

# Residential property management services

A market study

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### Glossary

# 1. Executive summary

- 1.1 This market study looks at the supply of residential property management services (RPMS) in England and Wales by property management companies in blocks where there are multiple leasehold flats and some shared facilities or common parts of the building.
- 1.2 The Office of Fair Trading (OFT) decided to carry out a market study following on from previous work and in response to complaints it had reviewed. The OFT was concerned that some property managers may be overcharging customers, providing poor-quality services or spending money on unnecessary works. It was also concerned about whether property managers dealt effectively with complaints, and about access to effective redress for leaseholders who were dissatisfied with the services they had received. On 1 April 2014 the Competition and Markets Authority (CMA) took over many of the functions of the Competition Commission and the OFT, including this market study.

## Regulatory framework

- 1.3 In the case of leasehold properties, the terms of the lease govern the relationship between freeholder and leaseholder. Typically, the freeholder retains responsibility for the repair and maintenance of the communal areas and structure of the building and the provision of communal services, and may appoint a property manager to arrange and manage these tasks on its behalf.
- 1.4 Leaseholders are obliged to pay variable service charges for maintenance and repair. While leaseholders consume the services, it is generally the freeholder who is the customer of the property manager. There are many variations to these arrangements and instead of freeholders, the landlord (with responsibility for property management) may be a Right to Manage Company (RTMCo)), where leaseholders have collectively exercised a legal right to take responsibility for building management.<sup>1</sup> Another alternative is a Residents' Management Company (RMC), which are often established for new developments.<sup>2,3</sup>
- 1.5 There are various legal safeguards that exist to protect leaseholders in relation to RPMS. In addition to RTM and the right collectively to purchase the

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<sup>1</sup> Residents are members of the RTMCo and elect a board to run it.

<sup>2</sup> In RMCs, each flat owner will become a shareholder in the company which will manage the freehold of the whole building.

<sup>3</sup> Another option is for the leaseholders collectively to purchase and own the freehold of the block (collective enfranchisement), under which building management will similarly rest with a leaseholder-run management company.

freehold, leaseholders have a right to take issues to the First-tier Tribunal – Property Chamber (Residential Property) (FTT) – for example, to appeal charges that are not ‘reasonable’. Other legal safeguards include the right to refer aspects of conduct to ombudsmen services, the right to consultation on major works, and obligations on transparency and disclosure. In addition to legal safeguards, advice to leaseholders on legal provisions is available from the Leasehold Advisory Service (LEASE).

## **Size of the market**

- 1.6 We estimate that there are up to 3.1 million leasehold flats in England and Wales which might receive RPMS (although some will self-manage).<sup>4</sup> Given current levels of housing demand and pressure on land, the number of flats being built is likely to continue to grow, as is the demand for RPMS.
- 1.7 Service charge levels vary widely but we estimate them on average to be just over £1,100 annually. This suggests that service charges could total £2.4–£3.5 billion a year. The service charges leaseholders pay are, primarily, payments for acquired services and works, as well as a management fee to the property manager for arranging and managing the works. Leaseholders may also pay additional charges, for example administration charges for consents, such as for subletting or alterations.
- 1.8 There are many property managers in England and Wales, but no national register of such companies exists. There are many small and local companies, far fewer regional companies and only a very few large and national operators.

## ***Trade and professional associations***

- 1.9 The Association of Residential Managing Agents (ARMA) is the main trade association for property managers. It told us that its membership looked after about half the leasehold flats in England and Wales. ARMA has a code of conduct for property managers and from 1 January 2015 its new code, ARMA-Q, comes into effect.
- 1.10 Property managers may also be members of the Royal Institution of Chartered Surveyors (RICS), and/or of the Association of Retirement Housing Managers (ARHM) and the Associated Retirement Community Operators (ARCO). RICS and ARHM also have codes of conduct which are recognised

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<sup>4</sup> The total number of leasehold properties is higher than this, but we have excluded single properties and others which are unlikely to receive RPMS.

by the Secretary of State. The FTT will refer to these in guiding its decisions, even for non-members.

## Scope of the study

- 1.11 This study covers RPMS in England and Wales.<sup>5</sup> It includes properties where local authorities or housing associations retain the freehold. In those cases, the local authority or housing association may offer RPMS itself or utilise a related company (such as an arm's length management organisation (ALMO)), rather than employing a private sector property manager.<sup>6</sup> The study excludes single dwelling properties, and freehold properties.<sup>7</sup>
- 1.12 We have looked at the supply of RPMS services as they impact on leaseholders who occupy the premises (ie as consumers), and also leaseholders who rent their properties to tenants.
- 1.13 The scope of our study is limited to consideration of the supply of RPMS. Many of the concerns that have been raised with us relate to the system of leasehold, and the relationship between freeholders and leaseholders which does not directly include the involvement of property managers. This study has not undertaken an assessment of the legal framework that underpins freehold and leasehold arrangements, nor of lease terms and how freeholders or landlords interpret and apply those terms except in so far as it impacts on the supply of RPMS (any such consideration would need to balance the rights both of leaseholders and freeholders). Nor have we given wider consideration to alternative models of property ownership (such as commonhold or other systems whereby the owners of flats are collectively responsible for the upkeep of the block).

## Methodology

- 1.14 In the course of our market study we have consulted widely and met with many key stakeholders. We have gathered information and views through:

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<sup>5</sup> Scotland and Northern Ireland were excluded due to differences in legal frameworks and past work done in those countries (particularly a 2009 OFT market study, *Property Managers in Scotland*).

<sup>6</sup> We use the term 'property manager' to include both individual property managers and property management companies. We include those blocks where responsibility for property management rests with an RTMCo or RMC. In some cases landlords may self-manage properties rather than employ a property manager, although this is not a practicable alternative for non-professionals in relation to larger blocks. We have not considered this model of supply further and instead have concentrated on employed property managers.

<sup>7</sup> We have not considered communal land management on estates unless it is delivered as part of an overall service charge to leaseholders.

- submissions from stakeholders including leaseholders, property managers, freeholders and other industry participants;
  - meetings with property managers, residents' associations, industry trade associations, housing organisations, local authorities, government departments, regulators and advisory services, property developers, freeholders and campaign groups;
  - roundtable meetings with panels of participants from trade associations, local authority/housing association organisations, campaign groups and leaseholder groups;
  - questionnaires issued to property managers, freeholders, developers, local authorities and housing associations;
  - a survey of leaseholders conducted on our behalf by Ipsos MORI (the 'leaseholder survey'); and
  - a review of key sources of existing research – including government research and policy documents, academic research and trade press articles.
- 1.15 In addition, we have referred to publicly available information, such as contained on various consumer campaign websites and in court records and decisions, where appropriate, both to gather further evidence and better to understand whether the submissions we have received are representative of issues present in the market.
- 1.16 In August 2014 we published an Update Statement<sup>8</sup> on our website, which outlined our analysis of the issues in the market and set out a variety of proposals for remedial action. We also published the report and results of the leaseholder survey.<sup>9</sup> We received detailed comments on our analysis and remedies proposals from many parties, and we met with interested stakeholders to consider and develop the analysis and remedies recommendations.

## Findings

- 1.17 We first set out findings from the evidence received on outcomes for leaseholders and aspects of how the market works. We draw conclusions on

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<sup>8</sup> CMA, *Residential Property Management Services: An update paper on the market study*, 1 August 2014.

<sup>9</sup> Ipsos MORI, *CMA Leaseholder Survey 2014*, August 2014.

the workings of the market, and outline our recommended remedial measures, from paragraph 1.47 onwards.

### ***Outcomes for leaseholders***

- 1.18 We gathered extensive qualitative evidence during the course of the study of examples of poor outcomes for leaseholders, including complaints relating to: high charges for services arranged by property managers; unnecessary or excessive works; little transparency and unexpected costs; poor communication; flawed procedures for consultations on major works; vertical integration between property managers and contractors or between property managers and freeholders; poor service and complaints handling; and ineffective or difficult to use redress schemes.
- 1.19 Inevitably the submissions we received emphasised complaints rather than views on where the market works well. We found that quality of service and satisfaction depended to a large extent on the quality of individual managers and the nature of the relationship between leaseholders and the individual property manager. It was clear that some property managers were seen as less competent or scrupulous than others. The strongest complaints we received included protracted disputes where there had been a breakdown of trust between the property manager and the leaseholder. We were struck that where poor outcomes arose the emotional impact on leaseholders, partly because these issues related to their home, could be extremely high.
- 1.20 We commissioned Ipsos MORI to undertake the leaseholder survey in order to obtain an overall representation of leaseholder experience. While there were some difficulties in sampling leaseholders, the results of the leaseholder survey were, generally, more positive than the individual complaints we received suggested. Overall, almost two-thirds (64%) of respondents rated the service provided by property managers as very/fairly good.
- 1.21 Leaseholder satisfaction levels were greatest for those in retirement properties (82%) and for those in non-retirement properties in private ownership (63%), but lower for those owned by local authorities (53%) or housing associations (53%).<sup>10</sup> Results were notably different for properties where there was either an RTMCo or an RMC; overall satisfaction was high with eight in ten rating services as good (83%) compared with just over a half (58%) for non-RTM/RMC leaseholders. While half of leaseholders (52%)

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<sup>10</sup> This excludes housing association retirement properties. Including retirement properties, the results are 67% for private sector and 58% for housing associations (unchanged for local authorities).

agreed that their property manager provided value for money, among RTM/RMC leaseholders this rose to nearly eight out of ten (78%).

- 1.22 Despite the relatively high levels of overall satisfaction, around four in ten respondents (42%) said they had had reason in the past for dissatisfaction with their property manager. The highest proportion was among leaseholders in local authority properties (57%), followed by housing associations (54%), private developments (39%) and retirement developments (28%).<sup>11</sup> Those that did not have an RTMCo/RMC were more likely to have complained than those with an RTMCo/RMC.
- 1.23 28% of respondents disagreed that their property manager provides value for money, with half of them saying they strongly disagreed. Over half of the submissions we received from leaseholders included reference to excessive or unnecessary charges.
- 1.24 Overall, we found the outcome for leaseholders to be mixed. The impression we gained was that in many cases property managers delivered an effective and efficient service and communicated well with residents. Our leaseholder survey indicates that many leaseholders are satisfied with the service they receive and value for money, and leaseholders in properties with an RTMCo/RMC have higher levels of satisfaction. A minority of respondents perceive there to be problems with outcomes. Where issues arise, they cover a wide range including quality of service, value for money and the ability to obtain redress. Moreover, where the relationship between property manager and leaseholder breaks down, the impact on leaseholders can be very significant.

### ***Leaseholder understanding of obligations***

- 1.25 There was a consensus among all stakeholders, including leaseholder representatives, that many leaseholders have a poor awareness of their obligations in relation to property management and service charges. We found that leaseholders often do not understand how property management arrangements work before they purchase the property, nor do some of them fully understand their obligations, even where they are given information ahead of purchase. The incentives for vendors and estate agents to highlight the cost and quality of property management to purchasers appears to be limited, with the result that many prospective purchasers have little awareness of leasehold and service charge liabilities when flat-hunting and may not be able to ask the relevant questions or factor these issues into their planning

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<sup>11</sup> Again the private development and housing association figures exclude any retirement elements in cases where we are comparing these results with those for the retirement property sector.

and decisions until a very late stage. Even post-purchase, understanding can be limited, and many property managers told us that a large part of their activities was in explaining RPMS and lease obligations to leaseholders.

### ***Communication and transparency***

- 1.26 Practices on provision of information by property managers varied and we heard of some examples of poor, incomplete or confusing information. However, many property managers engage constructively with leaseholders and we saw examples of comprehensive and readily accessible information. Views among leaseholders on the quality of information provided to them were mixed. While many respondents to our leaseholder survey rated the provision of information by property managers on what service charges have been spent on as very/fairly good, one in seven (15%) respondents rated it as very/fairly poor. Just over one in five (22%) respondents rated the consultation of leaseholders on major works as very/fairly poor. This contrasts with leaseholders' experience where there was an RTMCo/RMC where levels of consultation were seen to be good.
- 1.27 Landlords and/or property managers (depending on the terms of the lease) can charge for various administrative tasks and approvals, for example approvals to keep pets, sublet the property or to make structural alterations. These charges sometimes seemed high and disproportionate to the work required. We found that although some property managers publicised these charges in advance, often the existence or size of charges came as a surprise to leaseholders, and they were unlikely to be considered when tendering for the appointment of a property manager.

### ***Right to Manage***

- 1.28 RTM (and collective enfranchisement) provides a means by which leaseholders can collectively take over as landlords. This can occur where they are unhappy with their property manager and cannot influence their freeholder to make changes, or wish to remove their existing landlord from responsibility for property management. The threat of possible RTM also acts to some extent as a constraint on freeholders, who may fear a loss of control and a loss of potential revenue, such as from administration charges for approvals and insurance commissions. As noted above, where residents have an RTMCo (or an RMC), their degree of satisfaction over RPMS is higher. We heard of examples where newly formed RTMCos were able to achieve substantial cost savings (for example, in reducing insurance premiums). In other cases the RTMCo chose to increase service charges so as to offer a higher quality service. Sometimes RTMCos or RMCs could be badly run, or not

representative of all leaseholders' interests but these cases appear to be unusual. We found that RTM can sometimes be difficult to obtain, for example due to fellow leaseholders' apathy, or procedural objections to the RTM application by freeholders or property managers.

### ***Competition between property management companies***

1.29 Once a property manager has been appointed, we found switching to be low. Where switching does occur, it is mainly motivated by significant leaseholder dissatisfaction with the current property manager's performance. Switching may occur if the leaseholders can persuade their freeholder or the board of their RTMCo/RMC to switch. Because of the difficulties leaseholders face in obtaining information on the property manager's performance relative to other potential suppliers, in coordinating and in exercising control and choice, the constraint from competition between property managers for existing contracts appears to be weak. However, we did not find significant barriers to competition where a landlord does decide to tender for contracts. We found that entry (eg by lettings and estate agents) was relatively easy given the absence of statutory regulation and low start-up costs, although entry tends to be at a small scale. There is evidence of more active competition between property managers to be appointed at new developments (although sometimes developers have long-term integration or relations with property management firms).

### ***Buildings insurance***

1.30 Insurers may pay a commission or fee which can distort incentives in relation to the purchase of buildings insurance. In many cases it is the freeholder who places insurance and receives commission; the property manager may have no involvement, and there is no transparency of commissions to leaseholders. Where property managers place insurance they may receive fees or commissions, although recent FTT decisions have limited these to reflect services performed.

1.31 We were told by both leaseholders and property managers that commissions charged could be very high (in some cases, more than 40% of the premium). We found that this could result in high charges to leaseholders. While leaseholders can challenge the reasonableness of such charges, poor transparency and inadequate disclosure provisions under the existing regulatory regime, make this difficult for leaseholders to assess.

## ***Section 20 consultation***

1.32 The section 20<sup>12</sup> consultation process for major works provides transparency to leaseholders regarding planned major works and an opportunity to influence decisions on the choice of contractor and on works to be carried out. Although this serves a useful information and consultation function, we were told by many parties that the process for section 20 consultations were inflexible and that consultation thresholds were set too low.

## ***Vulnerable groups and retirement issues***

1.33 We found that leaseholders on low incomes were likely to be most impacted by any property management problems, particularly volatile and unexpected charges. First-time buyers often have a tight financial situation and may have a poor understanding of the obligations of leasehold and their liability for service charges.

1.34 As a group, the elderly or infirm might be more vulnerable due to their reduced ability to coordinate actions and willingness to get involved in exercising their rights (although this was challenged by many property managers who said the recently retired could be very knowledgeable and effective in representing their interests). While our leaseholder survey found the highest degree of satisfaction with property management among retirees, we also received a large number of submissions highlighting specific examples of problems that had arisen in retirement developments. These were consistent with the overall problems identified in the market. Further specific issues, exit charges and charges relating to the rents of on-site manager's flats, or the sale thereof, generally related to relations with the freeholder and the terms of the lease and so are outside the scope of this market study. We acknowledge that these are important issues and note that the Department for Communities and Local Government (DCLG) has referred exit fees to the Law Commission.

## ***Local authorities and housing associations***

1.35 We received a range of complaints concerning local authorities and housing associations, including a lack of transparency or concerns over efficiency and

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<sup>12</sup> The law requires that leaseholders paying variable service charges must be consulted before a landlord carries out qualifying major works or enters into a long-term agreement for the provision of services (section 20 of the Landlord and Tenant Act 1985).

cost control, particularly in the context of major block and estate upgrades such as the Decent Homes initiatives.<sup>13</sup>

- 1.36 Processes for consultation, transparency and accountability, internal complaints-handling mechanisms, and systems to spread or defer the cost of high service charges for major works, are generally more extensive and often operate better than in the private sector. Even so, levels of leaseholder satisfaction with service quality and value for money (as shown by our leaseholder survey) were lower for housing associations and particularly local authorities than for the private sector. We did not find evidence of any systematic failures of process or regulation which would account for lower satisfaction in these areas.
- 1.37 We were told of cases where individual local authorities were believed to be providing very poor standards of service or poor value for money with little or no engagement with leaseholders and little transparency or accountability.
- 1.38 Other possible explanations for the relatively lower levels of leaseholder satisfaction in local authority and housing association owned properties include: perceptions of services being focused on social tenants' interests rather than leaseholders'; the original right-to-buy (RTB) leaseholders being particularly sensitive to service charges given their income levels; the obligation for leaseholders to contribute to improvement works combined with the cost of updating old blocks which may in the past have received little maintenance (and that local authorities do not use sinking funds resulting in some very high charges when major expenditures occur); or an expectation among leaseholders of a higher degree of service and support from social landlords than among private property management.
- 1.39 We heard concerns from leaseholders that they may be receiving an unfair allocation of costs, given, for example, limitations in financial record keeping and the nature of long-term and borough-wide contracts. They felt that leaseholders were not given priority and may be used to cross-subsidise tenants. Several leaseholders objected to the liabilities for costs set out in their leases, for example for the upkeep of facilities on estates that were not immediately related to their specific block, and liability for improvement as well as repair costs, which were unlikely to be found in private sector leases.

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<sup>13</sup> Social providers (local authorities and housing associations) are required to bring their properties up to a minimum standard, and may receive central government grants to assist with part of the cost. Leaseholders will be liable for a share of costs. Some of the charges to leaseholders in these cases have run to many tens of thousands of pounds. In August 2014 DCLG announced the introduction of caps on service charges for future major works where this is part funded by central government (see DCLG [press release](#)).

1.40 We did not find persuasive evidence that the allocation of costs to leaseholders was inappropriate in any systematic way, although transparency and the explanation of how costs were allocated were sometimes poor. In fact, local authorities told us that often it was not possible to charge leaseholders for all costs and so effectively there was an element of cross-subsidisation in favour of leaseholders.

### **Codes**

1.41 As noted in paragraphs 1.9 and 1.10, various trade and professional bodies for residential property managers have introduced codes of practice which apply to their members. Not all property managers are members of a trade body.

1.42 Each of the codes contains some points that are of benefit to consumers which are not replicated in the others. However, there are also areas where we found that the codes could be improved. For example, the RICS code is expressly stated not to be mandatory, although non-compliance must be justifiable. ARMA-Q requires provision of information to leaseholders about additional charges but only on request.

1.43 In general the redress mechanisms set out in the codes are in-house processes and are not available until the leaseholder has exhausted the individual property manager's internal complaint resolution process. None of the codes involves any form of independent decision-maker at the stage of the consideration of the complaint by the trade body (ARMA-Q will provide for an Independent Regulator but they will not normally become involved until all existing channels of complaint have been exhausted).

1.44 Although the existing codes as described have their limitations, they serve an important function in raising standards across the sector. ARMA-Q will come into effect on 1 January 2015, and the ARHM and RICS codes are subject to review by DCLG and will require their respective members to adhere to higher standards.

### **Redress**

1.45 There are several ombudsman schemes that apply to residential property management, and DCLG has recently required all residential property managers in England to be registered members of an approved statutory redress scheme.<sup>14</sup> The various ombudsman schemes provide an

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<sup>14</sup> The Redress Schemes for Lettings Agency Work and Property Management Work (Requirement to Belong to a Scheme etc) (England) Order 2014.

independent dispute resolution service for leaseholders. However, issues concerning correct levels of service charges must be taken to the FTT (Leasehold Valuation Tribunal (LVT) in Wales).

- 1.46 The FTT provides an independent service for resolving certain disputes involving leasehold property. The FTT is intended to provide an easy and low cost route of redress for property disputes. However, the process can be both complex and costly for the lay person to navigate and outcomes can be difficult to predict. There are fees payable for most types of dispute, and there is no limit to the amount of costs that can be awarded. Some leases allow landlords/property managers to charge leaseholders for their legal costs and leaseholders' costs payable by landlords/property managers may be recovered from the leaseholder through the service charge, even if the leaseholders win their case.

## **Conclusions on how the market is working**

- 1.47 We have found that outcomes in the market are mixed. Many leaseholders are content with the service they receive. In addition there are many measures in place to protect leaseholder interests (see paragraph 1.5) which mitigate many of the concerns that we have found in the sector. However, some leaseholders have experienced significant problems or find service and value for money to be very poor. In extreme cases the costs suffered, or the stress and disruption arising for leaseholders, can be severe.
- 1.48 We found there to be scope for make existing measures to protect leaseholders work better or more consistently. These measures are important in a market such as this where the leasehold system raises issues of separation of control and accountability, and where, inevitably, there is a need for individual compromise in the appropriate level of property maintenance in communal blocks.
- 1.49 Our main conclusions on the causes of poor market outcomes are as follows:
- The basic leasehold structure, whereby responsibility for appointing and supervising property managers rests with the landlord while leaseholders bear the cost, is a major cause of the problems and discontent experienced. There is a separation of control for leaseholders; they are the 'consumer' of services provided and pay (indirectly, via a service charge) for those services but individually have relatively little ability to influence the work done or who is appointed to carry out the work.
  - In many cases there is a misalignment of incentives; landlords (particularly freeholders) do not carry the costs of property maintenance and so may

have weak incentives to ensure leaseholders are getting a good service and value for money. Landlords may also be vertically integrated with property managers or have commercial relationships with suppliers giving them incentives to do things that are not in the best interests of leaseholders (such as overcharging or conducting unnecessary works).

- Property managers may offer poor service and increase charges to leaseholders due to poor oversight and control from landlords given these misaligned incentives. Poor outcomes can be exacerbated by the limited constraint on incumbent property managers from potential competition.
- Some of the problems experienced are caused by the implementation of terms in the lease, over which property managers have no direct control, or relate to aspects of the freeholder-leaseholder relationship.
- Prospective leaseholders often have a poor understanding of their obligations to pay for RPMS when they purchase a leasehold property meaning they are unprepared for the charges that arise.
- There are significant problems with transparency and leaseholders' understanding of RPMS; they will often find it difficult to monitor the performance of property managers and to assess the quality and value of the service they provide, and so are less able to hold property managers to account.
- It can sometimes be difficult for leaseholders to coordinate effectively and act collectively. Recognised tenants' associations (RTAs) are one means by which leaseholders can coordinate and these possess some formal powers. In addition, the RTM is an important safeguard of leaseholder rights and acts to deter some excesses by freeholders and property managers. Leaseholders are more satisfied where RTM has been exercised or an RMC is in place, due to the leaseholder's ability to exercise greater control over their property management. However, in some cases the process of obtaining RTM can be complex or difficult.
- Complaints and redress systems, while extremely useful in protecting leaseholders, do not always provide adequate protection. They can be perceived by leaseholders as difficult, intimidating or risky (in terms of potential cost and outcome) to use.
- The complaints and dissatisfaction expressed with local authorities and housing associations is of concern. We recognise that tensions can arise given the difficulty in managing the different interest of tenants in social housing and leaseholders and there are sometimes limitations in the

explanations of how costs are allocated, and that the costs of improvement works can lead to very high charges. Nevertheless we also recognise that in many cases there are better processes for transparency, consultation and redress than in the private sector. It appears that in some cases poor outcomes result from the way leasehold property management is delivered in particular local authorities.

- 1.50 We have also found that the process for consultation on major works, section 20, while useful, is widely seen to be in need of an update to make it more flexible and with updated thresholds.

## **Recommendations**

- 1.51 In considering what remedies would be appropriate, we noted that for many leaseholders, overall the market works reasonably well, but that particular problems can and do occur where existing safeguards fail to provide adequate protection. We consider that the problems that exist in the market are best dealt with through targeted measures to improve the working of the current model, rather than through a fundamental reform of the regulatory framework. We note the existence of redress systems and/or safeguards, which provide a degree of protection in many cases and whose performance, where shortfalls are identified, can be enhanced.
- 1.52 There are currently a number of developments within the sector. These include:
- The adoption of a new self-regulatory regime, ARMA-Q, for ARMA managing agents (see paragraph 1.9). It aims to raise standards and quality of service, and features an independent Regulatory Panel and a Consumer Charter.
  - Other codes, for RICS and ARHM, are currently under revision and are subject to approval by the Secretary of State (see paragraph 1.44).
  - The introduction by DCLG of the requirement for property managers to belong to a statutory redress scheme (see paragraph 1.45).
  - DCLG's announcement of capping of service charges for local authority leaseholders where works are part funded centrally (see paragraph 1.35).
  - DCLG has also announced its consideration of a variety of other measures and has referred the issue of transfer (exit) fee covenants to the Law Commission (see paragraph 1.34).

- 1.53 We have decided to build on the existing self-regulatory regime, rather than, at this stage, to recommend major statutory regulation of the sector, even though this was the favoured option of many industry and consumer groups that engaged with us. This is because:
- Many issues can be addressed by safeguards embedded in codes and property law, although their strength and application might in certain cases need to be improved.
  - We believe that we should allow time for the various developments in the market to take effect.
  - One of the benefits of statutory regulation would be that it would apply to all property managers. However, we have seen no evidence to demonstrate that concerns are concentrated in those companies which are not subject to codes of conduct.
  - There are costs in implementing and monitoring/enforcing a statutory code and we do not wish to increase the burden or costs of regulatory compliance unnecessarily
  - A statutory code could act as a barrier to entry, reducing competition.
  - We were also mindful that in the short term recommendations for statutory regulation were unlikely to be accepted by Government and so would not be implemented. However, we do not consider that this is reason not to seek to influence the development of longer-term policy where we consider that there is clear reason to do so based on evidence from our findings.
- 1.54 We have therefore developed a set of recommendations covering five key areas:
- Pre-purchase remedies.
  - Remedies to improve transparency and communication, to be addressed via self-regulatory industry codes of practice.
  - Remedies requiring legislative change.
  - Remedies to improve transparency and communication in blocks owned by local authorities and housing associations.
  - Redress remedies.

We summarise these briefly below. We then summarise in paragraph 1.55 how our recommendations address the issues we have identified in the market.

### **A. Pre-purchase remedies**

#### *(i) Develop and provide guidance to prospective purchasers pre-purchase – recommendations to The Property Ombudsman/LEASE*

We recommend that when specific enquiries are made about property the estate agent provides a short information sheet providing key information on major facts about leasehold ownership (the information sheet to be produced by LEASE/Law Society).

We recommend that leasehold property particulars prepared by estate agents should state the current level of service charges.

A requirement to provide this information should be incorporated into the approved code of practice followed by estate agents and the associated guidance that supports it.

#### *(ii) Develop and provide standard questions at the conveyancing stage – recommendations to The Law Society/LEASE*

We recommend that a standard set of questions is used as part of the conveyancing process to ensure that the prospective leaseholder has sufficient information to make an informed decision on the purchase. This may be achieved by wider adoption of the Law Society's Leasehold Properties Enquires form (LPE1) and supported by Council of Mortgage Lenders guidance. We also recommend that conveyancers distribute the short information sheet on major facts about leasehold ownership.

### **B. Remedies to improve transparency and communication, to be addressed via self-regulatory industry codes of practice – recommendations to ARMA, RICS, AHRM, etc**

We recommend that industry codes of practice are updated to include the following:

*(i) A clear statement for each property they manage of: (a) purpose and responsibilities of the property manager; (b) property management plans and strategy; and (c) key information relating to past work.*

(a) The statement of purpose and responsibilities of the property manager should be included in their annual report and provided on request. This information should also be available on property manager websites.

- (b) The statement of property management plans and strategy must make clear all areas of work covered by service charges or fixed management fees and give an indication of expected work over the next planning period, expected to be a minimum of three to five years. It should also compare the costs to the sinking fund to enable leaseholders to form an expectation of the likely unfunded cost.
- (c) The statement of key performance indicators must include actual costs for material projects incurred over the last three to five years and other additional information, such as the level of service charge and any fixed management fees. To be provided to leaseholders on a regular annual basis.

*(ii) Disclosure of (a) what is included within the core management fee and rates of management charges; (b) administration and supplementary charges; and (c) commissions (including commissions earned by the property manager for arranging the buildings insurance)*

Property managers must, for each property they manage fully disclose details of:

- (a) the services and activities that are provided and paid for within a core management fee. This should distinguish between services provided under the service charge and as a management fee. Where non-routine projects incur a management fee, either fixed or related to the size of the project, the rates applied must be disclosed, including any points at which the rate of charge varies.
- (b) all administration and supplementary charges for services, to enable leaseholders to understand better the charges they face as a leaseholder.
- (c) any commission earned by the property manager (including fees/commissions in relation to buildings insurance).

*(iii) Full disclosure of corporate links*

Property management companies must disclose to leaseholders in the building any corporate relationship with the landlord for any property it manages, or with any contractors the property manager engages for work in the building, or any company providing or assisting in the procurement or administration of the insurance. Any relevant ownership relationship must be disclosed, eg common parent, subsidiary or affiliate or intermediary.

*(iv) Recognition/encouragement of better property management communication*

Property managers should have a plan and a strategy for regular communication and engagement with leaseholders to explain and discuss the decisions affecting them.

### **C. Remedies requiring regulation/legislative change – recommendations to DCLG**

Although most of our recommendations are to enhance self-regulation, we also recommend that DCLG make two specific legislative changes:

*(i) New legislation to give leaseholders rights to trigger re-tendering and rights to veto the landlord's choice of property manager*

New powers that would require the landlord to re-tender for a new property management company in circumstances where more than 50% of all leaseholders support re-tendering. In addition, the ability in certain circumstances to veto the appointment of a property management company where more than 50% of all leaseholders give their support. The use of this power would be subject to limitations to ensure that the power is not misused or unduly disruptive to the supply of RPMS.

*(ii) Review of section 20 rules (consultation with leaseholders in relation to major works)*

As set out in paragraph 1.32, it was generally accepted that amendments should be made to section 20 rules on consultation on major works. We recommend that DCLG review/revise section 20 of the Landlord and Tenant Act 1985 ('the 1985 Act'), to ensure that it does not impose unnecessary costs on all of the parties and delay necessary works.

### **D. Local authorities and housing associations remedies**

*(i) Share best practice – recommendations to local authorities/DCLG*

We recommend that Local Authorities should develop mechanisms to share best practice in working with leaseholders. By sharing information on what has worked well, other authorities may be able to raise their standard of service and provide improved levels of information to leaseholders.

*(ii) Leaseholder costs to be identified by block – recommendations to local authorities/housing associations/DCLG*

We recommend that both local authorities and housing associations should separate out the cost, as far as practicable, of providing services to leaseholders and social rental tenants, to make clear the costs that are being incurred by leaseholders for common services and to explain the allocation of costs in an accessible way.

## **E. Redress remedies**

*(i) Cheaper and quicker alternatives to taking claims to the First-tier Tribunal – recommendations to Ministry of Justice/DCLG*

We recommend the provision either of independent advice to the parties about the merits or otherwise of their case, or some form of alternative dispute resolution (either early neutral evaluation, mediation or other), separate from the current FTT process, for certain categories of complaint.

1.55 Our recommendations address the issues we have identified in the market by:

- Making prospective leaseholders more aware of the implications of leasehold and liabilities for service charges, so allowing them to make better decisions and to plan appropriately.
- Making leaseholders better informed about the responsibilities and performance of property managers. Increased control and transparency to leaseholders should increase pressures on property managers and landlords to take account of leaseholder interests.
- The recommendation that a majority of leaseholders should have a right to require re-tendering of property management services or veto over appointment of a particular property manager should provide the leaseholder with greater control without them having to acquire RTM (or collective enfranchisement), while giving existing property managers an incentive to communicate with leaseholders and maintain a good standard of service, and landlords an incentive to ensure property managers deliver a good service.
- By increasing the level of information available about leasehold and RPMS, leaseholders should become more aware of their responsibilities and also the options available to them, and reduce the detriment suffered because leaseholders are unaware of or are unable to prepare for their liabilities. Although the interests of leaseholders may vary, more informed leaseholders would be in a stronger position to act together.
- Improved access to redress, should issues arise that require action.

1.56 We consider that the remedies package would, in combination, be effective in addressing our concerns. By working at several points in the ownership cycle the measures are reinforcing. Aspects of our recommendations carry significant implementation costs, for example in the additional provision of information on property management plans and establishing a new mediation

service, but we consider that such costs are not out of proportion and justified in light of the significant benefits that could accrue to leaseholders.

- 1.57 We note that currently poor practice could continue among non-member property managers. Over time and with appropriate publicity our expectation is that membership of trade bodies that have the codes will be seen as a demonstration of quality such that non-member property managers will find it increasingly difficult to win business.
- 1.58 We do not propose remedial measures for issues which fall outside the scope of this study (ie the market for the provision of RPMS). However, as set out in our report we have identified issues in the freeholder-leaseholder relationship area, in particular relating to the purchase of property insurance by freeholders and the charging of rents for or sale of manager's flats in retirement developments. We note that the Law Commission is looking at exit fee covenants.
- 1.59 We will work with the trade and professional associations as well as DCLG, other government departments, LEASE, the FTT, local authorities and housing associations, estate agents and conveyancers and a variety of other bodies to encourage acceptance and implementation.
- 1.60 The success of our recommendations package will depend on their implementation and how effective they then prove to be in delivering the intended benefits and positive change in the market, in conjunction with the effects of the other changes in the market (see paragraph 1.52). Therefore, we will be keeping the market under review. The CMA may choose in the future to undertake a further examination of the sector, or parts of it if, in our view, such an examination appears to be appropriate.

## 2. Introduction

- 2.1 This market study was launched by the OFT on 4 March 2014. On 11 March 2014, the OFT and the CMA announced that, in the light of changes to the competition and consumer regime in the UK, responsibility for completion of the market study would pass from the OFT to the CMA.<sup>15</sup>
- 2.2 In this introductory section, we first set out the background to this market study, before explaining the approach we have used in conducting it.

### The CMA's mission and powers

- 2.3 The CMA works to promote competition for the benefit of consumers, both within and outside the UK, and aims to make markets work well for consumers, businesses and the economy. Market studies are one of a number of tools at the CMA's disposal to examine possible competition or consumer protection issues and address them as appropriate, alongside its enforcement and advocacy activities.
- 2.4 Market studies<sup>16</sup> are typically examinations into the causes of why particular markets may not be working well, taking an overview of regulatory and other economic drivers and patterns of consumer and business behaviour.<sup>17</sup> Possible outcomes of market studies may include:
- a clean bill of health;
  - improving the quality and accessibility of information to consumers;
  - encouraging businesses in the market to self-regulate;
  - making recommendations to Government or regulators to change laws, regulations or policy;
  - taking competition or consumer enforcement action; and
  - making a market investigation reference, or accepting undertakings in lieu.

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<sup>15</sup> See the [CMA's webpages](#) for copies of these announcements.

<sup>16</sup> Market studies are conducted under the CMA's general function as set out in section 5 of the Enterprise Act 2002, which includes the functions of obtaining information and conducting research. For more information on market studies, see [Market studies and investigations: Supplemental guidance on the CMA's approach](#) (CMA3), January 2014.

<sup>17</sup> For a more detailed explanation of the purpose of market studies, see chapter 2 of [Market Studies: Guidance on the OFT approach](#) (OFT519).

## **Background to the CMA's market study**

- 2.5 The OFT decided to carry out a market study following previous work and in response to complaints evidence it had received and concerns from other stakeholder contacts about the supply of RPMS. The OFT was concerned that some property managers may be overcharging customers, providing poor-quality services or spending money on unnecessary works. It was also suggested that some property managers may not deal effectively with complaints and there were concerns over access to effective redress.
- 2.6 On 3 December 2013 the OFT announced its proposal to conduct a market study on the provision of RPMS in England and Wales, in order to examine whether the market is working well for consumers, and if not, whether there is potential for improving how it functions. It published a Scoping Paper<sup>18</sup> calling for views on the proposed scope of the study. Following consideration of the responses received, the scope was extended from RPMS provided purely to privately-owned housing to include RPMS where the freehold of the block in question is owned by a local authority or housing association. The OFT launched the market study on 4 March 2014. The CMA took over the conduct of the market study on 1 April 2014.
- 2.7 We published an update paper<sup>19</sup> on 1 August 2014, which provided details of our early findings and sought views on possible remedial action to improve the performance of the market for leaseholders.

### ***Scope of the market study***

- 2.8 As outlined in the Final Statement of Scope,<sup>20</sup> this study covers RPMS in England and Wales. It considers the provision of services by property managers relating to the communal areas and the structure of a building in the following circumstances:
- (a) Blocks of flats/apartments/retirement properties where the freehold is owned by someone unconnected to the leaseholders who receive RPMS from a property manager/property management company (property manager).
  - (b) Blocks of flats/apartments/retirement properties where the freehold is owned by the leaseholders, who all have a share and vote some of their

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<sup>18</sup> [Property Management Services – A Scoping Paper, OFT1513](#), December 2013.

<sup>19</sup> [Residential Property Management Services – An update paper on the market study](#), August 2014.

<sup>20</sup> [Final statement of scope](#) issued by the OFT in March 2014.

number to be directors of a management company, which engages the services of a property manager

(c) Blocks flats/apartments/retirement properties where the freehold is owned by the local authority or a housing association which supplies RPMS, either directly or through a contracted property manager.

- 2.9 The study includes services provided to leaseholders who occupy the premises and also those who rent their properties to tenants. It does not consider single dwelling properties.
- 2.10 Additionally, the provision of RPMS in leasehold retirement properties is in scope. However, the provision of non-RPMS services, such as care services in retirement housing, is not. Nor are other issues around lease design, including exit charges. The OFT carried out a separate investigation into retirement housing exit fees which was closed in 2013.<sup>21</sup>
- 2.11 As noted in the Final Statement of Scope, this study did not undertake an assessment of the legal framework that underpins freehold and leasehold arrangements. We only considered the legal relationship between leaseholders and freeholders in so far as it impacts on the supply of RPMS.
- 2.12 Both Scotland and Northern Ireland were outside the geographic scope of the study. We noted the OFT's previous work carried out in relation to the market study into property managers in Scotland<sup>22</sup> and the Law Commission work in Northern Ireland.<sup>23</sup>

## **Information gathering – method and issues**

- 2.13 In the course of our market study we have gathered information and views through:
- submissions from stakeholders including leaseholders, property managers, freeholders and other industry participants;
  - meetings with property managers, residents associations, industry trade associations, housing organisations, local authorities, government departments, regulators and advisory services, property developers, freeholders and campaign groups;

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<sup>21</sup> Details of the investigation can be found on the [OFT archived website](#).

<sup>22</sup> *Property managers in Scotland – a market study 2009*, February 2009.

<sup>23</sup> [Northern Ireland Law Commission – review of the law on apartments](#).

- roundtable meetings with panels of participants from trade associations, local authority/housing association organisations, campaign groups and leaseholder groups;
  - questionnaires issued to property managers, freeholders, developers, local authorities and housing associations;
  - the leaseholder survey; and
  - review of key sources of existing research – including government research and policy documents, academic research and trade press articles.
- 2.14 During the course of the study we have reviewed over 600 individual written submissions from interested parties – including property managers, freeholders, leaseholders and residents associations.
- 2.15 We have gathered evidence on a voluntary basis. The response rate to some of the surveys undertaken, particularly those issued to the local authorities, has been disappointing. Further, even where parties responded to our surveys, they sometimes did not respond to all questions or provide comprehensive answers.
- 2.16 We also recognise that the stakeholders who have provided information to the study and answered questionnaires are, for the most part, a self-selecting group with particular interests or perspectives that may not be fully representative of the wider industry community.
- 2.17 We are also mindful of the limitations of the evidence we have received in leaseholder submissions, much of which is qualitative. We acknowledge that those that have been motivated to supply information are more likely to be leaseholders who are not happy with their incumbent property manager/freeholder or have previously experienced problems, as opposed to those leaseholders who may be content or happy with the services being provided or have not had cause to consider the quality of the service they receive.
- 2.18 The leaseholder survey was conducted to allow us to get an overview of all leaseholders' experiences more generally. The leaseholder survey has provided some useful evidence in this regard, including insights into what causes higher levels of leaseholder satisfaction.
- 2.19 As set out in more detail in the [leaseholder survey](#) report, it was difficult to identify a suitable sampling framework for the survey that was representative of all leaseholders. We recognise the limitations to the results (see paragraphs 4.5 to 4.7), but it does represent the views of a large group of

leaseholders and so provides an overview of market experiences previously unavailable.

- 2.20 Nonetheless, the evidence gathered, not only from the leaseholder survey but more generally, needs to be treated with caution. For example, leaseholders may not be well placed to evaluate the quality of service and value for money and there may be discontent even where these works are efficiently and competitively carried out. Alternatively, leaseholders may be receiving a poor-quality service and poor value for money but do not have sufficient information to be able to identify that this is in fact the case.
- 2.21 For these reasons, we attach more weight to evidence that is supported by multiple sources. In addition, we have referred to publicly available information, such as contained on various consumer campaign websites and in court records and decisions, where appropriate, both to gather further evidence and better to understand whether the submissions we have received are representative of issues present in the market.

## Structure of the report

- 2.22 This document, together with its appendices, constitutes our final report and sets out our findings based on our analysis of the evidence received during the course of the market study. It refers, where appropriate, to material published separately on the CMA website. The report, however, is self-contained and is designed to provide all material necessary for an understanding of our findings.
- 2.23 The remainder of the report is set out as follows:
- [Section 3](#) provides an overview of the RPMS sector, including leasehold ownership, residential property management services and the safeguards available to leaseholders. It sets out estimates of the size of the sector, and possible issues that might give rise to poor market outcomes for leaseholders.
  - [Section 4](#) explores how the RPMS market performs, including an assessment of the outcomes that leaseholders experience and the behaviour and incentives of property managers, issues relating to RTM, and consideration of competition between property managers.
  - [Section 5](#) looks at a number of aspects of the RPMS market which are separate from our overall assessment. This includes building insurance, retirement housing and local authority and housing association properties.

- [Section 6](#) considers the redress mechanisms available to leaseholders.
- [Section 7](#) presents our conclusions and recommendations.
- The appendices include further background and details of our analysis.

## **Acknowledgements**

2.24 The CMA would like to extend its thanks to all of the many people and organisations who have assisted us during the market study and enabled us to understand a wide range of perspectives on the RPMS sector.

### **3. Overview of the sector and issues potentially giving rise to poor outcomes for leaseholders**

3.1 In this section we provide a brief overview of:

- leasehold ownership and RPMS;
- property law and safeguards for leaseholders;
- the size of the leasehold sector;
- the size and structure of the RPMS sector;
- demand- and supply-side considerations; and
- possible issues giving rise to poor outcomes to leaseholders.

#### **Leasehold ownership and residential property management services**

3.2 Leasehold is a form of property ownership whereby the purchaser ('the leaseholder') is granted exclusive occupation and use of the property for a fixed period of time. This may only be for a very limited number of years, but it is often in excess of 100 years, or even 999 years (known as a 'virtual freehold').<sup>24</sup> Ultimate ownership of the property remains with the freeholder, who is entitled to recover full ownership rights once the term of the lease has expired. Rather than occupy the property, the leaseholder may be permitted to grant a further lease to a third party for a shorter time period, but often the freeholder will also be the immediate landlord of the occupant leaseholder.<sup>25</sup>

3.3 Every landlord-leaseholder relationship is governed by a lease, which is the property contract that sets out the details and conditions of the leaseholder's ownership of the property. The contract imposes mutual obligations on the parties relating to the use and upkeep of the property: for example, it may make the leaseholder liable to pay an annual 'ground rent' for his continued

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<sup>24</sup> Given the extensive time period over which many leases subsist it is common for leaseholders to sell their property for the remaining leasehold term to third parties. The length of the remaining period under the lease is one of the factors which determines the market value of the property. Leases can be extended and under certain circumstances leaseholders have rights to purchase an extension of the lease period.

<sup>25</sup>The freeholder is the person or company that owns the freehold title, ie the person who owns for an indefinite period the land that the building is upon and the building itself. If a freeholder grants a lease, they become a landlord. In turn, the person who takes that lease can sometimes grant an underlease to someone else. That makes them a landlord as well, but only to the person taking the underlease. For the purposes of this report, we use the term 'landlord' to mean the party responsible for the provision of property management and so the one who is responsible for the appointment of the property manager.

occupation of the property or it may restrict him from altering or subletting the property.

- 3.4 In the residential context, leasehold ownership is more common in properties comprising multiple units such as blocks of flats. This allows the landlord to retain control of the fabric and common parts of the property after the individual units have been purchased by leaseholders. The leases in such situations will make clear that the leaseholders are responsible for maintenance and repair inside their own flats, and the landlord for the maintenance and repair of the common parts and overall management of the block.
- 3.5 Where the landlord has primary responsibility for the management and maintenance of the building, there will be a corresponding obligation on the leaseholders to reimburse his management and maintenance expenses by way of service charges.<sup>26</sup> The proportion of those expenses each leaseholder is expected to pay will be governed by the terms of their respective leases. Under the 1985 Act there is a general safeguard against unreasonable service charges, which states that relevant costs shall be taken into account in determining the service charge only to the extent that they are reasonably incurred, and where the services or works are of a reasonable standard.
- 3.6 RPMS refers to the management of the work that is required to maintain the communal areas and the structure of a block of flats, such as cleaning and repair work. Sometimes the landlord or residents of small blocks of flats may carry out the management of the maintenance and repair of their own property themselves. However, this can be a complex and time-consuming task, and raises significant liabilities and obligations. Often (and especially in larger developments) landlords will engage third party agents (property managers/managing agents) to carry out their management and maintenance duties. Through this contractual arrangement a property manager is empowered to carry out the landlord's management functions, including the calculation and enforcement of service charges against the leaseholders. The property manager will be subject to the same statutory restraints on recovering service charges as the landlord would be if he carried out these functions himself. The property manager acts on the instructions of the freeholder and/or landlord. They are required to deliver services in accordance with discharging the landlord's obligations under the terms of the lease (and they may also be

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<sup>26</sup> The 1985 Act defines a service charge as 'an amount payable by a tenant of a dwelling as part of or in addition to the rent (a) which is payable, directly or indirectly, for services, repairs, maintenance, improvements or insurance or the landlord's cost of management, and (b) the whole or part of which varies or may vary according to the relevant costs.'

bound by statutory considerations) and so in some aspects of what they do they will have little or no discretion.<sup>27</sup>

- 3.7 Property management services are typically, but not always, provided by specialist property management agents.<sup>28</sup> In some cases in the private sector, the freeholder and the property manager are co-owned or vertically integrated (ie are under the same ownership). Local authorities and housing associations usually supply RPMS to their own housing stock.
- 3.8 Service charges are a variable charge to cover an apportionment of the total costs of cleaning, maintenance, repair and similar of the fabric and shared areas of the building. Most leases allow for the collection of service charges in advance, repaying any surplus or collecting any shortfall at the end of the year. The property manager will charge a management fee for carrying out the management function, recovered through the service charge. However, leaseholders may also pay further charges, for example administration charges when the property manager grants consents, such as for subletting, alterations and keeping pets (often the freeholder rather than property manager will be responsible for such approvals). Property managers may also receive other revenues, for example from provision of information to conveyancers, other services and commissions.
- 3.9 Leaseholders may be required to make additional contributions to a sinking/ reserve fund, either to cover estimated service charge expenses or in anticipation of major works on the property at some future date.<sup>29</sup> These contributions are subject to the same limitation of reasonableness as on service charge payments for costs already incurred. Payments into these funds are held for these purposes and so leaseholders are not entitled to any refunds on unspent elements when they sell their lease (but new residents can benefit from accumulated past funds).<sup>30</sup>
- 3.10 The responsibility for appointing and instructing the property manager generally rests with the landlord, who may or may not be a third party freeholder. Where leaseholders have obtained control of the management of the property through an RTMCo (see paragraphs 3.29 to 3.31), or where an RMC has been established, these parties act as the landlord for the property. In these cases, responsibility rests with the company board, usually but not necessarily

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<sup>27</sup> The property manager is responsible for discharging the contractual obligation under the terms of the lease (which may vary greatly between different properties) to ensure that the building is properly maintained.

<sup>28</sup> Other property-related or legal businesses may also be involved in the supply of RPMS.

<sup>29</sup> A leaseholder will not be liable to pay money into a sinking fund without an express provision to this effect in the lease.

<sup>30</sup> Section 42(6) of the Landlord and Tenant Act 1987 (the 1987 Act).

made up of residents. They will usually appoint a property manager (or sometimes may choose to self-manage property maintenance).

- 3.11 Alternatively, the property manager could be stipulated in the lease itself; there is a type of tripartite lease in which developers write a named property manager into each lease from the start of the development, often for an initial period or with a clause providing for the replacement of the named manager under certain circumstances.<sup>31,32</sup>
- 3.12 Our working assumption, based on our discussions with sector participants during the course of this investigation, is that the freeholder model of appointment (ie where the freeholder is the landlord) is the most prevalent type of arrangement and our assessment starts with consideration of this arrangement.<sup>33</sup> However, we recognise that there are many variants on this model.
- 3.13 Leases also usually require the freeholder to insure the building. In most cases the freeholder will be responsible for procuring the building insurance and it will usually be the freeholder's name in the contract with the insurance company, although in some cases, the property manager is responsible for doing. It is also usually the property manager who administers the insurance on the freeholder's behalf. Leaseholders are charged for the costs of insurance, usually as part of the service charge.<sup>34</sup>
- 3.14 In summary, the contractual relationship between the parties can be very complex. Leaseholders may have little control or influence over the property manager whose services they are consuming and for which they are paying.
- 3.15 The typical relationship between leaseholders, landlords/freeholders and property managers is depicted in the diagram below.

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<sup>31</sup> In a tripartite lease a management company is established for the management and maintenance of the common parts of the block for the general benefit of the leaseholders. A tripartite lease has three parties. It is a lease made between (a) the landlord; (b) the leaseholder; and (c) a management company. Under tripartite leases, landlords' obligations are generally limited in scope and usually often only extend to the collection of ground rents and the placing of insurance. A third party RMC can be written into a 'tripartite lease'. Membership of the RMC is made up of each leaseholder at the premises and it is the RMC that then has management responsibility for the premises in the place of the landlord. Tripartite leases are now commonly used by developers in new-build blocks. Leaseholders, by virtue of being a leaseholder in the block, usually have a share in the management company.

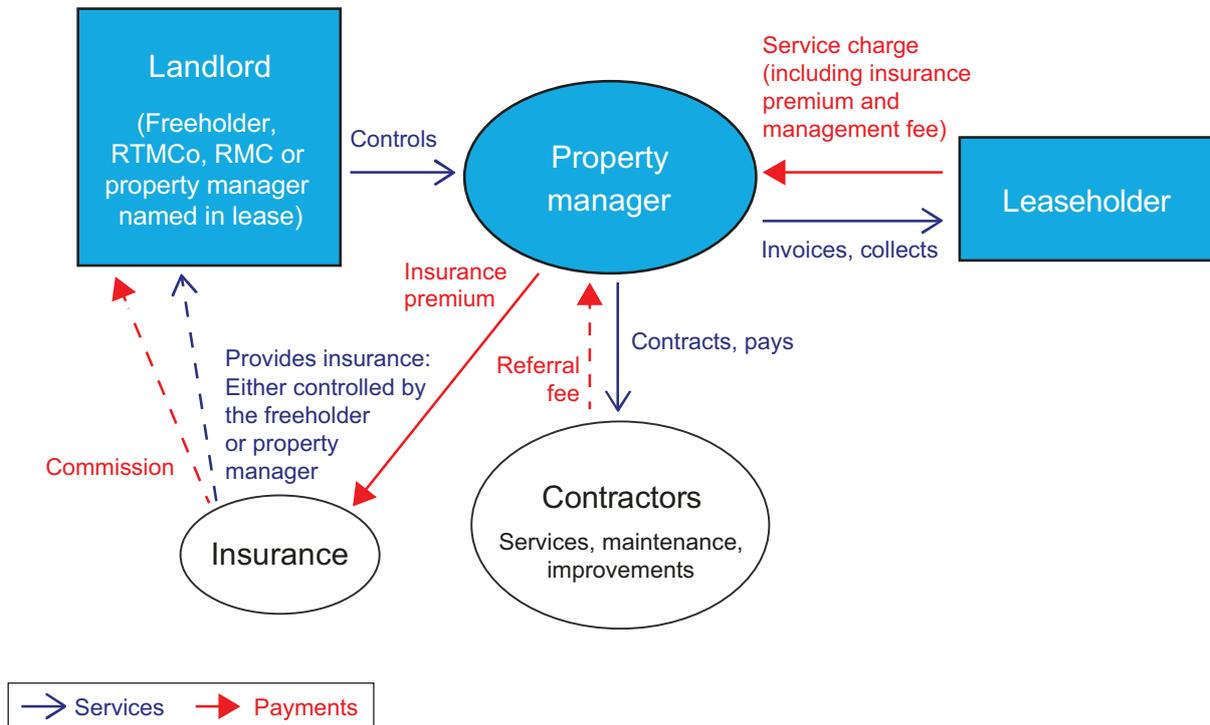
<sup>32</sup> Whilst these legislative provisions were enacted to try to shift the balance of power to leaseholders, tripartite leases and RMCs may in practice mean it is sometimes more difficult for leaseholders who are dissatisfied with the management of their building to change management and/or invoke the legislative procedures that were intended to benefit them.

<sup>33</sup> As noted elsewhere in this report, reliable market data for the sector is either not available or is difficult to verify so we have had to make some working assumptions based on the discussions we have had with sector participants.

<sup>34</sup> The supply of supplementary services from freeholder to leaseholder is not within the scope of this study, other than how property managers may assist with this through communication and charge collection.

FIGURE 3.1

**Services and payments between leaseholders, freeholders and property managers**



Source: CMA.

**Property law and safeguards for leaseholders**

3.16 This section sets out the various key safeguards for leaseholders in relation to the payment of service charges and conduct of property managers, as well as the legal mechanism for taking control of the management of premises from the landlord. Our assessment of some of these safeguards – those relating to redress – is set out in [Section 6](#) and the safeguards themselves (including references to the relevant sections of the applicable Acts) are set out in more detail in Appendix A.

**Service charges and sinking funds**

*‘Reasonableness’ of charges*

3.17 As noted in paragraph 3.5, the 1985 Act contains a general safeguard against unreasonable service charges (see Appendix A, paragraph 7). An individual is able to make an application to the FTT<sup>35</sup> for a determination as to the

<sup>35</sup> References to the FTT apply to both the FTT and the LVT in Wales.

appropriate level of service charges payable by a leaseholder.<sup>36</sup> Additionally, it provides that a leaseholder will not be liable for costs that were incurred more than 18 months before unless written notification of the costs incurred has been provided in that time. The 1985 Act imposes the same limitation of reasonableness on sinking fund contributions, and the FTT also has an analogous jurisdiction with regard to administration charges.<sup>37</sup>

### *Sinking funds*

3.18 At present there are no statutory provisions requiring landlords or their agents to hold sinking fund payments in specified accounts although this may be specified in the lease. However, any sums paid by way of service charges are required to be held by the landlord or property manager in trust for the contributing leaseholders.

### ***Provision of service charge information to leaseholders***

3.19 The 1985 Act gives leaseholders the right to demand from their landlord or property manager a written summary of any costs incurred in the previous 12-month period. Any service charge demand served on a leaseholder must be accompanied by a summary of the rights and obligations of leaseholders in relation to service charges. Leaseholders also have the right to inspect and take copies of any accounts, receipts and other documents supporting any summary of costs.

### ***Buildings insurance***

3.20 In the case of blocks of flats the freeholder, as ultimate owner of the block, will usually be responsible for the insurance of the property. Leaseholders are entitled to request a written summary of any insurance for which the leaseholder pays directly or indirectly through the service charge. The summary must include (a) the insured amount(s) under any relevant policy; (b) the name of the insurer(s); and (c) the insured risks of the policy. A leaseholder is further entitled to inspect and take copies of any relevant insurance policy or associated documents (see Appendix A, paragraphs 14 to 16).

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<sup>36</sup> See Appendix A and Section 6. In some cases, the FTT encourages initial mediation after cases are lodged.

<sup>37</sup> 'Administration charge' means an amount payable by a leaseholder for the grant of approvals under his lease, for the provision of information or documents by or on behalf of the landlord, in respect of a failure by the tenant to make a payment by the due date to the landlord or in connection with a breach (or alleged breach) of a covenant or condition in his lease.

### ***Scrutiny of property managers' performance***

- 3.21 The Leasehold Reform, Housing and Urban Development Act 1993 ('the 1993 Act') gave certain leaseholders the right to have a management audit carried out on their behalf. To qualify for this right, generally not less than two-thirds of the leaseholders need to act collectively.
- 3.22 Under the 1987 Act leaseholders can apply to the FTT for an order appointing a manager in substitution for the landlord or their property manager. Failings need to be demonstrated such as breach of any obligations relating to management functions at the relevant premises (see Appendix A, paragraph 25). The landlord and any property manager must first be allowed a reasonable period in which to remedy those matters. We were told that the FTT applies a high threshold to such applications and will grant them only in cases of serious failure.

### ***Recognised tenants' associations***

- 3.23 The 1985 Act gave leaseholders the ability to form RTAs. To be recognised, the RTA either has to be recognised by the landlord or it has to obtain a certificate of recognition from the FTT.
- 3.24 The secretary of an RTA is able to act on behalf of its individual members, with the members' consent, in a number of situations. These include the right to request a summary of relevant costs in relation to service charges, the right to inspect and take copies of the supporting accounts and other documents and the parallel rights relating to payments for building insurance. An RTA also has the right to participate on its own behalf in the consultation process on major works.
- 3.25 An RTA can appoint a qualified surveyor to advise on any matters relating to, or which may give rise to, service charges. The other right exclusive to RTAs is that of serving notice on the landlord requesting them to consult the RTA on matters relating to the appointment of a property manager.

### ***Consultation on major works***

- 3.26 A further statutory safeguard contained in the 1985 Act is the requirement for landlords or their agents to consult with leaseholders before going ahead with major maintenance or repair works that will be paid for through the service charge. At present, a landlord must comply with the consultation requirements if the contribution towards the cost of those works payable by any individual leaseholder exceeds £250. There are similar requirements for consultation on

any long-term qualifying agreement lasting for over a year and worth over £100 a year (including framework agreements).

- 3.27 The consultation has two stages. First, notice must be provided to each leaseholder describing the works and the reasons for them. Leaseholders and any RTA have 30 days to make observations, and can nominate a contractor from whom the landlord should try to obtain an estimate. Secondly, the landlord seeks estimates, at least one of which must be from a wholly unconnected contractor. The landlord must then provide details of the estimates to leaseholders, the statement must also contain a summary of any observations received during the initial notice period and the landlord's response to them, and invite comments within 30 days. If the landlord chooses the contractor who did not make the lowest bid, or is not that nominated by leaseholders, they must give leaseholders reasons and again invite comment. At each stage the landlord must have regard to leaseholder and RTA views but is not bound by them. In practice, landlords usually delegate section 20 consultations to property managers.

### ***Collective enfranchisement***

- 3.28 Leaseholders have the right upon qualification to compel the sale of the freehold building or part of the building to a Nominee Purchaser.<sup>38</sup> This will usually be a company in which the participating tenants are all shareholders. Upon completion of the purchase, the leaseholders each own a share in the company which owns the freehold. The board of that company, usually comprising a number of the leaseholders, will be responsible for the management of the building, including the appointment of a property management company if this is considered appropriate.

### ***The right to manage***

- 3.29 The Commonhold and Leasehold Reform Act 2002 (the 2002 Act) introduced a right enabling leaseholders to take over the management of their building by setting up an RTMCo. Leaseholders do not have to establish that the current landlord or property manager is at fault. The RTMCo assumes full management responsibility for the building and so is free to appoint any property manager of its choosing. The provisions and procedures relating to the RTM are set out in Appendix A.
- 3.30 The leaseholders must fulfil a number of criteria before they can assume management responsibility through an RTMCo. In order to acquire the right to

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<sup>38</sup> The 1993 Act, section 1 (as amended by the Commonhold and Leasehold Reform Act 2002).

manage, the block must not have more than 25% (by internal floor area) as non-residential parts, so for example a block with a substantial share of retail premises would not be eligible. At least two-thirds of the flats must be owned by long leaseholders, and the membership of the RTMCo must include long leaseholders accounting for at least half of the total number of flats contained in the building. Local authority owned properties are excluded. An RTMCo must be incorporated before the claim procedure is commenced, and it must give written notice to all long leaseholders informing them of the company's intention to acquire the right to manage and inviting them to become members of the company first.

- 3.31 The 2002 Act also contains strict rules relating to the form and contents of the claim notice and the parties to whom notice of the claim should be given. Parties, including landlords, can respond with a counter-notice, for example because of a breach of the statutory requirements for acquiring the right to manage, or a procedural defect in the claim. This then goes to the FTT for resolution.

### **Consumer law**

- 3.32 As well as the provisions of property law set out above, businesses engaging in property management services, and advertising properties to which property management services will be supplied, such as estate agents and property developers, may be subject to the provisions of consumer law. The Consumer Protection from Unfair Trading Regulations 2008 (CPRs) prohibit traders from engaging in unfair commercial practices in their dealing with consumers. Broadly speaking, the CPRs require traders not to treat consumers unfairly, and prohibit misleading or aggressive commercial practices, where these are likely to have an impact on consumers' transactional decisions,<sup>39</sup> as well as setting out some practices that are considered unfair in all circumstances. The CMA and Trading Standards services can apply to a court for an enforcement order to prevent infringements of the CPRs.<sup>40</sup>
- 3.33 The Unfair Terms in Consumer Contracts Regulations 1999 apply to business to consumer contracts which may include leases. These protect consumers against unfair standard terms in contracts with businesses (including freeholders) and require that written terms are expressed in plain, intelligible

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<sup>39</sup> The concept of a 'transactional decision' covers a wide range of decisions that have been or may be taken by consumers before, during and after a contract is formed.

<sup>40</sup> For more information, see the OFT's [guidance on the CPRs and BPRs for property sales businesses](#). This has relevant guidance on information that should be provided at the beginning of the sales process. See also the BERR/OFT [general guidance on the CPRs](#).

language. A standard term is unfair if contrary to the requirement of good faith,<sup>41</sup> it causes a significant imbalance<sup>42</sup> in the parties' rights and obligations arising under the contract, to the detriment of the consumer. An unfair term should not be included in a contract, recommended for use or enforced.

- 3.34 How consumer law would be applied in the context of property management would be for the courts to decide depending on the facts of the case.

### ***Ombudsman schemes***

- 3.35 Three Ombudsman schemes cover the market for RPMS: The Property Ombudsman, the Housing Ombudsman, and The Ombudsman Services: Property scheme, see Appendix B and paragraphs 6.26 to 6.31. These different schemes apply according to the nature of the work carried out by the residential property manager and the trade body to which they belong. These provide an independent dispute resolution service for leaseholders, but their remit tends to consider only certain types of complaint, for example they may exclude disputes on the level of service charges. DCLG has recently implemented the requirement set out in the Enterprise and Regulatory Reform Act 2013 ('the 2013 Act') that all residential property managers in England must be registered members of an approved statutory redress scheme (ie ombudsman schemes).<sup>43</sup>
- 3.36 The use of the various ombudsman schemes is free to the leaseholder but the ombudsmen will not examine complaints unless and until the property manager's internal complaint resolution process and the redress procedure under any relevant code have been exhausted.

### ***Other aspects to safeguard leaseholders***

#### ***Codes***

- 3.37 Several of the trade and professional bodies for residential property managers have introduced codes of practice which apply to their members. These codes are intended to provide a regulatory framework covering legislative requirements and good practice. ARMA, RICS and ARHM all have codes and ARCO has a charter, with plans to introduce a code soon. ARMA is introducing from

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<sup>41</sup> The requirement of 'good faith' embodies a general principle of 'fair and open dealing'. Openness requires that the term should be expressed fully, clearly and legibly containing no concealed pitfalls or traps and that terms that might disadvantage the consumer are given appropriate prominence. Fair dealing requires that a business does not take advantage of consumers' weaker bargaining position.

<sup>42</sup> The requirement of significant imbalance is met if a term is so weighted in favour of the business as to tilt the parties' rights and obligations under contract significantly in his favour.

<sup>43</sup> The Redress Schemes for Lettings Agency Work and Property Management Work (Requirement to Belong to a Scheme etc) (England) Order 2014.

January 2015 a new code, ARMA-Q. It aims to raise standards and quality of service, and features an independent Regulatory Panel and a Consumer Charter. However, not all property managers are members of a trade body.

- 3.38 Two of the codes have been approved by the Secretary of State under the Leasehold Reform, Housing and Urban Development Act 1993 – these are the RICS code and the ARHM code, which apply only in England. This means that the FTT can have regard to the requirements of these codes even when considering cases involving non-members. Both of these codes are currently under revision.
- 3.39 Relevant codes are described in Appendix B and discussed in paragraphs 6.6 to 6.25.

#### *Information provision*

- 3.40 LEASE is a non-departmental public body funded by Government to provide free legal advice to leaseholders, landlords, professional advisers, managers and others on the law affecting residential leasehold in England and Wales. Advice is offered online, by email or letter, in person or telephone and covers an understanding of the law, how it applies and what action can be taken in relation to issues such as: service charges; extending a lease; buying the freehold; RTM; and applications to the FTT. However, it does not provide casework or representational services.

### **The size of the leasehold sector**

- 3.41 We now set out estimates of the size of the leasehold sector and the total value of service charges paid. Data on this sector is not readily available. No official data on the number of leasehold properties is regularly collected and moreover, we are only considering blocks of flats which utilise RPMS. The figures which the CMA has been able to estimate were put together using various sources. Overall, the figures obtained only provide an idea of the size of the relevant sector.
- 3.42 Estimates from DCLG showed that in 2012/13 there were 4.1 million leasehold dwellings in England.<sup>44,45</sup> Of those, 2.8 million were leasehold flats, as show in Table 3.1.

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<sup>44</sup> DCLG, *Residential leasehold dwellings in England: Technical paper*, August 2014.

<sup>45</sup> The methodology used by DCLG involves a match between a sample of housing from the English Housing Survey data, the 2011 Census and data held by the Land Registry.

TABLE 3.1 Estimates of leasehold properties in England 2012/13

	<i>Dwellings '000</i>			
	<i>Detached house</i>	<i>Semi-detached and terraced houses</i>	<i>Flats (converted and purpose built)</i>	<i>Total</i>
Owner-occupied sector	223	825	1,352	2,400
Private rented sector*	<u>32</u>	<u>185</u>	<u>1,447</u>	<u>1,664</u>
	255	1,010	2,799	4,064

Source: DCLG.

\*DCLG explains that the private rented sector describes homes that are owned privately on a long lease and rented out or let to tenants as their main home.

3.43 The CMA also looked at the 2011 Census data on accommodation type within tenure type, which contains figures for both England and Wales. The Census data reports the number of flats, maisonettes and apartments in purpose-built blocks separately from the number of flats in converted or shared houses (see Table 3.2). These figures indicate a lower and upper estimate of the total number of flats receiving RPMS in England and Wales (2.1 and 3.1 million respectively), on the assumption that purpose-built blocks are more likely to receive RPMS whereas those in converted houses may not due to the smaller number of flats per building making it easier for freeholders or residents to self-manage.<sup>46</sup>

3.44 A number of other assumptions had to be made: we assumed that all flats/maisonettes/apartments in owned or shared ownership, and also all privately rented (including living rent-free) flats were held leasehold.

TABLE 3.2 Private leasehold properties – 2011 Census\*

	<i>Dwellings '000</i>		
	<i>Flats in purpose-built blocks of flats</i>	<i>Total number of flats</i>	<i>Flats in purpose-built block of flats as % of total</i>
England	2,016	3,043	66
Wales†	<u>56</u>	<u>93</u>	<u>60</u>
Total England and Wales	2,073	3,136	66
London	717	1,102	65

Source: ONS 2011 Census data.

\*'Flats in purpose built blocks of flats' includes only data for flat, maisonette or apartment in a purpose-built block of flats or tenement. 'Total number of flats' includes flat, maisonette or apartment in a purpose-built block of flats or tenement, in converted and shared houses and in a commercial building or mobile temporary accommodation.

†2011 Census data: table DC4403EW – Accommodation type by type of central heating in household by tenure Wales.

<sup>46</sup>2011 Census data: table DC4402EW – Accommodation type by type of central heating in household by tenure. See also the [Ipsos MORI CMA Leaseholder Survey 2014](#).

- 3.45 From Table 3.2 therefore, we estimate that the number of flats in England and Wales where property managers were employed (including property management delivered by local authorities and housing associations) was somewhere between 2.1 and 3.1 million in 2011.<sup>47</sup>
- 3.46 The view of stakeholders in this sector is that the number of leasehold flats has expanded significantly in the last two decades. Data from the National Home Building Council (NHBC) indicates that a total of 45,448 flats were completed since 2012 in the UK.<sup>48</sup> The NHBC estimates that 34% of new homes in the UK were new flat developments.<sup>49</sup> Given that such a high proportion of new properties are flats, which are most likely to be leasehold properties, this indicates that the leasehold sector is expanding.
- 3.47 With respect to the relative size of each landlord segment, the CMA has not found readily available data. From discussions with stakeholders it is our understanding that the investor-freeholder segment is by far the largest segment. We have obtained only limited figures relating to the other segments, namely local authority and housing associations, RTMCos and RMCs, as detailed below.
- 3.48 Using the DCLG data on leasehold flats, the CMA estimates that between 229,000 and 290,000 were properties owned by private leaseholders in local authorities' and housing associations' developments.<sup>50</sup>
- 3.49 The CMA estimates that the number of RTMCos in England and Wales is around 4,500, drawn from Companies House registrations where the company is described as RTMCo. It has been harder to estimate the number of RMCs using Companies House information. On examination of these companies it appears that RTMCos may only be a small proportion of the companies picked up in our search of Companies House data<sup>51</sup> since these include a wide range of other types of companies, such as property management companies, for example. This means the figure of 80,523 quoted in our update statement<sup>52</sup> was likely to have been a considerable over-estimate.

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<sup>47</sup> We note that the upper bound figure for England from this data source is not significantly different from the figure from DCLG, which gives us a degree of confidence.

<sup>48</sup> Annual New Home Statistics Review 2013.

<sup>49</sup> *ibid.*

<sup>50</sup> CMA internal research based on DCLG data on the number of RTB and Preserved RTB (PRTB) flat sales for local authorities and housing associations respectively. Moreover, the CMA used DCLG statistics about sales under the Right to Acquire Scheme which applies to housing associations, though the numbers for the latter are negligible in comparison to the RTB and PRTB schemes.

<sup>51</sup> A search of Companies House Data using the Standard Industrial Classification of Economic Activities 2007 (SIC 2007) code 98000 (Residents Property Management).

<sup>52</sup> [Update statement](#), paragraph 3.6.

## Size and structure of the residential property management services sector

- 3.50 We have used average service charges and the size of the leasehold sector (estimated above) to provide an approximate size (in value terms) of the RPMS sector. This is an oversimplification as average service charges do not include other charges to leaseholders, such as supplementary charges, commissions or insurance, but in the absence of better data it is a useful proxy.
- 3.51 Our main sources of data for service charges are the Ipsos MORI leaseholder survey and estimates by the London Assembly of services charges in London. It was not possible to check whether the sample of properties in the leaseholder survey accurately reflected the full population of properties in England and Wales and we note that service charges vary substantially between properties. Therefore, we compared the survey figures with those of an alternative source (the London Assembly figures) to check the reasonableness of the leaseholder survey estimates.
- 3.52 According to CMA calculations using data from the Ipsos MORI leaseholder survey, leaseholders pay an average of £1,123 in service charges per year. The London Assembly reported an estimated average service charge in London for private sector flats of £1,800–£2,000 a year (for local authority properties – based on London borough data – the report found the average service charge was £850 a year).<sup>53</sup> Given the likelihood that charges in London will be higher on average compared with the rest of the country, the London Assembly figures suggest our estimate from the leaseholder survey for England and Wales is plausible.
- 3.53 Using our survey average service charge of £1,123 per year and the size of the leaseholder segment estimated above, of between 2.1 million and 3.1 million flats, gives an estimate of overall service charges in England and Wales of between £2.4 billion and £3.5 billion in value terms.<sup>54</sup> To be clear, this value refers to payments of service charges by leaseholders; revenues to property management companies (the management fee element) will only be a relatively small proportion of this.

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<sup>53</sup> London Assembly, [Highly charged: Residential leasehold service charges in London](#).

<sup>54</sup> Average service charge of £1,123.20 per year multiplied by the total number of leaseholders of between 2.1 and 3.1 million (see paragraph 3.45).

## ***Structure of the property management sector***

3.54 We were unable to obtain precise figures for the numbers of property managers, revenues from management charges and other fees, and distribution across England and Wales. However, we note:

- ARMA, the sector's main trade body, told us that it had 312 members and 122 affiliate members in mid-2014. ARMA believed that its membership looked after around half of all leasehold flats in England and Wales.
- ARHM, the retirement sector's main trade body, had 55 members in mid-2014, which it estimated managed about half of the retirement housing stock in England and Wales.
- There are over 300 local authorities in England<sup>55</sup> and 22 principal areas in Wales,<sup>56</sup> which either self-manage or transfer management to an ALMO or housing association. There are roughly 50 ALMOS in England and Wales.<sup>57</sup>

3.55 The market structure for the supply of RPMS also has a number of features worth noting:

- The market seems to be characterised at the national level by a few large players with a long tail of smaller players. This view of the market was expressed to us at meetings with stakeholders. Also, in response to our questionnaires (see Appendix C), it seems that the majority of property management companies providing services to private developments (89%) had revenues of under £3 million in the last financial year. A smaller proportion (11%) registered revenues of more than £ 3 million per year.<sup>58</sup>
- Property management providers are mostly local or regional businesses (active in no more than a few regions or counties), with only a minority being active at national level. In particular, ALMOs and housing

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<sup>55</sup> Data from the Local Government Boundary Commission for England.

<sup>56</sup> Data from Welsh Government [website](#).

<sup>57</sup> Data from the National Federation of ALMOs [website](#).

<sup>58</sup> See Appendix C, question 9. Total number of respondents to the question: 99.

associations have traditionally provided management services only at the local level.<sup>59,60</sup>

- There is only a small degree of specialisation into different segments. A large number of property managers can supply services to investor and developer freeholders, and to RTMCos and RMCs. However, retirement properties may require some specialist services.<sup>61</sup>
- Finally, stakeholders told the CMA that there has been a large number of start-ups in recent years, albeit generally small scale, facilitated by a huge increase in the stock of leasehold flats during the last two decades, in particular outside London. Many of the new entrants are firms operating in related markets, such as estate agents, wanting to diversify.

## **Demand- and supply-side considerations in this market**

3.56 The CMA considered the potential demand- and supply-side substitutes and other constraints faced by property managers.

3.57 On the demand side, the alternative to obtaining RPMS from a property manager is to supply these services in-house or self-manage. It would appear that this is not considered to be appropriate by all types of landlords. Self-supply is most likely to be used as an option or constraint on third party property managers only in the case of relatively small properties, where self-management is most straightforward. The CMA was told that often outsourcing property management to a third party is likely to be the only option for some freeholders (eg investor-freeholders will not normally have the necessary skills to handle these tasks, which are complex and subject to substantial legislative and regulatory measures). For others the development of in-house provision is more appropriate due to their business models. For example, local authorities and housing associations are likely to be primarily dealing with

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<sup>59</sup> However, there is evidence of ALMOs and housing associations expanding beyond their traditional areas. For example, nearly half of the ALMOs in England provide some property management services to private freeholders (source: Right Time, Right Place, report by the National Federation of ALMOS). We have also heard anecdotally that housing associations are beginning to do the same.

<sup>60</sup> Responses to our questionnaires to property managers also confirmed this picture of the typical geographical spread of providers. Of 99 respondents answering a question about the regions of England and Wales in which they are active:

- 47 said they were active in only one region
- 22 said they were active in two or three regions in total
- of the remaining 19 with more widely spread businesses, 11 were active across most or all of England and Wales (seven or more regions)
- 64 were active only in London and/or the South-East

See Appendix C, question 10.

<sup>61</sup> Property managers of retirement developments tend to be specialist providers as the service can involve aspects of care and wellbeing requiring particular expertise. These firms tend to be vertically integrated developer/freeholder/property managers.

rental tenants and a wide range of social housing issues not found in private sector leasehold blocks, and have the scale to justify the development of their own departments. Some retirement developments combine the provision of RPMS with other services such as domestic and nursing care, and these freeholders may prefer to supply property management in-house.

- 3.58 On the supply side, there is some evidence of related businesses, such as estate and lettings agents, and some contractors, being able to diversify and start supplying RPMS quite easily. We heard that such entrants are unlikely to be credible in bidding to manage large blocks given the lack of track record, and in most cases might provide a competitive constraint only in some circumstances, such as for the management of relatively small buildings.
- 3.59 Overall, the alternatives to the use of property management companies on both the demand and supply side are limited, but will vary to some extent depending on the type of property and type of landlord.

### **Possible issues giving rise to poor outcomes to leaseholders**

3.60 We hypothesised that a number of aspects of the market for property management services could present significant issues driving poor outcomes for leaseholders. These are:

- separation of control;
- misalignment of incentives;
- coordination and free-rider problems;
- information asymmetries; and
- weaknesses in the protections to leaseholders.

3.61 We sought to consider whether each of these issues exists and might be likely to lead to leaseholders paying higher prices and/or receiving poorer quality service from their property managers than they would if they were not present. The different ways in which this may occur are discussed below.

#### ***Separation of control***

3.62 The acquisition of RPMS differs from the acquisition of other services, largely because of the allocation of responsibilities and liabilities within a typical lease. Separation of control refers to the fact that those who appoint and instruct the property manager – usually a freeholder or landlord – are often not the same as those who pay and receive RPMS directly, and are affected

by the price and quality of these services (the leaseholders), as explained in paragraphs 3.4 to 3.11. The freeholder or landlord will generally make no financial contribution.

- 3.63 An obvious implication of separation of control is that leaseholders will have no direct choice over the property manager in the building where they live or own a property. Consequently, if they are not completely satisfied with the services that are provided they are usually unable to address this issue directly by, for example, either reinstructing the property manager or switching to a different provider.
- 3.64 Leaseholders may complain to the freeholder or landlord, who will decide how to respond to this information. However, since the landlord may not be directly affected by the price or quality of the RPMS, they may have no incentive to react at all, or may not react in the way that leaseholders want. It is the separation of control in combination with misaligned incentives (see paragraphs 3.66 to 3.76 which could give rise to leaseholder detriment.
- 3.65 Freeholders may have low incentives to monitor aspects of the performance of the property managers they engage (for example, they may only be concerned with whether the property manager is properly discharging the freeholder's obligations under the lease). When this is the case, demand-side responses are likely to be low, ie the threat of freeholders switching away from a poorly performing property manager is low. This may lead to higher prices to leaseholders and poorer quality of services (including unnecessary work being carried out) than would otherwise be the case.

### ***Misalignment of incentives***

- 3.66 The separation of control issue explained above grants freeholders or landlords control over the supply of RPMS and other supplementary services to leaseholders. A freeholder might be able to exploit this to its own advantage, for example if it also supplies the RPMS through a downstream company. Alternatively, the property manager it employs could itself take advantage of leaseholders by increasing charges or providing a poor service, because of the freeholder exerting little or no pressure on the property manager to perform well.
- 3.67 The extent to which separation of control leads to poor outcomes for leaseholders will depend on the extent to which the incentives of the freeholder or landlord are aligned with those of the leaseholders. As explained below, incentives may not be closely aligned, as might be the case with investor-freeholders, and poorer outcomes may be expected. Alternatively, when a

building is controlled by an RTMCo or RMC, incentives will be more aligned with the collective view of leaseholders, leading to better outcomes.

- 3.68 There are various factors which can make the incentives of a freeholder more aligned with those of leaseholders, such as any interest in the resale value of leases (ie if the freeholder is also a leaseholder); the degree of vertical integration into the supply of RPMS; reputational effects; and political pressure. These factors may apply to some types of freeholders more than others and affect the degree to which they are responsive to leaseholder complaints, as set out below.

### *Investor-freeholders*

- 3.69 An investor-freeholder which is vertically integrated with a company providing RPMS would have limited constraints on how it supplies RPMS (other than the statutory protection available to leaseholders). Such a freeholder would have an incentive to appoint its downstream property management company to service the building and would have limited incentives to offer competitive prices and a good service. Of course, vertical integration may also allow freeholders to provide effective management of RPMS and ensure high-quality services if that were the freeholder's objective. In practice, most investor-freeholders are not vertically integrated in this way.
- 3.70 Investor-freeholders who outsource the RPMS to a third party property manager, are likely to have little incentive to take an active interest in the property manager's activities, other than to ensure that their risks are being covered. So, other than ensuring that the fabric and safety of the building is maintained, they have little if any interest in ensuring that the property manager is delivering value for money. This means that investor-freeholders potentially lack the incentive to exert sufficient demand-side pressure on property managers to perform well.<sup>62</sup> This lack of demand-side pressure could lead to prices that are higher and quality that is lower than would otherwise be the case.
- 3.71 It is possible that the risk of leaseholder complaints ending up in the FTT (which might occur if leaseholders can show that charges were not reasonably incurred) provides some incentive for investor-freeholders to hire reputable property managers (ie those that have generally provided a good service to leaseholders and generated few, if any, serious FTT complaints),

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<sup>62</sup> This is compounded by the fact that property managers' remuneration is often in the form of a percentage of the cost of the works carried out, which could provide an incentive on the property manager to carry out unnecessary or expensive work.

as liability in these cases lies with the freeholder. There is also the risk that leaseholders, if dissatisfied, will seek collective enfranchisement or RTM, which means the freeholder loses control over the property management and possibly other revenue streams.<sup>63</sup> These could help mitigate an incentive to exploit leaseholders or not to exert any demand-side pressure on the property manager.

### *Developer-freeholders*

- 3.72 We noted that in the case of new developments, while they still own some of the leases in a building, developer-freeholders will have an interest in the sale value of these leases, which may be affected by the price and quality of the RPMS that are provided at the time. They may also own several sites at a time and may be concerned with the (reputational) effect that providing a poor RPMS even in one site might have on their ability to sell leases in their other sites. Both of these effects better align the incentives of the developer freeholder with those of leaseholders in so far as the standards and cost of property maintenance are transparent to prospective purchasers and easy to compare. This may not be perfectly transparent as the property manager will have a very short track record of performance in most cases, no costs for long-term maintenance will yet have been incurred and faults that do arise may be covered by builders' guarantees.
- 3.73 Developer-freeholders will also face the same incentives as above regarding minimising the risk of complaints ending up in the FTT, as well as the risk that the development could turn to RTM.

### *RTMCos and RMCs*

- 3.74 Where RTMCos and RMCs exist the issue of separation of control itself will be less pronounced. That is, although any individual leaseholder will not have complete control over the appointment and instruction of the property manager, they will have voting rights that are proportional to their lease ownership. Further, the board is often primarily or wholly composed of leaseholders.

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<sup>63</sup> It follows that it is possibly better to align the interests of even investor-freeholders with the interest of leaseholders by having an effective redress mechanism which makes freeholders accountable for poor management. The CMA believes, however, that there may be limits to what a redress mechanism can achieve. A redress mechanism may, for instance, prevent more serious abuses of leaseholders and situations where the terms in the lease are not being met, but may not be sufficient to provide an incentive for the investor-freeholder to be actively engaged with the property manager and to seek value for money on a continuous basis. Other safeguards would need to be working well too, such as the threat of leaseholders exercising the right to manage.

- 3.75 Therefore RTMCos or RMCs will have incentives with respect to the engagement with the property manager that are more aligned with the collective view of all leaseholders in the building in question than is the case when a third party freeholder exerts control. As a result, there should be more pressure on the property manager to deliver value for money.
- 3.76 Exceptions could occur if the boards of RMCs/RTMCos become less engaged over time if they are not supported because leaseholders become apathetic. We were told that the members of boards may after a period of time reflect only the view of certain interest groups from among the leaseholders. Also, in the absence of suitable volunteer leaseholders to serve on the board of RMCs, these are largely led by representatives from developers or freeholders.

### ***Coordination and free-rider problems***

- 3.77 Coordination problems arise because in any communal building the objectives of individual leaseholders are likely to be diverse and may be poorly aligned, making it difficult for leaseholders to reach common views or decide on a single course of action. Examples of such differences between leaseholders might include differing objectives for those who live in the property and those who have bought as a buy-to-let investment, those looking to sell their property in the near future and those who are intending to retain it for many years, those who are willing and able to pay for higher standards of service and those who are not, or simply differences in individual priorities and tastes.
- 3.78 Apathy and free-rider problems exist when not enough leaseholders are willing to give their time and take responsibility (and in some cases accept liability for costs in appeals or legal responsibility as a director) to represent a collective interest. This may occur if leaseholders are simply not significantly interested in the issue in question or because some expect that they may be able to benefit from the efforts of other leaseholders without having to contribute towards solving the problem themselves.
- 3.79 These issues are problematic because there are many circumstances where outcomes for leaseholders could be improved if they were able to act collectively, or were able to do so more effectively. For example, it may be the case that complaints are not taken up to the FTT because of the inability of leaseholders to coordinate or because no one is willing to take on full responsibility. The perceived cost of taking a case to the FTT might be too high for individual leaseholders on their own.
- 3.80 It follows that it might take a long time for poor performance by a property manager to be addressed, if at all, as each leaseholder might be waiting to

'free-ride' on the efforts of other leaseholders in making the complaint and following it through.

- 3.81 Further, when communicating with property managers and landlords, leaseholders are more likely to be influential if they express a common view rather than a range of opinions.

### ***Information asymmetries***

- 3.82 This area of concern refers to the fact that leaseholders and possibly freeholders or landlords may not easily be able to monitor the behaviour of the property manager and/or assess the quality of the service they provide. For example, leaseholders and freeholders (or landlords) may not be able to tell how much effort the property manager has put into searching the market for good-quality contractors who offer a value-for-money service.
- 3.83 Even if leaseholders are provided with all of the relevant information they might need, they still may not fully understand or be able to evaluate the information such that they can determine whether work is necessary or whether they are getting value for money.<sup>64</sup> Some property managers told us that where leaseholders exercised their rights to inspect the property managers' paperwork, they were often swamped by the volume of information.
- 3.84 The implication of this is that property managers might not have the incentive to contain costs or perform well if poor performance will go undetected.
- 3.85 In addition, they might not have any incentive to provide levels of clear information to leaseholders that are sufficient to allow them to monitor the property manager closely, absent a legal requirement to do so (or one bound by a code of practice).

### ***Weaknesses in the protections to leaseholders***

- 3.86 Paragraphs 3.16 to 3.36 and Appendix A outline the substantial protections available to leaseholders. In addition, some property managers are members of trade associations and professional bodies with codes of conduct and complaint and redress systems which are also intended to act to protect leaseholder interests in this context. Therefore, leaseholders will experience a detriment to the extent that these systems are ineffective or incomplete in

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<sup>64</sup> The CMA was also told that there are issues regarding leaseholders not being fully aware of or fully understanding their obligations under the lease. When this occurs it can also give rise to dissatisfaction and tension between leaseholders, freeholders and property management companies.

their coverage, leaseholders are unaware of these systems, or they find it difficult to make use of them, for example if they are deterred by possible complexity, costs, time and risks. Weaknesses in redress are discussed in [Section 6](#).

### ***Conclusions on the expected performance of the sector***

- 3.87 Each of the main issues we identified above, namely separation of control combined with misalignment of incentives, coordination and free-rider problems among leaseholders and information asymmetries, could in theory on their own give rise to adverse outcomes for leaseholders. Cumulatively, this effect could be enhanced. Legal and other safeguards already exist to try to mitigate the effect of these issues, however, leaseholders will experience a detriment to the extent that these systems are ineffective or incomplete in their coverage, leaseholders are unaware of these systems, or they find it difficult to make use of them.

## 4. Findings

### Introduction

4.1 This section presents evidence on how well property managers perform for leaseholders. It explores the outcomes that leaseholders experience and how property managers appear to be constrained in practice by the institutional framework surrounding RPMS, by freeholders and by competition. It considers the perspectives of leaseholders themselves, leaseholder and consumer groups, freeholders and landlords of different types, property managers, other market participants and observers.

4.2 This section presents:

- evidence on outcomes for leaseholders in the RPMS market – drawn mainly from submissions made directly to the CMA and from the leaseholder survey, as well as from meetings and roundtables with leaseholders, market participants, observers and regulators;
- evidence on how freeholders and landlords affect the outcomes that leaseholders experience;
- evidence on how RTM affects outcomes for leaseholders, the constraints it places on property managers and freeholders, and any difficulties in its use;
- evidence on how, in practice, leaseholders can coordinate;
- when leaseholders may be particularly vulnerable in relation to property management; and
- evidence on how competition works and how it affects the outcomes that leaseholders experience.

4.3 We pick up on potential areas of concern in the market that were outlined in [Section 3](#) (potential weaknesses in redress are addressed in [Section 6](#)). We draw some conclusions in each area individually here, and present overall conclusions in [Section 7](#).

### Evidence on outcomes for leaseholders in the RPMS market

#### *Approach and sources of evidence*

4.4 In this section we primarily set out evidence from leaseholders on their experiences and perceptions of the RPMS they receive. We draw on submissions

received directly and, in particular, on the results of the leaseholder survey. We also draw on meetings and roundtables with leaseholder and consumer groups. We supplement this with figures and observations from property managers and freeholders/landlords, collected via meetings and questionnaires (see Appendices C and E). It should be noted that the responses to the questionnaires were fairly limited and may not be fully representative.

- 4.5 The leaseholder survey is the most comprehensive single source of evidence. Details are given in Appendix D. Ipsos MORI's full report is published on our webpages.<sup>65</sup>
- 4.6 This survey presented some challenges when designing and conducting it, given that there is little information about the size and structure of the RPMS market, and no comprehensive source of contact information for leaseholders to use as a sample basis. A random sampling approach was not tenable and so the survey was based on a purchased sample of around 62,000 self-identified leaseholders, drawn from multiple sources including lifestyle and product surveys. This does give rise to some limitations which are described by Ipsos MORI in section 1.5 of its report and in Appendix D.
- 4.7 Such limitations mean that any inferences must be treated with caution as there is uncertainty over the extent to which the surveyed population reflects the target population. However, it must also be stressed that, in the absence of other sources of evidence reflecting the range of experiences across all leaseholders, it was important to be able to put leaseholder complaints (from a small proportion of all leaseholders) into a context reflecting the whole market. Since the survey represents the views of over 1,000 leaseholders<sup>66</sup> it provides a much broader reflection of their experience of RPMS than has been available from any other source.
- 4.8 Regarding submissions that leaseholders made directly to this study, the CMA had received 552 submissions from individual leaseholders and groups as of early October 2014, largely constituting complaints about the conduct or service levels provided by property managers (the complaints by category reported in this section are based on that number).

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<sup>65</sup> [Ipsos MORI CMA Leaseholder Survey 2014](#).

<sup>66</sup> The majority of interviews were with owner-occupiers, and were spread across different groups as follows: leaseholders at private developments (411), at local authority developments (166), at housing association developments (97), and in retirement developments (131) – with an additional 192 responses lacking sufficient information to be classified by group. Within the private-development group, a reasonable split of interviews was achieved between leaseholders at blocks with an RTMCo/RMC (142) and those without (269). As expected, due to the UK Changes sample being based on self-identified leaseholders, very few private buy-to-let leaseholder interviews were achieved (53).

- 4.9 Summary data on complaints about property management made to the FTT, The Property Ombudsman and LEASE, is detailed below.
- 4.10 Complaints to and cases taken up by the FTT, The Property Ombudsman and LEASE can relate to issues wider than property management – for example, relating to the behaviour of estate agents, what landlords charge for extending leases or purchasing freeholds, or cases when landlords breach lease terms. However, complaints about property management also appear to be fairly common.
- 4.11 The FTT received 10,289 cases from leaseholders (on all issues) in the 2012/13 financial year, and 9,597 in 2013/14.<sup>67</sup> Decisions published by the FTT (and the LVT previously), and available on LEASE’s decision portal, suggest that during the last 15 years a total of 10,018 of the tribunal’s cases related to ‘service charges, Section 20 consultations, administration charges, appointment of a manager or variation of leases’ – ie, broadly, property management. We have made some reference to the outcomes of FTT cases to illustrate adverse outcomes to leaseholders, but note that these cases also show that redress has been achieved through existing channels.
- 4.12 The Property Ombudsman received 482 enquiries (not always complaints) about property management in 2012, and 614 in 2013. These translated into 13 actual cases dealt with in 2012, and 17 in 2013 – plus seven mediated resolutions in 2012 and two in 2013.<sup>68</sup>
- 4.13 During 2013/14 LEASE received 4,275 enquiries (not always complaints) about property management generally, 3,677 about section 20 consultations, 1,387 about administration charges and 10,838 about service charges. On most issues, around half of LEASE’s enquiries were from the London area.<sup>69</sup>
- 4.14 The rest of this section presents our findings on outcomes for leaseholders by theme.

### **Service levels**

- 4.15 Almost two-thirds (64%) of all respondents to the Ipsos MORI survey rated the overall service provided by their property manager as very/fairly good. The full report provides extensive detail of how leaseholders rated particular services or functions.<sup>70</sup>

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<sup>67</sup> Ministry of Justice; [Tribunal statistics quarterly: January to March 2014](#).

<sup>68</sup> [The Property Ombudsman Annual Report 2013](#).

<sup>69</sup> Enquiries data provided by LEASE directly to the CMA.

<sup>70</sup> [Ipsos MORI CMA Leaseholder Survey 2014](#).

- 4.16 One in five (20%) of all respondents rated the overall service provided by their property manager as very/fairly poor.
- 4.17 Satisfaction levels with the overall service were also recorded by the type of development managed. Satisfaction was highest (in terms of the percentage of leaseholders rating services as very/fairly good) at retirement (82%) and private developments (63%). Satisfaction was lower at local authority developments (53%) and at housing associations (53%).<sup>71</sup> Leaseholders in retirement developments generally expressed favourable views on services.<sup>72</sup> For example, information on what the service charge had been spent on was rated as very good by six in ten (62%) leaseholders in retirement developments. Leaseholders in private, local authority and housing association properties rated this service lower with 40%, 26% and 37% respectively rating very good.
- 4.18 The highest level of dissatisfaction (percentage rating overall services as very/fairly poor) was reported by leaseholders at local authority developments (26%), then by those with private providers (23%), and those at housing associations (22%). The lowest dissatisfaction levels were among leaseholders at retirement developments (8%).
- 4.19 Among leaseholders managed by an RTMCo/RMC, overall satisfaction was high, with eight in ten rating overall services as good (83%) compared with just over half (58%) for non-RTMCo/RMC leaseholders.
- 4.20 Leaseholders were generally happy with the quality of contractors. Seven in ten leaseholders (69%) rated them as good, with a quarter (27%) saying they were very good. Just over one in ten (13%) said the quality of contractors used was very or fairly poor. One-fifth of leaseholders in local authority properties (22%) rated the quality of contractors used as poor, a higher proportion than at any other type of development. Leaseholders in retirement properties viewed contractors favourably, with eight in ten (81%) rating their quality as very or fairly good.
- 4.21 Of submissions directly received by the CMA, 179 (33%) related in some way to poor-quality services or workmanship carried out by or on behalf of property managers. Forty-nine (9%) mentioned property managers not undertaking essential works or allowing excessive delays in work being carried out.

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<sup>71</sup> These comparisons exclude retirement properties in private developments and housing association figures. The results are 67% for private sector and 58% for housing associations (unchanged for local authorities).

<sup>72</sup> We note that leaseholder groups in the retirement sector believe there to be significant problems there, which seems at odds with this finding. Ipsos MORI could only record the views of those it surveyed and, as stated above, the lack of information about leaseholders makes it difficult to gauge how representative the survey sample is, of the sector as a whole and of the retirement subsector.

- 4.22 Meetings with freeholders, property developers, consumer groups and regulators, in particular, provided a cross-check to leaseholders' views on property managers' performance. They also provided some insights into property managers' businesses and incentives.
- 4.23 It was noted that particular employees of property managers, and the relationship they maintained with leaseholders, could substantially influence the quality and perception of services received – and some experiences were generally positive. For example, one freeholder responding to the CMA's questionnaire of freeholders said:<sup>73</sup> 'In my experience, no property management company will be perfect. Ours responds promptly to urgent issues but needs more chasing on less urgent matters.'
- 4.24 This corresponded to views expressed by consumer groups at roundtables, for example: 'The quality of the service was very dependent on the individual that was representing the firm. People dealing with accounts and legal matters were not very good. In terms of qualifications, PMs are not required to have the IPRM qualification. You may be dealing with completely unqualified people.'<sup>74</sup>
- 4.25 Freeholders/landlords answering the CMA's questionnaire (relatively few mostly smaller ones) suggested that the performance of the property managers they used was on average satisfactory rather than outstanding. However, explanatory comments on performance were more mixed, for example one freeholder said: 'Works with the directors; is flexible; communicates well; provides timely information; offers a personal service unlike our experience with large managing agent companies'.
- 4.26 In contrast other freeholders/landlords in their explanatory comments regarded services as poor. For example, they said of their property managers:

Under-resourced, under qualified, incompetent at administration, and hopeless in general.

[Company] have made my life a living hell. They have refused to send me any information regarding accounts ... I also send them cheques for payment, they cash this but do not disclose it, then take me to court without me knowing as they give the courts a wrong address, claiming I do not pay them. I have tried to sort this out but to no avail.

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<sup>73</sup> See Appendix E: question, 33, further information.

<sup>74</sup> IRPM – Institute of Residential Property Management, which offers professional qualifications in residential property management.

- 4.27 These broad concerns provided some support to those of consumer and leaseholder groups – who, when commenting on service levels, tended to be most critical about maintenance and repairs. For example:

Repairs have not been carried out promptly or competently, and the agent takes no responsibility for ensuring work is completed properly before making payment to contractors.

We consider the services we receive to be of very low quality. The managing agent neglects significant aspects of managing the property, resulting in the fire alarm regularly being faulty, the common parts of the building not being cleaned, the CCTV not being fixed for months, cockroaches from the commercial leasehold, noise nuisance from the commercial unit, etc.

According to information displayed in the stairwell, cleaning and cleaning check should happen daily but used to happen weekly. In the last few months, cleaning only occurred after I contacted [property manager] complaining about the state of the stairway.

- 4.28 It is important to put these criticisms into context. Leaseholders sending submissions to the CMA or attending roundtables tended to be those with some discontent or cause to complain – whilst it is possible that larger numbers with positive experiences of RPMS did not contact us. Other stakeholders agreed that whilst bad management quickly triggers discontent, good management is usually rewarded by silence.
- 4.29 Moreover, the industry told us that shortfalls in service standards could often be attributed to a ‘long tail’ of less experienced, less competent and sometimes less scrupulous property managers, typically outside of any trade association. Extensive building of leasehold flats during the last 20 years has encouraged entry into the sector, we were told, by reputable players but also by opportunists. However, we note that such a distinction was not evidenced by the leaseholder complaints that we received, which were as often about established providers as new ones.
- 4.30 Perhaps indicatively, one large freeholder with around 30,000 units and which actively monitors its managers told us that about a third were doing ‘a notably good job’. The other two-thirds were ‘a bit complacent at worst’ – but only rarely generated enough complaints from leaseholders to warrant replacing.

### ***Charges and value***

- 4.31 The leaseholder survey also asked respondents to what extent they agreed/ disagreed that their property manager (or local authority or housing

association) provided value for money. Overall, half (52%) agreed that they got value for money. 28% of respondents disagreed that their property manager provides value for money, with half of them saying they strongly disagreed. Among the different categories, levels of agreement were highest among those with an RTMCo/RMC, with nearly eight out of ten (78%) agreeing, followed by those in retirement properties with nearly seven out of ten (69%) agreeing. In private developments, half (52%) agreed, at housing associations 45% did, as did 40% at local authority developments.

- 4.32 Looking at perceptions of value for money by age group, younger leaseholders tended to agree least that they got good value. Half (51%) of 25 to 34 year olds disagreed, compared with three in ten (31%) of 45 to 64 year olds. By income, leaseholders in low-income households (up to £9,999) agreed most often, with 59% doing so, while those with a household income of £20,000–£39,999 agreed least (48%).<sup>75</sup> By development size, leaseholders in larger developments agreed most that they receive value for money. Two-thirds of those in developments of 20+ units (62%) agreed, compared with a third of those in developments which contain one to five units (35%).
- 4.33 A range of reasons were given by leaseholders for disagreeing that services gave value for money. Four in ten (43%) said that the costs of management were too high, one-third (32%) said repairs and maintenance were not carried out when required, and a similar proportion (30%) said services (unspecified) were poor and residents were not kept informed about what was going on (28%). Some respondents also mentioned the costs of repairs and maintenance being too high (20%) and the cost of insurance being excessive (6%).
- 4.34 Of complaints that the CMA received directly, by far the greatest number related to the level of service charges, with 287 (52% of the total) mentioning (sometimes among other issues) perceived excessive or unnecessary charges, and 121 (22%) mentioning a lack of transparency in how charges are calculated.

Meetings and round-tables also brought up a number of issues about charges, with views such as: Painting balconies – two staff for two weeks cost £28,000, seems very high. Other quotes were up to £55,000 which didn't seem credible, so I suspect quotes may not have been be genuine.

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<sup>75</sup>The majority of leaseholders who participated in the survey and responded to the income question stated that their gross household incomes, from all sources, was £29,999 or less. However, it should be noted that of the 1,050 respondents there were 38% who preferred not to say anything about their income.

- 4.35 From this wider evidence, it appeared that the greatest concerns related to the costs for major works which can sometimes cause severe distress to leaseholders, rather than general service charges.
- 4.36 Regarding property managers' own charges and service charges:
- On management fees, respondents to our landlord questionnaire told us that these were typically between £100 and £300 a year per unit (though only small numbers answered the relevant question with good information).<sup>76</sup>
  - However, administration fees for common actions (like sending information to leaseholders on request, liaising with freeholders over alterations and other issues, or issuing legal letters) can be quite high, for example between £50 and £150 for one action.<sup>77</sup>
  - On service charges, the leaseholder survey found (for 887 leaseholders), regular service charges were on average £93.60 a month (equivalent to around £1,123 annually), with only 15% of the sample reporting service charges of £150 a month or more.<sup>78</sup> This is consistent with other sources – for example, a 2012 report by the London Assembly found annual service charges in the capital (likely the highest in England and Wales) to average £850 a year per unit in the public sector and £1,800–£2,000 in the private sector.<sup>79</sup>
- 4.37 Regarding the costs of major works, freeholders, developers, residents' groups and others had all heard horror stories about poor tendering, cost overruns and other issues. It is, of course, difficult to assess definitively whether works were necessary or efficiently procured. However, indicatively, we did receive many strongly put complaints in the leaseholder submissions. Many complaints centred on the scale of charges, and some also drew attention to aspects of communication, consultation, process and performance of the works, including:

Major works are presented in a confusing way using legal jargon and wording and costings that make no sense. When we challenge works we are never supplied with a conclusive and precise answer. Three years ago each property had new double glazing windows installed, no surveyor entered our property to

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<sup>76</sup> Appendix E, question 17.

<sup>77</sup> Source: stakeholder meetings and desk research.

<sup>78</sup> Data provided by Ipsos MORI to the CMA, not appearing in the published report.

<sup>79</sup> London Assembly, [Highly charged: Residential leasehold service charges in London](#), March 2012.

measure up yet we were all charged a fee for this service. Again when challenged we were not supplied with a satisfactory answer.

In 2009/2010 [property manager] embarked on a singularly poor 'Major Works' programme for the four estates. For example, in the case of the blocks on the [X] Estate, blocks were charged around £26,000 for the replacement of cold water pipes that just were not done.

As far as we can tell, all works arranged by [property manager] are charged at exorbitant rates. We are usually not made aware of them until about twelve months after they occur when our residents' association representative has to do hours of detective work to see why we were charged hundreds of pounds to replace a light bulb or door handle. This happens every single year.

### ***Charges for administration and supplementary services***

- 4.38 In addition to service charges, leaseholders may be liable under the terms of leases for administration charges such as for approvals – for example, for subletting, for making alterations, or for keeping a pet. Lease terms are typically intended to protect the freeholder's interests in a building, to enable efficient administration and to protect other residents, and so approvals may be required before leaseholders can undertake these activities. A property manager may administer charges on behalf of the freeholder or exercise the approvals function itself. Sometimes approvals are a simple administrative exercise, but sometimes (as perhaps with alterations to the building) proper assessment of whether to grant approval can be a significant process.
- 4.39 Often, it is unlikely that leaseholders will need to pay much attention to these charges until they find that approvals are needed (though an exception might be with buy-to-let leaseholders, who may seek clarification in particular on subletting approval charges from the outset).
- 4.40 Several property managers told us that supplementary charges were readily accessible on their websites and so could be assessed by actual and prospective leaseholders at any time. However, leaseholders complaining in submissions to us said that in many cases there was little or no prior transparency of charges:

We were charged £195 for a deed of covenant to ensure we meet the obligations (as the new owner) of the lease. I accept that such a deed is necessary, but it was drafted by my solicitor, at my cost.

Administration fee for dealing with General Leasehold Enquiries including confirmation of ground rent/rent charge is £135.00.

- 4.41 Due to the lack of prior consideration or limited visibility, these charges might not play a role in the assessment of different property managers, and attention could focus more on the management fee. Consequently the level of these charges may be only weakly constrained. However, leaseholders can also challenge these charges through the FTT. Charges are also made for the disclosure of relevant information to purchasers' solicitors during the sales process for a leasehold property. Prospective leaseholders have no alternative but to purchase this service from the property manager, and so the only constraints on charges appear to be what is understood to be acceptable, as well as any guidance from FTT judgments where charges have been challenged. We received complaints about the levels of charges (and we acknowledge that in some cases finding, preparing and supplying detailed information for conveyancing may be no small task) but the major complaints we received were that property managers can be slow in providing the information and so may delay or imperil property sales.

### ***Control and appropriateness of costs***

- 4.42 Concerns were raised with us that, beyond having weak incentives to limit costs of works recharged to leaseholders, property managers might sometimes increase costs for their own profit. It was suggested this might occur in several ways, such as by using related companies rather than competitively tendered ones to do major works, or by generating work so that increased management fees can be charged.

### ***Unnecessary work***

- 4.43 Leaseholders, consumer groups and others mentioned a number of cases from recent years where property managers appeared to propose unnecessary works in order to profit from them.
- 4.44 One example given by a large freeholder was of an agent who may have avoided solving long-term problems at sites so that it could commission repeated short-term repair works, the suspicion being that this generated more revenue. However, freeholders did also say that apparently similar practices may have arisen from 'an unconscious bias to do works' in the interests of heading off problems at sites.
- 4.45 The FTT has sometimes found against property managers and/or freeholders for, effectively, proposing or carrying out unnecessary works (in practice, for

proposing to charge service charges that are not ‘reasonably incurred’<sup>80</sup>). In one case, for example, an integrated freeholder-manager proposed works and management fees exceeding £1 million shortly after acquiring the freehold. Yet when leaseholders challenged the necessity of works and costings at the FTT, the tribunal ruled that about £600,000 of the total bill would not have been reasonably incurred.<sup>81</sup>

- 4.46 FTT judgments against property managers also sometimes order them to repay leaseholders for service charges already incurred, typically for fairly modest sums. However, large repayment orders have sometimes been made. For example, in 2010 property managers at a development in Nottingham (with 120 units) were ordered to repay four years’ worth of service charges totalling over £700,000 but, in effect, deemed unnecessary.<sup>82</sup> In the same year, managers at a large riverside development in London (with over 1,100 units) agreed to repay over £1 million in service charges in an out-of-court settlement.<sup>83</sup>
- 4.47 These cases illustrate that there is potential for property managers to try to increase charges – but also that leaseholders’ interests can be protected by the FTT.

#### *Related companies*

- 4.48 While concerns have been expressed to us about the use of related companies, it is worth noting that, in principle, efficiency benefits can sometimes arise when property managers use related companies. For example, close relationships can facilitate management, provide quick accountability, avoid unnecessary tendering costs (especially across multiple sites) or ensure quality control (although in the absence of effective competition efficiencies may not always be passed on to leaseholders).
- 4.49 Leaseholders and consumer groups mentioned several cases from recent years in which related companies were argued to disserve leaseholders, and 13% (72) of complaints that we received directly mentioned property managers having organisational or other pre-existing connections to contractors and freeholders.
- 4.50 For example, we were told of a case where a property manager was said to have provided concierge services that were understaffed before going on to

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<sup>80</sup> See paragraph 3.17.

<sup>81</sup> [Decision of the FTT, case ref CAM/34UE/LSC/2013/0130.](#)

<sup>82</sup> [Decision of the FTT, case ref BIR/00FY/LSC/2009/0027.](#)

<sup>83</sup> St George Wharf, London, reported widely in the media in 2011.

employ temporary staff, paying commissions to an agency related in ownership to itself. In another case residents were repaid nearly £11,500 for insurance commissions and provision of an emergency call and door system through related companies.<sup>84</sup> We were also told of a case where the property manager appeared to quality-vet prospective contractors in such a way that only those contractors related to the property manager qualified for consideration.

- 4.51 In practice, the FTT has sometimes found against arrangements using inter-related companies – for example, in a case involving procurement of interphones, insurance and other services from related companies without competitive tendering, the FTT ordered the property manager to repay leaseholders in part for commissions paid to related companies for procurement, and for some management fees.<sup>85,86</sup>
- 4.52 Concerns about vertically integrated companies generally dated back a few years. Freeholders and developers said that, as far as they could tell, things may have improved since. Nonetheless, we were told that leaseholders and consumer groups continue to suspect some property managers of such activities, particularly by appointing related contractors that go on to do overpriced works.

### ***Communication and transparency***

- 4.53 Nearly a third (192) of the complaints we received directly mentioned poor communications between property manager and leaseholders. Just over a quarter of complaints concerned a lack of transparency in how charges are calculated. However, views from the leaseholder survey on the quality of information provided were varied. Nearly three-quarters (72%) of respondents rated provision of information by the property manager on what service charges had been spent on as fairly/very good, though one in seven (15%) rated it as fairly/very poor. Six in ten (62%) leaseholders in retirement developments rated provision of service charge information as very good, much higher than those in other types of developments: private (35%), housing association (33%) and local authority (26%).
- 4.54 When asked about information on major works, six in ten respondents (62%) rated it as very/fairly good, while, one in six (16%) rated it as very/fairly poor. Just over half (55%) of respondents rated consultations about views on major works as very/fairly good. Nearly one in four (22%) of respondents rated this

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<sup>84</sup> See [CHI/21UG/LIS/2012/0016](#).

<sup>85</sup> See [LON/00AX/LSC/2011/0220](#).

<sup>86</sup> See [LON/00AX/LSC/2001/022](#).

as very/fairly poor. One in four (26%) respondents rated consultations about which contractors to use as very/fairly poor. A third (31%) of leaseholders in local authority developments rated this as poor, much higher than the one in four in housing association developments (25%) and private developments (20%).<sup>87</sup> When asked about this issue, seven in ten (69%) leaseholders with an RTMCo/RMC at their property said consultation was good, compared with just over four in ten (43%) without an RTMCo/RMC.

- 4.55 There are obligations on property managers to provide information to leaseholders, see Appendix A. Leaseholders have the right to demand from their landlord or managing agent a written summary of any costs incurred in the previous 12 months and leaseholders have the right to inspect and take copies of any accounts, receipts and other documents supporting costs.
- 4.56 Members of the trade associations and professional bodies may also be subject to transparency obligations under their codes of conduct. For example, ARMA-Q will require an annual declaration to the client (freeholder) and leaseholders of income or other benefits earned in relation to the service charge, including by associated companies and in-house providers (but not necessarily of the sums involved). RICS requires that insurance commissions and all other sources of income to the managing agent arising out of management should be declared to the client and the tenants (leaseholders in this context).
- 4.57 Despite these protections, issues raised by leaseholders included a lack of explanation by property managers as to what charges actually represented, why they had been incurred and how they were justified. For example, submissions to the CMA included comments such as:

Many leaseholders have directly challenged them regarding particular spends, or requirements, or asked for account certification and audited accounts, only to be met with brick walls, dodged questions and arguments they hide behind along the lines of 'we can't show you the actual bank accounts due to the fact that there's a central pool'.

I've asked [property manager] on a few occasions to send me a breakdown of how my bill is worked out each year, and each time all they send me is figures but no explanation as to where my money has gone or what it's been spent on. I wrote to them last year asking for copies of all invoices/receipts for work carried out

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<sup>87</sup> These figures include retirement properties for private developments and housing associations.

to the property in the last eight years. They replied saying that they only keep five years' worth of receipts and invoices.

A lot of people have had maintenance activities added to bills which are not associated with their property. When this queried we are advised bluntly that all schedules are correct and failure to pay the full amount will result in legal action being taken. However I am glad to report that after engaging a solicitor they sent a letter advising they were looking into this.

- 4.58 We were told that there is no practical common standard for reporting on property management and that property managers' approaches vary widely. Some go to substantial lengths to explain ongoing costs, why major works were needed, details of tenders and other issues – clearly and intuitively. But others provide information only in irregular retrospective accounts that may be prepared poorly or to formal accounting standards incomprehensible to lay leaseholders. In partial mitigation, some issues may be due to the details of property management being inherently complex. We were also told that guidance had been produced for property managers outlining best practice.<sup>88</sup>
- 4.59 We were also told that when leaseholders were concerned about charges and sought to exercise rights to examine supporting documentation it could be difficult to get property managers to comply. We heard further that when leaseholders did get access they were sometimes overwhelmed by the quantity of information and the level of detail. For example:

The information provided by [property manager] is a minefield to interpret and really needs looking into by someone with an understanding of reasonable costs in comparison to similar properties.

- 4.60 Property managers are required to prepare accounts within six months of year's end. This is important so leaseholders can assess whether service charges (likely to have been paid on an estimated basis earlier in the year) were appropriate. Obligations are enforced by local authorities but we were told this is unlikely to be a priority for them and extensions to the time limit could be obtained where it could be shown exceptional circumstances delayed the final preparation of accounts. We heard that there could

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<sup>88</sup> ICAEW Technical Release Tech 03/11, Residential Service Charge Accounts Guidance on Accounting and Reporting in Relation to Service Charge Accounts for Residential Properties on which Variable Service Charges are Paid in Accordance with a Lease or Tenancy Agreement – Guidance – prepared by a joint working group comprising representatives of the Association of Chartered Certified Accountants, ICAEW, the Institute of Chartered Accountants of Scotland, ARMA and RICS.

consequently be substantial delays, making it very difficult to hold property managers to account. A leaseholder group said:

At present, it is not uncommon for accounts to be up to three years out of date. There is no penalty for this – but it's extremely likely that accounts that old will be wrong.

- 4.61 Another area raised was visibility in relation to sinking funds. These were often perceived as having very little transparency. We were also told that details of the status of funds were in some cases not provided. A leaseholder group said:

Leaseholders are often not told the status of a block's sinking fund – there's no transparency and you can't access accounts.

- 4.62 This is of particular concern, since sinking funds can be very large and their treatment by property managers is not subject to statutory regulation in the same way as usually applies to other professionals looking after clients' funds (eg solicitors).

### ***Consultation on major works***

- 4.63 Among complaints received directly by the CMA, 13% were about a lack of adequate consultation with leaseholders on major works. In the leaseholder survey (see above), over half (55%) of respondents rated consultation with leaseholders on major works as very/fairly good, with 22% rating it as very/fairly poor. Also, 26% rated consultation on which contractors to use as very/fairly poor. Satisfaction with this issue was much higher for RTM/RMC properties and lower in local authority ones.
- 4.64 As set out in paragraphs 3.26 and 3.27, landlords or their agents are required to consult with leaseholders before going ahead with major maintenance or repair works paid for through service charges.<sup>89</sup> At present, a landlord must comply with the consultation requirements if the contribution towards costs payable by any leaseholder exceeds £250. There are similar requirements for consultation on any long-term qualifying agreement lasting for over a year and worth over £100 a year (including framework agreements). We were told that property managers are usually appointed on contracts of one day under a year, which can be rolled over, hence consultation is not triggered.

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<sup>89</sup> The law requires that leaseholders paying variable service charges must be consulted before a landlord carries out qualifying major works or enters into a long-term agreement for the provision of services (section 20 of the 1985 Act).

4.65 In meetings and roundtables, leaseholders and consumer groups expressed a number of more detailed concerns about consultations:

- consultations had sometimes weak power to influence freeholders'/agents' final decisions on whether works were needed or appropriately timed;
- freeholders/agents were not compelled to pick bids providing best value;
- tenders did not always appear genuine: some appeared unrealistically inflated;
- when consultations were on long-term qualifying agreements, it was difficult for leaseholders to understand and contribute effectively when actual tasks were still abstract;
- the process was slow, cumbersome and confusing for many leaseholders, and delayed necessary works, whilst getting dispensation from the section 20 process was itself also time-consuming; and
- when works were discussed at RTMCo meetings, and agreement from leaseholders was obtained in principle, there was still an obligation to go through the full section 20 procedure.

4.66 Leaseholders and property managers expressed concern that the thresholds for consultation seemed inappropriate as the £250 threshold had been applied for many years but the value had not been increased over time. They felt that this meant consultation processes were triggered in small blocks for inappropriately small works. However, there was also concern that in very large blocks major items of expenditure could fall under the per-leaseholder allowance and so would not require consultation.

4.67 Assessing whether section 20 consultations and tendering are properly undertaken would require detailed case-by-case analysis, and opinions on reasonableness. We received examples of the process not appearing to work well, or of property managers or freeholders seeking to apply the system to their advantage or without proper care. However, we did not see evidence that this was a widespread or systematic failing, and we do see section 20 consultations as serving a useful function in protecting the interests of leaseholders. Any abuse by property managers or freeholders is also subject to potential redress at the FTT. Nonetheless we do see that there are frustrations, delays and costs in using the system, and that it can be triggered at unhelpfully low levels of expenditure.

## ***Understanding of obligations***

4.68 An issue on which we found almost universal agreement was that new leaseholders had little understanding of the implications of purchasing a leasehold property – in terms of their rights and obligations, block management and their liability for charges. Property managers told us that a large part of their interaction with leaseholders involved explaining such aspects. Seventeen (3%) of the submissions that we received directly expressed the view that the problems of leasehold property management were at least partly due to a lack of leaseholder understanding of their rights and obligations. Even leaseholder groups acknowledged that understanding was often very limited, with prospective leaseholders particularly failing to understand that they would not have personal control over expenses for which they could be liable.

4.69 Concerns were raised about the effectiveness of the advice purchasers receive through conveyancing. We were told:

- cheap or online conveyancing deals can fail to detail lease obligations and their implications properly;
- by the conveyancing stage, purchasers may overlook these issues amid the pressures and excitement of buying a new home – since they will have already invested considerable time and money, and may be emotionally committed or fearful of withdrawing from the transaction and having to start afresh, and additionally may be somewhat overwhelmed by the quantity and complexity of information they need to deal with; and
- even when advised of liabilities, purchasers may not realise the significance of variable lease charges, particularly if major expenditures are forthcoming and sinking funds will not fully cover them.

4.70 Before the conveyancing stage, it seems that vendors and estate agents (who act for the vendor) have weak incentives to highlight the costs or quality of property management to prospective leaseholders – they will not wish to highlight information that could deter a sale. Looking at estate agents' particulars of sale, we found that many did not specify whether a property was leasehold or freehold, quote remaining lease length, highlight any liability for service charges, or give many details of current service charges.<sup>90</sup> Thus,

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<sup>90</sup> We looked at flats for sale in eight different towns and cities in England and Wales, advertised on well-known property portal websites. For each flat, we looked at the full details available from the estate agents' own websites to see whether they indicated if the property was leasehold, if a service charge was payable and the level of any service charge. While some estate agents showed this information clearly, most made no reference to service charges.

prospective purchasers are not alerted early to potentially major outgoings. While there are many sources of advice about leasehold (such as from LEASE or ARMA), purchasers do need some appreciation of the issue before they can realise the need to seek such advice.

- 4.71 Mortgage lenders have an interest in purchasers being able to cover all outgoings. If leaseholders default on service charges, ultimately there is a threat of forfeiture of the lease to the landlord, and sometimes lenders find themselves covering costs so as not to lose their security. When there are unforeseeable charges such as for one-off repairs, leaseholders sometimes are forced to choose between making the payment and servicing other commitments. We heard from mortgage lenders' representative bodies that lenders will make an assessment of affordability which will include service charge information and, when available, any known forthcoming major works or inflationary terms in the service charge calculation. While this serves as a prompt to purchasers, we were told that the same problems as with conveyancing can apply, particularly that the information becomes available at a late stage of the purchase process and purchasers may not fully take in its significance.
- 4.72 The larger property developers stressed their efforts to inform prospective leaseholders about the management of new developments. Some said they provided detailed information packs breaking down costs per unit and giving estimates of possible increases during the years after purchase – although they also acknowledged that it could be difficult to get leaseholders to take on board even clear and simple information about property management, among all the other concerns of buying a property.

### ***Complaints and redress***

- 4.73 The leaseholder survey asked leaseholders whether they ever had reason to complain to their property manager and, if so, the main reasons for dissatisfaction. Overall, four in ten respondents (42%) said they had reasons for dissatisfaction. At local authority developments 57% did, and at housing associations 54% did – but fewer did at private developments (39%), and still fewer in retirement developments (28%). Non-RTMCo/RMC leaseholders were more likely to have complained than RTMCo/RMC ones: 49% and 26% respectively. Younger age groups were relatively more likely to answer 'yes' to this, as were leaseholders in London. A fifth (22%) of those who rated their property manager as good overall answered 'yes'.
- 4.74 A number of reasons were given for leaseholders being dissatisfied. The most frequently cited, by over a third (37%) of all respondents, was maintenance

and repairs of external common areas. The other main reasons for dissatisfaction included upkeep of outside areas (15%), maintenance/repairs of internal common areas (14%) and cleaning of internal common areas (6%). The main reasons to be dissatisfied were the same across all types of properties as well as across RTMCo/RMC and non-RTMCo/RMC.

- 4.75 A small minority of leaseholders interviewed had ever contacted either an ombudsman (22 of all 1,050 surveyed, or 2%), the FTT (33, ie 3%) or a local councillor/MP (78, ie 7%). There were mixed outcomes for those leaseholders who had contacted a local councillor or MP: 33 said their issue was resolved, while a similar number (31) said it was not (14 said the issue was ongoing). Of leaseholder complaints that we received directly, 172 (about 31%) said that the FTT was ineffective and/or expensive.
- 4.76 Awareness of the FTT was lower than for the ombudsman system among leaseholders taking part in the survey. One in five (21%) leaseholders who had not contacted the FTT said they were aware of the tribunal. Slightly fewer than four in five (78%) were not aware of the tribunal before the interview.
- 4.77 The operation of ombudsmen, the FTT and self-regulation schemes is set out in [Section 6](#)

### ***Findings on outcomes for leaseholders***

- 4.78 We gathered extensive qualitative evidence of poor outcomes for leaseholders. The results of the leaseholder survey were, generally, more positive than the individual complaints we received suggested. Overall, we found the outcome for leaseholders to be mixed. The impression we gained was that in many cases property managers delivered an effective and efficient service and communicated well with residents. But where issues arise, they cover a wide range including quality of service, value for money and the ability to obtain redress. Moreover, where the relationship between property manager and leaseholder breaks down, the impact on leaseholders can be very significant.
- 4.79 Practices on provision of information by property managers seemed to vary and we heard of some examples of poor, incomplete or confusing information. These seem to have driven many of the examples of poor outcomes.
- 4.80 The section 20 consultation processes for major works provides transparency to leaseholders regarding planned major works and an opportunity to influence decisions on works and the choice of contractor. Although this serves a useful information and consultation function (but does not give leaseholders any control), we were told by many parties that the process for section 20

consultations was inflexible and that consultation thresholds were set too low. There was a consensus among all stakeholders, including leaseholder representatives, that many leaseholders have a poor awareness of their obligations in relation to property management and service charges. We found that leaseholders often do not understand how property management arrangements work before they purchase the property, nor do some of them fully understand their obligations, even where they are given information ahead of purchase.

- 4.81 The incentives for vendors and estate agents to highlight the cost and quality of property management to purchasers appears to be limited, with the result that many prospective purchasers have little awareness of leasehold and service charge liabilities when flat-hunting and may not be able to ask the relevant questions or factor these issues into their planning and decisions until a very late stage. Even post-purchase, understanding can be limited, and many property managers told us that a large part of their activities was in explaining RPMS and lease obligations to leaseholders.

### **Freeholder-landlords and alignment of interests**

- 4.82 This section considers how far freeholder-landlords of different types – who instruct property managers in the absence of an RTMCo or RMC – may help ensure that property managers serve leaseholders well. This is of interest because, as set out in paragraphs 3.66 to 3.71, in principle freeholders' incentives may not be aligned with leaseholders'. Freeholders have the ability to help ensure that leaseholders are well served by property managers. However, we found that in practice freeholders' incentives can often remain disengaged from day-to-day property management.
- 4.83 We used meetings, roundtables and questionnaires to explore freeholders' business models and incentives.

### ***Investor-freeholders***

- 4.84 We look first at freeholders who own property as a commercial investment. We understand that large investors own a high proportion of the freeholds in England and Wales.
- 4.85 Investors earn returns from freeholds in several ways where allowed by the terms of the lease:
- collecting ground rent;

- charging approval or administration fees, eg for alterations or remortgages, or for providing information to conveyancers when a leasehold flat is being sold;
- receiving commission in the supply of services such as insurance;
- supplying RPMS and contracted services through vertical integration or the use of related companies;
- granting lease extensions;
- (when occasionally permitted by lease terms) charging exit fees when leaseholders sell on (although often these fees are paid into sinking funds rather than to the freeholder); and
- selling freeholds or subleases to other investors – for example, pension funds may be interested in ground-rent income to provide steady yielding assets.

4.86 Some freeholders are mainly concerned with ground rents, and treat other functions on a cost-recovery basis only or delegate them to property managers. But many freeholders see other income streams as a substantial part of their business models. Large investors told us that they generally did not do their own property management, saying it would be inefficient for them, and sometimes that it had been discredited by previous bad practices in the market.

4.87 We were told that these activities can be profitable at scale, so long as a freeholder's costs are not too high and any major liabilities of the landlord in leases are covered. Buildings must, in particular, satisfy Health and Safety and fire regulations, have general building insurance and be broadly well maintained. Freeholders can then avoid litigation, whilst buildings remain saleable. We were told that the value of a freehold interest in a block was likely to be small in comparison to the collective value of the leases.

4.88 We were told that in general, leaseholder satisfaction does not greatly affect the profitability of large investor-freeholders. The incentive can be to appoint a competent property manager to cover off major liabilities, but it appears they often take little interest in whether the quality of works exceeds the bare minimum required or whether charges are reasonable.

4.89 However, we were told that incentives can vary, depending on the finer details of the business model. An investor may have incentives to monitor property management and leaseholder satisfaction if, for example:

- it manages freeholds on behalf of others, like pension funds, with brands to protect or which worry about the value of investments becoming uncertain if leaseholders attempt RTM (thereby removing the freeholder's control over property management and possibly some revenue streams);
- it regularly buys freeholds from property developers that try to ensure good management for leaseholders in the years after they purchase; and/or
- it has relationships with its leaseholders for any reason – some freeholders said that by historical accident they were known personally to their leaseholders and tended to receive any complaints about management, which they tried to resolve.

4.90 Responses to the CMA's questionnaire of landlords tended to confirm that investor-freeholders have low incentives to get involved with day-to-day property management and leaseholders' concerns. In a sample of 70 mostly smaller investor-freeholders, few monitored property management,<sup>91</sup> got leaseholders involved in selecting the managers<sup>92</sup> or got involved in complaints handling.<sup>93</sup> Most also indicated that maintaining their properties was more important to them than leaseholder charges, satisfaction or complaints.<sup>94</sup>

4.91 Larger freeholders that the CMA met also, overall, tended to be relatively uninvolved with day-to-day property management or ensuring that leaseholders are satisfied. One – managing a large portfolio mainly on behalf of pension funds and other third party investors – said it monitored its property managers actively and would replace them if they underperformed, particularly so as to avoid RTM which could create uncertainties for its investor clients. It further explained that it prioritised quality of management above minimising leaseholders' fees. But others appeared to be more hands-off. One explained that it never saw most of its properties, and had not intervened in cases of poor management except, rarely, when buildings were physically endangered.

### ***Property developers***

4.92 The CMA met a number of property developers, including several of the UK's largest. Most did not remain as freeholder at many developments for long after building finished. Instead, they sold freeholds to investors. Occasionally

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<sup>91</sup> Appendix E, question 31.

<sup>92</sup> Appendix E, question 29.

<sup>93</sup> Appendix E, question 38 onwards.

<sup>94</sup> Appendix E, question 27.

some property developers retained some freeholds and self-managed them through an in-house subsidiary.

- 4.93 Developers said that to retain any involvement in developments could be costly and time-consuming. However, some developers told the CMA that it was important to them – culturally, and for the positioning of their brands – to take an active interest in leaseholders even after developments were completed. This could be through self-management – looking after sites until an RMC was staffed and appointed a property manager – or by writing a manager of their own choosing into tripartite leases.
- 4.94 Most major developers write property managers into leases to some degree, and investor-freeholders confirmed that it could make freeholds more attractive to purchase because it was harder for leaseholders to attempt RTM, which could create costs for freeholders to respond to or to contest (and could mean freeholders lose sources of income such as insurance commissions). As such, under this model, neither developers nor investor-freeholders may end up having a major role in disciplining the behaviour and performance of property managers.
- 4.95 Developers said they only wrote trusted managers into leases, judged to have reputational incentives to serve leaseholders well. Nonetheless, once managers are written into leases, and hard to remove, they can have weak incentives to serve leaseholders well. Moreover, developers' own reputational incentives to monitor management can grow weak after the first few years (although they may indirectly discipline management at older sites if they continue working with the same managers seeking appointment at newer sites).

### ***Retirement housing freeholders***

- 4.96 Leasehold retirement accommodation can vary widely in terms of the physical adaptations and services offered to residents, and in terms of the ownership and management models. This is described in paragraphs 5.29 to 5.66.
- 4.97 As with other accommodation, sometimes investors own freeholds and remain fairly distant from property managers that they, or an RTMCo, employ. As such, the remarks about investor-freeholders above would also apply here.
- 4.98 However, we heard from trade associations, developers, freeholders and property managers in the sector that, across the different types of retirement accommodation, it is more common than elsewhere for developers to retain freeholds and to have some involvement in managing sites, even if a property manager is also appointed. At developments offering services of any type,

and particularly at retirement communities, it is fairly common for the same company or group to develop, own freeholds and provide property management alongside the other services.

- 4.99 Trade bodies and operators in the sector argued that this integrated ownership and management could provide incentives to work in leaseholders' best interests. They said a common model – particularly at retirement communities – was for operators to cover their costs by a mix of revenues: from sales of units to leaseholders, from monthly fees (sometimes fixed during residents' lives) and often by charging exit fees when units are finally sold. They argued that, because development costs were high and took time to be covered in these ways, they had strong incentives to serve leaseholders well. Otherwise, they argued, they might suffer reputational damage, might have problems recruiting subsequent residents needed for ongoing profitability, and resale values (against which exit fees were charged) could be harmed.
- 4.100 However, it is worth noting that for this argument to be persuasive there would need to be good market information for prospective residents as well as no obvious lack of supply. Consumer bodies argued that supply did appear to be limited.<sup>95</sup> It is perhaps most plausible that this model removes incentives to under-maintain retirement complexes.
- 4.101 Retirement community operators also said that property management per se accounted for only a small proportion of their income, and that they profited more from wider services and care. Hence, they argued that it would not be sensible to alienate residents through poor or expensive RPMS.
- 4.102 Nonetheless, leaseholder and consumer groups continue to highlight cases of freeholders and property managers in the retirement sector allegedly over-charging leaseholders for services charges and works, as well as resisting RTM requests. Their submissions to this study recapped a number of FTT decisions from recent years in favour of leaseholders (see paragraphs 5.29 to 5.66).

### ***Findings on alignment of interests***

- 4.103 The basic leasehold structure, whereby responsibility for appointing and supervising property managers rests with the landlord while leaseholders bear the cost, is a major cause of the problems and discontent experienced. There is a separation of control for leaseholders; they are the 'consumer' of services provided and pay (indirectly, via a service charge) for those services but are

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<sup>95</sup> See for example, Age UK, [Housing in later life](#), July 2014.

not the customer and individually have relatively little ability to influence appointment decisions or the work done.

- 4.104 In many cases there is also a misalignment of incentives; freeholders do not carry the costs of property maintenance and so may have weak incentives to ensure that leaseholders are getting a good service and value for money. Freeholders may also have incentives from vertical integration with property managers or relations with suppliers to do things that are not in the best interests of leaseholders (such as overcharging or conducting unnecessary works). There are exceptions to this where interests are more closely aligned, such as where landlords have closer relationships with leaseholders (for example in some retirement models), where they are responsive to leaseholder complaints or where they have long-term interests, such as reputation as a developer, to protect.

## **Right to Manage**

### ***Leaseholders' experience with RTM***

- 4.105 The RTM<sup>96</sup> processes are described in paragraphs 3.29 to 3.31 and Appendix A. As noted in paragraphs 4.19 and 4.31, leaseholders with RTMCoS or RMCs tend to have higher levels of overall satisfaction with the services provided and with the value for money of property management than those with other types of landlord.
- 4.106 The leaseholder survey found that just over half (54%) of leaseholders were aware of RTM. As would be expected, awareness of RTM is higher among those who have exercised the right or live in developments managed by a RMC<sup>97</sup> (82% compared with 45% living in non-RTMCo/RMC developments). Whilst over half of all leaseholders surveyed were aware of the right, only a quarter (25%) have exercised – or tried to exercise – it. Of these, most (71%) have been successful.
- 4.107 The reasons why leaseholders had tried to take control of management related to poor service maintenance (18%) and dissatisfaction with the contractors in place at the time (17%), alongside poor value for money (12%).
- 4.108 More respondents thought that the management of properties and communal areas had got better since leaseholders had taken control (32%), than thought

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<sup>96</sup> And similarly collective enfranchisement which has the same effect of transferring the responsibilities of the landlord as well as giving ownership of the freehold to residents.

<sup>97</sup> About 11% of leaseholders with a private freehold said that their current property was managed through an RMC.

it had got worse (2%). That said, for a higher proportion of respondents the perception is that things have stayed the same (39%).<sup>98</sup>

### ***Difficulties in acquiring RTM***

4.109 An RTMCo must be incorporated before leaseholders can lodge a claim for RTM. Parties, including landlords, can respond with a counter-notice, for example because of a breach of the statutory requirements for acquiring the right to manage, or a procedural defect in the claim. This then goes to the FTT for resolution (see paragraphs 3.30 and 3.31).<sup>99</sup>

4.110 We were told that in some cases landlords and property managers would seek to obstruct the RTM process. There are strict rules relating to the form and contents of the claim notice and the parties to whom notice of the claim must be given. Sometimes challenges are made for good reason but we were told the rules provide opportunities to lodge objections to delay the process and increase costs, such as if the exact prescribed process has not been followed (eg if not all leaseholders have been properly contacted and consulted, even if their votes would not be sufficient to change the outcome of the vote).<sup>100</sup> Leaseholders may sometimes find it difficult to identify and contact all other leaseholders (especially where many are not resident but subletting their flats) and objections had been lodged on this basis, whether or not a clear majority of leaseholders had expressed support for the RTM process. We were told that property managers may not make contact lists available (citing confidentiality). One leaseholder told us:

It was extraordinarily difficult to gain the agreement of 50% of the flat owners and in fact several previous attempts had failed. The ability to make contact with leaseholders proved impossible in many cases as contact details were poor or ended up with banks/trusts where the owners are effectively anonymous ... Once we had sufficient leaseholders on board ... every effort was made by [the landlord] to sabotage this including engaging expensive lawyers to dispute our case.

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<sup>98</sup> Many more said that service charges had increased than decreased but because the responses reflected RTM/RMC changes which could have occurred several years ago, this may just be a reflection of inflation. Note that the number of respondents to these questions was low.

<sup>99</sup> The process for collective enfranchisement is similar and described in more detail in Appendix A. Similar procedural difficulties may therefore be encountered by leaseholders seeking to exercise their right to collective enfranchisement.

<sup>100</sup> For example, in one case there was a substantial delay in RTM being granted where one of the major grounds of objection was that the RTMCo did not correctly include 'RTM' in its name ([\[2013\] UKUT 0487 \(LC\)](#)).

- 4.111 We also heard that where RTM applications are challenged, this can impose legal costs on leaseholders, particularly where the landlord/property manager is able to charge its own legal costs as an administration charge to the leaseholders. We were given examples by LKP/Carlex of failed RTM cases leading to substantial costs. In one case, leaseholders lost their RTM application because of a discrepancy in the dates of the RTM ballots at different blocks on an estate, and they were left with bills totaling £30,000, divided between their costs and those of their landlord, which the leaseholders must pay.<sup>101</sup> In another ongoing case, the leaseholders (or a body acting on their behalf) face an estimated £25,000 legal bill for two failed court actions and a risk of further costs if they went to the Court of Appeal and lost again.<sup>102</sup>
- 4.112 There are also circumstances in which it can be difficult or impossible to obtain RTM, for example rights do not apply if the proportion of commercial property is above 25% or if not all flats have been sold, and it can be difficult to meet the required thresholds in mixed blocks with tenants, as is likely in housing association blocks. We also heard of cases where landlords or property managers have tried to put residents off by highlighting potential risks and costs and seeking to hold RTMCo directors responsible for any legal costs arising.
- 4.113 One in five of the leaseholder survey respondents who said that there had been an attempt to introduce RTM recalled the attempt as unsuccessful (20%). Both RTMCo and RMC leaseholders were asked how they would rate the process of taking control of management. Of 101 leaseholders providing answers, more said the process was easy (31%) than said it was hard (25%). Of those who said the process was hard, the main issues related to difficulties in engaging people, alongside the conflicting agendas and priorities which different groups (eg owners and renters) bring with them.
- 4.114 The CMA received 48 leaseholder complaints (9% of the leaseholder complaints we received) that said RTM was difficult to obtain.

### ***The constraint of RTM on freeholder behaviour***

- 4.115 There were mixed views on whether the potential threat of RTM and depriving freeholders of control over their properties, was likely to make a freeholder devote more time to monitoring property management or improving it to ensure it serves leaseholders well. One large investor-freeholder working for a pension fund said that it might switch management to avoid RTM for fear of

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<sup>101</sup> See Leasehold Knowledge Partnership [website](#).

<sup>102</sup> See The Campaign Against Retirement Leasehold Exploitation (Carlex) [website](#).

the uncertainties it could bring, but another major investor said it was relaxed about RTM since, when it occurred, residents were usually motivated to oversee property management effectively themselves. Differences in view may reflect the extent to which freeholders draw income from property management and related activities (eg insurance commissions) that would be lost in the event of RTM.

- 4.116 The threat of RTM exists in many circumstances but in some situations it will be clear that the requirements will not be met. In others, landlords will know that it could be difficult for RTM to be achieved, for example where there are many absentee leaseholders who may be difficult to contact, or where problems only affect a proportion of leaseholders, making it more difficult for them to reach agreement to act collectively. Moreover some landlords and property managers will try to obstruct the process. Further, RTM is quite a major change and a complex process which is only likely to be pursued where leaseholders have strong motivations. Therefore the constraint from RTM seems to be of variable impact, potentially quite weak in some cases. That said, some landlords clearly do view it as a potential constraint and most indicated they would generally prefer to avoid RTM, so as to ensure their interest in the building is properly protected (and also to protect other sources of income).

### ***Findings on RTM***

- 4.117 RTM (and also collective enfranchisement) provides a means by which leaseholders can collectively take over as landlords. This can occur where they are unhappy with their property manager and cannot influence their freeholder to make changes, or in cases where relations with landlords and property managers have broken down. The threat of RTM poses some constraint on freeholders and property managers and so may moderate their behaviour to some extent. Where residents have RTMCo (or an RMC), their degree of satisfaction over RPMS is higher. We consider that RTM and collective enfranchisement can provide a very valuable safeguard to leaseholders.
- 4.118 We note though that RTM is a major decision for leaseholders, as they take over the responsibility of being a landlord and the process can be difficult to implement. This is a big step, although it should be noted that this action also impacts significantly on the freeholder's interests. Such an action is quite extreme if the issue is one of dissatisfaction with the property manager rather than with the freeholder themselves. We note the concerns about the RTM and collective enfranchisement processes and we are worried about the possibility that leaseholders may be denied (or could be perceived to face a

risk of being denied) the opportunity to exercise these rights on the basis of procedural objections that are not relevant to the overall consultation outcomes, and the risk of legal costs mounting up.

## Coordination issues

4.119 As noted in paragraphs 3.77 to 3.81, leaseholders may find it difficult to coordinate themselves to represent their interests collectively, due to different views and objectives, and free riders. However, legal safeguards can often only be invoked by leaseholders if they do manage to coordinate and work together. RTAs are one recognised mechanism which allows leaseholders to exchange information and act collectively, and to exercise certain rights (see paragraphs 3.23 to 3.25). RTAs provide a useful forum and tool for representing leaseholder interests, although we were told of cases where freeholders and property managers had tried to obstruct the formation of associations or not cooperated in recognising them.<sup>103</sup> We consider that where leaseholders are organised and have a strategy for engaging with their property manager they are likely to be better able to represent their collective interests effectively and assertively. Property managers, acting with a clear mandate and instructions, also benefit and are more likely to be able to meet leaseholders' expectations.

4.120 While we received comparatively few submissions addressing these points, we nevertheless consider that this is likely to be a problem in the sector. There were some references to the difficulties in gaining the cooperation of other leaseholders or their apathy, and some complaints about different residents' groups having different agendas. We do note though that coordination issues did not emerge as a strong feature on the basis of the evidence and submissions received

## Vulnerable leaseholders

4.121 We considered whether any groups of leaseholders were more likely to be disadvantaged by any aspects of the market, for example because they were less able to exercise their rights or were more vulnerable to specific practices. Issues relating to retirement practices are discussed in paragraphs 5.29 to 5.66.

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<sup>103</sup> An example where the FTT had to determine whether a residents' association should be recognised is [One West India Quay Residents Association v One West India Quay Development Company \(Eastern\) Limited \(1\) and No. 1 West India Quay \(Residential Limited\)](#).

- 4.122 We heard that leaseholders on low incomes were likely to be most affected by problems, and particularly by volatile and unexpected charges. First-time buyers often have a tight financial situation and may have poor understanding of the obligations of leasehold and their liability for service charges, meaning that even standard charges could cause difficulties to some.
- 4.123 However, we did not find evidence of individual vulnerable groups concentrated in particular blocks provoking any exceptional behaviours by property managers.
- 4.124 Sometimes, leaseholders default on service charges – whether because of financial necessity or in protest at perceived unfair charges or poor service and conduct. At developments managed by local authorities and housing associations, there can be various ways of spreading or deferring payments – which are unlikely to be available in the private sector. In the private sector property maintenance generally needs to be funded in advance, and any failure to pay reduces the funds available to the manager and so can harm all residents. Ultimately, if a leaseholder refuses to pay after further demands and other legal recourse, the ultimate sanction a landlord can exercise is to ask for court approval of forfeiture of the lease. This can very occasionally happen, for example we were given details of a forfeiture order where the dispute originated in unpaid ground rent and service charges amounting to £3,500, which after interest and legal costs became £9,547. In consequence the £165,000 unmortgaged flat was forfeited. In some cases we heard that mortgage companies will make good unpaid charges so as to avoid forfeiture and the loss of their security.
- 4.125 We received little evidence to suggest that procedures for demanding payment were inappropriate, or that property managers (acting on behalf of the landlord) behaved inappropriately in these cases. However, leaseholder groups and others felt strongly that forfeiture was an entirely disproportionate sanction against what may be a relatively small value of unpaid charges. It was also noted that the landlord’s legal costs (which can be charged to the leaseholder) can rapidly mount up and represent a far greater claim against them, whether or not there is any validity to an initial grievance which may have driven a refusal to pay charges.

## **Competition between property management companies**

- 4.126 We now consider the nature and extent of competition in the market for RPMS and explore whether competitive pressures help provide good outcomes for leaseholders.

- 4.127 Property managers in the private sector are often small or medium-sized local companies, there being few large regional or national ones. We were told that many new property managers have established themselves in recent years, at least in some local markets. A driver may have been the extensive building of leasehold flats in the UK's cities during recent years. We heard that barriers to entry are low, since little capital is required (particularly as service charges are generally collected in advance) and regulation is light. Property managers who responded to our questionnaire said many had won more than a quarter of their total business during the last year.<sup>104</sup>
- 4.128 We heard that entrants are often lettings agents or other property businesses diversifying, as well as local entrepreneurs or contractors. Many seem to exit again quickly or to be bought out by larger rivals. Some freeholders and leaseholder groups believe that many entrants are opportunistic, not belonging to trade associations, charging low fees but also providing low-quality services.

### ***Competition to manage new developments***

- 4.129 In England and Wales about 30,000 new flats a year have been built for the last several years.<sup>105</sup> There are indications that competition at this level could be moderately intense but that it tends to favour established property managers over new entrants. It also tends to lead to property managers being written into leases, which could constrain later competition for existing business.
- 4.130 We met several of the largest property developers in England and Wales. Each had its own practices for tendering the management of leasehold developments, and its own experiences. However, a broad picture of the market emerged:
- Tenders usually receive good numbers of replies: there is rarely a need to search actively.
  - The large developers, at least, rely on trusted property managers more often than they appoint new ones. Though all said that practices varied across their regional businesses, and that they did appoint some newer

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<sup>104</sup> See, Appendix C, question 48: of 63 respondents, 42 had won over a quarter of their business during the last year. This could imply market expansion and entry, or some intensity of competition with or without expansion or entry.

<sup>105</sup> See National House-Building Council, [Annual New Home Statistics Review 2013](#), Tables 2 and 5. Most new flats are likely to be leasehold and in common blocks requiring some property management.

managers, they also indicated that they tended to rely on effective existing commercial relationships with managers with proven capabilities.

- Some developers retain influence over management for a period after building is completed. Some look after sites until an RMC is staffed and can appoint a manager, whilst others prefer to write managers of their own choosing into leases before withdrawing more quickly. These tripartite leases can mean there is no ability to replace the property manager unless leaseholders exercise RTM or make an application to the FTT for the appointment of a manager (see paragraphs 3.11 and 3.22). Even where there are RMCs in place, leaseholders' rights (such as the right to appoint directors) may not be activated until the last unit of a development has been sold, which may be some time after the first leaseholder has moved in.

4.131 We were told that managers written into leases could prove hard to remove, and could develop low incentives to serve leaseholders well. Developers said they appointed only trusted managers whom they monitored – partly to protect their own brands – and disciplined them by only awarding further business if leaseholders were well served. Nonetheless, this practice could undermine competition between property managers, particularly if it is widespread enough and if developers eventually stop monitoring. Developers could not say exactly how often they wrote managers into leases. But large freeholders said it happened often, perhaps making increasingly many property managers hard to remove.

4.132 We received submissions from leaseholders concerned about managers being written into leases – seeing no clear benefits to themselves, but opportunities for managers to profiteer. In some cases, the property managers were related to the developer. Another practice giving rise to complaint was where developers sold the freehold on completion of the development, and the freeholder was then able to bring in a related property manager (as was alleged to be a very common practice a few years ago, somewhat less now), which then left leaseholders vulnerable to exploitation.

4.133 A further concern was expressed by leaseholders and consumer groups. They said that some managers might set low management fees or estimate unrealistically low maintenance costs when pitching to developers for business – to reassure that developments would not be made less marketable for having high management charges – before raising charges to leaseholders once installed and hard to remove. However, we were also told that it could be developers that pushed for management expenditures to be constrained initially – again, typically for marketing reasons – instructing property

managers, for example, to avoid making sinking-fund contributions during the early years, and to rely on building guarantees to resolve maintenance issues.

- 4.134 Developers and property managers retorted that leaseholders could tend instinctively to resent service charges that naturally became necessary only some years after developments were completed. Nonetheless, this issue highlights at least a need for charges to be made more transparent to new leaseholders.

### ***Switching and competition to manage existing developments***

- 4.135 We now consider competition where there is an existing incumbent property manager. The process of competition has two aspects: whether competitive pressures from the threat of switching constrain the behaviour of incumbent property managers; and whether there is effective competition for contracts where the decision to tender a contract has been made.
- 4.136 Looking first at how incumbents may be disciplined by the threat of switching to other property managers offering better service, we observed three difficulties. First, it may be difficult to determine whether or not the existing provider offers value for money and whether alternative providers could credibly do better. Second, those with the strongest interest in the quality and value for money of RPMS, the leaseholders, may not have control over the decision to re-tender. Third, there may be costs and other barriers to switching.
- 4.137 It can be difficult for leaseholders to evaluate whether the service they receive is appropriate or efficiently procured – since it can be impractical for lay people to assess, for example, the quality of technical workmanship or to know whether contracts could have been placed at a lower price for the same standard of work. There is also little transparency on the costing and level of services offered by rival property managers and these aspects will in any case vary between sites depending on the nature of the lease, the requirements of the property and the instructions given by the landlord. Even if leaseholders believe they could obtain better services from a different property manager, if they do not have control of appointments through an RTM or RMC, the decision-maker (eg the freeholder) may not share the same incentive to test the market.
- 4.138 Looking at barriers to switching, we heard that leaseholders and freeholders may be reluctant to switch often, due to the potential for disruption, so the threat of switching may exert low competitive pressure in this market. At roundtables, leaseholders and residents associations gave mostly negative comments on switching, such as: ‘It is costly and time consuming to change

your property manager'. In our landlord questionnaire, 17 respondents answering a question on switching rated the difficulty as, on average, 3.8 out of 5.<sup>106</sup>

- 4.139 There were several references to the transition process between property managers being problematic. Freeholders, leaseholders and consumer groups all told us that outgoing property managers could be slow to hand over information, contacts or monies to their successors:

There were definite issues in the hand-over of accounting and contract information from previous agents, as no statutes govern switching.

It can take six to eight months to get monies from the outgoing property manager.

There are no rules on the level of co-operation between the outgoing and incoming property manager.

Agents when dismissed refused to hand over sinking-fund balances to new agents (although in one case the company at fault was an ARMA member and ARMA eventually forced it to comply).

- 4.140 Leaseholder groups also said that switching was not easy, even when RTMCos or RMCs were in place.

- 4.141 Some property managers also drew attention to the costs associated with switching. They said that tendering for contracts was a time-consuming and expensive business. A lot of work was required in taking on a new block, gathering all the necessary information, preparing plans, communicating with residents and so on. In the case of blocks with significant existing problems, it could take some years for a property manager to recover their start-up costs. They said that if there was a greater threat of frequent switching it might make bidding for certain blocks unattractive and might increase the costs to leaseholders.

- 4.142 There was only limited evidence that other property managers proactively sought to encourage switching away from incumbents. Landlords who responded to our questionnaire – mainly smaller ones – had not encountered intense competition for their business. Among the sometimes low numbers

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<sup>106</sup> See Appendix E, question 54.

answering relevant questions, most were not proactively approached for business by property managers,<sup>107</sup> often ended up choosing between two or three local ones when they went out to search,<sup>108</sup> and did not report great variation between them.<sup>109</sup>

- 4.143 However, other evidence suggests that competition between property managers can be intense once a decision has been made to switch provider, (other than in isolated areas where there may be few property managers). Our questionnaire of property managers found that respondents usually won significant proportions of their total business from competitors. Further, two large freeholders with UK-wide portfolios said they saw no shortage of good property managers, which sometimes did approach them cold for business.
- 4.144 Beyond indicators of the intensity of competition, we also found evidence about how property managers compete for existing business. Some focus on marketing to freeholders and appeal more to their interests than to leaseholders'. Submissions from property managers in response to the CMA's questionnaire found that many offer a range of services to freeholders, including help with property sales, architectural services, help with debt collection or leaseholder disputes, and outsourcing of freeholders' own functions (like lease valuation or due diligence).<sup>110</sup>
- 4.145 We also heard some concerns from freeholders and leaseholders where property managers were felt to have marketed themselves aggressively to RTMCos, over-promise, and if appointed then under-deliver. For example, one said 'Often, there's a risk when PMCs are marketing that they will pitch unrealistically low costs in order to secure business, which will then see service charges increase rapidly in ensuing year.'
- 4.146 However, some property managers were seen to compete actively to build reputations for quality management, and sought to appeal to RTMCos and freeholders with incentives to ensure leaseholder satisfaction. We did hear that word of mouth, recommendations and references were often given considerable weight in the choice of property manager to be appointed.

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<sup>107</sup> See Appendix E, question 49: of 26 respondents, 19 said they received no proactive approaches.

<sup>108</sup> Appendix E, question 48: of 23 respondents, nine chose between two or fewer managers, 17 between four or fewer. Question 52: these tended to be local firms, not regional or national.

<sup>109</sup> Appendix E, question 50: of 71 respondents, 56 indicated no significant variation between property managers considered.

<sup>110</sup> See Appendix E, question 15: 78 respondents earned a mean of 24% of their revenues from such services.

## **Prices**

- 4.147 Property managers' fees and charges are often individually negotiated with landlords and not disclosed publicly. Property managers, freeholders and developers all said that, broadly, property management was a low-margin business. We were told by various groups that this often led property managers to seek to supplement income through additional activities and supplementary charges. Indeed, many property managers acknowledged that a large proportion of revenues came from sources other than management fees, including charges for approvals and other services to leaseholders and also to freeholders, and commissions.
- 4.148 Leaseholder and consumer groups said that low profitability could also be driving bad practices. In their opinion, some property managers may put little effort into sites to cut or limit the costs of contracted services that were charged to leaseholders, or they may focus on more profitable activities such as providing services to freeholders. They also said that, whilst headline management fees could be low, charges for administration and supplementary service could be high because they were less transparent and unlikely to be a focus of interest in advance.

## **Findings on competition**

- 4.149 For the reasons identified above, we consider that in many cases competition in the market for RPMS may not work as effectively as it could, and in particular it may only impose a limited constraint on incumbent property managers because:
- landlords, like freeholders, with responsibility to appoint property managers may have less incentive than leaseholders to care about the quality and value for money of RPMS;
  - it may be difficult for leaseholders and others to assess in advance whether switching is likely to result in better outcomes;
  - property managers do not often compete proactively to try to persuade switching away from incumbents; and
  - there are barriers to switching – it can be a difficult, expensive or disruptive process.
- 4.150 Despite these problems, once a decision is made to switch property manager (usually following from a significant level of leaseholder discontent) competition between prospective new property managers at existing developments can be intense.

4.151 At new developments, though competition between property managers to acquire mandates may be fairly intense, it can also focus on minimising initial headline charges to reassure developers, which may not be appropriate for leaseholders later on. Also, developers often write property managers into leases, making them hard to remove if they underperform or overcharge.

## **5. Insurance, retirement properties and local authority and housing association properties**

5.1 In this section we look at three issues separately from our overall assessment of the market, due to different issues and aspects of concern:

- Buildings insurance – this differs from most services in that in many cases it is procured by freeholders or landlords rather than by the property manager, although property managers often administer aspects on behalf of insurers. Concerns particularly relate to practices around commissions which could distort choices and increase costs to leaseholders.
- Retirement properties – this was an area where we received submissions with concerns relating to the alleged vulnerability of retirees and specific practices in relation to the facilities in such properties as well as the general concerns about the RPMS market.
- Local authority and housing association properties – we extended the scope of the study to include leasehold properties where the freeholder was a local authority or housing association. This was in response to submissions raising concerns that similar problems apply here as apply in the private sector, with further concerns, for example in relation to the cost of major works and the difficulties of managing mixed properties where tenants live alongside leaseholders. In many cases RPMS is provided through in-house teams. There are differences in the way these housing providers are regulated and in the details of the legislation that applies, both relative to the private sector and between local authorities and housing associations.

### **Buildings insurance**

5.2 Buildings insurance is essential to cover the freeholder's liabilities in the event of major damage to the property. Usually the lease specifies the arrangements for how buildings insurance will be provided.

5.3 Responsibility for acquiring this insurance rests either with the landlord or is specified as part of the property manager's responsibilities. Landlords may delegate aspects of the procurement and administration of insurance to the property manager. Insurance costs are recovered from the leaseholders, usually as a component of the service charge.

5.4 Property managers and landlords may use brokers to help with the acquisition of insurance. Property managers may also undertake some administrative tasks such as claims handling and dealing with enquiries from leaseholders,

and will provide brokers and insurers with necessary information to obtain quotes.

5.5 A number of concerns were raised with us about these arrangements:

- First, where freeholders acquire property insurance, there were concerns they may not be obtaining best value on behalf of their leaseholders, either because the insurance coverage was said to include excessive or unnecessary cover (or alternatively that cover was not sufficient to cover all necessary demands),<sup>111</sup> or because they were receiving a commission. This may incentivise them to choose a more expensive insurer, as generally we assume the price charged will broadly reflect any commissions paid.
- Second, where property managers acquire property insurance, we were told the same issues can apply.
- Third, property managers sometimes use in-house or related brokers and insurance handlers. This also creates an additional opportunity for the property manager to make a margin.

### **Evidence**

5.6 There are a great variety of practices in relation to insurance and we have not received much detailed information on this issue from freeholders and property managers. We received 49 complaints from leaseholders, mainly about the cost of buildings insurance. Rates of commission are often not transparent to leaseholders. However, some leaseholders have been able to provide figures. One submission said the buildings insurance premiums for the block for the years 2005/06 to 2009/10 showed commission amounts corresponding to between 20% and 33% of the total cost. It said that such commission was never declared to the leaseholders at the time, although the commission was now declared and had come down to 14%. Other leaseholders referred to commissions and reductions in insurance costs when RTM gave them control of insurance procurement. One leaseholder stated:

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<sup>111</sup> Freeholders will need to protect themselves against major damage to the building. One area where several complainants expressed concern was on paying for terrorism insurance. They noted many blocks did not carry such cover. We were told that leases may specify what cover is needed, which may include terrorism or equivalent requirements such as cover against explosions, which might not be covered by general insurance if terrorist-related. Leases generally hold the freeholder responsible for ensuring the repair or replacement if a block is damaged and so freeholders will want to cover themselves against all risks however unlikely. It appears that determining appropriate cover can in part be a judgement. These aspects are of course appealable to the FTT for reasonableness.

Our freeholder arranged building insurance through two companies – an arms-length insurance broker and an associate company. Between them, these companies collected commissions for placing building insurance of between 24% and 57% of the underlying cost of insurance. Of this amount, the broker received 4-5% and [the other company] the balance (ie, 20-52%) ... When the RTM Company took control of the building and moved to a new insurance broker, it was able to reduce the annual cost of insurance by almost 30%.

- 5.7 Another leaseholder complained about the cost of what was seen as unnecessary insurance cover:

Our managing agent quietly gave us terrorism insurance without consultation and then took a 12.5% commission unbeknown to us. The cost of our building insurance then went up to £9,000 per year – thus pushing up the cost of service charges hugely. An inquiry of the other buildings around us revealed no one else in the area had terrorism insurance.

- 5.8 One campaign group referred to leaked documents from a large freeholder showing past commissions on insurance of 42.5%.

- 5.9 One property manager gave an example of where an incumbent property manager used an integrated company to secure insurance through a broker. When his company took over it was able to reduce insurance costs from £34k to £22–£23k using the same broker because it said it was no longer paying commissions.

- 5.10 Relatively few leaseholders who responded to our leaseholder survey (7%) rated insurance services as very/fairly poor. Only 6% of those who said property managers gave poor value for money said this was because the cost of insurance was excessive. On the other hand, the lowest rate of satisfaction with services provided by property managers related to insurance services where only 58% respondents rated them as very/fairly good.

- 5.11 Freeholders acknowledged in meetings that they often took commissions, although some said these were deliberately capped at moderate levels. We were told in these meetings that some freeholders (especially those not working for big institutional investors with reputation concerns) arranged insurance for profit, getting leaseholders either inflated premiums or inadequate cover. We were told that the auction value of freeholds varied depending on whether there was a right to place insurance.

5.12 The majority of respondents to our freeholder questionnaire said that while they arranged insurance, they did not receive any commissions or payments related to the arrangement of insurance at any of their properties (see Appendix E, paragraph 44). This was at odds with what we were told at the various meetings that the CMA held during the course of the investigation. The CMA notes that the response rate for this question (31 out of 71 freeholders who answered the questionnaire) was low.

5.13 The Financial Conduct Authority (FCA) has also referred to this issue in its report on commercial insurance intermediaries:

Certain lines of insurance (notably commercial property, residential property owners and landlords) consistently attracted very high rates of commission (generally over 35% and sometimes over 50%) given the relative lack of complexity in broking such products (which were frequently placed with a single provider or small panel).

Some of the intermediaries and insurers we spoke to expressed concerns that these commission rates exist because the customer buying the insurance product was not the business or individual ultimately bearing the cost of the product. This appears to result in some intermediaries and property owners sharing in high commission levels with the inflated costs (and any potential detriment) being borne by the underlying tenant or lessor.<sup>112</sup>

5.14 We also received several references to the commissions earned where the freeholder and property manager were vertically integrated. In particular, it was put to us that vertical integration can lead to a freeholder or property manager prioritising the commissions that can be earned over the best interests of leaseholders. While there might be strong efficiency arguments for vertical integration, given the lack of transparency over insurance commissions, we recognise there is a potential for conflicts of interest to arise. This concern is supported by a number of historical LVT cases where leaseholders have successfully challenged the reasonableness of commission payments.<sup>113,114,115</sup>

5.15 In respect of property managers, most that we spoke to, but not all, stated that they took a fee for insurance where they arranged it. Some said they chose

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<sup>112</sup> FCA, Commercial insurance intermediaries – Conflicts of interest and intermediary remuneration: Report on the thematic project, May 2014 (16pp&17).

<sup>113</sup> [Decision of the LVT, case ref LON/00BK/LSC/2008/0493.](#)

<sup>114</sup> [Decision of the LVT, case ref LON/00BE/LIS/2006/0512.](#)

<sup>115</sup> [Decision of the LVT, case ref LON/00AX/LSC/2011/0220.](#)

not to take any commission and instead included their costs within their standard management charge or had a fixed unit charge to leaseholders for arranging insurance. However, one property manager who used to do this said it was forced to stop because the apparently higher management charges meant it was less likely to win new business. In our questionnaire to property managers, the majority of respondents (55%) said that they received a commission to arrange insurance at their sites (see Appendix C, paragraph 46). Of 47 respondents who answered this question, 38 indicated that the commission covered services such as administration of claims and dealing with queries relating to the cover. The rest also mentioned policy administration, meeting with brokers and negotiating renewal terms.

### ***Limits on commissions and fees for property managers***

- 5.16 Property managers told us that based on FTT rulings, it was understood that they should no longer receive commissions from an insurance premium, unless they were a payment reflecting a service of equivalent value given in return.<sup>116</sup> Property managers told us that it was generally understood that commission levels for insurance of up to 20% could be considered 'reasonable' where the property managers were performing insurance-related tasks. We were told by one property manager that this meant high commissions to property managers were now a thing of the past.
- 5.17 Most property managers responding to our questionnaire said that the commission level was agreed with brokers to cover the value of the services provided; some said that the commission was a percentage of the premium, normally set around 7.5%; and a few indicated that they usually discussed the commission with the clients, based on work involved in managing claims and cover or through negotiation between directors and brokers.

### ***Transparency***

- 5.18 The 1985 Act contains additional leaseholder rights in respect of insurance payments.<sup>117</sup> Nonetheless, the CMA received some complaints from leaseholders that they were not told the details of the insurance policy, were unable

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<sup>116</sup> The leading court case on this subject is a Court of Appeal case, *Williams v London Borough of Southwark* 2001, ref 33HLR 224. The case drew a distinction between commissions that are payment for providing a service and simple profit taking. Southwark had an agreement with its insurance company that it received a discount of 25% on the premium in return for agreeing to place insurance with that company for five years. As part of that agreement, 5% of the commission was for a five-year loyalty bonus and 20% for administration by Southwark of insurance claims and renewals. The Court of Appeal held that Southwark could retain the 20% commission.

<sup>117</sup> See Appendix A for more detail.

to gain sight of the insurance documents, or were not told who the insurer was.

- 5.19 The RICS Service Charge Residential Management Code states at paragraph 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'. ARMA told us that its members endorsed, accepted and undertook to comply with this code.
- 5.20 However, there is no requirement on freeholders to disclose to leaseholders where they are in receipt of a commission for taking out the insurance. The FCA told us that when a freeholder, as a commercial customer, bought the buildings insurance, they could request details of any commission the insurance intermediary received in connection with the policy.<sup>118</sup> Although the leaseholders ultimately paid the insurance premium (eg via a service charge) they did not generally have rights under the policy that might entitle them to information about the commission paid or received.
- 5.21 In such circumstances, it is very difficult for leaseholders to assess whether the costs they are charged are reasonable. Because they do not have access to the necessary supporting information and claims history for the block or development they cannot get a like-for-like quote that would enable them to reach an informed view about the reasonableness or otherwise of the insurance premium. Further, some property managers said that leaseholders often did not understand the extent of cover required, the differences between private and commercial insurance, standard property insurance and block cover.
- 5.22 The FTT assesses whether charges are reasonable. Given the difficulties described in the preceding paragraph, they are likely to focus on procedural aspects such as whether a choice of insurers were asked to quote, and whether a reasonable explanation was offered for the choice of insurer chosen. The FTT might also consider whether charges are in line with market norms as far as this can be readily determined. However, it is unlikely to find costs unreasonable purely because comparable insurance might be found available at a lower cost.<sup>119</sup>

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<sup>118</sup> [ICOBS 4.4](#).

<sup>119</sup> When considering what is reasonable, the FTT is likely to take account of factors such as whether insurance has been acquired in line with normal practice in the sector, whether quotes had been obtained from a variety of sources including independent ones and so on. This is not necessarily the same as testing whether a process has been followed that provides leaseholders with outcomes offering the best value for money as would be expected in a fully competitive market.

## **Conclusions**

- 5.23 It is necessary for buildings insurance to be organised centrally and therefore responsibility will rest with the landlord or its agent. We have seen evidence that landlords and/or property managers can sometimes receive a substantial income from fees and commissions for the placement of insurance. This is likely to reduce the incentive to place contracts for insurance that provide the best value for leaseholders and we do not consider that the market therefore works well for leaseholders in these cases. These outcomes are facilitated because of the lack of information available to leaseholders that would help them hold landlords and managing agents to account, for example on commission rates paid to freeholders, and the fact that it is very difficult for leaseholders to get comparable quotes for insurance services to test whether prices are competitive.
- 5.24 In the absence of this information it will be difficult for leaseholders to decide whether they have a case to challenge reasonableness at the FTT, and in any case such tests are not intended to ensure that the value for money leaseholders receive is optimised.
- 5.25 We acknowledge that property managers receive reimbursement for work done. Anecdotally, there is some suggestion that commission rates have come down, albeit there seems to be an expectation that property managers are entitled to a 15% to 20% fee whatever administration work they do. It is not clear to us that the rates paid are necessarily fully reflective of the level of work and costs incurred. But where insurance is arranged by the property manager, transparency of commissions is dependent on adherence to the RICS code. This is to be welcomed. Nonetheless there is still a risk in the use of related companies such as brokers if these have not been properly market-tested. We consider it important that there is transparency in relation to the acquisition of insurance so as to help leaseholders hold property managers to account and as necessary exercise their rights to challenge unreasonable charges.
- 5.26 However, if the costs of administering insurance were recovered through the management charge, allowing transparency and accountability rather than being hidden in insurance commissions, this would reduce the risk that incentives to place insurance with different companies were distorted.
- 5.27 Where insurance is through a freeholder, we are concerned about the effects on incentives and the potential for distortion through commissions, and the lack of transparency. Freeholders often have a vested interest in insurance as a revenue stream. But such a feature is unlikely to work in the interests of

leaseholders; they will ultimately tend to pay the cost of commissions and may suffer inefficiencies or inappropriate coverage as a result.

- 5.28 As noted in paragraph 2.11, this study is into the supply of RPMS rather than the wider leasehold system and so we have not considered remedies in relation to freeholder-placed insurance, even though the cost may be passed on through the service charge. Nonetheless we do observe that this is an important issue; there is evidence of high commission rates being paid that will be expected to impose high costs on leaseholders. Given the difficulties of finding out whether such arrangements are in place and the difficulty of benchmarking insurance costs, it will be extremely challenging for leaseholders to discover whether the costs they are paying are excessive in relation to what might be achieved. Even then, the recourse open to them is to the FTT on the different grounds of reasonableness (rather than value for money), which will be difficult to demonstrate without suitable transparency. We note the incentives and opportunity applying given the unusual structure within the leasehold system. We therefore would encourage consideration of the appropriate coverage of regulation in this case by the FCA and by Government more generally.

## **Retirement housing**

- 5.29 Retirement housing is specifically intended for older residents and is usually subject to a minimum age requirement for ownership, typically 55 or 60. Purpose-built leasehold retirement housing will often have additional facilities such as lounges, laundry, on-site restaurant or guest bedrooms. In some cases there may also be an element of nursing and domestic care; for example, one variant is retirement communities, these sit between the traditional leasehold property (where no care is provided) and care homes (where care is delivered but people do not own their own home). There is almost always an alarm system, on-site staff are often provided, and some schemes will have a live-in on-site manager (or warden) payable through the service charge. This means that property management services can form part of a much larger suite of services than the property management function in general leasehold housing.
- 5.30 Retirement housing will generally be attractive to older people looking to downsize and be in an environment with similar people close by, and where a degree of care might be available. It has the added advantage that, where RPMS is available, residents will no longer be personally responsible for the upkeep of a property. For many, retirement housing can be their first experience of leasehold ownership.

- 5.31 When considering retirement housing, in addition to the property management services being provided, the CMA has also looked to ascertain whether residents of leasehold retirement properties are particularly vulnerable to adverse outcomes, and whether the provision of specialist services, such as on-site managers, could raise the potential for additional harmful practices.

### ***Retirement housing stock***

- 5.32 There are an estimated<sup>120</sup> 128,445 retirement properties in England and Wales (124,842 in England and 3,603 in Wales). This figure includes new schemes and developments currently under construction, with 3,000 properties added each year. This means that most retirement properties on the market are resales as opposed to new builds. The majority of retirement housing is sold on a leasehold basis either directly through the retirement housing developer or landlord, or on the open market through an estate agent. Retirement properties can also be offered on a 'shared ownership' basis which combines buying a leasehold interest in the property of between 25% and 75% and paying rent on the remaining part. Property developers will commonly carry out the property management functions themselves or hand over responsibility to a separate property management company.
- 5.33 The CMA, when confirming the scope of its market study,<sup>121</sup> was clear that the provision of property management services to retirement housing was within scope. However, the range of other services available in retirement housing, such as personal care, catering and domestic support services, were outside the scope of its work. In this respect, we recognise that it can be difficult to separate property management from the other services provided, especially when seeking views from leaseholders who might not fully appreciate the distinctions being drawn.

### ***Retirement housing freeholders***

- 5.34 With retirement housing, and in particular retirement communities, it is common for the same company or group to develop, own the freehold and provide property management alongside the other specialist services provided. Retirement housing providers also indicated that traditional property management services only account for a small proportion of their income, and that they profit more from wider services and care. For example, retirement housing providers may cover their costs by a mix of revenues; from sales of units to leaseholders, from monthly fees (sometimes fixed during residents'

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<sup>120</sup> Age UK factsheet – Buying retirement housing, April 2014.

<sup>121</sup> OFT, *Property Management Services: Final Statement of Scope*.

lives) and often by charging transfer fees when units are finally sold. As noted in paragraphs 4.96 to 4.102, operators said that, because development costs are high and can take time to be fully recovered, they have strong incentives to serve their leaseholders well. Otherwise, they argued, they may suffer reputational damage, may have problems attracting subsequent residents needed for ongoing profitability, and resale values (against which transfer fees are charged) could be harmed.

- 5.35 However, on this issue, leaseholder and consumer groups continue to highlight cases of freeholders and property managers in the retirement sector allegedly overcharging leaseholders for services charges and works, as well as resisting RTM requests. Their submissions to this study recapped a number of FTT decisions from recent years in favour of leaseholders.

### ***Self-regulation***

- 5.36 There are three main codes of practice that exist to protect residents' rights in retirement housing. The NHBC Sheltered Housing Code applies to any retirement property built after 1 April 1990 which is 'purpose built for residence by elderly people and which forms part of a scheme of grouped self-contained accommodation provided with a package of estate management services'. The code instructs the developer to ensure that residents' rights are fully protected by a legally binding management agreement between the developer or freeholder and the management organisation. All purchasers must also receive a purchaser's information pack giving important information about the scheme. The code applies to both newly built and second-hand properties.
- 5.37 The ARHM Code of Practice<sup>122</sup> sets out the legal obligations and promotes good practice for managing agents including private companies and housing associations that manage private retirement housing. Property management organisations that are members of the ARHM are bound by the ARHM's Code<sup>123</sup>. The ARHM Code also has government<sup>124</sup> approval which means that, although not all aspects of it are legally binding, if proceedings are taken against a property manager, for example for poor management, then its provisions can be considered by the FTT.

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<sup>122</sup> There is a separate ARHM Code of Practice for England and an ARHM Code of Practice for Wales. The two documents are very similar. The Wales Code of Practice was approved by the Welsh Government. Both versions can be accessed from the ARHM [website](#).

<sup>123</sup> The ARHM code also states that a management organisation should consult residents on all significant issues, hold annual meetings, visit schemes at least quarterly and encourage the setting up of residents associations.

<sup>124</sup> The ARHM Code of Practice for England, was approved by the Government under the 1993 Act. The code sets out statutory obligations that apply to the management of leasehold properties and additional requirements which should be followed as a matter of good practice.

5.38 ARCO is the main trade body for providers of housing with care (retirement communities/villages). ARCO's aim is to set standards for the development and operation of retirement communities and, to this end, it has developed a good practice charter which requires the provision of information on how a development is to be managed, the process for consultations, current and future costs and avenues for complaint. They are also currently developing a code.

### **Findings**

5.39 We received few complaints specific to retirement property issues prior to the publication of our update paper, and according to our leaseholder survey, leaseholders in retirement properties had higher levels of satisfaction than other leaseholders with property management services. Satisfaction levels were highest of any leaseholder groups (rating services as very or fairly good) for leaseholders in retirement properties (82%). Furthermore, the lowest level of dissatisfaction (rating services as poor or fairly poor) was for retirement developments (8%).

5.40 These positive results may be due to property management in retirement developments generally requiring a greater degree of service, visibility and interaction with residents. Additionally, it was put to us that in many cases personal relationships are formed and there is better ongoing communication, which can result in higher degrees of satisfaction. However, there does appear to be a significant proportion of leaseholders in retirement housing that encounter problems. In the leaseholder survey, despite being the lowest rating for all respondents, 28% of leaseholders in retirement housing had reason to be dissatisfied with their property manager; the most commonly mentioned concerns were in relation to external repairs (32%) and internal repairs (11%).

5.41 Additionally, we also received (71) submissions (largely after we published our update statement) raising concerns over the level of service provided in retirement housing. These were predominantly the same problems as those experienced in the private market more generally and included: concerns of excessive and/or unnecessary charging (41); poor communication from the property manager (21); ineffective and expensive redress mechanisms (12); poor levels of service and workmanship (11); and a lack of transparency, with particular reference to charging information (16) and the consultation process for major works (6).

5.42 We were also told that leaseholders in retirement housing may be more accepting of the service provided or less likely to recognise poor service or to want to complain, and so may be more vulnerable. We have, therefore,

considered vulnerability alongside other relevant issues, such as whether leaseholders in retirement properties have ready access to transparent pre-sale and charging information, or have the ability to act collectively or influence management decisions made on their behalf.

### *Information prior to purchase*

- 5.43 As noted in paragraphs 4.68 to 4.72, some purchasers of leasehold properties seem to go through the purchase process without acquiring a full understanding of their leasehold purchase and rights and responsibilities in respect of property management. It was put to us, however, that this is less prevalent for leaseholders in retirement housing, as the purchase is often a lifestyle choice and the ancillary services on offer form a large factor for the motivation and consideration in making a purchase of this kind. There is therefore usually a closer degree of communication between landlords and property managers and prospective purchasers to understand the nature of the purchase. We were told they might insist on a pre-sale meeting in many cases so as to ensure that the services offered are suitable for the purchaser's needs.
- 5.44 There is, however, still a significant subset of residents in retirement housing that appear to purchase their property without fully understanding the implications of leasehold ownership. This was highlighted in a number of submissions we received from leaseholders in retirement housing, for example: 'The lack of knowledge by elderly residents is taken advantage of ... elderly residents, believe they have purchased the flat including bricks and mortar.'
- 5.45 This has, in part, been put down by retirement housing providers to a lack of engagement with the information being provided or, as with the private sector more generally, the conveyancing process not sufficiently highlighting information to prospective purchasers. It also appears, however, that the best practice prevalent in most of the retirement housing market could be applied more widely.

### *Service charges and consultation*

- 5.46 As in the private sector more generally, leaseholders in retirement housing have the same rights regarding service charges and section 20 consultations. Additionally, the NHBC Code states that as soon as a potential buyer has paid a reservation fee, the freeholder must provide them with a purchaser's information pack. Included in this pack are, among other things, a full explanation of all fees or charges – including any transfer fees – that will be payable to the property developer or property manager. Furthermore, a high

percentage of respondents to the leaseholder survey (88%) rated the information on what service charges were spent on as either good or very good.

- 5.47 Despite this, the CMA received a significant number of complaints (63) from leaseholders in retirement housing that charges were too high and not clearly explained, especially where major works and ancillary services were concerned. In this respect, it was cited that charges were too high, the information available was not comprehensive enough to understand how individual charges related to the works being conducted, or that the information provided was too complicated to understand. For example:

I immediately became concerned at the size of the service charges and particularly [...] reluctance to explain how they calculated what we were being charged.

Over the last 7 years I have been battling [...] over unexplained charges which are sent every year. The reasons often provided are 'additional maintenance costs' for which no evidence has ever been provided.

- 5.48 It appears that a good proportion of leaseholders in retirement housing are receiving clear and understandable information about the services they receive. What is also clear, however, is that this is not universal, and a significant proportion of leaseholders in retirement housing want a better understanding of how their retirement housing is being run, what the budget covers and why they are paying what they do. Also, where residents do not fully understand the paperwork that they receive, more could be done to explain the charging information and consult residents on decisions that affect their retirement housing.

#### *Acting collectively and control*

- 5.49 We also heard conflicting reports on the ease with which residents in retirement housing can act collectively and exert control over the services received. For instance, it was put to us that in some cases residents associations are actively encouraged and that regular meetings are held with residents to explain service charges, annual accounts and upcoming works were a regular occurrence. Additionally, we heard that retirees, as they have more free time and may be recently retired and from a professional background, can be very adept at working together and holding property managers to account.

5.50 Conversely, we also heard that it can be difficult for those in retirement housing to act collectively, predominantly because residents no longer want, at this stage of their life, the hassle of having to deal with housing matters. We heard that this was perceived to be true for RTM, which was considered especially onerous in the retirement sector, and would more readily suffer from problems in retaining an active board due to the age of the residents in question. For example:

It proved impossible for the following reasons ... many residents had no experience of managing even their own affairs, and could not contemplate the idea; many residents were too feeble; others took the view that they were not long for this world, and it was irrelevant to them; others could not appreciate that they did not need to do the managing themselves, and were too frightened.

5.51 We also received anecdotal evidence that, even when leaseholders in retirement housing are minded to pursue RTM, the process can become frustrated by legal technicalities or uncooperative landlords and property managers.<sup>125</sup>

5.52 In general, therefore, leaseholders in retirement housing can struggle to influence property management decisions made on their behalf; especially as RTM may not be an appropriate or viable solution in all instances.

### *Complaints and redress mechanisms*

5.53 Generally, we found that leaseholders living in retirement housing are less likely to complain about the property management services they receive. Retirees can face particular difficulties in making complaints, including low awareness of the avenues of redress open to them over and above their on-site or property manager. For example, the leaseholder survey found that 40% of leaseholders in retirement housing were not aware of the ombudsman service and 70% were not aware of the FTT.

5.54 Additionally, for those leaseholders who do look to complain, it can be a daunting prospect. In particular, we received anecdotal evidence that leaseholders in retirement housing can be actively dissuaded from making a complaint, including the use of intimidation by their on-site or property

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<sup>125</sup> An example of this is *Avon Freeholds v Regent Court RTM Company Ltd*, where the Upper Tribunal (Lands Chamber) ruled that a failure by an RTMCo to serve a notice of invitation to all qualifying leaseholders – specifically an absentee leaseholder – did not have the effect of invalidating the RTM process as contested by the provider. In addition, the Upper Tribunal found that, where an RTMCo has given an invalid claim notice – due to a typing error – it was not required to withdraw that notice before serving a fresh claim. See [Avon Freeholds v Regent Court RTM Company Ltd \[2013\] UKUT 0213 \(LC\)](#).

managers, even when they have a genuine grievance. We also received many comments that the FTT is not an appropriate process for leaseholders in retirement housing, with the length and complexity of the process most commonly cited. For example:

I know a number of leaseholders who have applied to the previous LVT system for redress ... This is certainly a very daunting experience for elderly residents, particularly if they have little, or no, experience of the law. Most elderly residents see this as just too much of a hassle to use. Certainly, the process can be long drawn out, time consuming and often, very costly.

### *Vulnerability and specialist services*

- 5.55 We have also considered whether residents of leasehold retirement properties are particularly vulnerable to adverse outcomes. On the one hand, we recognise that many retirees are active, well informed and capable of standing up for their rights. It is also true to say, however, that due to their age, other leaseholders in retirement housing have a higher propensity for vulnerability. We now address whether the provision of specialist services could raise the potential for additional harmful practices, such as transfer charges and issues surrounding the provision of on-site managers' flats.

### *On-site managers' flats*

- 5.56 When retirement housing first originated, many schemes had a resident manager who was available to answer emergencies during most hours of the week. Over the years the nature of the on-site manager service has changed and many schemes now have a manager who visits for a few hours each day, so residents have become increasingly reliant on the use of alarm call systems. There have been many disputes, where live-in manager services have been withdrawn, as to whether this is consistent with the obligations of the lease, whether leaseholders should be compensated, and what should happen with the proceeds if the warden flat is sold (for example, we were told of residents receiving compensation in improved facilities or contributions to the sinking fund which were only a part of the sale proceeds).
- 5.57 The manager's salary and related overheads<sup>126</sup> can account for a substantial percentage of the service charge incurred by leaseholders, and disputes have occurred over whether the provider is entitled under the lease to recover rent

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<sup>126</sup> This will include, if the manager lives on site, the cost of maintenance of the manager's accommodation and may include rent if the lease allows it.

(which may be notional) for the property and what constitutes a reasonable amount. For example it was put to us by some leaseholders that they had already paid for the provision of the flat through the original purchase and the landlord was not incurring any real costs in providing that and so had no right to add a notional cost to the service charge. FTT cases have compensated leaseholders for such charges where no specific provision is made in the lease to charge for these rents.<sup>127</sup>

- 5.58 There have also been accusations that the live-in manager's flat rents have been artificially inflated, for example by basing it on comparable rents but not adjusting for the service charge and ground rent (which the landlord should not be charging itself for), the use of inflationary adjustments which are not permitted by the lease or do not reflect market rents, and instances where the landlord sold the property to a related company (with no credit to the block's sinking fund) and then leased it back at an inflated rate. We were also told of a case where a landlord, required to lower the rent on the warden's flat, responded by appropriating the income from use of guest suites that previously went to leaseholder funds.
- 5.59 Issues around the provision of on-site managers' flats, while highlighted to us as a potential concern, are outside the scope of this report in so far as their legality or otherwise is determined by the terms of the lease (as we are not assessing the terms of individual leases). Where the lease allows for the recovery of rent on such flats by property managers via the service charge, the statutory protections relating to the reasonableness or otherwise of such charges are applicable. The submissions we received concerned a number of different issues, rather than reflecting one specific practice, and tended to refer to issues around the terms of the lease and the actions of the freeholder, rather than those of the property manager. It is intended, however, that the remedies aimed at improving the transparency of charges and how they relate to the services being procured will facilitate a clearer appreciation of the cost and value of on-site managers' services.

### *Transfer fees*

- 5.60 The CMA received a number of complaints about the imposition of transfer fees, especially when associated with retirement housing.
- 5.61 A transfer fee, also known as an 'exit fee', 'departure fee' or 'deferred management fee', is a fee which a leaseholder in retirement housing is

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<sup>127</sup> For example, in [Oakland Court Worthing Residents Association v Oakland Pension Fund](#), the LVT found that Oakland Pension Fund were not entitled by the lease to charge residents a rent for the warden's flat through a service charge (as had been happening for 25 years) because there was no term allowing this.

required to pay to their landlord in a broad range of circumstances such as when they sell or rent their property or make changes to the occupants of the property, for example subletting, surrendering the lease or a change in occupation (such as when a relative or carer moves in with the tenant). The fees can vary between 0.25% and 12.5% of the sale price or open market value of the property (and may escalate cumulatively with the number of years of lease ownership). 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 at the discretion of the landlord.

- 5.62 This study has not attempted to re-examine the issues covered in a previous OFT investigation into the fairness and clarity of contract terms providing for transfer fees.<sup>128</sup> In addition, when confirming the scope of this study, the CMA was clear that issues around lease design, including transfer fees from retirement properties, were outside the scope of its work. We are aware that a number of the larger providers of retirement housing no longer apply transfer fees to their properties. We are also aware that DCLG has referred the issue of transfer fees to the Law Commission<sup>129</sup> for consideration, and we await the outcome of this work with interest.

## **Conclusions**

- 5.63 In general, we received fewer complaints specific to retirement property issues, and according to our leaseholder survey, leaseholders in retirement properties had higher levels of satisfaction with property management services than other leaseholders.
- 5.64 This may, in part, be due to property management in the open market being a remote function, whereas property management in retirement housing is often delivered on-site and includes elements of community management and face-to-face daily support which go beyond the remit of any similar type of housing found in the open market.
- 5.65 However, we have also found that leaseholders in retirement housing can face many of the same problems as those in the market more generally. For instance, we received a number of complaints about unclear charges, poor

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<sup>128</sup> That study looked at instances where a leaseholder is required to pay a fee 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. We note that the study did not cover other types of fee payable by leaseholders upon assignment such as contingency fund fees. These are similar charges but 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 (paragraph 2.6). See [OFT investigation into retirement home transfer fee terms: A report on the OFT's findings](#), February 2013.

<sup>129</sup> Law Commission, [Transfer of Title and Change of Occupancy Fees in Leaseholds](#).

service and less-than-effective redress mechanisms. We also found that leaseholders in retirement housing can face increased difficulties in influencing the property management services they receive or in exercising RTM. As a group, the elderly or infirm might be more vulnerable due to their reduced ability to coordinate actions and willingness to get involved in exercising their rights (although this was challenged by many property managers who said the recently retired could be very knowledgeable and effective in representing their interests). There are also issues specific to the retirement sector, such as transfer fees and charges relating to the rent of on-site managers' flats, which although outside the scope of this study raise further concerns over the operation of this market.

- 5.66 More generally, a leasehold property can be a very different proposition for retirees who would previously have been used to making all their own decisions, and are now faced with a property manager or freeholder who will be taking over many of these responsibilities. Under these conditions, it is very important that older people entering retirement housing are given the best chance of making a good initial decision, with effective safeguards in place for preventing and remedying problems after the initial purchase. In this respect, good-quality information about their rights and the obligations of the landlord/ freeholder, fair and clear contract terms, and the ability to make a complaint are complementary mechanisms for the protection of this group of leaseholders. In many instances these safeguards are in place, but best practice, more transparent information on service charges, especially when associated with major works, and more effective redress are still required for parts of the market.

## **Local authorities and housing associations**

- 5.67 Housing associations and local authorities,<sup>130</sup> jointly known as registered providers of social housing,<sup>131</sup> traditionally offer housing on a low-rent and secure, not-for-profit basis to those in need or struggling with housing costs. While we are dealing with these two types of providers together, there are significant differences in the ways in which they are run and operate, the ways they are regulated, and our findings on their performance. Housing associations are independent societies, bodies of trustees or companies established for the purpose of providing low-cost social housing for people in

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<sup>130</sup> In England and Wales, local authorities are the unitary authorities, district councils, the London Borough councils and the Common Council of the City of London.

<sup>131</sup> Registered providers are the bodies that own and manage social housing. They tend to be non-commercial organisations such as local authorities or housing associations.

housing need on a non-profit-making basis. Many housing associations are local organisations but some have extensive regional or national interests.

- 5.68 Housing associations and local authorities are also freeholders to private leasehold residential properties in their portfolios. This is, in part, a result of the sale of social housing through the RTB scheme. The RTB, introduced by the Housing Act 1980, gave tenants of social housing the opportunity to purchase their council homes at a discounted price through the RTB scheme. From August 2014, the discount that tenants can benefit from are up to £102,700 in London and £77,000 outside London.
- 5.69 Housing association tenants can also qualify for RTB if they were originally council tenants and their tenancy had been transferred to a housing association.<sup>132</sup> In addition to RTB, the Right to Acquire allows assured tenants of housing association properties to purchase their home, at a smaller discount than that available under RTB. Leaseholders can also purchase their housing association property through shared ownership,<sup>133</sup> which allows them to purchase a share of a property and pay rent on that part of the property retained by the freeholder. Often they can increase their share over time until they acquire full leasehold ownership.
- 5.70 RTB and other routes to leasehold have led to an increase in mixed-tenure developments, where social housing tenants live in residences alongside private leasehold properties. In addition, leaseholds within a housing association or local authority development can also be purchased privately. This predominantly occurs where a former owner purchased the property via one of the means described above and has, subsequently, sold the property on the open market. Consequently leasehold properties may also be privately rented to tenants.<sup>134</sup>
- 5.71 Where the housing association or local authority is the freeholder, under the terms of the lease they will usually be responsible for repairing and maintaining the structure and fabric of the building. They will perform this property management service directly,<sup>135</sup> or less commonly, through a private management company. For local authorities, property management may be

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<sup>132</sup> Housing association tenants that were originally local authority tenants and had their tenancy transferred to a housing association will have a 'preserved' RTB.

<sup>133</sup> Most shared ownership leasehold properties are granted by housing associations as part of their home ownership programme. The leaseholder will have a right to purchase additional shares in the property until they own 100% of the equity. The intention of shared ownership is to provide a first step into home ownership for those who are currently renting and cannot afford to purchase a home at the full market value.

<sup>134</sup> In some case social providers may sell leasehold properties in new developments as a source of funding.

<sup>135</sup> Housing associations also sometimes provide residential property management commercially to third parties.

provided through an ALMO.<sup>136</sup> Unlike private sector property management, such provision also requires the provision of services to social tenants and the accompanying administration and service tasks. The leaseholder, as in the private sector, will be required by their lease to contribute towards the cost of all such works.

### **Social housing stock**

- 5.72 Social housing is also subject to certain requirements, such as those required by the Decent Homes Standard,<sup>137</sup> to ensure that the housing stock meets minimum standards. Meeting these standards can require significant improvement and modernisation programmes, in particular where blocks were not constructed to the highest standards or have suffered from low levels of maintenance in the past. Additionally, aspects of these improvement programmes, such as repairs to the fabric of the building, adding insulation or replacing windows, can be very expensive and, subject to the level of government funding and the terms of the lease, leaseholders will be fully or partially liable for charges for their proportion of the costs.
- 5.73 As of March 2014, local authorities in England owned 1.68 million<sup>138</sup> dwellings and housing associations owned around 2.7 million homes.<sup>139</sup> As of October 2014, it is estimated that almost two million social housing properties have been sold since 1980. Of these, 1.8 million were local authority sales and just over 156,000 were housing associations sales since 1997.<sup>140</sup> Furthermore, of the two million properties sold, approximately 1.9 million were sold through RTB and around 95,000 via other means. Using the DCLG data on leasehold flats, the CMA estimates that between 229,000 and 290,000 of these are properties owned by private leaseholders in local authorities' and housing associations' developments.<sup>141</sup> In Wales, as of March 2014, there are approximately 226,000 social landlord dwellings, but comparable figures for

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<sup>136</sup> An ALMO is a not-for-profit company that provides housing services on behalf of a local authority. Usually an ALMO is set up by the authority to manage and improve all or part of its housing stock. Ownership of the housing stock itself normally stays with the local authority.

<sup>137</sup> Since 2001, the Decent Homes Standard has required that all occupied, managed housing stock owned by social landlords meet standards of decency. In order to be decent a home should be warm, weatherproof and have reasonably modern facilities.

<sup>138</sup> DCLG, [Local authority housing statistics: April 2012 to March 2013 England](#), 19 December 2013.

<sup>139</sup> Homes & Communities Agency – Statistical data return 2013 to 2014.

<sup>140</sup> The Right to Acquire scheme was introduced by the Housing Act 1996 with effect from 1 April 1997. The scheme enables eligible housing association tenants living in qualifying properties to buy their rented home at a discount.

<sup>141</sup> CMA internal research based on DCLG data on the number of RTB and preserved RTB (PRTB) flat sales for local authorities and housing associations respectively. Moreover, the CMA used DCLG statistics about sales under the Right to Acquire scheme which applies to housing associations, though the numbers for the latter are negligible in comparison with the RTB and PRTB schemes.

RTB and other sales are not readily available.<sup>142</sup> It should be noted, however, that not all of these dwellings will be flats or in receipt of RPMS.

- 5.74 In England, social housing is financially regulated and funded by the Government through the Homes and Communities Agency (HCA), the exception being funding in London which from April 2012 is the responsibility of the Greater London Authority. In Wales, the regulation and funding of housing associations is carried out by the Welsh Government. The government department responsible for overseeing the social housing sector is DCLG.

## **Findings**

### *Overview*

- 5.75 As in the private sector, we have found that market outcomes for some social housing leaseholders can be poor, and that there is reason to be concerned about some practices and outcomes in this part of the market. However, the leaseholder survey indicates that satisfaction and experiences of problems are mixed. Additionally, we observed a number of good practices by social housing providers which are not found in the private sector, which would be expected to enhance the quality of management of their leasehold and mixed tenure developments, see paragraphs 5.83 and 5.109.
- 5.76 However, this good practice is not consistent across the social housing sector. In many cases we found that leaseholders in social housing can face the same problems as those in properties where the freeholds are privately owned. For example, as in the private sector, we have received qualitative evidence for both local authorities and housing associations suggesting that leaseholders in social housing have concerns over excessive charges, poor service, unnecessary work and a lack of clear information on charges and consultations.
- 5.77 In total, the CMA received 161 submissions<sup>143</sup> raising concerns over the level of service provided by social housing providers. The vast majority of these (144) concerned the performance of local authorities and, in particular, the performance of a relatively small number of London based local authorities. The concerns raised included perceived excessive and/or unnecessary charging (105), poor communication from the property manager (94), poor levels of service and workmanship (91), ineffective and expensive redress

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<sup>142</sup> Social housing stock and rents as at 31 March 2014 – Welsh Government.

<sup>143</sup> The submissions were received between December 2013 and October 2014. The majority of submissions raised more than one concern.

mechanisms (72), and a lack of transparency, with particular reference to charging information (28) and the consultation process for major works (17).

### *Satisfaction with the service received*

- 5.78 Overall levels of leaseholders' satisfaction with service quality and value for money are lower than in the private sector, for those who live in a local authority owned property. For example, the leaseholder survey found that 26% of leaseholders in local authorities, compared with 20% of private leaseholders (and 19% in housing associations) rated the overall service provided either very or fairly poor. Leaseholders in the private sector were more likely to rate the overall service they received as very or fairly good (67%) compared with leaseholders in a local authority (53%) and housing association (58%). The leaseholder survey also showed that leaseholders living in local authority and housing association properties were most likely to have said they had had reason to be dissatisfied with their property manager (57% and 54% respectively).
- 5.79 Additionally, 54% of leaseholders in the private sector consider that their property manager provides value for money, compared with 40% of local authority leaseholders and 48% for housing association leaseholders.<sup>144</sup> This is despite service charges generally being lower for social housing residents, with an estimated average in London of £1,800–£2,000 per year for privately owned flats and £850 per year<sup>145</sup> for local authority owned properties.
- 5.80 There are a number of interrelated reasons that may account for this difference between the social and private sector. There has been a concerted effort by government and social housing providers to improve the standard of their housing stock, which leaseholders may be required by their leases to partially finance. We received some comment that, when leaseholders first exercised RTB or entered into shared ownership, they may have been unaware of the cost implications of being a leaseholder and/or were unaware of the extent of repairs that would be required to their property in the future. Also government policy, for example works undertaken to meet the Decent Homes Standard, could result in increased and unexpected charges for leaseholders.<sup>146</sup> In light of this, DCLG has recently announced caps on service charges where social

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<sup>144</sup> These figures differ from those in paragraph 4.31 because retirement properties have not been separated out.

<sup>145</sup> London Assembly, *Highly charged: Residential leasehold service charges in London*, March 2012.

<sup>146</sup> Local authorities and housing associations can receive funding from government to fully or partially fund major works. For instance, the 2010 Spending Review settlement made £1.6 billion available to local authorities – including those with housing stock managed by ALMOs – to help tackle the backlog of homes that are not meeting the Decent Homes Standard. A total of 46 local authority and ALMO landlords will receive backlog funding during 2011–15 to bring around 127,000 homes up to this standard.

providers are in receipt of central government funding, applying to future major works.<sup>147</sup> Regardless of its origin, an increase in service charges associated with major works can result in thousands of pounds per leaseholder<sup>148</sup> and be a considerable area of dispute. For example, one leaseholder stated:

After transfer the [new property manager] simply seized control. The process that followed was a Major Works Programme in two parts 'Internals' and 'Externals'... The 'Externals' affected Leaseholders and Section 20 Notices were served. The Contractor was appointed at a premium of 1 million pounds and the work costs ... were appalling.

- 5.81 Leaseholders in social housing may have lower disposable incomes, compared with those in the private sector, to pay for these works and so may be more sensitive to the level of charges. The average income of those buying social housing was £23,866 in 2013/14, compared with a UK average income of £27,000.<sup>149</sup> This is, to some degree, borne out by the leaseholder survey, which showed that leaseholders of local authority (11%) and housing association (6%) properties were more likely to face difficulties in making payments to their property manager (compared with 4% of leaseholders in the private sector).
- 5.82 Respondents to the survey of local authorities and housing associations (36) also identified the type of leaseholder that was more likely to encounter difficulties in paying their service charges. This included the elderly (14 mentions), leaseholders on low incomes or suffering from financial distress (12 mentions) and leaseholders who had exercised their RTB (10 mentions). The reason cited for the last category, leaseholders who had exercised their RTB, was that they did not expect to have to pay service charges or that exercising RTB had left them with limited funds to pay for subsequent service charges. Categories less commonly cited included the unemployed (eight mentions), those facing major works (four mentions), those in shared

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<sup>147</sup> DCLG announced in August 2014 that it will be capping charges to leaseholders for any future works funded by government. Specifically, the *Social Landlords Mandatory Reduction of Service Charges (England) Directions 2014* sets out that where repair, maintenance and improvement works to leaseholders' properties relate to programmes of work wholly or partly funded by a Secretary of State or the Homes and Communities Agency, the service charge payable by a resident leaseholder over any five-year period will be capped at £15,000 in London and £10,000 in the rest of England.

<sup>148</sup> A reason why these costs may be high is that some social housing stock may have been poorly maintained in the past, and high-rise blocks tend to be expensive to maintain.

<sup>149</sup> DCLG, [Social Housing Sales, England: 2012-2013](#), October 2013.

ownership (four mentions) and a general mention of vulnerable groups (two mentions).

- 5.83 Unlike the private sector, however, local authorities and housing associations can mitigate the effects of large bills by offering leaseholders interest-free loans, extended or deferred payment schemes or equity release, where they can accept a share in the property that will be recovered when the property is sold.<sup>150</sup> A number of social housing providers also mentioned that, in certain circumstances, they may write off debt or decide not to pass on some costs to leaseholders; something that is less likely to occur in the private sector.<sup>151</sup> Charges for major works will be volatile in the absence of a sinking fund, as is usually the case with local authorities (housing associations are more likely to use sinking funds to help manage the expense of major works). A recent TPAS/Wates report on leaseholder engagement<sup>152</sup> indicated, however, that these measures were not universal, with approximately 47% of local authorities (compared with 12% of housing associations) offering interest-free loans and 60% of housing associations (compared with 2% of local authorities) using a sinking fund.
- 5.84 It was also suggested that former tenants, who were used to a local authority as a social landlord, continued to have similar expectations of how they would be treated once they had exercised their RTB. In general, it is possible that leaseholders' expectations of how local authorities and housing associations will conduct themselves, due to their being not-for-profit registered providers of social housing, could differ from expectations in the private sector.
- 5.85 Another possible reason for the lower satisfaction levels is actual poor standards of service and performance by specific providers. This is consistent with the submissions received, which were very largely centred on a few local authorities. One of these London boroughs acknowledged that it had experienced past problems with a lack of prioritisation of leaseholder service, an under-resourced department, poor communication with leaseholders and poor service delivery, which it is now trying to rectify.

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<sup>150</sup> Generally it is unlikely that property managers in the private sector can offer similar schemes (although there may be some flexibility in practice where leaseholders are experiencing difficulties in paying service charges). This is because leases, and contracts with landlords, will usually make no facility for this and works usually need to be funded in advance.

<sup>151</sup> The Social Landlords Discretionary Reduction of Service Charges (England) Directions 2014 permit social landlords to reduce service charges for the costs of repair, maintenance or improvement to below the level of the mandatory cap where they consider it appropriate and reasonable to do so, subject to certain specified criteria to which the landlord must have regard when making a decision. These Directions do not apply to properties in Wales.

<sup>152</sup> TPAS/Wates Living Space, Leaseholder Engagement: Best Practice Research Outcomes, 2014 (The 'TPAS/Wates 2014 survey').

## *Communications and information on service charges*

- 5.86 Social housing providers are subject to the same obligations on communications and disclosure as private sector providers. For example, as in the private sector, social housing providers are also subject to section 21 of the Landlord and Tenant Act 1985, which gives leaseholders a right to a summary of the costs incurred in connection with the services recovered through the service charge. Social housing providers are also subject to additional legislative duties and procedures when compared with the private sector. For example, leaseholders in social housing, when purchasing a property, are provided with comprehensive advice on the costs associated with their purchase. This will include, when a property is purchased under RTB, a statutory duty<sup>153</sup> on the local authority to provide an estimate of all current and future costs associated with that RTB.<sup>154</sup>
- 5.87 In relation to the provision of information on charges, the leaseholder survey found that 64% of leaseholders in local authority and 72% of leaseholders in housing association properties rated the information they receive on what their service charge has been spent on as very or fairly good, while 25% of local authority and 19% of housing associations rated this information as fairly or very poor. The TPAS/Wates 2014 survey also found that 57% of respondents were unhappy or very unhappy with how their housing provider communicated with them about annual service charges; 61% were either dissatisfied or very dissatisfied with the breakdown of costs provided; and 52% were similarly dissatisfied or very dissatisfied with the way they were billed for works. Further, 54% of respondents said they were either dissatisfied or very dissatisfied with the information they were given about scheduled future works.
- 5.88 These findings are partially indicative of the confusion and mistrust that service charges can create. We also recognise that service charges, particularly where costs can be shared across many blocks for a number of different services, can be very complex and so data will be difficult to interpret.
- 5.89 In order to assess the quality of the service being provided, leaseholders need information that explains the cost, necessity and value of the services being received. We have heard, however, that where leaseholders are in the minority, or where a provider's systems are not geared towards serving leaseholders, those leaseholders are not always being provided with a full

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<sup>153</sup> Section 125 of the Housing Act 1985.

<sup>154</sup> This estimate will include the service charges to be incurred, repair or improvement costs to be paid during the first five years after purchase and any structural defects of which the landlord has knowledge. In addition, the local authority cannot charge a leaseholder for costs that are not included in this estimate, apart for an allowance for inflation.

breakdown of costs, on an ongoing basis, so that they can understand how service charges are apportioned and equate to the service being received. For example one leaseholder stated: 'Since 2009, we have repeatedly asked to see invoices relating to the charges for our block of flats. However, all they will give us is a mind boggling spreadsheet that supposedly details the management costs for the entire borough.'

### *Section 20 consultations*

5.90 Both social housing providers and the private sector are subject to section 20 consultations for major works and long-term contracts.<sup>155</sup> Leaseholders in local authority properties are more likely to rate consultation over the use of contractors as poor, 37% compared with 27% of those in housing associations and 25% in private properties according to the leaseholder survey. A number of submissions from leaseholders also commented on the section 20 process:

The Council carried out a section 20 consultation and made untrue statements, ie Officers specifically stated that the Council would survey windows and not change sound windows, but didn't bother and changed everyone's windows regardless.

Major works are presented in a confusing way using legal jargon and wording and costings that make no sense, when we challenge works we are never supplied with a conclusive and precise answer.

5.91 In addition, the TPAS/Wates 2014 survey found regarding major works:

- 59% of respondents were dissatisfied or very dissatisfied with information provided about the most recent major works;
- 61% thought the way the housing provider consulted with them over the most recent works was poor or very poor;
- 71% of respondents rated the value for money involved in the most recent completed works as poor or very poor; and

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<sup>155</sup> There are, however, a number of differences in section 20 procedures compared with the private sector created by the regulatory framework. For instance, where the proposed contract exceeds a particular amount, leaseholders in local authorities are not entitled by law to make any nominations, and may only make 'observations which the local authority must have 'regard to' but need not otherwise act on. Local authorities will also be subject to a variety of internal audits to ensure they are spending public money prudently. Additionally, under HCA rules, housing associations must have value for money at the heart of how they deliver their current and future objectives.

- overall 54% stated they were either dissatisfied or very dissatisfied with the major works overall.

5.92 Social housing providers universally stated that leaseholder engagement in the section 20 consultation process was low, and that they may lack the ability to recommend effective alternative providers. For example, leaseholders' ability to recommend alternative providers of specialist services, such as lift or roofing repairs, was questioned. This view is supported by the respondents to our local authority and housing association survey. Of the 47 responses to this question, 21 said that leaseholders rarely nominated an alternative contractor, followed by 16 who said 'Never', 7 who said 'Occasionally' and 3 who said 'Often'. This may be indicative of leaseholders' inability to identify alternative providers, apathy or limited opportunities to influence or engage with the formal section 20 consultation process.

### *Procurement of services*

- 5.93 The submissions received also indicated a belief among leaseholders that social housing providers were not effective purchasers of services or have long-standing links with ineffective contractors. This is perhaps reflective of it becoming increasingly common for social housing providers to enter into a long-term agreement for maintenance, repair and improvement works to their buildings. In part, this has stemmed from the Government encouraging private finance initiatives,<sup>156</sup> where the landlord contracts with a major company for a long period (up to 30 years) to provide all works to an estate or to all the buildings in the social housing provider's control.
- 5.94 The use of long-term contracts is intended to take advantage of economies of scale and, therefore, secure cost-effective outcomes for leaseholders, and local authorities indicated to us they believed they were able to secure much lower prices using this approach. However, it appears that leaseholders may not be receiving sufficient evidence to assess the value for money of the services they are receiving. There is also a suspicion from leaseholders that, once appointed, contractors are given free rein over the conducting of works and can charge whatever they like with little supervision of its quality or necessity. Further, it can be difficult for leaseholders to identify whether works are competitively priced and the allocation of costs between different blocks can be complex and obscure. In addition, one-fifth of leaseholders in local authority properties (22%) rated the quality of contractors used as poor, a

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<sup>156</sup> DCLG – Increasing the number of available homes.

higher proportion than any other development type. A large number of submissions from leaseholders drew this to our attention. For example:

My block recently had to have electrical work carried out in it (free for council tenants) ... The estimate they gave me was for around £2,500.00. I later called in four electricians from different companies to look at work that would be necessary in my flat and they gave me estimates for less than £600.000. This, naturally, made me wonder how much [contractor] had been overcharging the council for the main work in the public areas of my block.

- 5.95 Local authorities and housing associations disputed any tendency for inefficient procurement. In particular, they cited an incentive to procure services efficiently as they would bear any costs apportioned to social housing tenants. They, therefore, considered that the misalignment of incentives with leaseholders was likely to be far less than in the private sector. Housing associations also noted that they were subject to regulation, and that the HCA specifically required them to take account of value for money when procuring services.<sup>157</sup>

### *Complaints and redress mechanisms*

- 5.96 We were told that leaseholders in social housing benefit from a more effective complaints system than their private sector counterparts. For instance, social housing providers must have internal complaints procedures with designated targets for response and, when a provider's internal complaints procedure is exhausted, residents of social housing can ask for their complaint to be reviewed independently by a 'designated person', such as an MP or local councillor.<sup>158</sup> Once these avenues are exhausted, leaseholders are able to escalate their complaint to the Housing Ombudsman<sup>159</sup> and, failing a satisfactory resolution, the FTT.
- 5.97 A number of social housing providers also cited that, outside of the formal complaints handling procedures, leaseholders can write to their local MP or councillor when they have reason for an enquiry or complaint. In turn, the local MP or councillor has the ability to intervene on their behalf or help broker

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<sup>157</sup> The HCA set out economic standards that all registered providers, except for local authorities, must meet. These economic standards include, in addition to a value for money standard, a governance and financial viability standard and a rent standard. The Value for Money standard contains a specific expectation that providers should annually publish a robust self-assessment that sets out in a way which is transparent and accessible to stakeholders how they are achieving value for money in their operations. See [the HCA webpages](#).

<sup>158</sup> As part of the Localism Act 2011, designated persons were introduced by the Government to improve the chances of complaints about housing being resolved locally and to involve local politicians and local people in resolving local housing issues.

<sup>159</sup> The Housing Ombudsman is set up by law to look at complaints. The service is free, independent and impartial.

a resolution. It was put to us that, unlike the private sector, local authority providers can be subject to Freedom of Information Act 2000 (FOIA) requests. A FOIA request can therefore be used to compel local authorities, subject to certain exclusions contained within the Act, to provide access to service charge, accounts or major works information.

- 5.98 However, from the leaseholder survey, over half of local authority and housing association leaseholders (56%) who contacted their social property manager were dissatisfied with the clarity given around how their query would be dealt with, with 55% dissatisfied with the time it took the property manager to deal with their query. Also 40% who made contact with their property manager were dissatisfied with the ease of getting through to the right person.
- 5.99 Few of the social housing leaseholders interviewed said they had ever contacted an ombudsman, the FTT or a local councillor or MP. Of those who had contacted a local councillor or MP, opinion was split as to whether the issue had been successfully resolved.
- 5.100 There was also a general feeling from the leaseholder submissions received that complaints could become bogged down in a provider's internal complaints handling process, and that often leaseholders were faced with complaints handlers who did not understand leasehold, or the intricacies of the legal system, or their departments were under-resourced. For example, two leaseholders stated:

I have wasted huge amounts of time, money and energy repeatedly writing letters to chase up problems that have been neglected ... what should be straightforward and dealt with automatically ... always requires endless letters to no avail which are never properly responded to, it is extremely inefficient and frustrating.

Most staff are helpful & friendly but appear largely untrained in leasehold issues.

### *Mixed tenure developments*

- 5.101 A number of submissions received by the CMA also cited the difficulties that can arise from living in mixed-tenure developments, where being in the minority of residents compared with social tenants, can affect leaseholders' perceived ability to influence decisions regarding their development or their ability, when applicable, to exercise RTM. For example, it was suggested that differing interests can arise: social tenants may be in favour of major works as they are not directly impacted by the increased costs associated with that

work,<sup>160</sup> whereas leaseholders are more likely to oppose them because they will have to finance the work through increased service charges. Leaseholders may also object to liabilities they have under the terms of their lease, especially for the cost of facilities outside of their block or for facilities they never use.

5.102 There is also a perception among some leaseholders that their service charges and other ancillary payments are cross-subsidising other social housing residents. The CMA found that there was a widely held perception among leaseholders that unequitable charges were being levied on them, and that the costing information being provided by social housing providers was insufficient to dispel such concerns. They were also unable to understand how service charges are apportioned and equate to the service being received. Indeed, we received anecdotal evidence that some local authorities' systems may not be set up to provide leaseholders with accurate breakdowns of costs and that this can lead to conflicts with residents. For example, two leaseholders stated:

It is plain to see that those who have been fortunate enough to buy their property from [...] or from someone who previously did, are viewed as cash cows when it comes to paying for repairs.

I am dismayed. It is clear that within [...] leaseholders are viewed as those who should be paying and should be able to easily afford it.

5.103 This perception that leaseholders are cross-subsidising social tenants stems, in part, from comparisons with costs incurred by social tenants within the same housing block – who will predominantly pay a fixed rental charge. Social housing providers strongly refuted the allegation that cross-subsidies existed, stating that they were already required to separate out and identify relevant costs to construct service charges. They also argued that many of the services that leaseholders received were in fact part or fully funded by their housing budgets, which included the fixed fees paid by tenants. This is because it is not always practicable or possible to attribute some fixed costs to leaseholders, so they may not be charged for them. One local authority told us that accounting systems were not usually set up to distinguish between leasehold and tenant costs, and in any case many costs arose from procurement across multiple blocks. However, it said that charges and their allocation could be fully explained to leaseholders by those familiar with the specific

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<sup>160</sup> Social housing tenants will not incur increased charges to fund these works as they typically contribute through their pre-existing rental payments or are excluded from the requirement to make payments, due to being on full or partial housing benefits.

projects. Nonetheless many of the complaints we received seemed to arise from poor clarity of explanation of costs.

### *Right to manage and tenant management organisations*

- 5.104 When compared with private sector leaseholders, leaseholders in social housing can face additional difficulties in influencing or controlling the management services they receive. For example, leaseholders in social housing owned properties, due to the predominance of mixed-tenure developments and a difficulty in acting collectively, may find it difficult to form a tenants management organisation<sup>161</sup> (TMO). We received a number of submissions from leaseholders to this effect, for example: ‘There is possibly even greater difficulty for ex local authority leaseholders to rid themselves of underperforming ALMOs and switch to another provider.’
- 5.105 TMOs are a means by which local authority or housing association tenants and leaseholders can collectively take on the responsibility of some or all aspects of managing their properties.<sup>162</sup> To support this process, the HCA stipulates that all social housing providers, including housing associations, should give tenants opportunities to be involved in the management and maintenance of their homes. Therefore, a social housing provider that refuses to consider a proposed TMO, may be in breach of the HCA’s regulatory standards.
- 5.106 Where implemented, we have heard anecdotal evidence that TMOs can be effective at providing management services.<sup>163</sup> However, we also heard that TMOs are not a viable solution for all social housing leaseholders. This, in the main, stems from the difficulty of orchestrating collective action and aligning interests between a mixture of social and commercial tenants with the interests of leaseholders. For instance, in order to set up a TMO, tenants must

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<sup>161</sup> Under sections 27 and 27AB of the Housing Act 1985, local authority tenants are empowered to assume local authority landlords’ management functions through TMOs. Of the 176 leaseholders with a local authority freeholder that responded to our survey, 17 reported a TMO being in place at their property.

<sup>162</sup> Leaseholders in local authority owned buildings also have the right to enfranchisement, but in practice it is also often difficult to exercise. This is because in order to qualify, at least two-thirds of the flats in a building must be owned by private leasehold owners and not let to council tenants. As highlighted, local authority owned buildings tend to be a mix of leasehold owners and tenants, with tenants often being in the majority. In addition, the right to enfranchisement requires the purchase of the freehold ‘at a fair price’, meaning that the considerable costs involved, especially when considering the demographic of most social housing, may make this option not economically viable for many leaseholders.

<sup>163</sup> Tenants Managing, An Evaluation of Tenant Management Organisations in England – 2002. Although dated, this independent research showed that TMOs often manage their housing better than social housing providers, with their performance matching the top 25% of local councils in England.

form a group representing a minimum of 25 secure tenancies<sup>164</sup> and membership of the group must include at least 20% of the tenants and at least 20% of the secure tenants. One local authority leaseholder stated:

Our estate has been seriously considering a Tenant Management Organisation but it is extremely difficult to recruit and retain volunteers with the time and dedication necessary to keep up what amounts to a constant and mostly fruitless battle.

5.107 Additionally, where the freehold is owned privately, leaseholders in housing associations can obtain RTM but, in practice, this can be difficult due to the mix of residents and thresholds required. Furthermore, the right to seek the appointment of a new property manager<sup>165</sup> from the FTT is not normally available where the landlord is a local authority or housing association. For example, one leaseholder stated:

There is a general desire from residents to remove [...] as property managers but ... this process is not clear. It appears to the layperson that high costs and large amounts of time are required to change property managers. This scares resident groups off, leaving them with their current property managers and the cyclical frustrations experienced.

### *Scrutiny panels and tenant representation*

5.108 Social housing providers have mechanisms in place that, in the absence of the direct control provided by TMOs or RTM, allow tenants and leaseholders to have a collective voice and influence. For example, as in the private sector, residents are able to RTAs which provide a collective voice for residents who live in the same area or who have the same landlord.

5.109 The Localism Act 2011<sup>166</sup> also created a regulatory requirement for social landlords to work closely with their tenants and enable them to scrutinise the services they receive. The resulting scrutiny committees,<sup>167</sup> which can comprise tenant and leaseholder members, have the power to hold landlords to account for their decisions, performance and conduct. This can be done in a number of ways, including investigating the services or policy areas which

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<sup>164</sup> After the first 12 months of a council tenancy, the tenancy becomes secure, as long as the conditions of tenancy are met and rent is paid on time.

<sup>165</sup> Landlord and Tenant Act 1987, section 24.

<sup>166</sup> Overview and scrutiny committees were established in local authorities by the Local Government Act 2000. The current legislative provisions for overview and scrutiny committees are mostly contained in the Localism Act 2011.

<sup>167</sup> The Local Government (Wales) Measure 2011 sets out governance requirements for Welsh authorities. Welsh councils must operate executive arrangements and therefore must have overview and scrutiny committees.

are of concern and making recommendations to improve the services being provided. Additionally, to ensure tenants receive sufficient representation, ALMO boards are structured so that one-third of members are council tenants with the remaining positions filled by serving councillors and independents, often with business and housing experience.

5.110 These opportunities are, however, far from universal. We heard that in some cases, these largely focus on giving social housing tenants, rather than leaseholders, a say in how their properties are being run, although we did hear that some local authorities ensured that leaseholders and tenants are afforded equal representation, with no differentiation between them. Nonetheless, there was an impression that leaseholders were not the primary focus for many social housing providers, either because they were few in number or were not considered as the main priority given the providers' duties and objectives. For example, it often appeared that the leaseholder side of these organisations had poor staffing levels.

## **Conclusions**

5.111 We have found that outcomes in the social housing sector are mixed. There is evidence of good practice regarding the management of leasehold properties, with the regulatory framework governing the service charge information to be provided, the process used for formal consultation and the complaints handling mechanisms, appearing to work well in many instances. Moreover, as social housing providers are generally non-profit making bodies, there will not be the same incentives to overcharge leaseholders that might apply to landlords and property managers in the private sector.

5.112 However, the CMA received over 160 complaints about the information and service provided by social housing providers, while surveys report relatively low levels of satisfaction. A relatively small number of (London-based) local authorities made up the vast majority of these complaints. This appears likely to be the consequence of specific aspects of leasehold management in those areas rather than a general weakness in the systems for local authority leasehold housing. For instance, we heard mention of low prioritisation given to leasehold management, and poor service and communication from over-stretched departments. This did not appear to be a general or systematic problem across the local authority sector. We did not receive evidence of similar concerns about specific housing associations.

5.113 Social housing providers appear often to have the systems and processes in place to service leasehold residents more effectively than the private sector. However, where leaseholders are in the minority, or where a provider's systems are not geared towards serving leaseholders, residents are not

always given the information they require or given the impression that they are being treated equitably. This has created a climate of mistrust and dissatisfaction, where leaseholders believe they are overpaying for services or cross-subsidising other social housing residents.

- 5.114 More generally, and as found for the market more widely, prospective purchasers of social housing may not always be aware of what being a leaseholder entails. When considering purchasing a leasehold property, it is important to know, among other things, the current and future service charges that are likely to be incurred. There are many good examples of practice compared with the private sector, with purchasers (especially RTB purchasers) often in receipt of good levels of information (and an obligation not to exceed those charges for RTB purchasers). However, planned major works can significantly increase service charges, especially in the absence of sinking funds, so this information needs to be shared as effectively, and as far in advance as possible, to all leaseholders in social housing.
- 5.115 We have also found that some leaseholders are able to influence the services they receive, for example through RTAs and scrutiny panels. These systems can, however, be predominantly geared towards serving social housing tenants rather than leaseholders, which can add to the mistrust and dissatisfaction that pervades much of the sector.
- 5.116 There is good practice in the sector and a wider dissemination of this and a greater focus on the interests of leaseholders, including a greater influence over the property management services they receive and ensuring that systems are in place to provide accurate and ongoing charging information, will help ensure that, where applicable, the undesirable status quo does not become further entrenched.

## **6. Codes and redress**

### **Overview**

#### ***Introduction***

- 6.1 It is important that leaseholders can identify whether they have legitimate grounds for concern and, if that is the case, that they can then get their complaint resolved in an effective and timely manner, at a reasonable cost. It is equally important that, in circumstances where a leaseholder does not have a legitimate grievance, unwarranted complaints can be quickly resolved in a transparent way. There will be other cases where the law is unclear or its application requires clarification in the particular circumstances. In such cases, recourse to the FTT may be necessary.
- 6.2 The leaseholder, having established that they wish to make a complaint, will typically, in the first instance, use their property manager's internal complaints handling process. Where the internal complaint handling process does not result in a successful resolution of the issue, the leaseholder can seek redress by means of the procedures set out in any applicable trade body code of practice, the various ombudsmen schemes and ultimately the tribunals. Some of the complaints we received were critical of the existing structure of regulation, redress and safeguards. Thirty-five submissions from leaseholders (6%) said the current regulatory scheme was inadequate while 33 said the leasehold system itself was flawed and/or too complex.

#### ***Findings***

- 6.3 In response to our property managers' questionnaire, we were told that complaints were usually resolved through the property managers' internal complaints handling processes and therefore did not progress to alternative sources of redress.
- 6.4 Leaseholder representative bodies put to us that the level of complaints would be higher if leaseholders better understood what services they were being charged for and were better able to benchmark whether those services were being delivered at a reasonable cost and quality. More information and better transparency might also help to reduce the level of complaints.
- 6.5 Fifty-three out of 72 respondents to the property managers' questionnaire largely agreed that the avenues of redress available to leaseholders were effective. However, some of them also agreed that the process was costly and 32% (20 out of 62) suggested that improved regulation was required.

## Codes

- 6.6 ARMA, RICS, ARHM<sup>168</sup> all have codes and ARCO has a charter, with plans to introduce a code soon.<sup>169</sup> From 1 October 2014, all property managers must be registered members of an approved statutory redress scheme regardless of whether they are a member of any trade or professional body (see paragraph 3.35).
- 6.7 Almost 70% (57 out of 83) of respondents to the property managers questionnaire indicated that they were members of ARMA. Other trade associations mentioned by the respondents were RICS (43%), ARCO (5%), and ARHM (5%).
- 6.8 Not all of the property management companies active in this market are covered by a code. We have been told by some stakeholders that the problems in the market are largely caused by smaller service providers who are not signed up to any of the codes.<sup>170</sup> This has not been borne out by the complaints evidence received in the course of the study, most of which refers to members of existing trade and professional bodies.
- 6.9 The codes have been drawn up by the various trade and professional bodies covering the residential property management sector. They are not approved consumer codes.<sup>171</sup> The purpose of the codes is to require the members of the respective trade bodies to adhere to certain minimum standards of practice and behaviour. Such codes benefit consumers too. However, the codes principally serve the membership. By promoting higher standards of service and behaviour the trade association seeks to differentiate its members from firms that are not adhering to any code. The aim is to encourage consumers to use the services of the trade association members in preference to those firms that are not similarly 'regulated'. We were told by an interest group that the trade bodies have historically invited minimal leaseholder input when preparing the various codes.

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<sup>168</sup> We have not considered ARLA separately, although it is possible that some ARLA members will undertake some property management, and we note that ARLA's code begins, 'This Code of Practice ... applies to Residential Letting and/or Property Management services provided by a registered ARLA Member Firm ...'

<sup>169</sup> As already noted, there are a number of different codes, two of which have been approved by the Secretary of State under the Leasehold Reform, Housing and Urban Development Act 1993 – these are the RICS code and the ARHM code, which apply only in England.

<sup>170</sup> Some suggested that the CMA should recommend that all property managers be required to comply with ARMA-Q or the RICS code.

<sup>171</sup> Codes approved by the Trading Standards Institute under the Consumer Codes Approval Scheme (CCAS), which has the aim of promoting consumer interests by setting out the principles of effective customer service and protection (prior to April 2013 this was a function of the OFT). CCAS goes above and beyond consumer law obligations and sets a higher standard.

6.10 The 'Core criteria and guidance' published by the Trading Standards Institute in respect of the Consumer Codes Approval Scheme set out the requirements that must be met before a code will be approved under the Scheme. These include, among others, these features:

- Their sponsors should demonstrate how they exercise significant influence over their members and have the resources to ensure they can undertake the required monitoring.
- Stakeholders have been consulted during the drafting of the code and feedback from such bodies on the operation of the code is regularly obtained.
- A provision that compliance is mandatory.
- Provisions to remove consumer concerns and undesirable practices.
- Ensure that staff have adequate training and knowledge to fulfil the obligations of the code.
- Ensure that terms and conditions of supply are clear and contracts are fair.
- Provide for appropriate customer service provision, with additional help for vulnerable consumers.
- Provide for speedy, responsive, accessible and user-friendly procedures for dealing with customer complaints.
- Include provision for alternative dispute resolution.
- Provide for monitoring of the code's effectiveness and publicise the results of this.
- Provide for regular review of the code.
- Provide for a body to handle non-compliance.
- Ensure that relevant consumers are aware of the code and the complaint procedure.

6.11 Each of the codes contains some good points that are of benefit to consumers, some of which are not replicated in the others.

6.12 However, there are also areas where the codes do not meet the requirements of a good consumer code as described in paragraph 6.10. For example, the RICS code is expressly stated not to be mandatory, although non-compliance

must be justifiable. Property managers could, for example, seek to justify non-compliance with any provision on costs grounds.

- 6.13 Another example is in relation to the requirements concerning the provision of information to leaseholders about additional charges. RICS requires routine disclosure of such information, but as discussed above, compliance with the RICS code is not mandatory. ARMA-Q and ARHM<sup>172</sup> require provision of such information but only on request (and this may involve payment of a fee).
- 6.14 We note that all the codes allow the use of connected contractors. We recognise that the use of connected contractors is capable of delivering good value for money to leaseholders, but this should require full transparency and disclosure to leaseholders.
- 6.15 The codes differ in relation to disclosure in respect of income received as a result of the use of such contractors. ARMA-Q, when it comes into effect on 1 January 2015, will require an annual declaration to the client and leaseholders of all income and related income or other benefits in relation to the service charge, including associated companies and in-house providers. The RICS code requires that insurance commissions and all other sources of income to the managing agent arising out of the management should be declared to the client and the tenants (leaseholders in this context). It does not specify when this declaration should be made. ARHM states that property managers should declare to leaseholders on request any sources of income arising from the provision of their services.
- 6.16 In many cases, where something is not a statutory requirement, the codes will simply require that the property manager 'should' do or not do certain things, rather than requiring that they 'must' or 'must not'.
- 6.17 Both the RICS code and ARMA-Q set out 'convenience' as a factor to be taken into account when 'considering the guidance given by the code'/'taking management decisions within the framework of the code' respectively but in neither case is there an explanation of whose convenience this is.
- 6.18 In general the redress mechanisms set out in the codes are not available until the leaseholder has exhausted the individual property manager's internal complaint resolution process. We have not evaluated individual internal complaints processes, which will vary widely. The leaseholder survey indicated mixed experiences of complaints processes, with quite a high level of dissatisfaction over the process for those who had complained. For leaseholders who contacted the property manager themselves, over half

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<sup>172</sup> Although the current draft new ARHM code says that this information should be provided by default.

(56%) were dissatisfied with the clarity given around how their query would be dealt with, with 55% dissatisfied with the time it took the property manager to deal with their query. Four in ten leaseholders (40%) who made contact with their property manager were dissatisfied with the ease of getting through to the right person.

- 6.19 The redress mechanisms offered by the codes are all in-house processes and they generally apply to those firms which have voluntarily signed up to the codes (although approved codes may be taken into account in the FTT). In our view, some of the codes are better than others at including information about sources of assistance for complainants. For example, the RICS code specifies that property managers should make leaseholders aware of other organisations that can provide help, such as Citizens Advice and LEASE. Only ARMA-Q imposes any form of time frame for the complaint process to be completed (eight weeks, at the end of which access to the Ombudsman must be offered).
- 6.20 ARMA-Q will provide for an independent regulator but s/he will not normally become involved until all existing channels of complaint have been exhausted, ie the property manager's own internal complaints process, the relevant ombudsman and the FTT, although ARMA told us its independent regulator can take cases directly without waiting for the outcome of other avenues, if he judges there is a case for doing so. None of the other codes currently involves any form of independent decision-maker when the complaint is being considered by the trade body. In the cases of ARMA-Q, RICS and ARHM, there is provision for the referral of the matter to the appropriate ombudsman if it is not resolved by the complaint to the property manager. ARHM said that any breach of its code may be a significant part of the Ombudsman's decision, and the complainant can then refer to matter to ARHM which will check that compliance with the code has been determined correctly if the complainant remains unhappy following the Ombudsman's decision.
- 6.21 To date, we have not seen much evidence of monitoring of code compliance or taking disciplinary action against property managers in respect of code breaches. ARMA-Q provides for a three-yearly audit check, and the ARHM states that members are subject to audits to check their compliance with the code, but does not indicate the frequency of such checks. Although not set out in the RICS Code, RICS told us that member firms would be subject to audits at least every three years (firms identified as higher risk could be audited more frequently), and that RICS has the power to discipline, fine or expel individual members as well as member firms.

- 6.22 We did not receive many comments about the codes from leaseholders. This might reflect a lack of transparency of the codes at the moment and where we did hear references, there was some scepticism about the role of voluntary codes in assuring quality of services and concern about the lack of direct recourse to the professional bodies for leaseholders complaining about members.
- 6.23 We note the exceptions and optional nature of elements of some of the codes. Some stakeholders also said that the codes could be improved to allow fewer exemptions from compliance and that, since there are currently a number of different codes, which can be confusing, a unified code or formal regulation covering the entire market might be preferable.
- 6.24 There are current industry proposals to strengthen the existing codes regime, with the proposed introduction of ARMA-Q in response to the government's decision not to regulate the leasehold management sector and the creation of an ARCO code of practice, for property managers operating in the retirement communities segment of the market, to sit alongside the existing charter. Some of the property managers who responded to our questionnaires indicated industry regulation and a rationalisation of the codes into a single industry code of practice. Other developments include the 2013 Act redress scheme and revision of the RICS code, all of which should help to make the market work better. Some are still to be implemented or have not yet been in place long enough to demonstrate their effect. Whilst the CMA welcomes these initiatives, their success in addressing issues identified in this report will depend on more rigorous monitoring and enforcement of their respective members' activities than has been evident to date.
- 6.25 We recognise that ARMA, RICS, ARHM, and ARCO are professional bodies and trade associations which exist to raise standards in their sectors and represent their members' interests. Their codes are more than just a means of protecting their consumers' interests although they can have this effect. We also note that consumer protection is to some extent offered by the other legal safeguards in this sector. Therefore we have not proposed that these codes should necessarily be recast as approved consumer codes, instead recommending some revisions and extensions within the context of their existing status (see paragraphs 7.33 to 7.60).

## **Ombudsman schemes**

- 6.26 The various ombudsman schemes that cover the market for RPMS provide an independent dispute resolution service for leaseholders (see Appendix B). Different schemes can apply according to the nature of the work carried out by the residential property manager and the trade body to which they belong.

- 6.27 The use of the various ombudsman schemes is free to the consumer (leaseholder) but the ombudsmen will not examine complaints unless and until the property manager's internal complaint resolution process and the redress procedure under any relevant code have been exhausted.
- 6.28 Only 2% of leaseholder survey respondents had contacted an ombudsman regarding a property management problem, while less than half (44%) of those respondents who had never contacted an ombudsman were aware that such a service exists. DCLG has recently implemented the requirement that all residential property managers in England must be registered members of an approved statutory redress scheme, by way of an Order that came into force on 1 October 2014.<sup>173</sup> The requirement for compulsory membership of a redress scheme should ensure that leaseholders have access to effective redress. This development is welcomed by the CMA.
- 6.29 Taking an issue to the ombudsmen is not necessarily a speedy process. The Property Ombudsman has a target of 16 to 18 weeks for cases which proceed to formal review. In the period covered by its 2013 Annual Report this was generally met on average. The Housing Ombudsman took an average of 23 weeks to issue a final determination decision in the same period and Ombudsman Services dealt with 71% of property complaints within eight weeks in 2013/14.
- 6.30 In addition, the ombudsmen do not deal with issues concerning correct levels of service charges, but will deal with issues of process, consultation and transparency. The complaint evidence we have gathered suggests that service charge issues are at the heart of many complaints. It may be the case that many of the disputes that arise between leaseholders and property managers cannot therefore be dealt with by the ombudsmen and would have to be taken to the FTT.
- 6.31 The ombudsmen can award compensation to complainants in some circumstances. The Property Ombudsman and Ombudsman Services can award up to £25,000, although in those cases where a payment is awarded, the average award is a few hundred pounds in the case of the former and the most common award is around £100 in the case of the latter. Case studies on the Housing Ombudsman website indicate that any compensation payments it orders to be paid are usually modest sums.<sup>174</sup>

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<sup>173</sup> The Redress Schemes for Lettings Agency Work and Property Management Work (Requirement to Belong to a Scheme etc.) (England) Order 2014.

<sup>174</sup> [www.tpos.co.uk](http://www.tpos.co.uk); [www.ombudsmanservices.org](http://www.ombudsmanservices.org); [www.housing-ombudsman.org.uk](http://www.housing-ombudsman.org.uk).

## Tribunals

- 6.32 Legislation has given the FTT (and LVT in Wales) powers to resolve certain types of dispute involving leasehold property which would otherwise have to be dealt with by the courts, in order to provide a simpler and cheaper route to access to justice. Appeals from both tribunals can be made, with permission, to the Upper Tribunal and there is a further right of appeal to the Court of Appeal.
- 6.33 Consumer awareness of the tribunals service seems relatively low, compared with awareness of the existence of the ombudsmen. Only 3% of respondents to the leaseholder survey had ever contacted the tribunals service regarding a property management issue and only 21% of respondents who had never used the tribunals service were aware that the service exists.
- 6.34 We have been informed by bodies representing leaseholders that it can be daunting for individual leaseholders to take a case to the FTT. However, unless there is an RTMCo, RMC or RTA, that is what the individual leaseholder may have to do in order to get resolution of a dispute.
- 6.35 It can also be difficult for the individual leaseholder to identify whether they have a legitimate grievance or not. In this context, we note that the FTT is not a precedent-setting body and considers each case on its individual merits. This can mean some potential inconsistencies in decision-making and we were told this was sometimes perceived. It may also mean that there is a lack of clarity that may make it difficult for the leaseholder (and freeholders/ landlords and property managers) to assess how the FTT might regard certain practices or behaviour. It may also mean that the FTT is hearing and determining too many cases that are essentially covering the same issues on which informative rulings may have previously been made.
- 6.36 In addition, while there is a body of case law<sup>175</sup> that is being developed, and that can be referred to, decisions on the FTT website are not easily searchable.
- 6.37 LEASE (see paragraph 3.40) has a record of all tribunal decisions that can be accessed from its website. It is an important source of advice and information for both leaseholders and property managers. However, it cannot advise on the individual merits of a complaint or assist the leaseholder in progressing their complaint.

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<sup>175</sup> Previous decisions of the FTT may be useful for reference and can be referred to in evidence. Previous decisions of the Upper Tribunal set precedents which are binding on the FTT.

- 6.38 The FTT process is similar to going to court and we have been told by leaseholders that it can be complex for the lay person to understand. There are also fees payable for most types of dispute, although there is no fee for dealing with disputes concerning the price payable for the acquisition of freeholds or lease extensions and market or fair rents. The fees can be quite substantial – taking to a hearing a dispute regarding service charges in excess of £15,000 will cost £630 in England and £500 in Wales.
- 6.39 Previously, the LVT tended to be a ‘no costs’ based process, with both sides bearing their own costs provided they had acted reasonably. Furthermore, the LVT was only entitled to award up to £500 in costs if a party acted unreasonably or vexatiously and in practice costs orders were very rare.
- 6.40 There is now no limit to the amount of costs that can be awarded. The FTT has the discretion<sup>176</sup> to make a costs order where ‘a person has acted unreasonably in bringing, defending or conducting proceedings’, which widens the previous powers of the tribunal to make a costs award.
- 6.41 We heard that once an application is lodged and fees paid, the FTT will often offer mediation. We were told this can be very helpful and many cases can be resolved through these discussions, particularly if until then there had been misunderstandings or a breakdown in communication. However, this is only triggered once the case has been taken to the FTT.
- 6.42 Satisfaction with the FTT services where they have been used appears to be high. However, the CMA is also aware that leaseholders have a number of concerns about the current system.
- 6.43 For example, section 19(1) of the 1985 Act states that relevant costs shall be taken into account in determining the amount of a service charge payable for a period (a) only to the extent that they are reasonably incurred, and (b) where they are incurred on the provision of services or the carrying out of works, only if the services or works are of a reasonable standard. In cases brought before it, we understand that the FTT’s consideration of what is reasonable will reflect considerations such as whether costs were incurred following proper process. It is possible for there to be substantial differences of opinion on the need for particular works and services and how they should be performed, yet for these all to be ‘reasonable’. ‘Reasonableness’ does not require that costs should be as low as possible if there are sensible grounds for adopting a different decision.

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<sup>176</sup> Rule 13 of The Tribunal Procedure (First-tier Tribunal) (Property Chamber) Rules 2013 S.I. 2013 No. 1169 (L. 8).

- 6.44 We have received submissions from leaseholders that suggest that, for some, taking a case to the FTT is not seen as being a viable option because of the fees and the potential unlimited legal costs risks involved. While the FTT does not require the parties to be legally represented, the experience of many of the leaseholders and leaseholder bodies who contacted the CMA was that the landlord and/or property manager would have legal representation (and on occasion this could be a legal representative as senior as a Queen's Counsel). Individual leaseholders, on the other hand, are much more likely to be acting in person or with minimal legal professional assistance in order to keep down their costs. In the event that the case is lost, if the legal costs are recoverable in full, this could have serious financial implications for the leaseholder. This may mean that some leaseholders, who may have legitimate grievances that the FTT would be likely to support, may nevertheless be put off from pursuing their case. For example, one respondent said: 'The process is expensive and not mediation-friendly. I have just paid out £7,000, in fees awarded and allowed by the LVT'.
- 6.45 We were told that leases may allow landlords and property managers to recover from leaseholders, as an administration charge, their legal costs in defending a claim at the FTT. Although also subject to challenge on reasonableness, we were told that this can greatly increase costs and risks to leaseholders, can encourage landlords to defend themselves regardless of the merits, incentivises them to seek full legal representation and means that any claims by individual leaseholders could impose costs on fellow leaseholders in their block.
- 6.46 We have also received anecdotal evidence that the process for pursuing a case through the FTT is seen by some leaseholders as being too daunting, particularly for elderly or otherwise more vulnerable leaseholders. Evidence received during the course of this study, from individual leaseholders and from bodies representing leaseholders, indicates that there is a perception that the FTT process is weighted in favour of the freeholder/property manager because those parties will generally have far greater resources than the individual leaseholders and will therefore be able to engage the services of expert legal advisers.
- 6.47 An example to illustrate the weaknesses in the current system is that one respondent said:

This system benefits those who can afford to pay legal fees. When the freeholder is found at fault, the tribunal decision simply corrects the situation. Noting the financial and emotional stress imposed on the leaseholder, there is no 'punishment' for the freeholder for not fulfilling their duty in the first place.

6.48 Another submission said:

Unfortunately these [previous FTT] decisions do not constitute a legal precedent. This means that whenever a group of leaseholders seek to challenge the freeholder on this matter they are faced with the task of embarking on a potentially expensive, uncertain and unfair challenge via another tribunal. The unfairness arises because the process pits leaseholders, some of whom will be on relatively small and/or fixed incomes, against the resources of the freeholder's legal department. This often leads to the acceptance of a compromise figure which is inherently unfair to leaseholders.

6.49 There are also concerns that taking a case to the FTT is sometimes perceived to take too long. Currently, the target time from receipt of an application to decision is ten weeks, which is met for most cases (suggesting the perception does not reflect the usual FTT process). For more complex matters, the average time taken is 20 weeks. There may then be further appeals, as one respondent to our market study found: 'A simple service charge dispute concerning ... failure to consult for major works ... and historic service charges turned into an eight-year legal nightmare'.

6.50 Leaseholders and some other stakeholders indicated to us that they would welcome an alternative to the FTT/LVT that would provide a speedier, less costly method of resolving disputes at an earlier stage and would enable the FTT to concentrate on the more difficult cases that require a judicial resolution. Alternatives put to the CMA have included mediation, early neutral evaluation or some form of triage arrangement for assessing the merits of cases without the need for a full hearing. It was felt that these alternatives would prove less intimidating for leaseholders as they might be seen as more straightforward and less costly or risky. Some property managers recognised that these would in some cases provide a quick and easy resolution, such as a means of resolving simple misunderstandings. These possibilities are discussed in paragraphs 7.61 to 7.71.

## Conclusions

6.51 There are a wide range of statutory provisions to protect the interests of leaseholders and in many cases these appear to work well. It is unsurprising that in the complex world of property management disputes arise, and redress systems exist to address this. It is difficult to interpret usage figures – low levels of usage could reflect a market that serves customers well or redress systems that are poorly known or difficult to use, and vice versa. We believe that generally the existing redress systems can and largely do work well, but

our study findings suggest that there are some gaps in the redress system as it currently operates, as well as room for improvement with the current redress systems described in this section.

- 6.52 The existing codes as described have their limitations. However, they still serve an important function, are important in raising standards across the sector and serve an enforcement function that would otherwise be absent outside of the FTT and ombudsmen. There has been a lot of activity over the period of this study and there is more in prospect. ARMA-Q will come into effect on 1 January 2015, the ARHM code is subject to review by DCLG and the RICS code has been subject to consultation and is also subject to review by DCLG. The codes are being upgraded and will require their respective members to adhere to higher standards. In addition, monitoring will be more stringent and we would expect to see more evidence of enforcement for proven breaches of the codes.
- 6.53 These improvements may help to increase trade association and professional body membership, if membership is recognised as indicating a better quality service, which in turn should reduce the number of property managers operating outside of any regulatory mechanism.
- 6.54 The 2013 Act redress schemes should ensure that all property managers have internal complaints handling processes in place, as this is a requirement for membership of the various ombudsman schemes. However, given the limitations of the ombudsmen in terms of their remit to consider only certain types of complaint, it is not clear how much impact it will have in practice.
- 6.55 The FTT is generally seen by those who have used it as providing a good service. While it is more informal, quicker and probably cheaper than formal court processes, it is sometimes seen as complex and intimidating to use, and leaseholders can perceive a system that favours the professionals who might have more experience and access to better legal advice. Leaseholders can emerge from the process with high legal bills and a liability for the landlord/property manager's costs in some cases.
- 6.56 We consider that better communication between leaseholders and property managers, with better transparency and disclosure would help to reduce the incidence of some types of complaint. Examples are where the issue is based on simple misunderstandings between the parties, possibly in relation to inadequate disclosure or explanation relevant to the service charge or a leaseholder's misunderstanding of their obligations under the property lease. These sorts of cases can be escalated to the ombudsman and the FTT, which may be disproportionate in terms of the time and cost that are involved.

6.57 Overall, we recognise that there are limitations and risks in the redress systems that mean they may not always work as well for leaseholders as they could. But that said, we have not identified a major gap in the systems where leaseholders' interests are not protected at all. This does suggest that improvements to the market can be made via existing mechanisms. Existing safeguards can, where necessary, be strengthened to reduce the incidence of problems or to provide better recourse to redress, although improved standards, better monitoring or more active enforcement might be required. This is discussed in the recommendations described in the next section.

## 7. Recommendations

### Conclusions on how the market is working

- 7.1 We estimate that there could be up to 3.1 million leasehold flats in England and Wales which might receive RPMS, with service charges averaging around £1,100 annually (with many being far higher than that). This is therefore a very important sector of the economy.
- 7.2 We have found that outcomes in the market are mixed. Many leaseholders are content with the service they receive. In addition there are many measures in place to protect leaseholder interests (such as obligations on transparency and consultation, rights of redress to the ombudsmen and the FTT, self-regulation, the right to manage, etc). These are capable of mitigating many of the concerns that we have found in the sector.
- 7.3 However, some leaseholders have experienced significant problems or find service and value for money to be very poor. In extreme cases the costs suffered, or the stress and disruption arising for leaseholders can be severe.
- 7.4 We found there to be scope to make existing measures to protect leaseholders work better or more consistently. These measures are important in this market where the leasehold system raises issues of separation of control and accountability, and where, inevitably there is a need for individual compromise in the appropriate level of property maintenance in communal blocks.
- 7.5 Our main conclusions on the causes of poor market outcomes are as follows:
- The basic leasehold structure, whereby responsibility for appointing and supervising property managers rests with the landlord while leaseholders bear the cost, is a major cause of the problems and discontent experienced. There is a separation of control for leaseholders; they are the 'consumer' of services provided and pay (indirectly, via a service charge) for those services but individually have relatively little ability to influence the work done or who is appointed to carry out the work.
  - In many cases there is a misalignment of incentives: landlords (particularly freeholders) do not carry the costs of property maintenance and so may have weak incentives to ensure that leaseholders are getting a good service and value for money. Landlords may also be vertically integrated with property managers or have commercial relationships with suppliers giving them incentives to do things that are not in the best interests of leaseholders (such as overcharging or conducting unnecessary works).

- Property managers may offer poor service and increase charges to leaseholders due to poor oversight and control from landlords given these misaligned incentives. Poor outcomes can be exacerbated by the limited constraint on incumbent property managers from potential competition.
- Some of the problems experienced are caused by the implementation of terms in the lease, over which property managers have no direct control, or relate to aspects of the freeholder-leaseholder relationship.
- Prospective leaseholders often have a poor understanding of their obligations to pay for RPMS when they purchase a leasehold property meaning they are unprepared for the charges that arise.
- There are significant problems with transparency and leaseholders' understanding of RPMS; they will often find it difficult to monitor the performance of property managers and to assess the quality and value of the service they provide, and so are less able to hold property managers to account. We consider that in any market consumers should have the right to be properly informed about what they are paying for and should be able to hold the suppliers to account. In this context transparency and accountability is crucial.
- It can sometimes be difficult for leaseholders to coordinate effectively and act collectively. RTAs are one means by which leaseholders can coordinate and these possess some formal powers. In addition, the RTM is an important safeguard of leaseholder rights and acts to deter some excesses by freeholders and property managers. Leaseholders are more satisfied where RTM has been exercised or an RMC is in place, due to the leaseholder's ability to exercise greater control over their property management. However, in some cases the process of obtaining RTM can be complex or difficult.
- Complaints and redress systems, while extremely useful in protecting leaseholders, do not always provide adequate protection. They can be perceived by leaseholders as difficult, intimidating or risky (in terms of potential cost and outcome) to use.
- The complaints and dissatisfaction expressed with local authorities and housing associations is of concern. We recognise that tensions can arise given the difficulty in managing the different interests of tenants in social housing and leaseholders and there are sometimes limitations in the explanations of how costs are allocated, and that the costs of improvement works can lead to very high charges. Nevertheless we also recognise that in many cases there are better processes for transparency, consultation

and redress than in the private sector. It appears that in some cases poor outcomes result from the way leasehold property management is delivered in particular local authorities.

- 7.6 We have also found that the process for consultation on major works, section 20, while useful, is widely seen to be in need of an update to make it more flexible and with updated thresholds.

### ***Detriment***

- 7.7 Detriment is a measure of the extent to which consumers are disadvantaged by problems in the market, such as through paying higher prices or receiving sub-optimal service, than would be the case in a competitive or well-functioning market.
- 7.8 In this case, the manifestations of detriment are many and varied and do not necessarily have a direct cost associated with them. For example, some of the detriment arose where leaseholders felt that unnecessary work was being done, that prices paid were too high, or it was not planned and procured efficiently. However, for many leaseholders it was the surprise of finding out at a late stage about their liability for charges and the lack of advance warning of expenditure, rather than the fact that these costs needed to be paid, that caused significant detriment. Part of the dissatisfaction arose from the lack of control over and accountability of RPMS providers. There was greater satisfaction where leaseholders felt they had greater control through RMC/RTMCos, and we heard of cases where new RTMCos increased service charges so as to provide a better standard of property management, and increase leaseholder satisfaction.
- 7.9 It was not possible for us to evaluate for a range of cases whether work was necessary, whether judgements on appropriate work were reasonable, and whether they were done in the most efficient way possible. As shown by some of the findings of the FTT (see [Section 4](#)) there have been examples of works where costs were found to be unreasonable and very substantial revisions made, although there can be wide differences of opinion over what is reasonable. The FTT findings do not demonstrate how common such occurrences are or the extent to which existing redress corrects the overall problem.
- 7.10 As noted above, there are poor statistics on the size of the market, although we have given estimates based on the best information available. It is therefore necessary to make a series of assumptions to illustrate the possible scale of detriment. If we assume that detriment arises in just over a quarter of

the market<sup>177</sup> (based on dissatisfaction in the leaseholder survey on value for money) and as an illustration assume that it is equivalent in impact, were this to equate to between 5% and 10% of the value of the service charge, the detriment would be between £34 million and £98 million a year.<sup>178</sup> This is of course an illustrative hypothetical number only – the real incidence of problems is very uncertain (not least because perceptions of problems reflect a combination of misapprehension (ie perceived problems that are not justified) and ignorance (not knowing that the service and value for money you receive is deficient). The detrimental impact might be very much more or less than a hypothetical 5 to 10% effect, but it does show that potentially the detriment we seek to address is significant.

### **Remedial actions**

7.11 In considering what remedies would be appropriate, we noted that for many leaseholders, overall the market works reasonably well, but that particular problems can and do occur where existing safeguards fail to provide adequate protection. We consider that the problems that exist in the market are best dealt with through targeted measures to improve the working of the current model, rather than through a fundamental reform of the regulatory framework. We do not wish to increase the burden or costs of regulatory compliance unnecessarily and we note the existence of redress systems and/or safeguards, which provide a degree of protection in many cases and whose performance, where shortfalls are identified, can be enhanced.

7.12 Moreover, there are currently a variety of developments that should help improve the functioning of the market. These include:

- The adoption of a new self-regulatory regime, ARMA-Q, for ARMA managing agents. It aims to raise standards and quality of service, and features an independent Regulatory Panel and a Consumer Charter.
- Other codes, for RICS and ARHM, are currently under revision and are subject to approval by the Secretary of State (meaning that the FTT can have regard to the requirements of these codes in making its decisions). This should similarly help to raise standards and the quality of service.
- DCLG's statutory redress scheme should serve to improve the complaint and redress process.

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<sup>177</sup> 28%.

<sup>178</sup> £2.4–£3.5 billion value of service charges (see paragraph 3.53) multiplied by 28% (the proportion of dissatisfied leaseholders from the leaseholder survey) multiplied by 5 to 10% (hypothetical equivalent price effect).

- DCLG's announcement of capping of service charges for local authority leaseholders where works are part funded centrally should help to reduce the incidence of unexpected and large bills to leaseholders of local authority properties (though we note that the application of the cap is restricted/ subject to limitations).

7.13 DCLG has announced other measures including work looking to address:

- providing access to summaries of the determination of tribunal cases so people have a better understanding of the outcome;
- making it easier to get recognition of a tenants' association;
- increasing awareness of what being a leaseholder means before people buy leasehold properties; and
- gaining information on absentee leaseholders, especially where the leaseholders collectively wish to buy the freehold.

7.14 DCLG has also addressed the specific issue of transfer (exit) fee covenants, particularly found in the retirement sector, by referring the matter to the Law Commission.

7.15 Therefore, we have decided to build on the existing self-regulatory regime, rather than to recommend major statutory regulation of the sector, even though this was the favoured option of many industry and consumer groups that engaged with us.<sup>179</sup> This is because:

- Many issues can be addressed by safeguards embedded in codes and property law, although their strength and application might in certain cases need to be improved.
- We believe that we should allow time for the various developments in the market to take effect.
- One of the benefits of statutory regulation would be that it would apply to all property managers. However, we have seen no evidence to demonstrate that concerns are concentrated in those companies which are not subject to codes of conduct.

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<sup>179</sup> Proposals for remedial action were set out in our update paper and we received detailed comments on these from many parties, and we met with interested stakeholders to consider and develop proposals. Our final recommendations reflect this engagement.

- There are costs in implementing and monitoring/enforcing a statutory code and we do not wish to increase the burden or costs of regulatory compliance unnecessarily
- A statutory code could act as a barrier to entry, reducing competition.
- We were also mindful that in the short term recommendations for statutory regulation were unlikely to be accepted by Government and so would not be implemented. However, we do not consider that this is reason not to seek to influence the development of longer-term policy where we consider that there is clear reason to do so based on evidence from our findings.

7.16 We have therefore developed a set of recommendations covering five key areas:

- Pre-purchase remedies.
- Remedies to improve transparency and communication, to be addressed via self-regulatory industry codes of practice.
- Redress remedies.
- Remedies requiring legislative change.
- Remedies to improve transparency and communication in blocks owned by local authorities and housing associations.

7.17 Broadly our recommendations are intended to:

- provide information to prospective purchasers pre-purchase so that they have greater understanding of the implications of leasehold ownership and liability for service charges, and better information at the conveyancing stage;
- improve the performance of property managers;
- improve information provision to leaseholders through the improvements in self-regulation that we are recommending;
- encourage local authorities to share best practice;
- develop alternative redress systems to improve effectiveness;
- make the case for an alternative to RTM; and

- encourage a review of section 20 consultation procedures. These last two remedies will require legislative changes.

7.18 More specifically, implementation of our recommendations should:

- provide leaseholders with the information they need to make informed decisions including the nature and cost of the services they are paying for;
- provide greater ability for leaseholders to exercise control or influence over property managers and increase their ability to make use of RTM;
- encourage leaseholders to act cooperatively and coordinate in order to protect their interests;
- enhance the prospects of meaningful competition on the merits of property managers' offers; and
- enhance the safeguards that protect consumers (eg on consultation, complaint and redress).

7.19 The professional bodies/trade associations have indicated enthusiasm for developments that will make the market work better and improve outcomes for consumers, including in the longer term updates to their codes. We note that the coverage of the codes is far from complete and so poor practice among non-member property managers cannot be directly addressed by the trade and professional bodies that do have codes. Over time and with appropriate publicity our expectation is that membership of codes will be seen as a demonstration of quality such that non-member property managers will find it increasingly difficult to win business. To be successful, the CMA's recommendations will require both publicity and promotion of the codes by the industry and the effective monitoring and enforcement of them.

7.20 We do not propose remedial measures for issues which fall outside the scope of this study. We have not made an assessment of the legal framework that underpins freehold and leasehold arrangements, nor of lease terms and how freeholders or landlords interpret and apply those terms except in so far as it impacts on the supply of RPMS (and any such consideration would need to balance the rights both of leaseholders and freeholders). However, as set out in our report we have identified issues in the freeholder-leaseholder relationship area, in particular relating to the purchase of property insurance by freeholders and the charging of rents for or sale of manager's flats in retirement developments. We note that the Law Commission is examining the issue of exit fee covenants.

## Recommendations

7.21 Our full set of recommendations is set out below.

### Pre-purchase remedies

#### ***Guidance to prospective purchasers pre-purchase – recommendations to The Property Ombudsman/LEASE***

We recommend that when specific enquiries are made about a property the estate agent provides a short information sheet providing basic key information on major facts about leasehold ownership (the information sheet to be produced by LEASE/Law Society).

We recommend that leasehold property particulars prepared by estate agents should state the current level of service charges.

A requirement to provide this information should be incorporated into the approved code of practice followed by estate agents and the associated guidance that supports it.

#### ***Conveyancing stage – standard questions – recommendations to The Law Society/LEASE***

We recommend that a standard set of questions is used as part of the conveyancing process to ensure that the prospective leaseholder has sufficient information to make an informed decision on the purchase. This may be achieved by wider adoption of the Law Society's Leasehold Properties Enquires form 1 (LPE1) and supported by the Council of Mortgage Lenders guidance. We also recommend that conveyancers also distribute the short information sheet on major facts about leasehold ownership.

#### *How it addresses the concern or detriment identified*

7.22 When considering buying a flat, a prospective purchaser may not fully understand the implications of becoming a leaseholder. For example, they may not be clear about their responsibilities and the financial obligations they will face in respect of service charges, management charges and future maintenance and repair work. As a result, the prospective purchaser may be unable to make well-informed decisions or assess value for money, for example in comparing the respective costs associated with leasehold and

freehold properties, comparing different leasehold properties, or the affordability of a property.

- 7.23 The problem identified cannot be easily resolved simply by making information available on enquiry as the purchaser may not be aware of the need to obtain information in the first place. If prospective purchasers were made aware as early as possible that there would be a service charge to pay (such as when first looking at property particulars on a property portal or estate agent particulars) they would be prompted to make appropriate enquiries, either in relation to the leasehold property itself or to seek more generic information about what it means to be a leaseholder. They would be able to factor current service charge figures into their considerations of affordability and the value for money of different properties.
- 7.24 This remedy will also provide the prospective purchaser with a short information sheet that explains the basics of being a leaseholder. This needs to be provided at an early stage of the process, at the point where the prospective purchaser is assessing their purchase options. This document could be provided by estate agents along with the particulars for leasehold properties.
- 7.25 The short information sheet should provide further links to where additional information can be obtained and prompt prospective purchasers to seek specific information about properties, such as service charge levels and planned major works.
- 7.26 We note that some estate agents already provide good information on current service charges (along with information such as ground rents and unexpired life of the lease) on property particulars, but the picture is mixed and many do not provide even basic information on their sales particulars.
- 7.27 Following the initial contact with estate agents and the decision to proceed with the purchase of a leasehold property, the prospective purchaser will need further detailed information about the property. In the conveyancing process, a standard form (LPE1) is often used to collect information relating to the property such as legal ownership and any outstanding liabilities and responsibilities attaching to the property being purchased. This form is optional.
- 7.28 We are recommending that this form is revised to ensure that the most relevant information is collected and that this form then becomes the standard used. Information should be both complete and presented clearly. Prospective purchasers should be able to make a meaningful assessment of the costs involved. The Law Society has confirmed that the LPE1 form is to be reviewed and that the CMA findings will be taken into account in this review.

- 7.29 These remedies should ensure that leaseholders are more aware of their responsibilities and obligations and have a better understanding of the financial implications of being a leaseholder.

#### *Remedy design issues*

- 7.30 LEASE already provides information on its website explaining what it means to be a leaseholder.<sup>180</sup> The short information sheet would be based on this. The Law Society has also indicated to the CMA that a complementary guidance note could also be produced for use by conveyancers.
- 7.31 We recommend that The Property Ombudsman should review and consider further whether the Code of Practice for Residential Estate Agents requires revision to require the disclosure of significant terms, such as service charges for individual properties.<sup>181</sup> Our understanding is that the requirements of the approved code for estate agents apply where estate agents utilise property portals that provide 'a noticeboard' for the display of property particulars. It is important that prospective purchasers are able to make informed choices at the search stage where they are neither financially nor emotionally committed to a particular property. Including the requirement in the code is necessary to ensure that estate agents provide the information. If left as an option some estate agents might choose not to provide the information because of concerns that some prospective purchasers may be put off purchasing a leasehold property.

#### *How the remedy should be implemented*

- 7.32 The CMA will work with the relevant stakeholders to implement these remedies.

### **Remedies to improve transparency and communication, to be addressed via self-regulatory industry codes of practice – recommendations to ARMA, RICS, ARHM, etc**

- 7.33 These remedies cannot be implemented immediately post publication. The CMA will need to work with industry to agree detail of the recommendations. In the meantime, ARMA-Q comes into effect on 1 January 2015 and the RICS code has to be reviewed by DCLG. A number of the remedies proposed require action by property management companies. We note the progress

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<sup>180</sup> [Living in Leasehold Flats: A guide to how it works, your rights and responsibilities](#).

<sup>181</sup> Although not part of our consideration of residential property management, we were told about similar concerns in relation to the provision of information on the unexpired term of the lease and the ground rent payable.

made by RICS, ARMA and ARHM in promoting and enhancing the existing self-regulation regime and also note the introduction of some new industry codes, for example the ARCO code (which is retirement community specific) and intend to build on this. We consider that these recommendations should apply equally to ARHM and ARCO, though we recognise that in some retirement properties compliance with these recommendations will be dependent on whether the property management costs can be separately identified from the provision of other services, such as domestic and nursing care.

- 7.34 We encourage the continued development and evolution of self-regulation in this sector. Our best practice recommendations can be introduced through self-regulation and use of these codes. If an increasing quality of service is recognised as being associated with membership of the codes, this should encourage wider membership, reducing the number of companies that operate independently of the codes. During the course of this study there have been discussions about bringing these codes into closer alignment. The views of leaseholders should be sought and taken into account in revising these codes to ensure that the changes made are of practical benefit to leaseholders.

***Provision of information on property management responsibilities, plans, and past and future work***

We recommend that a clear statement be produced for each property they manage of: (i) purpose and responsibilities of the property manager, (ii) property management plans and strategy, and (iii) key information relating to past work to be provided to the leaseholder.

- The statement of purpose and responsibilities of the property manager should be included in their annual report and provided on request. This information should also be available on property manager websites.
- The statement of property management plans and strategy must make clear all areas of work covered by service charges or fixed management fees and give an indication of expected major works over the next planning period, expected to be a minimum of three to five years. It should also compare the costs to the sinking fund to enable leaseholders to form an expectation of the likely unfunded cost.
- The statement of key performance indicators must include actual costs for material projects incurred over the last three to five years and other additional information, such as the level of service charge and any fixed management fees. To be provided to leaseholders on a regular annual basis.

### *How it addresses the concern or detriment identified*

- 7.35 The statement of purpose and responsibilities of the property manager should set out clearly what services the property manager is providing, ie what it is contracted to provide under the management contract and the relevant property lease. This will help to both set and manage the expectations of leaseholders more realistically than may be the case at present.
- 7.36 One of the key differences between a landlord and a leaseholder is the ability of the landlord to determine the timing of any property repair. Due to the communal nature of leasehold ownership it is not possible for the individual leaseholder to control the timing of any works that are carried out. The statement of property management plans and strategy should set out clearly what major works are expected over the next three to five years and how the property manager expects to carry out these works, ie the roof will be replaced on block A, we will consult on the appointment of contractors 12 months before the work is expected to commence, etc. This will enable leaseholders to manage and plan their expenditure better.
- 7.37 Among the information asymmetries we have identified, a significant concern was the unexpected nature and cost of work that is carried out. Leaseholders need a better understanding of the potential liabilities that they face, in so far as they can be reasonably anticipated, so that they can then plan for the expenditure sufficiently in advance. This is particularly important in circumstances where either there is no reserve fund or the accumulated monies in the reserve fund may be insufficient. It is important that leaseholders have sufficient notification of pending works and the likely costs so that they can make sufficient provision for them in good time.
- 7.38 Similarly, the purpose of the statement of key performance indicators and historical costs is to enable the leaseholder better to assess the likely level of future outgoings and to make provision for that. It also provides some check on service charge increases that are out of line with previous years' expenditure and help leaseholders monitor property managers' performance. There may well be objective reasons for such differences, but such transparency will help the leaseholder, particularly newer leaseholders, to identify where that is not necessarily the case.

### *Remedy design issues*

- 7.39 By including for each property historical information on work carried out, details of planned future work, details of service charges and what is covered in core management fees, a leaseholder will have a more complete picture of the expenses that they are likely to face as a leaseholder in that block.

### *How the remedy should be implemented*

7.40 The detail of these remedies will need to be developed further. The CMA will work with the relevant stakeholders to determine what information should be provided and consider whether any exemptions should apply, for example, for small blocks of flats. In terms of principles, we recognise that it would be unreasonable to expect that all items of expense could necessarily be accurately predicted. The precise content of the statement of property management strategy will therefore need to be determined through discussion with stakeholders, to determine the minimum level of information that should be made available to leaseholders. In retirement properties implementation would depend on whether property management costs can be separately identified.

### ***Disclosure of fees, charges and commissions***

**We recommend disclosure of (i) what is included within the core management fee and rates of management charges, (ii) administration and supplementary charges, and (iii) commissions (including commissions earned by the property manager for arranging the buildings insurance).**

We recommend that property managers must, for each property they manage (because charges may vary depending upon the contract and administration charges set by the landlord) fully disclose details of:

- The services and activities that are provided and paid for within a core management fee. This should distinguish between services provided under the service charge and as a management fee. Where non-routine projects incur a management fee, either fixed or related to the size of the project, the rates applied must be disclosed, including any points at which the rate of charge varies.
- All administration and supplementary charges for services, to enable leaseholders to better understand the charges they face as a leaseholder.
- Any commission earned by the property manager (including fees/commissions in relation to buildings insurance).

### *How it addresses the concern or detriment identified*

7.41 Responses to our market study showed there were concerns that a property manager might be incentivised to carry out unnecessary works, due to a

commission payment or management fee being related to the value of the work carried out.

- 7.42 We recommend that property managers identify core activities that are predictable, for example routine cleaning and maintenance and administration, and include these elements under a fixed management fee. For larger-scale projects, the fee will usually need to be related to the scale of the project. However, the scale of charge that will be applied to different projects should be made clear to leaseholders. Another concern identified was poor transparency and incomplete disclosure of administration/supplementary charges for services or granting permission for activities not covered in the service charge (eg removing an internal wall, permission for keeping a pet, etc). In some instances charges were particularly high and unlikely to be immediately evident to the leaseholder. In other cases, some of the charges were covered within the service charge and no supplementary charges are made by the property manager.
- 7.43 There should be full disclosure of supplementary charges up front so that leaseholders can better assess all charges which they will face. By requiring disclosure of administration/supplementary charges, as well as identifying all items that are covered by the service charge, the leaseholder will be able to challenge the property manager to justify the level of those charges where they consider that they may not be reasonable.
- 7.44 Some of the submissions to our study have alleged that insurance can be very expensive and that substantial fees/commission payments are made for arranging the buildings insurance. If this is the case, this could mean that leaseholders are overpaying for insurance.
- 7.45 We recommend that this information is disclosed, together with a summary of what is covered by the insurance. If any fee/commission relates to discounts from taking out insurance for a number of buildings, this information should also be disclosed. This recommendation applies to property managers placing the insurance, and any of their related companies (such as brokers and insurance administrators) where there is a corporate relationship, but does not apply to landlords.

#### *Remedy design issues*

- 7.46 Increased disclosure would go a long way to address the CMA's concerns. The majority of respondents accepted and recognised that charges should not be hidden. Disclosure of activities covered by a core management fee, of supplementary charges and of insurance commissions rates received would help leaseholders to better understand the charges they would face. It is also

important that the disclosure itself should not disadvantage the property manager that chooses to disclose this information, compared with those that do not.

- 7.47 The leaseholder also needs to know where information on charges can be accessed. This should be included in any descriptive document explaining the property manager's activities, within any welcome packs and on the property manager's website.
- 7.48 We recognise that in some cases administration/supplementary charges may be applied by the landlord, rather than by the property manager. In this situation, we recommend that the property manager states which charges it applies and collects payment for as well as identifying areas it is not responsible for. As the freeholder relationship is excluded from the scope of this study, we are unable to make a direct recommendation to cover them, but note that it would be good practice if landlords also fully disclose any administration/supplementary charges that are made. Where charges are not clear, we would encourage leaseholders to request this disclosure.

#### *How the remedy should be implemented*

- 7.49 We recommend that these requirements are included in relevant industry codes. This recommendation should also apply to the retirement sector (where property management aspects are separable).
- 7.50 While a requirement of existing codes, the disclosure of core management fees and their coverage, of supplementary charges and insurance commission or other payments received should be regarded as minimum best practice across the sector and that all property managers, regardless of whether they subscribe to an existing industry code, should review and update their policies in this regard with immediate effect.

#### ***Full disclosure of corporate links***

We recommend that property management companies must disclose to leaseholders in the building any corporate relationship with the landlord for any property it manages, or with any contractors the property manager engages for work in the building, or with any company providing or assisting in the procurement or administration of the insurance. Any relevant ownership relationship must be disclosed, eg common parent, subsidiary or affiliate or intermediary.

### *How it addresses the concern or detriment identified*

- 7.51 The concern was that leaseholders may not get value for money because of links between the property manager and the freeholder, or between the freeholder and an appointed contractor. The effect of a link between property manager and freeholder could result in reduced competition, higher charges and/or payments could appear in a different part of the group, which might disguise the arrangement. If there is a link between the property manager and a contractor, the incentive to reduce costs may be limited, as the ultimate party paying for the service would be the leaseholder, not the property manager. The effect could be compounded if the property manager is paid a percentage of the project fee. In addition there could be an incentive to ensure that their related company wins the contract.
- 7.52 We recommend that the existence of any links between the property managing company and contractors is made explicit, when the bids are considered. If a contract is awarded to a related company, the existence of that relationship must be made clear to leaseholders. We expect that the visibility of the relationships, within the context of the wider information made available in other elements of the remedies package, will lead to greater scrutiny of any contracts made and reduce the likelihood of behaviour that would be contrary to leaseholders' interests.
- 7.53 Any relationship between the property manager and the freeholder should be made clear in all documents that explain the purpose and functions of the property manager, including any welcome pack and reference on the property management company's website.

### *Remedy design issues*

- 7.54 The disclosure of any relationship should be made clear in the same way as any relationship with an insurer is shown. It is a further area where inclusion in a code should increase compliance.

### *How the remedy should be implemented*

- 7.55 This remedy should be included as a requirement within existing industry codes, including retirement sector specific codes. The disclosure of any corporate ownership relationship with any contractors the property manager engages for work in the building or ownership relationship with a common parent, subsidiary, affiliate, or intermediary should be regarded as minimum best practice across the sector. All property managers, regardless of whether they subscribe to an existing industry code, should review and update their policies in this regard with immediate effect.

## ***Recognition/encouragement of better communication between property managers and leaseholders***

We recommend that property managers have a plan and strategy for regular communication and engagement with leaseholders to explain and discuss the decisions affecting them.

### *How it addresses the concern or detriment identified*

- 7.56 Our findings show that the relationship between property management companies and leaseholders needs to improve. Many of the issues that have been brought to our attention appear to result from poor communication, could have been addressed by better communication or could have been avoided entirely with better communication.
- 7.57 Better communication would be helpful when issuing service charge bills, explaining annual reports or budgets for forthcoming work when they are available. Better communication could also help to dispel any misunderstandings in relation to leaseholder responsibilities.
- 7.58 We have heard and seen examples of good communication practice and consider that the standards can be raised in areas where engagement is poor. A number of property management companies and some local authorities already arrange meetings with leaseholders. The larger property managers also provide a 'welcome pack' that contains important information that helps leaseholders to better understand their responsibilities and also provide information on their websites. This should be a standard requirement and expectation for any new leaseholder.

### *Remedy design issues*

- 7.59 In many cases the processes already exist; it is for the property manager to ensure that they use the channels that are available to them.

### *How the remedy should be implemented*

- 7.60 Minimum requirements could be built into the existing industry codes. Good communication should be regarded as minimum best practice across the sector and all property managers, regardless of whether they subscribe to an existing industry code, should review and update their policies in this regard with immediate effect.

## Redress remedies

### *Cheaper and quicker alternatives to taking claims to the First-tier Tribunal*

We recommend the provision either of independent advice to the parties about the merits or otherwise of their case, or some form of alternative dispute resolution (either early neutral evaluation, mediation or other), separate from the current FTT process, for certain categories of complaint.

#### *How it addresses the concern or detriment identified*

- 7.61 While legal representation is not required, the experience of some leaseholders that have made submissions to the CMA has been that taking issues to the FTT can be a potentially risky, costly, complex and time-consuming process. This potentially discourages their use when leaseholders are faced with poor service or poor value for money and wish to seek redress for a legitimate concern.
- 7.62 In addition, as noted in paragraphs 4.68 to 4.72, leaseholders may have poor understanding of their obligations under the lease terms with limited information easily available to them. In circumstances where property managers are also not communicating effectively or providing sufficient information to leaseholders, or leaseholders do not trust their advice, this can mean that some cases capable of resolution at an earlier stage may end up before the FTT, diverting the FTT's resources from addressing cases that raise more substantive legal issues. The absence of an early neutral evaluation or mediation process may mean the opportunity for some cases to be handled more effectively is missed, resulting in greater costs.
- 7.63 An alternative earlier dispute resolution process, outside the FTT process, could reduce the potential costs and help to resolve some complaints more promptly (including those arising through misunderstandings and poor communication). It is recognised that some costs would still arise and the funding of these costs would come from department budgeted spending. However, the costs arising should be lower than under the full FTT and allow some cases to be settled earlier in a more cost-effective and efficient way.
- 7.64 We support the additional redress bodies, particularly the ombudsman schemes, and recognise that some cases should go to the FTT. However, a wider range of redress options could provide a more proportionate way of providing solutions. To ensure that the different options for redress were used appropriately, the alternatives available would need to be clearly communicated to ensure that the most appropriate redress route was chosen.

### *Remedy design issues*

- 7.65 Mediation would be one alternative to taking action in court or tribunal. Mediation allows the disputing parties together to discuss the problem with a trained mediator and work out a solution in an informal setting. The mediator helps the party to clarify the issues and to try to reach a resolution that both are content with. Mediation can provide a quick, relatively inexpensive, informal and confidential means of settling a dispute.
- 7.66 Early neutral evaluation provides a way to take the advice of an independent, informed and qualified party who could advise on the relevant case and assess objectively the strengths and weaknesses of the issue being disputed. The parties would be better informed with a better understanding of whether or not they had a legitimate complaint to pursue or if it could be settled in some other way. There would also be a fee incurred for early neutral evaluation.
- 7.67 The CMA is neutral in its view as to whether mediation or early neutral evaluation may be most appropriate. Indeed, other alternative dispute resolution tools not considered here may be more appropriate and should also be considered.

### *How the remedy should be implemented*

- 7.68 LEASE previously provided a mediation service but this was withdrawn. We understand that this was because of lack of demand and cost. However, we also understand that the service was well regarded by those that did use it and that low demand was partly due to poor awareness of leaseholders as to its availability. We consider that a mediation service might be provided by LEASE or the FTT. In either case, the model would need to operate earlier and differently from FTT's current mediation, which requires the lodging of an application for an FTT hearing, with costs already incurred, making a full FTT hearing more likely.
- 7.69 During the course of this market study the feedback received from all parts of the sector, including leaseholders, about LEASE services has been very positive. The quality of advice and the information provided, and its independence, are generally well regarded. The provision of information and advice about the leasehold system of property ownership underpins many of our recommendations. The CMA considers that, for this market to work well, it is essential that LEASE continues to provide advice on request. Enhanced funding, possibly funded by the sector, would be necessary if LEASE were to reintroduce a mediation service to leaseholders. We recognise that LEASE is

currently subject to a triennial review and the outcome of this will impact on the resources available to it and the future business model to be followed.

- 7.70 Early neutral evaluation or 'triage' would probably have to be facilitated through the FTT, but separate from its current judicial mediation process. It might also be facilitated through the existing county court small claims process which provides a similar service.
- 7.71 We recommend that the Ministry of Justice work with DCLG on proposals for the introduction of a new dispute resolution scheme and consideration of an appropriate funding model.

## **Remedies requiring regulation/legislative change**

### ***New legislation to give leaseholders rights to trigger re-tendering and rights to veto the landlord's choice of property manager***

We recommend new powers that would require the landlord to re-tender for a new property management company in circumstances where more than 50% of all leaseholders support re-tendering. In addition, the ability in certain circumstances to veto the appointment of a property management company where more than 50% of all leaseholders give their support. The use of the power would be subject to limitations to ensure that the power is not misused or unduly disruptive to the supply of RPMS.

### ***Review of section 20 rules (consultation with leaseholders in relation to major works)***

We recommend DCLG review/revise section 20 of the Landlord and Tenant Act 1985. Section 20 provides important safeguards for leaseholders in terms of transparency and accountability. It also enables leaseholders to influence the decisions that are made on their behalf. However, our findings suggest that it is not currently working as well as it should and may be imposing unnecessary costs and delaying necessary works.

#### *How it addresses the concern or detriment identified*

- 7.72 Leaseholders may have limited influence or effective control over the quality, price or service of a property management company once the landlord has appointed the property management company, particularly in circumstances where leaseholders are unhappy or dissatisfied with the services being provided and they are not operating an RTMCo or RMC and the landlord is

not minded to intervene or to change the existing property management company. In such circumstances, leaseholders have limited means of effecting any change of property manager.

- 7.73 Dissatisfied leaseholders could take an action in the FTT to have a new property manager appointed (but fault has to be shown and the burden of proof can be difficult to evidence), or could exercise the RTM or collective enfranchisement. RTM requires leaseholders to set up a management company and take on the role previously undertaken by the landlord to appoint, oversee and manage the property management company. This is an important right and creates some rights of accountability and redress for leaseholders, by providing some control over property management, through re-tendering.
- 7.74 We support the principle of RTM and recognise the greater levels of leaseholder satisfaction where leaseholders have exercised their RTM. However, this is a demanding role. Not all leaseholders will be well equipped to take on such a role or have the necessary time or acumen to do so. Further, in the longer term, as the initial directors resign it may sometimes be difficult to replace them and maintain the RTMCo. RTM may not, therefore, be a practicable option for all leaseholders. This applies equally to collective enfranchisement.
- 7.75 By providing the possibility that a majority of leaseholders could require re-tendering, leaseholders would have available a course of action that should allow change and encourage improvement, other than the major actions from RTM, or seeking redress through the existing complaints mechanisms. One further advantage of this approach is that it imposes less cost and disruption on landlords and provides less of a challenge to freeholders' own interests than RTM. While they would face the cost of re-tendering and appointing a new property manager, they would not lose any of the sources of income they may enjoy as a landlord. It is less intrusive and more appropriate where the leaseholders' grievance is with the particular property manager rather than with the landlord.
- 7.76 There is a risk that the re-tendering could simply result in the reappointment of the same property manager, and no improvement being achieved. As a safeguard to the process, we recommend that leaseholders could have the right to veto the appointment of a property manager, provided more than 50% of leaseholders supported that action. This might be expected in circumstances where leaseholders were unhappy or dissatisfied with the choice of provider, probably after re-tendering. If an appointment was vetoed, the landlord would be required to provide an alternative.

- 7.77 The right to require a re-tender and the right to veto would have to be subject to limits to prevent their abuse or vexatious use. There may also need to be exemptions where property management is bundled with other services (such as in some retirement properties) or cannot be easily separated (such as in vertically integrated models, including housing associations and local authorities).
- 7.78 We consider that section 20 provides important safeguards for leaseholders in terms of transparency and accountability and it enables leaseholders to influence the decisions that are made on their behalf by the landlord.
- 7.79 At current levels (£250 per unit), it may be the case that the threshold is triggered too often in some smaller blocks of flats such that they face unnecessary consultation costs and delays in the work being carried out. At the other extreme, in larger blocks and developments, it can be the case that leaseholders are rarely consulted because the threshold triggers are not met. Revising the threshold could include retrospective index-linking to the Consumer Prices or Retail Prices Index. The possibility of a tiered approach could also be considered, to ensure that the consultation trigger is proportionate to the issue being addressed.
- 7.80 As well as the threshold issue, we identified various issues where the section 20 consultation process can be cumbersome and time-consuming, limiting leaseholders' ability to influence the behaviour of the landlord/management company. For example:
- We were told that the dispensation process takes too long and introduces cost and delay where leaseholders require repairs and/or maintenance to be carried out urgently and have agreed that the works should be carried out. It can take as long to obtain dispensation as it would to consult.
  - While leaseholders have rights to consultation, they are not able to exert any direct control over the extent or costs of the works. Leaseholders can nominate contractors, but we do not know how effective a constraint this is. We recognise that leaseholders may not have the necessary expertise to identify and nominate the most effective contractors; the lowest-cost contractor may not be the best candidate, as quality is also important.
  - The sections 20 process can also be avoided in some circumstances (for example, use of 12-month rolling contracts).
  - Revisions, including addressing loopholes, would make the section 20 process more useful for leaseholders to express their views and to exert some degree of control and challenge over costs incurred.

### *Remedy design issues*

- 7.81 The detail of these legislative proposals would have to be carefully thought through to ensure that they do not introduce unnecessary costs or adversely impact on the delivery of RPMS. It is expected that some engagement with the industry by Government would be required to find the best solution.
- 7.82 For the re-tendering and the right to veto, safeguards and some limits need to be considered if these changes were implemented, to reduce any risk of abuse. For example, the use of the veto would have to be limited so that leaseholders could not continually block the appointment of a property manager for the block.
- 7.83 We are not in a position to recommend detailed changes to section 20, rather we are recommending that it should be reviewed. However, we suggest that any review should take account of the issues raised in paragraphs 4.63 to 4.67.

### *How the remedy should be implemented*

- 7.84 To implement the re-tendering and the right to veto new legislation would be required. We recognise that this may not be possible in the short to medium term, but we nevertheless recommend that DCLG should in the longer term (within the next electoral cycle) give consideration to whether such rights would be beneficial to leaseholders. If there is support for these or similar measures, DCLG should consult with the sector and leaseholders to see how best this might be facilitated and to bring forward proposals to give effect to them.
- 7.85 We are also recommending that DCLG should review the working of section 20. We understand that DCLG does have plans to carry out such a review and we would encourage DCLG to undertake a review of section 20 as soon as is practicable.

## **Local authorities and housing associations remedies**

### ***Share best practice***

We recommend that local authorities should develop mechanisms to share best practice in working with leaseholders. By sharing information on what has worked well, other authorities may be able to raise their standard of service and provide improved levels of information to leaseholders.

## ***Leaseholder costs to be identified by block***

We recommend that both local authorities and housing associations should separate out the costs, as far as practicable, of providing services to leaseholders and social rental tenants, to make clear the costs that are being incurred by leaseholders for common services and to explain the allocation of costs in an accessible way.

### *How it addresses the concern or detriment identified*

- 7.86 We consider that some local authorities have poor standards and practices in relation to leasehold and the RPMS, but the problems may be concentrated in certain local authorities and that the structures and regulation are generally fit for purpose. The problems identified appear to be more to do with prioritisation, inefficiency and poor resourcing in certain local authorities. The remedy proposed seeks to address the issue of these poor performers. We have found instances of good practice that could provide a useful model for other local authorities. We recommend that the best practice of local authorities is shared and that a mechanism is set in place that will allow good practice to be identified, recognised and shared, allowing better practices to spread.
- 7.87 Some concerns with local authorities and housing associations result from information problems, with leaseholders unable to assess whether the service from their property manager provided value for money. This can be because information is not available, or it is not provided in a form intelligible to leaseholders or it is not clearly explained. In mixed developments, the division of payment for services between tenants and leaseholders is also sometimes unclear, creating concerns that leaseholders may be effectively subsidising other residents.
- 7.88 We recommend that the basis of charging by block is made more transparent, as far as practicable, and the basis for charging is explained by local authorities and housing associations in a level of detail sufficient to demonstrate that the charges and fees to leaseholders are appropriate. Leaseholders should then be better able to ascertain whether the apportionment of charges is reasonable.

### *Remedy design issues*

- 7.89 To share best practice effectively, it will be necessary to identify best practice; those practices then need to be explained and shared in a way that other local authorities could incorporate into their practices. We have not identified a

schedule of good and bad practice to be covered, rather we are proposing the facilitation of a means for them to address practice in relation to leasehold. This would be helped if recognition of good practice was encouraged within local authorities.

- 7.90 In showing costs divided between tenants and leaseholders, the local authority or housing association will need to take account of the size of development and, in mixed developments, the proportion of the leaseholders compared with tenants. One issue here may be the use of framework agreements where local authorities or housing associations use their bulk buying power to procure services for the whole of their housing stock. Where such contracts are used there needs to be clarity over how the costs of the contract are allocated across the housing stock and this needs to be communicated effectively too.

#### *How the remedy should be implemented*

- 7.91 Support from local authorities and DCLG is essential to encourage the sharing of best practice. Two areas where development of best practice could be considered are the handling and reporting of leaseholder feedback and developing customer surveys.
- 7.92 In relation to the allocation of costs, our understanding is that local authorities and housing associations separately identify and account for the leaseholder costs. The issue here is more about accurate record-keeping and ensuring that the allocation of costs as set out in the property lease is being followed and around effective communication. This recommendation does not, therefore, require local authorities or housing associations to do much more than what they are required to do as a matter of compliance with the existing legislation, subject to the additional explanation in an accessible way about how the costs have been allocated.
- 7.93 The CMA would prefer, in the first instance, to work with representative bodies representing the interests of local authorities and housing associations. Alternatively, we may take more targeted action if such an approach does not prove effective.

### **Effectiveness of our remedy recommendations**

#### ***How the measures address the issues of concern and resulting customer detriment***

- 7.94 A number of concerns with the operation of the market for RPMS were identified in our findings (see paragraph 7.5). Our recommendations are

intended to address these as set out at paragraphs 7.17 and 7.18. We now consider the effectiveness of this package of recommendations in meeting these concerns.

### *Separation of control*

- 7.95 Our measures are directed at making leaseholders better informed about the responsibilities and performance of property managers and with improved access to redress, should issues arise that require action.
- 7.96 The recommendation that a majority of leaseholders should have a right to require re-tendering of property management services or veto over appointment of a particular property manager should provide the leaseholder with greater control without them having to acquire RTM (or collective enfranchisement). This will also give existing property managers an incentive to communicate with leaseholders and maintain a good standard of service, and give landlords an incentive to ensure that property managers deliver a good service.

### *Misaligned incentives*

- 7.97 The recommendations for remedies to make leaseholders better informed should also better align the incentives of the leaseholders and landlords/property managers. By providing better information before the purchase is completed and through encouraging the best practice of welcome packs, the leaseholder will better understand their own responsibilities and those of the property manager and be better able to challenge where appropriate. This imposes some constraint on the landlord who might otherwise choose to ignore leaseholder interests in relation to RPMS. In addition, through the publication of charges and key performance indicators and a strategy for future repairs, leaseholders should better understand what cost to expect.
- 7.98 By making public any commission paid on insurance or any links with landlord or contractors, property managers will be more open and subject to challenge, helped by the availability of mediation or neutral evaluation, should action against property managers be considered.
- 7.99 Together these measures should make it more likely that a property manager will give greater attention to the interests of leaseholders.

### *Different leaseholders' interests and coordination difficulties*

- 7.100 The remedies aim to increase the likelihood of coordinating leaseholders' responses. We recommend that property managers engage with leaseholders to explain better the decisions that affect them.
- 7.101 By increasing the level of information available about leasehold and RPMS, leaseholders should become more aware of their responsibilities and also the options available to them, and reduce the detriment suffered because leaseholders are unaware of or are unable to prepare for their liabilities. Although the interests of leaseholders may vary, more informed leaseholders would be in a stronger position to act together.

### *Information asymmetries*

- 7.102 The increase in information being made available from the start of the purchase process, with leaseholder responsibilities being explained, and improved information relating to charges and future costs, should significantly reduce the problem caused by information asymmetries. Better information should mean that the scope for problems arising through misunderstandings is reduced. Greater awareness of the possibilities of redress and an extension to offer mediation or neutral evaluation will make it more likely that action will be considered if the information suggests that redress action is needed.
- 7.103 In these ways the detriment caused by information asymmetries should be reduced.

### *Weak competitive pressure on property managers*

- 7.104 Improved information should give insights into how well the property manager is performing and so allow leaseholders to put pressure on landlords. By recommending that a majority of leaseholders could require re-tendering for the property services contract or could veto the appointment of a property manager, the position of the leaseholders is enhanced.
- 7.105 The effect should be that the property manager is put under greater pressure to perform effectively because of the potential for re-tendering.

### *Ineffective redress*

- 7.106 Alternative dispute resolution/early neutral evaluation/mediation at an early stage in the redress process will help to address those issues that are capable of being resolved without a formal hearing through better communication between the parties. This will help to reduce costs and time delays in getting

an outcome. It will also help de-clutter the FTT and enable it to focus on more substantive cases.

#### *Poor awareness of leasehold pre-purchase*

7.107 Making prospective leaseholders more aware of the implications of leasehold and liabilities for service charges, will allow them to make better decisions and to plan appropriately.

#### *Overall impact*

7.108 Taken together we consider that the package of recommendations would be effective in addressing our findings, if fully implemented. We recognise that there are constraints on the changes that can be made within the existing leasehold legal structure, which means that the concerns related to separation of control and the consequences of differences in leaseholder interests cannot be addressed entirely.

7.109 By working at several points in the ownership cycle the measures are reinforcing.

#### ***Practicality of effective implementation, monitoring and enforcement***

7.110 Elements of the package rely on the active cooperation of stakeholders, notably the trade associations/professional bodies in making further changes to their codes. It is hoped that the raising of standards will further increase the positive reputation of membership of the relevant codes. In retirement properties, full implementation of these recommendations through the relevant retirement specific codes would depend on their applicability to the particular business model and, more specifically, whether the property management costs can be separately identified.

7.111 The cooperation of estate agents and conveyancers will be needed to ensure that the pre-purchase information is passed on to potential purchasers.

7.112 Some parts of the remedies package will require changes to regulation and support of the appropriate part of Government will be needed to achieve this. The timing of the electoral cycle may delay this action.

7.113 It is expected that the CMA and DCLG will need to have a continuing involvement with these stakeholders to ensure progress is made.

### ***The timescale for the remedy measures***

- 7.114 **Pre-purchase remedies:** Following supportive responses from LEASE, the Law Society and The Property Ombudsman, we would expect to be able to produce the information sheets and make the necessary changes to the codes within 12 months of this report's publication.
- 7.115 On the second of the pre-purchase recommendations (the provision of information at the conveyancing stage) we understand that the Law Society has existing plans to review LPE1 and that the CMA's findings will inform its review. We would expect that this review and the necessary changes to LPE1 could be achieved within 12 months of this report's publication.
- 7.116 **Transparency and communication:** When considering changes to self-regulation codes, we recognise that revisions to the RICS, ARMA and ARHM codes have recently been proposed and a steady state of up to 12 months may be needed before further changes. Nonetheless we expect work on further improvements to start in advance of this, with further changes to the codes within 24 month of this report's publication.
- 7.117 **Legislative change:** Work on new legislation to give leaseholders the right to trigger re-tendering and rights to veto landlords' choice of property manager is unlikely to commence in less than 12 months. The timescale for implementation would then depend on preparatory scoping and feasibility work and the Government's legislative priorities.
- 7.118 A review of section 20 is planned by DCLG. The scope and extent the review is to be determined, but we would expect this to be agreed within the next 6 to 12 months of this report's publication.
- 7.119 **Local authorities and housing associations:** To develop the sharing of best practice including provision of cost sharing information, support from the local authorities, housing associations and DCLG is necessary. The CMA will seek to identify and work with a representative body in the first instance but may take more targeted action. The CMA will develop its strategy and put it into effect within six months of the publication of this report.
- 7.120 **Redress remedies:** Although legislative change would be required to bring in any new form of alternative dispute resolution we would expect that planning work on this could be undertaken by the Ministry of Justice within 12 months of this report's publication.

### ***Costs incurred as a result of the recommendations***

- 7.121 Some costs would be incurred as a result of the remedies proposed:

- Pre-purchase information would need to be produced and distributed. The leaflets could be drafted by LEASE or the Law Society relatively easily. Estate agents and conveyancers would be able to pass information on to prospective purchasers as part of other regular communications. Information from vendors on service charges would be collected and printed in the same way as other key information. It is not expected that this will incur any significant cost and would be considered part of providing an effective service (but could be seen by some as deterring sales).
- Work would be needed by stakeholders to develop the proposed improvements to RICS, ARMA and AHRM codes. As both RICS and ARMA intend their codes to develop over time, some of this work would be expected to take place even without the recommendations. However, it is likely that a wider range of stakeholders will be involved in the process, leading to some incremental expense.
- Property managers would be required to provide the information requested, which in some cases would be in addition to information provided in the past, ie there will be costs involved if these tasks were not previously carried out. We were told these costs might be significant, but the work involved might be expected to be proportionate to the extent the property manager fell short of best practice.
- We are recommending that local authorities share best practice. We have not fully developed our implementation strategy in this regard, but it is likely that we will either seek to work with representative stakeholders and stakeholder groups to implement this recommendation or potentially take more targeted action.
- We believe that this is a largely cost-neutral recommendation. This is because local authorities and housing associations should be doing this already and any additional costs incurred, as a consequence of having to provide more explanation about the allocation of the costs, are likely to be offset by the reduction in enquiries and complaints from leaseholders querying service charge bills.
- We envisage that this would be part of a regular link between local authorities, without significant additional cost.
- A more material expense would arise from the formation of a new mediation or neutral evaluation redress service. The costs of running LEASE are likely to increase, even if mediation does not sit with it, as demand for its advice services is likely to grow as a result of our recommendations.

### ***Proportionality of our proposed package***

- 7.122 We did not consider that the costs to parties arising from the package of remedies that we have recommended will be significant, certainly in the context of the benefits that we would expect to accrue to leaseholders. As an illustration, if we estimate that the proportion of discontented leaseholders from the Ipsos MORI survey (28%) receive a 5 to 10% reduction in price, this provides a reduction in detriment of between £37 million and £98 million a year (see paragraph 7.10). We therefore concluded that the remedies that we are recommending are reasonable and proportionate.
- 7.123 The success of our recommendations package will depend on their implementation and how effective they then prove to be in delivering the intended benefits and positive change in the market, in conjunction with the effects of the other changes in the market (see paragraphs 7.12 and 7.13). Therefore, we will be keeping the market under review. The CMA may choose in the future to undertake a further examination of the sector, or parts of the sector or of specific issues related to RPMS if, in our view, such an examination appears to be appropriate.