Committee	Dated:
Community and Children's Services Committee Finance Committee	08/09/2017 12/09/2017
Subject: Financial Support with Major Works for Leaseholders	**Public**
Report of: Director of Community and Children's Services	**For Decision**
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Summary

The current Five Year Programme of Major Works to City of London estates is much needed, but will result in large service charge bills for a number of our leaseholders. The highest estimated costs will be for leaseholders in Great Arthur House, on the Golden Lane Estate, where the current project to replace the cladding and windows means that leaseholders will face particularly large bills. The City recognises that it can be difficult for some leaseholders to meet the costs of major works and it is appropriate to review the current range of measures offered.

The City already has provision in place to offer financial support to leaseholders in respect of major repairs bills, including payment by instalments, referrals for financial assistance to government departments and leaseholder loans. Under the terms of their lease, lessees can repay major works bills in instalments, effectively mortgaging their property to the City. In July 2010, the City approved a scheme providing a maximum discretionary loan of £41,000, with an interest-free period of up to three years. In addition, in cases of severe financial hardship, the City will consider buying back the tenant's property.

At the same time, the City has certain duties to keep a housing revenue account (HRA) and a duty to formulate proposals to secure that the account for each year does not show a debit balance. Where the City's duty is not compromised by the discretionary loan proposal, the City must still consider its fiduciary position in relation to its council tax payers, tenants and others who benefit from the application of the HRA funds as well as its power to provide discretionary loans to leaseholders, and must reasonably balance the interests of each.

Recommendation

Members are asked to:

• Consider the paper and to decide which of the options set out in paragraphs 21-24 they wish to be implemented.

Main Report

Background

1. Tenants who exercise their Right to Buy (RTB) do so under a leasehold agreement (or 'lease') with the City. The lease sets out, among other things, the costs which can be recovered from the leaseholder in respect of service charges, repairs, major works and improvements. The terms of the lease stipulate that leaseholders are responsible for the cost of works to their home that are the City's responsibility to carry out (e.g. replacement windows), and also for a defined proportion of the costs of works to communal areas of their block or the estate.

2. The City has a legal duty to recover these costs. It also has a duty under the Local Government and Housing Act 1989 (Part VI Housing Finance) (the 1989 Act) to keep a housing revenue account (HRA) and a duty to formulate proposals to secure that the account for each year does not show a debit balance (section 76 of the 1989 Act). The HRA 30 Year Business Plan, which every local authority housing provider is required to produce, is based on the assumption that leaseholders are charged for their proportion of the costs of works. The HRA includes rents and charges in respect of property, subsidy and other contributions and is debited by capital, repairs maintenance and management expenditures and other sums payable by an authority. Failure to collect service charge costs could severely compromise the HRA and its ability to fund the Five Year Major Works Programme and other necessary expenditures from this source. The City is in a fiduciary position in relation to its council tax payers, other tenants (including social tenants) and others who benefit from the application of the HRA funds. Failure to collect service charge costs from private homeowners could mean that, effectively, social tenants and others would be subsidising private homeowners. The City must also have due regard to the hardship to some leaseholders of being faced with high service charge demands.

3. In 1992, legislation was introduced to provide schemes to assist leaseholders of flats with the costs of major works. Under the Act and the Housing (Service Charge Loans) Regulations 1992 (the Regulations), local authorities were required to offer a mandatory loan scheme for RTB purchasers and their successors, effectively to run for a period of ten years from the date of the grant of their lease. The loan could offer assistance above an initial service charge cost of £1,500 in respect of major works, up to a limit of £20,000 (less any amounts already obtained under the right to a loan).

4. In 2008, in recognition of the fact that leaseholders were facing higher bills, the government issued a number of amendments to the Act and Regulations. (under the provisions of Loans for Acquisition or Improvement of Housing under Part XIV of Housing Act 1985 (the Act), sections 450A and 450B), amending the mandatory loan scheme and adding a discretionary power to provide loans to the existing mandatory scheme.

5. The mandatory loan is for 10 years for amounts more than £5000 (the repayable terms are shorter for loans below that sum) and the repayment period is also determined by adding up the amounts of any mandatory and discretionary loan amounts. The interest payable is subject to the statutory provisions relating to local authority mortgage interest rates. An administrative fee of up to £100 can be charged, plus legal cost for valuation, conveyancing, and Land Registry Fees.

6. A local authority is also permitted to offer discretionary loans. These may be offered either where a leaseholder is not entitled to a mandatory loan, or where the cost of the major works exceeds the mandatory loan limit of £20,000. The discretionary loan may be on terms that no interest is paid or interest is paid on only part of the loan (Regulation 6). Either loan must be secured by way of mortgage on the relevant flat (whether or not the flat is adequate security for the loan) (Regulation 7). The lender/local authority may charge administrative expenses and legal fees as it sees fit and may choose to add this amount to the loan. No repayment period is specified (unlike for mandatory loans). The discretionary powers may be used to offer loans on favourable or interest-free terms to leaseholders who meet certain criteria, such as being owner-occupiers.

7. The Housing (Purchase of Equitable Interests) (England) Regulations 2009 enable a local authority landlord, with the agreement of the tenant, to purchase an equitable interest in a flat for the purpose of assisting the tenant to meet some or all of the service charge payments. The cost of the equitable interest purchased (“the purchase price”) is met by the landlord reducing or cancelling the service charge payable as corresponds to the amount concerned (regulation 4 of those regulations). The housing authority is entitled to a specific share of the value of the flat when it is sold. Rent is chargeable on the share of the property reverting to the local authority.

Current Position

8. Failure to pay charges for major works is a breach of the lease, and could lead to legal proceedings and, in extreme cases, forfeiture. The City recognises that large bills for major works can cause financial hardship for some leaseholders and, therefore, already offers a range of support measures.

9. Under the terms of a City of London lease, leaseholders have the option to pay for major works over a ten year period, with interest. This allows them to spread the whole cost of large service charge bills. (Major works are defined as refurbishment, renewal or repair works that cost more than 2.5% of the valuation for the property when it was purchased.) This means that every City leaseholder has the ability to borrow the full cost of any major works from the HRA, for a ten year term, with interest.

10. Interest-payable loans are offered under the mandatory scheme to RTB purchasers and their successors for a period of 10 years from the purchase of the lease. The interest is regulated by the Housing Act 1985 and set at the standard national rate (currently 3.13%).

11. In July 2010, following the revised legislation, the Community and Children's Services Committee and the Finance Committee reviewed the discretionary loans offered to the City's leaseholders, and agreed new terms. Discretionary loans of up to £41,000 are currently offered with an interest-free period of up to three years.

12. Current payment options for discretionary loans are as follows:

Table 1 – Current payment options		
Loan amount	Interest-free period	Repayment period
£930.00.00 – £1,599.99	1 year	3 years
£1,500.00 – £4,999.99	1 year	5 years
£5,000.00 – £9,999.99	2 years	5 years
£10,000.00 – £41,000.00 (maximum)	3 years	10 years

13. The discretionary loans are only offered to resident lessees who occupy their property as their principal home. To qualify, the leaseholder must have a good credit history. The loans are secured by a mortgage on the property, and there are fees and an administration charge. Because the agreement of any existing mortgagee of the property is required, discretionary loans can take some time to arrange.

14. Following the interest-free period, the interest rate is variable and follows the standard national local authority mortgage rate (currently 3.13%).

15. Two other options were also agreed by Members in 2010. These were equity loans and a buy-back scheme. However, these are only offered as a last-resort measure in cases of extreme hardship, where it can be demonstrated that the leaseholder does not have the means to pay for major works and is at risk of homelessness without such support. These options are also only available to resident lessees. Agreement is subject to an assessment carried out in conjunction with the Town Clerk and Chamberlain, which includes means testing.

16. For buy-back, the purchase price is the lower of the current market price or the original RTB price (net of discount). Under this scheme, the full ownership of the property is returned to the City and the former leaseholder remains as a tenant. This option is only offered to the original RTB purchaser. There has been only one buy-back in the past five years.

Proposed Options

17. The Five Year Programme of Major Works will involve significant costs for some leaseholders, in particular those who own properties in Great Arthur House. It is, therefore, appropriate to review the current discretionary offer to flat owners and consider whether any changes should be made.

18. However, any decision made by your Committee in respect of discretionary measures must have regard to the City's legal duty to ensure that the HRA account for each year does not show a debit balance, and the duty to recover costs from leaseholders, while minimising costs on actionable debt recovery and offering leaseholders in financial hardship a reasonable opportunity to fulfil their obligations under the terms of their lease.

19. The HRA had total balances of £14.6m at 31 March 2017; however, this balance is expected to fall over the next few years in order to fund the Five Year Major Works programme. The HRA presently has no borrowing, but has the capacity to borrow up to a total ceiling of £25m.

20. Funding the major works programme is expected to mean that the HRA will need to return to borrowing up to £11m by the end of 2019/20. Any additional cost to the HRA of funding interest-free loan periods to owner-occupier leaseholders will increase the level of borrowing required. This in turn will mean the headroom to the ceiling of £25m for borrowing to support the aim of 700 new homes will be reduced. This will have an impact on the City's ability to deliver some of these homes.

21. Taking this into account, there are three options for Members to consider:

    a. Revert to an offer which comprises only the mandatory scheme and which is set out in the standard lease, with no discretionary measures offered.
    b. Maintain the current discretionary offer of a maximum loan of £41,000, with an interest period of three years, with no new additional measures.
    c. Increase the maximum threshold for the discretionary scheme to £72,500 (the current estimated cost of the Great Arthur House cladding works) with an interest-free period of three years.

22. Option a: No discretionary loans to owner-occupier leaseholders. This option would mean the withdrawal of the current £41,000 capped discretionary loan offer to leaseholders. Leaseholders could still apply for loans under the terms of their leases, but there would be no interest-free period. This option would mean that no costs in relation to interest foregone would be charged to the HRA, but it would also mean no additional financial support would be available to owner-occupier leaseholders and the risk that immediate demands for payment of large service charges could not be met. Although this is the most favourable scheme for the HRA, officers cannot advise this course of action as it gives only minimal support to leaseholders.

23. Option b: Continue to offer discretionary loans to owner-occupier leaseholders at a maximum level of £41,000 with up to three years of interest-free borrowing, as set out in Table 1 in paragraph 12 above, and the charging of professional and administrative fees. We would propose that these fees be capped at a maximum of £500. It is recommended that the current scheme be amended so that leaseholders are expected to pay the first £5,000 of any service charge demand, with the discretionary loan offer covering any additional amount. The total cost to the HRA in terms of interest foregone

based on a 100% take-up at the maximum borrowing limit by all eligible leaseholders on all City estates would be £530,000. A 75% take-up would charge £398,000 to the HRA. While this option does have an impact on the HRA, in officers' view the impact is not unreasonable. It does not, however, recognise the new demands on leaseholders of the Five Year Major Works Programme and may be insufficient to meet some leaseholder needs.

Option c: Offer discretionary loans to owner-occupier leaseholders at an increased maximum amount of £72,500 with up to three years of interest-free borrowing and charge legal and administrative fees. We would propose that these fees be capped at a maximum of £500. The interest-free periods would be as set out in Table 1, with the maximum amount increased to £72,500 from the existing £41,000. Leaseholders would be expected to pay the first £5,000 of any service charge demand with the loan offer covering any additional amount. The total cost to the HRA in terms of interest foregone based on a 100% take-up at the maximum borrowing limit by all eligible leaseholders on all City estates would be £612,000. A 75% take-up would charge £459,000 to the HRA. While this option does have an increased impact on the HRA, in officers' view the increase is marginal and it does recognise the new demands on leaseholders of the Five Year Major Works Programme. This is the option that officers advise, as it balances the needs of the HRA, and reflects a sensible balance between the City's competing duties and powers.

24. It is important to note that the discretionary loans set out in options b and c are supplementary to the entitlement to loans under the mandatory scheme and the contractual entitlement in the lease. Each eligible leaseholder would still be entitled to a loan with interest on any major works service charge costs, in addition to a loan under the discretionary scheme. As an example, if the full cost of major works to a leaseholder was £80,000 and a discretionary loan was offered up to £41,000, the leaseholder would still be contractually entitled to a loan for the remaining £39,000, but there would be no interest free period on this element. Similarly, if the threshold were to be raised to £72,500 and a discretionary loan was offered for that amount the leaseholder would still be contractually entitled to a loan for the remaining £7,500 but there would be no interest free period on this element.

25. Officers cannot recommend a higher level of support for leaseholders, as the cost to the HRA, the impact on the major works programme and the disbenefit to tenants would be too great.

26. The extension of equity loans or equity purchases from the current position to all leaseholders is not recommended, as there are already products on the financial market available to meet any demand for these. The cost to the HRA of making such loans could also be prohibitive and could jeopardise the programme of planned works and developments.

27. The extension of the buy-back scheme is also not recommended. Such a scheme would be complex and require additional staffing resources. With property prices unlikely to drop significantly, it is not expected that buy-back will be popular for homeowners on either a full- or shared-ownership basis.

However, it is recommended that the current buy-back scheme is retained as an option for leaseholders in severe financial difficulty.

Corporate & Strategic Implications

28. This proposal links to the department's strategic aim to enhance and promote a better quality of life for residents.

Financial Risk Implications

29. The City is responsible for the management of the HRA and should recover all sums of money owed by leaseholders. There could be a significant adverse effect on the ability of the HRA to adhere to the timing of its major works programme and meet its other objectives if increasing numbers of flat owners take up the offer of interest-free loan periods. The cost to the HRA of discretionary interest-free loan periods is set out in the body of the report, but in the worst-case scenario of a 100% take-up of loans by all leaseholders up to a maximum value of £72,500, the total cost would be £0.612m.

30. It is not expected that all eligible leaseholders would wish to take up a discretionary loan for the full amount owing; some may seek a partial loan and/or also look to extend their existing mortgage. The cost to the HRA of a 75% take-up would be £0.459m and a 50% take-up would be £0.306m.

31. A leaseholder who takes out a loan to pay for service charges for repairs and improvements to their property who is in receipt of Income Support, income-based Jobseeker's Allowance or Pension Credit can in certain circumstances obtain government assistance with their loan payments.

32. Please see attached Appendix 1 for a more detailed estimate of interest-free discretionary loan costs.

Legal Implications

33. Leading Counsel's advice has been sought in relation to the potential impacts on the HRA of the current discretionary scheme and the option to increase the available loan limit. Leading Counsel has advised that so long as all material considerations are taken into account, it is open to the City to provide discretionary loans under the terms considered in this report.

34. Under section 20 of the Landlord and Tenant Act 1985 as amended by the Commonhold and Leasehold Reform Act 2002, leaseholders must be consulted before the landlord carries out works above a certain value. The prescribed consultation process includes a requirement to serve notices before the start of the works setting out a description of the works, the reasons why they are necessary and the estimated total expenditure likely to be incurred.

35. There are lengthy and complex statutory procedures for dealing with the recovery of service and maintenance charges from residential leaseholders. The City will comply with these processes to ensure that the charges are both fair and lawful.

36. The City has power to provide discretionary loans to leaseholders and should have regard to any potential that demands for immediate payment of large service charges might lead to: a failure to recover the same, potential legal proceedings and legal costs, and ultimately to the risk of leases being lost through breaches of covenant.

37. The City also owes a fiduciary duty in managing the HRA to secure that it does not show a debit balance in any one year and for this reason it is necessary to endeavour to recover all sums of money owed.

38. It is also open to the City to consider whether any works should be postponed in order to keep the HRA in balance if there is a risk of deficit in any year due to the application of the proposal.

Equalities Implications

39. An Equalities Analysis (EA) was carried out at the commencement of the Housing Service Review – Leaseholders and Freeholders (Report HMASC 4 July 2016). In summary, the EA found that reviewing the financial support offered to leaseholders would not negatively affect any of the protected characteristic groups. To continue to meet our public sector Equality Duty, individual needs should be considered where appropriate when making decisions.

Conclusion

40. The government is keen for social landlords to offer help to their leaseholders who are facing significant major works bills and secondary legislation is in place to facilitate such measures.

41. The City of London Corporation is keen to offer support to our residents who may be facing difficulties paying these bills. Offering interest-free periods, higher loan limits and flexible repayment terms for service charge loans may help leaseholders meet the costs of their service charges.

42. There will be a cost to the HRA in terms of loss of interest. However, any increase in leaseholders seeking these loans will be managed under a structured payment plan and the scheme would be likely overall to reduce the risk of recourse to legal proceedings (and potential loss of leases) for non-payment of major works bills.

43. Where leaseholders are suffering particularly severe hardship, an equity loan, equity purchase or buy-back could also offer an alternative and may be offered in exceptional cases.

44. Members are asked to consider the options and to recommend either retaining the existing interest-free loan provisions or making changes to the existing scheme.

Appendices

Appendix 1 – estimated costs for interest-free loans

Background Papers

Payment Options for Long Leaseholders – Paper to Community and Children's Services Committee, 9 July 2010

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