

CONCEPT NOTE:

RENT REDUCTION – SEPARATING SERVICE COSTS



SUMMARY

This concept note updates a previous paper, which examined 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.

Further work in this area has caused a re-think of a key interpretation that applies to the treatment of service costs under the requirement for rent reductions. This concept note applies that revised interpretation. In it, we look at the potential effects of identifying a separate service charge element either within an existing, combined rent or as a separate de-pooled charge.

KEY CONCLUSIONS

The requirement for rent reduction strengthens the business case for separating service costs from the rent for social landlords in England. Any landlord that hasn't separated 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 separating service costs would affect the weekly rent and the requirement for rent reduction
- Any consequential changes required to the tenancy agreement
- Eligibility of the de-pooled service costs for housing benefit or universal credit
- The impact of separating service costs from rent on the landlord's business plan projections

Separating service costs can be a complex exercise. A landlord wishing to do so should consider establishing a resource to manage and implement the changes, with access to appropriate advice and guidance.

FOR FURTHER INFORMATION PLEASE CONTACT

We can help landlords to prepare or assess their business case for separating service costs. Glenn Smith, our Associate Director for Housing Finance, is available if you would like an informal discussion about the process or your next steps.

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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 four years, which has a substantial adverse impact on rent income. Positive inflation over the same period makes the real terms reduction even greater.

An affordable rent is defined as including service charges. However, this is not the case for the formula or target rent that applies to other social rents, where charges for services are treated as additional to the rent.

Some landlords do not make a separate charge for services alongside their social rent, and treat the rent as a single combined charge. Others have de-pooled the cost of some or all services from the rent. Where this has happened, the landlord establishes 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 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. They are governed by separate legislation to rents, recovering the cost of the services concerned.

The regulations impact on rent levels for both affordable and other social housing, but not service charges. This 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. Separating service costs from the rent could enable a landlord to achieve or safeguard full recovery of those costs.

For social housing, other than affordable rented housing, the regulations appear to allow a landlord to take the cost of services into account when calculating the rent reduction. A landlord that separates service costs from the rent defines a service charge to recover those costs. The regulations suggest that this adjustment could be reflected in the rent that is used to calculate the rent reduction requirement, including the rent at 8 July 2015 (which is used to measure the cumulative rent reduction). This may mean that service costs identified within a social rent that combines rent and a services element (other than an affordable rent) could be excluded when calculating the rent reduction, or the rent reduction requirement.

BENEFITS OF SEPARATING SERVICE COSTS FROM RENT

By separating service costs from rent a landlord distinguishes services that it provides to all tenants from those that it provides 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.

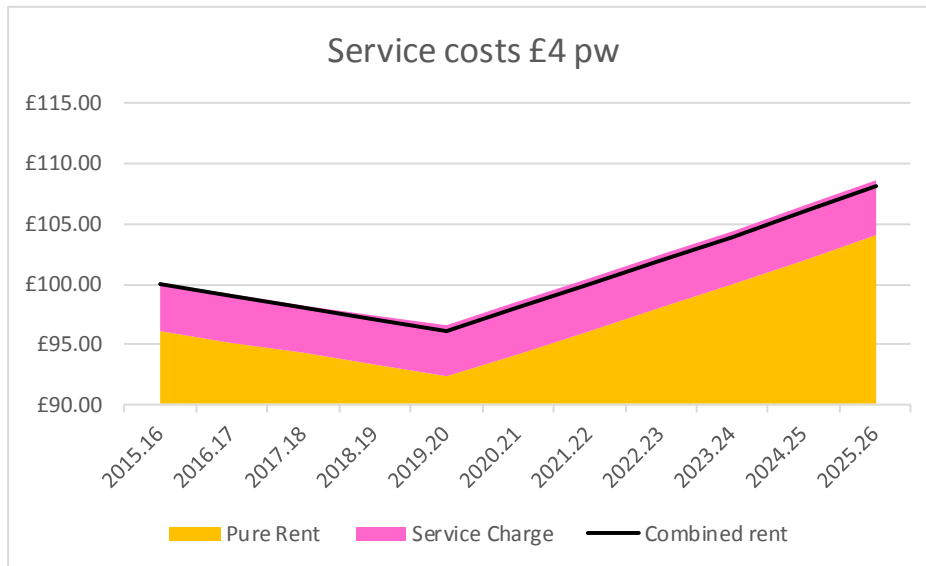
Recovering the costs from tenants through a separate service charge helps clarify hidden subsidy between tenants, and can help a landlord to implement fair charges that reflect the services received.

When service costs are separated from the rent, local authority landlords often reduce the rent by the same amount as the service charge that they introduce. This would mean that the tenant pays the same amount overall at the time that service costs are separated. Note, though, that practice can vary, with some landlords adding the separated charge to the existing rent.

After the charge has been separated, 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 reflect the costs of the service, as influenced by discussions with the service users.

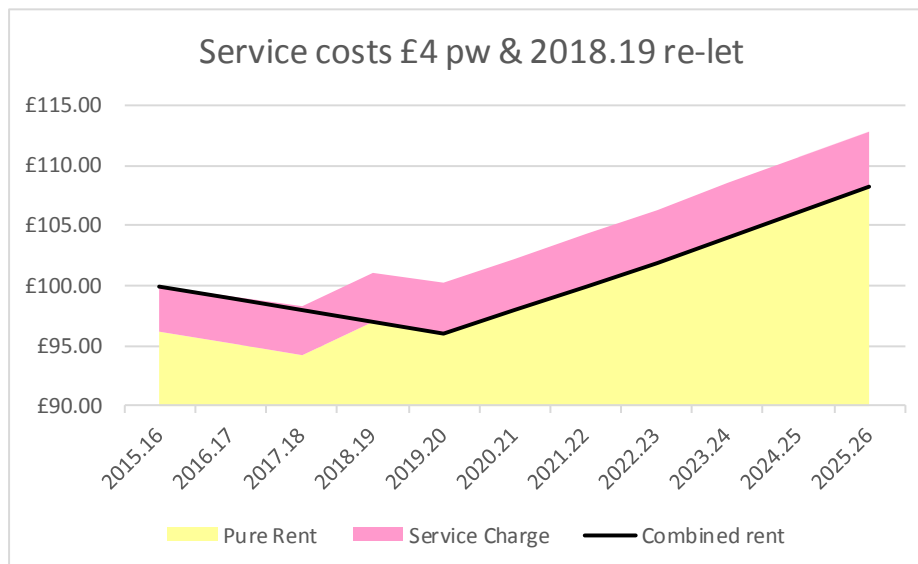
Concept note: Rent Reduction – Separating Service Costs

Our first example models the effects of separating service costs of £4 per week in 2017/18 from a dwelling with a combined rent of £100 before the start of rent reduction. It shows the total combined rent, the pure rent (after service costs have been identified), and the service charge. The combined rent and pure rent show 1% rent reductions from 2016/17 until 2019/20, then increases at CPI. The service charge increases at CPI throughout.



The example reveals some protection of income from services, though the financial effects are minor, with additional service charge income for the landlord of £0.35 pw in 2018/19 (£18.20pa). This rises to £0.53 pw (£27.56) by 2025/26.

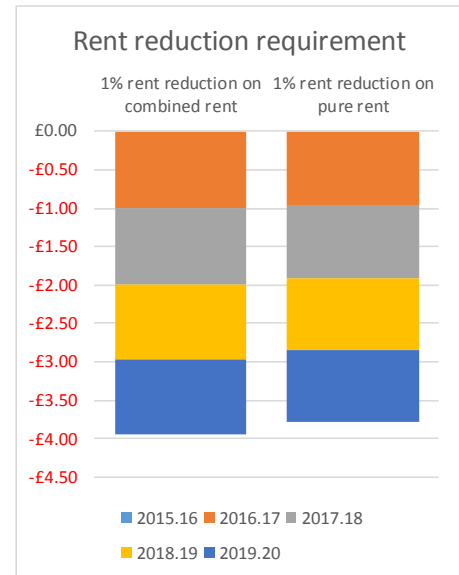
There are further potential gains for the landlord when they re-let a property where service costs have been separated during the rent reduction period. In this example, we assume the landlord re-lets the same property at formula rent at the start of 2018/19.



The formula rent would normally be higher than the pure rent, after identifying a separate service cost element. At the same time the landlord continues to recover the same service charges from the new tenant. The net effect is an increase in overall income from the property, both during the rent reduction period and in subsequent years. For this example, the total additional income is £4.08 pw (£212.16 pa), increasing to £4.69 pw (£243.88 pa) in 2025/26.

One effect of separating service costs is that it appears to alter the rent reduction requirement for a property. The regulations require a reduction in rent of 3.94% between April 2016 and March 2020.

For a combined rent of £100 pw, this means an overall reduction of £3.94 pw over that period. However, separating service costs of £4 a week in 2017/18 (and assuming CPI at 2%) suggests that the overall reduction for the lower, pure rent is £3.79 pw - a gain to the landlord of £0.15 pw per property, before allowing for the effects of re-lets.



DE-POOL OR CHARGE A COMBINED RENT?

Once a service cost element has been identified as part of the rent, a landlord has the option to either continue charging for services as part of a combined rent, or create a separate de-pooled service charge. Under both options the landlord needs to manage the service charge so that it reflects service costs and it is reasonable to expect that the charge to the tenant would remain the same under either alternative.

The following considerations may be relevant when choosing which approach to adopt:

- Both options need to be permitted by and compatible with the tenancy agreement
- It is arguable that a de-pooled service charge provides greater transparency
- Both options require discussion with tenants, but de-pooling a service charge for existing tenants requires more involved consultation

Choosing one approach may not necessarily exclude the other. For example, it may be possible for a landlord to charge a combined rent that contains a separate service charge element to existing tenants, and then convert to a fully de-pooled service charge when the property is re-let.

We recommend seeking advice on the alternatives before settling on an approach.

OTHER RELEVANT FACTORS

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

Because it can be difficult to explain the changes, it will be necessary to consult fully with tenants.

Some service charges may not be eligible for housing benefit or universal credit. It is therefore important to ensure that eligibility is considered when establishing the cost of services and any associated charges.

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.

The overall cost to the tenant may be greater than they would pay under the requirement for rent reduction if the landlord does not identify a separate service cost element. Of course, it is also possible that service costs could reduce in future years because of improvements in efficiency or changes in service levels that the landlord agrees with tenants.