



CPD Foundation

RICS professional statement - Service charges in commercial property

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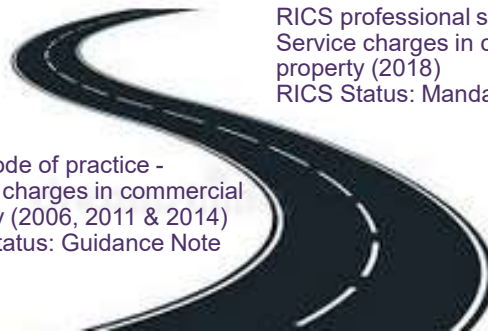


Introduction

- Background
- Why
- What does it mean
- Good news
- Document overview
- Conclusion



The journey so far...



RICS code of practice -
Service charges in commercial
property (2006, 2011 & 2014)
RICS Status: Guidance Note

RICS professional statement -
Service charges in commercial
property (2018)
RICS Status: Mandatory



Service Charge Guide to
Good Practice (1996 & 2000)
RICS Status: N/A



The journey so far...

- ✓ **22 years** since inception of industry collaborative guidance
- ✓ Consistently one of the most downloaded RICS documents
- ✓ Document that in the RICS' view 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."
- ? ...So why the need for the significant step of **Mandatory obligations** in the 6th iteration?



Why...

- Managing service charges is important and increasingly complex!
- Managers need to have a particular and demanding skill set
- Owners typically appoint – tenants generally have no say
- Owners and tenants are entrusting managers to perform their role consistently and effectively
- Things are far from perfect out there - increasing demands for the industry to improve, with well over 2,500 comments received on the consultation (simplified to 597)
- The role of the RICS to promote and enforce the highest industry standards
- ...so what does this mean?

'Tenants who agree to service charge clauses under which they contract to pay against a surveyor's estimate or an accountant's certificate rely upon the professional people involved performing their roles with professional scrupulousness, diligence, integrity and independence and not in a partisan spirit, supposing their only task to be to recover as much money as they can for the landlord.'

Jonathan Gaunt QC sitting as a deputy high court judge: *Princes House Ltd v Distinctive Clubs Ltd* [2006] All ER (D) 117 (sep). [2007] 14 EG 104 (CS)

RICS code of practice -
Service charges in commercial
property (2011 & 2014)



It means that...

With effect from **1st April 2019:**

1. RICS code of practice - Service charges in commercial property (3rd edition) has been **superseded**
2. We have an RICS professional statement that:
 - (i) **sets out best practice** in the management and administration of service charges
 - (ii) provides **mandatory obligations** that RICS members and regulated firms **must comply** with
 - (iii) and is **applicable to the whole of the UK** (although there are instances where different conditions may apply in Scotland and Northern Ireland – these are highlighted where appropriate)
3. Sections that use the word **“must”** set mandatory professional, behavioural, competence and/or technical requirements, from which members **must not** depart



It means that ...

4. There is an **expectation** that members engaged in this area will be familiar and **comply with the whole document** – the entire document is an RICS professional statement
5. We should only depart from the best practice requirements for “**justifiable reasons**”
6. It is **not** acceptable to simply comply with the mandatory obligations
7. There may be **legal and / or disciplinary consequences** for departing from professional statements, which may lead to a finding of negligence against a surveyor
8. **But it cannot override the lease** although, 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
9. And **proportionality** (regarding the extent to which owners and managers should seek to comply with the **recommended** best practice processes and procedures) is acknowledged



The good news...

You:

- ✓ Are here today!
- ✓ Have almost **6 months** until implementation

And ultimately:

- ✓ The RICS professional statement (“PS”) is **not** asking you to do anything that you shouldn’t already be doing in any event
- ? So how does the document work...?



It works as follows...

Four chapters:

1. – Introduction
2. – Aims and objectives, plus mandatory requirements
3. – Core principles
4. – Recommendations and guidance on how the PS can be followed

Appendices – additional information and resources to (i) support understanding and (ii) assist with implementation



The chapters...

Chapter 1 – Introduction

- What we have already discussed – the background & document status etc.

Chapter 2 – Aims and objectives, plus mandatory requirements

- The **four** aims remain to:
 1. **Improve general standards and promote best practice, uniformity, fairness and transparency** in the management and administration of service charges in commercial property
 2. Ensure **timely issue** of budgets and year-end certificates
 3. **Reduce** the causes of **disputes**, and to provide **guidance on the resolution** of disputes if these arise and
 4. 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.



The chapters...

Chapter 2 – Aims and objectives, plus mandatory requirements (cont.')

- The **nine** mandatory requirements are:
 1. All expenditure that the owner 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 **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 budgets, including appropriate explanatory commentary, are issued annually to all tenants.
 4. Owners and managers **must** ensure that an approved set of service charge accounts showing a true and accurate record of the actual expenditure constituting the service charge are provided annually to all tenants.

Acceptable
Standard of
Performance



The chapters...

Chapter 2 – Aims and objectives, plus mandatory requirements (cont.')

5. Owners and managers **must** ensure that a service charge apportionment matrix for their property is provided annually to all tenants.
6. Service charge monies (including reserve and sinking funds) **must** be held in one or more discrete (or virtual) bank accounts.
7. 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 have been made.
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.

Acceptable
Standard of
Performance



The chapters...



Chapter 3 – The core principles

- **Underpin and support** the mandatory requirements
- **Acknowledged** that some of the principles may be difficult to quantify, and in **rare** circumstances strict compliance may not always be possible
- **Appropriate** level of compliance may be based on the **professional judgement** of all parties as to what is appropriate and reasonable considering all the circumstances
- **24** (broadly similar) **core principles**, split into the following **11** sections:

1. The service costs

- Transparent, with all parties (i.e. owners, occupiers and managers) aware of how the costs are made up
- Management fees - fixed-price basis with no hidden mark-ups
- Procured on an appropriate VFM basis – competitive quotations / benchmarked
- Owners should not profit from the provision or supply of services – save for a reasonable management fee reflecting the actual cost of managing the services



The chapters...



Chapter 3 – The core principles (cont.)

2. Allocation and apportionments

- Allocated to the relevant expenditure category
- Where reasonable / appropriate – costs allocated to separate schedules & apportioned to those who benefit
- Basis and method of apportionment – demonstrably fair and reasonable reflecting availability, benefit and use

3. Communication and consultation

- Owner has the right to set standards by which their investment will be managed and has a duty to manage but managers should consult with occupiers regarding the standard / quality required
- Managers should communicate with occupiers to ensure services are delivered effectively for the benefit of all, and to ensure occupiers understand what they can expect to receive / pay
- Managers claiming compliance with the principles should be transparent in demonstrating how they comply



The chapters...



Chapter 3 – The core principles (cont.)

4. Duty of care

- Those certifying accounts should recognise that they have a duty of care to both owners and occupiers – professional care, diligence, integrity and objectivity
- The owner and/or manager has a duty to not only manage, but also a duty of care to both owners (whose investment they are servicing) and occupiers (who entrust the spending of their own business overhead and cash-flow by funding the services)
- Should be clear policies as to how the service charge will be managed

5. Financial competence

- When issuing statements of accounts and/or certifying expenditure, managers should do so in a non-partisan spirit, acting as experts
- In addition to the manager's certificate, annual statements of expenditure should be supported by an independent review of the accounts – see ICAEW Technical Release (Tech 09/14BL)
- Industry Standard Cost Classifications should be used



The chapters...



Chapter 3 – The core principles (cont.)

6. Occupier responsibilities

- Prompt payment of legitimate charges
- Representatives involved have an appropriate level of responsibility and authority to make decisions
- Recognising that VFM and maintenance of quality standards will be enhanced through partnership - proactive in the operation and use of services (e.g. waste separation)

7. Right to challenge / alternative dispute resolution [ADR]

- New leases (incl. renewals) should make provision for either party to instigate ADR as a cost-effective alternative to court action
- The parties can agree to resolve a dispute through ADR regardless

8. Timeliness

- Communication / Consultation between managers and occupiers – timely and regular to promote good working relationships and understanding
- Help avoid disputes and resolve any that may arise



The chapters...



Chapter 3 – The core principles (cont.)

9. Transparency

- Essential and will help prevent disputes
- Prompt notification of material variances ensures better working relationships

10. Value for money

- Service quality appropriate to location, use and character of the property
- Manager should procure quality service standards to ensure VFM at all times
- Aim – effective, VFM service not merely the lowest price

11. Exclusions

- Service charge costs should **not** include:
 - i. Initial costs (incl. leasing) relating to original design / construction of fabric, plant or equipment
 - ii. Setting up costs, incl. fit out and equipping of the on-site management offices
 - iii. Improvements above normal maintenance, repair or replacement – may incl. enhancement if such expenditure can be justified/demonstrated following an analysis of reasonable options/alternatives, and with regard to a cost-benefit analysis over the term of the occupiers' leases



The chapters...



Chapter 3 – The core principles (cont.)

- iv. Future redevelopment costs
- v. Costs / Fees relating to owner's investment interest – e.g. asset management and rent collection, letting units and matters between owners and an individual occupier
- vi. Costs attributable to void premises and/or the owner's own use
- vii. Costs arising out of the negligence of the manager / owner



The chapters...

Chapter 4 – Best practice to support the core principles

- 27 pages of recommendations / guidance on how the professional statement can be followed
- Not possible to go through this in detail today, but in essence you will find:
 - a broadly familiar format, albeit with some improvements in order and layout
 - some subtle changes to the language, as well as other more obvious changes – e.g.

4.4 Dealing with existing and new leases

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

- 1 All expenditure that the owner 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 must seek to recover no more than 100% of the proper and actual costs of the provision or supply of the services.
- 3 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.
- 4 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.

4.4.1 Existing leases

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

4.5.4 Balance sheets

Where the accounts are prepared on an accruals basis, they should be accompanied by a schedule of closing prepayments and accrued expenses. Openness and transparency can be further enhanced by the inclusion of 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 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.

4.6.4 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.



The chapters...

Chapter 4 – Best practice to support the core principles

- Accruals – in essence, little change to the stated definition:

“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.”

- However, additional commentary added:

“Often the cost of anticipated major works is included in the service charge budget but for whatever reason, no works were actually commenced during the service charge period in question. In such circumstances, the amount included within the original budget is frequently, and incorrectly, retained as an ‘accrual’ against the anticipated commencement of works in the next or subsequent years.

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 monies outside of a properly constituted sinking or reserve fund is contrary to best practice, and is considered to be wholly inappropriate under any circumstances.”

- Reserve / Sinking Fund or “**Agreed** contributions towards future works”



The appendices...

Appendix A: Compliance checklist

- Similar to the 3rd edition – some improvements in format, with a **new Core principle “Approval”** added, plus an additional **Transparency obligation** regarding full disclosure of the **manager’s fees**

Appendix B: Standard industry cost classifications

- Some changes in layout, but majority of classifications are very similar...but not all – e.g.
 - “H, S & Environmental Management” – **now** sub-class of “Professional Fees”
 - “Cleaning & environmental” – **now** “Cleaning and sustainability” plus “Landscaping and environment”
 - Addition of “Agreed contribution to future works” and “Miscellaneous charges”



The appendices...

Appendix C: Service charge accounting sample report

- Some fairly subtle changes to wording, but improvements in order, layout and format
- **Additional obligation** and **new Weighted Floor Area Apportionment Matrix** included:

C5.10.3 Summary of all fees charged by the managing agent

All fees charged by the managing agent 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 fees	£500	£500	-
Help desk	£250	£250	-
Staff salaries (on-site)	£250	£250	-
Office costs (on-site)	£50	£50	-
Electricity	£250	-	£250

CE 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
High street											



The appendices...

Appendix D: Commercial property service charge handover procedures

- RICS GN - Commercial property service charge handover procedures (2015) **now incorporated**
- Glossary – **moved** and various **new definitions added** (e.g. Arrears statement, Buyer, RPI, Seller etc.)



The conclusion...

- New RICS professional statement applies to **all** service charge periods **commencing from**

1st April 2019

- provides **mandatory obligations** that RICS members and regulated firms **must comply** with
- We should only depart from the best practice requirements for “**justifiable reasons**” - it is **not** acceptable to simply comply with the mandatory obligations
- Accruals...**not** unauthorised retentions
- **Full** apportionment information
- Have almost **6 months** until implementation...so get reading!

Any questions?



Please complete your evaluation form and return to RICS staff as you leave



RICS

