Proceed with care

Landlords and tenants need to be aware of the many legal provisions that govern residential service charges, since mistakes can prove costly. Natasha Rees explains

Recovery of residential service charges is a minefield for landlords, since those who do not follow statutory procedures, or ignore lease terms, can stand to lose thousands of pounds. The number of residential service charge disputes has risen sharply over the past decade, mainly as a result of the introduction of complicated procedures governing residential service charge collection, but also because of increases in the amounts of money involved.

Of course, disputes relating to luxury developments in central London can involve millions of pounds and landlords are becoming much more cautious when considering block management. The following cases illustrate how careful landlords need to be, and what steps they need to take to maximise service charge recovery.

Specified address

In the case of *Beitov Properties Limited v Martin* [2012], the Upper Tribunal (Lands Chamber) held that the service charges claimed in the case were not payable by the tenant because the demand had contained an inadequate address for the landlord. (The demand letter included the address of the landlord's managing agent rather than that of the landlord.) However, the landlord was able subsequently to serve a fresh demand that included the landlord's address, in compliance with the relevant statutory provision, and at this point the service charges did fall due.

Where large sums are involved, such issues may be more problematic, as landlords will not be able to claim interest on outstanding charges until they fall due. Landlords may also find that the statutory time limit for making the service charge demand has passed, at which point it will be impossible to rectify errors.

Time limit

There have been a number of cases concerning the statutory time limit for making service charge demands. Section 20B of the Landlord and Tenant Act 1985 essentially provides that a landlord has 18 months from when he incurs a service charge expense to (1) demand it as a service charge or (2) notify the tenants that they will, at a subsequent date, be required to pay the amount.

If the landlord falls foul of this limitation period, he will not be able to recover any sums incurred outside the time limit, even though the costs may have been reasonably incurred and the tenants may have benefited as a result.

In the appeal of *Brent Borough Council v Shulem B Association Ltd* [2011], the High Court ruled that a freeholder's letter notifying tenants of the estimated rather than the actual cost of major works did not constitute a valid demand or relevant notification for the purposes of Section 20B. As a result of this decision, the landlord in this case was unable to recover any of the total amount of around £640,000 demanded. This case highlighted the importance of ensuring that service charges are demanded in accordance with the terms of a lease, and that tenants are notified within 18 months of the costs being incurred.

Repairs or improvements?

One common area of dispute is attempts by landlords to recover the cost of works that the tenant claims are improvements rather than repairs. The distinction between the two could be the subject of another article, but essentially, landlords cannot recover the cost of improvements where the lease requires them to carry out only maintenance and repairs. This was illustrated by the case of *Tingdene Holiday Parks Limited v Cox* [2011], in which the landlord was unable to recover the cost of building a new children's play area as a service charge, because the new playground was considered to be totally different from the one it replaced and the lease allowed only for the recovery of the cost of repairs and maintenance.

What is reasonable?

All residential tenants have the right to challenge the reasonableness of their service charges in the Leasehold Valuation Tribunal (LVT) in accordance with section 19 of the Landlord and Tenant Act 1985, and there are numerous decisions on what is reasonable and what is not. In 2011, the Upper Tribunal had to consider an appeal regarding the cost of works totalling £638,000 and whether these were reasonably incurred. In the decision known as *Marie Garside and Michael Anson v RFYC Limited and BR Maunder Taylor* [2011], the tribunal held that the 1985 Act did not limit the scope of what was reasonable.

It felt that the term 'reasonable' should be given a broad, common-sense meaning. As such, the financial impact of major works on lessees through service charge demands, and considerations as to whether major works should be phased, could be material considerations when considering reasonableness. This means that landlords should consider the financial impact on tenants, including the nature and location of the property and the level of the charges demanded in any particular financial year compared to previous years, when deciding how to charge tenants for major works projects. When in doubt, it is possible to apply to the LVT before the start of the works for a determination as to the reasonableness of the costs.

Sweeping-up clauses

Many leases contain general 'sweeping-up' provisions stating that landlords can recover unspecified costs through the service charges. These need to be treated with caution, as courts and tribunals are reluctant to allow landlords to rely on them and usually require clear provisions for all costs demanded.

In the case of *Rettke-Grover v Needleman* [2011], the lease contained a sweeping-up clause that allowed the landlord to recover "the costs of any other services of whatever nature… from time to time… necessary or expedient for the efficient management of the building". The Upper Tribunal found that this wording was not specific enough to allow the landlord to recover the cost of employing accountants to prepare certified service charge accounts.

Legal costs

Over the last year, there have been a number of decisions regarding legal costs and whether these can be recovered through service charges. The rule until now has been that clear and unambiguous terms are required. This usually means that the words 'legal costs' or 'costs of legal advisors' have to be specified in the lease. In a decision known as *Plantation Wharf Management Company Limited v Jackson and Irving* [2011], the Upper Tribunal took a more common-sense approach to the issue. Rather than imposing a blanket ban on leases that fail to include reference to legal or solicitors' costs, it took the practical effects of the lease into account and construed it more widely. It decided that, on any fair construction of the lease, the legal costs that would be incurred in enforcing the covenants in the lease should be recoverable.

This was a welcome decision for landlords, who now have a greater chance of recovering their legal costs where leases are unclear. It will not help, however, where the lease terms are clear. In a more recent appeal, *Twenty Two Clifton Gardens Ltd v Thayer Investments SA* [2012], the Upper Tribunal decided that a landlord was not entitled to recover legal costs or surveyors' fees relating to LVT proceedings from a tenant who had failed to pay his service charges. In this case, the tribunal said the wording of the lease was unambiguous and did not provide a basis for recovery of costs against the defaulting tenant. It is therefore always important to consider lease terms carefully before embarking on enforcement action. In this case, all the non-defaulting tenants were held liable for the cost of the proceedings.

In *OM Property Management Ltd v Olaleye* [2012], the Upper Tribunal had to consider whether legal costs incurred by an in-house solicitor who had worked on an application to the LVT could be recoverable as a service charge. The LVT determined they were not a 'cost' and therefore not recoverable. However, this decision was reversed by the Upper Tribunal on appeal, based on the long-recognised principle that the costs of an in-house solicitor are to be dealt with on the same basis as those of an independent solicitor.

Forfeiture and costs

Finally, the Court of Appeal case of *Freeholders of 69 Marina St Leonards-on-Sea v John Oram and Mohammed Ghoorun* [2011] has caused some confusion over the steps that landlords must take in order to forfeit a lease for service charge arrears that are reserved as rent. Traditionally, it has been considered unnecessary to serve a section 146 notice on the tenant in order to forfeit, because the service charges are treated as 'rent in arrears'. This is because section 146 of the Law of Property Act 1925, which provides for the service of a notice on forfeiture, does not apply in the case of non-payment of rent.

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However, as a result of this Court of Appeal decision, it seems that a section 146 notice must be served in all cases. This is an example of the new statutory regulations making it harder for tenants. Where no notice is served, a tenant will have an automatic right to relief from forfeiture upon payment of the arrears. Following the service of a section 146 notice, the tenant will have to rely on the court's discretion, even if all arrears and costs have been paid.

In this case, the Court of Appeal also found that where the lease contains a provision that allows a tenant to recover solicitors' fees "incurred by the landlord incidental to the preparation and service of a notice under Section 146 of the Law of Property Act 1925 or in contemplation of proceedings under Section 146", then the landlord will be entitled to recover all of its legal costs incurred in both the LVT proceedings and in the subsequent County Court forfeiture proceedings. This is a very common costs clause in residential leases. When pursuing a tenant for residential service charge arrears, a landlord should therefore make it clear that any debt claim is a first step towards forfeiture of the lease to try and ensure that all legal costs can be recovered.

Conclusion

These cases illustrate how important it is to be aware of the terms of a lease and to be familiar with the many statutory provisions that govern residential service charges when dealing with residential property. Lack of vigilance can be costly for landlords. Tenants should also check their leases carefully, particularly when signing a new lease for a flat, to make sure they know exactly what costs they will be liable for. If the lease is poorly drafted, which is quite common with new residential developments, tenants should ask for service charge information before buying, to ensure that there are no significant management problems that could have an impact on the value of the flat itself.

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