Item No. 9.	Classification: Open	Date: 9 March 2021	Meeting Name: Cabinet
Report title:		Discretionary Service Charge Loan Policy Review	
Ward(s) or groups affected:		Council Leaseholders borough wide	
Cabinet Member:		Councillor Stephanie Cryan, Council Housing	

FOREWORD - COUNCILLOR STEPHANIE CRYAN, CABINET MEMBER FOR COUNCIL HOUSING

As a landlord the council offers loans to leaseholders who may need financial support for their service charge payments. The current policy has been in place since 2004 and has not been reviewed until now to ensure that the policy is in alignment with modern lending standards and the expectations of our leaseholders. This report sets out a new Discretionary Service Charge Loan policy that not only meets the council's legal requirements but also makes the loans more accessible and flexible for leaseholders.

The new proposals will provide greater reassurance to leaseholders who are suffering from financial hardship, as we will now take both savings and income into consideration when granting a loan. We will also be introducing new interest rates for both resident and non-resident leaseholders linked to the Bank of England base rate so that there is more flexibility within the policy.

By renewing our policy we can be more reactive to the financial needs of leaseholders seeking finance from the council.

RECOMMENDATIONS

Recommendations for the Cabinet

1. That cabinet notes the contents of this report proposing changes to improve the current discretionary service charge loan policy.

2. That cabinet agrees the changes to the policy as recommended in paragraphs 20-28.

Recommendations for the Leader of the Council

3. That the Leader of the Council delegates authority to the cabinet member for housing to agree a revised comprehensive policy reflecting the changes proposed in this report, and to review and if appropriate amend it, every five

years, or sooner if a significant event occurs (as defined by the Financial Conduct Authority (FCA)).

4. That the Leader of the Council delegates authority to the strategic director of finance and governance to review the service charge loan interest rates on an annual basis, in order for the council to be more reactive to business, economic and environmental changes.

BACKGROUND INFORMATION

5. The current service charge loan policy was originally put in place in 2004. A copy is attached as Appendix 1. The current terms and conditions are summarised in the attached Appendix 2. Since 2004 there have been a number of changes to both the homeowner portfolio and to the FCA guidelines.

6. The number of leaseholders has increased.

7. Many of the leaseholders are no longer the original right-to-buy council tenants and are new tenants who have bought on the open market.

8. Under normal conditions leaseholders who purchased their property on the open market would have a private landlord and no alternative but to seek funding for significant major works service charges through the private sector. Due to happenstance, the council is the landlord and offers loans. Under the circumstances it is reasonable for the council to offer conditions closer to those of the private sector regarding loans and rates offered to ensure that the Housing Revenue Account is not subsidising homeownership and the council is covering its costs.

9. As of November 2020 there were 5,333 leasehold properties out of 15,543 for which the leaseholder had a different contact address to the property, suggesting the leaseholder does not live in the property. The vast majority of these properties are sub-let at full market value (normally three or four times the social rent), and many have also been made into houses of multiple occupation.

10. Since the policy was originally put in place, the FCA has twice significantly changed its guidelines making lending standards and practices more stringent and robust. Although the council is not under FCA jurisdiction, it is best practice to follow the industry standards where possible. If there was no scope in the old policy to implement these alterations, they have been included in this policy change report to make them possible.

11. Other legislation has changed or been put in place, for example the Pre-action Protocol for Possession Claims based on Mortgage Arrears, the introduction of the Mortgage Credit Directive, and changes to affordability and income assessments.

12. Costs, charges, interest rates, and industry comparatives have changed.

13. Technology for valuing the property, credit checks, and testing if the leaseholder can afford the loan has vastly improved and in reaffirmation to the old policy's commitments to responsible lending and the tighter guidance, it is now easier and more accurate to make use of software for property valuations, credit checks, and assessing affordability.

KEY ISSUES FOR CONSIDERATION

14. Due to the demographic changes of the tenants, currently, the council is offering loans to leaseholders who otherwise would have private sector landlords where their only option would be private sector finance.

15. There is a cost to the Housing Revenue Account in the provision of service charge loans due to the generous rates and fees, and it is inequitable to the council's secure tenants to continue to subsidise homeownership in this way.

16. The council policy has fallen behind modern lending standards making lending more risky whilst also not meeting leaseholders' expectations. It is therefore in need of improving and updating.

17. The recommended changes to the policy are summarised below and in the attached Appendix 3. These changes only apply to discretionary loans. The council is obliged to offer loans to help with payment of service charges payable in the first 10 years after the grant of the lease. These mandatory loans are more tightly regulated as to the amount, term, interest rate and level of administration charges, and the council's current offer would be unchanged by these recommendations.

Recommended Policy Changes – new discretionary loans

18. That the policy and procedures are regularly updated to reflect modern dynamics and lending standards with particular focus on:

    - the application process (information we need to gather from and supply to the borrower),

    - assessing affordability through new technology (software), auto-decision making (software),

    - the arrears process (information we need to gather from and supply to the borrower as well as making available reasonable options before seeking possession through the Courts).

19. That technology (including automated decision making) be used for affordability and credit checking purposes. There are several reputable organisations that supply computer software to do this. The software works by checking credit agencies and banks' data. There is a small cost

per report which will be recharged to the borrower as part of the application fee.

20. That the fees continue to be reviewed annually in the Policy and Resources Strategy report (fees and charges appendix).

21. That the council is no longer the lender of last resort, as required by the current policy agreed in May 2004. This means that the council would have the discretion to allow a leaseholder who is in the process of switching mortgage provider to agree to the new provider taking a first charge over the property, without insisting that the service charge loan be repaid in full as part of the refinancing.

22. That the current policy is amended to allow administration, legal and application fees to be “rolled up” into the loan if the customer so wishes.

23. The May 2004 Policy stated “That loans are granted irrespective of the level of savings of an applicant”. It is recommended that:

    - Savings and investments should be taken into consideration as the leaseholder(s) might already have the money to pay for the invoice, but not the income to meet the affordability criteria at the time. Having savings should be taken into consideration to be used as an ‘emergency’ fund to help make payments and can also demonstrate responsible management of their finances.

    - Income should still be the priority when assessing affordability, as savings can be spent and the income would still need to be able to cover the payments.

24. For new repayment loans only, the following products will be available:

    - A repayment loan for resident leaseholders will have an interest rate of 2.5% above the Bank of England Base rate. There will be no cap, but a collar of 2.5%. A collar is the opposite of a cap. It is a minimum rate the interest can drop to. It should be reiterated that properties owned via a company are currently not suitable for any discretionary service charge loan from Southwark council.

    - A new repayment loan for non-residents only with an interest rate 4% above the Bank of England base rate. There will be no cap, but a collar of 4%. A collar is the opposite of a cap. It is a minimum rate the interest can drop to. It should be reiterated that properties owned via a company are currently not suitable for any discretionary service charge loan from Southwark council.

    - In exceptional cases, non-resident leaseholder may be offered the lower rates of interest offered to resident leaseholders or the deferred loan if they meet the criteria for exceptional hardship. The non-resident leaseholder must either meet:

- the [Mortgage Credit Directive Order 2015] (MCD) definition of a consumer buy-to-let and own no more than two properties (including their main residence).

- if the leaseholder is a commercial buy-to-let non-resident, the leaseholder must own no more than two properties (including their main residence) and have no other form of employment or income excluding benefits and pension.

- In future, if the council's interest rates change, the collar will be whatever the additional interest rate is on top of the base rate at zero i.e. if the council's interest rates were changed to 1.75% above base rate, but the base rate dropped to -0.5% ,the interest rate would be 1.75%. This should be implemented incase interest rates go negative so the council can still cover their costs.

- Leaseholders currently with loans will not have their interest rates changed as per their mortgage deeds; however the rates set out in this report will apply for all new loan applications with the exception of the deferred payment loans for customers suffering from exceptional hardship.

- The interest rates should be changed to cover the costs of the service so that it's not subsidised by residents and capped on that basis.

- The rate of interest payable on deferred payment loans for customers suffering exceptional hardship will stay the same at 2% above the Bank of England base rate, but with a collar of whatever the additional interest rate is on top of the base rate at zero. However, the criteria to obtain a deferred payment loan will be more clearly defined as per paragraph 25 below. The rest of the terms and conditions for deferred loans will stay the same.

- The rest of the terms and conditions for repayment loans will stay the same as the current repayment loans unless laid out in this change report.

25. Leaseholders who are residents of the property and suffering from exceptional hardship.

    - Failure to be granted a council repayment loan would not automatically mean the leaseholder will be eligible for a deferred payment loan.

    - Exceptional hardship experienced during the term of a repayment loan may lead to the loan being switched to a deferred payment product at the council's discretion. If subsequently the loan becomes affordable a repayment plan will be agreed with the leaseholder. This will also extend to those who currently have council loans.

- When exercising its discretion the council will apply the criteria set out in para 4(a)-(g) of the Social Landlords Discretionary Reduction of Service Charges (England) Directions 2014.

26. To revise the policy to allow Southwark council to charge a reasonable arrears charge for discretionary loan accounts that fall £50+ in arrears in two consecutive months or twice in a 12 month period to cover administration costs. This fee will be reviewed annually in the Policy and Resources Strategy report (fees and charges appendix). To allow for a robust arrears process to be put in place, including legal action as appropriate.

Policy implications

27. The proposed changes to the policy and procedures with particular focus on the application process, assessing affordability through new technology, auto-decision making, and the arrears process will ensure our standards are up-to-date to reflect modern lending expectations. It is recommended that the policy be reviewed a minimum of every five years to ensure it is still valid and following best practice. The policy should be reviewed sooner if a significant event occurs. This will mainly be based upon what the FCA defines as a significant event.

28. The use of technology and automated decision making will be acceptable methods for property valuations, affordability assessment, and credit checking: this will help ensure accuracy and consistency, and cut costs. Consumer protections required by the General Data Protection Regulation in connection with automated decision making and profiling will be incorporated into the council's procedures. In particular the council will, in each case where automated decision-making is used:

- Obtain the applicant's express consent
- Explain how the applicant can access details of the information used to create their profile
- Explain to the applicant how they can object to profiling
- Establish a procedure for applicants to access the personal data input into the profiles so they can review and edit for any accuracy issues
- Establish additional checks for our profiling/automated decision-making systems to protect any vulnerable groups (including children)
- Only collect the minimum amount of data needed and have a clear retention policy for the profiles we create.

29. Interest rates for new loans should be reviewed annually and the decision for changes to interest rates should be delegated to the Strategic Director of Finance and Governance in order for the council to be more reactive to business, economic, and environmental changes. The fees should also continue to be reviewed annually in the Policy and Resources Strategy report.

30. That the council is no longer the lender of last resort. As explained above this will allow the council to be more accommodating to leaseholders who wish to refinance their primary mortgage.

31. Increasing the interest rates for the repayment loans will increase revenue helping the service to be cost neutral. If the service is not cost neutral the difference is paid for by Housing Revenue Account (HRA) i.e. secure tenants. The interest rates will still be below most retail banks' standard variable rate for similar customers.

32. Creating a third product for non-residents. The product will be the same as the resident capital and interest repayment loan, but with a higher interest rate 4% above the Bank of England base rate. This will increase revenue into the council and is still below most retail banks standard variable rate for similar customers. This extra revenue will help to make the service cost neutral which is fairer for all tenants.

33. Interest rates on deferred loans for leaseholders who are suffering from exceptional hardship will remain the same. The criteria for exceptional hardship will be based on the Social Landlords Discretionary Reduction of Service Charges (England) Directions 2014 (or any revised version). This will ensure vulnerable leaseholders are appropriately recognised and protected. If a leaseholder experiences exceptional hardship during the term of their repayment loan, under the proposed changes to the policy, the council would have the ability to change their product to a deferred loan, which again will offer better protection to the leaseholder.

Community impact statement

34. The increase in interest rates will mean that the loans may become unaffordable to some leaseholders due to not meeting the affordability requirements for our very restricted product range. The private sector offer a wider variety of loans that might be more affordable, more flexible, or better suited to their needs. The private sector also offer subprime mortgages which are more expensive, but will help the leaseholder raise funding. In exceptional circumstances leaseholders who cannot afford a repayment loan may be offered a deferred payment loan, or buy-back (subject to available funding).

35. By increasing the interest rates, the loans will become cost neutral which will benefit the council's secure tenants who will not be subsidising homeowners.

36. The changes to the policy will benefit leaseholders by making the protection more robust.

37. Officers have considered the impact on borrowers who have protected characteristics for the purposes of the Equality Act 2010. The council will undertake a further Equality Impact Assessment.

38. Age, disability, pregnancy & maternity – borrowers who rely on a limited or fixed income may not be able to afford the new loans because of the increased interest rates. Under these circumstances the borrower may be considered for a deferred loan for exceptional hardship which requires no regular payment. The new policy may increase the numbers that seek deferred payment loans. There are other options we can also consider such as 'payment holidays' or increasing the term: these would be considered on a case by case basis.

39. It is not considered that the policy would have any material impact on persons or any particular gender, marriage/civil partnership status, race, sex or sexual orientation. As regards religion, the policy change has no material impact on any particular religion. The council currently does not offer any Islamic Finance Options for long term financing.

Resource implications

40. The service is currently fully resourced for the policy changes proposed and for some increase to the portfolio.

Legal implications

41. See the legal concurrent below.

Financial implications

42. The changes the policy will potentially help bring in additional revenue for the council. This will stop the subsidising of the service charge loans.

Consultation

43. Consultation has been carried out with Homeowner Council (HOC) on 6 November 2019. The Homeowner Council asked to see the cost analysis of the service charge loan service, and this has been forwarded to them. They gave no feedback regarding our consultation or cost analysis.

44. The draft report has not been taken to the MySouthwark Homeowners Board as they have disbanded.

45. The draft report was sent via email to the Homeowner Online Panel for feedback on 6 January 2021. Leaseholders were asked to give feedback by email. In summary the feedback from the leaseholders were:

- General queries asking for clarification about some of the proposed changes.
- A non-resident queried why non-residents should pay higher interest rates than residents and expressed their frustrations that they felt this was unfair.

46. Every leaseholder who gave feedback was responded to by email. Where applicable, leaseholders' questions were answered in our response. Leaseholders either did not reply to our response, or raised no further queries to our answers when they did.

SUPPLEMENTARY ADVICE FROM OTHER OFFICERS

Director of Law and Governance

47. Sections 450A, 450B, and 450C of the Housing Act 1985 (the 'Act') enabled the Secretary of State to make regulations to empower local authorities to grant loans in respect of service charges to leaseholders. The Secretary of State made those regulations in the Housing (Service Charge Loans) Regulations 1992/1708 (the 'Regulations') which came into force on 17 August 1992 and have been amended a number of times since then.

48. The legislation provides for two service charge loan schemes: under section 450A the council must, upon request, grant a loan to cover the costs of larger service charges in respect of repairs and improvements. Under section 450B local authorities have the power to grant loans either to help leaseholders who do not comply with the mandatory rules or to 'top up' mandatory loans which do not cover the whole amount of the service charge being demanded.

49. A discretionary loan may be on such terms as the council may determine and must be secured as a mortgage on the property. The council has freedom to set its own interest rates for discretionary loans provided such rates are reasonable. The council can charge a fee to cover administrative and legal fees, which can at the council's option be added to the amount of the loan.

50. The report proposes that some aspects of the council's decision-making should be automated. Such processes are regulated by the Article 22 of the General Data Protection Regulation and the report to the Cabinet Member attaching the consolidated and revised policy will need to detail how the requirements of the GDPR will be met.

51. In the exercise of all its functions, the council must have due regard to the public sector equality duty in Section 149 of the Equality Act 2010. Specifically to have due regard to the need to (a) eliminate discrimination, harassment, victimisation or other prohibited conduct, (b) to advance equality of opportunity and (c) foster good relations between persons who

share a relevant protected characteristic and those who do not share it. The relevant protected characteristics for this purpose are age; disability; gender reassignment; pregnancy and maternity; race; religion or belief; sex; and sexual orientation. The potential impacts on residents with these characteristics are considered in the 'community impact' section of the report.

52. Part 3D of the council's constitution provides that changes to existing fees and charges may be dealt with by the individual cabinet member, except for matters which affect more than one cabinet portfolio: such decisions should be taken by full cabinet.

Strategic Director of Finance and Governance - (H&M20/124)

53. The authority has a statutory obligation under the Statutory Instrument 1992/1708, The Housing (Service Charge Loans) Regulations 1992, to offer loans to leaseholders. Mandatory loan interest must be set as per Schedule 16 1985 Housing Act i.e. the higher rate of the 'Standard National Rate' or 'Local Average Rate' as defined in that Schedule. As of 31 March 2020 this was 3.6%. For discretionary loans, the authority is expected to charge a "reasonable" rate of interest. Reflecting the changes outlined in this report, a reasonable rate of interest has been determined by the council's Chief Financial Officer to be +2% above the Bank of England base rate for the deferred payment loans, +2.5% above the Bank of England base rate for residents repayment loans, and +4% above the Bank of England base rate for non-residents repayment loans.

54. The proposal to offer resident discretionary loans at base rate +2.5% (currently equivalent to a rate of 2.6%) is clearly more favourable to leaseholders than the mandatory scheme and should assist in achieving improved collection performance in respect of major works service charges. By no longer being the lender of last resort means the council's interests can be protected by securing debts against the property, whilst the fees and increase in the interest rate will help cover the costs of the service.

55. Neither scheme will entail any additional costs to the HRA. Reduced interest on cash flow received by the HRA will be offset by the interest paid on service charge loans and all administrative costs relating to the operation of the scheme will be recovered through the fees.

BACKGROUND DOCUMENTS

Background Papers	Held At	Contact
None		

APPENDICES

No.	Title
Appendix 1	2004 Policy
Appendix 2	Current terms and conditions
Appendix 3	Summary of key changes

AUDIT TRAIL

Cabinet Member	Councillor Stephanie Cryan, Council Housing	
Lead Officer	Dominic Cain, Director of Exchequer	
Report Author	Alexander Ross	
Version	Final	
Dated	25 February 2021	
Key Decision?	Yes	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER		
Officer Title	**Comments Sought**	**Comments Included**
Director of Law and Governance	Yes	Yes
Strategic Director of Finance and Governance	Yes	Yes
Cabinet Member	Yes	Yes
Date final report sent to Constitutional Team		25 February 2021