practice briefs

Managing homeownership

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Authors: Martin Green, Head of Homeownership and Tenant Management Initiatives and Louise Turff, Service Charge Construction Manager, LB Southwark and Matthew Saye, Assistant Director, Home Ownership Services, at One Housing Group; edited by John Perry of CIH.

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Managing homeownership

Schemes which give tenants the right to purchase their homes, such as right to buy and right to acquire, now stand alongside a wide range of 'intermediate' housing products such as shared equity and shared ownership leases, in most cases intended to help people into low-cost homeownership. As a result, housing management is no longer just concerned with social rented estates but with much more mixed and varied property portfolios. New skills have had to be acquired over the past 30 years: for example, local authorities and stock transfer housing associations have to manage estates that are pepperpotted with homeowners, many of whom sublet their properties or have sold them to private landlords; many housing associations now manage properties they have sold under different low-cost homeownership schemes.

This **practice brief** is about this management task. It complements the **practice brief** on *Promoting Homeownership* which describes the different low-cost homeownership schemes, how they are promoted and the work that takes place before property is sold under them. Practitioners should look at both; they can also find more details of the law on both aspects and many practical examples in **practice online** (www.cih.org/practice/online/).

Key differences about managing homeowners

Managing homeowners is a complex task, not only because of mixed tenure portfolios but because of the wide variations between freeholders and leaseholders, shared equity and shared ownership, older schemes such as rent to mortgage and newer ones such as Social HomeBuy, and complications such as underleases. The list seems to grow longer each year as new ideas and products are developed.

There is also a different set of statutory rules governing homeowners: in the last 30 years copious legislation has given them protection against unreasonable service charges and more rights to manage their blocks or to purchase their freeholds. These developments have increased the management burden and are the reason why this **practice brief** is heavy with statutory references.

The differences in the regime required to manage homeowners compared with periodic tenants are fundamental. Treating them equally should not mean treating the two tenures the same. One key difference is that, unlike managing social rented property, homeownership managers do not have the flexibility of pooled rents. Instead, expenditure must be accounted for item by item, block by block and estate by estate. Even today, while tenancy agreements rarely dictate how a pooled rent is calculated, a lease (or freehold transfer) describes exactly what services will be provided and charged for and how the charges will be calculated.

Another key difference is about consultation. Consultation with tenants about major refurbishment will invariably be about the work itself, but with homeowners it will centre on cost or value for money. Here are some examples:

- tenants may want a door entry system to be installed to improve security but leaseholders may resist on cost grounds
- leaseholders will question the need to renew rather than repair a roof or lift or whether external decorations must be done this year
- homeowners may argue that service charges are too high because repairs have not been carried out on time, pushing up costs
- those making sinking fund contributions may try to pressure landlords to utilise funds for their short-term benefit.

Homeowners increase the scrutiny of managers, who are constantly required to justify their reasons for a spending decision or the level of service provided.

Yet it is imperative that homeowners pay their fair share of the cost of communal services. Failure can cause conflict with periodic tenants who will see their rents as paying for any shortfall.

How the practice brief is organised

Post-sales management, by its nature, has service charges at its heart and thus the first four sections of this **practice brief** cover these charges. Further sections consider general management of leases, freehold tenure, further disposals and a range of new services which have been developed for homeowners.

This **practice brief** uses the term 'homeowners' where points apply across the board, but most frequently a distinction is needed between freehold service charge payers and all the other different types of homeowners on long leases: here the term 'leaseholder' is used (so this includes all leaseholders, shared owners, shared equity, etc). Where points relate to specific products only, this will be made clear.

Who should read this practice brief?

The **practice brief** is aimed at staff engaged in managing homeowners in both local authorities and housing associations. It applies both to staff working in specialist homeownership units and to those managing small portfolios alongside rented property. Because it also covers the management of properties sold under the right to buy or right to acquire, it will be relevant to nearly all social landlords in England and Wales.

Types of service charge and ground rent

Service charges result from contractual obligations to carry out services.

Where there is a simultaneous freehold and leasehold (or landlord and tenant) interest in land, a common arrangement is for the freeholder to be contracted to provide (communal) services and for the long-leasehold tenant to pay for them. These obligations are embodied in the lease – the contract over the land.

Service charges can be distinguished in several ways:

- fixed or variable
- if variable, estimated or actual service charges
- annual routine or major works service charges
- leaseholder service charges or freeholder service charges
- private sector profit centre or social sector cost centre
- sinking fund (or reserve fund) payments.

Ground rent is not a service charge but is dealt with in this section because it is another type of charge to the leaseholder.

Fixed or variable service charges?

Most modern service charges are 'variable': they rise or fall each year in line with expenditure. So, for example, if a landlord spends a lot in one year on repairs, hopefully next year's expenditure (and service charges) should be lower. A variable service charge is 'an amount payable by the tenant of a dwelling as part of or in addition to the rent' and:

(a) is payable directly or indirectly for services, repairs, maintenance, improvements, insurance or the landlord's costs of management and

(b) whole or part of which varies or may vary according to relevant costs (section 18 of the Landlord and Tenant Act 1985 – as amended).

There is no comparable statutory definition of a fixed service charge.

However, variable service charges are fairly modern – only widely used since the mid-1960s, primarily to protect landlords from the effects of high inflation. In earlier leases it was common for service charges to be 'fixed' – they bore no relationship to the cost of the landlord carrying out the services in any one year. For example, a lease could contain covenants obliging the landlord to carry out specific services (repairs, cleaning, grounds maintenance, buildings insurance, etc) and the leaseholder to pay, say £1000 p.a., with the amount linked to the Retail Price Index (RPI). This type of 'fixed' service charge arrangement fell into disuse as costs outstripped the RPI and left landlords out of pocket.

With variable service charges, the leaseholder contractually bears most of the risk. So, for example, if a lift is old and constantly failing, the leaseholder pays more in responsive repairs but gets a poorer service. If the lift is renewed, the leaseholder pays for a new lift. Should the landlord decide on a higher standard of cleaning or should fuel costs rise, the service charge increases.

Variable service charges developed in the private sector where the landlord's only income is the service charge and therefore it simply must cover costs. However in the social sector, landlords have other sources of income and could decide to share the risk with leaseholders by having a fixed service charge. The choice of a fixed charge should not be seen as a way to raise or reduce the landlord's income: it simply shares the risk and spreads the costs evenly throughout the term of the lease.

Most landlords have enough history of their costs to be able to calculate an average service charge (for a service, for a block or for a block type, etc), adding a unit management charge and a further charge to reflect major works (similar to a sinking fund contribution). This 'initial fixed service charge' for the property would be linked to inflation. This would give the leaseholders certainty – knowing their liabilities in advance – with no surprises such as a sudden increase in fuel costs or a major refurbishment scheme.

There is an advantage to the landlord in accepting some risk. Management of fixed service charges is far simpler: they are not governed by sections 18-30 of the Landlord and Tenant Act 1985 and so section 20 consultation does not apply, neither does the 'reasonableness' of the service charge nor the option to apply to the Leasehold Valuation Tribunal (LVT). The downside is that without proper budgetary controls a landlord can incur a sizeable deficit with no means of recovering it.

Introducing fixed service charges must be 'cost neutral', especially for local authorities and their Housing Revenue Accounts (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 extraordinary expenses in any one year.

Fixed service charges cannot be 'imposed' on existing leaseholders who have variable service charge covenants. Landlords would have to offer the alternative as a variation to the lease. Leaseholders should get independent legal advice and it should be made clear that there can be no 'switching back' to variable service charges, e.g. after major works have been carried out.

A pre-condition of moving to fixed service charges would be acceptance by the lenders. This would be checked for each individual variation by the conveyancing solicitor so it would be sensible to contact lenders first. Fixed service charges are not so different from sinking funds so their introduction may not cause concern.

The rest of this **practice brief** deals mainly with *variable* service charges because they are more common.

Estimated or actual service charges?

If the lease provides for it, service charges can be levied in advance. Charges levied in advance must be 'estimated' because actual costs cannot be known at that stage. Variable service charges, estimated and actual, are governed by sections 18-30 of the Landlord and Tenant Act 1985. Some of its provisions are:

- It is lawful to demand (and enforce) an estimated service charge if the lease provides for invoicing and payment in advance (section 18).
- Where a demand is made in advance it *must* be followed as soon as possible by an actual account showing true costs (section 19). This means that in any one year two sets of accounts must be done (estimated and actual), doubling the management costs. The alternatives would either be billing on actual accounts only (but this would have to include the opportunity cost of paying for services before collecting the income) or having a fixed service charge.
- A variable service charge *must* be reasonable (only include costs that have been reasonably incurred; the standard of building works or service must be reasonable) (section 19). Estimated service charges must show that they are a reasonable estimate of eventual liability.

Certain elements of a variable service charge are relatively easy to estimate in advance, for example, cleaning or grounds maintenance (or any other service with a contract where the tendered costs and levels of service are known or index-linked). Others are more problematic, e.g. predicting block by block and estate by estate what responsive repairs will be needed next year. (The estimate cannot be based on previous expenditure because if a lot of repairs were carried out, hopefully next year costs will fall.)

When estimating service charges for a forthcoming year, the current year will not have ended so the only actual expenditure that can be referenced is that *two years* prior to the one being estimated.

Other potential complications include:

- tendering exercises (especially if mid-year) which result in price changes (either way)
- non-annual events e.g. tree pruning
- volatile energy markets (compounded by estimated invoicing)
- policy changes (e.g. to increase the fund for cleaning) especially if mid-year.

Annual (routine) and major works service charges

Distinguishing between annual service charges and those for major works occurs only in the social sector and then where there is no sinking fund or reserve fund (i.e. in local authorities and other pepperpotted portfolios such as stock transfer housing associations).

Certainly most social sector leases make no such distinction and neither does the law.[1] Any attempt to make a policy based on such a distinction (i.e. to have a fixed service charge for revenue services only) would certainly fail.

The distinction is needed, especially by local authorities, because of the very different accounting treatments for major works: they are often funded from capital under rules in the Housing and Planning Act 1989, s48, which say that capital expenditure must result in 'enhancement' (decoration works are revenue-funded because redecoration does not result in 'enhancement').

The distinction is also made because any attempt to deal with major works service charges on an accruals basis (i.e. the year they relate to) is problematic as:

- expenditure on major works always takes more than a year (public sector tendering rules and retentions during defect liability periods usually result in a three-year, 10%-80%-10% split even for smaller jobs)
- social sector provisions (e.g. itemised repairs in the initial period of the lease or the inclusion of tenant-only works such as kitchens and bathrooms) mean that the only way of constructing a major works service charge on an accruals basis would be having the valuation certificates for stage payments to the contractor broken down to show an exact split of the work by block, by estate, by service chargeable and non-service chargeable expenditure and then down to building element (something never done and probably impossible).

It is common practice across all local authorities to deal with major works contracts as a single event even though this does not always accord with either the lease or the statutory provisions.

1 Although it could be argued that two public sector statutory provisions make some reference to them, i.e. service charge loans under s450 of the Housing Act 1985 as amended and SI 1992/1708; and the service charge reductions which can be made pursuant to sections 219-220 of the Housing Act 1996 and the subsequent Secretary of State directions in 1997, 1999 and 2000. Attempts to make a statutory distinction between annual and major works service charges in the regulations governing section 152 of the Commonhold and Leasehold Reform Act 2002 have now been shelved.

Leaseholder or freeholder service charges?

Leaseholders' service charges can be said (except for the provisions in the Landlord and Tenant (Covenants) Act 1995) to 'run with the land'. In other words, the leaseholder for the time being is responsible for the service charge. If a variable service charge is dealt with on an estimated/actual basis described above, then whenever the property is sold on (assigned) there will only be an estimated service charge for the current year. The actualisation of the estimated charge could be up to 18 months later and will be applied to the account irrespective of whether it is a credit or debit adjustment. It is for the parties on assignment to decide between themselves who gets the benefit (or burden) of the adjustment. There is a single continuous service charge account per lease.

Freehold service charges do not 'run with the land' but are governed by personal contractual agreements. Positive freehold covenants (i.e. to do something such as pay a service charge) are not binding on successors in title (see *Austerbery v Oldham Corporation (1885)*) – this principle was devised so as not to burden land with a succession of obligations. This means that upon sale (transfer) of the freehold interest the new freeholder should enter into a personal agreement with the supplier (there is no landlord/tenant relationship) to receive services and pay service charges.

This new agreement is called a deed of covenant. The more usual method adopted is that the freehold transfer contains the detailed service charge covenants and also a negative covenant (binding on successors in title) that the freehold shall not be transferred until and unless a deed of covenant is entered into by the transferee with the service provider agreeing to pay for the communal (estate) services. Should the deed of covenant not be signed on transfer, the original freeholder (transferor) will remain responsible for payment of the service charges despite not owning the property.

To reflect the fact that new accounts must be created on transfer, freeholder service charges are more usually actual service charges (reflecting the costs incurred).

The provisions governing variable service charges in Landlord and Tenant Acts do not apply to freeholders although there are some analogous provisions in the Housing Acts (see pages 41 and 42).

Private sector profit centres v social sector cost centres

Where there are variable service charges the profit/cost centre must reflect the lease arrangements – invariably leases will oblige the leaseholder to contribute to the cost of communal services to the block or estate and therefore these cost/profit centres must be established for each service-chargeable service.

There is obviously no such requirement with fixed service charges.

In the private sector (where all or most flats are sold on a long lease) the norm is to set up one account for the block (or estate) with sub-jobs for each service's expenditure; both the income and the expenditure are applied to the account, hence a profit centre. Compliance with the 'inspection of accounts' rules (set out in section 21 onwards of the Landlord and Tenant Act 1985) is achieved by allowing leaseholders access to the block account to inspect income and expenditure. Individual service charge accounts are kept for each leaseholder but this is merely a way of ensuring that each has made a proper contribution to the block (or estate) account. It could well be that the block/estate falls into deficit through, for example, non-payment by some leaseholders, and the landlord will have to ask for higher contributions while recovery action is taken. It is not uncommon for shareholders' meetings to name leaseholders in arrears and the action being taken. Much of the problem local authorities and housing associations have with the LVT is because the panel members have little experience of the social sector and limited understanding of how right to purchase schemes have superimposed leasehold management on a pooled accounting system.

In the social sector, leases often refer to two cost centres: block and estate. So, services to the block are apportioned by one divisor and services to the estate are apportioned by a different divisor. Often a third divisor is used for district heating schemes, for example. The most important issue (especially for local authorities) is that *income* cannot be attributed to the block (or estate) because:

- rents are pooled across the entire stock
- tenants' service charges (which are often fixed) are pooled across those receiving the service
- subsidy is part of pooled income
- even if rents/fixed service charges were 'depooled' the income would have to be further split to the block/estate/district heating system cost centres.

Social sector landlords with mixed tenure portfolios are notoriously poor at establishing the relevant geographical cost centres let alone coding the expenditure to them. This is a rigor that has to be imposed to deal with the complexities of variable service charges and the need to reflect costs disaggregated to block and estate level within, for example, an HRA framework that was developed to deal with pooled accounting processes.

Sinking (or reserve) funds

Sinking fund (or reserve fund) payments are not service charge payments. They are contractual payments made in advance and held in trust against future expenditure. All properties in a block or estate are required to contribute to a sinking fund.

The terms 'sinking fund' and 'reserve fund' are now often used interchangeably, but technically:

- **reserve funds** cover shortfalls in expenditure across accounting periods and/or relate to routine expenditure
- **sinking funds** are for items of major repair or renewal that occur infrequently and the fund builds up over a longer period of time.

Sinking funds or reserve funds may not be called this in leases, but there must be some basis under the lease terms for collecting such payments.

Local authority landlords cannot run a sinking fund for various reasons including:

- no sinking fund provisions in many leases
- authorities cannot afford to pay tenants' proportions (sinking fund payments are payments in advance, major works are funded by subsidised borrowing)
- properties are sold at different times
- the requirements of operating a HRA do not fit with sinking funds' ongoing nature.

Some social landlords run schemes in which individual leaseholders pay monies in advance and these are accounted for in individual accounts. These are not true sinking funds – which are communal funds designed to cover an entire block/estate rather than an individual's contribution. An 'individual scheme' has a fundamental weakness (especially for councils) because a leaseholder could demand work be done, citing the need for repair and the fact that the landlord has adequate contributions to cover his individual cost, while the landlord does not have sufficient overall funding to do the work.

The major benefit of sinking funds to landlords is that they avoid large one-off increases in costs when major capital expenditure is required, and all the associated difficulties with leaseholders. Proposing major works without having a sinking fund to cover the cost is very contentious.

There are other factors to consider with sinking funds:

- the management cost of running them (as opposed to interest earned)
- whether to have different sinking funds e.g. for cyclical decorations and another for major elements of building (and if so how the distinction between the funds will be made clear)
- what happens if the costs of repairs exceed the sinking fund balance
- how much to charge (either in cash terms or for example in some schemes for the elderly a proportion of resale value on assignment)
- dealing with bad debts/enforcement
- regularly reviewing leaseholders' contributions and life cycle costings.

Ground rent

The ground rent (or rent charge) is separate from a service charge. It is a regular payment due from the leaseholder to the landlord under the terms of a long lease, which reflects the rent of the unimproved land rather than the buildings on the land. (A similar application is in building leases, where the unimproved land is let to a builder for a long term at a low rent, the freeholder having the additional benefit of getting the land and buildings back at the end of the term.)

Ground rent is part of common law but many aspects have been modified by statute:

- the level of ground rent is restricted in right to purchase schemes e.g. £10 p.a. maximum in right to buy leases
- ground rent is zero on leases under part I, chapter II of the Leasehold Reform, Housing and Urban Development Act 1993
- collection of ground rent is now governed by section 166 of the Commonhold and Leasehold Reform Act 2002: the leaseholder is not liable to make a ground rent payment unless the landlord demands the rent by service of a notice in prescribed form and must state:
  - amount of ground rent due
  - date on which the leaseholder is liable to pay (if the demand is sent after the due date then the notice must state the date on which it would have been payable under the lease terms). *Note:* the date for payment must not be before the date specified in the lease and must be between 30 and 60 days after the date of service of the demand notice
  - name of the leaseholder(s)
  - period for which the rent demanded relates
  - name and address of the person/company to whom payment is to be made
  - name and address of the landlord (or agent) by whom the notice is served
  - certain supporting information.

For the prescribed format of the demand notice and the supporting information see the schedule to the Landlord and Tenant (Notice of Rent) (England) Regulations SI 2004/3096. **Practice online** has an example of a notice from One Housing Group.

A landlord cannot commence legal action for recovery of the debt or for forfeiture and possession unless he has first served the demand notice correctly and the leaseholder has failed to pay.

Constructing service charges

Service charges must be constructed in accordance with the terms of the lease, which should establish:

- the cost centres to be used
- how costs are apportioned
- which services are to be service charged.

There are some statutory limitations, notably that:

- only 'reasonable' costs should be included (s19, Landlord and Tenant Act 1985)
- statutory consultation must be undertaken first if certain costs are to be included (s20, Landlord and Tenant Act 1985 – as amended)
- leaseholders do not have to pay for costs incurred more than 18 months prior to invoice unless notices have been served (s20B, Landlord and Tenant Act 1985)
- leaseholders are entitled to 'inspect accounts' (s21, Landlord and Tenant Act 1985)
- service charge for repairs in the 'initial' period of right to purchase leases may be limited by the estimates given in those notices.

Cost centres

The lease or transfer will establish the 'property' which has been demised and, in the case of flats, the 'building' (or block) in which the property is situated and (if applicable) the estate (or scheme). In the case of houses there will be no 'block' but just the estate. Good practice is to define the block and estate by reference to a map, in addition to the name/address.

There may be a third cost centre: such as a district heating estate, often needed because a boiler house serves more than one estate, or part of an estate, or supplies different levels of service to different properties. The lease should allow for these block and estate definitions to change (additional properties can be built at the bottom of blocks; estate land can be developed or sold off), i.e. leases should allow 'derogation from grant'.

It is essential that the landlord's financial processes mirror these geographical cost centres, with expenditure codes which reflect the property, block, estate (or heating estate).

A simple expenditure code system

Codes all have the format DEEBB where D is a code for the district, EE for the estate and BB for the block. So for example:

- Code 10101 = the first block on the first estate in landlord district 1
- Code 10102 = the second block on the first estate in landlord district 1
- Code 10100 = the first estate in district 1 (no block)

A simple expenditure code system covering communal services

The format DEEBB above is extended to DEEBBSS, where SS is a code for a communal service. So for example:

- 01 = electricity
- 02 = gas
- 03 = grounds maintenance, etc.

Communal services are provided to blocks and estates; it is imperative that the landlord records which communal services are provided to which blocks/estates, including any differences. For example, acquired 'street' properties may not have communal areas to be cleaned or communal grounds; smaller blocks may not have lifts, dry risers, water pumps, etc; communal grounds may be attributed to estates or serve individual blocks.

Again, it is essential that the landlord's financial processes have expenditure codes which map communal services to geographical cost centres.

The more closely aligned the expenditure coding structures are to the lease definitions, the easier it is to construct service charges – with charges being less prone to error from manual intervention. For example, if communal repairs are not coded to the block and estate when they are undertaken but rather to a trade or budget code, then at year-end the repairs have to be 'reperformed' in financial terms i.e. identified, quantified and allocated to geographical cost centres, potentially leading to errors.

Coding expenditure by service to geographical costs centres which mirror lease/transfer definitions greatly assists the 'inspection of accounts' obligations (see page 56). Some expenditure types – such as repairs or electricity invoices – are easy to allocate to the geographical cost centres but others – for example, cleaning provided by a direct labour force or resident caretakers – may need a timesheet system to allocate (say) 'productive hours' to individual blocks and/or estates.

In some cases certain communal services may be carried out by parties other than the landlord/managing agent, e.g. Tenant Management Organisations. It is essential that they adopt processes similar to those above.

Apportionment

The cost of service charges must be apportioned to individual leaseholders according to the terms of the lease. There are no statutory provisions governing apportionment. It is usual for the lease/transfer to define the block and/or estate and include a methodology for how the block/estate service charge cost is apportioned to individual properties.

Examples of common methods of service charge apportionment

- gross values or rateable values
- number of flats in a block
- bedroom size (or weighting based on bedroom size)
- floor area
- reinstatement value (in the case of building insurance)
- a stated percentage

Leases may state that apportionment will be by 'any reasonable method as determined by the landlord at its sole discretion'. In these cases it is good practice to consult with leaseholders before determining a method, then using it consistently across the stock.

Some leases may define, service by service, how costs are apportioned. This can differ according to the service, for example:

- repairs and electricity invoices coded to the block may be apportioned between flats in the block
- the cleaning service may be divided among all properties which receive the service throughout the portfolio
- insurance premiums may be individual to the property.

Services

The lease will dictate which communal services are to be delivered and costs recovered. The services described in the lease are often groups of services described under a general nomenclature. In the panel is a typical breakdown of service types.

Typical breakdown of service types

1 Block cleaning
- contract costs
- variations from contract
- window cleaning (contract)
- window cleaning (materials)
- responsive repairs (unblock drains etc)
- materials and equipment
- indirect overheads

1(a) Caretaking
- salaries, superannuated pension, NI
- accommodation
- telephone
- uniform/materials
- transport
- materials
- indirect overheads

2 Block responsive repairs
- cost of works to communal parts of blocks
- direct overheads
- indirect overheads

3 Block lighting
- metered electricity
- planned preventive maintenance costs
- reactive repairs to lighting equipment
- meter reading costs
- direct overheads
- indirect overheads

4 Lift maintenance and monitoring
- planned preventive maintenance (contract)
- contract variations
- responsive repairs (contract)
- running costs
- responsive repairs – other
- remote monitoring equipment (contract)
- specialist cleaning
- emergency call-out
- telephone
- electricity
- lift inspection
- lift insurance including 3rd party
- direct overheads
- indirect overheads

5 Concierge/CCTV/ security
- supply of guards/staff (contract)
- camera cost and installation
- monitoring (contract)
- call out
- maintenance of CCTV equipment
- replacing equipment
- direct overheads
- indirect overheads

6 Door entryphones
- maintenance
- contract variations
- responsive repairs
- direct overheads
- indirect overheads

7 Fire protection
- maintenance
- contract variations
- responsive repairs
- annual inspection costs (certificates)
- call out
- direct overheads
- indirect overheads

8 Refuse storage
- contract costs
- contract variations
- plastic sacks
- palladin, euro and skip hire
- extra collections
- palladin, euro and skip replacement
- palladin, euro and skip repair
- reactive repairs e.g. cleaning of bays
- direct overheads
- indirect overheads

9 TV aerials
- annual maintenance
- emergency call-out
- reactive repairs
- direct overheads
- indirect overheads

10 Disinfestation/pest control
- maintenance
- reactive repairs
- direct overheads
- indirect overheads

11 Lightning conductors
- maintenance
- reactive repairs
- direct overheads
- indirect overheads

12 Water
- cold water tank maintenance (contract)
- cold water tank maintenance (responsive repairs)
- cold water tank inspection (water testing)
- water rates
- direct overheads
- indirect overheads

13 Heating and hot water
- fuel costs
- planned preventative maintenance
- responsive repairs
- contract variations
- insurance of boilers and other equipment
- electricity
- responsive repairs
- combined heat and power
  - unit maintenance
  - monitoring equipment maintenance
  - telephone
  - CHP income
  - government levy income
- direct overheads
- indirect overheads

14 Estate cleaning
- contracted workers
- variations from contract
- responsive repairs
- direct overheads
- indirect overheads

15 Estate responsive repairs (including road maintenance)
- cost of works to estate
- direct overheads
- indirect overheads

16 Grounds maintenance
- salaries
- materials
- transport/equipment
- variations
- indirect overheads

17 Estate lighting
- metered electricity/recharge from public realm where electricity from highway
- planned preventive maintenance (contract)
- equipment replacement
- reactive repairs to lighting equipment
- direct overheads
- indirect overheads

18 Tree maintenance
- contract
- contract variations
- emergency works
- direct overheads
- indirect overheads

19 Security
- guards (contract)
- dog wardens (contract)
- direct overheads
- indirect overheads

20 Playground maintenance
- responsive repairs

21 Other management costs
- third party landlord costs
- managing agent costs
- service charge audit fees

Notes:

1. **Direct overheads**
   Salaries of staff directly related to the service
   Oncosts of above
   Overheads that can be directly related to above
2. **Indirect overheads**
   Other organisational costs allocated on a reasonable basis generally in proportion to the cost of staff employed
3. **Contract**
   Services more usually contracted out. Cost included: wages, pensions, national insurance, materials, insurances, transport, on-costs, overheads, etc.

Major works service charge construction

As noted, there is no statutory distinction between annual service charges and those for major works and usually no distinction in the lease either. Thus major works service charges should be constructed on the same basis outlined above:

- **cost centres:** the contractor should be asked to tender against the geographic block/estate cost centres rather than giving a single contract price
- **apportionment:** any 'special cases', for example, getting tender prices for front doors (if landlord responsibility) or windows per flat, need to be consistent.

The main issue in constructing these service charges is 'contamination' of tender prices with items which should not be included in service charges to residential leaseholders. For example:

- kitchen, bathrooms, internal wiring, individual heating for periodic tenants
- structural/communal costs needing to be apportioned out to reflect commercial elements in the block
- estate works benefitting shops in estates, or garage areas where garages are rented separately.

The construction of major works service charges is intimately connected to the statutory consultation process (see pages 19-22).

Tenure types

The database must hold the tenure type of the property, block and estate to ensure that mistakes are not made, for example:

- extended leases not charged ground rents
- houses not charged insurance or 'block' repairs
- Social HomeBuy service charges apportioned (if appropriate)
- superior landlord costs picked up for underleased property.

Reasonable costs under section 19 of the Landlord and Tenant Act 1985 (as amended)

Costs can only be successfully included in a service charge demand for any period if:

- they are reasonably incurred
- the services or works are of a reasonable standard.

Parties may refer disputes over whether or not costs were (or are to be) reasonably incurred or the standard of work is reasonable to the LVT for a declaration. Any provision in a lease (including an arbitration clause) is void if it purports to determine the 'reasonableness' of a service charge. Parties can, if they wish, enter into a post-dispute arbitration agreement, the result of which would mean that no subsequent application could be made to the LVT on the matter.

If some of the costs are 'unreasonable' then a proportionate deduction to the service charge should be made: the wording of this section does not imply all or nothing (see *Yorkbrook Investments Ltd v Batten*). This may be very important for the manager who may, for example, be discussing non-payment of a demand due to inadequate cleaning for part of the year. A manager should not argue that a service is so inconsequential in terms of cost as to be unworthy of justification or explanation, because an LVT will give just as much emphasis to a low-cost service as to a high-cost one if convinced that it is of sufficient importance to leaseholders.

Statutory consultation about major works or contracts

Apart from any consultation with leaseholders that is undertaken as good practice, there are legal requirements about consultation on major works and service contracts which must be observed if the landlord is to be able to recover the cost of the services in full (i.e. exceeding the £250 or £100 p.a. limits – see below).

This section describes the statutory consultation process. The section includes:

- an overview of statutory consultation
- the statutory background
- processes to be followed in detail
- carrying out the contract
- how to deal with emergency works and other exceptional circumstances
- dealing with delays in the final accounts.

The **practice online** chapter contains a number of example procedures and charts to help the practitioner, that are only described briefly here.

Overview of statutory consultation process

What is now called 'section 20' consultation has been in place since the Housing Act 1974, but local authorities were exempt from the provisions until the rules were consolidated into the Housing Act 1980. The rules and financial limits were altered from September 1988 and were then replaced by the current arrangements in October 2003.

The current rules were subject to protracted consultation and were aimed at giving leaseholders more influence in the procurement of chargeable services and allowing (especially social) landlords to deliver maintenance and other services using 'long-term contracts'. The rules govern the procurement not only of building works but also of any services that will cost leaseholders more than £100 p.a. The regulations on long-term contracts are detailed and include compliance with EU procurement rules.

In essence, statutory consultation is now a two-stage process. A **notice of intention** is served before detailed plans are finalised, informing leaseholders what the landlord intends to do, giving them the opportunity to make observations and in some circumstances to nominate contractors. The **notice of proposal** is served after tenders are returned but before contracts are signed, informing leaseholders of the landlord's proposed action and again asking for observations. In certain circumstances a third notice may have to be served post-contract, justifying the landlord's reasons for entering into the contract. Care is needed to meet the legal requirements if additional works are identified while the contract is in progress.

Most importantly the section 20 rules are now overseen by the LVT who have the power, on application, to waive all or certain parts of the consultation process (for example, in emergencies) or to decide whether the consultation process has been properly undertaken (see box below).

Qualifying long-term agreements, covered by schedules 1 and 2, are agreements of more than 12 months where any individual leaseholder may receive a service charge of more than £100 p.a. Qualifying (repair) works, covered by schedule 4 (parts 1 and 2), occur where the service charge for any individual leaseholder would be more than £250. Schedule 3 deals with qualifying works carried out under a qualifying long-term agreement, which would result in a service charge of more than £250.

The reason for two schedules for each contract type is to differentiate between those contracts that are subject to EU rules (requiring an official notice to be placed in the Official Journal of the European Union – an OJEU notice), and those that are not. Schedules 1 and 4 (part 2) are for non-OJEU contracts, while schedules 2 and 4 (part 1) are for contracts requiring an OJEU notice. In the main the requirements for each of the two sets of schedules are similar, but some differences have to be taken into account when preparing the notices and statements.

In **practice online** there is a detailed flowchart showing the relationship and differences between the notices under the different schedules.

Statutory background

The regulations for section 20 consultation are in SI 2003 No 1987 – The Service Charges (Consultation Requirements) (England) Regulations 2003.

There are four schedules (one with two parts) governing statutory consultation with leaseholders:

- schedule 1 – covers *qualifying long-term agreements*, other than those for which an OJEU notice is required (see below).
- schedule 2 – covers *qualifying long-term agreements* for which an OJEU notice is required.
- schedule 3 – covers *qualifying works* under *qualifying long-term agreements*.
- schedule 4
  - part 1 – covers *qualifying works* for which an OJEU notice is required
  - part 2 – covers *qualifying works* for which no OJEU notice is required.

Processes to be followed in detail

Schedules 1, 2 and 4 (parts 1 and 2) all require a two-stage process. **Practice online** has detailed contents lists, procedure notes and proformas covering the different steps. The two stages are:

- **A notice of intention** must be served on all leaseholders, prior to tendering, giving details of the proposed contract and providing a 30-day observation period.
- **A notice of proposal** must be served post-tender, along with a statement giving the results of the tender process. A further 30-day observation period must be given for leaseholders to make comments on the prices received. In addition, the landlord must provide a brief résumé of the results of the first stage of the consultation.

Schedule 3 requires one notice only, which is a combination of the requirements of a notice of intention and notice of proposal for qualifying works. However, as the proposed works are to be carried out under a qualifying long-term agreement there is no requirement to provide details of the tender process, just the cost of the proposed works. Again a 30-day observation period allows leaseholders to make comments on the proposed works and costs.

Two important issues to be considered in serving the notices are these:

- A major difference between OJEU and non-OJEU notices is that where a contract or agreement is not subject to EU rules the leaseholders must be given the opportunity via the notice of intention to nominate a contractor to be asked to estimate for the agreement or contract. In addition, under schedules 1 and 4 (part 2), should the landlord elect to award the contract to neither the contractor providing the lowest estimate nor to a nominated contractor, then a *third notice* must be served on entering into the contract, providing details of why the chosen contractor has been preferred.
- Another difference between the statements of proposal for qualifying works is that while under schedule 4 (part 1) the landlord is required to provide individual estimated costs, under schedule 4 (part 2) – probably the most commonly used schedule for qualifying works – the landlord is only obliged to give the estimated cost of the proposed works in total. Most landlords however would consider it to be good practice to provide an estimated service charge within the statement also.

Carrying out the contract

Practice online has a typical process for carrying out a works contract and an example of a procedure note and proforma where the need for additional works arises. If additional works are identified as being required while the contract is in progress, the consultation process must again be followed.

Lack of consultation on service charges relating to additional works was an issue in *Martin -v- Maryland Estates Ltd [1999] EGCS 63*.

Martin -v- Maryland Estates Ltd [1999] EGCS 63

The landlord, Maryland, wrote to Martin who was a leaseholder, providing a specification of works and served a notice under s20 of the Landlord and Tenant Act 1985 with estimates. Martin intended to purchase the freehold under the Leasehold Reform Act. Maryland went ahead with the works.

Whilst the contract was in progress, additional works were identified and then carried out. The court refused Maryland a dispensation for failing to notify the leaseholder about the additions, determining that they had not acted reasonably in failing to notify them. Maryland appealed, arguing that they had acted reasonably and that they were entitled to £1,000 towards the additional works as their minimum sum under s20(1) of the 1985 Act.

The Court of Appeal held that the landlord had not acted reasonably. Whilst the leaseholder's attitude made it difficult to comply with all the consultation requirements, the complete failure to follow any of the requirements was not reasonable.

A commonsense approach was necessary to determine what was a single batch of qualifying works under s20(1). The purpose of s20(1) was to provide a threshold, not to incorporate a margin into every contract, so the landlord was not entitled to the payment.

Emergency works and other exceptional circumstances

Nothing in the regulations allows for emergency works to be undertaken before the end of the observation period (as had previously been catered for). Additionally, there are a number of qualifying long-term agreements where it is likely to be very difficult or impossible to comply with the regulations. In these instances the landlord has to apply to the LVT for dispensation from all or part of the regulations in order to serve valid section 20 notices. In the case of emergency works, because of the timescales that can be involved in an application, the landlord may have to carry out the repairs prior to obtaining dispensation, taking the risk that the tribunal will not find it reasonable to dispense with the requirements. If this were to happen, the effect would be to limit the service charge recovery to £250 per leaseholder.

Delays in final accounts for works

If final account costs are not to be billed within 18 months of them being incurred, notice must be served on the leaseholders under s20B advising them that these costs will be billed.

Practice online has a procedure note about final account costs under section 20B, used in LB Southwark.

Non-statutory consultation about major works

Social landlords will invariably consult with residents over matters of housing management. For local authorities this is a statutory obligation – in s105 of the Housing Act 1985 (as amended). Consultation good practice will include a wide range of issues about major works, such as:

- design solutions
- site location, layout, duration of works
- liaison officers, complaints, appointments.

Care must be taken, particularly on mixed tenure estates, to ensure that this general consultation does not conflict with the statutory consultation described above. As a point of good practice, many social landlords with investment programmes write to all homeowners each year to update them on what, if any, works of refurbishment are planned for their estates, which will result in service charges.

The '18-month rule' about recovering costs

Paragraph 4 schedule 2 of the Landlord and Tenant Act 1987 inserted s20B into the Landlord and Tenant Act 1985 – this section is of utmost importance to the portfolio manager because if its provisions are not followed (see box), then costs cannot be recovered from the leaseholders.

The '18-month' rule

Section 20B(1)

If any of the relevant costs taken into account in determining the amount of any service charge were incurred more than 18 months before a demand for payment of the service charge is served on the tenant, then (subject to subsection (2)) the tenant shall *not be liable* to pay so much of the service charge as reflects the costs so incurred.

Notes:

1. There were transitional arrangements set out by the statutory instrument bringing this section into force; these have now expired.
2. The whole matter hinges on 'the date the cost was incurred'.
3. The wording of the section provides that the leaseholder 'shall not be liable to pay' the service charge demanded and *not* that the service charge shall not include the costs. It is therefore possible for the landlord to include such costs and leave it to the discretion of the leaseholder as to whether or not they feel the situation warrants payment.

Subsection 20B(2)

Subsection (1) shall not apply if, within the period of 18 months beginning with the date when the relevant costs in question were incurred, the tenant was notified in writing that those costs had been incurred and that he would subsequently be required under the terms of his lease to contribute to the payment of a service charge.

If the lease provides for the annual demand of service charges only and certain costs incurred are omitted from the following demand, the next demand could well be outside the 18-month period. Subsection (2) allows the landlord, quite equitably, to remedy administrative errors that may result in omitting costs, by writing to the leaseholders to inform them that costs have been incurred and will be demanded in future service charges.

The date the cost is incurred is an important concept when considering both the initial and reference periods and the '18-month rule':

- schedule 6 paragraph 16B(1) of the Housing Act 1985 states that 'where a lease of a flat requires the tenant to pay service charges in respect of repairs … his liability *in respect of costs incurred in the initial period* of the lease is restricted'
- section 20B(1) of the Landlord and Tenant Act 1985 states that 'if any of the *relevant costs* taken into account in determining the amount of any service charge *were incurred more than 18 months …*'

Both of the above show that the date on which a cost is incurred is of prime importance.

It could be argued that the landlord becomes liable to pay costs as early as the date it enters into a contract for building work – once the contract is signed both parties are legally bound. There is some difficulty with this argument, however, because the legislation, in both cases cited above, is looking at *actual* costs incurred and at this earlier, tender-acceptance stage, the actual costs are not known (because of provisional sums, contingencies, on-site instructions, etc that affect final costs).

It is much more probable that costs are 'incurred' when they are first liable to be paid under the contract (the terms of a building contract may well state the dates of stage payments) or *at the latest* when the monies are actually paid (*West Ham v Grant*; *Capital and Counties Freehold Equity Trust v B.L. plc (1987)*). There is often very little difference between these two dates but which is appropriate may well turn on the facts of the individual case. Indeed, to consider the 'date the cost is incurred' to be as late as the date of payment seems to run contrary to s21 of the Landlord and Tenant Act 1985 as amended which indicates that costs can be incurred before payment. This section provides that any summary of costs to be furnished by a landlord should include details of costs incurred but for which no demand for payment has been made of the landlord. The portfolio manager is advised to play safe:

- when considering what costs were incurred in the initial period it should be remembered that after the initial period expires, costs are recoverable in full
- when considering the 18-month rule the safest date to work from is obviously the earlier date to ensure that the statutory obligations are complied with, within the 18 months limit.

Right to purchase offer notices – limitation of repair service charges

There are statutory limits on repairs service charges in right to purchase cases (right to buy, preserved right to buy and right to acquire). Section 4 of the Housing and Planning Act 1986 amended s125 and paragraph 16 part III schedule 6 of the Housing Act 1985 – Right to purchase offer notices for flats issued after 7th January 1987 – to insert binding estimates in respect of repairs and improvements (if the lease requires the tenant to contribute to these costs). The legislation recognises two types of repair:

- itemised building works – major capital or revenue schemes of repair, planned by the landlord
- non-itemised building works – routine, day-to-day repairs.

The landlord cannot exceed the estimated cost of these building works included in the offer notices for flats which are paid for in the 'initial period' (the first 5-6 years) of the lease except for an element of inflation.

The Housing Act 1985 had always called for all offer notices to contain (non-binding) estimates for each head of service and a total. The amendments made by the 1986 Act made repair estimates binding (except for an inflation element) in respect of flats. These provisions replaced the old '10-year structural defect guarantee' in paragraph 18 schedule 6 of the Housing Act 1985.

Practice online has a diagram showing a s125 'offer notice'.

Reference and initial periods

The 1986 legislation introduced the 'reference' and 'initial' periods. The legislation allows the reference and initial periods to end on different dates (usually a year apart, this has come to be known as the 'void' period). When this happens particular calculations must be made to ascertain the leaseholder's service charge liability.

The **reference period** is a period of between 5-6 years to which the estimated service charge liabilities contained in the s125 offer notice refer. It starts at a date stated in the offer notice – not more than six months after the issue of the notice, on a date estimated by the landlord as the date by which the conveyance should have been completed. It ends five years after it starts or more commonly, where the notice states the lease will provide for service charges to be levied by reference to an annual period, with the end of the fifth such period beginning after that date.

The **initial period** is a period within which the landlord's ability to recover service charges in respect of building works is limited to the estimates contained in the s125 offer notice plus an element in respect of inflation. Obviously then if building works are carried out in the initial period that are not mentioned in the offer notice at all, the landlord's ability to recover costs is limited to the estimate in respect of non-itemised repairs (Housing Act 1985, schedule 6 paragraph 16b (3) (1)). The initial period starts at the date specified for its commencement in the lease – it is important to note that if the lease includes provisions for service charges to be payable in respect of costs incurred in a period before the grant of the lease the initial period must begin with that period.

If the lease is silent as to the date the initial period commences it is taken to start from the date of the completion of the sale. The initial period ends five years after its start, except that if the lease provides for annual service charges it continues until the end of the fifth annual period beginning after the grant of the lease.

There are two major issues from the above:

- The end of the initial period is unaffected by its commencement date.
- Most landlords would want to collect service charges for major schemes of repair that are contained in the s125 offer notice but the costs of which are incurred before completion. The identification of the scheme (and therefore disrepair) would be reflected in a lower valuation. If the works are then carried out before completion, and the lease does not provide for the payment of service charges in the period before completion, the leaseholder has had double benefit: a lower valuation and the works carried out for which they cannot be recharged. It is far more equitable therefore to reflect the level of disrepair and the leaseholder's liability to contribute to the cost of repairs in the valuation of the dwelling and then subsequently to recharge the costs. Indeed the legislation allows for this.

The landlord's wish to collect service charge prior to completion would probably be limited to itemised schemes of repair; day-to-day repairs and the costs of other services would probably be construed as being covered by the rent which is payable up until completion.

In essence, the legislation endeavours to get the landlord to start the initial and reference periods on the same date:

- ideally the date of completion – any major itemised schemes of repair before this date would not be in the reference period so therefore not mentioned in the s125 offer notice and therefore not reflected in a lower valuation, *or*
- before the date of completion, where the landlord protects itself by ensuring it can recover costs of itemised schemes of repair by including lease covenants providing for the payment of such costs, notwithstanding the fact that they were incurred before completion.

The '18-month rule' may also need to be considered when issuing a demand for costs incurred before completion. The costs cannot be successfully included in the service charge demand if they were incurred more than 18 months before the service of the demand and the tenant has not been notified. If completion is delayed and the lease allows only for the issue of a service charge demand on a specific date, 18 months could well elapse: in this case the portfolio manager should write to the tenant indicating that the costs have been incurred and will feature in a future service charge demand.

Void period

The portfolio manager needs to bear in mind that it is the lease that will allow for the recovery of costs of itemised repairs incurred before completion and therefore these costs cannot be recovered until completion.

Example of a 'void' period

Suppose:

- a lease provides for annual service charges April-March
- the s125 offer notice was issued on 1st December 2003
- the reference period started on 1st March 2004 (the date by which the landlord anticipated completion would occur)

In fact completion does not occur until six weeks later, 14th April 2004. The lease provides for the initial period to start on 1st March 2004 – but the commencement date of the initial period being altered from the date of completion by the terms of the lease does not affect its *expiry* date. In this case the reference period will end on 31st March 2008 but the initial period will end on 31st March 2009.

It is quite possible for part of the initial period to fall outside the reference period; more usually because the initial period ends after the reference period ends. If this happens and the lease allows for annual service charges there will usually be a period of exactly one year which is still part of the initial period of the lease, despite the fact that the reference period has ended.

This has been called the 'void' period because it is still part of the initial period but there would be no estimates for repairs to be carried out, because the reference period has expired. Service charges for repairs are still limited because the initial period is still current; however, they are now limited by the statute because of the 'silence' of the s125 offer notice.

The statute (paragraph 16B schedule 6 of the Housing Act 1985) provides that where building works are carried out in the 'void' period that are not itemised anywhere in the offer notice, the ceiling limit above which the leaseholder cannot be asked to contribute toward the cost of the works is the rate produced by averaging over the reference period *all* works for which estimates are contained in the notice, together with an inflation allowance. Note then, that the average is taken from *all* the estimates contained in the offer notice, both itemised and non-itemised repairs, whether or not they have previously been undertaken and featured as part of previous service charge demands. SI 1986/2195 which dealt with inflation allowances has a separate paragraph that deals specifically with the inflation allowance calculation in these cases.

If building works are carried out in the 'void' period that are itemised in the s125 offer notice – perhaps they were originally anticipated in an earlier year – then they are dealt with in the normal way, the estimate plus inflation being the ceiling of the tenant's obligations to contribute to costs.

The statute is not prescriptive about what to do when the costs of an 'itemised repair' are incurred partly in the initial period and partly outside. **Practice online** contains more guidance on this eventuality.

The 'averaging' provisions in this part of the Act do not differentiate between itemised schemes of repair such as major works and the routine day-to-day repairs which are not itemisable and subject to an annual estimate rather than a specific estimate. The tenant is not required to pay in respect of building works that are undertaken in the void period, but which are not itemised (either because they are routine repairs or they are major works that were omitted) at a rate exceeding the average over the reference period of *all* works for which estimates are contained in the notice. So in the void period there is one ceiling for major schemes of repair and routine repairs.

At first sight the 'averaging' principle adopted by the legislators may seem arbitrary but with more thought the scheme is seen to be equitable. When the s125 offer notice is produced, the landlord can probably only look five years hence; it is out of the landlord's control if completion occurs at such a time that extends the initial period into year six where it currently has no plans. On the other hand the tenant is entitled to some protection in the initial period of his lease – central government's aim was to ease the path of owner-occupation for first-time buyers by ensuring that for this initial period their outgoings were predictable. Averaging helps both the tenant and the landlord – the tenant simply budgets for the same level of outgoings in the void period as for the first part of the initial period; the landlord is not usually limited only to the annual estimate for routine repairs (that is, it is not being penalised for not being able to crystal ball gaze into year six). A middle path seems to have been chosen.

In conclusion then for the void period to occur and *to be of importance* to the portfolio manager, four events all have to coincide:

- the lease must provide for service charges in respect of specified financial years *and*
- the reference period must start in a different financial year from the completion date of sale *and*
- building works must be being carried out in the void period *and*
- these building works are not itemised in the s125 offer notice.

Inflation allowances

For RTB sales, where the s125 offer notice was issued after 7th January 1987, the ability of the local authority to recover the cost of building works (i.e. itemised and non-itemised repairs) is limited to the estimates contained in the offer notice plus an element in respect of inflation which occurs between the date of the offer notice and the date the last cost was incurred (see below) in respect of the works. The estimated costs of repairs contained in offer notices are at 'current' prices, that is, prices

prevailing at the date of the offer notice. Inflation must be allowed for because the offer notices relate to works programmed for up to 5-6 years ahead.

The inflation element need only be calculated where the actual tendered costs of the proposed major works exceed the offer notice estimate. The estimate plus inflation gives an upper limit which cannot be exceeded – if the costs are below the estimate plus inflation, only the costs incurred by the landlord can be recovered.

Note: most local authorities' capital/revenue major refurbishment programmes include figures indicating the budgeted cost of works, when the works are to be done (not the current prices). These figures should therefore not be reproduced in offer notices – obviously though they can be used as a basis.

Statutory Instrument 1986/2195 dictates that the inflation allowance must be calculated using the following formula:

I = (E x C/P) – E

where

I = inflation allowance

E = the amount shown in the binding estimates contained in the s125 offer notice as being the tenant's estimated contribution in respect of the item

C = the index figure relating to the last date in the initial period on which costs were incurred in respect of the item (whether or not such costs were the full costs incurred)

P = the index figure relating to the date on which the landlord served the notice on the tenant (taking no account of any steps taken under section 177 of the Housing Act 1985 to rectify any previous errors)

'Index Figure' means an index figure now contained in the BIS *Upward Price Index for Direct Labour: Public Housing Repairs and Maintenance*. The term 'index figure' does not include a provisional index figure.

Billing service charges

Invoices

Invoices (demands for service charges) should be issued in accordance with the terms of the lease and should contain certain statutory information. Section 47 of the Landlord and Tenant Act 1987 provides that the demand must contain:

- the name and address of the landlord *and*
- if that address is not in England and Wales an address in England and Wales at which notices may be served.

Where a demand does not contain this information the service charges are not due until the information is given. However, if a receiver has been appointed by the courts whose function includes collecting service charges they are deemed to be due whether or not the invoices contain the relevant information.

There is an anomaly with regard to shared ownership leases and s47: as they are technically assured tenancies it could be argued that s47 does not apply. However, it is recommended that the 's47 information' is included on shared ownership rent and service charge demands.

The Housing (Service Charge Loans) Regulations (SI 1992/1708) paragraph 4 (I) provides that a demand for service charges in respect of repairs shall inform the tenant whether, in the landlord's opinion, the tenant is entitled to a loan under the right to a loan provision *and* – if the landlord thinks the tenant is entitled – what must be done to exercise the right. Note that the right to a loan does not apply to leases sold pursuant to the preserved RTB.

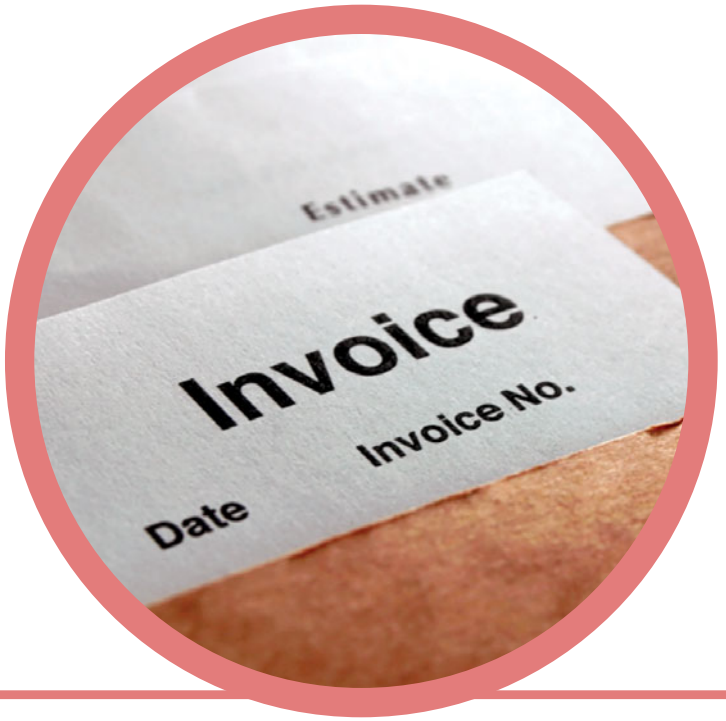
There is no statutory penalty for not including the information on invoices, but failure could result in a referral to the Ombudsman for maladministration.

Good practice for service charge invoices

They should include:

- the name and current (or last known address) of the homeowner
- the property the invoice relates to
- date of invoice
- the landlord's contact details
- payment reference details (invoice number)
- the year/period to which the invoice relates
- methods of payment (including landlord's bank account details).

Practice online has an example of an LB Southwark invoice for revenue service charges which do not entitle the leaseholder to a loan.



Breakdown (summaries)

The invoice will show the total service charge due, however it is good practice to enclose with the invoice a breakdown or summary of how it is made up by heads of charge (for example: cleaning, electricity, etc. – see pages 16-17). Where the invoice shows an actual adjustment for the previous year, it is good practice for the summary to show estimated and actual charges for each head of service.

An anomaly: summaries of account

The original wording of s21 of the Landlord and Tenant Act 1985 provided that, within certain timescales, the tenant could require of the landlord a 'summary of account' (audited if the block contained more than four flats). This section was repealed by the Commonhold and Leasehold Reform Act 2002 and replaced with a section containing very detailed obligations on the landlord to provide 'summaries of account' which included a statement by a qualified accountant. The detailed obligations were to be contained in regulations under s152 of the Commonhold and Leasehold Reform Act but government have decided not to bring the provisions of s152 into force. This has left a limbo situation where the previous provisions have been repealed but the proposed provisions were not brought into force. This also means the provisions contained in the proposed s21A about 'withholding of service charges' (until the summary of account is provided) are not in force either.

Practice online has an example of an LB Southwark service charge breakdown for estimated revenue service charges for 2011/12.

Statements

The landlord should periodically send homeowners 'statements' showing the current position of the service charge account. The statement should include the non-statutory information that is contained on invoices, including:

- balance brought forward from the last statement
- payments made
- invoices debited to the account
- credit adjustments (e.g. actual service charge credit)
- debit adjustments (e.g. a bounced cheque)
- balance carried forward.

Payment plans

An information sheet should be included with the invoice and breakdown setting out the different payment plans available to homeowners; this is especially important in the case of service charges for major schemes of refurbishment (see page 19).

Practice online contains information sheets used by LB Southwark and by One Housing Group.

Explanations

It is good practice to include with the service charge invoice an explanatory leaflet ('Your Service Charges Explained') which details how the service charges are constructed. It can include:

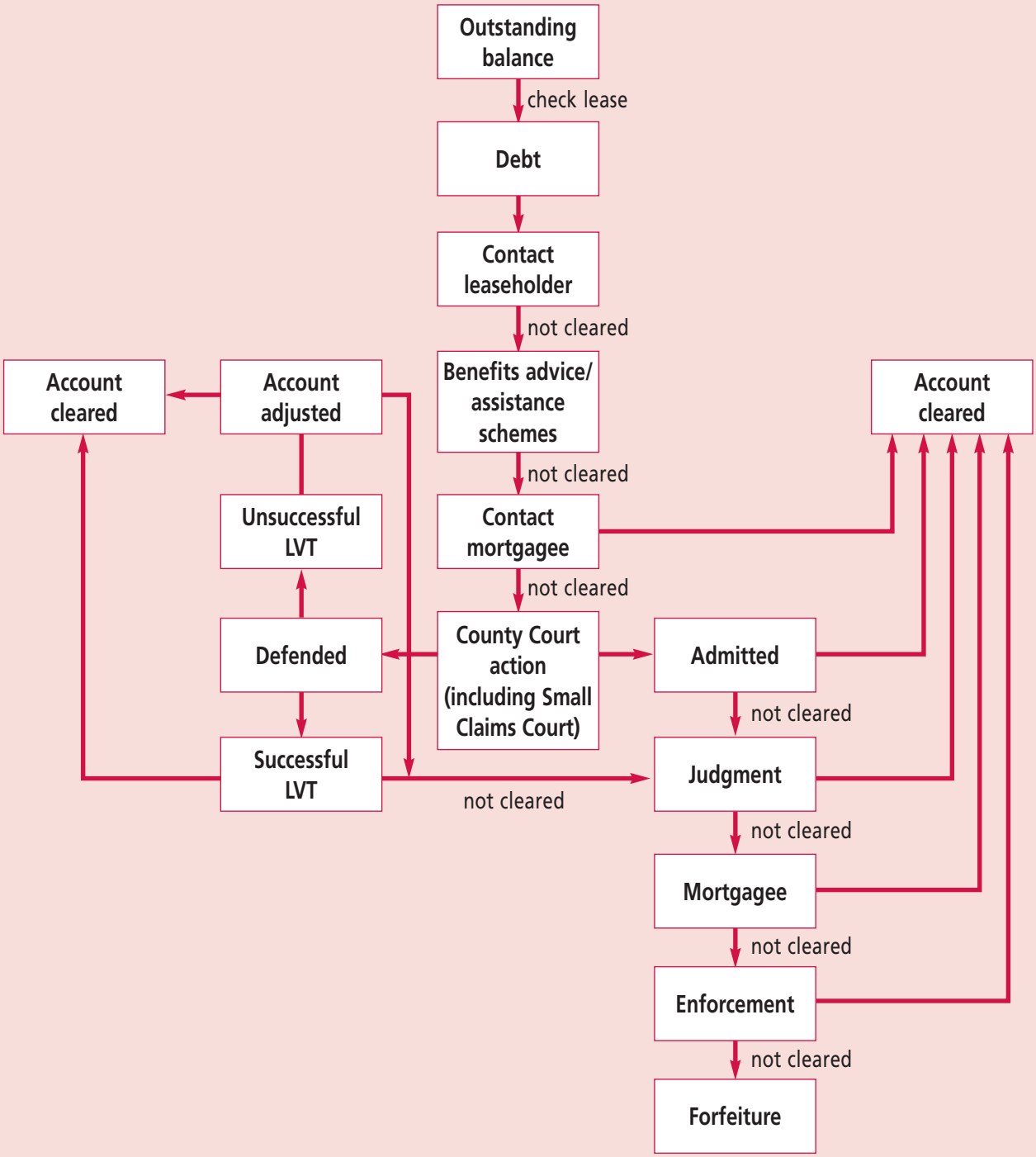
- what is included in each 'head of charge' (see pages 16-17)
- the difference between block and estate costs
- how costs are apportioned
- how any buildings insurance premiums are calculated.

Practice online has leaflets used by LB Southwark and One Housing Group.

Under s21B of the Landlord and Tenant Act 1985 (as amended), a demand for service charges must be accompanied by a summary of the rights and obligations of tenants, and a tenant may withhold payment if the summary is not given (any provisions of the lease relating to non-payment of service charges, e.g. interest, do not have effect). The regulations governing the summary are The Service Charges (Summary of Rights and Obligations and Transitional Provision) (England) Regulations (SI 2007/1257).

Recovering service charges from leaseholders

The recovery of variable service charges from leaseholders is mainly concerned with recovering money – rather than the possession proceedings often used in rent recovery from periodic tenants. Only in the most persistent cases would possession (forfeiture) of the lease be sought. This simple flow diagram describes the basic process:



Note: ground rent is dealt with on page 12.

Initial contact

When service charges are outstanding the first step is to consult the lease to ensure payment is due. For example, some leases will require the leaseholder to pay an estimated service charge by reference to an annual sum, payable quarterly in advance; other leases may only allow for payment of actual service charges. This is especially important when dealing with 'major works' service charges as leases seldom distinguish between those for routine services and those for 'one-off' major works. There is no statutory distinction. The lease will also dictate if interest can be applied to the outstanding balance and, if so, at what rate (e.g. five per cent above base rate) and whether simple or compound (if unstated it is taken to be simple).

It is essential that an internal process is established which identifies arrears as soon as they occur and establishes the principles around initial contact with the leaseholder:

- whether interest is applied to the balance being notified (for example the landlord may decide to warn leaseholders that interest could be applied but only apply interest to the account if and when a county court application is made)
- format of the letter (if the leaseholder is non-resident – whether letters should be sent to the leasehold address as well as a forwarding address and/or to managing agents)
- telephone contact rules
- email contact rules.

Initial contact with the leaseholder should incorporate benefit advice and information on any assistance schemes offered by the landlord.

Benefits advice

Few benefits are available to full equity leaseholders: basically only income support for the 'essential' elements of the service charge. There is inconsistent practice within the Department of Works and Pensions (DWP) around support for service charges to eligible claimants. DWP officials have commented that interpretation of the regulations depends upon the circumstances of each claim. For example, service charges for major repair works have been paid in some cases, but in others support has been in the form of monthly payments to cover interest on loans taken out to pay the service charge. It is good to know what the attitude of the local DWP office towards service charges will be and, if the landlord does not have specialist support staff, to establish a referral system to local voluntary agencies. Using such agencies has the advantage of not having the enforcement and support regimes in the same (landlord) organisation: unlike the protection housing benefit provides to periodic tenants, there are circumstances where individuals cannot sustain owner-occupation and will lose their homes (usually to mortgagees in possession).

Shared ownership leaseholders are eligible for housing benefit in respect of rent payments and the 'essential' elements of the service charge.

Assistance schemes

Most landlords have schemes to assist leaseholders to pay service charges. These may range from allowing leaseholders to pay annual service charges monthly (if, for example, the lease provides for the service charge to be paid annually or quarterly in advance) to more numerous and complex schemes to assist with major works service charges.

Practice online has an example of a payment options leaflet used by LB Southwark.

In certain circumstances the lease may provide for sinking fund payments which may ameliorate or negate the effects of 'one-off' major works service charges (see page 10).

Three common types of assistance schemes for major works service charges are described below.

Payments over periods – interest free

Landlords (especially local authorities) should get legal advice on their ability to give such assistance, i.e. to forego any interest on outstanding balances that may be due under the terms of the lease, which covers the opportunity cost of money spent in specifying, tendering and undertaking the major works. London local authorities more commonly allow major works service charges to be paid interest free over periods of 36-48 months.

Service charge loans

In these schemes the amount of the major works repair service charges, together with any administration/professional costs, are loaned to the leaseholder and secured as a mortgage charge on the property.

The rules governing service charge loans are set out in SI 1992/1708 made under amendments to s450 of the Housing Act 1985. The regulations cover two schemes:

- the mandatory scheme, which covers certain special (fairly restricted) circumstances where a loan must be granted and
- the discretionary scheme, which allows loans to be granted in other circumstances.

The loans are made by the landlord, except in the case of housing associations where the loan is made by the 'housing corporation' (sic) now the Homes and Communities Agency. The loan is interest-bearing but for discretionary loans the rate of interest can now be a 'reasonable rate' determined by the lender (see The Housing (Service Charge Loans) (Amendment) Regulations SI 2000/1963). The regulations allow for three basic types of loans:

- those requiring monthly payments of capital and interest which act like a normal repayment mortgage
- those requiring monthly payments of interest only during the term which can be linked to income support benefit
- those which roll up the capital and interest to be repaid on disposal of the property.

The service charge loan regulations are very detailed. **Practice online** has an example of the LB Southwark policy for dealing with service charge loans.

Note: where landlords grant these loans they will have to manage what can become sizeable mortgage portfolios.

Equity loans/equity release

In these schemes the amount of the major works repair service charge, together with any administration/professional costs, are expressed as a percentage value of the property.

- **Equity loans:** in these schemes the service charge is paid in lieu of the landlord taking a charge against the property to be paid on disposal, in the form of a percentage of its eventual sale price. In a market where property prices are increasing the relevant percentage could be calculated by expressing the service charge as a percentage of the current property value, the rise in property prices covering the interest which would otherwise be due. However in stagnant markets or situations where property values are falling the initial percentage may have to be higher to ensure the landlord recovers the service charge, costs and interest. Equity loans are simple to administer (they are a charge on the property) but the relevant percentage may be difficult to ascertain, requiring judgements around issues such as the state of the property market over the period until the property may be sold.
- **Equity share:** in these schemes the service charge is paid in lieu of the landlord taking a relevant proportion of the equity of the property and renting it back to the leaseholder. This may require the surrender of a full equity lease and grant of a shared equity lease. In these schemes the relevant proportion of the equity is more easily calculated – by expressing the service charge as a percentage of the current property value, because the rent will cover the interest. Equity share schemes are more complex to administer than equity loan schemes both in terms of conveyancing and agreeing the new lease terms.

The powers to assist leaseholders with equity loan and equity share schemes are set out in sections 308 and 309 of the Housing and Regeneration Act 2008. The statutory provisions are relatively simple, giving landlords scope to devise their own schemes. However the detailed policy decisions required to run either scheme can be complex; for example:

- whether to allow the schemes to pay estimated repair service charges and if so how to deal with the actual adjustment
- how the rent is set in shared equity leases; the assignment and staircasing provisions
- whether equity loan charges will allow any further advances
- the effect of the schemes on existing mortgages; acceptance by mortgagees.

Practice online gives an example of LB Southwark's policy for operating such schemes.

Waiving service charges

All of the above schemes are designed to help leaseholders pay their fair share of the costs of providing repairs services. Whether or not a landlord would want to waive otherwise payable service charges is a policy decision that has to be carefully judged; not only in terms of how the income shortfall is made up but also the implications of subsidising owner-occupation. Regulations under sections 219 and 220 of the Housing Act 1996 set out the circumstances in which local authority landlords must waive service charges and also their discretionary powers to do so:

- The mandatory scheme was initially designed to deal with the conundrum of whether or not local authorities could charge for grant-funded repair works i.e. whether the landlord local authority had incurred a cost. The mandatory directions dictate that the service charges in respect of certain grant-funded or assisted major works projects (more lately Private Finance Initiative or Community Challenge Fund schemes) should be capped at £10,000 in any five-year period (or a lower amount as previously agreed by the Secretary of State on application).
- The discretionary scheme is now mainly limited to being able to cap repair service charges which exceed £10,000 in any five-year period to £10,000 in cases of hardship.

Practice online has an LB Southwark paper which sets out the mandatory and discretionary rules in detail together with a hardship scheme to assist leaseholders.

Buy-backs

Where the leaseholder can no longer sustain homeownership, consideration could be given to buying back the property and leaving the occupier as a periodic tenant. Government policy allows local authorities to offset 35% of the cost (after the first £50,000) against right to buy receipt pooling. The detail of a buy-back scheme will differ from landlord to landlord but some key considerations include:

- repurchase at sitting tenant value (rather than open market value with vacant possession)
- whether this value will be enough to redeem existing mortgages/service charge arrears
- repairs required to ensure property is 'fit for habitation' at the commencement of the new periodic tenancy.

Practice online has an LB Southwark buy-back scheme for hardship cases.

County court action (debt recovery)

Before filing for proceedings in the county court, it is good practice to put the mortgagees on notice of the arrears. Most mortgagees will not pay the service charges at this stage (s81 of the Housing Act 1996 – a landlord cannot take possession proceedings unless the debt has been admitted by the leaseholder or determined as reasonable by an arbitration tribunal) but they may well write to the leaseholder to remind them that failure to pay service charges is a breach of the terms of their mortgage agreement.

Once the 'particulars of claim' are filed with the county court, the landlord will be notified of a hearing date and whether or not the case is to be defended. The filing of particulars of claim is a simple administrative task which need not be undertaken by lawyers although if they do they will be aware of the details of the case for the hearing.

Claim admitted/not defended

If the claim is admitted or not defended the county court will award judgement at its discretion. If the service charge debt is not cleared on the terms set by the court the landlord is able to take enforcement action:

- The first step is usually to approach the mortgagee to request payment. Most will contact their mortgagor to request payment is made within a specific period, failing this they will pay the outstanding sum (adding it to the mortgage balance). A few mortgagees will insist that a forfeiture notice (s146 Law of the Property Act 1925) is served before taking similar action.
- Alternatively (for example, if there is no mortgage) the landlord can return to court to enforce the debt judgement. This can take several forms such as distraint or attachment of earning (or benefits); but it is far more common for homeowners to put a mortgage charge on the property (at a rate of interest prescribed by the court). The charge will cover outstanding service charge balances together with costs.
- As a final step the landlord can apply for *forfeiture* i.e. to take possession. The lease is rescinded as though it never existed.

This draconian remedy should be used only as a last resort – the value of the property usually far outweighing the level of service charge arrears. First the landlord must serve a notice on the leaseholder which complies with the provisions set out in s146 of the Law of Property Act 1925:

- stating the nature of the breach of lease
- what must be done to remedy the breach
- the timescales for remedying
- the level of damages sought by the landlord (costs, etc.).

Note that s167 of the Commonhold and Leasehold Reform Act 2002 says that a landlord may not exercise forfeiture for failure by a tenant to pay a small sum or over a short period.

On expiry of the notice timescales, if the breach of lease is not remedied the landlord is entitled to possession (see *Billson v Residential Properties Ltd (1991)*) however in most cases the leaseholder is resident and are therefore afforded protection under the Protection from Eviction Act 1977. The landlord must obtain a county court possession order.

Note: at any time up to forfeiture the court may make an order for relief from forfeiture and indeed post-forfeiture may make an order altering the terms of any previous judgement. If forfeiture is gained, the property is re-let and relief granted, there are no grounds for the landlord to determine a secure or assured tenancy. The landlord could be in a position of being unable to surrender vacant possession. For this reason it is more usual to sell the property post-forfeiture thus any relief will be granted in the form of money.

Shared ownership leases

Possession proceedings against shared ownership leaseholders can be taken under schedule 2 of the Housing Act 1988, subsequent to service of a notice of seeking possession rather than a forfeiture notice. This is because technically the shared ownership lease as granted is an assured tenancy. The landlord should also be able to establish a mandatory ground for possession. In the case of *Richardson v Midland Heart Ltd* it was held that shared ownership leases were not long leases and a possession order was granted on ground 8. Landlords should be aware of the possible defences that could be attempted on the grounds of proportionality under human rights legislation, which stem from *Manchester City Council vs Pinnock* and subsequent cases.

If the claim is defended the county court will, at its discretion, refer any matters regarding service charges to the LVT which has the power to decide on such matters as: the reasonableness of a service charge, by whom and to whom the service charge is payable, and when and how much.

LVT cases are usually decided at a hearing where all the parties involved can attend to give oral evidence and explain their case. The hearings are more informal than the courts and there are no rules of evidence; for example, oaths are not taken. Hearings can be dealt with on the fast track (where there are a limited number of simple issues) or standard track and will often involve a visit to the property by the tribunal members. Cases can also be decided without a hearing on the basis of documents and written representations alone.

A more detailed explanation of the LVT is given in the booklet *Leasehold Valuation Tribunals: Guidance on Procedure* (see **www.rpts.gov.uk**).

Defended claims often involve a counterclaim (usually for disrepair) which will be decided upon by the court.

If the tribunal finds in favour of the landlord and the arrears are not paid the case is referred back to the county court for judgement and the process for undefended claims set out above can be followed. The tribunal may decide that some of the service charge monies are not due: in which case the service charge account should be adjusted before monies are demanded and the case referred back to the county court.

Freeholders

The distinction between variable service charges for leaseholders and freeholders is explained on pages 5-6. Where an estate property has been sold freehold there is obviously no landlord and tenant relationship between the homeowner and the owner (or managing agent) providing communal estate services. Neither does the landlord and tenant legislation apply.

Legislation about freeholder service charges

There is legislation governing freeholder service charges in the Housing Act 1985 which is similar to the provisions of sections 18-25 of the Landlord and Tenant Act 1985, except there are no statutory consultation arrangements. The legislation applies to 'public sector' authorities (s45: includes housing associations) and refers to the 'payee' (the person entitled to enforce payment of the charge) and the 'payer' (the person liable to pay it).

section 46: This section defined a variable service charge for the purposes of part II of the Housing Act 1985, repealed by the Housing and Planning Act 1986, which leaves us with the definition in s18 of the Landlord and Tenant Act 1985.

section 47: Costs can only be included if they are reasonably incurred and where the standard of works or services is 'reasonable'. Estimated service charges must be reasonable and must be adjusted to reflect actual costs. Only an arbitration agreement can be used to determine the reasonableness of costs.

section 48: The payer may require the payee to supply a written summary of costs within certain timescales. The summary must be in the same format as the service charge demands and must be certified by a qualified accountant as being a fair summary and supported by books and records. Once the payer has obtained a summary he has six months to require the payee let him inspect the books and records. The payee has one month to make the facilities available and then must keep them available for two months.

section 50: Makes it an offence for a housing association not to perform the duties set out above.

Freeholder obligation to pay

The transfer (often 'transfer of part' because the freehold of the individual property is made out of the freehold of the estate) will contain the conditions under which the house has been sold. It contains covenants (agreements) binding the freeholder either to perform certain actions (positive covenants) or not to take certain actions (negative or restrictive covenants). Among other things the positive actions can include the contribution towards estate costs for services, maintenance and management. By signing the transfer the freeholder agrees to abide by the covenants.

Positive covenants under common law do not bind subsequent owners, 'positive covenants do not run with freehold land' (*Tulk v Moxhay (1848)* and *Austerberry v Oldham Corporation (1885)*). The more usual way of dealing with these issues is by deed of covenant (a personal agreement) with the successor in title in which they agree to abide by covenants made in the original transfer (however see pages 9 and 42). In this situation the transfer will stipulate that the current freeholder will not transfer the property unless they get their successors in title to sign the deed of covenant. If the successor in title does not do this, the provisions in the transfer are not usually enforceable. However:

- *Halsall v Brizell (1956):* the defendants purchased a plot of land subject to freehold covenants to contribute toward the upkeep of roads and a sea wall. The claimants succeeded despite the covenant being positive, it being ruled that, 'it would be inequitable to take the benefit of a positive covenant with bearing some of the corresponding burden'. The Halsall decision has some limitations: it only applies where the benefit and burden are explicitly connected (*Rhone v Stephens (1994)*). Nevertheless it provides a potential mechanism for enforcing positive covenants against successors in title as most transfers link benefits (access, use, the payer being obliged to provide services, etc.) with the burden to contribute.
- Another remedy could be provided by taking action against the freeholder who, in contravention of the stipulation to the contrary, caused the property to be sold on without a deed of covenant being signed by the transferee. The contractual agreement to pay would still be with the former freeholder, it being a personal agreement not linked to the land (save for the original freeholder). There may be management difficulties in finding the previous freeholder.

Where there are no freehold covenants it may be possible to enforce estate charges using the 'quantum meruit' principle ('as much as he has deserved'). In an argument similar to the one in Halsall, if a freeholder had freely accepted certain benefits (for example, having the house supplied with heating and hot water from a communal boiler or the benefit of accessible private land) so he should accept a corresponding burden. If a freeholder does not accept these 'corresponding burdens' the option to deny supply/access/use by disconnection/injunction is always available.

Negative freehold covenants are binding on successors in title so long as they benefit the land (i.e. they are not simply for personal benefit).

Note that under section 609 of the Housing Act 1985 where a local housing authority has disposed of land under the act (e.g. right to buy) and the owner has entered into covenants with the authority, the authority may enforce the covenant against persons deriving title from the original owner notwithstanding that they are positive or negative covenants – so long as they are for the benefit of the land.

Estate management schemes

Estate management schemes were first employed by s19 of the Leasehold Reform Act 1967; similar provisions were set out in the Leasehold Reform, Housing and Urban Development Act 1993. In order to mitigate damage to estates that might result from fragmentation through (both individual and collective) enfranchisement, landlords *were* able to apply for an order to enable them to keep powers of management and rights against freehold properties on the estate, which includes enforcement of positive covenants against the current freehold owner. The powers that can be included in a scheme include recovering costs incurred by the landlord of the estate. Applications for approval of such schemes had to be made within two years of the commencement of the legislation.

Estate rentcharges

Now seldom established, an estate rentcharge is a periodic sum charged on land paid by a rent payer to a rent owner – there is no landlord/tenant relationship. Governed by the Rentcharges Act 1977, they make a rent payer's personal covenants enforceable by the rent owner and secure payment for the provision of services, repairs, etc. to the land affected by the rentcharge. They can be fixed or variable but must be reasonable in relation to the service provided (they should not include a profit element). The rent owner has a statutory right to enter the property to distrain or take possession until monies are paid.

General management of leases

Legislation

Leases are contracts over land and establish the detailed landlord/tenant relationship, i.e. the rights and obligations of both parties. Generally the parties are free to contract between themselves, however for right to purchase schemes there are certain 'implied' rules which apply even if omitted from the lease (or freehold transfer). These rules are set out in:

- **Right to buy:** schedule 6, Housing Act 1985
- **Preserved right to buy:** schedule 6, Housing (Preservation of Right to Buy) Regulations 1993 (SI 2241)
- **Right to acquire:** schedule 6, Housing (Right to Acquire) Regulations 1997 (SI 619)

From a post-sales management perspective the more important of these rules include:

- all rights, easements, premises, facilities and services enjoyed as part of the periodic tenancy are transferred

In the case of leases:

- the landlord to repair the structure, exterior, services and installations to the block/estate
- no obligation on the landlord to insure the block but if it is damaged or destroyed by fire or any other peril it is normal practice to insure against, the landlord will reinstate the block and cannot recover such costs
- unless otherwise agreed, the house to be kept in good repair (including decorative repair) or the interior of the flat to be kept in repair by the homeowner
- a lease provision is void if it restricts or prohibits assignment or subletting of the whole or part of the property.

In the case of shared ownership, the Homes and Communities Agency issues model leases (see **http://cfg.homesandcommunities.co.uk/Model-leases-for-housing-association-use-from-April-2010**). The landlord does not need to adhere to the model lease word-for-word but certain fundamental clauses are essential (see the HCA guidance at **http://cfg.homesandcommunities.co.uk/public/documents/circular%2003-08%20revision%20for%20cfg%20purposes%20FINAL%20290310.doc)**

The regulations provide for the withdrawal of funding should the clauses be omitted from leases.

Interpretation of the lease

It is imperative that the lease is read carefully and fully understood, it is useful to both management staff and leaseholders to explain each of the covenants in a lease in plain English. **Practice online** has an example of an LB Southwark lease with an explanation in plain English.

For shared ownership leases the HCA have produced plain English guidelines; these are given to prospective leaseholders during the conveyancing process.

Nuisance

There will invariably be a clause in the lease whereby the leaseholder covenants not to cause (or allow to be caused in the case where the property is sublet) a nuisance to neighbours. Nuisance can involve noise, pets, parking, water penetration, etc. and complaints have to be investigated and evidence of any breach of lease gathered. However, in the case of long leases possession proceedings cannot be started unless the LVT has determined that there has been a breach of lease or unless the tenant has admitted the breach. A landlord's application for such a determination is made under s168(4) of the Commonhold and Leasehold Reform Act 2002. It should be noted that:

- the tribunal's jurisdiction is limited to determining whether there has been a breach, the county court decides whether or not a lease should be forfeited
- shared ownership leases are not long leases (*Richardson v Midland Heart*) and therefore possession should be sought in the county court using the grounds in schedule 2 of the Housing Act 1988
- actions above are to enforce lease covenants – but in many cases anti-social behaviour can be dealt with instead by criminal action.

Mutual enforceability

Most leases include a 'mutual enforceability' covenant so that a leaseholder affected by nuisance can either take action themselves or insist that the landlord/managing agent take action. The lease often allows recharging the cost of the enforcement action to the individual leaseholder. Non-action by the landlord is a breach of lease; managers should therefore ensure that appropriate action is taken (i.e. at least to investigate allegations to decide whether actionable nuisance has occurred).

Access

An important aspect of post-sales management is the arrangements in the lease to be able to enter the premises:

- to inspect internal state of repair (e.g. to ascertain why water is leaking to a flat below)
- to draw up a schedule of dilapidations putting the leaseholder on notice of the need for internal repair and requiring works to be undertaken within certain timescales
- to carry out work in default if necessary
- to be able to access communal elements to carry out repairs for which the landlord is responsible
- in cases of emergency to enter without notice.

Local authority landlords can use other powers to enter in certain circumstances (e.g. verminous premises: s83 of the Pubic Health Act 1936). Other landlords can request the local authority to take action.

Further disposals

Homeowners often ask to purchase further interests in land, for example:

- shared ownership/equity leaseholders wishing to 'staircase' i.e. purchase a further tranche of equity
- full equity homeowners wanting to purchase adjacent land, etc.
- full equity homeowners wishing to purchase further legal interests.

Apart from these disposals there are also provisions which relate to the transfer of management responsibilities.

Staircasing

Shared ownership was designed with the intention that those purchasing would progress to full ownership and it is important that landlords deal effectively with requests to buy further equity shares. In some variations of the product, a share of the equity remains with the landlord in perpetuity.

Shared owners can purchase additional shares in a minimum of 10% tranches and final staircasing must also be a minimum of 10%. Most shared ownership leases have a staircasing memorandum (Appendix 1 of the current model lease) used to document the transaction. The shared owner (or most likely their solicitor) must ensure registration with the Land Registry. Landlords should keep up-to-date and accurate records of staircasing transactions, as the changes are essential information for the management of the units. For example, after a staircasing transaction the rent must be amended as the equity share it is based on will have changed.

On final staircasing to 100% a number of changes take place and various lease clauses fall away, including the mortgage protection clause and the restrictions on subletting. The property ceases to be an assured tenancy and becomes either a long leasehold or freehold property.

Practice online has a link to One Housing Group's staircasing process showing the detailed steps a shared owner needs to take and a leaflet available to owners.

Landlords may also receive notice from mortgagees that they are to staircase to 100% after repossessing a shared ownership property. Whilst mortgagees are not obliged to complete final staircasing to benefit from the mortgage protection clause, in practice they often do so.

Adjoining land and similar transactions

Local authorities have the power to dispose of land held for housing purposes under s32 of the Housing Act 1985, subject to conditions in section 33. They require Secretary of State's consent: however, general consents made under s34 set out circumstances where a specific application is not required (see **www.communities.gov.uk/documents/housing/pdf/138859.pdf**).

General consent allows a local authority to sell or grant a lease of any land, for best consideration, where the land is to be used for any purpose incidental to the enjoyment of a dwelling. This therefore includes, for example, disused laundry rooms, storage rooms, or roof voids of a building where such land is not included in the original demise of the dwelling. It also includes adjacent estate land, garages, store sheds, etc. When considering whether to sell it is imperative that the landlord/managing agent takes into account:

- Whether anyone else has rights over the land, e.g. the request may be in respect of estate land the enjoyment of which is included in other leases or transfer and there are 'non derogation from grant' covenants.
- If the sale would cause management or maintenance issues, e.g. selling gardens to ground floor flats or allowing rear extensions to be built in existing gardens where future scaffolding to maintain the block would have to be put.
- How the land is sold, e.g. roof voids to right to purchase leaseholders. (If a roof void is sold by varying the existing right to purchase lease, the landlord retains responsibility for the roof structure. However, if it is sold on a separate lease then specific repairing responsibilities for the roof can be demised to the leaseholder.)

For housing associations, the TSA now gives general and specific consents, not DCLG (see **www.tenantservicesauthority.org/server/show/nav.14479**).

Further legal interests

Collective enfranchisement

Under the Leasehold Reform, Housing and Urban Development Act 1993, leaseholders owning flats in the same building have the right to collectively purchase the freehold of the building (and appurtenant property) subject to certain criteria, the most important of which are:

- at least two thirds of the flats in the building must have been sold on long leases
- a minimum of 50% of flats must vote in favour
- to vote, a leaseholder must not own more than two flats in a building
- less than 25% of the floor area of the building is commercial
- the landlord is not a charitable housing trust.

There are many other rules (see the Leasehold Advisory Service website **www.lease-advice.org**).

Sale of freehold reversionary interest under the general consents

Consent F permits local authorities to sell the freehold interest to leaseholders provided they have been in residential occupation under a long lease for two years. The most important qualifying criteria are that the building contains only flats and common parts, all flats are sold on long leases and best consideration is obtained.

Practice online has a link to an LB Southwark policy dealing with such sales.

Lease extensions

Under part I chapter II of the Leasehold Reform, Housing and Urban Development Act 1993 the leaseholder can obtain a new lease for a period equivalent to the unexpired term of the old lease plus 90 years at a peppercorn ground rent, on payment of the market value. The new lease is substituted for the old lease but is on substantially the same grounds. Detailed rules can be found at **www.lease-advice.org**.

Individual enfranchisement

Under the Leasehold Reform Act 1967 long leaseholders of houses have the right to purchase the freehold or in some cases extend the lease. The leaseholder must have owned a non-commercial lease of the whole house for at least two years. The most complex provision is the valuation of the freehold interest. Detailed rules can be found at **www.lease-advice.org**.

Right of first refusal (step in rights)

Under part I of the Landlord and Tenant Act 1987 long lease tenants of blocks of flats have the right of first refusal where the landlord wishes to dispose of his interest in the property. The statute obliges the landlord first to serve a notice of his intention to sell on to qualifying tenants, giving them the opportunity to buy. Non-qualifying tenants (e.g. assured tenants) must not exceed 50% of flats. When an offer notice is served, tenants can refuse, accept, or make a counter offer. The landlord is free to sell so long as those tenants wishing to buy do not exceed 50% of flats. If a landlord tries to sell without giving notice the tenants can seek a county court injunction; if he sells without notice the tenants can purchase from the new landlord at the price he paid for the property. The legislation contains detailed procedures for the service of notices and counter notices. Many social landlords are exempt from these provisions (section 58).

Compulsory acquisition of landlord's interest in cases of mismanagement

Under part III of the Landlord and Tenant Act 1987 long leaseholders have the right to apply to the county court for an order to acquire the landlord's interest where the appointment of a manager (see transfer of management responsibilities below) would not be an adequate remedy or where a manager has already been so appointed for three years. The county court has to be satisfied that a number of conditions have been met before an order can be made and can impose conditions. Again, many social landlords are exempt.

Transfer of management

Appointment of managers by the Leasehold Valuation Tribunal

Under part II of the Landlord and Tenant Act 1987 leaseholders have the right to apply for an order appointing a manager where the landlord is in breach of his obligations. Except where the LVT has given dispensation, before exercising this right the tenant(s) must serve a preliminary notice on the landlord giving a reasonable opportunity to put matters right. The LVT has to be satisfied that mismanagement (including making unreasonable service charges) is proved and it is equitable to appoint a manager. Again, many social landlords are exempt.

Right to manage (establishing a Tenant Management Organisation – TMO)

Regulations under the Leasehold Reform, Housing and Urban Development Act 1993 (amended in 2008) grant secure tenants of local authorities a Right to Manage the landlord service to their homes, subject to a ballot. It has been consistently accepted that a majority of secure tenants (who vote) must be in favour of the proposal to develop a TMO, as well as an overall majority of those who vote. (Representations have been made that, with growing numbers of leaseholders, this condition should be removed for any developing TMO which has a majority of leaseholders but this has yet to be adopted within the legislation. As it currently stands therefore, it is possible for a majority of leaseholders to vote against a proposal and yet it still goes ahead.)

Right to Manage (long leaseholders)

Under chapter I part II of the Commonhold and Leasehold Reform Act 2002 leaseholders (through a Right to Manage company) have a right to take over management from the landlord or any manager. The LVT's jurisdiction does not cover all aspects of the Right to Manage but it can consider applications:

- by an RTM company for a determination that it was entitled to acquire the right to manage on the relevant date where the landlord disputes the entitlement
- by an RTM company for a determination that it is entitled to acquire the right to manage where the landlord is missing
- for a determination of the amount of costs incurred by the landlord (or other party to the lease other than the landlord and tenant) or a manager appointed under the Landlord and Tenant Act 1987 (see above) in association with the exercise of the right
- for a determination of the amount of accrued uncommitted service charges to be paid by landlord/third party/manager to an RTM company
- by the RTM company, a landlord or a tenant for a determination whether approval is to be given under the terms of a lease
- by an RTM company for a determination that the right may be exercised early.

Other services for leaseholders

As homeowner portfolios have grown so has the need to develop new services. The most important are described here:

- assignments and solicitors' enquiries
- buildings insurance
- inspection of accounts
- postponements.

Practice online has additional guidance on:

- deeds of discharge/rectification/variation
- gas servicing
- permissions (for alterations)
- recognised tenants' associations.

Assignments and solicitors' enquiries

In an open-market sale the lease is 'assigned': the purchaser takes over the existing (long lease) tenancy i.e. no new tenancy is created. This can result in the purchaser (assignee) becoming liable for an existing breach or obligation under the lease (e.g. the current leaseholder may have decided to sell the flat on receipt of a statutory consultation notice about a proposed major repair scheme). To protect their client's interests and comply with the terms of any mortgage, the purchaser's solicitors will usually ask direct from the landlord or via the vendor's solicitors for information on:

- any statutory notices served on the current leaseholder
- any major repair schemes planned in the next five years
- the last three years' service charges (estimates and actuals)
- the buildings insurance
- current balance on the service charge account
- current fire risk assessment
- known presence of high alumina cement, no fines concrete or asbestos
- amount of ground rent.

Solicitors often use a standard questionnaire with 80 or more detailed questions. There is no statutory obligation to answer, and leases rarely provide the landlord with any contractual obligation to respond either. However, without such a service leaseholders would find it very difficult to sell their property. In addition, the assignment of a lease invariably means the current leaseholder will have to pay all outstanding service charges, even disputed ones. It can therefore be in the landlord's interests to facilitate the assignment.

It is normal practice to make a direct charge for this service rather than fund it from the management fee. This is because many enquiries are from parties who are not current leaseholders but prospective leaseholders or their solicitors, etc. The fee should (*must* in the case of local authorities) be set at a level to recover the cost of providing the service rather than to make a surplus; it needs to be reviewed periodically to take account of changing workloads (which reflect the state of the property market) and salaries/costs. The London and South East Benchmarking Group figures for 2009/10 showed an average fee of £131 per enquiry, with a median of £130 across the 23 contributing organisations.

Essential elements of a pre-assignment service

- demand fees in advance (i.e. before replying) to avoid collecting them in arrears
- deal with enquiries in strict order by date of receipt to rebuff accusations of favouritism where there is more than one prospective purchaser
- consider having a two-tier service i.e. a higher fee for quick turnaround (e.g. 48 hours) – this helps where the enquiry is received after exchange but before completion
- certain information is confidential to the existing leaseholder – you will need either written permission to divulge it, or to send the answers to the vendor/their solicitor to forward to the purchaser/their solicitor
- repairs programmes are subject to change so any reply requires a suitably worded waiver (e.g. 'information is accurate at the date provided but can be subject to subsequent changes')
- regardless of the date of enquiry or sale there will only be an estimated service charge demand for the current year. Inform the solicitors that it is for the parties to agree between themselves who gets the benefit/pays for the actualisation credit/debit which will be applied to the account. Often solicitors will agree a retention sum to resolve the issue
- check for any charges on the property e.g. discount repayment, pre-emption, service charge loan, unowned equity. These should be picked up by the solicitors through land searches but it is good practice to bring them to their attention
- check for current statutory consultation notices where works or services have not begun or the service charges have not been demanded
- notify the solicitors of any residents' associations
- have to hand the buildings insurance policy details, schedules and cover arrangements.

Some or all of the information to be provided may be held by a local Tenant Management Organisation or a managing agent. It is essential that any procedure says who is to collate and answer the pre-assignment enquiry and receive the fee. It is not good practice to issue two replies because conflicting information could be provided.

Any procedure needs to take account of the doctrine of equitable estoppel where the landlord organisation may be estopped from enforcing lease terms, e.g. collecting service charges, if it can be shown that the leaseholder acted on false representations to their detriment. A common example would be where the landlord failed to notify the prospective purchaser of plans to refurbish the block. The prospective purchaser has the right to rely on the information furnished. The estoppel would not apply where, at the time of the enquiry, the

information was accurate but changed at a later date (see comments regarding waiver above).

Freehold interests in land are not assigned but transferred. Although many of the above issues relating to the assignment of leases will not apply, landlords may well receive pre-transfer enquiries in respect of freehold properties, especially where charges for estate services are levied. A separate, simpler procedure is needed for these enquiries which can be based on the relevant pre-assignment processes.

Assignments

After the sale (i.e. the lease has been assigned) the landlord will need to update relevant property records. Invariably the lease will contain a covenant obliging the current (new) leaseholder to notify the landlord of any assignment and the fee payable for updating the records. **Practice online** includes the clause on this from LB Southwark's standard lease.

The records need to be updated to show:

- the name of the new leaseholder(s)
- any new mortgagee
- the address of the new leaseholders (if not resident)
- the name and address of any managing agent they may use.

It is usual for any buildings insurance policy schedules to be updated with the information, in addition to the property records.

Often assignments are not notified to the landlord and subsequent notices or service charge demands issued in the name of the former leaseholder may be returned 'not known at this address'. A search of the Land Registry will reveal any assignment. The current leaseholder should be made aware of the breach of lease which has occurred (and, if necessary, that any failure to recover service charges caused by the breach can be remedied by forfeiture action). It is appropriate to refer the new leaseholders to their conveyancing solicitors.

Resales – shared ownership

For shared ownership properties, the pre-emption provisions in the lease mean that when shared owners wish to assign they first need to provide the landlord with the opportunity to find a purchaser for the property.

Practice online shows One Housing Group's process for the resale of an existing shared ownership property to a new owner and a leaflet available to owners.

Buildings insurance

A buildings insurance service should be provided otherwise homeowners will not be able to secure a mortgage. This section covers:

- the statutory background
- typical lease covenants
- negotiations about buildings insurance
- claims.

Statutory background

A social landlord with right to purchase leases is under no *statutory* obligation to provide buildings insurance. The provisions set out in the earlier section on Leases contain certain implied covenants by the landlord for RTB/RTA leases:

(2)(a) to keep in repair the structure and exterior of the dwelling house *and of the building in which it is situated* (including drains, gutters and external pipes) and to make good any defect affecting that structure.

(3) the covenant to keep in repair implied by sub-paragraph (2) (a) includes a requirement that the landlord *shall rebuild or reinstate* the dwelling house and the building in which it is situated in the case of destruction or damage by fire, tempest, flood or any other cause against the risk of which it is normal practice to insure.

Basically then a landlord can choose to 'self-insure' – set aside the insurance premiums, paying out of a reserve pool should an insurable risk occur.

Although there is no *statutory* obligation to affect buildings insurance there is often a *contractual* one – see below.

Inspection of accounts, etc.

A schedule to the Landlord and Tenant Act 1985 (inserted by the 1987 Act) sets out leaseholders' rights to information about insurance. Requests for a summary of insurance cover can be made in writing by the leaseholder or the secretary of any recognised tenants' association if the service charge includes insurance. The landlord has one month to furnish a summary which must include:

- the insured amounts
- the name of the insurer
- the risks covered.

Within six months of the leaseholder receiving the summary he/she, or the secretary with his/her consent, can apply in writing for the landlord to afford reasonable facilities for:

- inspecting the policy
- seeing evidence of payment of the premiums for that period and the preceding period
- taking copies or extracts.

If the insurance is effected by a superior landlord then the schedule in the Act sets out the requirements (for more detail see **Practice online**).

Assignment makes no difference to any request but the landlord is not obliged to repeat the insurance obligations for the same period for different leaseholders of one dwelling.

It is a criminal offence not to comply with the obligations above (local authorities are exempt from this provision).

Where the leaseholder pays a service charge in respect of insurance *and* it appears to the leaseholder that damage to the building has occurred in respect of which a claim could be made *by* the landlord *and* it is a term of the policy that any such claim should be made within a specified period, *then* the tenant may within the specified period, serve a written notice on the insurers stating the nature of the damage. The effect of the notice is to extend the specified period within which claims have to be made to six months, within which time the leaseholder can persuade a landlord to submit a claim or get an order for specific performance or an order to vary the lease to provide for submission of claims.

Two circumstances are described in more detail in **Practice online**:

- where the lease requires the leaseholder to use a nominated or approved insurer, the leaseholder can apply for an order obliging the landlord to nominate or approve another insurer
- where there is a long lease of a house, which requires the tenant to use an insurer nominated or approved by the landlord, the tenant may be able to use an alternative 'authorised insurer'.

Typical lease covenants

Despite the fact there is no *statutory* requirement to insure the block, invariably public sector landlords agree *contractually* to do so, commonly covenanting to 'effect and maintain the insurance'. This is because:

- most tenants have to secure a mortgage from a private lending institution, which would not lend if the landlord was 'self-insuring'
- this also applies to assignments (selling on) – if purchasers could not secure a mortgage on the flats, values would fall and the incidence of subletting would increase
- landlords do not want to take the risk
- insurance is easier to manage if it is 'under one roof'.

Practice online has a link to a typical insurance covenant.

Negotiations about buildings insurance

Staff find it difficult to negotiate buildings insurance cover because they have little/limited experience of the market. It can therefore help to:

- benchmark with neighbouring authorities/ landlords
- obtain more than one quote from insurance companies and make the procurement procedure at least partially competitive.

Claims experience

Insurance companies take account of the landlord's claims experience – if it is high they may well quote a premium based on last year's claims plus administration.

The incidence of leaseholders in blocks of flats tends to increase claims because of the need to ensure that costs that should be covered by insurance are indeed the subject of a claim and are not reflected in service charge costs.

It is useful to keep a (computerised) record of insurance claims, ideally block by block. Remember it may well be in the landlord's interest to self-insure (or insure for catastrophe only) if the block is entirely tenanted and the claims experience is low – e.g. sheltered blocks. However such a judgement (including the effect on premiums for the remaining stock) depends on keeping good records.

Claims are often made where act of error, omission or negligence on behalf of the landlord has exacerbated damage. It may also be the case that third parties' negligence caused the damage. In such cases claims should be 'subrogated' to keep claims experience (and subsequent premiums) to a minimum. This means that the insurer seeks to recover part of the insurance payment from the third party.

Rates

Insurance companies often quote a unit premium (e.g. per property archetype). If the insurance company quotes a rate in terms of £x per £1000 reinstatement value for the block, then the block premium must be apportioned. Although this may seem simple the manager must remember that buildings insurance covers fixtures and fittings that are the tenants' demise. Is it fair that all residents pay higher premiums because some have extra fittings?

The best answer is to apportion the basic block premium according to the terms of the lease (if the lease provides for the tenant to pay a reasonable proportion then floor area is a good benchmark to use), and require tenants to inform the landlord of any improvements so that an extra premium can be paid for the specific flat. In these circumstances the lease must provide that:

- the leaseholder informs the landlord of improvements
- the landlord arranges additional cover
- the cost of the additional premiums are flat-specific and not rechargeable on an apportioned basis.

Alternatively, with larger portfolios it may be possible to negotiate a deal with the insurer whereby the landlord/tenant is deemed to be covered for all improvements carried out by tenants internal to the flat.

Discounts

Discounts should be negotiated with insurers which reflect:

- term contracts – insuring the portfolio for longer terms
- where several policies are placed with one company e.g. lift insurance, professional indemnity, third party, etc.
- size of the portfolio.

Commission

Commission is often confused with or discussed at the same time as discounts. Commission reflects the savings the insurer makes with portfolio-wide policies, e.g. because the landlord chases bad debts rather than the insurer doing it. It can take the form of a rebate or a reduced premium rate – if it is the former the landlord needs to consider how to credit the leaseholders with this amount. Offsetting it against management costs is one practice.

Excesses

Standard buildings insurance policies have different excesses in respect of fire, escape of water, malicious damage, etc. Organising all relevant expenditure to be coded to cost centres that reflect those in the leases is a challenging task; having a system to code repair order costs so as to facilitate claims and recover any excesses is also challenging. One approach is to avoid any excesses on the perils: insurers will usually agree this for all but subsidence (which may well need to be dealt with as a major work – see below), in return for an excess buyout premium (expressed as £x per unit). The extra cost can be justified by a reduction in administration and service charges.

Remember:

- excesses are only a problem because of the need to construct disaggregated service charges for leaseholders (this does not arise for periodic tenancies/pooled rents)
- the excess buyout premium need only cover leasehold flats.

Revaluations

Reassessing the reinstatement value of the stock incurs expensive fees which have to be reflected in the service charge. Obviously a saving can be made in respect of 'tenant only' self-insured blocks. The manager needs to negotiate with insurers the longest possible period between revaluations (insurers usually insist on three years), using uplifting by inflation in intervening years (based on RPI, or more accurately on the BCIS index – **www.bcis.co.uk/site/index.aspx**). To ensure regular expenditure on valuation fees a rolling scheme can be devised (e.g. if revaluations are every five years, one fifth of the stock is revalued each year).

Valuations are based on reinstatement costs not the market value, i.e. the cost of complete rebuilding, less the cost of the land. It will reflect the type of building (e.g. traditional, system, etc.) and installations (e.g. lift, door entry, etc.). The manager must clarify with the insurer whether improvements (door entry systems, double glazing, etc.) need to be notified immediately or if increased reinstatement values can be picked up on the next revaluation.

Joint claims

Should an insured peril such as fire occur, damage could include items for which the landlord is responsible and those in the tenants' demise, typically: wiring to the flat, internal plaster work, skirtings, floorboards, sanitary ware, kitchen units, central heating systems, internal doors, etc.

If two separate claims are made, the landlord should ensure that they are correlated and that the tenant furnishes the necessary evidence. But from the insurance company's point of view there is one policy and one insured peril episode: they do not expect two claims (hence the need for them to be co-ordinated). If there is an excess who pays or in which proportion is the excess recharged?

Each case should be treated on its merits but there is nothing stopping the landlord from stepping outside the rules of the lease and coming to a mutually acceptable arrangement with the leaseholder, i.e. the landlord carries out all remedial works and makes the claim, or vice versa, depending who is responsible for the bulk of the repairs. The leaseholder is usually included on the insurance policy as 'an interested party' because they own certain areas of the building and therefore are eligible to make a claim (with the principal's – the landlord's – agreement).

Any such agreement should be in writing with a clear description of the limit of responsibility. For example, 'the landlord will claim for the damage to [tenants' demise items] and will repair/replace these items as part of the claim and remedial works but the cost of any non-claimable works will be the responsibility of the tenant'. If the manager agrees for the leaseholder to carry out work, the right to inspect it and insist on standards of workmanship is essential. The tenant's claim may well need to include the landlord's professional costs.

Tenant-only claims

'Tenant-only' claims (for damage to tenants' demise only) still need input from the landlord, to avoid inflated claims that could affect the insurance premium. The procedure should include the issuing of the claim form and its subsequent return to the landlord to check that costs are reasonable. If maintenance staff are consulted on costs, they should take into account that tenants lack the benefit of discounts on schedules of rates and other economies of scale; prices quoted to tenants will therefore be higher.

Practice online includes further material on ancillary insurance issues.

Practice online includes a link to a booklet produced by LB Southwark and its insurers Acumus which explains in detail comprehensive buildings insurance.

Inspection of accounts

Under section 22 of the Landlord and Tenant Act 1985 (as amended) where the tenant (or the secretary of a recognised tenants' association) has obtained a summary of accounts they may, within six months, write to the landlord requiring reasonable facilities for:

- inspecting all books and records supporting the summary and
- taking copies of them.

The landlord has one month to make facilities available and must keep them open for a period of two months.

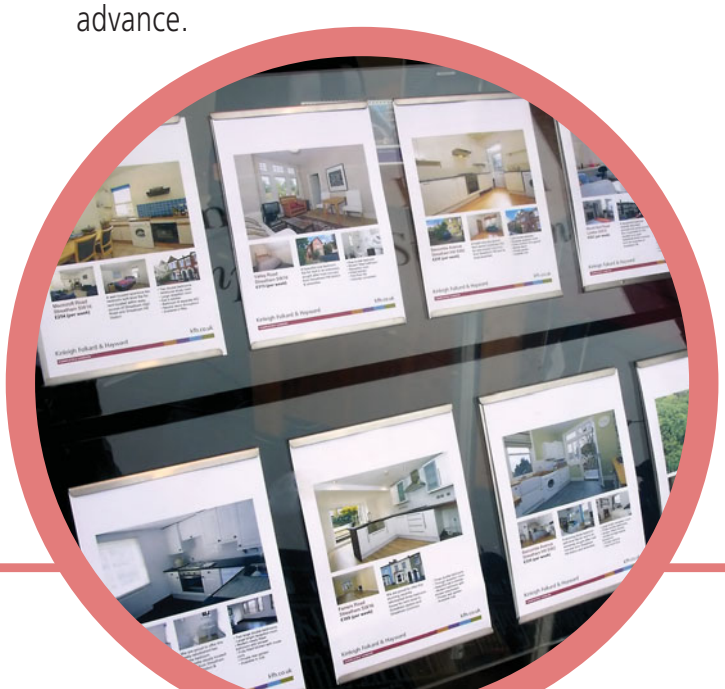
The landlord cannot make a direct charge for this (but can recover the costs by way of a management charge, and make a reasonable charge for taking copies).

Postponements

Under right to purchase sales, the current value of the property is discounted to arrive at the purchase price. The discount is not repayable so long as the property is not sold on within the discount repayment period (there are three minor statutory exceptions to this).

During the discount repayment period, the situation is policed by securing the discount as a charge on the property, registered at the Land Registry. The discount repayment charge's priority is secondary to any advance made by a lender (the mortgagee) to finance the purchase of the property. This means that, should the property be sold on within the discount repayment period, proceeds are first used to pay off the original advance, then to repay the discount, with the remainder going to the owner. It is this priority of the different charges on the property to which this section relates.

It is common in right to purchase cases for the new owner to seek an additional advance from their lenders – usually for home improvements such as fitted kitchens, bathrooms, etc. The lender will want the council's discount charge to be postponed in favour of their (usually) second advance.



This is an important area of work because of the statutory requirement for the landlord to agree or deny a postponement request. A policy should set the parameters to be used by officers in exercising discretion so that – in the event of judicial review – the rationale behind any individual decision can be justified.

Section 156 of the Housing Act 1985 (as amended) states that the discount charge must rank second, immediately after any advance made by an 'approved lending institution' for the purchase of the property. The exception is if the landlord serves a written notice on the institution consenting to the postponement of the discount charge. The landlord must issue written consent if the advance is for an 'approved purpose'. These include the cost of any works to the dwelling or service charges or further advances to repay original mortgages that rank in priority higher than the discount charge (i.e. remortgages for no greater amount).

An 'approved lending institution' now means an 'authorised mortgage lender' – normally a body operating under part 4 of the Financial Services and Markets Act 2000. The new definition puts the onus on the landlord to discover whether or not the proposed lender is an 'authorised mortgage lender' rather than relying on a published list.

The landlord has the discretion to issue written consent to postponement for any other purpose (e.g. for a loan to consolidate the owner's various debts), if the advance is from an 'approved lending institution'. In this case an 'approved lending institution' is: the Housing Corporation, building society, bank (or trustee savings bank), insurance company or friendly society or a body specified in an order by the Secretary of State.

This can be a complex area of work. Most advances are for improvements to the dwelling and often the landlord's consent, planning permission or building control permission all need to be obtained. A fee can be charged for the issue of written consent, but attention must be paid to paragraph 6, schedule 6 of the Housing Act 1985. This says that a provision of the conveyance or lease is void insofar as it purports to enable the landlord to charge the tenant a sum for or in connection with the giving of a consent or an approval. The postponement letter is not a provision of the lease (or conveyance) and the approval is not to the owner, rather it is to their mortgagee.

Where the written consent for postponement is for a mandatory purpose, workload can be reduced by using standard letters, etc. However, where discretion can be exercised it is essential to ensure that the landlord's fiduciary interests are protected. Even so there are relatively few occasions where a discretionary consent will not be given, e.g. where there is insufficient equity or where the lender is not an 'approved lending institution'.

In the case of advances for 'approved purposes' only, the landlord must give consent notwithstanding the amount to be advanced.

The landlord's fiduciary position could be at risk if the sum to be advanced, added to the original mortgage amount and the discount 'outstanding', exceeds the current value of the property. Of course, the value of the property can change from application date to completion date and some postponement requests are made after completion. In such circumstances if the landlord's discount charge were postponed in favour of a second advance and the owner were to be subsequently repossessed, after the first and second advances were paid off there would be insufficient funds to cover the discount to be repaid.

The risk to the landlord reduces with the passage of time after completion because the value of the dwelling normally increases and eventually the discount repayment period expires.

The amount of the current market value of the property is usually known, either because the request is being made during the purchase application or, if later, the lending institution insists on a revaluation before further advances are agreed. Given this, it is appropriate to adopt a 'sliding' scale so that, depending on the unexpired time of the discount repayment period remaining, discretion is only exercised if there is sufficient equity remaining after adding the discount repayment amount to the total of loans.

Example of sliding scale

Less than	1 year	95%
	2 years	92.5%
	3 years	90.0%
	4 years	87.5%
	5 years	85.0%

Obviously these percentages need to be set to take into account local market conditions.

Remember to look at CIH **practice online** for guidance on homeowner services not covered in this **practice brief** – as well as for a wealth of practical examples.

The Chartered Institute of Housing

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