Discharge or modification of leasehold covenants

There are a number of ways of dealing with a restrictive covenant affecting land where the person subject to the covenant wishes to have it discharged or modified. It may be possible to negotiate the discharge or modification with the person who has the benefit of the covenant, or it may be possible to obtain indemnity insurance to protect against the risk of the covenant being enforced. If neither of these options is possible or indeed suitable then section 84 of the Law of Property Act 1925 allows a person with an interest in land to make an application to the Upper Tribunal (Lands Tribunal) for a restrictive covenant to be discharged or modified. Jurisdiction to authorise the modification or discharge is conferred on the Tribunal by the Tribunals Courts and Enforcement Act 2007.[1] Whilst this right under s.84 is well known in relation to freehold land, it is often overlooked in relation to leasehold land and a recent decision of the Upper Tribunal, whilst not establishing any new law, acts as a reminder of the Upper Tribunal's powers in this respect.

The right to apply to the Upper Tribunal applies to leasehold land let for a term of more than forty years of which twenty-five years or more have expired.[2] The twenty-five years must run from the actual date that the lease was granted and not from any earlier date from which it may have been expressed to run. In *Earl of Cadogan v Guinness*[3] the lease had been executed on 31st January 1888 but was expressed to commence on 25th March 1874 and to run for ninety-nine years. As the lease had been created fourteen years after the date on which it was stated to commence, it was for a term of eighty-five years, not ninety-nine years. This meant that at the time of the relevant application under s.84 the relevant number of years, which at that time was fifty years, had not expired and the application failed.[4] The requirement that twenty-five years must have expired can mean that where a qualifying lease is replaced by a new lease, for example on a lease-back in the course of collective enfranchisement, the leaseholder's accrued right to apply to the Upper Tribunal is lost for a further 25 years.[5]

The Upper Tribunal has recently considered the modification of a user covenant in a long lease in *Shaviram Normandy Ltd v Basingstoke and Deane Borough Council*[6] and confirmed that no special considerations apply to the exercise of its discretion in relation to leasehold covenants.

The case involved Normandy House an early 1980s purpose built office building of over 76,000 sq ft in the centre of Basingstoke near to the railway station. The freehold of the building is owned by Basingstoke and Deane Borough Council which on 29 March 1985 had granted a headlease to Greytown Investments Ltd for a term of 150 years. The headlease included a covenant at clause 2(15) as follows which restricted the use of the building to offices only:

" … to use the Demised Premises only as a building of the type specified in Class II in the Schedule to the Town and Country Planning (Use Classes) Order 1972 as defined in Section 2 thereof and amenities and purposes ancillary thereto."[7]

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[1] As to procedure, see the Tribunal Procedure (Upper Tribunal) (Lands Chamber) Rules 2010 (SI 2010/2600).
[2] Law of Property Act 1925 s.84(12).
[3] *Earl of Cadogan v Guinness* [1936] Ch. 515.
[4] The requirement that there be fifty years of unexpired residue was reduced to twenty five years by Landlord and Tenant Act 1954 s.52(1).
[5] See for example *Midhage v 60 Coolhurst Road Ltd* [2008] L.&T.R. 206.
[6] *Shaviram Normandy Ltd v Basingstoke and Deane Borough Council* [2019] UKUT 256 (LC).
[7] Class II of the Town and Country Planning (Use Classes) Order 1972 (SI 1972/1385) refers to office use. This is now Class B1 in Part B of the Schedule to the Town and Country Planning (Use Classes) Order 1987 (SI

The lease also reserved an annual rent equal to 15.5% of the "aggregate of the net annual rents ... actually received by the lessee".

The building was formerly part of the UK headquarters of IBM which occupied it from 1985 until 2013 under an underlease which expired on 25 December 2014. After IBM vacated the building it had been vacant and had been allowed to fall into a state of significant disrepair, accelerated by vandalism.

In May 2015 the headlease was acquired by Shaviram Normandy Ltd which wanted to convert the building into a residential apartment block with 114 residential flats, to be let on assured shorthold tenancies at open market rents. The purchase price was £5.25 million plus £1.05 million VAT.

The conversion of the building to residential use was permitted under Class O of the Town and Country Planning (General Permitted Development) (England) Order 2015[8] without the need for express planning permission. However, residential use would still be in breach of the restriction on use in the headlease. The council as head landlord refused consent to the change of use and the leaseholder applied to the Upper Tribunal to vary the restriction in the lease.

The main ground on which the leaseholder relied was s.84(1)(aa). This applies where, in the circumstances set out in s.84(1A), the continued existence of the restriction would impede some reasonable use of the land for public or private purposes. The parties agreed that the use of the building for residential purposes would be a reasonable use and that this use was impeded by the covenants in the headlease. The issue in dispute was therefore in relation to the conditions in s.84(1A). These required the Upper Tribunal to be satisfied that the restriction, in impeding the use of the building for residential use, did not secure to the council any practical benefits of substantial value or advantage to them and that money would be an adequate compensation for the loss or disadvantage, if any, which the council would suffer from the discharge.

The council argued that, where the restrictions to be modified are set out in a long lease and the objections come from the reversioner, the Upper Tribunal should be particularly cautious in exercising its discretion under s.84. The Upper Tribunal considered whether leasehold interests should be special cases.[9] It confirmed that it was clearly correct that in s.84(12) Parliament has recognised the special position of landlords and afforded them protection not available to freehold covenantees. The covenants in a lease granted for a term of 40 years or less are outside the scope of s.84 altogether, and no application may be made for the first 25 years of a term of longer than 40 years. But beyond that there are no separate conditions for leasehold covenants.

The nature of an objector's interest was always a relevant consideration in an application under s.84(1), all of which turn on their own facts and on the impact which the proposed modification or discharge will have on the enjoyment by others of their own property. While the landlord of

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1987/764 (though the Upper Tribunal in para 18 of the judgment referred to it as now being Class B1 in Part 3 of the Town and Country Planning (General Permitted Development) (Amendment) Order 2013 (SI 2013/1101)).

[8] See Schedule 2 of the Town and Country Planning (General Permitted Development) (England) Order 2015 (SI 2015/596).

[9] See paras 16 and 17, *Shaviram Normandy Ltd v Basingstoke and Deane Borough Council* [2019] UKUT 256 (LC).

an extensive estate whose reversion will come in hand in the short or medium term had obvious estate management concerns to protect, the Upper Tribunal did not see why, in principle, the interest of a landlord should necessarily be more deserving of protection than that of a neighbouring owner or other person having the benefit of a restriction. It would all depend on the facts, and on the practical consequences of the suggested change.

In particular, the Upper Tribunal felt that it would be relevant in a leasehold case to consider the length of the unexpired term, the rent receivable, the other obligations owed by the leaseholder, the extent of the landlord's interests in any neighbouring land, and how all of those matters might be affected by the modification. Those factors would all be weighed up in addressing the statutory grounds of application before any question of discretion arose. If one of the statutory grounds was established the Upper Tribunal would then acquire jurisdiction and would then have to consider whether and how to exercise it. The Upper Tribunal said that it would expect it to be an unusual case in which a landlord's preference for preserving the character of its reversion justified refusal on a discretionary basis when the considerations underpinning that preference had not been judged strong enough to defeat the claim on substantive grounds.

The Upper Tribunal allowed the application for variation. It concluded that the restriction in the lease impeded the reasonable use of the building for residential purposes and it conferred no practical benefit of substantial value on the council. In reaching its decision the Upper Tribunal took into account the development plan[10] and the pattern for the grant or refusal of planning permission in the area.

The continuation of the restriction on the use of the building as offices secured no benefit to the council in relation to the capital value of the reversion. While the restriction secured a slightly higher annual income for the council, the receipt of any rent over the lifetime of the headlease was subject to risks. These risks were reflected in the yields of 5% for residential use and 6% for offices and were fully reflected in the resulting capital values of the reversion.[11] The Upper Tribunal also decided that there were no other benefits of substantial advantage to the council in enabling it to require continued office use.

The lease also contained in clause 2(12)(b) a requirement that every subletting of part of the building be on terms, including a full market rent, approved in advance by the landlord. The leaseholder sought modification of this so that it would not have to obtain the council's consent before each residential letting of any part of the building at a full market rent without a fine or premium for a term of up to three years. The leaseholder relied on s84(1)(a) on the basis that the restriction was obsolete due to changes in the character of the building or the neighbourhood or other circumstances which the Upper Tribunal may deem material.

The Upper Tribunal did not agree and was not satisfied that a covenant, the effect of which is to require consent to the terms and rent of a proposed underletting before that underletting can proceed, but which is subject to the proviso that consent cannot be unreasonably withheld or delayed, is a restriction "as to the user" of the land in question (as it must be for the Tribunal to have jurisdiction under s.84(1)). The Upper Tribunal did not accept that the requirement was obsolete, in the sense that it no longer served the purpose for which it was intended if the building is in residential occupation. The purpose of the relevant portion of clause 2(12)(b) was

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[10] Which sets out the council's policies and proposals for the development and use of land in their area.
[11] See para 99, *Shaviram Normandy Ltd v Basingstoke and Deane Borough Council* [2019] UKUT 256 (LC).

to provide reassurance to the council that it was not prejudiced by the terms of any letting and to enable it to be satisfied that a full market rent (in which it will share) is being charged. Mutual self-interest was not considered sufficient to provide that comfort when the building was to be restricted to office use, and the wider use being permitted did not change that. It was felt that the parties would be able to agree standard terms of letting, and the council may or may not wish in practice to concern itself with the identity of individual sub-tenants, but it is likely to take an interest in the rent being charged and it was entitled to do so.

This part of the decision can be contrasted with *Re Lee's Application*[12] where an application for the discharge or modification of an absolute covenant against subletting was refused. The applicant was the leaseholder of a flat that was one of 31 flats in a 1930s block on the sea-front in Hove. The lease of the flat was originally granted for a term of 125 years from 1 January 1973, but the term was later extended to 215 years.[13] The applicant went to work in Australia but intended to resume living at the flat on his return. In the meantime he decided to let the flat on an assured shorthold tenancy. The lease contained a covenant on the part of the leaseholder not "at any time during the term hereby granted to underlet or permit the flat to be underlet". The leaseholder sought the discharge of this covenant or alternatively its modification by the addition at the end of it of the words "save with the prior consent in writing of the Lessor, such consent not to be unreasonably withheld". He relied on ground (aa) in s.84(1). The lease also contained a covenant by the leaseholder not "to use or occupy the Flat otherwise than as a private residence for the sole occupation of the Tenant and his family and in particular not to use the Flat or any part thereof for the purposes of any business defined by Section 23(2) of the Landlord and Tenant Act 1954 or any statute amending or re-enacting the same." The leaseholder sought to modify this by the substitution of "the Tenant and" with the words "either the Tenant or any lawful sublessee and that person's".[14]

The applicant conceded that the fact that letting was prohibited in a block of flats could be seen as securing a substantial advantage. His case for modifying the restriction was based on the fact that the prohibition on subletting had already been formally modified in nine other flats in the block. However, in respect of two of the flats (one of which was not at the time sublet) it was quite clear that they could be sublet; but in respect of the other seven, the restriction on subletting had been removed, though it could be argued that the user clause still required occupation by the leaseholder.

The Upper Tribunal took the view that four of these leases still precluded subletting, but three did not, though the position with regard to the latter was not wholly clear. The ability to prevent an additional flat being sublet was nevertheless a practical benefit of substantial value to the company, whether or not it was unable to prevent the subletting of up to five other flats. The application was therefore dismissed.

It should also be noted that the Upper Tribunal took the view that, even if ground (aa) had not been made out, it would be difficult for the leaseholder to make a case that it should exercise its discretion in his favour. The leaseholder had flagrantly disregarded the terms of his lease, which called into question whether he would observe the terms of any modified covenant. He had sought permission to sublet, and this had been refused; but despite this he went ahead and granted a sublease. Moreover, after the Leasehold Valuation Tribunal had determined that he

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[12] *Re Lee's Application* [2012] UKUT 125 (LC).

[13] By virtue of a deed of variation and supplemental lease made pursuant to s.56 of the Leasehold Reform, Housing and Urban Development Act 1993.

[14] Though perhaps the words to be substituted should have been "the Tenant and his".

was in breach of covenant in doing this he granted a further sublease. But, as he had not made out ground (aa), the question of how the Upper Tribunal should exercise its discretion did not arise.

Section 84 does not apply to positive covenants.[15] The Court of Appeal considered whether a covenant was positive or restrictive for the purpose of s.84 in *Blumenthal v Church Commissioners for England*.[16] The case involved the grant of a headlease of a large house in Paddington in 1951. The intention was that the leaseholder was to convert the property after the headlease had been granted and sub-let it. Consequently the headlease contained various covenants specifying that certain parts of the property had to occupied by the Royal Society of Literature[17] together with accommodation for their housekeeper. A sublease was subsequently granted to the Royal Society of Literature. When this came to an end the leaseholder obtained a variation of the covenants to allow for residential occupation of the part of the property formerly occupied by the Royal Society of Literature. This variation also allowed part of the housekeeper's accommodation in the basement to be used for residential occupation. In 2001 the leaseholder then applied to the Lands Tribunal[18] to modify the lease so that the whole of the basement could be used for residential occupation.

The landlord argued that the covenants were positive covenants, not restrictive covenants, and so could not be modified under s.84. The leaseholder argued that if the covenants were positive then it would lead to an unreasonable result in that at the end of the sublease, the leaseholder would have been in breach of covenant, which the parties could not have intended.

The Court of Appeal decided that each covenant had to be construed in the context of the particular lease. The covenants had originally been included in the headlease to make sure that a respectable tenant occupied the property. It was not right to construe the covenants as a positive obligation rendering the leaseholder liable to find himself in breach of covenant in circumstances which he had no power to prevent. If the parties had intended that result when the covenants had been created, they would have made it clear. The covenant was restrictive and therefore the Lands Tribunal had jurisdiction to deal with the application for modification.

An example of a refusal by the Upper Tribunal to modify a leasehold covenant can be found in *Phillips v Goddard*.[19] The application was made by a group of leaseholders of holiday chalets at a holiday park near Padstow in Cornwall. Each lease had been granted for 999 years and contained a restrictive covenant not to use the property for any purpose other than that of a holiday chalet and not to occupy or permit the property to be lived in or occupied between 2 January and 28 or 29 February in each year, though the leaseholder could leave furniture and other effects in their holiday chalet during that period. The leaseholders sought a modification of the covenant to remove the prohibition on use and occupation during January and February.

Planning permission had been obtained in 1974 for the holiday park. This was subject to a condition that the development should not be occupied from 2 January to 28 or 29 February in

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[15] See for example *Re Blyth Corporation's Application* (1963) 14 P.&C.R. 56 and *Westminster City Council v Duke of Westminster* [1991] 4 All E.R. 136.
[16] *Blumenthal v Church Commissioners for England* [2004] EWCA Civ 1688.
[17] Founded in 1820, the Royal Society of Literature is the UK's charity for the advancement of literature – see *https://rsliterature.org*.
[18] The functions of the Lands Tribunal were transferred to the Upper Tribunal in June 2009 by the Transfer of Tribunal Functions (Lands Tribunal and Miscellaneous Amendments) Order 2009 (SI 2009/1307).
[19] *Phillips v Goddard* [2011] UKUT 346 (LC).

each year in order to ensure that the development was not used for permanent residential accommodation. In 2006 the landlord obtained a new planning permission for the development which removed the restriction on occupation during January and February. That prompted the leaseholders to apply for modification under s.84 in reliance on grounds (a), (aa) and (c). To support their application the leaseholders relied on:

- an alleged failure to enforce the restrictive covenant;
- the removal of the planning condition;
- the fact that a new term for 12 months without the restriction had been offered;
- the grant of a lease without such a restriction;
- the fact that the leaseholders could not be excluded from the holiday park in January or February if they wished to carry out maintenance on their chalets; and
- the fact that the landlord only carried out a small amount of maintenance work on the park during those months.

The landlord's responses to these were as follows:

- the offers of new leases were conditional on a number of matters, including a minimum of a 50% take up, but they had not been greeted with enthusiasm by the leaseholders and the plan for new leases was aborted;
- the one lease that had been granted without the occupation restriction had been granted by mistake;
- additional office and administration expenses would be incurred if the chalets were occupied in January and February;
- the landlord took their holidays during that period and would be prevented from doing so if the holiday park remained open for occupation; and
- it would be very much more difficult for the landlord to carry out the essential repair and remedial work if the park was occupied in those months.

The Upper Tribunal had regard to the fact that the landlord was the owner of the reversionary interest not only in the chalets which were the subject of the application, but of others that were not. The landlord had to maintain the common parts of the holiday park and had an interest in ensuring that they were well-maintained and that the park operated so that the value of new and future chalets could be maximised. Focusing on ground (aa) the Upper Tribunal held that the covenant still conferred practical benefits of substantial value to the landlord. A two-month shutdown enabled maintenance and improvement work to be carried out more economically and conveniently and allowed savings to be made in respect of staff and other running costs. In relation to ground (a), the Upper Tribunal held that the terms of the restrictive covenant still served a purpose that was capable of achievement. Its terms were wider than those of the restriction in the original planning permission. The benefits of a winter shutdown had not changed so it was not obsolete. Opposition under ground (c) failed because, for the reasons given under the other two grounds, the landlord would be injured by the modification sought.

Finally, mention should be made of section 610 of the Housing Act 1985 which gives the court the power to authorise conversion of a house into flats. A local housing authority, or a person interested in any premises, can apply to the county court if a conversion of the premises is prohibited by the provisions of the lease of the premises, a restrictive covenant or in any other way and either:

- owing to changes in the character of the neighbourhood in which the premises are situated, they cannot readily be let as a single dwelling house but could readily be let for occupation if converted into two or more dwelling houses; or
- planning permission has been granted under Part III of the Town and Country Planning Act 1990 for the use of the premises as converted into two or more separate dwelling houses instead of as a single dwelling house.

The court can vary the terms of the lease or other instrument imposing the prohibition or restriction, subject to conditions and on terms the court thinks just.[20] In addition, the court must give any person interested in the application an opportunity of being heard.

[20] The exercise of the court's discretion was considered in *Lawntown Ltd v Camenzuli* [2007] EWCA Civ 949.