LONDONASSEMBLY

Planning and Housing Committee

Executive summary: Highly charged

Residential leasehold service charges in London

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On 6 July 2011 the Planning and Housing Committee agreed to appoint Steve O'Connell AM as a rapporteur on its behalf to carry out a review of service charges in London.

Terms of reference

To understand the nature of service charges in London, how they are calculated, charged and administered by landlords, and paid for by leaseholders

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Contents

The full report can be found on the Committee's web page at:

http://www.london.gov.uk/who-runs-london/the-london-assembly/publications/housing-planning

Rapporteur's foreword

As an Assembly Member I, along with my colleagues, often receive letters from constituents who are leaseholders expressing concern over the way the service charge system operates in London.

While many express dissatisfaction with aspects of the system, and a few allege malpractice, others offer harrowing accounts from ordinary people, with limited financial means, that have received bills for tens of thousands of pounds for unexpected works.

When buying leasehold property many people are not aware of the rights and obligations that come with this form of tenure and so, for many, the complexity of the service charges regime comes as a shock.

Our call for views prompted great public interest and more than one hundred individuals and organisations submitted their thoughts – in several hundred pages of written views and information.

Clearly something that involves peoples' homes and often substantial and rising bills in a time when money is tight will arouse interest. And this interest is heightened when people perceive there is an unbalanced power relationship between landlord or their managing agents and individual leaseholders. The whole issue has become highly charged.

What I sought to do in this review was to look at ways to re-balance the relationship between leaseholders and landlords and in particular to look at the way the transparency of service charges can be improved and leaseholders can be given greater control over the way services to their homes are provided.

Nationally, there is little immediate prospect of further legislative reform, although some feel that this may be necessary in future. Nevertheless this report sets out a number of actions that can be taken by the Mayor, landlords in London, those involved in the legal aspects of service charges and leaseholders themselves to make the present system operate more equitably.

Steve O'Connell AM
March 2012

Executive summary

Service charges in London – more than half a billion pounds

This report considers one particular aspect of English property law, the freeholder- leaseholder relationship, and the way that service charges on residential leasehold property are determined and charged by landlords, and paid for by more than 500,000 London leaseholders. Most of these leaseholders are in the private sector, but there are significant numbers with social landlords, many as a result of the right to buy. We estimate that Londoners pay more than half a billion pounds annually in service charges.

Is the system working?

It is ten years since the last major piece of leasehold legislation came onto the statute book. In that time concerns over how service charges are levied and their scale have grown. The Minister for Housing is aware of the concerns raised by leaseholders: "service charges top the list of leasehold complaints… and it is accepted that there is some poor practice."

Our review has identified a number of aspects of the system that London leaseholders find particularly problematic and our report sets out a number of pragmatic steps that should be taken to help rebalance the relationship between landlord and leaseholder to deliver a fair and transparent way for service charges to be levied.

The consultation process

The law requires that leaseholders paying variable service charges must be consulted before a landlord carries out works above a certain value. Landlords must describe the work or services proposed and obtain at least two estimates. Leaseholders must be able to comment on both the works and estimates and even nominate alternative contractors. However, landlords are not obliged to enter into the lowest price estimate nor use a contractor nominated by the leaseholder.

The law is complex and prescribes the minimum consultation needed. In the private sector there is a code of practice that recommends landlords consult over and above the legal requirement. In the public sector however we have seen practice that goes further still. Overall it appears public landlords in London have developed a depth and breadth to their consultation on service charges that is far less evident in the private sector.

It is almost always beneficial to landlords to secure the buy-in of those who have to pay service charges. In future, landlords and those with other responsibilities may need to rethink past practice and improve their consultation with leaseholders from a very early stage. We recommend that the private sector management associations should review how their advice on service charge consultation is being implemented and, if improvements are found to be warranted, it should work with the best performing London social landlords to raise the standard of consultation.

How transparent are the charges?

Perhaps the most controversial aspect of service charges across all sectors is the transparency of charges. Perceptions exist among some leaseholders that charges are unnecessarily high and are inflated through a variety of mechanisms, meaning the landlord or managing agent benefits at the expense of leaseholders. Some Leasehold Valuation Tribunal (LVT) decisions confirm that this type of malpractice does occasionally happen: some landlords take substantial commissions for providing services from third parties; others have been found to award contracts to subsidiaries of their own company at inflated prices.

Despite a broad consensus that regulations to ensure greater transparency need tightening, we welcome voluntary moves from the private sector to improve this aspect of the system. There are lessons to be learned from moves toward greater clarity in the management of leasehold properties. An increasing number of managing agents are promoting their services as "highly transparent and open to leaseholder scrutiny". Such companies seem to be boosting confidence in the way leaseholders can access and understand all the information they need about how their services are procured and charged for. They are throwing out a challenge to the property management industry in general. These best practice principles should be adopted across the sector.

Adjudication and dispute resolution

The Leasehold Valuation Tribunal gives the opportunity for leaseholders to gain redress if they feel their service charges are not justified. Service charge related cases in London increased more than 54 per cent between 2005 and 2010. It is not just leaseholders using the system however – half the cases involve landlords trying to recover

costs they have incurred from leaseholders. The LVT acknowledges that cases will increase in the future.

But leaseholders cite the increasing complexity of the tribunal process, landlord intransigence in providing information, costs involved to assemble cases and the fact that landlords increasingly employ Counsel that disadvantages individuals who do not have access to legal advice.

To continue to provide a fair and balanced adjudication service, the LVT might develop in a number of ways in order to meet the challenge. It should review whether leaseholders are disadvantaged from either applying to tribunal, or in conducting their own cases, and it should set out plans for providing mediation or pre-application advice as a cost effective method of improving the dispute resolution process. Government needs to review whether it is possible to make making mediation a compulsory first step of settling disputes.

Leaseholders' right to manage

Legislation gives a right for leaseholders to force the transfer of the landlord's management functions to a company set up by them – a right to manage company. In London there are barriers to achieving the right to manage. This may explain the relatively low proportion of leaseholders that have taken up the option to date. Obstacles include the large numbers of absentee flat owners that make achieving the 50 per cent of residents needed to secure the right problematic. The high proportion of mixed use developments means the residential element is often below the 75 per cent level needed for right to manage.

Government should review whether barriers to achieving the right to manage in London means that the existing legislation is less effective here than elsewhere in England.

Do leaseholders have all the information they require?

The law is complex but nothing is more complex than the leases themselves. It appears from our review that buyers rarely consider the obligations to pay service charges when purchasing their property. Leaseholders need access to better information if problems are to be minimised. Some public landlords have established the practice of giving prospective leaseholders a range of advice and information on their rights and obligations - including service charges. All those involved in conveyancing leasehold property should supply much more

information to prospective leaseholders including: estimated service charges for the next five years; planned major works and details of the previous three years' service charges - as a minimum.

The way forward

The Government is confident that the current legislative framework can deliver the balance required to make the leasehold service charge system work. However, a significant number of London leaseholders feel that further reform may become necessary. Our report makes a number of pragmatic proposals for improving the way service charges are levied and calls for review in a number of key areas.

Recommendations

Recommendation 1
By the end of 2012 RICS, ARMA and ARHM should review how effectively the guidance given to the private sector on service charge consultation is being implemented.

If improvements are found to be warranted then the Committee recommends the private sector works with the best performing London social landlords to adopt best practice consultation guidance.

Recommendation 2
The Mayor should, in allocating Decent Homes funding in London under his new housing powers, make an assessment on the potential effects on leaseholders and in conjunction with the boroughs review how the financial impact on leaseholders – in terms of potentially large bills arising from Decent Homes improvements - should be managed without delaying the programme.

Recommendation 3
Where the Mayor allocates grants or funding for housing improvements in the future (for example energy efficiency), the financial effects (in the form of service charges) on leaseholders should be considered as part of the impact appraisal and should be managed without delaying the programme.

Recommendation 4
By the end of 2012 the LVT should review the impact of differential levels of professional legal support, advice and representation between parties at tribunals and introduce appropriate protocols if leaseholders are found to be disadvantaged from either applying to tribunal, or in conducting their own cases.

Recommendation 5
The Committee recommends that by the end of 2012 the LVT, in conjunction with LEASE, set out plans for providing an expanded service offering mediation, pre-application advice and assistance as a cost effective method of improving the dispute resolution process.

Recommendation 6
By the end of 2012 Government should review whether it is possible to make mediation a compulsory first step of the dispute resolution process.

Recommendation 7

By the end of 2012 the LVT should review how its rulings are enforced and whether there are suitable redress options for leaseholders if LVT decisions are not complied with within an appropriate period of time.

Recommendation 8

By the end of 2012 the Government should review whether the barriers to achieving the right to manage in London is meaning that the existing legislation (the Commonhold and Leasehold Reform Act 2002) is less effective in the capital than elsewhere in England.

Recommendation 9

The Committee recommends that by the end of 2012 the Law Society reviews the impact of its revised conveyancing protocol in terms of the quantity and quality of information that its members provide to prospective leaseholders. In particular, the Committee recommends that the Law Society reviews whether information relating to; served section 20 notices; estimates of service charges for the next five years; any planned major works and details of the previous three years' service charges are given to prospective leaseholders as standard practice.

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