

Review of Leasehold Service Charges

London Borough of Tower Hamlets

June 2014



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1. Introduction

1.1 Purpose of this report

1.1.1 This report has been prepared for the management of the London Borough of Tower Hamlets (LBTH) to bring to their attention various matters arising from our review in relation to leasehold service charges.

1.2 Scope of assignment

1.2.1 This review was conducted in accordance with our Engagement Letter, signed by London Borough of Tower Hamlets on 13 May 2014.

1.2.2 The examination involved selecting a sample of 10% of leasehold properties managed by Tower Hamlets Homes (THH), including those managed by the various Tenant Management Organisations (TMOs). THH managed a total of 8,995 leaseholders at 31st March 2013 including 404 properties that were managed by TMOs.

1.2.3 For the sample selected we undertook the following testing:

- a) Review direct cost allocations and overheads apportionments for service charges in relation to the 2011/12 and 2012/13 actual charges and determine whether these have been calculated in accordance with sound accounting principles, best practice and relevant Leasehold Valuation Tribunal (LVT) determinations.
- b) Review the change in calculation methodology in 2011/12 and 2012/13 and bring to your attention any concerns that we identify regarding compliance with statute, lease provisions and sound accounting practice.
- c) Examine the reasons for the changes in methodology and practice as set out in (b), and provide comments on their validity and impacts.
- d) Review the split of costs between leaseholders and tenants to ensure that this is transparent, fair, in accordance with relevant legislation and Council policy.
- e) Examine the billing methodology, including the layout/structure of the bill to determine whether the bills are clear, understandable and that costs are transparent.
- f) Examine ways to improve transparency and value for money in the charging and billing process.
- g) Benchmark charges against similar landlords and ALMOs.

1.2.4 We also reviewed the minutes of leaseholder Project Steering Group (PSG) and invited members of the PSG to submit their concerns to us for consideration during this review. We received one such response which we considered in the course of this review. At the request of LBTH, we did not meet with any leaseholders as part of this review.

1.2.5 The landlord is responsible for the maintenance of the service charge accounting records and the preparation of service charge accounts in respect of the costs in accordance with applicable Law and United Kingdom Generally Accepted Accounting Practice. It should be noted that our work involved sample testing and can not be relied upon to provide assurance that all legal and other obligations have been complied with, including those within the Landlord and Tenant Acts and Commonhold and Leasehold Reform Act 2002. Where we have identified failures to comply with relevant legislation, best practice or LVT determinations, we have included details within this report.

1.2.6 This report is to be regarded as confidential to the management of LBTH and is intended for use by the organisation only. No responsibility is accepted to any other person in respect of the whole or part of its contents. Before this report, or any part of it, is disclosed to a third party our written consent must be obtained.

2. Executive Summary

- 2.1 We have now completed our review a total of 900 individual leasehold service charge statements across 37 schemes. We raised a total of 114 queries which we have discussed with management. Our findings are summarised in Sections 3 to 9 of this report.
- 2.2 Our overall conclusion, based on our sample testing, is that the calculation methodology used in 2011/12 and 2012/13 is lease compliant and accords with sound accounting practice. No breaches of statute were noted as a result of our work. The apportionment of costs based upon the GV method is sound and has been consistently applied across the various direct cost headings.
- 2.3 Major changes were made to the methodology for calculating leasehold services charges in 2011/12. These changes achieved a more equitable apportionment of costs between tenants and leaseholders, and between individual leaseholders, and to ensure that the full costs of providing services to leaseholders, including overheads, are identified and charged to leaseholders. This led to a significant increase in the level of costs eligible to be recharged to leaseholders, and prompted THH to apply a 'dampening' subsidy to mitigate the effect of this on service charge bills in 2011/12.
- 2.4 In our experience, the adoption of full-cost recovery in respect of leasehold service charges is not a practice that is universally adopted across the local government and social housing sectors. We are aware of other ALMOs and housing associations that charge a level of management costs to their leaseholders that do not recover full costs of providing the leasehold service, or in some cases apply an arbitrary level of management costs that is not related to the actual level of costs incurred.
- 2.5 Whilst we accept that the adoption of the full cost recovery model in 2011/12 was a controversial move, we did not identify any evidence that this methodology results in charges to leaseholders that are either contrary to the terms of the lease or that otherwise appear unjustifiable.
- 2.6 We found evidence during our review that value for money is an important consideration for the leasehold team at THH, and the costs of providing services such revenue repairs, refuse, grounds maintenance, communal electricity and caretaking are all budgeted to reduce over the period from 2012/13 to 2014/15.
- 2.7 The overall pattern of average leasehold service charge bills over recent years, and budgets for future years, are set out below:

Year	£ Average SC
2008/09	1,003.00
2009/10	1,030.00
2010/11	1,027.86
2011/12	1,112.36
2012/13	1,215.05
2013-14 (E)	1,134.61
2014-15 (E)	1,128.00

- 2.8 We raise a number of recommendations for consideration by management, these are set out in Section 10 of this report.

3. Direct cost allocations and overhead apportionment

Objective a) Review direct cost allocations and overheads apportionments for service charges in relation to the 2011/12 and 2012/13 actual charges and determine whether these have been calculated in accordance with sound accounting principles, best practice and relevant LVT determinations.

3.1 Management charges

- 3.1.1 The way in which management costs are charged to leaseholders is one of the key changes that occurred between 2010/11 and 2011/12. It was acknowledged by Beever & Struthers following their review of leasehold service charges in May 2011 that THH was not fully recovering its management costs from leaseholders.
- 3.1.2 In order to fully recover the costs of managing the leasehold service, THH adopted an approach that involves allocating management costs directly to the relevant service to provide a total cost for each service. THH splits its management costs into the following 3 headings - **Leasehold Services**, **Housing Services** and **Management Costs** (including overheads). Each cost heading attracts a standard overhead whilst direct services also receive a % overhead cost, as explained further in 3.1.6.
- 3.1.3 **Leasehold Services** are the costs incurred by the Leasehold Team. Items included are the staff costs for the team, administration around the delivery of leasehold services and the costs associated with the chasing of debt from leaseholders. Costs are apportioned equally to all leaseholders, including those managed by TMO, as THH considers that all leaseholders receive an equal share of the service. The charge for 2012/13 was £1,805,845, which works out at £200.76 per leaseholder, and we did not identify from our sample testing any expenditure within this heading that should not be recharged to leaseholders by virtue of statute or the terms of the lease. This cost heading demonstrated only a marginal increase from the 2011/12 charge of £196.01. None of these services are shared with tenants and therefore it is appropriate that the entire charge is allocated to leaseholders.
- 3.1.4 **Housing Services** are the costs incurred by THH through the delivery of its housing services to both tenants and leaseholders. Around 40% of these costs are recharged to leaseholders, as is explained further in Section 6. These costs include relevant salaries of Housing Officers, Resident Engagement Officers, Anti-Social Behaviour (ASB) service costs and a proportion of senior staff salaries including the Head of Neighbourhoods. It also includes three Service Level Agreements (SLAs) for pest control, customer services and complaints. These costs are charged to all properties, both rented and leasehold, using the Gross Value (GV) method of apportionment, which is explained further in 3.2.2. Although our testing found that the charges for both years had been apportioned appropriately between tenants and leaseholders and were supported by appropriate evidence, the charges for 2011/12 and 2012/13 were £719,083.08 and £793,065.63 respectively, representing a 10% increase between the two years. We reviewed the reasons for the increase, which appeared to be reasonable and related to various non-recurring items.
- 3.1.5 **Management costs** are incurred in delivering the direct services. Management costs are variable and relate to the service itself, such as the cost of caretaking supervisors and repairs management. The majority of these costs are payroll costs. The costs are separately identifiable on the face of the service charge statement next to the direct costs of providing each service. We were able to validate these sums to actual costs incurred 2011/12 and 2012/13 for the sample of leasehold properties that we reviewed.

3. Direct cost allocations and overhead apportionment (Continued)

3.1 Management charges (Continued)

3.1.6 **Overheads** consist of the total relevant costs incurred by THH that cannot be allocated to the delivery of a particular service, for example a share of the salary of the Head of Finance. Overheads are recovered based on the % of direct costs they represent in the overall analysis undertaken. For example in 2011/12 direct costs were £62,174,274 and overheads totalled £10,448,394. Therefore every £1 of direct cost on the service charge statement had 17p of overheads allocated to it. Overheads were recovered at a rate of 17% of direct costs in 2011/12, which reduced to 13.49% in 2012/13. Management also felt that these would reduce to around 8% over the next two years through planned efficiency savings and streamlining of services, and this is reflected in the estimates provided for these periods.

3.2 Estate and Block Repairs

3.2.1 THH allocates its direct repairs costs under the following headings:

- Estate Repairs
- Block Repairs
- Door Entry System (DES)
- TV Aerial Repairs (TVA)
- Lift Repairs

A distinction is drawn between those repairs carried out on external areas which are considered 'Estate' whilst internal works to communal areas are treated as 'Block' repairs. The majority of DES and TVA costs are clearly allocated to the block to which they relate.

3.2.2 These headings were clearly coded in the repairs data extracted from the SX3 repairs system and provided to us by THH for the purposes of our review. The SX3 system contains the raw repairs data including the unit cost for the repair for the relevant contractor, a completion date and description of the work. Each individual repair is allocated against either the estate or block and the individual property charge is then apportioned using the property Gross Rateable Value (GV) set by Government to reflect the relative rental value of each property. This value is used to apportion the individual's share of each service in a fair and transparent manner across all properties in receipt of a service. The GV method arose as the primary apportionment method following the recommendations made by Beever & Struthers in their report on leasehold service charges dated May 2011, and we consider it to be a fair and transparent method for apportioning costs between tenants and leaseholders, and between individual leaseholders.

3.2.3 Using our data analysis software, we identified a number of duplicate repairs in 2011/12 and 2012/13. Further investigation identified that this problem often related to cases where more than one property had reported the same communal repair, as can often be the case where a lift breaks down. The consequence of this is an inflated repair cost to both leaseholders and tenants. The full list of 56 potential duplicate repairs that we identified was provided to management for investigation, and 14 were confirmed as duplicate charges totalling £1,262. These costs have now been removed from the charges levied to leaseholders. This error represents 0.01% of the total repairs costs of circa £12m over this 2 year period, which indicates that the day to day processes in place at THH to identify duplicated repairs are functioning effectively.

3. Direct cost allocations and overhead apportionment (Continued)

3.2 Estate and Block Repairs (Continued)

3.2.4 Our testing of the individual properties and discussion with management indicated that repairs costs peaked significantly in 2012/13. A comparison of estimated and actual costs from 2011/12 to 2014/15 is set out below:

	2011/12 Actual	2012/13 Actual	2013/14 Estimated	2014/15 Estimated
Revenue repairs	£5,382,549	£7,562,687	£5,510,792	£5,744,026

3.2.5 We discussed with management the volume of preventable repairs being charged to both tenants and leaseholders. An example of this is Ambrose Walk which had a total repairs cost (across the entire estate) of £34,170 in 2011/12 of which £12,837.96 related to responsive maintenance to the drainage. This trend also existed in 2012/13 where from a total of £42,566 spent on the estate in the year £9,851 related specifically to repairs to drainage.

3.2.6 We also compared THH's cost of repairs to a London ALMO with a large proportion of leaseholders similar to THH. Data for 2012/13 is set out in the table below, showing a very similar average cost to THH:

Revenue repairs	THH c. 9,000 leaseholders	Other London ALMO c. 5,000 leaseholders
Average cost per leaseholder	£630.57	£652.77

3.3 Block and Estate Caretaking

3.3.1 THH has undertaken a significant piece of work to allocate block and estate caretaking services in a clear and transparent manner based upon the amount of time spent by caretaking staff at each site. As a result, in 2011/12 and 2012/13 the total cost of providing these services is identified from the accounting system, allocated to each block or estate based on time spent at each site, and then apportioned to the individual properties using the GV method explained previously in 3.2.2. The apportionment of these charges across entire blocks and estates ensures that the charge is shared equitably between leaseholders and tenants, and we found no calculation or apportionment errors through our sample testing.

3.3.2 Our analysis of the caretaking costs in 2011/12 and 2012/13 indicates that over the two year period the total caretaking costs have reduced:

Caretaking costs	Actual 2011/12	Actual 2012/13
Direct services	£4,867,258	£4,861,457
Management costs	£830,231	£939,618
Overheads	£968,573	£782,565
Total	£6,666,063	£6,583,640

3. Direct cost allocations and overhead apportionment (Continued)

3.4 Grounds Maintenance

- 3.4.1 Grounds maintenance charges are allocated to the estate using the same methodology as estate caretaking costs, and the GV method ensures that all residents of the estate share a fair apportionment of the actual costs incurred. Our sample testing indicated that grounds maintenance costs are supported by appropriate evidence and are accurately and consistently apportioned between tenants and leaseholders, and between individual leaseholders.
- 3.4.2 The analysis of grounds maintenance below indicates that over the two year period we reviewed, the total costs charged to leaseholders have reduced:

Grounds maintenance	Actual 2011/12	Actual 2012/13
Direct services	£835,983	£635,623
Management costs	£47,207	£29,172
Overheads	£88,141	£71,324
Total	£971,331	£736,119

3.5 Bin Hire and Bulk Waste

- 3.5.1 Bin hire costs for 2011/12 and 2012/13 are taken directly from a cleaning services SLA with LBTH. We were able to reconcile relevant figures to the accounting system and we were satisfied that the totals were accurately extracted and allocated to each block, and individual property for the sample that we tested, based upon the GV methodology.
- 3.5.2 Bulk waste collection charges are calculated annually by taking the overall cost of bulk waste collection across all schemes over the course of the year, taking an average cost per visit and allocating this to each estate based upon the number of visits undertaken in a year. These total estate bulk waste collection costs are then apportioned to each property based upon their GV as a percentage of the overall Estate GV. Our testing confirmed that this was being applied consistently for the sample of properties we reviewed.

3.6 Communal Electricity

- 3.6.1 Our testing revealed that THH is accounting for electricity costs on a 'cash basis'. A number of the costs charged to leaseholders in 2012/13 and 2011/12 related to the previous year.
- 3.6.2 It is not uncommon for landlords to account for utilities in this manner as these companies are only required by law to provide an actual meter reading every 2 years. As a result of this the service charge statements often contain estimates which are then rectified the following year on receipt of the invoice. We observed across a number of the schemes that electricity costs vary considerably between the 2011/12 and 2012/13 statements as a result of this. An example of this is 1 Ambrose Walk where the leaseholder received an actual charge of £17.51 in 2011/12 followed by £211.10 in 2012/13. Many peers choose to accrue estimated costs so as to avoid these high fluctuations between one year and the next.

3. Direct cost allocations and overhead apportionment (Continued)

3.6 Communal Electricity (Continued)

3.6.3 Through discussion with management it was established that from 2014/15 THH will hope to present a more accurate charge each year as a quarter of properties managed by THH have now been fitted with 'smart-meters' enabling THH to obtain 'real time' meter readings. A progress report was provided showing that 343 of 910 communal supplies are currently fitted with smart-meters with plans in place to roll-out smart-meters to all other communal electricity supplies where this is technically possible.

3.7 Leasehold Valuation Tribunal (LVT) determinations

3.7.1 The LVTs that took place between 1st April 2011 and 31st March 2013 were reviewed fully as part of the audit and have been briefly summarised below in points 3.7.2 to 3.7.4. We considered the result of the decisions and assessed the extent to which THH has learnt from the outcomes of LVT determinations.

3.7.2 **13 Swinburne House** - an unsuccessful challenge was made at Tribunal over the charges including in the 2011/12 service charge statements. Challenges raised included the perceived duplication of housing management and administration charges, a lack of cleaning and maintenance taking place prior to 2010, and high communal electricity and horticultural charges. The decision of the tribunal was favourable for THH and did not lead to any suggested changes in process as a result.

3.7.3 **18 Robin Hood Gardens** – the tribunal determined that £575.40 of the amount due of £4,122.57 (unpaid service charges from 2009, 2010 and estimate for 2011) which related to administration charges and leasehold management fees was to be excluded as a result of the accounts being unclear. THH has since revised the content of these elements of the service charge in order to explain these costs more clearly.

3.7.4 **168 Stepney Way** – the tribunal heard challenges on the reasonableness of the service charges between August 2004 and September 2012 under the following headings; management charges, estate cleaning, communal energy, horticultural maintenance, block maintenance, estate maintenance, door entry maintenance and bulk waste. A challenge was made to the estate cleaning cost as a result the particular property being relatively low maintenance compared to others and therefore it was upheld that this charge would be no more than £100 per annum, which could be considered reasonable. The allocation of these costs has been addressed in the revised methodology which allocates the time spent at each property using timesheet data. We investigated the charge for this particular property and confirmed this as being £44 for 2012/13, considerably less than the LVT determination of £100. Bulk waste was also challenged successfully resulting in a reduction of £213.77 for the individual due to THH being unable to evidence that a competitive tender exercise had been undertaken to substantiate the increase in 2011/12. A cap of £118.78 was placed upon the management charge until 2015, after which the full cost can be recovered. The actual charge to the leaseholder for this service in 2012/13 was found to be £96.61, again within the LVT imposed cap.

4 Current calculation methodology

Objective (b) - Review the change in calculation methodology in 2011/12 and 2012/13 and bring to your attention any concerns that we identify regarding compliance with statute, lease provisions and sound accounting practice

- 4.1.1 Section 3 of this report sets out in detail the calculation methodology applied in 2011/12 and 2012/13. This represented a major change compared to the methodology previously adopted, and was designed to ensure a more equitable apportionment of costs and the recovery of the full costs of providing leasehold services including overheads. There were no significant changes to the methodology applied between 2011/12 and 2012/13.
- 4.1.2 Our overall conclusion, based on our sample testing, is that the calculation methodology used in 2011/12 and 2012/13 is lease compliant and accords with sound accounting practice. No breaches of statute were noted as a result of our work. The apportionment of costs based upon the GV method is sound and has been consistently applied across the various types of direct cost. Other apportionment methodologies are available, for example square footage of the property or equal share amongst properties with the block, but we do not hold the view that these would provide a more equitable result than the GV method.
- 4.1.3 LBTH uses two types of lease across its entire housing stock, the GLC lease and the LBTH lease. We reviewed both leases and found nothing unusual or that would give rise to restrictions to the expenditure that THH has charged to the sample of leaseholders that we reviewed.
- 4.1.4 The Eighth Schedule of the GLC lease covers service charges and contains standard terms including payment terms, recovery of costs, services included, the reasonable aggregation of costs and the charging of administration and overheads incurred by the Council in delivering the services. The Fifth Schedule of the LBTH lease contains broader terminology around the services however it still allows for a reasonable proportion of total expenditure to be recovered, and also covers payment terms which we found were adhered to.

5 Changes in methodology between 2010-11 and 2011-12

Objective c) Examine the reasons for the changes in methodology and practice as set out in (b), and provide comments on their validity and impacts.

5.1.1 THH made a number of methodology changes between 2010/11 and 2011/12, partly in order to implement the recommendations of the Beever & Struthers review. These can be summarised as follows:

- Identifying all overhead costs in order to be able to allocate them in a fair and transparent way, across the various front-line services.
- Allocating caretaker costs based on a management assessment of time spent at each site which replaced the previous procedure of identifying whether a property had features such as a 'stairwell' or a 'lift' and charging a flat amount for each attribute.
- Allocating bulk waste collection costs according to usage rather than by sharing costs equally across all properties.

5.1.2 Below is a table showing the changes in service charges between 2010/11 (old methodology) and 2011/12 (new methodology), by each major cost heading:

Comparison of Service Charges between 2010-11 and 2011-12

	2010-11	2011-12	Increase	Increase
	£	£	£	%
Repairs				
Block Repairs	1,012,905.35	895,477.77	- 117,427.58	
Estate Repairs	314,644.22	318,447.24	3,803.02	
Boiler Repairs	309,771.88	424,712.87	114,940.99	
Door Entry Repairs	96,647.77	94,851.24	- 1,796.53	
Lift Repairs	213,344.77	338,500.03	125,155.26	
TV Aerial Repairs	20,899.89	46,753.55	25,853.66	
	<u>1,968,213.88</u>	<u>2,118,742.70</u>	<u>150,528.82</u>	<u>7.6%</u>
Estate Services				
Bin Hire	165,442.63	181,646.05	16,203.42	
Bulk Waste	168,318.64	256,319.42	88,000.78	
Block Caretaking	1,556,294.58	1,927,268.45	370,973.87	
Estate Caretaking	816,654.79	931,481.89	114,827.10	
Grounds Maintenance	368,161.71	406,424.42	38,262.71	
Concierge	7,600.00	7,600.00	-	
	<u>3,082,472.35</u>	<u>3,710,740.23</u>	<u>628,267.88</u>	<u>20.4%</u>

Comparison of Service Charges between 2010-11 and 2011-12

	2010-11	2011-12	Increase £	Increase %
Central Services	£	£	£	%
Leaseholder Services	1,664,745.02	1,615,368.71	- 49,376.31	
Housing Management	661,273.58	-	- 661,273.58	
Housing Services	-	719,083.03	719,083.03	
	<u>2,326,018.60</u>	<u>2,334,451.74</u>	<u>8,433.14</u>	<u>0.4%</u>
Fuel Bills	£	£	£	%
Communal Electricity	733,258.75	660,599.61	- 72,659.14	
Boiler Fuel	668,897.20	668,345.59	- 551.61	
	<u>1,402,155.95</u>	<u>1,328,945.20</u>	<u>- 73,210.75</u>	<u>-5.2%</u>
Total	<u>8,778,860.78</u>	<u>9,492,879.87</u>	<u>714,019.09</u>	<u>8.1%</u>

5.1.3 Based on our sample testing, it appears that the new methodology accurately extracts costs from the accounting system and in doing so a number of costs that had previously been omitted in the 2010/11 accounts were picked up in 2011/12, which contributed to an 8% increase in the service charge. The impact of these costs not previously being charged to leaseholder was that the costs were in reality being subsidised by the Housing Revenue Account (HRA).

5.1.4 The specific charges that were not being charged in 2010/11 included:

- THH non-salary costs including surveys, consultancy, materials, services and transport totalling £4.8m;
- THH back-office staff costs including Finance, IT, HR, Business Development, Communications and Corporate Core staff salaries totalling £2.7m;
- THH overhead SLAs including premises £1.9m, ICT £1.5m, Legal Services £0.5m and various miscellaneous SLAs £0.2m.

5.1.5 The overall impact of the above is that a total of £11.6m was excluded from the old model, some of which relates to leaseholders and some to tenants. The impact on leaseholders is that approximately £239 per leaseholder of costs that had been incurred by THH were not being passed on in 2010/11 and thus were effectively being subsidised by the HRA.

5.1.6 We noted that a common concern raised by leaseholders on the PSG, and brought to our attention by PSG members, is the level of management fee. The changes in methodology have inevitably led to an increase in service charge for some properties, whilst others have seen a reduction. However it appears that the management charges are based on a logical apportionment methodology and we found no calculation errors in the application of that methodology in 2011/12 or 2012/13. Management charges will also appear high because of the way in which management fees related to direct cost headings are shown separately on the service charge statement, rather than being included in the direct cost heading. Further details on this point are set out in Section 7 of this report.

6 Split of costs between leaseholders and tenants

Objective d) Review the split of costs between leaseholders and tenants to ensure that this is transparent, fair, in accordance with relevant legislation and Council policy.

- 6.1.1 Our extensive sample testing found no instances where costs were being unfairly allocated to leaseholders such that the leaseholders could be considered to be subsidising tenants. The move to a full cost recovery model had the effect of transferring costs to leaseholders that were previously borne by the HRA, however we did not find evidence that leaseholders are subsidising the HRA as a result of the change in methodology.
- 6.1.2 Our review of the 2011/12 and 2012/13 statements identified that THH provides a rebate to leaseholders, referred to as ‘dampening’ of costs. This rebate effectively removed £262,726 and £626,954 of costs giving a total reduction of £889,680 in both years which equates to around £100 per leaseholder per year.
- 6.1.3 Discussion with management established that this rebate was initially applied in 2011/12 in order to limit the impact of the change in methodology to full cost recovery. The aim is for the subsidy to be reduced at a rate of 25% each year on a straight line basis, however our testing revealed that the full rebate is still being borne by the HRA.
- 6.1.4 As previously discussed in this report, 100% of the leaseholder costs (less the ‘dampening’ outlined in 6.1.2) are charged to leaseholders these costs are incurred solely for the benefit of leaseholders, plus around 40% of the housing management costs incurred in relation to services such as pest control, resident engagement, ASB and customer services.
- 6.1.5 The table below sets out data from the 2012/13 summary of costs:

	Total Service Cost	less Non Rechargeable Costs	Dampening	Total Rechargeable Cost	Leaseholder Share	%
HM Element - Pest Control Service	297,995	-	75,885	222,108		
HM Element - Resident Engagement	1,081,526	-	311,066	770,459		
HM Element - ASB Service	824,453	-	194,134	630,318		
HM Element - Customer Access Services	1,821,884	1,473,346	75,725	272,812		
Total Housing Management	4,025,858	1,473,346	656,814	1,895,698	793,065.63	41.83
Leaseholder Service	2,432,860	61	626,954	1,805,845	1,805,845	100

7 Billing methodology

Objective e) Examine the billing methodology, including the layout/structure of the bill to determine whether the bills are clear, understandable and that costs are transparent.

- 7.1.1 THH bills its leaseholders in line with common practice in the sector. In April leaseholders receive an estimate of the charges for the coming year which are then invoiced throughout the year. At the end of the year leaseholders receive a bill and covering letter which includes a service charge certificate and either an invoice or a credit note for the difference between the estimated charge and the actual cost. These are billed within 6 months of the year end as per the requirements of the Landlord and Tenant Act 1985 and Commonhold and Leasehold Reform Act 2002.
- 7.1.2 The GLC lease requires GLC leaseholders to pay half of the charge on 1st April and the remaining charge 6 months later. The LBTH leases require LBTH leaseholders to pay 4 equal instalments in April, July, October and January. However, THH has adopted a policy that allows all leaseholders to pay their service charge in 10 instalments throughout the year, which is a common approach and allows leaseholders to pay their charge in more manageable instalments.
- 7.1.3 The layout and structure of the bill produced by THH is unusual when compared to those of other ALMOs and housing associations. This is due to the direct management costs (explained in Section 3.1.5) being shown as a separate line below the direct cost of the service to which they relate, instead of being included in the direct cost as is the more common practice. This change was implemented as part of the Leasehold Policy Review, following the recommendation of Beever & Struthers that stated “For transparency, THH should inform leaseholders of the cost of the indirect management fees in the service charge actuals and estimates”. Although this arguably led to better transparency, with indirect costs now clearly presented under each direct cost heading to which they relate, in our experience the majority of landlords chose not to separate these charges out on the face of the statement. However, neither method of presenting this information is prohibited by the terms of either lease or statute.
- 7.1.4 On considering the content of the statements we also compared the estimated charge with the actual charge for both 2011/12 and 2012/13. We found that the estimated service charge is consistently being underestimated, in some cases by up to 30%. As a result significant costs are being recovered from leaseholders at the year end despite the actual charges only showing a modest change over the two years.
- 7.1.5 The table below analyses estimated v. actual service charge bills for 2011/12 and 2012/13. It is evident that the estimated service charge for 2012/13 was understated by 17%, resulting in significant additional charges to leaseholders in that year:

7 Billing methodology (Continued)

Average Service Charges

	2011-12			2012-13		
	Estimate (£)	Actual (£)	Adj. (£)	Estimate (£)	Actual (£)	Adj. (£)
Block Repairs	161.34	109.12	- 52.21	153.17	199.11	45.93
Estate Repairs	40.87	37.54	- 3.33	40.93	55.46	14.53
Boiler Repairs	267.96	356.90	88.94	257.54	221.29	- 36.25
Door Entry Repairs	20.84	15.80	- 5.04	17.22	21.27	4.05
Lift Repairs	146.84	108.56	- 38.27	81.93	122.34	40.39
TV Aerial Repairs	4.35	7.74	3.39	3.49	11.10	7.61
Bin Hire	12.95	22.15	9.20	21.24	21.52	0.27
Bulk Waste	18.51	31.28	12.77	19.85	30.08	10.23
Block CT	166.75	240.43	73.68	172.52	229.95	57.43
Estate CT	104.21	110.16	5.95	92.98	110.19	17.21
Grounds Maintenance	40.95	48.54	7.59	37.47	35.70	- 1.77
Concierge	100.00	100.00		618.63	100.00	- 518.63
Communal Electricity	82.44	80.38	- 2.06	71.73	84.08	12.35
Boiler Fuel	654.71	558.82	- 95.90	846.66	599.66	- 247.00
Leasehold Services	171.40	190.24	18.85	167.65	195.07	27.42
Housing Services	74.92	84.67	9.74	76.47	96.68	20.21
Total	1052.314	1,112.36	60.05	1036.427	1,215.05	178.62

7.1.6 When reconciling the 8,995 leaseholders at the end of March 2013 to the leaseholder statements provided we found that 312 leaseholders were not billed as a result of the property being sold during the year. Although a service had been provided, a system restriction means that leaseholders cannot be billed for part of a year. We recommend that this system issue be reported as the loss of income in 2012/13 was in the region of £27,000 based upon the average undercharge of £86.50 per property.

8 Transparency and VFM

Objective f) Examine ways to improve transparency and value for money in the charging and billing process.

8.1.1 THH separates out direct costs from the ‘management costs’ of providing each specific service on the face of its service charge statements. This is an unusual approach and not one that we have seen at other ALMOs and housing associations for whom we act. It is more typical to include within ‘direct costs’ the costs relating to the management of specific services. Some would argue that the approach adopted by THH is overly complicated, whilst others may argue that the approach gives greater transparency.

8.1.2 THH has made efforts to drive down costs in order to improve value for money. Some headline costs data is set out in the table below:

	2011/12 Actual (£)	2012/13 Actual (£)	2013/14 Estimated (£)	2014/15 Estimated (£)
Revenue repairs	5,382,549	7,562,687	5,510,792	5,744,026
Refuse services	1,026,632.62	1,019,889	1,035,043.03	980,257
Grounds Maintenance	736,119	971,332.32	996,330.77	908,000
Communal Electricity	1,792,570	1,711,737.16	1,482,655.19	1,550,151
Caretaking Service	6,583,641	6,666,063.13	6,316,314.22	6,372,722

8.1.2 THH has published a report entitled ‘Value for Money for Leaseholders and Tenants’. The document sets out THH’s plan to reduce costs and improve services, and also benchmarks THH costs against those of its peers. Back office cost savings of £1.1m were implemented for 2014/15 following a review that took place in 2013/14 and was applied to budgets in the 2014/15 financial year which aims to deliver a saving of £1.1m.

8.1.3 The table below shows a number of the measures of Value for Money outlined by THH in this document:

VFM consideration		
Communication costs	2009/10 - £711,000	2014/15 - £346,000
Office overheads per employee	Jack Dash House - £10,000	Harford Centre - £2,500
Tenant satisfaction	2010 – 58%	2013 – 77%
Leasehold satisfaction	2010 – 44%	2013 – 52%

8.1.4 The ‘Value for Money for Leaseholders and Tenants’ document is, however, very high level and does not set out in detail how cost reductions and service improvements are going to be achieved in practice, or how leaseholders will be consulted.

9 Benchmarking

Objective g) Benchmark charges against similar landlords and ALMOs.



9.1 HouseMark data

9.1.1 Our review of Housemark benchmarking reports for both 2011/12 and 2012/13 showed the following:

9.1.2 **Housing Management** –total cost of housing management (including overhead allocation) is in the upper median compared to a number of peers in the local area.

Organisations:



1	Poplar HARCA	4	Tower Hamlets Homes (2011/2012)	7	Gateway Housing Association
2	Old Ford Housing Association	5	Tower Hamlets Homes (2012/2013)	8	Eastend Homes
3	Swan Housing Association	6	East Thames Group	9	Tower Hamlets Community Housing

Total cost per property of Housing Management				
Comparator Group Quartiles		Upper	Median	Lower
		437.59	493.14	552.95
Id	Results for Tower Hamlets Homes	Result	Rank	Quartile
5	Tower Hamlets Homes (2012/2013)	483.84	4	
4	Tower Hamlets Homes (2011/2012)	477.23	4	

9.1.3 **Direct Housing Management** - the direct cost of housing management (excluding overhead allocation) is less favourable however THH still outranks a number of its peers.

Organisations:

1	Swan Housing Association	4	Poplar HARCA	7	Gateway Housing Association
2	East Thames Group	5	Tower Hamlets Homes (2011/2012)	8	Eastend Homes
3	Old Ford Housing Association	6	Tower Hamlets Homes (2012/2013)	9	Tower Hamlets Community Housing



Direct cost per property of Housing Management				
Comparator Group Quartiles		Upper	Median	Lower
		283.16	313.16	340.94
Id	Results for Tower Hamlets Homes	Result	Rank	Quartile
6	Tower Hamlets Homes (2012/2013)	327.51	5	
5	Tower Hamlets Homes (2011/2012)	317.80	5	

9 Benchmarking (Continued)

9.1.4 **Housing Management Direct Employee Cost** – housing management employees per property THH compares well to peers:

Organisations:

1	Old Ford Housing Association	4	Gateway Housing Association	7	Poplar HARCA
2	Swan Housing Association	5	Tower Hamlets Homes (2012/2013)	8	Eastend Homes
3	Tower Hamlets Homes (2011/2012)	6	East Thames Group	9	Tower Hamlets Community Housing

Cost per property of direct Housing Management employees				
Comparator Group Quartiles		Upper	Median	Lower
		226.56	243.15	259.35
Id	Results for Tower Hamlets Homes	Result	Rank	Quartile
5	Tower Hamlets Homes (2012/2013)	242.47	4	
3	Tower Hamlets Homes (2011/2012)	225.38	3	

9.2 Peer comparison

9.2.1 We spoke to a peer ALMO and Registered Provider (RP) to compare and contrast the processes and costs of THH and the two peer organisations in relation to leasehold service charges. This information is presented in the table below:

	THH	ALMO 1	RP 1
	Location: London Units: 22,000 Leaseholders: 9,000	Location: London Units: 15,000 Leaseholders: 5000	Location: London and Southeast Units: 30,000 Leaseholders: 4,500
1. Are management costs associated with the delivery of a specific service (such as repairs) included in the direct cost or recovered independently?	These are currently shown next to the direct cost as 'management' charge.	On-costs are incorporated into the direct cost of delivering services shown on the statement. For 2012/13 these were as follows; <ul style="list-style-type: none"> • Caretaking 33.19% • Tech repairs 27.03% • Entry Phones 31.03% • Lifts 48.30% 	Yes – management of repairs is included in the cost of the individual repair which includes on-costs of the contractor and any management associated with the service. The management fee is designed to cover all other – non attributable costs.

9 Benchmarking (Continued)

9.2 Peer comparison (Continued)

	THH	ALMO 1	RP 1
	<p>Location: London</p> <p>Units: 22,000 Leaseholders: 9,000</p>	<p>Location: London</p> <p>Units: 15,000 Leaseholders: 5000</p>	<p>Location: London and Southeast</p> <p>Units: 30,000 Leaseholders: 4,500</p>
2. What was your average leasehold service charge bill for 2012/13?	£1,215.05	£1,127	This varies too much to provide a reliable average. Some properties have a charge of £200 whereas others are charged £1,200.
3. Roughly, what is your management cost per unit and what services are covered by this?	Housing services (incl. pest Control, ASB, Resident Engagement) = In 2011/12 the average cost per property (based on 15,000) would be roughly £100.	Housing services (incl. ASB, Customer services and Resident Engagement) = £45.76	Management fee of between 5% and £200 of direct cost is applied depending on the terms of the lease.
4. What is the cost of delivering the leasehold service? Is this fully recovered from leaseholders?	Leasehold services = £200.76 No, there is an element of subsidy in both leasehold and housing costs.	Leasehold services = £148.17	Management costs are typically applied as a % of direct costs and are not directly related to the actual costs of providing the leaseholder service.
5. How do you allocate charges to individual properties?	GV is used. This allows the GV of the property to identify the % of the total GV (arrived at by adding up all properties in the block or estate) to be apportioned to that individual property.	Costs are identified at an estate or level and then either apportioned equally by the number of properties (including rented) with either the block or estate.	Where a % is stated in the lease this is charged, however for other charges a % allocation is made based upon the size of the property.

9 Benchmarking (Continued)

9.2 Peer comparison (Continued)

- 9.2.2 As discussed previously in this report, our peer comparison confirms to us that the splitting out of management costs relating to each service on the face of the service charge statement is not a common practice.
- 9.2.3 The costs of delivering leasehold services and housing services appear high compared to the London ALMO in our peer comparison, especially in view of the dampening subsidy. However we acknowledge that THH is adopting a full cost recovery model whereas the other ALMO can not demonstrate full recovery of overheads.
- 9.2.4 We consider the GV method of cost apportionment used by THH to be transparent and would appear to be a more equitable approach than simply dividing costs equally between leaseholders, a practice adopted by some peers. The allocation of costs based on floor area is the most common apportionment method that we see, however this does not necessarily deliver a more equitable apportionment of costs than the GV method.

10. Action plan agreed with management

Ref	Observation	Recommendation	Management response	Timescale / Responsibility
10.1	<p>Billing methodology</p> <p>THH currently presents the management costs in relation to each service separately on the face of the service charge statement. In our experience it is more common to include these costs within the direct cost of the service.</p>	<p>THH should consider providing the total cost of direct services on the face of the statement instead of listing separate management charges for each service provided.</p>	<p>Agreed. Now leaseholders are familiar with the detailed information available on demand, we will simplify the top level breakdowns to show just the full cost of each front line service, including breaking down 'management services' into ASB, pest control, resident engagement and customer access.</p>	<p>Implementation for 2014-15 estimates onwards.</p> <p>Service charge manager.</p>
10.2	<p>Failing to provide accurate costs for communal electricity</p> <p>THH is accounting for electricity costs on a cash basis. Our testing revealed that a number of the costs included in 2012/13 and 2011/12 leaseholder actuals related to previous years.</p> <p>Although it is not uncommon for landlords to account for utilities in this manner given the issues encountered in obtaining regular and reliable invoices from suppliers, accounting in this way means that actual costs are likely to fluctuate as a symptom.</p>	<p>THH should endeavour to ensure that smart meters are installed for all communal electricity supplies where this is technically possible.</p>	<p>Agreed. This project is in progress and we expect to complete it by the end of 2015. However, we will also accrue costs for each year where evidence of unusual billing patterns exists until then.</p>	<p>This project is in progress and we expect to complete it by the end of 2015.</p> <p>Service Charge Manager.</p>

Ref	Observation	Recommendation	Management response	Timescale / Responsibility
10.3	<p>Dampening of leaseholder and housing costs</p> <p>Our validation of the 2011/12 and 2012/13 statements identified that THH subsidises leaseholders dampening the costs that it recharges in the sum of £889,680 in both 2011/12 and 2012/13, which works out at £100 per leaseholder per year.</p> <p>The aim was for the subsidy to be removed at a rate of 25% each year on a straight line basis, however our testing revealed that the full subsidy still exists in the 2012/13 actuals.</p>	<p>It is recommended that the policy of applying the dampening subsidy be reviewed so that leaseholders are not subsidised by the HRA.</p>	<p>Agreed. We have reduced the dampening to 50% in the 2013-14 actual, will reduce it further to 25% for the 2014-15 actual and eliminate it for 2015-16 in line with the estimates for those years and in line with the original plan.</p>	<p>Implementation as described in response.</p> <p>Service Charge Manager.</p>
10.4	<p>Duplicate repairs</p> <p>We used Computer Assisted Audit Techniques (CAATs) to identify a number of duplicate repairs over the two year period tested.</p> <p>The full list of 56 potential duplicates identified was provided to management for investigation where 14 were confirmed as duplicates totalling £1,262 of overcharging.</p>	<p>THH should run similar tests to those performed by Mazars in future to mitigate the risk of this occurring again.</p>	<p>Partially Agreed. We note the error rate is already low (0.01% per paragraph 3.3) and further changes may not be cost effective. However, we will review of processes at the repairs call centre and supervision of contractors. We will also implement CAATS to further reduce any duplication of communal outs were identified.</p>	<p>Implementation for 2013-14 actuals onward.</p> <p>Head of Neighbourhoods, Planned Maintenance Manager, Service Charge Manager.</p>

Ref	Observation	Recommendation	Management response	Timescale / Responsibility
10.5	<p>Drain repairs and jetting</p> <p>Following our testing we raised concerns with management about the volume of preventable repairs being charged to residents. An example of this is Ambrose Walk which had a total repairs cost (across the entire estate) of £34,170 in 2011/12 of which £12,837.96 related to responsive maintenance to the drainage. This trend also existed in 2012/13 where from a total of £42,566 spent on the estate in the year £9,851 related specifically to repairs to drainage. This would indicate an underlying issue that is not being dealt with through communication to residents and as a result estates are experiencing a high number of preventable call outs and should be liaising better with their residents.</p>	<p>It is recommended that THH considers ways to improve communication with leaseholders in order to prevent unnecessary repairs, such as drain works.</p>	<p>Agreed. We will publicise the effects and costs of continually having to unblock drains to raise awareness with residents of the effect of pouring fats/oils and flushing objects down drains.</p>	<p>Implementation in a future edition of Open Door.</p> <p>Head of Communications & Governance.</p>
10.6	<p>Billing and statements</p> <p>When reconciling the 8,995 leaseholders at the end of March 2013 to the leaseholder statements provided we found that 312 were not billed as a result of being sold during the year. Therefore although a service had been provided a system restriction means that leaseholders cannot be billed for a part year service.</p>	<p>It is recommended that this system limitation be addressed so that charges are recovered for all leaseholders in receipt of a service throughout the year.</p>	<p>Completed. We have already implemented a system fix that removes this problem from 2014-15.</p>	<p>Implementation as described in response.</p> <p>Service Charge Manager.</p>

Ref	Observation	Recommendation	Management response	Timescale / Responsibility
10.7	<p>Billing and statements</p> <p>Our testing revealed that the estimated service charge is consistently being underestimated. As a result significant costs are being recovered from leaseholders at the year end despite the actuals only showing a modest change over the two years.</p>	<p>It is recommended that THH considers how it can improve the accuracy of its estimated charge.</p>	<p>Completed. We accept that there were variances between the estimates and actuals for 2011-12 and 2012-13 for two main reasons. Firstly, estimates were issued before the new methodology was implemented in Summer 2012 and the actuals were calculated afterwards. Secondly, repairs expenditure was higher than anticipated and some variation with the repairs head of charge is always to be expected. However, for 2013-14 onwards, estimates and actuals will have been calculated under the same methodology and average variances will be smaller.</p>	<p>Implementation for 2013-14 actuals onwards.</p> <p>Service Charge Manager.</p>

Ref	Observation	Recommendation	Management response	Timescale / Responsibility
10.8	<p>Value for money</p> <p>THH has published a document on value for money for leaseholders and tenants. However it is considered that this document is high level in the way that value for money is going to be provided to leaseholders.</p>	<p>It is recommended that THH develops detailed plans for the delivery of VFM objectives including consultation with leaseholders on how these objectives are going to be achieved.</p>	<p>Partially Agreed. Extensive savings have already been achieved, including as part of the 2014-15 budget process around overhead reductions. The vfm document published in Open Door was intended as a summary and high level document. In addition, services are generally provided on a tenure neutral basis so it would not be appropriate to consult exclusively with leaseholders as the recommendation implies. However, we will put a VFM Statement document detailing THH's focus on vfm on the THH website.</p>	<p>Implementation by end 2014-15.</p> <p>Service Charge Manager.</p>