FIRST-TIER TRIBUNAL
PROPERTY CHAMBER
(RESIDENTIAL PROPERTY)

Case Reference	:	CHI/21UG/LVL/2020/0004
Type of Application(s)	:	Variation of lease under section 35 Landlord and Tenant Act 1987.
Property	:	Flats 1-6, 36-38 Wilton Road Bexhill-on-Sea TN40 1 HX
Applicant	:	RMB 102 Limited
Representative	:	Eyre and Johnson limited t/a E&J Estates
Respondent	:	The Lessees of the Property
Representative	:	Heringtons LLP (as to Flats 1,2,3, 4 and 6)
Tribunal Member	:	Judge M Davey
Date of decision	:	24 May 2021

Decision

1. The Leases of Flats 1 to 6 inclusive at the Property are ordered, under section 38 of the Landlord and Tenant Act 1987, to be varied as specified in Annex 1 to this decision.

2. The Tribunal orders, under Section 20C of the Landlord and Tenant Act 1985 that the Landlord's costs incurred, or to be incurred, in connection with the proceedings begun by the Landlord Applicant's 1987 Act application are not to be treated as relevant costs for the purposes of any future service charge demand made of the Respondents who made section 20C applications.

Reasons for decision

The property and the leases

1. 36-38 Wilton Road, Bexhill-on-Sea TN40 1HX ("the Property") is a converted terraced house comprising 6 flats ("the Flats") over basement, ground floor and two upper floor levels. The then freeholder sold each flat on a 999-year lease ("the Lease") for a premium and annual ground rent. The leases were in common form and each will be referred to hereafter as "the Lease". The Applicant has supplied a copy of the Lease to Flat 1, which was granted by Robert Walter Henry Longhurst and June Phylis Longhurst to John Binnie Fleming and Evelyn Lottie Mabel Fleming on 2 September 1974 for a term of 999 years from 25 December 1973.

2. The current freeholder of the Property is RMB 102 Limited ("the Applicant"). The Applicant's managing agents are Austin Rees. The Lessees of the Flats ("the Respondents") are as follows:

Flat 1	Mr G.M. and Mrs C.M. Matthews
Flat 2	Mr D.S.Querns and Ms. N. Gedney
Flat 3	Mr K.J.Shorter
Flat 4	Mr G.James
Flat 5	Mr G.W.Usher
Flat 6	Miss G.A.Scott

The Application

3. The Applicant, by an application dated 6 November 2020, ("the Application") applied to the First-tier Tribunal (Property Chamber) (Residential Property) ("the Tribunal") under section 35 of the Landlord and Tenant Act 1987 ("the 1987 Act") for an order under section 38 of that Act varying the Lease of the Flats in the terms set out in the document annexed to the Application.

4. The Tribunal issued Directions on 3 December 2020. Further Directions issued on 22 December 2020 varied the timetable in the original Directions.

The Hearing

5. The Application was heard by FVH on 8 April 2021 by Judge Martin Davey. Mr. Steve Boon, of E&J Estates, represented the Applicant. Mr. Matthew Withers, of counsel, instructed by Heringtons, Solicitors, represented the Lessees of Flats 1-4 and Flat 6. The Lessee of Flat 5 has not responded to the Application.

Further submissions

6. After the hearing the parties made further written submissions, in response to questions raised by the Tribunal, in the course of which they modified their respective proposed variations.

The Applicant's Case

7. The Applicant says that the Application follows on from a decision in Hastings County Court in 2017, since when it has become apparent that the Lease does not provide for a balancing payment at the end of a service charge year should the service charge costs exceed the estimated sums demanded in advance. The relevant provisions of the Lease are as follows.

8. Clause 4(2) of the Lease contains a covenant by the Lessee to

> "Pay in every calendar year to the Lessor a maintenance contribution (being a one-sixth share of the costs of the Lessor in fulfilling his obligations under clause 5(3) hereof) and such maintenance contribution shall be paid by the Lessee as follows:
>
> The Lessee shall pay to the Lessor on the First day of January in each year in advance the sum of Twenty pounds on account of the maintenance contribution (the first payment or a proportionate part thereof as the case may be to be paid on the signing hereof) together with the balance (if any) of the estimated amount of the annual maintenance provision for the year such payment being computed in accordance with the provisions the Fourth Schedule hereto."
>
> The Fourth Schedule (Computation of Annual Maintenance Provision) provides as follows:
>
> 1. The annual maintenance provision in respect of any year (the expression "the year" for the purposes of these presents being the twelve months' period commencing on the First day of January) shall be computed in accordance with paragraph 2 hereunder
>
> 2. Such annual maintenance provision shall consist of the aggregate expenditure reasonably estimated to be incurred by the Lessor or the Lessor's Managing Agents (including provision for the Managing Agents' reasonable

fees) in such year for the purposes mentioned in clause 5(3) (allowance being made for any maintenance monies collected but not spent in any earlier year).

9. Clause 5(3) of the Lease provides a covenant by the Lessor

"(3) Subject to the Lessee contributing and paying as provided by Clause 4 (2) of this Lease to repair maintain decorate and renew:-

(i) The main structure and in particular *[Flats 2 and 4 only: and without limitation]* the roof drains and sewers chimney stacks gutters and rainwater pipes of the building

(ii) The gas and water pipes electric wires and conduits in under or upon the building as may be enjoyed or used by the Lessee in common with the owners and lessees of the other flats in the building

(iii) The path coloured brown on the said plan porch main entrance door and lobby and the passages landings and staircase of the building as enjoyed or used by the Lessee in common as aforesaid

(iv) The boundary walls and fences of the building

PROVIDED ALWAYS that (i) the Lessor shall not be liable under this covenant unless and until notice in writing of any alleged defect in repair (as distinct from decoration) has been given to the Lessor and (ii) the Lessee shall pay interest at the rate of Fifteen per centum per annum (as well before or after any judgment) on any sum owing from him by way of maintenance contribution for more than two months after the same shall have been demanded in writing by the Lessor

(v) In particular without affecting the generality of the foregoing the Lessor shall so often (subject as hereinafter provided) as reasonably required decorate the exterior of the building in such manner as shall be reasonably agreed by a majority of the owners or lessees of the flats comprised in the building or failing such agreement in the manner in which the same was last previously decorated or as near thereto as circumstances permit and in particular will paint the exterior part of the building usually painted with two coats at least of good paint at least once in every seven years

PROVIDED that (i) in arriving at the majority requirement as aforesaid the lessees of the flats comprised in the building shall take account of the desires of the Lessor as the owner of any flat not then demised as if the Lessor were the Lessee of such flat and (ii) if a majority of such lessees (having consulted the Lessor as aforesaid) desire the said exterior to be redecorated within any period of seven years they shall notify the Lessor of such desire in writing in sufficient time to enable the Lessor to include the estimated costs of such redecorations in the maintenance provision for the year following such notification

9. In its Application, as subsequently modified, the Applicant now seeks a variation of the Lease whereby Clause 4(2) and the Fourth Schedule would be replaced by the following.

"Clause 4(2)

Pay the Interim Charge and the Service Charge at the times and in the manner provided in the Fourth Schedule hereto

Fourth Schedule

INTERIM CHARGE AND SERVICE CHARGE

1. The following definitions apply:

"Accounting Period" the period commencing on the 1st January and ending on the 31st December in each year

"Interim Charge" one-sixth of such reasonable and proper sums to be paid on account of the Service Charge in respect of each Accounting Period as the Lessor shall reasonably estimate as likely to be incurred in that Accounting Period in respect of the Total Expenditure

"**Reserve Fund**" a fund held in the Fund Account containing the aggregate so far as unexpended of the Reserve Fund Contribution;

"**Reserve Fund Contribution"** the amount (if any) in each Service Charge Accounting Period as the Lessor may in its reasonable discretion estimate as a fair annual contribution by the tenants of the building from time to time to the Reserve Fund for the forward funding of regularly recurring major service items including, but not limited to, repair, decoration, maintenance and renewal (including any VAT charged on such sums to the extent that the Lessor is not able to obtain a credit for that VAT from HM Revenue & Customs);

"Service Charge" one-sixth of the Total Expenditure

"Total Expenditure" the aggregate of the reasonable expenditure properly incurred by the Lessor in any Accounting Period in carrying out its obligations under clause 5(3) of this lease the Reserve Fund Contribution and any other costs and expenses reasonably and properly incurred in connection with the building including the reasonable and proper fees of the Lessor's Managing Agents and accountant

2.1 The Interim Charge shall be paid to the Lessor by the Lessee by half yearly instalments in advance on the 1st January and 1st July in each year

2.2 If the Interim Charge paid by the Lessee in respect of any Accounting Period exceeds the Service Charge for that period then the surplus shall be credited to the Lessee against the next payment of the Interim Charge

2.3 If the Service Charge in respect of any Accounting Period exceeds the Interim Charge paid by the Lessee in respect of that period then the Lessee shall pay the excess to the Lessor within 28 days of service upon the Lessee of the certificate referred to in the sub-paragraph next following

2.4 As soon as practicable after the expiration of each Accounting Period the Lessor's accountant shall draw up and submit to the Lessee accounts setting out details of the Total Expenditure and Service Charge in respect of that period and shall certify the surplus to be credited to the Lessee or the excess due from the Lessee as the case may be.

The Case for the Respondents (Flats 1-4 and 6)

10. Mr Withers said that the Respondents do not accept that the Lease is defective and submitted that it is perfectly possible for the Applicant to recover its costs by using the existing provisions so as to ensure that the service charges demanded in advance were an accurate estimate.

11. Nevertheless, without prejudice to that submission, the Respondents argue that any variation should go no further than necessary to remedy the alleged defect. With that in mind they propose an alternative form of variation as follows.

Clause 4(2)

Pay the Interim Charge and the Service Charge at the times and in the manner provided in the Fourth Schedule hereto

The FOURTH SCHEDULE INTERIM CHARGE AND SERVICE CHARGE

1. The following definitions apply:

"**Accounting Period**" the period commencing on the 1st January and ending on the 31st December in each year

"**Fund Account"** the interest bearing account opened with [name of bank] in the name of the Lessor to hold the Reserve Fund

"**Interim Charge**" one-sixth of such reasonable and proper sums to be paid on account of the Service Charge in respect of each Accounting Period as the Lessor shall reasonably estimate as likely to be incurred in that Accounting Period in respect of the Total Expenditure

"**Lessee's Proportion**" one sixth of the Reserve Fund Contribution

"**Reserve Fund**" a fund held in the Fund Account containing the aggregate so far as unexpended of the Reserve Fund Contribution;

"**Reserve Fund Contribution"** the amount (if any) in each Service Charge Accounting Period as the Lessor may in its reasonable discretion estimate as a fair annual contribution by the tenants of the building from time to time to the forward funding of regularly recurring major service items including, but not limited to, repair, decoration, maintenance and renewal (including any VAT charged on such sums to the extent that the Lessor is not able to obtain a credit for that VAT from HM Revenue & Customs);

"**Service Charge**" one-sixth of the Total Expenditure

"**Total Expenditure"** the aggregate of the reasonable expenditure properly incurred and the sums of money reasonably set aside (including any VAT or any other tax thereon) by the Lessor in any Accounting Period in carrying out its obligations under clause 5(3) of this lease including the reasonable and proper fees of the Lessor's Managing Agents

2.1 The Interim Charge and the Lessee's Proportion of the Reserve Fund Contribution (if any) shall be paid to the Lessor by the Lessee by half yearly instalments in advance on the 1st January and 1st July each year

2.2 If the Interim Charge paid by the Lessee in respect of any Accounting Period exceeds the Service Charge for that period the Lessor shall be entitled to retain such surplus by way of addition of the same to the Reserve Fund and if not so retained shall be returned to the Lessee.

2.3 If the Service Charge in respect of any Accounting Period exceeds the Interim Charge paid by the Lessee in respect of that period then the Lessee shall pay the excess to the Lessor within 28 days of service upon the Lessee of the certificate referred to in the sub-paragraph next following

2.4 As soon as practicable after the expiration of each Accounting Period the Lessor's accountant shall draw up and submit to the Lessee accounts setting out details of the Total Expenditure and Service Charge in respect of that period and shall certify the excess (if any) due from the Lessee.

2.5 All interest earned in the Fund Account must be applied to the Reserve Fund for the benefit of tenants of the building from time to time

12. The Respondents thus accept that should the Tribunal make a variation then Clause 4(2) should be amended as proposed by the Applicant. However, the Respondents disagree with the terms of the Applicant's proposed Fourth Schedule as follows.

Reserve fund

13. The parties now agree that there should be provision for a Reserve Fund and that this should only be for clearly defined expenditure, in accordance with the rest of the Lease, and should have a clear contractual mechanism for its operation. However, the Respondents go further and submit that the operation of the Reserve Fund should be defined as a specific fund account held for the benefit of the building, and interest which accrues thereon must also be held for the benefit of the building (see Fund Account, Reserve Fund and sub-clause 2.5 in the Respondents' proposed terms).

14. Mr Boon, for the Applicant, said that modern estate management practice is not to have a separate account for a reserve fund which, given bank charges, would be expensive to set up and maintain at a time when interest rates are low. He says that in his experience, managing agents maintain either a general client account or a single account for each property but do not open a separate deposit account for reserve funds, which would entail an extra administrative burden, the costs of which would far outweigh the benefit of any interest earned. Mr Withers said that on the contrary, the Respondents' proposal reflects good practice, which would enable the Reserve Fund to be properly accounted for and protected. He said that bank charges are normal and in any even interest rates may rise. The key principle is separation of funds.

The definition of Total Expenditure

15. The Applicant proposes that the definition of *Total Expenditure* (being costs recoverable by the service charge) include *"any other costs and expenses reasonably and properly incurred in connection with the building."* Mr Withers for the Respondents argued that the Applicant's proposed variation, which did not feature in the Application, seeks to expand the sums that can be recovered under the Lease, and does not remedy any defect in the current provisions of the Lease pursuant to section 35(2)(e) of the 1987 Act. Mr Withers also says that it is difficult to see how section 35(2)(d) of that Act can apply and that the definition should therefore be limited to expenses properly incurred by the Lessor "in carrying out its obligations under clause 5(3) of this lease."

16. In summary, Mr Withers says that clause 5(3) of the Lease is not defective. It may be a bad bargain but it is no part of the Tribunal's function to rewrite a bad bargain.

Accountancy fees

17. The Respondents submit that the Applicant's proposed wording of Total Expenditure to include the reasonable and proper fees of the Lessor's Managing Agents and accountant goes further than is necessary and was not part of the original Application. The Respondents say that the original Lease contained no provision for the recovery of accountant's fees and this is not a defect that requires a remedy. It is simply the bargain that was struck. The Respondents argue that the addition of this provision goes further than required in order to remedy the defects, namely the alleged inability of the landlord to rectify the position following estimated service charges paid in advance where the expenditure exceeds the estimated sums. The Respondents accept that the reasonable and proper fees of the Lessor's Managing Agents should remain recoverable.

The Applicant's response

18. Mr Boon says that the situation has evolved since the Application was submitted. Whilst he accepted that the ground in section 35(2)(f) of the 1987 Act was not an appropriate ground in this case he argues that the

expanded definition of Total Expenditure to include *"any other costs and expenses reasonably and properly incurred in connection with the building"* would cover matters such as expenditure incurred in connection with health and safety and fire risk assessments. He submitted that section 35(2) (d) of the 1987 Act was engaged. That is to say that the Lease fails to make satisfactory provision for

> the provision or maintenance of any services which are reasonably necessary to ensure that occupiers of the flat enjoy a reasonable standard of accommodation (whether they are services connected with any such installations or not, and whether they are services provided for the benefit of those occupiers or services provided for the occupiers of a number of flats including that flat);

19. Mr Boon says that for this purpose, factors relating to the security of the flat and its occupiers and of any common parts of the building (e.g. health and safety measures) are relevant in determining what is a reasonable standard of accommodation, as provided for by section 35(3)(a) of the 1987 Act.

20. Mr Boon says that the Applicant concedes that this expansion of the definition of Total Expenditure is not one of the grounds set out in the Application dated 6 November 2020 but submits that it would be open to the Applicant to make further application to the Tribunal if not considered as part of the present Application.

21. In connection with the words "and accountant," Mr Boon submitted that it was within the Tribunal's jurisdiction to vary the Lease to incorporate these words on the grounds that the Lease fails to make satisfactory provision for "the recovery by one party to the lease from another party to it of expenditure incurred or to be incurred by him, or on his behalf, for the benefit of that other party or of a number of persons who include that other party"(section 35(2)(e) of the 1987 Act). The Applicant concedes this is also not one of the grounds set out in the Application but submits that it would be open to the Applicant to make a further application to the Tribunal if not considered part of the present application.

22. Mr Boon says that the Respondents accept that it is desirable for accounts to be prepared and such accounts to be certified by an accountant. He said that if the Tribunal were to determine that the Lessees should not pay for the services of an accountant, the Applicant proposes alternative wording for paragraph 2.4 of the Fourth Schedule as follows:

> 2.4 As soon as practicable after the expiration of each Accounting Period the Lessor's Managing Agents shall draw up and submit to the Lessee a certificate setting out details of the Total Expenditure and Service Charge in respect of that period and shall certify the excess (if any) due from the Lessee.

Effective date of any variation

23. Mr Boon asks the Tribunal to backdate any variation to 21 July 2014, being the date of the Applicant's acquisition of the freehold. He said that the Applicant concedes that this was not set out in the Application dated 6 November 2020, but submits that it provided all the information required by the prescribed form and that it notified the Tribunal and the Lessees of its intention to apply for backdating of any order at the earliest opportunity in order that the Lessees should be able to make submissions in their statements of case.

24. Mr Boon produced the Applicant's accounts for the service charge years ended 31 December 2015, 2016 and 2017, demonstrating, he says, that there were significant excess sums of £9,073.20, £955.98 and £6,904.20 respectively, whereas there were none for the years ended 31 December 2018 and 31 December 2019. Mr Boon said that it could be seen from the Lessees' statements of account that whereas there are unpaid service charges, none of these relate to the years ended 31 December 2015, 2016 or 2017.

25. Mr Boon said that prior to the court hearing in 2017, neither the Lessor, nor the Lessees, had appreciated that the Lease was defective. He said that in seeking a backdated order the Applicant is merely seeking to recover what is owed to it in respect of costs actually incurred by the Applicant.

26. Mr Withers admitted that the Tribunal has jurisdiction to order that any variation has retrospective effect pursuant to the 1987 Act and the Upper Tribunal authority of *Brickfield Properties Ltd v Botten* [2013] UKUT 133. However, he said that the Respondents deny that such an order should be made in this case. He suggested that the retrospective effect of any variation ordered would reward the Applicant for their inability to properly consider and follow the current wording of the Lease. He said that this is not a case where there is sufficient evidence of consistent underpayment or a failure to recoup 100% of expenditure because the lease fails to make satisfactory provision for or recoupment of the sums expended by the landlord, as was the case in *Brickfield*.

27. Mr Withers said that the Respondents' consent to variation, in the terms proposed, enables the Applicant to put in place a proper allowance for a Reserve Fund in circumstances where it is agreed that is preferable and allows for a balancing payment when necessary going forward, but he says that these provisions do not require retrospective effect. Their purpose is to deal with the future.

28. Mr Withers says that backdating any variation will provide the Applicant with a reward for its inability to properly consider the existing terms of the Lease, having demanded sums which were not properly recoverable under the Lease historically.

29. Mr Boon said that backdating of any order would not amount to a reward. Mr Boon suggested that on the contrary some or all of the Lessees are expecting to receive an unintended and undeserved windfall. He says however that whether or not the Lessees expected a windfall there is no evidence of prejudice to them if any order was to have retrospective effect. They will have paid no more then they should have paid and will not receive any additional service charge demands for the years in question.

30. Mr Withers says that it is denied that not backdating any variation would somehow provide the Respondents with any windfall and says there is no evidence of the same.

The Law

31. The relevant provisions of the Landlord and Tenant Act 1987 are set out fully in Annex 2 to this decision with reasons.

Consideration and decision

32. Part IV of the 1987 Act permits an application to be made to the Tribunal for an order of variation of a lease or leases. The present Application is made under section 35 of the Act which provides that the grounds on which such an application may be made are that the lease fails to make satisfactory provision in respect of one or more of the matters set out in section 35(2) sub-paragraphs (a) to (g). The Application of 6 November 2020 states that the ground relied on is that in paragraph (e) which reads

> "the recovery by one party to the lease from another party to it of expenditure incurred or to be incurred by him, or on his behalf, for the benefit of that other party or of a number of persons who include that other party;"

33. Following its Application and at the hearing the Applicant sought to expand the scope of the grounds relied on through its written and oral submissions and the Tribunal accepts that the Application should be treated as made in its expanded form. The Respondents were aware of the grounds relied on and were able to make submissions on the same.

34. The property 36-38 Wilton Road is a converted mid-terraced house comprising 6 flats over basement, ground floor and two upper floor levels. All the Flats have been sold on 999-year leases. The Lease places obligations on the Lessor to provide specified services and contains provision for recovery of the cost of providing those services. It is that provision for recovery of costs which the Applicant claims to be defective and in want of a remedy.

35. As it stands clause 4(2) of the Lease obliges the Lessee to "Pay in every calendar year to the Lessor a maintenance contribution (being a one-sixth share of the costs of the Lessor in fulfilling his obligations under clause 5(3) hereof. The Lessor's obligations under clause 5(3) are to repair maintain decorate and renew

(i) The main structure and in particular *[Flats 2 and 4 only: and without limitation]* the roof drains and sewers chimney stacks gutters and rainwater pipes of the building (ii) The gas and water pipes electric wires and conduits in under or upon the building as may be enjoyed or used by the Lessee in common with the owners and lessees of the other flats in the building (iii) The path coloured brown on the said plan porch main entrance door and lobby and the passages landings and staircase of the building as enjoyed or used by the Lessee in common as aforesaid and (iv) The boundary walls and fences of the building

36. The problem which has led to this Application, is that clause 4.2 goes on to provide that the said maintenance contribution is to be calculated in accordance with the Fourth Schedule to the Lease. However, that Schedule only provides for an estimated charge to be payable on 1 January each year. It makes no provision for a balancing charge at the end of the year that would permit the Landlord to recover the difference between the estimated and actual costs where the latter exceed the former. Thus the clear intention was that the Lessee should be liable for a one-sixth share of the actual costs but at the same time these costs were only calculated by reference to the estimated costs. There is no provision in the lease for a reserve fund.

37. In these circumstances the Tribunal agrees with the Applicant that the Lease is clearly defective. It also agrees that the Lease fails to make satisfactory provision with respect to the matters set out in paragraph (e) of section 35(2) of the 1987 Act. It prevents the Lessor from recovering expenditure incurred when complying with its obligations in clause 5(3) of the Lease being expenditure for the benefit of the Lessees.

38. The Respondents argue that such expenditure could be recovered under the Lease as it stands by ensuring that the estimated costs demanded match the costs subsequently incurred by the Lessor. That might well be true in some years but not always. It depends on the Lessor anticipating not only predictable service costs but also the unpredictable. Thus whilst the Lease makes provision for the recovery of the said expenditure it does not make *satisfactory* provision for recovery of the same. The whole point of a scheme that provides for advance estimated payments and end of year reconciliation and balancing debits and credits is to ensure that the landlord ultimately recovers its costs or the tenant is credited with any overpayment. A scheme that depends solely upon the Landlord accurately anticipating or overestimating costs yet to be incurred is not a satisfactory provision.

39. The matter then becomes one of the variations to be ordered. The parties are in agreement that Clause 4(2) of the Lease be replaced by the following.

"4(2) Pay the Interim Charge and the Service Charge at the times and manner in the Fourth Schedule hereto"

40. The Schedule also makes provision for a Reserve Fund and a Reserve Fund Contribution. The parties are agreed on the definition of these terms.

41. The Tribunal determines that it would correct a defect in the Lease to make provision for payment towards reserves on the ground that the Lease fails to make satisfactory provision with respect to the repair or maintenance of all or any of (i) the flat (ii) the building containing the flat, or (iii) any land or building which is let to the tenant under the Lease or in respect of which rights are conferred on him under it (section 35(2)(a) of the 1987 Act). The existence of a defined reserve fund will help prevent, amongst other things, essential redecoration or major repair works being delayed for lack of funds or being the subject of an extraordinary levy at the stage when the need for such work becomes apparent.

42. The parties differ as to some details of the Fourth Schedule. First, the Respondents argue that the Reserve Fund should be in a separate account from the rest of the payments made to the Lessor by the Lessees whereas the Applicant argues that this is not necessary, is contrary to management practice and would be disproportionately expensive to run.

43. The Tribunal accepts that the reserve fund should be for defined purposes, in which case the RICS Service Charge Residential Management Code recommends that the funds should be placed in a separate interest bearing account. The Tribunal therefore agrees with the Respondents that there should be a separate Reserve Fund Account.

44. The second matter is the d inclusion in the definition of Total Expenditure of "any other costs and expenses reasonably and properly incurred in connection with the building" and the third matter is the inclusion in that definition of the fees of the Lessor's accountant.

45. The Tribunal agrees with the Respondents that a variation that would permit the lessor to recover the first of these sets of costs is not necessary to rectify a defect in the Lease. The obligations of the Lessor are set out in clause 5(3) of the Lease. A lease is not defective because it might have been drafted differently. The Applicant relies on sections 35(2)(d) and 35(3)(a) of the 1987 Act. However, it fails to establish why the Lease as it stands prevents the Lessor from complying with health and safety requirements and even then why the Lessees should bear the cost if it did. The Lease could have been drafted to permit the Lessor to recover the costs of complying with such requirements but it was not and it cannot be said to be thereby defective for the purposes of section 35.

46. With regard to the Accountant's reasonable fee, it is quite true, as the Respondents contend, that the original bargain, whilst permitting a charge to be made of the Lessees in respect of the Managing Agents' fees, did not make provision for any charge in respect of accountancy fees. However, this was no doubt because the Lease failed to make provision for end of year accounts and certification of costs incurred.

47. The Tribunal agrees with the Applicant that if, as accepted by both parties, the variation to rectify the identified defect of a failure of the Lease to make provision for recovery of a service charge deficit requires the Lessor's Accountant to draw up and submit to the Lessee accounts setting out details of the Total Expenditure and Service Charge in respect of that period and to certify the excess (if any) due from the Lessee it is reasonable to make provision for recovery of that expense as a service cost.

48. The Remaining differences relate to the mechanism for payment of the Interim Charge and the Service Charge and how to deal with end of year deficits and surpluses.

49. For this purpose, the Applicant's proposal is structured as follows. (1) The Interim Charge (payable in advance in two instalments on 1 January and 1 July each year) is defined as being one sixth of such reasonable and proper sums to be paid on account of the Service Charge in respect of each Accounting Period as the Lessor shall reasonably estimate as likely to be incurred in that Accounting Period in respect of the Total Expenditure. (2) The definition of Total Expenditure is the aggregate of the reasonable expenditure properly incurred by the Lessor in any Accounting Period in carrying out its obligations under clause 5 (3) of the Lease and the Reserve Fund Contribution (including the reasonable and proper fees of the Lessor's Managing Agents and accountant). (3) The Service Charge is one sixth of Total Expenditure.

50. It follows therefore that the Interim Charge includes one sixth of the Reserve Fund Contribution as well as one sixth of the anticipated service costs. The Service Charge also includes one sixth of the Reserve Fund Contribution (which will have been payable in advance as part of the Interim Charge). The Applicant proposes that the end of year balancing exercise will therefore compare the Interim Charge with the Service charge, being one sixth of the Total Expenditure (as defined) and if the Interim Charge paid by the Lessee exceeds the Service Charge the surplus shall be credited to the Lessee against the next payment of Interim Charge (paragraph 2.2). If the Service Charge exceeds the Interim Charge the balance becomes payable within 28 days of service on the lessee of the certificate provided by paragraph 2.4 (see paragraph 2.3).

51. The Respondent's proposed variation differs in that it separates out from the Interim Charge the Lessee's one-sixth share of the Reserve Fund Contribution, which it defines as "the Lessee's Proportion". Both of these payments are to be made in advance. Because the Interim Charge is one

sixth of anticipated Total Expenditure, the latter term (which is defined as being the aggregate of the reasonable expenditure properly incurred *and the sums of money reasonably set aside* (including any VAT or any other tax thereon) by the Lessor in any Accounting Period in carrying out its obligations under clause 5 (3) of the lease including the reasonable and proper fees of the Lessor's Managing Agents (emphasis supplied)), must necessarily exclude the Reserve Fund Contribution. Service Charge is again defined as one sixth of Total Expenditure.

52. It follows that, under the Respondents' proposed variation, when the end of year reconciliation is performed the Interim Charge will not include the Lessee's Proportion and neither will the Service Charge. However, as noted above the Respondents' definition of Total Expenditure includes *the sums of money reasonably set aside*. This cannot be a reference to the Lessee's Proportion because that is separate from and payable in addition to the Interim Charge, which latter term is defined by reference to Total Expenditure.

53. Indeed this is clear from the Respondent's proposed paragraph 2.2 to the Fourth Schedule which provides that if the Interim Charge in respect of any Accounting Period exceeds the Service Charge for that period the Lessor shall be entitled to retain such surplus by way of addition to the Reserve Fund and if not so retained shall be returned to the Lessee.

54. The difficulty with this formulation is that the *sums of money reasonably set aside (if any)* for the purposes of paragraph 2.2 can only be ascertained by comparing the Interim Charge with the Service Charge. Thus it will only work if the italicized words were omitted from the definition of Total Expenditure. If that were the case the outcome of the reconciliation exercise will be the same under the Applicant's and the Respondents' proposed Fourth Schedule, save for the fact that the Applicant's draft provides for any surplus to be credited to the Lessee's next Interim Charge, whereas the Respondents' proposal gives the Lessor the option of adding the surplus to the Reserve Fund or returning it to the Lessee.

55. The Tribunal determines that the Applicant's solution is to be preferred as being consistent with the service charge scheme usually found in leases which make provision for advance charges and end of year adjustments, This also has the advantage of making it clear that the Reserve Fund is part of the service charge costs for the purposes of the Landlord and Tenant Act 1985 (see section 18).

Date of variation

56. The Applicant also asks for any variation to be retrospective arguing that this would be just and equitable. It relies on the decision of the Upper Tribunal in *Brickfield Properties Ltd v Botten* [2013] UKUT 133. In that case the Respondent's lease provided that the lessee was responsible for a specified percentage of the service charge costs. The lease was of one flat

in a development of seven blocks containing 56 Flats. The percentage contributions under each lease ensured that the total service charge came to 100% of the service costs. In 2006 the lessees of one block exercised their right to collective enfranchisement, which meant that the freeholder now had control of only 6 blocks. This meant that the total percentage payments of the flats in those blocks now came to 85.55%, the remaining 14.45% being attributable to the flats in the enfranchised block. Thus the lessor was now only able to recover 85.55% of its costs incurred in relation to the remaining six blocks. An application to vary the leases was made so as to ensure that the proportions payable under the leases of the flats in those six blocks added up to 100%. The application was made on the ground set out in section 35(2)(f) of the 1987 Act.

57. The Upper Tribunal confirmed that the First-tier Tribunal has power to order that any variation be backdated. The Upper Tribunal went on to hold that the F-tT's decision not to backdate the variation in that case was wrong and ordered that the variation be backdated to the date when the defect was created. The Judge found that the lessees had enjoyed the benefits of the services throughout that period and would obtain an unintended windfall if the variation were not to be backdated. They had been notified at an early stage that there was a defect and invited by the lessor to agree a variation but (save in three cases) had not responded, thereby giving rise to the need for the Applicant to apply to the tribunal under section 35 of the 1987 Act.

58. The Applicant in the present case argues that it is in a similar position to the applicant in *Botten*. The Tribunal disagrees. In *Botten* the Lessor was historically able to recover 100% of its costs. The defect that prevented this came about through the enfranchisement of one of the seven blocks following which the Lessor acted promptly to try to rectify the defect by agreement, only applying to the Tribunal when driven to do so as a last resort. In the present case the defect has been there from the beginning of the Lease in 1974. It became apparent in 2015 but there is no evidence that since that time the Lessors have sought to agree a variation of the Leases with the lessees. On the contrary the Lessors continued to request an advance payment each year and then billed the Lessees at the end of the year for any deficit. Indeed the Applicant seeks a variation to enable it to recover costs which are not recoverable under the Lease as it stands but for which the Applicant has been charging the Respondents including not only deficit charges, but also Accountancy fees and Health and Safety charges. Furthermore, in 2018 the Applicant demanded £35,761.68 including a reserve contribution of £19,883.40 to external decorations when the Lease fails to make provision for a reserve fund.

59. In 2015, 2016 and 2017 the estimated costs were significantly below the actual costs. In 2015 advance charges of £6,108 were demanded when the management fees and insurance premiums alone came to £4,360.90. In 2017, £3,663 was demanded when insurance and management fees came to £6,185.30. However, in 2018 £15,878 was demanded when expenditure was £7,305. It seems likely that this demand included the deficit for 2017. It is clear that the sums demanded by way of advance

charges have not been reasonable estimates in that in several years the costs have been predictably underestimated.

60. Mr Boon asked the Tribunal to backdate any variation because it would only be giving the Applicant sums to which it was entitled. However it was not entitled to such sums, which is why the Application for variation was made to the Tribunal! The Tribunal accordingly determines that the variation should not be backdated.

Section 20C Landlord and Tenant Act 1985.

61. Mr Boon, for the Applicant, stated that he was content for the Tribunal to make the order sought by the Respondent lessees of Flats 1-4 and 6 and the Tribunal accordingly makes the order requested, although it notes the absence from the Lease of any provision that would otherwise permit such costs to be recoverable as relevant service charge costs.

Right to appeal

1. A person wishing to appeal this decision to the Upper Tribunal (Lands Chamber) must seek permission to do so by making written application by email to rpsouthern@justice.gov.uk 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, that 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.

Annex 1

ORDER OF VARIATION

Clause 4(2) and the Fourth Schedule to the Leases of Flats 1-6 at 36-38 Wilton Road Bexhill-on-Sea TN40 1 HX shall be substituted as follows:

Clause 4(2)

Pay the Interim Charge and the Service Charge at the times and in the manner provided in the Fourth Schedule hereto

THE FOURTH SCHEDULE

INTERIM CHARGE AND SERVICE CHARGE

1. The following definitions apply:

"**Accounting Period**" the period commencing on the 1st January and ending on the 31st December in each year

"**Fund Account"** the interest bearing account opened with [name of bank] in the name of the Lessor to hold the Reserve Fund

"**Interim Charge**" one-sixth of such reasonable and proper sums to be paid on account of the Service Charge in respect of each Accounting Period as the Lessor shall reasonably estimate as likely to be incurred in that Accounting Period in respect of the Total Expenditure

"**Reserve Fund**" a fund held in the Fund Account containing the aggregate so far as unexpended of the Reserve Fund Contribution;

"**Reserve Fund Contribution"** the amount (if any) in each Service Charge Accounting Period as the Lessor may in its reasonable discretion estimate as a fair annual contribution by the lessees of the building from time to time to the forward funding of regularly recurring major service items including, but not limited to, repair, decoration, maintenance and renewal (including any VAT charged on such sums to the extent that the Lessor is not able to obtain a credit for that VAT from HM Revenue & Customs);

"**Service Charge**" one-sixth of the Total Expenditure

"**Total Expenditure"** the aggregate of the reasonable expenditure properly incurred (including any VAT or any other tax thereon) by the Lessor in any Accounting Period in carrying out its obligations under clause 5(3) of this lease including the reasonable and proper fees of the Lessor's Managing Agents and accountant

2.1 The Interim Charge shall be paid to the Lessor by the Lessee by half yearly instalments in advance on the 1st January and the 1st July each year

2.2 If the Interim Charge paid by the Lessee in respect of any Accounting Period exceeds the Service Charge for that period then the surplus shall be credited to the Lessee against the next payment of Interim Charge.

2.3 If the Service Charge in respect of any Accounting Period exceeds the Interim Charge paid by the Lessee in respect of that period then the Lessee shall pay the excess to the Lessor within 28 days of service upon the Lessee of the certificate referred to in the sub-paragraph next following

2.4 As soon as practicable after the expiration of each Accounting Period the Lessor's accountant shall draw up and submit to the Lessee accounts setting out details of the Total Expenditure and Service Charge in respect of that period and shall certify the surplus to be credited to the Lessee or the excess due from the Lessee as the case may be.

2.5 All interest earned in the Fund Account must be applied to the Reserve Fund for the benefit of tenants of the building from time to time.

Annex 2

Landlord and Tenant Act 1987 as amended

Section 35 Application by party to lease for variation of lease.

(1) Any party to a long lease of a flat may make an application to the tribunal for an order varying the lease in such manner as is specified in the application.

(2) The grounds on which any such application may be made are that the lease fails to make satisfactory provision with respect to one or more of the following matters, namely—

(a) the repair or maintenance of—
(i) the flat in question, or
(ii) the building containing the flat, or
(iii) any land or building which is let to the tenant under the lease or in respect of which rights are conferred on him under it;

(b) the insurance of the building containing the flat or of any such land or building as is mentioned in paragraph (a)(iii);

(c) the repair or maintenance of any installations (whether they are in the same building as the flat or not) which

are reasonably necessary to ensure that occupiers of the flat enjoy a reasonable standard of accommodation;

(d) the provision or maintenance of any services which are reasonably necessary to ensure that occupiers of the flat enjoy a reasonable standard of accommodation (whether they are services connected with any such installations or not, occupiers or services provided for the benefit of the occupiers of a number of flats including that flat);

(e) the recovery by one party to the lease from another party to it of expenditure incurred or to be incurred by him, or on his behalf, for the benefit of that other party or of a number of persons who include that other party;

(f) the computation of a service charge payable under the lease.

(g) such other matters as may be prescribed by regulations made by the Secretary of State.

(3) For the purposes of subsection (2)(c) and (d) the factors for determining, in relation to the occupiers of a flat, what is a reasonable standard of accommodation may include—

(a) factors relating to the safety and security of the flat and its occupiers and of any common parts of the building containing the flat; and
(b) other factors relating to the condition of any such common parts.

)

(3A) For the purposes of subsection (2)(e) the factors for determining, in relation to a service charge payable under a lease, whether the lease makes satisfactory provision include whether it makes provision for an amount to be payable (by way of interest or otherwise) in respect of a failure to pay the service charge by the due date.

(4) For the purposes of subsection (2)(f) a lease fails to make satisfactory provision with respect to the computation of a service charge payable under it if—

(a) it provides for any such charge to be a proportion of expenditure incurred, or to be incurred, by or on behalf of the landlord or a superior landlord; and

(b) other tenants of the landlord are also liable under their leases to pay by way of service charges proportions of any such expenditure; and

(c) the aggregate of the amounts that would, in any particular case, be payable by reference to the proportions referred to in paragraphs (a) and (b) would either exceed or be less than the whole of any such expenditure.

(5) Rules of court shall make provision—

(a) for requiring notice of any application under this Part to be served by the person making the application, and by any Respondent to the application, on any person who the Landlord, or (as the case may be) the Respondent, knows or has reason to believe is likely to be affected by any variation specified in the application, and

(b) for enabling persons served with any such notice to be joined as parties to the proceedings.

(6) For the purposes of this Part a long lease shall not be

(a) the demised premises consist of or include three or more flats contained in the same building; or

(b) the lease constitutes a tenancy to which Part II of the Landlord and Tenant Act 1954 applies.

(8) In this section "service charge" has the meaning given by section 18(1) of the 1985 Act.

Section 38 Orders varying leases.

(1) If, on an application under section 35, the grounds on which the application was made are established to the satisfaction of the tribunal, the tribunal may (subject to subsections (6) and (7)) make an order varying the lease specified in the application in such manner as is specified in the order.

(2) If—

(a) an application under section 36 was made in connection with that application, and

(b) the grounds set out in subsection (3) of that section are established to the satisfaction of the tribunal with respect to the leases specified in the application under section 36,

the tribunal may (subject to subsections (6) and (7)) also make an order varying each of those leases in such manner as is specified in the order.

(3) If, on an application under section 37, the grounds set out in subsection (3) of that section are established to the satisfaction of the tribunal with respect to the leases specified in the application,

the tribunal may (subject to subsections (6) and (7)) make an order varying each of those leases in such manner as is specified in the order.

(4) The variation specified in an order under subsection (1) or (2) may be either the variation specified in the relevant application under section 35 or 36 or such other variation as the tribunal thinks fit.

(5) If the grounds referred to in subsection (2) or (3) (as the case may be) are established to the satisfaction of the tribunal with respect to some but not all of the leases specified in the application, the power to make an order under that subsection shall extend to those leases only.

(6) A tribunal shall not make an order under this section effecting any variation of a lease if it appears to the tribunal —

(a) that the variation would be likely substantially to prejudice—

(i) any respondent to the application, or

(ii) any person who is not a party to the application,

and that an award under subsection (10) would not afford him adequate compensation, or

(b) that for any other reason it would not be reasonable in the circumstances for the variation to be effected.

(7) A tribunal shall not, on an application relating to the provision to be made by a lease with respect to insurance, make an order under this section effecting any variation of the lease—

(a) which terminates any existing right of the landlord under its terms to nominate an insurer for insurance purposes; or

(b) which requires the landlord to nominate a number of insurers from which the tenant would be entitled to select an insurer for those purposes; or

(c) which, in a case where the lease requires the tenant to effect insurance with a specified insurer, requires the tenant to effect insurance otherwise than with another specified insurer.

(8) A tribunal may, instead of making an order varying a lease in such manner as is specified in the order, make an order directing the parties to the lease to vary it in such manner as is so specified; and accordingly any reference in this Part (however expressed) to an order which effects any variation of a lease or to any variation effected by an order shall include a reference to an order which directs the parties to a lease to effect a variation of it or (as the case may be) a reference to any variation effected in pursuance of such an order.

(9) A tribunal may by order direct that a memorandum of any variation of a lease effected by an order under this section shall be endorsed on such documents as are specified in the order.

(10) Where a tribunal makes an order under this section varying a lease the tribunal may, if it thinks fit, make an order providing

for any party to the lease to pay, to any other party to the lease or to any other person, compensation in respect of any loss or disadvantage that the tribunal considers he is likely to suffer as a result of the variation.