

Leaseholder service charges: how fair and reasonable are they?

An investigation into perceptions and understanding of service charges and the issue of Right to Manage among leaseholders in London.

Executive summary

In 2018, 98% (9,242) of all new build properties sold in London were classified as leasehold – an increase of 3% since 2015. And it's not just London that's seeing a rise in the tenure. Nearly one in every five homes in England is now classified as leasehold (18%), up 7% in a decade.

Rightly or wrongly, leasehold has come under considerable criticism in recent years. The fact that the sector remains largely unregulated means the door is open for unscrupulous parties to abuse their positions. While charges can be high for legitimate reasons (such as major work projects or significant repairs) there is a distinct lack of protection and oversight for homeowners.

As a property management company operating in London, we frequently encounter leaseholders who do not always fully understand the tenure of their property or know what is right and reasonable to expect where charges are concerned. It is this which has driven us to investigate leaseholders' Right to Manage in more detail. Many of our customers are Right to Manage Directors who were driven to execute their Right to Manage as a result of paying service charges that were not comparable with the quality of services being received. They also experienced a lack of communication and transparency surrounding unspecified costs. We wanted to shine a light on these issues.

In December 2018 we commissioned an independent survey of one thousand homeowners in London who own their property and incur service charges. Our aim was to understand how they perceive the leasehold tenure, their views of service charges, the level of knowledge they have over how service charges are allocated and their understanding of their rights when it comes to managing the buildings in which their homes are located.

The findings have been stark, with many respondents claiming to have received significant and unexpected increases to service charges, while over a half have actual regrets about buying their home due to high service charges.

It's therefore no wonder that the subject of leasehold is high on the agenda for consumers, media and the Government. In the last six months, the Government consulted on proposed reforms to the

leasehold system in England, the Law Commission has conducted a consultation on leasehold enfranchisement and is undertaking one on Right to Manage. It is clear that more must be done to protect the rights of leaseholders and ensure they are educated on what is fair and reasonable where charges are concerned.

While the pros and cons of Commonhold can of course be debated, there isn't necessarily as much as an issue with leasehold as a tenure as there is with the current lack of regulation, protection and education.

We hope you enjoy the following insights derived from our first survey into the subject of leasehold service charges. We hope to be able to show a significant improvement to these findings in 2020.

Gary Cane, MD, PBM Property Management

Expectations versus reality

- **More than half experienced an unexpected increase to service charges**
- **One fifth have no idea what the majority of their service charge pays for**
- **46% are put off purchasing a new build home due to high service charges**

It may come as no surprise that one of the key grievances levelled at management agents is their performance – slow to deal with maintenance problems and failure to address nuisance and anti-social behaviour. An effective and responsive management agent was most important to a third of survey respondents (33%), and is viewed as more important than price which was deemed most important by one in four (26%). This highlights the importance consumers place on receiving a high standard of care from management agents, to the extent that it would be prioritised ahead of cost – especially for those under 44 where price was most important for one in five respondents (20%).

Despite this, one fifth of respondents (20%) have no idea what the majority of their service charge goes towards and over half (57%) have experienced an unexpected increase in their service charge in the last five years. Unfortunately, unexpected increases are par for the norm as service charges are often set at unrealistic levels which are too low to deliver the level of service required to maintain properties adequately over a 3-7 year period (so prices are subsequently increased).

Initially 'low' service charge costs can be down to a variety of reasons. New builds can have guarantees in place for 12 months for mechanical and engineering services and because they are

new, costs for repairs rise with the age of the building. There is also a commercial need for housebuilders to be competitive on service charges. Of course managing agents who simply under budget due to a lack of expertise or because they fear upsetting their clients are also a factor.

If the amount Lessees contributed to their reserve fund was factored into a properties value, this could present a solution to align those flat owners with shorter and longer term perspectives.

Unexpected increases can be due to a lack of experience on the behalf of the management agent and emphasises why the sector needs increased regulation.

Through increased regulation homeowners can be safeguarded against unscrupulous parties that abuse their position of power. Agents that undercut on prices to win business and then under deliver on contracts can result in a failure to complete essential checks and maintenance, potentially putting people at risk and contributing to a drop in property value.

Service charges are part and parcel of purchasing a new build, whether this is a flat or a house, buyers are likely to incur either maintenance charges or estate charges on developments. Nearly half of respondents (46%) are put off from purchasing a new build property due to service charges. This reticence on the part of buyers, especially young buyers, could be well placed with over half of respondents (53%) regretting the purchase of their home due to high service charges.

To help meet housing need the Government is targeting the delivery of 300,000 new homes a year and with initiatives like Help to Buy and shared ownership seeking to target first time buyers by making new homes more accessible it is concerning that this figure increases to 63% of under 35s. With the average age of a first time buyer in London resting at 30 years old, it is crucial that management agents address performance issues to ensure consumers are receiving value for money and adopt a better approach to communications so consumers are educated on the costs of building management and why short-term investment leads to long-term gain.

Cost control and unforeseen issues

- **Almost two thirds want greater influence over how service charges are spent**
- **25% unsure whether a reserve fund is in operation**
- **32% know there is no reserve fund at all for their building**

A lack of oversight and understanding of where costs are being allocated is another key issue for the survey respondents. Nearly two thirds (59%) would like to have more influence over how their service charges are spent, with nearly a third (29%) strongly agreeing with this. Increasing the use of

technology in the management of properties would help to drive collaboration and openness between management agents and owners. Using an online portal for owners to view workflow, quotes, appointed suppliers and invoices would increase visibility and accountability for owners.

Despite price being the most important factor for a quarter of respondents, 25% are unsure whether there is a reserve fund being actively maintained at their property and a third (32%) know that there isn't. Reserve funds are important for homeowners with a share of freehold or leasehold as it ensures that there is some money available for large scale projects when required – these can range from essential roof works, to replacement security features and lift repairs, significant costs if there is no money set aside.

Case study – Mark Heyburn

First time homeowner Mark Heyburn wasn't sure what to expect from his management agent when he first purchased his apartment three years ago.

“Almost immediately after purchasing it became apparent that my previous management agent wasn't following through with complaints that were being raised by myself and my neighbours. Looking back it was actually incredible to see the lack of service we were receiving when we had significant monthly outgoings to a company that was charged with ensuring the upkeep of our properties.”

“When you are renting a property you don't think about the value of your asset and how wear and tear can contribute to price drops. Transparency was a huge issue for me, I wanted to know how my money was being allocated and why certain suppliers were being selected. On more than one occasion there was a preferred supplier for a job and when quotes and invoices were requested these had mysteriously vanished.”

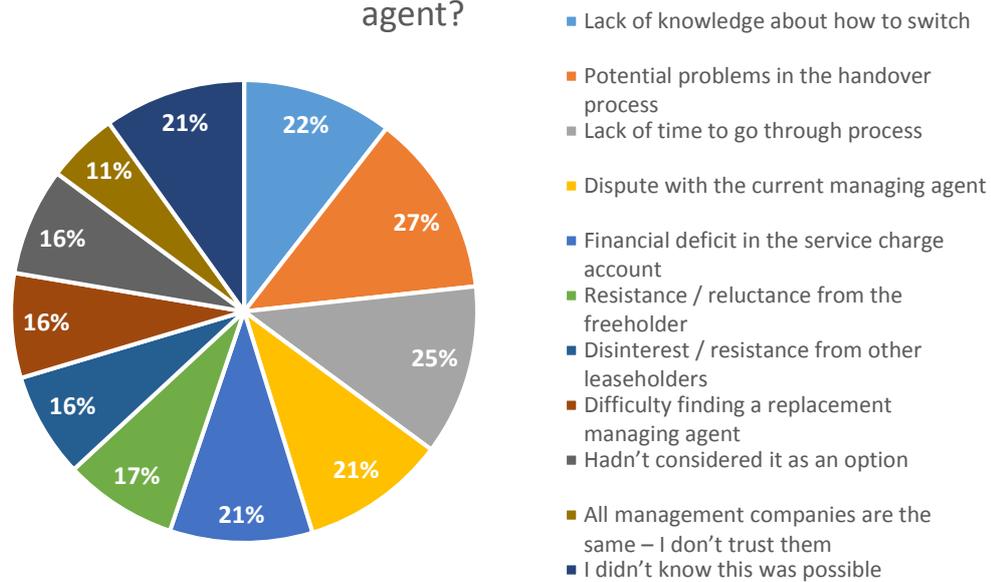
Taking charge

- **37% either don't know that changing managing agents is a possibility or haven't considered it**
- **Only 21% were aware of Right to Manage and 15% knew about options to enfranchise**

Despite the desire to have a greater influence over how service charges are spent, our respondents said that they were prevented from doing so by a lack of knowledge about how to switch (22%), a concern that there will be issues during the handover process (27%) and a lack of time to go through the process (25%). Nearly two fifths of respondents (37%) didn't know changing managing agents

was a possibility or hadn't considered it as an option. Education on the different ownership tenures would help consumers understand their rights and options. Considering the way in which media is consumed, especially among younger generations, the creation of Government and industry backed infographics and videos that distil the information buyers require into short and easily digestible content would be effective.

What prevents you from switching to a new management agent?



Younger buyers are more daunted by the task of switching management agents, with 33% of under 35s prevented from doing so due to a lack of knowledge and 39% concerned about potential problems during the handover process. Nearly half of under 24s (45%) view themselves as time poor and unable to go through the process of switching management agent, this decreased to 40% of those aged between 25 and 34 years old.

Nearly a third of respondents (27%) were unsure of the options to change management agent. A quarter (24%) thought a new manager could be appointed, while one fifth (21%) view Right to Manage as an option. Enfranchisement was only selected by 15% of respondents.

Right to Manage is an opportunity for leaseholders to take ownership of their costs and the service they are receiving. The transparency Right to Manage provides is one of the key benefits and helps people realise how costs are allocated and the importance of maintaining a reserve fund.

Case study – Mark Heyburn

For Mark changing management agents was worth the time invested to receive a better service, reduced costs and increased transparency.

“A year into living in my new apartment my neighbours and I started talking about changing management agent. It is quite a daunting task, but we knew we weren’t getting value for money. We decided we should look into setting up a Right to Manage company and went door to door in the apartment block to discuss the opportunity with other residents. Once over 50% of the owners were on board we set up the Right to Manage company and I, along with three other residents, became a director.

“We immediately went out to tender and PBM were our selected replacement management agent. They were able to efficiently identify where previous issues had been occurring and put in place a series of savings. We found out that our previous management agent had been charging 200% on top of our building insurance policy – it’s absolutely staggering when you think that this is probably happening all over the country. Our annual costs have decreased from an average of £2,250 to £1,500, but cost isn’t the only consideration - the responsiveness and transparency we now receive is ten times better.

“I would recommend Right to Manage to anyone unhappy with their current management situation, but go into it with your eyes open. Make sure you delve into the accounts and seek independent legal advice.”

Conclusion

Our research found that there is a fundamental lack of knowledge among homeowners as to how their service charges are being spent, and an overwhelming interest in wanting a greater understanding of how costs are allocated and why decisions are made. Homeowners aren’t fully aware of the options they have to remove their existing management agent and provide themselves with a better level of service and greater transparency. Right to Manage is a key opportunity for homeowners to manage their own service charges, but the path to Right to Manage does need to be streamlined to make the path to Right to Manage as easy as possible. We are currently developing a partnership with a solicitor to assist people in setting up Right to Manage companies. This will help to streamline the process and ensure that homeowners looking to set up Right to Manage are given all the guidance and information they require.

The most startling statistics, considering the prevalence of leasehold properties in London that automatically incur service charges, is the regret homeowners have over purchasing a home with service charge (46%) and the fact that 63% of people under 35 would be put off purchasing a new build due to service charge. The sector needs to address this image issue, a race to the bottom on prices does not serve homeowners well when they are looking for a service that provides them with cared for spaces that ultimately enhances the property value and creates a happy living environment. There should be increased regulation across the board to protect consumers and ensure they are equipped with the knowledge required to receive the best service from their management agent.

Definitions

Right to Manage – was introduced through the Commonhold and Leasehold Reform Act 2002. It gives leaseholders the statutory right to take over the management of their property from the landlord by setting up a Right to Manage company.

Leasehold Enfranchisement – is the process owners undertake when either extending their lease, or purchasing a share of the freehold (collective enfranchisement).

About PBM

PBM property management (Premier Block Management) is a property management company. Founded in 2009, the company manages a portfolio of properties across England. PBM places collaboration and transparency at the core of their business model to ensure that homeowners receive a level of service that creates happy homes, cared for spaces and enhances value.