

# Briefing Paper

## Implementing Service Charges in Wales

### February 2015



**The Housing Offices of Wrexham County Borough Council**

#### **Introduction**

In some, though not all, local authority areas there is pooling of service charges. This means that some tenants are paying for services they do not receive because the costs are spread between all of the landlord's tenants. The Housing (Wales) Act will end this practice with service charges in future being disaggregated and clearly identified. The changes may result in increased service charges for tenants who do receive eligible services.

The new policy, including the requirement to fully de-pool service charges is a good opportunity to ensure that costs are fully and correctly identified and take into account any changes that may be needed in view of welfare reform so that the Council can be certain of securing the maximum revenue possible. This is very important given the current financial climate and also a good opportunity to engage with residents as this is an important part of implementing the new rent policy.

The Welsh Government is introducing a new policy for social housing rents. The new rent policy applies to stock holding local authorities from April 2015, subject to exit from the Housing Revenue Account Subsidy system. The policy requires local authorities that currently pool rent and service charges to disaggregate service charges from rent; and to consider the impact on their Business Plan, the achievement of the Welsh Housing Quality standard and other government priorities. It requires that the de-pooling exercise be undertaken in full, to ensure only tenants that receive, or are entitled to receive, services pay the service charges. The Welsh Government regards de-pooling service charges as best practice.

The de-pooling of service charges is also required in the light of the introduction of Universal Credit. Under the Universal Credit, tenants will be required to provide information on the breakdown of their rents and service charges as part of their on-line Universal Credit applications. In addition, Under Housing Benefit rules the vast majority of services are eligible for Housing Benefit. Universal Credit regulations set out which services charges will be deemed eligible for benefit and those which are not. These regulations are summarised in Appendix C.

Local authorities have traditionally included the cost of providing additional service to shared or communal areas in the rent that all tenants pay, regardless of whether all tenants benefit from the services being provided. While a pooled approach to service charges is administratively simpler for the landlord, it also has a number of disadvantages:

- Tenants may be paying for services they don't receive.
- Tenants are unaware that they are, in fact, paying for services.
- Services provided, and quality of service, do not reflect the needs and aspirations of tenants.
- Financial arrangements can mean that the housing revenue account contribution to some services is not related to the cost of providing that service.
- The cost to the landlord of service provision can be unclear.
- It is difficult to demonstrate value for money.

Even before the introduction of the new policy for social housing rents in Wales and Universal Credit, there were reasons for de-pooling service charges:

- Introducing service charges can generate additional income from properties that receive the service.
- It is often considered to be unfair to ask tenants who are not receiving services to pay for them, whereas service charging those who receive the service is often considered to be fair and equitable.
- Charging tenants for services can improve the quality of the services being provided, as tenants are more likely to complain about poor service when they know they are paying for it.
- De-pooling service charges provides an opportunity to localise services to reflect tenants' needs and aspirations.

The new rent policy contains a set of key principles for landlords to follow:

- Social landlords should ensure that appropriate policies and procedures are put in place to ensure that service charges are based on full cost recovery, non-profit making and an open and transparent basis.
- Social landlords will need to consult with the affected tenants on, for example, the range, quality, frequency and cost of services provided and how costs will be apportioned between tenants.
- The rent increase notices provided to tenants each year must show separate charges for rents and service charges. Tenants should be provided with information in a clear and consistent format that sets out which service charges are deemed eligible for claiming Housing Benefit or Universal Credit.
- Social landlords to provide advice, as appropriate, to those tenants that would have to fund part, or all, of their service charges from their own resources.
- Service charges will be based on the estimated cost of the services to be provided in the forthcoming year.
- At the end of each year, service charges must be reconciled prior to, and as part of, the setting of estimated service charge costs for the following year.
- Each year, service charges will take into account any underpayment, or overpayment, for the previous year.

- Tenants should be provided with an annual statement and breakdown which ensures that they fully understand how the service charge is calculated.
- Tenants should also be provided with information on how they are able to challenge or raise concerns about the reasonableness of service charges.
- Where rent pooling currently applies and tenants do not receive, or are not eligible to receive, services, it will be for each social landlord to determine whether the weekly rent for those tenants should be reduced or held on a marked time basis.
- The de-pooling exercise may impact on tenants receiving support from a warden or support worker who is part funded through the Supporting People Programme Grant. In such cases social landlords are required to discuss the implications of this exercise with their Supporting People Regional Collaborative Committee and local authority Supporting People Team.

The Welsh Government has not yet set a date when de-pooling has to be completed, but the expectation is that the process should be well underway in April 2015 with completion over the following eighteen months to two years. The Welsh Government's approach is characterised by:

- Not providing detailed guidance on de-pooling
- Guidance will be high-level setting out the principles that need to be followed with fixed or variable service charges
- Landlords are asked to liaise with other landlords who have completed the exercise or made significant progress

Service charges are defined in law under the Landlord and Tenant Act 1985 as follows:

*"An amount payable by a tenant of a dwelling as part of or in addition to the rent which is payable directly or indirectly for services, repairs, maintenance, improvements or insurance or the landlord's costs of management and the whole or part of which varies or may vary according to the relevant costs."*

Until now, housing associations and local authorities have taken different approaches to service charges. Housing Associations have traditionally levied service charges. However, local authorities have traditionally 'pooled' service charges although they have levied some service charges in sheltered accommodation and have levied service charges on leaseholders following right to buy.

### **What Service Charges can be charged?**

Service Charges for tenants are governed by the provisions of the tenancy agreement. However, landlords can vary the terms of tenancy agreements as long as they remain within the statutory requirements of secure and assured tenancies and carry out an appropriate consultation with tenants.

Tenant service charges must be provided for in the tenancy agreement and include revenue items only. There is a need to decide what items to charge for. For example, in England many landlords charge for the maintenance of lifts in blocks of flats while others do not.

Service charges are commonly levied to cover the following costs:

- Staffing costs (including scheme managers, caretakers and cleaners)
- Heating and hot water fuel charges
- Light and power to communal areas
- Cleaning and refuse disposal
- Gardens and grounds
- Roads and car parking
- Management costs

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The calculation of service charges should include both the direct and indirect costs of the service including appropriate overhead and administration costs. Overhead and administration costs may need to be apportioned or allocated as described below.

It is necessary to decide the level at which costs will be collected. This can be done at block, estate, scheme or district level. Then there is a need to decide how to apportion costs to dwellings with units, bedrooms and bed spaces being common methods. There is sometimes an intermediate stage of apportionment, for example, using floor space to apportion costs between schemes.

### Administration

Administration fees can be based on actual costs or estimated costs. Actual costs can include the cost of the staff employed in administering service charges plus appropriate oncosts. This is the practice, for example, at Northampton Borough Council where I recently provided advice on service charges for leaseholders and tenants. Estimated administration costs are calculated as an on-cost on the cost of the direct service charges. For example, Oldham Borough Council, where I recently provided advice on service charges, decided to use a rate of 10% to recover overheads and administration. This is consistent with the advice of the rent officer who has also said that the use of 15% would be acceptable for housing associations.

### Staffing Costs

Service charges for staffing costs (including wardens, managers, caretakers and concierges) are usually calculated to include the full salary plus an on-cost less a proportion for general housing management. The costs of caretakers are often apportioned between estates and then between general management and service activities. In 1967 the London Rent Assessment Committee decided that an appropriate appropriation to service charges would be 15%.

The costs of national insurance, superannuation, life assurance and permanent health insurance can also be included in the calculation of the service charge. The cost of sick leave can be included in service charges up to a period of three months.

Certain expenses of staff (if reimbursed by the employer) can be included in the calculation of the service charge, including travel costs and council tax on staff accommodation. The costs of telephones, mobile telephones, broadband connections can also be included.

Warden costs can be pooled between schemes to protect tenants in smaller schemes from relatively high service charges as long as it can be demonstrated that all tenants receive the same standard of service regardless of which scheme they are in. However, it is not always possible to do this in the case of leaseholders because of the conditions that are usually found in the leases.

Caretakers' costs are typically apportioned between estates and then apportioned between services that are funded by rent and those that are funded by service charges. Examples of activities that are funded by rent include rent collection and accounting and routine repairs. Examples of activities that are funded by service charges include cleaning and gardening. Costs including the running costs of caretakers' vans can also be recovered through service charges including fuel, tax, insurance, maintenance and depreciation.

## Supporting People

A distinction must be made between staff who provide housing management services and those who provide housing support services. The former can be funded through service charges while the latter should be funded from Supporting People Grant. Supporting People Grant can fund other services including:

- An element of the cost of the warden / scheme manager
- Warden call system alarm costs
- Internal window cleaning to flats
- Cleaning of tenants' rooms

## Heating, Lighting and Energy

Where the landlord provides heating or hot water to individual dwellings this can be recovered through a service charge but such service charges are not eligible for housing benefit. Where the landlord pays the electricity or other utility bill for a building and then recharges the residents this is regarded as a private payment that is outside of the service charges system.

Service charges can be made for heating and lighting of communal areas including staircases, corridors and any communal rooms. This includes communal bathrooms, kitchens, laundries, areas for storing and recharging mobility scooters, guest rooms and the warden's office in a sheltered housing scheme. It also includes external lighting including car parks and street lights on private roads. Replacement of light bulbs and tubes can be included in service charges but not the repair of fittings. Such service charges are eligible for housing benefit.

One option for service charges for the heating and lighting of communal areas is to apportion the total electricity bill between flats and communal areas based on floorspace and to recover the communal element as a service charge.

## Cleaning

The cleaning of the outside of a property and the cleaning of common areas inside can be covered by service charges as long as the tenancy agreement or lease does not make it the responsibility of the resident. Where the local authority charges for refuse collection, the cost is recoverable through the service charge. Pest control can also be recovered through the service charge although where a particular resident is considered to be responsible for the infestation because of their lifestyle it is common to make a specific charge to that resident.

The cleaning of communal areas may be done by a caretaker, warden, cleaner or contractor. In calculating service charges there is a need to apportion the cleaners' wages between communal areas and other work and to add appropriate on-costs.

## Lifts, Furniture and Equipment

The cost of maintaining, insuring and depreciating lifts can be contentious. It is common for housing associations to include these costs in the service charge for all residents in a building, even those on the lower floors who may not make use of them. In 2002, the government issued guidance to local authorities to say that they should not charge tenants for lifts because the use of the lift is integral to the tenancy and should therefore be funded from the rents. The government also argued that it would be unfair for councils to charge service charges for lifts as this would make it more expensive to live in a high-rise flat than a street property. Consequently, most local authorities have avoided introducing service charges for lifts, although some have done so. Leaseholders are usually issued with service charges for lifts.

Maintaining, cleaning and renewing floor coverings in communal areas can be covered by a service charge. The correct treatment of floorings to corridors is less clear as the landlord has an obligation to provide safe access to all dwellings. A basic floor covering should therefore be funded from the rent while a better quality carpet could be funded from service charges.

If a landlord provides furniture within a dwelling the cost is usually recovered through the rent, but a service charge can be made for maintaining cookers, refrigerators or other 'white goods'. The cost of furniture in communal areas would be included in the service charge including the cost of providing and maintaining equipment in a communal laundry. Any income collected from use of the communal laundry would be deducted from the costs before calculating the service charge.

Where specialist equipment is installed in an individual dwelling – for example for disabled people – it would be usual to amend the tenancy agreement to make it explicit that the cost would be recovered through a service charge.

Other costs that can be met from service charges include electrical inspections, ventilation systems in common areas, emergency lighting in communal areas, fire fighting equipment, fire detection and smoke dispersal systems, fire risk assessments, sewage pumps, door entry telephones and CCTV.

### Grounds Maintenance

Costs of managing and maintaining open spaces can vary greatly and work can be carried out by contractors, staff or residents. Sometimes there is a need to include the maintenance and / or depreciation of plant. There can also be non-recurring costs such as tree surgery. There is often a lack of information on which to base the calculation of apportionments. One local authority recently resolved this question by dividing the borough into three zones and calculating a service charge for grounds maintenance in each zone per bed space. This is probably not an ideal approach and a more specific method would probably have been better if one could have been devised.

### Depreciation

Depreciation is commonly used in accounting and is a method of covering the costs of an asset by writing off its costs over its estimated life. Its potential use in calculating service charges was confirmed in the Regis property case (1958). Landlords are therefore able to collect depreciation as part of the service charge to recoup what they have already spent on a capital asset or to make provision for its replacement where the initial cost has been met by grant. In the latter case housing associations will often credit depreciation to a provision to which interest can also be added. This is distinct from establishing a sinking fund.

### Usage Charge

The 'usage charge' is commonly used in calculating service charges in sheltered schemes for smaller items of equipment that are provided to tenants. The principle is that the charge is based on 'fit for purpose' rather than a precise depreciation calculation. The landlord guarantees that the equipment will work at all times and will be replaced when required rather than in accordance with the estimated life used in calculating depreciation. The usage charge is based on depreciation but is also increased annually in line with inflation with the intention that it will generate sufficient resources to replace the equipment when required.

### What should not be included in Service Charges?

The former Institute of Rent Officers Educational Trust published a list of items of expenditure that should not be funded from service charges in 1994. This is still considered to be a definitive list and is as follows:

- Repair, maintenance and insurance of the dwelling structure, fixtures and fittings and of the installations within the dwelling as specified in section eleven of the Landlord and Tenant Act 1985.
- Provision, repair and maintenance of communal halls, stairways and passages.
- Provision of fixtures and fittings, including radiators, pipes etc. within the dwelling.
- Refrigerators, cookers and washing machines within the dwelling, if only provided by the landlord with no covenant to keep in repair or to maintain, would usually be treated as furniture. Cookers in communal facilities should be treated as a service.
- Voids.
- Decoration of common parts, other than communal rooms.
- Interior decoration of dwellings, including provision of decorating materials.
- Management costs for other than service items.
- Staff training levies.
- Deficits and surpluses arising from previous years' costs.

### Fixed and Variable Service Charges

A fixed service charge is where the landlord estimates the cost of providing services to a property at the beginning of each financial year. The tenant pays the service charge throughout the year and at no point will there be additional amounts to pay or refunds due back. This is the usual approach when making service charges to tenants.

Variable service charges occur where the landlord sets an estimated charge at the beginning of the financial year, and then produces a final account once the year is complete. The final account compares the actual costs in delivering services to a property against the estimate that was set, and may result in a credit back or an additional amount due from the resident. This is the usual approach when making service charges to leaseholders.

Section eighteen of the Landlord & Tenant Act 1985 defines a variable service charge as follows:

*“Service charge means an amount payable by a tenant of a dwelling as part of or in addition to the rent-*

- (a) Which is payable... for services, repairs, improvements, maintenance, insurance or the landlord's costs of management and*
- (b) The whole part of which varies or may vary according to the relevant costs.*

*“The relevant costs are the costs or estimated costs incurred or to be incurred by or on behalf of the landlord... in connection with matters for which the service charge is payable.*

*“For this purpose costs includes overheads and costs are relevant costs in relation to a service charge for which they are incurred, or to be incurred in the period for which the service charge is payable, or in an earlier or later period.”*

In defining best practice the English National Housing Federation states that:

*“The decision between a fixed and variable service charge regime is one for each housing association to make, and often will be finely balanced. A variable regime means much more stringent procedures but in exchange it guarantees that the landlord... can recover every penny spent on services. Generally, the larger the service charge in relation to the net rent, and the likelier it is to vary unpredictably from year to year, the stronger the case for a variable charge. However, in general needs housing, where service charges are relatively low and reasonably stable, a regime of fixed charges may well be adequate.”*

### **Service Charges that are Eligible for Housing Benefit**

Service Charges are eligible for housing benefit so long as they:

- Have to be paid as a condition of occupying the dwelling as a home; and
- Are not listed in the regulations as ineligible; and
- Are not excessive in relation to the service provided.

The Housing Benefit Regulations 2006 (as amended) set out the eligibility of service charges for housing benefit. The following services are usually eligible for housing benefit:

- Provision of a heating system
- Fuel for communal areas
- Furniture and household equipment
- Communal window cleaning
- Other exterior window cleaning that no-one in the household can do.
- Other interior window cleaning that no-one in the household can do
- Communal cleaning
- Other cleaning that no-one in the household can do.
- Emergency alarm systems in certain accommodation.
- General counselling and support that meets certain conditions
- Most communal services relating to the provision of adequate accommodation including children’s play areas, TV and radio relay and other services that are related to the provision of adequate accommodation. Such services include portering and refuse removal; lifts, communal telephones and entry phones; and communal laundry facilities.

Service charges for general counselling and support are eligible for housing benefit only if the following criteria are met:

- It is in supported accommodation
- The charges are for time spent on ‘general counselling’ or ‘other support services’
- The services are provided by the landlord personally or by a person on the landlord’s behalf.
- The services are general counselling and support that:
  - Assists the claimant with maintaining the dwelling’s security.
  - Assists the claimant with maintaining the dwelling’s safety (including arranging for checking the claimant’s own appliances if they could be a safety hazard.
  - Is directed at assisting the claimant with complying with the terms of his or her letting agreement relating to nuisance, rent liability, maintenance of the interior and / or the period of the letting – including in each case assisting the claimant with contacts with individuals or professional or other bodies with an interest in ensuring the claimant’s welfare.
  - Is for any other general counselling and support provided by a resident or on-call warden – but in this case only in accommodation that is one of a group of dwellings that the landlord lets as a matter of practice to people in need of general counselling and support.



Whether the landlord's normal overheads (such as maintenance, insurance and repairs) count as services or as part of the rent is an arguable point but in either case they are eligible for housing benefit.

The Welfare Reform Act of 2012 is leading to changes in how the welfare system works including how the housing costs of claimants are met. In particular the government is introducing the under-occupation penalty, benefits cap and unitary credit. The under-occupation penalty reduces housing benefit for tenants who are deemed to be under-occupying their homes but people of retirement age and people who live in exempt accommodation are exempt. The benefits cap does not apply to exempt accommodation and is set at £350 a week for single people and £500 for couples and families. It is anticipated that the government will produce clarification of the definition of exempt accommodation as part of the implementation of welfare reform. The universal credit will have a phased introduction but will not apply to tenants who are over working age or to those living in supported accommodation. Consequently, the welfare reforms are unlikely to have a significant impact on the arrangements for service charges and housing benefits in the accommodation that is currently under consideration.

### **Service Charges that are not eligible for Housing Benefit**

Schedule one of the 2006 Housing Benefit Regulations (as amended) lists ineligible service charges as follows:

- Most charges in respect of food.
- Laundry (other than the provision of premises or equipment to enable a person to do his or her own laundry).
- Leisure items such as either sports facilities (except a children's play area) or television rental and licence fees (unless it is the only practicable means of receiving the standard television channels).
- Cleaning of rooms and windows except cleaning of:
  - Communal areas
  - The exterior of any windows where neither the claimant nor any member of his or her household is able to clean them where payment is not made in respect of such cleaning by a local authority (including in relation to England, a County Council) or the National Assembly for Wales to the claimant or his or her partner or to another person on their behalf.
- Transport
- Charges in respect of furniture or household equipment and the use of such furniture or equipment where it will become the property of the claimant by virtue of an agreement with the landlord.
- Charges in respect of the provision of an emergency alarm system.
- Charges in respect of medical expenses (including the cost of counselling related to mental disorder, mental handicap, physical disablement or past or present alcohol or drug dependency).
- Charges in respect of the provision of nursing or personal care (including assistance at meal times or with personal appearance or hygiene).
- Charges in respect of general counselling or any other support services, whoever provides those services.
- Charges in respect of any services not specified above which are not connected with the provision of adequate accommodation.

The following services are usually ineligible for housing benefit in supported accommodation:

- Water charges
- Other fuel

- Meals
- Other window cleaning
- Other cleaning
- Emergency alarm systems outside certain accommodation
- General counselling and support that does not meet certain conditions
- Specific counselling and support
- Medical / Nursing / Personal care
- Other day to day living expenses including laundering, transport, sports facilities, TV and radio rental and licence and satellite service charges, any other leisure items or day to day living expenses or any other services that are not related to the provision of adequate accommodation.

### **Fair Access to Care**

Residents who are clients of social services will often pay Fair Access to Care charges. These charges are calculated with reference to what the client can afford (including rent, service charges and benefits) so increases in service charges can reduce Fair Access to Care income.

### **Examples of Approaches**

Denbighshire County Council has decided to introduce a variable charge policy for apportionment and recovery to all tenants who receive services. In year one individual rents will be reduced by the amount of chargeable services that tenants receive. £420,000 of service charges have been identified including £206,000 for grounds maintenance. Services that are considered suitable for service charges are:

- Grounds maintenance (Environmental and Play Areas)
- Cleaning (Buildings and Public Realm)
- Electricity and Gas (communal areas)
- Other: Repairs & Maintenance, Television aerials, Waste Disposal.
- Administration

Flintshire County Council has decided that:

- Service Charges will be phased in for existing tenants over three years from 2016 as follows:
  - 2016/17 – TV aerials, digital services & cleaning
  - 2017/18 – Laundry & janitor services
  - 2018/19 – Grounds maintenance & caretaking
  - Rents are not to be reduced
- Service Charges will be introduced for new tenants from 2015
- The total cost of each chargeable service will be shared equally between those who receive the service

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‘AWICS’ is available to provide practical advice and assistance in implementing service charges. For more information please contact Adrian Waite at [Adrian.waite@awics.co.uk](mailto:Adrian.waite@awics.co.uk) or 017683-52165.

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