



**FIRST - TIER TRIBUNAL
PROPERTY CHAMBER
(RESIDENTIAL PROPERTY)**

Case Reference : **CHI/43UF/LSC/2019/0051**

Property : **Flat 3, The Lodge, Wray Mill Park
Batts Hill, Reigate, RH2 0LJ**

Applicant : **Mr & Mrs Horlock**

Representative : **In person**

Respondent : **Wray Mill Park Management
Company Limited**

Representative : **Amanda Gourlay (counsel
Instructed by
Charles Russell Speechlys)**

Type of Application : **s.27A'85Act**

Tribunal Members : **Judge D Dovar
Mr K Ridgeway MRICS**

**Date and venue of
Hearing** : **19th November 2019, Crawley**

Date of Decision : **13th December 2019**

DECISION

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1. This an application for the determination of the payability of various service charges for the years ending 2016 to 2019.

Inspection and property

2. At the inspection the Tribunal were accompanied by the Applicants, Mr and Mrs Horlock along with Amanda Gorlay, Counsel, representing the Respondents.
3. The Property is situated in a development consisting of three blocks of flats, The Lodge, Mill Wray House and The Pavilion and surrounding grounds. The Lodge is three storeys with a brick facade, a pitch tile roof, containing five flats. Mill Wray House is four storeys with a brick facade, a pitch tile roof, containing twenty seven flats. The Pavilion is two storeys with a with a painted rendered facade, a pitch tile roof, containing six flats. In addition it is the only block to have six garages.
4. External decoration was generally in good order. The uPVC guttering for the Lodge attached to timber bargeboards and soffits which were in need of cleaning and painting.
5. The surrounding grounds were landscaped and well maintained. There was also adequate parking for all the flats. Additionally, the new lighting, referred to below, was shown to the Tribunal.

Issues

6. The application covers four issues, some of which overlap, a significant point being the treatment of the reserve fund by the Respondent. The issues are:

- a. The charges for communal electricity in the year end 2017;
- b. The cost of communal street lighting in the year end 2017 and 2019;
- c. Contributions to the reserve fund for the years 2016, 2017 and 2018; and
- d. Accountancy fees of £1,000 for the years ending 2016 and 2017.

Sinking and Reserve Funds

7. The parties have made various references to the reserve fund and the sinking fund and attempted to give them distinct and precise definitions. The Tribunal does not consider that these are precise terms of art, but rather, as the RICS Service Charge Residential Management Code (3rd Ed) ('the Code') comments in its glossary, the *'terms have become interchangeable over recent years. This Code uses the term reserve fund.'*
8. Under paragraph 7.5 of the Code, which is headed Reserve funds [sinking funds], it says

'The lease often provides for the landlord to make provision for future expenditure by way of a 'reserve fund', or 'sinking fund'. You should have regard to the specific provisions within the lease that may, for example, provide for a general reserve fund(s) for the replacement of specific components or equipment.'

The intention of a reserve fund is to spread the costs of ‘use and occupation’ as evenly as possible throughout the life of the lease to prevent penalising leaseholders who happen to be in occupation at a particular moment when major expenditure occurs. Reserve funds can benefit both the landlord and leaseholder alike by ensuring monies are available when required for major works, cyclical works or replacing expensive plant

...

The usual method of working out how much money is to go into the fund each year, assuming the lease/tenancy agreement does not make any other provision, is to take the expected cost of future works, including an allowance for VAT and fees, and divide it by the number of years which may be expected to pass before it is incurred.”

9. The Tribunal agrees that ultimately, it is the construction of lease terms, rather than the label attached to a fund, which is determinative of what sum can be demanded in advance, held and then defrayed as a service charge for non-annually recurring items of major works.
10. Finally, paragraph 7.16 the Code comments on reserve funds in the context of surpluses and deficits in service charge collection at the end of the financial year and states that leases typically provided for surpluses to either be:

‘credited towards the following years’ service charge budget

Credited to the reserve fund; or

Refunded to the leaseholders by their due proportion ...

[however]

Unless the lease states otherwise, you should not use any reserve fund as a float for the credit of surpluses and the debit of any deficits.'

Lease terms

11. With those considerations in mind, it is useful to set out the relevant provisions of the lease.
12. The Applicants' lease is dated 8th July 1991 and provides as follows (with reference to the Company being a reference to the Respondent):
 - a. It is for a term of 99 years from 29th September 1989;
 - b. By clause 2 (24), the tenant covenanted with the landlord

'(a) To pay and contribute to the Company a proportion of the total service charge incurred by the Company in complying with its covenants and obligations in this lease ... such proportion to be calculated according to the nature of each item of expenditure divided by the number of flats benefiting or entitled to benefit therefrom.

(b) To pay to the Company on the 25th day of March and the 29th day of September in every year in advance without deduction ... such sum or sums as the company shall from time to time determine (hereinafter called "the

*estimated sum”) on account of the Lessee’s liability for the half year following under sub-clause (a) hereof in respect of such part of the costs charges and expenses of the Company The Company in every year shall serve upon the Lessee a notice in writing duly certified by the Company of the actual amount of the Lessee’s aforesaid liability for the previous year up to the 25th day of March in each year and the Lessee shall forthwith pay to or be entitled to receive from the Company the balance (if any) by which such amount falls short of or exceeds the estimated sum already paid by the Lessee **PROVIDED ALWAYS that any amount repayable to the Lessee under this sub-clause may at the option of the Company be applied in or towards payment of the estimated sum due from the Lessee for future periods.***

(emphasis added)

- c. By clause 4 (3) the Company covenanted to maintain and keep in good and substantial repair various parts of the estate and by clause 4 (5) to redecorate various parts of the interior and exterior at least once every five years;
- d. In addition by clause 4 (10) the Company covenanted to

‘At its discretion open a sinking fund out of the service charge towards the future cost of replacing major items

of equipment or repairs or redecoration such sinking fund if opened to belong to the Lessees contributing thereto and be deposited in a separate bank account in the name of the Company.'

Operation of the service charge mechanism by the Respondent

13. The Respondent renders on account demands every six months in accordance with the dates provided for in the lease.
14. Those demands include a 'Service Charge' demand which is calculated by reference to a budget for the anticipated expenditure in the forthcoming year. The budget divides expenditure into three columns, one for each residential block. The Horlocks then pay 1/5th of the total expenditure allocated to the Lodge (as there are five residential units in their block). That is the figure that appears on their demand. This is the clause 2(24)(b) sum.
15. Most of the demands also include a 'Reserve Contribution' demand which varies from year to year (the Horlocks' apportionment being £750 for the years ending 2016-17, nothing for the year ending 2018, and £250 for the year ending 2019). This sum is claimed under clause 4 (10).
16. The clause 4 (10) sum is determined without reference to any particular item of expenditure. The budgets for the years ending 2015 to 2017 all include the Reserve Contribution, but no detail is given as to how that has been calculated. From 2018, there is no mention of a reserve on the budget. The minutes of the Respondent company meeting on 27th

February 2018, show that whilst reserves were raised, a ‘reasonable’ sum was suggested of £250 per property without reference to any specific item of expenditure.

17. This is also the inference from the witness statement of Mr Cobb, of Heritage Management Limited, the Respondent’s managing agents, who states that

‘... if the sum of £11,519 currently held in the sinking fund is utilised to make payment towards the costs of the works referred to above, this will result in the sinking fund having a zero balance. As such, it may be necessary for the Respondent to increase the reserve fund contributions in due course to seek to ensure that a reasonable balancing sum is accumulated in the sinking fund’.

18. Further, it was part of the Applicants’ case that specific items needed to be identified before a sum could be levied under clause 4(10) and the Respondent did not suggest that this was their practice. Indeed, as set out below, the communal outdoor lighting appears to have been conceived, funded and executed all within one service charge year and the cost of the proposed works to the Lodge have not been the specific subject of any reserve fund demand.

19. After the end of each financial year, accounts are drawn up. Any surplus is transferred to the reserve fund. Any deficit is made good by the reserve fund (as occurred in the years ending 2015 and 2016).

Excessive Reserve Fund Demands (years ending 2016-18)

20. In their application the Applicants put the question in clear terms
- ‘Does the charge towards the reserves comply with the lease and is it reasonable, when the reserve balance is increasing year on year and there is no identified reason for the increase.’*
21. There was no Reserve Contribution demand for the year end 2018. Therefore the challenge is to the charges for 2016 and 2017, both being in the sum of £650.
22. The Applicants considered that in order to establish a sinking fund, the specific purpose of the sums collected must be identified. It was not enough to consider that it would be a good idea to have some money set aside generally for large non-annually recurring items of expenditure. Indeed, Mr Horlock recalled that when he was on the board of the Respondent company there was a spreadsheet setting out the contributions per item, per year; in line with the extract from the Code above. As considered above, that does not appear to be the current practice.
23. Clause 4 (10) expressly refers to the categories for which the sinking fund can be set up for. The Tribunal agrees with the Applicants’ construction of the lease to the extent that it is not sufficient to simply consider what a reasonable amount would be to put into reserves. A greater level of detail should be provided as to the items, the costs and the period of time within which to build up sufficient reserves to defray a particular cost. The purpose of clause 4 (10) is along the lines suggested by the Code,

being to smooth out payment of major works over the years. The Respondent has not taken sufficient steps to achieve this.

24. In light of that, the Tribunal determines that none of the demands for the Reserve Contribution for the years ending 2016 and 2017 are payable by the Applicants. No other years where a charge had been levied were challenged.
25. The Respondent stated that they intended to utilise the money in the reserve fund to contribute towards the costs of redecoration of the Lodge. There was a significant shortfall, in that the reserves stood at around £11,000, whilst the cost of the works was anticipated to be around £50,000. The unfortunate irony is that had the Respondent planned further in advance for these works, they would have been entitled to have established a reserve fund to cover these identified costs and avoided the need to raise significant sums in one service charge year.
26. The Applicants contested the requirement of the costs for the intended works to the Lodge as they were improvements and therefore not recoverable as a service charge. Given the Tribunal's conclusion on the accumulation of funds to the reserve account, this question does not fall to be answered. However, it does appear that even if the proposed works had an element of improvement, that would probably still fall within the repairing and redecorating obligations in the lease.

Communal electricity

27. The Applicants challenged the sum of £2,060 charged for communal electricity for the year end 2017. This figure appears in the service charge accounts for the year end March 2017 as having been actually incurred in respect of Electricity for the Lodge. The Respondent agreed that that was incorrect in that it included £982.87, being the cost of electricity for the communal swimming pool and therefore should have been shared amongst all 38 residential units on the entire estate, rather than just being divided amongst the 5 within the Lodge.
28. Given that that sum was agreed, the Respondent contended that the matter was outside of the Tribunal's jurisdiction; s.27A of the Landlord and Tenant Act 1985, from which the Tribunal draws its jurisdiction is only engaged when there is a dispute.
29. Further, it was also pointed out by the Respondent that no demand for this sum has ever been made. For the year in question an on-account demand was in part based on an estimated electricity cost of £1,184.21 for the communal parts of the Lodge. The service charge accounts for that year show a total surplus of income over expenditure of £2,594. The entire surplus was then transferred to the reserve fund. Had the correct electricity charge been included, it would have increased that surplus by £982.87.
30. The Respondent has said it will adjust the accounts and move the additional surplus into reserves for the Lodge, relying on the proviso to clause 2 (24)(b) and clause 4 (10). It will also recharge that sum across

the entire estate so that the Applicants will pay 1/38 of the cost, rather than 1/5.

31. The intention to transfer to the reserves is problematic. For the reasons set out above, clause 4 (10) is not applicable to this surplus. Clause 2 (24)(b) is therefore the only means by which a surplus arising from this overcharge could be retained, rather than credited to the Applicants.
32. Clause 2 (24)(b) permits any surplus to be held in order to defray future costs under the proviso to that clause. The precise extent of the proviso is not entirely clear. As the Tribunal understood the Applicants' case it was that it was only permissible in relation to the following years expenditure and certainly not to cover the type of expenditure set out in clause 4 (10), which set out its own regime for a sinking fund for non-annually recurring items, such as a new roof.
33. The Tribunal agrees with this view. In light of the fact that Clause 4 (10) is not engaged, to hold onto this surplus, the Respondent must identify the 'estimated sum' that is to arise that it will be held in respect of. In that respect it is a reference to the next years on account demands. Given that one years accounts are produced at a similar time to the following years budget (and indeed usually form the starting point of a budget), the Respondent will be in a position to know how much will be payable on account and if there is a surplus from the previous year, that can be held in satisfaction of the new demand.

34. Given that the sum in question arose in the year end 2017 and there was a surplus for the following two years, it is difficult to see how that sum could be held to pay any deficit for those years, when there was none.
35. However, having arrived at that conclusion, it is now apparent that this is a matter that the Tribunal does not have any jurisdiction over given that it does not relate to any sum demanded or payable.

New External Common Parts Lighting

36. The following is common ground between the parties. In September 2016, the Respondent decided to replace the exterior communal lighting. The cost was £12,324 which was taken from the service charge reserves.
37. It then had second thoughts about taking the money from the service charge reserves. It decided to raise funds from its members through its memorandum of association and then pay those sums into the service charge account to replenish the reserves. The leaseholders, all being members of the Respondent company, received a 'Service Charge Demand' in respect of which the 'Charging Sector' was described as 'Memorandum & Articles of Association'. The Applicants' demand, dated 30th May 2017 was for £324,32; their 1/38th contribution to the total cost.
38. The process from deciding to have new lighting to ordering, paying and installing it, all happened in a short space of time, within one service charge year, such that there was no provision in any budget for this cost nor any reference to it in the year end accounts as an item of

expenditure. The figure of £12,324 does appear in the year end March 2017 service charge accounts under 'Other Debtors'. This reflects the fact that the Respondent became a debtor to the service charge account when it wrongly paid the cost of lighting from the reserve fund and therefore owes the fund that sum.

39. The March 2018 accounts show that 'Other Debtors' had reduced to £648. This represented the fact that all bar two leaseholders (including the Applicants) had paid the company charge, so that the Respondent had paid those sums into the service charge account in part satisfaction of its debt to the reserve fund.
40. The Applicants did not like the new lighting and did not consider that it was necessary. They did not pay the 30th May 2017 demand and deducted £324.32 from the service charge demand dated 7th March 2017; although the latter demand did not include the cost of the lighting. As a result, the Respondent considers that they are in arrears of service charge in the sum of £324.32 and subsequently they threatened, but did not follow up, legal action.
41. The Respondent contended that again the Tribunal had no jurisdiction as this was a matter of member contribution to the Respondent company and therefore not a service charge issue under s.27A of the Landlord and Tenant Act 1985. A situation that arose in *Morshead Mansions Ltd v Di Marco* [2008] EWCA Civ 1371 and in which the Court of Appeal confirmed that if a landlord company could demand sums from its members through its articles of association to pay for works to the estate,

they were not service charges for the purposes of s.18 of the Landlord and Tenant Act 1985, with the additional result that this Tribunal has no jurisdiction over their payability.

42. The Tribunal agrees that it has no jurisdiction over the sums raised through the articles of association. Further, by reason of the fact that no demand has been made for this item, it does not fall for determination whether any such demand is either within the terms of the lease or is reasonable.

Accountancy fees

43. The Applicants contended that for the two years that unqualified accountants had been engaged, the costs were not recoverable as the lease, in conjunction with the RICS Service Charge Code and the ICEAW Tech 03/11 release, did not permit unqualified accountants to produce service charge accounts when the lease was silent as to any qualification.
44. In any event, they took issue with the quality of the service provided as mistakes were made in their preparation of the accounts; such as an error in the reserve figures and the electricity usage mentioned above.
45. The Respondent contended that the cost was recoverable under the terms of the lease and that the other provisions relied on by the Applicants did not provide the gloss they were said to. Whilst there were some errors, they were corrected and the overall sum claimed was modest.

46. Having considered the materials relied on by the Applicants, they do not require the accountant to have the qualifications contended for. Further, whilst there may have been some errors, these were picked up (in part by the Applicants) and remedied and were not sufficiently egregious to warrant a reduction of what was a modest fee for accountancy services.
47. The Tribunal determines that these sums are payable in full.

Conclusion

48. The reserve contributions for the years ending 2016 and 2017 are not payable as they have not been demanded in accordance with the lease. The Tribunal does not have jurisdiction to deal with the issues over the communal electricity charges or the communal lighting costs. The sum claimed in respect of accountancy fees for the years ending 2016-17 are payable in full.

Section 20C

49. The Applicants have made an application under s.20C of the Landlord and Tenant Act 1985 to restrict the ability of the Respondent to recover the costs of these proceedings from them by way of service charge. The Respondent resisted this application and confirmed that it intended to recover its costs through the service charge provisions of the lease. It relied on the fact that even if successful, the sums would still need to be collected for the works intended for the Lodge.
50. The Tribunal makes an order in the terms sought and the costs of these proceedings shall not be recoverable by the Respondent from the

Applicants by way of service charges. Firstly, the Applicants have achieved some success in terms of the reduction of the reserve charges. Secondly, although the Tribunal did not have jurisdiction to deal with two of the issues raised, the underlying concern of the Applicants with the operation of the reserve fund highlighted problems with the manner in which it was being operated. The Respondent has mixed funds from surplus as well as those raised from its clause 4(10) demands. By its very nature, any surplus could not fall within a reserve fund set up under clause 4 (10). A surplus is not calculated and demanded in advance, but is only identifiable after the service charge accounts have been prepared. Thirdly, whilst the Respondent is right in that it is likely that the Applicants will still have to contribute sums to the intended works, this would not have occurred had the reserve fund been operated in accordance with clause 4 (10).

51. Finally, the Respondent had refused mediation due to the costs of the same compared to the low value of this claim. This is not a valid reason for refusal. It is more than possible that these matters could have been resolved without a hearing.

JUDGE D DOVAR

Appeals

A person wishing to appeal this decision to the Upper Tribunal (Lands Chamber) must seek permission to do so by making written application to the First-tier Tribunal at the Regional office which has been dealing with the case.

The application must arrive at the Tribunal within 28 days after the Tribunal sends to the person making the application written reasons for the decision.

If the person wishing to appeal does not comply with the 28-day time limit, the person shall include with the application for permission to appeal a request for an extension of time and the reason for not complying with the 28-day time limit; the Tribunal will then decide whether to extend time or not to allow the application for permission to appeal to proceed.

The application for permission to appeal must identify the decision of the Tribunal to which it relates, state the grounds of appeal, and state the result the party making the application is seeking.