18th September 2014

Residential Property Managers Market Study
Competition and Markets Authority
Victoria House
37 Southampton Row
London WC1B 4AD

Market study into residential property management services in England & Wales Invitation to make observations on the proposed scope of study

Dear Mr Eade,

We are writing in response to your invitation to make observations on the contents of your update paper on the market study published on 1st August 2014.

We set out our response below. We will initially take the opportunity to provide you with a summary of our key observations before outlining our response in detail.

Summary of our observations

The IRPM are pleased that the report acknowledges the contribution we have made to providing recognised qualifications within the sector and the high regard within which our qualifications are held.

The IRPM supports recommendations:

- That improve standards of residential property management
- To improve education, learning and qualification for property managers
- For greater regulation of property managing agents
- To improve the knowledge and information available to potential leasehold purchasers and to existing leaseholders
- To improve the transparency of cost information
- To reduce the cost and administrative burden imposed by Section 20 consultation thresholds
- To encourage greater use of ADR

The IRPM is concerned about:

- The lack of acknowledgement of the contractual role of the landlord
- An overstatement of the level of autonomy held by managing agents rather than their landlord clients
- An understatement of the proportion of the sector where management is already controlled by leaseholders collectively

- The lack of any appraisal of the effectiveness of current legal protections
- The lack of qualitative and quantitative research behind the alleged problems and proposed remedies
- An unqualified assumption that frequent switching of managing agents is in the best interest of leaseholders as consumers
- The unintended consequences of more frequent switching and shorter term management contracts
- The long term impact on the nation's housing stock of adopting short term management imperatives

The IRPM would make the following additional recommendations

- Longer term, fully consulted management agreements should be encouraged
- The CMA should have regard to legislation already enacted in other countries; particularly the Republic of Ireland

Outline response to the update paper on the market study

We support any study which aims to improve standards of residential property management. Improving standards within the sector has been one of our key aims since the institute was formed in 2002.

We particularly support any recommendations that would improve the knowledge and understanding of leaseholders and potential leaseholders. Lack of understanding of obligations entered into and the role of property managing agents is a frequent cause of dissatisfaction. Professional managing agents can assist in this process and it is incumbent upon them to seek to ensure that their customers are well informed. We support any proposals to ensure that purchasers are more informed at an early stage prior to finalising their purchasing decision.

Your report does, however, give us cause for concern in many areas. We remain concerned that you have not fully understood the contractual relationships that pertain within the sector and that you have had insufficient regard to existing legislation and case law. Your report does not highlight the current legal protections that exist for leaseholders and includes no critical analysis of how or why these protections fall short.

You say that the report does not carry out an assessment of the legal framework but the introduction of many of your recommendations will require a fundamental shift in the legal framework and in many cases primary legislation. We are concerned that such fundamental recommendations should be made without any assessment of the current legal framework.

Your report also makes limited reference to existing best practice guidance that regulated property managers are expected to follow, for instance there is no

reference to the RICS UK Residential Property Standards or to the Institute of Chartered Accountants' England and Wales (ICAEA) Technical Release 3/11.

Detailed response to the update paper on the market study

We have found it impossible to respond to your recommendations without having regard to and making observations on your detailed findings. We, therefore, make our observations on a paragraph by paragraph basis. For ease of reference we have aligned our comments to your paragraph numbering.

All our initial comments relate to the private sector. We comment on your public sector proposals separately.

2.3 We remain concerned that the CMA refuse to use the word **landlord** throughout this update. The update refers to freeholders and managing agents throughout, which implies:

a) reluctance to accept that the property management function is vested in the **landlord,** who is frequently not the freeholder and

b) reluctance to acknowledge the fact that property management agents are only acting as agent and whose duties are restricted by their terms of engagement and the laws of agency.

3.3 Without quoting any evidence, the report perpetuates the notion that "in most cases the responsibility for appointing and instructing the property manager rests with the freeholder". The responsibility for appointing and instructing the property manager rests with the **landlord**; who is very often not the freeholder, as confirmed by your figures in 3.6 below.

3.6 You dismiss the existence of 80,523 Residents' Management Companies (RMC) as if they have no relevance to the management of the leasehold stock.

RMCs are typically established at the time a lease is drafted, as a party to the lease, for the sole purpose of undertaking the management functions of that particular development from the date of first occupation. We do not, therefore understand your dismissal of this number by the phrase 'not all will be active'. We suggest that the vast majority will be active and those that are not have either ceased due to assignment of their obligations or the development was never constructed. We suggest these numbers will be a very small proportion of the total. On the contrary not all management companies are registered at Companies House as RMCs and the number is therefore more likely to be an under estimate than an over estimate of the number of management companies functioning as landlords.

The freehold of small developments of 2 or 3 flats will more typically be registered in the joint names of the individual proprietors. We, therefore, suggest that your figures

of c.81,000 actually under represent the total number of dwellings where the management function is vested in a RMC, RTM or the leaseholders collectively.

DCLG has recently published their estimate of residential dwellings in England. They estimate there are currently some 2.8M leasehold flats in England. Other publications from DCLG confirm that more than ½M of these dwellings are in the public sector; having been purchased under the Right to Buy, Right to Acquire or developed under various affordable homeownership schemes. These estimates, therefore, indicate that there are some 2.1- 2.3M leasehold flats within the private sector in England and a small additional number in Wales.

According to your figures there are some 81,000 RMCs and RTM companies but you have not made any assessment of the total number of leasehold flats within these developments. A modest average of 15 flats per development (as a purely indicative figure) indicates that the landlord function of more than 50% of the sector is contractually vested in these types of companies. The freehold interest will often by owned by other persons but the management control sits with the landlord not the freeholder.

This figure tallies with unscientific discussions held with our members, which indicate that RMC and RTM clients represent the majority of clients for a majority of our members.

Taking points 2.3, 3.3 and 3.6 together, we are very concerned that you are misrepresenting the contractual relationships within the sector. If the aim of the study is to concentrate purely on those properties where the management function is controlled by the freeholder the study should indicate clearly what proportion of the sector is included.

3.10 See 3.13

3.11 You refer to ‘value for money’ as if it is a legal imperative. The recovery of costs as a service charge is covered by Section 19 of the Landlord and Tenant Act 1985 which states that costs are only recoverable to the extent that they have been ‘reasonably incurred’. There has been a vast array of court interpretation of ‘reasonably incurred’ since 1976, much of which specifically refers to the recovery of insurance costs.

Within this section and elsewhere within your report you are attempting to impose ‘value for money’ or ‘best value’ criteria over established statute and case law. We support the concept of value for money which is already enshrined in best practice guidance and codes of practice but we do make the point that your proposals would require primary legislation to overturn the established interpretation of statute by the courts.

3.12 It is normal for agents in any sector to receive a fee for undertaking works.

Receipt of such fees does not provide an automatic incentive 'to undertake unnecessary works or to increase costs'. We note that you have not particularised how agents may 'increase costs' but we assume you are suggesting there is a perverse incentive not to procure services at best value rather than suggesting impropriety.

As in many areas of your report, you are implying that the agent has control of the scope of works, employment of contractors and approval of costs. All these functions lie with the landlord and the extent of an agent's delegated authority is as contractually agreed within the management agreement.

Statutory protection is already in place:

Under Section 19 of the Landlord and Tenant Act 1985, the **landlord** may only recover costs as service charges (including costs incurred in procuring and managing contracts) that have been reasonably incurred and leaseholders have the right to request a determination by a tribunal under Section 27A.

3.13 See 3.12.

Vertical integration also allows a landlord / agent to ensure that services are of the desired quality and represent value for money. There are often positive reasons and benefits for vertical integration which should not be dismissed by the automatic assumption that such arrangements are put in place purely to make extra profit. Your report includes no quantitative nor qualitative assessment. We are pleased to note, however, that you acknowledge in Appendix A paras 11 & 12 that there may be efficiency benefits to vertical integration. We would point out that there may also be quality and contractor accountability benefits.

Statutory protection is already in place:

Under Section 19 of the Landlord and Tenant Act 1985, the **landlord** may only recover costs as service charges (including costs incurred in procuring and managing contracts) that have been reasonably incurred and leaseholders have the right to request a determination by a tribunal under Section 27A.

3.14 Property managers have **no** direct ability to collect administration charges from leaseholders with whom they have no direct contractual relationship. Leases may provide for the landlord to charge a fee and the agent's management agreement may include remuneration from the landlord.

Statutory protection is already in place:

Landlord and Tenant Acts 1927 and 1988 both require consent not to be unreasonably refused.

Commonhold and Leasehold Reform Act 2002 (at Section 158 and Schedule 11) defines variable Administration Charges which are "payable only to the extent that

the amount of the charge is reasonable". Leaseholders may request a tribunal determination of the amount that is reasonable.

Administration charges are only payable if the demand is accompanied by a prescribed summary of rights, which advises leaseholders of their rights to challenge under S158.

The Upper Tribunal (UT) has determined that any demand for unreasonable charges negates the requirement to obtain consent by removing any breach of covenant. There is, therefore, already a huge incentive for landlords to ensure that they are not seeking unreasonable fees which could result in them totally losing control over subletting, alterations and other restrictive covenants as well as failing to recover their reasonable costs.

Regulated property managers are already expected to follow best practice which includes (RICS UK Residential Property Standards 5th Edition): *You should only seek to recover administration charges that are provided for within the lease or by statute, and only to the extent that they are reasonable.*

3.15 The landlord (who may or may not be the freeholder) has long term contractual obligations to maintain the asset of the building, typically for 99, 125 or 999 years. In practice these obligations arise in perpetuity.

Leaseholders typically have short term perspectives; for the length of their 'ownership'.

It is impossible for these incentives to be fully aligned. We would urge caution on how far these incentives should be aligned towards the short term nature of leaseholders' 'ownership'. We would urge you to consider whether such re-alignment is in the long term interests of the condition of the nation's housing stock. We believe this point is particularly pertinent at the present time when a large proportion of the stock is new build and has yet to require major capital expenditure.

In quantifying the risks and rewards of any re-alignment, lessons may be learned from other jurisdictions where common property ownership has been controlled by individual property owners for many years. We would particularly recommend that you have regard to the report of The Glasgow Factoring Commission, "*Addressing the challenges of property management, maintenance and repair for residential property in Glasgow*". Published in January 2014. The Glasgow Factoring Commission are very concerned about problems created by lack of investment in the building fabric over many years.

Coordination problems

3.16 We concur with this statement.

Information asymmetries

3.17 We do not understand why a landlord client cannot easily monitor the behaviour of the property manager or assess the quality of the service they provide.

It is incumbent upon a client to do so.

The landlord would be directly responsible for any costs which are determined to have not been reasonably incurred "because the service or works were not of a reasonable standard". Any leaseholder can request a determination under Section 27A, it is therefore, financially incumbent upon the landlord to ensure that costs are reasonably incurred.

You again make the assumption that works are being procured by a managing agent. They are being procured by the landlord (who is frequently a leaseholder controlled company).

3.18 This sentence ignores the factual starting point that it is for the landlord to determine what works are required and to agree to the costs. There is a whole raft of statutory protections in place to prevent landlords from recovering costs from leaseholders that have not been reasonably incurred and to consult with leaseholders prior to committing major expenditure.

Your report does not make it clear whether you believe these controls and decisions should be vested in leaseholders rather than the landlord but that is the implication to be inferred from your comments. If so, there would be significant increases in cost and administration. Later on in your report you allude to the extent of administration related to Section 20 consultation. Extending consultation and decision making process to all works would impose intolerable extra burdens on managing agents and costs on leaseholders.

An unintended consequence could be that necessary works are not undertaken at all and we refer back to our observations at 3.15.

Weak competition due to lack of pressure from buyers

3.19 You have provided no evidence to support the assertion that **landlords** find it difficult to evaluate the performance of their property manager. See 3.18.

We do not recognise the lack of competition you describe. The situation reported by our members is that they face very significant competition for business from both existing competitors and new entrants to the sector.

Your report is based on the pretext that regular switching of property management services is good for the market. We would urge caution in making this unevidenced and unchallenged assumption.

The role of a property manager is to manage the asset of the building, on behalf of the landlord, for the long term; extending into perpetuity. We would question whether frequent switching of agents is in the best interests of this role and in the long term interests of the state of the nation's housing stock.

Regular switching implies agents competing on cost to provide the cheapest acceptable service. The easiest way to compete on costs is to take a short term approach. Long term management requires significant investment in staff, training and support technologies; the costs of which are not readily recoverable over the short term.

Your preconception appears to be that ease and frequency of switching equates to increased leaseholder satisfaction which implies a better management service. It is not difficult to increase leaseholder satisfaction in the short term; one simply manages for the short term, keeping day to day costs to a minimum and making no provision for the future long term maintenance of the asset.

To use your own terminology, short term leaseholder satisfaction and long term asset management are potentially misaligned incentives. We would urge you to consider which is more important; especially bearing in mind the extent to which the leasehold stock is relatively modern, new build and yet to require major investment. We would also suggest that the profile of leaseholders is appropriate to these considerations. How many buy to let investor leaseholders intend to retain their investment in a particular building beyond the point where major re-investment is necessary?

We are concerned that taking a short term approach is neither in the interests of maintaining a quality housing stock nor in the interests of leaseholders (as a body) over the longer term.

In this regard we would draw your attention to the approach taken by the government in increasing competition and switching in other sectors. In the energy and telecommunications sectors there is competition of service delivery to the end user but the ownership and long term maintenance of the infrastructure remains vested in other organisations for the long term. With the railways there is competition for longer term service delivery contracts but the infrastructure and long term investment remains vested in National Rail.

A number of our members have reported that they are becoming increasingly wary of accepting new business which has been subject to switching on a number of occasions. It is not uncommon for such schemes to find it increasingly difficult to arrange competent property management services.

Property law safeguards

3.20 The legislation to which you refer protects leaseholders against the actions of landlords not property managers. Your refusal to use the word landlord makes your report inaccurate and misleading.

- We concur that poor / untimely information at point of sale is a significant problem. We suggest this is one of the major problems within the sector and support all initiatives to ensure that leaseholders are making fully informed purchasing decisions. We refer to our observations under proposed remedy number 1 and highlight the initiatives that have been instigated by the sector and the reluctance that has been encountered from the conveyancing profession.

- We support the concept of regulation. Successive governments have refused to implement statutory regulation and we support the professional and trade bodies within the sector who are requiring their members to comply with sector led regulation. We would support CMA recommendations to extend regulation to the whole sector.

- Leaseholders have significant rights of redress against their landlord; with whom they have a contractual relationship. Landlord clients have considerable rights of redress against their agents with whom they have a contractual relationship. There is unsurprisingly limited redress between leaseholders and managing agents because there is no direct contractual relationship between the parties.

  Regulated members of RICS and members of ARMA do, however, have to be members of an approved ombudsman service. This requirement is in the process of being extended to all managing agents by statute.

- You have not particularised why you believe RTM is difficult to exercise. We comment further at 5.8

3.21 We are not aware of a single local authority or housing association in the country that uses service charge monies to subsidise services to their secure or assured tenants.

On the contrary, it is extremely rare for LAs and RSLs managing mixed tenure stock (including Right to Buy and Right to Acquire properties) to fully recover a due proportion of all their costs as service charges.

LAs and RSLs are obliged by legislation and regulation to follow robust and transparent procurement practices. These often involve making contracts available to contractors across the European Union.

We are unsure why you believe their procurement practices would be less robust than the private sector.

We would suggest the CMA study this in depth before making any recommendations.

3.22 There are some extremely wide and far reaching assertions within this paragraph. We make no specific comment here as the assertions are covered within many other sections and proposed remedies and our comments there apply.

Early Findings

5.5 We make observations on each of your bullet points in turn:

- Services are provided by the landlord. Property managers act on their client's (usually the landlord) instructions. Under Section 19 of the Landlord and Tenant Act 1985, the landlord may only recover costs as service charges that have been reasonably incurred and leaseholders have the right to request a determination by a tribunal under Section 27A.

- Poor services. Services are provided by the landlord. Property managers act on their client's instructions. Poor quality services often reflect cheap services or partial service provision due to inadequate cash flow. Most leases provide for the payment of service charges in advance and non-payment by leaseholders is often the precursor to reduction in service level and service quality as this leads to inadequate cash flow.

  Under Section 19 of the Landlord and Tenant Act 1985, the landlord may only recover costs as service charges that have been reasonably incurred in providing services "of a reasonable standard". Any leaseholder can request a determination under Section 27A.

  If you are referring to poor service from managing agents we must question how promoting regular switching, which inevitably leads to competing based on level of management fees, is likely to have a positive effect on service provision?

- Transparency. Leaseholders have a statutory right to request a summary of expenditure under Section 21 of the Landlord and Tenant Act 1985 and having done so, the right to inspect all supporting documentation under Section 22. Non-compliance is a summary offence punishable by a fine or imprisonment.

  Leaseholders or Recognised Tenants Associations (RTA) have a statutory right to employ an Accountant or a Chartered Surveyor to undertake a management audit of the scheme which could include all contracts, tender documents etc.

  Landlords will need to provide all supporting documentation to defend the recovery of any costs at a tribunal.

Landlords are required to consult with leaseholders in advance of committing expenditure on qualifying works or qualifying long term agreements, to make all tender documents available for inspection and to invite observations.

In the absence of statutory service charge accountancy procedures, the professional bodies have put in place best practice requirements that their members are expected to follow. These include the requirement to provide service charge accounts on an annual basis, within 6 months of the end of the financial year, incorporating a balance sheet and certified by an independent accountant. We would support any recommendation to enshrine these best practice requirements in statute.

Leaseholders, therefore, have significant rights to receive (or view) details of all costs incurred and recovered as a service charge. If your report is suggesting that leaseholders should be entitled to increased prior consultation and disclosure of service contracts etc there would be significant increases in cost and administration.

- Poor communication. The IRPM support any initiatives to ensure effective communication with clients and customers. Our syllabus for our member exams includes:

  Managing effective relationships with clients and customers within which:

  - Candidates should be able to demonstrate effective management of relationships with clients and leaseholders and other parties through an understanding of the clients and customers' needs and behaviours. They should be able to show how to build rapport, confidence and trust with others.

  This will include:

  - providing evidence of the optimum methods of communicating with individuals and groups through a variety of media including oral and written methods, face-to-face and electronic formats, and the use of formal and informal meetings.
  - demonstrating the importance for obtaining information, processing it and providing information to interested parties.
  - providing evidence of letter and report writing, basic arithmetic and where necessary to make presentations including using graphical information to inform.
  - providing evidence of being able to influence negotiations with clients, customers and other parties.

  We fully support and encourage property managers to demonstrate they satisfy these and other requirements and obtain our recognised qualifications.

We would point out that many managing agents are investing heavily in information technology and utilising social media platforms to communicate with their customers. It is increasingly common for scheme specific websites and some managing agents already provide 'real time' information on works orders, service contractor performance etc.

- Flawed procedures in respect of consultations on major works. We do not understand the point you are making here or the concern to leaseholders. Section 20 regulations are very prescriptive in their requirements. Non-compliance / flawed procedures would result in a landlord either not recovering the costs in full as a service charge or incurring additional costs to achieve dispensation from not fully complying. Non-compliance will be to the financial detriment of the landlord and hence is, in effect, in the leaseholders' financial interests. We are, therefore, confused about this being listed in a table headed 'poor outcomes for leaseholders'.

- Vertical integration. We refer to our comments at 3.10 – 3.13. Your report includes no quantitative nor qualitative assessment.

- Poor complaints handling and ineffective and expensive redress. All regulated managing agents (members of RICS or ARMA) are required to have a published complaints procedure and subscribe to an independent ombudsman service. Statute will shortly extend these requirements to all managing agents who will be compelled to join a mandatory redress scheme.

5.6 Your report does not disaggregate complaints and dissatisfaction with landlords from dissatisfaction with their agents. The difference is rarely understood by leaseholders and qualitative research should ensure these issues are clarified.

A property manager's primary interaction with leaseholders is to demand service charge monies on behalf of their landlord client. Leaseholders often express dissatisfaction because they do not fully understand what services they are paying for. Leaseholders frequently believe that the totality of the service charge demanded is being paid to the managing agent. It may have been enlightening to have included an additional question within the survey; "how much do you pay your managing agent?" before asking if they considered the service represented value for money.

The average weekly fees paid to managing agents across the country is similar to the cost of one high street cup of coffee per week. It would have been enlightening to learn what percentage of leaseholders that realise this, think they are receiving poor value for money.

It is also imperative that the CMA understand the low level of fees and margin for cost savings when championing greater switching and competing on price. One wonders how price sensitive the same leaseholders are towards their weekly cup of coffee.

5.7 As a professional institute we support the rights of a majority of leaseholders to collectively take on the landlord functions. We would reiterate our comments at 3.6 that RMC and RTM landlords currently account for a large proportion (probably more than half) of private sector leasehold flats. Your report fails to acknowledge that fact.

5.8 We do not fully understand your comment that RTM is difficult to obtain. We acknowledge that the scheme enacted by parliament was overly bureaucratic and limited in the type of development covered; namely a stand-alone building with limited non-residential space. The Courts have tried to clarify RTM problems and have sought to apply common sense principles and (perhaps even) extend the right beyond the type of building(s) initially perceived by parliament. The courts and tribunals are, however, limited by the legislation enacted.

Within those limitations however, it is not difficult for a majority of leaseholders to exercise their right although parliament also enacted rights for landlords to challenge that the right exists. We would point out that any such challenges are by landlords not managing agents. Unfortunately the limitations imposed by parliament are not clearly understood and feedback that the right is difficult to obtain often refers to non-qualifying buildings or mixed use developments.

We would urge caution in making recommendations in response to suggestions that *it is sometimes difficult to generate enough participating members, especially where there are a significant number of buy to let investor leaseholders*. The criteria was set at a minimum of 50% participating leaseholders. The rationale being that a majority of leaseholders could exercise their right to take on the management functions of the landlord. RTM was never intended to confer a right on a minority of leaseholders to compulsory acquire the management functions over the majority; potentially against the wishes of that majority. If a majority of leaseholders do not wish to participate there is clearly no majority wish to exercise the right to manage. That is not the same thing as saying it is difficult to obtain.

In proposing any amendments to the RTM legislation one also needs to have regard to the rights of commercial tenants in mixed use developments. Their rights need to be preserved.

You rightly make the point that RTM does not ensure the landlord function is undertaken efficiently or with majority consent. Not all potential purchasers wish to obtain a leasehold interest in a building where the management function is vested in their neighbours. We would highlight that the many statutory protections available to leaseholders become significantly watered down (if not worthless) when the landlord against whom they have redress is a company in which they or their neighbours are the only shareholders and is a ‘man of straw’ with no income or assets of its own. Many leaseholders would prefer the protection of a landlord company from whom they can obtain financial recompense for non-compliance with leasehold legislation.

Taking the above together with the our analysis at 3.6 of the size of the market where the management is already under collective leaseholder control or potentially

under collective leaseholder control, we wonder if there is an equilibrium in the market place? Potential purchasers can already decide which type of landlord body they prefer and make their purchasing decision accordingly. We suggest that you explicitly consider the merits of this equilibrium before making recommendations to take it further in any particular direction. Increasing leaseholder choice to buy into one type of management control clearly limits that same choice in the alternative.

5.9 We concur that there is a need to ensure that potential purchasers are in receipt of sufficient information to make fully informed purchasing decisions. We submit that the level of ignorance amongst existing leaseholders is one of the key factors in determining dissatisfaction. We urge the CMA to ensure that 'buyer's remorse' is not the determinative factor within any qualitative and quantitative assessment of the management issues. It is incumbent upon the CMA to ensure that recommendations reflect genuine problems and not leaseholder ignorance or regret.

5.10 We refer to our comprehensive comments at 3.19 above. The experience of our members is that there is fierce competition for management instructions.

We would highlight that the sector is heavily price driven and question whether frequent switching of providers is in anybody's interests (let alone leaseholders).

There is evidence that many firms operating within the residential property management sector are currently making severally limited (if any) real returns on their property management business. The CMA should have serious regard to this situation when recommending greater competition and more frequent switching without proposing appropriate additional safeguards. There are no barriers to entry into the sector and your report does not give any increased confidence that statutory regulation will be an outcome.

We have genuine concern that encouraging increased switching and shorter term instructions in a very low cost, price sensitive sector may have negative effects on the quality of management and the safety of leaseholders' funds held by firms in financial distress.

5.11 We are somewhat taken aback by your comment that "price competition between property managers tends to focus on the management fee". The management fee **is** the property manager's remuneration for undertaking the agreed level of management services as detailed within the management agreement. How else is price competition expected to manifest itself if not by reference to the level of price at which competitors are prepared to contract?

We repeat our point from 5.6 that property management is a service which is not highly remunerated. We urge the CMA to have regard to this fact when promoting increased switching in a sector that has no barriers to entry and already competes on price.

With regard to delegated authority and charges for consents, we reiterate our comments at 3.14.

Leases rarely (**if ever**) delegate authority to property managers or any other party who are not themselves a party to the lease (typically as landlord). Leases may provide for the landlord to charge a fee and the agent's management agreement may include remuneration from the landlord but it is certainly not the case that leases delegate authority directly to a property manager to either grant consents or to recover a fee directly from a leaseholder.

Statutory protection is already in place:

Landlord and Tenant Acts 1927 and 1988 both require consent not to be unreasonably refused.

Commonhold and Leasehold Reform Act 2002 (at Section 158 and Schedule 11) defines variable Administration Charges which are "payable only to the extent that the amount of the charge is reasonable". Leaseholders may request a tribunal determination of the amount that is reasonable.

Your report appears to be making the assumption that property managers can compete at low levels of management fee because they can make excessive amounts of money from charging for consents. We suggest that any such opportunities are severely limited, are only available indirectly via the landlord and as pointed out above, any such charges are already subject to statutory 'reasonable' limitations.

The UT has determined that any demand for unreasonable charges negates the requirement to obtain consent by removing any breach of covenant. There is, therefore, already a huge incentive for landlords to ensure that they are not seeking unreasonable fees either directly or indirectly via their managing agents; which could result in them totally losing control over subletting, alterations and other restrictive covenants as well as failing to recover their reasonable costs.

5.12 We concur with your observations that there is active competition amongst managing agents for the management of new developments. We do not necessarily agree that such competition is less prevalent elsewhere and your report does not present any quantitative assessment related to these assertions.

Some leases are drafted on a tri-partite basis with the landlord function being vested in a manager. In such situations the manager takes on the management functions directly as landlord and would rarely appoint a managing agent. Your report appears to be making assertions that this is somehow wrong without making any qualitative assessment of the situation.

It is not within the remit of this response for us to provide you with a complete understanding of the rationale behind tri-partite leases or a resume of all the positives and negatives that may arise. We do however, reiterate the point that a manager under a tri-partite lease is a landlord and all our earlier comments regarding landlords and leaseholder rights of protection against the action of landlords apply.

Tri-partite leases have become very common over the last 20 – 30 years simply because developers and investor freeholders prefer not be encumbered with the landlord's management obligations. This appears to be a counter observation (from actual workings of the market) to the CMA's unquantified view that it is common for freeholders to seek to benefit from the management functions.

Leaseholders under a tri-partite lease retain all the protections against their landlord that they have against any other landlord.

Your comment specifically ignores leaseholders' rights to collective enfranchisement and the very strong rights under Section 24 of the Landlord and Tenant Act 1987 to request the appointment of a manager by a tribunal.

We are unsure that the CMA have totally understood the contractual relationships within tri-partite leases. This is perhaps best summarised by two questions:

1) What additional rights do leaseholders have to displace their landlord where they have bought into a lease that is not tri-partite? Answer; none.

2) Why do leaseholders require any additional rights and / or protections against tri-partite landlords than any other landlord?

If the underlying suggestion is that legislation should be introduced to require any manager under a tri-partite lease to be a RMC we would refer to our comments in relation to your proposed remedies number 9 and recommend the CMA has regard to legislation which already exists in the Republic of Ireland. Any such proposals require a broadening of the intent of the study to consider changes in the practices of developers.

5.13 We concur that many leases are poorly drafted. We would make the point that it is incumbent upon a leasehold purchaser to ensure that he is aware of the obligations that he is entering into at the time of purchase. We fully support recommendations elsewhere within the report that there is a need to ensure professional advice is obtained and provided to an adequate standard before a purchasing decision is made.

We do not however, fully understand the point that you are making about poorly drafted leases and their impact on the services provided, as agent, by property managers. A poorly drafted lease that is silent on responsibilities or cost recovery can only work to the detriment of the landlord. There must be clear obligations on behalf of a tenant for those obligations not to remain with the landlord. There must be clear clauses entitling a landlord to cost recovery to enable a landlord to recover those costs. Even where a lease is not silent but is ambiguous it will always be construed against the landlord under the *contra proferentum* principal.

5.14 As clarification to the footnote number 10: the law does not state that leaseholders MUST be consulted nor does it "set out precise procedures landlords

MUST follow". There is no requirement to consult unless the landlord wishes to fully recover costs as a service charge.

The consultation requirements apply to landlords. Not to property managers.

Our members and many of their clients and customers would support an increase in the threshold for undertaking consultation on qualifying works.

The regulations are perfectly clear that a qualifying long term agreement is an agreement for more than a year. There is no requirement for landlords to consult on contracts of a year of less. Your report gives the impression that entering into such contracts is 'consultation avoidance'. We are unsure whether you are suggesting extending the consultation requirements to shorter contracts. If so the administrative burden and additional costs faced by leaseholders would be substantial and it is likely that landlords would simply not enter into contracts but would buy services on an 'as and when needed' basis which would be both more costly for the leaseholders and less efficient.

5.16 Your report contains no evidence that the use of related companies results in inflated costs. We repeat our comments at 5.5 and 3.13: the use of related companies also allows a landlord / agent to ensure that services are of the desired quality and represent value for money. There are often positive reasons and benefits for vertical integration which should not be dismissed by the automatic assumption that such arrangements are put in place purely to make extra profit. Your report includes no quantitative nor qualitative assessment.

We note that you have concluded that the use of related contractors is less prevalent than in the past and also note that within Appendix A you recognise there may be benefits although these are not mentioned within the body of your report.

Proposals for remedial measures

6.1 "We now consider possible areas of remedial action to address the problems we have provisionally identified in the market." Your report has identified very few problems in the market. Your report contains many suppositions and possible issues but is extremely thin on qualitative or quantitative analysis.

We are concerned that you intend to propose remedial action to address problems which you consider **'may'** exist in the market rather than address problems that you have identified and quantified.

Your report also makes limited reference to the initiatives that have already been taken by professional bodies to improve the sector. These include:

- the establishment of the IRPM to provide independent qualifications and accreditation for property managers,
- ARMA's introduction of a compulsory self-regulatory regime; 'ARMA Q',

- The requirements of ARMA and RICS regulated members to subscribe to an independent ombudsman scheme. This requirement is about to be extended to all residential property managers by statute.
- best practice guidance that regulated property managers are expected to follow, including the
    - RICS UK Residential Property Standards
    - Institute of Chartered Accountants' England and Wales (ICAEA) Technical Release 3/11.
- The production of Codes of Practice approved by the Secretary of State, by ARHM and RICS.

A revised 3rd edition of the RICS Service Charge Residential Management Code is due to be considered by the Secretary of State shortly and you may wish to consider making any suggestions for additional or revised content to DCLG.

6.2 You state that your recommendations are limited to "how the market for RPMS might work better within the context of the existing leasehold system." But many of your proposals ignore the current legal protections that are in place and would require a fundamental change in the law.

6.3 We address each of your bullet points in turn:

- We agree and fully support any proposals to ensure that potential purchasers are in receipt of sufficient information to make fully informed purchasing decisions.

  The professional bodies working within the sector have sought to improve the situation but have encountered resistance from the conveyancing sector (see Table 2, para 1 below)

- Leaseholders can already act together if dissatisfied with their current service.

6.4 We are pleased to note the CMA acknowledge the considerable effort and cost being incurred by ARMA and their members in adopting ARMA-Q. In the absence of compulsory regulation, we fully support this initiative for self-regulation. In the absence of compulsory regulation, we welcome any CMA recommendations on how such standards can be applied to all property managers.

The paragraph on self-regulation however, provides little confidence that the CMA has fully understood and had full regard to the existing statutory protections and best practice safeguards. There are three codes of practice which have been approved by the Secretary of State for England under Section 87(7) of the Leasehold Reform Housing and Urban Development Act 1993.

Compliance with the RICS Service Charge Residential Management Code is not restricted to RICS members. It applies to the management of **ALL** residential

leasehold properties in England (except where the landlord is a public sector authority or a RSL).

Secondly, the Association of Retirement Housing Managers' (ARHM) Code of Practice applies to **ALL** leasehold retirement properties in England except those managed by public sector landlords who are not members of the ARHM. They have also published additional best practice guidance in Wales.

Table 2 Remedies proposals

1. Leaseholders do not fully understand the implications of being a leaseholder

We fully support any proposals to assist leaseholders in making fully informed purchasing decisions.

We note your comment that 'pre-sales information' provided by property managers is in many cases poor. This is the first mention of this assertion within your report. What is the factual basis for making this assertion? Property managers respond to requests from purchasers' solicitors (via the vendor) to provide information they desire. In practice the property manager frequently provides more comprehensive information than the purchaser's solicitor requests. There are many cases where the property manager is unaware that a flat is for sale, receives no request for information and only becomes aware, once the purchase has completed.

There was a joint industry initiative in 2013 whereby the professional bodies within the sector worked with the Law Society to establish a standard pre-sales questionnaire. Reluctance was encountered from the conveyancing profession to include more detailed management questions within the standard questionnaire. We fully support any proposals to improve the quality of pre-sales information and would recommend that CMA engage with the Law Society to achieve this objective.

LEASE (in conjunction with ARMA and ARHM) produce a very good leaflet entitled "Living in leasehold flats" which should be disseminated widely.

DCLG produce a very comprehensive guide: "Residential long leaseholders; a guide to your rights and responsibilities" which should also be disseminated widely.

Legislation is already in place in the Consumer Protection from Unfair Trading Regulations 2008 and the Business Protection from Misleading Marketing Regulations 2008. We note that guidance published by the OFT in September 12 already deals with these issues under 'Material Information' which may include:

- "the form of ownership (for example freehold or leasehold)
- the length of any lease
- the amount of the service charge, ground rent and any other"

It is clear that this guidance is not widely followed and estate agents often fail to disclose the form of tenure let alone details of ground rent and service charges.

We would recommend that this list be strengthened to require vendors and their agents make potential purchasers aware of:

- outline of obligations under the lease
- management arrangements for common parts
- major works proposals
- existing consultations and
- the level of reserve funds held.

Statutory powers to remedy this problem already lie with the CMA.

2. Leaseholders are not able to fully assess the true costs of ownership at the time of purchase

All our comments and suggestions at 1 above apply.

Standards sets of questions already exist. We suggest the CMA engage with the Law Society to ensure they are further improved and widely used.

Pre-purchase information packs typically provide the current budget, 3 years accounts and details of any major works expenditure envisaged in the near future.

The provision of more information within sales particulars may encourage prospective leaseholders to pay more attention to the comprehensive financial position during the conveyancing process.

3. The services provided by property management companies and detail of work carried out may be unclear to leaseholders

We are unclear what information you are suggesting is provided, to who, by whom and when? Each column of your table appears to relate to different things.

We fully support the development and wide dissemination of costed long term maintenance plans. These are already required by good practice guidance. The RICS UK Residential Property Standards 5th Edition includes:

> *You should also encourage your clients to draw up a costed, long-term maintenance plan that reflects stock condition information and projected income streams. This should be made available to all leaseholders and any potential purchasers upon resale. Where there is no provision in the lease for reserve funds, there is no entitlement to create or hold one and the money can be demanded back by the leaseholders. In these circumstances, or where the current provisions are likely to prove inadequate, you should make leaseholders aware and encourage them to make their own long-term saving provisions towards the estimated expenditure.*

Producing future costed plans costs money and many RMC landlords resist them.

We refer to our comments at 3.15 and 3.19 regarding the short term nature of many leaseholders' perceptions and the misaligned incentives towards the long term maintenance of the building.

In recommending future good practice requirements for RMCs and RTM Cos we would suggest you have regard to the statutory requirements placed on Owner Management Companies in the Republic of Ireland (as detailed in proposed remedy number 7 below).

There is limited incentive for property managers on one year contracts or subject to regular competition, to offer to produce such plans. Your recommendations here should have regard to our comments at 3.19 and proposed remedy number 7 (below).

4. Leaseholders do not understand their responsibilities or the redress that is open to them

We encourage our members to provide education to leaseholders on their rights and responsibilities. In our experience property managers already undertake this role on a continual basis.

The learning material upon which the IRPM examinations are based is available by subscription to leaseholders and members of the public as well as our members. We have made our Foundation Exam freely available within this learning material to encourage leaseholders, RMC Directors etc to validate and receive accreditation for their learning and to become more informed customers and clients. You do not have to be a member of the Institute to take out a subscription.

We fully support any initiative to improve the level of understanding amongst leaseholders.

5. Leaseholders are not incentivised to consider the benefits of collective action

We are in favour of leaseholders being aware of their legal rights and being able to receive sufficient information to make informed decisions. We refer to our comments at 1. above on the availability of very comprehensive free guidance already produced by DCLG and LEASE. We are, however, confused about your suggested remedies.

You appear to be suggesting that property managers should be incentivised to encourage the formation of recognised tenants associations (RTAs) or to promote the existence of the rights to collective enfranchisement or RTM.

From our experience, property managers and landlords frequently welcome the existence of a RTA. They provide landlords and property managers with a focal point of contact and consultation. It is not uncommon for property managers to support the development of 'flash' residents' associations which may be formed to represent collective views on a specific issue at a particular time. We fully support the establishment of fully representative recognised RTAs.

If you are also suggesting that property managers should be incentivised to encourage leaseholders to collectively enfranchise or to exercise RTM we would point out that this would be encouraging leaseholders to exercise rights against the legal interests of the property manager's client. Managing agents are expected to comply with the established laws of agency, including acting in the best interests of their clients.

6. Leaseholders' engagement / co-ordination may be poor

You propose to promote RMCs in new contracts. RMCs have been very prevalent in new leasehold developments for many years; we would even suggest within a sizeable majority of new developments. Your report points out that there are already some 80,523 such companies registered at Companies House.

We read your recommendations to suggest that developers should be encouraged to promote RMCs. Your report and recommendations needs to go beyond property management to achieve these objectives in requiring developers to change their practices.

As a professional Institute we expect our members to provide quality services to all types of landlord and we have no preference for one type over another. Should you / the government wish to promote RMCs more exclusively within new developments and promote or regulate good practice, we would suggest that you have regard to existing legislation in other jurisdictions. We would particularly recommend you have regard to the Irish Republic's Multi Unit Development Act 2011. This Act requires developers to establish Owner Management Companies and regulates their governance and management activities.

Leaseholder representative bodies already have the right to request recognition by the landlord. Where recognition is refused (or not replied to) there is a right to request a certificate of recognition from a First Tier Tribunal (FTT). Non-statutory guidance suggests that the determinant factors a FTT should have regard to are a) is the applicant truly representative of a majority of tenants? and b) do they have documented, democratic governance procedures? We suggest that a landlord should have regard to similar criteria.

We support the promotion and establishment of truly representative Recognised Tenants' Associations (RTAs). We would not support any proposal that 'makes it compulsory for the landlord to recognise **any** representative body'. We urge caution

in providing any statutory rights for a non-representative minority of tenants (or occupiers) that are greater than the rights already owned by each individual. Problems are often encountered in the management of blocks of flats where there are two or more different factions of leaseholders and / or occupiers with different agendas.

Your proposal is also that RTAs should be recognised by the property management company. Recognition needs to be by the landlord who has contractual and statutory obligations. A managing agent must automatically recognise any RTA recognised by their landlord client. Recognition by a management agent without recognition by their client would be irrelevant.

7. Leaseholders are unable to understand and assess the service being provided by the property management company

Your proposed remedies confuse provision of information on the services provided by property managers with information on wider service delivery and other contracts.

We shall confine our comments here to the provision of information on the services provided by property managers as there are already very significant statutory protections in place for leaseholders on wider service delivery issues.

You will note from our comments at 3.19 above, that we have concerns about whether frequent switching of property managers is in the best interests of long term asset management or the long term interests of leaseholders. There is already a perfectly workable solution which addresses both your concerns under this heading (and several other headings) and our concerns about short term management.

Section 20 of the Landlord & Tenant Act 1985 (as amended) requires landlords to consult on any qualifying long term agreements (QLTAs) if they wish to fully recover costs from any one leaseholder, under that agreement, in excess of £100 in any one year. The consultation regulations give leaseholders and RTAs the right to nominate a contractor and they require landlords to put together at least two proposals that must include at least one contractor not related to the landlord and at least one leaseholder nominated contractor (if any nominations were received). Proposals must include the name and address of the contractor, any connection to the landlord, description of the services to be provided, proposed length of contract, estimated cost and any provision for varying costs going forwards. Where the proposed agreement is for property management, the proposals must also detail any trade or professional association the manager is a member of and details of any code of conduct subscribed to.

It is not uncommon for large landlords to procure property management services by way of fully consulted qualifying long term agreements. We are aware of one such consultation currently being undertaken on one of London's prime residential portfolios. It is less common for smaller landlords to do so because they lack the expertise to undertake the consultation process. It is also not common for RMCs /

RTM Cos to procure property management services by way of QLTAs because they not only lack the expertise but are also often deterred by the administrative effort and costs involved. They also often lack the knowledge or fail to accept that the legislation applies to them equally as it does to any other landlord.

We submit that greater use of transparently tendered, fully consulted qualifying long term management agreements would address your concerns. We also believe that greater use of such procurement would be in the best long term interests of the housing stock and the leaseholders themselves. We would support any proposals to encourage landlords to make greater use of these arrangements and would suggest that you encourage RMCs and RTM Cos accordingly.

If you agree that our proposal has merit, it could be promoted to RMCs and RTM Cos by way of a Code of Practice. Secretary of State approval would give any such code statutory status. In this regard, we once again draw your attention to the statutory requirements placed on Owner Management Companies in the Republic of Ireland. Similar good practice requirements could be imposed on RMCs and RTM Cos in England and Wales by inclusion within an approved code of practice.

As your figures indicate, RMCs and RTM Cos already account for more than 50% of flatted developments. Larger institutional landlords already often procure long term management agreements. Any good practice requirements imposed on RMCs and RTM Cos would very quickly permeate the market as a whole.

8. Leaseholders are unable to understand and assess the service being provided by the Local Authority / Housing Association

Local Authorities and RSLs already publish results of KPIs and customer satisfaction surveys. There may be opportunities for more effective benchmarking of such information but there is always the difficulty of comparing like with like.

We are not entirely sure how your proposals are intended to be progressed but we are aware that you will be discussing the detail with practitioners who directly represent many of our members from within these sectors.

9. Property management companies may set very high administration charges

Statutory protection already exists.

Landlord and Tenant Acts 1927 and 1988 both require consents not to be unreasonably refused.

Commonhold and Leasehold Reform Act 2002 (at Section 158 and Schedule 11) defines variable Administration Charges which are “payable only to the extent that the amount of the charge is reasonable”. Leaseholders may request a tribunal determination of the amount that is reasonable. No administration charges are

payable unless the demand is accompanied by a prescribed summary of rights alerting leaseholders to their rights of challenge.

There is an increasing body of Upper Tribunal determinations that make your proposal to benchmark administration charges irrelevant, unnecessary and potentially against the financial interests of leaseholders.

You ask the question should any remedy include charges set by freeholders but collected on their behalf by property managers. We reiterate the point that property managing agents have no contractual ability to recover any costs from leaseholders. Administration charges are only recoverable by the **landlord** under the terms of the lease. The agent's management agreement may include equivalent remuneration from the **landlord** but it is certainly not the case that leases delegate authority directly to a property manager to either grant consents or to recover a fee directly from a leaseholder.

The UT has determined that any demand for unreasonable charges negates the requirement to obtain consent by removing any breach of covenant. There is, therefore, already a huge incentive for landlords to ensure that they are not seeking unreasonable fees either directly or indirectly via their managing agents; which could result in them totally losing control over subletting, alterations and other restrictive covenants as well as failing to recover their reasonable costs.

10. The cost of building insurance may be unnecessarily high

It is not appropriate to lump property managers and freeholders within the same sentence.

Property managers undertaking any insurance related work **are** subject to regulation by the Financial Conduct Authority and pay a not insignificant fee to be registered.

ALL property managers (outside the public sector) are required to comply with the RICS Service Charge Residential Management Code which includes an obligation (at 2.6):

> *Insurance commissions and all other sources of income to the managing agent arising out of the management should be declared to the client and to tenants.*

Managers of retirement properties are required to comply with similar obligations included with the ARHM Code of Practice.

Best practice guidance (RICS UK Residential Property Standards 5th Edition) includes:

You should have regard to section 2.6 of the Service Charge Code and the recommendations of the RICS Transparency Working Group.

Your client and leaseholders should be notified of any remuneration, commission and other payments you receive in connection with placing or managing insurance. You should also obtain your client's informed consent to retain any commission received.

It is best practice to declare any commission or other sources of income arising from the provision of services in the annual service charge accounts and statements. You should explain what services are provided for the remuneration received and demonstrate those services represent good value for money.

For those managing agents regulated by RICS or ARMA, non-compliance with the Code and Guidance is a regulatory breach. Any managing agents (not just members of RICS) not complying with the Code leave themselves open to legal action from their clients and expose the landlord to the risk of an application to the FTT for the Appointment of a Manager under Section 24 of Landlord & Tenant Act 1987. Any leaseholder has the statutory right to make an application under Section 24.

Statutory protection already exists.

Under section 30A and schedule 1 of the *Landlord and Tenant Act* 1985, leaseholders paying service charges, directly or indirectly, towards the cost of insurance (and any RTA) can request a written summary of insurance cover. They can also request to inspect the policy and related documents, which may include receipts for payment of the premium. Non-compliance, within 21 days of receipt of a written notice, is a summary offence.

The RICS UK Residential Property Standards (5th Edition) also includes the following best practice guidance:

You should be aware of the requirements for costs, recoverable as a service charge, to be 'reasonably incurred' and for the possibility of leaseholders to challenge it at an LVT. Insurance procured may not necessarily be the cheapest available, but should cover appropriate risks and be subject to market testing. You should regularly review the extent of cover and level of premiums for all insurances under your control.

We find it difficult to imagine any additional requirements that can be imposed on property managers acting within their delegated powers.

We note from para 2.3 of your report that you are "only considering the legal relationship between leaseholders and freeholders in so far as it impacts on the supply of RPMS". Your proposed remedies under 10 appear to go much further than this and suggest imposing significant obligations on freeholders relating to the procurement of insurance.

Our members are largely unaffected by any increased obligations placed on freeholders relating to insurance and we therefore have little comment to make. We do however, wonder how your proposed remedies may be introduced without primary legislation. There is a substantial body of case law relating to insurance costs being 'reasonably incurred'; much of which you appear to seek to reverse. We are unsure how this can be achieved without primary legislation.

11. <u>There is potential for LAs and RSLs to use property management income to cross subsidise other tenants or services</u>

We are unaware how the CMA has come to the conclusion that LAs and RSLs are subsidising other tenants out of service charge income.

It is extremely rare for LAs and RSLs managing mixed tenure stock (including Right to Buy and Right to Acquire properties) to fully recover a due proportion of all their costs as service charges. We are not aware of a single local authority or housing association in the country that uses service charge monies to subsidies services to their secure or assured tenants.

We would suggest the CMA study this allegation deeper before making any recommendations.

12. <u>Property management companies may carry out excessive or unnecessary works in order to increase their commission payment</u>

We refer to our comments at 3.12

You have provided no quantitative evidence of this alleged problem. We are concerned that you are proposing prescriptive regulatory requirements in response to supposition and pre-conceived ideas. Your suggested remedies fly in the face of a competitive market and would restrict the ability of providers to compete on alternative fee structures or bases of remuneration.

As in many areas of your report, you are implying that the managing agent has control of the scope of works, employment of contractors and approval of costs. All these functions lie with the **landlord** and the extent of an agent's delegated authority is limited to that contractually agreed within the management agreement. It is usual for agents to recover their costs of undertaking duties on behalf of their clients.

Statutory protection is already in place:

Under Section 19 of the Landlord and Tenant Act 1985, the landlord may only recover costs as service charges (including costs incurred in procuring and managing contracts) that have been reasonably incurred and leaseholders have the right to request a determination by a tribunal under Section 27A.

We assume you are referring to the Commonhold and Leasehold Reform Act 2002 and that by "breakdown of service charges" you are referring to the powers for the Secretary of State under Section 152 to introduce regulations requiring regular statements of accounts.

Section 152 was replaced in 2008 by Sections 303 and Schedule 12 of the Housing and Regeneration Act 2008 (which have also never been enacted).

We would support any action by the Secretary of State to enact Sections 303 and Schedule 12 which would increase leaseholders' protections against their **landlords** and improve the transparency of service charge funds held by landlords and their agents.

The professions have introduced their own good practice guidance in lieu of the government enacting statutory provisions. We refer you to the Institute of Chartered Accountants England and Wales (ICAEA) Technical Release 3/11: Residential Service Charge Accounts, published in October 2011. When Mark Prisk was Housing Minister he advised that he was open to the suggestion of approving this guidance as an approved code of practice. Any such approval would have similar effect to enacting the provisions you suggest (although not providing the wider benefits) and we would support such a recommendation.

13 Leaseholders may not be getting value for money because of vertical integration

We repeat our observations at 3.10, 3.12 & 3.13

Vertical integration also allows a landlord / agent to ensure that services are of the desired quality and represent value for money. There are often positive reasons and benefits for vertical integration which should not be dismissed by the automatic assumption that such arrangements are put in place purely to make extra profit.

Statutory protection is already in place:

Under Section 19 of the Landlord and Tenant Act 1985, the **landlord** may only recover costs as service charges that have been reasonably incurred and leaseholders have the right to request a determination by a tribunal under Section 27A.

We note that no quantitative or qualitative assessment is provided within your report. We are surprised that the CMA is suggesting prohibiting competition in the market for management services and restricting a freeholder's rights to invest in certain companies.

Consultation regulations under Section 20 already require disclosure for qualifying works and qualifying long term agreements. They also require estimates or proposals to be provided from contractors who are totally unrelated to the landlord.

Regulated property managers are already expected to follow best practice guidance contained within, The RICS UK Residential Property Standards (5th Edition) which includes:

> *Where you have a connection with any proposed contractor, whether financial or otherwise, this should be declared to your client and the leaseholders.*

You make the point that guidance is not mandatory. We would advise that the RICS Code of Practice is currently under review and a 3rd Edition will shortly be placed before the Secretary of State for approval. DCLG have advised in discussion, that they are only content with statutory requirements being included as mandatory requirements and all non-statutory requirements should be recommended best practice. CMA may like to discuss the issue of mandatory versus recommended compliance with DCLG.

14 <u>There is little pressure on freeholders to switch management companies</u>

The evidence of our members and our discussions with freeholders do not lead us to the same conclusions. Our members report that their employers typically face fierce completion for business. Freeholders typically advise that they do test the market regularly and take heed of leaseholder concerns and suggestions. It is not uncommon for freeholders to appoint new managing agents at the request of leaseholders.

You will have noted from our suggestions at remedy number 7 above, that we do see benefits in longer term, tendered management contracts and would repeat our suggestions regarding bringing in good practice recommendations.

We are unsure how you propose to implement your suggested remedy of 'requiring freeholders' without enacting primary legislation. Legislation would need to encompass all landlords not just freeholders.

15 <u>Leaseholders have little influence or effective control over quality or price of service provided by property management companies once the freeholder has appointed</u>

We are unsure how you propose to implement your suggested remedy of 'requiring freeholders to retender when requested by a minimum 50% of leaseholders' without enacting primary legislation. The landlord function is often vested in a party other than the freeholder. Any proposed legislation would need to encompass all landlords including RMCs and RTMs not just freeholders.

We have no objections to the proposal, however we suggest it will have very limited impact on the market. Our discussions with major freeholders suggest that they

would typically already take action when requested by a representative sample of leaseholders.

We would refer you to your remedy number 17 and suggest that, without seeking a remit to purchase or manage the development, obtaining a 50% majority may be even more difficult to achieve than you assert it is for RTM. Experience of our members suggests that it is often very difficult to get any engagement from leaseholders (let alone 50%) when consulted on management proposals.

If there are genuine management problems any one leaseholder already has the right to request a tribunal appoint a manager under Section 24 of the Landlord and Tenant Act 1987. Enforcing this right also opens up a potentially valuable right for leaseholders to compulsory acquisition of their landlord's interest under Part III of the Landlord and Tenant Act 1987. Any such acquisition is financially detrimental to the landlord by depriving him of any share of marriage value. It is clearly, therefore, not in a landlord's interests to ignore management standards as you allege.

We are unsure why you have not referred to existing statutory protection available to leaseholders within your report. You allege that there are no incentives for freeholders (landlords) to ensure good management without any reference to the fact that there is already an ultimate sanction of compulsory acquisition of his interests.

16 Leaseholders have little influence or effective control over quality or price of service provided by property management companies where the freeholder appoints

All our comments at 15 above apply equally here.

We are unsure how you are proposing to give leaseholders a right to veto a landlord's choice of property manager without enacting primary legislation.

We are also unsure how you are proposing to give leaseholders a power of approval to works without enacting primary legislation.

You appear to be suggesting that Section 20 consultation requirements are extended to all works and contracts and totally realigned to give ultimate choice of contractor to leaseholders rather than the landlord. This is a very wide ranging proposal with significant cost implications and property management ramifications. We will limit our comments to querying how you proposal to align this suggestion to a landlord's contractual obligations under the lease to provide services and maintain the property?

We also make the point that choice of contractor by leaseholders is often based solely on price and does not take into account the wider responsibilities placed on landlords and their agents e.g. health and safety, competency to do the job, CIS tax implications, etc.; all of which are driven by statute. As an example, leaseholders unaware of 'Working at Heights' statutory requirements often question why

scaffolding is needed on, say a three storey building, when external repairs are undertaken.

We would urge you to consider whether your proposed remedies will open up a minefield of litigation and cost burdens.

Your report ignores the rights that already exist for a representative group of leaseholders.

Under Section 30B of Landlord and Tenant Act 1985 a recognised tenants' association can already make a request to the landlord to be consulted on the appointment of managing agents or proposed changes to the appointment of managing agents.

17 Difficulty in reaching the RTM threshold

Our members manage leasehold properties for all types of landlords including RTM Cos and we, therefore, have limited preference for one type of landlord over another type.

We do, however, have concerns about your proposals to lower the threshold for RTM to below 50%. RTM was enacted as a means for the majority of leaseholders to compulsorily acquire the management of a block of flats from the landlord. If a 50% threshold is not obtainable there is clearly no majority will to exercise the right. RTM was never envisaged (throughout any of the consultation processes or draft acts of parliament that pre-dated CLRA 2002) as a right for a minority of leaseholders to compulsorily acquire the right to manage a block of flats against the will of the majority. We urge caution in recommending such minority rights.

18 Thresholds for Section 20 Consultation do not work well

Our members regularly comment that the £250 (including VAT) threshold for qualifying works is too low; especially for small blocks of flats. They also comment that such a low threshold invariably results in additional administration costs borne by leaseholders.

We would support recommendations to increase the threshold.

Your observations on Section 20 and the qualifying works threshold do not reflect the actual current legal position, in that they take no account of the High Court determination in the case of Phillips v Francis. An appeal of this decision is due to be heard by the Court of Appeal in October 2014 and we would recommend that the results of that case are used to inform any recommendations you make on review of the consultation proposals.

You refer to the exclusions of contracts for less than a year as being 'loopholes'. That is an entirely false definition. The consultation regulations specifically limit qualifying long term agreements to those agreements in excess of a year. If you are seeking to recommend extending consultation on QLTAs to those agreements for less than a year it will greatly increase the number of consultations that need to be undertaken and greatly increase the administrative burden and cost to leaseholders.

The original draft Commonhold and Leasehold Reform bill referred to contracts 'of a year or more' but parliament amended this to 'more than a year' following receipt of representations regarding cost implications. Your recommendations appear to be seeking to reverse this decision.

You appear to be proposing recommendations that would reduce the number of contracts for which statutory consultation is required for qualifying works but greatly increase the number of consultations for QLTAs.

We refer to our suggestions at 7. above. Recommending (or requiring) landlords to tender qualifying long term management agreements as best practice, may be a way of achieving your desired objectives relating to management agreements and eliminating what you perceive as a loophole i.e. short term contracts.

19. Standards can be low and self-regulation could be improved

We strongly support any increase in the number or quality of regulated managing agents.

A number of initiatives have already been taken by professional bodies to improve the sector. These include:

- the establishment of the IRPM to provide independent qualifications and accreditation for property managers,
- ARMA's introduction of a compulsory self-regulatory regime; 'ARMA Q',
- The requirements of ARMA and RICS regulated members to subscribe to an independent ombudsman scheme. This requirement is about to be extended to all property managers by statute.
- best practice guidance that regulated property managers are expected to follow, including the
    - RICS UK Residential Property Standards
    - Institute of Chartered Accountants' England and Wales (ICAEA) Technical Release 3/11.
- The production of Codes of Practice approved by the Secretary of State, by ARHM and RICS.

We support any proposals to extend regulation to all residential property management companies and to ensure their staff are appropriately qualified and experienced.

20. Limitations of current redress mechanisms

We support the increase in early neutral evaluation. Many professionals already provide this service. Early neutral evaluation can be a very effective, non-confrontational method of resolving many disputes; especially where there is no direct contractual relationship between the parties. Experience of our members, however, indicates that leaseholders have in the past been very reluctant to cover the costs of this and other ADR mechanisms. We would support any proposals to increase availability and awareness of early neutral evaluation and other ADR mechanisms.

LEASE used to provide a mediation service which was highly regarded. Unfortunately the service ceased due to lack of funding from government. You may wish to recommend additional government funding to support ADR.

All managing agents who are members of a self-regulatory regime already have to subscribe to an independent ombudsman scheme. You refer to the Housing Ombudsman but there are also two other ombudsmen schemes already operating in the sector and approved under the Enterprise and Regulatory Reform Act 2013. It will be mandatory for all managing agents to subscribe to an approved ombudsman scheme before the end of this year.

You appear to be recommending a move away from FTTs for the determination of payability and reasonableness of service charges and advocating a shift in such dispute resolution to the Housing Ombudsman (or presumably other ombudsmen).

This reflects your aim within the body of the report to replace the current statutory position of “reasonably incurred” with a statutory test of “value for money”. Any such changes would require primary legislation and there is a vast body of case law evidence on “reasonably incurred” from 1976 to date.

We would also urge caution that recommending any such changes in primary legislation would have the likely effect of generating a whole new field of litigation leading to a whole new body of case law. We would also point out that ‘cheapest’ does not often equate to best ‘value for money’ over neither the long term nor the short term.

Leases frequently provide for a dispute mechanism via arbitration. You will be aware that following the enactment of the Commonhold and Leasehold Reform Act 2002, all such provisions are null and void and a referral to arbitration must be freely agreed between the parties ‘post dispute’. We make this point purely to suggest that your recommendations may be going in exactly the opposite direction to previous

legislation; which has tended to move dispute resolution to the FTT rather than the reverse.

We do not share your assertions that the FTT is not the most appropriate forum to consider landlord and tenant disputes. Alternative forms of dispute resolution already exist but there appears to be limited leaseholder appetite to engage them. We totally support the greater use of ADR where appropriate but also consider the FTT to be the best forum for ultimate resolution of landlord and tenant disputes.

The RICS Code of Practice; *Service charges in commercial property (3rd Edition)* contains very comprehensive guidance on the use of ADR. This good practice guidance could easily be adapted and adopted into the residential sector.

Any recommendations should take account of the fact that alternative forms of dispute resolution are frequently more expensive than making an application to the FTT rather than less expensive.

Other remedies identified: Appendix A

2. We support any proposals for regulating managing agents; including statutory regulation.

5. Your comments are confusing. Codes of Practice approved by the Secretary of State already apply across the sector. They are not confined to members of the RICS or ARHM.

The RICS and ARHM approved codes of practice contain very similar requirements and property managers complying with one code are unlikely to fall foul of the other. The RICS Code has recently been reviewed and a 3rd Edition is to be considered by the Secretary of State shortly.

We do not therefore, understand the requirement for a unified code and suggest that CMA make any proposals to DCLG relating to additional content desired within the 3rd Edition of the RICS code.

6. As a professional institution offering qualifications in residential property management we fully support any proposals to increase and improve the level of education, training and qualifications within the sector.

The sector has come a long way in this regard. The IRPM has over 3,000 members just 12 years after being formed.

Licensing requirements do exist in other countries e.g. the USA and we would support any proposals for introducing similar requirements in England and Wales. At the present time however, we believe it is unlikely that any statutory requirement for

property managers to be licensed or hold a relevant qualification will be considered by the government.

Without a statutory licensing scheme, any requirement for holding relevant qualifications is likely to be related to a wider regulatory regime for property managing agents. We would support any requirements for regulation to include a requirement for senior staff to hold relevant qualifications or for qualified staff to be based in each office / area of work.

13. The RICS Code of Practice; *Service charges in commercial property (3rd Edition)* includes good practice requirement for standard industry cost classification. This includes standard 'cost class', 'cost category' and 'cost description' for commercial service charge accounts. This is intended to facilitate benchmarking of costs scheme by scheme.

Any meaningful benchmarking of residential service charge costs is likely to require the introduction of similar unified accounting codes. This may be included within any introduction by the government of statutory accounting requirements.

We question, however, how meaningful any benchmarking will be as schemes and service provision differ hugely. We also question who is likely to fund the development of any such benchmarking data.

15. Local Authorities do not commonly employ private sector managing agents to manage their leasehold stock because they do not typically own or manage leasehold blocks of flats.

Local Authority housing stock is almost entirely mixed-tenure stock with a mixture of owner occupiers, secure tenants and long leaseholders. Management is sometimes outsourced but they require management of the whole stock not management of a particular tenure type within that stock.

About the Institute of Residential Property Management

The Institute of Residential Property Management (IRPM) is a self-governing body funded by membership contributions and other revenue deriving from its activities.

The IRPM was launched in early 2002 as a means of delivering a portable professional qualification in residential property management, available to anyone working in the sector, and one which would be accepted by all those operating within it. Our key aims include:

- Raising standards within this professional sector
- Providing individuals with independent accreditation by way of training and examination as to their professional skills
- Providing a career development path for individuals and

- Aiding in the process of attracting and recruiting new entrants to the sector

Our membership has grown rapidly over twelve years and now stands at 3,000 members engaged in residential property management or ancillary activities, from both the public and private sectors, across the UK.

As a professional institute that has made a significant contribution to improving standards within the sector, we welcome any study into the property management profession. Your interim report, however, does not alleviate our concerns about the dearth of any rigorous academic research into the profession and the subsequent lack of informed conclusions on the workings of the sector.

The Institute and our members welcome the opportunity to make these observations. We would be delighted to discuss any of our observations with you, be involved in any future discussions or provide observations on any future proposals.

Yours sincerely,

Jeff Platt FRICS, FIRPM

Chief Executive

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