# Back to the future

## The retrospective variation of leases of flats under the Landlord and Tenant Act 1987

RESIDENTIAL VIEW

Nicola Muir

Sometimes the draftsman gets it wrong. Sometimes his only mistake is to fail to predict the future. Either way, a landlord can face a serious shortfall if the combined percentages of service charges payable under the leases for the block do not add up to 100%. While at first blush, the landlord's shortfall is the tenants' windfall, defective leases can seem a much less attractive prospect if the result is that the landlord is reluctant to provide services.

In practice, leaseholders often agree a pragmatic fudge whereby the shortfall is divided pro rata between them. However, where an informal arrangement is not possible or falls apart, an application may be made to the First Tier Tribunal (Property Chamber) for a variation of the lease under Part IV of the Landlord and Tenant Act 1987. It is often not until a new landlord takes over or the "right to manage" is acquired that the true nature of the defect is identified. Inevitably, there is a delay between the shortfall arising and the variation being effected. Who is liable for the shortfall during that period?

In *Brickfield Properties Ltd* v *Botten* [2013] UKUT 0133 (LC) the Upper Tribunal accepted that it had jurisdiction to order variations which take effect retrospectively. It thereby ensured that the landlord could recoup 100% of its expenditure throughout and would not be left to bear a shortfall which came about through no fault of its own. This will be very welcome news to landlords or RTM companies faced with this problem.

### Statutory power to vary leases

Except where the requisite majority of the parties to the lease can agree, the 1987 Act empowers the First Tier Tribunal to vary defective leases only in the limited circumstances listed in section 35(2). They include where the lease fails to make "satisfactory provision" for the computation of a service charge payable under the lease (section 35(2)(f)). This sub-section will only apply, however, if:

- the lease provides for any service charge to be a proportion of the expenditure; and
- other tenants of the landlord are also liable for a proportion of the expenditure; and
- the aggregate of the amounts so payable is either more than or less than the total expenditure (section 35(4)).

In other words, a variation can be made if the service charge percentages do not add up to 100%.

### Unfairly split expenditure

The scope for varying the lease on this ground is actually very limited. The tribunal has no jurisdiction to amend the lease on the basis that the contributions towards the expenditure are unfairly split. In *Morgan* v *Fletcher* [2009] UKUT 186 (LC), for example, the Upper Tribunal found it had no power to vary the leases where the landlords had reduced the service charge proportion payable in respect of their own flat and that of one other lessee to almost nil in order to bring the aggregate service charge down from 116% to 100%.

### Substantial prejudice

As well as establishing the relevant ground, the tribunal must also be persuaded that the variation is not likely substantially to prejudice anyone who cannot be adequately compensated under the Act and that there is no other reason why it would not be reasonable, in the circumstances, for the variation to be effected. Where service charge percentages are to be reallocated there will inevitably be a winner and a loser but, as HHJ Huskinson said in *Brickfield*, the substantial prejudice contemplated by section 38(6) cannot include the removal of an unintended and undeserved windfall.

### Tribunal orders

If the criteria for a variation under the Act are fulfilled, what order can the tribunal make? Section 38(4) permits the tribunal to vary the lease either in the manner proposed by any of the parties or to make "such other variation as the tribunal thinks fit". These are very wide words. If read literally, the provision would allow the tribunal to rewrite the lease into a fairer and more modern document. However, while this may well be desirable, it would seem that the variations ordered should be limited to those which are necessary to remedy the relevant prescribed defect – see *Gianfrancesco* v *Haughton*, Lands Tribunal, 6 March 2008 and *Re 416 & 418 Manchester Road*, LVT, 2 October 2012, LON/00BG/LVL/2012/0002&0012.

### Retrospective variations

Not only is there no guidance in the Act as to how the lease should be varied, there is also no stipulation as to when those variations should take effect. In *Brickfield*, the landlord sought to have the re-computation of the service charges backdated to the date on which the defect arose – around five years earlier. It was argued that, as the purpose of section 35(2)(f) is to cure a defect in a lease, there is no obvious reason why this cure should be applied from some arbitrary date subsequent to when the defect arose, for example, from the date on which a party applies to the First Tier Tribunal.

The Upper Tribunal agreed and found that it did have jurisdiction to backdate. In *Brickfield*, the estate originally consisted of seven blocks with the aggregate of the service charges adding up to 100%. When the aggregate of service charge proportions was subsequently reduced as a result of the collective enfranchisement of a single block, a shortfall arose. The Upper Tribunal found that the variation should take effect from the date of the transfer of the enfranchised block. The change of circumstances had upset the original scheme of the service charge provisions in a way that the draftsman could not easily have predicted or provided for.

In the majority of cases, there will have been no change of circumstances and the defect will have existed from the date of grant. As the defect may have existed for many years, the impact of *Brickfield* could be far-reaching. Although only those variations which the tribunal thinks fit will be made, the door is now open for the recalculation of service charge accounts long closed and the creation of liabilities retrospectively in defective leases.

*Nicola Muir is a barrister at Tanfield Chambers*

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