

Committee/Meeting: Cabinet	Date: 9 th January 2013	Classification: Unrestricted	Report No: CAB 58/123
Report of: Corporate Director: Aman Dalvi Originating officer(s) Jackie Odunoye - Service Head Housing, Strategy & Regeneration Authors: John Kiwanuka Housing Partnerships Manager (LBTH) Ben Whiteside - Leasehold Manager (THH)		Title: Payment Support Options to Leaseholders for Repayment of Major Works Recharges. Wards Affected: All	

Lead Member	Cllr Rabina Khan
Community Plan Theme	One Tower Hamlets & Great Place to Live
Strategic Priority	Ensuring Value for Money Across the Council

1. **SUMMARY**

- 1.1 The Council has circa 9,000 leasehold properties managed by Tower Hamlets Homes (THH). During the 5 year period of the Decent Homes Programme, there will be urgent need for supporting leaseholders with DH and major works capital repayments. DH works consultations with leaseholders under section20 are in progress. It is vital s20 consultation procedures are adhered to, as failure to do so can severely limit the amount the Council can charge for DH/major works. It is envisaged that circa 7,375 leaseholders will be consulted, and invoices totalling over £42 million issued over the 5 year period.
- 1.2 The council offer leaseholders a number of options to spread the cost of large major works payments or service charges over a number of years. Offering deferred payment to every leaseholder means that much of the income from leaseholder re-charges is delayed for up to five years. Such an arrangement would adversely impact on the cash-flow available for the DH programme and therefore, presents a risk to delivering Decent Homes. Appendix 1 to this report shows the current options given to leaseholders.
- 1.3 MAB in November 2011 agreed in principal to the proposals presented by officers for the support and payment options to be accorded to leaseholders.
- 1.4 This report sets out the case to the Council for changing leasehold payment options to encourage leaseholders to settle charges quickly by offering early

payment discounts, reducing the interest rates for those leaseholders unable to make full settlement to reduce financial burden and to limit access to those leaseholders in need of such assistance. The report also considers removing access to the deferred payment options set out in the report from non-resident leaseholders. These changes are aimed at improving cash flows to support the decent Homes programme and protect the council's financial position by removing possible subsidy from leaseholders operating a business through sub-letting.

2. DECISIONS REQUIRED

The Mayor in Cabinet is recommended:

- 2.1 To adopt the Payment options detailed at Appendix 1
- 2.2 To authorise the Corporate Director Development and Renewal in consultation with Assistant Chief Executive (Legal), to enter into all necessary documents to implement the decisions made in respect of this report.

3. REASONS FOR THE DECISIONS

- 3.1 Offering a discount for early payment encourages leaseholders, where possible to settle their charges quickly. Non- resident and resident leaseholders will be given an opportunity to benefit from the discount for a timely payment. It is envisaged that this approach will lead to improved cash-flows and lower recovery costs. This outcome is particularly important as it would reduce the risk of a funding shortfall for the Decent Homes programme which is partly dependant on income from leaseholders.
- 3.2 The current policy, offers interest-free periods to all non-resident leaseholders, exposes the council to a potential risk of losing up to £7.9 million as evidenced in the financial impact assessment [Appendix 2](#). Restricting interest-free periods to those who need them mitigates the risk. The restriction is equitable and justifiable as the converse would amount to subsidising leaseholders' businesses.
- 3.3 Interest-free payments can legitimately be offered to resident leaseholders to assist in collecting the charges in the shortest time possible from leaseholders where they are unable to pay the full cost quickly. This can be done in the interest of the Council and the tax payers generally under the general power of competence to minimise the risk of debt recovery and possible write-off.
- 3.4 The current interest rate for extended payment options longer than the initial 3 years is 8.895%. The 8.895% interest was based on the cost to the council of borrowing several years ago which has changed significantly. The proposed new rate of 5.34% is 0.5% above the current cost of borrowing, the 0.5% designed to cover the management of the debt during the repayment period.

Offering this rate of interest will be cost neutral to the Council but will assist those leaseholders facing financial difficulties.

4. ALTERNATIVE OPTIONS

- 4.1 **No early payment discount** – Not offering this option may result in income being received over a longer period with a consequence of increasing the likelihood for bad debt, and damaging relationship between Council & leaseholders, particularly through debt management and recovery actions. The early payment discounts are intended to help raise the much needed income quickly to fund the decent homes programme. This also offers non-resident leaseholders a financial incentive to pay the charges without delay.
- 4.2 **Continuing to offer every leaseholder deferred payment** - This option would put the council in the position where it was effectively subsidising businesses from the public purse which shouldn't be the case..
- 4.3 **Offering repayment terms over more than five years** – some Registered Providers offer loans in the form of a mortgage secured on the property. However, adopting this option would result in the council having a mortgage portfolio to manage, a position it is currently trying to run down. The option also has the effect of the Council building long term indebtedness to leaseholders especially as further works may well be undertaken before the loan for the decent homes works is repaid.
- 4.4 **Longer repayment periods** - Extending repayment over long periods whilst may be seen as being beneficial to leaseholders the converse may be true. Particularly, as it is likely that over a 10 year repayment period the landlord will have to undertake further work either through additional repairs or planned maintenance programmes which will result in further bills for the leaseholder. Effectively, this approach will have the implication of building indebtedness rather than assisting leaseholders in the long run.
- 4.5 **Provision of discretionary loans** – Some Local Authorities (LAs) and other Registered Providers (RPs) offer long term loans through mortgages at local authority mortgage rates and subject to equity in the property. However, this option would be challenging to adopt because to act as a lender on such a scale, the Council would have to fund the loans from its capital resources. The resultant mortgage portfolio would also need managing with future resource implications for managing such a service. Consequently, the Council would need to exercise extreme care not to contravene the Financial Services Authority regulations on financial advice and may have to apply for a Consumer Credit Licence.

5 BACKGROUND

- 5.1 The Mayor's Advisory Board (MAB) agreed in principle a raft of payment options for leaseholders proposed by officers including measure that distinguished between resident and non-resident leaseholders. MAB asked

officers to be mindful of leaseholders who let out their properties for personal reasons other than profit, and adopt criteria that avoided treating this group inequitably.

- 5.2 Following MAB a financial impact assessment on the proposed payment options was conducted. The financial impact assessment showed that the amounts involved in the payment options relating to non-resident leaseholders were financially significant to leaseholders and the Council – as shown in [Appendix 2](#)
- 5.3 The council currently offers leaseholders a number of options to spread the cost of large major works charges over a number of years. The current set of payment options were confirmed in the Leasehold Policy Review agreed by Cabinet in February 2011.
- 5.4 Among the payment options currently accorded to leaseholders include deferred payments. Deferred payments help leaseholders who would find it difficult to pay large repair bills. It is important to note that, although the Council endeavour to help leaseholders who have difficulty paying large bills, it should only be seen as the lender of last resort. Therefore deferred payment options should not be accorded to leaseholders who can reasonably access finance from the private market.
- 5.5 Deferred payment options effectively subsidise those leaseholders who are in the business of letting their properties. Furthermore, the approach results in income from leasehold major works re-charge being delayed for up to five years. These delayed payments negatively impact on cash-flows and potentially are a risk to delivering Decent Homes programme, particularly as re-payment for these works re-charges are programmed to be clawed-back into the programme.
- 5.6 However, the Council's ability to recharge major works capital expenditure to leaseholders is constrained if it does not consult with leaseholders as prescribed by law. Accordingly, it is vital for the Council and THH, to conduct leaseholder consultation in line with S.20 of the Landlord and Tenant Act 1985 (amended by section 151 of the Common hold and Leasehold Reform Act 2002). The Council is obliged to consult leaseholders where it is:
 - § Carrying out work which will cost any one leaseholder more than £250. This includes repairs, maintenance and improvements to their building and estate.
 - § Entering into a long-term agreement (for more than 12 months) with outside contractors for work, supplies or services which will cost any one leaseholder more than £100 a year. Examples include cleaning, grounds maintenance and surveying.
 - § Carrying out work under a long-term agreement where the work will cost any one leaseholder more than £250.
- 5.7 Section 20 consultation procedures generally involve 3 stages, these are:

- § **Stage 1:** the Notice of Intention. A notice setting out what works are proposed, why they need doing, inviting comments from lessees, and in some instances inviting nominations of contractors from lessees.
- § **Stage 2:** the Statement of Estimates. Once estimates for the works are obtained a notice to all lessees about the costs, how to inspect the estimates and inviting any comments.
- § **Stage 3:** the Notice of Reasons. Once the contract is awarded this notice must be sent if the landlord does not choose the cheapest estimate or a contractor nominated by lessees. It must explain why the landlord chose that particular estimate.

5.8 Furthermore, in specific cases the council can apply to the Leasehold Valuation Tribunal (LVT) for 'dispensation'. If the LVT gave the Council dispensation, it would not have to follow regulations for s.20 consultations fully. For the LVT to do this the Council would have to satisfy the LVT that it had taken all reasonable steps to make leaseholders aware of their plans and that the situation was an emergency.

6. SUPPORT PAYMENT OPTIONS FOR LEASEHOLDERS

6.1 **Early Payment Discount** - a recommendation is being made for an early payment discount of 5% of the value of the major works invoice for leaseholders who pay in full within 28 days of the date of the invoice. This level of discount is offered by a number of RPs including LAs, and it is seen as good practice. Respective landlords have found that such level of discount resulted in circa 20% to 40% of leaseholders paying the full cost immediately. The 5% discount offers a better option than taking one year interest free, currently allowed under the terms of the lease. It is hoped that the offer, which is available to all leaseholders, will act as an incentive to those leaseholders whose financial situation allows them to pay immediately.

6.2 Extended Interest Free Periods –

6.2.1 The approach is underpinned by the Council's general power of competence. It is envisaged the proposal will not only improve income by allowing interest-free payments but also accord assistance to leaseholders in an equitable manner. It is common practice for RPs to offer interest free repayment period of up to three years. The recommendation restricts interest free support for the second and third years to resident leaseholders only. The first year is interest free for all leaseholders as implied in the lease terms.

6.2.2 Nevertheless, it is recognised that some leaseholders may be sub-letting their properties for personal or family reasons. Therefore, officers recommend having discretion to consider a non-resident leaseholder access to the longer interest free and longer repayment options in the following circumstances:

- § Providing care to a family member and requiring them to reside with that family member.
- § Working away from the locality.
- § Relationship breakdown or fleeing domestic violence.

§ Financial difficulty and letting out the property to pay a mortgage (evidenced by an IVA or a mortgage statement showing arrears)

- 6.2.3 The existing interest rate for extended payment options longer than the initial 3 years is currently 8.895%. This was based on the cost to the council of borrowing several years ago which has now changed significantly. The proposed new rate of 5.34% is 0.5% above the current cost of borrowing, the 0.5% being to cover the management of the debt during the repayment period. Offering this rate of interest will be cost neutral to the Council but will assist those leaseholders facing financial difficulties.
- 6.2.4 Extended payment arrangements will be subject to an agreed payment plan. If a payment is missed then the arrangement will become void and the remaining unpaid balance will become due. To qualify for extended payment arrangements, the leaseholder must have paid their annual service charges up to date.
- 6.3 **Applying an affordability test to loans, interest free periods and voluntary charges** -This is aimed at ensuring that the Council is not regarded as the first point of call for low cost financing of DH / major works re-charges. Although the Council can be a lender of last resort, leaseholders will be required show evidence that they have not been able to obtain reasonably priced loans elsewhere, to access interest free or deferred payment options of more than one year. A means test will require leaseholders to evidence refusal for a loan from two mainstream lenders for the amount of the DH/major works recharge and complete a financial statement with officers in house.
- 6.4 **Voluntary Charge to a Property:** In exceptional circumstances an original RTB leaseholder, over 60 or receiving full benefit can apply for a voluntary charge that places a debt on his/her property equal to the invoice value plus a charge at 0.5% above Council borrowing (currently at 5.34%) until redemption. To qualify for this option, the leaseholder will need to demonstrate that he has no access to a Bank or Building Society loan; cannot use any other payment options; and must have sufficient equity in the property to apply to place a charge against the property until it is sold or assigned.
- 6.5 **Discretionary capping of service charges:** The Social Landlords (England) Discretionary Reduction in Service Charges Directions 1997 allows local authorities to reduce service charges to a maximum of £10,000 over 5 years. The policy is subject to a number of factors to which the council must pay regard including the lessee being the original RTB leaseholder; and living at property. No reduction based on exceptional hardship can be entertained unless the individual lessee specifically applies to have it considered.
- 6.5.1 Consequently, if a leaseholder decides to be considered for a reduction based on exceptional hardship, the council will have to take account of the following factors set out below.
- Whether it is the lessee's only or principal home,
 - the total service charge paid since purchase,
 - the service charge payable in the current year,

- the lessee's financial resources,
- ability to raise funds,
- whether extending the repayment period would assist, and
- any other relevant circumstances.
- grant a charge on property so that capped amount is repaid if the property is sold within 7 years.

6.5.2 It is extremely difficult to estimate how many leaseholders may be eligible for this discretionary reduction as it is not yet known how much will be spent in individual blocks or how many individual leaseholders in those blocks may benefit from this policy. Previous eligibility levels on major capital work schemes under this policy resulted in a reduction of around 5.7% of the total billed at that time.

6.5.3 On the basis of larger bills for future decent homes works if this policy resulted in 10% of the amount chargeable to resident leaseholders being subject to the discretionary capping the reduction in income to LBTH would be approximately £2m.

6.6 Council Statutory Loans

6.6.1 Statutory loans can be accessed by all leaseholders whose flats were purchased (by themselves or their predecessors) under right to buy, and are within the first ten years of their lease. The "loan" is limited to works for repairs and improvements where the charge to the leaseholder exceeds £2,250 up to a maximum of £30,000. The minimum loan is £750 and an administration charge to a maximum of £100 can be charged. The aggregate loan outstanding to any leaseholder is £30,000.

6.6.2 The loan is subject to interest at the local authority mortgage rate (fixed by the Secretary of State). The loan is secured on the property by way of a mortgage (though sufficient equity need not be demonstrated). These interest rates are always higher than mortgage rates in the market place meaning that the take-up of this option is low.

7. COMMENTS OF THE CHIEF FINANCIAL OFFICER

7.1 This report recommends that Cabinet adopt a number of payment options for the recovery of major works charges from leaseholders, as detailed in Appendix 1.

7.2 As highlighted to Cabinet in the 'Decent Homes Funding Gap Options' report in September 2011, due to the high numbers of leaseholders within the Authority, a significant element of the future HRA capital programme will be rechargeable to leaseholders, primarily through proposed additional external or communal area works undertaken to blocks, as well as necessary works within the non-Decent Homes element of the programme. Major works recovery from leaseholders is a key assumption within the thirty year HRA financial model.

- 7.3 The September 2011 report also highlighted the importance of all major works costs being recharged in accordance with the terms of the lease, and the fact that the Council has a legal duty to fully recover costs incurred, and to avoid the eventuality that tenants are subsidising leaseholders. Failure to achieve this will present a significant risk to the ultimate resourcing of the programme.
- 7.4 It is important to highlight that the Council's forward funding of works accruing to leaseholders presents a risk, and that any failure to collect major works could lead to the Council being left with a major unfunded liability.
- 7.5 This report outlines a new option available to leaseholders as well as amendments to existing policies. In terms of the specific initiatives proposed these are outlined and assessed below. The table in Appendix 2 shows the cost implications at net present value of each financing option.
- 7.6 It is not possible to accurately assess the cost impact of the proposed recovery options, however they should lead to an improved recovery rate and hence an improved cashflow position for the Authority.

7.7 **New Policy**

7.7.1 **Early Payment Discount**

This is the main addition to the leasehold major works repayment options that are currently in operation. It is proposed that a 5% discount will be granted to leaseholders who pay major works invoices within 28 days, the intention being to improve the Authority's cashflow position.

The analysis in Appendix 2 shows that offering a 5% prompt payment discount compares favourably with the net present value of the alternative interest free options over a two or three year period, which it is assumed will be the most popular repayment options.

While the Authority will be offering a reduction in charges, this loss must be balanced against the benefit of receiving payments earlier than would otherwise be the case. The costs of any discounts offered will be met from within the HRA capital programme. The offering of these discounts is affordable within the modelling that has been undertaken on the Council's thirty year HRA business plan.

7.8 **Amended Policy**

7.8.1 **Extended Interest-Free Payment Options**

Under the current policy all leaseholders are able to apply for interest free payment arrangements for up to 2 years on charges exceeding £1,000, and a discretionary loan of 3 years can be made available for invoices that exceed £6,000.

It is proposed that leaseholders who qualify for extended interest free payment options will be able to arrange interest free payments over 2 years for bills over £1,000, and over 3 years for bills over £6,000.

An affordability test will be applied to the loans to ensure that the Council is the “lender of last resort” rather than a first point of call to finance the loan (paragraph 6.3).

The net present value of these options is shown in Appendix 2, with assumptions of a net present value loss to the Authority of 7.0% on a two year interest free loan and 9.2% on a three year loan, compared to the full current charge. This is based on an inflation rate of 3.83%.

7.8.2 The following options incorporate an interest element:

- Statutory Loans
A fixed repayment term is offered based on the Council’s set interest rate, with the loan being secured on the property. This option is generally not a popular option because the alternatives offered by the Council are financially more attractive.
- Extended Payment Option
A thirty-six month interest free period followed by a two year repayment schedule based on the Council rate.
- Voluntary Charge on Property
A charge is placed on the property, with interest accruing at the Council rate until redeemed.

All the above options include an interest charge based on the prevalent rate set by the Council. It is proposed to reduce the current interest rate from 8.895% to 5.34% for payment options longer than 3 years to reflect the fact that the Council’s internal borrowing costs, on which the interest rate is based, are lower than when the rate was originally set. The rate charged will be reviewed annually and will reflect current market conditions that are in effect at the time.

7.9 **Existing Policy**

7.9.1 Discretionary capping of service charges

Discretionary capping of major works charges to a maximum of £10,000 is available in accordance with Council policy and is offered to leaseholders strictly in accordance with the conditions laid out in paragraphs 6.5.

7.10 Some of the options outlined above require a charge to be secured on the leasehold property to ensure that the Council’s interest is protected in the event of a default on the loan agreement. It is essential that all appropriate charges are secured to enable the Council to ultimately recover all charges due to it.

- 7.11 It is essential that the Authority continues to implement all policies to ensure that both service charges and major works are appropriately recovered from leaseholders.

8. CONCURRENT REPORT OF THE ASSISTANT CHIEF EXECUTIVE (LEGAL SERVICES)

- 8.1 Section 1 of the Localism Act 2011 provides a general power of competence for local authorities and replaces the “well being” powers from the Local Government Act 2000. It gives local authorities the same power to act that an individual generally has and provides that the power may be used in innovative ways. The only restriction is that there must be no statutory prohibition against the proposed action. There is no such prohibition on discounts for early payment.
- 8.2 Section 3 of the Local Government Act 1999 requires the Council as a best value authority to “make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness”.
- 8.3 Offering the payment options detailed in Appendix 1 including the discount for early payment of sums due to the Council can be seen as an efficiency measure as the Council will not have to expend resources in chasing late payments

9. ONE TOWER HAMLETS CONSIDERATIONS

- 9.1 This report sets out the case to the Council for changing leasehold payment options to (i) encourage leaseholders to settle charges quickly by offering early payment discounts,(ii) reducing the interest rates for those leaseholders unable to make full settlement quickly to reduce the financial burden and (iii) to limit access to those leaseholders in need of such assistance. The extent to which this can be achieved and DH programme targets reached will have a direct bearing on helping to achieve the Council's objectives in regard to tackling some of the inequalities and poverty effects in the borough.
- 9.2 The objective is that not only will the relevant leasehold properties have the much needed capital works carried on their homes, but also leaseholders will be supported with a raft of measures to lessen the burden of the resultant costs. The raft of support options in this report predominantly have leaseholders who are resident occupiers in mind, but non-resident leaseholders will also have access to the longer interest free and longer repayment options in the following circumstances:
- § Providing care to a family member and requiring them to reside with that family member.
 - § Working away from the locality.

- § Relationship breakdown or fleeing domestic violence.
- § Financial difficulty and letting out the property to pay a mortgage (evidenced by an IVA or a mortgage statement showing arrears)

9.3 Conversely, there are potential implications for Muslim leaseholders who own two or more properties, who may wish to secure Shariah-compliant finance options. A recently concluded EqlA highlighted the need to work with community partners and professional bodies to investigate whether Shariah-compliant repayment options are possible within the current statutory framework. Officers plan to open discussions with the London Muslim Centre, Islamic Bank of Britain and LBTH finance to explore ways that the Council could offer deferred payment options that are Sharia compliant.

10. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT

10.1 The DH Programme contains specific provision to improve the energy efficiency of the Council's own stock. For example, a significant proportion of the DH programme consists of renewing outdated, less efficient boilers with modern equivalents. In addition, all schemes, especially those involving new roofs, windows, heating and insulation are developed to maximise energy efficiency benefits. Work is also being undertaken to further develop this aspect of investment as part of the improvement plan arising from the Best Value review of the Council's major works function.

11. RISK MANAGEMENT IMPLICATIONS

11.1 The Decent Homes Backlog funding is year specific, with resources only being available for years three and four if the Authority successfully delivers the year one and two outcomes in accordance with the Government specified requirements. Flexibility has therefore been built into this element of the programme to enable adaptations to be made if necessary to ensure targets are met.

11.2 There is a risk arising from the Council being required to forward fund leaseholders' DH capital works. The options recommended to Cabinet for approval offer the best opportunity to ensure that income is received quickly and with the minimum effort in terms of debt recovery action. The main risk to the council is that the income is received too slowly to top up the budget to complete the Decent Homes programme and the cost of debt recovery action escalating if reasonable terms are not available to resident leaseholders. The restriction of some of the support to resident leaseholders also limits the risk to the council of challenge by local council tax payers who may feel they are subsidising council leaseholders operating businesses.

11.3 It is vital that S20 consultations are conducted in line with the prescribed procedure, ensuring that stages 1-3 are fully concluded in a proper manner. S20 severely limits the amount a landlord can charge for major works if the right consultation procedure is not followed.

12. CRIME AND DISORDER REDUCTION IMPLICATIONS

- 12.1 Crime and Disorder reduction implications on the DH Backlog Investment Programme is limited; however working closely with the ASB teams and local residents, schemes for e.g. door entry systems and environmental improvements, like additional lighting, contribute to a reduction of crime and disorder.

13. EFFICIENCY STATEMENT

- 13.1 The proposals contained in this report are made to ensure the council can maximise its resources, minimise costs on recovery action and offer leaseholders suffering financial hardship reasonable opportunity to fulfil their obligations under the terms of their lease.

14. APPENDICES

Appendix 1
Appendix 2

Local Authorities (Executive Arrangements) (Access to Information) (England) Regulations 2012

List of "Background Papers" used in the preparation of this report

-S.20 of the Landlord and Tenant Act 1985
(amended by section 151 of the Common
hold and Leasehold Reform Act 2002)
-S.1 of the Localism Act 2011

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