

OFT investigation into retirement home transfer fee terms

A report on the OFT's findings

February 2013

OFT1476

© **Crown copyright 2013**

You may reuse this information (not including logos) free of charge in any format or medium, under the terms of the Open Government Licence. To view this licence, visit www.nationalarchives.gov.uk/doc/open-government-licence or write to the Information Policy Team, The National Archives, Kew, London TW9 4DU, or email: psi@nationalarchives.gsi.gov.uk.

Any enquiries regarding this publication should be sent to us at: Marketing, Office of Fair Trading, Fleetbank House, 2-6 Salisbury Square, London EC4Y 8JX, or email: marketing@oft.gsi.gov.uk.

This publication is also available from our website at: www.oft.gov.uk.

CONTENTS

<i>Chapter/Annexe</i>	<i>Page</i>
1 Executive summary	4
2 Introduction	7
3 Relevant legal framework	11
4 OFT concerns about the fairness of transfer fee terms	22
5 Potential factors mitigating unfairness of transfer fee terms	37
6 Outcome of OFT investigations	44
7 Impact of OFT action on the future retirement homes market	56
8 OFT enforcement threshold	57
9 Wider policy and legislative issues	61
10 Private rights of action	66
ANNEXE 1	67

1 EXECUTIVE SUMMARY

- 1.1 In September 2009 the Office of Fair Trading (OFT) announced an investigation into the contract terms signed by owner-occupiers of purpose-built retirement homes. There are an estimated 105,000 leasehold retirement homes in the UK.
- 1.2 We considered that a number of terms relating to transfer fees - payable when a lease is assigned, sold or disposed of - may be unfair, and hence breach the Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs).
- 1.3 Transfer fee terms typically provide that a percentage of the sale price or original purchase price goes to the developer and/or managing agent when the property is sold or sub-let. The percentage charged varies between developments and the fees can amount to thousands of pounds.
- 1.4 Transfer fees should be distinguished from administration charges (which are challengeable for reasonableness in England and Wales, under the Commonhold and Leasehold Reform Act 2002 (CLRA), at the Leasehold Valuation Tribunal¹), as typically they are not paid in return for approval, provision of information or other services associated with a transfer but are simply payable in the event of an assignment or other transfer taking place.
- 1.5 In general, there are a number of features of transfer fee terms which in our view make them potentially unfair. In particular, consumers may struggle to understand the implications of the transfer fee (even when transparent) due to a lack of certainty about their future financial obligations. Transfer fees may also apply in wide-ranging and surprising

¹ The government body that determines disputes regarding matters concerning leases, service charge disputes and the management of blocks of flats

circumstances such as sub-letting, a change in occupation or surrender of the lease. Our concerns are exacerbated by the typical lack of transparency of transfer fee terms and by consumers' behavioural biases which may mean that they make poor purchasing decisions. It is also far from clear that consumers typically receive any obvious advantage in exchange for the transfer fee, or any service provided by the landlord, such that would lead them to expect that a fee is likely to become payable.

- 1.6 As a result of our investigation, a number of landlords have agreed to either cease enforcing a transfer fee, to replace it with a flat fee, or to make changes – such as only enforcing the term on final sale and not in a wide range of other circumstances - that mitigate what we consider to be the most egregious unfairness of their respective transfer fee terms. These changes should give more certainty to tenants about their liabilities, make it more economic for them to sub-let their properties, and in some cases reduce the amount that they are asked to pay. The landlords that have agreed to make changes include Fairhold Homes Limited and associated companies (Fairhold), a major player in the market, who agreed to make substantial changes to how they charge and enforce transfer fee terms in their 53,000 retirement homes leases.² We believe that the companies that were the subject of active OFT investigations are likely to cover the great majority of properties in the non-assisted retirement home market.
- 1.7 We have set out in the report a number of general principles that we would expect all landlords to abide by when enforcing transfer fee terms in existing leases; these principles represent the minimum steps we consider necessary to address the most egregious unfairness around such terms.
- 1.8 However, from an economic and policy perspective we remain of the view that the transfer fee model is not optimal for consumers. For this reason, although we have sought to improve the position for

² see www.of.gov.uk/news-and-updates/press/2012/77-12

leaseholders (tenants) in relation to existing leases, we have consistently maintained our position that we want this business model to cease being used in newly built or acquired developments. Consistent with that view, most of the landlords we have actively investigated have agreed not to include transfer fee terms in the leases of new retirement home developments, unless the transfer fee is for a service and is no more than the actual costs reasonably incurred.

- 1.9 We intend to keep the sector under review in order to monitor compliance with undertakings given to the OFT by some landlords, and will have specific regard to any new evidence or changes in the law that may arise.
- 1.10 Finally, we recommend that legislative reform be considered as a means to address the difficulties tenants have in challenging the reasonableness of transfer fees, such as for example by expanding the remit of the Leasehold Valuation Tribunal to allow the tribunal to rule on the reasonableness of such fees or by prohibiting the levying of such fees altogether.

2 INTRODUCTION

- 2.1 In September 2009 the OFT announced an investigation into the contracts signed by owner-occupiers of purpose-built non-assisted retirement homes. We considered that a number of terms relating to transfer fees - payable when a lease is sold, sub-let, surrendered or otherwise disposed of - may be unfair, and in breach of the UTCCRs.
- 2.2 The market wide investigation was launched following an initial OFT investigation into a transfer fee term used by McCarthy and Stone plc (McCarthy and Stone), a major builder of UK retirement apartments. We considered this term was likely to be in breach of the UTCCRs. The company said that it did not agree with our view but co-operated with discussions and agreed to make changes. McCarthy and Stone agreed in September 2008 to remove from future leases, and not to enforce in existing leases (whilst it remained the landlord), a term that involved charging consumers a 'transfer' fee of one per cent of the sale price when the property was subsequently sold. See the OFT press release at www.of.gov.uk/news-and-updates/press/2009/01-09
- 2.3 We continued to receive a number of representations and complaints about transfer fee terms. As a result, we decided to commence an investigation to consider whether such terms may be unfair. We considered a wide set of factors including the information provided to the consumer during the sales process, whether the businesses made the charges known to consumers, and whether consumers clearly understood the liability and took that into account in purchasing the lease.

Scope of OFT investigation

- 2.4 Our investigation focused on the fairness and clarity of contract terms providing for 'transfer fees' charged to occupants of purpose built, leasehold retirement home properties. The transfer fee, also known as a 'exit fee', 'departure fee' or 'deferred management fee', is the fee a leaseholder is required to pay to their freeholder in a broad range of circumstances such as when they sell or rent their property, dispose of it

in some other way or otherwise make changes to the occupants of the property.

- 2.5 It was not within the scope of our investigation to examine other fees payable during occupancy, such as service charges or management fees.
- 2.6 Further, our investigation did not focus on other types of fee payable by leaseholders upon assignment such as contingency fund fees.³ Some of the leases we investigated included contingency fund terms that were typically drafted in a similar form to transfer fee terms and provided for the charging of a percentage fee on assignment. However, contingency fund fees are typically paid into a ring fenced reserve fund to offset the cost of irregular and expensive works associated with the repair and maintenance of the development - as such, they involve wider and complex considerations as to the economic benefit that residents as a whole receive in reducing their annual service charge. Contributions to a reserve or 'sinking' fund may be classed as service charges, which tenants have the right to challenge at the Leasehold Valuation Tribunal⁴ if they feel such charges are unreasonable, however we express no opinion as to whether or not contingency fund fees that we have seen would fall into this definition. The fact that we did not focus on contingency fund fees should not be taken as an indication that the OFT considers the terms providing for these fees to be fair, and indeed in many cases the wording of the contingency fund fee term mirrors that used in respect of transfer fees. We also make a number of recommendations which also apply to contingency fund fees.

³ With the exception of a Fairhold lease term that gives the landlord the discretion to waive a contingency fund fee of one per cent of the open market value payable upon each sub-letting, in consideration for the tenant paying a sum equivalent to one month's rent (or the open market rent that would be paid for a one-month period, if greater) for each sub-let.

⁴ Under the Landlord and Tenant Act 1985.

Types of transfer fee term

- 2.7 Transfer fee terms are included in the lease drawn up by the developer of the property. The same terms apply throughout the whole length of the lease (often 99 to 150 years) during which time the landlords and tenants are likely to change many times. The precise effect of the transfer fee term will depend on how it is worded in the lease.
- 2.8 We reviewed a wide variety of leases containing transfer fee terms. There were differences in the drafting of these leases, and they also exhibited variations in the extent to which they could be construed as including provision for the payment of administration fees (within the meaning of the CLRA). Examples of transfer fee terms can be found at **Annexe 1**.
- 2.9 Under the terms of a typical transfer fee, a percentage of the sale price or open market value goes to the landlord when the property is sold, sublet or disposed of in some other way. Based on the leases we reviewed, the percentage fee can vary between 0.25 per cent and 12.5 per cent of the sale price or open market value of the property.
- 2.10 In most instances, the transfer fee is not linked to the provision of any service, but rather is simply an inexorable consequence of the assignment of the lease, that is it is simply triggered by the assignment. In other cases, the transfer fee is said to be a substitute for the payment of a ground rent.
- 2.11 In addition, there is a further business model known as a 'retirement village' model, in which transfer fees of generally a higher percentage are charged at the end of each occupation on the basis that the fee recovers part of the costs of providing extensive onsite communal services and extra care and support services – this is referred to as a 'use now, pay later' type model where deferred fees are recovered at the end of the occupation. The retirement village model has not been the primary focus of the OFT's investigation, but in our view the general principles set out at Chapter 8 may equally to apply to this type of model.

2.12 Whilst transfer fees are common in standard leases for retirement home properties, they are not found in other forms of long lease residential properties.

Size of market

2.13 The Association of Retirement Housing Managers (ARHM) estimates there to be some 105,000 leasehold retirement homes in the UK (that is, homes to purchase rather than rent). Those who build and manage retirement developments might have just one or two in their portfolio, while others are large national companies with many developments. Most of the homes are flats, but some are houses.

2.14 Most developments have a communal lounge area/garden for residents, and some also provide organised activities. Larger developments might also include other facilities such as a restaurant, bar, sport/leisure facilities or a hairdresser. Whilst communal facilities are provided, more specific assistance such as nursing or domestic assistance is not, and the properties are accordingly intended for residents who are able to continue to live independently. The minimum age for purchase is generally 55.

Geographic spread of retirement home properties containing transfer fee lease terms

2.15 Although our investigation was UK-wide, virtually all of the retirement home properties we identified whose leases contained transfer fee terms were located in England and Wales.

3 RELEVANT LEGAL FRAMEWORK

A. Unfair Terms in Consumer Contracts Regulations 1999 (UTCCRs)

Overview

- 3.1 The UTCCRs implement the EU Directive on unfair terms in consumer contracts. They came into force in the UK on 1 July 1995 and were re-enacted in 1999 (coming into force on 1 October 1999).
- 3.2 The UTCCRs protect consumers against terms in contracts they make with traders. Under Regulation 3(1) a consumer is 'any natural person who, in contracts covered by the UTCCRs, is acting for purposes which are outside his trade business or profession'. In contrast a seller or supplier is any natural or legal person who, in contracts covered by the UTCCRs, is acting for purposes relating to his trade, business or profession, whether publically or privately owned.
- 3.3 In our view, in general terms the UTCCRs are capable of applying to leases in the same way as to other contracts. In particular, they apply not only when leases are made between the freeholder and the original leaseholder but also when the lease is assigned, if the assignee is a 'consumer' for the purposes of the UTCCRs. How this affects transfer fee clauses in leases originally drafted before 1 July 1995 is a technical legal questions which can only be finally settled by a judgment of the court. However, our view is that the date of the original lease agreement cannot on its own make such terms immune from challenge for as long as the lease remains in force, which may be a matter of decades or even centuries.

Regulation 5

- 3.4 A standard term is unfair 'if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations under the contract, to the detriment of the consumer'. A standard contract term is one that has **not** been individually negotiated with the consumer.

- 3.5 The requirement of significant imbalance is met if a term is so weighted in favour of the supplier as to tilt the parties' rights and obligations under the contract significantly in his favour. This may be by granting to the supplier of a beneficial option or discretion or power, or by the imposing on the consumer of a disadvantageous burden or risk or duty. This assessment involves looking at the contract as a whole (Director General of Fair Trading v First National Bank Plc [2001] UKHL 52).
- 3.6 The requirement of good faith embodies a general principle of 'fair and open dealing'. Openness requires that the terms should be expressed fully, clearly and legibly and that terms that might disadvantage the consumer should be given appropriate prominence. However, transparency is not enough on its own, as good faith relates to the substance of the terms as well as the way they are expressed and used. Fair dealing requires that a supplier should not, whether deliberately or unconsciously, take advantage of the consumer's necessity, lack of experience, unfamiliarity with the subject matter of the contract, or weak bargaining position in deciding what their rights and obligations shall be. Good faith in this context is not an artificial or technical concept. It looks to good standards of commercial morality and practice (Director General of Fair Trading v First National Bank Plc [2001] UKHL 52).
- 3.7 When assessing the fairness of a term we consider how a term could be used. A term is open to challenge if it is drafted so widely that it could cause consumer detriment. It may be considered unfair if it could have an unfair effect, even if it is not at present being used unfairly in practice.

Regulation 7 – Plain and Intelligible

- 3.8 Regulation 7 imposes an obligation upon the trader to ensure that any term (including a transfer fee term) is expressed in 'plain and intelligible language'. In practice, this requires consideration as to whether the terms used 'are sufficiently clear to enable the typical consumer to have a proper understanding of them for sensible and practical purposes'. This involves an assessment as to whether 'the typical customer can

understand how the term affects the rights and obligations that he and [the trader] have under the contract' (See *OFT v Foxtons Ltd* [2009] EWHC 1681 and *Office of Fair Trading v Abbey National PLC and others* [2008] EWHC 875). This needs to be seen alongside other legal requirements whose effect is to require businesses as far as possible to put consumers into a position where they can make an informed choice, for instance the Consumer Protection from Unfair Trading Regulations 2008.

- 3.9 Further, for a term to be in plain intelligible language, the obligations it covers must not be in any way concealed, or employ language only understandable to lawyers. A term is likely to fall foul of this requirement if 'the impression given to a lawyer, after due consideration of the matter, is that the obligation has become somewhat buried...The point is that the obligation is one which requires some legal mining to bring it to the surface, and the typical consumer is not a miner for these purposes' (See *OFT v Foxtons Ltd* [2009] EWHC).

Regulation 6

- 3.10 Regulation 6(1) requires that the fairness of terms be assessed taking into account the nature of the goods or services for which the contract was concluded and by referring, at the time of conclusion of the contract, to all the circumstances attending the conclusion of the contract and to all the other terms of the contract. Lord Bingham observed in *Director General of Fair Trading v First National Bank Plc* ([2001] UKHL 52) that this involves considering the position of typical parties when the contract is made.

Potential exclusions from Regulation 5 UTCCRs: The Regulation 6(2) exclusions relating to price and subject matter

- 3.11 The assessment of the fairness of a term may not relate to the definition of the main subject matter of the contract or the adequacy of the price or remuneration as against the goods or services supplied in exchange. However the term must be in plain, intelligible language, and in any event other aspects of the term's fairness than whether it is good value

for money may be tackled (such as its prominence, any procedural requirements built into it, and the way it operates in relation to other terms of the contract).

- 3.12 If such terms are not expressed in plain and intelligible language, it is still open to an enforcer to consider all aspects of the fairness of the term, including the amount of any fee and whether or not it is excessive.
- 3.13 In considering the scope of this exemption, the Supreme Court in *Office of Fair Trading v Abbey National plc*,⁵ decided that this is an objective assessment, and not determined by whether charges may apply in contingent or special circumstances, or what the perceptions of the typical consumer might be of the contract they have entered into. Lord Phillips stated 'if it is possible to identify such price or remuneration as being paid in exchange for services, even if the services are fringe or optional extras, Regulation 6(2) will preclude an attack on the price or remuneration in question based on the contention that it was excessive by comparison with the services for which it was exchanged.'⁶

Adequacy of the price or remuneration as against the goods or services supplied in exchange

- 3.14 A number of landlords have argued that transfer fee terms constitute part of the price of the contract, and as such, are only challengeable for fairness to the extent that they are not in plain and intelligible language.
- 3.15 In relation to this point, some landlords have argued that at least some administrative services are provided at the point of transfer, including verifying the contractual suitability of the incoming occupant, and that the transfer fee is therefore, at least in part, the price for the provision of those administrative services. We do not in general accept that transfer fees are paid in exchange for services, but if such services are supplied then we consider that the CLRA is likely to apply, meaning that the

⁵ [2009] UKSC 6

⁶ *Ibid*, paragraph 78

amount the landlord may charge for those services must be no more than is reasonable.

- 3.16 It would be for the court to decide whether any particular transfer fee is to be considered to be part of the price as a matter of law, having regard to the facts of the case and the arguments put to it (which might include the deferred consideration arguments referred to at paragraphs 5.15 – 5.21). But we are sceptical that the transfer fee terms we have seen could properly be described as relating to the price for any goods or services supplied in exchange. That is bearing in mind, in particular, that they are so widely drafted in relation to the circumstances in which the fee falls due and so unpredictable in relation to the number of times the fee could become payable.

Main subject matter

- 3.17 It has also been suggested by some landlords that the transfer fee terms constitute part of the main subject matter of the contract, for example on the basis that when purchasing a lease a tenant is paying for a package of services, including the right to occupy the property and the right to assign or sub-let the property, together with other services to be provided by the landlord.
- 3.18 In our view the main subject matter of the contract is the provision of a leasehold interest in the land. The transfer fee terms do not in any way operate to provide to or confer on the consumer the leasehold interest (the main subject matter). On the contrary, the transfer fee terms operate to restrict the right a tenant would otherwise have to assign their interest in the property. Further, any services provided by the landlord which may be covered by the transfer fee are, in our view, so peripheral in nature that they cannot be properly described as constituting the 'main subject matter of the contract'.

OFT's duty to consider complaints

- 3.19 The OFT has a duty under the UTCCRs to consider complaints about the unfairness of a contract term. However, this does not automatically

mean that formal enforcement action will be taken in respect of each and every case where we believe that there is an infringement. We are required to exercise our regulatory functions in a way that is proportionate and targeted only at cases in which action is needed.⁷ We also have to act consistently with our published enforcement priorities and our available resources. In order to inform our decisions as to which cases to take forward, we apply prioritisation principles (see www.offt.gov.uk/shared_offt/about_offt/oft953.pdf) and have regard to our Statement of Enforcement Principles www.offt.gov.uk/shared_offt/reports/consumer_protection/OFT1221

OFT's powers under the UTCCRs

- 3.20 The OFT, together with certain other bodies, can take enforcement action to prevent the continued use by a trader of unfair terms.
- 3.21 The OFT has powers to take action on behalf of consumers in general by asking a court for an injunction (or an interdict in Scotland) against any person appearing to be using, or recommending use of, an unfair term. The court may grant an injunction on such terms as it thinks fit. An injunction may relate not only to use of a particular contract term but to any similar term, or a term having like effect, used or recommended for use by any person. A term found by a court to be unfair is not binding on consumers.
- 3.22 In addition, Part 8 of the Enterprise Act 2002 gives the OFT and certain other bodies (enforcers) separate powers against traders who breach consumer legislation. Under Part 8, the OFT and other enforcers can seek enforcement orders against businesses that breach UK laws giving effect to specified EC Directives – including the Unfair Contract Terms Directive – where there is a threat of harm to the collective interests of consumers.

⁷ Legislative and Regulatory Reform Act s.21.

3.23 In deciding whether or not to apply for an injunction (or enforcement order) we will have regard to whether it is proportionate and appropriate to do so in the light of all of the facts before us (in accordance with principles of good enforcement). This means taking account of a number of factors, including:

- whether satisfactory undertakings have been voluntarily offered by the landlord that address our concerns (we may accept suitable undertakings in lieu of court action)
- the legal risks associated with court action
- current OFT priorities.

3.24 The OFT itself has no powers to make a 'ruling' that a term is unfair or whether any individual consumer is entitled to compensation. Our view is not binding on the courts, or upon other enforcers, nor does it fetter our freedom to take further enforcement in the interests of consumers. It therefore remains open to us to take further action, for example, if voluntary undertakings in practice do not effectively address the consumer detriment arising from the use of a contract term.⁸

3.25 The focus of OFT investigations is on the **use** of unfair terms, both in relation to the inclusion of terms in future contracts and the enforcement of terms in existing contracts. We do not always take steps formally to remove terms in contracts, since undertakings requiring changes to enforcement of the terms are often sufficient to deal with any unfairness. The effect of a finding of unfairness is not, in any case, that the term ceases to exist, but that it does not bind the consumer. We would always have regard, in deciding what action to take in relation to a contract term, of the potential impact that a finding of unfairness and thus of unenforceability might have on the contractual rights of individual consumers under existing contracts.

⁸ The OFT may also consider issuing court proceedings where satisfactory undertakings cannot be agreed, or where undertakings are breached.

3.26 The UTCCRs also allow consumers to bring their own legal challenge, independent of any action by the OFT. A consumer may argue in a dispute with a landlord that the terms of the lease are unfair and ask a court to make a decision on the matter. This right can be enforced regardless of any view the OFT has given on the same or similar terms, or indeed, any action we have taken, particularly as individual consumers' circumstances could be distinguished from the position of consumers in general. See Chapter 10 in relation to private rights of action.

B. Property Law

3.27 A brief overview of relevant property law in England and Wales, and Scotland is set out below. However, the focus of this report is very much on relevant leasehold property law in England and Wales given virtually all of the retirement properties we identified with transfer fee lease terms were located there.

England and Wales

Commonhold and Leasehold Reform Act 2002 (CLRA)

3.28 The CLRA introduced rights in respect of administration charges. Schedule 11 to the CLRA sets out that an 'administration charge' demanded by the landlord must be reasonable and is only payable to the extent that it is reasonable.

3.29 An 'administration charge' is defined as an amount payable by a tenant as part of or in addition to the rent which, amongst other things, is payable, directly or indirectly (a) for or in connection with, the grant of approvals under the lease, or applications for such approval, (b) for or in connection with the provision of information or documents by or on behalf of the landlord. Further, a 'variable administration charge' (an administration charge payable by a tenant which is neither (a) specified in the lease, nor (b) calculated according to a formula specified in the lease) is payable only to the extent that the amount of the charge is reasonable.

- 3.30 The legislation gives the Leasehold Valuation Tribunal the power to determine whether an administration charge is payable. If an administration charge is variable (as defined), it may be determined to be unreasonable, but if it is not variable, any party to the lease may apply to the Leasehold Valuation Tribunal for an order varying the lease on the grounds that: (a) any administration charge specified in the lease is unreasonable, or (b) any formula specified in the lease in accordance with which any administration charge is calculated is unreasonable.⁹

The Landlord and Tenant Act 1927 (LTA)

- 3.31 Where the lease contains a covenant, condition or agreement providing that the tenant may not assign or sublet without the landlord's licence or consent, under section 19(1) of the LTA the consent cannot be unreasonably withheld and only reasonable costs incurred by the landlord (in respect of any legal or other expenses incurred in connection with such consent) are recoverable. A dispute as to the reasonableness of any such costs may be heard before a County Court and the landlord shall be bound to grant the licence or consent on payment of the sum determined to be reasonable.

Scotland

- 3.32 We understand that, in general, long residential leases are rare in Scotland. Since 1974 new residential leases have been restricted to 20 years by virtue of the Land Tenure Reform (Scotland) Act 1974. Further, the Long Leases (Scotland) Act 2012 converted (with some exceptions) most remaining ultra-long leases (over 175 years long) to ownership.
- 3.33 The Land Tenure Reform (Scotland) Act 1974 also rendered 'casualty' provisions (a provision in a lease which imposes a requirement for payment of a lump sum additional to the rent to the landlord, on the occurrence of specified events or at specified times) in leases executed

⁹ If the Leasehold Valuation Tribunal is satisfied, it may make an order to vary the terms of the lease, to substitute a reasonable amount or to amend the formula.

on or after 1 September 1974 unlawful, but landlords remained entitled to enforce 'casualties' in leases executed before that date. The Leasehold Casualties (Scotland) Act 2001 provided for extinction of many, but not all, casualties which survived the 1974 reform.

- 3.34 For the owners of sheltered and retirement housing, the Title Conditions (Scotland) Act 2003 also provides a system of majority rule for altering 'real burdens' in the title deeds, unless those title deeds already provide a different way for decisions to be taken.¹⁰ A 'real burden' is a condition which applies to a property. It restricts the owner's use of the property or it obliges him or her to do something (for instance to maintain the building, or contribute to the cost of a common facility). Real burdens are either set out in the title deeds of each property or are set out in a Deed of Conditions which applies to each property. In most cases the deeds provide that these real burdens can be enforced by the developer or manager of the complex. The general effect of abolition of the feudal system and of the 2003 Act was to remove control from the developer or management company and to give it to the owners who will be able to enforce or vary the real burdens which govern the complex.
- 3.35 Whether and how the 2003 Act might apply to transfer fee terms would depend on how any such charge was imposed.

C. Consumer Protection from Unfair Trading Regulations 2008 (CPRs)

- 3.36 The CPRs prohibit unfair commercial practices which distort consumers' transactional decisions. They place a general duty on traders not to trade unfairly when dealing with consumers. They set out broad rules for determining when commercial practices are unfair, including misleading actions such as false or deceptive advertising or misleading omissions

¹⁰ The Scottish Executive has published guidance on the effect of the Title Conditions (Scotland) Act 2003 on retirement housing: www.scotland.gov.uk/Topics/Justice/law/17975/tcsrhousing

(omitting important or essential information). The CPRs also contain a list of 31 specified banned practices or prohibitions and prohibitions on aggressive practices.

3.37 Both the OFT and local authority Trading Standards Services (TSS) may take civil enforcement action in respect of any breach of the CPRs as Community Infringements (breaches of EU-derived legislation) under Part 8 of the Enterprise Act 2002. Breaches of certain provisions of the CPRs are also criminal offences.

3.38 The OFT published guidance in September 2012 to help businesses involved in property sales - including property developers and agents who supply marketing or other services related to the sale of property or land - understand their responsibilities under the CPRs – see www.offt.gov.uk/OFTwork/estate-agents/guidance-overview

4 OFT CONCERNS ABOUT THE FAIRNESS OF TRANSFER FEE TERMS

- 4.1 In our view there are a number of typical features of transfer fee terms which make them potentially unfair.
- 4.2 In particular, we consider that transfer fee terms are onerous given that typically they apply in wide ranging and surprising circumstances and there is no obvious advantage that the tenant receives in exchange for the fee, or any service that the landlord provides. The method of calculating the fee often gives a fairly high degree of discretion to the landlord or their surveyor, and the valuation may be difficult for the consumer to challenge (in particular given the time pressure that may exist in relation to sale of a property). Such fees are not used in non-retirement home properties, and create a liability that is difficult for consumers to quantify, given that it is a percentage of a future unknown value. The terms providing for these fees are often in a schedule to the lease, are drafted in language that consumers may find hard to understand, and their full effects were not flagged in pre-sale material. These fees therefore have the potential to operate as a trap for consumers, who may enter into the lease transaction without realising their full liability. Even where the consumer is aware of the existence of the transfer fee, we are concerned that behavioural characteristics of consumers may mean that they do not take account of the full cost in calculating the price they are willing to pay to purchase the retirement home property. The larger the transfer fee payable, the greater the risk of consumer detriment in circumstances where there is no obvious benefit that the tenant receives in exchange for the fee.
- 4.3 We set out more fully below our main concerns about transfer fee terms.

Application of the fee to wide-ranging and surprising circumstances

- 4.4 The transfer fee may be payable not only on assignment upon sale, but in a surprisingly wide variety of other circumstances such as sub-letting, surrender of the lease, a change in occupation (for example, when a relative or carer moves in with the tenant) or upon inheritance. This

exposes the tenant to a wide range of unexpected liabilities and uncertainty as to when the transfer fee will be payable.

- 4.5 For example, even assuming a tenant is aware of the transfer fee term, they could not be expected to know on signing the lease whether it will be necessary to sub-let the property in the future and if so how many times. At the time the consumer agrees to the term it is therefore uncertain when the transfer fee will be triggered. Sub-letting can potentially multiply the transfer fee several times over and prospective tenants are unlikely to be able to assess with any certainty how often they may need to sub-let the property. Similar concerns apply in relation to the sharing of occupation such as, for example, getting married or a relative moving in.

Lack of certainty as to future financial obligations

- 4.6 The transfer fee is typically calculated as a percentage of the sale price or open market value. At the point of purchase the amount the consumer will be liable to pay under the transfer fee term is therefore unknown because:

- it is calculated as a percentage of a value which is unknown at the point of purchase and which may end up being determined by a surveyor, and
- consumers may become liable for the fee multiple times if, for example, they choose to sub-let.

- 4.7 This means that it is impossible for the consumer to understand or plan for what their future liabilities may be. In order to estimate the total transfer fee liability at the point of purchase the prospective purchaser will need to make a number of complex assumptions about:

- how long they will live in the property
- how much house prices will have increased in this time period

- whether due to illness, a downturn in the market (making it difficult to sell the property), or other reason they will need to sub-let the property, and if so, how many times they will need to sub-let it.

4.8 The future transfer fee liability is therefore highly uncertain and difficult to predict. An economic experiment conducted as part of the OFT's *Consumer Markets Contracts Study* (OFT1312, February 2011)¹¹ found that when asked to choose between two alternative deals with a combination of pay offs and fees, consumers were less likely to make the most favourable choice when the fees were probabilistic (that is, the fees were not payable with certainty, and the consumer did not have any control over whether they were incurred). This suggests that consumers are more prone to errors when assessing the value they are getting from the purchase of a retirement home property where a transfer fee is payable.

4.9 Transfer fees have been compared by some landlords to financial arrangements such as Shared Appreciation Mortgages (SAMs), where a lender agrees as part of a loan to accept (some) payment in the form of a share of the increase in value of the property. We do not accept that this is a valid comparison. First, SAMs are entered into with much greater transparency than transfer fees about the future liability. Unlike SAMs, transfer fees are not presented as credit arrangements, with all the mandatory rules of contractual and pre-contractual disclosure required when entering a credit agreement, together with the additional expectations of licensed credit operators; also unlike SAMs, a transfer fee is not presented as a sharing of the value of the property. Consumers understand themselves to own 100 per cent of the retirement home, rather than a lesser percentage. Further, transfer fees are not in fact credit, and individual purchasers cannot accept or reject it based on financial advice. Second, the repayment under a SAM occurs only once – on sale – whereas transfer fees may be payable in a wide range of other circumstances including upon sub-letting or a change in

¹¹ See www.of.gov.uk/shared_of/market-studies/consumercontracts/oft1312f.pdf

occupation. As such, the cost to the consumer of a SAM is far more certain relative to the potential costs of a transfer fee. Third, we have seen no evidence that the consumer typically receives any tangible benefit for the transfer fee whereas a central feature of SAMs is that the purchase cost is reduced as a trade off for giving up part of the future value of the property.

Excessive scope for landlords to determine the transfer fee

Calculation of the transfer fee as a percentage of open market value

- 4.10 Leases often provide that the transfer fee payable upon sale may be assessed as a percentage of the higher of the sale price or 'open market value' of the property. In such circumstances, the lease may provide that the open market value is to be assessed solely by the landlord.
- 4.11 We consider it unfair that the landlord is able to decide the basis on which the transfer fee is calculated. First, there is no control over how the landlord's surveyor will arrive at the 'open market value'. Second, assessing the 'open market value' is not an exact science and depends on finding comparable properties – there is considerable scope for differences of professional opinion as to what the accurate open market value is. Third, the tenant may have no means of challenging the 'open market value' arrived at by the landlord.
- 4.12 In certain circumstances the lease term may provide that it is open to the consumer to challenge the open market valuation arrived at by the landlord. However, in practice, this is likely to be difficult because employing a surveyor to do so is likely to be expensive, and likely to far outweigh the resulting difference in transfer fee sum to be paid.
- 4.13 It has been argued by some landlords that the inclusion of a reference to open market value is intended as an 'anti-avoidance' measure in circumstances where a sale is not conducted at arm's length and there is a deliberate under-value by the tenant for the purpose of reducing the transfer fee payable. We consider that instances in which an owner of a retirement home property would deliberately seek to undervalue a sale to

avoid payment of the full transfer fee due on assignment are likely to be very rare indeed.

Level of transfer fee is determined at the sole discretion of the landlord

- 4.14 The basis on which the transfer fee will be calculated is not always stated in the lease, allowing the level of the fee to be determined entirely at the discretion of the landlord. For example, a lease may state that the transfer fee shall be determined by the landlord and shall not exceed, or shall be up to, a percentage of the sale price or open market value, but give no guidance or other indication as to how the landlord will arrive at the figure they set. It is reasonable for the tenant to construe such a term as requiring some sort of assessment by the landlord as to the level of the transfer fee chargeable, and that there will be some objective basis for the level of the fee charged.
- 4.15 In our experience, in such circumstances the transfer fee is invariably charged, by default, at the maximum percentage fee allowed for in the lease.

Lack of transparency around the transfer fee term

- 4.16 Regulation 7 of the UTCCRs imposes an obligation upon the trader to ensure that any term is expressed in plain and intelligible language. The issue of whether a particular transfer fee term is expressed in plain and intelligible language necessarily falls to be considered on a case by case basis. However, in general, we do not consider that the transfer fee terms we have reviewed are set out in plain and intelligible language having regard to their positioning within the lease, the language used and the way in which they are presented and described in pre-sale documentation. Not only must the actual wording of the term be comprehensible to consumers, but they must also be able to understand how the term affects their and the landlord's respective rights and obligations. To be transparent, transfer fee terms should be sufficiently clear to enable the typical consumer to have a proper understanding of them and to be in a position where they can make an informed choice.

'Burying' of the Transfer Fee Term

- 4.17 In our view, the transfer fee obligation is typically not presented in a prominent place in the lease in order to draw attention to what is an onerous and unusual term. Further, the term is often not located alongside the other financial obligations (such as rent, service charge, or initial 'consideration'¹²) but is routinely contained in one of many schedules, usually un-indexed, and consequently less likely to be noticed. For a term to be in plain intelligible language, the obligations it covers must not be in any way concealed. A term is likely to fall foul of this requirement if 'the impression given to a lawyer, after due consideration of the matter, is that the obligation has become somewhat buried...The point is that the obligation is one which requires some legal mining to bring it to the surface, and the typical consumer is not a miner for these purposes' (See *OFT v Foxtons Ltd* [2009] EWHC).
- 4.18 Transfer fees are also unusual as they are not common in other forms of residential leases. It is therefore unlikely that consumers will be expecting to find, nor be alert to finding, such terms.
- 4.19 In summary, generally speaking the liability to pay a transfer fee is set out in a schedule to the lease, without flagging that it is an important financial obligation. We also have concerns about the language used and prominence given in surrounding pre-sale material.

Language

- 4.20 The language used in transfer fee terms is often not language to which the typical consumer would be accustomed and as such is language which they might easily misunderstand. In particular, the syntax and structure of the transfer fee terms is extremely difficult for a typical consumer to understand.

¹² Consideration is the concept of legal value in connection with contracts. It is anything of value promised to another when making a contract. It can take the form of money, physical objects, services, promised actions, abstinence from a future action etc.

- 4.21 Further, the scope of the wording used in transfer fee terms is often vague and undefined as to the breadth of circumstances covered, potentially exposing the consumer to a wide range of unexpected liabilities.
- 4.22 In particular, some transfer fees are drafted in a way that suggests the fee is in respect of costs and expenses actually incurred by the landlord, or may be lower than a specified percentage cap. It is unclear therefore how the term is actually to be construed and what obligations the consumer actually has.
- 4.23 In some cases the language is so complicated that we believe it is, in any case, difficult for the typical lawyer properly to understand.

Surrounding pre-sale documentation

- 4.24 Whilst the additional information received by consumers - for example, through the Purchaser Information Pack – varies in the clarity of the description of the transfer fee, in our view none of the examples of pre-sale documentation we reviewed clearly and prominently set out how the transfer fee was to be calculated and the full circumstances under which the tenant would be liable to pay the fee. As such, the description of the transfer fee term did not clearly convey the extent of the obligations to be imposed upon the tenant. Hiding or failing to provide material information to consumers about the nature of the transfer fee may potentially constitute a misleading omission under the CPRs.
- 4.25 Further, some of the pre-sale material we reviewed in our view gave a misleading impression that the transfer fee was in fact payable as an 'administration' fee in respect only of costs incurred by the landlord in connection with the provision of services, when this was not the case. This may also potentially constitute a misleading action contrary to the CPRs, in giving a misleading impression as to the purpose of the transfer fee and further, that the fee is reflective of the landlord's actual costs and as such its reasonableness is challengeable at the Leasehold Valuation Tribunal.

4.26 The lack of transparency surrounding transfer fee terms is likely, in our view, to reduce the extent to which consumers take such fees into account when deciding whether to purchase a retirement home property. This is further exacerbated by the inherent behavioural biases of consumers.¹³

Lack of avenues of challenge to the transfer fee

4.27 By and large tenants do not appear to have a channel of mediation or arbitration over the level of the transfer fee when it falls due because it is not generally characterised as a fee charged in respect of the cost of administrative services associated with the transfer of the lease, and as such appears to fall outside the scope of the CLRA.

4.28 Although it will depend on precisely how the term is drafted, transfer fees appear typically **not** to be an administration charge or a fee for the giving of consent challengeable in England and Wales at the Leasehold Valuation Tribunal¹⁴ as they are not paid in return for approval, provision of information or other services associated with a transfer but are simply payable under the term of the lease (see further Chapter 9).

4.29 The only other method open to the consumer to challenge the transfer fee is to argue that the term is unfair, but this is practically difficult. Further, there are time constraints as leases generally require the transfer fee to be paid within a fixed number of days after the completion of the assignment (some of the examples of transfer fee terms refer to seven days), failing which in some instances the incoming purchaser may become liable to pay it.

4.30 It is therefore likely that the outgoing tenant will pay the transfer fee, irrespective of their views of its fairness, because they will wish to complete the assignment of the lease.

¹³ See paragraphs 4.31 – 4.46 below for an explanation of these behavioural biases.

¹⁴ Under the CLRA and LTA.

Consumers' behavioural biases

- 4.31 There are a number of aspects to consumer behaviour which mean that they are unlikely to be able to judge well the implications of transfer fee terms and their attitudes towards transfer fees may change over time. This means that it is difficult for consumers to assess accurately the costs and benefits of transfer fees. The difficulties that consumers are likely to face are supported by the insights of behavioural economics and supporting empirical work. In particular, consumers have limits on their ability to take in and process information, and can make errors in how they use it. There are also systematic 'biases' that often affect how consumers behave.
- 4.32 There are three related aspects of consumer behaviour which are particularly relevant to the purchase of a retirement home property:
- anchoring and adjustment (focusing too much on the headline price alone)
 - short-sightedness
 - difficulty in forecasting uncertain future events and preferences.

Anchoring and Adjustment

- 4.33 When making a calculation or assessment of an offer, consumers tend to focus on one key known element (the 'anchor'), for example the upfront purchase price, and then fail to fully adjust their assessment of the total offer as additional costs are revealed.
- 4.34 Experimental evidence has shown that, when prices are partitioned into parts in this way, consumers tend to shop around less, are more likely to make the purchase, and tend to pay more overall.¹⁵

¹⁵ This evidence is reported at Annexes F and G of the OFT market study report, *Advertising of Prices*, October 2009.

- 4.35 In the context of retirement home properties, consumers are likely to anchor to the initial upfront purchase price of the property. Even though other costs may subsequently be revealed – such as service charges, contingency fees, and transfer fees – they continue to anchor to the headline purchase price and insufficiently adjust their mental calculation of the total value of the offer. This can increase a consumer's valuation of the 'deal' they are getting, reducing their incentive to compare properties and increasing their intention to purchase.
- 4.36 Moreover, consumers are only likely to receive legal advice - which should highlight the transfer fee term - late in the buying process and crucially after making a financial commitment to purchase the property. At this point, they are likely to be committed to the purchase,¹⁶ and less likely to take account of the transfer fee than they would have been at a much earlier stage in the sales process.
- 4.37 This behaviour is important at the earlier stage when the consumer is comparing the price of a particular retirement home property with either an alternative retirement home or some other residential accommodation option. Anchoring means that the consumer is unlikely to take sufficient account of the transfer fee, and, as a result, may not choose the best value option available. They may also end up paying more overall than they would have been willing to pay if they had taken the transfer fee fully into account.

Short sightedness

- 4.38 Even when consumers find out early on about all the fees they are liable to pay, they still give more attention to upfront costs and benefits than future costs and benefits.
- 4.39 This is likely to be particularly true of purchasers of retirement home properties. Purchasers of such properties have to be at least 55 years

¹⁶ This may be because of the search costs that would now be involved in looking elsewhere, because they have sunk costs into the process so far, and because they have become more personally committed to the property as the sale progresses.

old in most cases, but are often considerably older. Older people may have higher 'discount rates' which means that they particularly value money 'saved' today relative to a fee paid in the future. Purchasers focus on the benefits to them now of purchasing a retirement home property – being able to continue to live independently, security, and being close to family – and do not focus on the costs they (or their families) will incur at a later date, such as the transfer fee, even where they are aware of them.

- 4.40 This effect is likely to be exacerbated where the purchaser expects to remain living in the property until death, and not to need to move out into a care home due to declining health. As such, most prospective purchasers who know about the transfer fee may nevertheless expect that they will not have to pay the transfer fee and that, instead, it will come out of their estate after their death. This may further limit the extent to which they are likely to take the fee into account at the time of purchase. In particular, if they think they are getting some saving or benefit now, they may be willing to see a much higher sum taken from their estate after their death.
- 4.41 Heavy discounting of future payments and a strong focus on current benefits may be a rational preference. However, the potential for this preference to be exploited is high, for several reasons.
- 4.42 Firstly, consumers tend to make more mistakes in assessing deals when they involve delayed fees. An economic experiment conducted as part of the OFT's *Consumer Markets Contracts Study* (OFT1312, February 2011) found that when asked to choose the best deal between two alternative offers (with a combination of pay-offs and fees), consumers were less likely to choose the most favourable offer when the fees were delayed (that is, fees were payable later rather than now), particularly if a time limit was imposed on their decision.
- 4.43 Secondly, consumers may ignore the later fee to such an extent that there is very little constraint on what fee is charged. If little attention is paid to transfer fees their level may not be constrained, by competition and consumers comparing prices, in the way that prices are normally kept in check.

4.44 It is also unlikely that the fee will be challenged by those to whom the responsibility to pay the transfer fee often falls, because they may be grieving the death of a relative or otherwise engaged in arranging urgent nursing home accommodation for the relative. Further, it is practically difficult to challenge the fee at the point of payment. Furthermore, any description of it, in correspondence from the landlord, as relating to services allegedly supplied (where this is not in fact the case) may have the effect of creating a sense of obligation to pay, which may not be warranted.

The difficulties consumers face in forecasting future events and preferences

4.45 Consumers may initially disregard the transfer fee, but later regret their decision. In particular, people who initially place a low value on the transfer fee may find that, when incurring the fee in the future, their preferences have changed and that they would have preferred to have spent more effort in shopping around so as to avoid a transfer fee or incur a lower fee. This will be particularly true if they have made errors in predicting the likelihood of paying the fee. Not only is it difficult for consumers to predict when the transfer fee will be incurred, but it is difficult to predict how they will feel about the transfer fee in the future, as opposed to how they feel about it at the time of purchase. For example, they may find that they wish to sub-let but that the transfer fee makes it uneconomic to do so. For all the reasons set out earlier, it is very difficult for consumers to make predictions that take account of the possible long term consequences of the transfer fee term as a real or significant factor in the purchase.

4.46 In conclusion, we are concerned that the unusual, complex and delayed nature of transfer fee terms, coupled with behavioural biases, may mean that consumers do not make optimal purchasing decisions. As such, there are unlikely to be the same normal competitive constraints on the level of transfer fees as there are upon upfront purchase prices. As a result, we believe that transfer fees may lead to a significant imbalance between landlords and consumers, to the detriment of the consumer.

Other concerns

Restrictions on Assignment

- 4.47 We consider that lease terms that operate to restrict the tenant's right to assign the lease, in order to secure payment of a transfer fee to the landlord, may be unlawful as they amount to a fee for consent to assign.
- 4.48 Depending on the precise drafting of the lease term, such restrictions may:
- contravene section 19(1)(a) of the LTA by giving the landlord the right to require payment of an unreasonably high sum as a condition of giving its consent to an assignment or subletting for the property, and/or
 - provide for payment of a sum which constitutes an 'administration charge' within the meaning of paragraph 1(1) (a) or (b) of Schedule 11 of the CLRA and exceeds the amount which could be recovered as a reasonable charge.
- 4.49 The tenant should be free to deal with the property as they see fit, unless the landlord's consent is actually required. If the landlord's consent is required then any fee payable must be reasonable – in practice, reflecting only the actual reasonable costs the landlord incurs.
- 4.50 It has been argued by some landlords that tenants do not need to obtain consent to assign the property; rather than being a pre-condition of assignment of the lease, the transfer fee becomes payable only as a consequence of the completion of the assignment (that is, it only becomes due after the assignment has taken place) and is paid separately of any approval under the lease. We have, however, come across instances where the impression was given to tenants that consent was required to assign or sub-let the property and was subject to payment of the transfer fee. Such impressions are likely to constitute misleading actions contrary to the CPRs. Further, insisting on payment of a large fee as a condition for consent, where consent is not even required, may potentially constitute an aggressive or misleading commercial practice contrary to the CPRs.

Liability of incoming tenants

- 4.51 We have concerns about the unfairness of lease terms that purport to make an incoming tenant liable for an outgoing tenant's obligation to pay a transfer fee. In such circumstances the landlord will have a contractual right to pursue the incoming tenant for transfer fees unpaid by outgoing tenants, or indeed an incoming sub-tenant who rents the property and may be totally oblivious to their purported liability. In our view such terms attempt to transfer a personal liability to, or impose a secondary liability upon, the incoming tenant. We do not see why a landlord should be entitled to collect a transfer fee from the incoming tenant (who has no control over whether the outgoing tenant pays the transfer fee) where the liability is owed by the outgoing tenant.
- 4.52 Further, the drafting of some of the terms appear, in our view, to allow for 'double recovery' in circumstances where (i) the outgoing tenant has paid the transfer fee and the contract allows for the landlord to recover the fee again from the incoming tenant (for example, where the lease states that payment by the outgoing tenant does not affect the liability of the incoming tenant to make such a payment); and (ii) the outgoing tenant fails to pay the transfer fee and the incoming tenant is thereby liable to pay the transfer fee twice – on purchase and on the sale of the property.
- 4.53 Landlords have argued that in practice a purchaser's solicitor will generally not advise their client to complete an assignment without first being satisfied that all payments due under the lease have been paid. Notwithstanding this, we consider that there is no legal basis for making an incoming tenant liable for an outgoing tenant's obligation to pay a transfer fee, which is in effect a debt owed by the outgoing tenant to the landlord and akin to declaring that the debt is passed on to the incoming tenant. In our view, insisting on payment of a large fee by an incoming tenant could also potentially constitute an aggressive practice contrary to the CPRs.
- 4.54 Such a term may also in our view operate oppressively towards the outgoing tenant, since in the event of a dispute with the landlord about liability to pay the transfer fee, the incoming tenant may be dissuaded from purchasing the lease. Therefore this mechanism could have the

effect of putting pressure on the outgoing tenant to pay a sum that they would prefer to challenge, but do not, because of the need to complete their sale within a certain period of time.

5 POTENTIAL FACTORS MITIGATING UNFAIRNESS OF TRANSFER FEE TERMS

- 5.1 We have carefully considered various legal (and economic) arguments that a number of landlords have put to the OFT. We set out below those arguments that we think are relevant and which parties would be likely to present to a court in the event of a legal challenge.

Provision of pre-contract legal advice

- 5.2 It has been argued by landlords that practically every tenant who purchases a retirement home property will have received legal advice from a solicitor (at least for the purposes of conveyancing) prior to purchase, which ought to have brought the existence and nature of the transfer fee to their attention.
- 5.3 We accept that the majority of tenants will receive professional legal advice in carrying out the conveyancing process, and in consequence the existence and effect of the transfer fee ought to be pointed out to them.
- 5.4 However, in our view, even if a solicitor was consulted in relation to the transfer fee term, this would not assist an argument that such terms are fair in circumstances in which the meaning and effect of the term was not made clear either in the lease or surrounding documentation, was not expressed in plain and intelligible language and was not given sufficient prominence. Additionally, where there is a fundamental uncertainty around the effect of the transfer fee term, a solicitor will not be in a position to advise consumers as to the true effect of the term.
- 5.5 Further, it is not certain that the consumer will in every conveyance receive a careful and detailed report setting out the specific nature of the transfer fee liability, particularly given that transfer fee terms are uncommon in long term residential leases. Even where a report is given, it is not certain that the consumer will identify and appreciate the nature and extent of their obligations from the report. As such, we do not accept that tenants will invariably receive clear legal advice as regards the content of the covenants contained in the lease.

- 5.6 In conclusion, in our view the mere fact that a consumer would typically receive legal advice does not render the transfer fee term 'fair'. Legal advice cannot deal with the uncertainty around the effect of the transfer fee term, beyond drawing attention to its existence and that the liabilities arising from it will be uncertain.

Transparency

- 5.7 Landlords have argued that transfer fee terms are in fact sufficiently clear and transparent, in that appropriate language is used in the context of a lease document, references to the fee are made in the point-of-sale material, and the fee is clear in the context of a property transaction given the role of the legal adviser to the tenant.
- 5.8 In our view, insofar as consumers are aware of the transfer fee liability, it is only likely to be in the context of final sale and not in the other wide range of circumstances to which it will apply.
- 5.9 We maintain that the terms are often not in language with which a typical consumer would be familiar, they are often 'buried' in the schedules to the lease and not located alongside other financial obligations, and further there is a lack of certainty over the size of the transfer fee to be paid, the circumstances in which it is payable, and when and how often it will be paid.

Economic Efficiency arguments

- 5.10 Some landlords have contended that the transfer fee business model provides tangible benefits to consumers, specifically by ensuring that retirement home accommodation (which some landlords have argued have higher build costs) is built and by reducing the upfront purchase price for tenants (representing a form of 'deferred consideration'). It is argued that, without the transfer fee income, developers would have to bid less for the land, scale back on communal facilities, or increase the upfront purchase price. Essentially this argument is that without some form of income stream of this nature, retirement home developments would either not be built or would be built to a much lower specification.

It also suggests that residents are living in a retirement home property that is worth more than they have actually paid for it. It is argued that the alternative to transfer fees would be a higher upfront price or higher ground rents.

- 5.11 We recognise that, in principle, there could be some efficiency benefits to transfer fee terms. However, as discussed further below, we do not think that consumers are in a sufficiently strong position to effectively weigh up the discount they may receive on the purchase price against the higher and uncertain liabilities they will face in the future. Furthermore, we have seen no evidence which suggests that the removal of transfer fee terms from future developments would lead to a material negative impact on the quantity or quality of retirement home properties supplied.

Funding considerations

- 5.12 It has been argued by landlords that the viability of building retirement home properties is dependent on the income stream from transfer fees. It has been put to us that there are additional costs incurred in building a retirement home development rather than a standard residential housing development (for example, communal living rooms, guest flats, wider corridors, specialist alarm and security systems, and specialist lifts) and that these costs cannot be recouped from the initial sale of the properties as the benefits accrue to everyone living in the property over the life of the lease. By charging every tenant a transfer fee over the life of the lease, the developer can obtain a market return and recoup its costs. As such, the prospective income from transfer fees is factored into the developer's business model when acquiring and developing land and acts as an incentive for the development of retirement home properties.
- 5.13 For example, a property developer might make the following calculation. If the construction of a retirement property with a 125 year lease would be economically viable in return for a minimum of £133,000 upfront at the point of sale, then it would also be viable to build a retirement property using £100,000 from an upfront sale and £33,000 borrowed at

an interest rate of four per cent, provided that the developer also receives a one per cent transfer fee every seven years, and house prices rise each year by five per cent. This means that the property developer is willing to build a £133,000 property in return for £100,000 and a transfer fee in the contract.

- 5.14 In our view, there are a number of potential funding options available to developers – for example, the charging of a ground rent - other than reliance on the future income stream from transfer fees, which in any event may be difficult to predict (given the uncertainty around the timing of when, and how often, each fee will be incurred). Further, the property market in other long lease residential developments manages to remain viable without the use of transfer fees.

Transfer fee as deferred consideration

- 5.15 In line with the reasoning above, it has also been put to us by some landlords that the transfer fee represents a form of deferred consideration¹⁷ and, whilst not paid in return for a service, benefits consumers by reducing the upfront purchase price both when a tenant initially acquires the property and when a subsequent tenant purchases the property.
- 5.16 It is further argued that prospective tenants would not be willing to pay an upfront price that would enable developers to achieve a return on the retirement development necessary to obtain the required funding (that is, reflective of the higher build costs for developments of this type) but that they are willing to pay a lower-than-expected upfront price that is subsequently accounted for by an element of deferred consideration in the form of a transfer fee.
- 5.17 We acknowledge that, in theory, in some circumstances it may be of value to a prospective purchaser to obtain a deferment of part of the

¹⁷ In other words the total cost of the property is spread over time, allowing the purchaser effectively to pay in instalments.

purchase price of the property until they, or their inheritors, sell the property. For example, the deferment could be 'pay 95 per cent now, five per cent when you sell'.

- 5.18 This would mean the consumer receiving a lower upfront price in return for the later transfer fee. However, in our view the difficulty is that there is no effective constraint in place to ensure that the upfront price is sufficiently low to balance the potentially large amount of money that buyers are committing to pay at a later date.
- 5.19 For consumers that are comparing a retirement property with a transfer fee with the price of a standard residential property without such a fee, the necessary calculation of costs and benefits are difficult. Transfer fee terms are complex and there is fundamental uncertainty around the costs a tenant may incur.
- 5.20 A consumer is also more poorly equipped than a developer to make comparisons between upfront and deferred prices, meaning that developers may be able to take advantage of consumers' inexperience and behavioural biases. The tenant does not know what the ultimate cost of their transfer fee will be, due to the broad range of circumstances in which it may apply and also the uncertainty around the timing of when, and how often, the fee could be incurred. However, the developer will have a portfolio of retirement properties and so may have a better understanding of the average transfer fee and how often, on average, it is likely to be paid. This may provide the developer with a strong informational advantage over the tenant.
- 5.21 In conclusion, we do not accept the notion that the transfer fee represents deferred consideration in any meaningful sense; it is not presented to prospective purchasers as such by the landlord, it is not offered as credit, and it is triggered by a wide range of unpredictable circumstances. In particular:
- We would expect such a form of price deferment to be clearly calculated and set out for the buyer as a choice, either in the pre-

sales literature or leasehold agreements. We have seen no evidence of such a choice having been presented to prospective purchasers.

- The transfer fee is calculated as a percentage of an unknown future sale or open market value, and may become payable on multiple occasions which cannot be easily predicted (for example, in relation to a short sub-letting). It is unclear how these triggering events fit with the argument that the transfer fee is a deferred consideration or how a prospective tenant could meaningfully adjust the upfront purchase price they were willing to pay to take account of this. The behavioural biases of consumers will further reduce the likelihood that this is done fully or at all.
- We have not seen any convincing evidence to substantiate the contention that purchasers have received an upfront discount on the purchase price.

Conclusions on economic efficiency arguments

- 5.22 It is arguable that, in principle, transfer fee terms could support efficiencies which would benefit consumers. This is most likely to be the case where transfer fee terms are transparent and certain (such that they are only payable once on sale and the maximum amount payable can be determined at the point of purchase), and where competition is sufficiently intense that the income from such fees is fully transferred to the consumer through lower upfront prices.
- 5.23 However, we have not seen compelling evidence that any higher profits due to the use of transfer fees would lead to sufficiently intense competition on upfront purchase prices, such that they would be driven down low enough so that consumers are made no worse off financially from the use of transfer fee terms. As such, consumers may end up paying more or not purchasing the optimal property for them. Further, even if consumers were in fact no worse off financially, there may still be other forms of detriment – for example, they may feel misled if the true effect of the transfer fee was not made clear to them prior to purchase.

- 5.24 We have not seen specific evidence showing that consumers have been offered lower upfront purchase prices in exchange for transfer fees being included in contract terms. In any case, evidence of somewhat lower purchase prices would not be sufficient to show that consumers are no worse off under transfer fees. Furthermore, this potential trade off has not been made clear to consumers. In particular, developers have not offered consumers a choice between a higher upfront price and no transfer fee and a lower upfront price and a transfer fee.
- 5.25 Insofar as developers and landlords make commercial decisions based on the existence of a future income stream from transfer fees, we note that the property market in other long lease residential and commercial premises manages to remain viable without the use of such fees. As such, we consider that going forward retirement home developers should adopt alternative funding options. We have not seen any evidence to suggest that the removal of transfer fee terms from future developments would lead to a material negative impact on the quantity or quality of retirement home properties being built, although in respect of existing developments it is possible that landlords have structured their current business with the transfer fee income in mind.

6 OUTCOME OF OFT INVESTIGATIONS

- 6.1 In September 2009 we issued formal written notices to 26 retirement home businesses (estimated to represent over 80 per cent of the retirement homes market) setting out concerns over the transfer fees charged when residents sold or rented their properties.
- 6.2 At that time a number of businesses informed us that they would either no longer enforce the transfer fee in existing leases or would only charge a reduced flat fee, or would only seek to recover their administration costs.
- 6.3 In December 2010 we narrowed our active investigations to focus on a smaller number of businesses, which we considered to be significant players in the market. The investigation into the remaining businesses was put on hold with the aim of ensuring that the investigation was run in the most effective way (on the basis that the findings from the active investigations would read across more generally to those investigations currently on hold).
- 6.4 In relation to the active investigations referred to above, we have secured voluntary undertakings from three landlords and closed our investigation of another landlord on the basis of satisfactory clarification of the principles it currently applies when enforcing transfer fee terms.
- 6.5 In broad terms, the voluntary undertakings ensure that transfer fee terms are only enforced in the leases of existing retirement home properties on final sale and not in a wide range of other circumstances, where the impact of what we consider to be their inherent unfairness is mitigated.

Details of undertakings secured

- 6.6 We briefly summarise below details of the undertakings provided by three landlords. Undertakings were voluntarily given, without any admission of any breach of the law, by each of the landlords.

Fairhold Homes Limited and associated group companies (Fairhold)

6.7 Fairhold, a major player in the sector, agreed to make substantial changes to how it charges and enforces transfer fee terms in its 53,000 retirement home leases:¹⁸

- It clarified that leaseholders will not pay any transfer fee when the lease is passed on through inheritance or surrendered, or when a relative or carer moves in with them.
- A flat fee of £85 (to be adjusted in future years in line with inflation) will be charged for sub-letting, replacing the current transfer fee of one per cent of open market value.
- A transfer fee of one per cent will continue to be charged on sale. But it will now be calculated against the lower of either the price the tenant sold the property at, or the price the tenant originally paid for the property. The fee was previously calculated as a percentage of the higher of the sale price or open market value.
- Fairhold will also provide potential new purchasers with clear information summarising all the amounts payable under the lease. This will be presented in an easy to read format accompanied by worked examples, helping potential leaseholders understand what they are agreeing to before they purchase. Fairhold will do this where it is made aware that the person has an interest in buying one of its retirement homes

6.8 Fairhold has also agreed that where the terms of an existing lease give it discretion to waive a separate contingency fund fee of one per cent of the open market value payable upon each sub-letting, it will instead charge a fee equivalent to one month's rent (in accordance with the waiver) for each sub-let by way of an assured shorthold tenancy agreement.

¹⁸ see www.offt.gov.uk/news-and-updates/press/2012/77-12

6.9 Fairhold has also undertaken that it will not charge a transfer fee in any new leases it obtains through the acquisition or development of properties, unless the fee is for a service and represents its reasonable costs.

Hart Retirement Developments (Southern) Limited and Hart Retirement Developments (Thamesnorth) Limited (Hart)

6.10 Hart agreed to make changes to how it enforces transfer fee terms¹⁹ in its 14 retirement home developments in England and Wales:²⁰

- It clarified that a transfer fee will not be payable upon the tenant's interest first being passed on to a beneficiary under a will or intestacy, when sub-letting, or in circumstances where there is otherwise a change in occupation, an equity release or a surrender.
- The transfer fee will continue to be charged on final sale. But for **existing tenants** the transfer fee payable on sale will now be calculated against the lower of either the price the tenant sold the property at, or the price the tenant originally paid for the property adjusted by the Retail Price Index. The fee was previously calculated as a percentage of the higher of the sale price or open market value. As a result, the amount of the transfer fee payable upon sale may in some instances be less than would previously have been the case.
- **Existing tenants** will also be given the option to switch to paying a quarterly ground rent in place of the transfer fee if they want greater certainty in planning their future financial liabilities. If tenants choose to switch to paying a ground rent, they will need to pay a lump sum

¹⁹ The transfer fee requires tenants to pay between 1.5 per cent and five per cent (dependent on how long the property was owned) of the higher of the sale price or open market value of their property in a number of circumstances. Hart does not charge a ground rent at these developments.

²⁰ see www.offt.gov.uk/OFTwork/consumer-enforcement/consumer-enforcement-completed/hart/

at the time of switching equivalent to the notional ground rent that they would have paid for the period between the purchase of the property and their decision to switch.

- **Future tenants** will be given the option at the outset to make a fresh decision between paying a quarterly ground rent or a transfer fee on final sale. If they choose the transfer fee option, the fee payable will now be calculated on the sale price (and no longer on the open market value if higher) avoiding disputes about what the property was really worth.

6.11 Hart has also undertaken that it will not include a transfer fee provision in any new retirement housing it constructs, unless the fee is for a service and represents its reasonable costs.

Pegasus Retirement Homes plc (Pegasus)

6.12 Pegasus, a developer of retirement home properties, agreed amongst other things:²¹

- not to enforce the one per cent transfer fee term in the leases of two retirement home sites where it continues to own the freehold, until such time as the freehold is transferred to third parties under existing contractual agreements
- that in relation to sites that it may develop in the **future** for the purpose of the sale of retirement properties, were it to include a transfer fee term in the lease of a property:
 - it will only require payment of a transfer fee in the event of an assignment or an under-letting²² by way of sale; a transfer fee will not be payable in any of the following events:

²¹ See www.ofc.gov.uk/OFTwork/consumer-enforcement/consumer-enforcement-completed/pegasus/

²² Underletting by way of sale refers to where a long lease is created and sold at a premium.

- the tenant's interest first being passed on to a beneficiary under a will or intestacy
 - sub-letting by means of an assured shorthold tenancy at a market rent
 - a surrender of the lease
 - in circumstances where there is a change in occupation of the property without any change in the legal or beneficial ownership of the lease
 - the tenant transferring their interest in the lease, without any payment, to a spouse or partner,
 - the tenant granting a mortgage or charge over the lease in order to raise finance.
- the transfer fee payable will be calculated on the sale price and no longer on the open market value if higher, avoiding disputes about what the property is really worth
 - it will not require a tenant to pay a transfer fee which is determinable only at the sole and absolute discretion of Pegasus up to a specified percentage of the sale price (as distinct from being calculable by reference to a stated percentage).

6.13 The undertakings relating to future sites were given by Pegasus without prejudice to the ability of the OFT to initiate further enforcement action in future.

Scope of undertakings

6.14 The undertaking undertakings apply to transfer fee terms of **like or similar effect** to those under investigation. We cannot, however, predict what future business models or forms of drafting businesses may develop.

6.15 In relation to existing leases, the undertakings deal with whether and how transfer fee terms are **enforced** by landlords. We have not sought to

agree with the landlords that they will seek to vary the terms in these leases both because this can only be done with the consent of the tenants involved, and also because securing the manner in which terms are enforced is usually sufficient in tackling problems in existing contracts. We are mindful that there can be issues in circumstances where the freeholds of retirement properties are sold on by a landlord. Some landlords have therefore undertaken to us that they will not sell their freehold interests without securing the agreement of the prospective purchaser to comply with the terms of the undertakings.

Outcome of other active OFT investigation

6.16 We closed our investigation of **Hanover Housing Association (Hanover)** - parent of the Hanover Group which owns over 4,400 freehold interests in leasehold retirement home properties – on the basis of the satisfactory clarification by Hanover of the principles it currently applies when enforcing transfer fee terms.²³ In particular:

- Hanover confirmed that in all but one of the sample leases that we reviewed, the transfer fee is charged in respect of services undertaken by the landlord (referred to as an '**administration**' transfer fee) and is therefore subject to a test of reasonableness under the CLRA and can be challenged in the Leasehold Valuation Tribunal if they are excessive. As such, where the lease entitled Hanover to an 'administration' transfer fee, stated to cover Hanover's costs, of 'up to' or 'not exceeding' a certain amount (such as a percentage of the sale price or open market value), or to a fixed percentage of the sale price or open market value, Hanover only collected a fee that reflected justified and reasonable administration costs.
- In relation to those remaining leases that contained transfer fee terms arising from an event, but not related to the provision of

²³ see www.offt.gov.uk/OFTwork/consumer-enforcement/consumer-enforcement-completed/hanover

services (referred to as a '**non-administration**' transfer fee), Hanover addressed a number of our concerns about how, and in what circumstances, such clauses were enforced in practice. In particular, Hanover confirmed that it will only charge such fees where the tenant is selling the property – where they are sub-letting, Hanover will only normally charge a reasonable sum to cover the landlord's costs, and where the property is inherited, the fee would generally be charged only when the heir has sold the property; we reserved our position on our remaining concerns.

- Hanover also confirmed that where it was the author of a new lease, it did not intend to insert a transfer fee term other than to enable it to recover its reasonable costs in dealing with a transfer.

Overview of investigation outcomes

- 6.17 We believe that the parties that have been the subject of active OFT investigations, together with McCarthy & Stone plc (who previously gave voluntary undertakings to the OFT following our investigation), are likely to own the great majority of properties in the non-assisted retirement home market.
- 6.18 Where we have secured voluntary changes, we have not secured uniform outcomes with all landlords for a number of reasons. First, the landlords' existing leases and business models are different. Second, we are constrained by the limits to which each firm can voluntarily agree to undertakings – some are either controlled or constrained by finance providers such as funding banks or bondholders. Third, enforcement action where there are differences in circumstances between cases has to be individually targeted and can only be resolved by individual negotiations, which inevitably tend to produce a non-uniform result. Only legislation could deliver a uniform market.
- 6.19 Although some landlords have agreed not to enforce transfer fee terms at all in existing leases or to only charge a reduced flat fee, others were unwilling to agree to the voluntary ending of the transfer fee on final sale. We have therefore thought very carefully about whether in principle we should seek to take court action to seek an Order that the terms are

unfair and therefore not binding on consumers. In doing so, we have carefully considered a number of factors put forward by landlords in support of allowing them to continue to rely on transfer fee terms in existing leases in the context of final sale:

- claims that businesses took into consideration when designing this income stream that consumers receive legal advice on purchase of a retirement home, and could therefore be expected to consider the terms of the lease fairly carefully
- arguments that in general, point of sale literature draws attention to the existence of the transfer fee on final sale (although generally not in other contexts)
- arguments that in so far as consumers are aware of the existence of the transfer fee, they are aware of its application to final sale
- claims that the transfer fee ought to have been taken into consideration to some extent in the price agreed at purchase.

6.20 As we have set out elsewhere in the report, we are generally sceptical about many of the arguments put forward by retirement home landlords. However we believe that the settlements that we have accepted tackle the most egregious unfairness around transfer fees, and on that basis we have been prepared to reserve our position on other aspects of these terms. The most detrimental features (and the aspects most complained about) of transfer fees relate to the application of the fee on sub-letting, and how the fee is calculated in all cases. We have dealt with these aspects through the changes negotiated with a number of landlords, and through making clear in this report the standards that we expect to see adhered to in the retirement home industry.

6.21 We anticipate that some stakeholders will question why we did not bring court proceedings to try to secure change where landlords were unwilling to agree to the voluntary ending of the transfer fee on final sale. Most significantly, we considered that the changes volunteered by the parties under investigation have dealt with the most egregious features of these fees, and therefore further proceedings would have more limited overall impact. Further, litigation would have delayed the

implementation of the changes landlords have been willing to make, meaning that consumers would not have enjoyed the benefits and clarity that the agreed settlements bring. Moreover, we consider, on the basis of recent experience in comparable cases, that court proceedings, with appeals, could have taken many years and involved heavy costs for all those involved. These factors were relevant in our consideration of the risks and resources necessary to bring court proceedings to secure changes beyond those offered.²⁴

- 6.22 However, we remain of the view that the transfer fee model is not optimal for consumers, and makes it difficult for consumers to assess their full liability under the lease. For this reason we have improved the position for tenants under existing leases to the extent possible without incurring the uncertainties and delays of litigation, and have consistently maintained our position that we want this business model to cease being used in future developments.
- 6.23 We will keep the sector under review, in order to monitor compliance with the undertakings that have been given, and will have specific regard to any new evidence or changes in the law that may arise.

Specific OFT concerns that have been addressed

Leases of existing retirement home properties

Application of the transfer fee to wide-ranging and surprising circumstances

- 6.24 A percentage transfer fee will only be charged on final assignment by way of a sale, and not in a range of other circumstances such as sub-letting, upon inheritance, or a change in occupation.
- 6.25 We hope that, as a consequence, this will in particular have the effect of freeing up the sub-letting market in retirement home properties. A major source of complaint has centred around consumers who, upon inheriting

²⁴ See OFT 953 Prioritisation Principles, www.of.gov.uk/shared_of/about_of/oft953.pdf

retirement home properties (with incumbent service charge and ground rent liabilities), have been unable to sell due to the downturn in the housing market but have found it uneconomic to sub-let the property in circumstances where a large transfer fee has been charged upon each sub-let.

Lack of certainty as to future financial obligations

- 6.26 The consumer's future financial liability will now be assessed with greater certainty - for example, by the landlord:
- calculating the transfer fee as a percentage of the lower of either the price the tenant sold the property at, or the price the tenant originally paid for the property, thereby allowing the tenant to assess their maximum potential liability prior to purchase
 - giving tenants the option of choosing to pay a ground rent rather than a transfer fee
 - in circumstances where the transfer fee term is apparently linked to costs and expenses incurred in the provision of services or the giving of consent, only charging a fee for those services actually supplied and subject to a test of reasonableness in accordance with the LTA and CLRA.

Excessive scope for Landlords to determine the transfer fee

- 6.27 Most landlords have agreed not to require tenants to pay a transfer fee upon sale that may be calculated as a percentage of the open market value, thereby addressing our concern that it is unfair for the landlord to be able to decide the basis on which the transfer fee is calculated. This will prevent disputes about what the property was really worth and the right level of the fee.

Lack of transparency around the transfer fee term

- 6.28 The transparency of the transfer fee term will be enhanced, providing prospective tenants with greater clarity as to its nature and effect. Some of the measures agreed by landlords include:

- providing a clear and prominent explanation of the transfer fee in the Purchaser Information Pack
- providing a stand-alone summary or 'key facts' document explaining the financial liabilities under the transfer fee term, including the circumstances under which the tenant will become liable to pay the fee, how the transfer fee is calculated and worked examples
- providing the future tenant's conveyancer with a memorandum to be attached to the front of the Lease and Deed of Covenant drawing attention to the Transfer Fee
- inviting the conveyancer acting for a future tenant to provide a certificate confirming that they have advised their client about the existence of the transfer fee.²⁵

6.29 Further, where applicable, landlords have agreed to revise any pre-sale documentation that gave the misleading impression that the transfer fee was an 'administration' fee, or that the tenant received any service or valuable benefit for paying it.

6.30 Whilst we welcome the increased transparency of the transfer fee term, it should be noted that this will only benefit future purchasers rather than existing tenants. Further, landlords may not always be made aware of a sale until after contracts have been exchanged and as such, may not always have sufficient opportunity to provide pre-sale material to the incoming tenant.

Newly created or acquired leases

6.31 In relation to future leases, most of the landlords have agreed not to include transfer fee terms in the leases of new developments obtained through development or acquisition, other than in circumstances where

²⁵ Whilst such a certificate may form part of the pre-sale documentation, in our view it cannot be relied upon in itself as evidence that the consumer actually had a clear understanding of the nature and effect of the transfer fee term.

the fee is for a service and is no more than the actual costs reasonably and necessarily incurred in providing that service. As such, any fee will be open to challenge at the Leasehold Valuation Tribunal.

7 IMPACT OF OFT ACTION ON THE FUTURE RETIREMENT HOMES MARKET

- 7.1 It is not the OFT's role to prescribe the manner in which a landlord arranges its commercial affairs, as long as the resulting business practices and terms are fair. However, we maintain the view that businesses in the retirement homes sector should, going forward, adopt alternative business models that do not rely on charging consumers a 'transfer fee' of the type that were the subject of our investigation.
- 7.2 Specifically, we are not convinced that greater transparency of the transfer fee term (both in relation to the prominence and certainty of the term) would, in itself, eliminate the potential for consumer harm. In particular, we take the view that the unusual nature of transfer fee terms, coupled with consumers' strong behavioural biases, are such that there remains a risk of consumer detriment.
- 7.3 To that end, most of the landlords we have actively investigated have agreed not to charge a transfer fee in the leases of any new developments, unless the transfer fee is for a service and is no more than the actual costs reasonably incurred. This is a key aspect of the settlements we have agreed.
- 7.4 We expect businesses to come up with alternative business models that allow purchasers to better assess, and appreciate, their total liabilities under a lease, than the transfer fee model commonly used to date. We understand that a number of developers have already adopted alternative business models that do not rely on transfer fee terms.
- 7.5 It is not, however, possible to predict how the retirement homes market may evolve. It is possible, for example, that new fixed transfer fees may be introduced, the fairness of which would need to be assessed on a case-by-case basis.

8 OFT ENFORCEMENT THRESHOLD

- 8.1 Based on our findings, we consider that transfer fee terms, as typically currently drafted, are likely to constitute unfair terms under the UTCCRs. If a court were to find that a transfer fee term was unfair, such a term, or elements of that term, would be unenforceable and the court would not have power to redraft the term to make it more fair. We have, however, decided not to test this in the courts at this stage on the basis that the landlords we have reached agreement with have either voluntarily dropped the transfer fee, replaced it with a flat fee, or agreed to make various changes to the way they enforce such terms with a view to mitigating what we consider to be their inherent unfairness. We have reserved our position on certain remaining concerns to see if the mitigating factors are sufficient. However, we set out below a number of general principles that we would expect all landlords to comply with.

Existing Leases

Limiting the circumstances in which the transfer fee is charged to final sale

- 8.2 If charged at all, a transfer fee should only be payable on final assignment by way of a sale, and not in any other circumstances such as sub-letting, upon inheritance, a change in occupation, surrender or an equity release.

Providing certainty as to the tenant's transfer fee liability

- 8.3 The tenant should be able to assess their maximum potential liability arising under the transfer fee term, for example by being offered one or more of the following options:
- through the charging of a flat fee
 - through the calculation of the transfer fee as a percentage of the lower of the price the tenant originally paid for the property or the sale price achieved by the tenant

- by being given the option to switch to a ground rent
- by the transfer fee being expressly treated as credit.

Not using the 'open market value' of a property as a basis for calculating the transfer fee payable on sale

8.4 Tenants should not be required to pay a transfer fee on sale that is calculated on the basis of the open market value of the property. We consider it unfair that a landlord is able to determine the property value against which the transfer fee will be calculated, even in circumstances where the lease term allows for the tenant to dispute the landlord's valuation.

Ensuring the transfer fee term is transparent

8.5 A landlord's obligations under the UTCCRs may not be discharged solely by reliance upon the fact that a tenant will receive advice from a solicitor or conveyancer prior to purchase.

8.6 The transfer fee term must be sufficiently clear to enable the typical consumer to have a proper understanding of it, which requires not only that the actual wording of the term is comprehensible to consumers but that they can understand how the term affects their and the landlord's respective rights and obligations.

8.7 It should also be made clear to consumers whether the transfer fee is:

- simply payable as a consequence of an assignment of the lease taking place but not related to the provision of any services or consent, or
- payable in respect of any administrative services undertaken by the landlord (including fees for the landlord to give their consent under a lease) and is therefore subject to a test of reasonableness and challengeable at the Leasehold Valuation Tribunal in England and Wales. In this regard we expect statements made by landlords about the nature of the transfer fee, and what it is for, to be completely

accurate and not misleading. We do not expect landlords to give the impression that a transfer fee is a condition for consent, or paid in respect of any services provided by the landlord, unless the landlord also makes clear the consumer's rights to challenge the fee before the Leasehold Valuation Tribunal.

- 8.8 In practice, we would expect that in addition to pre-sale material - such as the Purchaser Information Pack – including a clear and prominent explanation of the transfer fee term, prospective tenants will also be provided with a 'key facts' summary document explaining their financial liabilities under the transfer fee term (including the circumstances under which the tenant will become liable, how the transfer fee is calculated and a number of worked examples).
- 8.9 We expect landlords and their managing agents to use their best endeavors to bring the transfer fee term (in addition to other material information about the retirement home property) to the attention of prospective tenants. This would include, for example, not only providing pre-sale documentation to the prospective tenant or their solicitor but also, where it was not possible to obtain details of the prospective tenant's solicitor, providing such documentation to the seller's solicitor with prominent instructions that it be passed to the buyer as quickly as reasonably practicable.

OFT enforcement policy

- 8.10 We expect landlords to abide by these overarching principles when enforcing transfer fee terms in existing leases. They represent the **minimum** steps we consider necessary to address the most egregious unfairness around transfer fee terms.
- 8.11 We will have regard to these general principles on a case-by-case basis when considering whether enforcement action under the UTCCRs might be appropriate against a landlord who enforces transfer fee terms in contracts with consumers. The principles are not, however, intended to be exhaustive or set in stone and will be kept under review in the light of new case law or legislation that may emerge in relation to the fairness of

transfer fee terms or any evidence of significant continued consumer detriment. If we receive further complaints, we would be obliged to consider them, in the context of any new evidence and any changes in the law.

- 8.12 We will also have regard to the OFT's published *Prioritisation Principles* (www.offt.gov.uk/shared_offt/about_offt/oft953.pdf) and *Statement of Consumer Protection Enforcement Principles* (www.offt.gov.uk/shared_offt/reports/consumer_protection/OFT1221), to ensure that any enforcement action is carried out in a way that is transparent, accountable, proportionate, consistent, and targeted only at cases where action is needed. As such, we will decide our enforcement approach to any particular case in light of all the facts before us, our current overall priorities and the appropriate legal considerations.

Newly created or acquired leases

- 8.13 We take the view that the nature of transfer fee terms, coupled with consumers' strong behavioural biases, are such that there remains a risk of consumers suffering detriment.
- 8.14 We consider that landlords should not include or enforce transfer fee terms in newly created or acquired leases, other than in circumstances where the fee is for a service and is no more than the actual costs reasonably and necessarily incurred in providing that service, or where it is presented as a credit facility.

9 WIDER POLICY & LEGISLATIVE ISSUES

Lack of clarity in the legal framework

- 9.1 The legislative framework that applies to transfer fee terms depends very much on precisely how they are drafted, which means that it can be confusing for tenants to understand their rights. Our investigation has found that transfer fees often appear to fall outside the scope of the CLRA and the LTA because of the way they are drafted. The CLRA and LTA impose restrictions on charging fees in respect of administrative services undertaken by the landlord (including fees for the landlord to give their consent under a lease), but do not appear to restrict the charging of fees where there is no administrative service at all and which are laid down in leases either as a pre-condition for exercising the right to assign or as an inexorable consequence of it. In some cases transfer fees are drafted as fees in respect of costs and expenses incurred in the provision of administrative services by the landlord, but in many others they are not, and in still other leases, it is not clear.
- 9.2 Where a transfer fee is drafted as a fee payable in respect of administrative services provided by the landlord in relation to a transfer of the lease, individual tenants may be able to challenge the fee either in the Leasehold Valuation Tribunal (under Schedule 11 to the CLRA, seeking either an adjudication as to whether the amount charged is reasonable or a variation of the lease) or in the County Court (under the LTA, in relation to the reasonableness of the costs occurred in connection with the granting of consent). However, it must be emphasised that this ability to challenge appears to depend on exactly how the lease in question is drafted (in particular whether the fee purports to be an administration charge or a fee in return for approval, the provision of information or other services associated with a transfer) and/or on the impression given in the pre-sale documentation as to the purpose of the transfer fee.
- 9.3 Where the transfer fee is not explicitly linked to the provision of a service, but is said to be charged as part of a business model which involves the provision of services on a 'use now, pay later' basis, it is

not clear that this would necessarily fall within the scope of the CLRA, in particular given the importance of how the lease is drafted in triggering CLRA protection.

Difficulties in challenging the transfer fee

- 9.4 We are not currently aware of any instances in which the Leasehold Valuation Tribunal has made a decision on a transfer fee term or determined that such fees (or fees of a similar nature) are within its jurisdiction. We note, for example, the following decision of the Leasehold Valuation Tribunal in relation to a lease clause that provided for payment upon assignment of a selling service fee of five per cent of the enhanced value of the flat - www.residential-property.judiciary.gov.uk/Files/2006/April/700019K3.htm. The applicant asked the Leasehold Valuation Tribunal to determine, inter alia, that the selling service fee was an administration charge within the meaning of Schedule 11 to the CLRA and was unreasonable and thus not payable. The applicant further contended that the management company neither offered nor carried out any kind of sales service to leaseholders other than registering a transfer, for which a separate fee was payable under the lease. The Leasehold Valuation Tribunal came to the conclusion that the 'selling service fee' did not fall within the definition of administration charge or variable administration charge within Schedule 11 to the CLRA and as such it did not have jurisdiction to determine the application.
- 9.5 In addition to these concerns, transfer fees (and contingency fund fees) generally fall due for payment where the tenant is under some time pressure to dispose of the property (such as by way of sale or sub-letting). Tenants may be facing costs such as service charges, which are leaving them out of pocket, and once a sale is agreed, will not be likely to be in a position to challenge a fee within the timescale of completion.

Amount of the transfer fee

- 9.6 The fundamental problem that tenants (who have complained to us) have with transfer fees, both in terms of understanding their purpose and scale, and also in accepting that they are in any way reasonable, is

the fact that the transfer fee appears typically not to be paid in respect of any service or benefit that accrues to the tenant at the time the fee is paid. It appears simply to be a fee that is charged as a consequence of dealing with the property. Where no service is provided at the point of payment, it is difficult to assess what would be a 'reasonable' transfer fee under the leases as currently drafted, other than 'zero'. The fee therefore, in our view, appears to operate as a burden or fine, and exhibits the same sort of features that the LTA and CLRA seek to restrict – namely large charges which exploit the fact that a tenant wishes to deal with their property, and is beholden to the landlord in order to do so.

- 9.7 We can, however, envisage circumstances where the landlord is put to an administrative cost in processing the assignment and it would be reasonable for landlords to recover these. What is reasonable would depend on the circumstances, and is suitable for assessment by a Leasehold Valuation Tribunal.

Impact on the housing market

- 9.8 Given the current difficulties in the housing market, it is not efficient for properties to remain empty, where they could otherwise be occupied, and there is a real risk that retirement homes may remain unoccupied in circumstances where the owner is having difficulty selling the property, and it is not economical to sublet it due to the amount of the fees to be paid.

Recommendations

- 9.9 **We therefore recommend that legislative reform be considered by expanding the remit of the Leasehold Valuation Tribunal to allow the tribunal to rule on the reasonableness of all transfer fees (possibly through an amendment to Schedule 11 to the CLRA and/or any other necessary changes). Further, or alternatively, there could be consideration of whether the model currently in force in Scotland of restricting or prohibiting certain classes of fees would be appropriate.**

- 9.10 Although transfer fees may in some limited circumstances be challengeable as administration charges, the ability to challenge by itself may not resolve the difficulties that tenants face where trying to sell or sublet their property in a short timescale.
- 9.11 In our view consideration of such a redress route must also bear in mind that under the terms of a lease, the landlord may be able to recover their costs through the service charge, even if they are unsuccessful in defending a challenge. This is likely to have an impact on whether landlords are more or less willing to defend challenges that have strong merit, rather than to settle. It is also likely to have an impact on the incentives of a tenant to bring a challenge, if the end result is an increase in service charge, irrespective of the outcome.

Contingency Fund fees

- 9.12 Although not the focus of our investigation, most of the concerns we have about the drafting and application of transfer fees also apply to so-called Contingency Fund Fees. These tend to be drafted in very similar terms to Transfer Fees, and apply in the same range of circumstances, including sub-letting and change of occupation. Contingency Fund Fees may be covered by other legislation as service charges, and so may be challengeable in the LVT. However, where the fee is applicable on sub-letting, because it can be large, this could also have a significant impact on the ability of a tenant to sublet their property, or even have it occupied at all. Where it applies on final sale, it is also practically difficult to challenge, since generally the fee must be paid before the sale can complete.
- 9.13 Any reform should therefore consider all fees that are charged under a lease, including contingency fund fees.
- 9.14 We acknowledge that a decision as to whether legislation would be useful and appropriate at this stage or in the future is a matter for the appropriate Government Departments, the Department for Communities and Local Government (who have the policy lead on residential

leasehold) and the Ministry of Justice (who have policy lead on land law and Leasehold Valuation Tribunals).

10 PRIVATE RIGHTS OF ACTION

- 10.1 In our view the voluntary undertakings we have received from a number of landlords would not prevent a leaseholder from bringing any challenge of their own in court. Our acceptance of these undertakings should not be construed as any form of endorsement of the fairness of the respective transfer fee terms.
- 10.2 In addition to action taken by the OFT or other enforcers, individual consumers have their own rights under the UTCCRs. Where a term is not drafted clearly, it must be construed in the way that most benefits the consumer. An unfair term is not binding on the consumer and a supplier cannot rely on it in any dispute. Consumers cannot be made to comply with obligations arising from unfair terms, and may make claims for compensation or other redress even if the term states that they may not. A consumer may argue in a dispute with a supplier that the terms of a contract are unfair and ask a court to make a decision on the matter. This right exists independently of the OFT's powers under the UTCCRs and can be enforced regardless of any view we have given on the same or similar terms, or indeed, any action it has taken. Ultimately the question of whether or not a term is unfair is a question for the court to decide.
- 10.3 We are unable, however, to provide direct advice or assistance to individual consumers, and strongly advise that tenants seek legal advice before considering any such action.
- 10.4 Further, we cannot say with certainty that our findings will apply to a particular lease, as the unfairness of any lease term would need to be assessed by a court on a case-by-case basis by reference to all the circumstances surrounding the conclusion of the contract.
- 10.5 In addition to private rights of action, in some circumstances there may be scope for disputes to be taken to mediation; however we would recommend that tenants seek independent advice before doing so.

ANNEXE 1

EXAMPLES OF TRANSFER FEE LEASE TERMS

Example 1:

'Not to offer to assign underlet or otherwise part with possession of the Flat without first notifying the Lessor of the Tenant's intention so to do and further to notify the Lessor not later than seven days after becoming contractually bound to the assignment underletting or parting with possession and at legal completion to pay to the Lessor a transfer fee of 1% of the gross sale price or open market value (which in default of agreement shall be determined by the Lessor's surveyor) whichever shall be the greater sum and if the transfer fee shall not be paid within seven days of the said assignment underletting or parting with possession then the said fee shall be due and payable by the assignee undertenant or occupier as the case may be'.

Example 2:

'To pay to the Lessor on the creation or any devolution of any legal or equitable estate or interest in the Property or on a change of occupation a sum equal to 1% of whichever shall be the greater of:

(a) the gross proceeds of sale of the Property or

(b) the open market value thereof at the date of such creation devolution or change (such sum to be determined in default of agreement by a surveyor appointed by the Lessor)

plus 1/2% of such value for each complete or partially complete year during which the person effecting such creation devolution or change shall have been entitled to an estate or interest in the Apartment or been in occupation thereof

Provided that:

(a) such sum shall in no circumstances exceed 5% of such proceeds or such value (as appropriate)

(b) (i) no sum shall be payable on the death of a person who is beneficially entitled to any such interest as a joint tenant

(ii) no sum will be payable where a charge arises on a change of occupation where

(aa) one spouse leaves the Property and the other remains in occupation provided that when that remaining spouse ceases to occupy the Property the charge will be payable notwithstanding that the remaining spouse may have remarried or

(bb) there is a temporary change of occupation for a period of three calendar months or less

(c) (i) if a personal representative (which term for the purposes of this paragraph includes the plural where appropriate) of a deceased Lessee shall:

(aa) assent to the vesting of the Property or any legal or equitable estate or interest therein in any person or

(bb) not have assented to the vesting of the Property in any person within twelve months of the date of death of the Lessee'.

Example 3:

'...upon any assignment transfer or underletting or otherwise parting with possession of the Premises whether to a nominee of the Lessor or otherwise the Lessee shall pay to the Lessor a transfer fee (being in respect of the Lessor's costs in maintaining a waiting list of potential purchasers and vetting and approving proposed purchasers) of 1.5% of the gross sale price or (in the event of an assignment transfer or underletting other than at arms length) the open market value (which in default of agreement shall be determined by the Lessor's Surveyor) within seven days of completion of any such assignment transfer or underletting or of parting with possession of the Premises...'.