



# Housing and Community Safety Scrutiny Commission

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## **Service Charges**

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# What is a service charge

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## ○ **The Law**

Section 18 of the Landlord & Tenant Act 1985 – the meaning of “service charge” and relevant costs”

- (1) In the following provision of this act “service charge” means an amount payable by a tenant of a [dwelling] as part of or in addition to the rent –
  - (a) which is payable directly or indirectly, for services, repairs, maintenance [improvements] or insurance or the landlord’s costs of management, and
  - (b) the whole or part of which varies or may vary according to the relevant costs.
- (2) The relevant costs are the costs or estimated costs incurred or to be incurred by or on behalf of the landlord, or a superior landlord, in connection with the matters for which the service charge is payable.
- (3) For this purpose –
  - (a) “costs” includes overheads, and
  - (b) costs are relevant costs in relation to a service charge whether they are incurred, or to be incurred, in the period for which the service charge is payable or in an earlier or later period.

# What is a Service Charge

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## ○ **The Law**

Section 19 of the Landlord & Tenant Act 1985 – limitation of service charges: Reasonableness.

- (1) Relevant costs shall be taken into account in determining the amount of a service charge payable for a period –
  - (a) only to the extent that they are reasonably incurred, and
  - (b) where they are incurred on the provision of services or the carrying out of works, only if the services or works are of a reasonable standard;and the amount payable shall be limited accordingly.
- (2) Where a service charge is payable before the relevant costs are incurred, no greater amount than is reasonable is so payable, and after the relevant costs have been incurred any necessary adjustment shall be made by repayment, reduction or subsequent charges or otherwise.

# What is a Service Charge

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- **The Law** – s. 19 Reasonableness amended by part 3 of the Housing Act 1996
- A tenant by whom, or a landlord to whom, a service charge is alleged to be payable may apply to a Leasehold Valuation Tribunal [now the First Tier Tribunal] for a determination-
  - (a) whether costs incurred for services, repairs, maintenance, insurance or management were reasonably incurred,
  - (b) whether services or works for which costs were incurred are of a reasonable standard, or
  - (c) whether an amount payable before costs are incurred is reasonable



# What is a Service Charge

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- Reasonableness is not an all or nothing test
- A service charge is not inherently unreasonable due to its size:-
  - Is the work necessary
  - Is the cost within industry norms
  - Has the work been done to a reasonable standard



# The Lease

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- Southwark's standard lease requires the council (as the landlord) to issue an estimated service charge prior to the start of each financial year
- There is no separation between annual revenue service charges and major works service charges
- The estimate is based on the costs the landlord is expecting to incur within the financial year, including those for major works
- The leaseholder is required to pay the estimated service charge in four equal amounts on 1<sup>st</sup> April, 1<sup>st</sup> July, 1<sup>st</sup> October and 1<sup>st</sup> January
- At the end of the financial year, once the actual costs are known, the landlord issues the actualisation of the service charge (including any major works expenditure). The actualisation may lead to a debit or credit on the service charge account
- Any debit is due to be paid within 30 days of notification
- Any credit is applied to the account
- The lease has no mechanism for refunds
- We will refund credits on application if the account is clear and the credit is more than £100.



# Transfer Agreement

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- Houses are usually sold via a transfer agreement
- If the house is on an estate the transfer agreement will normally contain covenants for the payment of charges for communal services
- Freeholders are not charged on an estimated basis, but only once the actual costs have been incurred
- The transfer requires payment within 30 days of the invoice
- Freeholders are currently not required to be consulted under s20, and neither are they protected under s20b
- The council does issue freeholders with consultation letters mirroring s20 when qualifying work is proposed for which they will be charged (mainly communal heating systems and roofs)
- Freeholders are given the option of paying their actual charge interest free over 12 months



# Payment Options

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- Revenue service charges can be paid on the quarter days in accordance with the lease or over 12 months in equal instalments (interest free)
- An actual service charge debit can be paid over the remaining six months of the financial year
- Extending payment terms for revenue service charges builds debt, as at least one new invoice will be issued each year
- There are various options for major works service charges:-
  - Payment in accordance with the lease, on the quarter days of the year when the expenditure is due to be incurred
  - Payment over 12 months in equal instalments (interest free) from the April following the invoice date
  - Payment over 36 months in equal instalments (interest free, but for resident leaseholders only)
  - For invoices of more than £7,200, payment over 48 months in equal instalments (interest free but for resident leaseholders only)
  - A longer term service charge loan at a low rate of interest
  - An equity share or equity loan
  - In exceptional circumstances the council may be able to buy-back the property if the leaseholder cannot afford the service charges
  - These are still the widest range of options in London
- <https://www.southwark.gov.uk/home-owners-services/service-charges/ways-to-pay-major-works-costs>





# Payment Options

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- Currently re-looking at offering longer term interest free period for resident leaseholders
- Interest free periods come at a cost to the HRA, as council pays interest on borrowing for major works schemes
- Costs are frequently incurred on major works schemes before the estimated service charges are issued. On occasion the total cost is incurred prior to invoicing
- Any decision to extend the period must take into account the impact on the HRA as it will involve the tenants subsidising homeowners

# Housing Revenue Account Income 2022/23

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**Income of £287.3m from:**

- **Rents - £202.1m**
- **Fixed service charges - £16.5m**
- **Heating charges - £9.3m**
- **Variable service Charges - £33.3m**
- **Garages - £6.0m**
- **Commercial Rents - £8.3m**
- **Fees, charges, capitalisation, recharges - £11.8m**



# Housing Revenue Account Expenditure 2022/23

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- **£287.3m expenditure including:**
  - **Repairs - £59.2m (including responsive repairs, planned maintenance etc)**
  - **Heating - £22.5m (inc £12.2m district heating)**
  - **Leasehold Buildings Insurance - £5.3m**
  - **Cleaning and Grounds maintenance - £18.2m**
  - **Debt charges - £30.6m**
  - **Depreciation - £53m**
  - **TMOs – £7m**



# Lift Costs

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Total cost of lift service in 2021/22 - £4,899,450.59

Not chargeable - £1,114,387.29

Net Chargeable figure - £3,785,063.30

Chargeable lift costs:

Repairs (inc PPM)	£2,055,726.91
Electricity	£762,986.57
<b><i>Sub Total</i></b>	<b><u>£2,093,843.88</u></b>
Overheads	<u>£966,349.82</u>
<b><i>Total</i></b>	<b><u>£3,785,063.30</u></b>

# Lift Costs to Green Towers

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- Total lift costs to Green Towers

Repairs (inc PPM)	£12,086.79
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Electricity	£2,052.44
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Overheads	<u>£4,044.04</u>
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<b>Total</b>	<b><u>£18,183.27</u></b>
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# Service Charge Apportionment

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- Schedule 3 paragraph 6 (2)
  - The Landlord may adopt any reasonable method of ascertaining the said proportion and may adopt different methods in relation to different items of costs and expenses



# Service Charge to Green Towers

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- No of properties in Green Towers - 80
- Each property given weighting of 4 units plus number of bedrooms
- 17 one bed properties (weighting of 5)
- 63 two bed properties (weighting of 6)
- Total units – 463
- 59 secure tenants (14 one bed & 45 two bed)
- 21 leaseholders (3 one bed and 18 two bed)



# Service Charge to Green Towers

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Total lift cost – £18,183.27

Divided by total units - 463

Multiplied by property weighting – 5  
or 6

One bed property -  $£18,183.27/463*5$   
= £196.36

Two bed property -  $£18,183.27/463*6$   
= £235.64





# Service Charge to Green Towers

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- Total charges to one bed properties  
– £3,338.18
- Total charges to two bed properties  
– £14,485.09
- Total amount paid by secure tenants  
– £13,352.73
- Total amount paid by leaseholders -  
£4,830.54



# Reconciliation

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- Total lift costs £18,183.27
- Total cost to tenants £13,352.73
- Total cost to leaseholders £4,830.54
- Total sum charged £18,183.27



# No Charge to Ground Floor

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- Four properties – 2 one bed properties, 2 two bed properties
- Divisor reduces to 441
- Service charge for one bed properties increases to £206.16
- Service charge for two bed properties increases to £247.39



# Administration Fee

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- Schedule 3 paragraph 7 (7)
  - The employment of any managing agents appointed by the Council in respect of the building or estate or any part thereof provided that if no managing agents are so employed then the Council may add the sum of 10% to any of the above items for administration.
- The administration fee goes towards to the services provided wholly to home owners:-
  - Construction, billing and collection of service charges
  - Statutory consultation
  - Communications with homeowners
    - Leaflets
    - Home Owners Guide
    - Drop in sessions
    - Public meetings attended by HOS staff
  - Homeowners fund
- Income from administration fee does not cover the costs of providing the service



# Heating/Fuel Costs

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- Homeowners pay their fair proportion of the cost of fuel used and repair and maintenance of the boiler and infrastructure serving their property.
- The charge is weighted in accordance with the size of the property and the type of service provided
- Tenants pay a weekly charge for fuel only, based on the anticipated boroughwide cost of fuel for the forthcoming year
- Homeowners service charges are actualised, so they only pay for fuel used and repairs and maintenance carried out
- Tenants charges are not actualised
- The council bulk buys its fuel at a much lower rate than that obtained on the domestic market
- The council currently has a fixed rate in place for gas until April 2023. This is at a much lower rate per KWH than the domestic market.



# Heating/Fuel Costs

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- Communal systems are recommended as more cost effective over time and environmentally better
- The older the system the more repairs are required, so the higher the cost
- Newer systems are more efficient
- The Council must install heat meters where possible
- Where heat meters are installed homeowners will be charged for the cost of actual fuel used
- Repairs and maintenance of the infrastructure will still be charged on the weighting method
- The Council bulk buys gas, leading to a cheaper rate than that on the domestic market

# Average service charge - Gas

Weighting Factor 4.52 (Full Heating & Hot Water)											
	0 Bed	1 Bed	2 Bed	3 Bed	4 Bed	5 Bed	6 Bed	7 Bed	8 Bed	10 Bed	
22-23		700.47	790.61	969.45	1063.42	1112.75	1154.79	1335.77	1507.48	1058.49	1677.43
21-22		410.8	386.67	455.4	497.14	582.34	696.12	827.87	714.04	507.94	
20-21		378.66	385.03	461.05	523.41	647.62	857.08	917.96	912.49	819.84	809.37
19-20		416.05	436.64	525.38	575.79	678.9	866.72	1046.3	936.2	1144.76	950.52
Weighting Factor 3.5 (Full Heating Only)											
	0 Bed	1 Bed	2 Bed	3 Bed	4 Bed	5 Bed	6 Bed	7 Bed	8 Bed	10 Bed	
22-23		668.94	836.17	820.86		1355.43	1505.11				
21-22		267.67	334.59	330.32		544.49	602.25				
20-21		236.64	295.8	363.77		488.36	532.43				
19-20		281.5	351.87	385.23		573.53	633.37				
Weighting Factor 2.5 (Partial Heating)											
	0 Bed	1 Bed	2 Bed	3 Bed	4 Bed	5 Bed	6 Bed	7 Bed	8 Bed	10 Bed	
22-23		412.13	465.91	850.18	1170.58	1203.67					
21-22		160.1	197.72	355.47	496.33	509.97					
20-21		124.39	265.74	270.36	428.46	494.09					
19-20		173.1	326.29	336.66	531.61	549.52					
Weighting Factor 1 (Hot Water Only)											
	0 Bed	1 Bed	2 Bed	3 Bed	4 Bed	5 Bed	6 Bed	7 Bed	8 Bed	10 Bed	
22-23				180.55	209.48						
21-22				76.41	89.91						
20-21				61.11	71.87						
19-20				95.5	117.6						



# Reducing Service Charges

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- Homeowners pay a variable service charge constructed from the actual costs incurred in managing and maintaining the structure, exterior, common parts and common services to the block and estate
- In order to reduce the service charge there would need to be a reduction in cost. This is likely to be attained only by a reduction in service. For example:-
  - If a block is served by a lift, the lift could be decommissioned
  - Only urgent and emergency repairs could be carried out
  - A reduced caretaking and grounds maintenance service could be provided
- While this would reduce the expenditure, and thus the service charge, it would also lead to deterioration of the block, estate and communal services, and ultimately devalue the property when the leaseholder comes to sell
- The average time between a leaseholder buying and selling on is approximately 7 years, although the original right to buy leaseholders often sell on soon after their discount period has ended.
- The Council could be at risk of legal challenge by leaseholders if the block and estate are allowed to fall into disrepair. Tenants would also have the right to take legal action for disrepair





# Reducing Service Charges

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- It is not an option to simply not charge homeowners their fair proportion of costs
- The HRA is ring-fenced – if homeowners do not pay their fair share of the costs then the burden falls to the tenants
- This reduces the available income for services, which in turn would lead to a reduction of provision, ultimately leading to a deterioration of the block and estate with the same risk of disrepair claims and problems of resale
- Instead the council provides alternative ways to pay in order to assist leaseholders, even though this is at a cost to the HRA



# Right to Buy

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- Housing Act 1985
- Schedule 6 implied covenants
  - Council (landlord) retains responsibility for structure, exterior, common parts and communal services
  - Landlord must provide buildings insurance
  - No impediment to sub-letting
- Leaseholders must pay their fair share of the costs



# Amending the Lease

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- Surrender and regrant of approx 14,500 leases
- Cost at least £1,000 per lease – total cost to HRA at least £14,500,000 (more likely to be a much higher figure, especially if compensation to the leaseholder is required)
- Need to agree the surrender and re-grant with each leaseholder – this is likely to be impossible to achieve
- Change to new leases causes difficulty as the council would need to administer and manage different landlord obligations
- Changing the lease would not resolve the central issue of costs – leaseholders would still be obliged to pay their fair share of costs incurred on services provided by the council



# Leases

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- Most leases contain the same or similar covenants
- Earlier leases have individual block definitions identified by Valuer, rather than standard definition
- Earlier leases may have services crossed out if not received at the time
- Since 2003 leases have been standard
- Limitations to service charge may be applied in the first five financial years of the lease (subject to s125 Housing Act 1985)