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FREEHOLD AND BLOCK MANAGEMENT

Residential service charges

RESIDENTIAL SERVICE CHARGES

Disputes about residential service charges are one of the biggest ‘problem areas’ for freeholders, accounting for over half of the cases brought before the Residential Property Tribunal in 2022. Most disputes arise out of the Landlord and Tenant Act 1985 (the ‘Act’), which imposes strict requirements and limitations on freeholders in relation to demanding service charges, as well as consultation obligations for long-term agreements and large projects.

SERVICE CHARGE DEMANDS

All service charge demands sent to residential leaseholders must comply with the following requirements:

- Freeholders must provide leaseholders with an address in England and Wales for service of notices.
- The service charge demand must contain the name and address of the freeholder (not just the name and address of the managing agent).
- The service charge demand must contain or be sent with a summary of leaseholders' rights and obligations in relation to service charges. The contents of the summary are prescribed and must be in printed format in at least size 10 font.
- Service charge demands must be sent within 18 months of the freeholder incurring the costs included within it.

Demands which do not comply with all of the above requirements are not due and payable by the leaseholder, so it is important to get the contents of the demand right, or risk failing to recover all of the costs incurred.

WHAT CAN BE CHARGED TO LEASEHOLDERS?

The scope of the services which can be charged to leaseholders will be determined by the terms of the lease. Most modern leases are drafted widely to ensure that freeholders are not unduly restricted from recovering from leaseholders the costs they incur in providing services.

However, even where costs are recoverable in accordance with the terms of a lease, leaseholders benefit from additional statutory protection by virtue of section 18 of the Act, which provides that the freeholder may only include costs in the service charge which are reasonable. If advance payments are sought (most leases will permit the freeholder to demand interim service charge payments), then they also must be reasonable.

'Reasonable' means that the costs must have been reasonably incurred by the freeholder, and the works or services to which they relate must be of a reasonable standard. Reasonable does not mean that the freeholder always has to choose the cheapest option; there will always be a number of factors to consider. Some risk areas to consider include:

- Is routine maintenance work being carried out more frequently than actually necessary?
- Are the contractors being used completely independent or do they have an existing relationship with the freeholder or managing agents?
- Are any commission or referral payments being made by the contractors chosen?
- Have quotes been sought from more than one contractor?
- Where repairs are required, is the work being done on a like for like basis, or does it go beyond this?

Freeholders and managing agents should have regard to the RICS Service Charge Residential Management Code, which contains best practice guidelines for managing service charges.

Leaseholders who dispute the service charges imposed by a freeholder can apply to the First-Tier Tribunal (Property Chamber) for a determination on whether the charges are reasonable and whether they are due and payable. The Tribunal does not typically award legal costs, and also has the power to make an order that any legal costs incurred by freeholders in dealing with such applications may not be passed onto the leaseholders via the service charge.

WHAT INFORMATION HAS TO BE PROVIDED ABOUT SERVICE CHARGES?

Leaseholders are entitled to ask for more information about the service charge demands served on them. Under section 21 of the Act, they can ask for a summary of the service charges incurred in the last accounting year (or for the twelve months prior to the request, if accounts are not produced on an annual basis). The leaseholder must make the request in writing, and the freeholder must comply within one month of the request, or six months of the end of the relevant accounting period, whichever is later. A leaseholder can only make a request once in relation to each accounting year.

If there are more than four flats in the building, the summary must be certified by an accountant to confirm that it is a fair summary and that sufficient supporting information (receipts, accounts and other documents) has been provided by the freeholder.

After receiving a service charge summary, leaseholders are also entitled until section 22 of the Act to inspect and take copies of the accounts, receipts and other documents which support the summary. The freeholder must make these available, free of charge, within one month of a request (although a reasonable charge can be made for copying documents).

Failure to comply with a section 21 request within the above deadline is a criminal offence, punishable by a fine of up to £2,500, so it is important to deal with all requests received promptly.

CONSULTATION

Under section 20 of the Act, freeholders are obliged to consult with leaseholders before doing either of the following:

- Entering into a qualifying long-term agreement ("QLTA") for the provision of services. Long-term means an agreement for a term longer than twelve months. Freeholders and managing agents should be careful of entering into agreements which are expressed to be 'rolling' or 'auto-renewing' – these may constitute QLTAs, even if the initial fixed term is a year or less, although this will depend on the exact wording of each individual agreement.
- Carrying out qualifying works which cost more than £250 per leaseholder. Qualifying works do not include routine window cleaning, gardening, cleaning etc but can include repairs, planned maintenance or major repair or improvement works. In determining whether the cost of works will exceed £250 per leaseholder, freeholders should look at each individual set of works – the £250 threshold is not an annual cap. However, freeholders cannot artificially carve works up into chunks in order to try and evade the consultation requirements.

The consultation process is set out in the Services Charges (Consultation Requirements) (England) Regulations 2003 and is as follows:

1. First, serve written notice on each leaseholder of the intention to enter into a QLTA or carry out qualifying works. A general description of the agreement or the works planned needs to be included in the notice. Notice also needs to be served on the recognised tenants' association (RTA), if there is one.
2. The leaseholders (and RTA) must be given a period of 30 days to submit their observations on the proposed QLTA or works, which the freeholder must have regard to. They can, if they wish, submit the names of contractors from whom they want the freeholder to seek an estimate.
3. Next, seek the estimates. If any of the leaseholders or the RTA have nominated a contractor, an estimate must be sought from that contractor (or from at least one contractor

nominated by the tenants, if more than one has been nominated), as well as any others the freeholder decides to seek estimates from.

4. Then, select at least two estimates to take forward to the second stage of the consultation as proposals. At least one of these proposals must be unconnected with the freeholder – this means that the contractor must not have any family or company relationship with the freeholder i.e. no shared directors or managers, or close relatives of directors or managers.

5. The leaseholders (and the RTA) need to be given written notice of the proposals. The notice needs to include:

   a. A copy of the proposals, or details of the place and times where the information can be inspected

   b. A summary of the leaseholders' observations on the initial notice

   c. If possible, an estimate of how much each leaseholder will have to contribute, or if that is not possible, the total expenditure for the agreement or project.

6. The leaseholders then have a further 30 days to make observations on the proposals, which again the freeholder must have regard to when selecting which proposal to proceed with.

7. Finally, once the QLTA or contract for works has been entered into, serve written notice on each leaseholder within 21 days, summarising the observations made and the freeholder's response, and the reasons for entering into the agreement. It is not necessary to give reasons if the contractor selected is one who was nominated by the leaseholders.

Failure to comply with the consultation requirements has significant consequences: the maximum leaseholders will be liable to pay is limited to £100 per leaseholder, for a QLTA, or £250 per leaseholder, for qualifying works.

The First-Tier Tribunal (Property Chamber) does have the power to dispense with the consultation requirements (including retrospectively) if it is reasonable to do so – for example where there was no real prejudice suffered by the leaseholders. However, the power is not exercised lightly, and it is always preferable for freeholders to ensure that the consultation requirements are strictly adhered to. Freeholders frequently delegate their management responsibilities to managing agents, which is perfectly permissible, but should remember that it is they, and not the managing agents, who will be liable to leaseholders for any breaches of the consultation obligations.

LEGAL SUPPORT

Please contact our property litigation team if you need assistance with:

- Advice on non-payment of service charges by leaseholders
- Responding to section 21 or 22 requests from leaseholders
- Determining whether or not a section 20 consultation needs to be carried out
- Drafting section 20 consultation documents

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