An Overview of the Residential Block Property Management Sector in England and Wales

| 2019 |
4.3 million leasehold residential dwellings

Owner-occupied sector | privately owned/let in the private sector

- 2.31m dwellings owner-occupied
- 1.71m dwellings private rented
- 0.28m social

Leasehold houses/flats

- 1.40m leasehold houses
- 2.86m leasehold flats
- 0.04m social
Background

The size of the residential block property management sector is hard to ascertain, with even the number of leaseholds open to question. The Ministry for Housing, Communities and Local Government (MHCLG) Housing Statistical\(^1\) estimated that in 2016-17 there were 4.3 million leasehold residential dwellings in England (see table below), which represents 18% of the housing stock. Of these, 2.31 million dwellings (54%) were in the owner-occupied sector and 1.71 million (40%) were privately owned and let in the private rented sector. There were 1.40 million (33%) leasehold houses and 2.86 million (67%) leasehold flats. The House of Commons Library\(^2\) echoed the estimate of 4.3 million leasehold homes. In 2014 the Competition and Markets Authority (CMA)\(^3\) estimated that service charges averaged £1,100 per unit and could total between £2.4 and £3.5 billion per year.

### Estimated number of leasehold dwellings, by tenure & dwelling type, 2016-17

<table>
<thead>
<tr>
<th></th>
<th>All houses (Detached and Semi-detached/Terraced)</th>
<th>Flats</th>
<th>Total</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Owner occupied</td>
<td>1,015</td>
<td>1,293</td>
<td>2,308</td>
<td>54%</td>
</tr>
<tr>
<td>Private rented sector</td>
<td>316</td>
<td>1,397</td>
<td>1,713</td>
<td>40%</td>
</tr>
<tr>
<td>– All private sector</td>
<td>1,330</td>
<td>2,690</td>
<td>4,021</td>
<td>94%</td>
</tr>
<tr>
<td>Local Authority</td>
<td>2</td>
<td>54</td>
<td>56</td>
<td>1%</td>
</tr>
<tr>
<td>Housing Association</td>
<td>74</td>
<td>114</td>
<td>188</td>
<td>4%</td>
</tr>
<tr>
<td>– All social sector</td>
<td>76</td>
<td>168</td>
<td>244</td>
<td>6%</td>
</tr>
<tr>
<td><strong>All tenures</strong></td>
<td><strong>1,406</strong></td>
<td><strong>2,858</strong></td>
<td><strong>4,265</strong></td>
<td><strong>100%</strong></td>
</tr>
</tbody>
</table>

Sources: English Housing Survey; Land Registry; MHCLG Dwelling Stock Estimate 2016; VOA Council Tax Stock of Properties 2016

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1. MHCLG Estimating the number of leasehold dwellings in England, 2016-17, 25 October 2018
2. House of Commons Library Briefing paper Number 8047, 12 April 2019
3. Competition and Markets Authority: Residential property management services: a market study, 2 December 2014
The Managing Agent (MA) industry is dominated in terms of number of firms by smaller businesses. Using ARMAs membership database (which includes nearly all of the larger firms operating in England and Wales), over 80% of ARMA member firms manage fewer than 4,000 units.
ARMA has 300 member firms and the total number of residential managing agent firms in England and Wales is estimated to be 870⁴. ARMA members manage over 1.10m units and given that 9 of the top 10 firms in the country are ARMA members (who between them manage 500,000 units) it is estimated that non-ARMA firms manage circa 1.23m units, giving a total of 2.33m units under management out of the 4.02m in the private sector. This means that 1.69m leaseholds are under some form of self-management, either by landlords, Residential Management Companies (RMC’s), Right to Manage (RTM) companies or private individuals on their own.

In 2016 an anonymous survey of ARMAs members was undertaken by BenchmarkMyBusiness, an independent firm. The highlights of the survey included that the average number of employees per firm was 28.9 and had been trading for 24.6 years. The average age of the business principals was 50.8 years.

The funds held by Managing Agents (MA’s) on behalf of their clients are considerable. As of April 2019, it is mandatory for lettings agents to have Client Money Protection – but not MA’s. This is an anomaly given that letting agents typically hold £100,000’s of client money whereas MA’s hold £ millions. The BenchmarkMyBusiness survey gave an average of £6.2m per firm, with £5.2m of that sum being reserve funds and similar levels are seen in the statistics given by ARMA firms as a part of their membership renewal. That gives a potential of up to £5bn of leaseholder funds held in trust.

The contribution of the sector to the economy is difficult to establish but again using the data from the BenchmarkMyBusiness survey indicative numbers can be derived. Each MA will contribute approximately £582,000 per annum in VAT, NI, corporation tax and staff income tax. With approximately 870 firms in the sector that equates to £500m per annum whilst directly employing 25,000 people.

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⁴ Figures supplied by The Property Ombudsman (TPO) and the Property Redress Scheme (PRS)
Profitability

17.8%

6.8%

-12.5%

FIRMS WITH LESS THAN £500,000 TURNOVER PER ANNUM

FIRMS WITH MORE THAN £500,000 TURNOVER PER ANNUM

AVERAGE NON-FINANCIAL UK SERVICE COMPANIES
Profitability

The bulk of residential property management businesses are small concerns and do not pay a salary to working principals. When the BenchmarkMyBusiness numbers were normalised by adding back the cost of these businesses paying their working principal a salary of £60,000 per year it was found that, on average, managing agents made an EBITDA profit of only 5.5%. Firms that turned over less than £500,000 per annum made a 12.5% loss. Larger businesses with an annual turnover in excess of £500,000 made a 6.8% profit. This compares to the average non-financial UK service company net rate of return of 17.8%.

The market landscape, at least amongst the Resident Management Company (RMC) and Right to Manage (RTM) clients, seems to be that all managing agents are the same and hence the cheapest is the best choice. However, effective property management is a people intensive business, so working for low (or even negative) margins means that leaseholders cannot be given the level of service that they would want, that the building deserves or that MA’s would like to give them. More transparency between firms and their leaseholders may help here – if leaseholders realised that their managing agent was only making £10 profit per annum per unit perhaps a sensible discussion about how much time could be offered in exchange for a reasonable fee as opposed to the “whoever is the cheapest agent” conversation could take place.

Consolidation

When the graph highlighting that the sector is composed of mainly small firms is combined with the age profile of the owners and the fact that profitability is reliant on the owner effectively working for free in the smaller firms it is difficult to escape the conclusion that within the next ten years there will be a dramatic consolidation of the industry as owners sell up, retire or leave the sector. This will leave fewer, bigger firms using technology to drive down costs and improve margins.

Government oversight

In October, 2017 the Department of Communities and Local Government (DCLG) issued a Call for Evidence entitled “Protecting consumers in the letting and managing agent market”. Within that document a MA was defined as “A person or company appointed by the owner (or someone operating on their behalf) to manage that property, and their role may include, for instance repairs and maintenance.”. In April 2018 the now renamed MHCLG published its response to the Call for Evidence.
Regulation

The Call for Evidence on regulation was announced by the then Secretary of State for Housing, Communities and Local Government, the Rt. Hon. Sajid Javid at the ARMA Conference in October 2017, and is being continued by his successor, the Rt. Hon. James Brokenshire. The leasehold sector has been described as “broken”, although probably based more on anecdotal examples than cold, hard statistics, which seem lacking in the industry. The Government focus is also more on the housebuilding sector as this represents a long standing failing to achieve required growth levels.

However, the political will is behind reform, witnessed by the significant ramping up of personnel in the MHCLG. As an industry we welcome this direction as it can only serve to improve standards across the sector and level the playing field between those ARMA agents that subscribe to a Consumer Charter and Standards, with the costs that such responsible behaviour entails, and agents that operate in isolation and make their own rules.

Regulation – individuals versus firms?

The current direction of regulation is that individuals within sales, lettings or block management firms should have a nationally recognised qualification. There is still a lot of work to be done on this topic – who sets and maintains the qualification, who will deliver it, how much will it cost, what will continuous professional development look like? It is also recognised that block management involves a greater degree of risk and responsibility so sales and letting will probably need Level 3 (A level) qualifications whereas block management Level 4 (Undergraduate). There will also likely need to be a distinction between people within the same firm – it does not seem reasonable to expect the receptionist to have the same level as the business principal. And what about specialist areas such as accountants?

ARMA’s stance on regulation is that it should primarily reside at the level of the company rather than the individual. Companies are the entity contracted to maintain a block. Companies are where complaints, redress and sanctions are aimed. Regulating companies would be easier, faster and cheaper to achieve. An independent Regulator could charge a fee for issuing a licence to operate (reviewable every three years), lessening the cost burden on the taxpayer. Professional bodies could apply to be recognised by the Regulator and could take away some of the administrative burden such as the “fit and proper” person assessment, Professional Indemnity insurance and Client Money Protection levels. This licence to operate could later be finessed such that X% of principals need a certain qualification and all client staff need a certain level of training/qualification in order to be allowed to join the professional body.
Regulation – who should be regulated?

The intended reforms are to protect leaseholders and hence it follows that regulation should not only encompass professional managing agents but anyone who is managing property on behalf of leaseholders and this is reflected in the definition of MA given in the Government’s October 2017 paper. This should include landlords, RTM, RMCs and even private individuals – indeed anyone who self-manages. We have estimated above that self-management could include as many as 1.69m leaseholders but to what extent this extends down the scale of leasehold is open to debate as it would be heavy handed to regulate a house split into four flats. However, even a relatively small block of ten flats will have a service charge turnover of £11,000 according to the CMA and using the 1 to 5.2 service charge to reserve fund ratio held at the bank from the BenchmarkMyBusiness survey potentially a reserve fund of £57,200 – a total of nearly £70,000. There is therefore scope for significant abuse, compounded by self-managed blocks likely having no Professional Indemnity or Client Money Protection insurance to cover theft and hence leaseholders are more vulnerable than where a professional managing agent is engaged.

Apart from the financial consequences self-managed blocks are almost certainly not as aware of property legislation such as the need to follow the lease, Section 20, and particularly Health & Safety and Fire regulations and updates. There are numerous instances where MA’s have been given instructions that are contrary to the lease or legislation.

Given that so many leaseholders are living under self-management, regulation should apply across the board.

Regulation – how to improve standards for all leaseholders?

ARMAs suggestion is that anyone who is responsible for a block of flats should have to undergo a minimum level of education on property law, Health and Safety and Fire. This includes all RTM and RMC board directors and landlords. This should be online so that those people with day jobs can fit it into their schedule. It should be free and provided by a body such as LEASE (Leasehold Advisory Service).

Regarding the day-to-day management of the block that person or company should either obtain the ARMA proposed licence to operate from the Regulator themselves or appoint someone who has that licence. That is the only way to protect all leaseholders.
Leasehold reform

Apart from regulation there are two main areas to look at under leasehold reform that will affect MA’s, namely ground rents and commonhold.

Firstly, the proposed abolition of ground rents or restriction to £10 on future developments and after lease extension (Note: average ground rents are estimated to be £371 pa for new builds and £327 for pre-2016 property). An MA’s role in ground rents is usually restricted to the collection and payment to the landlord of the ground rents. However, the larger implication of the abolition will be the impact upon the landlord community. Why would a landlord stay connected to the building without an income stream? As a result, developers are unlikely to find landlords to manage the buildings and will move towards the RMC type of arrangement to offload the responsibility for the development. This will remove the professional self-managing landlord from the eco-system. This offers opportunities for MA’s in terms of increased business as without professional landlords self-managing leaseholders will either have to manage the property themselves or they will need to employ an MA. On the downside for MA’s, the client will most likely be a lay board that only meets occasionally and may have a limited grasp of the ever-changing legislative landscape. This potentially introduces either delays to works or for risks to be unfairly passed to the MA along the lines of “Do what you think best” - which works well until a dispute arises.

Secondly, the overhaul of leasehold to potentially transfer the ownership of a property to the residents themselves. This can be achieved in various means but for the sake of simplicity let us consider the commonhold model. Commonhold has its attractions but is not a silver bullet as there are benefits and drawbacks.

Starting on the easiest benefit, a common form of contract between properties will make life easier for MA’s and residents alike – as opposed to every building having a different lease as we currently find. Having said that, buildings have such variety it is hard to imagine an all-encompassing single document and we are likely to see a common document but with some form of annex detailing the individual quirks of that particular building. But at least the quirks will be in one place rather than spread out in clauses throughout the document. Having a Government mandated set of rules in the Commonhold Community Statement (CCS) will also allow changes and improvements to the wording to be applied across the whole commonhold stock.

As detailed above concerning ground rent, having ownership transferring to the residents will be good for MA’s in terms of the potential for increased business, with resident commonhold boards likely to be unwilling to handle the day-to-day management of the property themselves and hence look for an MA. However, in this case there are wider implications as the whole purpose of moving towards a structure such as commonhold is to protect the residents of the developments themselves. It is highly unlikely that by giving residents of blocks the management of their own properties that disputes will cease. If we look at RMCs and RTMs, where the residents make there own management decisions, complaints still manifest themselves.

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6 Implementing reforms to the leasehold system in England – a consultation (Oct 2018) para 3.2. MHCLG
They may perhaps reduce in number (although there is no data currently available from the First-tier Tribunal [Property Chamber] or The Property Ombudsman), but they are likely to become more personal and entrenched as, for example, instead of a leaseholder being handed over to a debt collector for non-payment of service charges by a faceless third-party landlord, the dispute will now be between people who know each other, live together and regularly meet face to face.

In May 2012, the University of New South Wales conducted a study on strata (the Australian version of commonhold). The report stated that 39% of executive committee respondents had experienced problems on coming to agreement on how to run schemes with respect to expenditure. The majority of respondents to the survey of strata owners (75%) indicated that there was some, or significant, cooperation between owners in their scheme. However, a significant minority (18%) said that there was little or no cooperation, and a lack of engagement and apathy of owners was raised as a concern in both the owners and executive committee surveys.

Recruitment to a resident board is also likely to be problematic, particularly post-Grenfell where people are becoming more aware of the problems and liabilities of being a board member. Again, in Australia 37% of executive committee respondents said their committees had found it difficult to recruit members due to a variety of factors including time and perceived problems with the operation of the committee.

A board made up of lay members of the development, meeting monthly or quarterly in their own spare time will be very unlikely to be able to gather in the first instance, let alone as time unfolds and the environment changes, the knowledge required to effectively manage their blocks. In the Australian survey of executive committee members, respondents were asked to identify the most important factors that influence the practice of executive committee members, other than the legislation. The most common response was the skills, knowledge and experience of executive committee members and three-quarters (74%) of respondents thought that formal training of executive committee members would be beneficial to them in their committee roles and this is one way in which the industry can try to help this situation by offering training to directors. ARMA already offers free training to the clients of its members via an online portal.

The final consideration that is worth bearing in mind and will affect MA’s is that the board will tend to have a shorter timeframe when looking at items of major expenditure – in some cases preferring a sticking plaster approach to move the costs further on in time, even perhaps until after they envisage themselves having sold their unit. In the Australian study, while the majority (58%) of executive committee survey respondents said there had not been any occasions where coming to an agreement regarding the running of their scheme was problematic, a significant minority (39%) said there had been problems. The most common issues resulting in disagreements were those relating to major expenditures, including major repairs. The most common explanations given for these disagreements related to personality clashes and the competing interests of individuals in a scheme.

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4.3 million leasehold residential dwellings

£1 trillion total market value

per every 1% devaluation, due to commonhold, the collective value of the 4.3 m leaseholders drops by £10 billion
Leasehold reform and the current stock

A significant aspect of the proposal to invigorate commonhold, perhaps even making it compulsory on new builds, is what effect this will have on the existing 4.3m leasehold units?

If commonhold is perceived to be superior to leasehold, then either commonhold will be more expensive to buy or existing leasehold prices will be affected negatively. For commonhold to thrive it cannot be seen as more expensive than leasehold and hence it would seem logical that current leasehold stock will be seen as “second class” and hence discounted. The average price of a unit is £228,147† and the estimate of 4.3m gives a total market value of over £1 trillion. Every 1% devaluation in the value of leasehold therefore equates to £10 billion being wiped off the collective value of those 4.3m leaseholders.

The suggested answer to the problem of what to do with the current stock is to make it attractive to convert to commonhold. However, this presents a couple of difficulties to be overcome. Firstly, conversion will require all the leaseholders in a development to agree and to also be in a position to fund the acquisition of the freehold from the freeholder. Secondly, what happens if less than 100% of a building wants to convert? In this case there will need either to be a compulsory conversion for those leaseholders who may be perfectly happy with their current situation or those that may not be able to afford to convert (and the proposed loans that have primacy over mortgages will not work in reality). Compulsory conversion for those who would prefer to stay leasehold isn’t an attractive concept on an ethical or political basis. However, the alternative is for the block to partially convert, leaving a mixture of commonhold and leasehold. This will inevitably be more expensive to manage – for example major works will require two separate sets of consultations.

Larger properties will likely be even more complex, requiring discreet portions of the building to be reduced to sections, each of which has a say on its own particular budget. Again, this will increase administration as instead of a single landlord or board the MA will have to deal in addition with a representative (or group) from each section and response deadlines will need to be strictly enforced in order for demands to be issued on time.

We must also recognise that converting to commonhold will require a far greater supply of willing directors than we are seeing at present. There will need to be training put in place, particularly for more complex developments. It is foreseeable that with the possibility of liabilities (including jail) under the Hackitt review commonholds (and RTMs and RMCs) may struggle to find new directors. One potential way around this is to attract more people to apply, for example, by paying people to be directors. It is also possible that we can see a new job being created, that of the professional board director, although this is increasing costs and is starting to stray away from the whole reason for commonhold i.e. to have a greater say in your own block.
Summary

There is considerable change afoot in the leasehold sector with regards to Managing Agents. The prospect of regulation is welcome, although the mechanism of individuals requiring yet to be defined qualifications as opposed to the faster, cheaper and easier licence to operate at the level of the firm has to be questioned.

ARMAs preferred solution would be for regulation to be at the level of the firm (as contracts and redress lie at this level), with a Regulator providing a licence to operate, perhaps with the help of designated Professional Bodies. This will be easier, faster and cheaper to implement and maintain than individual qualifications.

Anyone who wishes to be a director (RTM/RMC/Commonhold) or landlord must attend a free, online, training course explaining the basics of UK company and property law.

Any firm or person that wishes to manage a block on behalf of other leaseholders should obtain the licence to operate from the Regulator or employ someone who has that licence.

The MA sector faces substantial upheaval, with significant consolidation likely alongside a government led shift in clients away from professional landlords towards self-determination by unit owners. The latter pose both an opportunity for increased business for MA’s, combined with practical difficulties with working with a lay board that meets only occasionally and cannot reasonably be expected to remain contemporary with legislative changes.

Commonhold presents an opportunity for MA’s in terms of increased business, but the effect upon the current 4.3m leaseholders should be the basis for an impact assessment to be made by the Government. Conversion of the current stock of leasehold poses ethical and practical difficulties depending upon whether conversion is compulsory or voluntary, partial or complete.

It is unclear as to what specific questions commonhold in the answer to that cannot also be addressed by further leasehold reform.