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MAN/00BN/LSC/2009/0011

RESIDENTIAL PROPERTY TRIBUNAL SERVICE

**LEASEHOLD VALUATION TRIBUNAL
of the NORTHERN RENT ASSESSMENT PANEL**

DETERMINATION WITH REASONS

LANDLORD AND TENANT ACT 1985 – SECTIONS 27A & 20C

Premises: Old Sedgwick 703, 705 & 706
Royal Mills, 2 Cotton Street, Manchester M4 5BW

Applicants: Mr R Carey
Mrs M Halliwell
Mr M Taylor

Respondents: ING RED UK (Royal Mills) Limited
Royal Mills Management Limited

Tribunal Members: Mr J W Holbrook LL.B (Chairman)
Mr T Vincent MA, FRICS
Mr L Bottomley M.I.Fire.E., JP

DETERMINATION

- A. Each of the Applicants is liable to pay a "Building Service Charge" in respect of their respective apartments within the Building. The Building Service Charge is payable to ING RED UK (Royal Mills) Limited, and the amounts payable by each Applicant for the accounting period commencing on 1 January 2007 and ending on 31 December 2007, and for the accounting period commencing on 1 January 2008 and ending on 31 December 2008, are shown in the following table:

| | Building Service Charge | | |
|-------------|--------------------------------|---------------------------------|-----------------------------|
| | OS 703 Mr Carey | OS 705 Mrs Halliwell | OS 706 Mr Taylor |
| 2007 | £469.39 | £484.51 | £582.16 |
| 2008 | £1,685.29 | £1,882.92 | £1,648.65 |

- B. Each of the Applicants is also liable to pay an “Estate Service Charge” in respect of their respective apartments within the Building. The Estate Service Charge is payable to Royal Mills Management Limited, and the amounts payable by each Applicant for the accounting period commencing on 1 January 2007 and ending on 31 December 2007, and for the accounting period commencing on 1 January 2008 and ending on 31 December 2008, are shown in the following table:

| | Estate Service Charge | | |
|------|-----------------------|-------------------------|---------------------|
| | OS 703 Mr Carey | OS 705 Mrs Halliwell | OS 706 Mr Taylor |
| 2007 | £173.09 | £222.53 | 276.37 |
| 2008 | £770.81 | £951.95 | £847.05 |

- C. The costs incurred by the Respondents in connection with these proceedings are not to be regarded as relevant costs (within the meaning of section 18(2) of the Landlord and Tenant Act 1985) to be taken into account in determining the amount of any service charge payable by any of the Applicants.

REASONS

Introduction

1. This case concerns an application by the owners of three neighbouring residential apartments for a determination of their liability to pay service charges. The building in which the apartments are located forms part of a complex mixed-used development close to Manchester city centre. The service charge is itself complex and, to an extent, this complexity is unavoidable due to the nature of the services it relates to and the need to ensure that the burden of paying for those services is shared equitably between a diverse range of occupiers. Nevertheless, these proceedings were characterised by the Applicants' struggle to obtain meaningful financial information from the Respondents and their managing agents, by the production and revision of accounts and financial statements that were difficult to understand, and by a general lack of transparency and effective communication between the parties.
2. In essence, however, the Applicants' reasons for applying to the Leasehold Valuation Tribunal (“the Tribunal”) were simple: as Mr Taylor put it, the Applicants felt that they were faced with increasing service charges which were not being properly explained to them – the Applicants “just wanted to know where [their] money was going”. This sentiment is

entirely reasonable. However, it is clear that the Respondents' administration of the service charge prior to (and even, at times, during) these proceedings made it very difficult for this to happen. To their credit, the Respondents did fully acknowledge during the final hearing that the dispute between the parties had been significantly exacerbated by a lack of financial transparency on the Respondents' part. As Mr Calder put it, by providing financial information that was difficult to follow, the Respondents had provoked a very wide attack on the management of the building. There is much truth in this. Even so, the Respondents contended throughout that the running of the building was generally sound. Subject to certain exceptions, the Tribunal agrees with this general contention. However, although the reduction in service charges which the Tribunal has now ordered relate, in the main, to fairly modest amounts, what has been achieved by these proceedings is much greater transparency in the communication of information about service charges and other matters. Mrs Halliwell noted during the course of the hearing that, as a result of the proceedings, "avenues of communication have now been agreed". This is pleasing to note, but it is a pity that it required lengthy, and no doubt expensive, litigation to bring this about.

3. The Tribunal's jurisdiction to determine service charges is limited to the service charges payable by and to the parties to these proceedings only. However, it is likely that these proceedings will come to affect the service charge position of other occupiers of the Royal Mills estate, at least indirectly. This is because the Respondents may decide that they should issue (or re-issue) service charge statements for 2007 and 2008 to other occupiers who are affected by the revisions to the service charge accounts made in anticipation of these proceedings. Where this happens, it would not be unreasonable, in the Tribunal's view, for other occupiers to expect the Respondents to adopt the same approach to the recovery of excess (or 'balancing') service charge contributions as the Respondents adopted for the purposes of these proceedings. This is notwithstanding the fact that this determination is not binding on the Respondents in that regard.

Background

4. On 3 March 2009 an application was made to the Tribunal under section 27A of the Landlord and Tenant Act 1985 ("the 1985 Act") for a determination of liability to pay service charges in connection with three residential tenancies of separate apartments at Old Sedgwick, Royal Mills, 2 Cotton Street, Manchester M4 5BW ("Old Sedgwick"). The application was made by Mr R Carey of Apartment 703 ("OS 703"), Mrs M Halliwell of Apartment 705 ("OS 705") and Mr M Taylor of Apartment 706 ("OS 706").

5. The application related to two separate service charge periods: namely, the year ending 31 December 2008 and the year ending 31 December 2009. The Tribunal subsequently granted permission for the year ending 31 December 2007 to be included in the application also.
6. The Applicants also applied to the Tribunal under section 20C of the 1985 Act for an order preventing the Respondents, ING RED UK (Royal Mills) Limited and Royal Mills Management Limited, from recovering costs incurred in connection with the proceedings before the Tribunal under section 27A as part of the service charge.
7. The Tribunal held a pre-trial review on 22 April 2009 following which Directions were issued to the parties. Further Directions were issued at a hearing on 7 January 2010, and the hearing of the substantive issues before the Tribunal was held over three days at the Tribunal's offices at 5 New York Street, Manchester M1 4JB on 22, 23 and 30 March 2010. At that hearing, Mrs Halliwell and Mr Taylor appeared in person. Mr Carey did not appear at this (or any other) hearing, but he had written to the Tribunal to indicate that he agreed with the arguments of the other Applicants. The Respondents were represented by Mr M Pryor of counsel instructed by Russell-Cooke LLP.
8. The Tribunal received a substantial bundle of documentary evidence, running to some five volumes. This included a number of versions of service charge accounts for the periods in dispute, budgets, individual service charge statements and demands, ledgers and invoices, together with statements of case and witness statements. At the hearing, oral evidence was given by Mrs Halliwell and Mr Taylor and, for the Respondents, by Mr H Calder, Director of Project Management for ING RED UK Limited, and by three representatives of the Respondents' appointed managing agents for the Estate, Livingcity Asset Management Limited ("LCAM"): Mr M Gallimore, Managing Director of Livingcity Limited; Mr P Atkins, Director of LCAM; and Mr I Eaton, Estate Services Manager for LCAM.
9. On the morning of 22 March 2010 the Tribunal inspected OS 705 and OS 706, together with the common areas of the Royal Mills development in the presence of Mrs Halliwell and Mr Taylor together with Mr Pryor and representatives of LCAM. The Tribunal did not inspect OS 703 but assumed it to be broadly similar to the other two apartments.

Description of the Premises and of the Royal Mills development

10. The Premises comprise three large residential apartments on the 7th and 8th floors of Old Sedgwick. These are the top two floors of Old Sedgwick. Each apartment is accessed from the same corridor on the 7th floor, and

has accommodation on two levels including an open plan kitchen and living area, three bedrooms (one with en-suite facilities) and a separate bathroom/wc. OS 705 also has a roof terrace. Although the three apartments are similar in character and amenity, their internal layouts differ, as do their gross internal areas – OS 706 being the smallest of the three and OS 705 the largest.

11. Old Sedgwick is part of a larger building (“the Building”) consisting of a conversion of two former mills: Old Sedgwick Mill and New Sedgwick Mill. The Building includes 125 apartments, 59 of which are one bedroom; 46 of which are two bedroom and 20 of which are three bedroom. It is constructed around a courtyard and also includes substantial commercial space consisting of retail units and also separate business premises over five floors known as “the Business Centre” (a large part of which ‘bridges’ the courtyard). Much of the courtyard is covered by a glass roof creating a covered communal space known as “the Atrium”. In addition to corridors leading to the various apartments on the upper floors, the common parts of the Building that are accessible to the residential occupiers include entrance corridors on the ground floor, refuse disposal areas, two lifts and a lobby for the delivery and collection of post. There is also a room housing plant in connection with the supply of heating and hot water. The Estate management office is located on the ground floor of the Building, being accessed from the courtyard/Atrium.
12. The Building itself does not include any car parking areas. However, it is part of a mixed-use residential and commercial estate known as Royal Mills (“the Estate”). The Estate currently comprises three separate buildings. Whilst the Building is a conversion from two old mills, the other buildings are new-build: “McConnell” is a block consisting of 13 floors extending from -3 to 8th floor, the bottom four floors of which are devoted to car parking, with residential apartments above. “Fairbairn” is a block consisting of 9 floors from -3 to 5th floor, with residential apartments on the 4th and 5th floors, a commercial unit (as yet unlet) on part of the ground floor, and car parking taking up the rest of the building.
13. The renovation of the Building was completed in April 2006. However, the current buildings on the Estate are only phase 1 of an overall intended development. Phase 2 is yet to be constructed. The Tribunal noted that the Building appeared to be in good condition, and that the common parts were clean and well-maintained. However, many of the retail units are presently empty and unlet and this contributed to the courtyard/Atrium lacking the feeling of a ‘community hub’ which the Respondents envisage it having once the Building is fully let.
14. The Estate is situated about half a mile north of Manchester city centre in an area of urban regeneration known as the Ancoats Urban Village.

The Leases and the service charge machinery

15. Each of the Applicants is the owner (or co-owner) of a long leasehold interest in one of the apartments to which the application relates. Each apartment is the subject of a separate lease (together referred to as "the Leases") granted for a term of 150 years from 1 January 2004 and reserving an initial rent of £175.00 per annum. The lease of OS 703 is dated 24 August 2007; the lease of OS 705 is dated 3 September 2007; and the lease of OS 706 is dated 20 July 2007. It was agreed that, for all material purposes, the provisions of Leases are identical.
16. The Leases are tripartite agreements, made between ING RED UK (Royal Mills) Limited (as "Landlord"); Royal Mills Management Limited (as "Estate Management Company"); and the relevant Applicant (as "Tenant"). The Landlord and the Estate Management Company have separate and distinct obligations under the Leases. For example, pursuant to clause 8.2 the Landlord must keep the Building in good and substantial repair and, pursuant to clause 8.3(a), it must insure the Building. The Landlord also covenants (at clauses 8.4 and 8.6 respectively) to decorate, clean and light the internal communal parts of the "Building Common Parts", and likewise in respect of the exterior of the Building. In contrast, the Estate Management Company is obliged, pursuant to clause 9.2, to keep the "Estate Common Parts" and "Car Park" in good and substantial repair; to decorate, maintain, clean, furnish and light the Estate Common Parts (clause 9.3); and to keep the grounds of the Estate in good order and stocked with plants (clause 9.4).
17. In return, of course, there are various tenant's obligations. For example, clause 7.1 of the Leases contains a Tenant's covenant:
- "to pay the contributions to the Landlord equal to the Building Service Charge Percentage of the amount which the Landlord may from time to time expend and as may reasonably be required on account of anticipated expenditure on rates services repairs maintenance or insurance being and including expenditure described in the Second Schedule the contributions being due on the 25 March 24 June 29 September and 25 December of each year".
18. Clause 7.2 of the Leases contains a further Tenant's covenant:
- "to pay contributions to the Estate Management Company equal to the Estate Service Charge Percentage of the amount which the Estate Management Company may from time to time expend and as may reasonably be required on account of anticipated expenditure described in the Third Schedule the contributions being

due on the 25 March 24 June 29 September and 25 December each year”.

19. Finally, clause 7.3 of the Leases obliges the Tenants to pay an additional charge, known as “the Ancoats Urban Village Estate Charge” to the Estate Management Company on 1 January in each year. This charge was described during these proceedings as a quasi poll tax paid by tenants whose premises are on the Ancoats Urban Village Estate. However, there was no dispute between the parties as to the amount or payability of this charge, and it was not considered further by the Tribunal.
20. The “Building Service Charge Percentage” is defined in clause 1.12 of the Leases as “[s]uch fair and reasonable proportion as is properly attributed to the Flat of the expenditure described in the Third Schedule in relation to the Building and Service Installations exclusively serving the same”. The “Estate Service Charge Percentage” is then defined in clause 1.13 as “[s]uch fair and reasonable proportion as is properly attributable to the Flat of the expenditure described in the Fourth Schedule in relation to the Estate Common Parts and the Designated Parking Area”. When one turns to the schedules to the Lease, however, it is clear that the drafter made a slip in both clause 1.12, by referring to the third schedule, and in clause 1.13, by referring to the fourth schedule. In fact, it is the second schedule which details the Building Service Charge Expenditure, and the third schedule which details the Estate Service Charge Expenditure. The parties did not make an issue of this point during the proceedings, and the fact that it is a mere drafting error is obvious from a comparison of the schedule reference in clauses 7.1 and 7.2 and from the fact that the fourth schedule is actually about regulations, and not about service charge expenditure. The Tribunal therefore interpreted the definitions in clauses 1.12 and 1.13 as if they referred to the second and third schedules to the Leases respectively.
21. The expenditure listed in the second schedule to the Leases – the Building Service Charge Expenditure – comprises (according to paragraph 1) expenditure incurred:
 - a) in the performance of the Landlord’s functions under the Leases;
 - b) in respect of the costs of managing the Building;
 - c) “in the provision of services facilities amenities improvements and other works where the Landlord in the Landlord’s reasonable discretion from time to time considers the provisions to be for the general benefit of the Building and its tenants and whether or not the Landlord has covenanted to make the provision”;

- d) in the payment of bank charges and interest; and
 - e) in providing a reserve fund.
22. Paragraph 2 of the second schedule then proceeds to set out the machinery for ascertaining the amount of the "Building Service Charge" (which is defined in clause 1.8 of the Leases as "the contributions equal to the Building Service Charge Percentage of the expenditure described in the Second Schedule"). Paragraph 2 provides as follows:
- "As soon as convenient after the expiry of each accounting period of not more than twelve months commencing with the accounting period now current there shall be prepared and submitted to the Tenant a written summary ("the Building Statement") setting out the Building Service Charge Expenditure in a way showing how it is or will be reflected in the demands for payment of the Building Service Charge and showing money in hand. The Building Statement will be certified by a qualified accountant as being in his opinion a fair summary complying with this requirement and sufficiently supported by the accounts receipts and other documents produced to him".
23. Paragraph 3 provides that the accounting period may be varied, and paragraph 4 provides a balancing mechanism for reconciling the actual amount of the Building Service Charge once this has been determined for a particular accounting period against amounts paid on account.
24. The third schedule to the Leases is in very similar terms to the second schedule. It sets out the heads of expenditure which are comprised within the Estate Service Charge Expenditure (these mirror those set out in the second schedule but also include premiums for insuring the Estate Common Parts against employers' liability, third party and public risks), and details the machinery for ascertaining the Estate Service Charge for each accounting period by reference to a certified "Estate Statement".
25. The expressions "Building" and "Estate" are defined in the Leases in such terms as make them, for practical purposes, synonymous with the use of those expressions in this determination. However, the relevant provisions of the Leases (clauses 8.4, 9.2 and 9.3, for example) refer to additional expressions which are also defined in the Leases. In particular:
- Clause 2.3 defines "Building Common Parts" as: "all parts of the Building (excluding Flats, the Block Common Parts, the Commercial Common Parts and the Retained Building Parts and the Atrium) from time to time provided for the common use of more than one of the tenants or occupiers of the Building and their visitors and members of

the public including without limitation any of the following which fall within this definition: the interior Atrium area (but excluding the structure, glazing and exterior parts of the Atrium) pedestrian accesses passages stairways circulation areas lifts escalators landscaped areas fire escapes storage areas refuse collection and disposal areas"; and

- Clause 2.7 defines "Estate Common Parts" as: "all parts of the Estate (including the Common Parts within or appurtenant to other buildings on the Estate and the Atrium but excluding the Flats the Commercial Units the Building Common Parts the Block Common Parts the Commercial Common Parts) open from time to time provided for the common use of the tenants and occupiers of the Estate and their visitors and members of the public".

26. These definitions are not entirely satisfactory because they refer to expressions which are not defined elsewhere in the Leases, such as "Block Common Parts", "Commercial Units", and "Commercial Common Parts". It is important to know what these expressions mean in order to understand the full extent of the Respondents' obligations under the Leases. Whilst it is possible to give a common sense construction to "Commercial Units" and "Commercial Common Parts", the expression "Block Common Parts" is less readily intelligible. The only other use of this expression in the Leases is in the definitions of "Retained Building Parts" and "Retained Block Parts", which are themselves far from clear. The Tribunal tends to agree with Mr Pryor's contention that this definitional confusion is a further example of unfortunate drafting (the drafter having perhaps confused concepts used in lettings of commercial units in the Building which are not relevant to the residential leases) and that, in practice, there is no sensible distinction to be drawn between "Building" and "Block" in the present circumstances. In any event, the Respondents' obligations are largely defined by reference to the Building and the Estate Common Parts. The Tribunal found that the defects in the drafting of the Leases do not materially impact on the issues that fall to be determined in these proceedings.
27. In summary therefore, the disputed elements of the service charges under the Leases must be considered as two distinct entities (and the amounts payable determined accordingly): first, in relation to the Building Service Charge payable to ING RED UK (Royal Mills) Limited; and, second, in relation to the Estate Service Charge payable to Royal Mills Management Limited.

The Law

28. Section 27A(1) of the Landlord and Tenant Act 1985 ("the 1985 Act") provides:

“An application may be made to a leasehold valuation tribunal for a determination whether a service charge is payable and, if it is, as to-

- (a) the person by whom it is payable,
- (b) the person to whom it is payable,
- (c) the amount which is payable,
- (d) the date at or by which it is payable, and
- (e) the manner in which it is payable.”

29. The Tribunal has jurisdiction to make a determination under section 27A of the 1985 Act whether or not any payment has been made.

30. In making any such determination, the Tribunal must have regard to section 19 of the 1985 Act, subsection (1) of which provides:

“Relevant costs shall be taken into account in determining the amount of a service charge payable for a period-

- (a) only to the extent that they are reasonably incurred, and
- (b) where they are incurred on the provision of services or the carrying out of works, only if the services or works are of a reasonable standard;

and the amount payable shall be limited accordingly.”

31. Section 19(2) states that “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 by repayment, reduction or subsequent charges or otherwise.”

32. “Relevant costs” are defined for these purposes by section 18(2) of the 1985 Act as “the costs or estimated costs incurred or to be incurred by or on behalf of the landlord, or a superior landlord, in connection with the matters for which the service charge is payable.”

33. Subsection (1) of section 20C of the 1985 Act provides:

“A tenant may make an application for an order that all or any of the costs incurred, or to be incurred, by the landlord in connection with proceedings before a court or leasehold valuation tribunal ... are not to be regarded as relevant costs to be taken into account in determining the amount of any service charge payable by the tenant or any other person or persons specified in the application.”

34. Section 20C(3) gives the Tribunal power to “make such order on the application as it considers just and equitable in the circumstances”.

The Issues

35. The fundamental issue to be determined by the Tribunal in these proceedings is the amounts that are payable by each of the Applicants in respect of Building Service Charge (“BSC”) and Estate Service Charge (“ESC”) for each accounting period for which service charge accounts were available at the time of the final hearing, namely the year ending 31 December 2007 (“2007”) and the year ending 31 December 2008 (“2008”). It was recognised that it would not be possible to make a precise determination of the amounts payable for the year ending 31 December 2009 (“2009”) as service charge accounts for that period were unavailable.
36. At the commencement of the final hearing, the Respondents maintained that the amounts that are payable in this regard for 2007 and 2008 were as follows:

| | BSC | | |
|-------------|----------------------------|---------------------------------|-----------------------------|
| | OS 703 Mr Carey | OS 705 Mrs Halliwell | OS 706 Mr Taylor |
| 2007 | £1,366.62 | £1,584.34 | £1,480.08 |
| 2008 | £2,824.11 | £3,286.95 | £2,659.96 |

| | ESC | | |
|-------------|----------------------------|---------------------------------|-----------------------------|
| | OS 703 Mr Carey | OS 705 Mrs Halliwell | OS 706 Mr Taylor |
| 2007 | £217.76 | £258.00 | £317.13 |
| 2008 | £798.22 | £982.43 | £873.80 |

37. During the hearing on 7 January 2010 the parties agreed that there were a number of subsidiary issues that needed to be determined in order to reach a conclusion on the principal issue of the amounts payable. It was agreed that the subsidiary issues are:
- a) Whether there are mathematical mistakes and/or inaccuracies within the service charge information provided in evidence by the Respondents.
 - b) Whether there are discrepancies between the general service charge certificates and the individual certificates sent to each of the Applicants.

- c) Whether there is duplication of costs within the service charge accounts.
 - d) Whether the costs of services are properly apportioned between residential and business occupiers of the development.
 - e) Whether services that have been provided were of a reasonable standard, with particular regard to:
 - The cleaning and decoration of the 7th floor of the Building,
 - The condition of the Murray Street entrance corridor,
 - The condition of the reception area/office, and
 - The condition of the communal waste area.
 - f) Whether costs incurred during 2007 in the provision of services itemised in paragraphs 2.1 and 2.2 of the Applicants' Statement of Claim are reasonable.
 - g) Whether costs incurred during 2008 in the provision of services itemised in paragraph 5.1 of the Statement of Claim are reasonable.
 - h) Whether costs incurred in connection with the operation of the communal heating system are recoverable under the service charge and, if so, whether the amounts charged are reasonable.
 - i) Whether costs incurred in insuring the Building are reasonable.
 - j) Whether the amounts claimed for management fees are reasonable.
38. In addition, whilst the Tribunal would not make a final determination of the amounts payable for 2009, it would provisionally consider whether the figures in the 2009 service charge budget are reasonable.
39. The final issue is whether the Tribunal should make an order under section 20C of the 1985 Act.

Issue a) : Whether there are mathematical mistakes and/or inaccuracies within the service charge information provided in evidence by the Respondents

40. The difficulties the Applicants have experienced in obtaining meaningful information to back up the service charge demands presented to them are at the heart of this case, and have led to the Applicants having

considerable mistrust in the reliability of any financial information the Respondents have produced.

41. The three Applicants purchased their respective apartments on various dates during 2007 and have since been receiving quarterly demands for BSC and ESC. LCAM had made available annual budgets detailing anticipated service charge expenditure. However, prior to these proceedings, no service charge statements or end of period accounts had been provided to the occupiers of the Building. There were various exchanges between the Applicants and LCAM on financial and management issues, such as the costs of insurance and energy supply and the amounts paid and payable under the service charge. Relations between the Applicants and LCAM appear to have become increasingly strained and no satisfactory resolution of these issues was achieved. No doubt the situation was not assisted by the lack of definitive service charge figures.
42. In response to the Tribunal's Directions, the Respondents submitted service charge statements and accounts for each of the Applicants in June 2009. Separate sets of information were provided in respect of the BSC and the ESC. However, whilst self-contained information was provided for 2008, the statements and accounts for the previous periods were presented in consolidated form, covering the period from 4 August 2006 (being the date of practical completion) to 31 December 2007. It was therefore impossible to make any meaningful comparison between the 2007 service charge budgets and the figures contained in the subsequent service charge statements and accounts. And, even in relation to the figures for 2008, it was very difficult to make such a comparison because the heads of expenditure in the service charge statements and accounts were significantly different to those in the budget for the corresponding period.
43. In recognition of these difficulties, the Respondents applied to the Tribunal in September 2009 for a variation of its case management Directions which would permit them to re-submit the financial information in a form which would be easier to understand, and which would hopefully narrow the issues between the parties. The Tribunal agreed to this request on the basis that revised accounts would be submitted during October 2009. This did not happen, and indeed it was not until the date initially set for the final hearing, 7 January 2010, that the Tribunal saw revised BSC and ESC statements and accounts covering the 2007 calendar year only. Not only was the information therein presented in a manner that facilitated an understanding of the allocation and apportionment of service charge costs, and a comparison with the 2007 budget but, unlike the previous version, the information related to a period of not more than twelve months. No doubt these changes were made on counsel's advice, for it is

clear that the earlier version of the statements failed to comply with the requirement in paragraph 2 of the second schedule to the Leases as regards the permissible length of the accounting period.

44. The late production of this crucial financial information required the Tribunal to adjourn the final hearing until late March 2010, by which time the Respondents had further refined the figures for 2007 and had also produced revised financial information for 2008. Thus it was not until these proceedings were at a very advanced stage that the Applicants were in possession of the definitive service charge statements and supporting accounts on which the Respondents would rely. It is therefore hardly surprising that they should continue to harbour doubts as to the reliability of this information. In Mrs Halliwell's case, these doubts about the accuracy of the figures were compounded by an ongoing disagreement with LCAM about how much she had actually paid in service charges since purchasing her apartment in 2007. A determination of that particular question is beyond the Tribunal's jurisdiction. However, the disagreement appeared to have arisen (at least in part) as a consequence of the complexity of LCAM's accounting practices and from a general lack of transparency. Whilst it was pleasing to note that some degree of consensus on the point seemed to be achieved during the course of the hearing, it is a pity that it had taken so long to achieve it.
45. Notwithstanding the difficult history of this matter, by the time of the Tribunal's determination, it had before it certified Building Statements and Estate Statements for each of the Applicants (for 2007 dated 28 January 2010, and for 2008 dated 27 or 28 January 2010) which were adequate for the purposes of paragraph 2 of the second schedule to the Leases, and which were supported by certified accounts in respect of each of the two accounting periods. Given the complexity of the occupation and management structures of both the Building and the Estate (already mentioned and discussed further under head d) below), this information is necessarily complex and remains quite difficult to follow. However, subject to some relatively minor defects which are taken into account elsewhere in this determination, the Tribunal was satisfied – having probed the integrity of the financial information over several days of oral evidence – that the final versions of the statements and accounts did stand up to scrutiny, and did form a valid basis for the Respondents' claims for the payment of service charges under the Leases. No mathematical mistakes or inaccuracies were noted by the Tribunal.
46. Nevertheless, in the course of re-formulating the Building Statements and Estate Statements for 2007, and also the Estate Statements for 2008, the Respondents decided to change the basis of allocation of a number of costs within the service charge and, as a consequence, the basis on which those costs were apportioned between occupiers (and hence the

amounts charged to each Applicant) also changed, leading to a significant increase in the total amounts payable by each Applicant in comparison with the total amounts shown as payable by them in earlier versions of the service charge statements. To their credit, the Respondents readily conceded at the final hearing that the Applicants should not be liable to pay any such 'balancing charge', and the Tribunal agrees. Consequently, once any other deductions have been made in pursuance of this determination, the final amounts payable in respect of BSC and ESC should be reduced by an amount, the "Balancing Adjustment", equal in each case to the difference between the original and revised charges, which are set out in the tables below.

| | BSC Balancing Adjustment | | |
|-------------|---------------------------------|---------------------------------|-----------------------------|
| | OS 703 Mr Carey | OS 705 Mrs Halliwell | OS 706 Mr Taylor |
| 2007 | £860.46 | £1,062.52 | £850.94 |
| 2008 | £1,054.68 | £1,312.13 | £928.73 |

| | ESC | | |
|-------------|----------------------------|---------------------------------|-----------------------------|
| | OS 703 Mr Carey | OS 705 Mrs Halliwell | OS 706 Mr Taylor |
| 2007 | £36.23 | £26.81 | £30.31 |

Issue b) : Whether there are discrepancies between the general service charge certificates and the individual certificates sent to each of the Applicants.

Issue c) : Whether there is duplication of costs within the service charge accounts.

47. Issues b) and c) can conveniently be dealt with together. The Applicants formulated their Statement of Case in this matter long before the final versions of the service charge certificates and supporting accounts (referred to above) became available. It is not therefore surprising that the Applicants found it difficult to reconcile the various financial information which was then available to them. However, the Tribunal noted that their allegations of inconsistencies between the service charge certificates and the underlying accounts on which they are based arose, at least in part, from an error in interpretation as it appears that an attempt was made to reconcile the service charge statements they had received with a set of accounts relating to the building service charge for McConnell, which clearly have no relevance to Old and New Sedgwick. The Applicants also appear to have made an incorrect assumption as to the basis on which expenditure is attributed to the service charge (ie., that costs are attributed

on a linear basis over time, when in fact they are attributed to the service charge period in which they are incurred).

48. As it happens, the re-presentation of the service charge statements and accounts during the course of these proceedings supersedes much of these arguments and, having obviously received the revised versions of the accounts and certificates, the Applicants did not pursue these issues in any detail at the final hearing, other than to voice their (understandable) concern as to the continuing complexity of the information and to reiterate their general lack of confidence in the Respondents' ability to produce reliable figures. In the event, the Tribunal was satisfied that there were no discrepancies between the final service charge certificates and the supporting sets of accounts. Nor did the Tribunal find any duplication of costs within the accounts or the individual certificates.

Issue d) : Whether the costs of services are properly apportioned between residential and business occupiers of the development.

49. Although the service charge machinery contained in the Leases is relatively straightforward, the application of the service charge in practice is extremely complex. This complexity arises not only from the fact that the costs of servicing and managing the Building and the Estate are accounted for separately, but also from the fact that the Estate, and indeed the Building, is occupied on a mixed-use basis which includes retail and office commercial occupiers, as well as residential occupiers, all of whom 'consume' services in different ways and to differing extents. In recognition of this uneven consumption of services, different categories of service charge expenditure must be apportioned between the occupiers of the Estate and the Building in such a way as to achieve a fair outcome.
50. During the hearing Mr Pryor provided a detailed explanation of the Respondents' approach to this challenge. A summary is also to be found in the explanatory notes accompanying each set of service charge accounts. The fundamental principle is that costs are apportioned on the basis of floor area. These apportionments are described in the explanatory note as follows:

"These operate in two ways. Where possible, costs are expended on an Estate-wide basis. The starting point is to apportion costs between the BSC and the ESC (the apportionment is to a large extent a question of judgment). Then it is necessary to appropriate costs between the three buildings in the Royal Mills Estate, Old and New Sedgwick, McConnell and Fairbairn. Each flat or unit in Royal Mills bears an area which forms a proportion of the overall area of the particular Building and the Estate ... This gives a simple

proportion that a particular flat bears to the overall area of Old and New Sedgwick Building.

“However, since the various services are used differently by different parts of Old and New Sedgwick Building, in particular the Business Centre under the canopy roof, and the simple area proportion that each flat bears to the entire building would not be a fair apportionment to use for all services, so instead a series of different apportionments are used for different costs. The costs in the [Building Statement] are divided between these apportionments thus:

- a. Apportionment #1 – these are costs that are used exclusively by the Residential Area only;
- b. Apportionment #2 – these are the services used by the Residential areas and Business Centre under the canopy roof but not by other commercial units within Old and New Sedgwick Building;
- c. Apportionment #3 – these are the costs used by the Business Centre only;
- d. Apportionment #4 – these are the cost of works, maintenance etc to Structural and Shared Common Parts.”

51. In addition, however, where a residential lease is granted part way through a service charge period (which, for 2007, is the case for each of the three Leases held by the Applicants), a further layer of apportionment is required, but based on time rather than floor area. The purpose of this apportionment is simply to ensure that if a lease has been in existence for, say, only the final three months of a one year service charge period, the associated liability for service charges will be for just one quarter of the amount that would have been payable had the lease endured for the whole of the period.
52. Thus, although the Leases simply provide that the Tenant is to contribute “such fair and reasonable proportion as is properly attributed to the Flat” of the relevant expenditure, this simplicity is deceptive: there is in fact no single percentage which can be applied to the total BSC expenditure in order to calculate an individual occupier’s contribution, as different percentages must be applied to different types of expenditure. There is, however, a fixed percentage for the ESC on the basis of the proportion that a unit’s floor area bears to the overall lettable space, although the costs comprised within the ESC may themselves have been subject to apportionment between the ESC and one or more of the three building service charges, and this is again subject to a time apportionment for ‘new’ leases.
53. The three apartments owned by the Applicants are considered ‘large’ in comparison with others in the Building, and so the Applicants bear a

greater proportion of the service charge costs than do many of their neighbours. However, because the three apartments do not have the same gross internal areas, they also bear slightly different percentages of BSC and ESC one with another. In addition, both Mrs Halliwell and Mr Taylor have the use of an Estate car park (whereas Mr Carey does not), so OS 705 and OS 706 bear an additional cost in this regard also. In addition, for 2007 the variances between the service charges for the three apartments are also increased by the fact that they are subject to differing time apportionments in recognition of the fact that the Leases were granted on different dates.

54. The Tribunal was satisfied that the above service charge apportionment structure, complex as it undoubtedly is, is appropriate to achieve an equitable distribution of costs between the different categories of occupier within the Estate and the Building. Mr Pryor was also able to demonstrate how the layers of apportionment could be tracked through the service charge budgets and accounts and from there to the individual Building Statements and Estate Statements in their final form.
55. Nevertheless, the Tribunal noted that a critical element in achieving such an equitable distribution of costs would be the judgments made as to the basic division of a particular head of expenditure between Estate costs and buildings costs, and between residential occupiers and commercial occupiers. The Tribunal explored this with the Respondents in some detail during the final hearing and, subject to one point concerning the cost of maintaining the sprinkler system (see below), was satisfied that these judgments were fair and based on reasonable considerations. For example, in apportioning the costs of staff time between the Estate and buildings service charges, the Tribunal heard that the initial apportionment was based on LCAM's experience in managing other complex developments, but that it was a decision tailored to the particular circumstances of Royal Mills Estate, and was kept under review by monitoring staff timesheets to check that the actual allocation of staff time between the various component parts of the development reflected the apportionments used to allocate staff costs to individual occupiers service charges.
56. The Tribunal was not satisfied that the current basis of apportioning the cost of maintaining the Building's sprinkler system was appropriate. These costs (which have only been incurred from 2008 onwards, as the sprinkler system was not in use before then) have been apportioned on a 60:40 split between the business and residential occupiers of the Building, and amounted to £4,600 in 2008. However, although the sprinkler system does protect areas on the ground floor of the Building to which residents have access, its primary purpose is to protect the Business Centre and the Tribunal accepted the Respondents' suggestion that it would be more

appropriate to apportion the cost between business and residential occupiers on a 75:25 basis. The Respondents accepted that this should be the case for future years. As far as the 2008 BSC is concerned, however, the Respondents also accepted that a deduction of £15.00 in respect of each apartment ("**Deduction A**") would represent a reasonable approximation of the difference between the two bases of apportionment.

Issue e) : Whether services that have been provided were of a reasonable standard, with particular regard to:

- **The cleaning and decoration of the 7th floor of the Building,**
- **The condition of the Murray Street entrance corridor,**
- **The condition of the reception area/office, and**
- **The condition of the communal waste area.**

57. The Applicants considered that the services with which they have been provided were, in certain respects, of an unsatisfactory standard. They complained that the communal corridor giving access to their apartments was poorly decorated and that dirt and damage was caused by workmen regularly using it as a means of access to the Building's roof, often depositing tools and equipment in the 7th floor lift lobby, thereby soiling the carpet. There had been a hole in the ceiling in the lift lobby area which it had taken some months to repair. The Applicants were particularly concerned about the condition of the communal refuse area on the ground floor, which they said was often dirty and malodorous. Mrs Halliwell had seen a rat in this area, which is accessed from the Murray Street corridor and which, it was asserted, also suffered from unpleasant smells emanating from the refuse area. Finally, the condition of the reception/management office, accessed via the atrium, was said to be poor.
58. The Tribunal was faced with conflicting evidence in relation to some of these issues. For example, the Respondents stated that the refuse area was properly cleaned and washed out once a week. Job sheets displayed in the refuse room corroborated this assertion, although the Applicants contested this, saying that the cleaning and maintenance of the Building had been stepped-up since the commencement of the proceedings and particularly in the run-up to the Tribunal's inspection visit. Whilst certainly not discounting this possibility, the fact was that at the time of the inspection, the refuse room was in a clean and acceptable condition. It was fitted with an extractor fan system designed to come on automatically when the lights in the room are turned on and the level of smell was no worse than one might expect in the circumstances. The smell was not noticeable from the Murray Street corridor when the door was closed, and the corridor itself was clean and well lit. The 7th floor corridor was clean, well-decorated and free from clutter. The repair to the ceiling was visible,

but had been effected to a satisfactory standard. The Respondents explained that the hole had originally been made to drain water caused by a leak in the roof above. It had been necessary to leave the hole exposed until the cause of the leak had been dealt with, and then the ceiling had been re-plastered and allowed to dry out before being repainted. The Tribunal accepted this explanation.

59. On balance, therefore, the Tribunal found that the services provided in respect of these matters had been provided to a reasonable standard. As far as the reception/management office was concerned, the Tribunal noted that 'reception' is something of a misnomer: it is not an area that visitors to the Building will generally visit, but rather an office for the building management staff. It is adequate for that purpose, and any embellishment of its presentation would presumably have to be reflected in increased service charges.

Issue f) : Whether costs incurred during 2007 in the provision of services itemised in paragraphs 2.1 and 2.2 of the Applicants' Statement of Claim are reasonable

60. The Tribunal next considered a number of specific challenges to the reasonableness of costs included in the 2007 BSC. These challenges had been formulated prior to the production of the final and definitive versions of the accounts and Building Statements, and the issues raised during the hearing were therefore slightly different from those itemised in the Applicants' Statement of Claim. It was also convenient to consider some heads of expenditure for 2007 and for 2008 at the same time.

Lift maintenance & telephone, and door entry systems

61. The Applicants considered that the total costs incurred for lift maintenance (£3,535) and lift telephone (£2,353) were unreasonably high – particularly in relation to the telephone which is solely intended to enable passengers to speak to a central control room in the case of a lift breakdown. They also questioned whether some costs incurred under this head (and others) were necessary given that much of the equipment in the Building should be covered by warranties.
62. The Respondents confirmed that various aspects of the Building's equipment was indeed covered by warranties, but made the point that warranties cover only the costs of rectifying defects, and not the cost of routine maintenance – which must be undertaken in order to preserve those warranties.
63. As far as lift maintenance costs are concerned, the Tribunal found these to be reasonable, both in terms of the aggregate cost and in terms of the

cost per unit, which is quite modest. There is a lift maintenance contract in place with Otis, but additional costs are incurred for repairs not covered by the contract, particularly those caused by misuse of the lifts, such as propping the lift doors open. The Respondents produced a copy of the maintenance contract and of invoices for some of the supplementary costs.

64. Although 'lift telephone costs' does cover the costs of some additional telecoms equipment, including alarm and door entry intercom systems, the total cost incurred did appear to be remarkably high. The Respondents acknowledged that an accounting error had been made in this regard and that this item had been overstated in the accounts by the sum of £1,405.79. The BSC for each of the Applicants must therefore be reduced by the appropriate percentage of this sum. The appropriate percentage is the percentage by reference to which the Applicants' contributions to lift telephone costs were calculated for 2007, as these appear on their individual Building Statements. These percentages, and the resulting deductions from the BSC ("**Deduction B**") are as follows:

| | Lift telephone (2007 BSC) | | |
|-------------------------------|---------------------------|-------------------------|---------------------|
| | OS 703 Mr Carey | OS 705 Mrs Halliwell | OS 706 Mr Taylor |
| Appropriate percentage | 0.44% | 0.45% | 0.54% |
| Deduction | £6.19 | £6.33 | £7.59 |

Heating plant maintenance and other mechanical and electrical equipment

65. In 2007, expenditure on heating plant maintenance was £59,095 (against a budgeted cost for that period of £7,500). In 2008, expenditure under this head was £39,431 (again against a budget of £7,500). The Tribunal was asked to determine the reasonableness of this expenditure for each year.
66. The Respondents' evidence was that, in respect of each service charge period, approximately £40,000 of this expenditure related to the maintenance of the two gas-fired boilers which service the Building. A copy of the maintenance contract was produced at the hearing. The remainder of the expenditure related to the costs of maintaining other pipework and electrical installations servicing the Building. In terms of the apparent divergence between the budgeted and actual costs, it was explained that the original intention had been to invoice separately for the costs of the boiler maintenance contract in like fashion to the method by which occupiers are charged for the consumption of gas (see issue (h) below). Consequently, the service charge budgets for 2007 and 2008 only included an estimation of the 'other' M&E maintenance costs, and excluded the principal cost – that of maintaining the boilers. In the event,

however, it had been decided to recover all these costs via the BSC on the basis of area apportionments. The 2009 budget reflected this change of approach for future periods.

67. The fact that this is a major item of expenditure is undeniable. However, the question for the Tribunal is whether or not it is reasonable, and in the absence of any evidence that the maintenance of the extensive and sophisticated M&E equipment within the Building could have been procured more cheaply, the Tribunal found no valid basis to interfere with the costs actually incurred. In reaching this conclusion the Tribunal noted the Respondents' evidence that the boiler maintenance contract had been entered into initially with the company that had installed the boilers, in order to preserve warranty protection, but that a process of competitive tendering was now underway to ensure value for money in future periods. The Tribunal also noted the Respondents' assurances that these costs did not include maintaining the separate 'CHP' system (the significance of which is discussed under issue (h) below), although they did include some modest costs relating to the monitoring of the interface between the CHP system and the gas-fired boilers.

Interior landscaping

68. There was some confusion as to the nature and extent of the services provided in connection with the provision of decorative plants in the common parts of the Building. However, it was established that a contract is in place for the rental of 12 plants and planters, situated adjacent to the Building's entrances and also in the atrium. The contract covers the maintenance of the plants, and their replacement with artificial plants if and when necessary. The total cost is £58 per week and whilst this is not significant, the Tribunal considers it to be a commercial rate for the service. The expenditure is reasonable.

Waste management and disposal

69. Domestic refuse is collected from the communal refuse areas on the Estate by Manchester City Council free of charge. However, the Respondents incur additional costs in respect of the removal of other waste – such as cardboard packaging and discarded furniture – on an ad hoc basis. In 2007, the cost attributed the BSC for waste management was £8,343. In 2008, the accounts actually show a credit of £1,017 under this head (presumably due to a realignment of costs on an Estate-wide basis). For 2007 and 2008 taken together, the total cost charged for waste management and disposal was therefore £7,326.
70. The Applicants maintained that this expenditure was unreasonable for two reasons. First, the Council provide a free, on-request removal service for

cardboard and furniture. Second, the waste disposal service is provided by a company associated with LCAM, and this brings into question whether the service is provided at a competitive rate.

71. The Respondents' position was that waste left in corridors and other common areas needs to be removed quickly in the interests of good estate management. Many of the apartments within the Building were purchased and furnished within a short period of time soon after the Building's completion, generating large quantities of discarded packaging. This was removed by a company called Livingcity Works Ltd, a sub-contractor of LCAM and the Respondents. Whilst a member of the same corporate group as LCAM, the company is managed separately from LCAM, and the terms on which it provides services are negotiated at arm's length, due regard being taken of the rates charged for similar services by its competitors. The costs of removing waste are attributed specifically either to the ESC or to the BSC for the particular building from which the waste in question was collected.
72. The Tribunal accepted that it is appropriate for LCAM to pay for waste disposal services where it is appropriate to do so in the interests of good estate management. It also found no impropriety with the arrangement entered into between LCAM and Livingcity Works Ltd in this regard. However, the Tribunal also concluded that in some instances it would have been appropriate to make use of the Council's free collection services in order to minimise costs. LCAM does not appear to have considered this as a possibility, and so the Tribunal concluded that the Applicants' contributions under this head of charge should be reduced over the two year period. The deduction ("**Deduction C**") should be applied to the 2007 BSC, but should also allow for the credit each Applicant received in 2008. The resulting deductions are therefore as follows:

| | Waste management (2007 BSC) | | |
|------------------------------------------|------------------------------------|---------------------------------|-----------------------------|
| | OS 703 Mr Carey | OS 705 Mrs Halliwell | OS 706 Mr Taylor |
| 2007 & 2008 contributions | £21.13 | £20.88 | £29.18 |
| Deduction | £10.57 | £10.44 | £14.59 |

Replacement of roof slates

73. During the inspection visit, the Tribunal was asked to note the arrangements for access to the exterior of the Building for the window cleaners. These entail the window cleaners descending from anchor points at roof level in order to access the windows on the floors below. In order to do that, they must cross the pitched roof, partly adjacent to OS

703, using a series of fixed roof ladders. However, the Applicants say (and it is not denied by the Respondents) that in fact the window cleaners habitually walk over the roof itself, trailing their safety ropes after them, and frequently cause damage to the roof slates in the process. The Applicants object to having to contribute to the replacement of roof slates damaged in this way, and also consider that the replacement slates are of an inferior quality in comparison with the originals.

74. The Tribunal agreed with the Applicants. Whilst it notes the Respondents' evidence that the window cleaners must walk on certain parts of the roof, such as valleys between the pitches, it cannot be sensible management practice to allow them routinely to damage the roof. In any event, the costs of repairing damage caused in this way should not simply be passed on to the Building's occupiers. Although the costs in question are not separately itemised in the BSC (being included under the head of 'Sundry repairs – external', the Respondents produced copy invoices showing that £434.75 had been spent on replacing roof slates in 2007, and £1,903.50 had been spent in 2008. The Tribunal found that these amounts were not reasonably incurred, and that the Applicants' contributions towards them should therefore be deducted from both the 2007 and 2008 BSC.
75. The deductions from the 2007 BSC ("**Deduction D**") are therefore as follows:

| | Sundry repairs - external (2007 BSC) | | |
|-------------------------------|---------------------------------------------|---------------------------------|-----------------------------|
| | OS 703 Mr Carey | OS 705 Mrs Halliwell | OS 706 Mr Taylor |
| Appropriate percentage | 0.32% | 0.33% | 0.39% |
| Deduction | £1.39 | £1.43 | £1.70 |

76. The deductions from the 2008 BSC ("**Deduction E**") are as follows:

| | Sundry repairs - external (2008 BSC) | | |
|-------------------------------|---------------------------------------------|---------------------------------|-----------------------------|
| | OS 703 Mr Carey | OS 705 Mrs Halliwell | OS 706 Mr Taylor |
| Appropriate percentage | 0.89% | 0.99% | 0.87% |
| Deduction | £16.94 | £18.84 | £16.56 |

Issue g) : Whether costs incurred during 2008 in the provision of services itemised in paragraph 5.1 of the Statement of Claim are reasonable

77. Again, the Applicants' case in relation to the specific matters set out in this part of their Statement of Claim had moved on in the light of the financial

information which had since become available. However, in addition to the issues discussed above, the Tribunal considered the following specific challenges to the 2008 BSC:

Staff costs

78. Based on their inspection of versions of the accounts that have since been superseded, the Applicants were concerned that expenditure on staff costs appeared to have increased by 99% in 2008. According to the final versions of the accounts, however, expenditure on 'Residential Staff Costs' was £16,131 in 2007. In 2008, expenditure under this head was £26,932; an actual increase of 67%. However, the Respondents explained that the 2008 figure actually included expenditure previously shown in the accounts under the heading of 'Cleaning – Internal Common Parts' which, for 2007, had been £9,400. Once this difference in presentation is taken into account, it is apparent that although combined staff/cleaning costs have increased, the amount of the increase is much more modest. The Respondents' evidence was that the increase is attributable to an increase in staff and cleaning resources across the Estate.
79. The Respondents provided an indicative schedule of the total Estate-wide staff costs, which also showed the basis on which those costs were to be apportioned between different parts of the Estate and its different categories of occupier. The Tribunal found no evidence that either the amount of these costs, or the basis on which they were apportioned, was unreasonable.

Fire equipment maintenance

80. The Applicants were also concerned about the increase in expenditure on 'Fire equipment maintenance' between 2007 and 2008: costs incurred under this heading had risen from £4,592 to £10,433. As noted above, £4,600 of this increase in expenditure is attributable to the maintenance of the Business Centre sprinkler system, as no such maintenance had been necessary in 2007 (the Tribunal has already considered the basis of apportionment of that element of the expenditure). Given that the costs of maintaining fire equipment would inevitably increase as the equipment itself ages, the Tribunal found the amount of expenditure under this heading was reasonable.

Maintenance of entrance gates

81. The Applicants wanted to know whether they were being required to contribute to the upkeep of a large pair of gates which provide access to the Business Centre from the street. No such expenditure was itemised within the 2008 accounts, but any sums reasonably incurred in the upkeep

of these gates would be recovered on a proportionate basis from all occupiers of the Building as such expenditure would relate to the upkeep of the exterior of the Building (to which all occupiers are required to contribute).

Interest on reserve funds

82. Finally, the Applicants queried why the service charge accounts showed that the Respondents were maintaining reserve funds of £45,000, but no credit was given for bank interest on such funds. It appears that the simple answer is that reserve funds exist as an accounting entry only: if all the service charges demanded from occupiers had been paid, then there would indeed be substantial funds in hand. However, the arrears position is such that no reserves have actually been accrued.

Issue h) : Whether costs incurred in connection with the operation of the communal heating system are recoverable under the service charge and, if so, whether the amounts charged are reasonable

83. Hot water is generated by two gas-fired boilers located in a central plant room on the ground floor of the Building. That hot water is then circulated around the Building to provide hot running water and heating for the Building's occupiers. A charge, based on the amount of heating and hot water used by individual occupiers, is included within the BSC. The charges ("gas costs") that have been included in the Applicants' individual BSCs for 2007 and 2008 are shown in the following table.

| | BSC Gas Costs | | |
|-------------|----------------------------|---------------------------------|-----------------------------|
| | OS 703 Mr Carey | OS 705 Mrs Halliwell | OS 706 Mr Taylor |
| 2007 | £430.52 | £620.02 | £316.95 |
| 2008 | £423.90 | £610.48 | £312.08 |

84. The Applicants dispute the gas costs on two levels. First, they challenge the Respondents' ability to include any charge for the provision of heating and hot water in the BSC. Second, they challenge the reasonableness of the gas costs.
85. The first of these issues can be dealt with reasonably shortly: the Tribunal finds that the Respondents do have power to include gas costs – provided those costs are reasonable – in the BSC. Paragraph 1(c) of the second schedule to the Leases (which defines the Building Service Charge Expenditure) provides that the BSC may include costs incurred "in the provision of services facilities amenities improvements and other works where the Landlord in the Landlord's reasonable discretion from time to time considers the provisions to be for the general benefit of the Building

and its tenants and whether or not the Landlord has covenanted to make the provision". It is clear that the provision of a communal heating and hot water system is a service which is of general benefit to the Building and its tenants and is therefore a service that the Respondents may charge for if they choose to provide it. The Applicants say that they were not notified, before they purchased their apartments, that there were communal facilities of this kind, and consider that they should not be forced to pay for heating and hot water provided by the Respondents. Issues about any pre-contract representations which may, or may not, have been made on this subject raise issues that go beyond the Tribunal's jurisdiction. In any event they do not alter express terms of the Leases, which are quite clear. To the extent that any occupier of the Building consumes heating and hot water provided by the Respondents, it is right that they should pay the reasonable costs of providing it.

86. The Tribunal then considered the reasonableness of the amount of the gas costs. Mr Calder, for the Respondents, explained in some detail the basis on which gas costs are incurred and then attributed to individual occupiers of the Building. Once again, the arrangements are of some complexity.
87. In essence, individual meters installed throughout the Building measure the amount of hot water that is supplied by the central gas-boilers to each apartment or other unit within the Building. A conversion factor is then applied to calculate the cost of the gas consumed in doing so. To this is added an extra amount to allow for the fact that a certain amount of heat (approximately 2 – 3% of the total generated, according to Mr Calder) is lost in transmission between the boilers and the meters that measure individual consumption. The aggregate of these two calculations for any given apartment or unit produces its total gas costs for the period in question. It can be seen, therefore, that gas costs are apportioned on the basis of actual consumption, rather than by reference to floor area, and the Tribunal agrees that this is the appropriate basis on which charges for gas costs should be made. It is equally apparent, however, that the reasonableness or otherwise of these charges is dependent upon the Respondents applying a conversion factor that produces a unit cost for heating and hot water which is itself reasonable.
88. The task of identifying an appropriate conversion factor is made more difficult by the complex and unusual technical set-up which exists within the Building and, in particular, by the fact that, in addition to the two gas-fired boilers mentioned above, the Building is equipped with a separate Communal Heating Plant (or 'CHP') system. Mr Calder likened the CHP system to a small gas-fired power station which is capable of generating electricity for the common parts of the Estate, a by-product of which process is heat that would supplement the conventional boilers in the

generation of hot water. The CHP system only operates efficiently if there is a certain minimum level of demand for the electricity it generates. That level of demand will only be seen (if at all) once Phase 2 of the Royal Mills development is complete. As a result, the CHP has not hitherto been brought online.

89. This leaves the Respondents needing to provide the Building with heating and hot water, but without the efficiency savings which the CHP could theoretically bring. In addition, the Respondents have, until recently, been purchasing the gas to fire the conventional boilers under a fixed-term, fixed-price contract with the utility supplier that had carried out the infrastructure works in the Ancoats area that were required to provide the Building with a gas supply in the first place. This contract had effectively capitalised the cost of those infrastructure works, with the result that the unit cost of the gas purchased by the Respondents was very high. The rationale for entering into such a commercial arrangement is unclear, but it is apparent that, had the conversion factor referred to above been based on the actual price for gas paid by the Respondents, the gas costs to individual occupiers would have been extremely high indeed. Taking 2007 as an example, it seems that gas costs calculated on this basis would have been an astounding £5,599.35 for OS 703; £8,063.65 for OS 705; and £4,121.92 for OS 706.
90. The Respondents acknowledged that an attempt to pass on these costs in full to tenants of the Building would be wholly unreasonable. The Tribunal agrees. Mr Calder's evidence was that the Respondents had instead considered a 'basket' of available domestic gas tariffs, and had taken the average cost per therm for the purposes of the conversion factor to be applied for the purposes of calculating the gas costs to be included in the BSC. The Respondents calculate that the resulting charges afford the Building's occupiers a 9% price advantage over the costs of operating individual electrical heating systems of the kind conventionally found in multi-occupied buildings. The Tribunal was satisfied that the approach adopted in this regard was reasonable.
91. The Tribunal queried the fact that gas costs attributed to the Applicants for 2007 were only marginally less than for 2008, notwithstanding the fact that none of the Applicants acquired their apartments until the second half of the year. The explanation (which the Tribunal accepted) was that difficulties in obtaining individual meter readings were such that individual bills had not been prepared for 2007, and the Respondents could not accurately apportion total individual consumption between 2007 and 2008: total consumption had therefore been apportioned between the two periods on a roughly 50:50 basis.

Issue i) : Whether costs incurred in insuring the Building are reasonable

92. The BSC accounts for 2007 show that expenditure incurred in insuring the Building was £83,176. For 2008, the figure is £70,877. The Applicants dispute the reasonableness of these costs. In particular, they point to the fact that the insurance premiums included a 35% commission payable to the insurance broker (the suggestion being that the broker may have been motivated to insure with the chosen insurer more by the prospect of a large commission than by the competitiveness of the premium). Mr Taylor also told the Tribunal that his own insurance adviser had told him that it would be possible to insure the Building for approximately £60,000, which figure would include any commission.
93. Mr Gallimore gave evidence on this issue on behalf of the Respondents. He noted that the insurance period runs from June and thus it is not coterminous with the accounting period for service charge purposes. As a consequence, the premium payable for a particular insurance year is attributed to two service charge periods. This has a tendency to flatten out changes in the amount of premium payable for service charge purposes. However, Mr Gallimore was able to confirm that the premium payable to Norwich Union/Aviva (with whom the Building has been insured since completion) decreased in the second year, that is from June 2008, but has increased significantly for the current period, that is from June 2009. Mr Gallimore considered that the increased cost of insurance reflected not only the claims history in respect of the Building, but also a general market increase in insurance premiums.
94. Mr Gallimore informed the Tribunal that the insurance of the Building is arranged on the Respondents' behalf by independent insurance brokers, Bollington Commercial Limited. This is one of a small number of specialised brokers in the Manchester area which, in Mr Gallimore's view, have the expertise and experience to deal with the Building. He confirmed that the brokers did receive a commission for placing the insurance with Norwich Union/Aviva, and that this commission was indeed in the region of 35% of the premium. However, he considered this to be a private arrangement between insurer and broker. Neither the Respondents nor LCAM share in the commission and, critically, it does not affect the overall cost of the insurance to the Respondents (and thus to tenants of the Building). This is because insurance commissions are not 'added on' to the premium, but are instead negotiated between the insurer and the broker once the insurer has assessed the risk and decided the premium. In other words, the amount of the commission affects the amount of premium the insurer receives, and not the amount the policy holder pays.
95. When the insurance was renewed in 2009, the brokers sought quotes from 15 insurers. Ten declined to offer cover. Three insurers provided

quotes which were not considered to be competitive. The remaining two insurers offered similar quotes and the decision was taken to renew the policy with Aviva, which was regarded as offering best value not only in terms of price but also in policy terms and claims administration.

96. Finally, Mr Gallimore was of the view that the competitiveness of the current insurance arrangements could be demonstrated by comparing the buildings insurance rate obtained from Aviva with rates achieved for the insurance of other developments. For 2009, the buildings rate for the Building is 0.0833% (plus a terrorism premium of 0.0319%). This compares very favourably with the rates obtained for other developments managed by LCAM (for example, Marshall Mill in Leeds, where the current buildings insurance rate is 0.16%; and Smithfield, Manchester, where the rate is approximately twice that for Royal Mills).
97. Taking all of these matters into account, the Tribunal was satisfied that the costs attributed to the BSC for both 2007 and 2008 in respect of the insurance of the Building are reasonable. Whilst having due regard to Mr Taylor's evidence, the Tribunal was disadvantaged by the absence of any direct evidence from Mr Taylor's advisor as to the matters he had taken into account, and the precise terms on which alternative insurance might be available. It was therefore unable to accept the contention that equivalent insurance could have been found at a significantly reduced cost.

Issue j) : Whether the amounts claimed for management fees are reasonable

98. Management fees are included in both the BSC and to the ESC. The total management fees shown in the service charge accounts for 2007 and 2008 are set out in the following table:

| | Management Fees | |
|-------------|-----------------|---------|
| | BSC | ESC |
| 2007 | £23,489 | £15,208 |
| 2008 | £23,458 | £17,594 |

99. The Applicants challenged the reasonableness of these fees, pointing out that they exceeded the budgeted forecasts for management fees (which were £20,000 pa for the BSC and £15,000 pa for the ESC). They also pointed to the general service charge arrears position for the Estate, and their own dissatisfaction with the management services provided by LCAM, as evidence of inadequate management of the Estate, justifying a reduction in the level of management fees payable.

100. Mr Gallimore's evidence was that LCAM have been involved with the management of the Estate since its inception. There is a separate management fee for each building and for the Estate. Each such fee is independently apportioned between the different categories of occupier. The amount of the fee does not depend on the amount of the overall service charge costs, but is a fixed global fee, the apportionment of which varies according to the number of occupiers. The average annual management fee for residential occupiers of the Building is £213.92 inclusive of VAT. However, given that the gross internal area of the Applicants' apartments is larger than average, they will tend to bear a larger than average management fee. Mr Gallimore considered the level of management fees to be reasonable and well within the known parameters of the fees charged by LCAM's competitors, which indicate that the going rate for management fees in respect of Manchester city centre apartments is between £200 and £300 per annum, exclusive of VAT. As far as the divergence from budget is concerned, Mr Gallimore explained that the budgets had failed to reflect the fact that management fees are subject to VAT. It was noted that, for 2009, the budget for management fees had been increased to £21,000 exclusive of VAT for the BSC, and £15,750 exclusive of VAT for the ESC.
101. The Tribunal was satisfied that the basis on which management fees are applied to the service charge is, in principle, reasonable and that the amount of those fees for 2007 and 2008 would also have been reasonable had the management of the Estate and Building been of a reasonable standard. However, the Tribunal found that, in certain respects, there had been significant failings in management which justified a reduction in the amount of management fees included in the service charge for 2007 and 2008.
102. Although the Tribunal found that in most respects the day to day management of the Estate and Building was of a satisfactory standard, there have clearly been some difficulties in terms of management. The Tribunal was made aware that a notice under section 22 of the Landlord and Tenant Act 1987 had been served jointly by the tenants of some 65 apartments on the Estate as a preliminary to a possible application for the appointment of a manager. The Tribunal was not concerned with that matter in the present proceedings. However, whilst the evident dissatisfaction of the parties to that notice does not itself amount to evidence of unsatisfactory management practices, neither is it a ringing endorsement of the present arrangements. In addition, the Applicants had themselves presented evidence of their own dissatisfaction in terms of the way in which LCAM had responded to their complaints and queries in the period before the commencement of these proceedings.

103. Of greater concern, however, was the fact that these proceedings had highlighted serious deficiencies in the administration of the service charge itself. The effect of the relevant provisions of the Leases, read in conjunction with section 19 of the 1985 Act, is that tenants are entitled to expect not only that service charge expenditure will be reasonable in amount, and that services will be provided to a reasonable standard, but also that they will be presented, in a timely fashion, with the information they need to verify that this is the case. That had not happened in this case. Prior to bringing these proceedings, no service charge accounts had been provided, even for 2007. When, pursuant to the Tribunal's Directions, accounts and associated statements were produced, they were largely incomprehensible and (as far as the initial service charge period was concerned) made up for an impermissible accounting period. It took some months more, and two revisions, before accounts and statements were made available that were both compliant with the requirements of the Leases and comprehensible. This does not reflect a reasonable standard of service.
104. The Tribunal concluded that the identified failings in the standard of management services required that the management fees included in the BSC and ESC for both 2007 and 2008 should be reduced by 25% across the board. The effect of this on the amounts payable by the Applicants is set out in the following tables.
105. In relation to the 2007 BSC, the deductions ("Deduction F") are as follows:

| | Management fees (2007 BSC) | | |
|----------------------------------------------|-----------------------------------|---------------------------------|-----------------------------|
| | OS 703 Mr Carey | OS 705 Mrs Halliwell | OS 706 Mr Taylor |
| Contributions from Building Statement | £74.46 | £76.45 | £92.38 |
| Deduction | £18.62 | £19.11 | £23.10 |

106. In relation to the 2007 ESC, the deductions ("Deduction G") are as follows:

| | Management fees (2007 ESC) | | |
|--------------------------------------------|-----------------------------------|---------------------------------|-----------------------------|
| | OS 703 Mr Carey | OS 705 Mrs Halliwell | OS 706 Mr Taylor |
| Contributions from Estate Statement | £33.75 | £34.64 | £41.81 |
| Deduction | £8.44 | £8.66 | £10.45 |

107. In relation to the 2008 BSC, the deductions ("Deduction H") are as follows:

| | Management fees (2008 BSC) | | |
|----------------------------------------------|-----------------------------------|---------------------------------|-----------------------------|
| | OS 703 Mr Carey | OS 705 Mrs Halliwell | OS 706 Mr Taylor |
| Contributions from Building Statement | £208.78 | £232.23 | £204.08 |
| Deduction | £52.20 | £58.06 | £51.02 |

108. In relation to the 2008 ESC, the deductions ("Deduction I") are as follows:

| | Management fees (2008 ESC) | | |
|--------------------------------------------|-----------------------------------|---------------------------------|-----------------------------|
| | OS 703 Mr Carey | OS 705 Mrs Halliwell | OS 706 Mr Taylor |
| Contributions from Estate Statement | £109.63 | £121.91 | £106.99 |
| Deduction | £27.41 | £30.48 | £26.75 |

Summary of amounts payable

109. It follows from all of the above that the amounts payable by the Applicants in respect of service charges under the Leases can be summarised as follows:
110. For 2007, the Building Service Charge is:

| | 2007 BSC | | |
|---------------------------------------------------|----------------------------|---------------------------------|-----------------------------|
| | OS 703 Mr Carey | OS 705 Mrs Halliwell | OS 706 Mr Taylor |
| Total contribution from Building Statement | £1,366.62 | £1,584.34 | £1,480.08 |
| Less: | | | |
| Deduction B | £6.19 | £6.33 | £7.59 |
| Deduction C | £10.57 | £10.44 | £14.59 |
| Deduction D | £1.39 | £1.43 | £1.70 |
| Deduction F | £18.62 | £19.11 | £23.10 |
| Sub-total | £1,329.85 | £1,547.03 | £1,433.10 |
| Less: | | | |
| Balancing Adjustment | <u>£860.46</u> | <u>£1,062.52</u> | <u>£850.94</u> |
| Total payable | £469.39 | £484.51 | £582.16 |

111. For 2007, the Estate Service Charge is:

| | 2007 ESC | | |
|-------------------------------------------------|--------------------|-------------------------|---------------------|
| | OS 703 Mr Carey | OS 705 Mrs Halliwell | OS 706 Mr Taylor |
| Total contribution from Estate Statement | £217.76 | £258.00 | £317.13 |
| Less: | | | |
| Deduction G | £8.44 | £8.66 | £10.45 |
| Sub-total | £209.32 | £249.34 | £306.68 |
| Less: | | | |
| Balancing Adjustment | <u>£36.23</u> | <u>£26.81</u> | <u>£30.31</u> |
| Total payable | £173.09 | £222.53 | £276.37 |

112. For 2008, the Building Service Charge is:

| | 2008 BSC | | |
|---------------------------------------------------|--------------------|-------------------------|---------------------|
| | OS 703 Mr Carey | OS 705 Mrs Halliwell | OS 706 Mr Taylor |
| Total contribution from Building Statement | £2,824.11 | £3,286.95 | £2,659.96 |
| Less: | | | |
| Deduction A | £15.00 | £15.00 | £15.00 |
| Deduction E | £16.94 | £18.84 | £16.56 |
| Deduction H | <u>£52.20</u> | <u>£58.06</u> | <u>£51.02</u> |
| Sub-total | £2,739.97 | £3,195.05 | £2,577.38 |
| Less: | | | |
| Balancing Adjustment | <u>£1,054.68</u> | <u>£1,312.13</u> | <u>£928.73</u> |
| Total payable | £1,685.29 | £1,882.92 | £1,648.65 |

113. For 2008, the Estate Service Charge is:

| | 2008 ESC | | |
|-------------------------------------------------|--------------------|-------------------------|---------------------|
| | OS 703 Mr Carey | OS 705 Mrs Halliwell | OS 706 Mr Taylor |
| Total contribution from Estate Statement | £798.22 | £982.43 | £873.80 |
| Less: | | | |
| Deduction I | <u>£27.41</u> | <u>£30.48</u> | <u>£26.75</u> |
| Sub-total | £770.81 | £951.95 | £847.05 |
| Less: | | | |
| Balancing Adjustment | <u>NIL</u> | <u>NIL</u> | <u>NIL</u> |
| Total payable | £770.81 | £951.95 | £847.05 |

2009 service charges

114. As noted earlier in this determination, the Tribunal considered that it would be inappropriate to make a final determination of the amounts payable by the Applicants in respect of the 2009 BSC and ESC. At the time these proceedings were commenced, the 2009 accounting period was still current and, even by the date of the final hearing, the Respondents had not had a reasonable period in which to finalise the 2009 accounts and associated service charge statements, particularly given the fact that the accounts for earlier periods were themselves in a state of flux until shortly before that hearing. The fact that the Tribunal makes no determination in this respect means that the Applicants retain the right to make a future application for a determination of their 2009 liability should they wish to do so.
115. Nevertheless, the Tribunal has indicated its view of the general approach which it would expect to see carried through to the 2009 service charge in terms of major items such as insurance, gas costs and management fees. In addition, the Tribunal took note of the service charge budget for 2009 which was produced at the hearing by the Respondents. Mr Gallimore assured the Tribunal that the final accounts and statements for 2009 are likely to show few, if any, significant departures from the budgeted costs. It is also to be expected that the accounts and service charge statements for 2009 and beyond will be produced in timely fashion and in line with the approach which was finally adopted for the 2007 and 2008 accounting periods.

The application under section 20C of the 1985 Act

116. The Tribunal finally considered whether it should make an order to prevent the costs which the Respondents have incurred in these proceedings from being recoverable by means of future service charges. The Respondents confirmed at the hearing that they would not be seeking to recover their costs by these (or other) means and, for the avoidance of doubt, the Tribunal decided to make the order applied for. In doing so, the Tribunal had regard not only to the fact that the Applicants had successfully challenged the amounts of the BSC and ESC on a number of grounds, but also that the more timely production of final, clear and consistent accounts by the Respondents would probably have served to shorten these proceedings by a number of months, and to have reduced the number of issues which were in dispute between the parties.



.....
Jonathan Holbrook
Chairman

24 May 2010