UPPER TRIBUNAL (LANDS CHAMBER)

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LT Case Number: LRX/45/2009
LRX/100/2009

TRIBUNALS, COURTS AND ENFORCEMENT ACT 2007

LANDLORD AND TENANT – service charges – whether charges payable under leases within definition – whether amount payable might vary according to cost of providing services – held that charges were within definition – appeals dismissed – Landlord and Tenant Act 1985, s 18(1)

IN THE MATTER OF TWO APPEALS FROM DECISIONS OF THE LEASEHOLD VALUATION TRIBUNALS

BY

(1) SOUTHERN HOUSING GROUP LIMITED
and
(2) FAMILY HOUSING ASSOCIATION (WALES) LIMITED

Re: (1) LRX/45/2009
Room 25, Ada Lewis House,
1 Dalmeny Avenue,
London N7 0LD

Re: (2) LRX/100/2009
29 Princess Of Wales Court,
Mansel Road,
Bonymaen,
Swansea SA1 7ES

Before: The President

Sitting at 43-45 Bedford Square, London WC1B 3AS
on 13 July 2010

Justin Bates, instructed by Hockfield and Co for Southern Housing Group Limited and by Morgan Cole LLP of Cardiff for Family Housing Association (Wales) Limited

The following cases are referred to:

Home Group Ltd v Lewis LRX/176/2006, 3 January 2008, unreported
Chand v Calmore Area Housing Association Ltd LRX/170/2007, 25 July 2008, unreported

The following further case was referred to in argument:

Minster Chalets Ltd v Irwin Park Residents Association LRX/28/2000, 27 April 2001, unreported

DECISION

1. These two appeals from decisions by leasehold valuation tribunals on applications under section 27A of the Landlord and Tenant Act 1985 raise the same question: whether the LVT in each case was correct in concluding that the lease provided for a "service charge" within the meaning of section 18(1) of the Act. The unsuccessful contention of the present appellants in each case was that the relevant lease does not make payable an amount "which varies or may vary according to the relevant costs" as provided for in section 18(1)(b), so that the tribunal did not have jurisdiction to determine the application under section 27A. Neither of the original applicants, Ms Joanne Hall and Mrs Diane O'Grady, respond to the appeal.

2. Southern Housing Group Ltd is a registered social landlord and the owner and manager of Ada Lewis House, 1 Dalmeny Avenue, London N7 0LD, which comprises hostel accommodation. Ms Hall was an assured shorthold tenant of room 25 in the hostel, holding under an assured shorthold tenancy agreement. Part 1 of the tenancy agreement, headed "Rent and Service Charges", provided as follows:

> "1.1 What you pay for the property
>
> The total rent you have to pay each week for the property starting from the date of this agreement is made up as follows:
>
> | | |
> |---|---|
> | Net rent | £40.29 |
> | A variable service charge made up of | |
> | Schedule A
Schedule B
Schedule C
Schedule D
Schedule E | |
> | Current scheme service charge | £27.93 |
> | Water rates (if appropriate) | £ 1.45 |
> | Other charges | £ 1.62 |
> | The total rent you should pay each week | £71.31 |
>
> **1.2** The total rent
>
> The total rent is due weekly and in advance and must be received by us on Monday of each week (but if you prefer you can arrange with us to pay the rent on a monthly basis in advance)…
>
> 1.5 Changing the net rent
>
> a We may increase or decrease the net rent at any time during the first year of this tenancy by giving you at least one month's notice in writing telling you the amount of the new net rent and the date on which you must start paying it. Thereafter, we may in accordance with the provisions of Sections 13 and 14 of the Housing Act 1988 increase or decrease the net rent by giving you at least

one month's notice in writing telling you the amount of the new net rent and the date on which you must start paying it. Correction of any significant errors that would result in a reduction in the amount payable will come into effect immediately on notification and will be backdated to the date of change. We will not increase the net rent within less than one year of the date of the last increase.

The new net rent will be amount stated in our notice, unless you refer the notice to a Rent Assessment Committee to have a market rent determined. In that case the maximum net rent you will have to pay for the following 12 months will be the rent determined by the Rent Assessment Committee. You have the right to refer the notice to a Rent Assessment Committee during the first six months of the tenancy.

b. At any time during the tenancy you and we may agree that your net rent will be increased in return for improvements to the property carried out by us. Any such agreement will state the amount of the increase, the date from which it will take effect and the improvements to which it relates. Any such increase will not count as an increase for purposes of clause 1.5a above.

1.6 Services we provide

In this tenancy agreement 'services' means the services set out in Schedules A, B, C, D and E attached to this agreement, as altered, added to, modified, reduced or removed from time to time.

We agree to provide and maintain the services and to renew the equipment referred to in the schedules as and when appropriate. We are not obliged to provide services if we are unable to provide any of them for reasons beyond our control. Wherever possible, we will give you reasonable notice before we stop providing a service.

All costs relating to the services listed in Schedules A, B, C, and D will be apportioned between all the dwellings which receive those services or to which those services are available.

1.7 Changing the services

We may, but only after consulting you, any recognised tenants' association and any other tenants who would be affected by the increase, add to, remove, reduce or vary the services we provide.

1.8 Calculating the service charge

The proportions in respect of the services for the property are stated in the schedules. If there is any change in the number of dwellings which receive services or to which services are available (for example, if neighbouring or adjoining schemes are included in the scheme), or if it is reasonable for us to vary the proportion for any other reason, we will recalculate the service charge proportions for the property in accordance with the schedules. We will give you notice of any such recalculation and will supply you with a copy of the service charge calculation (and, if applicable, recalculation each year).

We will supply you with a copy of the service charge calculation each year when we issue the notice telling you the new amount of the service charge payable.

1.9 Surpluses and deficits

If the cost of services we provide under Schedules A, B, C and E in any one period of 12 months is higher or lower than the income receivable during the same period in respect of such services then surpluses and deficits will be apportioned between the tenants in the same proportions as they are liable to contribute to the cost of services in question at the end of that period. Surpluses or deficits will be subtracted from or added to the service charge payable for the following 12 months or as otherwise agreed by us and a majority of the tenants who contribute towards the cost of such services.

If the cost of heating services we provide under Schedule D in any one period of 12 months is higher or lower than the income receivable during that same period in respect of such services, then any surplus in respect of the provision of heating and hot water will be refunded to tenants in the same proportion as they are liable to contribute towards the costs of these services at the end of that period. Any deficit will be apportioned between those tenants in the same proportions and added to the service charge payable for the following 12 months or as otherwise agreed by us and a majority of the tenants who contribute towards the cost of such services.

1.10 Changing the service charges

We may increase or decrease the service charge by serving a notice on you telling you how much the new service charge will be and when you will have to start paying it. We will usually change the service charge once a year on the first Monday in July. We may change the service charge ore than once a year during the transitional period from fixed to variable service charges or if there is a material change to the services we provide or the costing of services provided. In any event we will not increase the service charge more than twice in any 12-month period.

If we do not know exactly how much it will cost us to provide the services, we may estimate our costs and make any necessary adjustments at the first change of the service charge after we produce our accounts for the period.

Our service charges are subject to the provisions of the Landlord and Tenant Act 1985 (as amended from time to time). These provisions include an obligation in us to consult you before we incur large items of expenditure. You can ask us for a copy of the leaflet we have prepared which explains the effect of these provisions. This includes tenants' rights to refer our service charge to the Leasehold Valuation Tribunal for them to test its reasonableness; your right of access to the detailed accounting records and invoices; your right to have an audit of the financial records and arrangements for correction of any errors that might be discovered."

3. Ms Hall made application to the LVT (for the London Rent Assessment Committee) under section 27A for the determination of her liability to pay certain services charges. The LVT determined the question of jurisdiction as a preliminary issue, deciding the matter in her favour in a decision dated 10 February 2009.

4. Section 18(1) and (2) provide 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, 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."

5. Before the LVT Mr Justin Bates, relying on the decisions of the Lands Tribunal in *Home Group Ltd v Lewis* (LRX/176/2006, 3 January 2008, unreported) and *Chand v Calmore Area Housing Association Ltd* (LRX/170/2007, 25 July 2008, unreported), contended that the service charge referred to in the agreement was not a variable service charge for the purposes of the Act but rather a fixed charge with a provision for increase or decrease by the service of a notice.

6. In *Home Group*, the tenant made a monthly payment in respect of the net rent, the service charge and the water charge, the amounts of these being specified in the tenancy agreement, which provided as follows:

> "1.3 In this Agreement the term 'Rent' refers to the sum of the net rent, and service charge and water charge set out above or as varied from time to time, in accordance with this Agreement. The payment of monthly rent is due in advance on the 1st day of each month.
>
> 1.4a During the first year of this tenancy the Association may increase or decrease the Rent payable only once. The Association may increase or decrease the Rent payable only once. The Association will give the Tenant no less than one calendar month's notice in writing stating the new Rent.
>
> 1.4b After the first year, the association will increase or decrease the Rent once a year by giving the tenant no less than one calendar month's notice, in writing, of the increase or decrease. The notice shall specify the Rent and the included Service Charge proposed."

7. The manner in which the landlord calculated the rent for the forthcoming year was set out in paragraph 10 of the decision.

> "Put broadly the service charge element is calculated by estimating the costs of providing the services for the service charge year from the forthcoming 1 April. There is consultation with the tenants on these figures. A management fee is included. Once this proposed overall service charge figure has been calculated the position then is as follows, according to the Appellant's evidence. Once set, the monthly service charge is a fixed charge for the financial year and does not vary according to the actual costs during the course of that year. If the Respondents' actual expenditure on the items for which a service charge is levied exceeds the amounts tenants are contractually liable to pay, it absorbs the shortfall itself; if the actual expenditure is less, it retains the difference. There is no 'year end' accounting and no payment of a balancing charge."

8. The Tribunal (Judge Huskinson) concluded that the service charge in the tenancy agreement was not a service charge within section 18. He said:

> "21. There is nothing in the tenancy agreements indicating that any altered rent is to be calculated in any particular manner, or linking an alteration in rent (including service charge) with an alteration in the costs of providing any relevant services. Accordingly, it seems to me that section 18(1)(b) is not satisfied. It is true that it can be said that the Appellant in deciding whether to serve a notice of increase and, if so, how much that increase should be may well inform itself (as indeed it accepts it does) by reference to the estimated costs of providing services in the forthcoming year. However the ability in someone to serve a notice increasing the rent, if it chooses to do so, and to calculate that proposed new rent taking into account increases in the costs of services does not enable it in my judgment to be said that the rent (including service charge) is a payment 'the whole or part of which varies or may vary according to the relevant costs'. The sum payable does not vary in accordance with the relevant costs. Nor in my judgment can it be said that it 'may vary' in accordance with those costs. There is no direct relationship between the amount of the costs as a cause and the amount of the service charge as a consequence. Interposed between the amount of the costs and the amount of the service charge is the independent decision of the landlord (here the Appellant) or of the Rent Assessment Committee as to how much the new rent/service charge should be. Of course it can be said that the Appellant and that Rent Assessment Committee may take into account the reasonably estimated amount of the service costs in the forthcoming year, but that in my judgment is at least one remove from a situation where a rent varies or may vary according to the relevant costs."

9. In *Chand v Calmore Area Housing Ltd* the Tribunal (Judge Reid QC) adopted Judge Huskinson's reasoning where the provision of the tenancy agreement and the operation of the rent increase and decrease provision were effectively the same as in *Home Group*.

10. In the present case the LVT rejected Mr Bates's contention that the terms of the Southern Housing Group agreement were to the same effect as in the two Lands Tribunal decisions for the purpose of determining whether the service charge was within section 18(1). It saw as the

vital difference clause 1.9, the effect of which was that, if the estimate of service charge costs contained in the relevant schedules transpired to be higher or lower than the income receivable during the relevant period, then there would be a reconciliation of the relevant surplus or deficit at the end of that period. The LVT said:

> "5.4 The view of the Tribunal…is that the addition of this further clause in this particular agreement differentiates this case from those examined by the Lands Tribunal in the two decisions referred to. This particular provision makes it very clear, in the view of the Tribunal, that there is indeed, as stipulated by His Honour Judge Huskinson, 'a direct relationship between the amount of the costs as a cause and the amount of the service charge as a consequence'. The effect of the provision in clause 1.9, as understood by the Tribunal, is that if the estimate of services for one year proves to be inaccurate, such variation as thereafter takes place by the reconciliation is indeed linked to the 'cost of services' as specifically provided for in clause 1.9. There is no provision in the tenancy agreement for some form of random variation unassociated with the 'costs of services'.
>
> 5.5 Although for the purposes of section 18(1)(b) the service charge may not necessarily vary (ie if no notice is served), it is indeed the position that it 'may vary according to the relevant costs'. In other words, on a proper construction of clause 1.9 and section 18 of the Act, the service charge in this case is one in respect of which 'the whole or part…may vary according to the relevant costs'. It was not in contention that those relevant costs were indeed costs or estimated costs incurred or to be incurred by the landlord 'in connection with the matters for which the service charge is payable' for the purposes of section 18(2) of the Act, and in any event the Tribunal finds that clause 1.9, for the reasons indicated, does indeed make that link between the variation and the expenditure on such relevant costs.
>
> 5.6 It follows that the Tribunal has concluded that the service charges as referred to in the context of this tenancy agreement are indeed variable service charges for the purposes of the Act and that in all the circumstances the Tribunal does have jurisdiction."

11. Mr Bates submits that the LVT was wrong in its conclusion. He says that the service charge provisions do not vary according to the "relevant costs" as required by section 18(1)(b) but are fixed unless and until a notice of variation is served in accordance with clause 1.10 of the lease; and, whilst it may be the case that the appellant would consider past costs (and shortfall) when setting charges in the future, that does not make the subsequent fixed charge into a variable service charge. There is simply a fixed charge which may, after the service of a notice, be replaced with a further fixed charge. An increase in costs would not necessarily be passed on to tenants either in the existing service charge year or in any future service charge year.

12. I do not accept these contentions. While it is the case that clause 1.10 does not require that the service charge should vary according to the cost of the services, it provides that the landlord may change the service charge more than once a year if there is a material charge to the service provided or the costing of services provided. Thus under this provision the service

charge may vary according to the relevant costs. Moreover under clause 1.9 there is express provision that, if the cost of providing services in any one period is higher or lower than the income receivable during that period in respect of such services, the surpluses and deficits will be apportioned between the tenants and the surpluses or deficits subtracted from or added to the service charge payable for the following 12 months. Mr Bates says that the amount payable in each year will be a fixed amount – fixed by the notice served under clause 1.10 – and the fact that the fixed amount for one year will reflect the surplus or deficit in the previous year does not make the service charge for either year a variable service charge. I cannot agree. The amount payable as the service charge is that stated in clause 1.1 (£27.93), which can be varied by notice to reflect the surplus or deficit referred to in clause 1.9. Such variation will be one made in accordance with the relevant costs. It does not seem to me that, because the variation reflects the costs in the previous year, the service charge is not one that may vary according to the relevant costs.

13. Clause 1.1 describes the service charge as a "variable service charge", and it is right to do so. Moreover clause 1.10 makes reference to the tenant's "rights to refer our service charge to the Leasehold Valuation Tribunal for them to test its reasonableness". That reference is, in my view, clearly not misplaced.

14. In the second appeal the appellant is a provider of social housing and the owner and manager of Princess of Wales Court, Mansel Road, Bonymaen, Swansea. Mrs O'Grady is the tenant of 29 Princess of Wales Court under an assured tenancy. The tenancy agreement provided for service charges in the following provisions:

> "1.1 You agree to pay the following charges to the Association weekly in advance at the commencement and throughout the period of the tenancy subject to 1.2 below.
>
> | | |
> |---|---|
> | Gas Heating | £ 6.36 |
> | Rent | £49.52 |
> | Service Charges | £ 8.27 |
> | Support Charge | £ 6.36 |
> | Total Weekly Payment | £65.66 |
>
> 1.6 The Association may vary the amount of Service Charge payable every six months by giving the tenant 4 weeks written notice of any change at any time throughout the duration of this agreement. The notice shall specify the proposed new Service Charge.
>
> 1.7 Service Charges
>
> The Association will provide the following services, equipment or furniture at the Property for which the tenant will pay a Service Charge.
>
> You will be provided with a breakdown of the Service Charge items included at the commencement of the tenancy.

Service Costs may be apportioned between tenancies receiving a service. If you disagree with the reasonableness of the costs or standard of service you may appeal to The County Court.

1.8 Service Charge Policy

The Association will seek to recover through Service Charges only its actual expenditure incurred in providing services, equipment and furniture plus an administration fee. Where services are provided to a number of premises the Association may apportion the charge."

15. At the hearing of Mrs O'Grady's application for a determination of her liability to the service charge the appellant raised as a preliminary issue the contention that the service charge were not a service charge within section 18(1) because the amount payable by the tenant was not an amount that varied or might vary according to the relevant costs. The LVT (for the Wales Rent Assessment Committee) rejected this contention and proceeded to determine the substantive issue. It granted permission to appeal in relation to the decision on the preliminary issue and refused permission to appeal on other grounds. I later refused permission to appeal on those other grounds.

16. Mr Bates submits, as he has done in relation to the Southern Housing appeal, that the service charge does not vary but is fixed until varied by notice (here under clause 1.6), the effect of the notice being to establish a new fixed charge. Undoubtedly if clause 1.6 stood on its own it would entitle the landlord to vary the amount of service charge without regard for the cost of the services. But it does not stand on its own. It is subject to clause 1.8, which, although expressed as "Service Charge Policy", is properly to be construed as a contractual provision. Mr Bates accepts this. The effect of the provision is to limit what the landlord can recover through the service charge to "its actual expenditure incurred in providing services, equipment and furniture plus an administration fee". Thus the service charge may vary according to the costs of providing services. That a notice by the landlord is under clause 1.6 is a prerequisite of any variation having effect is nothing to the point. That is simply the machinery by means of which a variation is made. It is immaterial also, in my view that the variation may reflect expenditure incurred in the provision of equipment and furniture as well as the cost of services. Nor does it matter that it is up to the landlord whether any variation is made at all even where the cost of providing the services has increased or that the landlord if he wishes may recover less than his costs. It is the right conferred on the landlord to vary the service charge and the limitation on that right by reference to the cost of providing the services that means that the charge may vary according to the cost.

17. The difference between the provisions of the tenancy agreements in *Home Group* and *Chand v Calmore Area Housing Ltd* and those of the leases in the present cases is that in the former there was nothing in the agreements indicating that any altered rent was to be calculated in any particular manner, or linking an alteration in rent (including service charge) with an alteration in the costs of providing any relevant services; whereas in each of the present cases there is provision enabling the landlord to vary the service charge but imposing a limit to any increase by reference to the costs of providing the services.

18. In my judgment, therefore, each LVT came to the correct decision in determining that section 18(1) applied. Both appeals are dismissed.

Dated 15 July 2010

George Bartlett QC, President