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# RICS Service Charge Code Professional Statement Update

Browne Jacobson LLP

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## Introductions:



- Brian Hession, a commercial real estate partner specialising in investment and asset management.

- Lucinda Chaplin, trainee solicitor in commercial real estate.



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# General overview

## Introduction

- Background
- Effect of new Professional Statement
- How does the document work?
- Case studies
- Questions
- Conclusion



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# Background

- Why has the RICS intervened?
- RICS guidance since 1996



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## Effect of new Professional Statement

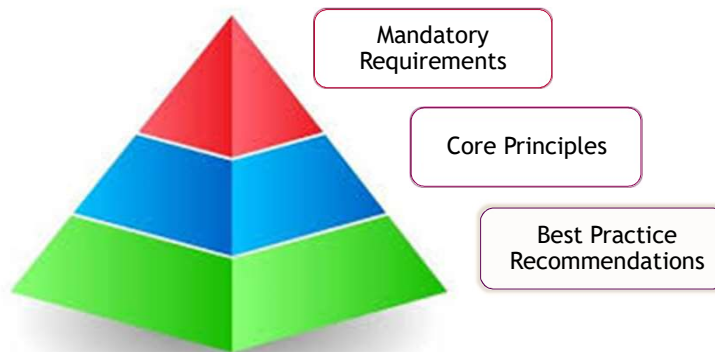
1. Sets out best practice in the management and administration of service charges;
2. Provides mandatory obligations that RICS members and regulated firms must comply with from 1 April 2019;
3. Doesn't override lease;
4. More likely to be used in practice owing to mandatory status; and
5. Failure to comply = negligence.

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## How does the document work?



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## Mandatory requirements

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

1. All expenditure that the owner and manager seek to recover **must** be in accordance with the terms of the lease.
2. Owners and managers **must** seek to recover no more than 100% of the proper and actual costs of the provision or supply of services.
3. Owners and managers **must** ensure that service charge budgets, including appropriate explanatory commentary, are issued annually to all tenants.

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## Mandatory requirements cont.

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.
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.

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## Mandatory requirements cont.

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.

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## Core principles



These have been split into 11 categories:

1. Cost of the services
2. Apportionment
3. Good communication with tenants
4. Managing agent owes duty of care to both parties
5. Financial competence
6. Occupier responsibilities
7. Disputes
8. Timeliness
9. Transparency
10. Value for money
11. Exclusions

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## Best Practice Recommendations

- Outlines behaviours that support the core principles
- Commentary to assist understanding of core principles

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## Case study 1

- 10 year lease.
- Air con needs replacing in year 9.
- T has employed “Annoying Auditors Ltd”.
- T refusing to pay service charge as contribution towards the cost of the new air con not “fair and reasonable” as required by Core Principle 2.
- Lease silent.
- Can T do this?

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## Case study 1 - answer

- No - BPR 4.9.1 says: “Occupiers can be required to pay a higher service charge at the end of the term. If an owner can demonstrate that repairs are necessary to comply with the lease during the term the costs are likely to be reasonable, even where the lease is about to end”.
- Mandatory Requirement 2 - only sums in dispute should be withheld.
- BPR 4.6.1 - Unnecessarily intrusive service charge consultants exhibit behaviour which is not best practice and aggravate the L & T relationship.

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## Case study 2

- 10 storey office building.
- Floors 1 - 8; 9am to 5pm. Floors 9 and 10; 8am to 8pm.
- Ts of floors 1 - 8 refusing to contribute to the costs of out of hours air con.
- Lease doesn't specify that out of hours air con treated differently.
- Can Ts do this?

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## Case study 2 - answer

- BPR 4.1.2:

“Not all of the occupiers will benefit from the services to the same extent. In such circumstances, it may be necessary to divide the service charges into separate schedules to reflect the benefit enjoyed by individual tenants. The allocation of costs to separate schedules is essential in achieving a fair and proper apportionment of costs between those occupiers that benefit from specific services”.

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## Case study 3

- 99 year lease.
- Lease sets out an initial £90 p/a service charge subject to fixed annual 10% increases. This would result in the service charge eventually reaching over £0.5m p/a.
- On what basis under the PS could Ts argue that the service charge figure is a cap, not a fixed increase?

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## Case study 3 - answer

- Mandatory Requirement 2 - no over-recovery.
- Core Principle 2 - apportionment must be fair and reasonable.
- Arnold v Britten (Supreme Court, 2015)

“A court should not look for drafting infelicities to facilitate a departure from the natural meaning. Commercial common sense should not be invoked retrospectively just because the contractual arrangement would work out badly for one of the parties”.

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## Case study 4

- Rent reviews in shopping centre due in 2020.
- L proposing to update common parts in 2019. Service charge pot to pay for works.
- Enhanced common parts will result in rent increase on review.
- Can Ts refuse to contribute towards the works?

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## Case study 4 - answer

- BPR 4.9.1 - the service charge should not include improvement costs beyond normal maintenance, repair or replacement.
- BPR 4.9.6 - if refurbishment results in higher rent, the owner (not the service charge) should pay for the cost.

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## Case study 5

- L has installed kiosks in a shopping centre for temporary Christmas traders.
- The service charge has paid for the kiosks.
- Who is entitled to the income from the kiosks?
- Would the answer be different if the owner paid for the kiosks?

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## Case study 5 - answer

- BPR 4.11.3
- If item funded by service charge - income credited to service charge.
- If L has paid for the item - L keeps income.
- If the item uses the other services - L or T should contribute to the service charge. Costs shouldn't be borne by the other Ts via the service charge.

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## Conclusion

- New PS applies to all service charge periods commencing from 1 April 2019.
- Provides mandatory obligations that RICS members and regulated firms must comply with.
- Only depart from BPRs for “justifiable reasons” - not sufficient to simply comply with Mandatory Requirements.
- Failure to comply = potential negligence.

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# Questions?

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All information correct at time of production.

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