LRX/9/2006

LANDS TRIBUNAL ACT 1949

LANDLORD AND TENANT – Service Charge – whether contribution to a reserve fund justified in respect of certain potential future items of expenditure.

IN THE MATTER OF AN APPEAL FROM A DECISION OF THE LEASEHOLD VALUATION TRIBUNAL FOR THE MIDLAND RENT ASSESSMENT PANEL

BETWEEN **F C H HOUSING AND CARE** **Appellant**

and

MR I BURNS AND MR G MOLLOY **Respondents**

Re: Gospel Lane,
Acocks Green,
Birmingham B27 7AZ

Before: His Honour Judge Huskinson

Case decided upon written representations (by agreement between the parties and pursuant to a direction from the President)

DECISION

Introduction

1. The Appellant appeals to the Lands Tribunal, with permission, from the decision of the Leasehold Valuation Tribunal for the Midland Rent Assessment Panel ("LVT") dated 1 August 2005 whereby the LVT ruled, inter alia, that the Appellant was not entitled to recover certain items more particularly described below from the Respondents for the service charge years 2004-2005 and 2005-2006.

2. The Appellant is the freehold or long leasehold owner (it matters not which) of a block in which are situated four flats. The Respondents each, separately, hold one such flat from the Appellant on a long lease at a low rent, in each case the lease being a shared ownership lease. As regards Mr Burns his share in the flat is 50 per cent, but I am unaware regarding the position concerning Mr Molloy.

3. The matter was referred to the LVT by the present Respondents under section 27A of the Landlord and Tenant Act 1985 for a determination regarding their liability to pay service charges for the above mentioned years. The various matters disputed before the LVT are summarised in paragraph 12 of the LVT's decision in the following terms:

> "(a) the percentage proportion of the total service charges for the Development payable by the Tenant;
>
> (b) whether the service charge provisions in the Lease permit the Landlord to recover items as contributions to a future repairs fund;
>
> (c) if the answer to 9(b) above is 'Yes', whether the Landlord's failure to seek to recover such items in the annual service charges from the commencement of the Lease (1995) to 2004-2005 (inclusive) amounts to an estoppel (a waiver of the Landlord's right to include such items for 2005-2006);
>
> (d) if the answer to 9(c) above is 'No', whether certain specified items in the Landlord's 'contribution to future repair fund' are reasonable;
>
> (e) whether the inclusion of 'New Insurance Charge – £13.81' (in addition to 'New Service Charge – £32.40') in the Landlord's notice of a change of the new total rent from 1 April 2005 is double-counting to the effect Mr Burns is being asked to pay twice for insurance; and
>
> (f) whether the service charge provisions in the Lease permit the Landlord to recover an audit fee and a management fee."

4. The LVT summarised its decision in paragraph 27 in the following terms:

> "(a) the proportion of the total service charges for the Development payable by the Tenant is 25%;

(b) the service charge provisions in the Lease permit the Landlord to recover items as contributions to a future repairs fund;

(c) the Landlord's failure to seek to recover such items as contributions to a future repairs fund in the annual service charges from the commencement of the Lease (1995) to 2004-2005 (inclusive) does not amount to an estoppel (a waiver of the Landlord's right to include such items for 2005-2006);

(d) items 5 and 8 in the table in para 17 above are reasonable in the Landlord's 'contribution to future repair fund' – items 1, 2, 3. 4, 6, 7 are not reasonable;

(e) the Landlord undertakes to investigate whether the Landlord has overcharged and/or double counted for the insurance premiums and to repay any such excess; and

(f) the service charge provisions in the Lease do not permit the Landlord to recover an audit fee or a management fee."

5. The only points challenged by the Appellant before the Tribunal are the LVT's findings under paragraph 27(d) and (f). In summary the Appellant argues:

(1) items 1, 2, 3, 4, 6 and 7 as shown in the table in paragraph 19 of the decision are reasonable sums which can properly be included in the service charge as payments into a reserve fund; and

(2) the service charge provisions allow the Appellant to include an item which is described as "management fee" in the service charge. The Appellant has made clear it no longer seeks to challenge the exclusion of the audit fee.

6. By agreement between the parties and pursuant to the direction of the President this came to me for decision upon written representations. The Appellant's representations are contained within its statement of case dated 14 February 2006 and its letter of 30 June 2006 as well as its grounds of appeal. Mr Burns submitted a reply under cover of his letter of 27 February 2006 and has made further observations in certain further correspondence all of which I have taken into account. As regards Mr Molloy he was one of the applicants before the LVT and was notified by the LVT of its decision of 1 August 2005 and also of the LVT's decision to grant permission to appeal to the Lands Tribunal. It subsequently emerged that Mr Molloy had not been served with the appropriate papers regarding the appeal before the Lands Tribunal. This has been rectified and Mr Molloy has notified the Tribunal by a letter dated 25 May 2007 that he is content to rely on the submissions of Mr Burns.

Facts

7. Mr Burns holds his flat under a lease dated 30 June 1995 which was originally granted between Friendship Housing as lessor and MM Krynicki as lessee, the flat then being known as Plot 68 on the first floor of the relevant building. I have not seen Mr Molloy's lease but the LVT proceeded on the basis that the terms of the relevant lease were to be found in Mr Burns' lease and that there were no particular terms, different from these in Mr Molloy's lease. I proceed on the same basis.

8. The lease includes the following provisions:

(1) The expression "SERVICE COST" is defined as follows:

"The net cost of complying with the landlord's obligations (whether imposed by this lease or by law), including the reserve provided by Clause 6 (H)

[the costs is the cost after crediting contributions from any other sources – for example, payments by tenants for breach of their repairing covenants, insurance proceeds, and bank interest]".

(2) The "SERVICE CHARGE" is defined as 25% of the SERVICE COST.

(3) Clause 5(A)(b) comprises a covenant on the part of the Tenant to pay:

"(b) the SERVICE CHARGE (calculated as in clause 6(H)), paying

* On the starting date, for each remaining day of that calendar month, 1/365th of the estimated SERVICE CHARGE for that ACCOUNTING YEAR
* And then, in advance on the first day of each following month, 1/12th of the estimated SERVICE CHARGE for the current ACCOUNTING YEAR (adjusted by bringing forward any balance in the tenant's favour from the previous year)
* And each year, on receipt of the SERVICE CHARGE NOTICE (required by clause 6(H), any balance shown due."

(4) Clause 6 contains various covenants on the part of the landlord including a covenant to keep the building (other than the flat) in such repair as is reasonable having regard to the class and age of the building and also an obligation to manage the estate, maintaining the facilities to a reasonable standard and employing people or firms at its discretion. There are also included certain other covenants including a covenant to insure and also in clause 6(H) a covenant in the following terms:

"H (1) Arrange for a professionally qualified surveyor to estimate the SERVICE COST and SERVICE CHARGE for the next ACCOUNTING YEAR including in those figures (to reduce undue fluctuation in the SERVICE CHARGE) a reserve towards expenses not incurred every year.

(2) NOTIFY the tenant of the estimates before the ACCOUNTING YEAR begins

(3) NOTIFY the tenant, as soon as practicable after the end of each ACCOUNTING YEAR and supplying copies of the accounts, of the difference between the estimated and actual SERVICE COST (in each case apart from any reserve not spent during that year) and of the corresponding difference between the estimated and actual SERVICE CHARGE."

9. I have not seen any demands for service charge payments or for estimated service charge payments for the relevant years, nor have I seen any document purporting to be an estimate from "a professionally qualified surveyor" as contemplated by Clause 6(H)(1). Also there is no reference to any expert evidence (either in oral or written form) being before the LVT from any such surveyor.

10. The Appellant sought to include within the service charge for 2005-2006 a yearly contribution in respect of each flat in the building towards the expected eventual replacement cost of various items listed as No.1 to 8 in the table in paragraph 19 of the LVT's decision. The LVT's decision regarding this claimed contribution to a reserve fund can be summarised as follows:

(1) The LVT recognised there was provision in the lease entitling the Appellant to recover items by way of contribution towards a reserve fund, see paragraphs 15, 16 and 27(b).

(2) The LVT decided on the evidence before it and from its inspection of the premises that as regards items Nos.5 and 8 in the table there was a certainty of an identifiable want of repair within an ascertainable time and that the amounts in the table were reasonable and could therefore be included within the service charge.

(3) As regards the other items the LVT stated as follows in paragraph 21:

> "We find, from what we saw at our inspection that, apart from exterior decoration and oil staining to the tarmac, there is no evidence of disrepair to suggest an anticipation of wants of repair in the reasonably foreseeable future; to the effect that it cannot be said that there is an identifiable prospect of want of repair, ascertainable in time, and any anticipatory of a want of repair is so uncertain as to make the contributions sought by the Landlord as unreasonable."

Relevant statutory provisions

11. The Landlord and Tenant Act 1985 as amended defines the expression "service charge" in section 18(1) and recognises that the whole or the part of the service charge may vary according to "the relevant costs". Section 18(2) provides that relevant costs are the costs or estimated costs incurred or to be incurred by or on behalf of the landlord (or a superior landlord) in connection with matters for which the service charge is payable. It is further provided that costs are relevant costs in relation to a service charge:

> "... whether they are incurred, or to be incurred, in the period for which the service charge is payable or in an earlier or later period."

Section 19 lays down a limit to the extent that relevant costs can be taken into account in determining the amount of a service charge for a period. So far as concerns costs which have not yet been incurred subsection (2) provides:

"(2) Where a service charge is payable before the relevant costs are incurred, no greater amount than is reasonable is so payable, and after the relevant costs have been incurred any necessary adjustment shall be made ...."

Appellant's arguments

12. The Appellant contends that it is its policy and duty to collect money from leaseholders in a way that reduces the fluctuations in service charges from year to year and that it seeks to do this by establishing a future repairs fund for the benefit of leaseholders. The Appellant points out that LVT's ruling in paragraph 27(b) of the decision accepts this point, but the Appellant argues that the LVT then in effect contradicts itself in paragraph 27(d) by excluding most of the items which the Appellant sought to include within the reserve fund. The Appellant points out that the money is not the Appellant's and is held in a designated deposit account for the tenants and that the terms of the lease make clear that there should be a reserve fund towards expenses not incurred every year. The Appellant contends that it is seeking to do no more than what is contemplated by the lease. As regards the disallowance by the LVT of the management fee the Appellant argues that what it calls management charges for its internal purposes fall within the definition of service costs within the lease. The Appellant argues the LVT was wrong in concluding that the service charge provision in the lease do not permit the Appellant to recover a management fee.

Respondents (Mr Burns') arguments

13. The principal points advance by Mr Burns in his written submissions can be summarised as follows:

(1) Mr Burns says he understood when he purchased his share of his flat that there would not be additional costs beyond the rent.

(2) He argues that he should not be responsible to contribute towards future costs which may be very remote and which may occur after Mr Burns feels he will either be deceased or relocated.

(3) Mr Burns objects to building up a sinking fund to benefit, perhaps, a complete stranger in the future.

(4) Mr Burns objects to paying the full 25% of the service cost because he is only a 50% share owner of one of the four flats.

(5) Mr Burns makes criticisms of the manner in which the building and the communal areas have been dealt with by the Appellant and makes suggestions regarding how any additional money could be better spent by the Appellant.

(6) Mr Burns asks the Lands Tribunal uphold the decision of the LVT for the reasons it gave.

Conclusion

14. Mr Burns may feel upset at being asked to contribute towards these disputed sums through the service charge. However the answer must turn upon the terms of the lease and the state of the evidence. The lease makes clear provision for payment of a service charge in addition to the rent and this remains so irrespective of any misunderstanding Mr Burns may have had when he purchased his lease. Also his point that he should contribute less than 25% was raised before the LVT and decided against him (see paragraph 14) and there is no appeal by Mr Burns against that finding.

15. The Appellant is clearly entitled in principle (and subject to the matters recorded in the next paragraph) to include within the service cost a reserve towards expenses not incurred every year. The Appellant is entitled to do this in order to reduce undue fluctuation in the service charge. There is express provision to this effect in the lease and the LVT recognised this.

16. However such a sum (ie by way of a contribution to a reserve towards future expenditure) can only be included if both the provisions of the lease are satisfied and the provisions of section 19 of the Landlord and Tenant Act 1985 are satisfied:

(1) As regards the provisions of the lease it is necessary that the Appellant arranges for a professionally qualified surveyor to estimate the service cost and the service charge for the next accounting year including in those figures (to reduce undue fluctuation in the service charge) a reserve towards expenses not incurred every year.

(2) As regards section 19 of the Act, a cost can be a "relevant cost" for the purpose of the service provisions in the Act even though the cost has not yet been incurred and is to be incurred in a later period. Thus a cost in the nature of the costs in dispute in this case can in principle be included in a service charge for the year 2005/6 even though the costs are to be incurred in a later period. However where (as here) the service charge is payable before these relevant costs are incurred, no greater amount than is reasonable is payable. In other words the amount that can be included in the service charge for 2005/2006 in respect of this contribution to a reserve towards future expenses must be a reasonable amount.

17. Accordingly if the disputed items of cost in respect of payments into a reserve fund were properly to be included in the Respondents' service charge for 2005/2006 it was necessary for the Appellant to be able to satisfy the LVT of the following two points:

(1) that a professionally qualified surveyor had addressed his/her mind to the question of the reserve fund and had included in the estimated service cost an amount as a reserve towards expenses not incurred every year, such a figure not being an arbitrary one but being a figure which the surveyor considered appropriate "to reduce undue fluctuation in the service charge"; and

(2) that the sum so included in the service charge as a contribution towards this reserve was of no greater amount that was reasonable.

18. There is no evidence before me to indicate that the requirement in paragraph 17(1) above was satisfied. The LVT makes no reference to the existence of any estimate from a professionally qualified surveyor as contemplated in Clause 6(H)(1). However the LVT did not decide the point against the Appellant on the basis of the lack of any such estimate as required by the lease.

19. The LVT has not disregarded the provision regarding a reserve fund and has not disallowed the items referred to in paragraph 27(d) on the basis that the Appellant is not entitled to provide for a reserve fund. Instead the LVT has properly considered the question of whether the sums sought to be included within the service charge by way of contributions towards future costs of the various items are reasonable sums. The LVT has concluded that two of the items are reasonable but the others are unreasonable for the reasons which the LVT gives in paragraph 21.

20. I can see no error of law or fact in the LVT's conclusion in paragraph 21. The LVT found upon the evidence it had and upon its inspection of the premises that the need for repairs was not to be anticipated on these items in the reasonably foreseeable future. The LVT found (as it was entitled to do) there was not an identifiable prospect of want of repair at any ascertainable point in time regarding the disallowed items and it found that any anticipation of a want of repair is so uncertain "as to make the contributions sought by the Landlord unreasonable".

21. The Appellant does not suggest that the LVT failed to take into consideration any expert evidence from any surveyor which weighed in support of the Appellant's contention. The lack of any such expert evidence from a professionally qualified surveyor in support of the Appellant's case, being evidence justifying in a reasoned manner the reasonableness of the inclusion of the various disputed items, confirms me in my conclusion that the LVT was entitled to reach the decision it did for the reasons it gave.

22. The LVT's decision against allowing the inclusion in the service charge of a contribution in respect items 1, 2, 3, 4, 6 and 7 and my dismissal of the Appellant's appeal against this finding is a finding in respect of the service charge year 2005-2006. For future years it would be open to the Appellant again to seek the inclusion in the service cost and the service charge of certain items as contributions towards a reserve towards future expenses and it would open to the Appellant to seek to persuade the LVT that, on the evidence then available, such a contribution was properly included having regard to the requirements of the lease and the requirements of any other relevant statutory provisions including in particular the Landlord and Tenant Act 1985 section 19. The present decision is therefore not to the effect that such contributions can never be included within the service cost and service charge. It is however a conclusion, in agreement with the LVT, that on the evidence available to the LVT these items were not properly included in the service charge year 2005-2006.

23. I now turn to the claim to include an item in respect of what is described as "management fee" in the service cost and service charge. The amount in question for the year 2005-2006 for Mr Burns was £49.27 management fee. The LVT did not make any adverse findings to the effect that the costs which relate to the management fee were unreasonably incurred or that the services (in respect of which the management fee is charged) were not of a reasonable standard. Instead the LVT found that the management fee was not recoverable because of the absence in the lease of any clear and plain wording permitting the inclusion of such a charge.

24. With respect to the LVT I disagree with its conclusion on this point. The definition of service cost is set out above and is the net cost of complying with the Appellant's obligations under the lease. As I understand it the management fee which the Appellant has sought to include in the 2005/6 service charge year is a sum of money which represents the costs to the Appellant of performing its obligations under Clause 6. The Appellant's submission of 30 June 2006 refers to costs such as surveyor reports, arranging insurance cover and the day to day maintenance of the rent accounts. I conclude that such items are capable of forming part of the service costs and are therefore recoverable as part of the service charge. I can see potential argument in future years (none has been raised in respect of the present year) in respect of the quantification of these amounts. If the Appellant reasonably obtains a surveyors' report and the fee is itself reasonable, then there should be no difficulty regarding such a cost. But insofar as the Appellant seeks to claim some proportion of the wages of permanent members of its staff as representing the time spent on this particular building there may be room for argument as to how appropriate it is to include any such costs. However for the year 2005/2006 I disagree with the only reason given by the LVT for disallowing these costs and, there being no dispute raised regarding quantum, I find that the sum of £49.29 is properly included within the service charge for each of the Respondents.

25. No party made any application to the Lands Tribunal for any order for costs and I make none.

26. In the result I allow the Appellant's appeal to the extent that the figure of £49.27 management fee is properly included within the service charges payable, separately, by each of the Respondents. Save as aforesaid I dismiss the Appellant's appeal.

Dated 3 July 2007

His Honour Judge Huskinson