



Rent reduction: service cost de-pooling

Concept note: June 2016

This note examines the potential effects of de-pooling service costs from the rent for social landlords in England, following the introduction of the Welfare Reform and Work Act 2016 and The Social Housing Rents (Exceptions and Miscellaneous Provisions) Regulations 2016.

We examine the pros and cons of service charge de-pooling for the landlord, and have included some worked examples. These show the effects of de-pooling service costs of £4 a week for an example tenant, who was paying a weekly rent of £100 before the start of rent reductions. Our illustrations assume that service costs increase in line with CPI inflation, once de-pooled, and that rents increase in line with CPI inflation after the rent reduction period.

Overview

The Social Housing Rents (Exceptions and Miscellaneous Provisions) Regulations 2016, made under the Welfare and Work Act 2016, require social landlords in England to implement 1% rent reductions for social and affordable rented units for four years commencing 1 April 2016. This requirement applies to social and affordable rented units provided by housing authorities and housing associations. The net result is a total cash reduction in the rent charged to those units of 3.94% over the four year period, which has a substantial adverse impact on the rent income generated. If inflation over the same four year period is positive, then this will lead to an even greater 'real terms' decrease in rental levels.

Some landlords do not make a separate charge for services, and treat the rent as inclusive. Others have de-pooled the cost of some or all services from the rent. Where this has happened, the landlord has established the cost of services, which are outside the core management and maintenance activities that are provided to all tenants and covered by the rent, and then recovers these costs as service charges from the tenants of the properties concerned.

Service charges tend to relate to additional activity that is specific to a block or estate, such as the maintenance of communal parts or grounds maintenance. They are governed by separate legislation to rents, and should be designed to recover the cost of the services concerned. Any changes in the cost of services should be taken into account when setting the service charge for the coming year.

While the regulations impact on rent levels, it is clear that service charges are not affected. This is a significant point and means that landlords do not have to reduce service charges by 1% a year in line with rents and can continue to recover the cost of services in full. Because it is in an organisation's interests to maximise its income, this strengthens the business case for landlords to de-pool service costs from the rent, if they are not currently achieving full recovery of those costs.

This briefing note has been prepared by Glenn Smith, associate director of financial consultancy, CIH consultancy



Potential benefits of service cost de-pooling

Transparency and accountability

By de-pooling service costs from the rent a landlord is able to account separately for services that are provided to all tenants, and those that are provided to specific properties. This makes the cost of services more transparent to both the tenant and the landlord. It also makes the landlord more accountable, as they need to be able to explain to the tenant the reasons for any increase or reduction in service charges.

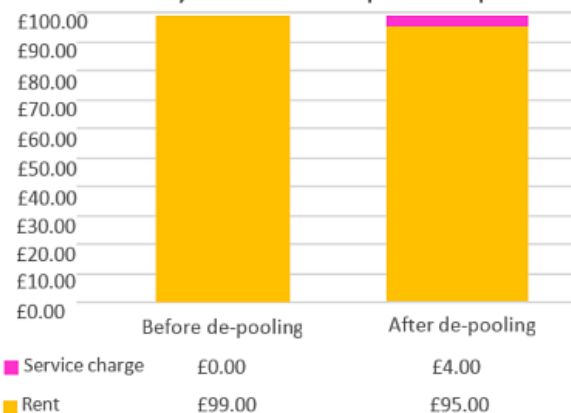
Removal of cross-subsidy

Recovering the costs from tenants through a separate service charge also removes a hidden subsidy, which all tenants would otherwise pay through the rent in respect of services that are received by a smaller number of tenants.

Impact on the tenant

When service costs are de-pooled into a separate service charge, the landlord has to reduce the rent by the same amount as the service charge that they introduce. This means that the tenant pays the same amount overall at the time that service costs are de-pooled – the amount that they save on the rent is paid in service charges. After de-pooling, increases or decreases in the rent will continue to be in line with the landlord's rent policy, as influenced by statute and government policy. Future service charges should increase or decrease in line with the costs of delivering the service, as influenced by discussions with the service users.

Paid by tenant – De-pool £4 pw

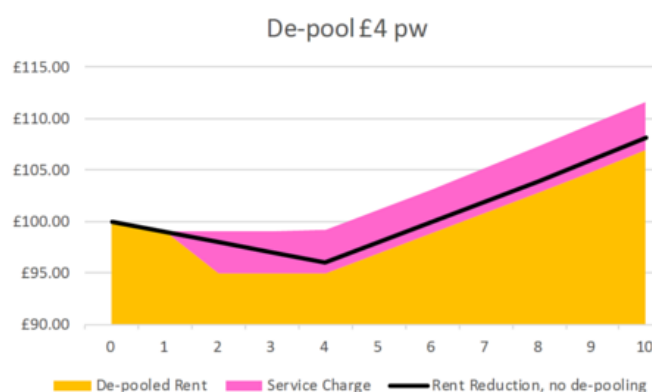


Service cost de-pooling has the same effect as rent reduction

When a landlord de-pools service costs it makes a permanent reduction in the rent, and this counts towards the requirement for rent reduction imposed by the regulations.

De-pooling 1% of the rent for a property at the start of year two would therefore mean that the requirement for reducing rents further in year three is already met.

A landlord that de-pools service costs equating to more than 1% of the rent would be able to adjust the level of rent reduction they need to make for that tenant in future years, and may avoid the requirement for further rent reduction. For example, a landlord that de-pooled service costs amounting to 3.94% of its rent for a property at the start of year one would have reduced rents by the full amount required by the regulations, and would not then need to make further reductions in rent for that property. The below illustration shows the effect of de-pooling service costs of £4 per week at the start of year two. In this case, overall income from the property is maintained, even though the rent has been reduced.



Further advice and support

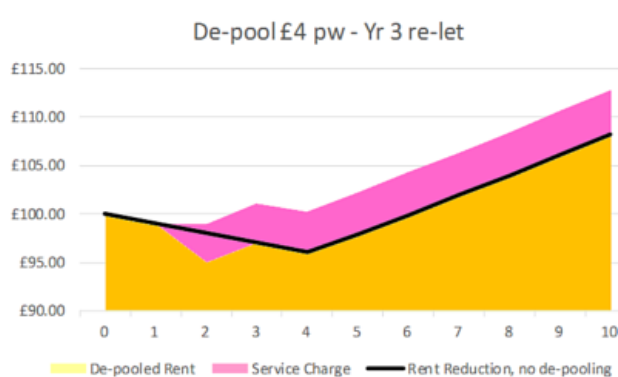
CIH consultancy is able to help landlords prepare or assess their business case for service cost de-pooling. For further information or to arrange an informal discussion about the process or your next steps please contact Glenn Smith, Associate director of financial consultancy on 07974 675731 or email glenn.smith@cih.org.



Increased income on re-let

Our modelling also shows that there are potential gains for the landlord if they re-let a property where service costs have been de-pooled during the rent reduction period. In this case we have assumed the same property in our previous example is re-let at the start of year three. Under these circumstances, the landlord would be able to re-let properties at the formula rent, which is normally higher than any de-pooled rent. At the same time the landlord continues to recover the same service charges from the new tenant.

As our diagram shows, the net effect for the landlord is an increase in overall income from the property, both during the rent reduction period and in subsequent years.



Other relevant factors

Complexity

Introducing a separate service charge makes the rent setting process more complex for the landlord, who would need to set up robust methods for accounting for the cost of services to each property and the income collected.

Consultation

Because it can be difficult to explain the changes being made, it will be necessary to consult fully with tenants about the landlord's plans.

Eligibility

It is possible that some de-pooled service charges are not considered to be eligible for housing benefit or universal credit. It is therefore important to ensure that eligibility is taken into account when de-pooling the cost of services.

Tenancy agreement

The landlord may need to update their existing tenancy agreement if it does not already make it clear that the tenant must pay any service charges that are due as a condition of occupying the dwelling.

Future costs to the tenant

While the tenant pays the same amount in the year that service costs are de-pooled, it is possible that the overall amount they would otherwise pay will be greater than they would pay under the requirement for rent reduction if the landlord does not de-pool service costs. Of course, it is also possible that service costs could reduce in future years as a result of improvements in efficiency or changes in service levels that the landlord agrees with tenants.

What actions should the landlord consider

The requirement for rent reduction strengthens the business case for de-pooling service costs from the rent for social landlords in England. Any landlord that hasn't fully de-pooled the cost of services from the rent should consider the prospective impact of doing so, while weighing up the potential advantages and disadvantages. The initial step would be to conduct a scoping exercise to establish:

- which properties receive services, along with the costs of providing those services
- current charges made for services
- how de-pooling service costs would affect the weekly rent
- any consequential changes required to the tenancy agreement
- eligibility of the de-pooled service costs for housing benefit or universal credit
- the impact of service charge de-pooling on the landlord's business plan projections

De-pooling service costs can be a complex exercise. Any landlord wishing to go through the process should consider establishing a dedicated resource to manage and implement the changes.