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FIRST-TIER TRIBUNAL
PROPERTY CHAMBER
(RESIDENTIAL PROPERTY)

Case Reference	:	CHI/24UB/LSC/2013/0127-36
Property	:	The 4128 properties set out in Appendix A to Directions dated 19th November 2013
Applicant	:	Sovereign Housing Association Limited
Representative	:	Mrs K Leach Mr K Dey Mr T Snook
Respondents (Lead cases)	:	Mr J Coleman Miss L Clayton Mr S G Karpik Mr R D Cooke Mr D Selway Mr MA Jones Mrs V Portess Mrs L Cross Mr R L Smallbone Mrs V J Williamson Miss E Carter Mr J Wilson and Ms S Ware Mr A Adams
Representative	:	
Type of Application	:	Reasonableness of prospective service charges
Tribunal Member(s)	:	Judge D Agnew (Chairman) Mr T E Dickinson BSc FRICS Mr J Mills
Date of Decision	:	9th June 2014

DECISION

Background

1. On 6th September 2013 the Applicant applied to the Tribunal under section 27A(4) of the Landlord and Tenant Act 1985 ("the Act") for a determination that if the Applicant were to adopt a new scheme for charging their management expenses in the service charges they will render to their 4128 tenants of their leasehold stock for the years 2014 and 2015 those charges would be reasonable and therefore recoverable

2. The Applicant is a housing association and the freehold owner or head leaseholder of over 4000 properties in various locations throughout southern England. This is as a result of a merger of several different housing associations. Consequently, the leases that the Applicant has inherited are of several different types depending upon who was the original landlord. For the purposes of the Application, the leases were divided into ten different categories.

3. The Tribunal decided that a number of lead cases would be selected one for each category of lease. Directions were issued by the Tribunal which identified the lead cases and set out Directions to be followed in those cases. The Directions provided that they would be served on every one of the 4128 Respondents and that any of the Respondents whose leases had not been selected as lead cases could apply for them to become lead cases. Three Respondents asked for their cases to become lead cases and they were so designated.

4. The Directions provided for the Applicant to file and serve a detailed statement of case upon the Respondents in the lead cases and for those Respondents to reply. Written statements of case in reply were filed and served by Miss Emma Carter (supplemented by a statement from her father, Mr Brian Carter) and by Mr Stefan Karpik, Mr David Selway, Mr Tebutt-Russell on behalf of Mrs Cross and Mrs Cross herself, Jonathan Wilson and Susan Ware and Mr James Coleman.

5. The matter came before the Tribunal for an oral hearing at the Tribunal Centre, Taunton on Tuesday 15th April 2014. The hearing was attended by Mrs Karen Leach, the Applicant's Leasehold Strategy Manager, Mr Tim Snook, the Applicant's Finance Business Partner and Mr Kevin Dey, the Applicant's Director of Intermediate Housing. The Respondents who attended the hearing were Mr Karpik and Mr and Mrs Selway.

The Applicant's case

6. The Applicant explained the reason behind the Application was that hitherto it had been charging within the service charge a management fee of 15% of the cost of services. On being appointed to his position in 2011, however, Mr Dey examined the cost of providing management of the properties and found that lessees were being "undercharged" by

approximately £450,000 per annum. Thus, it was said, "social rents" (that is rents from tenants with assured tenancies) are in effect subsidising the leasehold estate by that amount. The Applicant considers this to be unfair and has devised a scheme to remedy this for which they ask the Tribunal to determine as being reasonable and therefore recoverable from the lessees.

7. The proposals are the result of calculating the cost of managing the properties based on the amount of time estimated to be attributable to the management required for the different types of lease and the services effected and the salaries of those employed to carry out the management. Thus, in general terms, the greater the time involved in management, the higher the management fees charged to the lessee.

8. Mrs Leach explained that they had stripped out of the costs of providing the management any proportion of executive and directors' costs and the costs of two out of the three IT systems used by the Applicant. There are three systems as a result of the legacy of three housing associations coming together. This resulted in a basic fee of £126 per unit, which they rounded down to £125. The basic fee covers all rent account management, raising service charges, receiving and processing payments, the costs for the IT system, telephones, computer access, health and safety and human resources costs for staff, training, the services of leasehold services officers (LSO's) who have contact with lessees by telephone, email and face to face, preparation of annual service charge statements (actual and estimated) and arranging the buildings insurance coverage. This was designated as a proposed Category A charge.

9. Proposed Category B charges included all the services as for Category A plus the management of grounds maintenance contracts (including hard surfaces and play areas) and inspections by surveyors and LSO's.

10. Proposed Category C charges include the services provided in Categories A and B but in addition the management of internal and external block services, management of cleaning contracts and all service and maintenance contracts such as cleaning, fire risk assessments, lifts, caretaker, door entry systems, communal lighting and inspections by surveyors and LSO's of repairs and cyclical maintenance.

11. Proposed category D charges would apply where external management companies and/or their managing agents deliver most of the services within Categories B and C. They invoice the Applicant who passes them on to the lessees.

12. The Applicant's proposed charges for the various Categories are as follows:-
Category A - £125
Category B - £150
Category C - £185

Category D - £150

13. The Applicant had benchmarked its fee proposals against other housing associations and private management companies and set out the results in its statement of case. Some associations continue to charge 15% of the cost of services. Others charge a management fee ranging from £90 per unit for the basic fee equivalent to the Applicant's Category A to £250. Category B equivalent charges range from £135 to £287, Category C equivalent from £195 to £304. Only one other, Places for People, have an equivalent to Sovereign's Category D who charge £230 per unit.

14. The Applicant sent out consultation packs to explain the proposed changes to leaseholders. In some instances meetings were arranged. The feedback from the consultation exercise was included in the Applicant's statement of case and bundle of documents for the hearing. As a result of the feedback the Applicant proposed to phase the proposed increases in over a three year period commencing April 2015. Thereafter the current intention is to increase the management charges by inflation and periodically review the appropriateness of the costs including further benchmarking.

The Respondents' case

15. None of the Respondents in the lead cases supported the application. All considered the proposals unfair for various reasons. Some of them would see their service charges increase significantly if the proposals were put into effect. A brief summary of the more important points of their objections follows. The Tribunal read through their written statements of case carefully and noted everything that was said even though, in the interests of conciseness, it may not be noted below.

16. Mr Karpik has a shared ownership house. His principal objection was that he did not consider that his lease provided for the landlord recovering the cost of collecting rent and arranging for buildings insurance cover. He considered that there was no evidence of under-recovery of management costs from the leasehold owners or of them subsidising the social rented stock. He said that the Applicant had failed to take into account rents and capital receipts from sales which have increased due to inflation. He thought it unfair that leasehold owners who comprise 11% of the total number of the Applicant's tenants should bear 33% of the costs of running the Applicant's IT system. His management fee for 2013/14 was £7.40. Under the Applicant's proposals this would increase to £150 per annum (Category B), an increase of 2,000% which, he says, is inherently unreasonable.

17. Mr Selway acquired his flat under the Right to Buy scheme. In 2012/13 his management fee was £55 per annum. Under the Applicant's proposals this would increase to £185 (Category C). He maintains that it cannot be fair to be asked to pay three times as much for receiving the same thing. Further, such a large increase could never have been

contemplated when lessees acquired their properties. He says that the Applicant has stated that their costs of management are £x and that they therefore seek to recover that amount without demonstrating that their overheads are reasonable. He points out that under the proposals he is being asked to contribute towards the costs of managing properties with lifts and properties with caretakers which are likely to be more costly to manage. He argues that the financial affect of such proposed increases on lessees who are of modest means should be taken into account. Finally, he says that the consultation process was flawed in that it did not make clear that a 15% charge for management of major works would be charged in addition to the management fees proposed under the scheme under consideration.

18. Mr Tebbutt-Russell on behalf of Mrs Cross considered that the Applicant had not shown a need to increase the management fee. Mrs Cross owns a flat acquired under the Right to Buy provisions. The proposed category in her case is Category B where she would be paying £150 per annum instead of £8.56 as it was in 2012/13. He echoes Mr Selway in saying that there has been no independent review of the efficiency of the management. He compares the cost of management of Mrs Cross's property with that of a similar flat a few miles away which is significantly cheaper than the Applicant's proposals. He considers £150 per annum to be a ludicrous amount for placing a contract to mow grass and trim hedges/shrubs and the occasional check which, he says, can no doubt be combined with checks on other properties nearby. He considers that the Category D charge where other companies carry out the management to be an unnecessary layer of management. Mrs Cross also wrote on her own behalf saying that the proposed charges represent an increase for her of 94% which she says is excessive.

19. Mr and Mrs Wilson bought their property, which is a house, in 1996 under what was known as a "do-it-yourself" shared ownership scheme. They own 65% of the equity. All repairs and maintenance are their responsibility. All the Applicant does for the proposed management charge of £125 per annum (Category A) is arrange buildings insurance the premium for which was £47.27 in 2013/14. It will also send out a demand for the rent and the service charge and receive payment in. They say that they could arrange their own buildings insurance in the market for less than the proposed management fee which would be three times the amount of the insurance premium itself.

20. Miss Carter has a shared ownership flat for which she paid a management fee in 2013/14 of £97.44. In the Applicant's bundle it is stated that under the proposed scheme the standard management fee of £125 would be charged. However, as this is a full service lease, the Tribunal anticipates that the actual charge will be under Category C, namely £185 per annum, almost double the current figure. Representations were received from both Miss Carter and her father who went into considerable detail including graphs to show how unfair they considered the proposed charge to be. These reasons cannot do

justice to the amount of detail provided by Mr and Miss Carter but they should rest assured that the Tribunal has taken all their representations fully into account when reaching its decision. The main thrust of their representations is that the proposed increase is far too high and is beyond what anyone such as Miss Carter buying a flat under shared ownership could reasonably have expected to pay for management fees. She says that she carefully considered the costs applied in previous years when deciding whether or not she could afford to buy. She feels that four lease categories are insufficient to reflect the true costs of each individual property in the Applicant's portfolio. Properties vary considerably in construction, age, weather exposure and occupancy, all of which, they say, affect the cost of management. Within Category C properties there is a wide disparity of management requirements, some having a lift, some a caretaker, some requiring legionella testing, others that do not. She says it is unfair to lump all these properties together under one category.

21. Mr Coleman's representations were along the same lines as those already referred to above. He mentions lack of evidence that the Applicant has taken any steps to reduce overheads but it has simply sought to pass the burden onto the leaseholders. He, too, asks why he should have to pay more for the same level and quality of service.

Post hearing representations

22. After the hearing but before the Tribunal had made its determination the Applicant sought to make further representations and cite legal authority in support of its application. This was partly due to the fact that before the hearing the Tribunal issued to those present a copy of a recent decision of the Upper Tribunal in a similar case, namely *Waverley Borough Council v Arya [2013] UKUT 0501 (LC)* and gave the parties the opportunity of reading the case in case anyone should want to refer to it during the hearing. All parties were content for the hearing to proceed after having read through the case. In the event no one did refer to it. However, after the hearing the Applicant felt that it should refer to some other authorities. They were *London Borough of Southwark v Benz [2013] UKUT 0375 (LC)* and *Blackpool Borough Council v Cargill [2013] UKUT 0377 (LC)*. Unusually, due to the importance of this case for so many lessees and the landlord, and as the Tribunal had not completed its deliberations, the Tribunal allowed the further representations to be made and gave the Respondents in the lead cases the opportunity of responding thereto.

23. It was said by the Applicant that in these two cases the Upper Tribunal approved management fees on the same basis as the proposal under consideration. In the Southwark case the Upper Tribunal approved the apportionment of costs on a Borough-wide basis and approved the method of allocating staff time to provision of management, as the Applicant had done in this case, although time sheet records would have been more accurate. Only Mr Karpik and Miss Carter responded: Miss Carter re-stating how unfair the Applicant's proposals were and

Mr Karpik going into further detail as to why he says his lease does not allow for the cost of management for collecting rent or arranging buildings insurance. Mr Karpik went on to suggest an alternative scheme whereby the landlord charges a flat rate as determined by the Tribunal or 30% of the service charge whichever is the lower, instead of the current 15% of the service charge.

The Law

24. By section 27A(4) of the Landlord and Tenant Act 1985 ("the Act) an application may be made to a [First-tier Tribunal (Property Chamber)] for a determination as to whether, if costs were incurred for services, repairs, maintenance, improvements, insurance or management of any specified description, a service charge would be payable for the costs and, if it would, as to -

    (a) the person by whom it would be payable,
    (b) the person to whom it would be payable,
    (c) the amount which would be payable
    (d) the date at or by which it would be payable and
    (e) the manner in which it would be payable.

25. By section 19 of the Act service charges are only payable to the extent that they are reasonably incurred: in other words, that the amount is reasonable.

The determination

26. There was no challenge from any of the Respondents in the lead cases that the Applicant was entitled to claim a fee for management save for Mr Karpik who claimed that his lease did not entitle the Applicant to charge for the cost of collecting his rent or for arranging the buildings insurance. The Tribunal was satisfied that in every case, including that of Mr Karpik, the relevant leases do entitle the Applicant to claim its management costs from the lessees by way of service charge. As for leases containing the same wording as Mr Karpik's lease as set out in paragraph 27 below, this will include the cost of collecting rent and arranging buildings insurance.

27. The relevant provision in Mr Karpik's lease is as follows:-
    "3.4 To contribute a fair proportion to be assessed from time to time by the Landlord of
    (a).....
    (b) the reasonable fees charges and expenses of the surveyor or any accountant or other person whom the Landlord may from time to time employ in connection with the management and maintenance of the communal facilities including the computation and the collection of rent and the computation of and collection of other monies due from the Leaseholder hereunder and if any such work shall be undertaken

by an employee of the Landlord then a reasonable allowance for such work"

28. Mr Karpik, not unreasonably, contends that this clause is to do with the communal facilities and nothing else. The Tribunal accepts that the wording of the clause is not felicitous because it looks as though "including" implies that what follows is simply an expanded explanation of what has gone before in the clause. However, the Tribunal does not consider that to be right because the collection and computation of rent has nothing to do with the management and maintenance of the communal facilities. The Tribunal finds, therefore, that the computation and collection of rent and other monies was intended by the draftsman to stand independently of the management and maintenance of the communal facilities and is therefore legitimately included in the management fee payable by the lessees through the service charge.

29. The Tribunal now makes the following general observations, in no particular order, with regard to this case.
a) the Service Charge Residential Management Code, Second Edition, issued by the RICS and approved by the Secretary of State specifically does not apply where the landlord is a public sector authority or Registered Social Landlord

b) whilst a set management fee of a specific amount is generally speaking desirable as it provides the payer with certainty as to the amount he or she is going to be required to pay, the percentage charge does at least have the advantage that management fees will bear some relation to the amount of the rest of the service charge

c) if a service charge item has not historically covered the true cost of the service that is not in itself a reason for the Tribunal to find that the landlord is unable to recover the full cost for the future, provided that the lease enables the landlord to recover that cost. In those circumstances the only matter for the Tribunal to determine is the reasonable cost of providing that service

d) whilst the Tribunal has considerable sympathy for those who may be facing a significant increase in their management fees and who feel that is not fair, that of itself is not the issue for the Tribunal. It is not whether the increase is reasonable that the Tribunal has to determine but whether the charge is reasonable for the service provided

e) there is some force in the argument that the Applicant is simply seeking to recover its cost of management without there being a full investigation by the Tribunal (because the necessary evidence has not been provided) that the Applicant's overhead costs are reasonable and that it is efficient in carrying out the tasks it needs to do. However, if at the end of the day the proposed charge is in line with charges one would expect to find particularly in the private sector where the market can be expected to drive efficiency, then the Tribunal would normally

be prepared to declare itself satisfied that the charge is reasonable. After all, that is what it normally does when it considers whether a management fee is reasonable. It asks itself whether the fee is in line with what others charge in the market for a similar service. The Tribunal accepted that the Applicant had allocated the costs of 12 full time staff in calculating its proposed leasehold management fees and that there were a further 14 staff responsible for sales, assignments, consents and inquiries whose costs were not included in the proposed management fees.

f) the Tribunal does not consider it helpful for the Applicant to talk in terms of the leaseholders being "subsidised" by the social renting sector. The leaseholders are right to point out that other factors such as the increase in the capital value of the landlord's share of the freehold come into play if such a term is used. However, the question that the Tribunal has to answer is solely whether the amount being sought by the Applicant under the proposed scheme for management charges is or is not reasonable. Questions as to whether the Applicant would survive if it does not recover more, or whether or not it can afford to continue as it has in the past are irrelevant to what the Tribunal has to decide

g) the Tribunal is not concerned with the adequacy or otherwise of the Applicant's consultation process. It was unsatisfactory in that it omitted to make clear that there would be a charge of 15% of the cost of major works to cover the cost of managing those works in addition to the management charges for other services. However, the Tribunal repeats that the only question it is concerned with is whether or not the scheme as proposed is reasonable

30. Having made the foregoing general points the Tribunal now turns to the specific scheme that it is being asked to approve. As was probably evident during the course of the hearing the Tribunal have some concerns with the scheme as currently proposed. The Tribunal acknowledges the problems faced by the Applicant in trying to come up with a scheme which deals with the many different types of property and different types of leases with differing service being provided by the landlord and which at the same time is relatively simple to operate and be easily understood by the service charge payers. However, the Tribunal does not consider that the scheme as currently proposed is sufficiently nuanced to be able to operate fairly for all service charge payers. It is important that it should be so because by seeking this order from the Tribunal it is effectively depriving the individual lessees from challenging the reasonableness of the management charge in their particular case for the next three years or so.

31. The Tribunal's concerns can be illustrated by specific examples. The Applicant has made no allowance for leaseholders who have no communal internal services or external estate services save, say, for a small amount of communal grass cutting, as in the case of Mr Karpik.

The grass cutting, for which he pays £40.08, takes him from a Category A to a Category B charge. He is effectively being charged £25 to collect £40.08. But the basic charge of £125 seems high for a lessee such as Mr Karpik. He has a house, so there are no communal parts. The rent each year has to be calculated in accordance with a formula and collected, but his would normally be borne by the landlord had it not been for the specific provision in this lease. Someone in Mr Karpik's position is going to have very little if any call upon the time and services of the leasehold service officers. It is true that he has the benefit of buildings insurance being arranged for him, but the cost of this for a year is only approximately £50. If the Applicant is covering its cost of management for a fee of £150 per annum in Mr Karpik's case to collect what in 2013/14 was a service charge of approximately £90 that is an indication that something is not right. In the Tribunal's opinion the basic fee needs to be lower and that there be more gradations in fee according to the services actually being provided in the individual case. The basic fee (Category A) also includes an element of rent computation and collection and is proposed to be charged to some lessees who do not pay rent as shared owners. The Applicant has 1,000 leaseholders who do not pay a monthly rent.

32. The Tribunal was content with the Category C charge for leases where there is a full service involving maintenance and repair of common internal and external parts and such a fee would be commensurate with management fees in the private sector.

33. The Tribunal was concerned with the proposed charge (£150) for Category D leases. In some cases the work involved for the Applicant will simply be to pass on the service charges that have been demanded by the managing agents who actually carry out the management. A charge of £150 for that is excessive and therefore unreasonable. A justification for part of that charge given at the hearing was that it was to compensate the landlord for the risks involved in having to pay charges in advance to its own landlords and then recoup the same charges at a later date from its lessees. The Tribunal did not consider that this was a legitimate charge for the Applicant to make. The Applicant decided to enter into the leases on the terms of those leases and to sub-let on different terms to its own lessees. It was unreasonable in the Tribunal's view for the Applicant to seek to pass "compensation" for this onto the lessees. On the other hand, the Tribunal understood that there were some cases where the Applicant finds itself as "piggy in the middle" in having to sort out disputes between its own lessees and its own landlord or their agent and that this can be time consuming and therefore costly. The Tribunal is not sure how the Applicant can devise a proposal that would cater for the cases where it has little or no involvement on the one hand and a considerable amount of involvement on the other. What does seem to be the case to the Tribunal, however, is that it would be unreasonable to penalise those lessees where the Applicant has little or no involvement by charging what in effect amounts to a double amount of management fees for those lessees.

Conclusion

34. The Tribunal considers that the application before it was to approve the proposed scheme as a whole and that the application therefore either succeeds as a whole or fails as a whole. In view of the Tribunal's concerns about parts of the Applicant's scheme it feels unable to grant the application and say that should service charges as proposed be made that they would be payable. The application therefore fails in toto. The Tribunal hopes, however, that the reasons given for its decision will assist the Applicant in re-thinking its scheme and hopefully come forward with a more nuanced scheme that eliminates as much as possible the unreasonableness that the Tribunal has identified in the scheme as currently proposed. The Tribunal understands the difficulties facing the Applicant in this task and appreciates that it will be disappointed that much of its hard work that has gone into this application has so far come to nought. Whether or not the Applicant will wish to come forward with a fresh application or not is entirely a matter for it to decide but if it wishes to it has the best part of a year in which to do so before any new charges would be applied. As far as the Tribunal is concerned, it would not expect there to be a further full consultation exercise though the Applicant may consider that it would be good practice to do so.

35. In order to comply with Rule 23(5)(a) of the Tribunal Procedure (First-Tier Tribunal) (Property Chamber) Rules 2013 and under its case management powers under Rule 6 of the said Rules, the Tribunal directs that **the Applicant must send a copy of this decision to every party in the related cases (that is, not the lead cases).** Within 28 days after the date on which the Applicant sends a copy of the decision to a party in the related cases that party may apply to the Tribunal in writing for a direction that the decision is not binding on the parties to a particular related case. If no such application is received the decision in the lead cases will be binding on the parties in each of the related cases and the Applicant's application under section 27A(4) of the Act will fail as against the Respondents in the related cases as well as those in the lead cases. If an application to the Tribunal is made by a party in any of the related cases within the 28 day period the Tribunal will give further directions to deal with that application.

Dated the 9th June 2014

Judge D. Agnew (Chairman)

Appeals

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

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

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

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