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FIRST-TIER TRIBUNAL
PROPERTY CHAMBER
(RESIDENTIAL PROPERTY)

Case Reference	:	**LON/00BK/LSC/2016/0042**
Property	:	**56 Westbourne Terrace, London W2 3UJ**
Applicant	:	**56 Westbourne Terrace Freeholders Association Limited**
Representative	:	**Mr J Sandham, Counsel**
Respondents	:	**The leaseholders of the Property as listed in Appendix 1**
Representative	:	**Mr J Ross, Solicitor, of Forsters LLP (just representing Mr & Mrs Perry and Ms Thorn)**
Type of Application	:	**For the determination of the liability to pay a service charge**
Tribunal Members	:	**Judge P Korn** **Mrs E Flint DMS FRICS IRRV**
Date and venue of Hearing	:	**31st August 2016 at 10 Alfred Place, London WC1E 7LR**
Date of Decision	:	**16th September 2016**

DECISION

Decision of the Tribunal

(1) The amount payable by the Respondents between them by way of estimated service charge for the year to 31st March 2016 (each according to their respective share) is £15,300.00.

(2) In the context of a possible cost application, the further directions in paragraph 42 below should be noted.

Introduction

1. The Applicant seeks a determination pursuant to section 27A of the Landlord and Tenant Act 1985 ("**the 1985 Act**") as to the reasonableness and payability of the estimated service charge for the year to 31st March 2016 which it proposes to charge to the Respondent.

2. The relevant statutory provisions are set out in Appendix 2 to this decision. Within the hearing bundle are copies of the leases of Flat 1 and Flat 2. It was common ground between the parties that the two leases are in the same form as each other and as the other flat leases for all relevant purposes. References below to "the Lease" are to the lease for Flat 2.

3. There are 10 leaseholders but 11 leases in total as Mr Davies is the leaseholder of two flats (Flats 9 and 11).

Preliminary points

4. It was noted by the Tribunal at the outset of the hearing, and accepted by both parties, that the proper Applicant in this case is 56 Westbourne Terrace Freeholders Association Limited as the Respondents' landlord, and not its managing agent.

5. The Applicant was represented at the hearing by Mr Sandham of Counsel. As regards the Respondents, Mr and Mrs Perry and Ms Thorn were represented by Mr J Ross, solicitor, of Forsters LLP, but the other Respondents were not represented.

Applicant's case

6. The Applicant was seeking a determination, pursuant to sections 27A(3) and 19(2) of the 1985 Act as to the reasonableness of the budgeted expenditure for the year to 31st March 2016. It was common ground between the parties that the service charge certificates for the year to 31st March 2016 had not yet been produced and that the debits or credits to be applied to the service charge account had not yet been ascertained.

7. At the hearing, Mr Sandham accepted that the 2015/16 year had already ended and that it was a little unusual to consider the estimated service charge at this stage, but the year was not closed because audited accounts had not yet been produced. He said that there was a history of litigation, and if the Applicant had waited to make an application to the Tribunal as to the reasonableness of the actual costs this would have involved a long wait. Mr Sandham characterised the application as a noble attempt to head off litigation.

8. In the Applicant's submission, provided that the estimate of budgeted expenditure has been made in good faith there is little or no scope to challenge the estimate except by relying on section 19(2) of the 1985 Act, and Mr Sandham referred the Tribunal to the case of *Pendra Loweth Management Ltd v Mr & Mrs North (2015) UKUT 91 (LC); (2015) L. & T.R. 30.*

9. The budgeted expenditure for the previous year, namely the year to 31st March 2015, was £24,950. The budgeted expenditure for the year to 31st March 2016, i.e. the year in respect of which a determination is sought, is the lower amount of £22,860.

10. Only a limited number of items were being disputed by Mr and Mrs Perry and by Ms Thorn, namely (i) the anticipated costs of audit/accountancy (£850), (ii) company secretarial costs (£300), (iii) professional fees (£600), (iv) directors' and officers' insurance (£300) and (v) a £5,000 provision for the reserve fund.

11. As regards the anticipated costs of audit/accountancy, in the Applicant's submission there could be no objection to paying these as the Lease makes express provision for the recovery of these in paragraph 1(1)(ii) of the Third Schedule. The accounts were also considered to be in furtherance of the landlord's obligations under clause 5 of the Lease. Similarly, the Applicant submitted that the professional fees were prima facie recoverable under clause 5(e) and that this was sufficient in the context of estimated unknown fees.

12. As regards the company secretarial costs and the directors' and officers' insurance, the leaseholders covenanted under paragraph 1(1) of Schedule 3 to the leases to contribute to "the total expenditure incurred by the Lessor in any Accounting Period (i) in carrying out their obligations under Clause 5 of this Lease". Since the Applicant's principal activity was that of property management on behalf of members it followed, in the Applicant's submission, that its administrative costs should be recoverable. Specifically in relation to the directors' and officers' insurance, in the Applicant's submission it was an implied term of the Lease that in order to function the landlord (if a company) needed to incur that sort of cost, and Mr Sandham referred the Tribunal to the overall definition of Total Expenditure in this regard.

13. As a general point, Mr Sandham said at the hearing that all company-related costs should be recoverable from leaseholders as it was a leaseholder-owned company and therefore the distinction was artificial.

14. In relation to the reserve fund, the Applicant was entitled to make provision and such sums were treated in the Lease as expenditure incurred: see clause 5(h). The expenditure was in pursuance of a 10-year major works plan. Mr Sandham also submitted that as a result of an earlier tribunal decision the only way for the Applicant to fund major works in advance without borrowing was by making provision in the reserves in this way.

Mr Cross's evidence

15. Mr Cross was a Property Services Manager employed by KDG Property Limited, managing agents for the Applicant, and had provided a written witness statement. At the hearing he said that he did have the Applicant's authority for making the application.

16. In cross-examination he accepted that the running costs for 2014/15 were nearer £10,000. Mr Ross asked him why there were two separate sections in the 2015/16 budget and put it to him that section 1 related to corporate expenditure as distinct from service charge expenditure, but Mr Cross said that he was unable to comment. He had not set the budget and so was unable to answer any questions on it.

17. Mr Cross said that the application had been made by someone who no longer worked at KDG. He was not aware of any dispute having precipitated the application and could not comment on the rationale for the application.

18. When asked whether he considered £22,860 to be a reasonable budget Mr Cross says that it was because it was in line with the previous estimate. Specifically as regards the accounting fee in the budget, Mr Cross said that this related to year end accounts.

Respondents' response

19. Mr and Mrs Perry and Ms Thorn had only become aware of the application in June of this year, as the Applicant had not served a copy on the Respondents.

20. Mr Ross referred the Tribunal to paragraph 10 of Mr Perry's written witness statement in which he stated that the real concern about the use of service charge funds was that the Applicant had incurred irrecoverable fees of approximately £14,000 in pursuing previous unsuccessful proceedings and had recourse to the sinking fund in order to make payment of at least some of these fees.

21. In Mr Ross's submission, the Applicant's actions – for example in stating to the Tribunal that there were no respondents – were aimed at making an application without the Respondents knowing anything about it. In addition, the Applicant did not serve any evidence on the Respondents until the Thursday before the hearing.

22. The sole basis for the reasonableness of the budget seemed to be the amount of the previous budget. It was also of concern that even now the Applicant claims not to be able to tell the Respondents what the actual expenditure has been for 2015/16. This is despite the fact that it is a small building and the service charge year ended 5 months ago. It was a reasonable assumption, in Mr Ross's submission, that if the actual expenditure was similar to budgeted expenditure the Applicant would have said so.

23. Mr Ross said that Mr Cross, despite being the Applicant's only witness, was unable to comment on anything. The budget had been plucked out of thin air, and it was a low maintenance building.

24. On a specific point, there was no provision in the Lease for recovery of company expenditure.

Tribunal's analysis and determination

25. This application is for a determination as to the reasonableness of the 2015/16 budget. However, notwithstanding Mr Sandham's reference to a history of litigation and this being a noble attempt to head off litigation, the evidence before the Tribunal that the Respondents are frequent and/or unreasonable litigators is very thin indeed, as is the evidence that the budget was disputed or even known to the Respondents prior to the application being made.

26. We note that initially the Applicant's managing agents were not legally represented. However, the nature of their dealings with the Tribunal and with the Respondents following the issuing of the application suggests a lack of willingness on their part either (a) for the Respondents to be involved in the process or (b) to substantiate their case in support of the application.

27. The Applicant's only witness, Mr Cross, was not aware of any dispute having precipitated the application and could not comment on the rationale for the application. Furthermore, despite being the Applicant's only witness, Mr Cross was unable at the hearing to provide any pertinent information or to provide answers to relevant questions. This is not necessarily Mr Cross's fault personally, but it is indicative of an application which – if not intrinsically misconceived – has at the very least been made and pursued seemingly without adequate thought.

28. The Applicant's position appears to be that the budget for 2015/16 is reasonable because it is slightly less than the budget for 2014/15. However, in our view it is simply not reasonable to base a budget solely on the previous year's budget, particularly where – as here – the previous year's budget exceeded actual expenditure by £9,072.24, i.e. by over 57% of actual expenditure.

29. As noted by the Tribunal at the hearing, there are various factors that a reasonable landlord could take into account when trying to set a reasonable budget. The previous year's actual expenditure is of relevance, and it is surprising that the previous year's expenditure was not known when the budget was put together. Even if it was not known in detail, this is a small building and the Applicant should at the very least have had rough final figures available. Actual expenditure in the two or three years prior to 2014/15 is also of relevance, and there is no evidence before us that this was taken into account either. In addition, knowledge of particular anticipated items of expenditure and/or knowledge of reasons why particular items of expenditure might not be incurred in 2015/16 would also be relevant, but again there is no evidence before us that these points have been considered. There is also no evidence that the budget has been tested against known expenditure in 2015/16 itself, even though the service charge year in question ended 5 months before the hearing.

30. To the extent that the Applicant has focused on the issues, it has limited itself almost entirely to those items which have been disputed by Mr and Mrs Perry and Ms Thorn. However, Mr and Mrs Perry and Ms Thorn are not the applicants and it was for the Applicant to substantiate its own case, not merely to respond to comments made by some of the Respondents on specific issues, especially in the absence of a properly argued case on the Applicant's part to which the Respondents might have been able to respond more fully if the Applicant had articulated its case.

31. Mr Sandham has referred us to the Upper Tribunal decision in *Pendra Loweth Management Ltd v Mr & Mrs North* by way of support for the proposition that there is little or no scope for challenging an estimated service charge except by relying on section 19(2) of the 1985 Act. We accept that this was the Upper Tribunal's conclusion, but the key point here is that the estimated service charge can be challenged under section 19(2). Unlike *Pendra*, this is not a case which turns on the precise methodology of the process gone through by the landlord in preparing the budget; the issue here is that there is almost no evidence that the landlord has been through any sort of process at all. Also unlike *Pendra*, this is not a case in which anyone is seeking to argue that the reasonableness of the estimated service charge is connected to non-compliance with technical requirements such as the provision of certified accounts.

32. Under section 19(2), *"where a service charge is payable before the relevant costs are incurred, no greater amount than is reasonable is so payable, and after the relevant costs have been incurred any necessary adjustment shall be made by repayment, reduction or subsequent charges or otherwise"*. The issue is the reasonableness or otherwise of the estimated charge. As a result of the inadequacy of the Applicant's case, we are unable to conclude that the estimated service charge figure for the 2015/16 year is a reasonable one; indeed, it is simply unclear to us on what basis the figure has been chosen, save for the insufficient reason that it is similar to the overestimated figure for 2014/15. We are therefore forced to substitute an alternative figure, albeit in circumstances of unsatisfactory information on which to base such alternative figure.

33. In our view, the most reasonable starting point is the actual expenditure for 2014/15, in the absence of details of the actual expenditure for 2015/16. Neither party has brought any evidence to demonstrate that the expenditure for 2014/15 was either exceptionally high or low and therefore we consider that it can also serve as a reasonable estimate of the expenditure for 2015/16 subject to any specific other factors which are apparent from the limited evidence. The starting point, therefore, is £15,892.83, which we will round up (as we are just dealing with an estimate) to £15,900.00. In our view, the only other factor to take into account on the basis of the evidence is whether there are any categories of expenditure which are irrecoverable as a matter of interpretation of the Lease. If there are any irrecoverable categories then this would also have been the case in 2014/15. If an itemised budget is being presented for a determination as to payability, then in our view those items (if any) which are irrecoverable as a matter of interpretation of the Lease must be adjudged not payable.

34. We are satisfied that most of the items in the budget are of a type (if not necessarily an amount) which makes them recoverable in principle under the Lease, and in the absence of a specific challenge we do not consider it necessary to list them one by one. We will therefore just focus on those categories which are the subject of a dispute.

35. In relation to the reserve fund contribution, clause 5(h) of the Lease allows the landlord *"to set aside (which setting aside shall for the purposes of the Third Schedule hereto be deemed an item of expenditure incurred by The Lessor) such sums of money as The Lessor shall reasonably require to meet such future costs as The Lessor shall reasonably expect to incur of replacing maintaining and repairing those items which The Lessor has hereby covenanted to replace maintain or renew"*. Under clause 4(1) the tenant covenants to pay the Interim Charge at the times and in the manner provided in the Third Schedule. The Interim Charge is defined in the Third Schedule as a sum on account of the Service Charge, and the Service Charge is defined by reference to Total Expenditure.

36. Total Expenditure is defined as *"the total expenditure incurred by The Lessor ... (i) in carrying out their obligations under Clause 5 of this Lease (ii) in paying the fees of Accountants and Managing Agents and other professional fees for preparing and auditing accounts required under this Schedule and (iii) in putting aside any reserves properly and reasonably required for the running and maintenance of The Building (including the provision of a reserve on account of anticipated future expenditure) and in connection with the performance and observance during the whole of The Term of the covenants on the part of The Lessor herein contained".*

37. We are satisfied that the definition of Interim Charge is wide enough to include reserve fund contributions as it cross-refers to the definition of Total Expenditure which itself includes in paragraph (iii) putting aside reserves and also in paragraph (i) refers to expenditure incurred in carrying out the landlord's obligations under clause 5, which includes clause 5(h) referred to above.

38. As regards the anticipated costs of audit/accountancy, paragraph (ii) of the definition of Total Expenditure above covers the landlord's expenditure *"in paying the fees of Accountants and Managing Agents and other professional fees for preparing and auditing accounts required under this Schedule"*, and in our view this is wide enough to cover anticipated costs of audit/accountancy.

39. As regards professional fees, under clause 5(e) of the Lease the landlord covenants to *"(i) employ such staff (if any) ... as may be reasonably necessary to carry out any of the duties herein specified which The Lessor may require (ii) retain the services of managing agents to manage the Building (iii) employ from time to time such contractors as may be necessary to enable The Lessor to meet its obligations hereunder and (iv) enter into such service or maintenance contracts as may be necessary ...".* As noted above, the definition of Total Expenditure includes expenditure in carrying out the landlord's obligations under clause 5, and this includes clause 5(e). Whilst in our view clause 5(e) does not necessarily cover all types of professional fee, the item in dispute is an estimated amount for whatever professional fees may arise, and we consider this provision to be wide enough to cover professional fees as a general concept. Once the actual service charge has been calculated there may be questions as to whether specific types of professional are recoverable, but this does not prevent the Applicant allocating an amount to professional fees generally.

40. As regards company secretarial costs and the directors' and officers' insurance, Mr Sandham has argued that leaseholders are obliged to contribute towards the cost of the Applicant complying with its obligations under the Lease and that since the Applicant's principal activity is that of property management on behalf of members it follows that its administrative costs should be recoverable. He has also argued

that all company-related costs should be recoverable from leaseholders as the Applicant is a leaseholder-owned company and therefore the distinction is an artificial one. However, we do not accept this. There is no specific provision in the Lease covering these items, nor in our view is there a more general provision which could reasonably be interpreted as covering them. There is no evidence that the original landlord was a leaseholder-owned company and therefore that the parties might have had it in mind when entering into the Lease that company costs would be recoverable under the service charge. But in any event there cannot, in our view, be a general presumption that the landlord's internal company costs can be recovered from leaseholders through the service charge in the absence of an express provision allowing it to do so, and provision for recovery of these costs from flat owners needs to be made in the normal way in their capacity as members of the company in such proportions as may be agreed.

41. Therefore, neither the estimated company secretarial costs of £300 nor the estimated directors' and officers' insurance of £300 is payable. As our starting point was that £15,900 would be a reasonable estimated charge in the absence of any specific reasons further to reduce it, the amount payable is further reduced by £600 to reflect the irrecoverable nature of company secretarial costs and directors' and officers' insurance, and therefore the amount payable by the Respondents between them by way of estimated service charge for the year to 31st March 2016 (each according to their respective share) is £15,300.

Cost Applications

42. No cost applications have yet been made, but Mr and Mrs Perry and Ms Thorn ("**the Represented Respondents**") have reserved their position as regards the possibility of a cost application under Rule 13(1)(b) of the Tribunal Procedure (First-tier Tribunal) (Property Chamber) Rules 2013. If the Represented Respondents wish to pursue such a cost application they must make such application in writing to the Tribunal by no later than 5pm on **30th September 2016**, copying the Applicant in to the application. Such application shall contain (i) a breakdown of the costs in respect of which recovery is sought (ii) a brief narrative explaining what each item relates to (iii) details of fee rates where recovery of fees is sought and (iv) a brief supporting statement explaining the basis on which the application is being made. If the Represented Respondents do make such a cost application the Applicant may send to the Tribunal brief written submissions in response, with a copy to the Represented Respondents, by no later than 5pm on **14th October 2016**. The Tribunal will then make a determination on the basis of written submissions alone.

43. Mr Sandham for the Applicant confirmed that the Applicant had no intention of trying to recover its costs in connection with these proceedings through the service charge.

Name: Judge P Korn **Date:** 16th September 2016

RIGHTS OF APPEAL

A. If a party wishes to appeal this decision to the Upper Tribunal (Lands Chamber) a written application for permission must be made to the First-tier Tribunal at the regional office dealing with the case.

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

C. If the application is not made within the 28 day time limit, such application must include a request for extension of time and the reason for not complying with the 28 day time limit; the Tribunal will then look at such reason and decide whether to allow the application for permission to appeal to proceed despite not being within the time limit.

D. The application for permission to appeal must identify the decision of the Tribunal to which it relates (i.e. give the date, the property and the case number), state the grounds of appeal, and state the result the party making the application is seeking.

APPENDIX 1

List of Respondents

Mr C & Mrs W Perry
Mr A Lee and Mr B Mirmikidis
Mr J Polturak
Dr M Alimadadian
Merladona Trading Ltd
Mr P & Mrs W Archibald
Mr F Costariol and Ms B Pinccin
Ms T Uehara
Mr R Davies
Ms L Thorn

APPENDIX 2

Appendix of relevant legislation

Landlord and Tenant Act 1985 (as amended)

Section 18

(1) In the following provisions of this Act "service charge" means an amount payable by a tenant of a dwelling as part of or in addition to the rent -

(a) which is payable, directly or indirectly, for services, repairs, maintenance, improvements or insurance or the landlord's costs of management, and

(b) the whole or part of which varies or may vary according to the relevant costs.

(2) The relevant costs are the costs or estimated costs incurred or to be incurred by or on behalf of the landlord, or a superior landlord, in connection with the matters for which the service charge is payable.

(3) For this purpose -

(a) "costs" includes overheads, and

(b) costs are relevant costs in relation to a service charge whether they are incurred, or to be incurred, in the period for which the service charge is payable or in an earlier or later period.

Section 19

(1) 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 provisions 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.

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

Section 27A

(1) An application may be made to the appropriate 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.

(2) Subsection (1) applies whether or not any payment has been made.

(3) An application may also be made to the appropriate tribunal for a determination whether, if costs were incurred for services, repairs, maintenance, improvements, insurance or management of any specified description, a service charge would be payable for the costs and, if it would, as to -
(a) the person by whom it would be payable,
(b) the person to whom it would be payable,
(c) the amount which would be payable,
(d) the date at or by which it would be payable, and
(e) the manner in which it would be payable.

(4) No application under subsection (1) or (3) may be made in respect of a matter which -
(a) has been agreed or admitted by the tenant,
(b) has been, or is to be, referred to arbitration pursuant to a post-dispute arbitration agreement to which the tenant is a party,
(c) has been the subject of determination by a court, or
(d) has been the subject of determination by an arbitral tribunal pursuant to a post-dispute arbitration agreement.

(5) But the tenant is not to be taken to have agreed or admitted any matter by reason only of having made any payment.