

Item No.	Classification Open	Date: 4 th May 2004	Meeting Name Executive
Report title:		Leasehold Service Charge Loans	
Ward(s) or groups affected:		All Wards Affected	
From:		The Strategic Director of Housing	

RECOMMENDATIONS

The Executive is asked to agree:-

1. That the principle policy relating to the council's use of its discretionary power is that the council is only a lender of the last resort
2. That discretionary loans can be used either alone or in conjunction with a mandatory loan as individual circumstances dictate.
3. That the terms of any discretionary loans be those set out in Appendix A to this report
4. That the following administrative fees be charged initially and be index-linked and amended annually by the Strategic Director:
 - £175 in respect of discretionary loans alone
 - £75 in respect of discretionary loans granted in conjunction with mandatory loans
 - £100 for mandatory loans.
5. That any administrative fee or legal costs in respect of a discretionary loan is payable before the advance is finalised only being added to the loan when no other payment option is available.
6. That the professional cost of the conveyance including valuation, solicitors and land registration fee will also be recharged to applicants, payable on the same conditions outlined in paragraph (5) above.
7. That discretionary loans are only given subject to leaseholders proving their income is sufficient to meet payment and there is sufficient equity in the dwelling.
8. That loans are granted irrespective of the level of savings of an applicant.

KEY ISSUES FOR CONSIDERATION

9. The Housing and Planning Act 1986 amended the Housing Act 1985 to provide local authorities with the power to grant loans in respect of service charges. The legislation provides two service charge loan schemes: a mandatory code (The Right to a Loan) where the council must, upon request, grant a loan to cover the costs of larger service charges in respect of repairs; and a discretionary code which gives local authorities 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.
10. This report argues that service charge loans are an inherent part of any comprehensive service charge arrears recovery procedure and indeed that in certain circumstances individual leaseholders will have no alternative but to take a loan from the council to avoid possession proceedings. It further argues that the mandatory code is so restrictive as to be ineffective for many of Southwark's Leaseholders and that the sensible use of its discretionary powers will enable Southwark to properly deal with situations where large service charges are being levied. The Council will usually only be the lender of last resort, offering service charge loans only when other options have been explored and found to be unavailable to individual leaseholders.

Introduction

11. Section 5 of the Housing and Planning Act 1986 amended section 450 of the Housing Act 1985 by adding sections 450A, 450B, and 450C which provide local authorities (and certain other social landlords to whom the Right to Buy applies) with the power to grant loans in respect of service charges to leaseholders and their assignees. Section 450A deals with situations where a local authority must grant a loan, section 450B gives local authorities discretion to grant loans in other cases. These two schemes are examined in a little more detail later in this report.
12. Loans could not be granted by local authorities until six years after this primary legislation was passed when statutory instrument 1992/1708 (the Housing (Service Charge Loans) Regulations) came into force on the 17 August 1992. The reason for these powers being brought into play was to help leaseholders who found themselves in the poverty/red lining/negative equity trap. These provisions were the first in the series of four measures aimed at 'assisting' RTB leaseholders (the other three being the RICS Code, mortgage indemnity powers and the flat swap scheme) The regulations were aimed at two groups:
 - (i) leaseholders who, despite adequate income, could not get a loan in the private sector because of negative equity or because their block was 'system built' and
 - (ii) people on income support (now mainly OAP's) who would not be able to secure a private loan

13. The improvement in the property market has removed the negative equity problem but loans are still very important for the second group because DSS regulations strictly prohibit the payment of a capital service charge. The only way that elderly leaseholders could stave off action is to take a loan from the council (their only realistic lender) and claiming DSS 'interest only' Income Support.
14. Given that the only option to most private owner-occupiers, (asking their mortgagees to fund repairs or improvements), may not be available to Southwark's leaseholders, a sensible loan policy is the only alternative to recovery action. Having said this a discretionary service charge loan will usually only be agreed when other options have been investigated and exhausted. Such a process will include, for example, written refusal from private sector lenders to grant a loan.
15. Southwark does not have a complete policy governing the exercise of all of its discretions on service charge loans, although certain infrastructure and procedures to deal with applications for repayment schemes, established by a report to the Executive on 22nd October 2002, are in place. This report deals solely with loans secured as Mortgages on the property and sets out terms that are to be offered in addition to the repayment schemes set out in the 22nd October 2002 report.
16. The report on payment options that was agreed by Executive on 22/10/2002 included three payment schemes that were to be secured as mortgages on the properties. However these payment plans were neither as advantageous nor flexible as those envisaged in this report. Although the unsecured payment scheme over three years proved popular, with over 400 leaseholders opting for this method, very few applications were received for the interest bearing secured options. Records show that only one such mortgage loan was actioned.

Mandatory Scheme

17. The Right to a Loan prevails in only fairly limited circumstances, the essential parameters being:
 - (a) that the service charge is in respect of repairs and
 - (b) that the demand is between £2,000 and £20,000
 - (c) (Note: these are figures cited in the regulations, they are index linked annually to the RPI from January 1992 rounded up to the nearest £10) and
 - (d) the service charge is demanded in the first ten years of the lease and
 - (e) the leaseholder makes an application in writing within six weeks of receiving the demand and
 - (f) accepts the offer of a loan within four weeks of its being made.

18. The Right to a Loan only applies to that amount of a repair service charge over and above the first £1,500 demanded (this figure is also index linked as above). Thus should a leaseholder comply with the mandatory loan rules, they would still be left with £1,500 service charge debt unless the council agreed an additional discretionary loan amount to cover this amount.
19. The Right to a Loan prevails whether or not there is sufficient equity in the dwelling and irrespective of the leaseholder's income. All loans, whether mandatory or discretionary must be secured by a mortgage of the flat and must be at an interest rates set by the ODPM. These rates have historically been much higher than those offered by the private sector. Councils are duty bound to charge the higher of the standard national rate or the local average rate, the rate currently charged would be about 9%.
20. The 1992 regulations set out, at Schedule 1, the terms of mandatory loans which must apply and a maximum administration fee of £100 which must be added to the loan at the leaseholder's request.

Discretionary Loans

21. The Housing and Planning Act (1986) set down discretionary powers to grant loans in all other cases where the leaseholder (including their assignees) are liable under the terms of the lease to pay service charge in respect of repairs. The terms of a discretionary loan may be on such terms as the council may determine (Appendix A) and must be secured as a mortgage on the flat. Originally there was no discretion as to the interest rate to be charged however the Housing (Service Charge Loans) (amendment) (England) Regulations 2000 gave local authorities freedom to set their own rates for discretionary loans.
22. The collection of service charges from leaseholders must be vigorous. Quite apart from the council's fiduciary duty and the opportunity cost of late income, councils are under a duty to collect capital funded service charges due either during the financial year in which the money is spent or the following financial year. Capital funded repair service charge are not insubstantial - £5,000 is the norm and charges between £10,000 and £15,000 are not uncommon. Leaseholders may not have such lump sums saved. It is usual practice for most home owners to fund costly repairs from further borrowing but for some of Southwark's leaseholders who live in high rise system built blocks, lenders will not grant further mortgages because of the type of construction, even if the leaseholder has adequate income to pay. It should not be ignored either that lending institutions have, in the past, refused to grant mortgages on 'council blocks' citing management problems and funding of repairs as an excuse. Bearing this in mind it could be argued that equity dictates that councils offer discretionary loans as a matter of last resort when leaseholders cannot secure a loan elsewhere, either at all or without incurring severe financial penalties.

23. Earlier in this report the example of pensioner leaseholders was mentioned. If elderly leaseholders on limited pension income (with, say, some Income Support) receive a large service charge demand they may have no way of paying: there is no 'rent rebate' equivalent for service charges and DSS rules specifically prohibit the payment of capital service charges. The pensioner leaseholder could be facing eviction and would not be able to secure a loan in the private sector. The option would be to take a council loan, in these cases the DSS will pay the interest only on the loan direct to the council.
24. Having examined situations where the sensible use of its discretion saves the Council costly arrears recovery action and keeps people in their homes, it must be countered there are situations where other interests argue against the exercise of the Council's discretion or suggest it is only used in exceptional circumstances. As mentioned above, a mandatory loan must be given irrespective of adequate equity in the flat or the leaseholders income – this is not the case for discretionary loans. The council has a fiduciary duty to its rent and property tax payers and where it can, it should secure the loan against a property that has sufficient equity should the loan be defaulted. In addition proper checks should be made to ensure that a leaseholder will be able to finance the additional mortgage.
25. The situation that arises when a flat is sub-let also needs consideration. Right to Buy leaseholders have the right to sublet their flat. In doing so they make a commercial decision and as they are not using the property as their only or principal home it is questionable whether or not a discretionary loan should be given in respect of service charges. Having said this, it is dangerous to have a policy which prohibits sublet flat leaseholders being offered a loan because sometimes these leaseholders have no alternative but to sublet. There are occasions where elderly leaseholders have to sublet their flat, having moved into private care accommodation, because they cannot sell their high rise flat. Indeed some leaseholders may have moved away to find work, are living in private rented accommodation use the rent from subletting the flat to over the mortgage. In all cases it seems more equitable to look at the individual circumstances prevailing to determine whether or not a loan should be granted.
26. The 1992 regulations give local authorities discretion to charge any level of fee for discretionary loans so that the Council can recover its administration costs. It is proposed that this is set at £150. The regulations also allow, in the case of discretionary loans, for the council to insist that the fee is paid separately rather than adding it to the loan. It is proposed that this power is used and that the fee is only added to the loan when there is no alternative. Similarly the Council's professional costs for conveyancing, valuation and land registration etc will be recovered separately from the leaseholder, only being added to the loan in case of severe hardship.

Leaseholder Council

27. The Leaseholder Council received a report on service charge loans at its meeting a Monday 26th January 2004. The following observations were made:
 - (a) that the rate of interest for discretionary loans could be borrowing rate plus 1% to cover administration costs.

- (b) that a fee level of £150 be set additional to valuation and conveyancing fees
- (c) that the Strategic Director of Housing be granted discretion to add fee charges to loans
- (d) non resident leaseholders should not be granted loans except in exceptional circumstances agreed by the Director of Housing.
- (e) companies should not be eligible for discretionary loans
- (f) a fee level of £75 be charged in addition to conveyancing costs for mortgage redemption
- (g) loans should not be granted where there is no equity
- (h) that the Strategic Director of Housing be given discretion to allow top up discretionary loans to mandatory loans
- (i) the loan period to be a maximum of 25 years
- (j) Leaseholder Council to be provided with the agreed procedure for dealing with service charge loans.

SUPPLEMENTARY ADVICE FROM OTHER OFFICERS

Borough Solicitor & Secretary

28. The legal basis for the Council's power to make service charge loans derives from sections 450A, 450B and 450C of the Housing Act 1985, as amended. The Secretary of State introduced regulations to bring the service charge loan provisions of the Housing Act into force with effect from 17 August 1992, when the Housing (Service Charge Loans) Regulations 1992 were made. The regulations have since been amended by the Housing (Service Charge Loans) (Amendment) (England) Regulations 2000. The effect of the principal legislation and the regulations is set out in the body of the report. The existing scheme of delegated authority is sufficient to allow officers to offer leaseholders loans using the council's discretionary powers.
29. The Executive will note that in certain, fairly limited, circumstances a lessee has the right to receive a service charge loan from the Council. The Council has a wider discretion to grant loans in other circumstances or to provide additional assistance to lessees who are unable to make the minimum contribution which is expected under the mandatory scheme. In agreeing a general policy for application in connection with the discretionary service loan scheme the Executive will wish to be satisfied that the scheme strikes a fair balance between the needs of individual lessees, particularly those in hardship, and the Council's general fiduciary duty to recover all monies owing to it and to manage its resources effectively in the interests of the community as a whole.

Chief Finance Officer

30. The authority has a statutory obligation under the Statutory Instrument 1992/1708, The Housing (Service Charge Loans) Regulations 1992, to offer loans to leaseholders. These regulations require mandatory loans to be charged at the Council's consolidated rate, currently 9.376%. For discretionary loans, the authority is expected to charge a "reasonable" rate of interest and this has been determined by the Council's Chief Financial Officer to be base rate +1.5%.
31. The proposal to offer discretionary loans at base rate +1.5% (currently equivalent to a rate of 5.5%) 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. The Council's interests will be protected by securing these loans against the property.
32. 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 charges levied in advance as set out in Appendix A.

Conclusion

33. Procedures will be put in place to ensure Council widely 'advertises' the Right to a Loan. To this end major works service charge invoices will contain relevant information from January 2004 and the new Right to Buy computer system can provide for the Right to Buy offer notices to similarly contain relevant information based on the policies proposed by this paper.
34. Detailed procedures will also be produced dealing with all aspects of mandatory and discretionary loans setting out the work of both the Housing and Finance Divisions but with emphasis on the criteria staff are to use when making a decision on whether or not to grant a discretionary loan. The procedures will be agreed by the Strategic Director of Housing to ensure they are robust enough to withstand any challenge to the power to exercise discretion in making a loan.
35. This paper recognises the fact that a service charge loan may be the only option available to a leaseholder to pay a large service charge demand and, so long as the Council's fiduciary interests are protected, Southwark should use its discretion to offer loans. The granting of loans will be an inherent part of a comprehensive service charge recovery procedure ensuring that leaseholders have as many options as possible for paying charges properly levied.
36. It should be noted that this policy contributes to one of the Council's principle Community Strategy objectives of 'tackling poverty'.

Background Papers		Held At	Contact
Leasehold Service Charge Loans		Leasehold Management Unit, 113 Lorrimore Road	Martin Green 51418
Lead Officer	Keith Broxup - Strategic Director of Housing		
Report Author	Martin Green		
Version	Final		
Dated	23.04.04		
Key Decision?	No		
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / EXECUTIVE MEMBER			
Officer Title		Comments Sought	Comments included
Borough Solicitor & Secretary		Yes	Yes
Chief Finance Officer		Yes	Yes
List other Officers here			
Executive Member		Yes	No
Date final report sent to Constitutional Support Services			23 rd April 2004

Terms of Discretionary Service Charge Loans

1. The loan will be secured on the property to which the service charge relates and charged at the Land Registry and that the mortgage agreement allows the mortgagee Landlord to add further amounts to the loan in the circumstances where future service charges for repairs are not paid in accordance with the terms of the lease.
2. The rate of interest to be charged will be variable be set at 1.5% above the base rate.
3. The loan is granted on using the annuity method with equal instalments comprising of both principal and interest.
4. The loan is repayable by monthly instalments due on the 15th day of each month.
5. In the event of any default on the loan interest will be charged at the prevailing rate seven days beyond the due date.
6. The offer of a loan is granted subject to the financial status of the applicant and the equity remaining in the property. Loans will be granted irrespective of the level of savings of applicants but income checks will include interest on any savings.
7. The maximum period of the loan is 25 years.
8. The administration charges will be payable before the advance is finalised and will only be added to the loan when no other option is available. The administration charge will be as follows:
 - £175 for discretionary loans alone.
 - £75 for discretionary loans granted in conjunction with mandatory loans.
 - £100 for mandatory loans.

And thereafter be index-linked and amended annually as appropriate by the Strategic Director of Housing.

9. Professional costs of conveyancing including valuation, solicitors and land registry fees will be recharged to applicants and payable as (8) above.
10. Discretionary loans will not be given to private companies and to non resident leaseholders only in exceptional circumstances.