hml hmlholdings plc

07 June 2012

Mr Paul Watling
Planning and Housing Committee
Scrutiny Manager
Greater London Authority
City Hall
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Dear Mr Watling

Residential leasehold service charges in London

I and the management team at HML read with great interest the London Assembly's paper on Residential Leasehold service charges published in March 2012. We understand that you are inviting comments and feedback and we welcome the opportunity to do so.

It might be helpful if, by way of introduction, I provided some background on HML. We are a property services group focused almost exclusively on the private residential sector. HML Holdings plc. is quoted on the London Stock Exchange and has four subsidiaries that are managing agents (HML Andertons, HML Hathaways, HML Hawksworth and HML Shaw). All of these companies are members of ARMA and we are also in the process of joining the Leasehold Knowledge Partnership. We manage approximately 35,000 residential properties primarily in the London area. The majority of these properties are flats although we do manage mixed use buildings and housing estates under freehold and leasehold ownership. HML Andertons manages the Charter Quay development noted in your report (recent LVT adjudication p32).

In the first instance I would say that we are very supportive of the substance and recommendations of your report and we are both appreciative of and sympathetic to your observations regarding the many complex and frequently highly charged issues associated with leasehold. While wishing to avoid any duplication of the points you have made we would like to add the following observations and comments that we hope are helpful and encouraging in terms of developing this initiative further.

1. Regulation of residential managing agents

We are supportive of ARMA's general view that managing agents should be accredited and regulated. I am sure you are aware that ARMA is working towards a self-regulated system of accreditation which is more demanding of the standards of its members than hitherto has been the case. As much as this initiative is admirable it remains of course optional for managing agents to join ARMA. Without legislative support to make qualification compulsory there is always likely to be room in the market for those who choose not to qualify to undermine the good of those who do.

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Inevitably those managing agents who are not members of ARMA are able to offer their services at substantially lower rates as they are less likely to have to comply with the many requirements that ARMA membership obliges them to.

Having formerly operated within the strictures of the FSA in the financial services industry and practiced in the auditing profession, the freedom with which managing agents are legally able to operate is an enigma to me. In particular the freedom to unrestrictedly manage the bank accounts of clients without any specific control requirements seems extremely relaxed to me when compared with others who manage Trust funds.

I think that the manner in which regulation is implemented in the legal, accounting or surveying professions is likely to be part of the solution for managing agents. By this I am suggesting that authorisation to practice as a residential managing agent will only be meaningful when professional accreditation is mandatory. This means that a professional qualification (such as the Institute of Residential Property Management IRPM) by the principals of a business should be necessary to be accredited. If accreditation were to be awarded to companies then the 'fit and proper' examination of their directors would need to include professional qualification.

Ultimately accreditation of individuals or companies would need to be supported by a regulatory authority with the ability to sanction those who do not comply.

2. Transparency

We support entirely the requirement that landlords or managing agents should be required to disclose the fact that they participate in any additional remuneration arising from charges to leaseholders.

There are however a number of observations that we believe may help clarify some of the awkward issues within this debate.

i. Ownership of the managing agent by the landlord

The most important disclosure that we believe should be compulsory for managing agents to make to leaseholders is related ownership. They should be obliged to disclose if they have, or any party to whom they are financially connected has, any beneficial interest in the freehold title. Such a relationship clearly gives rise to doubts about their impartiality.

ii. Use of contractors, suppliers and professional advisors

We agree that there is a wide range of opinion on the conflicts and the benefits of landlords or managing agents using related parties to undertake services that are chargeable to leaseholders. Establishing a precise accounting methodology that determines the exact value of the 'participation' is open to a wide range of interpretations. This is particularly so when you consider the many ways participation can be structured e.g. commissions, fees, profit share or ownership itself.

We believe that the overwhelming majority of leaseholder concerns could be met by a simple but mandatory disclosure requirement describing the nature of the participation. This should, of course, be accompanied by the leaseholders' collective right to insist on a supplier other than the one the landlord wishes to use (so long as that supplier is equally independent).

3. Commission on insurance

Insurance commission has, as you have reported, commonly been used as an illustration of landlord or managing agent abuse. The purpose of this point is simply to differentiate between the insurance commissions earned by a landlord and those earned by managing agents.

Firstly and, as something of an aside, it is interesting to note the popular misconceptions that occur within our market regarding insurance commissions. It is insurance brokers, not managing agents, who are obliged under their FSA code of conduct to disclose their brokerage to their clients. This obligation was designed for the insurance industry as a whole and does not specifically require a broker (let alone a managing agent) to make such a disclosure to a leaseholder. The irony is therefore that a broker must disclose his or her brokerage to his client (i.e. the landlord) but the landlord has no requirement to disclose his own commission to his leaseholder.

In designing the process for detail with insurance commissions we believe that the landlord's "introductory" commission should be recognised as distinctly different from the commission a managing agent may earn.

More often than not a landlord who receives a commission on the placing of buildings insurance is doing so by virtue of the fact that he is required (or empowered) by the lease to place the insurance. The landlord seldom spends any time or incurs any administration costs in doing so. This is not the case for the managing agent whose role is more akin to a broker than it is to a "commission earner". In other words the managing agent is actually assisting a broker in providing part of the insurance service on behalf of the insurance company. That service includes information gathering for underwriting, collection of the premiums and assistance with claims management. An insurance company can understandably see this assistance as work for which for which the managing agent should be reasonably remunerated for. Perhaps the residential managing agent community should stop calling this income "commission" (which implies commission for selling or introducing) and start referring to it as an "insurance administration fee".

4. Leasehold information on purchase

We wholeheartedly agree with your observations and recommendations regarding the disclosure of information to leaseholders on purchase. While this will not necessarily achieve a full understanding of the complexities of the Landlord and Tenant Act (particularly to the less conscientious buyer) it should help to alert leaseholders to the fact that leasehold ownership is not a straight forward arrangement. It will certainly invite those who are willing to take the time to understand the process to make a more thorough enquiry.

5. Complaint Resolution

We respect and understand that making mediation prior to application to the LVT may assist less complex cases. The the extent to which disputes can be resolved is however invariably dependent on the quality of the understanding the parties have. We agree that there could be merit in creating a forum or process for mediation or arbitration aimed at cases of limited complexity and value. Such a process could be used, for example, during pre-trial reviews to oblige the parties to go to arbitration if an appointed senior representative from the LVT deems it to be it the appropriate course of action. This stage, i.e. pre-trial review, would be more equal and accessible if the parties were not permitted to employ council.

6. Qualification for the right to manage process

We agree with your observations that the qualification to be able to use the right to manage process does in practice appear to be a blunt instrument (or at least to not be sufficiently refined to address the needs of a significant part of the market).

In particular we would add:

i. The qualification requirement that no more than 25% of the internal floor area should be reduced and the definition of commercial versus residential areas clarified. It could also be argued that there should be no exception for commercial areas at all. This would oblige landlord developers to set up mechanisms such as separate head leases for the commercial and residential sectors.

ii. Residential estates where common areas are shared by apartments and leasehold (or freehold) houses that fail the 25% rule should also be removed from RTM exemption. We believe that it is not the intention of the Act to exclude estates from the right to manage process by virtue of the area that the houses occupy (houses more often than not wish the RTM process to succeed).

7. Accounting Standards

We would like to add our weight to ARMA's disappointment that the draft guidance notes on the accounting for service charges have not been progressed.

Of particular concern is the remaining weakness that Service Charge accounts do not require the disclosure of a balance sheet. As much as we appreciate that a service charge regime is not a legal entity in itself the absence of a balance setting out deficits or reserves or amounts owing to or from the landlord or other third parties is a fundamental weakness that only exasperates the potential for misunderstanding. Although it is unlikely a landlord would refuse to do so, it is ludicrous that technically he does not have to provide a Residents Association with a balance sheet. This means that the leaseholders would be unable to establish exactly what reserves they (not the landlord) have accumulated.

The point raised in the report regarding long term estimates similarly would need to reflect the building up of reserves within a balance sheet.

8. Terrorism Insurance

Under the excessive commissions and linked companies section of the report (p33) an observation is made regarding terrorism insurance (4.9). We appreciate that the remark observing that terrorism insurance is a waste of time is made in inverted commas. However it illustrates how easily popular misconceptions are arrived at if this is meant to be an example of an excess or abuse. Terrorism insurance is an optional and complicated cover that has evolved within the insurance industry over a period of time. Many would say it is irresponsible not to have this cover in current circumstances, particularly in London. We do not believe this observation adds any credibility to the leaseholders' otherwise legitimate call for greater clarity in this area.

9. Common-hold versus leasehold

The report illustrates fairly conclusively what little inclination there is to use common-hold for new residential developments. Our observation would be that this is more a reflection of the degree to which leasehold is an established and understood ownership structure within the development community and the legal profession that supports it. Outside of making

common-hold mandatory there is little likelihood of it coming into general use. Enfranchisement and the establishment of Residential Management companies whose shares are owned by leaseholders does provide a workable substitute. It does of course have the additional advantage of having the established control structures of the Companies Act.

I would reiterate our overall support for the review that you are undertaking and I hope that these observations are helpful. Please do not hesitate to contact me should you wish to discuss any of these subjects with me.

Yours sincerely

R H C Plumb
Chief Executive Officer

cc. Michelle Banks Chief Executive ARMA