Heed the terms of the lease

Natasha Rees considers a decision that highlights the importance of complying with correct procedures when seeking to recover service charges

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'The payment of service charges is a matter of routine which follows annual accounting, payments on account and final balances. In view of this, a business-like approach to construction of the lease is unlikely to permit very much deviation.'

The Upper Tribunal recently reached a decision, in an appeal, concerning the strictness with which contractual procedures for the recovery of service charges must be observed, and the degree of flexibility available to a landlord to deviate from those procedures, either deliberately or inadvertently. The decision in *Southward LBC v Woelke* [2013] highlights how important it is to heed to the terms of the lease when issuing and serving service charges demands. Service charges, which include sums for major works will not be recoverable unless they are demanded in accordance with the lease.

Background

Mr Woelke was the long lessee of a flat in one of the 19 blocks on Tabard Gardens Estate in South-East London. The landlords were Southwark Council who took over direct management of the estate following the collapse of a management co-operative in 2004. It was Southwark's practice to separate its demand for payment of service charge for major works, from its demands for payment for routine services.

During the period 2003 to 2010 two major works projects were commenced. The first project began in 2003 when the co-operative decided to replace the windows in 19 blocks on the estate. Mr Woelke's share of the cost was estimated to be £3,486.97. The works were completed in June 2004 shortly before Southwark took over direct management of the block. After Southwark took over it became apparent that a number of documents had been mislaid. The statutory 18-month limitation period under s20B of the 1985 Act had passed by the time Southwark was able to ascertain how much each lessee was actually liable to pay for the works. It therefore restricted its claim to the estimated sum originally notified to leaseholders. On 6 July 2005 Southwark invoiced Mr Woelke for the windows. It sought payment of £3,487.27.

The second major works project involved the refurbishment of the cold water storage tanks on the estate which was completed in 2010. On 22 September 2008 Mr Woelke was informed that his share of the estimated cost for the water tank works was £517.68. On 7 October 2009 Southwark invoiced Mr Woelke £518.49 for the estimated cost of the works. Following completion of the works on 4 November 2010 Southwark wrote to Mr Woelke with details of the final sum due of £552.99, which included professional fees and administration charges. A further invoice for the extra sum of £34.50 was provided.

Mr Woelke refused to make any payment for either the windows or the cold water storage tanks. In the end Southwark brought a claim in the County Court for the total sum of £4,039.26. Mr Woelke disputed the claim and it was transferred to the Leasehold Valuation Tribunal.

The lease

Mr Woelke's lease was in a standard form for long leases granted under the 'right to buy' provisions of the Housing Act 1985. The Third Schedule of the lease was divided into two parts. The first part, the 'annual service charge', provided machinery for the tenant to contribute towards the costs incurred annually by Southwark. The second

part allowed for the collection of a reserve fund for items of significant capital expenditure.

The provisions in the Third Schedule followed a conventional pattern of charging for the cost of works by reference to defined years with equal quarterly payments followed by a balancing charge. The annual service charge was defined as a fair proportion of the costs and expenses incurred in the year in providing the relevant services.

The LVT decision

Mr Woelke challenged the service charges claimed for the window replacement on four grounds. The first of these was that the sum demanded was based purely on an estimate and that no final demand had been served. On the water storage tanks he challenged the adequacy of the statutory consultation process.

Southwark claimed that the charging procedure they had followed was in accordance with the terms of the lease. They provided witness evidence saying that they had charged the costs in accordance with Part 1 of the Third Schedule. The LVT disagreed. The LVT said that Southwark did not operate a reserve fund for major works even though the lease allowed it. They felt that Southwark's practice of issuing separate demands: one for 'ordinary service charges' on an annual basis and the other for major works, which could well cover two or more service charge years, was in breach of the lease terms. They felt that Southwark was obliged by the terms of the lease to issue one demand, which included both ordinary service charges and any part of a major works project that related to that particular service charge year. Although the LVT found that Mr Woelke's challenges to the actual charges were of no substance, they felt they had no alternative but to order that the charges were not payable because they had not been demanded in accordance with the lease. Southwark applied for permission to appeal and the LVT granted permission on the sole ground relating to the construction of the lease.

The landlord's submissions

Phillip Rainey QC, who was acting on behalf of Southwark, contended that the LVT was wrong to hold that the lease required a single consolidated notice of service charges. He relied on the Court of Appeal decision in *Universities Superannuation Scheme Ltd v Marks & Spencer plc* [1999] as authority that the LVT should give effect to the purpose of the service charge provisions rather interpreting them literally. He also relied on the case of *Leonora Investment Co Ltd v Mott Macdonald* [2008] where it was held that the failure to comply with the service charge procedure could be rectified by serving a revised certificate. On this basis he felt that there could be an additional notification of the cost of the major works separate from the notification regarding routine works.

It was also claimed that 'routine works' usually applied to works on the tenant's own block but 'major works' to the whole estate and that if they were unable to split the charges up this would cause practical difficulties. Finally, it was submitted that the operation of a reserve fund was incompatible with Southwark's accounting obligations under the Government and Housing Act 1989.

The tenant's submissions

Ms Parry on behalf of Mr Woelke argued that the LVT was correct in its decision, but that it had been wrong to suggest a revised service charge notice was permissible. She argued that compliance with the procedures under the lease was an essential pre-condition of the tenant's liability. She also argued that the comments regarding Mr Woelke's challenges to the charges should be disregarded.

The Upper Tribunal's decision

Martin Rodger QC, the Deputy President of the Lands Chamber, considered the appeal. He set the scene in the opening lines of his judgment when he stated:

> In every case the extent of a leaseholder's obligation to pay service charges will depend on the particular terms of the lease under which the obligation arises.

In view of this, he felt that *Universities Superannuation Scheme Ltd* was of limited assistance because it concerned the construction of a completely different lease. The decision in *Leonora Investment Co* did resemble Southwark's case more closely as the landlord in that case had failed to follow the service charge procedure laid down by the lease. The Court of Appeal in that case had, however, found that the tenant was not liable to pay for the major works until the landlord had followed the contractual route, which would entitle it to recover the balance of the full year's service costs.

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In his discussion of the case Martin Rodger QC set out what steps he considered were required to ensure that service charges would be payable. He felt it was necessary to identify the minimum requirements laid down by the lease, which create the obligation to pay and then to consider whether the circumstances of the case satisfy those minimum requirements. He then set out how best to approach this test as follows:

- It is not appropriate to adopt a technical or legalistic approach.
- The service charge provisions of leases are practical arrangements which should be interpreted and applied in a business like way.
- The payment of service charges is a matter of routine which follows annual accounting, payments on

account and final balances. In view of this, a business-like approach to construction of the lease is unlikely to permit very much deviation.

- When entering into a long residential lease the parties must be taken to intend that the service charge will be operated in accordance with the terms they have agreed.

- Leaseholders should be able to work out for themselves whether a sum is due to be paid by reading the lease and comparing the process it describes with the information provided in support of the demand by the landlord, without the involvement of lawyers or other advisers.

Applying this test to the case, he stated that the definition of the service charge payable by the lessee was 'a fair proportion of the costs and expenses… incurred in the year'. This he said connected the sum payable by the tenant to the landlord's expenditure in that year.

He also said that there was some flexibility introduced by the wording that time was not of the essence, and also because of the general rule that stipulations regarding time are not regarded as essential unless a contract provides that they are. This meant that although the lease required the landlord to notify the tenant of its estimate before the commencement of the service charge year, if it failed, it could do so at a later date.

He then considered whether the landlord was entitled to omit from its estimate some component of expenditure. In this case it was the share of the window replacement contract or the cost of the water tank replacement.

In relation to the window replacement he went through the steps that Southwark took regarding the charges for the window replacement:

- On 30 October 2003 a statutory consultation notice was given for the window works which estimated the total cost

- On 11 December 2003 the contract for the window replacement was entered into for a period of 24 weeks with practical completion on 21 June 2004 so it was likely that the tenant would be liable for a charge in 2005/2006.

- The yearly estimate was due to be served before 1 April 2005 but did not include the cost of the window works

- An invoice for the full sum due for the windows which included expenditure incurred over two years was served on 6 July 2005.

Unless the notice contained all of the pieces of information required it would fall short of the requirements of the lease and no liability would arise.

The judge did not accept that certain parts of the yearly estimate were inessential. He felt that the service charge machinery was not complicated or technical but clear and straightforward. Unless the estimate contained all of the pieces of information required it would fall short of the requirements of the lease and no liability would arise. In view of this, the invoice given on 6 July 2005 was ineffective. Likewise the invoices submitted for the replacement of the cold water storage tanks on 7 October 2009 and 4 November 2010 were also ineffective. On this basis the appeal was dismissed.

Correct notification

Martin Rodger QC set out in his judgment the four features that had to be included in any notification in order to create liability:

- It had to notify the tenant of the amount of service charge payable for the relevant year.

- It had to contain or be accompanied by a summary of the costs incurred.

- It should state the balance due if any.

- It should include a summary of costs showing how the apportionment to the flat had been calculated.

He went on to say that a departure from these minimum requirements was not irremediable. If the landlord wishes to collect the contributions to which it is entitled, it only needs to provide an additional notification that includes the four features set out above and which allocates costs to the years that they were incurred; this way the landlord has more than one opportunity to get its demands right.

Conclusion

This is a judgment that emphasises how important it is for a landlord to understand and comply with the service charge machinery of the lease. In this case the lease relied on annual accounting and any departure from that was clearly going to cause confusion. Landlords will be relieved to hear that if they make a mistake, the position is not irretrievable and that if the right notice is served, even at a later date, the tenants should then become liable, provided the landlord does not fall foul of the eighteen month limitation period imposed by s20B of the Landlord and Tenant Act 1985. The judge also made it clear that parties are at liberty to enter into separate agreements that avoid the machinery of the lease should they so wish. This might be required where the tenants want to spread larger one-off payments over a number of service charge years. A clear prior agreement will however be imperative to avoid any later challenge by the tenants. ■

Leonora Investment Co Ltd v Mott Macdonald Ltd [2008] EWCA Civ 857

Southward LBC v Woelke [2013] UKUT 349 (LC)

Universities Superannuation Scheme Ltd v Marks & Spencer plc [1999] 1 EGLR 13