometimes prove lengthy if it is a complex case.

A further benefit of RFR, but one without a cost implication, is timing. Because there are strict time limits the purchase under RFR can be much quicker (generally not more than 6 months) than under a 1993 Act enfranchisement (which can sometimes takes more than 12 months) or even a claim under the Right to Manage.

Therefore, a valuer might advise that an offer under RFR, which is at a price higher than might be expected under the 1993 Act, should be accepted. The final decision is, of course, a matter for the tenants.

Theoretically, the price under RFR should be less than under collective enfranchisement under the 1993 Act. This is because a third party purchaser (ie one that does not have an existing interest in the property) should not be willing to pay any marriage value as they cannot make a gain from marrying two interests together with the consequent uplift in value.

Example

For a full explanation of this see our leaflet *Valuation for Collective Enfranchisement*, which provides an example of how a price for the freehold of a block of 10 flats could be calculated. It shows the freeholder's interest excluding marriage value (in other words, just the right to receive the ground rent and, at the end of the leases, the flats with vacant possession) as being worth around £15,000. However, 50% of the marriage value (the uplift between the value of the tenants' flats after they have granted themselves long leases as compared with the value of the flats on the current leases plus

£15,000 as above) amounts to £67,500, making the total price for the freehold under the 1993 Act £82,500.

Theoretically, in the above example, the freeholder should not get more than £15,000 for his interest in the open market. However, the situation is seldom that simple due to the complication of 'hope value'. This is what a purchaser pays over and above the pure investment value for the hope of being able to sell longer leases in the future or from other ways of making money not included in the conventional investment value calculation.

Looking at the example, if the purchaser paid £15,000 for the freehold and the tenants were to exercise their right to collective enfranchisement the very next day, he might receive £67,500 for the interest more than he had paid. Although such a rapid scenario is unlikely, an investor in a competitive market will be prepared to pay more than the bare £15,000. He will look at the potential windfall of £67,500 and will assess how quickly he is likely to receive that money and bid accordingly. If he is prepared to risk half his potential profit, he will pay, say, an additional £30,000 over and above the £15,000, making the price in the market around £45,000.

The figures will, of course, depend on the situation, but tenants should consider carefully whether or not to reject a landlord's offer simply because it seems higher than they might have expected.

Appendix 5

Useful addresses

Leasehold Valuation Tribunals in England (part of the Residential Property Tribunal Service)

London

10 Alfred Place, London, WC1E 7LR
Tel: 020 7446 7700 Fax: 020 7637 1250

Eastern

Great Eastern House, Tenison Road, Cambridge, CB1 2TR
Tel: 0845 100 2616 Fax: 01223 505116

Northern

1st Floor, 5 New York Street, Manchester M1 4JB
Tel: 0845 100 2614 Fax: 0161 237 3656 or 0161 237 9491

Southern

1st Floor, Midland House, 1 Market Avenue, Chichester, PO19 1PJ
Tel: 0845 100 2617 Fax: 01243 779389

Midlands

2nd Floor, Louisa House, 92-93 Edward Street, Birmingham B1 2RA
Tel: 0845 100 2615 or 0121 236 7837 Fax: 0121 236 9337

Leasehold Valuation Tribunal for Wales

(sponsored by the Welsh Assembly Government)

1st Floor, West Wing, Southgate House, Wood Street, Cardiff CF1 1EW
Tel: 029 2092 2777 Fax: 029 2023 6146

Residential Property Tribunal Service (RPTS) National Helpline:
0845 600 3178

LEASE, 31 Worship Street, London EC2A 2DX Tel: 0845 345 1993 or 020 7374 5380 Fax: 020 7374 5373
Email: info@lease-advice.org Website: www.lease-advice.org

ODPM, Leasehold Reform Team, Zone 2/H10, Eland House, Bressenden Place, London SW1E 5DU
Tel: 020 7944 4287 Fax: 020 7944 4287 Email: enquiryodpm@odpm.gsi.gov.uk Website: www.odpm.gov.uk

Welsh Assembly Government, Cathays Park, Cardiff CF10 3NQ (Llywodraeth Cynulliad Cymru, Parc Cathays, Caerdydd CF10 3NQ)
Tel (Ffon): 029 20 82 3025 Fax (Ffacs): 029 20 82 5136