

**Service Charge Collection
In Multi-Unit Developments**



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STUDENT DECLARATION OF ORIGINALITY

I declare that the material which is submitted in this thesis towards the award of the Master (MSc) in Real Estate is entirely my own work, except as acknowledged, and has not been submitted for any academic assessment other than part-fulfilment of the award named above.

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ABSTRACT

The purpose of this study is to examine the way in which service charges are collected in Ireland. Owners Management Companies (OMCs) are a unique company structure set up for the specific purpose of managing Multi-Unit Developments (MUDs). The OMCs are responsible for the management, maintenance and control of the commonly owned property and for collecting the contributions due, known as service charges. This research highlighted a number of challenges relating to the collection of these service charges.

The study first explains the structure of an OMC and what exactly service charges are, followed by a review of the legislation in Ireland and a comparison with other jurisdictions. The literature identified issues unique to Ireland, particularly enforcement of the MUD Act and the lengthy legal process involved in collected service charge arrears.

Based on the research, the methodology was designed to include interviews with stakeholders such as directors, agents and accountants, a survey of OMC members and an analysis of the accounts of 50 property management companies.

The findings identified that there was a risk of insolvency among some OMCs in Ireland, caused by the difficult legal process for debt collection in Ireland, inconsistencies in providing for bad debts in the annual accounts, and a lack of understanding of the obligations associated with purchasing a unit in a MUD. The high levels of service charge arrears mean that the OMCs are unable to function in an efficient manner and many have not established a sinking fund.

The thesis concludes by recommending measures that could be considered to help mitigate against the risks faced by OMCs and suggests further research in the area.

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LIST OF ABBREVIATIONS

OMC	Owners Management Company
MUD	Multi-Unit Development
CLG	Company Limited by Guarantee
NCA	National Consumer Agency
ODCE	Office of Director of Corporate Enforcement
AGM	Annual General Meeting

GLOSSARY OF TERMS

Debtors: Individuals owing money to a company.

Multi-Unit Development: A development containing apartments, houses and/or duplexes in which the common areas are owned by an OMC.

Owners Management Company: A company set up for the specific purpose of managing the common areas within a development.

Mixed-Use Development: A development containing both commercial and residential units.

Members Funds: The net worth of the company.

Sinking Fund: A fund set up by the OMC containing funds that are ring fenced and held in a separate bank account for capital projects.

Reserves: Money held from previous financial period.

Deficit: Expenditure has exceeded income and the company is in a loss-making position.

Surplus: Income has exceeded expenditure and the company has reserves remaining at the end of the financial year.

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CHAPTER ONE: INTRODUCTION

1.1 Context

This thesis explores the subject of service charge collection within Multi-Unit Developments (MUDs). The research examines the structure of the Owners Management Company (OMC) set up to manage MUDs and the way in which service charges are collected within these developments. Currently, service charges are collected annually and if an individual refuses to pay the debt collection process is lengthy and expensive; this is particularly difficult for struggling developments as they operate on a not-for-profit basis. Service charges are subject to the statute of limitations, meaning if the debt is not collected within 6 years it is statute barred. It is a vicious circle, as non-payment of service charges can impact on the development as services will inevitably be reduced or withdrawn. This can cause other property owners to stop paying their service charges, which means a further reduction in services, and so on. The research identifies a number of major issues unique to service charge collection in Ireland as well as exploring the impact that non-payment can have on a development and the consequences for the development if it becomes insolvent. The roles of all of the stakeholders, including the developer, the directors, the members and the agent, are examined as well as the role of the Government.

1.2 Aims

The aim of the dissertation is to evaluate the service charge collection procedure in Ireland as it relates to multi-unit developments and where necessary make recommendations for reform.

1.3 Objectives

The main objectives are to:

- Examine the current procedure for collecting service charge arrears.
- Analyse the way in which the accounts are prepared for OMCs.
- Evaluate the MUD Act (2011) and other relevant legislation in terms of how it supports developments in the collection of service charges.
- Assess the understanding of the obligations of the various stakeholders in a MUD.
- Recommend proposals for reform.

1.4 Structure

Chapter One introduces the context and outlines the thesis aims and objectives.

Chapter Two reviews the relevant literature and explains the complex structure of an OMC and the role of the various stakeholders within this structure. The review also looks at the legal and financial matters relating to OMCs as well as briefly comparing the Irish system to other jurisdictions.

Chapter Three presents a review on the literature on research methodology and research design, including the qualitative and quantitative methods used.

Chapter Four presents the findings of the interviews, surveys and accounting analysis. It also analyses these findings by looking at whether or not the service charge collection process is working, if OMCs are at risk of insolvency and, finally, governance and legal issues.

Chapter Five summarises the overall conclusions and recommendations arising from the research findings and analysis and suggests further research in the area.

CHAPTER TWO: LITERATURE REVIEW

2.1 Introduction

This literature review examines the role of the OMC in Ireland today, exploring the theory behind the operation of a successful OMC and evaluating the way in which service charges are collected. This review identifies the main issues impacting the effective operation of an OMC, in particular service charge collection and debt recovery. It also examines the regulations surrounding OMCs and the role of the developer, agent, accountant, director and members, and concludes by identifying the main issues raised by the literature to be used in expert interviews.

2.2 The Structure of the Owners' Management Company

There exists an interdependence of unit owners. It is most common in Ireland for multi-unit development ownership to be structured in the form of a company, usually called an owners' management company 'OMC' (The National Consumer agency [NCA], 2008). The management company is established for two key purposes:

- To be the legal owner of the unit and common area leaseholds.
- To manage and maintain the common areas.

The management company is the established structure in the Irish property development market, particularly in multi-unit developments (ODCE, 2008). The ownership rights associated with buying an apartment are not the same in legal terms as buying a house. In Ireland most houses are owned freehold, which essentially means that the purchaser acquires legal ownership of both the property and the land on which it is built. The framework for ownership in multi-unit developments is based on leasehold (Government of Ireland, 2009). Leasehold means that the purchaser owns the property but not the land on which it is built. Leaseholds in a multi-unit development tend to have long leases which can be sold on to a new owner (National Consumer agency, 2008). A 'unit' in a multi-unit development is defined as the individual apartment, flat, duplex unit or other self-contained accommodation, which together with other such units make up the entire development (Lujanen, 2010).

A multi-unit development is owned and maintained by the unit owners on a communal basis. This is because all owners share, use and own the common areas, for example halls, gardens and parking, with other units. Unit owners pay an annual fee known as a service charge for the maintenance of these common areas (Office of Director of Corporate Enforcement [ODCE], 2008). These common areas are owned by an OMC, which is a not-for-profit company limited by guarantee and established to be the registered owners of the common areas within a development. The OMC is owned and controlled by the individual apartment owners, although they may employ an agent to operate on their behalf and appoint a board of directors from amongst them to instruct the agent (Gogan, 2008). Within an OMC each member is required to pay a service charge; these service charges fund the running of the OMC; however, if they are not paid the debtors level increases and the management company gets into difficulty (Bailey and Robertson, 1997).

The theory behind the operation of a management company is effective; all owners work together to ensure the development is maintained to a high standard. However, in practice, handover between developer and management company can be difficult; residents can be disinclined to do the job properly and often continuity of management is affected when key individuals lose interest (Tonkin, 1985). The unique ownership structure of multi-unit developments means that corporate governance within these structures can be difficult to manage and there is a lack of transparency in the context of managing apartment buildings (Paulsson, 2007).

Mixed-use developments meaning developments containing both residential and commercial property historically have more problems, and problems of a different nature to homogeneous complexes (Ploeger, 2014). The Multi-Unit Development (MUD) Act is a piece of legislation that was introduced in Ireland in 2011 to regulate the ownership and management of common areas, primarily aimed at apartment schemes and the apartment content in mixed-use developments, but also including conventional housing where a service charge scheme is being operated in relation to estate common areas. (Government of Ireland, 2011)

2.3 Key Stakeholders in an Owners' Management Company

2.3.1 *Developers' obligations*

A developer establishes an OMC when construction commences and takes the role as the company director initially. As each property is sold the owner must enter into an agreement with the developer and other property owners to pay service charges to the OMC.

When introduced in 2011, the MUD Act was seen to deal with a critical issue regarding the retention of ownership by some developers of common areas. In the past developers could legally retain ownership of the common areas and control management of the estate until the last apartment was sold. This meant that owners did not decide how service charges were levied, with many developers refusing to pay service charges for their unsold units. As of the 1st of April 2012 developers were given a 6-month deadline to complete the transfer of common areas which means that they had to ensure that the OMC was the legal owner of all of the shared areas within the development under Sections 4 and 5 of the MUD Act (2011). However, the Act did not allow for the enforcement of this provision.

Under section 24 of the MUD Act, an OMC may apply to the Circuit Court for an order to enforce the obligation on the developer to transfer the common areas to it; however, such proceedings are likely to be expensive and represent a heavy burden on the unit owner if they have to be brought by an individual. Under section 3, a developer cannot transfer an interest in a residential unit unless the developer has established an OMC and the common areas and the reversion in the residential units have been transferred to that OMC. Also required is a contract between the developer and OMC setting out the rights and obligations of the developer relating to the completion of the development. (Government of Ireland, 2011) It is extremely important to have this legislation in place as the developer will not necessarily be focused on acting in the best interests of the development. Tonkin (1985) explains that the management of a property after it has been sold is not the primary concern of the developer as his main source of profit is in the initial building development, not in the time-consuming and unprofitable details which inevitably arise in dealing with the general upkeep of the property.

2.3.2 The role of the members

The individual property owners are all shareholders of their management company, therefore they effectively own the management company, which in turn owns all of the common areas. Each property owner has one vote, in accordance with the MUD Act (2011). Prior to this, leases were often structured in such a way as to allow commercial property owners to have more voting rights than the residential unit owners. At the AGM the members appoint directors by vote. They may also appoint a managing agent to act as a third party managing the development on their behalf.

The management company directors act in a voluntary unpaid capacity and do not have the benefit of support resources. There is a marked reluctance amongst apartment owners to become directors of their own management companies because it takes up time (Sirr, 2010). Many owners actively seek to avoid involvement, which subsequently undermines board authority (Yip et al., 2007). Despite their shortcomings OMCs are of more benefit to the members than the alternative (Wyldbore-Smith, 1990).

2.3.3 The role of the directors

OMCs are legally obliged to hold an AGM. At that meeting the members elect directors to sit on the board of the management company and manage the development at an operational level. They generally work with a managing agent and will make decisions regarding daily expenditure, minor repairs and taking legal action against debtors. (Gogan, 2008) Directors' fiduciary duties have been codified in the new Companies Act 2014. The obligations are onerous for management company members and contribute to the difficulty in attracting new directors annually. The new Companies Act (2014) also places a new obligation on directors of private companies to appoint a suitably qualified person as the company secretary. Such person must have the skills necessary to maintain the statutory records of the company. The company secretary is no longer required to ensure compliance with company law as this obligation has now transferred to the directors. This is interesting because the managing agent often acts as secretary for a fee; however the responsibility will now transfer to the directors, who act in a voluntary capacity. (Government of Ireland, 2014) Gogan (2008) also points out that directors also have the responsibility of deciding what sanctions should be taken against members that do not pay their service charges. This is difficult as these members can be neighbours or friends.

2.3.4 The role of the managing agent

There is usually a managing agent on board when the developer transfers his interests and responsibilities to the management company. Gogan (2008) explains that the directors must decide if they should

- Retain the existing managing agent
- Appoint an alternative managing agent
- Dismiss the managing agent and manage the development without one.

Management companies need to ensure that the agent is knowledgeable and competent not only in the technical aspects of their role but also functionally. The cost structure of their services should be clearly revealed to the client at the beginning of their contract, as additional unexpected costs can be a factor leading to customers switching agent (Levi, 2014). They must also ensure that the agent is registered with the property services registry authority, the main function of which is to regulate property service providers (Government of Ireland, 2014). According to Scarret (1986), much criticism has been directed towards agents when management companies under perform; however it is the lack of clear guidance and specific legislation that is the problem.

2.3.5 The role of the accountant

The National Consumer Agency (2008) identifies what the apartment owner should look out for in advance of buying an apartment or house in a multi-unit development or as a concerned member of the management company. They highlight that the key is in the accounts. When examining the company's audited accounts the member should look at the auditor's report and check what they have to say about the books of account kept by the company. Any shortcomings identified in the auditor's report should be raised and discussed at the company's AGM. Auditors do not judge the appropriateness of the company's actions or activities, they simply report. Where the auditors are unable to report positively, they may 'qualify' their audit report. Niren (1991) explains that if there are more than four apartments in a building the costs provided must be certified by a qualified accountant, who must confirm that the information given is a fair summary. The auditors must satisfy the members that all records have been verified and checked.

The new Companies Act (2014) has provided an audit exemption for companies limited by guarantee (CLGs). OMCs now fall into this category, however any one member may object to this. This could be quite a dangerous change as it provides for less accountability and transparency as technically the accounts do not have to be audited by an external auditor, they can be prepared and filed with the CRO by the managing agent's in-house accountant or by the directors themselves. Although this measure was introduced to reduce the financial burden on small companies it could lead to a conflict of interest. Issues with transparency and accountability can be the result of OMCS not requesting financial records be audited and overspending by committees. Good financial health requires the financial statements and records to be audited on an annual basis by an independent auditor (Johnson, 2015).

2.4 Financial Matters

2.4.1 The Budget

At the end of the financial year an annual budget is prepared for the OMC, this budget estimates the amount of money required to run the development and the management company itself for the subsequent year. The budget is prepared by the board of directors in conjunction with the agent, however it must be formally approved at the AGM (Gogan, 2008). Section 18 of the Multi-Unit Developments Act 2011 deals with service charges and there remain no provisions in company law to determine the level at which a management company should fix its service charges, or to give any guidance as to how they should be calculated (ODCE, 2008). Apportionment refers to the method by which the percentage of the overall service charge for the development is attributed to individual owners. The calculation may be based on a number of factors, for example, the size or type of unit, the services availed of by a unit, or the total number of units in the development (National Consumer Agency, 2008). According to Scarret (1986), many of the early service charge provisions were badly drawn, resulting in uncertainty and under funding of maintenance requirements, and sometimes resulting in deteriorating relationships between parties.

2.4.2 Collection of service charges

The obligation on unit owners to pay service charges and the entitlement of management companies to collect them arise fundamentally from the covenants and obligations which both OMCs and multi-unit property owners enter into in the

conveyancing documents by which they purchase their properties added to the general obligations that apply to all OMCs set out in the MUD Act 2011 (ODCE, 2008).

Service charges in Ireland are calculated in line with the head lease and there is no standard means by which management companies levy service fees, which leads to a belief that service charges are unfair or disproportionate. The result is management companies often lack the funds required to enable them run the development effectively (Lujanen, 2010). Service charge administration, collection and increasing debtors levels are a major challenge for management companies today. Members of the OMC need to see what they are getting for their service charge through visual improvements to the development. They do not always see the cost of accounts, insurance and agents' fees as valuable, although these are necessary expenditure items (Fakhrudin et al., 2011). In order to treat unit owners equally, it would be advisable for the OMC's to collect not only the amount the unit owner owes, but also charges that arise in pursuing the debt and all litigation costs, including reasonable attorneys' fees. This aspect would support administratively light measures in debt collection procedures (Lujanen, 2010). There are major concerns surrounding the lack of transparency of the composition of service charges. A service charge may be low for the first year of a resident's occupation as little maintenance is required but then may escalate rapidly much to the surprise of the new owner (Sirr, 2010).

2.4.3 Service charge arrears

The Society of Chartered Surveyors (SCSI, 2014) indicates that the majority of OMCs increase their service charge budget annually. There is a significant problem with individual members refusing to pay their service charges and OMCs often cite lack of funds as the reason that these debtors are not pursued. For those unit owners that are paying, it means an increase in service charges to pursue the non-payers through legal mechanisms which are not only costly but can take up to 5 years.

The National Consumer Agency (2008) explains that stopping payment of service charges may be a breach of your contractual obligation under the terms of your lease. If an owner does not pay their fees they may be liable to legal action and any outstanding debts can be tied to the unit. If your management company does not collect charges, it will run short of money and in time it may not be able to provide even the most basic

services. Sirr (2010) further explains that many residents withhold their service charge payment in protest when they are unhappy with the service provided; however threats of suing and forfeiture of leases for non-payment are expensive for the OMC to enforce and usually result in payment of the service charges owed the day before a case appears before a court, resulting in expensive and non-recoverable legal fees. Managing agents often threaten to remove non-payers from the block insurance, deny parking permits or bin store access and add interest to their accounts. The lease generally provides for the addition of interest to a service charges account and it can be an effective way of encouraging payment. Gogan (2008) points out the importance of having a clear service charge collection policy to ensure that the members of the OMC are aware of the process and the implications of non-payment. It is important that members understand the fundamentals of what they have bought into. As the OMC is a not-for-profit company it is solely reliant on service charges to function. The non-payment of service charges will inevitably lead to the deterioration and dilapidation of a development. Non-paying members are often unable to vote at the AGM, therefore having no control over the future expenditure of the management companies. Although members often withhold payment in protest it actually dilutes their ability to effect change within their OMC. (Gogan, 2008)

The OMC can chose to wait until the property is sold; at this point the service charges are easily collected as the vendor needs the agent to complete 'the MUD Act pre contract enquires' along with supporting documentation; prior to the introduction of the MUD Act it was a document called a Requisition 37. A sale cannot be completed without this and therefore the directors will instruct the agent not to release the documentation until service charges have been paid in full or an undertaking is received (Law Society, 2015)

If the property is not sold and the debt is accumulating year on year the directors together with the managing agent will often have to make the decision to pursue legal action against non-paying members. Where a sum of less than €6,348 is due it can go before the District Court as an ordinary contract debt. The solicitor will issue and serve a Civil Summons claiming the debt on the member. The documents needed to get a judgment/summary decree are:

- An affidavit of debt sworn by yourself or by someone on your behalf (e.g. company accountant, company secretary)
- A completed decree form.

If the District Court is satisfied to enter judgment then the OMC will get a signed decree from the District Court (Courts Service, 2014) Bowe and O'Brien (2009) explain that debtors generally fall into three categories: those who dispute that the amount is due at all; those who admit they owe the money but just will not pay it and those who admit they owe the money but simply do not have the means to pay. Once the Court proceedings have been issued the next stage of the process is enforcing the judgment against the debtor by sending the judgment to the Sheriff's Office for collection of money or goods to the value of the debt. The judgment can be registered as a charge over the debtor's property without the consent of the debtor. If there are other charges already registered such as a mortgage or other judgments registered before the service charges, the service charges judgment lines up behind them (Mason, Hayes & Curran, 2006).

2.4.4 The sinking fund

A sinking fund is like a pension fund for a development (Gogan, 2008) It is for capital expenditure within the development such as major structural repairs, refurbishment and redecoration or replacement of expensive equipment. The MUD Act (2011) introduced a requirement for all OMCs to establish and maintain a sinking fund. It determined that the sinking fund contribution should be €200 per member per annum or amount otherwise agreed at an AGM. The contribution to the sinking fund should be ring-fenced and must be immediately paid into the sinking fund when payment is made by the member. Lujanen (2010)

2.5 Legal Matters

2.5.1 The New Companies Act 2014

The Companies Act (2014) came into effect on 1 June 2015 and has introduced significant reforms in company law in Ireland. The Act consolidates previous legislation on companies limited by guarantee not having a share capital, which is the company type of most OMCs in Ireland. Unless exempted, an existing guarantee company will be

required to change its name at the end of the transition period ending on 30 November 2016 so that its name ends in company limited by guarantee (CLG) (Companies Act, 2014)

Major changes impacting OMCs:

- A CLG can avail of an audit exemption but any one member may object to same.
- A CLG may have as few as a single member and no maximum number of members but the constitution of the CLG must specify the number of member(s) with which it is to be registered.
- The CLG has a single-document constitution which will incorporate the memorandum and articles of association. The memorandum sets out the company objective, while the articles of association set out the rules.
- A CLG requires at least two directors.
- The AGM may be dispensed with if a CLG has a single member.

It is worth noting that the Charities Act (2009) and the office of the Revenue Commissioner rules currently restrict the ability of charities to pay directors. Under section 116 of the Companies Act (2014) every company is required to keep a register of the company's members, containing details of the names and addresses of each member. Every company's register of members, including that of a management company, is a public document. It may be inspected free of charge by any member of the company, and by any other person on payment of a nominal fee (Companies Act, 2014, s.119). Given that there is a specific legal basis for the provision of this data, there would be no issue from a data protection point of view with a management company making these registers available for inspection to members of the company (Data Protection Act, 1988, s.9.2).

2.5.2 The Multi-Unit Development Act 2011

As previously mentioned, in 2011 Ireland introduced the Multi-Unit Development Act (MUD Act) aiming to support OMCs and protect their members. This is the main piece of legislation governing MUDs. The Act applies to MUDs, defined as land on which

there are buildings erected comprising no fewer than 5 residential units in which it is intended amenities, facilities and services are to be shared. In addition to applying to the concept of traditional apartment developments, Section 2 of the Act expands the application of the Act to residential housing developments where there is a management company structure and also to mixed-use developments comprising commercial and residential units to the extent that amenities, facilities and services are shared by the commercial and residential units. The main issues that have presented themselves since the implementation of this Act in 2012 are the lack of awareness and understanding among members and the lack of sanctions against developers, directors and members who do not comply with the Act. Paulsson (2007) states that all rights given to owners' associations must be given by statute, bylaws and different types of agreement, while Lujanen (2010) argues that the language used in legislation is difficult for non-legal people to understand, and can lead to further problems. The unique ownership structure of MUDs means that corporate governance within these structures can be difficult to manage and there is a lack of transparency in the context of managing apartment buildings (Paulsson, 2007).

2.5.3 The Data Protection Act 1988

Under section 9.1 of the Data Protection Act an OMC cannot disclose the personal data of the members without their consent unless such disclosure is explicitly provided for in the memorandum and articles of association of the company as a condition of membership.

2.5.4 Statute of Limitations 1957

Claims for service charges are subject to a statutory limitation period of 6 years from the date the sums are properly due under the terms of the lease. The exception to this is if the leaseholder has acknowledged the debt within the limitation period. An example of this is where a demand for payment is sent out to which the leaseholder confirms there is an outstanding amount or balance due. The limitation period will then run from the date of the last acknowledgment. Within 18 months of incurring a cost that is intended to be recovered through the service charge the OMC must either demand the payment in the prescribed method or the member must be informed that these costs have been incurred and reimbursement will be sought at some time in the future (Government of Ireland, 1957)

2.6 Other Jurisdictions

Apartment living or living in a MUD is relatively new to Ireland when compared with other countries. In 2011 there were 177,587 apartments occupied in Ireland. This is a 27% increase from 2006 and represents 10.9% of all households occupied (Central Statistics Office, 2011).

In the Finnish housing company model, the common area property is owned by a special form of limited liability company, of which the co-owners are shareholders. The shares are divided in such a way that they provide an exclusive right of possession of a certain unit. In Ireland the OMC structure is a company limited by guarantee; in the UK a similar structure exists, while in Canada condominium corporations are used. In the USA these are called organization of unit owners and the legal form is a corporation. Italy and Sweden operate under a similar model, while in Australia the system is known as 'Strata title' but the system is similar to the condominium model. In the Russian Federation, even if an owners' association exists, the membership is voluntary. From 1996, the Russian Federation Law on Homeowners' Associations had included a provision that made this membership compulsory, but it was found to be unconstitutional by the Russian Federation Constitutional Court (Lujanen, 2010).

Lujanen (2010) explains that in many other countries owners' management associations are informal and voluntary, without a structured company with directors responsible for the decision making. Bailey and Robertson (1997) point out that it can be incredibly difficult to manage both a formal and an informal owners' management association in an effective way. In the cooperative model a member can always leave the cooperative, even if a new member has not been found as a replacement. This phenomenon has even resulted in bankruptcies among cooperatives, for instance in Sweden. In a Finnish housing company, the shareholder is obliged to pay all monthly payments and to fulfil other obligations as long as the shareholder has not sold the respective shares to a new shareholder. This difference is important because the Finnish arrangement ensures that the monetary streams to the company are stable, as compared with housing cooperatives (Lujanen, 2010). The Finnish housing model has taken it one step further: if the owner fails to pay the monthly payments, the company can take possession of the unit in question for a maximum of 3 years and pay the unpaid amount using revenue earned from rent. This decision is made at the shareholders' meeting. In cases such as this,

however, the owner does not lose his or her ownership. The shareholder may then ask a court to examine whether the housing company has grounds to take possession of the unit (Lujanen, 2010). This is something that could be immensely beneficial in Ireland.

2.7 Conclusion

In conclusion, it is evident from reviewing the literature that the OMC structure in Ireland needs to be improved. The introduction of the MUD Act (2011) represented the first piece of legislation directly aimed at OMCs. This was a welcome move. However, although the Act states that every member must pay their annual service charge and further stipulates that it is recoverable as a simple contract debt, it does not give the OMC any powers of enforcement. The literature has shown that the debt collection process in Ireland is slow and costly. The statute of limitations further restricts OMCs who have not pursued those members in arrears for service charges as after 6 years the outstanding service charges may be statute-barred. This is difficult as the member may not have been pursued due to lack of funds within the OMC. Other legislation such as the new Company's Act 2014 have introduced changes that directly affect OMCs such as the removal of the requirement to have the annual accounts audited. This could impact transparency within an OMC. Members do not want to pay their service charges when they do not feel that they are getting the required service. This leads to a lack of funding, which in turn leads to a further reduction in service. It is evident that there is a lack of understanding around OMCs in Ireland and the key stakeholders are not always aware of their role and the obligations associated with that role, with particularly poor participation among owners. Without the introduction of sanctions against those members who fail to pay their service charges and OMCs that fail to establish a sinking fund there is a real risk that many OMCs in Ireland could become insolvent. There needs to be a simplified legal mechanism to collect the debt outside of the traditional court system.

Having reviewed the literature the following questions have arisen:

- Has the MUD Act helped to improve members' understanding and encouraged payment of service charges?
- Is the process of calculating and collecting service charges fair and transparent?
- Have OMCs established sinking funds?

- What is the level of non-payment within OMCs in Ireland?
- Do OMCs provide for bad debts?
- Do OMCs ever write off bad debts?
- Why do people not pay their service charges?
- How can the OMC encourage members to pay?
- Should tenants be allowed to pay service charges?
- Should the Government intervene?
- Should a regulator be introduced to deal with disputes around non-payment of service charges?

CHAPTER THREE: RESEARCH METHODOLOGY

3.1 Introduction

The research topic for this thesis is an examination of the impact of non-payment of service charges whether or not a new debt collection approach is needed to ensure that OMCs do not become insolvent. Creswell (2007) categorises research into two distinct types: quantitative and qualitative. The research methodology for this thesis is mixed, using both qualitative and quantitative research to gain a greater insight than if a single methodology were used.

The qualitative approach has its origins in the academic tradition and places its emphasis on the numbers that represent opinions or concepts. The qualitative research for this thesis was based around semi-structured interviews that were designed having reviewed the literature on OMCs and the debt collection process.

The quantitative research included a survey aimed at OMC members and a review of the most recently available financial statements for a select number of OMCs in Ireland.

3.2 Research Methodology

3.2.1 Qualitative research

Qualitative research encompasses several approaches to research that are, in some respects, quite different from one another. Yet all qualitative approaches have two things in common. First, they focus on phenomena that occur in natural settings – that is, in the real world, and, second, they involve studying those phenomena in all their complexity (Leedy & Ormrod, 2005). Interviews are used as a method of collecting data for research purposes. An interview can be defined as a method of data collection in which one person (an interviewer) asks questions of another person (a respondent); interviews are conducted either face-to-face or by telephone (Whiting, 2008). The options available for this thesis included interviewing agents who work with and manage OMCs on a daily basis at an operational level, interviewing the directors of OMCs who voluntarily manage their development at a strategic level, and interviewing accountants who audit the books and records for OMCs. According to Creswell (2007), the concept of purposive sampling is important in qualitative research. For this research

interviewees were selected based on their knowledge and involvement with OMCs. This demonstrates purposive sampling, which means respondents are selected because they can purposely inform an understanding of the research problem and central phenomenon in the study (Goulding, 2005) This is known as phenomenological research, which involves interviewing individuals, following set procedures that end with the essence of the meaning of the data collected (Creswell, 2007). In phenomenological research it is essential also that all participants have experience of the phenomenon studied (Creswell, 2007).

Qualitative research can result in one or more of four potential outcomes (Peshkin, 1993). These are as follows:

- Description: The nature of situations, relationships, processes, people, settings and systems can be explained.
- Interpretation: It can provide new insights into particular behaviours, attitudes, and ways of working.
- Verification: It can give the researcher the chance to test assumptions in a real-world context
- Evaluation: Qualitative research allows the researcher to judge the effectiveness of policies.

3.2.2 Quantitative research

Quantitative research involves quantifying data and generalising results from a sample of the population of interest to measure the incidence of various views (Park, 2016). The quantitative research approach enables the testing of objective theories by examining the relationship between variables (Creswell, 2009) The quantitative approaches chosen for this research were:

- A survey of OMC members
- Desk-based analysis of accounting data.

Surveys are designed to provide a snapshot of how things are at a specific time. There is no attempt to control conditions or manipulate variables; surveys do not allocate

participants into groups or vary the treatment they receive. Surveys are well suited to descriptive studies, but can also be used to explore aspects of a situation, or to seek explanation and provide data for testing hypotheses. The option chosen for this thesis was to survey OMC members to get a snap shot of their understanding of their obligations. It is important to recognise that a survey is a research strategy, not a research method (Kelly et al., 2003)

Desk-based study involved an accounting analysis profiling the accounts of 50 Dublin-based OMCs. Desk research refers to secondary data or that which can be collected without fieldwork.

3.3 Research Design

3.3.1 Interview design

Interviews can be structured, unstructured or semi-structured. In a structured interview the interviewer asks interviewees a series of pre-established questions, allowing only a limited number of response categories. Organising and quantifying the findings is thus generally straightforward (Qu & Dumay, 2011). This type of interview tends to generate quantitative data and therefore is not as common as semi-structured or unstructured in qualitative research (DiCicco-Bloom & Crabtree, 2006). Based on this understanding of structured interviews, this option was ruled out. Unstructured interviews are like guided conversations and are widely used in ethnographic research, where the researcher identifies key informants from observing participants in their natural setting (DiCicco-Bloom & Crabtree, 2006). These participants are selected based on their knowledge, role and willingness to effectively communicate with the researcher. Semi-structured interviews were deemed to be the most practical method to apply for this thesis. They can provide qualitative data that is reliable and comparable. According to Cohen and Crabtree (2006), some of the characteristics of semi-structured interviews include:

- The interviewer and respondents engage in a formal interview.
- The interviewer develops and uses an 'interview guide.' This is a list of questions and topics that need to be covered during the conversation, usually in a particular order.

- The interviewer follows the guide, but is able to follow topical trajectories in the conversation that may stray from the guide when he or she feels this is appropriate.

Unlike unstructured interviews, which typically follow a period of observation, semi-structured interviews are usually the only data source a researcher undertakes during the course of a qualitative research project. The interviews are generally scheduled with notice given and open-ended questions are used, which are based on and informed by the literature review carried out by the researcher (DiCicco-Bloom & Crabtree, 2006). When preparing for semi-structured interviews and designing the questions Turver (2010) advises the following:

- Wording should be open ended.
- Questions should be as neutral as possible.
- Questions should be asked one at a time.
- Questions should be worded clearly.
- Be careful asking ‘why’ questions.

For this thesis the questions were designed to build on the knowledge and understanding of the interviewee and the knowledge developed by reading and carrying out an extensive review of the literature on service charges, the debt collection process in Ireland and OMCs. The initial questions (1-6) were designed to gain an understanding of the respondent’s knowledge of OMCs. The next set of questions (7-13) were designed to identify the issues surrounding the collection of service charges and test the findings of the literature review against the operational environment in an OMC and the experience of the participants involved. For example, there is consensus in the literature that the statute of limitations applies to service charges, the researcher was interested to see if the respondents were aware of this or agreed that it did. The final questions (14-20) were designed to identify solutions and establish whether the respondents felt the current system was working effectively.

The interview questions used can be found at Appendix A with a synopsis of interviews at Appendix C and transcripts of each interview can be found at Appendix D.

3.3.2 Survey design

Questionnaires as a form of quantitative research are one of the most widely used means of collecting data (Rowley, 2014). Data is collected under controlled conditions in order to rule out the possibility that variables other than the ones under study can account for the relationships identified (Park et al., 2016). This research produces data based on real-world observations (empirical data) and the data that are produced are likely to lack depth or detail on the topic being investigated. Securing a high response rate to a questionnaire can be difficult. (Kelly et al., 2003). This questionnaire targeted OMC members with a specific set of questions relating to service charges.

Questionnaires are typically used in survey situations, where the purpose is to collect data from a relatively large number of people. They are used where the researcher wants to profile the sample in terms of numbers or to be able to count the frequency of occurrence of opinions, attitudes, experiences, processes, behaviours, or predictions (Rowley, 2014). There are techniques to increase response rates: a questionnaire must be concise and easy to understand, reminders should be sent out, and methods of recruitment should be carefully considered (Kelly et al., 2003).

For this research, the questionnaire was targeted at members of OMCs in Ireland. The questionnaire consisted of 15 questions specifically aimed at establishing patterns in the behaviour of OMC members. The questionnaire and results are available at Appendix E and the comments at Appendix F.

3.3.3 Desk-based research

The desk-based research conducted was in the form of a review examining the financial statements of all 50 randomly selected OMCs limited by guarantee and extracting accounting information relevant to this research project. The full analysis is available at Appendix H. The values/details extracted were as follows:

- Location of development
- Number of directors
- Budget/ Income 2015
- Debtors level 2015

- Debtors level as a percentage of budget
- Debtors level in previous accounting period
- Increase or decrease in debtors level from 2014 to 2015
- Surplus/Deficit in income and expenditure account
- Level of sinking fund
- Members funds
- Provision for bad debts
- Bad debt write-off
- Auditors report
- Emphasis of matter.

3.4 Setting and Participants

Interviews are used to discover understandings of a particular group who share critical similarities related to the research question (DiCicco-Bloom & Crabtree, 2006). Given the research topic and question, it was necessary for the interviewees to have experience in working with OMCs. Interviews were carried out with five managing agents, five directors of management companies and two accountants. In preparation for the interviews, the researcher considered the following advice (Turner, 2010):

- Choose a setting with little distraction.
- Explain the purpose of the interview.
- Address terms of confidentiality.
- Explain the format of the interview.
- Indicate how long the interview usually takes.
- Tell them how to get in touch with you later if they want to.
- Ask them if they have any questions before you both get started with the interview.
- Don't count on your memory to recall their answers.

For all but one interview, the interviewee's preference was for the researcher to go to them. The researcher introduced herself, the research topic and explained to each interviewee that their responses would be treated confidentially but that their names would be included in a listing of interviewees. Permission was requested to record each

interview and it was advised that notes would be taken. A full typed transcript of each interview is available in Appendix D.

The survey was circulated to the managing agents and directors that had been interviewed and they agreed to email it to the members of the OMCs with which they were involved. The survey was also posted on social media. Participants were all OMC members and the first question in the questionnaire was used to confirm this.

3.5 Ethical Considerations

According to Creswell (2007), a qualitative researcher faces many ethical issues when collecting, analysing and preparing findings. Ethical issues are categorised in terms of consent procedures, deception or covert activities, and confidentiality towards participants. All participants have the right to privacy, anonymity and confidentiality; however, true anonymity can only exist where the participant's identity cannot be linked to the data (Whiting, 2008). Deductive disclosure, or internal confidentiality, occurs when individuals can be identified based on particular traits, or responses to questions. The interview respondents for this research consented to their names and positions being included in a table; however their responses are not directly associated with the name of the individual. Confidentiality is required, for ethical purposes, but there is also a perception that affording confidentiality will impact on participants' responses. In a 1980 study examining the effect that confidentiality had on interviewees, there was a very strong correlation between assured confidentiality and disclosure (Woods & Regis-McNamara, 1980).

The survey respondents are completely anonymous, their names were not required to complete the survey and the only requirement was that respondents were members of management companies. The survey did not ask what OMC they were a member of or where that management company is located.

The analysis of management company accounts is not confidential, and the information used for this analysis is available to download online for a small fee. Although the information is in the public domain the researcher used the location rather than the name of the individual management companies in the analysis.

3.6 Data Analysis

Qualitative research produces vast amounts of data to analyse, in the form of transcripts and observational notes. This raw data provides descriptions but not the explanations required in order to analyse and determine findings (Pope et al., 2000). Inevitably, the researcher will begin to think about the responses that have been given during an interview and will be analysing as they carry out their research. This process of data collection and analysis eventually leads to a point in the data collection where no new categories or themes emerge. This is referred to as saturation, signalling that data collection is complete (DiCicco Bloom & Crabtree, 2006). The data analysis in qualitative research consists of preparing and organising data for analysis, then reducing the data into themes through a process of coding and condensing the codes and, finally, representing the data in figures, tables, or a discussion (Creswell, 2007).

The quantitative approach is concerned with finding evidence to either support or contradict hypotheses informed by the qualitative approach. The numerical data produced is analysed using mathematical and statistical methods.

3.7 Conclusion

This research project is informed by a mixed approach of both qualitative and quantitative research. Twelve interviews were carried out with key stakeholders involved in working with OMCs. The quantitative research included a survey aimed directly at OMC members. This was completed by 80 respondents. Finally, the audited accounts of 50 OMCs were analysed and the debtors level (service charge arrears) was expressed as a percentage of the income figure to ascertain the sustainability of the OMCs.

CHAPTER FOUR: FINDINGS AND ANALYSIS

4.1 Introduction

The interview questions were informed by the research from the literature review. Interviewees were asked 20 questions, divided into sections A, B and C. Section A directly related to the respondent and their experience in dealing with OMCs and service charges; section B focused on the issues surrounding the collection of service charges, while section C examined the solutions to increasing service charge payment levels within OMCs. Five managing agents were interviewed, in addition to five OMC directors and two accountants.

Surveys were targeted at members of OMCs, aiming to establish behavioural patterns in service charge payments and an understanding of the OMC structure. Eighty respondents completed the survey, which was published online.

Finally, a quantitative analysis of the financial statements of 50 randomly selected OMCs limited by guarantee was performed, primarily to identify the service charge arrears (referred to as ‘debtors’) within these companies and compare it with the income in the same financial period, but also to identify any other anomalies in the financial statements.

4.2 Findings

4.2.1 *Interview findings*

Part A – The Respondents

Question 1: Are you familiar with owners’ management companies in Ireland?

All respondents answered that they were familiar with OMCs in Ireland, with agents referencing the number of developments that they managed.

Question 2: What is your role in dealing with an owners’ management company?

Agents listed themselves as agents. Directors listed themselves as directors, with some of them also acting as company secretary and residents association members. Accountants listed themselves as accountants, auditors and advisors.

Question 3: Have you ever had to pay service charges?

Four out of the five agents had never paid service charges. All of the directors stated that they paid service charges. One of the accountants had the personal experience of paying service charges.

Question 4: How do you feel about paying service charges?

All of the agents were very aware of the importance of paying service charges. One agent however said, *“I would never purchase an apartment in Ireland because of service charges.”*

The directors unanimously agreed that they didn’t have a problem paying service charges, with one of them saying that they are *“essential”* and another highlighting that *“I think that in the past the whole service charge issue was very controversial because it wasn’t seen as value for money.”*

One accountant said that he treated service charges like any other bill, while the second described them as a *“fair and equitable way of dealing with common areas.”*

Question 5: What, in your opinion, are the main reasons for failure to pay service charges?

Reasons listed by agents:

- People overstretch themselves and don’t pay the first year charge and then it escalates.
- Recession, job losses, the economy generally.
- Lack of understanding.
- When people don’t have enough money service charges are the bill that can be forgotten.
- Services can’t be withdrawn, as if one doesn’t pay others will continue to pay.
- Understanding deficit meaning that owners have a lack of understanding relating to their legal obligations as members of an OMC.

Reasons listed by directors:

- Failure by OMC to engage with the members to ensure that steps are taken to initiate a payments system.
- The members feel they shouldn't have to pay and they don't fully understand service charges.
- Inability to pay.
- Unwillingness to pay – the view that someone else will pay.

Reasons listed by accountants:

- People are unaware of why they must pay service charges because it remains a relatively new phenomenon in Ireland.

Question 6: In your opinion, how does non-payment of service charges impact on the development?

Most of the agents interviewed pointed out that the development will suffer if service charges are not paid as services will be restricted or withdrawn. One agent described it as follows: *“It’s a vicious circle. Worst case scenario the management company could run out of money and not be able to pay the electricity, for example, which would make an apartment building uninhabitable as fire safety equipment would not be operational. Essentially, non-payment of service charges impacts the quality of the scheme, as equipment and the building generally are not maintained it ends up costing more to replace in the future.”*

Directors pointed to the visual implications of non-payment such as the appearance of the development as well as the withdrawal of services, with one director noting that it can have a negative impact on *“community spirit”* and another director noting that a deterioration in a development can lead to *“antisocial behaviour”* such as vandalism.

The accountants interviewed also highlighted the risks of services being withdrawn, with one accountant stating, *“biggest risk which people don’t seem to realise is that the accounts will not be prepared and filed and the company could be struck off, in which case no house or apartment owner will be able to sell their property until such time as*

the company is reinstated, which will cost the OMC thousands and they will have to go to the High Court so, you see, maintaining the management company is essential.”

Part B – The Issues

Question 7: In the development that you are involved with do all members pay their service charges due year on year?

Amongst the agents most answered yes, while two indicated that 90% of members pay all service charges due year on year. One agent estimated the figure at around 60%, and the final agent simply indicated that all members do not pay their service charges year on year, noting that *“You might have, let's say, a 30-40 grand debt figure sitting there but that could be three owners.”* One of the directors answered, *“No,”* while another stated that it *“varies from year to year depending on the economic circumstances.”* The remaining three directors indicated that between 75% and 85% of members paid their service charges due each year.

The accountants both stated that not all members pay their service charges due year on year, with one accountant stating, *“There are the people that always pay on time, the people that never pay on time and the people that you have to chase every year.”*

Question 8: Does the development(s) have a debtors level greater than the annual budget?

Two of the agents answered *“No,”* while a third agent said that although it was not the norm, he had encountered developments like this. Another agent stressed the importance of having a contingency in the budget to subsidise non-payers, while the final agent stated that *“In some of our larger developments in particular in one or two instances it would be up to one and a half times the annual budget but the larger developments can sustain that right and it's not a bad thing either, 20% of the members owe 80% of the debt.”*

Two of the directors answered *“No.”* One was unsure, while the other two did have experience of this problem, with one stating that it was caused by *“directors' apathy”* and the other stating that *“it's because of 8 people out of 234 who haven't paid in years.”* The accountants both answered yes, with one stating, *“Yes there are some*

developments with a debtors level greater than the annual budget, however I have generally found that this comes down to a small number of people who haven't paid for a long period of time."

Question 9: Does the development(s) have a provision for bad debts?

Three of the agents answered that yes, the developments that they manage have a provision for bad debts, with one stating that *"it's not a bad debt write-off but it's making the balance sheet look that bit more realistic. If we haven't collected the money in 18 months the auditor will start writing off 50% of that initially and then that would increase."* The other two agents explained that the developments that they worked with did not have a provision for bad debts in their accounts, with one saying, *"The approach we would always take is that the debt is attached to the property."* The directors all claimed that their developments did not have a bad debts provision, with one director concurring with the agent that *"eventually all outstanding debts will be paid or recouped when the dwelling is sold."* The accountants both stated that the developments that they work with do have a provision for bad debts. One accountant said, *"Where interest is added to the account I always set up a provision for bad debts for two reasons: 1. This is not service charge income and therefore often not enforceable through the courts even if it is written into the lease, and 2. It is often written off by the directors when settlement is reached. I believe it is important to allow a provision for bad debts as if a property goes beyond the statute it can be more onerous to try to collect that income if a judgement hasn't been secured and directors often make settlements with people."*

Question 10: Does the development(s) ever write off bad debts?

All five agents stated that the OMCs that they work with do not write off bad debt, with one agent highlighting that *"the management company would actually be in breach of title if they did that, if they wrote off services charges in relation to a particular unit, because the management company are in contract with all the owners in relation to it."* All five directors answered *"No,"* and one accountant stated that they have only written off the interest element of service charges, while the other said, *"One is being written off at the moment because it's reached statute of limitations and it's to do with the original developers, who have gone into liquidation."*

Question 11: Is the development(s) impacted by the statute of limitations?

Two of the agents said “Yes,” with one giving a specific example: “*There was one case where we decided to pursue a member for non-payment of service charges. He owed €20,000 and we only got €9,000 due to statute of limitations.*” The other three said “No,” with one agent stating, “*Our view is the debt sits with the property. You will always collect the service charge prior to the sale closing.*” Another agent highlighted the point that if the member is aware and has acknowledged that the debt is owed then the statute is negated. Only one director stated that their development was impacted by the statute, however other observed that it is important to be aware of the legal angle. Both accountants answered “Yes,” with one accountant explaining that “*there was a case where service charges hadn’t been paid in 8 years and a receiver refused to pay beyond the 6 years and the directors were so desperate to collect the large amount owing for the previous 6 years that they accepted a settlement to get much-needed funds into the company.*”

Question 12: What factors do you believe affect the level of bad debts within a development?

Agents listed the following factors:

- Location of development
- Quality of the scheme
- The initial operation of the management company by the developer
- The cost of the service charge per annum
- The nature of the ownership
- Lack of understanding among members
- Appearance of development

Directors listed the following factors:

- Unemployment/personal circumstances
- Economic circumstances
- Level of enforcement/ collection of outstanding fees

Accountants listed the following factors:

- Too many investor-owned properties
- Downturn in the economy

Question 13: Are there any groups more likely to be non-compliant?

Four of the agents stated that landlords/investors are more likely not to pay, with one of them stating that house owners as opposed to apartment owners are less likely to pay. Two of the directors stated that landlords are less likely to pay, while the other three answered that there was no specific group less likely to pay, with one director commenting that *“In my experience problems affect any section or any individual no matter what background.”*

The accountants both stated that landlords/investors are less likely to pay, with one accountant also mentioning, *“house owners who purchased their properties in the boom time and claim not to have been made aware by the solicitor that service charges were payable annually.”*

Part C – The Solutions

Question 14: Do you think tenants should have the option to pay the service charges if they wish to?

The consensus among the agents was that there was no legal basis for tenants to pay service charges, with one agent pointing out that it could further complicate the debt collection process and there could potentially be data protection issues. One agent explained that he was *“aware of a small number of tenants who pay the service charges. I have seen some long-term tenants wanting to have more interest in the management company. The reality is from a legal and a company structure point of view they have absolutely zero say.”*

Four out of five of the directors felt that tenants should not pay service charges, however one felt that they should as they are using the property. One director noted that although he does not feel tenants should pay service charges he did feel that they should pay for waste.

One accountant answered “No,” while the other said, “Yes. *I think they should as some of these people have an agent that collects the rent and there could also be a mechanism for government to get involved, so when they pay their rent, it doesn’t get paid direct to the landlord.*” – meaning that the service charges are deducted at source from a tenant’s rent.

Question 15: What measures would you suggest OMCs take to encourage payment?

Some agents were in favour of discounting, while others were against it, suggesting that “*your budget is overstated by the discount amount.*” Another agent suggested that transparency was key and the addition of interest to the late payer’s accounts as well as withdrawing services such as refuse, access devices and parking permits. The directors suggested that communication was key. Two directors also mentioned discounting, with flexibility of payment, vigilance and prompt action against non-payers being mentioned. The accountants interviewed suggested getting all members onto standing orders and acting quickly against non-payers.

Question 16: Do the OMCs with which you work add interest to the service charge account?

All agents stated that the OMCs with which they worked added interest. Most directors agreed the same – one was unsure – and both accountants stated that the OMCs with which they worked added interest.

Question 17: Do the OMCs with which you work take legal action against non-paying debtors?

Four of the agents answered “Yes,” with one agent pointing out that “*a judgment won’t turn into cash and that’s a big problem then for a management company because certainly today I would know of many landlords that might have 10-15 judgments against them, that’s not going to help the management company so then ultimately other owners have to subsidise those non-payers.*” One said that they don’t usually because “*the Irish system is too sympathetic as well and payment orders are usually for a very small amount versus what’s outstanding.*” Four of the directors answered “Yes,” while one answered “Not yet.” Both accountants answered “Yes.”

Question 18: Do you think the current legal system for collection of service charge debt works well?

The consensus amongst agents was “No,” with one stating, “*I think MUD could have done that little bit more and actually inserted that basically if service charges are not paid services may be withdrawn.*” All directors answered “No,” with two suggesting that a new mechanism similar to the small claims court system could be beneficial. Both accountants answered “No,” highlighting again that the process could be simplified.

Question 19: Has the MUD act helped owners’ management companies collect service charges?

All agents believed that the MUD Act is flawed and doesn’t do anything to help service charge collection. Two of the directors felt that the MUD Act has “*helped to educate OMC members,*” but the other three directors felt that it didn’t help. One accountant stated that they didn’t think that it had helped, stating, “*The problem with it is that it has no teeth, it sets down obligations such as a developer’s obligation to transfer common areas, owner’s obligation to pay service charges, owner’s obligation to provide contact details, however there are no consequences for those owners who do not comply.*” The other accountant said, “*It has helped with service charges for empty units and other things, because previously developers just wrote off anything that they owned because they owned the management companies.*”

Question 20: Do you think the Government should intervene if there is a risk that an OMC will become insolvent?

Two of the agents answered “No,” while three answered “Yes,” with one stating, “*MUD has provided a further kind of tool for those that don’t want to pay their service charges,*” The directors’ views were also mixed, with only two answering “Yes,” One director stated “*the risk of moral hazard is too great. OMCs that are bailed out with public money will set a bad example to other OMCs who will naturally expect similar assistance. There is no incentive therefore for OMCs to get their house in order*” while the accountants both answered no.

4.2.2 Survey findings

4.2.2.1 Owners management company members survey

Q1. Do you pay service charges on a property?

	Yes	No
Responses	80	0
Percentage	100%	0%

Q2. What kind of property is it?

	House	Apartment	Duplex
Responses	34	40	6
Percentage	43%	50%	8%

Q3 What size is the development in which the property is located?

	<20	20-49	50-99	100-200	>200
Responses	7	12	16	16	29
Percentage	9%	15%	20%	20%	36%

Q4. Do you live in the property?

	Yes	No
Responses	50	30
Percentage	63%	38%

Q5. Is it a rental property?

	Yes	No	Skipped
Responses	29	28	23
Percentage	36%	35%	29%

Q6. Are you happy to pay service charges?

	Yes	No
Responses	56	24
Percentage	70%	30%

Q7. Did you understand when purchasing the property that you would have to pay service charges every year?

	Yes	No
Responses	62	18
Percentage	77.5%	22.5%

<i>Q8. At what level are your service charges set?</i>	<€200	€200- €500	€500- €1000	€1000- €1500	>€1500
Responses	16	17	19	15	13
Percentage	20%	21%	24%	19%	16%

<i>Q9. Do you think this is good value?</i>	Yes	No
Responses	38	42
Percentage	47.5%	52.5%

<i>Q10. Do you pay your service charges on time annually?</i>	Yes	No
Responses	57	23
Percentage	71.3%	28.8%

<i>Q11. Are you happy with the level of service that you receive?</i>	Yes	No
Responses	42	38
Percentage	52.5%	47.5%

<i>Q12. Is your development maintained to a high standard?</i>	Yes	No
Responses	38	42
Percentage	47.5%	52.5%

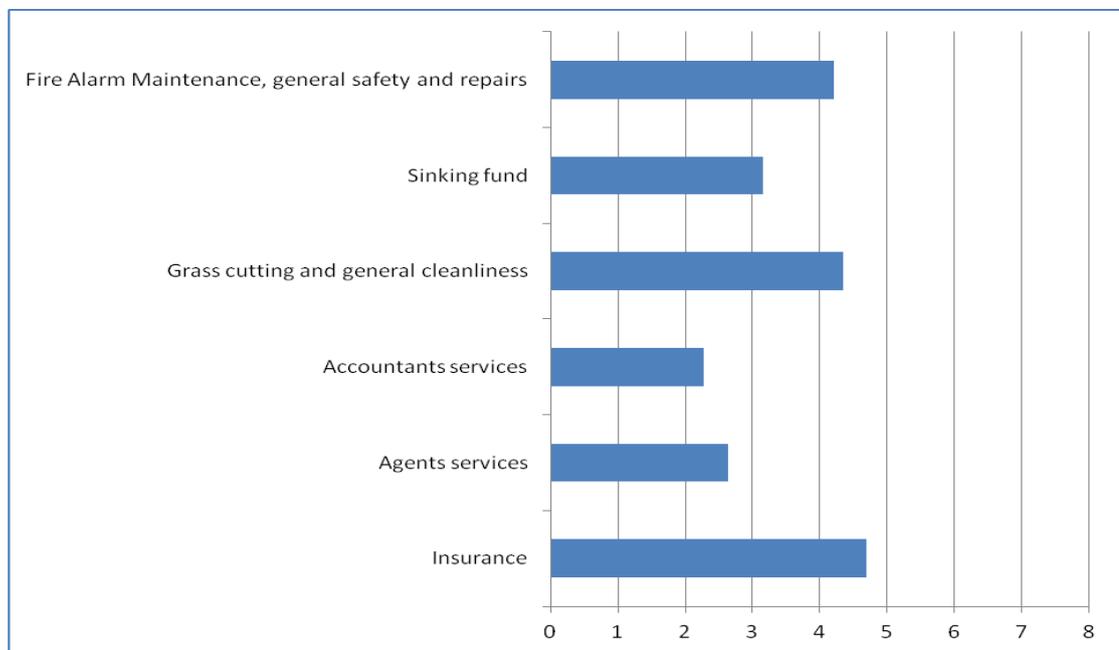
<i>Q13. Do you fully understand why you must pay service charges?</i>	Yes	No
Responses	62	18
Percentage	77.5%	22.5%

<i>Q14. Are you familiar with the Multi-Unit Development Act (MUD Act) 2011?</i>	Yes	No
Responses	29	51
Percentage	36.3%	63.8%

Q15. Can you rate these services from 1-6, 1 being the most important for your development and 6 being the least important?

Results:

Insurance	4.69
Agents services	2.64
Accountants services	2.28
Grass cutting and general cleanliness	4.34
Sinking fund	3.15
Fire alarm maintenance, general safety and repairs	4.21



(Source: Author)

Figure 4.1: Services ranked in order of importance

4.2.2.2 Survey comments

There were 19 comments submitted by survey participants. A full table of the comments is available in Appendix F. The comments have been categorised under the following headings:

Developer Issues

One respondent highlighted this issue, commenting, *“Just getting started on maintenance after the builder failed to hand over the management company, so in ‘catch up’ mode on standard of the property.”*

Transparency

Three respondents commented specifically identifying this issue, with one saying, *“While I am to a large degree satisfied with the service received, I do not think there is a lot of transparency in how the management company engages with various service providers i.e. is it done on the cheapest prices, levels of services etc.”*

Fees are too high

Seven respondents identified with these issues, with comments such as *“high charges with little comeback if I complain about things needing repair. Grass and hedges only cut once a month during summer. Talked with other owners and all have similar issues. A lot of the apartments are leased so that can also prove difficult.”*

Other owners not paying

Seven respondents commented on this issue, with one highlighting, *“I just wish that they chased up the debtors in a more productive way. There always seems to be a shortfall in the sinking fund and they mention the number of debtors each year. I think they should be prosecuted!”*

Lack of Owner Participation

Three respondents highlighted this issue, commenting *“The lack of attendance at every meeting is depressing.”*

Local Authority/ Government Intervention

Six respondents mentioned some form of intervention, with one respondent saying, *“Unfair that council maintains old developments but young people have to pay for maintaining theirs. I'm an accidental landlord. It's not really a rental property. I had to move home with my parents.”*

4.2.3 Profile of accounts

The table below highlights the most significant data extracted from the financial statements, however a full analysis can be found in Appendix H.

Table 4.1: Data extracted from financial statements of 50 OMCs

Location	Budget/ Income	Debtors Level	% of budget
Killiney Co. Dublin	€20,000.00	€0	0.00%
Howth Rd. Raheny Dublin 5	€67,848.00	€876.00	1.29%
Donnybrook Dublin 4	€111,903.00	€1,502.00	1.34%
Blackrock, Co. Dublin	€ 53,644.00	€927.00	2%
Dublin 6	€7,800.00	€248.00	3.18%
Dublin 16	€ 24,067.00	€880.00	3.66%
Queenstown, Monkstown Co. Dublin	€38,400.00	€1,569.00	4.09%
Haddington Road Dublin 6	€39,248.00	€3,099.00	7.90%
Castleknock, Dublin 15	€27,720.00	€2,232.00	8%
Merrion Rd, Dublin	€367,382.00	€35,947.00	10%
Monkstown Co. Dublin	€44,800.00	€4,643.00	10.36%
Dublin 2	€166,839.00	€21,200.00	12.71%
Malahide Co. Dublin	€39,305.00	€5,006.00	12.74%
Sydney Parade Ave Co. Dublin	€143,500.00	€19,123.00	13%
Dublin	€25,872.00	€3,650.00	14%
Drumcondra	€123,707.00	€17,609.00	14.23%
Dundrum Co. Dublin	€28,560.00	€4,121.00	14.43%
Whitworth Road Drumcondra Dublin 9	€6,410.00	€929.00	14.49%
Balbriggan Co. Dublin	€26,455.00	€4,157.00	15.71%
Milltown, Dublin 6	€981,093.00	€157,833.00	16.09%
Ballsbridge, Dublin 4	€5,250.00	€850.00	16%
Sydney Parade Ave Co. Dublin	€12,000.00	€2,214.00	18.45%
Rathmines Dublin 6	€125,449.00	€24,377.00	19.43%
Mill brook Village Milltown Dublin 6	€193,626.00	€40,422.00	20.88%
Sword Co. Dublin	€30,654.00	€6,564.00	21.41%
Hanover Quay Dublin 2	€614,146.00	€136,997.00	22.31%
Terenure, Dublin 6	€73,644.00	€17,427.00	23.66%
Dublin 4	€991,557.00	€257,659.00	26%
Rathfarnham	€185,832.00	€48,543.00	26.12%

Location	Budget/ Income	Debtors Level	% of budget
Haddington Road Dublin 4	€143,933.00	€40,507.00	28.14%
Dublin 6	€27,317.00	€7,955.00	29.12%
Earlscourt Dublin 8	€95,140.00	€27,922.00	29.35%
Clonskeagh Rd, Dublin 6	€15,300.00	€ 5,100.00	33%
Dun Laoghaire Co. Dublin	€33,000.00	€11,578.00	35.08%
Blanchardstown	€115,538.00	€ 44,127.00	38.19%
Balbriggan, Co. Dublin	€214,038.00	€113,008.00	53%
Swords Co. Dublin	€39,106.00	€ 21,714.00	55.53%
Newcastle Co. Dublin	€238,261.00	€139,408.00	58.51%
Blackrock, Co. Dublin	€6,000.00	€ 4,325.00	72%
Dublin 1	€14,228.00	€10,528.00	73.99%
Hillfield Road Rathgar	€78,759.00	€62,661.00	79.56%
Mount Andrew, Lucan	€20,116.00	€16,438.00	81.72%
Holyroad apartments Dublin 4	€35,000.00	€28,651.00	81.86%
Dalkey Co. Dublin	€13,200.00	€12,457.00	94.37%
Balbriggan Co. Dublin	€123,924.00	€151,543.00	122.29%
Balbriggan, Co. Dublin	€112,085.00	€149,364.00	133%
Naul Co. Dublin	€31,115.00	€ 42,230.00	135.72%
Oaktree Martello Towers Balbriggan	€26,593.00	€42,365.00	159.31%
Knocklyon, Dublin 16	€13,333.00	€26,106.00	195.80%
Clonee, Dublin 15	€6,000.00	€11,885.00	198%

(Source: Author)

From the table above it can be seen that the debtors level expressed as a percentage of the income in the financial year analysed ranged from 0% to 198%. Based on these 50 OMC's examined the average debtors level is 43.24% of the service charge budget.

The analysis also included examining the debtors level in each set of accounts and comparing it with the previous financial period. In 23 of the accounts the debtors level had decreased when compared with the previous financial period, while in 27 OMC's the debtors level had increased. Thirty-one OMC's had a surplus in their income and expenditure statement, however 18 had a deficit and one broke even.

The majority of developments had strong net worth, that is, the members fund was a positive figure. Only two of the 50 developments had a provision for bad debts, while none of the developments had written off any bad debts.

Twenty-nine of the developments had a sinking fund provision specifically set aside in a designated bank account and noted on the financial statements. In two sets of accounts the auditor had noted that the sinking fund was tied up in debtors, while one noted the budgeted amount was not transferred to the sinking fund. Five of the auditors noted that funds had been transferred from the sinking fund in that accounting period, with one having wiped out the sinking fund completely due to improvement works.

One of the OMCs analysed was listed for strike off and in six of the OMCs profiled the auditor has noted that the common areas are not transferred, while in one case the auditor was unable to establish if the common area was transferred. A final interesting note in one of the accounts analysed was that one director was paid €500 remuneration for her services on the board.

4.3 Analysis

4.3.1 Is the service charge collection process working?

It would appear from the research that the service charge collection process is failing. Reasons cited by interviewees for owners not paying their service charges included economic factors, a general unwillingness to pay, as well as the fact that services in a MUD are not easily withdrawn, and the ‘free rider’ theory – people feel that they can get away with not paying if everyone else is subsidising them. The information deficit and lack of understanding by people was also highlighted by all groups interviewed as an issue. This is a very interesting point as when OMC members were surveyed 68% of house owners surveyed were aware when they purchased their property that they would have to pay service charges annually, while 85% of apartment owners were aware. This would indicate that there is an information deficit among ‘OMC members’. This point was further enforced when the survey results were filtered to see those members who were not happy to pay

service charges: 85% of them were not familiar with the MUD Act and 50% of them did not know why they must pay service charges at all.

One of the agents interviewed highlighted that it is “*a vicious circle.*” When people don’t see value for money they stop paying and when they stop paying services are reduced and so more people stop paying, and so on. With this behaviour there is a risk that the management company will not be able to operate and would become insolvent. House owners surveyed rated grass cutting and cleanliness as being the most important expense items, while apartment owners rated insurance.

The consensus among all interviewees was that investors are less likely to pay service charges than owner occupiers. Interestingly, house owners were also identified as a problem group, with one interviewee stating that house owners as opposed to apartment owners are less likely to pay, with lack of understanding as the reason for non-payment. This is reiterated in the results of the OMC members survey. On analysis, 42% of respondents were house owners, while 58% were apartment owners. Of the house owners 85% lived in the houses and of those owner occupiers only 55% were happy to pay service charges. This is interesting because 80% of the apartment owners surveyed who were owner occupiers were happy to pay their service charges.

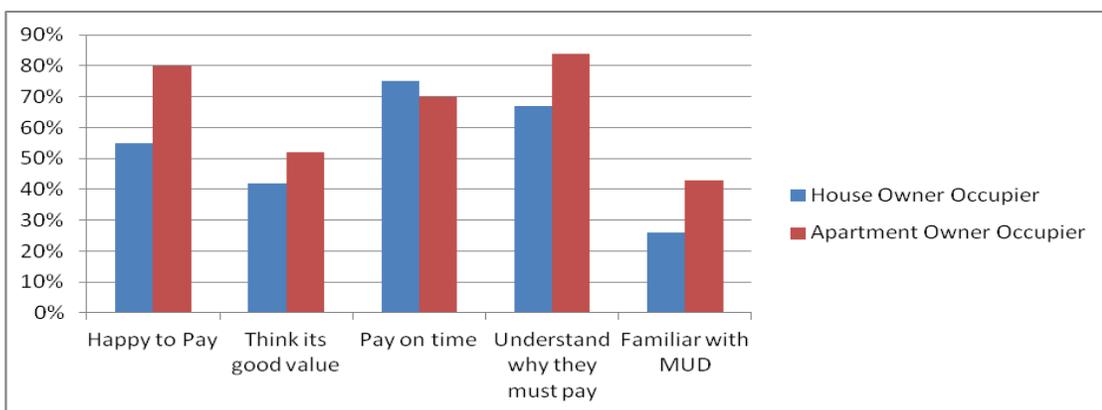


Figure 4.2: Apartment owners versus house owners

(Source: Author)

Of the investors surveyed, 83% owned apartments or duplexes. 80% understood that they would have to pay service charges annually when they purchased their property, however 43% of investors did not think their service charges were good value. Only 60% claimed to pay on time.

When asked about a bad debts provision many of the agents and directors interviewed were of the view that the statute of limitations doesn't apply to service charge arrears and that the debt is collectable when the property is sold, therefore there is no need to provide for that bad debt. One agent explained that he provided for a bad debt provision in cases where service charges weren't recovered within 18 months of the request for payment; however, the debt was never written off, just included in a provision for the purposes of making the balance sheet look better. Interestingly, the accountants both stated that the developments with which they work have a provision for bad debts, with one of them pointing out that any interest added should be provided for in a bad debts provision as it is not necessarily as collectable as service charge income. When asked if they ever actually wrote off bad debts all interviewees said no, except the accountants. However, one accountant explained that he had only ever written off interest, while the other explained that he had been involved in an unusual case where the directors wrote off the debts of the receiver as he had gone into liquidation. One agent explained that to write off bad debts would actually be in breach of title, which is an interesting observation. If bad debts are not provided for it means that the debtors figure will increase year on year.

The directors suggested that communication and flexibility of payment might be the key to getting members on board. There were mixed views around using discounting as an incentive to encourage payment, however all interviewees agreed that adding interest to service charges, withdrawal of services and legal action were proven methods of encouraging payment. One of the accountants interviewed stressed the importance of prompt action against non-payers. Among members that were surveyed 75% of house owners and 70% of apartment owners claimed that they paid their service charges on time annually, with one survey respondent commenting that they "*wish that they chased up the*

debtors in a more productive way. There always seems to be a shortfall in the sinking fund and they mention the amount of debtors each year. I think they should be prosecuted!”

The survey yielded an interesting result relating to the level at which service charges are set and the impact that this could have on members' willingness to pay. When surveying apartment owners paying more than €1500 per annum, 70% indicated that they did not think it was good value, with 50% not paying on time. However, when compared with apartment owners paying between €500 and €1000, 82% thought it was good value and 90% claimed to pay on time.

4.3.2 Are owners' management companies at risk of insolvency?

From the accounting analysis it can be seen that most companies have a high debtors figure, which is representative of outstanding service charges. When measured as a percentage of the budgeted income for a development in a given year it allows a comparison between OMC's in terms of service charge arrears. This comparison highlights that the problem is common to most management companies, to varying degrees. A mere 18% of the management companies analysed had a debtors level that represented less than 10% of their annual budget; a further 52% had a debtors level between 10% and 50% of their budget. This in itself isn't worrying, however when combined with the knowledge that 54% of the companies profiled had increased their debtors level from the previous financial period the concern would be that the levels would continue to increase, pushing those companies to have a higher debtors level every year. A worrying 18% of the accounts analysed showed a debtors level between 51% and 100%. Finally, 12% of accounts recorded a debtors level in excess of the total income needed to run a development for one financial year.

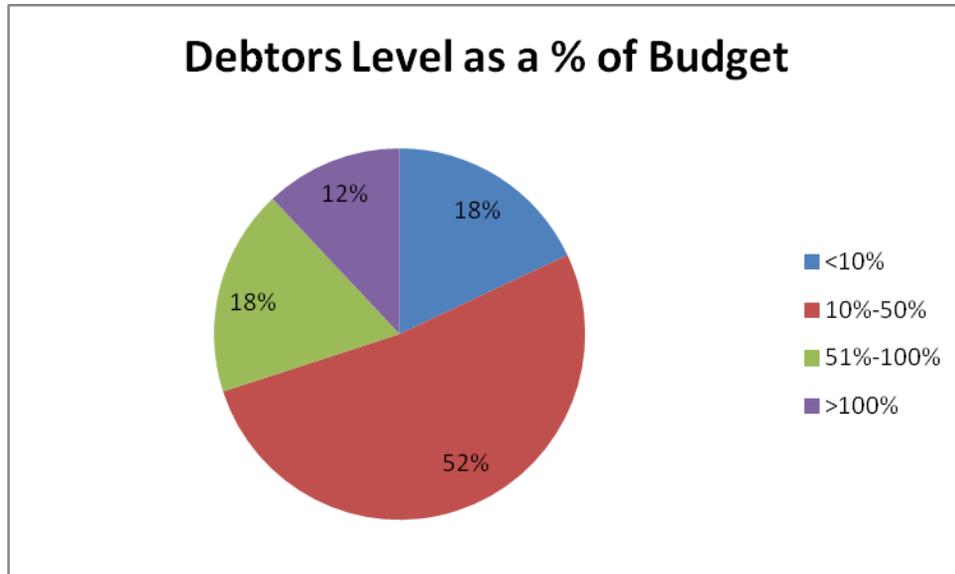


Figure 4.3: Debtors level as a percentage of Budget

(Source: Author)

The interviews further informed this research with interviewees stating that the debtors are often made up of a concentrated group of individuals who have not paid for years. The accountants interviewed also highlighted the risks of service being withdrawn, with one accountant explaining that if the accounts are not paid for they won't be filed and if they are not filed the company will be struck off and no one in the development will be able to sell their property.

Interviewees stated that between 60% and 90% of debtors are paying in full each year, which is in line with the OMC members survey, where 70% of overall respondents claimed to pay on time annually. There was a mixed response when asked if the amounts owed by debtors were greater than the budget. One agent pointed out that 20% of the members owed 80% of the debt and therefore debtors levels being greater than the budget won't necessarily impact the development.

From the accounting analysis it can be deduced that some OMC's have not complied with the MUD Act (2011) and do not have a separate sinking fund established as of yet. Alternatively, the accountant preparing their books and records has not included any

reference to the sinking fund, perhaps because he/she is not familiar with the MUD Act (2011).

4.3.3 Governance and legal issues

This research has identified a range of governance and legal issues affecting OMCs in Ireland. The statute of limitations has been identified in a practical situation as impacting on OMCs, with one agent giving an example of a case where their OMC lost out on €11,000 in service charges due to the statute of limitations. Although most agents and directors took the view that the debt stays with the property, it is evident from this case that if it goes to court the judge won't necessarily agree. Service charges are unique as they are the only non-government charge that is excludable from insolvency arrangements so they remain payable even in insolvency. The logic is that a purchaser would not buy a property without service charges being cleared and so will insist on clear unencumbered title. Therefore the only bargaining power an OMC has is when a member is selling their property and needs the agent to complete the MUD Act pre contract enquiries in order to close the sale; however that does not help if a person is not paying their service charges and intends to live in a property indefinitely.

On the issue of legal action, one agent observed that “*a judgement won't turn into cash,*” which is a relevant point as the literature confirmed how difficult it can be to obtain a judgement, let alone enforce it, particularly for a small OMC being run on a not-for-profit basis.

All interviewees were in agreement that MUD hasn't done enough for management companies, highlighting the lack of enforcement. However one director interviewed did point out that it has helped to educate OMC members. The members survey identified that a mere 26% of house owners and 43% of apartment owners were familiar with the MUD Act (2011). One such member identified that it is “*unfair that council maintains old developments but young people have to pay for maintaining theirs,*” which is a valid point for house owners.

On the question of government intervention views were mixed however one director brought up the issue of “*Moral Hazard*” explaining that government intervention would effectively be a de-incentive to helping OMC’s be self-sufficient.

4.4 Conclusions

This research has identified a number of issues around the financial stability of OMCs in Ireland. It is also clear from the research that debtors levels are a growing problem within OMCs. The analysis of the accounts clearly highlights the urgency of this issue, with 30% of the accounts analysed recording debtors levels that are greater than 50% of their annual budget. However, when interviewed, the agents, directors and accountants verified that this problem stems from a small percentage of debtors not paying over a long period of time, which means that the other owners effectively must subsidise the non-payers. Although this clarifies the issue it does not dilute the effect of the debtors level increasing year on year – the company will eventually become insolvent. It is also worrying that five years after the introduction of the MUD Act only 58% of OMCs have sinking funds in place.

There are a number issues that need to be addressed to mitigate against the risk of OMC insolvency:

1. There does not appear to be a uniform approach to the way in which accounts for OMCs are prepared. It would appear that there are some highly diligent auditors who have prepared the accounts including references to common area transfer and fire safety, highlighting the risks associated with bad debts and recording the sinking fund as a separate line item on the balance sheet, while others do not reference any of the above – even to say that they are not in place. With the new Companies Act negating the requirement for OMCs’ accounts to be audited, it is going to be more difficult to adopt a uniform approach. There is also the issue of bad debts: some agents and directors of OMCs have a provision, while others do not, but none of them actually write off bad debts. It would appear that there needs to be clarification on the following issues:

- Accountants should identify and address whether there is a sinking fund in place.
 - Debtors level should be highlighted in the accounts and broken down to show how many debtors owe the amount outstanding and how many years it relates to.
 - A bad debts provision should be included for any debts approaching the statute of limitations if legal action is not being pursued.
2. It is also evident that the legislation impacting OMCs needs to be examined, primarily:
- Statute of Limitations – should this be applicable to OMCs or does the debt stay with the property? If the debtor has acknowledged that the sum is outstanding then it should be collectable in full as the other members have paid theirs and the non-paying member has benefited from the services; however the research has shown that in practice the 6-year rule applies and this needs to be examined further.
 - The MUD Act – it is clear from the research that there is a lack of knowledge and understanding amongst members of management companies. This was highlighted by all stakeholders interviewed and surveyed and was further emphasised by the low levels of familiarity with the MUD Act (2011). Agents and directors have very little faith in the Act as it does not have any repercussions for non-compliance.
 - Government intervention may be required if there is a risk that a number of OMCs could become insolvent over the next few years.

CHAPTER FIVE: CONCLUSIONS AND RECOMMENDATIONS

5.1 Conclusions

This thesis has examined service charge collection in multi-unit developments. The research has highlighted issues around non-payment of service charges, including the risk of insolvency for many OMCs in Ireland today. The structure under which OMCs in Ireland have been set up means that there is an interdependence between unit owners, with the research from interviews and surveys indicating that approximately 20%-30% of unit owners do not pay their service charges on time and are in an arrears situation. The research also indicated that an average of 54% of management companies analysed had an increase in their debtors level from the previous financial period. This poses a risk to these OMCs as if they become insolvent, basic amenities such as waste disposal and grass cutting would cease. For those living in apartments with common areas electricity and fire alarm systems would be cut off, followed by insurance not being paid, agents resigning due to non-payment and, finally, the annual accounts would not be prepared and filed, meaning the company would be struck off and all owners would be unable to sell their properties.

Of the developments analysed, 18% had a debtors level that was greater than 100% of their annual budget, meaning that the amount owed to the OMC was more than the amount needed to run the development for one year. This might mean that in the short term the development could survive with reduced services, they could pay the insurance, the agent's fees and the electricity; however they would unlikely to be able to establish a sinking fund. There is a real risk that if there was a major problem such as the fire alarm system becoming obsolete, the development would be unable to replace it.

The research has indicated that the New Companies Act (2014) could have an impact on the transparency around the preparation of the annual accounts of an OMC as there is no longer a requirement to have the accounts audited. It would also appear from the analysis that a uniform approach to the preparation of these accounts needs to be adopted, with a specific requirement to highlight the debtors level and analyse it further, along with a specific mention of the sinking fund.

The research also examined the MUD Act of 2011 and its role in the collection of service charges. The findings indicated that the MUD Act does not do anything to enforce the payment of service charges or the establishment of a sinking fund as there are no repercussions for non-compliance with this Act. Interestingly, the research also highlighted that the majority of OMC members were not familiar with the MUD Act.

A number of regulatory bodies exist to regulate the property industry in Ireland such as the Property Services Regulatory Authority (PSRA). The function of the PSRA is to regulate agents and auctioneers, ensuring that they are licensed. The Private Residential Tenancies Board (PRTB) act as a dispute resolution service between landlords and tenants as well as maintaining a register of landlords and tenants; however there is no regulatory body established to keep a register of OMCs or to resolve disputes between developers and OMCs or OMCs and members, or to ensure that OMCs are complying with the MUD Act (2011).

These conclusions have given rise to recommendations and suggestions of further research in this area.

5.2 Recommendations

1. A statutory body such as the PRTB should be charged with taking responsibility for OMCs in Ireland. They should keep a database of all OMCs and provide dispute resolution services between OMCs and members. They should also keep a database of OMCs which can be filtered against their existing database of rented properties in Ireland to provide the OMCs with information on which properties are investor owned within a development.
2. Fast-Track Courts System: The statute of limitations of 6 years is having an impact on the collection of service charges. A fast-track court system similar to the small claims court should be established to enable OMCs to collect amounts due or obtain a judgement. The practice in Finland should be examined, whereby management

companies are given powers to take possession of the unit in question for a maximum of 3 years and pay the unpaid amount using revenue earned from rent.

3. Standardised accounts preparation for all OMCs: All OMCs should be required to prepare and file their annual accounts in the same format, making specific reference to the sinking fund and analysing debtors in more detail. There should also be clear guidance as to whether or not OMCs should provide for bad debts and/or write off bad debts.
4. The Data Protection Act prohibits an OMC from disclosing the personal data of the members without their consent, unless such disclosure is explicitly provided for in the memorandum and articles of association of the company as a condition of membership. OMCs should include this provision in their new company constitution to enable them to publish the unit number and amounts owing of all properties in the non-statutory part of their accounts. The exclusion of this information is unfair as the common areas are owned equally by all members and there should be complete transparency for all unit owners.
5. OMCs need increased participation from members. In order for this to happen members must be educated when they are purchasing their property.
6. Enforcement of the MUD Act regarding the obligation to pay service charges, with penalties for failing to do so and a mandate to withdraw services from non-payers.
7. It could be useful if the Office of the Revenue Commissioners were to introduce a form of tax relief for those individuals paying service charges as it appears to be unfair that those living in properties that are located in a MUD are subject to service charges while those living in estates that have been taken in charge by a local authority are not.
8. Passing service charges on to tenants on long-term leases. This could be facilitated by the PRTB. Tenants could have the right to request proof that service charges are paid and if the landlord fails to provide this they could elect to pay them and be approved by the PRTB to have this deducted from their rent.
9. The PRTB or PSRA could consider collecting a small percentage of the budget of all OMCs to create a national sinking fund which could be accessed by any OMC in distress subject to approval from the governing body in question.

5.3 Further Research

The primary concern raised in the research is the risk of insolvency associated with some OMCs. Based on the above research it could be highly beneficial to adopt a case study approach analysing a number of OMCs over a 1-year financial period to track the performance of these OMCs and to further analyse the debt collection process.

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APPENDICES