FIRST - TIER TRIBUNAL
PROPERTY CHAMBER
(RESIDENTIAL PROPERTY)

Case Reference	**:**	**CHI/43UC/LSC/2019/0056**
Property	**:**	**Flats 7 and 36 Central Walk, Station Approach, Epsom, Surrey KT19 8BY**
Applicants	**:**	**1. Concepcion Gell** **2. Chris Rankin**
Representative	**:**	**Mr Wade Barker**
Respondent	**:**	**Central Walk Limited**
Representative	**:**	**Ms Katie Gray, Counsel**
Type of Application	**:**	**Determination of service charges: section 27A Landlord and Tenant Act 1985**
Tribunal Members	**:**	**Judge E Morrison** **Mr R A Wilkey FRICS**
Date and venue of Hearing	**:**	**13 November 2019 at Sutton SSCS Tribunal**
Date of decision	**:**	**20 November 2019**

DECISION

The applications

1. Under the application dated 24 May 2019 the applicant lessees applied under section 27A of the Landlord and Tenant Act 1985 ("the Act") for a determination of their liability to pay their individual proportions of service charges in the sum of £7704.00. The precise nature of this application is considered further below. The Respondent is the lessee-owned freeholder of the block.

2. The Tribunal also had before it applications under section 20C of the Act and paragraph 5A of Schedule 11 to the Commonhold and Leasehold Reform Act 2002, for orders that the Respondent's costs of these proceedings should not be recoverable through future service or administration charges.

3. Initially Central Walk RTM Company Limited was also named as a Respondent. It emerged that this company is no longer in existence and the remaining parties agreed that it should be removed as a party.

Summary of decision

4. The on account service charges recoverable by the Respondent are reduced by the following amounts:

   (1) £125.58 in respect of first applicant
   (2) £101.69 in respect of the second applicant.

5. An order is made under section 20C of the Act as set out in paragraph 46 below.

Background

6. The Tribunal did not inspect the property but it is common ground that Central Walk comprises a purpose built block of 64 flats completed in about 2003. Flats 1-48 are individually demised on long leases. Flats 49-64 are demised under a single headlease to Thames Valley Housing Association ("TVHA"), which has granted sub-leases of individual flats on a shared ownership basis.

7. The lessees of Flats 1-48 are responsible for 75% of the service charges; TVHA is responsible for the remaining 25%.

8. The Respondent has accepted that, due to the application of section 20B of the Act, it cannot recover some service charges from TVHA. The sums in question are £5455.07 for year ending 31 March 2015 and £2248.93 for year ending 31 March 2016: a total of £7704.00.

9. The service charge accounts for year ending 31 March 2018 disclose that the sum of £7704.00 was debited from the reserve fund held on trust for the lessees of Flats 1-48, and credited to the reserve fund held for TVHA, thus making good the deficit on the TVHA service charges.

10. The applicant lessees object to the use of the reserve funds for this purpose.

The Lease

11. The Tribunal had before it a copy of the lease for Flat 7 and was told that the leases for Flats 1-48 are in like terms, save that individual lessee's proportion of the service charge costs may vary. The lease is for a term of 999 years from 26 November 2003.

12. The relevant provisions in the lease may be summarised as follows:

    (a) The lessee is required to pay a stated proportion (1.63% for Flat 7) of specified costs incurred by the lessor for the maintenance expenses set out in the Sixth Schedule ("the service charges");
    (b) Payments on account, based on an estimate, are due on 1 April and 1 October in each year;
    (c) The lessor must prepare an account audited by an independent accountant as soon as practicable after the end of each service charge year, and the lessor must serve a copy of the account and accountant's certificate on the lessee;
    (d) The account must distinguish between actual expenditure and a reserve for future expenditure;
    (e) The service charge expenses may include "such sum as shall reasonably be considered necessary … to provide a reserve fund or funds for items of future expenditure to be or expected to be incurred at any time in connection with the Building" (paragraph 14 of the Sixth Schedule).

Representation and Evidence at the Hearing

13. The applicants were represented by Mr Wade Barker of Bamptons Management, who informed the Tribunal he was doing so *pro bono*.

14. The Respondent was represented by Ms Katie Gray, counsel, instructed on a direct access basis.

15. A bundle had been prepared in accordance with the Tribunal's directions. This incorporated the parties' statements of case, and documents relied upon. The applicants also provided, as requested by the Tribunal, copies of on account service charge demands received for year ending 31 March 2020, the current service charge year, along with the supporting budget prepared by the respondent.

16. There were no witness statements, and no oral evidence. The hearing was dealt with on submissions.

The Law and Jurisdiction

17. Sections 19 and 27A of the Act are as follows:

> ***19. Limitation of service charges: reasonableness.***
>
> *(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 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.*
>
> *(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.*
>
> ***27A. Liability to pay service charges: jurisdiction***
>
> *(1) 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.*
>
> *(2) Subsection (1) applies whether or not any payment has been made.*
>
> *(3) An application may also be made to a leasehold valuation 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 …*

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

18. Under section 20C of the Act a tenant may apply for an order that all or any of the costs incurred by a landlord in connection with proceedings before a 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.

19. Under paragraph 5A of Schedule 11 to the Commonhold and Leasehold Reform Act 2002 a tenant may apply to the Tribunal for an order which reduces or extinguishes the tenant's liability to pay an "administration charge in respect of litigation costs".

Procedural background

20. The application form submitted by the lessees stated that a determination was sought in respect of year ending 31 March 2018. In response to a Notice that the Tribunal was minded to strike out the application for lack of jurisdiction, the applicants clarified, in a letter dated 5 August 2019, that they were objecting to future service charges insofar as these were due to using £7704.00 of reserves to pay off the uncollectable arrears from TVHA. They submitted that the Tribunal had jurisdiction to assess the liability to pay future service charges.

21. Judge Tildesley OBE did not strike out the application, and issued directions which identified the following issue as the one to be determined:

"Whether the allocation from reserves to discharge uncollectable service charges from previous years is authorised by the lease and reasonable".

The directions went on to incorporate the applicants' letter dated 5 August 2019 as part of their case. It was therefore clear from that point onwards that the application sought a determination in respect of future service charges under section 27A(3) of the Act, rather than a determination of the service charges for year ending 31 March 2018. It was also clear that the challenge was based solely on the use of the reserves. The parties did not request an oral hearing but upon considering the papers the Tribunal decided that a hearing was required.

The applicants' case

22. The applicants contended that the transfer of £7704.00 from the reserves held on trust for them and the other lessees of Flats 1-48 was

unauthorised. The lease did not permit the use of one lessee's reserve to subsidise past service charges attributable to another lessee. The only provision in the lease referring to the reserve fund was paragraph 14 to the Sixth Schedule, which provided that the fund was for "items of future expenditure". The respondent was liable, one way or another, to repay that money to the reserve.

23. Under section 27A(3) of the Act the Tribunal could determine whether the on account demands, in respect of future costs, were payable. Those demands should be reduced by each lessee's proportion of £7704.00, thus making up for the monies taken out of the reserve.

24. Mr Barker also drew the Tribunal's attention to what he said were further questions about the accuracy of the service charge accounts for year ending 2018. He accepted these matters were not before the Tribunal, but noted that those accounts also disclosed that not all of the reserve fund was held in a separate account; some was held in the general income and expenditure account. The sum of £7704.00 had in fact been debited from the income and expenditure account, but it was not expenditure authorised by the lease. A debit to the reserve fund was properly characterised as a capital item.

25. The budget supporting the on account demands for the current service charge year included an allocation of £5000.00 for a "sinking fund contribution" (i.e. reserve fund), and £17,250.00 for external repairs and maintenance.

The respondent's case

26. The respondent's primary submission was that the Tribunal had no jurisdiction to hear a dispute where the sole issue related to deductions made from the reserve fund, unless that issue was relevant to what sum was payable in any service charge year. The Tribunal therefore could not decide whether the reserve fund had been depleted otherwise in accordance with the lease, or, if so, whether the lessees should be credited. This was clear from the Upper Tribunal decision of *Solitaire Property Management Co. Ltd v Holden* [2012] UKUT 86 (LC). Ms Gray directed the Tribunal to the following paragraphs of HHJ Huskinson's conclusions:

> *31. It is important to note that the LVT concluded that the amounts which had been demanded by the appellants for the reserve funds were reasonable. Accordingly the sums demanded as payments towards the reserve funds, i.e. the sums demanded within the demands for the on account payments, were properly payable. The LVT does not suggest otherwise.*

32. It is puzzling as to why the LVT considered in these circumstances that it should examine the reserve funds provision in the way it did. The LVT did not consider the reserve funds position for the purpose of deciding a question arising under Section 27A as to how much was payable as service charge in any given year. In another case it could theoretically become relevant, for the purpose of deciding how much was payable by way of service charge by a tenant in a particular year, to decide questions regarding the status of money in the reserve funds. For instance if in a particular year a tenant argued that less should be demanded for a particular heading of expenditure because reserve funds should have been drawn upon for some or all of that head of expenditure, then the situation regarding such reserve funds could become relevant to decide this question under Section 27A – including consideration (if the landlord's case was that there was no money in the reserve fund to draw upon) of the question of whether the landlord had improperly spent the reserve funds in some unauthorised manner. However in a hypothetical case such as that the situation regarding the reserve fund is something which needs to be decided for the purpose of deciding a question expressly within the LVT's jurisdiction, namely how much is payable by way of service charges by a tenant in a particular year. In the present case the LVT do not purport to suggest that any decision they reached in respect of the reserve funds impinged upon how much was payable by way of service charges in any of the years which were under consideration by them. Instead the LVT's consideration of this reserve funds position appears to have been an entirely separate consideration as to whether the trust funds held by the appellants had been wrongly depleted by them and whether the appellants should in consequence make good to the new trustee (i.e. the new manager, Mr Bulmer) any monies wrongly used from the reserve funds. This question was separate from and did not involve consideration of any question arising under Section 27A as to how much was payable by any tenant by way of service charges in any particular service charge year.

33. In my judgment the LVT had no jurisdiction to embark upon this breach of trust inquiry in circumstances where such inquiry was not necessary to decide a question arising under section 27A. I further conclude that the LVT was not entitled to find that it had jurisdiction to act in the manner it did by (i) categorising the reserve funds as held by the appellants as a service charge, (ii) finding that the appellants had committed a breach of trust by misusing the reserve funds; and (iii) finding that the appellants' obligation to make good the trust monies which had been wrongly spent could properly be categorised as an obligation to pay a service charge, such that the LVT could find that the appellants as debtors were obliged to pay this money as a service charge to Mr Bulmer as the creditor.

27. Ms Gray said the same reasoning applied to the applicants' case. Although the Tribunal has jurisdiction under section 19(2) to consider individual service charge items in the budget supporting the on account demands for the current year, the applicants had not suggested that any particular item of service charge expenditure in the budget for year ending 31 March 2020 was unreasonable, and should therefore be disallowed under section 19(2) of the Act. The applicants were in effect just seeking reimbursement of monies allegedly wrongly spent from reserves.

28. Where a lessee challenges service charges, the initial burden is on the lessee to identify the items complained of and the general nature of the objection. Only once the lessee establishes a prima facie case does the burden shift to the lessor to meet those allegations: *Yorkbrook Investments Ltd v Batten* (1986) 18 HLR 25. The applicants had not challenged any particular item of expenditure in the 19/20 budget. If they had challenged the proposed allocation of £5000.00 for the sinking fund (reserves), the respondent would have produced evidence about its future plans for major works. Today was the first time any challenge to that specific item had been mentioned.

29. When asked to make submissions as to whether the disputed use of the reserve funds was authorised by the lease, Ms Gray refused to be drawn, saying only that she had no instructions to deal with this point, other than to point out that while paragraph 14 to the Sixth Schedule addressed the basis for payments *into* the reserve fund, it did not cover the basis for payments *out*. Nor did Ms Gray attempt to answer Mr Barker's other queries regarding the accuracy of the accounts.

30. The respondent's position was that if the applicants wished to challenge the use of the monies in the reserve fund, the appropriate course was to issue a claim for breach of trust in the courts.

The applicants' response

31. Mr Barker submitted that the relevant facts in this case were distinguishable from those in *Holden*, as in this case the fact that monies had been mis-spent from reserves was relevant to assessing the reasonableness of the on account demands. It fell within the caveat to Judge Huskinson's conclusion, as spelt out in the third and fourth sentences of paragraph 32 of the decision.

32. He also submitted that it was implicit in the way that the applicants had put their case that they challenged the on account demands insofar as they were based on a budget seeking an allocation for reserves or for major works that might be paid for from reserves.

Discussion and determination

33. This application has been made solely because the applicants dispute the use of their reserve monies to make good uncollectable service charges attributable to another lessee, TVHA, whose reserves are held separately. The respondent has failed to offer any justification for use of the reserve funds in this way, even though the Tribunal found, after considering the issue of jurisdiction at the outset of the case, that this was the very issue to be addressed. There was no application made by the respondent to vary or appeal that finding, and the Tribunal is therefore proceeding in accordance with it.

34. The Tribunal finds that it does have jurisdiction to deal with this issue because in this case, unlike in *Holden*, the application concerns a demand for monies on account, towards costs that are not yet incurred, or at least were not incurred when the demands were made. All the comments made in paragraph 32 of *Holden* relate to situations where expenditure has already been incurred and accounts showing how the expenditure has actually been funded are available. In this case the applicants argue that sums payable on account should be reduced, because it is not reasonable to require them to pay up when the respondents have mis-used their money. That is very different to the situation in *Holden*, which concerned only past service charge years, and, significantly, where the issue of mis-use of reserves was a point raised only by the LVT, not by the parties (see paragraph 8 of *Holden)*. The applicants' case, whether or not it succeeds, justifies a determination in accordance with the prior direction.

35. A further ground for jurisdiction is that the applicants' case is in substance a set-off claim. The word "set-off" has not been used by the applicants, who are not legally represented, but that is the reality of their case, as the respondent has acknowledged. It is well established that the Tribunal has jurisdiction to determine set-off claims in appropriate cases: *Continental Property Ventures v White* [2006] 1 EGLR 85. In *Holden* there was no claim to a set-off.

36. The respondent has been given a full opportunity to persuade the Tribunal that use of the reserve funds was authorised. On the evidence before it, the Tribunal is satisfied that the payment out of £7704.00 from that part of the reserve fund in which the applicants' contributions were held on trust for them was not a use authorised by the lease. Paragraph 14 to the Sixth Schedule of the lease makes it plain that the purpose of the reserve is to fund items of future expenditure. Making good deficiencies in the collection of previous years' service charges demanded (but uncollectable) from another lessee whose funds are held separately, cannot fall within this purpose. Ms Gray's submission that paragraph 14 only governs the basis for payments in, rather than payments out, of the reserve fund, relies on an artificial straining of the language of paragraph 14. We are satisfied that a reasonable person would understand the "expenditure" referred to in paragraph 14 to

mean only expenditure falling within the Sixth Schedule. Ms Gray did not suggest that the challenged transfer of funds could be justified in this way.

37. In parenthesis we add that we find the respondent's suggestion that the disputed use of the reserves must be litigated in the courts by means of a breach of trust claim to be highly unattractive. The costs of so doing would be entirely disproportionate to the sum in dispute.

38. The next question is whether the Tribunal's finding as to mis-use of the reserve fund is something that can be considered as affecting whether the amount demanded is "reasonable" within the meaning of section 19(2) of the Act. Ms Gray is correct in stating that the applicants have not identified any particular items of expenditure in the budget which they regard as unreasonable. Indeed the budget itself was only produced by the applicants in response to a request from the Tribunal shortly before the hearing. It is also correct that *Yorkbrook Investments* places the initial burden on the lessee to identify the specific charges he is disputing. We note that the budgeted sum for the "sinking fund" is similar to that in last year's budget, and we accept Ms Gray's point that the budgeted sum for external repairs and maintenance does not include any items of "major works" that might fall under section 20 and reasonably be funded by reserves.

39. There is therefore no basis upon which the Tribunal can find that any element of the budget supporting the on account demands is in an unreasonable amount.

40. However, that is not the end of the matter. It is the overall sum demanded that the applicants say is unreasonable, by some £7704.00, and their reason for so saying has been adequately explained. We are satisfied that such a claim falls within the scope of section 27A(3) of the Act.

41. The correct approach to be taken under section 19(2) has been considered very recently by the Court of Appeal in *Avon Ground Rents Ltd v Cowley & Others* [2019] EWCA Civ 1827. In *Avon*, as here, the budgeted sums were not themselves in an unreasonable amount. The issue was whether on account demands for the full cost of extensive remedial works were unreasonable, where the possibility that third party payments (from insurers) would subsequently reduce the sums the lessees had to provide was known when the demands were made. The Court of Appeal held that the First-tier Tribunal and Upper Tribunal had been entitled to take into account the anticipated third party payments and reduce the amounts payable on account accordingly.

42. Nicola Davies LJ explained the correct approach as follows:

31. The sums at issue in this case are payable in advance, based on an estimate of anticipated expenditure made before any of the remedial

work has been done. The UT considered a number of decisions of the tribunal and its predecessor, the Lands Tribunal, which included Parker v Parham [2003] EWA Lands LRX/35/2002 and Knapper [v Francis L & TR 20] . In my judgment the UT was correct to conclude at [51] that whether an amount is reasonable as a payment in advance is not generally to be determined by the application of rigid rules but must be assessed in the light of the specific facts of the case. A number of considerations ought or may properly have to be taken into account in determining the question of reasonableness under section 19(2) which would include the time at which the landlord would, or be likely to, become liable for the costs, and how certain the amount of those costs is.

32. The wording of section 19(2) of the1985 Act is intended to allow for flexibility. There is no definition as to what is reasonable nor do I find that further justification is required in order to define that word. The sense of section 19(2) is to encompass within the word "reasonable" any number of circumstances as was envisaged by the President, George Bartlett QC, in authority of Parker at [23].

33. As to what is "reasonable" is for the relevant tribunal to determine, as was done by the FTT in these proceedings. It is an exercise which the tribunal is well-equipped to perform, assessing the relevant facts of each individual case and arriving at a determination based on the evidence. The question as to whether the possibility of third-party payments can be taken into account in deciding what might be reasonably demanded on account will depend on the facts of the individual case. If certainty were to be required this would constrain the discretion of the tribunal when in reality what is required is a test which allows account to be taken of all relevant matters and to those matters will be attributed appropriate weight. This is particularly so when the purpose of the statutory provision is to protect tenants from unreasonable demands.

34. The appellant's submission that in construing section 19(2) and determining what represents a reasonable amount, no account should be taken of a likely payment, ignores the reality of many situations. It would result in unnecessary expenditure, by leaseholders having to pay higher service charges than were reasonable, or by having to embark upon what could be lengthy legal proceedings in order to recoup monies which had been overcharged.

35 .The imposition of rigid rules by this court, the practical effect of which would be to constrain the discretion of the tribunal in its determination of what is reasonable, is neither helpful nor cost-effective.

43. Applying the approach and reasoning of *Avon*, and considering it highly probable that the respondent would be held liable to reimburse the applicants for their proportion of the £7704.00 taken out of reserves if appropriate court proceedings were taken (see paragraph 37

above), this Tribunal considers that the sums requested on account from the applicants are unreasonable to that extent. There is no difference in principle between taking into account a probable third party payment to replenish service charge funds, and a probable landlord reimbursement. There is no evidence that reducing the payments on account in this way will have any adverse effect on the respondent or the management of the block; the sums involved are very small and the respondent accepts that the reserves are "healthy". In short we accept the claim of mis-use of reserve funds is a relevant matter which we are entitled to take into account in deciding what sum is reasonable and payable under section 19(2). So doing will also hopefully avoid the need for further potentially expensive court proceedings which would be entirely disproportionate.

44. Alternatively we reach the same result by determining the set-off claim, which is directly related to the service charges and is straightforward. We determine the set-off claim, on a balance of probabilities, in the applicants' favour. The Tribunal has no power to order payment of money by the respondent to the applicants but can adjust the amount to be paid by the applicants as a result of a valid set-off. Dealing with the set-off in these proceedings is a proportionate way of resolving this dispute and in accordance with the overriding objective to deal with cases fairly and justly.

45. Accordingly, the on account demands for service charge year ending 31 March 2020 will be reduced by £125.58 (1.63% of £7704.00) for the first applicant and by £101.69 (1.32% of £7704.00) for the second applicant.

Section 20C application

46. In deciding whether to make an order under section 20C a Tribunal must consider what is just and equitable in the circumstances. The circumstances include the conduct of the parties and the outcome of the proceedings. The Tribunal is troubled that the respondent refused to engage with the applicants to provide an explanation for the funds transfer. Although the sums in dispute for these applicants are comparatively insignificant, the issue of misuse of reserve funds is not. It was therefore reasonable for the application to be made, and it has been successful. We find it is just and equitable for an order to be made that to such extent as they may otherwise be recoverable, the Respondent's costs in connection with these proceedings are not to be regarded as relevant costs to be taken into account in determining the amount of any service charge payable by the applicants.

Paragraph 5A application

47. Ms Gray accepted there was no basis upon which the respondent could seek to recover its costs from the applicants as an administration charge. In those circumstances there is no need to make any order under paragraph 5A.

Concluding remarks

48. There appears to be a considerable history of disagreement between the parties resulting in a breakdown in communication. This is the second application to the Tribunal. It is to be hoped that in future there will be renewed efforts to engage with each other constructively over any issues arising, so that further contested proceedings can be avoided.

Dated: 20 November 2019

Judge E Morrison

Appeals

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

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

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

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