



ADVICE NOTE

UNDERSTANDING RESIDENTS' MANAGEMENT COMPANIES

A guide to the differences between being a
leaseholder and a shareholder



Note:

As the leading trade body for residential leasehold management, ARMA is also an important resource for leaseholders. Our Advice Notes cover a range of topics on the leasehold system to help leaseholders understand their rights and responsibilities and ultimately get the most out of living in their flat.

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SUMMARY

It's quite common for a block of flats to be owned or managed by a company made up of the leaseholders. These are usually known as Residents' Management Companies (RMCs) or Right to Manage Companies (RTMs) — for ease, we'll use "RMCs" to refer to both in this Advice Note.

Being a leaseholder and being a shareholder or member of an RMC is not the same, even though you could be both. RMC directors need to keep a clear distinction between the two roles when making decisions.

In this Advice Note, we'll take a look at some of the differences between the two roles and how this can affect the way your block is run.

DIFFERENCES BETWEEN SHAREHOLDERS AND LEASEHOLDERS

There are both legal and practical reasons why being a shareholder and being a leaseholder is different, even though you could be both.

As a shareholder or member of your RMC you will be entitled to take part in decision-making (although this will probably be restricted to voting to remove the board of directors). If you think the board has wrongfully exceeded its powers, you can take the company to Court under the Companies Act 2006. Your liability to the company and its creditors is limited to the extent of your shareholding or guarantee (this is commonly £1). You can't otherwise be forced to participate in the running of the company.

As a leaseholder, you are contractually bound under your lease to abide by the covenants to the RMC or landlord, which will include the payment of service charges. Any breach of covenant would render you liable to Court action (possibly leading to forfeiture of your lease) or an appearance before the First-tier Tribunal (Property Chamber) in England or the Leasehold Valuation Tribunal in Wales.

If you think that the RMC is in breach of its own covenants, or has acted or charged unreasonably, then you may take the company to Court or to the Tribunal under Landlord & Tenant legislation. Your rights as a leaseholder are not restricted if you're also a member of an RMC.

An RMC board should never, and has no legal right to, take a decision that's against the terms of the leases for the block — even if there's complete unanimity. No managing agent should ever advise this either. Tribunals will not view evidence of meeting agendas and minutes of meetings as relevant to issues that go against the terms of the lease and contravene Landlord and Tenant legislation.

IT'S ESSENTIAL THAT THE RMC DIRECTORS AND THOSE ADVISING THEM ARE FAMILIAR AND UP-TO-DATE WITH LANDLORD & TENANT LEGISLATION AS WELL AS THE COMPANIES ACT 2006.

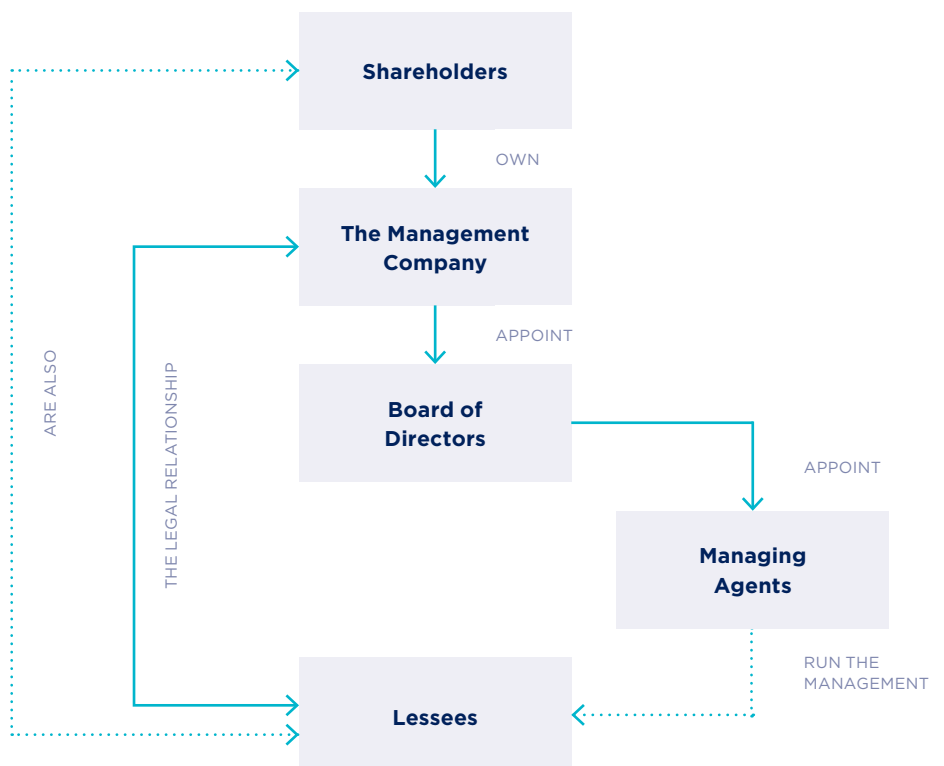
RMCS' DUTIES TO LEASEHOLDERS

The duties that RMCs have towards leaseholders will be set out in the leases and can take two forms: either the RMC is a party to the leases with its covenants set out expressly; or the RMC will be directly responsible for performing the landlord's covenants (at least insofar as they relate to management matters).

Either way, the fact that leaseholders are also shareholders or members of the RMC means that the RMC has no excuse for failing to perform its obligations under the leases. Contractual duties (such as repairs, maintenance, insurance and service charge accounting) are combined with statutory duties (including restricting service charges to reasonable amounts and consulting on major work) and are owed to all leaseholders by the RMC as though it were an institutional landlord; the law recognises no difference.

It's essential that the RMC directors and those advising them are familiar and up-to-date with Landlord & Tenant legislation as well as the Companies Act 2006.

Below is a chart showing the various relationships and responsibilities in a typical block of flats:



DISTINCTIONS BETWEEN SERVICE CHARGES AND COMPANY EXPENDITURE

RMCs will have control over two separate funds: the service charges and the company's own money.

The company's funds derive from its share capital and subscriptions or levies from members. If it owns the freehold the RMC may also charge ground rent or receive income from the sale of lease extensions.

The service charge fund is made up of contributions from leaseholders in accordance with the terms of their lease. The RMC is a statutory trustee for those contributions (S.42, Landlord & Tenant Act 1987) and the beneficiaries under the trust are the leaseholders.

One of the fundamental duties of a trustee is to account for all funds received and spent. Service charge money is not 'owned' by the RMC and should not be accounted as assets of the company. The leases will (hopefully) set out clearly how service charge money may be spent. Both contractually and by statute, service charge money can only be spent on items authorised under the leases and such expenditure must be reasonable.

It's good practice to keep the company's money and service charge money separate.

Tax

Any interest earned from service charges is taxable as trust income. Other money held by the company, including ground rent, is taxable at the rate for corporation tax.

PREPARING ANNUAL ACCOUNTS

The requirement for an annual statement of account for service charges will be set out in the lease. This is not the same as the annual company account for the RMC, which is required by Companies House. Best practice for service charge accounting is set out in guidance issued by the Institute of Chartered Accountants in England and Wales (ICAEW) and ARMA. You can download this for free from the Leasehold Library on the ARMA website.

Approval of the service charge account is not for the shareholders or members of an RMC to do. The lease may require the statement to be certified or audited professionally but it should be issued to all leaseholders — not just shareholders or members.

RMCs must submit an annual company account to Companies House. This is a requirement of company law. The statement may need an audit as well but this depends on what's stated in the company's Articles of Association. The directors of the company must approve the RMC accounts. It's not the responsibility of the shareholders. This is set out in the Companies Act 2006.

ADMINISTRATION COSTS FOR RUNNING THE RMC

It's rare for leases to allow the costs of running an RMC to be recovered from the service charges — especially if it's an RTM. It's important to realise the significance of this: if the lease doesn't allow the costs of running the RMC to be recovered as a service charge, then those costs should be paid for by the RMC from its company funds — not from service charges paid by the leaseholders. Examples include directors' & officers' liability insurance, submitting annual returns and preparing annual accounts for Companies House.

MAJOR WORK AND LONG TERM AGREEMENTS

Under Section 20 of the Landlord & Tenant Act 1985 (S20), landlords must consult with all leaseholders if proposed work to their block is likely to cost any one leaseholder £250 or above. The same applies if they intend to enter into a long-term agreement with a contractor to provide services for over a year. RMCs and RTMs are included in this requirement to consult.

Don't fall into the trap of thinking S20 consultation doesn't apply to you because everyone in your block is a member of the RMC. Even if a unanimous decision is made at your residents' meeting to go ahead with work, S20 consultation is still required by law. Just because shareholders, members or directors have taken a decision, it doesn't mean that landlord and tenant law can be ignored.

If you don't consult properly, you will be subject to a penalty: the maximum costs leaseholders can be made to pay for the work will be limited to £250. This is regardless of the final bill.



FURTHER INFORMATION

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ARMA and the ICAEW have published best practice for service charge accounting. You can download this for free from the Leasehold Library on the ARMA website at www.arma.org.uk

For more on the Section 20 Consultation process, download ARMA's Advice Note on the topic. Again, you can get hold of it for free from the Leasehold Library: www.arma.org.uk

Note:

Whilst every effort has been made to ensure the accuracy of the information contained in this ARMA Advisory Note, it must be emphasised that because the Association has no control over the precise circumstances in which it will be used, the Association, its officers, employees and members can accept no liability arising out of its use, whether by members of the Association or otherwise.

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