

Apartment Owners' Network

Representing the owners of apartments and houses in managed estates

BY EMAIL: rcuconsultation@centralbank.ie

Registry of Credit Unions
Central Bank of Ireland
PO Box 559
New Wapping Street
North Wall Quay
Dublin 1

27 June 2017

Dear Sirs,

**Re: Consultation on Potential Changes to the Investment Framework for Credit Unions
Consultation Paper CP109**

On behalf of the Apartment Owners' Network I enclose our submission in relation to the above.

We should be obliged if you would confirm safe receipt of our submission in time for your deadline of tomorrow, 28 June 2017.

We have copied this submission to the Irish League of Credit Unions for their information.

Yours faithfully,



David Rouse
Director

Cc by email: Mr. Ed Farrell
CEO, Irish League of Credit Unions

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Submission

to

Registry of Credit Unions

**Consultation on Potential Changes to the Investment
Framework for Credit Unions**

27 June 2017

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Abbreviations/Acronyms Used

| | |
|---------|-------------------------------------------------|
| AHB | Approved Housing Bodies |
| AON | Apartment Owners' Network CLG |
| CLG | Company Limited by Guarantee |
| CRO | Companies Registration Office |
| DCC | Dublin City Council |
| MUD Act | Multi-Unit Developments Act 2011 |
| ODCE | Office of the Director of Corporate Enforcement |
| OMC | Owners' Management Company |
| PIA | Personal Insolvency Arrangement |
| PI Act | Personal Insolvency Act 2012 |
| PMA | Property Management Agent |
| PSRA | Property Services Regulatory Authority |

1.0 Introduction

1.1 Summary of submission

Section 7 of the Consultation Paper seeks views on potential additional investment classes for Credit Unions, viz.-

“2. Do you have any comments on the potential introduction of additional investment classes for credit unions and the appropriateness of the classes being considered by the Central Bank?”

3. Taking account of the appropriate risk profile for credit union investments, are there any additional investment classes that the Central Bank should consider? If so, please outline the investment classes and why such investment classes are considered appropriate for credit unions.”

We submit that Credit Unions be permitted to provide loan funding to Owners' Management Companies¹ of Multi-Unit Developments², i.e. residential estates comprised principally of apartments.

As we explain in our submission, there are strong parallels between Credit Unions and OMCs. Both are underpinned by an ethos of volunteerism. Their activities are founded on mutuality. They are not for profit. They are community organisations. Their members have strong common bonds and interests.

Lending to OMCs would match Credit Unions' social objects to the pressing need for funds to meet building investment in multi-unit developments experiencing cashflow challenges.

The Network submits that the low risk nature of OMC lending would match the prudent profile of lending already undertaken by Credit Unions.

Permitting Credit Unions to lend to OMCs will have the dual benefit of addressing the funding difficulties of OMCs and providing an investment class appropriate to Credit Unions.

¹ “Owners' Management Company” is defined in section 1(1) of the Mud Act 2011, and means “*subject to subsection (3), a company established for the purposes of becoming the owner of the common areas of a multi-unit development and the management, maintenance and repair of such areas and which is a company registered under the Companies Acts;*”.

² “Multi-Unit Development” is defined in section 1(1) of the MUD Act 2011 and is “*a development being land on which there stands erected a building or buildings comprising a unit or units and that- (a) as respects such units it is intended that amenities, facilities and services are to be shared, and (b) subject to section 2(1), the development contains not less than 5 residential units;*” <http://www.irishstatutebook.ie/eli/2011/act/2/enacted/en/html>

1.2 About the Submitter

The Apartment Owners' Network is a volunteer-led, independent, non-party political organisation. Membership of the Network is diverse. We represent the interests and views of owners, both owner occupiers and investors, and OMCs of dwellings in managed estates throughout Ireland.

As of the date of this submission, 470 multi-unit stakeholders approximately are engaged with the AON. Many more multi-unit estates engage with the Network on an ad hoc or informal basis.

The AON has working relationships with various national and local government agencies. These include the Law Reform Commission, the Department of Justice and Equality, the Department of Housing Planning Community & Local Government, the PSRA, the ODCE, the Housing Agency, Dublin City Council ("DCC") and the other Dublin Local Authorities.

We work with other organisations in the sector including the Society of Chartered Surveyors Ireland (Residential Committee). We have working links with the Owners Corporation Network in Australia.

The Network played a central role in securing the formulation and enactment of the Multi-Unit Developments Act 2011 ("the MUD Act"). We contributed to the preparation of the Property Services (Regulation) Act 2011, and related secondary legislation.

We meet in open forum approximately once a month at DCC Civic Offices, Wood Quay, Dublin 8. Meetings and activities are currently facilitated by funding from DCC, and by the work of its volunteer members.

The Network incorporated as a Company Limited by Guarantee (No. 592683) on 10 November 2016, and is establishing formal structures as a national representative organisation.

Further information about the Network's activities is available at-
www.apartmentownersnetwork.org

1.3 Context to submission

1.3.1 Apartment numbers nationally

Census 2016 recorded that there are over 204,000 occupied apartments in Ireland³. 500,000 people approximately live in homes in multi-unit developments⁴.

There has in the last 10-15 years been a rapid growth in the number of apartment/multi-unit development homes as a component of the national housing stock. Apartments, which have increased in number by 85% since 2002, accounted for 12% of all household types in 2016, compared with 11% in 2011.

According to Census 2016⁵ since 2011 there has been an increase of 15% in the number of apartment dwellings in the State. In the same period the total number of homes in the country grew by 3%. This means that the apartment sector represents by far the fastest growing component of the national housing stock.

Apartments are the main household type in the Dublin City local authority area. They account for 35% of all occupied homes in the capital.

Given these rapid changes, public policy including tax policy, should support the sustainability of apartments and multi-unit developments as a key component of the national housing stock.

1.3.2 Brief overview of apartment management

In order to inform the reader, and to provide context for the proposal in this submission, we present a brief explanation of how apartment and multi-unit developments are structured and managed.

OMCs – how they work

An Owners' Management Company comprises a board of volunteer directors, typically civic-minded residents or owners in the estate. The directors are elected by the wider body of apartment/unit owners in the estate, i.e. the membership of the OMC.

In the vast majority of cases the directors are not paid. However, they are charged with the primary responsibility of managing the estate common areas and shared services, and of ensuring adherence to the principles of good estate management.

Effective stewardship of the OMC is vital to ensuring the upkeep of the estate. It is essential to ensuring that the estate is a good community in which to live.

The MUD/OMC model of apartment management in Ireland means that property assets worth hundreds of millions of euro are under the stewardship of volunteer directors.

³ Census of Population 2016 - Profile 1 Housing in Ireland <http://www.cso.ie/en/releasesandpublications/ep/p-cp1hii/cp1hii/od/>

⁴ Presentation to AON by P Mooney, Benchmark Property, 14 January 2016

⁵ Census 2016, Chapter 9 "Housing"

www.cso.ie/en/media/csoie/releasespublications/documents/population/2017/Chapter_9_Housing.pdf

Other than the usual CRO and ODCE filing requirements and enforcement measures, and the generality of Company Law, there is no specific regulation of OMCs.

The OMC agrees a budget each year and levies an annual service charge on each unit owner. This management fee pays for the aforementioned services. It is required by law to include a contribution to a long-term sinking fund for non-recurring/capital expenditure (e.g. lift replacement).

A management agent is appointed by the OMC to attend to the day-to-day operational running of the estate. This includes common area maintenance and upkeep, block insurance, domestic waste disposal, landscaping, etc.

Mutuality/community ethos

It is important to note that while taking the form of a body corporate, an OMC is in reality a community/mutual organisation. This is reflected in the fact that an OMC is often referred to as “the residents’ committee”.

An OMC is established in law typically as Company Limited by Guarantee. It is not-for-profit, by definition has no shareholders, and does not pay a dividend.

Any excess of income over expenditure is either allocated to a sinking fund, or it is carried forward towards the cost of provision of estate services for the following year.

1.3.3 Service charge recovery challenges

Service charge debt recovery and OMC illiquidity are widely accepted as the most significant and immediate financial challenges confronting OMCs and their directors⁶.

Many OMCs are faced with current fee recovery rates of less than 70%. Aged debtors can run to five or more years, and cumulatively can represent in excess of 100% of the OMC annual budget. Building investment (sinking) fund provision is in many cases tied up in debtors. As a consequence many OMCs are forced to give priority to the costs of basic estate services only: insurance, refuse collection and common area lighting.

Excludable debt

The mutual and unique nature of annual service charge debt was given recognition in law by section 2(1) of the Personal Insolvency Act 2012. Services charges are an “excludable” debt under the PI Act, meaning that they may be covered by a Personal Insolvency Agreement only with the consent of the creditor, in this case the Owners’ Management Company.

⁶ *Owners’ Management Companies, The Ticking Time-Bomb Of Service Charge Collection*, Adele McKeown BA MSc, presentation to SCSi PM FM Conference, 2 June 2017
<https://apartmentownersnetwork.org/2017/06/19/adele-mckeown-scsi-presentation-omc-service-charge-collection/>

Similarities with Credit Union finance

In many ways service charge debt and estate services are analogous to the financing Credit Union sector. They have the same collective and mutual features. In both cases, where compliance levels and recovery rates are poor, the success of the community suffers.

Where a proportion of individuals fails to contribute, there are adverse effects for the wider community. In the case of apartment developments the adverse effects are felt by neighbours and other owners.

Properly funded OMCs that can-

- meet their annual expenses (particularly non-discretionary costs such as insurance and waste collection), and
- appropriately enhance the estate over time,

ensure the maintenance and improvement of apartments as a growing component of the national housing stock. Sound financial management reduces the risk of developments looking to the State or local government for support in the future for funding; this is in contrast to regrettable difficulties experienced in recent high profile cases.

Service charge arrears restrict the provision of vital services, negatively impacting the overall quality and supply of owner occupier and rental property to the market.

The Network submits that allowing Credit Unions to lend to OMCs will support the orderly operation of OMCs in the wider public policy interest. It is submitted that this will sustain the apartment/MUD sector as a housing type into the future.

2.0 Details of Submission

We expand below on the detail of our submission; it reflects the shared community and not for profit ethos of Credit Unions and OMCs. Our proposal is intended to support the sustainability of apartment dwellings as a rapidly growing proportion of the national housing stock.

Our proposal meets a gap in the funding arrangements currently available to OMCs. At the same time it opens up to Credit Unions an investment class appropriate to the sector, in terms of counterparty characteristics and risk profiles.

Our proposal reflects our practical and lived experience of issues arising in the management of multi-unit developments.

2.1 Credit Unions and OMCs – Common Themes

As noted, Credit Unions and Owners' Management Companies have many similar characteristics. Both are underpinned by an ethos of volunteerism. Their activities are founded on mutuality of obligations.

OMCs and Credit Unions are not for profit concerns. As organisations they are grounded in their communities. Their members have strong common bonds and interests.

Loan funding by Credit Unions to OMCs would match Credit Unions' social objects to the pressing need for building investment (sinking) funds in apartment blocks with cashflow challenges.

Credit Union ethos - statutory basis

Section 6 of the Credit Union Act, 1997 sets out that Credit Unions must be formed for the following objects-

- the promotion of thrift among its members by the accumulation of their savings;
- the creation of sources of credit for the mutual benefit of its members at a fair and reasonable rate of interest;
- the use and control of members' savings for their mutual benefit;
- the training and education of its members in the wise use of money;
- the education of its members in their economic, social and cultural well-being as members of the community;
- the improvement of the well-being and spirit of the members' community; and
- subject to section 48, the provision to its members of such additional services as are for their mutual benefit.

Under section 6(3) admission to membership of a Credit Union requires a common bond between members. One such bond is "*residing or being employed in a particular locality*" (section 6(3)(b)).

Membership of an OMC is defined by the ownership of a property ("unit") in a multi-unit development. The OMC owns the common areas of the estate. In this way the interests

of OMC members are bound together. OMC members are concerned with the proper maintenance and upkeep of the common areas, for the enjoyment of quiet and peaceful occupation of their properties.

OMC members are neighbours, as are those Credit Union members possessing the common bond of residing in a particular locality, as provided for in Credit Union legislation.

The Network submits that there are natural links between, and purposes common to Credit Unions and OMCs. Lending by Credit Unions to OMCs is consistent with the statutory framework for Credit Union lending. Such lending will have a public policy benefit in terms of the sustainability of the apartment sector.

2.2 Section 4.3 - Investments in Approved Housing Bodies

We note in particular that Section 4.3 of the Consultation Paper seeks views as to whether it is appropriate for Credit Unions to undertake investments in AHBs.

We submit that there are strong parallels between AHBs and OMCs, and if investment in AHBs is permitted, lending to OMCs should be allowed.

AHBs and OMCs are privately operated, non-profit organisations in the housing sector. They are underpinned by a social/community theme.

It is submitted that OMCs carry significantly fewer risks and complexities compared with AHBs. There is no development risk with OMCs, nor is there planning permission risk.

We note the following commentary in Section 4.3 (page 15)-

“As with all investments, it is important that credit unions understand that they cannot outsource the judgement regarding investment risk to an external party such as an investment adviser and that the credit union remains responsible for both the investment decisions and the protection of the funds of its members. It is vital that, if credit unions propose investing in AHBs they fully understand the specific characteristics of the underlying investment, the investment vehicle and all associated risks.

Funding from credit unions would also represent a new source of funding for AHBs which may result in certain risks arising as new processes, policies and procedures are developed and implemented by credit unions and AHBs.”

We submit that the same issues arise where Credit Unions lend to OMCs. However, the characteristics of OMCs, and the associated risks, are less complex than those associated with AHBs. We submit that relative to AHBs credit risk assessment of OMCs should therefore be straightforward. We comment on the practicalities of this in Section 2.4 below.

2.3 Australian Apartment Model

Our experience is that of the apartment management models internationally, the closest in similarity to Ireland is the Australian “Strata” model.

Owners’ corporations/strata management companies are the Australian equivalent of Irish OMCs.

Mainstream Australian commercial finance providers lend to strata companies. Examples of lenders in the Australian market are Macquarie Bank⁷ and Westpac Bank⁸. There are also specialist strata finance providers in the Australian market⁹.

We are not aware of such funding available from the Irish pillar banks or other providers. We submit that lending by Credit Unions to OMCs will bridge this gap in the Irish environment. As explained above, there is a natural fit between the funding needs of OMCs and the investment classes of Credit Unions.

2.4 Credit Risk of OMCs

Residential OMCs are governed by a board of directors elected by its membership (the unit owners). Typically the directors are unpaid and are also members (property owners in the estate). As outlined above, it is usual practice for the board to appoint a Property Managing Agent to manage the OMC, with the directors exercising governance, setting policies and deciding on major expenditure.

In conjunction with the Agent, the board formulates an annual budget. This budget covers the annual maintenance of the common areas, insurance, waste management, etc. In addition, the budget incorporates provision for an annual contribution to a building investment (“sinking”) fund. This fund is for large future capex projects such as lift replacement, roof replacement and common area redecoration.

Under the MUD Act the proposed annual budget must be presented to a general meeting of members for approval. Once approved, the budget is sub-divided among members as an annual service charge.

Liquidity risk

Liquidity risk has been a considerable challenge for OMCs throughout the financial crisis. Poor rates of service charge payment have led to, and continue to lead to significant aged debtor balances.

However, from the outset it should be highlighted that with proper financial management and debtor controls, there should not be a solvency risk for OMCs. Effective

⁷ Macquarie bank Strata Improvement Loans (“SIL”) are provided for major renovations, unbudgeted items, e.g. fire order upgrades or emergency repairs, large-scale capital works, etc. See for more details- <http://www.macquarie.com/au/business-banking/loans-asset-finance/expertise/strata-loan> provides lending <http://www.macquarie.com/au/business-banking/campaigns/strata-improvement-loan>

⁸ Westpac bank- <https://www.westpac.com.au/business-banking/industries/strata/>

⁹ Lannock Strata Finance is a specialist strata financing company- <https://lannock.com.au/>

stewardship by the directors, with the operational assistance of the Agent, ensures that most OMCs eventually recover 100% of service charge debt.

The provisions of the lease between the OMC and the debtor, and the unwillingness of a potential purchaser to acquire a unit with arrears attaching, mean that the debt is eventually discharged on a sale of the property.

Most recent Irish academic research¹⁰ has shown that circa 25% of service charge accounts surveyed were in arrears to some degree. A small proportion of the accounts surveyed (5-10%) were in severe arrears. Multiple years' worth of service charges can accumulate, particularly in the case of investor-owners of multiple units in one development.

Most owners in arrears typically make some level of payment to reduce their balances outstanding over time; this is particularly so in the case of owner occupiers. However, the cashflow shortfall to the OMC means that the element of the service charge that should be set aside for sinking fund provision is instead used to meet essential day-to-day expenditure such as waste disposal, insurance, electricity, etc. As a result of this liquidity problem, many OMCs will not have sufficient funds to meet the cost of infrastructure upgrades, for example lift replacements or common area refurbishment.

Permitting Credit Unions to lend to OMCs will have the dual benefit of addressing the funding difficulties of OMCs and providing an investment class appropriate to Credit Unions.

OMC insolvency – very low risk

As noted above, the risk of an OMC becoming insolvent is very low.

The assets of an OMC are made up of cash balances and service charge debtors. Service charges are ultimately fully collectable. OMC management (i.e. the directors) will not facilitate the sale of a unit until the service charge debt has been cleared in full. Therefore, the risk of bad debts and service charge write-offs is extremely low. It will be observed from an analysis of financial statements of OMCs that for this reason they do not carry bad debt provisions.

As noted earlier, service charges are an “excludable” debt under section 2(1) of the Personal Insolvency Act 2012. They may be included in a Personal Insolvency Agreement only with the explicit consent of the creditor OMC. As the debt is recoverable from a property sale, it is only in rare and exceptional circumstances that an OMC would consent to the inclusion of service charge debt in a PIA.

Poor OMC management practice is the final risk that must be considered when assessing the risk of lending to an OMC. The Network is aware of a small number of OMCs that have been struck off by the CRO. These have occurred predominantly

¹⁰ “Owners’ Management Companies: The Ticking Time-Bomb Of Service Charge Collection” Adele McKeown, BA, MSc, Presentation to SCSi, 2 June 2017
<https://apartmentownersnetwork.org/2017/06/19/adele-mckeown-scsi-presentation-omc-service-charge-collection/>
“Service Charge Collection In Multi-Unit Developments” Adele McKeown, MSc in Real Estate, DIT Thesis, December 2016
<https://apartmentownersnetwork.files.wordpress.com/2017/06/a-mckeown-service-charge-collection-muds-full-thesis.pdf>

where developers have retained control of the OMC and did not hold AGMs, or failed to file Annual Returns with the CRO.

The provisions of the MUD Act have greatly reduced the risk of OMC strike-off. The MUD Act stipulates how OMCs are to be managed, and it provides for the speedy and cost-effective re-instatement of OMCs struck-off.

Security & maturity

The Network submits that, given their underlying social/community function, lending to OMCs would involve covenants and terms similar to those attaching to loans already provided in the Credit Union sector. The cost of finance should reflect the low risk nature of the investment. It is submitted that the duration of loans would match OMC sinking fund investment periods.

Credit Unions' risk assessments

The Network submits that Credit Unions' credit committees are well placed to assess OMCs of developments in their local areas.

We submit that the following matters are relevant to assisting with the assessment of the creditworthiness of an OMC-

- Financial statements and an Annual Return are filed with the CRO.
- Although not required for OMCs incorporated as CLGs, most OMCs arrange a statutory audit.
- OMC finances are not complex; they are readily comprehensible to Credit Union credit committees.
- Subject to meeting Data Protection rules, and where Company Law and the OMC Constitution allow, a list of OMC members (i.e. the owners responsible for services charge payment) may be provided to a Credit Union.
- In the vast majority of cases the OMC board is comprised of directors owning properties (either as occupiers or landlords) in the estate, meaning that they have strong connections to the local area in which the Credit Union operates. It is suggested that the OMC directors will be known in the local area.
- There is a licensing and regulatory regime for Property Management Agents. This is operated by the PSRA¹¹. Estates managed by licensed PMA are likely to carry a lower risk than those managed by unlicensed PMA.
- Conveyances of estate common areas to the OMC under the MUD Act should be registered with the Property Registration Authority. Compliance with this obligation signifies a well-run OMC.
- Proposals have been advanced by the Law Reform Commission for the greater regulation of OMCs¹²; the Network supports these. The information available from such regulation could form the basis for credit rating of OMCs.
- The Network supports the inclusion in the Central Credit Register of owners' service charge debts. This would be arranged under the Credit Reporting Act 2013. It would provide a further credit check of the membership of the OMC.

¹¹ <http://www.psr.ie/Website/npsra/npsraweb.nsf/page/licenceapplications-newlicence-en>

¹² http://www.lawreform.ie/_fileupload/consultation%20papers/cpMUDs.pdf

The Network submits that there is ample material available to allow Credit Unions undertake appropriate credit risk assessments of OMCs in their geographical area.

Deposit products

While not a matter for this consultation, we take the opportunity to note that Credit Unions could provide long-term deposit account products to OMCs with healthy sinking fund balances.

We submit that the mutuality/community ethos and themes may apply to the provision of such products in the same way as they apply to proposed Credit Union lending to OMCs.

3.0 Conclusion

Allowing Credit Unions to lend to OMCs will have the dual benefit of tackling the funding difficulties of OMCs, and providing an investment class appropriate to Credit Unions.

OMC lending would be a prudent investment for Credit Unions.

We submit that the counterparty characteristics, in particular local/geographical factors, and the low risk profile of OMCs are appropriate to investment by the Credit Union sector.

OMC lending has public policy benefits consistent with the social objectives of the Credit Union movement. The proposal is in keeping with the existing legislative framework that underpins the movement.

The Network wishes to thank the Registry for the opportunity to make a submission. We trust that the views expressed will be given due consideration in the Registry's deliberations.

We would be glad to meet to expand on our proposal at a meeting or another appropriate forum.