

## Summary: Intervention & Options

Department /Agency:  
**Communities & Local  
Government**

Title:  
**Impact Assessment of Residential Leasehold Reform -  
Service charges to be held in designated account**

Stage: Final

Version: 4 (See Ev. Base)

Date: November 2007

**Related Publications:** Consultation paper - "A Consultation Paper on Regular Statements of Account and Designated Client Accounts" - July 2007

**Available to view or download at:**

<http://www.communities.gov.uk>

**Contact for enquiries:** Ian Fuell

**Telephone:** 0207 944 3463

**What is the problem under consideration? Why is government intervention necessary?**

Service charge payers can be asked to hand over large sums of money to their landlord or his agent (the payee) to pay for the upkeep of their property. Existing legislation provides some protection for this money (need to hold it in trust in two or more funds), but information received from stakeholders over a number of years has highlighted difficulties in establishing that service charges are being held correctly and about the ease at which abuses could take place, together with the lack of suitable rights of redress.

Regulatory intervention is required to address these deficiencies.

**What are the policy objectives and the intended effects?**

To provide service charge payers with improved transparency and safeguards in respect of the service charges that they pay by making amendments to section 42 of the Landlord and Tenant Act 1987 as amended by section 156 of the Commonhold and Leasehold Reform Act 2002 (the 2002 Act) - otherwise known as section 42A of the Landlord and Tenant Act 1987 (the 1987 Act) at the same time as other associated measures. This should ensure that any misapplication of the funds is easier to discover which in turn should help to reduce the risk of any fraud.

**What policy options have been considered? Please justify any preferred option.**

1. Do nothing
2. Amend section 42 of the 1987 Act, as amended by s.156 of the 2002 Act (with associated regulations). (preferred option). This option will provide increased transparency and protection in relation to service charge monies but payees will at the same time have a greater degree of flexibility in operating accounts which will help to minimise burdens and costs to service charge payers.

**When will the policy be reviewed to establish the actual costs and benefits and the achievement of the desired effects?** 10/2012

**Ministerial Sign-off** For final proposal/implementation stage Impact Assessments:

***I have read the Impact Assessment and I am satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impact of the leading options.***

Signed by the responsible Minister:

..... Date:

## Summary: Analysis & Evidence

Policy Option: 1

Description: Not implement and repeal section 156

<b>COSTS</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups' Landlords/ managers recovering variable service charges in the residential private sector would not need to do anything in addition to what is currently required. No extra costs would be incurred with this option for either landlords/managers or the tenants paying service charges .
	<b>One-off</b> (Transition)	<b>Yrs</b>	
	<b>£ None</b>		
	<b>Average Annual Cost</b> (excluding one-off)		
<b>£ Unchanged</b>		<b>Total Cost (PV)</b>	<b>£</b>
Other <b>key non-monetised costs</b> by 'main affected groups' Continued difficulties would be experienced by tenants in ensuring that their service charge money is being held and used for the correct purposes. Any existing tension between parties would continue.			

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups' Landlords/ managers recovering & holding variable service charges in the residential private sector and the tenants paying those charges will not incur any additional costs.
	<b>One-off</b>	<b>Yrs</b>	
	<b>£ None</b>		
	<b>Average Annual Benefit</b> (excluding one-off)		
<b>£ unchanged</b>		<b>Total Benefit (PV)</b>	<b>£</b>
Other <b>key non-monetised benefits</b> by 'main affected groups' None identified.			

**Key Assumptions/Sensitivities/Risks** The current provisions do not ensure that there is transparency about the service charge monies held on behalf of tenants which means that it can be difficult to discover any misappropriation of funds.

Price Base Year	Time Period Years	<b>Net Benefit Range (NPV)</b> £	<b>NET BENEFIT (NPV Best estimate)</b> £
--------------------	----------------------	-------------------------------------	---

What is the geographic coverage of the policy/option?		England/Wales	
On what date will the policy be implemented?		N/A	
Which organisation(s) will enforce the policy?		Courts	
What is the total annual cost of enforcement for these organisations?		£ See Ev base	
Does enforcement comply with Hampton principles?		Yes	
Will implementation go beyond minimum EU requirements?		No	
What is the value of the proposed offsetting measure per year?		£ N/A	
What is the value of changes in greenhouse gas emissions?		£ No change	
Will the proposal have a significant impact on competition?		No	
Annual cost (£-£) per organisation (excluding one-off)	Micro None	Small None	Medium None
Are any of these organisations exempt?	No	No	N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)		(Increase - Decrease)
Increase of £	Decrease of £	<b>Net Impact</b> £

Key:	Annual costs and benefits: Constant Prices	(Net) Present Value
------	--	---------------------

## Summary: Analysis & Evidence

Policy Option: 2

Description: Amend and implement section 42A as set out in s.156 of the 2002 Act (with associated regulations).

<b>COSTS</b>	<b>ANNUAL COSTS</b>		Description and scale of <b>key monetised costs</b> by 'main affected groups' The amended proposals should substantially reduce the costs which the consultation paper in 2004 highlighted as arising for landlords/managers recovering variable service charges in the residential private sector from previous proposals, costs that would have been passed onto tenants.
	<b>One-off</b> (Transition)	<b>Yrs</b>	
	£ See Ev. Base		
	<b>Average Annual Cost</b> (excluding one-off)		
	£ See Ev Base		<b>Total Cost (PV)</b> £
Other <b>key non-monetised costs</b> by 'main affected groups' Where additional admin burdens (and costs) are incurred by landlords/managers and are passed onto tenants, this could create initial tension between the parties, though any such tension should reduce once the benefits become apparent, and is not expected to be as significant when compared to option 1 (do nothing).			

<b>BENEFITS</b>	<b>ANNUAL BENEFITS</b>		Description and scale of <b>key monetised benefits</b> by 'main affected groups' None identified.
	<b>One-off</b>	<b>Yrs</b>	
	£ N/A	0	
	<b>Average Annual Benefit</b> (excluding one-off)		
	£ N/A		<b>Total Benefit (PV)</b> £
Other <b>key non-monetised benefits</b> by 'main affected groups' The greater transparency that will be provided to service charge payers in relation to how their service charge monies are held, the ability to use more effective sanctions for non-compliance, and the potential for easier detection of fraud if it occurs will provide reassurance, and should lead to fewer disputes.			

**Key Assumptions/Sensitivities/Risks** Assumption that vast majority of landlords/managers will comply creating increased protection & transparency for tenants. Risks - misuse of tenants' right to withhold service charges until compliance, although this right is considered an effective and reasonable means of ensuring compliance.

Price Base Year 2007	Time Period Years	<b>Net Benefit Range (NPV)</b> £	<b>NET BENEFIT (NPV Best estimate)</b> £
-------------------------	----------------------	-------------------------------------	---

What is the geographic coverage of the policy/option?		England and Wales	
On what date will the policy be implemented?		Expected April 2009	
Which organisation(s) will enforce the policy?		Tenants (using rights)	
What is the total annual cost of enforcement for these organisations?		£ 0 (see Ev. Base)	
Does enforcement comply with Hampton principles?		Yes	
Will implementation go beyond minimum EU requirements?		N/A	
What is the value of the proposed offsetting measure per year?		£ N/A	
What is the value of changes in greenhouse gas emissions?		£ None anticipated	
Will the proposal have a significant impact on competition?		No	
Annual cost (£-£) per organisation (excluding one-off)	Micro Unknown	Small Unknown	Medium unknown
Are any of these organisations exempt?	No	No	N/A

<b>Impact on Admin Burdens Baseline</b> (2005 Prices)		(Increase - Decrease)	
Increase of £	Decrease of £	<b>Net Impact</b>	£

Key: Annual costs and benefits: Constant Prices (Net) Present Value

## Evidence Base (for summary sheets)

[Use this space (with a recommended maximum of 30 pages) to set out the evidence, analysis and detailed narrative from which you have generated your policy options or proposal. Ensure that the information is organised in such a way as to explain clearly the summary information on the preceding pages of this form.]

### **Background to the RIA**

The Commonhold and Leasehold Reform Act 2002 (section 156) contains provisions that set out to address the deficiencies highlighted by stakeholders where accounting for service charges are concerned. However, these have not yet been implemented.

Information arising from the previous consultation paper - "Accounting for Leaseholders Monies & summaries of tenants rights and obligations" carried out in June 2004 on these issues has been updated as a result of the latest consultation paper – "A Consultation Paper on Regular Statements of Account and Designated Client Accounts, published in July 2007, where possible. Monetary information has been given where possible, taking account of information obtained from the consultation exercises and from continuing dialogue with stakeholders, though it should be noted that it has been difficult to establish actual costs with any certainty, in particular any additional costs that may be incurred. This is partly due to the nature of the measure and that any additional costs will only become clear on the implementation of the detailed requirements to be specified in regulation (and which formed part of the 2007 consultation), and the extent to which these differ from the current practices of all affected landlords/managers (the payees).

### **The problem and reason for government intervention**

Tenants can be asked to hand over large sums of money (service charges) to payees for works and services. Whilst existing legislation already requires this money to be held by the payee in trust as a single, or two or more funds, it does not guarantee that service charge payers can easily establish whether that money is being held properly and is being used for the purposes for which it was collected. Tenants raised concerns about the possible fraudulent use of the money which would not be easy to detect under the existing requirements, and they felt that any measures needed to be backed by appropriate sanctions in the event of non-compliance by payees. The majority of respondents to previous consultation exercises also agreed that improvements are needed to the existing level of protection available and to the level of transparency, and the government agrees.

### **The objective**

We wish to provide increased transparency in relation to service charges monies in order to make it easier for tenants to discover fraudulent activity, and introduce appropriate sanctions where a payee fails to comply with the law. This is part of a package of measures is aimed at improving transparency for tenants in relation to their service charge monies.

### **Extent of Consultation**

Public consultation took place on this provision in November 1998 and again in August 2000 as part of the Draft Bill and Consultation Paper. An informal discussion paper was then sent to key stakeholders for comment in November 2002 after the Commonhold and Leasehold Reform Act 2002 (the 2002 Act) received Royal Assent in May 2002) and a public consultation exercise took place in June 2004 on the detail of what should be contained in regulations. A further consultation exercise took place in July 2007 following the redevelopment of the original proposals. Included as part of these consultations were:

#### Within Government

The Small Business Service

Local Government Association

London Councils

CLG

#### Public consultation

Public consultation has taken place on each occasion with over 600 stakeholder organisations and individuals. These include:

Association of Residential Managing Agents  
Federation of Private Residents Association  
The Leasehold Advisory Service  
Association of Retirement Housing Managers  
Council of Mortgage Lenders  
Housing Corporation  
Housing Ombudsman  
Institute of Chartered Accountants in England and Wales  
Association of Chartered Certified Accountants  
The Law Society  
Royal Institution of Chartered Surveyors  
British Property Federation  
Financial Services Authority  
Chartered Institute of Public Finance and Accountancy  
Campaign for the Abolition of Residential Leasehold  
National Housing Federation

Various financial institutions were also consulted, together with other leaseholder representative groups, and tenants associations, and individuals who had responded to previous consultation exercises on similar issues. A number of face to face meetings and discussions have also been held, as well as several visits to stakeholders.

Prior to, during and subsequent to the consultation exercises communication and dialogue has taken place with stakeholders and others affected, including landlords, tenants and managing agents etc. As a result of the extensive stakeholder engagement that has taken place and the comments received, section 156 of the 2002 Act has been redeveloped.

## **Policy Options**

### **Option 1**

#### **Do nothing (repeal section 156 of the 2002 Act and not implement amendments to the 1987 Act)**

##### *Economic costs and benefits*

Landlords/Managers (payees) - With no additional requirements being placed upon them their position will remain the same and they will be able to continue with their current regime.

Tenants - Their position would remain the same. They would not have to pay any additional costs, but would not benefit from the additional transparency, protection and sanctions afforded by option 2 below. It would remain difficult for them to establish that their service charges are being held securely and being used correctly.

##### *Enforcement*

The only existing way for a tenant to take formal action against a payee that is failing to hold service charges correctly (where evidence of this is available) would be to instigate court action. Evidence is unavailable as to how many actions have been taken, but it is understood to be very few based on the present legislation.

##### *Exempt organisations*

The existing requirement to hold service charges in trust does not apply to tenants of the following: local authorities, registered social landlords, the housing corporation, fully mutual housing associations, the Broads or a National Park Authority, the commission for New Towns or a Development corporation, a housing trust which is a charity.

##### *Other Impacts*

See annex for further details.

## Option 2.

**Amend section 42 of the 1987 Act, as amended by s.156 of the 2002 Act (s.42A of the 1987 Act) - with associated regulations. Preferred option.**

### Economic costs and benefits

Landlords/Managers (payees) – Whilst some payees may be required to open up more accounts to fully comply with this option, removing the requirement that no other funds are held in the account, which this redeveloped option does, allows payees greater flexibility with the separation of service charge funds into separate designated accounts. This means that a number of service charge funds can be held in one account, even if they are unrelated to each other. There will be other safeguards if payees opt to manage the service charges under their control in this way, to ensure that the required level of transparency is provided.

There may of course be some costs incurred for compliance with the new requirements (letters to financial institutions confirming account names and details etc. where not already done), where payees do not already comply. However, we understand from stakeholders that a significant number will already be complying (in the main) with the proposed new requirements as a result of the need to comply with Codes of Management Practice approved by the Secretary of State. Where additional costs are incurred however, these costs are believed to be outweighed by the overall benefits to service charge payers with the greater transparency that should result from this, and the additional rights to take action for non-compliance. Costs should also be kept to a minimum because of the greater flexibility being provided by the redeveloped proposals, in the number of accounts that need to be operated.

Establishing reliable costs have been difficult to come by or quantify in any detail, but information available to us indicates that implementing section 156 of the 2002 Act without the additional amendments to the 1987 Act that have since been identified, would mean that a significant number of accounts would need to be opened (perhaps in excess of 100,000), and that the costs for the work involved to ensure compliance, e.g. identifying the accounts needed, dealing with money laundering issues, setting up the accounts, through to running and reconciling them could cost up to £40m. The information provided is assumed to relate to about 750,000 service charge payers that may be affected. If the assumption is made that there are 1.5m that may be affected, costs for compliance could then amount to £80m.

By further amending the 1987 Act as it will be amended by the 2002 Act (s.156) should therefore bring about the benefits intended by the legislation, but because of the greater flexibility that it provides this should be achievable at more reasonable cost, particularly since it would appear that many payees are already complying to a greater or lesser degree with this option.

Tenants - They will benefit from the greater degree of protection and transparency being provided for their service charge monies together with sanctions available for non-compliance. Whilst they will be asked to contribute towards any additional compliance costs incurred by the payee, these should be considerably reduced from those that may otherwise be necessary if section 42 of the 1987 Act is amended by s.156 of the 2002 Act but without the additional amendments to the 1987 Act that have since been identified.

### Enforcement

There are 2 types of enforcement/sanctions that could apply if a payee fails without reasonable excuse to comply with the measures being introduced. The most powerful of these is believed to be the service charge payer's ability to withhold payment of a service charge where the payee fails to hold service charges in the manner designated. This sanction costs nothing to enforce, and is designed to avoid the need for court action where possible. Withholding service charges could in the longer term affect the maintainance of the building, although the charges become payable once the payee complies. The payee will in any case be under a duty to maintain the property under the terms of relevant leases and so should be encouraged more readily to comply with the legislation. Action could otherwise be taken for a summary offence which would be subject to a fine not exceeding level 4 on the standard scale (£2,500). In this case the local housing authority has the power to bring proceedings, or proceedings can be brought by an individual.

### Exempt organisations

The existing requirement to hold service charges in trust does not apply to tenants of: local authorities, registered social landlords, the Housing Corporation, fully mutual housing associations,

the Broads or a National Park Authority, the commission for New Towns or a Development corporation, a housing trust which is a charity.

Other Impacts

See Annex for further information.

Summary: Analysis & Evidence (Annual cost (£-£) per organisation) - explanation

Whilst payees (landlords or their agents) will incur the costs in the first instance, these will most likely be passed on to service charge payers through their service charges. Establishing a cost per ‘organisation’ in this instance would prove difficult since this would require additional information about the number of payees (including Resident Management Companies) and the number of flats they manage affected by the proposal etc. The likely costs would also vary widely in each case. Therefore, because costs will in the main fall to the service charge payer, a better indication may be to extrapolate the possible annual costs on a per flat basis. Consultation on previous proposals indicated that set up costs could be £10 per flat and ongoing costs anything between £5 and £50 per flat.

**2007 Consultation exercise (amended proposals) – Support and cost information**

The amended proposals received a large amount of general support from respondents compared to the original proposals which was either unqualified or accompanied by comments or suggestions about their practical application, as follows:

	Overall support (unqualified & qualified)	No overall support/No Comment	Not supported	Total responses
Individual Leaseholders	9	8	1	18
Property Management Companies	5	1	3	9
Residents’ Management Companies	0	4	0	4
Surveyors	1	1	1	3
Accountants	2	1	0	3
Local Authorities & ALMOS (exempt from provision)	0	19	1	20
Registered Social Landlords (exempt from provision) *	4	11	1	16
Representative/trade /other organisations	7	13	1	21
Others	4	1	0	5
<b>Totals</b>	32	59	8	99

\* Some responses were from ‘Groups’ that comprise or represent more than one housing association and therefore a large number of units (E.g. AnchorTrust – 24,000 sheltered housing units; Whitefriars Housing Group – 17,000 tenancies; Affinity Sutton Group – 50,000 homes; Orbit Group – 27,000 homes).

However little information was provided about any additional costs that could result which may indicate that for many of those respondents any such costs were not considered to be significant. While some costs were provided by a few respondents (3) to this did not elicit any further information that could reasonably be applied on a more general basis to allow us to narrow the costs down further

than above, either at organisation or individual level, particularly about any possible additional costs bearing in mind that those payees and tenants affected by this measure will already be incurring some costs as a result of the existing requirements.

For example, one bank is assumed to charge £1k for operating separate accounts for each property managed and each transaction. However, the proposals will allow the funds of more than one property to be held in one account. One managing agent anticipates £50k software costs if virtual accounts are not allowed, yet the provisions will not prevent their use of virtual accounts. One registered social landlord anticipates costs of £2.5k per year, yet these landlords are exempt by legislation from having to comply with this provision.

As mentioned previously, it is believed that this redeveloped proposal should substantially reduce the costs compared with the original 2002 Act proposal, and should not add significantly to the costs already being incurred.



## Specific Impact Tests: Checklist

Use the table below to demonstrate how broadly you have considered the potential impacts of your policy options.

**Ensure that the results of any tests that impact on the cost-benefit analysis are contained within the main evidence base; other results may be annexed.**

Type of testing undertaken	<i>Results in Evidence Base?</i>	<i>Results annexed?</i>
Competition Assessment	No	Yes
Small Firms Impact Test	No	Yes
Legal Aid	No	Yes
Sustainable Development	No	Yes
Carbon Assessment	No	Yes
Other Environment	No	Yes
Health Impact Assessment	No	Yes
Race Equality	No	Yes
Disability Equality	No	Yes
Gender Equality	No	Yes
Human Rights	No	Yes
Rural Proofing	No	Yes

## **Specific Impact Tests**

### **Competition Assessment**

We have assessed the impact of the policy options against the Office of Fair Trading checklist criteria and believe that there is unlikely to be a negative competition impact as a result. The provisions will apply to all landlords/managers (payees) that are responsible for collecting variable service charges in respect of private sector residential properties.

### **Small Firms Impact Test**

The majority of landlords and managers of leasehold properties would be considered small businesses, although there are a few landlords with larger portfolios of leasehold property.

As a result of extensive consultation that has previously taken place with stakeholders in the sector affected, including individual leaseholders and landlords, as well as bodies such as Association of Residential Managing Agents, Association of Retirement Housing Managers, Royal Institution of Chartered Surveyors, Institute of Chartered Accountants in England and Wales, Association of Chartered Certified Accountants, Federation of Private Residents Associations, Campaign for the Abolition of Residential Leasehold, Leasehold Advisory Service, London Councils, Local Government Association, British Property Federation and others, together with ongoing stakeholder engagement, we propose to adapt the measures originally set out in the Commonhold and Leasehold Reform Act 2002. These reflect the concerns raised by stakeholders in respect of the additional costs and burdens that are believed would ensue from the original provisions. This will achieve the overall objectives of improved transparency and safeguards where service charges are concerned.

We have discussed these issues with the Small Business Service who are content with our approach.

### **Legal Aid**

There are no anticipated legal aid impacts.

### **Sustainable Development**

The preferred option, which recognises the need for improving tenants' rights, will not have any discernable effect on sustainable development issues.

### **Carbon Assessment**

The preferred option will not have any discernable impact on the sectors or key sources of greenhouse gas emissions. Namely energy, industrial processes, solvents and other product use, agriculture, land-use change and forestry and waste. We do not therefore believe there is a need to undertake a full carbon impact assessment.

### **Other Environment**

The preferred option will not have a serious impact on other environmental issues identified in the environmental impact guidance published by DEFRA. Namely the predicted effects of climate change; a change in the financial costs or the environmental and health impacts of waste management; air quality; the appearance of the landscape or townscape; the degree of water pollution; levels of abstraction of water; exposure to flood risk; disturb or enhance habitat or wildlife; or affect the number of people exposed to noise or the levels to which they are exposed.

### **Health Impact Assessment**

Whilst the preferred option appears to have no direct impact on the health of those it is designed to benefit (service charge payers), the additional transparency and protection provided

should help mitigate any worry or concern that may currently exist by providing an additional level of comfort and clarity in the way service charges are held. It will also allow a clear course of action to be taken where non-compliance or fraud is detected, at no cost to the tenant. Those required to comply with the measure (payees) who may have to carry out some extra work to do so because they may not already comply, may initially adopt a negative approach to it. However, the longer term effects should benefit all those affected, particularly the tenants, by creating greater certainty and a better level of transparency, leading to greater cohesion and understanding.

### **Race Equality**

Where racial groups are affected by the preferred option they will be affected equally. There is no evidence to indicate that any particular racial group will be affected differently from any other, that it will affect relations between racial groups, or that any one racial group will be unlawfully discriminated against either directly or indirectly. All those affected will also have the same expectations.

### **Disability Equality**

The preferred option will not have any specific impact in relation to disability equality.

### **Gender Equality**

The preferred option will apply to and affect those women and men that it applies to equally, and will not affect either gender differently or disproportionately.

### **Human Rights**

The preferred option will not engage or affect anyone's Convention rights.

### **Rural Proofing**

The preferred option will not have a different or disadvantageous impact on anyone in rural areas that will be affected by it. It will apply to everyone in exactly the same way, including those in urban areas.