

## **LANDLORD LIABLE TO RETURN SURPLUS SERVICE CHARGE MONIES**

**The Message:** Landlords may be liable to repay unexpended service charge contributions back to their tenants at the end of their Leases.

**The Case:** In the absence of a clear provision that sums collected from the tenant to fund future expenditure were to belong to the landlord and/or to be held in a separate reserve fund, then a tenant may well be entitled to recover any unexpended service charge monies at the end of a Lease (Brown's Operating System Services Limited-v-Southwark Roman Catholic Diocesan Corporation (1/03/2007)).

Mr Brown's company rented 3 out of the 5 business units at St Agnes House in Blackheath from the Corporation. He paid 68.25% of the total service charge and his contributions each year included a sum towards future expenditure. By the time his Leases ended, the Corporation was holding a surplus of £15,500 in relation to his contributions to future expenditure but it claimed it had no liability to repay these monies and its case succeeded in the County Court. Mr Brown appealed to the Court of Appeal.

The Court of Appeal had to consider the terms of the Leases to determine who the service charge contributions belonged to. It made it clear that each lease depends on its own terms and that it would not be bound by a previous case authority relied upon by the Corporation where the Court had held unspent contributions to a depreciation fund to meet the cost of replacing air-conditioning plant belonged to the landlord.

The Leases provided that the service charge could include a reasonable provision for future expenditure and that any excess arising from the payments on account during the year could be retained to cover any deficiency in the following year. The Leases specifically provided that the excess funds had to be used to meet any shortfall in any year before any demand could be made for any additional contributions.

What happened in practice was that any surplus at the year end was carried forward as an allowance for future repairs. Crucially, the Leases did not make any provision for a reserve fund to be set up so the monies remained general service charge monies available to meet any shortfall in normal service charge expenditure. There was just one pot of money rather than two pots.

The Corporation relied heavily on the absence of any provision providing for any repayment of any monies on termination of the Leases in support of its argument that any surplus funds belonged to it. However, the Court did not regard this as decisive as it considered the contributions were only intended to cover expenditure during the Leases and not expenditure thereafter. It decided that the monies were held simply to help fund years of heavy expenditure so that the tenant did not suddenly have to pay any larger than normal sums.

As the funds were only held to help meet the tenant's liability for future service charges, they could no longer be held by the Corporation once the Leases ended and there was no further service charge liability. At that point, they should have been repaid to Mr Brown's company.

In the light of this Judgment, it is important for a landlord to establish the exact status of the funds it has collected to meet future costs and, if they are not genuine reserve funds, the landlord should ensure they are spent on repairs before the Lease ends so that it does not have to return them to the tenant.