

# Acknowledgements

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## RICS standards framework

RICS' standards setting is governed and overseen by the Standards and Regulation Board (SRB). The SRB's aims are to operate in the public interest, and to develop the technical and ethical competence of the profession and its ability to deliver ethical practice to high standards globally.

The [RICS Rules of Conduct](#) set high-level professional requirements for the [global](#) chartered surveying profession. These are supported by more detailed standards and information relating to professional conduct and technical competency.

The SRB focuses on the conduct and competence of RICS members, to set standards that are proportionate, in the public interest and based on risk. Its approach is to foster a supportive atmosphere that encourages a strong, diverse, inclusive, effective and sustainable surveying profession.

As well as developing its own standards, RICS works collaboratively with other bodies at a national and international level to develop documents relevant to professional practice, such as cross-sector guidance, codes and standards. The application of these collaborative documents by RICS members will be defined either within the document itself or in associated RICS-published documents.

### Document definitions

Document type	Definition
<b>RICS professional standards</b>	<p><b>Set requirements or expectations for RICS members and regulated firms about how they provide services or the outcomes of their actions.</b></p> <p>RICS professional standards are principles-based and focused on outcomes and good practice. Any requirements included set a baseline expectation for competent delivery or ethical behaviour.</p> <p>They include practices and behaviours intended to protect clients and other stakeholders, as well as ensuring their reasonable expectations of ethics, integrity, technical competence and diligence are met. Members must comply with an RICS professional standard. They may include:</p> <ul style="list-style-type: none"><li>• mandatory requirements, which use the word 'must' and must be complied with, and/or</li><li>• recommended best practice, which uses the word 'should'. It is recognised that there may be acceptable alternatives to best practice that achieve the same or a better outcome.</li></ul>

Document type	Definition
	In regulatory or disciplinary proceedings, RICS will take into account relevant professional standards when deciding whether an RICS member or regulated firm acted appropriately and with reasonable competence. It is also likely that during any legal proceedings a judge, adjudicator or equivalent will take RICS professional standards into account.
<b>RICS practice information</b>	<p><b>Information to support the practice, knowledge and performance of RICS members and regulated firms, and the demand for professional services.</b></p> <p>Practice information includes definitions, processes, toolkits, checklists, insights, research and technical information or advice. It also includes documents that aim to provide common benchmarks or approaches across a sector to help build efficient and consistent practice.</p> <p>This information is not mandatory and does not set requirements for RICS members or make explicit recommendations.</p>

## Glossary

Term	Definition
<b>Accrual accounting</b>	Considered to be the standard accounting practice for most service charges, with the exception of very small operations. This requires that costs be recognised in the accounts when incurred, not when the invoice is actually paid. This is the opposite of cash accounting, which recognises transactions only when there is an exchange of cash.
<b>Accruals</b>	Expenses incurred in a period for which no invoice has been received at the period end. As the cost relates to the period, it is to be charged to the service charge account for that period.
<b>Adjudication</b>	A simple and efficient method of settling disputes. An adjudicator uses their own knowledge and investigations while weighing the evidence presented by the opposing parties. This helps them to reach a decision that is legally binding until the original dispute is referred to arbitration or the courts, or is settled between the parties themselves.
<b>Administration charges</b>	The manager's costs in procuring services directly (in other words, not through a contractor) where the actual cost of the service (e.g. the site-management team) is recovered through the service charge. The administration charge is intended to reimburse the manager's indirect costs (e.g. payroll, staffing,

	etc.) and is recorded to the cost category where they are incurred, as would apply if the service(s) were contracted.
<b>Alternative dispute resolution (ADR)</b>	The collective description of methods used to resolve disputes other than through the normal judicial process.
<b>Allocation</b>	The splitting of the costs of a service to assign them to a specific schedule or cost category.
<b>Amenities and facilities</b>	Desirable or useful features, services or resources that are provided to make a place more pleasant and convenient, e.g. information desk, way finding, mobility services, children's play areas and clubs, free Wi-Fi, Click and Collect services, free phone charging, customer lounges or seating areas, etc.
<b>Apportionment</b>	The spreading of costs within schedules between occupiers who benefit from the services in that schedule, based on the availability, benefit and use of the services.
<b>Arbitration</b>	A procedure whereby two parties in a dispute agree to be bound by the decision of an independent third party (the arbitrator). The role of an arbitrator is similar to that of a judge, although the procedures are often less formal. An arbitrator is usually an expert in their own right.
<b>Arrears statement</b>	A transaction list of all unpaid charges demanded by the landlord from the tenants, collated on a tenant by tenant basis.
<b>Balancing service charge</b>	The resulting difference between an individual tenant's apportionment of expenditure and the on-account service charges demanded from that tenant for any specific service charge accounting period, also having regard to any service charge concessions that may have been granted.
<b>Buyer</b>	The buyer is the new/prospective owner of the property.
<b>Commercial property</b>	All property that is not residential or agricultural and includes retail, office, industrial and leisure properties.
<b>Completion date</b>	The date of the sale of a property.
<b>Customer services</b>	The services provided to help and assist visitors to a property.
<b>Depreciation charge</b>	The 'cost' to the owner representing the measure of the wearing out, consumption or other reduction in life of an asset.

<b>Direct charges</b>	Any expenditure that is charged directly to individual occupiers and not funded via the on-account service charges.
<b>Early neutral evaluation (ENE)</b>	ENE is an ADR technique. ENE is voluntary, confidential and conducted on a 'without prejudice' basis. The evaluation is non-binding, and aims to help clarify and define legal and factual issues in the dispute, identifying risks and likely outcomes before further significant resources are spent on the matter.
<b>ICAEW</b>	The Institute of Chartered Accountants in England and Wales.
<b>Independent expert determination</b>	In the UK and other territories this is a process where an independent third party, acting as an expert rather than as a judge or arbitrator, is appointed to decide a dispute (as an independent expert or 'expert determiner' – not to be confused with an 'expert witness').
<b>In trust</b>	Money or monies kept in a separately named account that is held in trust within the bank account of its owner.
<b>International total occupancy cost code (ITOCC)</b>	ITOCC from the Investment Property Databank (IPD) Occupiers Property Databank (OPD) was designed to be the standard form of measuring property and facilities costs for all businesses and public-sector organisations. The code is prepared with the help of IPD occupier and other leading occupiers, consultants, accountants, service providers, developers and academics. As 'total' suggests, it takes account of all of the costs of occupancy, not just those in the common part(s).
<b>Landlord</b>	The term used in landlord and tenant legislation to denote the person or company who owns and rents or leases premises. The person or company may own the freehold or may have a superior leasehold interest in the property themselves. To avoid confusion, this term is only used in this professional standard where the context makes this necessary. In all other cases the reference is to 'owner'.
<b>Manager</b>	The person or team that budgets, forecasts, procures, manages and accounts for the services that comprise the service charge, whether they are the owner, an in-house team, management company or a managing agent (including any wholly or partly owned related companies).
<b>Management charge</b>	The management charge is the reasonable price for the total cost of managing the provision of the services at the location,

	<p><u>and relates only to work carried out in managing and operating the services and administering the service charge.</u></p>
<b>Management fees</b>	<p><u>The remuneration of the manager and related entities including any profit element, for managing the services comprised in the service charge. Typically, this includes the supervision of the site team, overseeing the site contractors and the accounts work necessary to budget, forecast, manage, disperse, balance and apportion the service charge.</u></p> <p><u>Specifically, these fees are not to include property management work separate from the service charge, such as owner approvals, income generation or rent collection.</u></p> <p><u>Where the subject property/site management team is not sufficiently large enough to justify specific service managers (for example, a health and safety manager or building surveyor) additional specialist fees may be charged to the relevant cost category for the 'manager provided' service.</u></p>
<b>Management handover date</b>	<p><u>The date on which the responsibility to manage the property transfers from one property manager to another.</u></p>
<b>Marketing and promotions</b>	<p><u>Advertising and other forms of promotion of a shopping centre intended to bring additional custom to the centre (as distinct from attractions and entertainments of a general amenity, benefit, service or attraction within the centre).</u></p>
<b>Matrix</b>	<p><u>An array of costs set out in rows and columns, which is used as a system of methods and principles in the allocation and apportionment of costs between occupiers.</u></p>
<b>Mediation</b>	<p><u>The generally accepted description of commercial mediation is a voluntary, non-binding, private dispute resolution process in which a neutral person helps the parties to reach a negotiated settlement. A core principle of mediation is that the parties 'control' the outcome, rather than it being imposed on them.</u></p>
<b>Not for profit, not for loss</b>	<p><u>Descriptions of the service charge costs, which are not inflated for profit (although the individual services within the costs may contain a profit element for the individual supplier); but also, there is no residual loss (assuming a fully let property with no concessions on service costs to specific occupiers) left for the owner to pay.</u></p>
<b>Occupier</b>	<p><u>A person in possession or occupation of premises and usually responsible for payment of the service charge to the owner.</u></p>

<b>Office service charge analysis report (OSCAR)</b>	Produced by Jones Lang LaSalle, OSCAR is an industry-leading benchmark. The industry cost classifications set out in Appendix B have been designed and agreed with IPD occupiers so that the OSCAR data can be incorporated into ITOCC from its OSCAR form for regular year-on-year, but not exceptional, expenditure.
<b>On account service charge</b>	An estimated charge raised in advance and anticipation of the final service charge liability, calculated from the service charge budget.
<b>Owner</b>	The person who receives or is entitled to receive the rent. This person is usually responsible for the provision, management, and administration of the services and the service charge. In practice the owner may appoint a manager to discharge the owner's obligations under the terms of the lease.
<b>Planned preventative maintenance (PPM)</b>	PPM is maintenance that is performed purposely and regularly to keep the fabric, facilities, plant and equipment of a building in satisfactory operating condition by providing for systematic inspection, detection and correction of failures, either before they occur or before they develop into major defects. PPM also helps to identify the point at which such items can reasonably be deemed to have reached the end of their economic life, such that replacement or renewal may be necessary. PPM programmes are usually prepared in periods of between 5-10 years in advance, and is to be regularly reviewed and updated at frequent intervals.
<b>Prepayments</b>	Expenses paid in a given period that relate to the following period in whole or part.
<b>Rateable value</b>	An official estimate of the value of a property used as a basis of local taxation. Rateable value is said to be the amount equal to the rent at which the property might reasonably be expected to be let from year to year if the occupier undertook to pay all of the usual occupier rates and taxes, and was also to bear the cost of repairs, insurance and other expenses (if any) necessary to maintain the property in a state to command that rent.
<b>Rebranding</b>	The upgrading of house or corporate style, logos, names badges, etc.
<b>Refurbishment</b>	The renovation of fabric or equipment to bring it to a workable or better condition. It is often a different concept to repair or improvement, and usually includes elements of both. Where a

	refurbishment project includes improvements or enhancements beyond normal repair or maintenance, this element of the cost would usually be met by the owner.
<b>Relaunching</b>	Marketing to change the perception in the eyes of its target audience. This may be for letting purposes (an owner's cost), or may benefit both owner and occupier – for example, a shopping centre following refurbishment – in which case, an agreement is to be reached as to how the relaunch costs are split between the parties.
<b>Reserve fund</b>	A fund formed to meet anticipated future costs of maintenance and upkeep in order to avoid fluctuations in the amount of service charge payable each year (for example, for external cleaning and redecorations).
<b>Retail price index (RPI)</b>	A measure of inflation in the UK published monthly, or such other comparable national statistics published from time to time.
<b>Sale contract</b>	The contract setting out the terms on which the property is to be sold and transferred between the seller and buyer.
<b>RICS Dispute Resolution Service (DRS)</b>	RICS DRS can provide a simple, fast and cost-effective approach to resolving disputes in the complicated world of property and construction, where disputes are bound to arise.
<b>Seller</b>	The previous/current owner of the property.
<b>Services</b>	Where the word 'services' is used, the reference includes works, such as maintenance and repair of the fabric and structure, and true services, such as the provision of heating, lighting, cleaning, security, etc.
<b>Service charge account</b>	The service charge funds held for a specific property.
<b>Service charge apportionment</b>	The method and details of apportioning liability between tenants for contributing to a service charge.
<b>Service charge apportionment matrix</b>	Schedules containing as a minimum the information shown in appendix C (CD and CE).
<b>Service charge arrears</b>	Any on-account service charge or balancing service charge owed by a tenant to the landlord.
<b>Service charge budget</b>	The expenditure estimated by the landlord or its manager that will be incurred in a given service charge accounting period.

<b>Service charge reconciliation</b>	A comprehensive comparison of all service charge income demanded against all service charge expenditure (including accruals and prepayments) for a given service charge accounting period. This enables the calculation of any balancing charges and credits due from tenants and/or landlords.
<b>Schedules</b>	The allocation of service charge costs into separate parts to reflect the provision, usage, benefit or availability of services between individuals or groups of occupiers.
<b>Sinking fund</b>	A fund formed by periodically setting aside money for the replacement of a wasting asset (for example, heating and air-conditioning plant and equipment, lifts, etc.).
<b>Statement of service charge expenditure</b>	The account of service charge expenditure/costs and related notes. Commercial leases usually provide for an annual statement of service charge expenditure to be issued to occupiers following the end of each service charge period.
<b>Tenant</b>	The term used in landlord and tenant legislation to describe any person (physical or legal) who owns the leasehold interest in property and is liable to pay the service charge under the terms of the lease. As with 'landlord', this term is only used when the context requires; references in the context of commercial property and service charges are to 'occupier'.
<b>Value for money</b>	Good value for money is the optimal use of resources to achieve the intended outcomes. 'Optimal' means 'the most desirable possible given expressed or implied restrictions or constraints'. Value for money is not about achieving the lowest initial price.
<b>Virtual bank account</b>	A subsidiary or sub-account of a physical bank account that allows segregation of funds, e.g. in respect of individual properties, from other funds in the same account or alternatively where funds can be clearly identified through the use of separate ledgers.
<b>Void liabilities</b>	The share of the agreed service charge expenditure for any service charge accounting period that is attributable to vacant lettable accommodation.

## 1 Introduction

Industry collaborative guidance for This professional standard sets out industry best practice for performance, processes and procedures relating to the management and

administration of service charges for commercial and mixed-use properties. The document has been developed over several years and now further enhanced by individuals representing leading property bodies.

It has been adopted and endorsed as the established industry standard for the management of service charges in commercial property was first published in 1996. This is the 6th iteration of what has become known as the Service Charge Code and is now published as a 1st edition for both RICS professional standard.

In the 22 years since its inception, the Code has had a profound and positive impact on the commercial property sector and has facilitated major improvements in standards of delivery and accountability for service charges.

The move to formalising the Code as an RICS professional standard is a further significant step forward. This step not only underlines the importance of managing service charges consistently and effectively but also represents a continued evolution of best practice processes and procedures in an increasingly complex and challenging area of commercial property management, which requires practitioners to have a particular and demanding skill set.

This professional standard sets out best practice in the management and administration of service charges in commercial property, and provides mandatory obligations that non-RICS members, RICS members and RICS-regulated firms engaged in this area must comply with.

For clarity, please be aware that this entire document is an RICS professional standard and RICS expects that members engaged in activity relating to service charges will should be familiar with and must comply with the whole document.

If members depart from the best practice requirements set out in the document they should only do so for justifiable reasons. It is not acceptable to simply comply with the mandatory obligations contained in this document. this document to ensure delivery of the ethics, conduct and competencies expected.

All practitioners acting for landlords, managers and tenants should use best endeavours to achieve the standards of performance and competencies set out in this professional standard.

The aims and objectives of this professional standard are to:

- improve general standards and promote best practice, uniformity, fairness and transparency in the management and administration of services charges in commercial property
- ensure timely issue of budgets and Chapter 2 of this document outlines service charge year end accounts
- reduce the causes of disputes and to provide guidance on the resolution of disputes if these arise
- provide guidance to solicitors, their clients (whether landlords or tenants) and managers of service charges in the negotiation, drafting, interpretation and operation of leases, in accordance with best practice.

There may be limited circumstances when it is not practical to comply, however, any departure **must** be clearly explained.

While the geographic scope of this standard is the UK, many of the principles are globally applicable and may support service charge management outside the UK.

Parties acting for either landlords or tenants should ensure that they advise their respective clients that they are either bound (in the case of RICS members and RICS-regulated firms) or are voluntarily seeking to comply with this professional standard as the benchmark for best practice.

- It is an important element in delivering and demonstrating best practice that the aims and objectives of this professional standard, along with stating its mandatory requirements.
- Chapter 3 sets out the core principles.
- Chapter 4 gives recommendations and guidance on how the professional standard can be are followed.
- Appendix A onwards contains additional information and resources to support an understanding of the professional standard and assist with its implementation.

This professional standard is effective for all service charge periods commencing from 1 April 2019 and supersedes the RICS code of practice *Service charges in commercial property*, 3rd edition.

This professional standard is applicable across the United Kingdom. You should be awareWhere matters are referred to RICS or where disputes arise (particularly those that there are instances where different conditions may apply in Scotland and Northern Ireland. These are highlighted where appropriate.

## **1.1 Limitations of the professional standard**

### **Existing lease terms**

This professional standard cannot override the lease but, if read in conjunction with it, can enable users to identify the best way forward in interpreting that lease to ensure effective management of services.

This professional standard sets out specific mandatory requirements for RICS members and there may be legal and/or disciplinary consequences for members in departing from professional standards, which may lead to a finding of negligence against a surveyor. However, subject always to the terms of the lease, a failureescalate to meet the standards set out in the professional standard will not of itself be sufficient to negate or limit an occupier's liability to pay a service charge in accordance with the terms of the lease.

As business practice constantly evolves, solegal action), it is with service charges. Negotiating a new lease, or the renewal of an existing lease, provides an ideal opportunity to ensure that modern and flexible best practice service charge clauses are incorporated within the lease contract to facilitate effective management of the property and aid the relationships between the parties.

An alternative dispute resolution (ADR) clause will enable any difficulties during the term of the lease to be resolved efficiently and with reduced cost. All parties should carefully consider the principles and requirements of this professional standard prior to entering into a new or renewal lease.

### **Proportionality**

The extent to which owners and managers should seek to comply with the recommended best practice processes and procedures set out in important that adherence to this professional standard will often depend on a variety of issues, such as the size, nature and type of property, the aggregate of the total service charge costs and the amounts payable by individual occupiers, and this should be consistent with best-value principles can be demonstrated, including reasons for departure from the mandatory requirements or core principles and which must also be communicated to the practitioner's client.

Nevertheless, owners, managers and occupiers should seek to comply with the mandatory requirements and core principles set out in Where reference is made to specific case law in this professional standard, it is suggested that legal advice should always be sought to confirm its relevance and application in individual circumstances. Note that decisions of the courts relate to the specific wording of the lease and individual circumstances of each case. Nevertheless, general principles can be inferred as to how the courts may interpret disputes in similar situations.

Please note that a glossary of terms is included at the end of this professional standard at all times.

### **1.1 The service charge arrangement**

Service charges deal with the costs of servicing and operating a property, to comply with the landlord's lease obligations for the provision of services.

The individual service charge arrangements are set down in the lease(s) and with the broad aim is to entitle of permitting the owner/landlord to recover their defined charges and any associated administrative costs incurred in the operational management of the property. This will may, for example, include reasonable costs of maintenance, repair and replacement (usually where beyond economic repair) of the fabric, plant, equipment and materials necessary for the property's operation, plus the costs of any other works and services the parties agree are to be provided by the owner, but subject to reimbursement/landlord and reimbursed by the occupier/tenant.

If the property is fully let, the owner will normally be able/landlords and their managers should not expect to recover all expenditure on services through the service charge, except any concessionary discounts the owner may have given.

Usually, there will be a manager who administers those services, for which they will receive a fee.

The City the costs of London Law Society has drawn up service charge lease provisions carrying out improvements or of asset management initiatives intended to enhance the value or attractiveness of the landlord's investment. These are costs that

have been specifically designed to comply with the principles and provisions should be borne by the landlord. See subsections 4.9.3 to 4.9.6 of this professional standard. This can be accessed from the City of London Law Society website, for more detail.

### **RICS Subject always to the terms of the lease, a failure to meet the standards and regulatory requirements**

In terms of professional behaviour and conduct, all RICS members are bound by the RICS Rules of Conduct.

You must also comply with any related RICS set out in this professional standard – global and UK.

For ease will not itself be sufficient to negate or limit a tenant's liability to pay a service charge in accordance with the terms of reference these include the current editions of: the lease.

- RICS property measurement
- Real estate agency and brokerage
- UK commercial real estate agency
- Conflicts of interest
- Conflicts of interest – UK commercial property market investment agency.

Further information can be found on the RICS website.

### **1.2 Existing lease terms**

This professional standard cannot override the terms of the lease. Where a lease is silent or the wording is unclear or ambiguous, the standards of performance, processes and procedures implemented in managing and administering the service charge should be in accordance with this professional standard.

### **1.3 Proportionality**

While managers should comply with this professional standard, the degree to which elements are relevant will often depend on the size, nature, quality and type of property, the aggregate of the total service charge costs and the amounts payable by individual tenants. At all times this should be consistent with value for money principles.

### **1.4 Code adherence and complaints**

RICS members have a professional duty to promptly disclose the details of any regulated member that is reasonably believed to have materially breached RICS standards (Bye-Law B5.2.1(c) of the Royal Charter and Bye-Laws). The duty to speak up is an important part of the profession's 'moral compass'.

However, anyone can report a concern relating to poor service or lack of adherence to this professional standard by RICS members or RICS-regulated firms. The process for this is set out in section 4.6.

### **1.5 ICAEW guidance**

The Institute of Chartered Accountants in England and Wales (ICAEW) issued a technical release in 2014: TECH 09/14BL, Accountants' reports on commercial property service charge

accounts. This sets out good practice guidance in the conduct of a review engagement for an independent accountant's report on the annual statement of service charge expenditure.

ICAEW is currently reviewing TECH 09/14BL to bring it up to date. It is scheduled for reissue later in 2025, at which point ICAEW and RICS will assess the need for further amendments to this professional standard. Until then, the current version of TECH 09/14BL should continue to be used by reporting accountants.

General references in TECH 09/14BL to the 'RICS Code' should be construed as references to this professional standard, as appropriate. Cross-references in TECH 09/14BL to specific sections of the Code, and extracts from the Code quoted in TECH 09/14BL, should be read as relating to the relevant section in this professional standard, as appropriate. References in this professional standard to TECH 09/14BL should be similarly construed.

## **1.6 Effective date**

This professional standard is effective for all service charge periods commencing from 31 December 2025.

This professional standard is effective from 31 December 2025.

## **2 Mandatory requirements**

The aims and objectives of this professional standard are to:

- improve general standards and promote best practice, uniformity, fairness and transparency in the management and administration of service charges in commercial property
- ensure timely issue of budgets and year-end certificates
- reduce the causes of disputes, and to provide guidance on the resolution of disputes if these arise and
- provide guidance to solicitors, their clients (whether owners or occupiers) and managers of service charges in the negotiation, drafting, interpretation and operation of leases, in accordance with best practice.

Professionals involved in the management of service charge accounts must act in accordance with the following principles:

The following mandatory requirements represent the minimum acceptable standard of performance for RICS members and RICS-regulated firms.

1 All expenditure that the owner and landlord and manager seek to recover **must** be in accordance with the terms of the lease.

2 Subject to section (sections 4.24, 4.5 and 4.7, owners and managers).

2 Managers **must** seek to recover no more than 100% of the proper and actual costs of the provision or supply of the services. (sections 4.3 and 4.5).

3 Owners and managersManagers **must** ensure that service charge issue to tenants: budgets, including appropriatean explanatory commentary, are issued annually to all tenants.

at least one month prior to the start of the service charge year (section 4—Owners and managers must ensure that .5)

an approved set of service charge year end accounts showing a true and accurate record of the actual expenditure constituting the service charge are provided annually to all tenants within four months of the service charge year end (section 4.5).

5—OwnersWhere these timescales cannot be met, a timely explanation **must** be provided of when they will be issued and the reason for the delay in line with the mandatory communication provisions. This does not dispense with the obligation to provide both. Where there is a legitimate reason for the delay in issuing budgets or reconciled year end accounts, managers **must** use all reasonable endeavours to issue these as soon as practicably possible.

4—Managers **must** ensure that a service charge apportionment matrix for their property is provided annually, which clearly shows the detailed basis of calculation and the total apportionment per schedule for each unit, is provided with the budget and service charge account to all tenants—(sections 4.2 and 4.5).

65 Service charge monies (including reserve and sinking funds) **must** be held in one or more discrete (or virtual) bank accounts—(sections 4.5 and 4.7).

76 Interest earned on service charge accounts—or where separate accounts per property are not operated, a proper and reasonable amount of interest calculated on normal commercial rates—must be credited to the service charge account after appropriate deductions (e.g. bank charges) have been made.(section 4.5).

87 Where acting on behalf of a tenant, practitioners **must** advise their clients that if a dispute exists any service charge tenants are not generally entitled to withhold payment withheld by the tenant should reflect only the actual sums in dispute of service charges that have been properly demanded. However, in certain circumstances withholding of payment of any difference arising from mathematical or computational error may not be considered unreasonable (section 4.4 and 4.6).

98 When acting on behalf of a landlord, practitionersmanagers **must** advise their clientsensure that, following resolution of a dispute, any service charge that has been raised incorrectly should be adjusted to reflectcorrect the error without unduedelay—(sections 4.4 and 4.6).

These mandatory requirements represent what is considered to be an acceptable standard of performance for RICS members and regulated firms.

To provide a service that represents best practice in the management of service charges, practitioners should fully read this standard, which contains advice on RICS expectations on the implementation of the core principles and how to adhere to the mandatory principles.

### 3 The core principles

These principles underpin and support the mandatory requirements listed in chaptersection 2 of this professional standard. It is acknowledged that some of the following principles may be difficult to quantify, and in rare circumstances strict compliance may not always be possible. The appropriate level of compliance may be based on the professional judgmentjudgement of all parties as to what is appropriate

and reasonable considering all the circumstances. However, managers should use best endeavours to achieve the standards of performance and degrees of competency set down in this professional standard.

### **The service costs**

#### **1 All costs should be transparent so that all parties, owners, occupiers and managers, 3.1 Management**

##### **(See section 4.1)**

Those involved in the management and administration of service charges should recognise that they have a duty of care to both landlords and tenants to always act with professional care, diligence, integrity and objectivity.

Managers have a duty of care to both the tenants, on behalf of who they administer and manage the service charge, and to the landlord whose investment they are aware of how the costs are made up. servicing.

Management fees should be ~~onset out as~~ a fixed ~~price basis~~ cost with no ~~additional fee elements in other cost headings~~. Service quality should be appropriate to the location, use and character of the property. ~~hidden mark-ups~~.

2 Best practice recommends The manager should procure quality service standards to ensure that services are procured on an appropriate value for money basis always achieved, and that competitive quotations are obtained or the costs benchmarked. The aim is to achieve effective, value for money service rather than the lowest price.

3 OwnersLandlords should not profit from the provision or supply of services. Save for a reasonable commercial management fee that reflects the actual costs of managing the services, the amount ~~an owner a landlord~~ may recover is limited only to the proper and actual cost incurred in the provision or supply of services.

#### **3.2 Allocation and apportionments**

##### **(See section 4 Costs.2)**

All costs should be allocated transparent so that all parties, landlords, tenants and managers are aware of how the relevant expenditure category costs are made up.

Where reasonable and appropriate, costs should be allocated to separate schedules and the costs apportioned to those who benefit from those services.

5 The basis and method of apportionment should be demonstrably fair and reasonable to ensure that individual ~~occupier~~ tenants bear an appropriate proportion of the total service charge expenditure that clearly reflects the availability, benefit and use of services.

#### **3.3 Communication and consultation**

##### **(See section 4.3)**

Communication and consultation between managers and tenants should be effective, timely and accurate to encourage and promote good working relationships and understanding regarding the provision, relevance, cost and quality of services. Timely

and regular communication and consultation would also be expected to help avoid disputes and resolve them should they arise.

6 While the owner has the right to set the standards by which their investment will be managed and has a duty to manage, managers should consult with occupiers regarding the standard and quality of service charge provision required.

7 Transparency is essential to achieving good communication. By being transparent in the budget and accounts, the explanatory notes, policies adopted and day-to-day management, the manager will help prevent disputes. Prompt notification of material variances to budgets or forecasts ensures better working relationships between the landlord, manager and tenant.

Managers should communicate with occupiertenants to ensure services are delivered effectively for the benefit of all, and to ensure that occupiertenants understand what they can expect to receive and how much they are required to pay.

8 Managers claiming compliance with the principles of this professional standard should be transparent in demonstrating how they comply with it.

### **Duty of care**

9 Those certifying Managers should adopt a full open book approach to requests for information, using electronic systems where possible.

### **3.4 Financial competence**

**(See section 4.5)**

When dealing with service charge accountscharges, managers should recognise they are spending the tenants' money and that they delays in reporting projected or actual expenditure can have a duty of care to both owners and occupiers to act with professional care, diligence, integrity and objectivity.significant adverse impact on tenants.

10 The owner and/or manager has a duty to manage the property, as well as a duty of care to both the occupiers, who entrust the spending of their own business overhead and cash flow by funding the services, and to the owner whose investment they are servicing.

11 There should be clear policies as to how the service charge will be managed.

### **Financial competence**

12 When issuing statements of accounts and/or certifying expenditure, managers should do so in a non-partisan spirit, acting as expertsan expert in their field.

13 In addition to the manager's certificate, annual statements of service charge expenditure should be supported by an independent review of the service charge year end accounts in line with the ICAEW Technical Release (TechTECH 09/14BL).

14 The Industry Standard Cost Classifications should be used in reporting budget and actual expenditure.

OccupierService charge year end accounts should include a statement signed by the manager to confirm that the accounts, supporting notes and any accompanying

information records a true and accurate reflection of the actual costs to the landlord of providing the services to the property for the relevant period. The manager should ensure that there are sufficient controls and procedures in place to mitigate the risk of costs being included where no liability existed at year end (see appendix B4).

Where invoices are not received in respect of an accrual brought forward from the previous year, the accrual should be credited back to the service charge unless there is a realistic expectation that an invoice will be received in the immediate future.

In the event of a sale of the property or a change of manager, it is essential that a definitive timescale, within which accounts will be closed and handed over, is agreed.

Landlords and managers should ensure that the management contract provides for the existing manager to be retained post-sale or effective termination of the management contract to ensure a comprehensive and complete handover of the service charge accounts information to the new landlord/manager, with recognition that a fee may also be payable (see Appendix C).

### **3.5 Timeliness**

#### **(See section 4.5.11)**

Managers must issue budgets and service charge year end accounts to tenants. Timescales remain at least one month prior to the start of the service charge year for budgets and statements of actual expenditure in the form of service charge year end accounts, within four months of the service charge year end.

In the event of any delay in meeting these timescales, managers must inform tenants of the reason for the delay, provide as much information as is practicable on the anticipated level of budget and/or actual expenditure and when the budget or year-end statement will be issued. The notification of delay and supporting commentary does not dispense with the mandatory need for a budget to be issued.

### **3.6 Tenant responsibilities**

15 OccupiersTenants should ensure prompt payment of all legitimate service charge on-account and balancing charges.

16 Occupiers should recognise that the service charge provision of any lease has legal effect, and should ensure that any representatives involved in discussions, meetings, etc. have an appropriate level of responsibility and authority to make decisions concerning service charge matters.

17 In recognition that value for money and maintenance of quality standards will be enhanced through partnership, occupiertenants should be proactive in assisting ownerslandlords in the operation and utilisation of services and service systems. For example, by separating waste to facilitate appropriate and cost-effective recycling, adopting energy-saving measures, etc. as far as reasonable within a tenant's daily business operations.

#### **Right to challenge/alternative dispute**

### **3.7 Dispute resolution (ADR)**

#### **(See section 4.6)**

All new leases (including renewals) should make provision for either party to require the resolution of disagreements through alternative dispute resolution (ADR) as a cost-effective alternative to court action.

**19** If the parties cannot agree a mediator, or an independent expert to determine the dispute, the President of RICS should (on request) nominate a suitable person. Where leases do not allow for ADR, parties are reminded that there is nothing to stop them agreeing to use ADR to resolve a dispute.

### **Timeliness**

**20** ~~Communication and consultation between managers and occupiers should be timely and regular to encourage and promote good working relationships and understanding with regard to the provision, relevance, cost and quality of services. Timely and regular communication and consultation would also be expected to help avoid disputes and resolve them should they arise.~~

**21** ~~Managers should issue budgets to occupiers, including an explanatory commentary and apportionment matrix at least one month prior to the start of the service charge year. Detailed statements of actual expenditure, together with accounting policies and explanatory text, should be issued within four months of the service charge year-end.~~

### **Transparency**

**22** ~~Transparency is essential to achieving good communication. By being transparent in the accounts, the explanatory notes, policies and day-to-day management, the manager will help prevent disputes. Prompt notification of material variances to plans or forecasts ensures better working relationships between owner, manager and occupier.~~

### **Value for money**

**23** ~~Service quality should be appropriate to the location, use and character of the property. The manager should procure quality service standards to ensure that value for money is achieved at all times. The aim is to achieve effective, value for money service rather than merely the lowest price.~~

### **3.8 Exclusions**

**24** Service charge costs should not include any of the following:

- ~~Any~~any initial costs (including the cost of leasing, lease-hire purchase or other similar financing arrangement of equipment) incurred in relation to the original design and construction of the fabric, plant or equipment.
- ~~Any~~any setting up costs, including costs of fitting out and equipping the on-site management offices that are reasonably considered part of the original development cost of the property.
- ~~Any~~any improvement costs above the costs of normal maintenance, repair or replacement. ~~Service charge costs may include enhancement of the fabric, plant or equipment, where such expenditure can be justified following an analysis of reasonable options and alternatives, and with regard to a cost-benefit analysis over the term of the occupiers' leases. Managers should provide the facts and figures supporting such a decision. (see section 4.8)~~

- Futurefuture redevelopment costs.
- Costscosts and fees relating to the owner'slandlord's investment interest, for instanceexample, asset management and rent collection, cost of letting units and matters between the ownerlandlord and an individual occupierThitenant (this last category may include activities such as enforcement of lease covenants, dealing with landlord consents for assignments, sub-lettingsubletting, alterations, rent reviews, additional opening hours, etc.).
- Costscosts attributable to void premises and the owner'slandlord's own use of the property.
- Anyany costs arising out of the negligence of the manager or ownerlandlord.

### 3.9 Exceptions

Service charge costs may include enhancement of the fabric, plant or equipment where, having been fully communicated to and agreed with tenants, and where such expenditure is supported following an analysis of reasonable options and alternatives, and having regard to a cost-benefit analysis over the term of the tenants' leases. This includes incorporation of sustainable alternatives (see section 4.9).

## 4 Best practice to support the core principles

### 4.1 Administration Management

The best practice recommendations in this section will help RICS members and RICS-regulated firms and non-members achieve the following mandatory requirement:

~~2 Subject to section 4.2.7, owners requirements and managers must seek to recover no more than 100% core principles.~~

#### 4.1.1 Duties of the proper and actual costs of manager

~~The landlord has the provision duty to manage or supply delegate management of the property, and the responsibility to administer and account for the tax properly due on the service charge. Best practice requires the manager to recognise a duty of care, both to the tenants who fund the services being provided, and to the landlords whose investment they are servicing.~~

#### 4.1.1 Standard and quality of service provision

~~The aim of service provision is to Managers should also ensure that services are beneficial and relevant to the needs of the property, its owner, its occupiers and their customers.~~

~~Managers and occupiers should consider the nature, type and complexity of each property, as the levels and standards of service provided will differ according to these factors. In providing these services, the aim is to achieve effective, value for money service rather than the lowest price.~~

~~The manager is responsible for:~~

- ~~ensuring the standard of services provided are monitored~~
- ~~ensuring all staff involved in the quality and cost of the services provided are regularly reviewed and~~
- ~~demonstrating that service standards are being delivered and value for money is being achieved.~~

~~It is recommended that management policies and procedures be established to define the procurement management, administration and management of services. It also ensures the respective obligations of owner and occupier are discharged and services are provided efficiently, economically, cost-effectively and safely.~~

~~Where there are sound reasons for implementing alternative procedures to those set out in this professional standard, the manager should explain and justify these in advance.~~

~~Effective communication is key to achieving best practice. The aim is to provide transparency between manager and occupier in the way services are provided and managed, and in how the costs of these services are recovered.~~

~~On occasion, additional services will be provided outside the service charge. Occupiers are entitled to expect similar transparency, accountability, etc. in these services. This professional standard applies to these as well.~~

#### **4.1.2 Staffing and personnel**

On site management staff are required to have a sound knowledge of appropriate modern business practices and to be adequately skilled to provide the best and agreed performance standards. As they will need appropriate skills in general management, employment and health and safety matters, any necessary training costs may also be covered by the service charge.

To ensure the services are provided efficiently and cost-effectively, approval of service charges are appropriately sufficient staffing of the right type and calibre is to be provided. In keeping with the goal of transparency, it is best to declare the total costs for such additional staff and competently trained.

Site management teams and managers should perform according to defined standards. It is also advisable to measure and review performance regularly against these performance standards.

Where reviews of staffing levels are undertaken, it is reasonable that costs associated with achieving beneficial changes – such as the termination of employment contracts – are recovered under the service charge. This is provided that such costs can be justified following the analysis of reasonable options, and that the purpose is proven to achieve greater cost-effectiveness and value for money.

#### **4.1.3 Management charges**

##### **41.1.3.1 Total cost of management**

The total cost of management is the reasonable price for managing the provision of the services at the location, and relates only to work carried out in managing and operating the services and administering the administration of the service charge.

The total cost of management might comprise two elements:

- i—the fee charged by the manager and related entities for managing and supervising the services for a site (the management fee) and
- ii—the cost of the site-specific management staff, including accommodation and ancillary office costs, etc., whether in a full- or part-time capacity (the site-management costs).

• No two buildings are identical in the way they need to be run to meet the requirements of all parties with an interest in the property. Management fees and site-management costs should be set at the appropriate level.

It is not for this professional standard to prescribe the operating business model of the manager.

For instance, where in addition to the usual role undertaken by that of a property manager, a regional facilities manager is employed to oversee a number of properties, managers should be aware of the additional costs in creating a tiered management structure and should be prepared to demonstrate that the total cost of management is fair and reasonable in the circumstances and consistent with the value for money principles set out in this professional standard. Managers should be prepared to explain the role of the regional facilities manager, the number of properties that they are involved with, and exactly how their costs and time are split between them.

Best practice requires transparency and a management structure where costs are clearly identified and explained. It is therefore recommended that this information be contained withinin the explanatory notes included in the budget and in the annual service charge accounts.

#### **4.1.31.2 Management fees**

The management fees charged shall comprise only the reasonable costs and overheads borne in the process, including a reasonable profit element of operating and managing the services. These would also and reflect the actual work necessary to fulfil the principles of this professional standard. It is recognised that whoever is providing the service is entitled to cover their costs and overheads, including a reasonable profit element.

Management fees should relate only to the actual work carried out in managing and administering the service charge. Other costs—The manager will often perform additional roles and duties relating to investment interests, for instanceexample, asset management and rent collection—. In such cases, the fees the manager charges in relation to performing such additional duties should not be excluded from included in the service charge management fee, which would be stated in the service charge report. The professional standard requires that fees be set on and comprise a fixed price basis rather than being calculated as a percentage of expenditure. cost to the landlord.

Fees based on a percentage of the budgeted or final service costscharge are no longer considered appropriate and are a disincentive to the delivery of value for money. The This professional standard requires that management fee should, therefore, be a fixed fee fees be set at a level for the service charge year. Fees may be subject to annual review or indexation other than in exceptional circumstances, such as a change of manager where an in-year adjustment may be required.

It is recognised that manysome older leases may refer to the management fee as a percentage of the total service charge, or contain a percentage cap.

This professional standard cannot override the terms agreed between the parties and recorded inof the lease. However, where the lease limits the amount or quantum of the fee recoverable from occupiertenants it is a matter between the ownerlandlord and occupiertenant and should not prevent or limit the manager's ability to charge a commercial fee that reflects the requirements of this professional standard. In certain circumstances, this may result in a shortfall in the recovery of service charge costs on behalf of the ownerlandlord, but the overriding principle should be to achieve the best practice principles for the management and administration of services charges set down in commercial propertythis professional standard.

Managers should confirm in the service charge report:

Management is a service and where managers are separately appointed, the management contract should not be treated differently to any other contract entered into for the provision of services. Managers should, therefore, communicate to tenants either on request or as a matter of good practice, included in the service charge pack:

- the basis and duration of their appointment

- when they were appointed
- a summary of the services manager's duties in connection with the management of the services and the service charge, and the management fee payable, which is recoverable under the service charge and
- that the owner/landlord bears a proper cost of all other duties performed by the manager in relation to matters outside of the service charge.

Where the owner/landlord manages the property in-house, they should have due regard to the principles as outlined previously, in this professional standard and be able to support the basis of their fees when benchmarked against other comparable service providers. and comply with the disclosure in the bullet points above.

Where a lease includes a cap on the amount of management fee chargeable, unless stated in clear and unambiguous terms, it is the general intention that it refers to the fee the manager receives and not the on-site management costs.

Where specialist reports (e.g., such as fire-risk assessment reports, Disability Discrimination Act (DDA) reports, and health and safety reports, etc.), are prepared by specialists working for the same organisation as the manager, the costs should be excluded from the management fee. Fees for these additional services should represent value for money and be clearly and separately stated within the service charge reports issued to tenants and included under a related cost classification.

#### **4.1.1.3.3 Management companies**

In certain instances, such as a business park or industrial estate, the freehold is sold or long leases granted of individual plots or building, and the common parts are retained by the estate owner or held in common ownership, it is common for the management of the park or estate to be the responsibility of a management company created specifically for that purpose.

Management companies are to comply with the provisions of this professional standard. However, as the management companies' sole purpose is the management of the estate, and plot owners will often be the sole shareholders of the company, it would be usual for the service charge to bear the full cost and overheads of the company itself, for example, staff salaries, company registration and accounts fees, director indemnity insurances, etc. But as there would be no intention of accruing a profit to the company, no management fee would be chargeable.

Where a management fee is charged and recovered through the service charge, this places the management company in the same role as a managing agent and the costs referred to in this section would not be directly recoverable and considered part of the management fee.

#### **4.1.1.4 Other income**

There should be transparency regarding all otherAll sources of income and related income or other benefits to the manager and related entities (i.e. rebates, commission or incentives) arising out of the management or provision of services, which should be declared in the annual year-end service charge accounts. On request, owners/landlords and managers should declare what services are provided for the income received and

which should only be retained in return for a service of value and should be proportionate to the service. These may include insurance fees (including commissions).

#### **4.1.3.4 Duties of the manager****1.5 Site management costs**

The total on-site management cost should be explicitly shown in the budget and service charge year end accounts and allocated under the 'site management cost' heading.

On-site management staff are required to have a sound knowledge of appropriate modern business practices and to be adequately skilled to provide the best and agreed performance standards. The owner has the duty to manage or delegate management of the property, and the responsibility to administer and account for the tax properly due on the service charge. Best practice requires the manager to recognise a duty of care, both to the occupiers who fund the services being provided, and to the owners whose investment they are servicing.

The manager will usually perform additional roles and duties relating to investment interests, for instance asset management and rent collection. In such cases, the fees the manager charges in relation to performing such additional duties should be excluded from the service charge management fee.

#### **4.1.3.5 Site management costs**

Site management costs are the full employment costs for sufficient staff, as described in section 4.1.2. The job titles of the staff will vary, however, the total cost of the staff is to include including wages, national insurance (NI), tax, compliance with statutory requirements, training and other appropriate benefits.

Site management costs might also include:

- the costs of providing appropriate office accommodation and administrative support where necessary
- a reasonable fee representing the human resources (HR) and payroll costs associated with dealing with staff (often referred to as an administration charge) and
- separate specialist consultancy fees payable, for instanceexample, in connection with the carrying out of health and safety risk assessments, asbestos surveys, etc., and whichthat should be clearly identified in the budget and service charge year end accounts withinin a related cost classification and referred to in the expenditure report notes.

One way of ensuring the costs reflect value for money is to compare them to a third party providing similar services. Where such fees are included the basis of calculation and/or quantum of the fees included should be clearly communicated to occupiers to aid transparency.

The total on-site management cost should be explicitly shown in the service charge accounts and allocated under the 'site management cost' heading. Where reviews of staffing levels are undertaken, it is reasonable that costs associated with achieving beneficial changes, such as the termination of employment contracts, are recovered under the service charge. This is provided that such costs can be evidenced following the analysis of reasonable options, and that the purpose is proven to achieve greater cost-effectiveness and value for money over the term of the tenant's lease.

Staff costs should not generally be split between other account code headings unless there is an appropriate reason for doing so and in such a case this should be explicitly noted in the budget and statements of actual expenditure.

For instance, the cost of an on-site facilities management team and on-site contract managers of the main building services, e.g. security or cleaning managers (either directly employed staff or those employed through third-party agencies, etc.) should be included as part of the 'site management cost', whereas a security or cleaning supervisor employed by the relevant service provider should be included in the security or cleaning cost classification.

However, where such costs are not included as a 'site management cost' but allocated to a specific cost heading (i.e. cleaning or security) the manager should be clear and explicit as to how these management costs have been treated.

Where additional management or supervisory functions are carried out by non-site-based staff, for instanceexample, a regional/area facilities manager, these costs should be clearly identified and included under the 'site management costs' where they are performing site specific tasks.

Where such functions are performed in placeroles represent a delegation of, rather than in support of, the duties usually expected of or performed by the manager and included withinas part of the management fee, the costs should not comprise or be regarded as a site management cost but as part of the management fee.

Where ~~the cost of non-site or site-based staff is apportioned to more than one property, the calculation and basis of allocation should be clearly and explicitly communicated to occupiers in the budget reports and statements of actual expenditure.~~

~~Similarly, any additional administrative charges included should be clearly and explicitly identified.~~

~~Where on-site staff~~ are responsible for more than one property, their costs (and any appropriate accommodation and administrative support costs) are ~~best to be~~ distributed accordingly so that each property covers a fair share of the cost. The service charge report should identify clearly whether this is the case and how the costs are split.

~~Many buildings require management 24/7.~~ If it is reasonably considered that a property requires out of hours support, a manager may ~~consider supporting the function of the on-site staff by providing~~ provide a customer support help desk to deal with property matters outside of usual business hours, or when the manager cannot be contacted. Where this is reasonably and necessarily provided ~~as an alternative to employing additional on-site staff~~, the reasonable cost of running this service may be ~~recovered from~~ recoverable under the service charge.

~~If the manager is instructed by~~ Where a tenant ~~to provide~~ is provided with services or facilities ~~services for directly in respect of~~ their demised ~~property, e.g. premises, for example,~~ cleaning, security, etc., the costs, including an appropriate apportionment of the manager's ~~charges fees and the on-site management costs~~ for providing these services should be ~~directed charged directly~~ to the relevant tenant and **not** included in the service charge. Additionally, if the ~~site management team (whose costs are recovered from the service charge)~~ are involved in the administration, oversight or contract management, etc. of these tenant services, an appropriate apportionment of their costs should be excluded from the service charge, and the basis for this apportionment should be transparent. In other words, 100% of the site management staff costs should not be recovered from the service charge if the team are also involved in providing tenant services.

Similarly, if the on-site management team are also involved with activities that are not directly related to the provision or management of the site services, such as asset management initiatives or rent collection on behalf of the ~~owner~~ landlord, an appropriate proportion of their cost and overhead should be borne by the ~~owner~~ landlord and **not** included in the service charge.

#### **4.1.31.6 Notional rent for management accommodation**

~~Many~~ Notwithstanding that ~~many~~ leases contain ~~provisions~~ provision for the inclusion of a notional rent ~~within~~ in the service charge ~~for, it is generally not considered appropriate to charge tenants notional rent in respect of~~ management accommodation, or for other where:

- ~~the~~ premises ~~used in connection with the management of the property. Notional rents were originally included to provide developers with a return on otherwise unlettable space~~ are reasonably considered to be incapable of beneficial occupation for any other purpose or

- reasonable provision has not been made as part of the original design and to cover the initial provision costs for management accommodation, construction of the building.

In many cases, management accommodation cannot be separately let, and thus has no market value other than as a location for such an operation. However, there are situations where the management premises comprise accommodation (offices) that would otherwise be reasonably considered as a lettable space; in, such as offices. In these cases, there is an element of rent foregone by the landlord to provide accommodation for the on-site management team.

It is generally not considered appropriate to charge occupiers notional rent in situations where either the premises are incapable of beneficial occupation for any other purpose, or where provision has not been made for facilities management accommodation – for example, a modern building designed without facilities management accommodation as part of the original design specification.

There is also an argument that if notional rents are applied, it A reasonable assessment of the 'cost' to the landlord in making reasonable provision for the on-site management accommodation may discourage an efficient use of space, or a consideration of alternative uses for areas currently occupied by centre or facilities management. be a legitimate cost recoverable under the service charge.

#### 4.1.42 Contract procurement

##### 4.1.42.1 Service standards and provision

It is best practice to ensure that all contractors and suppliers perform according to written performance standards. On the basis that the manager is approving payment of supplier costs, on trust for the tenants, the manager should regularly measure and review performance against these defined performance standards, as well as to regularly review the appropriateness of the standards used.

##### 4.1.4.2 Procurement of services

It is the responsibility of the manager to identify the procurement strategy most suitable for the property, based on an appropriate level of service and value for money.

The See the current edition of RICS' *Procurement of facility management* includes the following for mandatory requirements for procurement practice carried out by RICS members:

- 1 You must have a clearly defined, detailed scope of the services, defining what it is and is not included.
- 2 You must state clear objectives for the procurement project.
- 3 You must develop evaluation criteria that reflect your objectives.
- 4 You must have a clear pricing structure stating what services and costs are included and what is excluded.
- 5 You must have clear timescales for the procurement process.
- 6 You must provide a clear payment mechanism.

7 You must comply with relevant data protection rules.

~~The manager may common practice to~~ use either an in-house or third-party procurement specialist to deliver ~~best~~ value for money solutions. ~~Where not explicitly included as long as part of the manager's duties under the management agreement and if~~ the purpose is to achieve greater cost-effectiveness and value for money. ~~The, the reasonable~~ cost of any procurement specialists employed ~~is considered to~~ may be recoverable through the service charge, ~~but, It is not considered appropriate or acceptable to include procurement fees as part of the costs~~ gross cost of providing a particular service. Managers should ensure that there is transparency in procurement fees, which should be clearly identified in the service charge report, along with details of whether it is a one-off fee or is to be spread over the duration of the contract (see appendix C). Appendix B).

It is intended that the fee payable should reflect the work undertaken, which may also be performance-related.

~~It is the responsibility of the manager or the procurement specialist to develop procurement systems; vet and select the most appropriate contractors, based on track record, skill and management experience; and prepare a contract and specification – including Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE) information – where appropriate. Contract costs are to be transparent and in accordance with the provisions for transparent accounting.~~

~~The manager or procurement specialist is~~ Managers or procurement specialists are expected to be responsible for the provision of full pre-qualification assessments of suppliers and contractors ~~in terms of their; including verifying contractor financial standing, health and safety records and environmental credentials, etc.~~

- ~~financial standing and proven compliance with health and safety~~
- ~~appropriate indemnity in respect of the services provided, including any undertakings via subcontractors (with provisions for prior approval thereof) and~~
- ~~proven environmental/sustainability credentials.~~

~~Whether or not managers employ procurement specialists their approach to the procurement process outlined in this section should be transparent.~~

~~Managers should ensure that there is transparency in procurement fees and charges for verifying contractor financial standing, health and safety records, and environmental credentials, etc. including cost or fees charged either to their client or the suppliers and contractors.~~

If any fees are received from suppliers or contractors, the manager should clearly state, in the service charge accounts, what these are and what they are for. Managers should also be aware that the practice of requesting fees (other than a reasonable administration charge) from contractors for inclusion in approved contractor lists, contract tendering, etc., is contrary to best practice, and is wholly inappropriate under any circumstances.

~~On receipt of tenders, a tender report should be prepared containing recommendations on which contractor is most suitable.~~ Copies of all tender documents should be made

available for inspection, if requested. If further copies are required, ~~the manager is managers are~~ entitled to charge for the time, cost of copying and postage of such documents. ~~Best practice is that the tender report and recommendations should be reviewed and approved by someone who is not directly connected with managing the actual delivery of the services on site.~~

~~Owners~~Landlords and/or managers are often able to achieve substantial savings and other benefits in the provision of services through bulk purchasing or through the placing of group contracts. However, the pricing of services under such contracts can often differ in ~~either~~ providing a single-contract sum, a separate cost per property or a schedule of rates for different services.

Where such bulk or group contracts exist, ~~occupier~~tenants are not entitled to have access to documents relating to properties other than the one they occupy. However, where the contract/tender includes other properties, transparency in terms of the apportionment and allocation of costs to the subject property is essential.

Where contracts are reviewed, it is reasonable that costs associated with achieving beneficial change, such as termination of contracts, are recovered under the service charge. This is applicable where such costs can be justified~~evidenced~~ following the analysis of reasonable options, and where the purpose is to achieve greater value for money and cost-effectiveness.

#### **4.1.53 Value for money**

Service provision and quality is to be appropriate to the location, use and character of the property. ~~The manager~~Managers should procure quality service standards to ensure that value for money is always achieved ~~at all times~~. The aim is to achieve effective, value for money service rather than the lowest price.

~~Occupiers are to be proactive in assisting managers with operating and using services that are consistent with the aim of achieving value for money, for example, separating waste to facilitate appropriate and cost-effective recycling.~~

~~The manager is to~~Managers should keep all costs under review, and where appropriate (generally every three years), ~~require contractors and suppliers to submit contracts should be re-tendered or~~ competitive ~~tenders or provide competing~~ quotations obtained. However, where it is considered that formal re-tendering would not be cost-effective or practical, ~~the manager~~managers should regularly benchmark the service standards and pricing to confirm that value for money is still being achieved.

In this context, 'regular' is subject to interpretation as to what is reasonable in the circumstances. Annual reviews may, ~~in certain circumstances~~, be considered excessive and not cost-effective, whereas three-yearly might be reasonable, but ten-yearly would not.

Managers should require major service providers to demonstrate that their services, methods and processes are continually reviewed to ensure value and efficiency.

#### **4.1.64 Direct recoveries**

Service charges usually include the cost of utilities for any common parts and services. Traditionally, buildings and/or rent insurance is apportioned to occupiers payable by tenants outside of the service charge arrangement as a directly recoverable cost, with occupier~~st~~tenants often being responsible for payment of electricity ~~& and~~ gas consumption supplied to the occupied premises direct to the utilities provider. In some circumstances, however, the lease may provide for the cost of buildings insurance and demised electricity to be recovered within~~in~~ the service charge.

Where owners~~landlords~~ are seeking to recover the cost of insurance and utilities outside of the service charge arrangement, occupier~~st~~tenants are entitled to expect the same level of transparency and accountability, etc. in these services, since this professional standard is also applicable to these.

#### **4.1.6.15 Insurance**

##### **Value for money**

Where ownersandlords are responsible for insuring the property, the insurance policy terms should be fair and reasonable and, represent value for money, and be placed with reputable insurers.

Policies commonly include an ability to note the interest of tenants either generically or individually, as well as any subrogation waivers and non-invalidation provisions for the benefit of the tenant. Again, these should be in line with lease obligations.

While insurance premiums are usually billed outside the service charge, landlords and managers should also adopt a fair and reasonable manner of allocation and provide details of the building apportionment, when requested.

##### **Commission and other financial incentives**

The principle of commission retention (at a reasonable level to reflect the work undertaken) is now long established. In its base form, the use of commission to cover administrative costs – including broker fees – is to be recognised, also the owner'slandlord's ability to benefit from the economies of scale generated by the pooling of risks into a common programme.

OwnersIn accordance with the principles that the landlord should not profit from the provision of services or that it should only recover the actual costs incurred in the provision of services, where advantageous rates are secured, for example, from placing a group contract, the value of any discounts should be passed on to tenants in full. This includes any form of incentivised rebates linked to policy performance.

Landlords, managers and related entities should at all timesalways disclose any remuneration, commission, rebates and other sources of income and related income or other benefits received in connection with placing or managing insurance and details of any arrangements that impact on the level of premium or commission, e.g. for example, captive entities.

##### **Service**

###### **Owners are obliged to Insurance claims**

Landlords should provide full insurance details on request, and to be able to explain the process by which occupierstenants can make claims under the policy. Owners should also provide details of the basis of apportionment of the

Where service charge funds are used to carry out works subject to an insurance premiumsclaim, managers are required to disclose all pending insurance claims in the service charge year end accounts. This is particularly relevant where the costs of any claim have been included in the service charge accounts but the claim has not yet been settled and a credit to the service charge accounts is therefore awaited.

Policies are expected to include an ability to note the interest of occupiers either generically or individually, as well as any subrogation waivers and non-invalidation provisions for the benefit of the occupier. Again, these are to be in line with lease obligations.

#### 4.1.6.2 Utilities

Where a service is provided directly to an occupier tenant or to the occupied premises – such as mains water or electricity supply as distinct from common works and services – it is important that the manager managers and occupier tenants understand the basis on which the service is provided, and whether the costs are intended to be included within in the service charge account, or are to be issued as a separate charge.

Separate metering, or full submetering of utility supplies, is considered essential to ensure an apportionment of cost between occupier tenants that reflects actual consumption and usage.

Costs Consumption should be recovered in accordance with the terms of the leases, which ought to should allow additionally for the payment of a reasonable administrative charge. The recovery should state unit costs and the basis of the manager's or any other administration charge. Therefore, if an administration charge is levied by the manager it should be transparent and clearly communicated to occupiers. The recovery should include copies of the original utility invoices in order to comply with the requirements for transparency set out in this professional standard.

To avoid ambiguity, and to further ensure that accurate consumption and billing is recorded for occupier tenants, it is recommended best practice that the cost of reading meters (where carried out by a third party) is included as an acceptable cost under the service charge. Otherwise, such costs would usually comprise part of the on-site management costs. The installation of additional meters to deliver improved cost apportionment or recharge may be deemed legitimate service charge expenditure where the cost benefit is in the interests of some or all tenants.

Occupiers should be aware of the ever increasing pressure placed on owners by utility providers for prompt payment and should, therefore, ensure that all invoices are paid promptly. In certain circumstances payments in advance may be appropriate.

It is now also becoming increasingly common practice for utility companies to request that owners landlords either pay large security deposits or higher energy rates.

Where a lease makes specific provision for the inclusion of a security deposit as a service charge cost, both owners landlords and occupier tenants are urged to ensure that the lease allows for the occupier's tenant's proportion of the deposit to be reimbursed on expiry, or alternatively on sooner determination of the lease, in the event of a change of owner landlord/manager, or if the deposit is otherwise reimbursed by the utility company.

Where a lease makes no such provision, it is considered appropriate for the owners to open a dialogue with occupier landlords to seek to agree an agreement with tenants to pay a security deposit in return for contract supply rates, as opposed to default supply rates.

The payment of a deposit can be included in on-account payments for the relevant service charge period, credited at year – end and then re-budgeted for the following period. Therefore, if a lease expires in any given period, the occupier tenant should receive an appropriate credit in their final service charge balance.

#### **4.1.7 The Heat Network (Metering and Billing) Regulations**

The Heat Network (Metering and Billing) Regulations 2014 (the Regulations) implemented the requirements in the EU Energy Efficiency Directive and came into force on 18 December 2014. The Regulations aim to give consumers better control over the energy they consume in heating and cooling their premises.

The duties under the Regulations apply to a 'heat supplier'. A landlord is a heat supplier if all of the following apply:

- there is a distribution of thermal energy in the form of steam, hot water or chilled liquids from a central source in a building
- the thermal energy is used to provide heating, hot water or cooling
- the building is occupied by more than one final customer and
- the landlord bills more than one tenant for the heat or hot water that that person has used (or a proportion of).

The Regulations require, among other things, for landlords to install meters to measure the consumption of heating, cooling or hot water supplied to each tenant and to ensure consumers' bills are accurate and based on actual consumption.

The Regulations further require that at least once a year the bill must be based on an actual reading and that bills must be issued at least quarterly if provided electronically, or at least six monthly otherwise.

Compliance with the Regulations can have serious and unintended consequences for managers of service charges. Principally, most commercial leases provide for landlords to issue an estimate of anticipated expenditure for the forthcoming service charge period, for the tenants to pay a sum 'on account' during that service charge period, with a reconciliation carried out at the end of the service charge period of the actual expenditure against the original budget.

It is unlikely that leases would envisage or facilitate the landlord to demand, or for the tenant to pay, additional interim or regular demands for the cost of energy consumption from the landlord's central plant.

Government advice produced in November 2019 confirmed the Regulations are a statutory instrument that have effect in criminal law. The Regulations, therefore, override the terms of the occupational leases, as failure to comply would constitute a criminal offence.

Therefore, managers should clearly communicate to tenants the requirements under the Regulations and recognising this may be incompatible with the procedures set down in the lease, but is nevertheless a statutory obligation.

#### **4.2 Allocation and apportionment**

##### **4.2 Allocation and apportionment**

The best practice recommendations in this section will help RICS members and RICS-regulated firms achieve the following mandatory requirements:

2 Subject to section 4.2.7, owners and managers**Managers** **must** seek to recover no more than 100% of the proper and actual costs of the provision or supply of the services.

~~3 Owners and managers 4 Managers~~ must ensure that a service charge apportionment matrix ~~for their property is provided annually, which clearly shows the detailed basis of calculation and the total apportionment per schedule for each unit, is provided with the budget and service charge account~~ to all tenants.

#### **4.2.1 Schedules**

~~Costs should be fairly and reasonably allocated to the relevant expenditure category. Where reasonable and appropriate, costs should be allocated to separate schedules and the costs apportioned to those who benefit from those services.~~

The basis and method of allocating and apportioning the service charge expenditure ~~is to~~ should be transparent and clearly communicated to all. Any inducements or concessions to attract ~~occupier~~tenants to a property should be borne by the ~~owner, landlord~~ and not spread among other ~~occupier~~tenants. The rationale for the apportionment between ~~occupier~~tenants should be set down in writing, and re-examined periodically to ~~see~~ assess whether there is a need for a new apportionment matrix or ~~new apportionment~~ method to be applied.

~~If any change to the basis of apportionment is considered appropriate or necessary, such amended apportionment should be rational, reasonable and clearly communicated to tenants. Such changes should reflect longer term changes in the benefit, use and apportionment, for example, closure and subdivision of a former major anchor unit. For example, a landlord should not be permitted to amend a weighted floor area basis of apportionment (see subsection 4.2.3) to reduce the landlord's own exposure to a shortfall in the recovery of service charges due to void or vacant premises.~~

#### **4.2.1 Schedules**

In many cases, particularly regarding buildings with a variety of users, not all ~~of~~ the ~~occupier~~tenants will benefit from the services to the same extent. ~~In such circumstances, it may~~ ~~Where reasonable and appropriate, costs should~~ be ~~necessary~~ ~~allocated to~~ ~~divide the service charges into~~ separate parts ~~(or~~ schedules) to reflect the availability, benefit and use of services, ~~with each part being individually apportioned between occupiers according to the core principles. The allocation of costs to separate schedules is essential in achieving a fair and proper apportionment of costs between those occupiers and apportioned to those~~ that benefit from ~~those~~ specific services. ~~Occupiers~~Tenants will, therefore, often pay different percentage apportionments under different schedules.

#### **4.2.2 Flexibility**

It is worth considering that the availability, benefit and use of the services ~~within~~in a building, and the demand for those services by individual users, could vary over time – therefore, leases would benefit from being drafted to include flexibility and variation. ~~For example, additional units may be created or the use of a property may change, causing different demands for services and necessitating a change to the costs/payments structure. Even with the grant of shorter term leases, the ability to change allocation and apportionment methods, where necessary and appropriate, could~~

~~be made available during the term to ensure service charges are spread fairly and reasonably between beneficiaries and users, over time.~~

#### 4.2.3 Void and unlet premises

~~Occupiers are not expected to be liable for the costs attributed to unlet premises; the owner should meet the cost of these~~, as well as any special or personal concessions given to individual ~~occupiers~~.

~~Owner~~tenants. ~~Landlords~~ are also responsible for bearing a fair proportion of costs attributable to their own use of the property, for example, where an on-site management premises is also used for other purposes unconnected with the day-to-day management of the building and services.

#### 4.2.4 The apportionment matrix

~~Managers are to~~To enable an individual tenant to verify the basis on which their proportion of the service charge has been calculated, managers **must** provide a full apportionment matrix to all ~~occupier~~tenants that clearly shows the basis and method of calculation, including any applied weighting (see subsection 4.2.8), and the total apportionment per schedule for each unit ~~within~~in the property/complex. ~~For the avoidance of doubt and to~~To preserve confidentiality, this should exclude details of any individual concessions or other arrangements between individual ~~owner~~landlords and ~~occupier~~tenants; these are costs that are normally ~~to be~~ borne by the ~~owner~~. ~~An individual occupier should be able to clearly verify the basis and method~~landlord. Note that provision of ~~calculation used in arriving at their percentage~~an apportionment matrix as described above is **not** considered to be an infringement of General Data Protection Regulations (GDPR).

#### 4.2.5 Floor-area apportionment

Apportionment based on floor area is the most common and often the simplest method of apportionment. The standard floor-area apportionment is the ratio the premises bear to the total lettable parts of the building or estate.

Measurements should be done in accordance with the current edition of RICS property measurement, that sets out definitions of the measurement of buildings and their applications.relevant RICS property measurement guidance. Where the service charge is apportioned based on floor area, managers should ensure that the method and basis of measurement used is consistent. In certain situations, it may be appropriate to apportion costs allocated to separate schedules using different methods of measurement, but different measuring methods should not be used in the same schedule.

The basis of measurement used should be clearly communicated to tenants together with confirmation of how the floor areas have been established, for example, from computer-generated drawings, other drawings or by laser or tape measurement, and whether ~~or not~~ the areas have been verified by an independent third party.

So far as they are able, occupierstenants are expected to check be responsible for checking and verify verifying the accuracy of the details in respect of their own premises and raise any anomalies or errors with the manager without undue delay.

#### **4.2.6 Rateable value apportionments**

Rateable values are no longer recommended as an appropriate method for calculating service charge apportionments.

Rateable values take account of a variety of factors relating to value, such as location, etc., and do not generally reflect a reasonable assessment of the benefit and use of common services.

While manySome older leases may require service charges to be apportioned based on rateable value, with no provision for any alternative basis to be used and notwithstanding that this professional standard cannot override the contractual terms of any lease, it. It is nevertheless the view of the RICS Service Charge Code working grouprecommended that rateable value apportionments should be changed to such other recognised methods of apportionment consistent with the aims and aspirations as set out in this professional standard.

Where the use of rateable value apportionments is unavoidable, ownerslandlords and managers should be aware that rateable values may change over time as occupierstenants have the right to appeal against assessments by the Valuation Office Agency. In such circumstances, it is considered best practice to use the values in the rating list at the service charge year end date. The date of the rating list and rateable values used should be clearly communicated to occupierstenants.

In respect of mixed-use schemes, it is also important to recognise that the system of domestic rates was abolished many decades ago.

#### **4.2.7 Fixed percentage or fixed amount**

In some instances, the amount or percentage of the overall service charge costs the occupienttenant pays may be fixed at the time the lease is granted. The fixed percentage or amount offers certainty and simplicity but is inflexible. However, it may be advantageous for short leases where the property or the costs, standard and level of services provided, are unlikely to vary significantly. Provision is often included to review the fixed percentage if the property is altered or extended.

Fixed amounts or fixed service charge percentages can give rise toresult in situations where the total service charge recoverable can be less than or greater than 100% of the actual cost of providing the services. In such circumstances, and notwithstanding the principle that ownersmanagers **must** seek to recover no more than 100% of the proper and actual costs of the provision or supply of the services, the terms of the lease remain paramount, and this professional standard cannot override the terms of the lease.

When dealing with the renewal of leases containing fixed amounts or percentages, all parties are encouraged to take reasonable steps to ensure that the terms of the lease reflects the best practice principles set down in this professional standard.

## 4.2.8 Apportionment of service charges in shopping centres:weighted-floor area apportionment and mixed-use schemes

### 4.2.8.1 Weighted floor area apportionment

In addition to the usual recommended methods for the apportionment of service charges, many shopping centre developments often feature a 'weighted-floor area' basis of apportionment that seeks to reflect the different costs involved in servicing different sized units.

A weighted-floor area apportionment discounts the percentage the occupiertenant pays over a certain size to reflect the benefit of the services provided. The floor area is divided into bands with a progressive discount, and is a similar concept to the zoning of shops for rental purposes.

For example, a 5,000m<sup>2</sup> unit may not cost five times that of a 1,000m<sup>2</sup> unit, but a 500m<sup>2</sup> unit may cost twice that of a 250m<sup>2</sup> unit.

There is no such thing as a standard weighting formula. Where the use of a weighted formula is considered to be appropriate, this is to should be formulated to reflect the particular circumstances, size of units, layout and use of the scheme being serviced (see below).

The following is for illustrative purposes only:

The first 500 m<sup>2</sup> @ 100%

The next 500 m<sup>2</sup> @ 80%

The next 2,000 m<sup>2</sup> @ 70%

The next 2,000 m<sup>2</sup> @ 60%

Excess over 5,000 m<sup>2</sup> @ 50%

In this example, a 1,000 m<sup>2</sup> unit has a weighted floor area of 900 m<sup>2</sup> [i.e. (500 x 100%) + (500 x 80%)] whereas a 10,000 m<sup>2</sup> unit has a weighted area of 6,000 m<sup>2</sup>. Although 10 times larger in floor area, the 10,000 m<sup>2</sup> unit pays approximately six and a half times the service charge of the smaller unit.

#### **Example of a weighted floor area apportionment**

The following is for illustrative purposes only.

The first 500m<sup>2</sup> @ 100%

The next 500m<sup>2</sup> @ 80%

The next 2,000m<sup>2</sup> @ 70%

The next 2,000m<sup>2</sup> @ 60%

Excess over 5,000m<sup>2</sup> @ 50%

In this example, a 1,000m<sup>2</sup> unit has a weighted floor area of 900m<sup>2</sup> [i.e. (500 x 100%) + (500 x 80%)] whereas a 10,000m<sup>2</sup> unit has a weighted floor area of 6,000m<sup>2</sup>. Although ten times larger in floor area, the 10,000m<sup>2</sup> unit pays approximately six and a half times the service charge of the smaller unit.

Similarly, the floor area of ancillary basement and upper-floor accommodation, or of remote storage, might be discounted to reflect the reduced benefit derived from certain services as distinct from the ground-floor retail space or main offices.

However, weightings should not generally be used to make an adjustment for services that are not provided (see subsection 4.2.1).

For the avoidance of doubt, a reasonable and fairly administered weighting formula for apportionment of the service charge cannot usually be considered a concession.

#### **4.2.8.2 Mixed-use schemes**

The mixture of commercial and residential uses presents challenges that will often require both residential and commercial service charge management skills and expertise.

The extent to which the landlord will be obliged to provide and carry out works and services will, in respect of both commercial and residential leases, depend on a strict

interpretation of the wording of the lease. The *Landlord and Tenant Act 1985*, subsequently amended by the *Housing Act 1996* and *Commonhold and Leasehold Reform Act 2002*, imposes statutory constraints in respect of service charges for residential properties.

It has been a common misconception among many practitioners that if the residential element of a mixed-use scheme was 'let' under a single head lease, it would not be subject to the residential legislation. The cases of *Heron Maple House Ltd v Central Estates* [2002] 1 EGLR 35 and *Oakfern Properties Ltd v Ruddy* [2006] EWCA Civ 1389 have determined that a landlord of a lease that includes both residential and non-residential elements must follow the statutory procedures laid down by the *Landlord and Tenant Act 1985* (as amended) to ensure that non-recovery does not result due to an infringement of the legislation designed to protect residential occupants only.

See the current edition of RICS' Service charge residential management code.

However, not all mixed-use schemes include residential property. A mixed-use scheme might also involve a variety of different commercial uses such as retail, offices and leisure.

Nevertheless, for mixed-use schemes it will often be necessary to consider the direct benefit and use of services relevant to different types of tenant. This may be useful when considering the relative weighting of charges to different tenants or groups of tenants.

Residential leases in mixed-use schemes should also be flexible to cope with changes to the basis of apportionment that may be reasonably necessary over time.

Residential leaseholders have the option of challenging the payability of service charges at the First Tier Tribunal (FTT), and where a specific apportionment is not set in the lease, this could extend to the reasonableness of the apportionment methodology used. Although there is no requirement for costs to be allocated according to the most reasonable split, there should be a defendable rationale behind both individual apportionments and any commercial/residential split. The FTT has no jurisdiction to determine the level of commercial service charges payable, but any determination of residential service charges may, by default, lead to the landlord having to meet any shortfall not recoverable under the commercial leases.

### **Building Safety Act 2022**

The *Building Safety Act 2022*, which received royal assent on 28 April 2022, is primary legislation and establishes an effective regulatory framework for the construction industry and introduces clearer standards and guidance regarding the responsibility for fire and building safety throughout the life cycle of higher-risk buildings.

It applies to a self-contained building, or self-contained part of a building, which is at least 11 metres high or has at least five storeys and contains at least two residential units.

The Act provides that no costs relating to the remediation of a 'relevant defect', for example, the removal and replacement of external cladding, will be recoverable from

leaseholders and that the landlord should be liable for any such remedial works to the building.

Crucially in that respect, the Act makes no distinction between residential and non-residential premises and, therefore, the exclusion from the recovery of costs applies to both commercial and residential premises.

#### **4.2.8.3 Estate charges**

In a large mixed-use scheme, which provides common areas accessible to the public, all tenants might be considered to have the availability, benefit and use of the public areas. However, in apportioning the costs of maintaining and servicing these areas (often referred to as an 'estate charge'), consideration should be given to the manner and way in which different tenants operate and use the estate.

For example, while it might reasonably be assumed that all tenants benefit from maintaining the exterior and structure of the building in good repair in direct proportion to the space occupied, a direct floor area comparison may not be appropriate for certain 'soft' services, such as cleaning of the public areas comprising the estate. For example, retail tenants might generate a significantly greater footfall in terms of customers and, therefore, benefit from a significantly higher utilisation of the public realm, compared with office or residential tenants.

However, detailed consideration is needed when considering the application of weightings to reflect the user as it should not automatically be assumed that the commercial tenants of a mixed-use scheme necessarily benefit proportionately more from the provision of the estate services compared with the residential tenants. The design and layout of a scheme will be a contributing factor. For example, retail tenants may generate significant footfall where the scheme is intended as a 'destination' shopping location, but the reverse may be true if the retail element of the scheme is considered as ancillary to the residential or other elements of the scheme. Similarly, the hours of use might be a factor where leisure operators (such as cinemas, bars, restaurants, etc.) might trade for periods longer than other commercial and non-commercial tenants.

In such circumstances, the aim is to achieve an apportionment of the service charge that is fair and reasonable to all tenants and reflects the commercial realities that some schemes are underpinned by the presence of commercial premises without which the scheme would not exist. In the case of mixed-use schemes that include residential, the charges applied to the residential elements should fairly reflect acceptable market tolerances and fundamentally constitute a reasonable charge to levy on that use for the services supplied.

Commercial leases typically contain greater flexibility than residential leases, with the ability to change the basis of apportionment to reflect changing circumstances and factors. However, residential tenants usually require greater certainty over future costs and seek to have the contribution towards service charges stated as a fixed percentage in their leases. However, in accordance with the principles set out in this standard, landlords should bear the cost of any shortfall in residential allocation that might arise and not pass these on to the commercial tenants (and vice versa).

#### **4.2.9 Owner'sLandlord's cost/profit centres**

Where there is a separate cost or profit centre within in a property complex or estate that generates income for the owner landlord that is not credited to the service charge account, the costs associated with maintaining and running that cost centre should not be allocated to the service charge account (for example, car parks, EV charging, mobile phone masts, advertising, radio aerials, etc.). If the separate cost/profit centre derives benefit from building the building or estate, equipment staff or services that form part of the service charge, the cost/profit centre should be incorporated into the service charge matrix (for example, the car park, management office, etc.). Alternatively, owners landlords can estimate and declare a contribution to the service charge that reasonably reflects the benefit and use of the common services enjoyed.

#### **4.2.10 Tenant alterations**

Alterations carried out by tenants may have an impact on or affect the calculation of the apportionment of occupier tenant service charge liabilities.

Tenant alterations that change any factor on which the apportionment calculation is based (such as, but not limited to, floor area, rateable value, or the extent of use and benefit of the services derived) might determine whether adjustments to tenant service charge apportionments would be appropriate.

In the case of a warehouse or distribution centre, the introduction of an additional mezzanine floor, in preference to full eaves-height racking, may not affect or increase the utilisation of the premises, and, therefore, the use and benefit of the common services.

However, a mezzanine floor installed in a unit on a retail park might generate additional sales and customer footfall, with a corresponding increase in goods deliveries, etc. and an increase in the enjoyment, use and benefit of common services such as parking, security, cleaning, etc.

While this situation can often present a dilemma for the landlord, the answer may often be found in the precise wording of the lease. If the lease makes specific reference to the basis on which the service charge apportionment is to be calculated – for instance example, for the floor area –, the landlord would be obliged to factor in the additional floor area of the demised premises to the apportionment matrix.

Where the lease does not make specific reference to the basis of apportionment and refers, for instance example, to a 'fair and reasonable proportion as determined by the landlord's surveyor', the landlord's surveyor, acting as an expert, manager is be required to adopt a basis of calculation that conforms with the basic principles of service charge apportionment. This would need to should be demonstrably fair and reasonable to ensure that individual tenants bear an appropriate, fair and reasonable proportion of the total service charge expenditure that reflects the benefit of the services enjoyed.

When dealing with alterations to premises – particularly where these require the prior consent or approval of the landlord – it is always desirable that careful consideration should be given to the potential impact on the calculation of the service charge, to

ensure that the apportionment continues to be fair and reasonable. This is in view of the underlying principles set out in this professional standard.

~~Landlords are also advised~~It is advisable to consider including appropriate wording ~~within~~in any licence for alterations to clarify the position and basis of calculation of the service charge for the future.

### 4.3 Communication and consultation

The best practice recommendations in this section will help RICS members and ~~RICS~~regulated firms achieve the following mandatory ~~requirement~~requirements:

~~3 Owners~~2 Managers **must** seek to recover no more than 100% of the proper and ~~managers~~actual costs of the provision or supply of the services.

~~3 Managers~~ **must** ensure that ~~service charge~~issue to tenants:

~~budgets, including appropriate~~an explanatory commentary~~are at least one month prior to the start of the service charge year~~

~~an approved set of service charge year end accounts showing a true and accurate record of the actual expenditure constituting the service charge within four months of the service charge year end.~~

~~Where these timescales cannot be met, a timely explanation **must** be provided of when they will be issued annually to and the reason for the delay in line with the mandatory communication provisions. This does not dispense with the obligation to provide both. Where there is a legitimate reason for the delay in issuing budgets or reconciled year end accounts, managers **must** use all reasonable endeavours to issue these as soon as practicably possible.~~

#### 4.3.1 Communication

~~As poor communication often gives rise to disputes, effective~~Effective communication is key to achieving best practice. ~~Here the~~The aim is to provide ~~full~~full transparency ~~between manager and occupier~~on all service charge matters in the way services are provided and managed, and in how the costs of these services are recovered. Communication ~~needs to~~should be timely and continuous, and ~~works best~~is most effective when managers and ~~occupier~~tenants deal with each other's ~~reasonable~~ enquiries and ~~reciprocal~~ obligations promptly and efficiently.

~~Managers are advised to seek feedback from occupiers on the performance management standards and service delivery, and take any action on this feedback as appropriate.~~

~~It is also important to have a clear communication structure.~~ Best practice requires managers to provide ~~full transparency on all service charge matters to include budget and reconciliation information and, if requested,~~ access to copy invoices that make up the service charge expenditure. This can be achieved, for example, by providing tenants ~~and occupiers~~ with access to a password protected web portal that holds all ~~of~~ this information.

However, for larger properties with a high volume of transactions, it might be more practical to provide sufficiently detailed invoice and expenditure listings to enable the tenant to identify specific invoices for review.

Where hard copies of the supporting documentation concerning the certified accounts are supplied, managers are entitled to make a proper and reasonable charge for the time, cost of copying and postage of such documents. However, where this information is held in existing electronic files, easily to hand and transmitted by email, it is expected that any charges would be nominal.

Where hard copies of the supporting documentation concerning the certified accounts are supplied, the manager is entitled to make a proper and reasonable charge for the time, cost of copying and postage of such documents. However, where this information is held in existing electronic files, easily to hand and transmitted by email, it is expected that any charges would be nominal.

Best practice requires managers to hold regular meetings with occupiertenants, and occupiertenants have a duty of care to participate in these meetings and to be proactive in informing managers of the key contacts who deal with service charges. However, where the occupiertenant is a large company or multiple retailer for instance, it is advisableimportant to ensure appropriate communication takes place with the occupiertenant's head office, as local staff may not be fullyawareof or knowledgeable of service charge matters and the potential cost implications for which they may not have authority.

Managers arealsoobligedtoshould make key contact information available to occupiertenants – for instanceexample, the managementsurveyormanager, credit controller, accounts clerk, etc. – as well as the names of any on-site staff, along with their roles and responsibilities.

Managers aretoprovideoccupierswithacopyofthemanagementpolicy, whichshouldcontainrefertotheircomplianceandtheexistenceofthisprofessionalstandardinformationabouthowthepropertyismanagedandtheaimsofthemanagementteam(e.g.themanagerintheircommunication,budgetoryear-endpacksandtheon-siteteam).makeacopyavailableifrequested. Managers should also inform occupiertenants of any future plans for the property, particularly if these are likely to have an impact on the service charge.

#### **4.3.2 Consultation**

Managers of residential premises arerequiredtomust follow statutory consultation procedures, and shouldbekeenlyawarethatiffailuretofollow the proper procedure isnotfollowed,maylimit the amount theythatcanrecovermightbelimitedrecovered.

Managers of commercial property are not generally obliged to 'consult' with occupiertenants prior to incurring costs that are ultimately to be recovered under the service charge arrangement. However, some commercial leases might set out certain procedures to be followed, perhapsforexample, prior to incurring large extraordinary costs, such as major fabric or plant replacements, etc. The courts have recently ruled in anumberofseveral instances that ownerslandlords are obligated to follow the terms of

leases strictly when recovering service charges. Therefore, to ensure recovery of the service charge, managers should take particular care to follow exactly the procedures as set down withinin the lease.

Even where the lease is silent, it is considered best practice for managers to consult with occupiers with regard to tenants regarding the standard and quality of the service charge provision(s) required. While the manager has a duty to manage the property and will not wish to avoid expenditure that might have a detrimental effect on the owner'slandlord's investment, managers should ensure that the standard of service provision (and therefore the cost to occupiertenants) does not unnecessarily exceed the reasonable requirements and needs of the occupiertenants.

#### **4.3.3 Budgeting and cost review**

It is the manager's duty to keep expenditure under constant review in order to identify any unforeseen variances and to notify occupiertenants accordingly.

When significant variances in actual costs against budget are likely, it is good practice for the managermanagers to notify occupiertenants promptly and within the current service charge year. When substantial works are planned, summary details of the results of tenders and the process used should be communicated to the occupiertenants, together with full information on the programme of works, costs and the process to be adopted for keeping occupiertenants informed.

Occupiers are entrusting their business overheads/operating costs to an external manager, and as such are entitled to be notified of any significant or material variances to the forecast as soon as possible.

Whether a variance against forecast is to should be regarded as significant or material will often be a subjective assessment, dependent on a variety of issues such as the size, nature and type of property and the amounts payable by individual occupiertenants. Prompt notification of unforeseen variances in the total annual spend should be made to all occupiertenants with an explanation as to how this is being mitigated at the earliest opportunity.

##### **For example:**

On an annual service charge budget of £5,000,000, an aggregate variation (+/-) of £5,000 (1%) may not be considered material. However, if the same variation was against a single cost heading or cost code of say £10,000, representing a 50% variation, this would be considered to be material.

However, an aggregate variation of £5,000 against a £100,000 annual budget would be material, irrespective of whether the cost related to a single or multiple cost headings.

#### **4.4 Dealing with existing and new leases**

The best practice recommendations in this section will help RICS members and RICS-regulated firms achieve the following mandatory requirements:

- 1 All expenditure that the ownerlandlord and manager seek to recover **must** be in accordance with the terms of the lease.

2 Subject to section 4.2.7, owners and managers<sup>2</sup> Managers **must** seek to recover no more than 100% of the proper and actual costs of the provision or supply of the services.

87 Where acting on behalf of a tenant, practitioners **must** advise their clients that if a dispute exists any service charge tenants are not generally entitled to withhold payment withheld by the tenant should reflect only the actual sums in dispute of service charges that have been properly demanded. However, in certain circumstances withholding of payment of any difference arising from mathematical or computational error may not be considered unreasonable (section 4.4 and 4.6).

98 When acting on behalf of a landlord, practitioners<sup>managers</sup> **must advise their clients<sup>ensure</sup> that, following resolution of a dispute, any service charge that has been raised incorrectly should be adjusted to reflect<sup>correct</sup> the error without undue-delay. (sections 4.4 and 4.6).**

#### 4.4.1 Existing leases

The basis by which service charges are operated and managed is set out in the lease.

Many service charge disputes are caused by the failure of managers and/or occupier<sup>st</sup>tenants to read and properly understand the respective obligations and liabilities under the contractual arrangement made between them. Therefore, care and attention is required to understand the contractual basis of the service charge arrangements properly.

Existing leases may contain service charge provisions that differ from the recommendations in this professional standard. Where this is the case, this professional standard cannot override the lease, but existing service charge clauses are to be interpreted as far as possible in line with the principles and practices set out here<sup>in this professional standard</sup>. This applies unless the lease specifically stipulates a different approach, which, therefore, has legal force.

Where doubt or possible ambiguity exists, it is recommended that specialist professional advice be sought. Where an existing lease lacks the necessary guiding provisions to manage the service charge process, the requirements of this professional standard should apply.

#### 4.4.2 New leases

As new leases are granted and older leases renewed, it is essential to bring service charge clauses up to modern standards. If modernisation of the service charge provision of the lease is required, both to meet best practice and in the interests of compatibility with other occupier<sup>st</sup>tenants, and this results in an increase or decrease in the amount payable by the occupier<sup>tenant</sup>, this is to<sup>should</sup> be taken into account<sup>considered</sup> in any negotiations – for instance<sup>example</sup>, as reflected in the rent payable.

While this professional standard cannot override the lease, it does set out the industry-accepted best practice in the field of service charges. It will help solicitors, their clients (be they owners<sup>landlords</sup> or occupier<sup>st</sup>tenants) and the managers of service charges to draft, interpret and operate leases in accordance with best practice.

It is recommended that owners<sup>occupiers</sup>landlords<sup>tenants</sup> and their solicitors ensure the lease they sign reflects this professional standard, which will enable more effective,

business-focused service charge management during the course of the lease. Terms should be relevant and appropriate, recognising the length of the lease term, and the scale and type of property concerned. At the time of lease renewal, the service charge clauses will certainly require review and probably modernisation and updating. It is recommended that new leases be drafted with sufficient flexibility to allow for changes in best practice.

~~The attention of owners~~Landlords, managers and ~~occupiers~~is tenants should also ~~drawn to be aware of~~ the Code for Leasing Business Premises, ~~current edition of the Code for leasing business premises~~, which provides further guidance for negotiations before the grant of a new lease ~~or~~ and at the time of any lease renewal ~~in creating a document~~.

The City of London Law Society has previously drawn up service charge lease provisions that is clear, concise and authoritative, ~~reflected the provisions of the code at the time~~. These may also be subject to review and updating, therefore, it is recommended that interested parties keep abreast of any updates.

~~This document is currently being updated by RICS and will be released later in 2018.~~

It is unlikely that all leases ~~within~~in a multi-let property will fall for renewal on the same date. Modernising the service charges on an ad-hoc basis may lead to a 'dual' service charge, where in effect two service charge arrangements would operate in tandem, with one based on the older form of leases, and the other based on the modern form. Interim arrangements may, therefore, be necessary to ensure the practical operation of the services and the recoverability of the service costs during the intervening period until such time as all leases have been modernised. For example, renewal leases might reflect the ideal service charge regime going forward, as well as the status quo, so that when the tipping point is reached, the owner~~landlord~~ can swap~~swap~~ from the old lease service charge regime to the new.

#### 4.4.3 Sweeper clauses

It is often difficult to predict precisely what services might be provided through the duration of a long lease, and which are to be covered by the service charge. To avoid the risk of incurring costs that might fall outside of the service charge, most leases contain a 'sweeper' provision entitling the owner~~landlord~~ to charge, not only for the services specifically listed, but also for other miscellaneous services that might be provided in the future but only in the context of the existing services specified in the lease and sweeper clauses tend to be interpreted narrowly by the courts.

This is not usually a problem for short leases, however, as in these cases, it is far easier to accurately predict the services that are to be provided. Unless a lease incorporates very clear wording to the contrary, if the owner~~landlord~~ had in mind the provision of a service, but has not covered the right to include the cost of providing it in the service charge, the owner~~landlord~~ will not generally be able to use the sweeper clause as authority to recover the cost.

A sweeper clause cannot be used to cover the cost of something that was left out of the lease in error. The intention is to give the owner~~landlord~~ the ability to provide further services that are not identified or in contemplation at the time the lease was granted,

and that, for any reason, are considered necessary or desirable to be provided at a later time.

#### **4.4.4 Professional arbitration on court terms (PACT)**

~~The Civil Procedures Rules (CPR) determine that alternative dispute resolution (ADR) must be considered before litigation, or the parties risk a punishment of costs by the courts.~~

~~PACT is a scheme offered by RICS and the Law Society as a form of ADR for lease-renewal disputes.~~

~~The scheme provides the opportunity for owners and occupiers to have the terms and rent payable under their new lease decided by a surveyor or solicitor, acting as either an arbitrator or independent expert. It is important to note that any decision made by either an arbitrator or independent expert is legally binding.~~

~~The objective of the scheme is to increase the effectiveness and flexibility of the legal system, and to give a greater choice to owners, occupiers and their advisers through the lease-renewal process.~~

Where a landlord intends to rely on a sweeper clause to recover costs that are not otherwise specifically referenced in the service charge provisions, this should be clearly communicated to tenants.

### **4.5 Financial controls and competencies**

The best practice recommendations in this section will help RICS members and RICS-regulated firms achieve the following mandatory requirements:

- 1 All expenditure that the ownerlandlord and manager seek to recover **must** be in accordance with the terms of the lease.
- 2 Subject to section 4.2.7, owners and managers2 Managers **must** seek to recover no more than 100% of the proper and actual costs of the provision or supply of the services.
- 3 Owners and managersManagers **must** ensure that service charge issue to tenants: budgets, including appropriatean explanatory commentary, are issued annually to all tenantsat least one month prior to the start of the service charge year
- 4 Owners and managers must ensure that an approved set of service charge year end accounts showing a true and accurate record of the actual expenditure constituting the service charge are within four months of the service charge year end.
- 5 Owners andof when they will be issued and the reason for the delay in line with the mandatory communication provisions. This does not dispense with the obligation to provide both. Where there is a legitimate reason for the delay in issuing budgets or reconciled year end accounts, managers must use all reasonable endeavours to issue these as soon as practicably possible.

4 Managers **must** ensure that a service charge apportionment matrix for their property, which clearly shows the detailed basis of calculation and the total apportionment per schedule for each unit, is provided annually with the budget and service charge account to all tenants.

65 Service charge monies (including reserve and sinking funds) **must** be held in one or more discrete (or virtual) bank accounts.

76 Interest earned on service charge accounts—or where separate accounts per property are not operated, a proper and reasonable amount of interest calculated on normal commercial rates—**must** be credited to the service charge account after appropriate deductions (e.g. bank charges) have been made.

~~In this professional standard, references to Tech 09/14BL are to Tech 09/14BL Accountants' Reports on Commercial Property Service Charge Accounts issued by ICAEW in effect on the date of this standard and to any amended or replacement version of it. Where Tech 09/14BL refers to earlier versions of the RICS code of practice for service charges in commercial property it should be interpreted as if referring to this professional standard with such changes as may be required to give effect to the substance of the guidance.~~

#### 4.5.1 Accounting policies

Service charge year end accounts should include a comprehensive list of accounting policies and principles on which the accounts are prepared as well as other information, including:

- whether the accounts are prepared on an accruals- or, where permitted, cash-basis and
- the terms of reference of the independent accountant's review or audit and
- whether the owner/landlord has waived the exemption to charge VAT (opted also known as an option to tax).

#### 4.5.2 Other disclosures

Other information to be disclosed includes:

- a description of the intended purpose for any sinking fund or reserve fund, together with an explanation of the tax treatment of contributions to and interest earned on such funds, and details of the trust where such monies are held
- a statement of all contributions to and expenditure from the sinking fund or reserve fund account, together with the account opening and closing balances, and the amount of interest earned and tax paid in the relevant period
- a statement of any forward funding agreed and included in the service charge accounts
- a statement detailing how insurance claims are accounted for
- an analysis of any material variances between budget and actual expenditure, with a detailed commentary to explain trends and variances where these are significant and
- statements by the owner/landlord and/or manager, to approve the service charge year end accounts in accordance with subsection 4.5.3.2.

- Included in appendix C is details of all pending insurance claims where the service charge has funded and is to receive the insurance settlement and
- confirmation that the landlord has borne the cost of all void units and concessions.

See Appendix B for a sample report setting out the disclosures and information that managers should include in the service charge accounts.

#### **4.5.3 Approval and review of service charge year end accounts**

##### **4.5.3.1 The requirementsRequirements of the lease**

It is usual for leases to provide for an annual service charge year end accounts statement to be issued to occupiertenants following the end of each service charge period; this would normally include a summary of the costs and expenditure incurred in the provision of the services and a calculation of the service charge due. The lease may use different terminology (for instanceexample, referring to annual 'statements'), but in this professional standard such statements are 'service charge accounts''year accounts'. Where timescales are provided in leases these are not overridden by those in this professional standard.

Many leases will set out the procedures regarding the preparation of the service charge accounts, and will often require that they are formally approved by the landlord or on the landlord's behalf, for instanceexample, by the landlord's surveyor or managing agentmanager. Terminology used for this approval may vary from lease to lease. For instanceexample, leases may refer to the service charge accounts being 'certified'. -In this professional standard the term 'approval' refers to the equivalent process however described in the lease.

Leases might also require the accounts to be reviewed by an independent third party (such as a chartered accountant) and for the third party to report on their review. Again, terminology may vary from lease to lease. Where a lease requires an 'audit' to be carried out, the implications should be considered carefully as outlined herein this professional standard. In other cases, managers should determine what form of review would be most appropriate taking into accountconsidering the requirements of the lease (which will always prevail) and this professional standard.

It is essential that any contractual requirements in the lease be duly followed, including any requirement that an independent audit be carried out. Compliance with the requirements and procedures set down in the lease may be a 'condition precedent', and recent case law has determined that where a lease sets down specific requirements and procedures, a failure to comply may adversely prejudice the owner'slandlord's ability to recover such sums.

ManagersTherefore, managers should therefore ensure that service charge accounts are issued strictly in accordance with the procedures and requirements as set out under the terms of the lease.

##### **4.5.3.2 Approval of the service charge year end accounts**

The purpose of approval of the service charge accounts is toshould confirm that the accounts produced:

- represent the actual expenditure incurred by the ownerlandlord in supplying the services to the building and
- that the expenditure the ownerlandlord is seeking to recover is in accordance with the terms of the leaseslease and, where practicable, the provisions of this professional standard.

The accounts should be approved by or on behalf of the landlord as complying with these statements. In approving the accounts, the manager is required to act in a professional, non-partisan manner, and not supposing that the only task is to recover as much money as they can for the ownerlandlord.

The approver should be an appropriately qualified, competent person with experience in dealing with service charges. The approver should also recognise that in approving the service charge accounts, they have a duty of care to both ownerslandlords and occupiertenants to act with professional care, diligence, integrity and objectivity.

The lease might also set down the credentialsor qualifications required of the person who is to approve the accounts.

For transparency, the status of the person approving the service charge accounts, and the capacity in which they are acting, should be made clear (for instanceexample, a director or employee of the landlord or the manager or surveyor as agent for the landlord).

In certain instances, approval may be issued in the name of the manager. Where this is the case, managers should have clear internal procedures in place that control who may sign in the name of the firm, and to ensure that this is an appropriately senior individual.

Where the manager undertakes the approval, the management fee is toshould include this cost. Where the lease requires approval by someone other than the manager, the costs of approval of the service charge accounts, together with the fees of that person, should usually be recovered through the service charge.

The approval of the service charge accounts is not intended to provide independent assurance regarding their preparation. The review of the accounts by an independent accountant is considered in sectionsubsection 4.5.3.3.

#### **4.5.3.3 Review of the service charge year end accounts**

An independent accountant might be engaged to review the service charge accounts and provide assurance regarding their preparation. The types of reports prepared by accountants that canshould be attached to service charge accounts are detailed in TECH09TECH 09/14BL and fall intoone of two categories:

- i—Anan audit report, carried out in accordance with the International Standard on Auditing (ISA) (UK) 800 (Revised)2018: *Special considerations – Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks* (see subsection 4.5.3.4).
- ii—Anan independent review report, carried out in accordance with the International Standard on Review Engagements (ISRE) 2400 (Revised)2018: *Engagements to Review Historical Financial Statements* (see subsection 4.5.3.5).

The level of assurance provided by these reports and details of the work undertaken in preparing the reports can be found in TECH 09/14BL.

#### **4.5.3.4 Auditing of the service charge accounts**

An audit is an independent external review ~~process~~ that adds to the credibility of an entity's disclosures, be it their annual financial statements, systems of internal control or compliance with contractual or legislative obligations. It will also add credibility to the service charge accounts.

An audit involves performing procedures to obtain evidence that a specified process is being followed ~~in order~~ to reassure that there is no material misstatement ~~within~~ in the information subject to the audit (or in this case, the service charge accounts).

Where a lease made after 1980 specifically refers to an 'audit', this should be carried out in accordance with ISA 800 (UK) and should be performed by a registered auditor unless all the ~~occupier~~tenants confirm in writing that they wish to depart from the terms of the lease. Even in this case, it may be necessary to consider a variation of lease terms (see [TechTECH](#) 09/14BL for further information).

If all ~~occupier~~tenants confirm that they do not wish to carry out a full audit, as required in the lease, an independent review should be carried out instead (see [subsection 4.5.3.5](#)).

In carrying out an audit in accordance with accepted auditing standards, the auditor will assess the level of risk involved in the instruction, and adjust the level of work (and cost) accordingly. By its very nature, an audit is likely to be ~~extremely~~ time consuming, and ~~hence~~ costly, particularly for larger properties with many leases in operation. The auditor may also need to employ an expert ~~in order~~ to carry out certain aspects of their work, for example, a review of the leases, on their behalf.

The auditor's reasonable and proper costs and fees should, subject to the terms of the lease, be charged to the service charge account.

Leases that refer to 'audit' and were made before 1980 may not have anticipated the work required by a modern auditing framework. In this case, the manager should consider whether conducting a modern audit would provide best value for ~~occupier~~tenants. In such situations, ~~owners/manager~~the landlord or manager may consider having an independent review ~~of the kind noted in section 4.5.3.5~~ carried out instead. [\(see subsection 4.5.3.5\)](#). Further detail on construing references to 'audit' is contained in ICAEW [TechTECH](#) 09/14BL.

#### **4.5.3.5 Independent review of the service charge year end accounts**

If the lease requires an independent review other than an audit to be carried out, the ~~owners/manager~~landlord or manager should engage an independent reporting accountant to examine the service charge accounts of the property.

Where a lease requires the service charge to be audited but an independent review has been conducted instead for the mentioned permissible reasons, ~~owners~~landlords and managers should make this clear in the service charge accounts.

The onus and style of an independent accountant's review differs from an audit. Such review engagement should be carried out in accordance with ISRE 2400 (revised). The, the scope of an independent accountant's review in accordance with ISRE 2400 (revised) which is discussed in detail in Tech09 TECH 09/14BL and includes information on the type of procedures that an independent accountant may carry out. It would be usual for service charge accounts to be prepared by the owner/landlord or manager. In practice, for many small properties, an accountant (who may be the reporting accountant) may be engaged to prepare the statements from accounting records maintained by the owner/landlord or manager. However, the owner/landlord or manager will retain responsibility for the preparation and approval of the statement.

As stated in Tech TECH 09/14BL, the independent accountant should issue a review report in accordance with ISRE 2400 (revised), which gives a conclusion as to whether the service charge accounts have been prepared in accordance with the provisions of this professional standard.

For smaller properties where the lease may be silent or the independent review is optional, the cost of carrying out an audit or independent review may be disproportionate to the total service charge expenditure. To be consistent with the best value principles and dependent on the quantum and nature of the expenditure, an external audit or independent review will give credibility to the service charge accounts. However, an audit or independent review does not absolve the owner/landlord or manager of their responsibility to prepare and approve reliable service charge accounts in accordance with subsection 4.5.3.2. In addition, an audit or independent review should not be used as a substitute for an alternative report or method of approval specified in the lease, unless this has been agreed with the occupier/tenants in writing in advance as noted above.

#### **4.5.3.6 Independence of the reporting accountant**

The International Ethics Standards Board for Accountants (IESBA) Code requires reporting accountants carrying out independent reviews to be independent of the entity whose financial statements are being reviewed. The accountant's independence safeguards the accountant's ability to form a conclusion without being affected by influences that might otherwise compromise that conclusion. Independence enhances the accountant's ability to act with integrity, to be objective and to maintain an attitude of professional scepticism. In the context of a review of an annual service charge accounts/account, the reporting accountant should not be an employee or director or associate of the owner/landlord or manager of the property concerned or of any associate or agent of the owner/landlord or manager.

All ICAEW members of chartered accountancy bodies (e.g. the Institute of Chartered Accountants in England and Wales (ICAEW)) are required to adhere to strict ethical standards covering independence, as well as complying with other ethical and the ICAEW's Code of Ethics, including independence requirements in, and firms must apply the FRC's Ethical International Standard, as applicable. Any accountants on Quality Management (ISQM) (UK) 1, Quality Management for Firms that Perform Audits or Reviews of Financial Statements, or Other Assurance or Related Services Engagements.

Accountants appointed to carry out an independent a review engagement should be members a member of a chartered accountancy one of the bodies listed in Appendix 6 of TECH 09/14BL, who are entitled under the rules of the body to which they belong to engage in public practice. As noted in the introduction of this professional standard, TECH 09/14BL is currently being updated. The update of Appendix 6 is not currently expected to have a significant effect on accountants eligible to be appointed to carry out review engagements.

#### 4.5.4 Balance sheets

Where the accounts are prepared on an accruals accrual's basis, they should be accompanied by a schedule of closing prepayments and accrued expenses. Openness In the spirit of openness and transparency can be further enhanced by the inclusion of, it is good practice to include a balance sheet or cash reconciliation as part of or in addition to the statement of actual expenditure. These provide a full account of the assets and liabilities on the service charge account at both the start and end of the accounting period. Typical assets include prepaid expenses, cash balances held, long-term cash funds and service charge arrears. Typical liabilities include accrued expenses, sinking and reserve funds, and service charges collected in advance.

If a The balance sheet or cash reconciliation is included in the service charge accounts, it should be included in the scope of any independent review of the service charge accounts.

#### 4.5.5 Industry standard cost classifications

Appendix BA of this professional standard includes details of industry standard cost classifications that should be used in reporting budget and actual expenditure.

The industry standard cost classifications provide 3three levels of analysis as follows:

- cost class
- cost category and
- cost description.
- cost class
- cost category and
- cost description.

As a minimum acceptable level of reporting service charge budgets and statements of actual expenditure should be prepared at **cost class and cost category** level.

Adoption of the industry standard cost classifications will reap enormous benefits for the industry, as this will facilitate better cost comparison between properties and the benchmark indices. It will also reduce costs, and assist in the transfer of information between managers and owners when properties are sold, or when there is a change of manager (i.e. from in-house to external, or between managing agents).

However, to To achieve an appropriate level of transparency in accordance with the principles of this professional standard, it is recommended best practice that budget and budgets and actual expenditure analyses are should be provided at the detailed

**cost description** level whenever practicable, and particularly in respect of larger properties, with a summary of the total costs under each cost category.

In accordance with the core principle of proportionality, it is acceptable for smaller properties or those with limited service charge expenditure (for example, industrial sites) to report at the higher cost category level, although this should generally be regarded as an exception rather than the norm.

To maintain consistent industry standards and to facilitate benchmark comparison, managers and those responsible for preparation of the accounts are encouraged to use all best endeavours to comply with the cost class and cost category analysis as set out and not permit the creation of new cost categories or cost classes.

To maintain consistent industry standards and to facilitate benchmark comparison, managers and those responsible for preparation of the accounts are encouraged to use all best endeavours to comply with the cost class and cost category analysis as set out and not permit the creation of new cost categories or cost classes.

However, the The detailed cost descriptions set out are for illustrative purposes only and not intended to represent an exhaustive list, but are included for illustrative and guidance purposes only. Individual cost descriptions may vary from manager to manager, and the inclusion of additional cost descriptions is encouraged where this will facilitate greater transparency and clarity with regard to regarding the expenditure incurred or proposed.

#### **4.5.6 Budgets and actual expenditure accounting**

The use of the standard cost classes and categories in industry standard format are essential if benchmarking is to be effective. However, for benchmarking purposes, accounts are only required at cost category and cost class level. It is not intended that benchmark analysis of expenditure be carried out at cost description level.

#### **4.5.6 Budgets and actual expenditure accounting**

The service charge accounting sample report (see [appendix C](#)[Appendix B](#)) establishes a basic framework for the preparation of service charge accounts, and identifies areas for special consideration by managers and reporting accountants.

Owners and managers must ensure that an estimate of anticipated service charge expenditure is provided annually. This is to be accompanied by appropriate Managers must issue to tenants:

- budgets, including an explanatory commentary for the occupiers, together with a breakdown of their proportion of the costs. It is considered best practice that budgets are issued at least one month prior to the commencement start of the service charge year.
- Owners and managers must ensure that detailed statements of actual expenditure, together with accounting policies and explanatory text, are issued annually. It is considered best practice that annual statement of expenditure should be issued an approved set of service charge year end accounts showing a true and accurate

record of the actual expenditure constituting the service charge within four months of the service charge year end.

Where these timescales cannot be met, a timely explanation **must** be provided of when they will be issued and the reason for the delay in line with the mandatory communication provisions. This does not dispense with the obligation to provide both. Where there is a legitimate reason for the delay in issuing budgets or reconciled year end accounts, managers **must** use all reasonable endeavours to issue these as soon as practicably possible.

The accounts are to give an adequately detailed and comprehensive summary of items of expenditure, with full explanations of any material variations (+ or -) against the budget, and in a reasonably consistent format year-on-year.

It is recommended that the budgets and accounts be issued with a report that provides the following minimum information:

It is recommended that the budgets and accounts be issued with a report that provides the following minimum information:

- a comprehensive level of detail to enable occupiertenants to compare expenditure against estimated budget
- explanations of significant individual costs and of variances from the previous year's budget/accounts
- a comparison against the previous year's actual costs, where appropriate
- information on core matters critical to that account (e.g. explanations of significant individual costs and of variances from the previous year's budget/accounts
- a comparison against the previous year's actual costs, where appropriate
- information on core matters critical to that account (e.g. levels of allocation, apportionment, details of key service contracts, report on tendering, etc.)
- the achieved and/or targeted measures of improved management performance (e.g. successes in delivering improved quality services and greater value for money)
- on-site management team costs, separately identified
- a schedule of opening and closing prepayments and accrued expenses, details and results of the most recent previous and forthcoming tendering exercisesthe achieved and/or targeted measures of improved management performance (e.g. successes in delivering improved quality services and greater value for money)
- on-site management team costs, separately identified
- a schedule of opening and closing prepayments and accrued expenses, details and results of the most recent previous and forthcoming tendering exercises. Occupiers are to (tenants should) be advised of the contractors who are providing the services)
- a full apportionment matrix that clearly shows the basis of calculation and the total apportionment per schedule for each unit within the property/complex and
- the date of issue.
- a full apportionment matrix that clearly shows the basis of calculation and the total apportionment per schedule for each unit within the property/complex and
- the date of issue.

A set of industry-standard cost classifications has been drawn up, and is included in appendix BAppendix A (see also section 4.5.5). As a minimum standard when reporting

service charge costs to occupier/tenants, these should be used at cost-class and cost-category level.

#### **4.5.7 Right to challenge Change of landlord or manager**

In the event of a sale of the property or change of manager, it is essential that a definitive timescale in which accounts will be closed and handed over, is agreed.

As soon as practicable – but no later than four months following the date of completion of a sale of a property, or a change of manager – a closing statement of expenditure (subject to all requirements of this professional standard, including full details of all service charge expenditure, accruals, pre-payments, etc., for all outstanding service charge years) should be approved by or on behalf of the previous landlord or manager and provided to the new landlord or manager, up to the date of sale/transfer.

The new landlord or manager should issue any future budget in such a way that it provides sufficient information to enable tenants to compare it with the most recently issued approved accounts. The tenants can then convert historical data into a consistent format for comparison where they were not responsible for previous years.

Where a property has had more than one manager in place during the service charge period, the compilation of the service charge accounts may need to be reconfigured if:

- the former manager has supplied full supporting documentation to the new manager in a timely manner, the expenditure for the full period should be amalgamated and the service charge accounts prepared as normal
- full supporting documentation has not been supplied in a timely manner, the expenditure incurred by the two managers should be disclosed separately in the service charge accounts.

Where the expenditure for each manager is disclosed separately, the approval by the new manager should only cover the period under their control.

Note that under the second approach there may be a period of the service charge accounts that will not have been approved or reviewed.

For further information on the best practice processes and procedures in the event of a property's sale, or other circumstances where the manager changes, see Appendix C.

This is particularly relevant to solicitors when drafting and reviewing sale contracts.

#### **4.5.8 On-account payments**

Service charges are usually 'reserved as rent' in the lease, however, the service charge is neutral in income and expenditure terms after year-end balancing charges/credits.

Service charge monies will be held in one or more discrete (or virtual) bank accounts in recognition of the fact that the monies are being held to deliver the service expenditure.

Furthermore, and based on the principle that landlords should not profit from the supply of services, all interest earned should be credited to the service charge account (after appropriate deductions have been made, such as bank charges, tax, etc.).

Where separate accounts are not operated per property, or advance payments from more than one property are held in a single account, a proper and reasonable amount of interest on normal commercial rates **must** be credited to the benefit of the service charge.

#### **4.5.9 Interest on service charge accounts**

Interest earned and late payment interest **must** be credited to the service charge account. Bank charges and account operating costs are to be offset against the interest. Landlords are required to perform their obligations under the terms of the lease, and to account to tenants for any balancing charges due or owed at the end of the service charge period.

Leases often enable landlords to recover the cost of borrowing to fund expenditure as a cost to the service charge. In older leases, there is a risk of having to fund shortfalls from negative cash flows.

It is the landlord's responsibility to fund the contribution in respect of void units and concessions, and to make these payments to the account as promptly as payments made by tenants. If a landlord is not as prompt as tenants are required to be, the interest charges should apply in line with the payments made by tenants.

When communicating with tenants through budget and expenditure reports, managers should unambiguously state their policy concerning the crediting of interest to the service charge.

#### **4.5.10 Interest on borrowing within service charges**

Leases should enable landlords to recover the reasonable and proper cost of borrowing to fund major non-cyclical or exceptional unbudgeted expenditure as a cost to the service charge. Where the lease is silent, there is a risk of having to fund shortfalls from negative cash flows. Where landlords are crediting interest earned to the service charge account, they should be reassured that charging the interest at reasonable and commercial rates on borrowed money to fund major non-cyclical or exceptional unbudgeted expenditure meets best practice requirements (see section 4.7).

Where an agreement has been reached that the landlord funds the cost of works in the first instance and then recovers a percentage or all of those costs at a later date through a voluntary arrangement, an appropriate note should be included in the service charge expenditure report (see subsection 4.7.4.5).

#### **4.5.11 Timeliness**

When dealing with service charges, managers should recognise they are effectively spending the tenants' money and that delays in reporting projected or actual expenditure can have a significant adverse impact of the tenants' business operations. Therefore, in the event of any delay in meeting the best practice timescales, managers should immediately inform tenants of the reasons for the delay and provide as much information as is practicable on the anticipated level of budget and/or actual expenditure.

It is the responsibility of the manager to provide the tenants with budget and year-end accounts for anticipated and actual service charge expenditure in accordance with the timescales adopted herein. This should include sufficiently detailed explanatory comments regarding costs proposed or incurred, together with details of the basis of allocation and apportionment, to enable tenants to reasonably understand how their liability has been calculated.

Budgets should be issued at least one month prior to commencement, and year-end accounts issued within four months of the end of the service charge year in question. In the event of an anticipated delay in issuing budgets in these timescales, managers should immediately inform tenants of the reasons for the delay and provide as much information as is practicable on the anticipated level of budget and/or actual expenditure.

Where there is a legitimate reason for the delay in issuing budgets or reconciled year-end accounts, managers **must** use all reasonable endeavours to issue these as soon as practicably possible.

#### **4.5.12 Benchmarking and cost analysis**

Adoption of the industry standard cost classifications (see section 4.5.5 and Appendix A) is recommended to facilitate better cost comparison between properties and the benchmark indices. It will also reduce costs and assist in the transfer of information between managers and landlords when properties are sold, or if there is a change of manager (for example, from in-house to external, or between managers).

Further, these cost classifications are largely compatible with industry benchmark indices, which will facilitate a benchmark comparison of costs.

However, when using benchmark information to compare operating costs for any building, caution is needed. Industry benchmark indices are not intended as a definitive database of costs for operating service charges in commercial buildings, instead serve to highlight indicative trends in service charge costs. Buildings differ substantially in terms of construction, age, layout, gross-to-net floor area ratio, staffing and security levels, hours of operation, and standards of maintenance and management.

These analyses take the average of service charges for similar properties, and provide a guide to the cost-effectiveness of the management service. However, each property will have its own variations from the average and, therefore, 'beating the benchmark' is not necessarily proof of service efficiency and value for money. Industry benchmark indices provide an excellent guide, but managers may wish to reflect further on how their specific property is performing from a value for money perspective.

#### **4.6 Dispute resolution**

The best practice recommendations in this section will help RICS members and RICS-regulated firms achieve the following mandatory requirements:

7 Where acting on behalf of a tenant, practitioners **must** advise their clients that tenants are not generally entitled to withhold payment of service charges that have been properly demanded. However, in certain circumstances withholding of payment of any difference arising from mathematical or computational error may not be considered unreasonable.

8 When acting on behalf of a landlord, managers **must** ensure that, following resolution of a dispute, any service charge that has been raised incorrectly should be adjusted to correct the error without delay.

#### **4.6.1 Overview**

There are times where parties may disagree on matters, such as which services are chargeable, what benefit the tenants individually or collectively receive, how they are allocated and apportioned and/or how much they cost.

Traditionally, leases have not allowed for any form of redress for the tenants and, therefore, expensive court action was seen as the only route to challenge the service charges payable.

Where service charge disputes arise, it will usually be of benefit to both parties to resolve them quickly, as going to court can be slow and expensive and represent a disagreeable process for both sides. In most service charge disputes, court action will not be a cost-effective solution and in almost all instances should be avoided.

The likelihood of disputes is increased by the practices that fail to comply with best practice outlined in this professional standard.

Some managers display a lack of transparency in their service charge arrangements and a lack of responsiveness to reasonable enquiries from tenants. Conversely, some tenants employ consultants, paid on a 'no win, no fee' basis, who undertake unnecessarily intrusive investigations into the service charge arrangements, going beyond reasonable due diligence. Those types of approaches fall far short of best practice and aggravate the relationship between landlord and tenant.

Instead, stakeholders should adjust their behaviour in ways that will reduce the likelihood of a dispute arising. Landlords should comply with their lease obligations to provide service charge information and look to conform to the best practice outlined in this professional standard. The information and responses to a tenant's reasonable enquiries should be provided promptly and efficiently. Full explanations should be provided where the service charge includes unexpected costly items.

Tenants should ensure that the enquiries raised by their consultants are reasonable. If tenants are unhappy with a service charge demand, their response should be proportionate with a view to focusing on the items at issue at the outset, to reduce the possibility of a protracted dispute arising.

The decision of the Supreme Court in *Sara & Hossein Asset Holdings Ltd v Blacks Outdoor Retail Ltd* [2020] EWCA Civ 1521, in relation to the conclusiveness of a landlord's service charge certificate, turned on the specific lease wording. What can be taken from the decision is that where a lease provides for a landlord's service charge certificate to be conclusive, the tenant is not entitled to withhold payment of any disputed items, but this does not prohibit the tenants disputing its service charge bill at a later date. This is what is called a 'pay now, argue later' approach. Tenants are not generally entitled to withhold payment of service charges that have been properly demanded although in certain circumstances withholding a proportion of any payment due would not be considered unreasonable, for example, where there is a mathematical or computational error. In

such circumstances, the tenant or their consultants should clearly explain why payment is being withheld and how the withheld amount has been calculated.

More generally, all stakeholders, are encouraged to have an on-going dialogue, liaising and seeking to address each other's concerns in relation to the service charge regime to avoid issues escalating into more serious disputes and potential litigation. Equally importantly, this will promote stronger long-term operational relationships between managers, landlords and tenants.

However good the relationships, there will occasionally be genuine disputes over service charges. If there is such a dispute, the parties are encouraged to define the issues and particularly to establish the precise nature of the dispute and whether it arises from a proper interpretation of the contractual terms and obligations as set out in the lease, or whether it is an issue of compliance with the standards of performance set out in this professional standard.

If the matter concerns a contractual dispute under the terms of the lease, the parties should seek to resolve matters by negotiation or otherwise through alternative dispute resolution (ADR). This can often provide a quicker and more cost-effective way of resolving service charge disputes than using the courts. Landlords and tenants are encouraged to use ADR, even when the governing lease does not expressly provide for it. A party who declines to use ADR can be penalised in any subsequent cost order granted by the courts.

#### **4.6.2 Complaints**

It is not always straightforward to differentiate between a complaint against a manager and a contractual dispute under the terms of the lease. Complaints about matters such as service delivery, timescales and cost are typically landlord/leaseholder disputes. This section covers complaints against the direct actions and/or behaviour of the manager.

RICS requires RICS-regulated firms to have a formal written Complaints Handling Procedure in place to deal with complaints about their own work and that of their staff. The procedure should be made available to clients and leaseholders. It should include a short series of steps and response times for its various stages and should provide for leaseholders to complain to the landlord. The procedure should provide for complaints about staff to be made to a responsible principal and for them to be investigated quickly and fairly. It should include details of the nominated Ombudsman Scheme to which the manager belongs.

#### **4.6.3 Reporting concerns about an RICS member or RICS-regulated firm**

RICS can only accept concerns about RICS members or RICS-regulated firms in writing. Concerns can be emailed to [complaints@rics.org](mailto:complaints@rics.org) or alternatively an online form can be completed on the RICS website.

RICS may investigate poor service where the service is unacceptably low (and thus is serious enough to warrant an investigation).

Though not an exhaustive list, poor service is more likely to be investigated if:

- it is a serious departure from RICS' standards of professionalism or is otherwise in the public interest to pursue
- RICS has received other complaints about the RICS member's or RICS-regulated firm's service or
- the RICS member has not responded to or addressed concerns about their service in a timely manner.

Though not an exhaustive list, poor service is less likely to be investigated if:

- there is a single one-off incident of poor service
- RICS has not received any other similar reports or concerns about the RICS member or RICS-regulated firm
- there is insufficient evidence to support the concerns raised or
- the concerns raised have been remedied.

In most cases, complaints of poor service can be resolved with the RICS member through their Complaints Handling Procedure.

#### **4.6.4 Complaints Handling Procedure**

Where there is a complaint of poor service, the manager's Complaints Handling Procedure (CHP) should be obtained to submit a formal complaint. The CHP should include the option of referring the complaint to their appointed Alternative Dispute Resolution (ADR) provider.

This is because complaints about service failures or unsatisfactory work can sometimes be considered under these processes, even though they do not meet the RICS threshold for an investigation.

#### **4.6.5 Right to challenge**

This professional standard cannot override an occupier's a tenant's legal right to challenge incorrect or inappropriate service charges subject to the prevailing statute of limitations.

Where the manager has demonstrably complied with the provisions of the lease and this professional standard, it is recommended that the manager allow occupiers tenants a reasonable period (e.g. for example, four months from issue) in which to raise enquiries or request further information in respect of the approved service charge accounts.

When querying costs, tenants, and/or their professional advisers, should (where possible) provide managers with a comprehensive list of areas to be queried at the outset and should not use every interaction as a means of introducing further queries or challenges unrelated to original queries.

Managers are expected to should deal with reasonable enquiries promptly and efficiently, and to make all relevant paperwork available for inspection. Where a tenant raises queries or seeks clarification on any matters relating to the budget or actual costs, the manager should deal with such proper enquiries promptly and efficiently.

Where hard copies of the supporting documentation concerning the certified accounts are supplied, the manager is entitled to make a proper and reasonable charge for the time, cost of copying and postage of such documents. However, where this information is held in existing electronic files, easily to hand and transmitted by email, it is expected that any charges would be nominal.

Where hard copies of the supporting documentation concerning the certified accounts are supplied, the manager is entitled to make a proper and reasonable charge for the time, cost of copying and postage of such documents. Tenants, However, where this information is held in existing electronic files, easily to hand and transmitted by email, it is expected that any charges would be nominal.

Occupiers and consultants appointed on their behalf, have a duty to respect and conform to the principles of this professional standard. In the interest of promoting a swift and harmonious resolution of service charge queries, there should be openness and transparency towards managers in disclosing the occupier's brief to their basis on which a consultant and is appointed, whether remuneration is on a contingency their fee basis, is fixed or linked to any savings made.

#### **4.5.8 Change of owner or manager**

In the event of a sale or change of manager, it is essential that a definitive timescale within which accounts will be closed and handed over, is agreed.

As soon as practicable – but no later than four months following the date of completion of a sale of a property, or a change of manager – a closing statement of expenditure, subject to all requirements of this professional standard, including full details of all service charge expenditure, accruals, pre-payments, etc. for all outstanding service charge years should be approved by or on behalf of the old landlord and provided to the new owner/manager, up to the date of sale/transfer.industry best practice

The new owner or manager should issue any future budget in such a way that it provides sufficient information to enable occupiers to compare it with the most recently issued approved accounts. The occupiers can then convert historical data into a consistent format for comparison where they were not responsible for previous years.

Where a property has had more than one manager in place during the service charge period the compilation of the service charge accounts may need to be reconfigured:

- If the former manager has supplied full supporting documentation to the new manager in a timely manner, the expenditure for the full period should be amalgamated and the service charge accounts prepared as normal.
- If full supporting documentation has not been supplied in a timely manner, the expenditure incurred by the two managers should be disclosed separately within the service charge accounts.

Where the expenditure for each managing agent is disclosed separately, the approval by the new manager should only cover the period under their control.

(Note that under the second approach there may be a period of the service charge accounts that will not have been approved or reviewed.)

For further information on the recommended processes and procedures in the event of a property's sale, or other circumstances where the manager changes, see the current edition of RICS' *Commercial property service charge handover procedures* (see appendix D).

This is particularly relevant to solicitors when drafting and reviewing sale contracts.

#### **4.5.9 On-account payments**

Service charges are usually 'reserved as rent' in the lease; in reality however, the service charge is neutral in income and expenditure terms, after year-end balancing charges/credits. Service charge monies will be held in one or more discrete (or virtual) bank accounts in recognition of the fact that the monies are being held to deliver the service expenditure.

Furthermore, and based on the principle that owners should not profit from the supply of services, all interest earned should be credited to the service charge account (after appropriate deductions have been made, i.e. bank charges, tax, etc.).

Where separate accounts are not operated per property, or advance payments from more than one property are held in a single account, a proper and reasonable amount of interest on normal commercial rates must be credited to the benefit of the service charge.

#### **4.5.10 Interest on service charge accounts**

Interest earned and late payment interest should be credited to the service charge account. Bank charges and account operating costs are to be offset against the interest. Owners are required to perform their obligations under the terms of the lease, and to account to occupiers for any balancing charges due/owed at the end of the service charge period.

Leases often enable owners to recover the cost of borrowing to fund expenditure as a cost to the service charge. In older leases, there is a risk of having to fund shortfalls from negative cash flows.

It is the owner's responsibility to fund the contribution in respect of void units and concessions, and to make these payments to the account as promptly as payments made by occupiers. If an owner is not as prompt as occupiers are required to be, the interest charges should apply in line with the payments made by occupiers.

When communicating with occupiers through budget and expenditure reports, managers should unambiguously state their policy concerning the crediting of interest to the service charge.

#### **4.5.11 Interest on forward funding of service charge costs**

Leases should enable owners to recover the reasonable and proper cost of borrowing to fund major non-cyclical or exceptional unbudgeted expenditure as a cost to the service charge. Where the lease is silent there is a risk of having to fund shortfalls from negative

cash flows. Where owners are crediting interest earned to the service charge account, they should be reassured that charging the interest at reasonable and commercial rates on borrowed money to fund major non-cyclical or exceptional unbudgeted expenditure meets best practice requirements. (See also section 4.8 – *Provision for anticipated future expenditure*.)

In situations where an agreement has been reached whereby the landlord funds the cost of works in the first instance and then recovers a percentage or all of those costs from the tenants through the service charge at a later date, an appropriate accounting policy should be included within the notes to the service charge expenditure report, along with a note disclosing the full details including the amount of interest charged on the deferred amounts.

#### **4.5.12 Timeliness**

It is the responsibility of the manager to provide the occupiers with budget and reconciled accounts for anticipated and actual service charge expenditure at the appropriate time. This is to include appropriate explanatory comments with regard to costs proposed or incurred, together with details of the basis of allocation and apportionment, to enable occupiers to reasonably understand how their liability has been calculated.

Budgets should be issued at least one month prior to commencement, and reconciled accounts issued within four months of the end of the service charge year in question.

Where an occupier raises queries or seeks further clarification on any matters relating to the budget or actual costs, the manager should deal with such proper enquiries promptly and efficiently.

#### **4.5.13 Benchmarking and cost analysis**

Adoption of the standard industry cost classifications (see section 4.5.3 and appendix B) is recommended to facilitate better cost comparison between properties and the benchmark indices. It will also reduce costs and assist in the transfer of information between managers and owners when properties are sold, or if there is a change of manager (e.g. from in-house to external, or between managing agents).

Further, these cost classifications are largely compatible with industry benchmark indices, which will facilitate a benchmark comparison of costs.

However, when using benchmark information to compare operating costs for any building, caution is needed. Industry benchmark indices are not intended as a definitive database of costs for operating service charges in commercial buildings, but do serve to highlight indicative trends in service charge costs. Buildings differ substantially in terms of construction, age, layout, gross-to-net floor-area ratio, staffing and security levels, hours of operation, and standards of maintenance and management.

These analyses take the average of service charges for similar properties, and, therefore, provide a guide to the cost effectiveness of the management service. However, property is not mass-produced in similar formats (as is a car, for example), and therefore each property will have its own variations from the average; therefore, 'beating the

~~'benchmark' is not necessarily proof of service efficiency and value for money. Industry benchmark indices provide an excellent guide, but managers may wish to reflect further on how their specific property is performing from a value for money perspective.~~

## **4.6 Dispute resolution**

~~The best practice recommendations in this section will help RICS members and regulated firms achieve the~~ The following mandatory requirements:

- ~~8 Where acting on behalf of a tenant, practitioners must advise their clients that if a dispute exists any service charge payment withheld by the tenant should reflect only the actual sums in dispute.~~
- ~~9 When acting on behalf of a landlord, practitioners must advise their clients that following resolution of a dispute, any service charge that has been raised incorrectly should be adjusted to reflect the error without undue delay.~~

### **4.6.1 Introduction**

~~There are times where managers, owners and occupiers can disagree on matters such as which services are chargeable, what benefit the occupiers individually or collectively receive, how they are allocated and apportioned and/or how much they cost.~~

~~Traditionally, leases have not allowed for any form of redress for the occupiers and, therefore, expensive court action was historically seen as the only route to challenge the service charges payable.~~

~~Where service charges~~ section deals with contractual disputes ~~arise, it will usually be of benefit to both owners and occupiers to resolve them quickly, as going to court can be slow and expensive and represent a disagreeable process for both sides. In the majority of service charge disputes, court action will not be a cost-effective solution and in almost all instances is to be avoided~~ under the terms of the lease.

~~The likelihood of disputes is increased by the practices of some managers, owners and occupiers, who continue to fail to comply with best practice within this professional standard.~~

~~Some managers and owners display a lack of transparency in their service charge arrangements and a lack of responsiveness to reasonable enquiries from occupiers. Conversely, some occupiers employ consultants, paid on a 'no win, no fee' basis, who undertake unnecessarily intrusive investigations into the service charge arrangements, going well beyond reasonable due diligence. Those types of approaches fall far short of best practice and aggravate the relationship between landlord and tenant.~~

~~Instead, managers, owners and occupiers should look to adjust their behaviour in ways that will reduce the likelihood of a dispute arising. Landlords should comply with their lease obligations to provide service charge information and look to conform to the best practice standards of this professional standard. The information and responses to an occupier's reasonable enquiries should be provided promptly and efficiently. Full explanations should be provided where the service charge includes unexpected costly items.~~

Occupiers should ensure that the enquiries raised by their consultants are reasonable. If occupiers are unhappy with a service charge demand, their response should be proportionate with a view to focusing on the items at issue, in order to reduce the possibility of a dispute arising. While the occupier may choose to challenge and perhaps not pay for the items at issue, the other undisputed items that have been properly demanded should be promptly paid in accordance with the lease.

More generally, managers, owners and occupiers and their advisers are encouraged to have an on-going dialogue, liaising and seeking to address each other's areas of concern in relation to the service charge regime, in order to avoid issues escalating into full-blown disputes and potential litigation. Equally importantly, this will promote stronger long-term operational relationships between managers, owners and occupiers.

However good the relationships, there will from time to time be genuine disputes over service charges. If there is such a dispute, the parties are encouraged to define the issues and to seek to resolve matters through alternative dispute resolution (ADR). This can often provide a quicker and more cost effective way of resolving service charge disputes than using the courts. Landlords and tenants are encouraged to use ADR, even when the governing lease does not expressly provide for it. A party who declines to use ADR can be penalised in any subsequent cost order granted by the courts.

#### **4.6.2 Complaints**

It is not always straightforward to differentiate between a complaint against a manager and landlord/leaseholder disputes. Complaints about matters such as service delivery, timescales and cost are typically landlord/leaseholder disputes. This section covers complaints against the direct actions and/or behaviour of the managing agent.

Managers **must** have a formal written complaints-handling procedure in place to deal with complaints about their own work and that of their staff. The procedure should be made available to clients and leaseholders. It should include a short series of steps and response times for its various stages and should provide for leaseholders to complain to the landlord. The procedure should provide for complaints about staff to be made to a responsible principal and for them to be investigated quickly and fairly. It **must** include details of the nominated Ombudsman Scheme to which the manager belongs. See the current edition of RICS' Complaints handling.

#### **4.6.3 ADR as industry best practice**

The Civil Procedure Rules (CPR) are the rules used by the civil courts in all cases in England and Wales. They apply to everyone involved in the litigation process, including parties, their legal representatives and judges.

In the CPR, alternative dispute resolution (ADR) is defined as a: 'collective description of methods of resolving disputes otherwise than through the normal trial process'. In other words, ADR is any method for resolving a dispute, which that avoids the need for a court to intervene.

The CPR obliges parties to explore and use ADR if it is practical to do so. The position the courts take is that litigation should always be a last resort. The courts will explore the

extent to which parties ~~before them~~ have endeavoured to avoid litigation,<sup>7</sup> and have properly considered using ADR to resolve their dispute.

The courts have power to stay legal proceedings and direct parties to explore and, if appropriate, use a viable method of ADR rather than go through the trial process. Courts will frequently require parties to provide evidence that ADR has been properly explored. If a party has not taken steps to source a viable method of ADR, or has declined to use ADR, a court will likely want to know why. If the court is not satisfied with the explanation, the reluctant party could be penalised in a costs order. ~~A number of~~<sup>Several</sup> cases in recent years have demonstrated that there are progressively fewer excuses that courts are prepared to accept for not using ADR.

All new leases (including renewals) should ideally provide for ADR where it concerns service charge disputes. Where leases contain no provisions for referral of disputes to ADR, there is nothing to stop the ~~owner~~<sup>landlord</sup> and ~~occupier~~<sup>tenant</sup> agreeing to use an ADR process to help them find a resolution to a dispute.

#### **4.6.46.1 Recommended ADR methods for service charge disputes**

While there are many methods of ADR, two methods particularly lend themselves to resolving service charges disputes:

- mediation and
- independent expert determination.

Both procedures involve the appointment of an impartial person who is knowledgeable and experienced in the subject matter of the dispute.

Parties who choose to use mediation or independent expert determination often do so because, ~~not only~~ <sup>are</sup> the procedures <sup>are</sup> usually quicker and more cost-effective than litigation, they are <sup>also</sup> private and confidential.

If the parties cannot agree on the identity of their mediator or independent expert, <sup>or</sup> need further information about dispute resolution procedures generally, they can seek assistance from the RICS Dispute Resolution Service (DRS).

Whether the issues in dispute are technical ~~or~~ surveying, valuation or legal, RICS DRS can advise the parties of a suitable person(s) who they can agree to appoint. Alternatively, RICS DRS can appoint an appropriately qualified and impartial mediator or independent expert if the parties cannot agree who to appoint, and they require a neutral and objective appointment to be made (see section<sup>subsection</sup> 4.6.57).

#### **4.6.4.16.2 Mediation**

In mediation, the role of the ~~independent person (the)~~ mediator is to foster a negotiated settlement between the parties. The mediator's function is not to impose a decision, but to facilitate and structure discussions between the parties,<sup>7</sup> and guide them to a mutually acceptable outcome. The mediator can, if the parties wish, provide recommendations on how their dispute could be settled.

Mediation is particularly helpful where parties wish to maintain friendly relationships with each other and/or want to avoid getting embroiled in a potentially confrontational

process. Mediation, unlike many other forms of ADR, seeks to achieve compromise that satisfies both parties, and it is often described as a 'win-win' procedure.

Mediation proceedings are usually conducted on a 'without prejudice' basis. This means that nobody can the discussion remains confidential, and the parties cannot use what has been said or recorded in the mediation in any subsequent legal proceedings, and the mediator cannot be called as a witness in any subsequent court proceedings. What is said remains confidential. The process is informal. A mediation hearing often lasts no more than one day, which makes it more cost-effective compared to court, and the parties usually agree to share the costs of the mediation between them.

A mediated settlement is generally recorded in a formal agreement, which contractually binds the parties to the outcome.

#### **4.6.4.26.3 Independent expert determination**

Independent expert determination involves the appointment of an impartial person who is highly proficient in the subject matter in dispute. The independent expert's function is to gather information and evidence from the parties, and make their own enquiries, to arrive at a decision on the dispute.

Where parties refer a dispute to the decision of an independent expert, they will normally enter into a contractual agreement to be bound by the decision of the independent expert. A decision cannot normally be challenged unless it can be shown it is founded on a manifest error. In practise, it is very unusual for an independent expert's decision to be overturned by the courts.

Independent expert determination is particularly useful at resolving disputes involving questions around the valuation of property and/or costs of works carried out.

The fees of an independent expert are usually split equally between the parties, unless they both agree that the independent expert will decide who will be responsible for paying their fees.

Other costs, such as expenses incurred by the parties in preparing their case and instructing professional or legal representation, are usually split between the parties equally, unless they both agree that the independent expert will apportion responsibility for paying the costs between the parties.

This professional standard encourages parties to agree that independent experts provide reasoned determinations when dealing with service charge disputes. Like other forms of ADR, expert determination is private and confidential to the parties involved in a dispute. The contents of a reasoned determination will only be known to the parties involved in the dispute. It cannot automatically be disclosed to other tenants. It does not follow that a reasoned determination will be helpful to other tenants, unless one or both parties to the determined dispute agree to disclose their expert's determination.

One possible way to achieve consistency in decisions by third parties on service charges is for the same independent expert to be appointed on subsequent disputes. For example, when RICS DRS is asked to appoint independent experts to resolve more than one dispute in a shopping centre, industrial complex or block of offices where there is a

~~single landlord and multiple tenancies under different leases, RICS DRS will normally appoint the same expert.~~

#### **4.6.57 RICS Dispute Resolution Service (DRS)**

For further information about mediation, independent expert determination and other forms of ADR, and how to source independent appointments, please contact:

RICS Dispute Resolution Service (DRS)

**E:** [drs@rics.org](mailto:drs@rics.org)

**T:** +44 (0)20 7334 3806

**W:** [www.rics.org/dispute-resolution-service](http://www.rics.org/dispute-resolution-service)

**W:** [www.rics.org/dispute-resolution-service](http://www.rics.org/dispute-resolution-service)

RICS DRS has issued informative fact sheets for surveyors and the public, covering the different methods of ADR, areas of disputes, courts, tribunals and other processes involved in resolving disputes. The fact sheets mainly cover the jurisdiction of England and Wales, but some also cover the position in other jurisdictions. Please see DRS Services for more information.

#### **4.7 Mixed-use developments**

~~Recently, there has been an increase in mixed-use developments. While the concept is not new, what is different about mixed-use developments today is the increase in the introduction of residential units into commercial buildings. This is being driven not by organic growth, but by public policy.~~

~~The mixture of commercial and residential uses, in management terms, presents challenges that will often require both residential and commercial service charge management skills and expertise.~~

~~The extent to which the owner will be obliged to provide and carry out works and services will, in respect of both commercial and residential leases, depend on a strict interpretation of the wording of the lease. The *Landlord and Tenant Act 1985*, subsequently amended by the *Housing Act 1996* and *Commonhold and Leasehold Reform Act 2002*, imposes statutory constraints in respect of service charges for residential properties.~~

~~It has been a common misconception among many practitioners that if the residential element of a mixed-use scheme was 'let' under a single head lease, it would not be subject to the residential legislation. The cases of *Heron Maple House Ltd v Central Estates* [2002] 1 EGLR 35 and *Oakfern Properties Ltd v Ruddy* [2006] EWCA Civ 1389 have determined that an owner of a lease that includes both residential and non-residential elements will also need to follow the statutory procedures laid down by the *Landlord and Tenant Act 1985* (as amended) to ensure that non-recovery does not result due to an infringement of the legislation designed to protect residential occupants only.~~

~~See also the current edition of RICS' *Service charge residential management code*, which is approved by the Secretary of State for England.~~

## 4.87 Provision for anticipated future expenditure

The best practice recommendations in this section will help RICS members and RICS-regulated firms achieve the following mandatory requirements:

1 All expenditure that the ownerlandlord and manager seek to recover **must** be in accordance with the terms of the lease.

3 Owners and managers must ensure that service charge budgets, including appropriate explanatory commentary, are issued annually to all tenants.

65 Service charge monies (including reserve and sinking funds) must be held in one or more discrete (or virtual) bank accounts.

### 4.87.1 Background

The nature of commercial leases and, in particular, the length of these leases, has changed substantially over recent years. Many items managed under the service charge will have a life expectancy longer than the lease term being granted. OwnersLandlords and occupiers need totenants should carefully consider how they will recover (or pay for) these major expenditure items when they are due. It is, therefore, recommended that proper planned preventative maintenance (PPM) plans are used.

In addition to regular expenditure on services, ownerslandlords and occupiers may need totenants should make provision for occasional one-off outlays on replacing major items of equipment (such as a heating system). Major expenditure of a regularly recurring nature (such as external redecorations) can also cause significant fluctuations in the amount of service charge payable each year.

The move towards shorter leases creates difficulties in the recovery of the cost of long-term maintenance / or repair. For example, an occupiera tenant occupying under a lease for a term of, say, five years, may only have a 'transitory' interest in the replacement of a boiler, which might have a life expectancy far beyond the term of their lease. That occupiertenant is, therefore, not likely to be interested in the replacement of the boiler at an indeterminate date in the future.

Contrast this with the situation of an incoming occupiertenant who has signed a new lease that includes a liability for payment of a proportion of the cost of repair and replacement of the owner'slandlord's plant, who then finds that the boiler requires replacement within the first year of the term.

To the extent that these items can be foreseen, it may make sensewould be wise for the cost of major extraordinary expenditure items to be spread over a number ofseveral years (and over a number of lease periods) by setting up a sinking fund or reserve fund, rather than charging the whole cost to the current occupiertenants in the year in which the equipment is replaced.

### 4.87.2 Legal and tax challenges

Where a landlord collects money for anticipated future expenditure over time, the problem fortenants has been that they are at risk of becoming unsecured creditors if the landlord becomes insolvent or the landlord fails to undertake the works in a timely and comprehensive manner, or at all.

Therefore, the solution is the creation of a sinking fund held on trust for the tenants from time to time, into which contributions are paid by the tenants (and the landlord in respect of any voids) and in which funds accumulate until such time as they are required.

However, there are various different ways in which a sinking fund arrangement can be put in place, with potentially different tax consequences. As a result, many landlords prefer to avoid the issue altogether.

Furthermore, while for residential property interest earned on accumulated funds is taxable only at the basic rate of income tax, in the commercial property context trust income is taxable at the trust rate. This not only means that commercial sinking funds pay a higher tax but that there is also a substantially increased administrative burden with the need to file trust tax returns.

The~~Therefore, the~~ creation of sinking funds under trust has not therefore been popular primarily due to the uncertainty surrounding the tax treatment, the terms under which the fund is held and the way in which the fund is administered in practice.

#### **4.87.3 The contractual arrangement**

An occupier~~A tenant~~ will only be liable for making contributions towards a sinking fund or reserve fund, or for payment of a depreciation charge, so far as the lease allows.

Where the lease is silent, the owner~~landlord~~ cannot insist on including such arrangements within~~in~~ the service charge.

Issues that should be clarified between the owner~~landlord~~ and occupier~~tenant~~ include:

- the 'ownership' of the money
- the purpose for which the fund is being accumulated and its timescale and
- what will happen to it at the end of the lease<sup>2</sup>.

It may be that the fund will continue to exist after an individual occupier's~~tenant's~~ lease expires, and so the money will remain within~~in~~ the fund until it is needed. What happens to the fund when the subject building is demolished is often not thought about;<sup>2</sup> therefore, any unexpended monies may 'revert' to the owner~~landlord~~ by default.

Occupiers~~Tenants~~ should be aware of the potential for bearing a proportion of large costs during the course of~~relatively shorter-term leases~~, and are advised to carry out appropriate due diligence prior to signing any lease. Owners~~Landlords~~ are required to act reasonably in seeking to recover any large costs from occupier~~tenants~~ who take leases during the latter part of the life cycle of plant and equipment.

Whichever arrangement is used, clear communication is vital.

#### **4.87.4 Sinking funds, reserve funds and ~~depreciation~~depreciation charges**

Some confusion~~Confusion~~ has arisen in the sector as the description and purpose of such funds has become interchangeable. The following definitions set out industry guidance on how these terms are to~~should~~ be used.

**A sinking fund** is: a fund formed for a defined purpose by periodically setting aside money for the replacement of a wasting asset (for example, heating and air-conditioning plant and equipment, lifts, etc.).

**A reserve fund** is: a fund formed for a defined purpose to meet anticipated future costs of maintenance and upkeep to avoid fluctuations in the amount of service charge payable each year (for example, for external cleaning and redecorations).

**A depreciation charge** is: a measure of the wearing out, consumption or other reduction in the life of an asset (for example, heating and air-conditioning plant and equipment, lifts, etc.). An amount would be included in the service charge to reflect the 'cost' to the landlord based on the initial cost of an installation, rather than on the future cost of replacement.

#### 4.87.4.1 Sinking (or replacement) funds

It is recommended to set out There should be a clear policy as to outlining the purpose for which the monies are being built up, (for example, to replace the lifts within the building. This will require the owner to) and managers should act reasonably in estimating the amount of the contributions due. Ideally, the The policy will should also set out the basis used in calculating the charge, and include details of:

- how the monies will be held
- to whose order and
- how financial matters, including interest and tax, will be accounted for.

Where monies are held to the order of many, it would then be best for them to they should be held 'in trust' and protected from any liquidation or financial arrangements. Where monies are held in a client account that is properly named and designated as a trust account, case law suggests this might be sufficient to form an implied or constructed trust, and be so recognised by the bank where it is held (see *Kayford Ltd* [1975] 1 All ER 604, [1975] 1 WLR 279). In the case of more substantial funds, it may be advisable to have a formal trust deed setting out the arrangements, trustees, etc.

The ownership of monies in a sinking-fund monies is often poorly defined, particularly when the purpose of the fund has been discharged. However, a A well-set-up defined fund will usually should clarify what is being paid and by whom, to what purpose, and what will happen once that purpose has been achieved – or, in other circumstances (such as demolition), to residual monies – and to whom these monies will be disbursed. This may also possibly include any former occupier tenants who contributed to the fund.

At the same time as While other occupier tenants are making their contributions, the owner landlord should contribute to the fund for any void properties as though they were the occupier tenant.

Sinking funds remain part of the service charge, and all payments made out of the fund should be clearly communicated to occupiers, tenants and included as part of the annual reconciliation of the service charge.

The nature of sinking funds means that they are best suited to being collected over the life of the item for which they are intended. Many leases of older buildings might make

provision for a sinking fund, but if no fund has commenced, this may create a sense of inequity and unfairness if occupiertenants who took leases later in the life of the building were asked to contribute towards the full replacement cost.

Where major works are anticipated in the relatively short term, and it is decided to spread the cost during the period leading up to the point at which when the expenditure was incurred, this then becomes a reserve rather than a sinking fund.

#### **4.87.4.2 Reserve funds**

Reserve funds are generally relatively short-term in nature,<sup>7</sup> and are created for a specific purpose;<sup>8</sup> for example, external redecoration of a building or internal redecoration of common parts, the purposeaim being to minimise fluctuations in the amount of year-on-year service charge payable by an occupier as a resulta tenant because of regularly recurring items. As such, a reserve fund can only relate to those costs that are reasonably incurred during the term of an individual occupiertenant's lease.

Following the Court of Appeal decision in *Brown's Operating System Services Ltd v Southwark Roman Catholic Diocesan Corporation* [2007] EWCA Civ 164 and *Friends Life Management Services Ltd v A&A Express Building Ltd* [2014] EWHC 1463<sup>9</sup>, it is generally accepted that reserve funds are to be regarded as occupierstenants' monies, and if the fund has not been expended on expiry or sooner determination of the lease, the occupiertenant is entitled to repayment of any monies contributed to the fund.

Reserve funds remain part of the service charge, and all payments made out of the fund should be clearly communicated to occupierstenants and included as part of the annual reconciliation of the service charge.

#### **4.87.4.3 Depreciation charges**

Depreciation is the measure of the wearing out, consumption or other reduction in the life of an asset. By this definition, it is clearly the owner'slandlord's money. This view is supported by the decision in *Secretary of State for the Environment v Possfund (North West) Ltd* [1997] 2 EGLR 56, which determined that depreciation charges belong to the ownerlandlord absolutely.

OccupiersTenants do not want to pay for either the initial provision of an item (believing that to be the owner'slandlord's responsibility<sup>10</sup>) or to have to pay for something twice. If the ownerlandlord is recovering any depreciation from the service charge, it is essential that the wording on the lease recognises this, and also requires the ownerlandlord to carry out replacements to potentially pre-agreed service levels, etc.

#### **4.87.4.4 Forward funding**Best practice principles

Where provision for future expenditure is to be made within the service charge accounts such sums should not be included asIn managing sinking funds, reserve funds or depreciation charges, the following is considered best practice.

- Monies accumulated in a sinking fund or reserve fund are to be held in one or more separate discrete (or virtual) bank accounts to be maintained 'in trust' for the tenants.

~~The landlord or manager should act reasonably accruals but should be considered as contributions towards reserve or sinking funds as above and reported accordingly.~~

~~Accruals are expenses for goods and services actually incurred in a period for which no invoice has been received. As the cost relates to the period, it should be charged to the service charge account for that period.~~

~~However, in certain instances, owners and/or managers often seek to collect or retain money in anticipation of future expenditure by 'accruing' costs within a service charge period prior to any works being committed or any liability for expenditure being incurred.~~

- ~~Often the cost of anticipated major works is included in estimating the amount of the sinking fund or reserve fund contributions to be included in the service charge, which should relate to specifically identified expenditure only (for example, repairs or replacement of the roof, boiler plant, lift, etc.) rather than other unidentified future expenditure.~~
- ~~the~~  
~~The landlord or manager should provide a clear explanation of the basis of calculation of the sinking fund or reserve fund contribution and the items it relates to, and should apply a realistic assessment of the anticipated life cycle of the item in question and the funds accumulated from previous service charge periods (including any interest).~~
- ~~Landlords should make all payments into the sinking fund or reserve fund to account for void premises and concessions.~~
- ~~Service charge expenditure statements should clearly state any contributions to and expenditure from the sinking fund or reserve fund account, along with the account opening and closing balances, the amount of interest earned and any tax paid in the relevant period.~~
- ~~Where expenditure is required for any item that a sinking fund or reserve fund is established, the landlord should apply funds from the sinking fund or reserve fund towards such costs.~~
- ~~On completion of the sale of a property, the vendor should pass all sinking fund or reserve fund monies held to the purchaser, together with any accrued interest. Advice should be sought to ensure any tax liability on the fund is appropriately mitigated and accounted for.~~
- ~~Charges made in respect of depreciation belong to the landlord. Accordingly, where a depreciation charge is made, the responsibility for the cost of replacement moves to the landlord. The landlord or manager should act reasonably in estimating the amount of the depreciation charge and should provide a clear explanation of the basis of the charge calculation and the details of the specific items for which the depreciation charge is calculated.~~
- ~~A proper and reasonable depreciation charge should be considered as an annual cost to the landlord rather than recovery of the initial cost of installation.~~
- ~~Depreciation charges and sinking funds/reserve funds are mutually exclusive. A depreciation charge cannot be made where a sinking fund or reserve fund is or will be made in respect to a specific item, and vice versa.~~

#### **4.7.4.5 Funding of future costs**

## Agreed retention of funds already collected (non-accruals)

Where a provision for future expenditure is to be made in the service charge accounts, such sums should **not** be included as accruals.

Often the cost of anticipated work (major or minor) is included in a service charge budget but for whatever reason, no works ~~were actually are~~ commenced during the service charge period in question. In such circumstances, managers frequently seek to collect or retain money by incorrectly and improperly retaining the amount included ~~withinin~~ in the original budget ~~is frequently, and incorrectly, retained~~ as an 'accrual' against the anticipated commencement of works in the next or subsequent years.

Accruals are expenses for goods and services wholly delivered or performed in a service charge period for which no invoice has been received. As the cost relates to the period, it should be charged to the service charge account for that period. If no expenditure has been incurred, ~~it follows that~~ costs cannot then be 'accrued' into the service charge period.

Therefore, where no liability for costs has been incurred, the retention of ~~occupier~~ tenant monies outside of a properly constituted sinking fund or reserve fund is contrary to best practice, and is ~~considered to be wholly~~ inappropriate ~~under any~~.

Subject always to the terms of the lease, tenants should be given credit for any underspend of actual expenditure against the original budget.

Where funds have already been collected for works and were not progressed in the budget period but instead are anticipated to be carried out in the immediately subsequent service charge period, it may be pragmatic for managers to retain the money, rather than issuing refunds or credits, only to collect large balancing charges a year later.

However, a tenant may not be liable for the whole or a proportion part of their service charge liability for the works proposed in the event their lease expires or is otherwise determined prior to the commencement of works.

To avoid any accusations of impropriety or sharp practice, and to ensure complete transparency of the service charge accounts, in such circumstances, managers should agree with tenants as to how it is intended to deal with the retention of money already collected in advance of the issue of the year-end statement of actual expenditure, and to give tenants the opportunity to request full reimbursement.

However, where the lease ~~There might also be instances where goods, services or works are ordered and either partly complete or parts ordered but not delivered. These also do not necessarily form a valid accrual as the goods or services have not been wholly delivered or performed. The key issue is the extent to which goods and/or services have been 'performed or delivered'. For example:~~

a Where a project has started but not been completed within the relevant service charge period, an accrual might be permissible where there is demonstrable evidence of the value of works completed at the service charge year end. Any balance of the cost of the works to be completed in the subsequent service charge period might be an agreed retention (see above).

b The placing of an order for works or parts, where no works have actually commenced or, for instance, where the ordered part has not been delivered to site as a result of a long lead time, does not make specific give rise to a liability and therefore no valid accrual could be made, but might be an agreed retention (see above).

Where it is practical for these costs, or part, to remain in the closed service charge year, the treatment needs to be clearly disclosed and should be shown within the year-end accounts as 'agreed retention of funds already collected' and not in another cost code.

The exact treatment of these should be specifically and individually agreed with tenants and disclosed with those performing the audit or accounting review. RICS has produced a template to assist with this (*Voluntary agreement template 1: Agreement to retain monies included in a budget and already collected but where work has been deferred until a subsequent service charge period*), which can be found on the RICS website.

#### **Agreed contribution towards future works**

Where a lease makes no provision for the setting up of a sinking fund or reserve fund, it can often be beneficial to both owners and landlords and occupiers to spread the cost of anticipated future works over a number of several service charge periods. Such a voluntary arrangement will require to be separately agreed and any would normally be outside of the terms of the lease and outside service charge provisions. This voluntary agreement should set out what will happen to any accumulated funds in the event the lease expires or is otherwise terminated prior to the service charge period in which the expenditure is actually incurred (see subsection 4.8.4.2). RICS has produced a template to assist with this (*Voluntary agreement template 2: Agreement to forward fund the cost of future works*), which can be found on the RICS website.

Any forward funding agreed should be disclosed separately in the expenditure report under a different heading and not within another cost code, and titled, for instance, 'Agreed(such as 'agreed contributions towards future works') and not in another cost code. Further details of the forward funding should also be disclosed within the notes to the expenditure report.

#### **4.87.4.56 Payment plans**

Where a sinking fund or reserve fund or other basis of forward funding has not been put in place, the incidence of significant or extraordinary one-off expenditure can often represent an onerous burden for tenants. In such circumstances an owner, a landlord might be agreeable to recovering the costs over more than one service charge period (perhaps prepared, as a gesture of goodwill to ease the burden on an occupier's tenant's cash flow), to recover the costs over more than one service charge period. Where the lease is otherwise silent, this is to should be regarded as a concession—, which is should not to be confused with a reserve or sinking fund, reserve fund or a depreciation charge.

In granting such a concession, there needs to should be a clear agreement, which would often be expressed as 'personal only' to each occupier. It would be usual to ensure that the tenant. The period over which the expenditure is to be recovered is should usually be within the term of an individual occupier's tenant's lease. The agreement would should also need to set out outline what will happen with regard to regarding payment of any

outstanding balance on the original costs owed, in the event the occupiertenant assigns their lease or becomes insolvent, or if the lease is otherwise determined.

Where the occupiertenant is a single individual such an arrangement could, under certain circumstances, be considered to be a credit agreement under the Consumer Protection Act 1987, and therefore it is recommended that legal. Legal advice should be sought prior to entering into such an arrangement.

As any agreement is personal to each individual tenant, the arrangement is outside of the provisions of the service charge and, therefore, the costs carried forward should not be included in future service charge budgets or year-end accounts. Likewise, the charges for the agreed concession should also not be levied in the service charge. Excluding the costs in future year service charge accounts will avoid the unintentional scenario where future tenants might be charged for the cost of works that pre-dated their occupation.  
RICS has produced a template to assist with this (Voluntary agreement template 3: Agreement to defer the recovery of costs incurred by the landlord over future periods, known as a payment plan), which can be found on the RICS website.

#### **4.87.4.6 Best practice principles7 Disclosures**

In managing It has always been a requirement for schedules to be provided in the expenditure reports but this is now extended to include:

- sinking and funds, reserve funds or and depreciation charges, the following is to be considered as best practice:
- Monies accumulated in a sinking or reserve fund are to be held in one or more separate discrete (or virtual) bank accounts to be maintained in trust for the occupiers.
- The owner or managing agent should act reasonably in estimating the amount of the sinking or reserve fund contributions to be included within the service charge, which should relate to specifically identified expenditure only (for example, repairs or replacement of the roof, boiler plant, lift, etc.) rather than other unidentified future expenditure.
- funding future costs
  - agreed retention of funds collected
  - agreed contribution towards future works
- accruals The owner or manager is to provide a clear explanation of the basis of calculation of the sinking or reserve fund contribution and the items to which it relates, and should apply a realistic assessment of the anticipated life cycle of the item in question and the funds accumulated from previous service charge periods (including any interest).
- Owners are to make all payments into the sinking or reserve fund to account for void premises.
- Statements of service charge expenditure should contain a clear statement of any contributions to and expenditure from the sinking fund account, along with the account opening and closing balances, the amount of interest earned and any tax paid in the relevant period.

- Where expenditure is required in respect of any item for which a sinking or reserve fund is established, the owner should apply funds from the sinking or reserve fund towards such costs.
- On completion of the sale of a property, the vendor should pass all sinking or reserve fund monies held to the purchaser, together with any accrued interest. It is advisable to seek advice to ensure any tax liability on the fund is appropriately mitigated and accounted for.
- Charges made in respect of depreciation belong to the owner. Accordingly, where a depreciation charge is made, the responsibility for the cost of replacement moves to the owner. The owner or manager is to act reasonably in estimating the amount of the depreciation charge, and is to provide a clear explanation of the basis of the charge calculation and the details of the specific items for which the depreciation charge is calculated.
- A proper and reasonable depreciation charge is to be considered as an annual cost to the owner rather than recovery of the initial cost of installation.
- Depreciation charges and sinking/replacement funds are mutually exclusive. A depreciation charge cannot be made where a sinking or reserve fund is or will be made in respect to a specific item, and vice versa.
- prepayments and deposits.

To ensure transparency, each should be accompanied by notes setting out the description of the works concerned, but also further notes included in the expenditure report on the accounting treatment and balance. To ensure familiarity with these requirements, see Appendix B.

#### **4.98 Initial provision, replacement and improvement of fabric, plant and equipment**

The best practice recommendations in this section will help RICS members and RICS-regulated firms achieve the following mandatory requirements:

2 Subject to section 4.2.7, owners and managers Managers must seek to recover no more than 100% of the proper and actual costs of the provision or supply of the services.

3 Owners and managers must ensure that service charge Managers must issue to tenants: budgets, including appropriate an explanatory commentary, are issued annually to all tenants, at least one month prior to the start of the service charge year

4 Owners and managers must ensure that an approved set of service charge year end accounts showing a true and accurate record of the actual expenditure constituting the service charge are within four months of the service charge year end.

Where these timescales cannot be met, a timely explanation must be provided annually to all tenants of when they will be issued and the reason for the delay in line with the mandatory communication provisions. This does not dispense with the obligation to provide both. Where there is a legitimate reason for the delay in issuing budgets or reconciled year end accounts, managers must use all reasonable endeavours to issue these as soon as practicably possible.

#### **4.98.1 The principles of replacement and improvement in the context of service charges**

The service charge ~~would usually~~ should be limited to the recovery of the reasonable costs of maintenance, repair and replacement (~~usually~~ where beyond economic repair) of the fabric, plant, equipment and materials necessary for the property's operation.

Service charge costs should not include:

- ~~1~~ any initial costs (including ~~the cost of leasing, lease-hire purchase or other similar financing arrangement~~ of equipment) incurred in relation to the original design and construction of the fabric, plant or equipment
- ~~2~~ any setting-up costs that are reasonably ~~to be~~ considered part of the original development cost of the property
- ~~3~~ improvement costs above the costs of normal maintenance, repair or replacement (see ~~section~~~~subsection~~ 4.98.5) or
- ~~4~~ future redevelopment costs.

Service charge costs may include improvements or enhancement of the fabric, plant or equipment where such expenditure can be ~~justified~~~~evidenced~~ following the analysis of reasonable options and alternatives, and ~~with~~~~having~~ regard to a cost-benefit analysis over the term of the ~~occupiers' tenants'~~ leases. Managers should provide the facts and figures to support and justify such a proposal.

~~Current~~~~There is significant~~ case law ~~that~~ has determined that the length of the original or unexpired term of the tenant's lease may be a factor in determining whether costs are recoverable. ~~Current decisions do not give occupiers authority to sustain a proposition that, as a general rule, they cannot be required to pay a higher service charge for works carried out towards the end of the term of their lease. If an owner can demonstrate that repairs are necessary to comply with the obligations under the terms of and within the life of the lease, the costs are likely to be recoverable, even from a tenant whose lease is about to end. See the following leading, but not exhaustive, cases for guidance on interpretation:~~

- [Fluor Daniel Properties Ltd and others v Shortlands Investments Ltd \[2001\]](#)
- [Scottish Mutual Assurance v Jardine Public Relations \[1999\] E.G.C.S. 43.](#)

#### **4.98.2 Initial provision of fabric, plant and equipment**

Service charge costs should not include any initial costs (such as ~~the cost of leasing, lease-hire purchase or other similar financing arrangement~~ of equipment) incurred in relation to the original design and construction of the fabric, plant or equipment. The ~~owner~~~~landlord~~ is expected to provide these.

This also extends to the cost of fitting-out and equipping any on-site management facilities, as these costs will be indistinguishable from other facilities and equipment ~~that comprise part of the property~~, such as:

- lifts
- heating, ventilating and air-conditioning plant
- security systems or
- toilets, etc.

~~that comprise part of the property.~~ It is expected these systems will be provided for the management, administration and operation of the property's services from the outset.

In line with best practice, the initial cost of providing such furniture and facilities ~~are~~should not ~~to~~ be included as part of the service charge.

#### **4.98.3 Like-for-like replacement**

The service charge should be limited to the costs of replacement and renewal of fabric, plant or equipment only, providing:

- the relevant items being replaced or renewed are beyond economic repair, or efficient or economic operation
- replacement or renewal of such items is a relatively lower cost compared with the much greater cost that could occur due to material postponement of the replacement or renewal or
- replacement or renewal of such items is a proper requirement of any public or competent authority or legislation, or of the insurers.

Plant and equipment reaches the end of its economic life when it is more ~~economic cost effective~~ to replace it than to maintain it. Whether equipment is approaching the end of its economic life or not is determined by an inspection of the plant in operation by an experienced engineer. As equipment approaches the end of its economic life, it is reasonable to anticipate that failures will occur with increasing frequency; therefore, a review of service records, along with records of the occurrence and frequency of failures, will help to establish whether it is necessary to replace it.

#### **4.98.4 Replacement with enhancement**

~~Where plant and equipment that has become~~ The replacement of dilapidated or worn-out ~~is replaced, the replacement plant and equipment~~ will usually include an element of enhancement or upgrade of the previous equipment, ~~due to the fact that~~because the replacement will be of an equivalent modern standard.

Strictly speaking, replacement of plant and equipment by its modern equivalent would generally fall ~~within~~in the definition of repair and not improvements. However, there may ~~well~~ be a tendency towards exceeding the design specification of the original equipment ~~in order~~ to meet modern requirements, or to introduce new products or practices intended to improve the service levels and/or value for money.

If the costs are to be recovered through the service charge, it is important to consider whether the intention is to improve or repair the existing equipment.

If the additional cost of carrying out the improvement can be ~~justified~~evidenced on a cost-benefit basis~~—~~ for example, a reduction in the ongoing maintenance costs, increased energy efficiency, etc~~—~~— there is a case for the service charge to be made to cover these. In such circumstances, proper communication, supported by figures to support and justify such a proposal, will help achieve a practical and common-sense solution~~.~~(see subsection 4.8.7).

#### **4.98.5 Improvement and enhancement**

Service charges would not generally include the cost of improvement above the cost of normal maintenance, repair and replacement; but, However, it is likely that circumstances will arise where ownerslandlords and occupiertenants would see a direct benefit from the introduction of new innovations or additional improvement or enhancements of the building fabric, plant, or equipment. The service charge might include such costs where the expenditure can be justifiedevidenced following analysis of reasonable options and alternatives, and having regard to a cost-benefit analysis over the term of the occupiertenants' leases. Managers should communicate any proposals clearly to occupiertenants and provide the facts and figures to support and justify such a proposal (see also sectionsubsection 4.98.7).

#### **4.98.6 Refurbishment**

Refurbishment is a different concept to improvement. Within the scope of the refurbishment works proposed, there may include elements of catching up on accumulated disrepair as well as elements of improvement.

The amount occupiertenants will contribute towards the cost of refurbishment will depend on the extent and nature of the works proposed, in addition to the wording of the lease.

OwnersLandlords will seek to protect the value of their investments and to maximise rental levels. Refurbishments are often dictated by market forces, and often timed to coincide with rent reviews or lease expiries. Occupierexpiry. Tenants usually object to contributing towards the cost of refurbishment because not only will they be paying for the cost of refurbishmentcosts through the service charge, but also through increased rents as a resultbecause of any improvements.

When refurbishments result in higher rental values, the owner is tolandlord should be responsible for the cost of enhancements or improvements above those of maintenance.

The need to carry out extensive repairs or to replace services is also considered in the decision to refurbish. Prior to a refurbishment, major repairs or replacements may be deferred to benefit from economies of scale through placing one major works contract. The improved efficiency of the new environment and any improved services may produce cost savings in day-to-day services management, resulting in the annual service charge being reduced.

OccupierTenants may still be liable for the costs of repair or replacement carried out as part of a larger refurbishment contract, as though the works had been started separately from the refurbishment.

#### **4.98.7 Communication**

To ensure agreement and avoid dispute, if it is proposed to include the cost of improvements in the service charge, this is toshould be communicated to occupiertenants before any expenditure is committed. It would also be advisable to record anyAny agreement should be recorded in writing.

In the case of refurbishment, the ~~owner's~~landlord's proposals ~~are to~~should be communicated to all ~~occupier~~tenants well in advance of commencement of any works to explain which costs the ~~occupier~~tenants are responsible for in relation to the service charge. Best practice also recognises the need to establish regular communication between the manager and the ~~occupier~~tenants to monitor the refurbishment and to agree which elements of the works are to be considered service charge costs. This reduces or avoids the potential for dispute over any unexpected costs following completion of the works.

#### **4.10 Social, economic and environmental sustainability**

##### **4.9 Environmental, social and governance**

The best practice recommendations in this section will help RICS members and ~~RICS~~-regulated firms achieve the following mandatory requirements:

- 1 All expenditure that the ~~owner~~landlord and manager seek to recover **must** be in accordance with the terms of the lease.
- 2 ~~Subject to section 4.2.7, owners and managers~~ **Managers** **must** seek to recover no more than 100% of the proper and actual costs of the provision or supply of the services.

###### **4.10.1 Green leases**

~~The sustainability debate has been focused on how to develop more sustainable buildings, but it has ignored two issues:~~

- ~~what to do with existing buildings and~~
- ~~the role of the occupier in reducing emissions.~~

~~Green leases - commercial property leases that set down obligations on behalf of landlords and tenants to co-operate with the aim of reducing waste production and energy and water consumption - may be one way of addressing these issues.~~

~~Owners and occupiers~~Environmental, social and governance (ESG) relates to non-financial criteria, factors or standards relevant to businesses that may be considered in investment decisions and reporting by companies and may also be relevant to wider stakeholders and consumers.

~~However, landlords and managers should understand that their own corporate or company aspirations may not necessarily be shared by their tenants. Therefore, caution should be exercised when seeking to include costs or services in a service charge that relate to a landlord's ESG strategy or standards, but may not represent delivery of a true 'service' or may encompass improvements or enhancement, the cost of which should be borne by the landlord.~~

###### **4.9.1 Sustainable property management**

~~Landlords and tenants are advised to be now more acutely~~ aware of the environmental impact of their respective ~~business~~ operations. ~~This professional standard~~RICS supports and promotes a cooperative and collaborative approach in recognising and managing the environmental impact of the occupation and management of commercial premises. ~~It is not for this professional standard to set out the scope of this, but it is acknowledged~~

that property management now embeds these objectives as best practice. The Better Building Partnership has been leading the development of property management services, which seek to improve the sustainability of commercial buildings and provides valuable freely available resources and toolkits. Their Responsible Property Management Toolkit provides practical guidance for asset managers, property managers and facilities managers on embedding sustainability in property management services. However, it is important to reinforce that all expenditure that the landlord and manager seeks to recover **must** be in accordance with the terms of the lease. Delivery of these sustainable initiatives may fall in the category of improvement and not be recoverable under leases.

#### **4.9.2 Collaborative property management**

Leases are legally binding documents that are not easy to amend, but this does not mean that a collaborative approach to sustainable property management cannot be achieved. There may be value in owners and landlords and occupiers and tenants entering into a non-legally binding memorandum of understanding (MoU), which provides a roadmap for cooperation between the parties on improving the environmental performance of buildings. This allows the MoU to be updated to reflect the latest business practice as agreed between the parties during the term of the lease.

Further information can be obtained from the Better Building Partnership's Green Building Management Toolkit.

#### **4.10.2 Carbon Reduction Commitment Energy Efficiency Scheme**

In May 2010, the government committed to increasing the proportion of tax revenue accounted for by environmental taxes. The government classifies environmental taxes as those that meet all of the following three principles:

- 1 The tax is explicitly linked to the government's environmental objectives.
- 2 The primary objective of the tax is to encourage environmentally positive behaviour change.
- 3 The tax is structured in relation to environmental objectives (for example, the more polluting the behaviour, the greater the tax levied).

The Carbon Reduction Commitment Energy Efficiency Scheme (often referred to simply as 'the CRC') is defined by the government as an environmental tax based on these principles.

The CRC is aimed at improving energy efficiency and cutting emissions in large public- and private-sector organisations. It does not apply to all organisations but owners, managers and occupiers should continue to monitor for any updates.

The CRC dilemma is that it is a tax levied on organisations and is not property specific. Furthermore, it is a tax levied at the highest corporate level of an organisation and therefore in many instances the tax would not be paid by a tenant's immediate landlord, but by the landlord's parent company.

~~CRC is not, therefore, a property specific charge in the same way that the Climate Change Levy is directly linked to actual electricity or gas consumption and as a tax on organisations is not a tax or charge on landlords per se.~~

~~The position is further complicated in situations where the owner is responsible for the electricity supply to the whole of a building and is able to recover the cost of direct electricity consumption to the occupational premises, in addition to the costs of the landlord common parts areas, through the use of sub-meters, etc. In such circumstances, the owner in effect and inadvertently becomes liable for payment of CRC costs for which the occupier would otherwise have been directly liable.~~

~~In older leases it is a matter of contract law as to whether the lease specifically and unambiguously permits the landlord to recover the cost of CRC within the service charge. While the debate continues as to whether, in principle, CRC costs should properly be recoverable under a service charge arrangement owners and occupiers, managers and lawyers should carefully consider the implications when drafting new leases.~~

~~Nevertheless, there should be a fair and reasonable approach in the apportionment and recovery of CRC costs between owners and occupiers, based on the core principle that owners should be able to recover the full cost of providing bona fide services to occupiers and that occupiers should be in a no better or worse position than had they occupied premises on the basis of a full repairing and insuring lease, although with the emphasis on the ethos that the 'polluter should pay'.~~

~~Where CRC costs are to be recovered under a service charge arrangement the following is considered to embody best practice:~~

- ~~1 Occupiers should not be responsible for the owner's costs of managing and administering the CRC scheme.~~
- ~~2 Owners owe a duty of care to take such steps as are reasonably necessary to keep costs down and to procure that the relevant member of the group that has CRC responsibilities complies with its duties.~~
- ~~3 The method of apportionment across the landlord's group and between buildings owned by the landlord's group should be:
  - ~~a fair and reasonable and~~
  - ~~b consistently applied.~~~~
- ~~4 In the spirit of openness and transparency, occupiers should be provided with information to reasonably verify the accuracy and performance of these objectives (particularly in relation to the method of apportionment).~~

~~Note the government has confirmed that the CRC is to be abolished and organisations will report under the CRC for the last time by the end of July 2019 and surrender allowances for emissions from energy supplied in the 2018-19 compliance year by the end of October 2019.~~

#### **4.109.3 Improving environmental performance**

~~The sharing of Sharing pertinent data and other related information is essential. For this reason, it encouraged. It is advisable important for owners landlords, managers and~~

~~occupierstenants~~ to cooperate ~~onwith~~ the running of ~~any building management systems and on a range~~ the premises and implementation of environmental improvement measures. ~~Non-reporting will incur heavy penalties for owners and occupiers.~~ Cooperation on data sharing is essential.

There should be a fair and reasonable approach to:

- ~~the apportionment of sustainability costs between owners and occupiers, although consistent with the principle outlined previously that there should be an emphasis on the ethos that the 'polluter should pay'~~
- the carrying out of works that improve the environmental performance of the building ~~and acknowledging that some practices might take the costs outside those recoverable under the lease~~
- ~~restrictions on works by either party that adversely affect the environmental performance of the building.~~
- ~~assessment of cost justification, supported by an objective cost-benefit analysis to justify improvement costs above the costs of normal maintenance, repair or replacement (for example, installation of energy efficient plant)~~
- ~~sharing information and operational approaches as far as it is reasonably required for management of the premises.~~

In accordance with the principles set out in this professional standard, improved sustainability and other environmental improvement measures ~~are to should be taken into account considered~~ when ~~considering and~~ assessing whether any ~~particular~~ service or provider offers value for money. ~~These are also to be factors in any cost-benefit analysis carried out to justify improvement costs above the costs of normal maintenance, repair or replacement (for example, the installation of energy efficient plant).~~

#### **4.109.4 Energy Performance Certificates (EPCs)**

For the avoidance of doubt, the cost of obtaining an Energy Performance Certificate (EPC) would not normally be considered a recoverable service charge cost. An EPC is only required when a building is sold or rented, and therefore has no relevance to, nor is it a requirement for, the provision and management of common services.

#### **4.109.5 Minimum Energy Efficiency Standards and EPCs**

The *Energy Efficiency (Private Rented Property) (England and Wales) Regulations* 2015 introduced Minimum Energy Efficiency Standards (MEES) and are intended to improve the performance of existing private rented domestic and non-domestic ~~property stock~~ across England and Wales. ~~From 1 April 2018, it became unlawful for a~~ ~~Landlord~~ ~~landlord~~ to let a non-domestic ~~property that was deemed 'sub-standard' under the Regulations, these being properties with a current and~~ registered EPC with a rating of ~~worseless~~ than 'E' ~~, referred to as a substandard property.~~ While certain exemptions may be sought by a ~~given~~ ~~Landlord~~ ~~landlord~~, unless they are able to evidence and register these on the government's PRS Register, they will be unable to lawfully grant a new letting, a renewal lease or a lease extension ~~of such a 'sub-standard' on the substandard property; this was effective from 1 April 2018 and infringements.~~

Infringements are subject to Local Authoritylocal authority enforcement, including financial penalties of up to £150,000.–

From 1 April 2023, the Regulations will be extended to prohibit the continuing of existing lettings of 'sub-standard' non-domestic properties e.g. with an EPC rating of less than 'E' (for example, those on longer leases), in which case. Landlords of such properties will be subject to enforcement action and financial penalties if they permit such lettings to continue.

The obligation for compliance rests firmly with the lessorlandlord and the cost of obtaining an EPC wouldshould not normally be considered as a recoverable service charge cost as it is not a requirement for the provision and management of common services.

Subject to the terms of the lease and the principles set out in this professional standard, any subsequent costs of improving energy efficiency might comprise a legitimate service charge item, as long asif there is a proportionate cost benefit to tenants (see sectionsubsection 4.109.3).

#### **4.109.6 Social initiatives**

Buildings and its tenants can have an impact on local stakeholders. Communication and involvement with local stakeholders and communities is recognised as of being of benefit to all. While the direct benefits of this can be difficult to quantify, this professional standard supports and promotes a cooperative and collaborative approach.

4.11 Additional best It is important to establish a plan for how actions can have a positive impact on the local community and engage with tenants and visitors. Care is needed to ensure that such initiatives are not delivered for the benefit of the landlord's wider ESG goals at the expense of the service charge. There should be engagement with contributing tenants and publication of those activities organised at the property. It is common practice guidance for shoppingfor landlords to contribute to this function.

### **4.10 Shopping centres, retail and leisure parks and business campuses**

#### **4.110.1 Marketing and promotions**

The marketing of and promotional activity supporting schemes such as shopping centres, retail and leisure parks and business campuses, are recognised as being of joint benefit to all stakeholders, and areshould therefore rightlybe jointly funded. This would usually be expected to be on a 50/50an equal basis unless specific circumstances determinerequire a different approach. This joint funding should cover not just the actual marketing and promotions, but alsoand the costs of providing specialist staff (and accommodation, etc.) whether directly or via an agency arrangement.

The service charge budget and accounts should be transparent and should include the gross marketing and promotional expenditure and the contribution from the ownerlandlord and clearly show the net contribution due from the occupiertenants.

It is best practice for marketing plans (including promotions) to be prepared and presented to occupierstenants in advance of the period to which they relate. It is often useful to agree and regularly review marketing plans with occupiertenant/retailer associations in order to analyse their effectiveness, and to ensure that the stated objectives are achieved.

As marketing and promotions are of joint benefit, it is important for owners/landlords and managers to encourage occupierstenants to recognise that they have an obligation to proactively communicate their views on the best approach to marketing and/or promotions.

Any costs incurred in relation to the initial promotional launch and/or rebranding of a scheme should be borne by the owner,landlord and should not to be considered as recoverable service charge costs. It is recommended that any plan to relaunch a scheme be discussed between ownerthe landlord and occupierstenants so that they can agree to an appropriate split of the expenditure to each party.

The marketing of vacant units is not a service charge item.

#### **4.110.2 Customer services, amenities and facilities**

##### **4.110.2.1 Pedestrian flow and car counting**

Systems that collate information on the number of customers or cars visiting a site often can provide useful data to managers to help schedule resources to match the varying needs and demands of schemes. Such systems, if solely used for this purpose, are quasi-management tools and the cost of operating and maintaining such systems should therefore be clearly and explicitly shown as a separate cost heading within budget and actual expenditure reports. Best practice requires that the information obtained is to should also be shared with occupierstenants in a timely manner (at least quarterly) as a matter of course. Managers should be able to demonstrate how this information is used to adapt the service provision.

However, pedestrian flow and car counting data, used for landlord marketing and/or combined with sales or turnover statistics, is principally a tool for measuring or monitoring the effectiveness of marketing and promotion expenditure and should be either a shared marketing cost or a landlord cost, depending on the nature of the data collected and the extent to which it is shared.

Where the service charge bears an element of the cost, all pedestrian flow the data collected is should be shared regularly, to be issued to occupiers ensure the information remains useful and relevant, and managers should provide a clear explanation as a matter of course to how this information has informed decisions in service delivery.

##### **4.110.2.2 Entertainments and seasonal decorations**

The costs of entertainments, attractions, Christmas and other seasonal decorations and events within schemes are not classed as a marketing and promotional cost, but are regarded as amenities or facilities and should be included under the appropriate cost heading (see *Boots UK Ltd v Trafford Centre Ltd* [2008] EWHC 3372 (Ch)).

##### **4.110.2.3 Amenities and facilities**

Scheme management has moved beyond just providing clean, safe and secure environments, partly as a response to changing customer needs and expectations. There are many additional services, facilities and amenities that are often considered as a standard requirement by customers, for example, the provision of free Wi-Fi connectivity, customer services (appropriate to the property), or mobility and less able or other services for disabled people.

Where providing such services requires the addition of a new facility, this would generally be considered to be an improvement and the installation cost should be met by the owner landlord, while the on-going operating and maintenance cost, subject always to the terms of the lease, would usually be met through the service charge, as is standard practice with other areas of expenditure.

It is considered too prescriptive to attempt to provide a list of potential additional services herein this professional standard, as these might vary considerably from property to property, but the provision of such amenities and facilities should be appropriate to the property and location and be the subject of appropriate consultation and communication with occupier tenants.

The potential for the requirement to provide additional amenities and facilities will often result from technological innovations and where or changes in customer behaviours. Where this is the case, the provision of additional services and amenities should be carefully considered, be appropriate to the location and provide benefit to the customer experience and equally may increase scheme awareness and attraction.

#### **4.110.3 Commercialisation (non-core income)**

Increasingly, owners landlords are finding additional non-core income streams from their investments. They are entitled to receive this income from the investment they have made; however, if the service charge has provided either the initial capital or ongoing services for the income stream, the income is to should be used as a credit against the service costs. When the owner landlord provides the capital but uses the services to support the operation, a fair and reasonable contribution to the service charge is to should be made by the owner landlord to reflect the benefit and use of the services. Best practice for the owner landlord is to clearly state their policy with regard to regarding miscellaneous income within in the development.

As well as rents being collected on occupational leases, income is also generated from other sources. Many properties receive income from vending-machine takings, selling recyclable waste, etc., while owners landlords might also receive income from promotional space (e.g. for example, advertising on displays and drums, and in car parks, electric vehicle (EV) charging points, etc.) and licences granted for other activities within in the common part areas (e.g. for example, children's rides, photo booths, etc.). Occupiers Tenants may also have (chargeable) use of photocopiers in the management offices. How such income is treated varies considerably from property to property, and from owner landlord to owner landlord.

There is to should be a clear statement of policy on how and to where costs and income generated from services and activities are allocated. Transparency is required at all times.

Income derived from the provision of a service or activity (where the cost is included in the service charge), should be treated as a service charge credit (for example, photocopy and fax reimbursements, etc.). Income derived from promotional activity is to should be credited to the marketing expenditure budget.

Where the owner, landlord retains income from common-part areas, and the space is used on a permanent or semi-permanent basis, e.g. (for example, retail mobile units (RMUs) or kiosks), the space is to should be included in the service charge apportionment matrix. Alternatively, appropriate equivalent credit is to should be given for the costs of that space.

For less substantial or temporary fixtures, a sum is to should be credited to the service charge to reflect a contribution towards the benefit of the services enjoyed. Owners are to Landlords should estimate and declare a contribution to the service charge to reflect the benefit and use of the common services enjoyed.

Managers are to should clearly state their policy on how costs and income generated from services and activities are allocated. The following general principles should apply:

- If the item is not funded by the service charge, nor does it use any services, 100 per cent% of the income goes to the owner, landlord
- If the item is funded by the service charge, the income is credited to the service charge (e.g. photocopying for occupiers, tenants)
- If the item uses some of the services and/or needs support from the site team who are being paid via the service charge, a contribution is to should be made to the service charge in accordance with the policy.

In addition to the minimum information set out in section subsection 4.5.46, budgets and statements of actual expenditure are to should also to include a statement detailing how income generated from commercialisation or mall income is dealt with, and how shared services are charged. The statement is should also to clearly set out how this income impacts on the service charge, and what reimbursement has been made to it.

## Appendix A: Compliance checklist

This compliance checklist is a basis to enable owners, managers and occupiers to self-assess their compliance with the core principles set out in this professional standard. However, merely ticking the boxes does not constitute full compliance with the professional standard, which also entails adhering to the further recommended best-practice recommendations as provided to support the core principles.

Core principle	Evidence	Comply
<p><b>Value for money</b></p> <p>Procure an appropriate level of service for the occupiers in the building.</p> <p>Demonstrate that services offer good value for money.</p>	<p>Competitive tender.</p> <p>Other market testing.</p> <p>Regular cost benchmarking.</p>	
<p><b>Transparency</b></p> <p>All costs, apportionments and policies are explicit and open to any scrutiny by occupiers or their agents.</p>	<ol style="list-style-type: none"> <li>1. A full apportionment matrix for the entire property/estate/complex along with appropriate percentage allocation calculations is published.</li> <li>2. All policies are outlined in budget packs.</li> <li>3. Detailed explanations are provided in year-end statements where the costs have materially varied from the budget.</li> <li>4. The landlord bears the cost of all voids and concessions.</li> <li>5. The manager's fees relating to the property during the year are fully disclosed in the notes to the expenditure report.</li> </ol>	
<p><b>Timeliness of reporting</b></p> <p>All reports are issued within timeframes recommended by the professional standard.</p>	<ol style="list-style-type: none"> <li>1. Budgets are issued at least one month prior to the start of the service charge year.</li> <li>2. Year-end statements of actual expenditure are issued within four months of the end of the service charge year.</li> </ol>	
<p><b>Approval</b></p> <p>Actual expenditure approved by the manager or an audit or independent review.</p>	<ol style="list-style-type: none"> <li>1. Certificate issued by manager.</li> <li>2. Audit or independent review undertaken in accordance with the lease and TECH09/14BL.</li> </ol>	

<p><b>Management fee</b></p> <p>The management fee reflects a reasonable cost to undertake necessary work to manage and operate the services and to administer the service charge.</p>	<ol style="list-style-type: none"> <li>1. Fixed fee (not per cent of service charge).</li> <li>2. Meets professional standard guidelines on what can and cannot be charged for management.</li> </ol>	
<p><b>Duty of care to occupiers—consultation and approval</b></p> <p>All costs are recoverable in accordance with leases.</p> <p>The occupiers are consulted where appropriate for their agreement to the levels of service and services to be offered.</p>	<ol style="list-style-type: none"> <li>1. All occupiers are given the opportunity to comment on the budget.</li> <li>2. The occupiers are consulted on the levels of service and/or the introduction of new services.</li> <li>3. All communication and queries are to be dealt with fully and in a timely fashion.</li> </ol>	
<p><b>Standardised financial reporting</b></p> <p>Budgets and statements of actual expenditure are reported in line with this professional standard's cost categories.</p> <p>Where appropriate, separate schedules are prepared to allocate costs to reflect the availability, benefit and use of different services.</p>	<ol style="list-style-type: none"> <li>1. Standardised cost categories are used.</li> <li>2. Separate schedules are included as appropriate.</li> <li>3. Full allocation and apportionment schedules included as standard.</li> </ol>	
<p><b>Interest income and expenses</b></p> <p>Separate interest-bearing accounts are operated for each building, with all interest income and expenses credited or expensed within the service charge.</p>	<ol style="list-style-type: none"> <li>1. Bank statement of interest income and expenses.</li> </ol>	

<p><b>Professional standard-compliant terms in new leases</b></p> <p>New leases have adopted professional standard-compliant terms.</p>	<p>1. Standard lease terms.</p>	
<p><b>Support for alternative dispute resolution (ADR)</b></p> <p>ADR is supported and recommended as the basis to resolve service charge disputes.</p>	<p>1. Lease makes provision for ADR in the event of dispute.</p> <p>2. ADR is proactively pursued to facilitate resolution of disputes.</p>	

## Appendix B: Standard industry cost classifications

### B1A1 Notes

- The cost descriptions are for illustrative purposes only and not intended to represent an exhaustive list.
- OwnersLandlords and managing agentsmanagers are encouraged to include additional cost descriptions where this will facilitate greater transparency and clarity with regard to regarding the expenditure incurred or proposed. However, to maintain industry standards and to facilitate benchmark comparison, the cost-class and cost-category structure should not be altered.
- Where reasonable and appropriate, cost should be allocated to separate schedules. Separate cost categories are should not to be used to describe activities provided across different elements of a subject property, such as the estate, car park, etc. However, where multiple schedules are not used, in order to achieve transparency it may be necessary to repeat certain cost descriptions to make a clear distinction between specific areas where costs have actually been incurred, for example, cleaning costs for estates and car parks.

## **A2 Cost classifications**

Cost class			
	Cost category		
		Cost description	Notes
<b>Management</b>			
	<b>Management fees</b>		
		Management fees	<a href="#">Owner's Landlord's</a> or manager's fees for managing and administering the services that are permitted to be recovered under the terms of the lease, excluding rent collection, asset management, etc.
	<b>Accounting fees</b>		
		Service charge accounting fees	Fees for preparation of <a href="#">year-end</a> service charge statement and reconciliation.
		Independent accountant's fees	Independent accountant's fees to review the <a href="#">year-end</a> service charge <a href="#">year end</a> accounts.
		Audit fees	Auditor's fees for carrying out a formal audit of the service charge.
	<b>Site-management resources</b>		
		Staff costs	Direct employment or contract costs for provision of staff for management of on-site facilities.
		Receptionists/concierge	Direct employment or contract costs for <a href="#">the</a> provision of reception and concierge staff, including associated administrative and training costs.
		Site accommodation (rent/rates)	Rent, service charge and rates associated with the site-management accommodation.
		Office costs (telephones/stationery)	Day-to-day running costs of the on-site management office.

	Systems	Costs of computer licences, <a href="#">etc.</a> and other systems.
	Help desk/call centre/information centre	Operational costs for providing <a href="#">helpdesk</a> <a href="#">help desk</a> /call centre/information centre facilities.
	Administration fee	Fees for HR and payroll costs associated with dealing with on-site staff (where not included as part of the management fee).
<b>Professional fees</b>		
	Landlord's risk assessments, audits and reviews	Consultancy fees and other costs associated with <a href="#">the</a> provision and review of <a href="#">owner's</a> <a href="#">the landlord's</a> health and safety (H&S) management systems.
	Other professional fees	Fees of specialist consultants engaged in respect of the provision of services.
	Legal fees	Legal advice in respect of the placing or termination of contracts for the provision of services.
<b>Utilities</b>		
	<b>Electricity</b>	
	Electricity	Electricity supply to common part and retained areas and central plant, excluding the direct consumption of <a href="#">occupier(s).</a> <a href="#">the tenants.</a>
	<b>Gas</b>	
	Gas	Gas supply for the <a href="#">owner's</a> <a href="#">landlord's</a> central plant, excluding the direct consumption of <a href="#">occupier(s).</a> <a href="#">the tenants.</a>
	<b>Fuel oil</b>	

		Fuel oil	Fuel-oil supply for the <u>owner's</u> <u>landlord's</u> central plant, emergency generators, etc., excluding direct consumption of the <u>occupier</u> <u>tenant</u> (s).
	<b>Water</b>		
		Water and sewerage charges	Water supply to <u>the</u> central plant, common part and retained areas, excluding direct consumption of the <u>occupier</u> <u>tenant</u> (s).
	<b>Utility consultancy</b>		
		Utility procurement and consultancy	Consultancy and procurement fees incurred for negotiating, reviewing, auditing and reporting on all utilities.
<b>Soft services</b>			
	<b>Security</b>		
		Security guarding	Direct employment or contract costs incurred in providing security guarding for the building(s).
		Security systems	Servicing and maintenance of building security systems (e.g. CCTV, access control, intruder alarms, etc.).
	<b>Cleaning and <u>sustainability</u><u>sanitation</u></b>		
		Cleaning	Cleaning of <u>the</u> common-part and retained areas.
		Window cleaning	Cleaning of external windows.
		Hygiene services/toiletries	Cleaning and servicing of <u>the</u> common-part toilets and toiletry accommodation.
		Carpets/mats hire	Provision of dust and rain mats to <u>the</u> common-part areas.
		Waste management	Refuse collection and waste-management services provided for building <u>occupier</u> <u>tenants</u> .

	Pest control	Pest-control services provided to <u>the common-part</u> and retained areas.
	Snow clearance/road gritting	Costs incurred in clearing snow and supplying snow-clearing equipment and gritting salt.
<b>Landscaping and <u>environmental</u>enlivenment</b>		
	Internal floral displays	Providing and maintaining floral displays <u>within</u> in the common part areas.
	External landscaping	Provision and maintenance of external landscaped areas and special features.
	Seasonal decorations	Provision and maintenance of seasonal decorations to <u>the common-</u> part areas.
	Events and entertainments	Events and entertainments <u>within</u> in the common <u>part</u> part areas.
<b>Marketing and promotions</b>		
	Marketing	Marketing and advertising in accordance with <u>the</u> marketing strategy.
	Research	Research into local market conditions, customer surveys, pedestrian flow counting systems, etc.
	Marketing staff costs	Direct employment of staff or staff contract costs for marketing and promotional activity.
	Landlord's contribution to marketing	Financial contributions made by <u>the</u> landlord towards marketing and promotions.
<b>Hard services</b>		
	<b>Mechanical and electrical services (M&amp;E)</b>	

	M&E maintenance <a href="#">and repair</a>	<a href="#">Planned Details of the</a> maintenance and repair of contract for the owner's landlord's M&E services, including the contractor's <a href="#">health and safety (H&amp;S)</a> compliance.
	<a href="#">M&amp;E repair</a>	<a href="#">Repair and planned maintenance costs for the landlord's M&amp;E services</a>
	Life safety systems maintenance <a href="#">and repair</a>	<a href="#">Planned Details of the</a> maintenance and repair of contract for the owner's landlord's fire protection, emergency lighting and other specialist life safety systems, including the contractor's H&S compliance.
	<a href="#">Life safety systems repair</a>	<a href="#">Repair costs of the landlord's fire protection, emergency lighting and other specialist life safety systems.</a>
	H&S (mechanical and electrical)	Works carried out to M&E plant and equipment in accordance with H&S regulations or recommended best practice.
	M&E/life safety systems inspections and consultancy	Auditing the quality of maintenance works and the condition of M&E plant and life safety systems to ensure H&S and statutory compliance.
	Car parking M- <a href="#">&amp;E</a> maintenance <a href="#">and repairs</a>	<a href="#">Maintenance and repair of Details of the maintenance contract for</a> entry systems, payment systems, car counting systems and other specialist car park equipment.
	<a href="#">Car parking M&amp;E repair</a>	<a href="#">Repair costs of entry systems, payment systems, car counting systems and other specialist car park equipment.</a>
	<b>Lifts and escalators</b>	
	Lift maintenance contract <a href="#">and repair</a>	<a href="#">Maintenance and repair of Details of the maintenance contract for</a> lifts in the common part and retained areas, including the contractor's H&S compliance.

		<a href="#">Lift repair</a>	<a href="#">Repair cost of lifts in the common part and retained areas.</a>
		Escalator maintenance <a href="#">and repair</a>	<a href="#">Maintenance and repair of Details of the maintenance contract for</a> escalators in the common part and retained areas, including contractor's H&S compliance.
		<a href="#">Escalator repair</a>	<a href="#">Repair cost of escalators in the common part and retained areas.</a>
		H&S (lifts and escalators)	Works carried out to lifts and escalators in accordance with H&S regulations or recommended best <a href="#">practicespractice</a> .
		Lift and escalator inspections and consultancy	Auditing the quality of maintenance works, the condition of lift plant and H&S <a href="#">and statutory</a> compliance.
		<b>Suspended-access equipment</b>	Suspended-access equipment includes all forms of high-level access equipment maintenance, e.g. hatchways, eyebolt, fall address and cradles.
		Suspended-access maintenance <a href="#">and repairs</a>	<a href="#">Maintenance and repairs to Details of the owner's maintenance contract for the landlord's</a> suspended-access equipment, including the contractor's H&S compliance.
		<a href="#">Suspended access repair</a>	<a href="#">Repair costs of the landlord's suspended access equipment.</a>
		Suspended-access inspections and consultancy	Auditing the quality of maintenance works, the condition of suspended-access equipment and H&S compliance.
		<b>Fabric repairs and maintenance</b>	
		Fabric repairs and maintenance	Repair and maintenance of the building structure and fabric <a href="#">to the common part</a> and retained areas.

	Redecoration	Redecoration and decorative repairs.
	H&S ( <a href="#">Fabric</a> <a href="#">fabric</a> )	Works carried out to <a href="#">the</a> building fabric in accordance with H&S regulations or recommended best practice.
	Building fabric inspections and consultancy	Auditing the quality of maintenance works, the condition of the building and H&S compliance.
	Car park fabric maintenance and repairs	Maintenance and repair of the car park structure, fabric and road surfaces.
<b>Income</b>		Distinct activities that yield a true income to the service charge account.
	<b>Interest</b>	
	Interest	Interest received on service charge monies held <a href="#">within</a> <a href="#">in</a> the <a href="#">owner's</a> <a href="#">landlord's</a> or manager's bank account.
	<b>Income</b>	
	Car park income	
	Commercialisation income	
	<a href="#">PV and EV charging</a>	
	Vending machine income	
	Gift card income	
	Other income	
<b>Income operating expenses</b>		
	Operating expenses	Overheads, expenses and operational costs incurred in providing any of the income streams, including gift cards.
	Bank charges and transaction costs	Cash collection costs, transaction fees related to income.

	Staff costs	
<b>Insurance</b>		
	<b>Engineering insurance</b>	Landlord's engineering insurances.
	Engineering insurance	
	<b>Engineering inspections</b>	
	<b>All-risks insurance cover</b>	Landlord's all-risk insurance costs.
	Building insurance	
	Loss of rent insurance	
	Public and property owner's liability	
	Landlord's contents insurance	
	<b>Terrorism insurance</b>	Landlord's terrorism insurance cover.
	Terrorism insurance	
	<b>Submitted and pending insurance claims</b>	Where service charge funds have been used to settle costs that are or may be subject to an insurance claim, the costs should be shown in the expenditure report.
<b>Exceptional expenditure</b>		
	<b>Major works</b>	
	Project works	Exceptional and one-off project works, over and above <u>the</u> routine operational costs.
	Plant replacement	Replacement of the whole or major components of plant and equipment (where beyond economic repair).
	Major repairs	Significant one-off repairs or maintenance costs over and above the costs of routine operational maintenance and repair.
	<b>Forward funding</b>	

	Sinking <a href="#">funds</a> <a href="#">fund</a>	<a href="#">Forward funding of specific major replacement projects (e.g. plant and equipment replacements, roof replacements, etc.). A fund formed for a defined purpose by periodically setting aside money for the replacement of a wasting asset.</a>
	Reserve <a href="#">funds</a> <a href="#">fund</a>	<a href="#">Forward funding of specific periodic works</a> <a href="#">A fund formed for a defined purpose to even out/meet anticipated future costs of maintenance and upkeep to avoid fluctuations in annual</a> <a href="#">the amount of</a> service charge costs (e.g. internal/external redecorations) payable each year.
	Depreciation charge	<a href="#">Depreciation charge in lieu of sinking/replacement fund contribution for major plant and equipment costs.</a> <a href="#">A measure of the wearing out, consumption or other reduction in the life of an asset.</a>
	<a href="#">Agreed retention of funds already collected</a>	<a href="#">Where costs have been included in the service charge budget, but no liability existed at the year end to qualify as a valid accrual. The costs remain posted in that year in accordance with terms agreed between the landlord and tenants.</a>
	Agreed contribution to future works	Forward funding of major projects but where the lease does not allow for a sinking <a href="#">fund</a> or reserve fund to be set up. This is a voluntary arrangement and <b>must therefore</b> be agreed in writing between the <a href="#">owners</a> <a href="#">landlords</a> and individual <a href="#">occupiers</a> <a href="#">and tenants</a> <a href="#">with</a> full details provided <a href="#">within</a> <a href="#">in</a> the notes to the service charge expenditure report.
<b>Miscellaneous charges</b>		
	<b>Irrecoverable VAT</b>	

		Irrecoverable VAT	Cost of any irrecoverable VAT (if not included in headings above).
<b>External contributions</b>			
		Contributions from <a href="#">internal</a> <a href="#">external</a> parties	
		Contributions to external parties	

## Appendix CB: Service charge accounting sample report

In managing the provision of services and in certifying the service charge, managers have a duty to both owners and landlords and occupiers and tenants to act with professional care, diligence, integrity, and objectivity.

Accounting for service charges in the property industry is a specialist area that requires expertise and an understanding of the sector.

The current edition of RICS' professional standard *Service charges in commercial property*, RICS professional standard, 1st edition, recommends as best practice that an annual statement of service charge expenditure should be certified by the manager to confirm that it represents a true and accurate record of expenditure incurred in supplying the services to the building, and that the. The expenditure being recovered is should be in accordance with the terms of the occupational leases.

The professional standard also recommends that annual statements of service charge expenditure should be reviewed by an independent accountant.

The Institute of Chartered Accountants in England and Wales (ICAEW) and RICS have has issued a technical release (Accountants' reports on commercial property service charge accounts (TECH 09/14BL)) to provide guidance on reporting on commercial service charges. ThisThe technical release provides good practice guidance on technical and practice issues relevant to the work of accountants and other professionals.

This sample report sets out recommended best practice for the disclosures and information that managers should provide to the accountants appointed to carry out an independent review of service charges and to tenants.

It is not for this professional standard to prescribe the operating business model of the manager and, therefore, there is no strict layout or order of preference for the statement of service charge expenditure. However, it is recommended best practice that the statement of service charge expenditure should include the following elements:

- the expenditure report (C3B3, BA and CA and CBBB)
- the service charge certificate (C4B4)
- the independent accountant's report
- notes to the expenditure report and variance report (C5B5 and CCBC)
- operational review (C6B6) and
- the apportionment matrix (CDBD and CEBE).

The information referred to in this sample report under 'Operational review' is considered to be best practice to meet the core principles for communication and transparency as set out in the professional standard as to the nature, type and cost of services provided but would usually be. The operational review, service charge allocation and apportionment and general notes are outside of the scope of the independent accountant's review.

### Statement of service charge expenditure

[OWNER'S LANDLORD'S NAME]

[PROPERTY NAME AND ADDRESS]

[dd/mm/yyyy] TO [dd/mm/yyyy]

**Total service charge expenditure** £

### **C1B1 Introduction**

This report has been produced by [manager's name] on behalf of [owner's landlord's name], landlords of [property name] and relates to the reconciled service charge for the period [dd/mm/yyyy] to [dd/mm/yyyy]. This report has been produced having regard to the best practice guidelines for service charges in commercial property that have been published through the collaboration of a number of several professional bodies representing a diversity of interests throughout the property industry.

The report is intended to provide further explanation as to actual service charge costs incurred and any material variances against the property budget issued to tenants on [dd/mm/yyyy]. A summary and detailed expenditure report is included at CAsection BA with a variance report showing percentage charge year-on-year at CCsection BC.

### **C2B2 The management team**

[Insert names and contact details of management team, i.e. property managers, building/centre manager, accounts manager, etc.]

### **C3B3 Service charge expenditure report**

The summary or detailed expenditure report should be inserted. This should be prepared and presented in accordance with the current edition of the RICS professional standard, RICS' Service charges in commercial property. Examples of the summary and detailed expenditure reports are included as CAsections BA and CBBB respectively, to this sample report.

## **B4 Service charge certificate**

### **Model landlord surveyor's certificate**

**Certification period: [dd/mm/yyyy] to [dd/mm/yyyy]**

Landlord: .....

Managing agent: .....

Building: .....

I hereby certify that, according to the information available to me, the attached statement of service charge expenditure, supporting notes and accompanying information on pages [X] to [Y], records the true and accurate actual cost to the landlord of providing the services to the property for the period [dd/mm/yyyy] to [dd/mm/yyyy], in accordance with the current edition of the RICS professional standard, RICS' Service charges in commercial property.

Signed .....

Signed .....

[Name and qualifications]

Position

---

For and on behalf of [manager's name]

---

C5Date of issue .....

## **B5 Notes to the expenditure report**

### **C5B5.1 Accounting policies**

#### **C5B5.1.1 Accruals basis**

A statement should be made as to whether the accounts are prepared on an accruals basis or cash basis (note: that best practice recommends all statements of service charges should be prepared on an accruals basis).

#### **C5B5.1.2 Independent accountant's review or audit**

A statement should be made as to the terms of reference and scope of the independent accountant's review or audit of the service charge.

#### **B5.1.2 Insurance claims**

A statement should be made detailing how insurance claims are accounted for, e.g. for example, it is policybest practice to recognise income in respect of insurance claims in the service charge period in whichwhere confirmation has been received from the insurers that the claim will be settled. The associated costs of the claim are charged to the service charge in the period in whichthat the costs are incurred.

#### **C5.1.3 Landlord forward funding**

A statement should be made detailing how forward funding by the landlord is accounted for, e.g. where the costs of major works expenditure has been borne upfront by the landlord the cost is to be recovered through the service charge in accordance with the terms agreed between the landlord and tenants.

This section may also be used to provide further details in respect of other policies accounting policies adopted in preparing the expenditure report. For example, details of landlord contribution to the service charge.

### **C5B5.2 VAT**

#### **Example wording**

With effect from [dd/mm/yyyy] the landlord elected to waive the exemption from VAT. Therefore, all service charge expenditure is shown exclusive of VAT. VAT will be charged at the appropriate rate on all service charge payments demanded/invoiced by the landlord.

**OR**

The landlord has not elected to waive the exemption from VAT and therefore all service charge expenditure is shown inclusive of VAT where applicable.

**[Example wording]**

With effect from [dd/mm/yyyy] the landlord elected to waive the exemption from VAT. Therefore, all service charge expenditure is shown exclusive of VAT. VAT will be charged at the appropriate rate on all service charge payments demanded/invoiced by the landlord.

**[OR]**

The landlord has not elected to waive the exemption from VAT and therefore all service charge expenditure is shown inclusive of VAT where applicable.

### **B5.3 Sinking fund/and reserve fund**

This section ~~is to~~should include a description of the intended purpose of any/each sinking/fund and/or reserve fund and details of the calculation of the contributions together with an explanation of the tax treatment of contributions to and interest earned on such funds, and details of the bank account where such monies are held.

It is important to recognise and understand the distinction between sinking funds and reserve funds and all contributions thereto should be accounted for separately.

Balance brought forward as at [dd/mm/yyyy] £

Contributions during the year excluding interest £

Interest credited £

Expenditure during the year excluding tax £

Tax paid £

Balance carried forward as at [dd/mm/yyyy] £

£5

<u>Sinking fund (example)</u>	£	£
<u>Opening balance brought forward as at [dd/mm/yyyy]</u>		
<u>Contributions during the year excluding interest</u>		
<u>Interest credited</u>		
<u>Less – expenditure during the year</u>		
<u>Closing balance carried forward as at [dd/mm/yyyy]</u>		

### **B5.4 Depreciation charges**

This section ~~is to~~should include a clear explanation of the basis of the charge calculation and details of the specific items for which the depreciation charge is made.

### **C5B5.5 Agreed retention of funds already collected**

Where agreement has been reached for the landlord to retain monies within the service charge account that have already been collected but where work has been deferred until a subsequent service charge period, the costs should not be shown as an accrual

but in the expenditure report under a separate heading in forward funding titled 'agreed retention of funds already collected'. Details disclosed in this note should include:

- the nature of the works
- contributionsthe amount originally included in the budget
- the cost (if any) incurred in the current service charge period and
- balance of the original budget amount being retained and to be credited to the service charge in the next or subsequent service charge period.

#### **B5.6 Agreed contribution towards future works**

Where the lease does not specifically allow for sinking funds and/ or reserve funds to be set up, but there is an agreement between the ownersandlords and occupierstenants to include a charge in the service charge by way of a reserve fund in anticipation of future works, then these costs should be shown on the expenditure report under a separate heading within forward funding titled, 'Agreed 'agreed contributions towards future works'. Details disclosed in this note should include:

- the nature of the works
- the total cost
- the amount being charged to the tenants via the service charge and
- a timetable of when the charges will be made.

#### **C5.6 Landlord forward funding**

Details disclosed should include:

- the nature of the works
- the total cost
- the amount being rechargedcharged to the tenants via the service charge and
- a timetable of when the rechargescharges will be made.

If the owner is seeking to include interest on borrowed monies full details are also to be provided.

- C5balance of fund brought forward
- contributions made during the year
- expenditure in the year and
- balance of fund carried forward.

The extent of these provisions should also be applied for payment plans referred to in subsection 4.7.4.6 with required adjustment.

#### **B5.7 Banking**

A clear statement is to should be provided as to whether service charge monies are held in one or more discrete (or virtual) bank accounts and whether interest earned is credited to the service charge account.

## **C5B5.8      Commercialisation**

Where income is generated from services and activities in the property, include a clear statement of policy on how and to where costs and income generated from such services and activities are allocated.

## **C5B5.9      Marketing and promotions**

The service charge accounts should be transparent and should include the gross marketing and promotional expenditure and the contribution from the ownerlandlord, to clearly show the net contribution due from the occupierstenants.

Gross marketing/promotion expenditure	£
Contribution from the <u>ownerlandlord</u>	£
Net marketing/promotion expenditure	£

## **C5B5.10-    Total cost of management**

### **C5B5.10.1   Management fees**

The manager should provide details of the basis of their appointment and whether this relates only to the subject property or includes other propertyproperties owned by the same landlord~~or~~ client.

The manager should confirm the basis of the fee, e.g. for example, a fixed fee subject to annual review/indexation and should include a clear statement as to whether the fee relates only to work carried out in managing the service charge. RICS' professional standard *Service charges in commercial property* clearly states that asset management and rent collection costs are excluded from the service charge management fee.

GoodBest practice would be to confirm this in the service charge budget and statement of actual expenditure.

### **C5B5.10.2   On-site management**

The manager should provide details of all on-site management staff and the total employment costs, which would usually include National Insurance, pension contributions and other direct employment costs. A separate breakdown of any other costs incurred in employing on-site staff, such as the provision of office accommodation, etc. should be provided.

If staff are employed on more than one property, a clear explanation is to should be given of the calculation of the costs charged to the subject property, which should generally only relate to those costs associated with the actual time spent working on that property.

If a separate administration charge is made in relation to human resources and payroll costs associated with dealing with on-site staff, this should be clearly stated together with the fee amount of the fee and identified as a separate cost heading.

### **C5B5.10.3   Summary of all fees charged by the managing agentmanager**

All fees charged by the managing agentmanager should be separately disclosed in the service charge accounts. This can either be done by using separate codes on the face of

the expenditure report or by providing additional detail by way of a note. An example note is provided below:

Expense code	Total fees	Professional fees	Procurement fees
Management fees	£1,000	£1,000	-
FM Facilities management fees	£500	£500	-
Help desk	£250	£250	-
Staff salaries (on-site)	£250	£250	-
Office costs (on-site)	£50	£50	-
Electricity	£250	-	£250

Where there have been multiple managers during the period, the relevant fees should be shown in separate columns.

### **C5B5.11 Accruals**

These accruals are expenses for goods and services actually incurred in a period for which no invoice has been received. As the cost relates to the period, it should be charged to the service charge account for that period.

Large round sum provisions included to spread the cost of significant works over a period of time are not accruals as they do not represent a liability at the end of the period. Accordingly, they should not be included as accruals but should be considered as contributions towards reserve funds or sinking funds and disclosed separately (see sections B5.5 and B5.6).

A schedule of material accruals included in the service charge expenditure should be provided. Where invoices are not received in respect of an accrual brought forward from the previous year, the accrual should be credited back to the service charge unless there is a realistic expectation that an invoice will be received in the future.

Large round sum provisions included to spread the cost of significant works over a period of time are not accruals as they do not represent a liability at the end of the period. Accordingly, they should not be included as accruals but should be considered as contributions towards reserve or sinking funds and disclosed separately (see section C5.3).

C5A note should be included stating that in preparing the pack, it has been agreed with those conducting the review and approval of service charge accounts (see subsection 4.5.3) that no material accruals have been included where there is no liability at year end.

## **B5.12 Prepayments and security deposits**

A schedule of prepayments and deposits held (such as for utilities) should be included in the service charge expenditure for the period should be provided (including utility deposits).

## **C5B5.13 Empty units and concessions granted to tenants**

Where appropriate, costs are apportioned on a daily basis and, for the avoidance of doubt, it is confirmed that the landlord bears an appropriate proportion of the service charge expenditure in respect of voids and vacant premises.

Likewise, if any tenant has any form of concession, whereby their contribution towards the service charge is capped, or is lower than the apportionment due, the landlord pays the difference.

## **C6B5.14 Insurance claims**

Where service charge funds have been used to settle costs that are or may be subject to an insurance claim, the costs should be shown in the expenditure report under a separate heading titled 'submitted and pending insurance claims'. Details disclosed in this note should include:

- date of the claim
- the nature of the works undertaken
- the cost incurred in the current service charge period and
- balance incurred in the previous service charge periods potentially to be received.

## **B6 Operational review**

This section should comprise a comparison between the budgets and finalised actual expenditure for each service line for the period in question. The report should be prepared using the same headings as the service charge expenditure report and should include a detailed commentary and an explanation of significant variances.

## **C6B6.1 Service procurement**

### **C6B6.1.1 Procurement fees**

Where a procurement specialist is used, this should be clearly stated together with the amount of the fee and the cost category in which it is included. A clear explanation should also be provided as to the basis of calculation of the fee to demonstrate delivery of best value solutions, greater value for money and cost-effectiveness.

## **C6B6.2 Contracts**

The manager should provide tenants with a schedule of contracts in force during the service charge period with details of:

- the contractor, a summary of
- the scope of the contract,
- the annual contract sum,
- the date of commencement and

- length of the contract and dates of any reviews.

Where a contract has been retendered or placed during the service charge period, the manager should provide a brief summary of the results of the selection process and a clear explanation of the rationale for the appointment.

Where appropriate, and at least every three years, contractors and suppliers should submit competitive tenders or quotations although, However, where this is not considered to be cost effective, the manager should benchmark the service standards and pricing to confirm value for money.

For each of the main service lines, the manager should provide a summary of when the service line contract was last retendered.

### **C6B6.3 Service charge allocation and apportionment**

#### **C6B6.3.1 Service charge allocation – schedules**

Where costs are allocated into separate schedules, managers should provide a detailed description of the schedules and the basis and rationale for the cost allocation.

**For example:**

#### **Service charge allocation**

Costs are allocated to separate schedules and the costs apportioned to those who benefit from those services as follows:

[Insert list of schedules and description]

Schedule 1 Estate

Schedule 2 Building 1

Schedule 3 Building 2

[Note to managers – add additional schedules as necessary to achieve fair and reasonable allocation of costs.]

#### **Schedule 1 – Estate**

[Note to managers – add additional schedules as necessary to achieve fair and reasonable allocation of costs].

#### **Schedule 1 – Estate**

[Insert detailed description of schedule and basis of allocation].

#### **Schedule 2 – Building 1**

#### **Schedule 2 – Building 1**

[Insert detailed description of schedule and basis of allocation].

#### **Schedule 3 – Building 2**

#### **Schedule 3 – Building 2**

[Insert detailed description of schedule and basis of allocation].

**C6**

### **B6.3.2 Service charge apportionment**

Managers are to should provide a full apportionment matrix for the property/complex to all occupier tenants, which clearly shows the basis of calculation and the total apportionment per schedule for each unit within the property/complex. To avoid doubt and to preserve confidentiality, this should exclude details of any individual concessions or other arrangements between individual owners and landlords and occupier tenants; these are costs that are normally to be borne by the owner landlord. An individual occupier should be able to clearly verify the basis and method of calculation used in arriving at their particular percentage apportionment.

Managers should also be transparent with regard to regarding the treatment of void and unlet premises, and the cost attributable to the owner's landlord's own use of the property (see empty units and concessions granted to tenants in [Section B5.13](#)).

See [CD sections BD](#) and [CEBE](#) for example apportionment matrices.

### **C6B6.4 Notes on expenditure**

A full copy of the budget is enclosed in Appendix A in both summary and detail detailed form. The total anticipated expenditure for [property name] is £xxx£ [...] split across x [...] schedules.

The expenditure comprises the following:

Note to managers:

Include summary information under each standard industry cost classifications detailing the service provided, the cost and comments on the specification or staffing levels, last tendered, etc. Explanatory notes are to include a detailed explanation of significant individual costs together with an analysis and full explanation of any material variances between budget and actual expenditure.

Service charge budgets and actual expenditure reports should use the standard industry cost classifications. As a minimum acceptable level of reporting, all reports should be detailed at cost class and cost category level as below.

However, to achieve transparency in accordance with the principles of the professional standard it is recommended best practice particularly in respect of larger properties, that budget and actual expenditure reports and analyses should be provided at detailed cost description level whenever practicable, with a summary of the total costs under each cost category.

In accordance with the proportionality statement included under the professional standard's core principles, for smaller properties or those with limited service charge expenditure (e.g. industrial sites) it is considered acceptable to report at the higher cost category level although this should generally be regarded as an exception rather than the usual practice.

C7

Note to managers:

Include summary information under each standard industry cost classification detailing the service provided, the cost and comments on the specification or staffing levels, last tendered, etc. Explanatory notes should include a detailed explanation of significant individual costs together with an analysis and full explanation of any material variances between budget and actual expenditure.

Service charge budgets and actual expenditure reports should use the standard industry cost classifications. As a minimum acceptable level of reporting, all reports should be detailed at cost class and cost category level as shown in section BA.

However, to achieve transparency in accordance with the principles of the professional standard, it is recommended best practice (particularly in respect of larger properties) that budget and actual expenditure reports and analyses should be provided at detailed cost description level whenever practicable, with a summary of the total costs under each cost category.

In accordance with the proportionality statement included under the professional standard's core principles, for smaller properties or those with limited service charge expenditure (for example, industrial sites), it is considered acceptable to report at the higher cost category level, although this should generally be regarded as an exception rather than the usual practice.

## **B7 General notes**

[Insert any other relevant information<sup>1.1</sup>]

**BA Example service charge summary expenditure report**

**Period** [dd/mm/yyyy] to [dd/mm/yyyy]

**Property address**.....

<b>Cost category</b>	<b>Expense total</b>	<b>Schedule</b>	<b>Schedule</b>	<b>Schedule</b>
		<b>1</b> <b>Estate</b>	<b>2</b> <b>Building 1</b>	<b>3</b> <b>Building 2</b>
<b>Management</b>				
Management fees	£60,000	£10,000	£25,000	£25,000
Accounting fees	£1,600	£1,600		
Site management resources	£71,135	£21,135	£26,600	£23,400
<b>Health, safety and environmental Professional fees</b>	£10,000	£10,000		
<b>Subtotal</b>	<b>£142,735</b>	<b>£42,735</b>	<b>£51,600</b>	<b>£48,400</b>
<b>Utilities</b>				
Electricity	£229,900	£5,900	£112,000	£112,000
Gas	£11,050	£1,050	£5,000	£5,000
Fuel oil ( <b>heating</b> )	£0			
Water	£7,000		£3,500	£3,500
<b>Utility consultancy</b>				
<b>Subtotal</b>	<b>£247,950</b>	<b>£6,950</b>	<b>£120,500</b>	<b>£120,500</b>
<b>Soft services</b>				
Security	£144,100	£137,500	£3,500	£3,100
Cleaning and <b>environmental sanitation</b>	£185,730	£52,250	£58,300	£75,180
<b>Landscaping and enlivenment</b>				
Marketing and promotions				
<b>Subtotal</b>	<b>£329,830</b>	<b>£189,750</b>	<b>£61,800</b>	<b>£78,280</b>
<b>Hard services</b>				
Mechanical and electrical services ( <b>M&amp;E</b> )	£187,970	£32,750	£74,750	£80,470
Lift and escalators	£24,500		£14,000	£10,500
Suspended access equipment	£5,300		£2,800	£2,500
Fabric repairs and maintenance	£99,325	£36,850	£40,700	£21,775

<b>Subtotal</b>	<b>£317,095</b>	<b>£69,600</b>	<b>£132,250</b>	<b>£115,245</b>
<b>Income</b>				
Interest	-£1,068	-£332	-£373	-£363
Income from commercialisation				
<u>Income operating expenses</u>				
<b>Subtotal</b>	<b>-£1,068</b>	<b>-£332</b>	<b>-£373</b>	<b>-£363</b>
<b>Insurance</b>				
Engineering insurance	£900		£500	£400
All risks insurance cover				
Terrorism insurance				
<u>Submitted and pending insurance claims</u>				
<b>Subtotal</b>	<b>£900</b>	<b>£0</b>	<b>£500</b>	<b>£400</b>
<b>Exceptional expenditure</b>				
Major works	£92,483		£92,483	
Forward funding	-£90,000		-£90,000	
<b>Subtotal</b>	<b>£2,483</b>	<b>£0</b>	<b>£2,483</b>	<b>£0</b>
<u>Miscellaneous charges</u>				
<u>Irrecoverable VAT</u>				
<u>External contributions</u>				
<b>Grand total</b>	<b>£1,039,925</b>	<b>£308,703</b>	<b>£368,760</b>	<b>£362,462</b>

**BB Example service charge detailed expenditure report**

**Period** [dd/mm/yyyy] to [dd/mm/yyyy]

**Property address**.....

Cost category	Expense total	Schedule 1 Estate	Schedule 2 Building 1	Schedule 3 Building 2
<b>Management</b>				
<b>Management fees</b>				
Management fees	£60,000	£10,000	£25,000	£25,000
<b>Accounting fees</b>				
<u><a href="#">Service charge accounting fees</a></u>				
<u><a href="#">S/C audit</a></u> <u><a href="#">Independent accountant's fees</a></u>	£1,600	£1,600		
<u><a href="#">Audit fees</a></u>				
<b>Site management resources</b>				
Staff costs	£15,000	£15,000		
Receptionists/concierge	£50,000		£26,600	£23,400
Site accommodation (rent/rates)	£4,335	£4,335		
<u><a href="#">Office costs</a></u> (telephones/stationery)	£1,800	£1,800		
<u><a href="#">Health, safety and environmental Systems</a></u>				
<u><a href="#">Help desk/call centre/information centre</a></u>				
<u><a href="#">Administration fee</a></u>				
<u><a href="#">Professional fees</a></u>				
<u><a href="#">Risk</a></u> <u><a href="#">Landlord's risk</a></u> assessments <u><a href="#">and</a></u> audits <u><a href="#">and reviews</a></u>	£10,000	£10,000		
<u><a href="#">Other professional fees</a></u>				
<u><a href="#">Legal fees</a></u>				

<b>Subtotal</b>	<b>£142,735</b>	<b>£42,735</b>	<b>£51,600</b>	<b>£48,400</b>
<b>Utilities</b>				
<b>Electricity</b>				
Electricity	£224,000		£112,000	£112,000
<u>Electricity procurement consultancy</u>	<u>£5,600</u>	<u>£5,600</u>		
Fuel (standby electrical power)	£300		£300	
<b>Gas</b>				
Gas	£10,000		£5,000	£5,000
<u>Gas procurement/consultancy</u>	<u>£1,050</u>	<u>£1,050</u>		
<b>Fuel oil (heating)</b>				
<b>Water</b>				
Water and sewerage charges	£7,000		£3,500	£3,500
<b><u>Utility consultancy</u></b>				
<u>Utility procurement and consultancy</u>	<u>£6,650</u>	<u>£6,650</u>		
<b>Subtotal</b>	<b>£247,950</b>	<b>£6,950</b>	<b>£120,500</b>	<b>£120,500</b>
<b>Soft services</b>				
<b>Security</b>				
Security guarding	£132,000		£132,000	
Security systems	£12,100	£5,500	£3,500	£3,100
<b><u>Cleaning and environmental sanitation</u></b>				
Internal cleaning	<u>£91,200</u> <u>106.700</u>	<u>£15,500</u>	£38,400	£52,800
<u>External cleaning</u>	<u>£15,500</u>	<u>£15,500</u>		
Window cleaning	£22,800		£9,600	£13,200

Hygiene services/toiletries	£8,180	£4,500	£3,680	
<u><a href="#">Carpets/mats hire</a></u>				
Waste management	£9,050	£9,050		
Pest control	£1,600	£700	£500	£400
<u><a href="#">Snow clearance/road gritting</a></u> <del><a href="#">Seasonal decorations</a></del>				
<u><a href="#">Landscaping and enlivenment</a></u>				
Internal floral displays	£9,400		£4,800	£4,600
<u><a href="#">External landscaping</a></u> <del><a href="#">Estate cleaning</a></del>	£18,000	£18,000		
<u><a href="#">Seasonal decorations</a></u>	£1,000		£500	£500
<u><a href="#">Events and entertainments</a></u> <del><a href="#">External landscaping</a></del>	£9,000	£9,000		
<b>Marketing and promotions</b>				
<u><a href="#">Marketing</a></u>				
<u><a href="#">Research</a></u>				
<u><a href="#">Marketing staff costs</a></u>				
<u><a href="#">Landlord's contribution to marketing</a></u>				
<b>Subtotal</b>	<b>£329,830</b>	<b>£189,750</b>	<b>£61,800</b>	<b>£78,280</b>

## Hard services

### Mechanical and electrical services

M&E maintenance <del>contract</del>	£151,250	£20,000	£63,000	£68,250
M&E repairs	£16,250	£2,150	£6,750	£7,350
<u><a href="#">M&amp;E inspections and consultancy</a></u>	£7,500	£7,500		
Life safety systems maintenance	£11,350	£2,350	£5,000	£4,000

Life safety systems repairs	£1,620	£750	£870
<u><a href="#">H&amp;S (mechanical and electrical)</a></u>			
<u><a href="#">M&amp;E/life safety systems inspections and consultancy</a></u>	<u>£7,500</u>	<u>£7,500</u>	
<u><a href="#">Car parking M&amp;E maintenance</a></u>			
<u><a href="#">Car parking M&amp;E repair</a></u>			
<b>Lift and escalators</b>			
Lift maintenance contract	£21,000	£12,000	£9,000
Lift <u>repairs</u> <u>repair</u>	£3,500	£2,000	£1,500
<u><a href="#">Escalator maintenance</a></u>			
<u><a href="#">Escalator repair</a></u>			
<u><a href="#">H&amp;S (lifts and escalators)</a></u>			
<u><a href="#">Lift and escalator inspections and consultancy</a></u>			
<b>Suspended access equipment</b>			
<u>Maintenance contract</u> <u>Suspended access maintenance</u>	£5,100	£2,700	£2,400
<u>Repairs</u> <u>Suspended access repair</u>	£200	£100	£100
<u><a href="#">Suspended access inspections and consultancy</a></u>			
<b>Fabric repairs and maintenance</b>			
<u>Internal repairs and maintenance</u>	<u>£50,000</u>	<u>£35,000</u>	<u>£15,000</u>
<u>External</u> <u>Fabric</u> repairs and maintenance	<u>£656,775</u>	<u>£35,000</u>	<u>£621,775</u>
<u>Redecorations</u> <u>Redecoration</u>	£5,700	£5,700	
<u>Estate</u> <u>repairs and maintenance</u> <u>H&amp;S (fabric)</u>	£32,100	£32,100	

<u>Building fabric inspections and consultancy</u>	<u>£4,750</u>	<u>£4,750</u>	-	-
Car park <u>repairs and maintenance</u> <u>and repairs</u>	<u>£4,750</u>	<u>£4,750</u>	-	-
<b>Subtotal</b>	<b>£317,095</b>	<b>£69,600</b>	<b>£132,250</b>	<b>£115,245</b>

## Income

### Interest

Interest	-£1,068	-£332	-£373	-£363
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### Income from commercialisation

Car park income

Commercialisation income

PV and EV charging

Vending machine income

Gift card income

Other income

### Income operating expenses

Operating expenses

Bank charges and transaction costs

Staff costs

<b>Subtotal</b>	<b>-£1,068</b>	<b>-£332</b>	<b>-£373</b>	<b>-£363</b>
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## Insurance

### Engineering insurance

Engineering insurance	£900	£500	£400
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### All risks insurance cover

Building insurance

Loss of rent insurance

Public and property owner's liability

Landlord's contents insurance

**Terrorism insurance**

Terrorism insurance

Submitted and pending insurance claims

<b>Subtotal</b>	<b>£900</b>	<b>£500</b>	<b>£400</b>
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**Exceptional expenditure**

**Major works**

Project works

Plant replacement	£92,483	£92,483
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Major repairs

**Forward funding**

Sinking funds	-£90,000	-£90,000
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Reserve funds

Depreciation charges

Agree retention of funds already collected

Agreed contribution to future works

<b>Subtotal</b>	<b>£2,483</b>	<b>£0</b>	<b>£2,483</b>	<b>£0</b>
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Miscellaneous charges

Irrecoverable VAT

External contributions

Contribution from external parties

Contributions to external parties

<u>Subtotal</u>	<u>£0</u>	<u>£0</u>	<u>£0</u>	<u>£0</u>
<b>Grand total</b>	<b>£1,039,925</b>	<b>£308,703</b>	<b>£368,760</b>	<b>£362,462</b>

 CCBC Example service charge variance report

**Period** [dd/mm/yyyy] to [dd/mm/yyyy]

**Property address**.....

	<b>Previous year actual</b>	<b>Current year budget</b>	<b>Current year actual</b>	<b>Actual v budget</b>	<b>Current v previous actual</b>
<b>Management</b>					
Management fees	£60,000	£60,000	£60,000	0.00%	0.00%
Accounting fees	£1,500	£1,600	£1,600	0.00%	6.67%
Site management resources	£66,000	£70,000	£71,135	1.62%	7.78%
Health, safety and environmental	£5,000	£15,000	£10,000	-33.33%	100.00%
<b>Subtotal</b>	<b>£132,500</b>	<b>£146,600</b>	<b>£142,735</b>	<b>-2.64%</b>	<b>7.72%</b>
<b>Utilities</b>					
Electricity	£218,700	£236,000	£229,900	-2.58%	5.12%
Gas	£9,700	£12,500	£11,050	-11.60%	13.92%
Fuel oil ( <a href="#">heating</a> )					
Water	£6,880	£7,500	£7,000	-6.67%	1.74%
<b>Subtotal</b>	<b>£235,280</b>	<b>£256,000</b>	<b>£247,950</b>	<b>-3.14%</b>	<b>5.39%</b>
<b>Soft services</b>					
Security	£144,100	£144,100	£144,100	0.00%	0.00%
Cleaning and environmental	£176,543	£180,000	£185,730	3.18%	5.20%
Marketing and promotions					
<b>Subtotal</b>	<b>£320,643</b>	<b>£324,100</b>	<b>£329,830</b>	<b>1.77%</b>	<b>2.87%</b>
<b>Hard services</b>					
Mechanical and electrical services	£193,750	£180,000	£187,970	4.43%	-2.98%
Lift and escalators	£24,500	£24,500	£24,500	0.00%	0.00%

Suspended access equipment	£5,300	£53,000	£5,300	-90.00%	0.00%
Fabric repairs and maintenance	£34,500	£50,000	£99,325	98.65%	187.90%
<b>Subtotal</b>	<b>£258,050</b>	<b>£307,500</b>	<b>£317,095</b>	<b>3.12%</b>	<b>22.88%</b>
<b>Income</b>					
Interest	-£989	-£1,000	-£1,068	6.80%	7.99%
Income from commercialisation					
<b>Subtotal</b>	<b>-£989</b>	<b>-£1,000</b>	<b>-£1,068</b>	<b>6.80%</b>	<b>7.99%</b>
<b>Insurance</b>					
Engineering insurance	£800	£1,000	£900	-10.00%	12.50%
All risks insurance cover					
Terrorism insurance					
<b>Subtotal</b>	<b>£800</b>	<b>£1,000</b>	<b>£900</b>	<b>-10.00%</b>	<b>12.50%</b>
<b>Exceptional expenditure</b>					
Major works		£90,000	£92,483	2.76%	
Forward funding	£25,000	-£90,000	-£90,000	0.00%	-460.00%
<b>Subtotal</b>	<b>£25,000</b>	<b>£0</b>	<b>£2,483</b>		<b>-90.07%</b>
<b>Grand total</b>	<b>£971,284</b>	<b>£1,034,200</b>	<b>£1,039,925</b>	<b>0.55%</b>	<b>7.07%</b>

CD

**BD Example service charge apportionment schedule %**

**Period** [dd/mm/yyyy] to [dd/mm/yyyy]

**Property address** .....

<b>Unit/address</b>	<b>Tenants</b>	<b>Area (sq. ft.)</b>	<b>Schedule</b>	<b>Schedule 2</b>	<b>Schedule 3</b>		
			1	Building 1	Building 2		
<b>Estate</b>							
<b>Building 1 (Tower block)</b>							
Ground floor		10,600	7.41%	10.43%			
1st floor		15,400	10.76%	15.16%			
2nd–4th floors		46,200	32.29%	45.47%			
5th floor		4,900	3.42%	4.82%			
6th floor		4,900	3.42%	4.82%			
7th floor		4,900	3.42%	4.82%			
8th floor		4,900	3.42%	4.82%			
9th floor		4,900	3.42%	4.82%			
10th floor		4,900	3.42%	4.82%			
<b>Total building 1</b>		<b>101,600</b>	<b>-</b>	<b>100.00%</b>	<b>-</b>		
<b>Building 2</b>							
Ground floor and first floors		9,750	6.81%		23.49%		
1st floor		6,500	4.54%		15.66%		
2nd floor		6,500	4.54%		15.66%		
3rd–5th floors		18,750	13.10%		45.18%		
<b>Total building 2</b>		<b>41,500</b>	<b>-</b>	<b>-</b>	<b>100.00%</b>		
<b>Grand total</b>		<b>143,100</b>	<b>100.00%</b>	<b>-</b>	<b>-</b>		

BE Example service charge apportionment schedule % (weighted floor areas)

Period [dd/mm/yyyy] to [dd/mm/yyyy]

Property address .....:

			Weighting					Sch 1	Sch 2	Sch 3	Sch 4
Unit no	Tenant name	NIA (sq. ft.)	0- 5000	5,001- 10,000	10,001 - 20,000	Over 20,000	Weighted area	All tenants	High street only	Main mall	Offices
			100%	80%	70%	60%		147,785	14,060	126,825	6,900
<b>High street</b>											
1		350	350				350	0.24%	2.49%		
2		12,800	5,000	4,000	1,960		10,960	7.42%	77.95%		
3		300	300				300	0.20%	2.13%		
4		1,200	1,200				1,200	0.81%	8.53%		
5		500	500				500	0.34%	3.56%		
6		750	750				750	0.51%	5.33%		
							<b>14,060</b>				
<b>Main mall</b>											
7		1,050	1,050				1,050	0.71%		0.83%	
8		7,250	5,000	1,800			6,800	4.60%		5.36%	
9		1,050	1,050				1,050	0.71%		0.83%	
10		1,780	1,780				1,780	1.20%		1.40%	
LSU 1		29,700	5,000	4,000	7,000	5,820	21,820	14.76%		17.20%	

11		1,500	1,500				1,500	1.01%		1.18%	
12		1,500	1,500				1,500	1.01%		1.18%	
13		2,700	2,700				2,700	1.83%		2.13%	
14		1,800	1,800				1,800	1.22%		1.42%	

			Weighting					Sch 1		Sch 2	Sch 3	Sch 4
Unit no	Tenant name	NIA (sq. ft.)	0-5000	5,001-10,000	10,001-20,000	Over 20,000	Weighted area	All tenants	High street only	Main mall	Offices	
			100%	80%	70%	60%		147,785	14,060	126,825	6,900	
Dept store		56,500	5,000	4,000	7,000	21,900	37,900	25.65%		29.88%		
15		3,375	3,375				3,375	2.28%		2.66%		
16		2,200	2,200				2,200	1.49%		1.73%		
17		6,000	5,000	800			5,800	3.92%		4.57%		
18		5,500	5,000	400			5,400	3.65%		4.26%		
LSU 2		25,900	5,000	4,000	7,000	3,540	19,540	13.22%		15.41%		
19		270	270				270	0.18%		0.21%		

20		12,200	5,000	4,000	1,540		10,540	7.13%		8.31%	
21		1,800	1,800				1,800	1.22%		1.42%	
							<b>126,825</b>				
<b>Offices-</b>											
1st floor		2,450	2,450				2,450	1.66%			35.51%
2nd floor		2,450	2,450				2,450	1.66%			35.51%
3rd floor		2,000	2,000				2,000	1.35%			28.99%
							<b>6,900</b>	-			-
		<b>184,875</b>					<b>147,785</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>	<b>100.00%</b>

**BF Example service charge apportionment schedule £**

**Period** [dd/mm/yyyy] to [dd/mm/yyyy]

**Property address**.....:

		Sch 1	Sch 2	Sch 3	Sch 4	
Unit no	Tenant name	All tenants	High Street only	Main mall	Offices	Total
		£50,000.00	£25,000.00	£50,000.00	£10,000.00	£135,000.00
<b>High street</b>						
1		£118.42	£622.33			£740.75
2		£3,708.09	£19,487.91			£23,196.00
3		£101.50	£533.43			£634.93
4		£406.00	£2,133.71			£2,539.71
5		£169.16	£889.05			£1,058.21
6		£253.75	£1,333.57			£1,587.32
<b>Main mall</b>						
7		£355.25		£413.96		£769.20

8		£2,300.64		£2,680.86		£4,981.50
9		£355.25		£413.96		£769.20
10		£602.23		£701.75		£1,303.98
LSU 1		£7,382.35		£8,602.40		£15,984.75
11		£507.49		£591.37		£1,098.86
12		£507.49		£591.37		£1,098.86
13		£913.49		£1,064.46		£1,977.95
14		£608.99		£709.64		£1,318.63
<b>Dept Store</b>		£12,822.68		£14,941.85		£27,764.53
15		£1,141.86		£1,330.57		£2,472.44
16		£744.32		£867.34		£1,611.66
17		£1,962.31		£2,286.62		£4,248.93
18		£1,826.98		£2,128.92		£3,955.90
LSU 2		£6,610.96		£7,703.53		£14,314.48
19		£91.35		£106.45		£197.79
20		£3,565.99		£4,155.33		£7,721.32

21		£608.99		£709.64		£1,318.63
<b>Offices</b>						
1st floor		£828.91			£3,550.72	£4,379.63
2nd floor		£828.91			£3,550.72	£4,379.63
3rd floor		£676.66			£2,898.55	£3,575.21
		<b>£50,000.00</b>	<b>£25,000.00</b>	<b>£50,000.00</b>	<b>£10,000.00</b>	<b>£135,000.00</b>

## Appendix **DC**: Commercial property service charge handover procedures

### **D1C1** Service charge accounts – handover procedures

#### **D1C1.1** Sale of a property

On the sale of a property, the onus should be on the seller (either themselves or via their managing agentmanager) to provide to the buyer (or their managing agentmanager) all the necessary information about the service charge in a timely manner. Sale contracts and the resulting completion statements may make some provision for service charge monies either in express clauses or using the standard conditions of sale. However, these contract clauses rarely contain sufficient detail. Ideally, they should deal with:

- the reconciliation of any outstanding closed service charge years
- the handover of any credit balance on the service charge account
- the recovery of any shortfall or arrears, including specifically which party (buyer or seller) can pursue the arrears and how and
- the supply tosupplying the buyer (or itsmanaging agentof their manager) with adequate records and information to provide continuity in the management and administration of the service charge arrangement for the current service charge year.

Commercial service charges generally fall into one of two categories:

- i— those where the landlord recovers costs periodically, say quarterly, based on actual expenditure incurred andor
- ii— those where the landlord collects on-account sums in advance, usually quarterly, and reconciles the service charge at the end of the service charge year, comparing actual expenditure against the on-account payments demanded and then producing certificates detailing the resultant credit or debit due on the account.

The correct wording for the sale contract will vary between these two, but the service charge code statesthis professional standard suggests that in both cases, reconciliation of the current years' service charge should be achieved within four months of the year-end. Where appropriate (and/or required), allowance should be made for an audit or review by an independent accountant within this timetable.

The sale of a property can occur at any point during the service charge year. Although some leases permit a change to the service charge year end, it is recommended best practice not to do so save in exceptional circumstances. SoTherefore, the sale usually occurs part way through (rather than at the end of) a service charge year. The buyer (or itstheir manager) will be responsible for reconciling the service charge for that year. Inorder toTo do so properly and on time, it is essential that the seller (or their manager) provides full information withinin a relatively short time frame of the sale.

Where there are prior service charge years for which the closing accounts have not yet been issued, the seller (or itstheir manager) should be obliged in the sale contract to

fully reconcile any outstanding service charge accounts for those prior years withinin a specified period (certainly no later than two months after completion of the sale). Often, it is the buyer (or the buyer's agenttheir manager) that will actually issue the demands for any balancing charges, credits or certificates (whether to existing or former tenants) once the reconciled accounts are available. Whether the buyer accepts responsibility for pursuing payment will be a matter for negotiation.

In some transactions, the buyer is not prepared to deal with previous years. The buyer will insist that the seller reconciles these and issues the accounts before completion.

Where possible, buyers should ensure that sale contracts contain measurable sanctions if information, certification and/or service charge credit balances are not provided withinin the time frames set. Ideally, the buyer should make a retention from the sale price pending satisfactory receipt of the relevant details. Alternatively, the sale contract could impose liquidated damages, although to be enforceable under contract law the amount of the liquidated damages should reflect a reasonable measurement of the anticipated loss. Otherwise, it may be considered a penalty clause and prove unenforceable.

#### **D1C1.1.1** **Property financial information**

The following information would usually be requested under standard enquiries before contract. If not, such information should be required to be passed to the buyer (or their agentmanager) prior to completion, or within five working days of the completion date:

- service charge accounting period
- service charge apportionment basis
- details of void areas, landlord's liability and landlord's funding
- details of any tenant direct charges
- current service charge budget
- copies of the last three years' reconciled service charge accounts
- details of commercialisation income and interaction with the service charge accounts
- details of any sinking funds, reserve funds or depreciation charges, including current valuation statements, assets, contribution, schedules and expiry dates of funds and
- a statement of funds currently held in the service charge account along with a list of creditors.

#### **D1C1.1.2** **Tenant financial information**

The following should also be provided to the buyer within five working days of the completion date:

- demand addresses, agency arrangements, trading names and contact details
- tenancy details, including occupancy and vacancy dates, and an up-to-date tenancy schedule
- details of all tenant arrears including disputes, payment plans and breaches
- details and copies of the last tenant on-account demands both for service charges and direct charges
- for direct charges involving utilities, the basis of collection and up-to-date meter readings should be provided and
- an interest summary showing credits to the service charge account.

### **D1C1.1.3 Financial transfer**

This is the physical movement of funds between the buyer and seller in the sale process. At completion, the service charge bank account may contain monies that have not yet been expended. The amount will depend on the level of service charge tenant arrears and the amount owed to suppliers for services rendered. The amount to transfer may be very small.

The sale contract should provide that prior to completion, the seller should supply a full statement of tenant service charge arrears and also, within five working days after completion, an updated statement of arrears as at the completion date. The buyer will then be responsible for collecting from the tenants any outstanding or future on-account payments or balancing charges covering the current open service charge year.

Unless otherwise agreed in the sale contract, the seller remains able to collect any arrears for previous service charge years. In practice, the buyer may agree to pursue arrears for any past service charge years and to account to the seller for what is recovered. Such an arrangement usually excuses the buyer from taking proceedings against their tenants to recover the arrears. In some cases, the buyer may not agree to do this at all, and the seller will have to collect in the arrears prior to completion.

If there are extensive arrears for the currently running service charge year, the buyer may adjust the purchase price to deduct these to avoid the risk of non-payment.

The seller should ensure, so far as is practicable, that all supplier invoices and credit notes are issued and paid from the service charge account prior to completion. In some cases, the buyer may be willing to allow the seller to pass to the buyer, after completion, any supplier invoices for works carried out prior to completion, and the buyer will settle these.

Where the closing balance on the service charge reconciliation for the current service charge year will be a positive sum, the seller should transfer the estimated credit balance to the buyer within five working days of completion. Note that if historic arrears reduce the cash balance held by the seller's agentmanager, the seller is toshould ensure their agentputsinmanagerhas sufficient funds to transfer the full cash balance appropriate to the service charge period current at the date of sale.

The buyer may have to fund the service charge account in the period between the completion date and the date when the service charge account is credited with funds from the seller or itstheir manager, or payment by the tenants of on-account sums.

#### **VAT**

~~Where a building is elected for VAT a shortage in the service charge funds can often arise as a result of an issue with regard to the recovery of VAT in respect of service charges for landlord void premises.~~

~~Payment requests issued in respect of the landlord's service charge liability for void premises cannot include VAT as this is contrary to HMRC guidance. However, landlord clients are usually responsible for preparing their own VAT returns, which would include the VAT element in respect of void premises. The transfer of the funding for VAT~~

~~between landlord and agent should therefore be normal operational practice throughout the course of the management instruction.~~

~~However, a shortfall in the management accounts can occur if the client does not remit back to the managing agent the recoverable VAT included in its VAT return.~~

~~Practitioners are advised to be aware of this potential problem and sellers are to reimburse the service charge account if there is a shortage of funds on transfer resulting from a difference between output and input VAT.~~

## **D1**

### **VAT**

Where a building is elected for VAT, a shortage in the service charge funds can often arise because of an issue regarding the recovery of VAT in respect of service charges for landlord void premises.

Payment requests issued in respect of the landlord's service charge liability for void premises cannot include VAT as this is contrary to HMRC guidance. However, landlord clients are usually responsible for preparing their own VAT returns, which would include the VAT element in respect of void premises. The transfer of the funding for VAT between landlord and agent should therefore be normal operational practice throughout the course of the management instruction.

However, a shortfall in the management accounts can occur if the client does not remit back to the manager the recoverable VAT included in their VAT return.

Practitioners should be aware of this potential problem and sellers are to reimburse the service charge account if there is a shortage of funds on transfer resulting from a difference between output and input VAT.

### **C1.1.4 —— Statements of service charge movements**

#### **Current service charge year**

As described in section [D1C1.1](#), as soon as practicable but in any event within four months of the completion date, the seller (or their [agentmanager](#)) should provide a statement of service charge movements for the period from the start of the current accounting period up to the completion date. The statement should include:

- the income received on account of the service charge, with copy demands
- the statement of service charge expenditure incurred with copies of vouchers/invoices
- an analysis of seller landlord's liabilities and tenant direct charges, marketing and commercialisation accounts. [These \(these\)](#) should be separately identified and where tenant direct charges apply these should be treated separately to the service charge)
- a service charge cash reconciliation (calculated as detailed in [appendix B section C3](#))
- an up-to-date arrears statement (if changed from the statement issued within five working days after completion), together with explanatory notes on any disputes and
- explanatory notes on major variations from the original budget for that service charge accounting period.

Where the closing balance on the service charge cash reconciliation is a positive sum, the seller shall transfer to the buyer within five working days of the issue of the service charge cash reconciliation, the positive balance (after deduction of any interim payment already made on account of such credit balance under section [D1C1.1](#)).

Where the closing balance on the service charge cash reconciliation at the date of transfer is negative (this will occur when the expenditure exceeds the income), the buyer should reimburse such negative balance to the seller within five working days of the issue of the service charge cash reconciliation.

The buyer (or its manager) should then be responsible for completing the full year service charge reconciliation. This is to should include certifying the accounts and arranging for their independent review or independent audit, where required, in accordance with the latest edition of the service charge code this professional standard.

The buyer (or its manager) should then issue the statement of expenditure and any balancing service charges to the tenants at the end of the service charge year in the usual way.

### **Prior service charge years**

If there are prior service charge years for which the closing accounts have not yet been issued, the contract should set out what is to should happen. See section [D1C1.1](#) for various options.

#### **[D1C1.1.5](#) Sinking and reserve funds**

In all instances where the seller operates sinking funds or reserve funds, the information about these will normally be provided in response to standard preliminary enquiries before contract. If not, the sale contract should provide for the following information to be supplied before the completion date (or at the latest within five working days after completion):

- details of all funds and assets covered
- details of the term of the fund, expiry date and life expectancy of the assets
- a full statement showing fund values broken down between each asset and details of landlord and tenant contributions, tax and interest
- a statement of expenditure from each fund, if applicable and
- details of tax liability and any trust status applicable to each fund.

#### **[D1C1.1.6](#) Depreciation charges**

If the service charge included depreciation charges, but details have not been provided in response to standard enquiries before contract, the sale contract should provide for the following information to be supplied, before the completion date (or at the latest within five working days after completion):

- details of all assets covered by the charges
- details of the period of cover including start date and cost of asset and
- the final book value of each asset and details of the charges recovered from each service charge year, from each tenant up to the completion date.

#### **[D1C1.1.7](#) Security deposits for utilities**

~~There has been a growing trend over recent years for utility~~ Utility companies ~~to~~ might request a security deposit from ~~owners~~ ~~landlords~~ as a condition of the supply agreement.

If that utility supply agreement is to be novated to the buyer, the seller should obtain confirmation that the supplier recognises the buyer as the beneficial ~~owner~~ ~~landlord~~ of the security deposit, and the security deposit will roll over with it. The sale contract should then provide for the buyer to reimburse the seller an amount equivalent to the deposit. This could be included in the financial transfer procedure set out in section [D1C1.1.3](#).

If the utility supply agreement is to be terminated on completion (and the buyer is to arrange its own in substitution), the seller can arrange direct for the refund to it of the deposit.

If the original deposit was included as a 'cost' in any previous service charge period, the buyer should account for the return of the deposit as a credit item as part of the service charge reconciliation up to the date of sale.

## **[D1C1.2](#) Change of manager**

A change of manager will often occur ~~as a result because~~ of a sale of property, in which case, the procedures outlined in section [D1C1.1](#) should be adopted. Where a change in manager occurs for any other reason, the following procedures should apply (and the obligation to comply with them should form part of the management contract).

### **[D1C1.2.1](#) Property financial information**

The same information listed in section [D1C1.1.1](#), together with VAT election paperwork where applicable, should be provided to the new manager no later than three weeks before the management handover date.

### **[D1C1.2.2](#) Tenant financial information**

The same information listed in section [D1C1.1.2](#) should be provided to the new manager no later than three weeks before the management handover date.

### **[D1C1.2.3](#) Financial transfer**

On the management handover date, the ~~old~~ ~~previous~~ manager should provide to the new manager a full-service charge arrears list, together with tenant history reports and details of disputes, payment plans and bad debts. It is recommended that the ~~old~~ ~~previous~~ manager transfers to the new manager an amount equal to its reasonable estimate of the credit balance on the service charge account, within five working days of the management handover date. The ~~old~~ ~~previous~~ manager should provide to the new manager (within two months of the management handover date) a final service charge cash reconciliation (calculated as detailed in [appendix B](#) [Appendix C](#)), together with a transfer of funds equating to the cash balance analysed in the service charge cash reconciliation (less the earlier sum transferred, if any).

### **[D1C1.2.4](#) Statements of service charge expenditure**

A change of manager is likely to be known in good time, unlike completion of sales that can take place at short notice. Consequently, it should be possible for the transfer timetable to be quicker. However, it is recommended that the same timetable as in a sale (as set out in section [D1C1.1.4](#)) is adopted in the management contract as a backstop.

#### **[D1C1.2.5](#) Sinking and reserve funds**

The same procedures apply as in section [D1C1.1.5](#), but all statements and transfers should be made to the new manager no later than the management handover date.

#### **[D1C1.2.6](#) Depreciation charges**

The same procedures apply as in section [D1C1.1.6](#), but all statements should be issued to the new manager no later than the management handover date.

### **[D2C2](#) Supplier information**

A lack of communication between the buyer and seller, (or between oldthe previous and new manager,) concerning suppliers can lead to a failure to terminate or novate supplier contracts and result in unauthorised work being carried out and incorrect invoices being issued.

In the course ofDuring a sale, a buyer would normally ask for details of the supplier contracts before exchanging the sale contract. In particular, the buyer will be focusing on the novation or termination provisions. The buyer can then decide whether to request novation, assignment or termination of individual contracts, and will provide for this in the sale contract. If the supplier contract is to be terminated, the period of notice may overrun completion, meaning the seller has tomust pay supplier invoices for the period after completion or handover, so attention should be paid to this early on during the sale process.

Where there is a new manager appointed, the ownerlandlord should consider, in advance, which supplier contracts (held in the name of the outgoing manager) are capable of novation or assignment by agreement, into the name of the new manager, and obtain any necessary consents. If the supplier contract cannot be novated or assigned, the ownerlandlord or manager is to assess what notice should be given to terminate it, and a new contract may need to be established with a new supplier.

It is important to focus on this early to avoid unnecessary duplication of payments to oldprevious and new suppliers. In some cases, the supplier contract will actually be with the ownerlandlord (the client) so a change of manager will not precipitate any need for novation, assignment or termination.

Where no arrangements are made for novation, assignment or termination of the supplier contract, the seller or previous manager will be responsible for any costs arising under the contract following completion/handover, including any contract penalties as a result of early termination of contract etc.

If the supplier contract has been novated, assigned or terminated, the oldprevious manager should not give instructions or order works from that supplier following completion/handover.

### **D3C3 Example reconciliation statements**

#### **On completion of sale**

<b>Income received from tenants for current open service charge year</b>		<b>£</b>
<b>Less:</b>	Expenditure incurred/paid for current open service charge year	<b>£</b>
<b>Add:</b>	Vendor's liability at the date of completion for the current open service charge year	<b>£</b>
<b>Add:</b>	Accruals at the date of completion for the current open service charge year	<b>£</b>
<b>Service charge cash to be handed over on completion</b>		<b>£</b>

#### **On handover**

<b>Service charge demanded from tenants for current open service charge year</b>		<b>£</b>
<b>Less:</b>	Expenditure incurred/paid for current open service charge year	<b>£</b>
<b>Less:</b>	Service charge arrears for current open service charge period	<b>£</b>
<b>Less:</b>	Arrears from past service charge years	<b>£</b>
<b>Service charge cash to be handed over on transfer</b>		<b>£</b>

#### **Glossary of terms**

<u><b>Term</b></u>	<u><b>Definition</b></u>
<a href="#"><u>Accrual accounting</u></a>	<u>Considered the standard accounting practice for most services, except for very small operations. This requires that costs be recognised in the accounts when incurred, not when the invoice is actually paid. This is the opposite of cash accounting, which recognises transactions only when there is an exchange of cash.</u>
<a href="#"><u>Accruals</u></a>	<u>Expenses incurred in a period for which no invoice has been received at the period-end. As the cost relates to the period, it should be charged to the service charge account for that period.</u>
<a href="#"><u>Administration charges</u></a>	<u>The manager's costs in procuring services directly (not through a contractor) where the actual cost of the service (e.g. the site-management team) is recovered through the service charge. The administration charge is intended to reimburse the</u>

	<u>manager's indirect costs (e.g. payroll, staffing, etc.) and is recorded to the cost category where they are incurred, as would apply if the service(s) were contracted.</u>
<u>Agreed contributions to future works</u>	<u>Where a lease makes no provision for a sinking fund or reserve fund, it can be beneficial to both landlords and tenants to spread the cost of anticipated future works over several service charge periods. This voluntary arrangement should be specifically agreed between the parties and formalised in a written agreement and made clear in the service charge (see subsection 4.7.4.5).</u>
<u>Agreed retention of funds already collected</u>	<u>Where costs have been included in the service charge budget, but no liability existed at the year end to qualify as a valid accrual. This voluntary arrangement should be specifically agreed and documented between the parties and made clear in the service charge that the costs remain posted in that year in accordance with terms agreed (see subsection 4.7.4.5).</u>
<u>Allocation</u>	<u>The splitting of costs of a service to assign them to a specific schedule or cost category.</u>
<u>Apportionment</u>	<u>The division of costs within schedules between those premises that benefit from the services in that schedule, based on the availability, benefit and use of the services.</u>
<u>Arrears statement</u>	<u>A transaction list of all unpaid charges demanded by the landlord from the tenants, collated on a tenant-by-tenant basis.</u>
<u>Balancing charge</u>	<u>The resulting difference between an individual tenant's apportionment of expenditure and the on-account service charges demanded from that tenant for any specific service charge accounting period, also having regard to any service charge concessions that may have been granted.</u>
<u>Beyond economic repair</u>	<u>When fabric or plant and equipment is in disrepair or has deteriorated or become obsolescent, the estimated cost of remedial works demonstrably exceed the cost of replacement or are so out of proportion as to fail to provide value for money in terms of ongoing costs of maintenance, and failure could impact delivery and/or reliability of service provision.</u>
<u>Customer services, amenities and facilities</u>	<u>The services provided to help and assist end users of the property including tenants, tenant's staff and visitors, including desirable or useful features, services or resources that are provided to make a place more pleasant, convenient and</u>

	<u>appealing, (e.g. information desk, wayfinding, mobility services, children's play areas and clubs, free wi-fi, free phone charging, customer lounges or meeting areas, etc.).</u>
<u>Depreciation charge</u>	<u>The 'cost' to the landlord representing the measure of the wearing out, consumption or other reduction in life of an asset.</u>
<u>Direct charges</u>	<u>Any expenditure that is charged directly to individual tenants and not funded via the on-account service charges.</u>
<u>Improvements</u>	<u>Works that go beyond a reasonable definition of maintenance and repair, renewal or replacement, but excluding replacement of fabric or plant and equipment where beyond economic repair with its modern and often more efficient equivalent.</u>
<u>In trust</u>	<u>Money or monies kept in a separately named account that is held in the bank account of its landlord.</u>
<u>Landlord</u>	<u>The person who receives or is entitled to receive the rent. This person is usually responsible for the provision, management and administration of the services and the service charge. Also referred to as the 'owner'.</u>
<u>Manager</u>	<u>Any suitably qualified firm or person that budgets, forecasts, procures, manages and accounts for the services that comprise the service charge, whether they are the landlord, an in-house team, management company or a managing agent (including any wholly or partly owned related companies).</u>
<u>Management fees</u>	<u>The remuneration of the manager and related entities including any reasonable profit element, for managing the services comprised in the service charge. Typically, this includes the supervision of the site team, overseeing the site contractors and the accounts work necessary to budget, forecast, manage, disperse, balance and apportion the service charge. Specifically, these fees are not to include property management work separate from the service charge, such as landlord approvals, income generation or rent collection.</u> <u>Where the subject property/site management team is not large enough to justify specific service managers (for example, a health and safety manager or building surveyor) additional specialist fees may be charged to the relevant cost category for the 'manager provided' service.</u>

<u>Management handover date</u>	<u>The date on which the responsibility to manage the property transfers from one property manager to another.</u>
<u>Marketing and promotions</u>	<u>Advertising and other forms of promotion of a retail centre, property or estate intended to bring additional custom for the benefit of the occupational tenants (as distinct from attractions and entertainments of a general amenity, benefit, service or attraction within the retail centre, property or estate – often titled 'events' to differentiate).</u>
<u>Materiality</u>	<u>Information is 'material' if omitting, misstating or obscuring it could reasonably be expected to influence the decisions that the stakeholders make based on the financial statement, which provides financial information about the service charge cost expenditure.</u>  <u>Materiality depends on several factors, such as the size and nature of the item, the quality and type of property, the aggregate of the total service charge and the amounts payable by individual tenants, based on a professional assessment in the surrounding circumstances.</u>
<u>On-account service charge</u>	<u>An estimated charge raised in advance and anticipation of the final service charge liability, calculated from the service charge budget.</u>
<u>Payment plan</u>	<u>Where cost of major works expenditure has been borne upfront by the landlord and is recovered over a number of subsequent years, in accordance with terms agreed between the landlord and tenants.</u>
<u>Planned preventative maintenance (PPM)</u>	<u>PPM is maintenance that is performed purposely and regularly to keep the fabric, facilities, plant and equipment of a building in satisfactory operating condition by providing for systematic inspection, detection and correction of failures, either before they occur or before they develop into major defects. PPM also helps to identify the point at which such items can reasonably be assessed to have reached the end of their economic life, such that replacement or renewal may be necessary. PPM programmes are usually prepared in periods of between five to ten years in advance and are to be updated at frequent intervals.</u>
<u>Prepayments</u>	<u>Expenses paid in a given period that relates to the following period in whole or part.</u>
<u>Refurbishment</u>	<u>The renovation of fabric or equipment to bring it to a workable or better condition. It is often a different concept to repair or</u>

	improvement and usually includes elements of both. Where a refurbishment project includes improvements or enhancements beyond normal repair or maintenance (which may themselves include a degree of environmental enhancement), this element of the cost would usually be met by the landlord.
<u>Relaunching</u>	Marketing to change the perception in the eyes of its target audience. This may be for letting purposes (a landlord's cost) or may benefit both landlord and tenant, for example, a shopping centre following refurbishment, in which case, an agreement should be reached as to how the relaunch costs are split between the parties.
<u>Reserve fund</u>	A fund formed for a defined purpose to meet anticipated future costs of maintenance and upkeep to avoid fluctuations in the amount of service charge payable each year (for example, for external cleaning and redecorations).
<u>Services</u>	This includes works, such as maintenance and repair of the fabric and structure, and true services such as the provision of heating, lighting, cleaning, security, or as otherwise defined by the lease.
<u>Service charge account</u>	The service charge funds held for a specific property.
<u>Service charge budget</u>	The expenditure estimated by the landlord (or their manager) that will be incurred in a given service charge accounting period.
<u>Service charge reconciliation</u>	A comprehensive comparison of all service charge income demanded against all service charge expenditure (including accruals and prepayments) for a given service charge accounting period. This enables the calculation of any balancing charges and credits and produces a statement of expenditure.
<u>Service charge year end accounts</u>	The accounting pack detailing the actual expenditure at the closure of the service charge period. The lease may use different terminology (such as annual 'statements'), but in this professional standard, such statements are referred to as 'service charge year end accounts' or 'service charge accounts'.
<u>Schedules</u>	The allocation of service charge costs into separate parts to reflect the provision, usage, benefit or availability of services between single or groups of tenants.

<u>Sinking fund</u>	A fund formed for a defined purpose by periodically setting aside money for the replacement of a wasting asset (for example, heating and air-conditioning plant and equipment, lifts, etc.).
<u>Statement of service charge expenditure</u>	The account of service charge expenditure/costs and related notes. Commercial leases usually provide for an annual statement of service charge expenditure to be issued to tenants following the end of each service charge period.
<u>Tenant</u>	A person in possession or occupation of premises and usually responsible for payment of the service charge to the landlord. Also often referred to as 'occupier' or 'customer'.
<u>Total cost of management</u>	The reasonable price for managing the provision of the services at the location and relates only to work carried out in managing and operating the services and the administration of the service charge.
<u>Value for money</u>	The optimal use of resources to achieve the intended outcomes. Value for money is not about achieving the lowest initial price.
<u>Virtual bank account</u>	A subsidiary or subaccount of a physical bank account that allows segregation of funds, e.g. in respect of individual properties, from other funds in the same account or alternatively where funds can be clearly identified through the use of separate ledgers.
<u>Void liabilities</u>	The share of the agreed service charge expenditure for any service charge accounting period that is attributable to vacant or void accommodation.