

A design for living

Natasha Rees analyses a case where the removal of the residence condition caused some ingenious arguments to be raised



Natasha Rees is a partner at Forsters

Under the Leasehold Reform Act (LRA) 1967, a leaseholder of a house is entitled to acquire the freehold if certain conditions are met at the date that the notice of claim is served. Since the Commonhold and Leasehold Reform Act (CLRA) 2002 came into force, a tenant no longer needs to have resided in the property for three years as a condition of acquiring the freehold, except in limited circumstances. The tenant need only have owned the property for two years. In other words, the test of residence has been replaced by a test of ownership. One consequence of this is that commercial tenants who previously could not satisfy the residence test may now qualify. Since there remains a limited residence test for business tenancies, commercial tenants will only qualify if they do not occupy the property exclusively for the purpose of their business and can establish that the property is a 'house'.

As a result of this change in the law, judges have had to consider whether a building falls within the definition of a 'house' in a range of different circumstances that would not previously have arisen. On 5 November 2009 HHJ Marshall QC gave judgment in *Hosebay Ltd v Day & anor* [2009], which concerned a building that was being used as serviced apartments. This case provides a good summary of the recent decisions in this area of the law and also highlights the problems caused by the removal of the residence condition.

Background

The case concerned three properties, numbers 29, 31 and 39 Rosary Gardens, South Kensington, situated on the Day Estate. Hosebay Ltd acquired leases of each property in 1996. At the

date of the claim each property had been converted for use as 'serviced apartments', although the judge said that they were better described as 'rooms with self-catering facilities'. The business operation (known as Aston Apartments) covered all three properties and provided short-term accommodation for tourists and visitors to London. Each of the rooms had a small kitchenette, a table and chairs, and the requisite number of beds, but no sitting area, no laundry facilities and little cupboard space. The staff comprised a general manager, various juniors who operated the reception, cleaners and laundry-women. The judge concluded that the use of the properties was tantamount to that of a 'self-catering hotel'.

Prior to the enfranchisement claim being made, the owners of Hosebay set up a company called Hindmill Ltd, which took underleases of the three properties from Hosebay. The intention was to create a situation where the headlessee company was not in occupation for the purposes of its business and, therefore, not subject to the Landlord and Tenant Act (LTA) 1954. The freeholder had originally resisted this but later granted licences to underlet where required. This in turn meant that Hosebay was able to make a claim to enfranchise the three properties under LRA 1967 without having to satisfy a residence condition.

On 23 April 2007 Hosebay served notice on the Day Estate to acquire the freeholds of each property. The Day Estate disputed the validity of the notices on two grounds. First, it denied that the relevant property in each case was a 'house' within the meaning of s2(1) LRA 1967 (the house issue). Second, it claimed that the relevant lease in each case was a lease to which Part

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II LTA 1954 applied, which in principle excludes a lease from falling under LRA 1967 (the business tenancy issue).

Relevant legislation

Under the original s1 LRA 1967, the right to enfranchise was conferred on 'the tenant of a leasehold house occupying the house as his residence' and by s1(1)(b) a qualifying tenant had to be not merely a tenant under a long lease at a low rent, but also, at the relevant time, had to have been:

... occupying it as his residence for the last five years or for periods amounting to five years in the last ten years.

The effect of these provisions was to prevent a company tenant from enfranchising because it could not occupy the property as a residence.

In 1993 the residence condition was reduced to three years and, following the introduction of CLRA 2002, the residence condition was removed (save in limited circumstances) and replaced with a two-year test of ownership. The judge in *Hosebay* said that it had apparently been thought that a two-year test of ownership would be sufficient to deter the use of the Act by investors or speculators as a business opportunity. She questioned whether this was the case, but acknowledged that there was clearly an intention not to benefit business operations because CLRA 2002 did apply a residence condition for business tenancies pursuant to a new s1(1B):

This part of this Act shall not have effect to confer any right on the tenant of a house under a tenancy to which Part 2 of the Landlord and Tenant Act 1954 applies unless, at the relevant time, the tenant has been occupying the house, or any part of it, as his only or main residence (whether or not he has been using it for other purposes):

- (a) for the last two years; or
- (b) for periods amounting to two years in the last ten years.

To qualify as a 'house' under s2(1) LRA 1967, a property must be 'designed or adapted for living in' and, if it passes that test, it must 'reasonably be called a house'.

Assessing the house issue

Before the residence condition was abolished, the definition of 'house' under LRA 1967 did not cause many problems because the tenant had to live in the building. It was therefore likely to be 'designed or adapted for living in' and the words 'reasonably so called' were treated as words of limitation. Since the removal of the residence condition, the definition under s2(1) has caused much judicial debate. The first limb of the test was considered by the House of Lords in *Boss Holdings Ltd v Grosvenor West End Properties Ltd & ors* [2008]. The second limb of the test was considered more recently by the Court of Appeal in *Prospect Estates Ltd v Grosvenor Estate Belgravia* [2009].

Arguments raised

'Designed or adapted for living in'

Counsel for *Hosebay*, Mr Radevsky, relied heavily on *Boss Holdings*. He argued that the properties were each 'designed and adapted for living in' for one of three reasons:

- they were originally designed for living in as a family home and that alone suffices;
- such adaptation work as has been done has not, as a matter of fact, been so substantial as to remove or change the admitted original 'design... for living in' because the original structural walls and feature remain; or
- such adaptation work is correctly analysed as merely having changed the buildings to a different type of living accommodation, so they continue to be designed and adapted for living in because that is the use to which they are being put.

Counsel for the freeholder, Mr Johnson QC, argued that the test was not determined by the original design purpose of the building, and that a building designed for living in can lose that quality by subsequent adaptation, despite the doubt expressed by Lord Neuberger in *Boss Holdings*. He argued that qualification for the right to enfranchise is determined on the date of the notice, a fact that was recognised in *Boss Holdings* itself. He went on to state that 'living in', in this context, connotes living in as a residence, which means with some degree of permanence. The shifting population of tourists and visitors who occupied the properties were not in his view 'living in them'.

Mr Radevsky responded by stating that the test was concerned with the physical features and attributes of the building rather than its use. He submitted that the issue was whether the design of the building was such that it was capable of being lived in.

'House, reasonably so called'

Mr Johnson submitted that following *Prospect Holdings* the test for the second limb was now clearly a test of user. The buildings, which he claimed were being used as a hotel, were being used entirely for commercial purposes.

Mr Radevsky accepted that he was bound by *Prospect Estates* but argued that it could be distinguished. He claimed that the decisive fact in *Prospect* was that office use was prescribed by the lease, so at least 90% of the building could not lawfully be used for living. In this case the lease described each building as a 'messuage or dwelling house', and the user clauses expressly authorised and indeed prescribed use as either residential flats (numbers 29 and 39) or as a single family residence

Section 2(1) of the Leasehold Reform Act 1967

'For the purposes of this part of this Act, 'house' includes any building designed or adapted for living in and reasonably so called, notwithstanding that the building is not structurally detached, or was or is not solely designed or adapted for living in, or is divided horizontally into flats or maisonettes and:

- (a) where a building is divided horizontally, the flats or other units into which it is divided are not separate houses, though the building as a whole may be; and
- (b) where a building is divided vertically the building as a whole is not a 'house' though any of the units into which it is divided may be.'

or high-class furnished accommodation (number 31).

Analysing the business tenancy issue

This concerned the status of Hosebay's lease and whether it was a business lease at the date of the claim. If it was, it would have been subject to the new residence test introduced by CLRA 2002. As a company it would not have been able to satisfy the residence test and therefore would not have been entitled to make a valid claim for the freehold. The issue depended on whether the grant of the underleases by Hosebay to Hindmill and the transfer of the business of Aston Apartments to Hindmill were effective, so that Hosebay was no longer in occupation

that presently define the state of the law on the definition of a 'house' for the purposes of LRA 1967. However, she felt that it was a point of construction that had to be judged in the context of LRA 1967 as it was originally enacted. While non-residents and investors or speculators may now be able to take advantage of rights conferred by the Act, their investment or speculation still has to be in properties which are 'residences' or 'homes'.

In relation to the first limb of the test she stated that she was not bound by *Boss* to accept that it was a simple alternative test. She preferred the conclusion that a building which was originally a 'house' might become disqualified by a sufficient change of

to the terms decided on and proposed to be implemented. There was no pretence or secrecy about them, and they were not shams. She concluded that the arrangements between Hosebay and Hindmill were potentially effective, as a matter of law, to achieve the desired decoupling of the business occupation of the property. She was also satisfied, despite the absence of payment between Hosebay and Hindmill at the date of the claim, that those arrangements had been sufficiently implemented to achieve the relevant position.

As a result, the judge declared that Hosebay was, at the time of service of its three notices under LRA 1967, entitled to acquire the relevant freeholds.

Conclusion

As a postscript to her judgment HHJ Marshall added that she had reached her conclusion with reluctance but was at least satisfied that it arose from an unusual combination of circumstances. Although the circumstances were unusual it is clear that tenants are becoming more ingenious in successfully decoupling their business use and occupation from the relevant tenancies. There are also a number of commercial headlessees who are currently considering whether to make a claim where their building is completely sublet already and where no ingenious solution would be required. Although the judge considered that the effects of *Hosebay* are likely to be confined to its peculiar facts, there are plenty of commercial tenants who will be pleased to see that steps can be taken to avoid the residence condition and that buildings in commercial use can, in certain circumstances, qualify for enfranchisement.

The freeholder has been granted leave to appeal the decision, although at the time of writing it is not yet known whether that opportunity will be taken. ■

Boss Holdings Ltd v Grosvenor West End Properties Ltd & ors [2008] UKHL 5

Hosebay Ltd v Day & anor (Unreported, Central London County Court, 5 November 2009)

Prospect Estates Ltd v Grosvenor Estate Belgravia [2009] EWCA Civ 1281

Tandon v Trustees of Spurgeon Homes [1982] AC 755

The judge felt that 'designed or adapted for living in' was concerned with the design or adaptation of the building itself, rather than with how the building was equipped or furnished.

for the purpose of its business at the date of the claim.

Counsel for the freeholder argued that the evidence showed that nothing of substance had occurred regarding the supposed transfer of the business or giving effect to the underleases at the relevant time. He claimed that in reality Hindmill was operating Hosebay's business from the properties as agent or manager. Hosebay was, therefore, in occupation for the purpose of a business being carried on by it, through its agent or manager, at the date of the notice of claim.

Counsel for the tenant stated that this was confusing the concept of 'sham' with that of an 'artificial arrangement'. In this case the transactions were intended to take effect according to their purported terms, so as to achieve the desired effect of decoupling the business occupation of the properties from Hosebay's leases. The transactions were artificial because they were entered into for an artificial purpose, but that motive did not stop them from being effective.

Judge's decision

The judge concluded that each property was a 'house' within the definition in LRA 1967. She stated that *Boss* and *Prospect* were clearly the two authorities

physical character. The question that had to be answered was whether the adaptation works caused it to be a building that was no longer 'designed or adapted for living in'. The judge felt that the definition was concerned with the design or adaptation of the building itself rather than with how the building was equipped or furnished. She concluded that despite the changes made to the fabric of each building they were either by origin, or by current adaptation, 'designed or adapted for living in'.

In relation to the second limb of the test, the judge did not accept that *Prospect* introduced a test of user. She felt that the Court of Appeal had followed *Tandon v Trustees of Spurgeon Homes* [1982] and had concluded that there were exceptional circumstances, namely a commercial user clause in the lease, which meant that it was not a house reasonably so called. As a result, she stated that there would have to be 'exceptional circumstances' for her to conclude that each property was not a 'house reasonably so called' and that in this case there were no such exceptional circumstances.

A business tenancy?

In relation to the business tenancy issue the judge was satisfied that, on the evidence, the transactions were intended to take effect exactly according