

Written evidence submitted by the Mainstay Group Ltd [LHR 440]

Housing, Communities and Local Government Committee Inquiry into Leasehold Reform

Thank you for your request for input as part of the Committee's Inquiry into Leasehold Reform. We welcome your inquiry and enclose our full response. This response outlines in detail the nature of our concerns whilst emphasising our absolute support for the overarching principles of reform; namely to ensure a fair and equitable system for all leasehold property owners.

Leasehold ownership and management is well established in England and Wales and any reform of these areas must be proportionate, based on a full assessment of facts and not rhetoric, consult fully with all stakeholders and be entirely thought out and seamless if it is to deliver a modern and beneficial system for flat owners in England and Wales.

To date stakeholders have been faced with a number of separate consultations both from MHCLG and the Law Commission. We appreciate that many teams are tackling quite complex matters but the approach runs the danger of not achieving a holistic solution.

It is important next that a cool-headed approach be taken to understand the actual problems within this sector to ensure that uninformed rhetoric does not drive forward unnecessary changes or solutions that actually disadvantage consumers. For example, much has been spoken about 'toxic leases' but we believe that these represent only a fraction of the leasehold sector and the industry has done a huge amount to resolve these problems already.

It is important also to be very clear who the consumer is within the context of this consultation. Our customer base of some 80,000 flatted leaseholders suggest that 58% are owned by buy to let investors, 42% are owner-occupied and we believe that our sector also has another major stakeholder whose views need to be heeded, namely the pensioners whose capital is tied up within pension funds of our institutional investment sector.

We think that very careful thought needs to be given before leasehold is abandoned. Leasehold is a system that can be made to work extremely well for the leasehold owner with appropriate reform. We do not believe that Commonhold or its cousins in other jurisdictions actually solves what we consider are the problems with our current system and indeed will introduce new ones. Introducing a new form of tenure will inevitably lead to a two-tiered system which will not help consumers and make leasehold management costly.

We consider that the beneficial role of the institutional corporate investor has been ignored in this debate. One of the main incentives for founding Mainstay in 1999 was as a response to the industry's need for a customer focussed leasehold service and we have been pleased to see the emergence of the modern breed of freehold owner from the institutional sector which shares this ambition. These modern owners care deeply about customer service, fairness and the health and safety of their customers. They typically have valuable high-profile reputations which drives out fairness and good consumer outcomes. They also see their interest in buildings as being very long term in contrast to the relatively short period of the average leasehold ownership.

Rather than diminish the role of the freeholder we would like to see the government look more radically at how all freeholders might be compelled to take on a more significant role ensuring that buildings are managed for the long term needs of consumers, with a real focus on Health and Safety.

This finally brings us on to regulation. We believe that all who own or manage leasehold should be subjected to overarching regulation with real teeth. My own industry has been calling for regulation for some time. It is all very well for the new breed of modern freeholders to take an industry leading approach to consumers but something must be done about the historic freeholders who do not always act in the best interests of consumers. We believe that regulation of all will drive up the standards of the average performers and drive out of the sector the bad ones.

As matters currently stand, we believe that there is a clear and present danger that the Government will drive away the very responsible landlords that they should be wanting to retain.

We hope that the enclosed report adds value to your inquiry. We shall be happy to be called upon to give input in person should the Committee consider that this would be beneficial.

Please note appendices have been sent via email to the Committee's Clerk on 12th September.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'G Donaldson', is enclosed in a light grey rectangular box.

Graham Donaldson
Chairman

Housing, Communities and Local Government Committee (MHCLG COM) into leasehold reform

Presented on behalf of Mainstay Group

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1.0 Overview

1.1 We welcome the Committee's inquiry into Leasehold Reform. We believe reform is long overdue, in the light of a number of abuses which have been prevalent within the current system.

1.2 We are however concerned that the current approach to reform is too 'piecemeal'. This is illustrated by the number of consultations to which we have been asked to contribute in recent months.

1.03 These include consultation from the Government on leasehold reform: Tackling unfair practices in the leasehold sector, three consultations by the Law Commission on Commonhold, Enfranchisement and the Right to Manage, together with ongoing consultations by MHCLG on Regulating Letting and Managing Agents and also on peppercorn ground rents.

1.03 We fear that the resulting outputs will be disjointed at best. There is an opportunity to adopt a more holistic approach to reform, with better outcomes for all concerned, including the customer.

2.0 About Mainstay

2.01 Mainstay is an independently owned managing agent, specializing in delivering high quality leasehold property management and asset management encompassing over 80,000 properties. Coming up to our 20th anniversary we are one of the largest residential managers operating across England and Wales and work with most of the top developers in the UK and a number of the major institutional investors in the residential ground rent sector.

2.02 We act on behalf of a wide range of client groups, including:

- Owner controlled Management Companies (Right to Manage Companies (RTM) and Resident Management Companies (RMCs))
- Professional freeholders
- Developers

2.03 We also act as freehold agents for large pension funds specialising in residential ground rents. As such, we are employed to act as professional advisors to oversee the conduct of a number of leasehold managing agents and to ensure that they deliver services in accordance with best practice.

2.04 Our range of clients and customers gives us a unique overview of market dynamics and the interplay between leasehold customers and freeholders.

3.0 Government proposals

3.01 Government proposals are clearly well intentioned. There is a need to give better protection to consumers, in the light of recent abuses (in particular the impact of ‘doubling’ ground rents). The following measures are both welcome and essential:

- Making it easier for leaseholders to enfranchise
- Improving the effectiveness of Right to Manage – including leasehold and freehold homeowners whose homes are located on wider estates and who are currently been precluded under current legislation.
- Introducing Regulation for Managing Agents
- Doing away with leasehold for all new houses (other than where, in specific circumstances it is necessary)
- Ensuring that Ground Rents are fair and reasonable
- Ensuring that other charges (such as Consents and Admin fees) are fair and reasonable
- Ensuring that rights of redress for homeowners are straightforward and easily accessible to all, including freehold householders required to contribute to estate charges.

3.02 There is a danger however that the current approach to leasehold reform has not yet adequately assessed the risks and potential negative consequences that are inherent in any enforced and wholesale change to what is a well-established system. In particular, some of the proposed measures are potentially flawed and bear greater risk if not well considered. These include:

- Doing away with leasehold as a form of tenure for all new apartment buildings
- Reducing existing ground rents to a peppercorn

It is essential that however reform proceeds, a balanced account is taken of the views of all groups of stakeholders; in particular appropriate consideration must be given to the views of professional experts from within the industry, who are best placed to consider the full range of risks and consequences.

4.0 Assessment of the leasehold market

4.01 We understand that there are an estimated 5.1 million flats in the UK; 56% (2.9 million) of which are leasehold. It is a long established and flexible system of tenure that has evolved and been subject to reform and improvement over very many years.

4.02 The leasehold ownership structure is understandably much more common amongst flats than houses. With just 8% of houses in the private sector being leasehold. Overall, 21% of privately owned property is leasehold.¹

Scale of onerous leases

4.03 Much recent discussion has centred on the volume and impact of onerous leases (also known as 'doubling ground rents'; namely a lease which has ground rents doubling every 10 or 15 years). Some reports have suggested this to be 'around 100,000'².

4.04 Winckworth Sherwood LLP has carried out extensive research to ascertain the actual numbers of such onerous leases. They have found the reality to be significantly different from that reported. There are in the region of 12,000 of these leases, out of a total of 4.5 million leasehold properties in England and Wales. This equates to less than 0.3% of all leaseholds.

4.05 All the investors with whom we have dealings have reached out to leaseholders and offered to convert onerous leases into RPI reviewed leases. They have also offered to cover all reasonable legal fees. Currently 45% have taken up the offer and the conversions have either been completed or are in process.

4.06 Despite this small market share, the Law Commission have continued to focus on onerous leases, whilst traditional long leases, (which typically have much fairer terms) have

We would urge the Committee to insist that the Law Commission must be presented with a fair and accurate assessment of the market in order to ensure that solutions are proportionate to the scale of the problem.

been ignored.

¹ Note that these are estimates from DCLG, which are calculated based on the English Housing Survey, DCLG's Dwelling Stock Estimate 2015, and VOA Council Tax Stock of Properties 2015. The figures are classified as 'Experimental Official Statistics' and have not been tested to the same requirements that National Statistics have been.

² <https://www.mortgagefinancegazette.com/features/lets-talk-leasehold-14-02-2018/> [Accessed 9th August 2018]

5.0 Leasehold Reform

5.01 In the past 30 years, there has rightly been a marked transfer in the balance of power from freeholder to leaseholder. Legislation has increasingly protected the rights of consumers and this is to be celebrated and encouraged. There continue to be areas in which more needs to be done including:

- Updating laws relating to consultation on major works and Qualifying Long term Agreements
- Strengthening the rights of leaseholders to choose their managing agent
- Regulation of all who manage property including Managing Agents and resident run developments to ensure best practice
- Regulation of Freeholders to protect consumer rights
- Introducing consumer protection where a Resident controlled Management Company is in place.
- Wherever possible all leasehold interests should be held by the leaseholder indefinitely rather than for a term of years
- Compelling resident run developments to provide their freeholder with reasonable relevant information free of charge to demonstrate that the property is being well managed

5.02 This can be achieved relatively simply however, through Regulation of Freeholders and Resident Management Companies alongside Managing Agents, Licensing, Codes of Practise and the introduction of a Housing Ombudsman. We believe that the underlying system of Leasehold is a good and workable one, which is an integral part of the British legal system and which has evolved and changed over the centuries.

Measures that effectively do away with Leasehold as a form of tenure would seem to be draconian – a sledgehammer to crack a nut.

Alternative systems of tenure in other jurisdictions have themselves taken considerable time to be refined and we are concerned that introducing an equivalent system in England and Wales will similarly take decades to be ironed out.

6.0 Commonhold

6.01 The Government has declared its intention to effectively 'do away' with the current leasehold system for new developments, but has failed to evidence that Commonhold brings with it fewer problems and challenges.

6.02 How does Strata Management measure up?

The Strata Management system commonly used in Australia is generally cited as being most akin to how Commonhold can work in the UK. Yet it has had very many challenges which have needed to be addressed by a series of changes in legislation over a protracted period of time.

6.03 The outcome appears to be no better at protecting consumer rights than our current system, as evidenced in the report "Governing the Compact City: The Role and Effectiveness of Strata Management" Produced by the University of New South Wales' City Futures Centre (contained in appendix 1)

6.04 This report makes it clear that there are significant potential pitfalls in having a system which relies entirely on resident-controlled management companies. More specifically it found that:

- Many people are not aware of their rights and responsibilities as strata owners
- Owner engagement and apathy is a problem
- 37% of survey respondents said they had found it difficult to recruit people to sit on executive committees
- Others were unable to exercise their rights to have a say in their scheme; had been bullied or intimidated or felt their vote would not make a difference.
- Coming to agreement in strata schemes can be a difficult and slow process
- The performance of executive committees is highly variable
- There is confusion regarding the respective roles and responsibilities of managing agents and executive committee members
- Satisfaction with strata managing agents is highly variable with only half the strata owners saying they were satisfied
- There are problems with the performance of developers in setting up new schemes which cause knock-on effects on its long-term management
- Concerns over maintenance often focus on long term planning and funding issues
- Many owners are concerned that planning and budgeting for repairs and maintenance in their schemes is inadequate
- Many owners are dissatisfied with the level of their strata levies (service charges)
- Coming to an agreement regarding spending money can be a difficult and slow process.

6.05 No system can be 100% effective but we believe that the current leasehold system (with comprehensive reform) represents the best solution for consumers.

6.06 The Performance of Resident Controlled Companies in the UK

The risks relating to Resident controlled Companies are also evidenced through a series of case studies and a survey of managing agents (operating in England and Wales) earlier this year (see appendix 2 & 3). These cite numerous ways in which resident-controlled companies can fall short and fail to protect their customers. These include:

- Failing to ensure residents' Health and safety.
- Failings in financial and operational stewardship.

- Lack of volunteers due to concerns over director's personal liability.
- Relationship issues and dysfunctional leaseholder-controlled management.
- Directors not acting in the long-term best interest of the scheme and making decisions solely based on cost.
- Inability to make decisions and lack of clear instructions.
- Managing agents forced to resign due to reputational concerns over the poor conduct of Resident Directors.

Clearly, when comparing the shortcomings of Commonhold within the Australian Strata system with resident controlled developments in England and Wales, there are very many similar themes. It is difficult to understand therefore why the government is advocating the enforcement of Commonhold in the UK.

6.07 The Risks of removing the Freeholders' role as a Safety Net

Under our current system, managing agents can call upon the freeholder to step in when failures occur and to ensure that residents' rights (and homes) are protected. By introducing Commonhold, the government would be removing the role of freeholder as a very important safety net.

6.10 The value of this role has been well illustrated, in light of the recent focus on fire safety. In her report on fire safety standards, Dame Judith Hackitt emphasised the need for a duty holder with clear roles, responsibility and accountability. A role currently carried out by freeholders in the private sector.

6.11 Professional freeholders also fulfil a number of other essential functions:

6.12 Where an immediate threat has been identified, responsible freeholders have stepped in to fund safety measures (such as waking watches). They have also engaged with developers and other stakeholders to find longer term solutions and to mitigate the costs on behalf of leaseholders.

6.13 They ensure that developers fulfil their obligations to remedy significant buildings defects. Their professional expertise and ongoing commercial relationship with developers means that they are able to apply greater pressure to resolve such issues.

6.14 Freeholders generally own less than 2% of the economic benefit of any property. Despite this, we are aware of a number of instances where they have spent significant sums in legal fees to ensure that other parties fulfil their obligations with regard to remedying buildings defects.

They play an invaluable role in ensuring that there is adequate buildings insurance cover and oversee regular reinstatement valuations.

6.15 Where there are disputes amongst neighbours, they act in the role of arbiter, fulfilling their obligations to ensure compliance with the lease where significant nuisance arises

6.16 Freeholders are also called upon when needed to lend funds to the service charges; particularly when there are insufficient funds to cover insurance and essential expenditure such as on Health and Safety.

Large institutional freeholders have the financial firepower to take on negligent developers, vexatious litigators and others who are threatening resident groups.

Professional freeholders have a very long-term interest in residential developments and therefore the resolve to see thorny problems through to resolution. They base decisions on the long-term best interest of the development rather than on short term personal gain.

Institutional freeholders cherish their good reputation and are thus compelled to act with probity and fairness to customers. Regulation of all freeholders would bring other freeholders in line with these behaviours or would cause the poor ones to exit the market.

Far from diminishing the role of the freeholder we believe that freeholders under a code of practice and legislation should be both compelled to have a responsibility to monitor the welfare of the developments which they do not directly manage and also be given the right to compel resident groups to provide them with crucial management information (such as accounts, budgets, long term maintenance plans and fire risk assessments).

7.0 Enfranchisement

7.01 The Committee is rightly concerned with what can be done for existing leaseholders affected by onerous leases (such as doubling ground rents). It is our experience that responsible landlords have now dealt with this injustice and are supporting leaseholders to convert such leases to RPI linked reviews. We welcome the work of the Law Commission in reviewing the enfranchisement process and anticipate that the outcome of this review will be a new methodology which will secure a fair deal for all stakeholders and make it simpler and easier for them to enfranchise.

7.02 We are deeply concerned that the Law Commission has been provided with inaccurate information on which to base its deliberations and decisions and that it relies heavily on this information in its paper on its 'direction of travel' in making enfranchisement "fairer, cheaper and simpler". There are significant inaccuracies in the analysis of the current approach to valuation. It also presents a picture of the market that does not reflect reality.

7.03 In particular it relies on the common misconception that onerous leases dominate the market. We understand that they account for less than 0.5 percent of all leasehold homes. Given the relatively small extent of the problem, we believe it could be best resolved by compelling all freeholders to amend the lease or cap ground rent increases based on RPI.

7.04 The value placed by freeholders on potential investments is currently determined by market forces. Very significant levels of investment by pension fund providers have been made in this market over the past 15-20 years. In their rhetoric about fairness to consumers the government fails to consider the impact on this hidden group of consumers. Please see the recent communication with the Law Commission at appendix 4 for further details.

It is import for government to be clear who its consumers are in their proposed reforms. They can be listed as Buy-to -Let investors, owner occupiers, and freeholders (many of whom are pension providers). From an analysis of our own portfolio of residential management we have found that 58% of flats are owned by Buy-to-Let investors and only 42% are owner occupiers. Any decisions which adversely affect the value of freehold portfolios owned by pension funds will have a significant impact on the value of pensions for a much wider group of customers.

8.0 Future of the market: regulation

8.01 The government has indicated its intention to regulate the work of Managing Agents; a measure which was announced by Sajid Javid at The Association of Residential Managing Agents (ARMA)'s annual conference in November 2017, and which was unanimously welcomed by ARMA's members.

8.02 With the relatively recent entry to the market by blue chip corporate freeholders (early 2000's) professionalism amongst freeholders has most emphatically been raised. We fear that by deconstructing the current system, this will raise the risk that high quality freeholders will exit the industry, making way for more disreputable freeholders.

8.03 Any abuses on the part of less reputable freeholders, could best be addressed through regulation. If freeholders were required to be licensed and to adhere to a Code of Practise, this could address the current problems efficiently, and in a way that would not bear the risks inherent in a complete overhaul of the system. It is understood that a number of freeholders are working together to draft such a Code of Practise, and we would urge the Inquiry to consider this as a much more workable solution to the current challenges.

A regulated freeholder industry overseen by a regulator with teeth and real financial penalties would sharpen up sloppy practices and cause the unscrupulous to exit

8.04 Impacts of a 'two-tier' system

By introducing commonhold, the government would be creating a 'two-tier' system. There are a number of potential unanticipated consequences:

- Greater complexity and potential confusion amongst homeowners, who would need to understand the differences between commonhold and leasehold ownership
- Potential for some homeowners to be disadvantaged. There is a risk that there will be a perceived increased risk of owning either commonhold or leasehold property – this could potentially impact on the value and ability to borrow against flats with varying forms of tenure.
- Managing agents would need to work to a further set of rules for Commonhold blocks, requiring additional expertise and therefore higher administration costs.

9.0 Conclusion

9.01 We strongly advocate regulation and the introduction of an all encompassing Code of Conduct, which sets controls over all parties; namely the developer, freeholder, resident controlled management companies, and leasehold managing agents. We believe this is the most effective way to ensure the rights of all consumers are protected; whether these be resident owners, buy to let landlords, or the many thousands of individuals whose pensions would be adversely affected by the approach to reform which is currently proposed.

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