IN THE UPPER TRIBUNAL (LANDS CHAMBER)

Neutral Citation Number: [2018] UKUT 370 (LC)
Case No: LRX/10/2018

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LANDLORD AND TENANT – SERVICE CHARGES – lessee's obligation to contribute towards lessor's costs of management – contribution variable in first year of term by reference to costs incurred – contribution to increase thereafter by RPI – whether a variable service charge – s.18(1)(b), Landlord and Tenant Act 1985 – appeal allowed

IN THE MATTER OF AN APPEAL AGAINST A DECISION OF THE FIRST-TIER TRIBUNAL (PROPERTY CHAMBER)

BETWEEN:

THE ANCHOR TRUST **Appellant**

- and -

MR LESLIE WABY AND OTHERS

Respondents

Re: Betterton Court,
Pocklington
YO42 2ET

Martin Rodger QC, Deputy Chamber President

Harrogate Civil Justice Centre

23 August 2018

Justin Bates for the Appellant
Gill Nieuwland spoke on behalf of the Respondents with the permission of the Tribunal

The following cases are referred to in this decision:

Coventry City Council v Cole [1994] 1 W.L.R. 398

Gateway (Leeds) Management Ltd v Naghash [2015] L. & T.R. 36, [2015] UKUT 333 (LC)

Longmint v Marcus LRX/25/2003, [2004] EWLands LRX_25_2003

Windermere Marina Village Ltd v Wild [2014] UKUT 163 (LC)

Introduction

1. Betterton Court in Pocklington is a purpose-built development of 32 retirement flats let on long leases each of which includes provision for a service charge. By a decision given on 19 October 2017 the First-tier Tribunal (Property Chamber) ("the FTT") ruled on the reasonableness of the service charges in respect of the years from 2013 to 2018. Three elements of that decision are now in issue in this appeal and cross-appeal.

2. The first issue concerns an allowance which the standard form of lease permits the landlord to include in the service charge to cover its own management costs; the lease provided that that allowance was to be based on the sum allowed in the first year of the term (1994) which was to be up-rated annually by reference to the retail prices index. Since at least 2005, however, the management allowance had been increased annually by reference to a different index and it was the leaseholders' case that they were entitled to reimbursement of charges which they claim to have overpaid as a result.

3. The second and third issues arise from the inclusion in the lease of provision for a sinking fund for major capital expenditure. This fund was to be accumulated by a 1% levy on the sale price of each of the flats at Betterton Court whenever they changed hands during the term of the lease. In practice the sinking fund has not accumulated as much money as the leaseholders say it would have done if the levy had been collected in the manner provided for by their leases. They assert that they, as the current generation of leaseholders, should be protected against charges for capital works which are now required and which, they say, would have been capable of being met in whole or in part by contributions by their predecessors if the sinking fund had been properly administered.

4. These and many other issues were raised by a group of leaseholders, including the respondents to this appeal, in an application to the FTT under section 27A, Landlord and Tenant Act 1987 made on 1 June 2017. The names of the leaseholders who remain parties to this appeal as respondents are included in an appendix to this decision.

5. The FTT determined that the management allowance had not been calculated in accordance with the requirements of the lease, and directed that it should be recalculated using the fee levied by the appellant, the Anchor Trust, in 2005 as the starting point to which the retail prices index should be applied to up-rate it for each subsequent year. 2005 was the

first year in which the Anchor Trust was responsible for the management of Betterton Court. In reaching that conclusion the FTT rejected the leaseholders' case that the management allowance should be recalculated based on the sum allowed in 1998, which was said to be the earliest year for which there was evidence of the sum charged for management.

6. The FTT also directed that once the management allowances had been recalculated the sums overpaid by the leaseholders should be refunded by the appellant to the service charge account. In reaching that conclusion it rejected the appellant's case that the funds should be held by it to be repaid on request to individual leaseholders or their estates in respect of the period when they held their leases (including those who had subsequently died or sold their flats).

7. With the permission of the FTT the appellant now challenges the decision on the reimbursement of overpaid management allowances. Additionally, and with the consent of this Tribunal, the appellant makes a more fundamental attack on the FTT's decision, contending for the first time that it had no jurisdiction to make any determination in relation to the disputed management allowance because it was not a "service charge" within the meaning of section 18(1), Landlord and Tenant Act 1985 ("the 1985 Act") because it was not a cost which "varies or may vary according to the relevant costs" (i.e. the costs of management) but varied instead by reference to an index.

8. Some of the original group of leaseholders who are party to the appeal sought and obtained the permission of the Tribunal to cross-appeal against the FTT's determination concerning their liability to contribute towards the cost of capital works which ought, they say, to have been capable of being met by the sinking fund.

9. At the hearing of the appeal the appellant was represented by Mr Justin Bates of counsel and the respondent leaseholders by Ms Gill Nieuwland, who is an experienced and knowledgeable lay representative.

The relevant statutory provisions

10. Sections 18 to 30 of the 1985 Act contain provisions conferring protection on tenants from the burden of having to pay unreasonable or unanticipated service charges. Jurisdiction is conferred on the FTT by section 27A of the 1985 Act to determine whether a "service charge" is payable and, if so, by whom and in what amount.

11. Section 18 of the 1985 Act provides as follows:

> "18.— Meaning of "service charge" and "relevant costs".
>
> (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."

The lease

12. Each of the 32 flats at Betterton Court is let on a lease in a standard form. I was shown the lease of flat 25. It was granted on 23 November 1994 by the original developer, Barrett York Ltd, to Frances Mary Pickles and is for a term of 150 years from 1 September 1993. The landlord is referred to in the lease as "the Lessor" and the tenant or leaseholder is "the Lessee".

13. On completion of the development and following the grant of leases of all of the flats in the building, the freehold interest in Betterton Court was transferred to a company named Regent Management Ltd. It was responsible for the provision of services and the management of the building until 2004. It then appointed the appellant, which is a charitable housing association, to take over responsibility as its agent or manager. In 2008 the appellant acquired the freehold interest in the building and became the Lessor in its own right.

14. The lease identifies two distinct categories of service charge. The "current service charge" is payable under clauses 3.1 and 3.2 and is intended to provide for regular and routine maintenance, management and insurance of the building and other services identified in Part I of the Third Schedule. The "deferred service charge" is defined by clauses 3.4 and 3.5 and is intended to provide a sinking fund for future capital expenditure described in Part II of the Third Schedule.

The current service charge

15. By clause 3.2 the current service charge is payable quarterly in advance and is a specified proportion of the Lessor's estimate of the costs and expenses of providing the services during the service charge year. That estimate is to be based on the actual cost of the previous year together with provision for any expected increase or decrease in costs for the succeeding year.

16. It was hoped to avoid significant fluctuations in the current service charge from one year to the next since clause 3.2(d) of the lease provides that:

"… the Lessor shall so far as practicable endeavor to equalize the amount of the current service charge from year to year by including in the costs and expenses in each Service Charge Year reasonable provision for future expenses and liabilities and shall carry such

amount in a property repairs reserve fund for expending in subsequent years."

17. By clause 3.3 the Lessor is to supply audited accounts as soon as practicable after the end of each service charge year showing the amounts expended in that year "and any surplus or deficit will be carried forward to the accounts for the subsequent year."

18. The routine expenses listed in Part I of the Third Schedule include the following, at paragraph 4:

> "The fees and disbursements paid to any managing agents appointed by the Lessor in respect of the Estate or a reasonable allowance to the Lessor in respect of its own management costs. With effect from 1 January 1995 and on every subsequent 1 January there shall be added to the fees or allowance for the year ended 31 December 1994 such percentage as is equal to the percentage increase in the figure at which the Index of Retail Prices stands on the 1 January in each year over the figure which the Index stood on the 1 January 1994."

Paragraph 4.3 provided that if it became impossible to calculate the adjustments to the price by reference to the Index, or if there was any dispute as to the amount of the fees or allowance, the dispute was to be determined by an arbitrator who was to have full power to determine what would have been the increase in the Index had it continued on the original basis.

19. The expenses mentioned in Part I of the Third Schedule as being included in the current service charge also included the cost of undertaking repairs to the building (paragraph 5), and at paragraph 8:

> "Such sum as shall be estimated by the Lessor to provide a property repairs fund to meet any of the costs expenses outgoings and matters mentioned in the foregoing paragraphs of a cyclical nature."

The deferred service charge

20. The provisions relating to the accumulation of a sinking fund by means of the deferred service charge (as distinct from the property repairs fund referred to in paragraph 8 of Part I of the Third Schedule which is part of the current service charge) are in clauses 3.4 and 3.5 of the lease and in Part II of the Third Schedule. As far as material they provide as follows:

> "3.4 The Lessee hereby covenants with the Lessor to pay to the Lessor the deferred service charge to provide a sinking fund for depreciation and the costs and anticipated costs of renewal and replacement of the lifts (if any) and plant within the estate and of upgrading and improving the Estate and other future or contingent capital expenditure so far as not included within the current service charge and as more particularly specified in Part II of the Third Schedule.
>
> 3.5.1 The deferred service charge shall … be paid on completion of every assignment or disposition … of the whole of the dwelling …

3.5.2 The amount of each payment of the deferred service charge (on the occasion of an assignment or disposition by the original Lessee or if the original Lessee is more than one person by the survivor of them or his personal representatives) shall be the Deferred Service Charge proportion of the Purchase Price paid by the Lessee on his acquisition of the dwelling or the re-sale price of the dwelling whichever is the higher.

…

3.6 If the sinking fund referred in clause 3.4 or 3.5 hereof proves to be insufficient for the purposes set out in Part II of the Third Schedule the lessor may treat the whole of part of any insufficiency as if it were an expense falling within Part I of the Third Schedule and if the sinking fund shall in the opinion of the Lessor exceed what is reasonably necessary for the purposes set out in Part II of the Third Schedule the whole or any part of such excess may at the absolute discretion of the Lessor be used for the benefit of the Lessees of dwellings on the Estate as a whole whether by setting it against the expenses falling within Part I of the Third Schedule or otherwise."

21. Part II of the Third Schedule describes the expenditure for which the sinking fund is intended to provide; it comprises:

"All costs and expenses incurred (or anticipated to be incurred in the future) by the Lessor in fulfilment of its obligations under clause 5 of this Lease (and value added tax thereon) in so far as such expenditure is not included in the current service charge and relates to the renewal or replacement or major overhaul of any and every part of the Estate and the plant (including the lifts, (if any)) and the appurtenances thereof including any expenses incurred in rectifying or making good any inherit structural defect within the Estate: the renewal or replacement of heating apparatus ducts service pipes and wires within the Estate; and interest paid on any money borrowed by the Lessor to defray any expenses incurred; all costs and expenses for future liabilities expenses or payments for renewing upgrading or improving the Estate and whether certain or contingent or arbitrary or discretionary."

22. It is also relevant to refer to the recital at the beginning of the Third Schedule which explains that Part I relates to the costs and expenses of running and maintaining the estate in respect of which the current service charge is payable, while Part II relates to costs and expenses of a capital nature "which are not included in the current service charge but which are to be met by a sum payable on assignment of this Lease in accordance with clauses 3.4 and 3.5." Despite this apparently clear distinction, the recital then provides that:

"The allocation of expenses between Part I and Part II shall be in the sole determination of the Lessor."

The FTT's decision

23. As far as the leaseholders were concerned the main issue for the FTT to resolve was the dispute over the management of the sinking fund. They contended that the service charges for the years 2013/14 to 2017/18 were unreasonable because a greater contribution should have been made by the sinking fund or by the property repairs fund. They criticised Anchor Trust for failing to accumulate sufficient reserves and argued that it should have made greater

provision for future expenditure. For its part, Anchor Trust responded by saying that it could not accumulate more in the sinking fund than the lease allowed and pointed out that it had proposed that all leases be varied to increase the sinking fund, but its proposal had not been accepted.

24. The FTT considered the position was very clear. Anchor Trust was correct that it could not "collect additional sums to supplement the sinking fund" even if it would be useful to do so. It was said to be an unfortunate consequence of the drafting of the lease that the current leaseholders now had a larger burden than they might have had if greater amounts had been paid into the sinking fund. The FTT found specifically that "throughout the period applied for the sinking fund has been properly administered."

25. The other major issue concerned the allowance for the costs of management. At the hearing before the FTT it was not suggested that the way in which the allowance was to be calculated under the lease gave rise to any issue of jurisdiction. Nor was it argued by Anchor that the payment of the management allowance by the leaseholders year after year, without any challenge, meant that the quantum of the charge must be taken as having been agreed so as to deprive the FTT of jurisdiction by reason of section 27A(4) of the1985 Act.

26. The FTT dealt with the issue of management allowances at paragraphs 44 to 55 of its decision. It noted that the lease did not permit the recovery of the cost of employing an estate manager, but provided only an allowance for management costs. It was common ground that the management allowance had not been calculated in accordance with the lease because, since it took over management in 2005, Anchor had not used the retail prices index but had increased the charge annually by reference to a calculation provided by the Housing Corporation and its various successors as the regulator of social housing for use in adjusting the cost of services provided to occupiers of affordable housing. It was also common ground that no information was available about the sum charged for management in the first full service charge year after the leases were granted, 1994, which the lease provided was to be used as the base year for indexation. The correct sum payable could not therefore be calculated reliably.

27. The solution proposed by the leaseholders was to apply the RPI index to the earliest management allowance for which there was evidence. That was a charge of £4222 levied in 1998 (referred to as the "Wheeldon" allowance). Anchor's preference was to apply the RPI index to the management charge it had levied in its first full year in control, 2005, when it had charged £9043. I was informed that the application of the correct index to the 1998 allowance would not produce a figure for 2005 as high as the £9043 actually charged in that year. The use of 1998 as the base year would produce a significantly lower management charge for each year from 2005 to 2018, and would create a much larger credit in favour of the leaseholders.

28. The FTT resolved the dispute in paragraph 52 of its decision in which it said this:

> "Faced with an absence of a reliable figure the Tribunal must therefore consider what is reasonable in the circumstances. The Tribunal finds these to be well managed flats and

> the service charges including management fees (less estate manager charges) charged by the respondent are not unreasonable. The respondent has been managing the property for 12 years and the key complaint of the applicants in their application to the Tribunal appears to be that they wanted the managing agents to have spent more of the tenant's money on the property – not that they had failed to carry out works or failed to manage the property effectively. It seems to the Tribunal to be unjust to retrospectively impose a figure of less than half for a property that the applicants accept has been largely successfully managed. In the absence of another more persuasive figure, and considering the nature of the property, the level of management required and the desire for active management of the tenants the Tribunal conclude that the 2005 figure proposed by the respondent represents a reasonable figure for management fees for this property. The Tribunal therefore orders that management fees are to be recalculated on this basis."

29. The FTT's decision was therefore in favour of Anchor Trust's approach to the determination of the amount of the management charge. It was nevertheless acknowledged by the Trust that the outcome of the recalculation directed by the FTT would be that it had collected more in management charges than it had been entitled to. The FTT dealt with the issue of reimbursement of the amount eventually found to have been overpaid at paragraph 55:

> "The sums to be refunded belong to the tenants (either past or present, depending upon their agreements) and not to the respondent, and therefore for the respondent to retain the sums pending claim is not a satisfactory solution. Therefore the only fair course of action is for the overpayment of management fees (as calculated with reference to the Wheeldon figures) to be refunded to the service charge account into which they were paid, and for any individual claims to be made in due course depending upon the arrangements between parties upon assignment of their lease."

The reference to the "Wheeldon figures" is a reference to the 1998 management charge which the leaseholders had argued should be the base year, rather than the 2005 figure which the FTT had directed should be the new base year in paragraphs 1 and 52 of its decision. Since the FTT had already decided in paragraph 52 that the charges were to be recalculated using 2005 as the base year this reference to the Wheeldon figures was clearly an accidental error which would no doubt have been corrected had it been pointed out to the FTT when permission to appeal was requested.

30. The first consequence of the FTT's decision is that Anchor Trust is required to recalculate the management charge going back to 2005. What the FTT intended should happen next is less clear. It directed that the overpayments should be "refunded to the service charge account into which they were paid". This has been understood by Anchor to mean that it is to credit the amount of the overpayment going back to 2005 to the service charge account of the current leaseholders, irrespective of the extent to which that sum was overpaid by the current leaseholder or by a previous leaseholder. The FTT then seems to have contemplated that any claim by a former leaseholder to share in the sum reimbursed would be resolved between the current and previous leaseholders by reference to the contract or contracts under which the lease has been transferred since 2005.

31. Anchor Trust fears that claims may be made against it by former leaseholders or their

estates in respect of sums which the FTT has required it to credit to the account of the current leaseholder. It is said that would require it to make provision in its accounts for potential claims which it has already paid, and would deprive it of the opportunity to take points in its defence against former leaseholders which it has chosen not to take against the current leaseholders. Its preference, which the FTT rejected, was that in each case it should reimburse the leaseholder or former leaseholder who made the overpayment (or their estate) and that it should retain the overpayments for that purpose until claims are received.

The issues

32. On behalf of Anchor Trust Mr Bates made three broad submissions:

> (a) the management allowance was not a service charge within the meaning of section 18(1) over which the FTT had jurisdiction and its determination concerning the correct amount of the charge should be set aside;
>
> (b) alternatively, if that was wrong, the FTT had been entitled to direct that the management allowance be recalculated using 2005 as the base year, but it had had no power to order repayment of the sums it considered to have been overcharged; and
>
> (c) if that was wrong, the FTT should not have ordered re-payment to *all* leaseholders, but only to those who had taken part in the proceedings (which did not include former leaseholders or leaseholders who had died and whose interest in their lease now formed part of their estate).

33. On behalf of the leaseholders Ms Nieuwland argued on the cross-appeal that the Lessor ought to have collected greater sums than it actually did. The FTT was not correct when it said that Anchor Trust could not collect additional sums to supplement the sinking fund. The equalization provision in clause 3.2(d) allowed the accumulation of a property reserve fund for expenditure in subsequent years (see paragraph 16 above). The sums which the FTT found to be reasonable contributions towards the cost of the major works now required were unaffordable for the leaseholders, as insufficient money was available in the sinking fund. The leaseholders' proposed solution was that Anchor Trust should make a contribution and that the sums demanded on account of the cost of major works should be reduced.

Issue 1: Jurisdiction - is the management allowance a service charge?

34. The first issue is whether a charge which is not fixed by the lease for the first year of the term but is to vary according to the costs incurred in providing the relevant service in that year, but which is then to vary by applying an index to the first year's cost, is a service charge within the meaning of section 18 of the 1985 Act.

35. Mr Bates submitted that although management was undoubtedly a service within section 18(1)(a) of the 1985 Act the effect of section 18(1)(b) was that, to be a service charge over which the FTT has jurisdiction, a charge for management must be one which "varies or may vary" according to the costs incurred by the landlord. A charge which varies in accordance with an external index is therefore not a service charge. In support of that proposition, which was not disputed by Ms Nieuwland, Mr Bates referred to *Coventry City Council v Cole*

[1994] 1 W.L.R. 398 (a case concerning section 621A, Housing Act 1985, where the definition of service charge is effectively the same as in section 18). The Court of Appeal there held that a fixed contribution towards the cost of repairs which was to be increased annually by reference to an index of building costs was not a service charge.

36. It did not matter, Mr Bates submitted, that the wrong index had been used to increase the management charge. Whether RPI was used, or the charge was increased by reference to guidance from the regulator of social housing, in either event the charge was not a service charge for the purpose of section 18(1).

37. Mr Bates identified a contrary argument based on the words "the whole or part of which" varies or may vary according to the relevant costs. Even if *part* of the service charge (*i.e.* the management allowance) did not vary with relevant costs, the lease provided for the payment of a single service charge composed of many elements, including the cost of insurance, cleaning and repairs, almost all of which were variable. It might be argued that so long as part of the sum payable may vary according to the relevant costs the whole of the charge was a service charge within section 18 and the FTT would have jurisdiction over all the component parts. Mr Bates identified two decisions of this Tribunal which might be thought to support such an argument: *Longmint v Marcus* LRX/25/2003 on which Ms Nieuwland relied, and *Warwickshire Hamlets Ltd v Gedden* [2010] UKUT 75 (LC). In both cases the Tribunal had declined to apply section 18(1) to a single service charge comprised of many different components as if it was a number of separate charges, each of which had to satisfy the requirements of the section in its own right.

38. Mr Bates pointed out that the reasoning of the Lands Tribunal in *Longmint* and of this Tribunal in *Warwickshire Hamlets* had subsequently been doubted by the Tribunal in *Gateway (Leeds) Management Ltd v Naghash* [2015] L. & T.R. 36, a decision of mine concerning a contribution to be made by the tenant to the cost of rent payable by the landlord to a superior landlord, in which I said at [26]:

> "If a charge levied by a landlord includes an element which, whether directly or indirectly, had nothing to do with services, repairs, management etc, then the Tribunal would not, I suggest, be given jurisdiction to rule on the recoverability of that sum by s.18 and s.27A(1) simply because the sum was aggregated with the costs of other matters which were services."

39. The Tribunal's preferred approach in *Longmint* and in *Warwickshire Hamlets* that a service charge should be regarded as a single charge, rather than a number of component charges, had also been criticised by the authors of *Service Charges and Management* (4th Edn, para.12-009):

> "… there is a danger that this interpretation renders the definitional words in subs.18(1) and (2) redundant… the Upper Tribunal placed too much weight on the form of the charge rather than considering the substance and nature of the charge. It remains to be seen whether this decision will be followed in the higher courts."

40. Mr Bates therefore submitted that *Longmint* should not be followed. He invited me to

find that the management allowance which was included in the service charge was not itself a service charge over which the FTT had jurisdiction.

41. Mr Bates' fall-back position was that, if it had jurisdiction, the FTT had been entitled to come to the conclusion it did and to require that the management allowance be recalculated using the figure for 2005 as the starting point for indexation. Neither party had any evidence as to what the management fee should have been had the lease been applied properly since 1994. The contractual provision that an arbitrator should determine the appropriate increase was void by virtue of section 27A(6) of the 1985 Act for the reasons given by the Tribunal in *Windermere Marina Village Ltd v Wild* [2014] UKUT 163 (LC) so it fell to the FTT to make the determination doing the best it could. The FTT had been satisfied that the actual management charge for 2005 had been a reasonable one so there could be no objection to its use for the purpose of setting a new base year. Its decision should not be disturbed.

42. For the leaseholders Ms Nieuwland sought to introduce additional facts which were not referred to in the decision of the FTT. She suggested that although the lease provided for the management allowance to vary only by reference to an index, in reality the index provided by the regulator had not been used consistently and there had at one stage been an addition to the annual charge at the rate of £3 per flat per month which was not referable to any index. As the charge had not, in practice, been determined by applying an index it ought to be treated like any other variable charge.

43. Ms Nieuwland also said that it could be demonstrated that the fee charged in 2005 was not a reasonable fee, as the FTT had believed, because the FTT had wrongly assumed that VAT had been payable at 17.5% whereas the correct rate at that time had been 12.5%.

44. The choice of 2005 as the new base year was arbitrary, Ms Nieuwland submitted. 1998 was more likely to be accurate and should be preferred as the property had had a commercial landlord which was unlikely to have overlooked the opportunity to obtain an annual increase of at least RPI. There had been a substantial increase of as much as 12% in 1999 which could not be related to any index, and even if the correct index had then been applied until 2005 to select any year after 1999 would lock in the impermissible increase from that year.

Discussion and conclusion on issue 1

45. This issue concerns the jurisdiction of the FTT (and of this Tribunal) and it was for that reason that permission was given to raise it for the first time on the appeal. It is an issue of law, the answer to which depends on the terms of the lease but not otherwise on the detailed facts of this case. In particular, it is not affected by the new factual issues about the manner in which the management charge may have been calculated from time to time which Miss Nieuwland introduced in her oral argument. It is not possible for those issues to be investigated on the appeal as they were not presented to the FTT and it made no findings of fact concerning them. At this stage I will assume (as did the FTT at paragraph 47 of its decision) that the management allowance has been increased annually by reference to an index (albeit the wrong index) since at least 2005.

46. A charge for management is clearly within the scope of section 18(1)(a). Nevertheless, the statutory protection against unreasonable service charges given to tenants by section 18 to 30 of the 1985 Act is not applicable to every charge under a lease simply because it is payable directly or indirectly for services, repairs, maintenance, improvements or insurance or the landlord's costs of management. It is additionally necessary that the charge should satisfy the requirement of section 18(1)(b) that the whole or part of it varies or may vary according to the relevant costs (i.e. the costs of providing service). A particularly striking example of the non-availability of statutory protection where a charge varies by reference to a factor other than the amount of the relevant costs is *Arnold v Britten* [2015] UKSC 36 in which a fixed initial service charge of £90 per annum was to be increased on a compound basis by 10% every three years with the result that the charges soon far outstripped inflation and would reach a level of more than £1 million a year by the end of the term. Sections 18 to 30 have no application to such a provision as it does not provide for the charge to vary according to the relevant costs.

47. In *Coventry City Council v Cole* [1994] 1 W.L.R. 398, on which Mr Bates relied to demonstrate that a fixed charge which varies by reference to an index is not within section 18, Neill LJ explained at 408 G-H why in principle that should be the case:

> "The reasonableness of a fixed charge can be examined at the time when the long lease is being negotiated. Assuming the fixed charge is reasonable the tenant is protected over the whole period of the lease from fluctuating and unpredictable costs. His only exposure to risk is in the risk attendant on a clause which depends on inflation."

48. It would therefore be wrong for a tribunal to assume jurisdiction to consider the reasonableness of a charge which is fixed, or which varies by reference to an index. Such a charge falls outside section 18(1)(b) and, for the purposes of the statutory protection, is not a service charge at all.

49. But what of a charge which is to be variable in the first year but fixed thereafter, increasing only by the application of an index to the first year's figure? It is not difficult to see why this unusual hybrid should have been attractive to the parties. This is retirement housing likely to be occupied by leaseholders on fixed incomes, and the lease includes indications that the parties wanted to avoid fluctuations in charges from one year to the next. Because it was a new development the cost of management, especially if undertaken in-house by the Lessor rather than by an agent, may have been difficult to predict with any confidence. The expedient of waiting until the first full year's costs were known before fixing the charge for future years might have been regarded as more attractive than speculating about what those costs might be or allowing the charge for management to vary from year to year depending on the cost of providing the service.

50. Whatever the reason for the parties agreeing that the allowance for management costs should be ascertained in this way, it seems to me to be clear that, in the first full year at least, the charge for management was a service charge within the meaning of section 18(1). In that first full year, 1994, the Lessor was entitled to "a reasonable allowance" in respect of its own management costs. The amount of such an allowance was liable to depend on the costs actually incurred, or estimated to have been incurred, by the Lessor in that year and was

therefore variable according to the relevant costs.

51. The charge for management payable for the first year was therefore a service charge. If the leaseholders were dissatisfied with the management service they received or considered the allowance claimed was too expensive there would have been no obstacle to them seeking a determination that the allowance was not a reasonable one. In 1994 such a determination would have been by the court rather than by a tribunal, but the availability of the protection against unreasonable charges conferred by section 19, 1985 Act, was otherwise substantially the same in 1994 as it is now.

52. After the first year the allowance for management ceased to be variable by reference to the cost of providing the service. With effect from 1 January 1995 the charge varied annually by reference to the Index of Retail Prices. The basis of the charge changed from costs actually incurred to a historic sum increased by reference to an index, i.e. it became the type of charge which the Court of Appeal in *Coventry v Cole* held was not a service charge.

53. Can a charge for a particular service be a service charge one year, and not a service charge the next? I would answer that question affirmatively. A service charge is simply "an amount payable" which otherwise satisfies the description in section 18(1); it is necessary to determine in relation to each amount payable whether it is or is not a service charge within the statutory definition. If it is in respect of a matter within section 18(1)(a) and is capable of varying with the cost of services it will be a service charge; if it becomes variable otherwise than by reference to the landlord's costs there does not seem to me to be any reason why a change in the basis on which the charge is calculated should not have the effect that the charge is no longer one to which section 18 to 30 of the 1985 Act apply. In what was perhaps a more common arrangement (although not often encountered in modern leases) where the amount payable for a particular service was fixed for the first year, but variable in subsequent years, the charge for the first year was not a service charge, but the charges for subsequent years were. In this case it is the first year's charge which was variable by reference to relevant costs, and therefore a service charge, but the following years were not. The result, in my judgment, is that since 1995 the charges for management have not been service charges within the meaning of section 18 of the 1985 Act.

54. That conclusion seems to me to be consistent with the explanation given by Neill LJ in *Coventry v Cole* why fixed charges made variable by an inflation index are not in need of statutory protection. The charge in this case became fixed only after the first year, but the charge for the first year was susceptible to challenge under section 19. It may therefore be taken that the base charge was reasonable since, if it was not, it could have been reduced at the leaseholders' initiative to one which was reasonable. The leaseholders were therefore protected from fluctuating and unpredictable costs except to the extent that such fluctuations were the result of inflation.

55. What of the contrary argument identified by Mr Bates as being available to the leaseholders? It was that a service charge should be regarded as a single sum (as the Tribunal is said to have found in both *Longmint* and in *Warwickshire Hamlets*) and that it was sufficient that part of that single sum be capable of varying according to the relevant costs to

enable the whole sum to be recognised as a service charge. In my judgment those contentions do not require a different outcome.

56. As I have already noted, a service charge is "an amount payable" which otherwise satisfies the requirements of section 18(1). I can see nothing in logic or language to require that an amount be treated as indivisible where in reality it is the aggregate of a number of smaller amounts; an amount payable does not cease to be an amount payable just because it is added to other amounts payable to produce a larger bill. The aggregate sum includes each of its component parts. No difficulty is encountered in practice in examining the individual components (the relevant costs) to determine whether they were each reasonable incurred in the provision of a service of reasonable quality. Tribunals perform that exercise every day. Why then should the fact that one amount satisfies the requirement of section 18(1) in being capable of varying according to the relevant costs mean that another amount which does not have that characteristic must nevertheless be treated as falling with the statutory scheme of protection?

57. In *Longmint* the Lands Tribunal (HHJ Rich QC) considered whether a management charge equal to 15% of the cost of other services provided by the landlord was a service charge within the meaning of section 18(1). It held, at paragraph 23, that for the purpose of section 18(1)(b) it was not necessary that every constituent part of a service charge must vary according to relevant costs: "even if it was right that some part of that amount was not so varied, it would not take the amount payable under clause 2(3) out of the definition of service charge. As I read s.18(1)(b) it is sufficient if part varies according to relevant costs". The Tribunal also went on to hold that it was not necessary that the charge for management should vary according to the cost of management, and if that was wrong it nevertheless concluded that the charge for management did vary according to the cost of management since on the proper construction of the lease, if no management cost was incurred the landlord would not be entitled to the additional 15% of the cost of other services.

58. On any view, the management charge in *Longmint* was variable with the cost of services as was the service charge as a whole. The Tribunal did not have to consider a charge such as in this case, part of which is not variable except by reference to an index. The conclusion to which Mr Bates drew my attention and which I have quoted above was that the inclusion of a component which was not variable with relevant costs was not sufficient to take the whole amount out of the definition of service charge. That is unsurprising and does not deal with how the individual components themselves are to be approached. The Tribunal's decision was that the costs of management did vary according to relevant costs either because they varied with the total cost of other services, or because they varied in the sense that if no management cost was incurred at all, the 15% would not be recoverable. It follows that I do not think *Longmint* provides the basis of an argument that, when looked at in isolation, a management charge which is variable by reference to an index is a service charge within the meaning of section 18(1).

59. The second decision to which Mr Bates invited my attention, was the decision of the Tribunal (HHJ Huskinson) in *Warwickshire Hamlets*. The issue there was whether the first-tier tribunal had had jurisdiction to consider the recoverability of that part of a service charge which comprised a contribution towards the rent payable by the landlord to a head landlord.

At paragraph 38 the Tribunal said this:

> "Having regard to the wording of section 18 I conclude that it is necessary to examine whether the lessee is required to pay "an amount" in addition to the rent. The answer is yes the lessee is obliged to pay such an amount and this amount is the Charge. The next question is whether the Charge is payable directly or indirectly for services repairs, maintenance, improvements or insurance or the landlord's costs of management. In my judgment it plainly is so payable. I reject the suggestion that it is necessary, when considering jurisdiction, to subdivide the Maintenance Expenses into each and every separate ingredient and then to treat each such ingredient as though it was a separate amount charged in addition to the rent and then to see whether this separate amount falls within the provisions of section 18. "

60. As I have previously stated in *Gateway v Naghash*, for the reasons at paragraph 38 above, I respectfully disagree with this part of the Tribunal's reasoning. In my judgment the scope of the statutory protection given to tenants in relation to service charges, as defined in section 18(1), cannot, by an accident of drafting, be extended to other contractual payments which are not themselves service charges. In *Warwickshire Hamlets* the charge in question was to reimburse rent payable by a management company to a head landlord for common part including gardens, parking spaces and a warden's flat. The Tribunal considered that was part of the cost of services since without control of the common parts the management company would not be in a position to provide services to the tenants. The rent of the common parts fell within section 18(1)(a); it was variable and so satisfied section 18(1)(b). I therefore agree with the outcome of the *Warwickshire Hamlets* appeal, but I do not find it helpful in determining this appeal.

61. In my judgment, for the FTT or this Tribunal to have jurisdiction in relation to a charge, it is not enough that it be included as one component of a larger charge some elements of which satisfies the statutory definition of a service charge. Any discrete part of a composite charge which fails to satisfy that definition falls outside the scope of sections 18 to 30 of the 1985 Act. In this case, after 1994, the management allowance payable as part of the service charge by the respondents did not fall within section 18(1) because it was not variable according to relevant costs.

62. My decision on this aspect of the appeal would not be different if the appellant had been shown to have misapplied the contractual mechanism for calculating the management allowance to an even greater extent than it acknowledged to the FTT. In her submissions on the appeal Ms Nieuwland submitted that the appellant had supplemented the Homes and Communities Agency index by an additional charge of £3 per flat per month, as well as collecting a one-off increase of 12% in 1999 which was unrelated to any index. If these points were taken before the FTT they are not considered in its decision and they may have become lost in the mass of unnecessary and unexplained documents provided to it; in any event, there is no cross-appeal suggesting that the FTT failed to deal with the respondents' case. If the facts asserted by Ms Nieuwland are correct, the additional sums collected may not have been payable. I have therefore considered whether it is necessary to remit the issue of management charges to the FTT to enable it to investigate these issues, but I have concluded that it is not. For the reasons I have already given the FTT lacked jurisdiction to determine the application concerning the management allowance payable as part of the

current service charge. Jurisdiction would not be conferred upon it by a misapplication of the contractual provisions, unless they amounted to a variation of the lease which changed the basis of calculation to one which came within section 18(1). That has not been suggested.

63. My conclusion is therefore that the FTT did not have jurisdiction to determine the amount properly payable in respect of management and its decision must be set aside.

The remaining issues on the appeal

64. I can deal briefly with the other issues in the appeal.

65. Given the limitations of the evidence presented to it the FTT would have been entitled (had it had jurisdiction) to direct that the recalculation of the management charges should take 2005 as the base year. Neither party knew what the management allowance had been in the first year of the term, 1994, and it was impossible to know whether the figure included in the Wheeldon email took into account increases to which the Lessor had been entitled in the preceding years. It was clear that the calculation of management charges had been undertaken on an incorrect basis since 2005, but it was not clear on the material which appears to have been before the FTT that it had gone wrong at any earlier date. The FTT was satisfied that the 2005 figure was a reasonable charge for management and, if it had had jurisdiction, it would have been proper for it to adopt 2005 as the base year for recalculation. It did not have jurisdiction but rather, as the dispute was about the amount of the allowance, the parties had agreed in the lease that it would be within the jurisdiction of an arbitrator appointed under paragraph 4.3.

66. I should make it clear that I have reached no conclusion on the various challenges to the management charge which Ms Nieuwland sought to rely on and which were not referred to by the FTT. The FTT's conclusion that the management charge for 2005 was reasonable was not one which it was open to it because it lacked jurisdiction even to consider the issue. If the parties are unable to resolve their dispute by agreement it will not bind any future court or arbitrator required to apply paragraph 4 of the Third Schedule.

67. Assuming jurisdiction to determine the amount of the overpayment, I would accept Mr Bates submission that the FTT had no power to direct that the overpaid sums should be dealt with by reimbursement otherwise than as required by the lease. In particular it had no power to order repayment of the sums it considered to have been overcharged. Had it been in a position to determine the amount of overpayments, which for the reasons I have given in relation to issue 1 it was not, the FTT's power would not have extended to any other direction. Under section 27A, 1985 Act, the FTT is empowered to determine whether a service charge is payable, and if it is, the amount of the charge, the person by whom it is payable etc. The enforcement of the FTT's decision is a matter for the County Court.

68. The proper treatment of any overpayment under the terms of the standard form of lease is that any surplus found to have been collected during the service charge year is required to be carried forward to the accounts for the subsequent year (clause 3.3). The appellant acknowledges that there have been overpayments, and I assume it intends to credit them to

the individual leaseholders' accounts as required by clause 3.3 at least to the extent that they are the result of payments by the current leaseholders. I heard no argument about the position of former leaseholders, or their estates, but in principle the FTT was correct that the destination of funds overpaid by a previous leaseholder, and which should have been credited to the accounts for subsequent years under clause 3.3, will depend on the terms on which individual leases were sold. If a current leaseholder considers that he or she has an entitlement to be credited with sums overpaid by a previous owner of their flat, they will need to explain the basis of their belief to the appellant and, if agreement cannot be reached, it will be necessary for them to seek relief from the County Court.

69. The FTT was not entitled to consider the position of any leaseholder who was not party to the application under section 27A, 1985 Act. To the extent that the FTT purported to direct repayment of sums to leaseholders who had not made an application (which in any event it had no power to do) its direction would be of no effect.

The cross-appeal

70. There are two points in the cross-appeal. The first is simple and agreed; the second may be of no practical significance.

71. The leaseholders applied to the FTT for a determination under section 27A, 1985 Act of the reasonableness of the contributions they had been required to make in the years 2014 to 2018 towards the property repairs fund in anticipation of major works. The FTT made no such determination.

72. The leaseholder's case was that the sums demanded were unaffordable and unreasonable in light of the equalisation obligation in clause 3.2(d) of the lease and the history of what the leaseholders say has been Anchor Trust's failure to make sufficient provision in the past. The leaseholders were entitled to a determination of that application and it is therefore necessary that the matter be remitted to the FTT for consideration of that aspect of the application. On behalf of Anchor Trust Mr Bates agreed that that was the appropriate course, and I am satisfied that the material and argument provided to me do not enable me to reach a conclusion on it.

73. The other aspect of the leaseholders' cross-appeal is against the FTT's acceptance of Anchor Trust's case that it could have done nothing more to build up the sinking fund. For what it is worth I consider that the FTT was wrong to find the position to be as clear as it said it did in paragraph 41 of its decision where it explained:

> "The interpretation of the lease as applied by the respondent is correct. They are not able to collect additional sums in advance to supplement the sinking fund even if their stock surveys might suggest it would be useful to do so …."

74. I agree that it was not open to Anchor Trust to increase the deferred service charge proportion (the percentage contribution of the purchase price payable on every assignment of the lease, and which was one percent in each case). But the FTT appears to have overlooked

both the equalisation obligation in clause 3.2(d) and the provision of clause 3.6 (see paragraph 20 above) which, so far as material operates "if the sinking fund … proves to be insufficient for the purposes set out in Part II of the Third Schedule" and then allows the Lessor to "treat the whole or part of any insufficiency as if it were an expense falling within Part I of the Third Schedule."

75. In my judgment the sinking fund insufficiency provision is capable of being read as including a power to deal with a prospective insufficiency by collecting additional funds in advance, and not just as a power to respond once a shortfall has occurred. As a matter of language a fund may "prove to be insufficient" if it is obvious that it is and will remain too small for the task required of it in the future. If the sinking fund grew to be obviously too large there would be no need to wait for expenditure to be incurred before distributing a surplus, and it would be consistent and permissible to allow the insufficiency to be assessed from time to time and a contribution collected through the current service charge. That appears to be how the power has been interpreted in practice (at least in recent years) with Anchor Trust collecting contributions to the sinking found as well as to the property repairs fund through the current service charge on a regular basis.

76. Whether that conclusion is of any practical benefit to the leaseholders is another matter. The equalization obligation under clause 3.2(d) requires that the Lessor should "so far as practicable endeavour to equalize the amount of the current service charge". In contrast, clause 3.6 provided a power, but not an obligation, to supplement the sinking fund through the current service charge. It may be possible to read the two provisions together to impose a limited obligation to endeavour so far as practicable to equalize the current service charge by collecting sums to supplement the sinking fund, but even so it is not obvious what the result of compliance would be, since it would depend on what was practicable.

77. The leaseholders say that more money ought to have been collected from them and their predecessors in the past, but even if it could be demonstrated that Anchor Trust was in breach of an obligation and should have collected more, it does not follow that the leaseholders should now be credited with sums not collected in the past or entitled to damages of an equivalent amount. To the extent that those sums ought to have been collected from the current leaseholders it is hard to see how they could have a claim for damages since the money they say should be in the sinking fund would have come from them. To the extent that it is said funds ought to have been collected in the past, it is possible that a healthier fund to meet future capital expenditure costs would have increased the price the leaseholders would have had to pay to acquire their flats.

78. It follows that while I allow the cross-appeal on the meaning of clause 3.6 there is no other remedy to which I consider the leaseholders are entitle at this stage.

79. Mr Bates made it clear when he opened the appeal that Anchor Trust did not oppose the making of an order in favour of the leaseholders under section 20C, 1985 Act, and I therefore direct that no part of the costs incurred by it in connection with this appeal shall form part of any service charge payable by any of the respondents.

Martin Rodger QC
Deputy Chamber President

9 November 2018