

Legal Alert

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Service Charges in Commercial Property – the new RICS Professional Statement

In contrast to the residential sector, commercial property service charges are fairly lightly regulated. Threats of legislation have been kept at bay by a series of voluntary Codes of Practice. The [latest version](#) was published by the RICS in September 2018 and will come into force in April 2019. For the first time, the Code will be in the form of an RICS Professional Statement and some parts of it will be mandatory for surveyors and property managers who are RICS members.

The new Statement builds on established best practice but some of the requirements will be new for many property owners and managers. The Statement consists of nine mandatory requirements, backed up by non-mandatory core principles and a wide range of practical examples of best practice. The key aims of the Statement are to improve standards and promote best practice in the management and administration of commercial property service charges, achieving greater uniformity, fairness and transparency.

Mandatory requirements:

- Landlords should make sure that all the expenses they seek to recover are in accordance with the lease and do not add up to more than the actual cost of providing the services.
- Each year, tenants should be provided with budgets and approved service charge accounts, plus a service charge “apportionment matrix” showing the proportion of the total costs attributable to each unit.
- Service charge monies must be held in discrete bank accounts, separate from the landlord’s own money, and interest earned should be credited to the service charge.
- Where there is a dispute, tenants should be advised to withhold only the disputed amount.
- Landlords should be advised to adjust service charges promptly once any dispute has been settled.

Core principles and best practice:

The purpose of the core principles is to underpin and support the mandatory requirements and they are, in turn, fleshed out by practical examples of best practice. The Statement recognises that it may not always be appropriate to comply strictly and the parties will need to use their professional judgement. Most of the key principles fall under the following headings:

Service costs

The costs should be transparent. Services should be procured on a value for money basis, but this need not mean at the lowest possible cost. Management fees should be fixed and not based on a percentage of service costs and should reflect the actual cost of providing and managing the services.

Allocation and apportionment

The Statement recognises that in a multi-let development, some services will benefit some tenants more than others. They should be apportioned in a way that is demonstrably fair and reasonable, so that individual occupiers pay a proportion that reflects the extent to which they benefit from specific services.

Communication, consultation and competence

The Statement encourages those managing service charges to consult and communicate with occupiers about the standard and quality of service charge required and the anticipated costs, in good time to avoid disputes arising. Managers should act fairly and impartially and should be able to show how they are complying with the Statement. Budgets and the apportionment matrix should be provided at least a month before the start of the service charge year. If it becomes clear that there will be a significant difference between budgeted and actual costs, managers should inform occupiers promptly. Year-end statements should be provided to occupiers within four months of the end of the service charge year. The accounts do not need to be fully audited, unless this is specifically required by the lease – instead, the Statement recommends a more cost-effective independent review that complies with specified accounting principles.

Challenge and dispute resolution

Service charge disputes can be costly, so the Statement encourages the use of alternative dispute resolution mechanisms, such as mediation or expert determination and suggests that this should be included in all new leases.

Exclusions and commercialisation of common parts

Most modern leases will set out a list of heads of expenditure that should always be excluded from the service charge and the Statement underlines this important principle. Initial capital expenditure and improvements that go beyond repair should be excluded, although the Statement acknowledges that sometimes, it may be more cost-effective to replace items in need of repair with better alternatives. The best practice guidance looks in more detail at some specific types of expenditure that may arise in relation to shopping centres, retail and leisure parks and business campuses, including marketing and promotions, systems for counting footfall and cars and extra amenities such as wi-fi and mobility aids. Best practice envisages that marketing costs should be shared 50/50 but that the costs of other systems and facilities should be reviewed on a case by case basis. Anything managers propose to provide through the service charge should be appropriate to the property and location and should be the subject of consultation and communication with occupiers.

Where common parts produce income, for example by licence fees for kiosks and vending machines, the allocation of costs and income should be transparent. Where an item is wholly or partly funded by service charge, an appropriate proportion of any income should be credited to the service charge.

What difference will this make to the way leases are drafted and interpreted?

The RICS acknowledges that the Statement cannot override the express terms of leases that have already been granted but it is clearly hoping that the underlying principles and practices will nonetheless become standard practice. The key obstacle for the RICS to overcome is that the Statement is directed at surveyors and managers and even the mandatory requirements will not bind landlords. The best practice guidance recommends that existing leases are interpreted in accordance with the principles and practices in the Statement and that these should be followed in the drafting of new leases but it remains to be seen how far this will actually happen.

In practice, this may not matter as much as it might at first appear. Many of the requirements and recommendations in the Statement can be put into practice by managers without needing to be dealt with expressly in lease drafting. Landlords are increasingly willing to treat tenants as partners with a shared stake in the success of a development. This, coupled with the need for managers and surveyors to follow the Statement, should open the door for the best practice set out in the Statement to become standard.