CHI/29UM/LSC/2009/0041

THE RESIDENTIAL PROPERTY TRIBUNAL SERVICE

DECISION OF THE SOUTHERN LEASEHOLD VALUATION TRIBUNAL

27 DELAMARK ROAD, SHEERNESS, KENT ME12 1RB

Applicant: Nicholas Potter (First Floor Flat A)

Represented by: In person

Respondent: Southern Land Securities Ltd (Landlord)

Represented by: Barry Taylor of Hamilton King Management Ltd

Date of Hearing: 23 July 2009

Date of application: 9 March 2009

Members of the Leasehold Valuation Tribunal:

Mr M Loveday BA(Hons) MCIArb
Mr R Athow FRICS MIRPM
Ms L Farrier

INTRODUCTION

1. This is an application for a determination of liability to pay service charges under s.27A of the Landlord and Tenant Act 1985 ("LTA 1985") and administration charges under paragraph 5 of Schedule 11 to the Commonhold and Leasehold Reform Act 2002. The application relates to 27 Delamark Road, Sheerness, Kent ME12 1RB.

2. By an application dated 9 March 2009, the Applicant, who is the tenant of the First Floor Flat A, sought a determination in respect of relevant costs, ground rent and an administration charge. A pre-trial review was held on 15 April 2009. Both parties prepared statements of case and submitted documentary evidence in accordance with the directions given at the pre-trial review.

3. A hearing took place on 23 July 2009. The Applicant appeared in person. Mr Barry Taylor of Hamilton King Management Ltd (managing agents for the property) appeared on behalf of the respondent landlord. The parties identified the following issues:
   (a) The extent to which the relevant costs of insurance premiums are recoverable under the terms of the lease.
   (b) Whether the insurance costs set out in the statements of service charges dated 31 December 2006, 31 December 2007 and 31 December 2008 were reasonably incurred and/or reasonable under section 19(1) of the Landlord and Tenant Act 1985.
   (c) Liability for an administration charge of £170.25 in 2008.
   (d) Liability for interest of £34.34 charged by the landlord on 25 December 2008.
   (e) Limitation of the landlord's costs in the proceedings under Section 20C of the Landlord and Tenant Act 1985.

FACTS

4. The Tribunal inspected the property before the hearing. 27 Delamark Road is a three storey Victorian house close to the High Street in Sheerness. The house is of typical brick construction under a pitched replacement tile roof with a two storey bay to the

front. The house has been divided into two maisonettes with a communal entrance hallway. The ground floor flat was empty at the time of the inspection. Flat A is on the first and second floors. It was noted that the timber frame windows to the front of Flat A (and a number of to the rear) had been replaced with UPVC sealed units.

5. By a lease dated 8 September 1989, Flat A was demised for a term of 99 years from 29 September 1988. The demise included the roof of the house, and the lease imposed full repairing obligations on the lessee in respect of the upper parts of the house. By clause 3 the lessee agreed to pay a ground rent in advance on the first day of January in each year:

   > *"and paying by way of additional ground rent from time to time on demand sixty six point six six (66.66%) of the costs incurred by the Lessor in maintaining insurance of the Building pursuant to paragraph (2) of Schedule 5".*

   By paragraph (2) of the Fifth Schedule the landlord agreed:

   > *"to insure and ... to keep insured the Building against loss of damage by fire and such other risks as are normally insured against loss of damage by fire and such other risks as are normally insured in a comprehensive house policy in its full insurable value with insurers of repute ..."*

   The lessees' covenants were set out in the Fourth Schedule to the lease. By Schedule 4 Part I paragraph (2) the lessee agreed *"to pay all outgoings payable in respect of the demised premises"*. There was a covenant against alterations at paragraph (4) of Part II, but the only restriction on alienation was a covenant against alienation of part at paragraph (10) of part II.

6. It appears that at some stage the previous lessee carried out alterations to the structure in breach of covenant by removing the original windows and installing UPVC units. As a result, the parties entered into a Deed of Variation, a copy of which is included in the hearing bundle. The Deed is dated 2 February 2006. The Deed recites that the respondent gave retrospective consent for the works. The lease was also varied to include new covenants against alienation. These included the following provision at paragraph (10)(b) of Part II of the Fourth Schedule:

"Not to assign transfer or underlet the demised premises without the previous written licence of the Lessor, such licence not to be unreasonably withheld in the case of a respectable and responsible person and to pay to the Lessor or the Lessor's solicitors or agents all costs charges and expenses incurred by the lessor of and incidental to the issue of such licence ..."

7. The landlord raised the following demands:

   (a) A statement of service charges dated 31 December 2006 which includes £1,065.24 for buildings insurance and £62.58 for administration. The applicant's share of the insurance was £710.09.

   (b) A statement of service charges dated 31 December 2007 which includes £1,118.50 for buildings insurance and £62.58 for management. The applicant's share of the insurance was £745.59.

   (c) A statement of service charges dated 31 December 2008 which includes £1,046.13 for buildings insurance and £60.16 for management. The applicant's share of the insurance was £697.35.

   (d) An account statement dated 26 January 2009, which includes a sum of £34.34 "interest charged 1 May 2008 to 25 Dec 2008".

INSURANCE – CONTRACTUAL PROVISIONS

8. In each year the property was insured by the respondent under a landlord's 'block insurance' policy provided by AXA Insurance UK. The first issue arises because the AXA Insurance policy which the landlord took out was a "Flats Insurance" policy. It is common ground that an insurance policy for a house divided into flats was generally more expensive than a policy for a house used as a single dwelling. The question is whether the lease permits the landlord to recover the higher cost of a 'flats' insurance policy (such as the one it did in fact take out), or whether the landlord is limited to recovering the lower cost of a 'house' insurance policy.

9. <u>Applicant's case</u>. Mr Potter relied on the express wording of paragraph (2) of the Fifth Schedule. He contended that the provision required the landlord to provide *"a comprehensive house policy in its full insurable value with insurers of repute"*. Insofar as there was any ambiguity in the Lease (whose provisions largely favoured the

landlord), that ambiguity should be resolved in favour of the tenant. The landlord should be limited to recovering the lesser cost of a 'house' policy.

10. Respondent's case. Mr Taylor relied on the preceding words in paragraph (2). The primary requirement was for the landlord *"to insure and ... to keep insured the Building"* which gave it a wide discretion as to the type of policy it could take out. The subsequent words then required two specific risks to be insured against, namely (a) *"damage by fire" and (b) "such other risks as are normally insured in a comprehensive house policy"*. The reference to the *"comprehensive house policy"* was therefore merely a reference to the insured risk, not the type of policy to be taken out. Furthermore, the Schedule was to be construed in the light of the factual background at the date the lease was granted in 1989, when the property was already divided into two flats. At that stage it would have been obvious that a landlord would wish to take out a 'flats' insurance policy - since a 'house' insurance policy would not have sufficed for a house converted into flats. For example, when such a conversion was carried out, there was double the chance of a water damage occurring within the property, and this additional risk needed to be insured against.

11. The Tribunal prefers the arguments of Mr Taylor. In its view, the words *"comprehensive house policy"* plainly refer to the risks to be included in a policy of insurance rather than the type of policy to be taken out. It would have been obvious at the time of the lease that a 'flats' insurance policy would be appropriate and there is no obvious reason why the parties would have required the landlord to obtain inadequate insurance cover which would have been disadvantageous to both the landlord and the leaseholder. The Tribunal does not therefore consider that there is any ambiguity which needs to be resolved against the landlord *contra proferentem*.

INSURANCE – S.19 LANDLORD AND TENANT ACT 1985

12. The issue here is whether the relevant costs of insurance were reasonably incurred under s.19(1) of the Landlord and Tenant Act 1985.

13. Applicant's case. Mr Potter contended that the costs of the insurance premiums in each of the three years were not reasonably incurred. He did not accept that the landlord had gone through a proper process to insure the building. However, his main contention was that the insurance costs were in any event excessive. He had obtained a number of quotations through brokers for insuring the building, and produced two to the tribunal.

14. Mr Potter described the process for obtaining these quotations. First, he obtained a build cost for the property by using the RICS Building Costs Information Service ("BCIS") website. This suggested a build cost of £160,560 for the building. Mr Potter then approached specialist insurance brokers posing as a landlord, and gave them the details provided by the respondent in relation to the AXA insurance policy. He put a range of build costs to the brokers in order to obtain a spread of quotations – some build costs being lower than the figure suggested by the BCIS, and some higher. The first quotation he obtained was from AXA Insurance (through Rentguard Insurance Brokers) which suggested a premium of £142.50 for a build cost of £150,000 (including tax and terrorism cover). Mr Potter produced an email with details of the cover and a copy of the policy terms and conditions. The second quotation was from Zurich Insurance (through ResidentsLine brokers) which suggested a premium of £315 for a build cost of £200,000 (including tax) and terrorism cover of £52.50. Mr Potter produced a letter from the brokers dated 8 June 2009 confirming these details with a "Key facts" summary of the policy terms. Both quotations were for 'flats' cover and they showed that the cover obtained by the landlord was too expensive. The landlord's block policy may well have included additional features compared to the alternative quotations he had obtained, but this was "gold plating" of the policy by the landlord.

15. Respondent's case. Mr Taylor gave details of the landlord's process for securing insurance. The landlords had a policy that if leaseholders came up with a lower insurance quotation than the landlord, they were happy to insure with the leaseholders' nominee – since it was ultimately the leaseholders who paid the premiums. Insurance was arranged by the freeholder who market tested the

premiums each year though the broker Reich Insurance brokers. The policy was a block policy covering hundreds (but not thousands) of the landlord's properties. A letter from Reich was provided dated 12 May 2009 which referred to the "Southern Land Securities portfolio with AXA Insurance plc". In the past three years, the selected insurer had been AXA Insurance. Within that block policy, the broker looked at the declared build value in each case, and its was revalued regularly by indexation (indeed, it was not uncommon for residents to approach the landlord and suggest that the build cost should be increased, as had recently happened in the case of 33 Delamark Road). No commissions were paid to the agent or to the landlord. Mr Taylor produced two documents giving information about the AXA cover in two of the three years. Each document was headed "Blocks of Flats – Summary of Cover" and it described the policy as "our Hamilton King Blocks of Flats Insurance Policy" (the policy holder was described as "Hamilton King Management Ltd"). The sums insured were £250,644 (for the year ending 24 December 2007) and £263,177 (for the year ending 24 December 2008). Each referred to terms and conditions in the "Master Schedule of Cover". Mr Taylor also referred to an AXA Flats Insurance Policy document which set out the full terms of that policy.

16. As to Mr Potter's two quotations, Mr Taylor submitted that they were not on a like for like basis. He produced a letter from Reich dated 22 July 2009 (Mr Potter did not object to this letter going before the Tribunal) containing a critique of the alternative AXA and Zurich quotations. Reich stated that the actual block cover in place was a bespoke policy provided by AXA – whereas the two quotations were 'market' policies. There were six specific features of the AXA block policy which were not generally provided by 'market' policies. These included "trace and access" cover for up to £5,000 incurred in investigating and making good the source of water bursts, damage to underground cables and so on. The policy also included unrestricted cover for unoccupied properties and a "reinstatement of cover" provision. In addition, Mr Taylor pointed out that the flat downstairs was empty, and that this should have been reflected in the two alternative estimates from the lessee (this was not a factor with the landlord's policy since the premium took into account that there might be empty properties in the landlord's portfolio). There was no evidence that the

Zurich/ResidentsLine policy was a 'flats' policy – it appeared to be an ordinary domestic householder's insurance. The declared values were also less in the two quotations obtained by Mr Potter. When asked by the Tribunal about the method of allocating a premium to each individual building within the block policy, Mr Taylor stated that the premiums appeared in the statements of service charge for each year. He was unable to produce evidence of the way the landlord or Hamilton King Management arrived at these figures. When asked about the method of arriving at the initial sum insured for 27 Delamark Road, he was unable to explain how the build costs figure had initially been arrived at – although build costs were updated each year by indexation.

17. Tribunal's decision. Whether a relevant cost is *"reasonably incurred"* under s.19 of the Act involves both (a) consideration of the landlord's process for incurring that cost and (b) an assessment as to whether those costs are out of line with the market norm. Useful guidance is given in the Lands Tribunal cases of ***Forcelux v Sweetman*** [2001] 2 EGLR 173 and ***Veena SA v Cheong*** [2003] 1 EGLR 175.

18. In this instance, the process for obtaining insurance as part of the block policy has been subjected to some scrutiny, and the tribunal considers that aspects of this process are wanting. In particular, a necessary and important step has not been explained, namely the means of allocating part of the global premium paid to AXA under the Master Policy to this particular property. There is simply no explanation about how this was done – although the two "summary of cover" documents do refer to a Master Schedule of Cover. The difficulty is exacerbated by one apparent discrepancy between the insurance documents. The block insurance policy was described by Mr Taylor and Reich as the landlord's policy, although the two Summary of Cover documents referred to the "Hamilton King Block s of Flats Insurance Policy". Furthermore, the Tribunal was not shown any Summary of Cover document for the 2005/06 insurance year. In short, it was impossible from the documents provided to understand whether the landlord's method of allocating premiums to 27 Delamark Road was a reasonable one.

19. Against this background, there is evidence that the relevant costs charged by the landlord were significantly out of line with the market norm. Mr Potter has supported his submissions with evidence about build costs being significantly below those relied on by the landlord. Although the use of the RICS website may appear crude, there is at least evidence to show how this figure was arrived at. The website states that this should only be used as a guide and that it is not substitute for professional advice and judgement, particularly where a property has any unusual features. Flats are excluded because types of construction differ widely, as do responsibilities for shared parts. Similarly, he has used two specialist brokers to provide quotations. Inevitably quotations from brokers given to a tenant will never match precisely the actual policy taken out by a landlord and the Tribunal has regard to the inevitable tendency of a broker or insurer to give a low quotation to attract the potential customer. However, the difference between the two quotations obtained by Mr Potter and the sum allocated by the landlord to this building are striking (in particular AXA has given Mr Potter an estimate for insurance which is approximately one eighth of the premium actually charged by the landlord for insurance of the same property by the same insurer). The Tribunal is satisfied that these policies were reasonably comparable to the AXA 'flats' insurance taken out by the landlord. The huge discrepancies in premiums cannot be explained by either (a) the Reich critique or (b) Mr Taylor's reasoned criticisms of the two insurance quotations. The Tribunal notes that there was no suggestion of any special factors which might have had a dramatic increase in the insurance premium for this property which is reflected in the block policy insurance figure, but which was absent from the two comparables. There is no suggestion, for example, that AXA (or the landlord) increased the allocated premium to reflect a poor claims history, floods risks etc. The Tribunal therefore finds that the relevant costs of insurance in each of the three years were not "reasonably incurred" within the meaning of s.19(1).

20. It is necessary to determine the extent to which the relevant costs of insurance were reasonably incurred in order to arrive at a figure for the service charge which is payable. The range between Mr Potter's quotation and the landlord's figure is wide. However, it adopts the sums insured by the landlord for the years ending 24

December 2007 and 2008 as representing approximately rebuild costs for a property of this size. given at the same rate as those given by the landlord. For the first of the three years (where the landlord has given no figure for the sum insured) the Tribunal takes a figure of £235,000 , being an approximate midway point between the previous year's cover and that of the following year The Tribunal considers that reasonable insurance premiums for the property (allowing the landlord some flexibility for including bespoke terms in a block policy) would be £750 for the year ending 24 December 2006, £825 for the year ending 24 December 2007 and £850 for the year ending 24 December 2008.

21. The lessee's contribution to these costs under the lease is 66.66%. The Tribunal therefore finds he is liable for £515, £550 and £567 in the three years in issue.

ADMINISTRATION FEE – MORTGAGE REGISTRATION

22. Mr Potter's application sought a determination in respect of £135, which has been suggested as a fee payable to the landlord's legal department to provide counterpart lease. There the managing agents' fees of £35.25 for this document. The lease had been needed for a certificate of compliance in connection with the remortgaging of the flat in 2008. The landlord had suggested this was payable for the agents under the amended provisions in the lease set out in the Deed of Variation.

23. At the hearing, it emerged that these sums had not been demanded by the landlord because the remortgaging had not proceeded. Mr Taylor also suggested that if Mr Potter did need a copy of the lease to re-mortgage the property, and he was in the difficult financial circumstances that he is in at the moment, they would in all probability waive the agent's fee. However, without any demand for payment or any immediate prospect that the landlord will charge anything to the tenant, the Tribunal considers there is no charge which is "payable" under paragraph 5 of Schedule 11 to the Commonhold and Leasehold Reform Act 2002.

INTEREST

24. This also raises issues under Schedule 11 to the Commonhold and Leasehold Reform Act 2002. Interest of £34.34 was charged to the applicant's account on 25 December 2008 and was included in the service charge statement dated 26 January 2009.

25. Applicant's case. Mr Potter put his case in three ways. First, he contended that interest was not chargeable under the lease. Secondly, he argued that he had not missed any payments of rent or service charge, so it was wrong to charge him any interest. Thirdly, interest had been charged at 4% above base rate per annum, and this rate was excessive. Such a rate was a penalty or a punishment.

26. Respondent's case. Mr Taylor explained the way in which the interest by reference to correspondence. This was a scheme to help lessees by allowing them to spread their payments over 12 months. A final demand to Mr Potter dated 2 March 2006 explained the scheme in this way:

> *"Have you considered paying by our 12 Monthly Instalment Scheme by Direct Debit? The cost is spread over 12 equal monthly payments making paying your account much easier than having to find the full amount of each bill. By paying a regular amount each month you know exactly how much you need to pay and when. See overleaf for details."*

At some stage in late 2006 or early 2007, a written illustration was prepared by the agents for Mr Potter showing how a Direct Debit instalment scheme would work. The sum due for ground rent and service charges was calculated at £1,074.54. The illustration stated that this could be paid in twelve instalments of £89.55 each. However, a small amount of interest will be applied to Mr Potter's account at 4% above base rate on the reducing balance as the account should have been settled in full within 28 days from the due date. Mr Potter availed himself of this facility and paid the 2007/08 charges by twelve instalments of £89.55. In 2008/9, Mr Potter again received an illustration and he paid twelve instalments of £79.45. The interest of £34.34 was payable under this scheme.

27. Mr Taylor submitted that although interest was not specifically mentioned in the lease, it was recoverable under paragraph (2) of Schedule 4. Under this provision, the lessee was obliged *"to pay all outgoings payable in respect of the demised premises"*. The sum was an *"outgoing"* of the landlord because he borrowed money at 4% above base rate. Furthermore, the rate was not excessive. Mr Taylor dealt with many leases in the course of his work, and 4% above base was very much the norm for residential leases. It was, in any event the rate at which the landlord borrowed money.

28. Tribunal's decision. Mr Potter is plainly incorrect that he was not in arrears. Mr Taylor's careful narrative shows that he was in arrears – but that (a) the lessee was permitted to be in arrears under the terms of an agreement collateral to the lease, and (b) that that agreement provided for interest at 4% above base rate. However, the Tribunal rejects the argument by Mr Taylor that the interest provision is an "administration charge" under Schedule 11 to the 2002 Act. The concept of interest was well understood in 1989 when the lease was drawn – yet the draftsman chose not to spell out any obligation to pay or to specify a contractual rate of interest. The Tribunal does not see any basis for implying any term for payment of interest – it is not necessary to import such a term to give business efficacy to the lease and an interest provision is not so obvious that it would be assumed to have been included in the lease in any event.

29. As to Mr Taylor's ingenious argument that interest is an "outgoing", the Tribunal considers that the word "outgoing" is a perfectly ordinary English word which means a sum which is "expended". Interest is payment for use of money, something very different to an "outgoing". In any event, the lease limits the outgoings to those "payable in respect of the demised premises". In fact, Mr Taylor's analysis shows that the interest was charged under an agreement to allow the tenant to pay rent late. That agreement was collateral to the lease.

30. It follows that interest in this case is not payable under the terms of the lease; indeed, it is not an "administration charge" at all under Schedule 11 to the 2002 Act. It is possible that that collateral agreement is enforceable and that Mr Potter is required to

pay interest as a result of the scheme he has entered into - but is a matter for a court not a Leasehold Valuation Tribunal.

s.20C APPLICATION

31. Mr Potter applied for an order under s.20C of the Act. It should be recorded that he accepted that the landlord had complied with directions and had not acted otherwise unreasonably in connection with the application. However, Mr Taylor confirmed that the landlord would not be seeking to add any of the agents' costs in connection with the present application. It was therefore agreed that the tribunal need not make any determination under s.20C.

CONCLUSIONS

32. The Tribunal's decision is therefore:

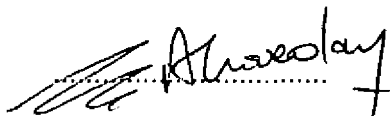
    (a) In paragraph (2) of Schedule 5 to the lease, the landlord is permitted to affect a "flat" insurance policy and to recover the costs under the service charge provisions of the lease.

    (b) The applicant is liable to pay £515 in respect of insurance for the year ending 24 December 2006, £550 for the year ending 24 December 2007, and £567 for the year ending 24 December 2008.

    (c) The 'fee' of £135 in 2008 was never demanded nor paid. It is therefore not an "administration charge" at all under Schedule 11 to the 2002 Act.

    (d) The interest of £34.34 is not payable under the lease. It is in any event not an "administration charge" at all under Schedule 11 to the 2002 Act.

    (e) No order is made under section LTA 1985 s.20C.



Mark Loveday BA(Hons) MCIArb
Chairman
24 July 2009