

Item No.	Classification: Open	Date: 20 March 2014	Decision Taker: Deputy Leader and Cabinet Member for Housing
Report title:		Fixed Service Charges	
Ward(s) or groups affected:		All	
From:		Head of Specialist Housing Services	

RECOMMENDATIONS

1. That in accordance with the Cabinet decision on 22 October 2013, to develop a policy to offer all leaseholders the option to surrender their current lease for a new lease on a fixed service charge basis, the Deputy Leader and Cabinet Member for Housing agrees the policy outlined below. This offer would be made once only to each leaseholder and would be kept open for a limited period.
2. That the Deputy Leader and Cabinet Member for Housing notes the risk to the HRA should any leaseholder with a fixed service charge lease apply for a lease extension.

BACKGROUND INFORMATION

3. On 12 July 2011 the Housing and Community Safety Scrutiny sub committee agreed to carry out a scrutiny of 'leaseholder charging' (of the council's leaseholders) in the borough. At its meeting on 11 October 2010 the Deputy Leader and Cabinet Member for Housing had said that he wanted to ensure that leaseholders were being treated fairly and that it would be useful for the sub committee to investigate the issue. The sub committee co-opted members from Southwark's Homeowner Council and LAS (Leaseholders across Southwark) 2000 and reported in March 2012. On 17 April 2012 the cabinet approved the report including its 14 recommendations.
4. One of the recommendations of the sub-committee was that the council should investigate the possibility of offering leaseholders the option of a fixed service charge incorporating both the annual and major works service charges. The sub-committee urged the Deputy Leader and Cabinet Member for Housing and the Strategic Director of Housing and Community Services to make a thorough assessment of the financial and legal implications for the council and see whether there were any difficulties that would need to be overcome in order to make this option available to leaseholders.
5. Home Ownership Services met with the Head of Legal Services to discuss the feasibility of the scheme. It was agreed that if there was no impediment and the Cabinet assented, then Home Ownership Services would offer all leaseholders the opportunity to surrender and renew their lease on a fixed service charge scheme. If the scheme was to be implemented then the fixed service charge would need to encompass both the cost of providing day to day services and ad-hoc major works.

6. Home Ownership Services then investigated the viability of the proposal and its potential risks. The proposal was then included in the Homeowner improvement plan report submitted to Cabinet on 22 October 2013 and subsequently approved. The Cabinet report is attached as appendix 1 to this report.

KEY ISSUES FOR CONSIDERATION

7. Within a ring-fenced housing revenue account it is imperative that home owners pay their fair share of the cost of services and management, including repairs. If home owners do not pay their fair proportion then the burden falls on the rent payers and the general public (through, for example, housing benefit). It is inequitable that the cost of home ownership should be subsidised by those who cannot afford owner occupation and the tax payer.
8. There are currently over 13,000 leaseholders in the borough who would be eligible for the option of fixed service charges. Of these, approximately 5,000 are sub-letting their properties.
9. Since 2009 there have been over 1,500 major works bills issued for more than £10,000 with over 800 of those being for more than £15,000.

Policy implications

10. The council must ensure that the total revenue received from fixed service charges over a thirty year period will cover its expenditure on the management and maintenance on the properties in question.
11. The council has over ten years worth of service charge information which will allow for an annual fixed service charge to be calculated on each property with sufficient accuracy to protect the HRA and ensure that the leaseholders who opt to surrender their current lease and renew on a fixed service charge basis will still pay their due proportion of the costs of maintaining their block.
12. Attached to this report, as Appendix 2, are examples of fixed service charge archetypes to give an indication as to the level of service charge that would relate to certain building types. However, each application would need to have a specific fixed service charge constructed to reflect anticipated expenditure over a thirty year period. The charge would be based on an average of previous annual service charges plus an estimate of potential future major works based on a thirty year life cycle for each building element.
13. The council is proposing to offer current leaseholders the option to enter into a fixed service charge lease because it recognizes that many leaseholders have difficulties in paying large major works bills on an ad-hoc basis, and an annual fixed charge will allow homeowners to have certainty about their annual costs, spreading payments for refurbishment contracts and elemental renewal over a larger number of years.
14. The offer will be made to leaseholders on a ward by ward basis, and will initially ask for expressions of interest within one month of the letter being sent. Ward councillors will be informed of the offer being issued. The policy will be presented to Homeowners Council and a communications protocol established. The offer letter will include a fact sheet to answer the main queries that leaseholders would have, and contact details of the officer responsible for the

administration of the scheme would be given if further information is required.

15. For any leaseholder expressing an interest a fixed service charge would then be constructed and a formal offer made. Once the offer is accepted the council would then process the surrender of the current lease for a new lease with a fixed service charge. The new lease would also include the ability to apply an inflationary increase to the fixed figure on a periodic basis. There would be no option for the leaseholder to return to a variable service charge lease, as the fixed charge will be constructed to reflect expenditure over a thirty year period.

Community impact statement and equalities analysis

16. The decision maker has an obligation to take into account the council's duty under the Equality Act 2010 which requires the council to have due regard when taking decisions to the need to:
 - a) eliminate discrimination, harassment, victimisation or other prohibited conduct;
 - b) advance of equality of opportunity between persons who share a relevant protected characteristic and those who do not share it;
 - c) foster good relations between those who share a relevant characteristic and those who do not share it.
17. Of particular regard are issues of age, disability, gender assignment, pregnancy and maternity, race, religion or belief, sex and sexual orientation.
18. Having due regard to the need to advance equality of opportunity is further defined in s.149 of the Equality Act as having due regard to the need of:
 - a) removing or minimising disadvantages connected with a protected characteristic;
 - b) taking steps to meet the different needs of persons who share a relevant protected characteristic
 - c) encouraging persons who share a relevant protected characteristic to participate in public life or any other activity in which they are under represented.
19. An equality analysis is not required as this offer will be made to all leaseholders on the same basis, irrespective of any protected characteristic. Acceptance of the offer will be on a voluntary basis only.
20. Many homeowners of ex local authority stock are on limited incomes and have difficulty in paying variable service charges, particularly large major works bills.
21. The option of a fixed service charge lease will allow certainty of expenditure to homeowners on an annual basis, allowing for them to budget accurately. The cost of managing a fixed service charge lease is also lower, as sections 18-30 of the Landlord and Tenant Act 1985 (as amended) only applies to variable service charges, so there would be no need to carry out statutory consultation, and there can be no disputes on the amounts due.

22. However, the fixed service charges will have to incorporate anticipated major works costs over a thirty year lifecycle, which will make them significantly higher than the current variable revenue service charge. This, and the fact that the service charge cannot be disputed, may limit the interest from leaseholders.
23. There will be no impact on the wider community unless the fixed service charge is calculated incorrectly and leads to a long term loss to the HRA, which would have to be made up from rental income. This is unlikely to happen as the council has sufficient historical data to accurately calculate an annual charge.
24. The option to enter into a fixed service charge lease will be offered to all leaseholders on an equal basis.
25. The proposal to offer current leaseholders the opportunity to enter into fixed service charge leases supports the council's commitment to providing improved value for money.

Resource implications

26. The administration of the policy to offer fixed service charges will be carried out on a ward by ward basis by Specialist Housing Services, and will require a new fixed term post to be created in order to administer the policy. While the job description will need to be evaluated it is anticipated that the post will be grade 8 and will last for a period of 18 months, an expenditure of approximately £54,000. There will be a single offer made to leaseholders, which will remain open to expressions of interest for a period of one month. If a leaseholder expresses an interest then a specific annual fixed service charge will be constructed and issued for agreement. The fixed service charge will be constructed from historic revenue service charge information, previous major works contracts carried out to the block, future programmed major works to the block, the stock condition survey and life-cycle estimates for elements and communal services. The charge will be based on the size of the property, using the current weighting methodology of number of rooms. If the leaseholder then wishes to proceed the new fixed service charge lease will be prepared. The leaseholder can be accommodated within the Home Ownership village at Tooley St.
27. Specialist Housing Services has a Residential Conveyancing team in place, and long term conveyancing contracts which can be utilised for the construction of a standard fixed service charge lease and the process of surrender and renewal for any leaseholder who takes up the option. The conveyancing can be done under the existing contract with a negotiated rate based on the current rate for a surrender and renewal of the lease. The current contract rate varies with the complexity of the transaction, ranging from £400 to £900. It is anticipated that the surrender and re-grant to a fixed service charge lease would be relatively simple and therefore the costs would fall to the lower end of the scale. The council would not seek to recharge its own administrative or legal costs, but the leaseholder would be responsible for his/her own legal and conveyancing costs.

Legal implications

28. Specialist Housing Services examined whether or not the council would be able to offer leaseholders the opportunity to surrender their current lease in exchange for a new lease with fixed service charges.

29. In summary the position is that there is no legislative reason as to why a fixed service charge lease could not be offered to current leaseholders, although the proposal would only be practicable if the base figure for service charges payable in year one was accurate, and the assumptions made on the scope of the service did not vary much or at all over the lifetime of the fixed charge. The council must ensure that leaseholders on a fixed service charge lease would still be paying their fair proportion of the cost of maintaining and managing their properties, so that their homeownership is not being subsidised by the secure tenants and the tax payer.
30. However, a future risk was identified, to the effect that if a leaseholder with a fixed service charge lease made an application for a lease extension. In such a case the fixed charge might be considered "rent" for the purposes of Chapter II of the Leasehold Reform Housing and Urban Development Act 1993. As there is no definition of the work "rent" in the Act this is not a point on which any opinion could be definite, and there is no useful case-law that could be relied upon.
31. However, if a fixed service charge is considered to be "rent" for the purposes of the Act then a lessee could buy out the liability by making a lease extension claim under the Act, because it provides that a new lease must be at a peppercorn rent. In the absence of any useful case law it is advised that a 1993 Act claim poses a risk to the proposal to offer a fixed service charge lease. If a fixed service charge was to be considered as "rent" then the council would need to assess how the charges should be capitalised in the event of an application to extend the lease, and how this would be accounted for in the Housing Revenue Account for future expenditure.
32. Further research was then carried out on the specific questions of whether or not a proposal to introduce fixed service charges would be compliant with local government finance, whether the creation of a "sinking fund" as part of the proposal would offend local government finance law and whether a fixed service charge would be considered rent for the purposes of the 1993 Act.
33. It is believed that there is no express prohibition within local government finance law which would prevent the authority from implementing the proposal in principle, as long as the base service charge figure is accurate. The council would have to be satisfied that it had struck the right balance between the interests of the leaseholders and the secure tenants as the result of any shortfall in a fixed service charge would result in increased rents for the secure tenants. The duty to prevent a debit balance on the HRA in any year means that the estimated expenditure and income must be based on sound projections. This duty also requires the authority to review matters from time to time in order to consider whether a deficit is likely to arise, in order to take the appropriate action. A decision to introduce fixed service charges would limit the council's ability to adjust projections throughout the year if this were to prove necessary.
34. There is nothing in the provisions of the Local Government and Housing Act 1989 which would prohibit the creation of a surplus in the HRA, but the HRA must be viewed as a single account with the debits and credits made in accordance with the Act. Were a sinking fund to be created from the fixed service charges then this would have to be used to bring the HRA back into balance if it was in debit.

35. On the issue of a fixed service charge being considered as “rent” for the purposes of the 1993 Act, it should be noted that this is a risk. Further, in this case, if a leaseholder was to buy down the fixed service charge on a lease extension claim the resulting sum would have to be treated as a capital receipt by the council. The granting of a lease extension is the disposal of a capital asset. The value of the disposal of the asset and the fixed service charge would be so intimately connected that the latter could not be viewed separately and any sum resulting from such a transaction would be a capital receipt within the meaning of the Local Government Act 2003, and so subject to the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003. The receipt would only be able to be used for specific purposes including the ability to defray capital expenditure for which leaseholders would be liable to make a contribution. However, the receipt would not be available to cover the annual management and maintenance costs of the sold property.
36. This risk is impossible to quantify as it can only be resolved by case-law, and there is no case-law for this set of circumstances. Variable service charges are the norm in both the private and public sectors, so there has never been a need to identify in a court whether or not a fixed service charge is considered to be rent.

Financial implications

37. In Southwark there is sufficient cost history to be able to calculate an average service charge (be it an average for a service; an average for a block or a block type etc). To this could be added a unit management charge and a charge to reflect major works costs. The major works element would be set to reflect the cost life cycle of a block (i.e. its component elements). This is available because the council has to have a thirty year business plan. This will reflect the landlord’s obligations over the length of the lease. This ‘initial fixed service charge’ for the flat would then be subject to inflation. It is common valuation practice to undertake discounted cash flows over long periods. The fixed service charge would be set at a level to reflect the council meeting its contractual obligations rather than not having the money to meet them. They could be set for archetypes across the stock rather than reflect the condition of each individual block and its investment profile.
38. The methodology would give the leaseholders certainty - they would know in advance what their liabilities will be. They would not be surprised by a sudden increase in fuel costs or worried by a major repairs contract.
39. For the landlord there is some payback for accepting some of the risk. The management of fixed service charges is far simpler to manage: fixed service charges are not covered by sections 18 – 30 Landlord and Tenant Act 1985 and therefore section 20 consultation does not apply; neither does the ‘reasonableness’ of the service charge or application to the First Tier Tribunal.
40. It has to be stressed that the introduction of fixed service charges has to be seen as ‘cost neutral’ to the HRA; otherwise tenants will complain that their rents are subsidising the leaseholders. Thus the ‘initial fixed service charge’ must be set at a level that will recover costs over time and over the stock as a whole, levelling out extraordinarily expensive expenditure in any one year.
41. There may be instances where a leaseholder wishes to enter into an agreement

to pay a fixed service charge where extensive major works, and therefore high service charges, are due in the near future. In these instances it would appear that the HRA is making an immediate loss of income. However, the income is actually being spread over a far long period (30 years based on standard life cycle costings for most elements), which the leaseholder will be required to pay whether or not costs are actually incurred in any individual year. The proposal is to make a “once only” offer to leaseholders and therefore only a few would have major works imminent. The proximity of major works would (in cash flow terms) affect the initial fixed service charges.

42. Fixed service charges cannot be ‘imposed’ on existing leaseholders who have variable service charge covenants in their leases. The council would offer leaseholders the opportunity to surrender their current lease and enter into a new fixed service charge lease. Leaseholders would have to get their own independent legal advice and it would have to be made clear that there would be no opportunity to ‘switch back’ to variable service charge regime e.g. after major works were carried out.
43. It should be noted that there is a risk if a leaseholder with a fixed service charge made an application for a lease extension, as the fixed charge might be considered to be “rent” for the purposes of Chapter II of the Leasehold Reform Housing and Urban Development Act 1993, though no useful case law exists on the issue. Furthermore, if the charge was considered to be rent, should a leaseholder with a fixed service charge lease subsequently apply for a lease extension the fixed service charge element would have to be capitalised as part of the purchase price. The HRA would receive a single lump sum payment for all management and maintenance costs over the lifetime of the extended lease, and this sum would have to be treated as a capital receipt.
44. Home Ownership Services considers that the take up of the scheme would be low, considering the probable annual charge to individual leaseholders under a fixed service charge lease, which could not be challenged or disputed. Therefore although there is a risk to the HRA of having to capitalise the charge due to a lease extension, the probability of it happening on a wide scale is very low.

Consultation

45. The proposal to offer fixed service charges was one of the outcomes of the report on leaseholder charging by the Housing and Community Safety Scrutiny Sub-Committee. The sub-committee’s report and the officers response was reported back to Homeowners council in 2012. Further consultation was undertaken with Homeowners council in October 2013, following the Homeowner Improvement Plan report to cabinet on 22 October.
46. Once the policy is approved a further report will be taken to Homeowners council to keep the delegates informed. Each leaseholder will then be written to on a ward by ward basis. The relevant ward councillors will be informed prior to the letter being issued and given details of the process.

SUPPLEMENTARY ADVICE FROM OTHER OFFICERS

Director of Legal Services

47. The legal implications and the risks associated with this approach are covered in great detail in the body of the Report itself.
48. As identified in paragraph 26, there is no legislative reason as to why a fixed service charge lease could not be offered to current leaseholders.
49. As identified in paragraphs 27-33, a degree of risk does exist in adopting this approach specifically in relation to applications for a lease extension. The risk revolves around the interpretation of the word “rent” for the purpose of chapter 2 of the Leasehold Reform Housing & Urban Development Act 1993. The Act fails to define the word “rent” and there is no useful case law on this specific point. Therefore this risk should be taken into account when making a decision in relation to this specific policy.
50. All other legal risks as well as the legal benefits of this approach are set out in detail in the body of the Report itself.
51. In taking this decision the decision maker must have regard to the council’s equality duty set out in section 149 of the Equality Act 2010. The report author has demonstrated how those duties have been considered in the body of the report at paragraphs 16-25 in the Community Impact Statement and Equalities Analysis.

Strategic Director of Finance and Corporate Services

52. The proposal for fixed service charges is one that requires further detailed work to establish the potential quantum of individual property charges across the stock. Given the necessary inclusion of major works in the service charge calculation, it is anticipated that this option may only have limited appeal to homeowners, notwithstanding the certainty that a fixed service charge provides. However, within the context of a ring fenced HRA, it remains incumbent on the council to ensure full cost recovery over the long term to protect against cross subsidization from tenants’ rents, as the report acknowledges.

BACKGROUND DOCUMENTS

Background Papers	Held At	Contact
Housing and Community Safety Scrutiny Report March 2012	160 Tooley Street, SE1 2TZ	Shelley Burke, Head of Overview and Scrutiny Tel: 020 7525 7344

APPENDICES

No.	Title
Appendix 1	Cabinet Report Homeowner Improvement Plan 22 October 2013
Appendix 2	Fixed Service Charge Archetypes

AUDIT TRAIL

Lead Officer	Martin Green, Head of Specialist Housing Services	
Report Author	Louise Turff, Service Charge Construction Manager	
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Key Decision?	Key	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER		
Officer Title	Comments Sought	Comments Included
Director of Legal Services	Yes	Yes
Strategic Director of Finance and Corporate Services	Yes	Yes
Cabinet Member	Yes	Yes
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