

RICS Practice Standards, UK

Service charges in commercial property

2nd edition, code of practice



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Service charges in commercial property

RICS code of practice

2nd edition (GN 24/2011)



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Foreword

It is with great pleasure that I introduce to you the second edition of the RICS Code of Practice for Service Charges in Commercial Property.

The first edition of the Code set down a marker as to the standards of management required in commercial property and this new edition builds on that. The core principles behind the previous edition of the Code namely communication, transparency and timeliness remain key in the 2011 Code.

Without doubt, awareness of the need for better management among managers, owners and occupiers has been heightened by the Code and the efforts of all the pan-industry bodies in promoting it. There is evidence, albeit anecdotal, that the Code has led to improvements in the standards of management being achieved in much of the commercial property sector.

Increased engagement with the legal profession is a key aspiration of the new Code. Whilst the Code cannot override leases we expect that as leases renew or new leases are granted that they are drafted to reflect what is seen as best practice and espoused by the Code.

Accordingly, alongside the new Code, further content has been developed by the Central London Law Society and the Practical Law Company setting out alternative standard lease clauses which reflect the Code.

The Code recognises occupiers must have a right of challenge. It is recommended that in the future all leases will contain ADR clauses that allow the parties to cost effectively settle disputes in service charge matters.

The old axiom applies ‘one can’t manage without measurement’. The Steering Group recognises the sterling work of Jones Lang LaSalle with their OSCAR benchmarking service. For 20 years this has provided substantial amounts of data. Without doubt if the property industry is to deliver on its key objective of transparency enabling owners, managers and their customers to be aware of how service charge costs are derived then an independent and substantially larger benchmarking service will be the next step in this process.

The previous Code introduced Industry Standard Cost Classifications. The adoption of these is recommended as a ‘must’ in service charges going forward. Similarly the use of independent accountants’ certificates (rather than audits) is introduced for the first time.

The Code is in a clearer format. The core principles are set out at the start of the Code with guidance and supporting information provided thereafter. We believe this will be simpler to follow and easier for parties to adopt and comply with.

Whether owner, occupier or manager, the Code creates a framework of Best Practice and I commend this second edition to you all.

C S Edwards FRICS

Chair Pan Industry Service Charge Code Steering Group

Acknowledgments

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RICS guidance notes

This Code of practice has the status of a guidance note. It provides advice to practitioners. Where procedures are recommended for specific professional tasks, these are intended to embody 'best practice'.

Although practitioners are not required to follow the advice and recommendations contained in the note. They should note the following points.

When an allegation of professional negligence is made against a practitioner, the court is likely to take account of the contents of any relevant guidance notes in deciding whether or not the practitioner had acted with reasonable competence.

A practitioner conforming to the practices recommended in this note is unlikely to be adjudged negligent on account of having followed these practices. However, practitioners have the responsibility of deciding when it is appropriate to follow the guidance. If it is followed in an appropriate case, the practitioner will not be exonerated merely because the recommendations were found in a guidance note.

On the other hand, it does not follow that a practitioner will be adjudged negligent if he or she has not followed the practices recommended in this note. It is for each individual practitioner to decide on the appropriate procedure to follow in any

professional task. However, where practitioners depart from the practice recommended in this note, they should do so only for good reason. In the event of litigation, the court may require them to explain why they decided not to adopt the recommended practice.

The Code has been prepared to promote best practice in terms of service charges for commercial properties in new leases or renewed leases. Circumstances can arise where the suggested best practice in this Code cannot be applied. This Code therefore should not compel owners, occupiers or managers to an inappropriate course of action. Transparency simply requires that in the event the Code is inappropriate the reasons for this are shared with all relevant parties and a record kept.

In addition, guidance notes are relevant to professional competence in that each practitioner should be up to date and should have informed him or herself of guidance notes within a reasonable time of their coming into effect. In the opinion of the approving professional bodies, this guidance note represents best practice.

Effective Date

The Service Charges in Commercial Property Code of Practice and supporting guidance are effective from 1 October 2011.



Introduction

The service charge arrangement

Service charges enable an owner to recover the costs of servicing and operating a property from the occupiers and others that benefit from and use the services and facilities provided.

The service charge arrangement is set down in the lease(s) and the aim is to entitle the owner to recover his charges and associated administrative costs incurred in the operational management of the property. This will 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 any other works and services which the parties agree are to be provided by the owner and subject to reimbursement by the occupier.

If the property is fully let, the owner will normally be able to recover all expenditure on services through the service charge, except any concessionary discounts the owner has given.

Usually there will be a manager who administers these services (for which he/she will receive a fee).

Service charge costs **will not** include:

- Any initial costs (including the cost of leasing of equipment) incurred in relation to the original design and construction of the fabric, plant or equipment.
- Any setting up costs, including costs of fitting out and equipping the on-site management offices that are reasonably to be considered part of the original development cost of the property.
- 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 the

analysis of reasonable options and alternatives and having regard to a cost benefit analysis over the term of the occupiers' leases.

Managers should provide the facts and figures to support and vindicate such a decision.

- Future redevelopment costs.
- Such costs which are matters between the owner and an individual occupier, for instance: enforcement of covenants and collection of rents; costs of letting units; consents for assignments; sub-letting; alterations; rent reviews; additional opening hours, etc.
- Any costs arising out of the failure/negligence of the manager or owner.

New service charge lease provisions

The City of London Law Society and Practical Law Company have both drawn up service charge lease provisions which have been specifically designed to comply with the principles and provisions of this Code. These are available as downloads from the following links:

www.citysolicitors.org.uk/FileServer.aspx?oID=976&IID=0 (suggested service charge provisions for an office building)

www.citysolicitors.org.uk/FileServer.aspx?oID=975&IID=0 (suggested service charge provisions for a shopping centre)

<http://property.practicallaw.com/6-505-4928>

Use of this Code of practice

Section 1 of this document outlines the aims and objectives of this Code, along with stating its core principles. Section 2 then gives recommendations and guidance on how the Code can be followed. Sections 3 and 4 contain additional information and resources to support your understanding of the Code and assist you with the implementation.

Section 1: The Code

Service Charge Code ('The Code')

Aims and objectives

- To improve general standards and promote best practice, uniformity, fairness and transparency in the management and administration of services charges in commercial property.
- To ensure timely issue of budgets and year end certificates.
- To reduce the causes of disputes and to give guidance to resolving disputes where these do occur.
- To provide guidance to solicitors, their clients (be they owners or occupiers) and managers of service charges in the negotiation, drafting, interpretation and operation of leases in accordance with best practice.

The core principles

“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]

The service costs

- 1 Best practice requires services to be procured on an appropriate value for money basis and that competitive quotations are obtained or that cost are benchmarked.
- 2 Owners should not profit from the provision or supply of services. Save for charging a reasonable commercial management fee to reflect the actual costs of managing the services the amount recoverable by an owner is limited only to the proper and actual cost incurred in the provision or supply of services.
- 3 All costs are to be transparent so that all parties, owners, occupiers and managers, are

aware of how the costs are made up.

Management fees are to be on a fixed price basis with no hidden mark ups.

Allocation and apportionments

- 4 Costs should be 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.
- 5 The basis and method of apportionment should be demonstrably fair and reasonable to ensure that individual occupiers bear an appropriate proportion of the total service charge expenditure that reflects the availability, benefit and use of services.
- 6 Managers are to make a full apportionment matrix available to all occupiers, which clearly shows the basis of calculation and the total apportionment per schedule for each unit within the property/complex.

Certification

- 7 Certified accounts of expenditure are to represent a true and accurate record of expenditure incurred. Those certifying service charge accounts must recognise that they have a duty of care to both owners and occupiers to act with professional care, diligence integrity and objectivity.

Communication and consultation

- 8 Whilst the owner has the right to set the standard to which his investment will be managed and has a duty to manage, managers will consult with occupiers with regard to the standard and quality of service charge provision required.
- 9 Managers will communicate with occupiers to ensure services are delivered effectively for the benefit of all and to ensure that occupiers understand what they can expect to receive and how much they are required to pay.
- 10 Managers claiming compliance with the principles of this Code will be transparent in demonstrating how they comply. An example is to use the checklist at appendix A.

Duty of care

- 11 The owner and/or manager has a duty to manage the property and also has a duty of care to occupiers, (who entrust the spending of their own business overhead and cash flow by funding the services) and to the owners, (whose investment they are servicing).
- 12 There will be clear policies as to how the service charge will be managed.

Financial competence

- 13 In incurring costs in the provision of services the manager is spending the occupiers' money. Managers must demonstrate a high degree of competence, professionalism, integrity, diligence, objectivity and transparency in dealing with the service charge accounts.
- 14 When issuing statements of accounts and/or certifying expenditure managers must do so in a non-partisan spirit, acting as experts. The manager must therefore ensure that all costs have been incurred and are properly recoverable in accordance with the leases.
- 15 Service charge monies will be held in one or more discrete bank accounts, recognising that monies are held to deliver the service expenditure.
- 16 All interest earned, or where separate accounts per property are not operated a proper and reasonable amount of interest calculated on normal commercial rates, will be credited to the service charge account after appropriate deductions have been made, i.e. bank charges, tax, etc.
- 17 The recommended Industry Standard Cost Headings must be used in reporting budget and actual expenditure.

Occupier responsibilities

- 18 Occupiers will ensure prompt payment of all service charge on-account and balancing charges. Where a legitimate dispute exists, any payment properly withheld should reflect only the actual sums in dispute.
- 19 Occupiers will recognise that the service charge provision of any lease has legal effect and will ensure that representatives involved in discussions, meetings etc. have an appropriate level of responsibility and authority to make decisions concerning service charge matters.

- 20 In recognition that value for money and maintenance of quality standards will be enhanced through partnership, occupiers will be proactive in assisting owners in the operation and utilisation of service and service systems, e.g. separating waste to facilitate appropriate and cost effective recycling, adopting energy saving measures, etc.

Right to challenge/dispute resolution

- 21 All new leases (including renewals) should make provision for either party to require the resolution of disagreements through the use of alternative dispute resolution (ADR) as a cost effective alternative to court action.
- 22 If the parties cannot agree a mediator or independent expert to determine the dispute the president of the 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 go to ADR to resolve a dispute.

Timeliness

- 23 Communication and consultation between managers and occupiers need to be timely and regular to encourage and promote good working relationships and understanding with regard to the provision, relevance, cost and quality of services.
- 24 Managers will issue budgets to occupiers, including an explanatory commentary 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, will be issued within four months of the service charge year end.

Transparency

- 25 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 prevent disputes. Prompt notification of material variances to plans or forecasts ensures better relationships between owner, manager and occupier.

Value for money

- 26 Service quality is to be appropriate to the location, use and character of the property. The manager is to procure quality service standards

to ensure that value for money is achieved at all times. The aim is to achieve value for money and effective service rather than lowest price.

Limitations of the Code

Existing lease terms

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

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

An ADR clause will enable difficulties during the term of the lease to be resolved efficiently.

The parties should carefully consider the principles and requirements of this Code 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 down in this Code will often be dependant upon 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 should be consistent with best value principles.

Nevertheless, owners, managers and occupiers should at all times seek to comply with the core principles set down in this Code.

Section 2:
Recommended best practice to support the
core principles

1 Administration

1.1 Standard and quality of service provision

The aim of service provision is to ensure 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 value for money and effective service rather than lowest price.

The manager is responsible for ensuring that the standards of services provided are monitored, that the quality and cost of the services provided are regularly reviewed and, where possible, demonstrate that service standards are being delivered and value for money is being obtained.

Management policies and procedures are to be established that define the procurement, administration and management of services, and to ensure 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 the ones set out in the Code the manager should be able to explain and justify these in advance.

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

On occasion there will be additional services provided outside the service charge. Occupiers are entitled to expect similar transparency, accountability, etc. in these services. The Code applies to these as well.

1.2 Staffing and personnel

On-site management staff should have a sound knowledge of appropriate modern business

practices and be adequately skilled to provide best and agreed performance standards. They will need appropriate skills in general management, employment and health and safety matters and necessary training costs may be covered by the service charge.

To ensure the services are provided efficiently and cost effectively sufficient staffing of the right type and calibre are to be provided. The total costs for staff should be declared.

Site management teams and managers should be required to perform according to defined performance standards. It is 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 change, such as termination of employment contracts, will be recovered under the service charge provided such costs can be justified following the analysis of reasonable options and the purpose is to achieve greater value for money and cost effectiveness.

1.3 Management charges

1.3.1 Total cost of management

The management charge is the reasonable price for the total cost of 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 service charge.

The management charge might comprise two elements:

- the fee charged by the manager for the management and supervision of the services to a site (the management fee)
- the cost of site specific management staff, whether based on-site full time or part time (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 the site management costs will need to be set at the appropriate level with this in mind and the management structure in place should meet the requirements of the building and of this Code.

It is not for this Code to prescribe the operating business model of the manager. However, best practice requires transparency and a management structure where costs are clearly identified and explained within the explanatory notes included in the budget and actual expenditure reports to occupiers.

1.3.2 Management fees

The management fees charged should be a reasonable costs and overheads in relation to the operation and management of the services. This should reflect the work necessary to fulfil the principles of this Code. It is recognised that whoever is providing the service is entitled to cover their costs and overheads including a reasonable profit element.

The manager should ensure that the management fee relates only to the work carried out in managing the service charge. Other costs, i.e. asset management and rent collection should be excluded from the service charge management fee. The service charge report should state this fact.

The Code requires that fees are set on a fixed price basis rather than being calculated as a percentage of expenditure. Percentage is no longer appropriate and is considered to be a disincentive to the delivery of value for money. The management fee should be a fixed fee subject to annual review or indexation.

It is recognised that many leases refer to the management fee as a percentage of the total service charge or contain a percentage cap. This guide cannot override the terms agreed between the parties and recorded in the lease. However, where the lease limits the amount or quantum of the fee recoverable from occupiers it is a matter between the owner and occupier and should not prevent or limit the manager's ability to charge a commercial fee which reflects the requirements of this Code. In certain circumstances this may result in a shortfall in the recovery of service charge costs on behalf of the owner but the overriding principle must be to achieve best practice principles for the management and administration of services charges in commercial property.

Managers should confirm in the service charge report: the basis of their appointment; when they were appointed; and the basis of the management fee payable, which is recoverable under the service charge. Where the owner manages the property in-house they should be able to support the basis of their fees when benchmarked against other comparable service providers.

It is advisable for the costs of reports undertaken by specialists working for the same organisation as the manager (i.e. fire risk assessment, DDA reports, health and safety reports) to be excluded from the management fee; and for any fees for these additional services to be stated clearly and represent value for money. If other costs of providing the management service are being included as separate items, the management fee should reflect this separate 'accounting' as part of the management service.

Further detailed information and guidance is available in an RICS information paper: *Limiting liability in property management contracts*.

1.3.3 Duties of the manager

Items 11 and 12 of the core principles outline duty of care responsibilities relating to service charges. 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 that ownership brings. Best practice requires the manager to recognise a duty of care to occupiers, who fund the services being provided, and the owners whose investment they are servicing.

The manager will usually perform additional roles and duties relating to investment interests, i.e. asset management and rent collection. In such cases the fees charged by the manager in relation to the performance of such additional duties is to be excluded from the service charge management fee.

1.3.4 Site management costs

Site management costs will be the full employment costs for sufficient staff, as described in 1.2. The job titles of the staff will vary. The total cost of the staff will include 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; and/or
- a fee representing the HR and payroll costs associated with dealing with staff (often referred to as an administration charge);
- separate specialist consultancy fees payable, for instance, in connection with the carrying out of health and safety risk assessments, asbestos surveys, etc. and which should be clearly identified in the service charge accounts.

One way of ensuring that 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.

Where on-site staff oversee more than one property, their costs (and any appropriate accommodation and administrative support costs) should be adjusted accordingly so that each property picks up a fair share of their cost. The service charge report should identify if this is the case and how costs are split.

Many buildings require management 24 hours a day, 7 days a week. A manager may consider supporting the function of the on-site staff by providing 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 provided as an alternative to employing additional on-site staff, the reasonable cost of running this service may be recovered from the service charge.

1.3.5 Notional rent for management accommodation

Many leases contain provisions for the inclusion of a notional rent within the service charge for management accommodation or other 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 and to cover the initial provision costs for management accommodation.

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 (e.g. offices) that would otherwise be lettable space; in these cases, there is an element of rent foregone to provide accommodation for the on-site management team.

It is generally not advisable to charge occupiers notional rent in situations either where 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 including facilities management accommodation as part of the original design specification.

There is also an argument that the receipt of a notional rent acts as a disincentive to the efficient use of space and the consideration of alternative uses for areas occupied for centre or facilities management.

1.4 Contract procurement

1.4.1 Service standards and provision

It is advisable to ensure that all contractors and suppliers perform according to written performance standards. It can prove valuable to regularly measure and review performance against these defined performance standards; as well as regularly reviewing the appropriateness of the standards used.

1.4.2 Procurement of services

It is the responsibility of the manager to identify the procurement strategy suitable for the property based on appropriate level of service and value for money. The manager may use a procurement specialist to deliver best value solutions so long as the purpose is to achieve greater value for money and cost effectiveness.

The cost of any procurement specialists employed is considered to be a cost that is recoverable through the service charge but the costs should be clearly identified in the charge report, along with details of whether it is a one-off fee or spread over the length of the contract. The fee payable should reflect the work undertaken and may be performance related.

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

Further information can be obtained from the RICS information paper: *TUPE: information for property managers*.

The manager or procurement specialist should be responsible for the provision of full pre-qualification assessments of suppliers and contractors in terms of their financial standing; proven compliance with health and safety; appropriate indemnity in respect of the services provided, including an undertaking through sub-contractors (with provisions for prior approval thereof) and proven environmental/sustainability credentials.

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 to owners.

If any fees are received from contractors managers should clearly state what these are. Managers should also be aware that the practice of requesting fees from contractors for inclusion in approved contractor lists, contract tendering, etc. is contrary to best practice and is considered to be wholly inappropriate under any circumstances.

Upon 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. Should copies be required the manager will be entitled to charge for the time, cost of copying and postage of such documents.

Owners 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 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 occupiers are not entitled to have access to documents relating to properties other than the one they occupy, although where the contract/tender includes other properties there should be transparency in terms of the apportionment and allocation of costs to the subject property.

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 where such costs can be justified following the analysis of reasonable options and the purpose is to achieve greater value for money and cost effectiveness.

1.5 Allocation and apportionment

1.5.1 Schedules

Costs should be apportioned to each occupier in accordance with items 4 and 5 of the core principles.

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

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

In many cases, particularly buildings with a variety of different users, not all 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 parts (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 that benefit from specific services. Occupiers will

therefore often pay different percentage apportionments under different schedules.

1.5.2 Flexibility

It is worth considering that the availability, benefit and use of the services within a building, and the demand for those services by individual users, could vary over time; and 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 thus changing the costs/payments structure. Even with the grant of shorter-term leases the ability to change allocation and apportionment methods, where necessary and appropriate, should be available during the term to ensure service charges are spread fairly and reasonably between all the beneficiaries and users.

1.5.3 Void and unlet premises

Occupiers are not to be liable for the costs attributed to unlet premises; the owner is to meet the cost of these, as well as any special or personal concessions given to individual occupiers. Owners are also responsible for bearing a fair proportion of costs attributable to their use of the property, e.g. where an on-site management premises are also used for other purposes unconnected with the day-to-day management of the building and services.

1.5.4 The apportionment matrix

Managers are to make a full apportionment matrix available to all occupiers, which clearly shows the basis and method of calculation and the total apportionment per schedule for each unit within the property/complex.

For the avoidance of doubt and to preserve confidentiality this should exclude details of any individual concessions or other arrangements between individual owners and occupiers, which are costs that are to be borne by the owner. An individual occupier should be able to clearly verify the basis and method of calculation used in arriving at his or her particular percentage apportionment.

1.5.5 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.

RICS *Code of measuring practice* sets out definitions of the measurement of buildings and their recommended applications, e.g. Gross External Area (GEA), Gross Internal Area (GIA) Net Internal Area (NIA) etc.

Where the service charge is apportioned based on floor area, managers should ensure that the method of measurement used is consistent. Do not mix different measuring methods in the same schedule.

1.5.6 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 many leases require service charges to be apportioned based on rateable value with no provision for any alternative basis to be used, and notwithstanding that this Code cannot override the contractual terms of any lease, it is nevertheless the view of the steering group that rateable value apportionments should be changed to such other recognised methods of apportionment consistent with the aims and aspirations as set down on this Code.

1.5.7 Owner's cost/profit centres

Where there is a separate cost or profit centre within a property complex that generates income for the owner, which is not credited to the service charge account, the costs associated with maintaining and running that cost centre will not be allocated to the service charge account (e.g. car parks, mobile phone masts, advertising, radio aerials, etc.). If the separate cost/profit centre derives benefit from staff or services that form part of the service charge then the cost/profit centre will be incorporated into the service charge matrix (e.g. car park, management office, etc.). Alternatively, owners can estimate and declare a contribution to the service charge to reflect the benefit and use of the common services enjoyed.

1.5.8 Tenant alterations

Alterations carried out by tenants may have an impact upon or affect the calculation of the apportionment of occupier service charge liabilities. When dealing with alteration to premises, particularly where these require the prior consent or approval of the owners, careful consideration should always be given to the potential impact upon the calculation of the service charge to ensure that the apportionment continues to be fair and reasonable.

Further information and guidance can be obtained from RICS information paper: *Apportionment of service charges and tenant alterations*.

1.6 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 outside of the service charge arrangement as a directly recoverable cost, with occupiers often being responsible for payment of electricity/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 the service charge.

Where owners are seeking to recover the cost of insurance and utilities outside of the service charge arrangement, occupiers are entitled to expect similar transparency, accountability, etc. in these services. The Code applies to these as well.

1.6.1 Insurance

Value for money

Where owners 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.

Commission

The principle of commission retention is now long established. In its base form the use of commission to cover administrative costs including broker fees should be recognised and also the owner's ability to benefit from the economies of scale generated by the pooling of risks into a common programme.

Owners and managers must always disclose any commission they are receiving.

Service

Owners should provide full insurance details on request. Owners should also explain the process by which occupiers can make claims under the policy.

Policies should include the ability to note the interest of occupiers and include subrogation waiver and non-invalidating provisions to the benefit of the occupier, again in line with lease obligations.

Further information and guidance can be obtained from the RICS guidance note: *Insurance for commercial property managers*.

1.6.2 Utilities

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

Separate metering or full sub-metering of utility supplies is considered essential to ensure an apportionment of cost between occupiers that reflects actual consumption and usage.

Costs should be recovered in accordance with the terms of the leases, which ought to allow additionally for the payment of a reasonable administrative charge. The recovery should state unit costs and admin charges and include copies of the original invoice in order to comply with the requirements for transparency set out in this Code.

To avoid ambiguity and to ensure accurate consumption and billing is recorded for occupiers 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 cost would usually comprise part of the on-site management costs.

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 becoming increasingly common for utility companies to request that owners either pay large security deposits or higher energy rates.

Where a lease makes specific provision for inclusion of a security deposit as a service charge cost, both owners and occupiers should ensure that the lease allows for the occupier's proportion of such deposit to be reimbursed upon expiry or sooner determination of the lease, in the event of a change of owner/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 occupiers to seek to agree 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 the year end and then re-budgeted for the following period. Therefore, if a lease expires in any given period the occupier will receive an appropriate credit in their final service charge balance.

2 Communication and Consultation

2.1 Communication

Poor communication often gives rise to disputes.

Effective communication is key to achieving best practice – the aim being to provide transparency between manager and occupier in the way services are provided and managed and how the costs of these services are recovered. Communication needs to be timely and continuous and works best when managers and occupiers deal with each other's reasonable enquiries and reciprocal obligations promptly and efficiently.

Managers should seek feedback from occupiers on the performance management standards and service delivery and action this as appropriate.

It is important to have a clear communication structure. Best practice requires managers to hold regular meetings with occupiers; and occupiers have a duty of care to participate and to be proactive in informing managers of the key contacts who deal with service charges.

Managers are also to make key contacts information available to occupiers, i.e. management surveyor, credit controller, accounts clerk, etc., and the names of on-site staff along with their roles and responsibilities.

Managers are to provide occupiers with a copy of the management policy, which should contain standard information about how the property is managed and the aims of the management team (manager and site team). Managers should also inform occupiers of any future plans for the property, if these have an impact on the service charge.

2.2 Consultation

Managers of residential premises are required to follow statutory consultation procedures and will be keenly aware that if the proper procedure is not followed the amount that they can recover might be limited.

Managers of commercial property are not generally obliged to 'consult' with occupiers 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, perhaps prior to incurring large extraordinary costs such as a major fabric or plant replacements, etc. The courts have recently ruled in a number of instances that owners must strictly follow the terms of leases when recovering service charges. In order to ensure recovery of the service charge managers should pay particular care to follow the procedures set down within the lease.

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

2.3 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 occupiers accordingly.

When significant variances in actual costs against budget are likely, it is good practice for the manager to notify occupiers 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 occupiers together with full information on the programme of works, costs and the process to be adopted for keeping occupiers informed.

Occupiers are entrusting their business overheads/operating costs to an external manager and 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 be regarded as significant or material will often be a subjective assessment, dependent upon a variety

of issues such as the size, nature and type of property and the amounts payable by individual occupiers. Prompt notification of unforeseen variances in the total annual spend should be made to all occupiers with an explanation as to how this is being mitigated at the earliest opportunity.

3 Dealing with new and existing leases

3.1 Existing leases

The basis by which service charges are operated and managed is set down in the contract between the owner and occupier; the lease.

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

Existing leases may contain service charge provisions which differ from the recommendations in this Code of practice. Where this is the case, this Code cannot override the lease but existing service charge clauses are to be interpreted as far as possible in line with the principles and practices as set out here, 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 is sought.

3.2 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 occupiers, and results in an increase or decrease in the amount payable by the occupier, this should be taken into account in negotiations and, for instance, reflected in the rent payable.

This Code cannot override the lease but it does set out industry accepted best practice in the field of service charges. It will help solicitors, their clients (be they owners or occupiers) and the managers of service charges, draft, interpret and operate leases in accordance with best practice.

It is recommended that owners, occupiers and their solicitors ensure the lease they sign reflects this

Code, 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 lease term and the scale and type of property concerned. At lease renewal the service charge clauses will certainly require review and probably modernisation/updating. It is recommended that new leases be drafted with sufficient flexibility to allow for changes in best practice.

The attention of owners, managers and occupiers is also drawn to the Code for Leasing Business Premises, which provides further guidance, for negotiations before the grant of a lease or lease renewal, in creating a document which is clear, concise and authoritative.

Further information can be obtained from www.leasingbusinesspremises.co.uk.

It is unlikely that all leases within 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; 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 can swop from the old lease service charge regime to the new.

3.3 Sweeper clauses

It is often difficult to predict precisely what services might be provided through the duration of a long lease and which should 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 to charge not only for the services

specifically listed, but also for other miscellaneous services that might be provided in the future.

This is not usually a problem for short leases; however, as it is far easier to accurately predict the services which are to be provided. In these cases, unless a lease incorporates very clear wording to the contrary, if the owner had in mind the provision of a service, but he has not covered the right to include the cost of providing it in the service charge, he 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 the ability to provide further services that are not identified or in contemplation at the time the lease was granted and which for any reason are considered necessary or desirable to be provided at a later time.

3.4 PACT

The Civil Procedures Rules (CPR) determines that ADR must be considered before litigation or the parties risk a punishment of costs by the courts.

Professional Arbitration on Court Terms (PACT) is a scheme offered by RICS and the Law Society as a form of alternative dispute resolution (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 both owners, occupiers and to their advisers through the lease renewal process.

4 Financial controls and competencies

4.1 Accounting principles

Service charge statements should include a comprehensive list of accounting policies and principles upon which the statement is prepared, including:

- whether the statements are prepared on an accruals or cash basis
- whether the owner has waived the exemption to charge VAT (opted to tax)
- 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
- 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
- sign off statements by the accountants and/or manager with regards to compliance, financial accuracy and the use of appropriate accounting policies.

4.2 Audit and certification of service charges

4.2.1 The requirements of the lease

It is usual for leases to provide for an annual statement to be issued to occupiers following the end of each service charge period giving a summary of the costs and expenditure incurred in the provision of the services and of the calculation of the service charge.

Many leases will set out the procedures regarding preparation of the annual statement and will often require that the annual statement is to be 'certified' by the landlord's surveyor, managing agent and

sometimes the landlord's accountant. However, certain leases might also require the statement to be 'audited'.

It is essential that contractual requirements in the lease are followed. 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, failure to comply may adversely prejudice the owner's ability to recover such sums.

Managers should ensure that service charge statements are issued strictly in accordance with the procedures and requirements as set down under the terms of the lease.

There is currently widespread confusion, however, as to the intention and purpose of the certification process and the requirement for 'auditing' of service charges. Furthermore, the terminology used in relation to the issuing of annual statements of account, particularly in older leases, may be quite generalised and may not reflect modern auditing and accounting standards and practice.

Independent accountants issuing a report on a statement of service charge expenditure will often carry out differing levels of work and will each sign a different style of report. Consequently there is little understanding of the level of assurance that owners and occupiers can take from the report, and potentially confusion regarding the actual work undertaken by independent accountants.

4.2.2 Service charge certification

The purpose of certification of the service charge accounts is to provide occupiers with the comfort and certainty that the accounts produced:

- represent a true and accurate record of the expenditure incurred by the owner in supplying the services to the building; and
- that the expenditure the owner is seeking to recover is in accordance with the terms of the leases.

Annual statements of service charge expenditure should be certified by the manager as complying with the statements above. In certifying the statement the manager is required to act in a professional manner and not in a partisan spirit, supposing the only task being to recover as much money as they can for the owner.

Notwithstanding any specific requirements of the lease, the certifier will need to be an appropriately qualified competent person with experience in dealing with service charges and also needs to recognise that in certifying the service charge they have a duty of care to both owners and occupiers to act with professional care, diligence, integrity and objectivity.

The lease might also set down the credentials/ qualifications required of the person to certify the service charge statement. In certain circumstances, the lease might specifically allow the surveyor or accountant to be an employee of the landlord.

In the interest of transparency the status of the person issuing the certificate and the capacity in which the certificate is issued should be made clear (i.e. landlord's surveyor, accountant, etc.).

In certain instances certification 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 that this should be an appropriately senior individual.

Where certification is undertaken by the manager the cost should be comprised within the management fee. Where the lease requires certification by someone other than the manager the costs of certification of the service charge, together the fees of an independent accountant will be recovered through the service charge.

4.2.3 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.
- An audit involves performing procedures to obtain evidence that a specified process is

being followed to give occupiers sufficient comfort that there is no material misstatement within the information subject to the audit, in this case, the service charge accounts.

Where the lease specifically refers to an 'audit' this is to be carried out in accordance with International Auditing Standards (IASs) (UK and Ireland), and should be performed by a registered auditor.

In carrying out an audit in accordance with accepted auditing standards it is the auditor that would assess the level of risk involved in the instruction and adjust the level of work (and cost) accordingly. For instance, the auditor is likely to require a copy of the lease or leases governing the administration of the property and summarise the expenses that may be charged to the occupiers. This exercise is likely to be extremely time consuming, and hence costly, particularly for larger properties with many leases in operation. The auditor may need to employ an expert in order to carry out this review on their behalf.

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

Frequently, the work required by a modern auditing framework is not what was anticipated when leases were drawn up; especially where the original lease dates back many years. Where this is the situation the manager faces a dilemma whereby the lease requires an 'audit' but an audit in accordance with auditing standards may exceed that which was intended. An audit may not, therefore, provide best value for occupiers. In such situations owners/managers may consider it appropriate to engage an independent accountant to examine the service charge accounts of a property, rather than carry out an audit.

If the lease specifies that an audit is to be carried out then this should be undertaken, unless the occupiers confirm in writing that it is not required. In these circumstances, an independent accountants' report should be prepared.

4.2.4 Independent accountants' report

In the majority of cases it is considered appropriate for owners/managers to engage an independent reporting accountant to examine the service charge accounts of a property rather than carry out an

audit, as the cost of an 'audit' in accordance with auditing standards is likely to be disproportionate and may not offer value for money.

Even where a lease requires the service charge to be audited, or certified by the landlord's auditors, owners and managers will need to make clear whether an audit under accepted auditing standards has been carried out or an independent accountant's report prepared.

The onus and style of an independent accountant's review differs from an audit. The procedures carried out may include:

- checking whether the figures contained in the information were extracted correctly from the accounting records maintained by the manager; and
- checking, based on a sample, whether entries in the accounting records were supported by receipts, other documentation or evidence inspected.

It would be usual for the service charge statements to be prepared, and certified, by the owner or manager. In practice, for many small properties, the reporting accountant may be engaged to prepare the statements from accounting records maintained by the owner or manager as well as providing the independent accountant's report. In these circumstances, the owner or manager will retain responsibility for the preparation and certification of the statement.

Where the lease is silent or audit is optional, managers should not use an external audit or independent accountant's report as a means of giving credibility to service charge expenditure at the occupiers' expense, unless agreed with the occupiers in advance. In addition, an audit or independent accountant's report should not be used as a substitute for an alternative method of certification specified in the lease, unless agreed with the occupiers in advance.

If an occupier requests an audit (subject to clarification of 'audit' as above) or independent accountants' report, the manager should agree and the costs thereof should be charged to the occupier.

4.2.5 Recommended best practice

- Annual statements of service charge expenditure should be certified by the manager

to confirm that they represent a true and accurate record of the expenditure incurred by the owner in supplying the services to the building, and that the expenditure the owner is seeking to recover is in accordance with the terms of the leases.

- Annual statements of service charge expenditure should be reviewed by an independent accountant. However, to be consistent with best value principles this requirement should be considered as optional for smaller properties and dependent upon the quantum and nature of the expenditure.
- In certifying the service charge, managers have a duty of care to both owners and occupiers to act with professional care, diligence, integrity and objectivity.
- Should the lease require an audit to be carried out then this should be undertaken, unless the occupiers confirm in writing that this is not required. In these circumstances, an independent accountants' report should be prepared.

The Institute of Chartered Accountants in England and Wales (ICAEW), the Association of Residential Managing Agents (ARMA) and RICS have issued a consultation draft technical release to provide guidance on accounting for residential service charges. While this has been issued for public comment and further detailed guidance for commercial service charges is to be issued in due course, this document provides useful further reading:

www.icaew.com/en/about-icaew/what-we-do/technical-releases

4.3 Standard industry cost classifications

Appendix B includes details of Industry Standard Cost Classifications which must be used in reporting budget and actual expenditure.

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

- Cost class
- Cost category
- Cost description.

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

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

However, to achieve transparency in accordance with the principles of this Code it is recommended best practice that budget and actual expenditure analyses 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. However, for smaller properties or those with limited service charge expenditure (e.g. industrial sites) the minimum level of detail that would be acceptable would be to report at cost category. However, 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.

However, the detailed cost descriptions set out are 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 the expenditure incurred or proposed.

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 should be carried out at cost description level.

4.4 Budgets and actual expenditure accounting

The proposed guidance seeks to establish a basic framework for the preparation of service charge accounts, and to identify areas for special consideration by preparers and reporting accountants/auditors.

As per item 20 of the core principles, the manager will provide an estimate of likely service charge expenditure accompanied by appropriate explanatory commentary on it to the occupiers, together with a breakdown of their proportion of the costs, at least one month prior to the commencement of the service charge year.

Detailed statements of actual expenditure, together with accounting policies and explanatory text, will be issued within four months of the service charge year end.

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 are issued with a report that provides the following minimum information:

- A comprehensive level of detail to enable occupiers to compare expenditure against estimated budget.
- Explanations of significant individual costs and of variances from the previous year's budget/accounts.
- Comparison against the previous two years' actual costs where appropriate.
- Information on core matters critical to that account (e.g. levels of allocation, apportionment, 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).
- Separately identified on-site management team costs.
- Details and results of the last previous and forthcoming tendering exercise. Occupiers are to be advised of the contractors who are providing the services.

- Full apportionment matrix which clearly shows the basis of calculation and the total apportionment per schedule for each unit within the property/complex.
- Date of issue.

A set of industry standard cost classifications has been drawn up and included in appendix B (see also 4.3). It is essential that these are used at cost class and cost category level.

4.5 Right to challenge

This Code cannot override an occupier's right in law to challenge incorrect or inappropriate service charges subject to prevailing statute of limitations.

Where the manager has demonstrably complied with the provisions of the lease and this Code of Practice, it is recommended that the manager allow occupiers a reasonable period (e.g. four months from issue) in which to raise enquiries or request further information in respect of the certified accounts. Managers are expected to deal with reasonable enquiries promptly and efficiently and make all relevant paperwork available for inspection. Where copies of the supporting documentation concerning the certified accounts are supplied, it is acceptable for an appropriate fee to be charged.

4.6 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 not later than four months, following the date of completion of a sale of a property or change of manager, full details of all service charge expenditure, accruals, pre-payments, etc. for all outstanding service charge years should be provided to the new owner/manager up to the date of sale/transfer.

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 last issued certified accounts and to convert historical data into a consistent format for comparison where they were not responsible for previous years.

Further information with regard to the processes and procedures that should be followed in the event of a sale of a property or other circumstances where the manager changes is included in an RICS information paper: *Commercial property service charge handover procedures*.

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

4.7 On-account payments

Service charges are usually 'reserved as rent' in the lease. In reality 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 discreet bank accounts, recognising that monies are 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, or where separate accounts are not operated per property a proper and reasonable amount of interest calculated on normal commercial rates, will be credited to the service charge account (after appropriate deductions have been made, i.e. bank charges, tax etc.). Where advance payments from more than one property are held in a single account a proper and reasonable amount of interest calculated on normal commercial rates is to be credited to the benefit of the service charge.

4.8 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 account to occupiers for any balancing charges due/owed at the end of the service charge period.

Modern leases often enable owners to recover the cost of borrowing to fund major non-cyclical 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 from void units 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, interest charges should apply in line with payments 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.

4.9 Forward funding of service charge costs

Leases should enable owners to recover the cost of borrowing to fund major non-cyclical expenditure as a cost to the service charge. In older leases 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 on borrowed money to fund major non-cyclical expenditure meets best practice.

4.10 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 to include appropriate explanatory comments with regard to costs proposed or incurred together with details of the basis of apportionment, to enable occupiers to reasonably understand how their liability has been calculated.

Budgets will 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 seek further clarification on any matters relating to the budget or actual costs the manager shall deal with proper enquiries promptly and efficiently.

4.11 Benchmarking and cost analysis

Adoption of the standard industry cost classifications (see 4.3 and appendix B) is considered essential to facilitate better cost comparison between properties and the benchmark indices; and will also reduce costs and assist in the transfer of information between managers and owners when properties are sold, or 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 benchmark comparison of costs.

However, when using benchmark information to compare operating cost 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. '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.

4.12 Value for money

In providing the services the owner/manager should at all times endeavour to achieve value for money and effective service rather than lowest price. 'Value for money' can be simply defined as: '*Paying no more for no less than is required.*'

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

The manager is to keep costs under review, and where appropriate and in any event every three years, require contractors and suppliers to submit competitive tenders or provide competing quotations. However, where it is considered that formal re-tendering would not be cost effective or practical the manager should benchmark the service standards and pricing to confirm value for money is still being achieved.

It is advisable for managers to require major service providers to demonstrate that their services, methods and processes are continually reviewed to ensure value and efficiency.

5 Dispute resolution

There are times where managers and occupiers disagree as to which services are chargeable, what benefit the occupiers individually or collectively receive and/or how much they cost. Traditionally, leases have not allowed for any form of redress for the occupiers and therefore expensive court action has been necessary to query the service charge (please refer to paragraph 4.5).

It will usually be of benefit to both owners and occupiers to resolve service charge disputes quickly, as going to court can be slow and expensive. Many occupiers can become dissatisfied and, believing that disputing a service charge in the courts is not cost effective, withhold payment instead. Occupiers should not arbitrarily withhold payment of sums properly demanded, although where circumstances dictate any payment withheld should relate to the actual sums queried or in dispute and not the whole of the service charge due.

Alternative dispute resolution (ADR) can provide a more cost effective way of resolving service charge disputes than the courts and it is recommended that this process is used even when leases do not expressly provide for it (see 5.1).

When disputes are resolved base rate interest should be paid or allowed in respect of the period during which the relevant amount has been underpaid or overpaid. In mediation the parties will agree what they want and an independent expert will determine what the lease says.

5.1 Alternative dispute resolution as industry best practice

The glossary of terms in the Civil Procedure Rules 1999 defines ADR as a: 'Collective description of methods of resolving disputes otherwise than through the normal trial process'.

Since April 1998 the courts have encouraged parties to use ADR rather than go to trial. From April 2006, the courts have been obliged to take into account whether the parties have given proper consideration to the use of Alternative Dispute Resolution (ADR), and used it to resolve their

dispute if appropriate. The attitude of the courts is that litigation should be a last resort. The courts can require parties to provide evidence that alternative means of resolving their dispute were properly considered. A party can be penalised in costs for failing to give proper consideration to the use of ADR even if it wins at trial. Therefore it is strongly recommended that in disputes about service charges ADR should be considered before taking legal action.

All new leases (including renewals) should provide for ADR of service charge disputes, and if the parties cannot agree on the person to provide that service, a decision can be taken by the President of RICS to appoint such a person. Applications for appointments of mediators, independent experts and arbitrators by the President are managed by the RICS Dispute Resolution Service (www.rics.org/drs).

Where leases contain no ADR clauses there is nothing to stop the owner and occupier agreeing to use ADR to help them find a resolution to a dispute between them. It is possible that a party who declines to use ADR if it is available could be penalised in a costs order if the court considers they have refused to engage in ADR without a good reason.

There are issues as to which form of ADR is most appropriate to service charges. The options are varied and include:

- early neutral evaluation;
- mediation (facilitative or evaluative);
- independent expert determination; or
- arbitration.

5.1.1 Early neutral evaluation

Early neutral evaluation (ENE) is an ADR process whereby a neutral party is retained by both parties to provide a non-binding evaluation on the merits of a dispute. As the name suggests this is usually most effective if attempted early in the life of the process before positions become entrenched and significant costs have been incurred. There are no procedural requirements for ENE beyond those agreed between the parties.

The advantages of ENE are that where parties are engaged in direct discussions, the opinion of a mutually respected neutral may assist the negotiations. An evaluative opinion from a neutral surveyor who understands the practical issues relating to the management and administration of the service charge, or a senior legal professional on a disputed point of contractual construction, can assist the parties with a realistic appraisal of their cases and avoid deadlock and/or positional bargaining.

5.1.2 Mediation

Mediation is a non-binding structured settlement negotiation facilitated by a neutral third party, the mediator, who has no decision-making power. The objective of mediation is to achieve a mutually satisfactory agreement between the parties rather than have something imposed by a third party.

In a facilitated mediation, the mediator encourages the parties to look at the issues from each other's point of view and their views are 'reality tested', so that they can see the strength and weakness of each other's respective positions. This process enables the parties to form a more balanced view of their position and allows them to come to a genuine agreement as to a way forward.

In an evaluative mediation the mediator takes a different role and uses his or her expertise to give the parties an honest appraisal of how their dispute, or certain aspects of it, might play out in a more formal hearing. Armed with this information, the parties may then choose to negotiate a settlement on a different basis to anything previously on offer.

A mediated settlement is generally recorded in a formal agreement (a contract). The mediation proceedings are 'without prejudice', which means that nobody can use what has been said or recorded in the mediation in any subsequent legal proceedings, nor can the mediator be called as a witness in any subsequent court proceedings. What is said is confidential and remains confidential. The process is informal. A mediation hearing often lasts no more than one day. This makes it cost effective compared to court, with the parties sharing the costs of the mediation between them.

There are several organisations that can provide mediators. RICS Dispute Resolution Services (DRS) can provide mediators who are chartered surveyors experienced in property matters.

There are no formal rules and procedures for mediation and in some cases, the parties may wish to adapt the process so that it is less facilitative.

5.1.3 Independent expert determination

This is an ADR process where an independent third party (usually a chartered surveyor or solicitor who is an expert in the subject matter) determines the outcome of the dispute. The basis of the appointment of the independent expert is that he or she is empowered by an agreement between the parties to make a final and binding decision. The agreement of two parties to refer their dispute to independent expert determination creates a contractual obligation on them to be bound by the decision of the independent expert. It is very unusual for such an independent expert's decision to be overturned by the courts.

The independent expert will usually be a specialist in the matter of service charges. It is, usual for parties to make submissions to the independent expert, who will normally incorporate them into his or her decision-making process. An independent expert will generally make a decision on a dispute based on the application of his or her personal expertise in the subject matter, the results of their personal enquiries and the persuasiveness of the parties' representations.

In independent expert determination, the parties will usually be invited to agree the precise issues which are in dispute and the independent expert will then set out the procedures to be followed to reach a determination of the dispute. Occasionally there may be need for a meeting of all the parties and/or a visit to the relevant property.

The fees of an independent expert are usually split equally between the parties unless it is agreed between them that the expert will also decide who will be responsible for his or her costs as part of the overall determination of the dispute.

Other costs, i.e. costs incurred by the parties in preparing their case and instructing professional or legal representation, are usually split between the

parties unless it is agreed between them that the expert will also decide who will be responsible for interparty costs as part of the overall determination of the dispute.

While this process can be more formal than mediation, the expert is free to use his own knowledge and investigation to come to a final and binding determination of a dispute.

5.1.4 Arbitration

Arbitration in England, Wales and Northern Ireland is regulated by the *Arbitration Act* 1996. In Scotland it is regulated by the *Arbitration (Scotland) Act* 2010. A request may be made to the RICS dispute resolution service for an arbitrator to be appointed, or the involved parties can agree on one. The process is more formal and the arbitrator (who will no doubt have some knowledge of service charges) will decide the outcome of the dispute based on the evidence before him. The arbitrator is not allowed to stray outside the evidence before him.

As with independent expert determination, the process may involve meetings known as 'hearings' and submissions. The decision of the arbitrator is usually known as his 'award' and he is also entitled to decide on both his own costs and the costs of the parties in the dispute.

5.1.5 RICS DRS fact sheets

RICS DRS has issued a highly informative, recently reviewed series of easy to read fact sheets for surveyors and the general public, covering the different 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 refer to www.rics.org/drtoolkit and www.rics.org/disputeresolution for more information.

6 Mixed use schemes

Recently there has been a huge increase in mixed use developments but 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 driven not by organic growth but by public policy.

The mixture of commercial and residential uses, in management terms, presents particular challenges and 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 upon the strict interpretation of the wording of the lease. *The Landlord and Tenant Act 1985* (LTA), 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) and *Oakfern Properties Ltd v Ruddy* (2006) have determined that a owner of a lease that includes both residential and non-residential elements will also need to follow the statutory procedures laid by LTA 1985 (as amended) to ensure that non-recovery does not result due to an infringement of the legislation designed to protect residential occupants only.

Further detailed information and guidance is available in two RICS information papers:

- *Managing mixed use developments*; and
- *Apportionment of service charges in mixed use developments*

Your attention is also drawn to RICS *Service charge residential management code*, which is approved by the Secretary of State for England and has RICS guidance note status.

7 Provision for anticipated future expenditure

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

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

To the extent that these items can be foreseen, it may make sense for both parties to spread the cost over a number of years by setting up a sinking fund or reserve fund, rather than charging the whole cost to the current occupiers in the year in which the equipment is replaced. Some confusion has arisen as the description and purpose of such funds has become interchangeable. The following definitions set out industry guidance on how these terms should be used.

A **sinking fund** (also known as a replacement fund) allows the owner to build up a fund to pay for repair and replacement of major items of plant and equipment.

A **reserve fund** is a fund intended to equalise expenditure in respect of regularly recurring service items to avoid fluctuations in the amount of service charge payable each year.

A **depreciation charge** enables the owner to include an amount in the service charge to reflect the 'cost' of the annual depreciation of plant and equipment and is based on the initial cost of an installation, rather than the future cost of replacement or repair.

Further detailed information and guidance is available in RICS information paper: *Sinking funds, reserve funds and depreciation charges*.

8 Initial provision, replacement and improvement of fabric, plant and equipment

The service charge would usually 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 will not include:

- any initial costs (including the cost of leasing of equipment) incurred in relation to the original design and construction of the fabric, plant or equipment
- any setting up costs that are reasonably to be considered part of the original development cost of the property
- improvement costs above the costs of normal maintenance, repair or replacement (but see below); or
- future redevelopment costs.

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

Recent case law 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 higher service charge for works carried out towards the end of the term. If an owner can demonstrate that repairs are necessary to comply with its obligations under the terms of the lease and within the life of the lease, the costs are likely to be recoverable even from a tenant whose lease is about to end.

8.1 Initial provision of fabric, plant and equipment

Service charge costs will not include any initial costs (including the cost of leasing of equipment) incurred in relation to the original design and construction of the fabric, plant or equipment. The owner 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 such as lifts; heating, ventilating and air conditioning plant; security systems; toilets; etc. which comprise part of the property. These systems will be expected to 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 not to be included as part of the service charge.

8.2 Like-for-like replacement

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

- 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 low cost when compared with the much greater cost that might be occasioned by material postponement of the replacement or renewal; or
- replacement or renewal of such items is a proper requirement of any public or competent authority, legislation, or of the insurers.

Plant and equipment reaches the end of its economic life when it is more economic to replace it than to retain and 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 and a review of service records and records of the occurrence and frequency of failures. As equipment approaches the end of its economic life it is reasonable to anticipate that failures will occur with increasing frequency.

8.3 Replacement with enhancement

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

Strictly speaking, replacement of plant and equipment by its modern equivalent would generally fall within 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 recoverable 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 on a cost-benefit basis, e.g. a reduction in the ongoing maintenance costs, increased energy efficiency, etc. there is a case for the service charge to pay. In such circumstances proper communication together with figures to support and justify such a proposal will help achieve a practical and common sense solution.

8.4 Improvement and enhancement

Service charges would not generally include the cost of improvement above the cost of normal maintenance, repair and replacement as above; but it is likely that circumstances will arise where owners and occupiers 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 justified following analysis of reasonable options and alternatives and having regard to a cost/benefit analysis over the term of the occupiers' leases. Managers should communicate any proposals clearly to occupiers and provide the facts and figures to support and justify such a proposal (see also section 9).

8.5 Refurbishment

Refurbishment is a different concept to improvement. Within the scope of the refurbishment works proposed there may be elements of catching up on accumulated disrepair and elements of improvement.

The amount occupiers will contribute towards the cost of refurbishment will depend on the extent and nature of the works proposed and the wording of the lease.

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

When refurbishments result in higher rental values, the owner is to 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.

Occupiers 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.

8.6 Communication

If it is proposed to include the cost of improvements in the service charge, that fact should be communicated to occupiers before any expenditure is committed, to ensure agreement. It would be advisable to record any agreement in writing.

In the case of refurbishment, the owner's proposals are to be communicated to all occupiers well in advance of commencement of any works to explain which costs are to be the responsibility of the occupiers through the service charge. Best practice also recognises the need to establish regular communication between manager and occupiers to monitor the refurbishment and what is to be considered as service charge costs. This reduces or avoids the potential for dispute over any unexpected costs following completion of the works.

9 Environmental Sustainability

The sustainability debate has very much focused on how to develop more sustainable buildings. But this has ignored two key issues: what to do with existing buildings, and the role of the occupier in reducing emissions. The recent emergence of green leases in the UK may be one way of addressing these issues. Green leases are standard commercial property leases pertaining to co-operation between owners and occupiers with the aim of reducing energy and water consumption and waste production.

Owners and occupiers should be aware of the environmental impact of their respective operations and this Code supports and promotes a cooperative and collaborative approach in recognising and managing the environmental impact of the occupation and management of commercial premises.

Leases are binding documents that are not easy to amend. There may be value in owners and occupiers entering into a non-legally binding 'memorandum of understanding', (MoU), which provides a roadmap for co-operation 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.

Further information can be obtained from the Better Building Partnership's 'Green Building Management Toolkit', which is available at www.betterbuildingspartnership.co.uk/download/bbp-green-building-managment-toolkit-1.pdf and from www.leasingbusinesspremises.co.uk.

The sharing of data and other related information is essential, and owners, managers and occupiers should co-operate on the running of any building management systems and on a range of

environmental improvement measures. Non-reporting will incur heavy penalties for owners and occupiers. Co-operation on data sharing is essential.

There should be a fair and reasonable approach to:

- the apportionment of sustainability costs between owners and occupiers, although with the emphasis on the ethos that the 'polluter should pay'
- the carrying out of works that improve the environmental performance of the building; and
- restrictions on works by either party which adversely affect the environmental performance of the building.

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

For the avoidance of doubt, the cost of obtaining an Energy Performance Certificate (EPC) would not normally be considered to be a service charge recoverable 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.

However, costs which might subsequently be incurred in addressing any issues that come to light as a result of obtaining an EPC might fall to the service charge subject to the terms of the lease and the principles set out in this Code.

10 Additional best practice guidance for shopping centres

10.1 Marketing and promotions

The marketing of and promotional activity supporting a retail shopping centre scheme are recognised as being of joint benefit to all stakeholders and are therefore rightly jointly funded. This joint funding should cover not just the actual marketing and promotions, but also 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 owner, to clearly show the net contribution due from the occupiers.

It is best practice for marketing plans (including promotions) to be prepared and presented to occupiers in advance of the period to which they relate. It is often useful to agree and regularly review marketing plans with occupiers/retailers association in order to analyse their effectiveness and to ensure that the stated objectives are achieved. Where the service charge bears the cost, all pedestrian flow data collected is to be issued to occupiers, as a matter of course.

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

Costs incurred in relation to the initial promotional launch or rebranding of a scheme are to be borne by the owner and are not to be considered as service charge recoverable costs. Re-launching a centre should be discussed between manager and occupiers and an appropriate split of the expenditure to each party agreed.

The cost of entertainments, attractions, Christmas and other seasonal decorations and events within the shopping centre is not usually considered to be a marketing and promotional cost but are to be regarded as amenities or facilities. Where such

costs are included within the service charge they would not be jointly funded as above.

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

10.2 Commercialisation (non-core income)

Increasingly owners are finding additional non-core income streams from their investments. It is clear that they are entitled to receive this income from the investment they have made; if, however, the service charge has provided either the initial capital or provides ongoing services for the income stream then the income is to be a credit against the service costs. When the owner provides the capital but uses the services to support the operation, an appropriate contribution to the service charge is to be made. Best practice is for the owner to clearly state his policy with regard to miscellaneous income within 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 shopping centres and malls also receive income from promotional space (e.g. advertising on displays and drums, and in car parks) and licences granted for other mall activities (e.g. children's rides, photo booths, etc). Occupiers may also have (chargeable) use of photocopiers in the management offices. How such income is treated varies considerably from property to property and owner to owner.

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

Income derived from the provision of a service or activity, the cost of which is included in the service charge, is to be treated as a service charge credit, e.g. photocopy and fax reimbursements, etc.

Income derived from promotional activity is to be credited to the marketing expenditure budget.

Where the owner retains income from common part areas and the space is used on a permanent or semi-permanent basis, e.g. barrows or kiosks within shopping malls, the space is to be included in the service charge apportionment matrix or appropriate equivalent credit given for the costs of that space.

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

Managers are to clearly state their policy on how costs and income generated from services and activities are allocated. The simple rules are:

- If the item is not funded by the service charge, nor does it use any services, 100% of the income goes to the owner
- If the item is funded by the service charge, the income is credited to the service charge (e.g. photocopying for occupiers)
- If the item uses some of the services and/or needs support from the site team who are paid by the service charge, a contribution, in accordance with the policy, is to be made to the service charge.

In addition to the minimum information set out in 4.4, budgets and actual expenditure reports should also include a statement detailing how income generated from commercialisation or mall income is dealt with, and how shared services are charged, setting out how they impact on, and what reimbursement has been made to, the service charge.

10.3 Apportionment of service charges in shopping centres: weighted floor area apportionment

Please also see paragraph 1.5 and RICS information paper: *Allocation and apportionment of service charge costs* which provide general guidance.

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

A 'weighted floor area' apportionment discounts the percentage the occupier will pay 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.

Therefore, for example, a 5,000 sq. metre unit may not cost five times that of a 1,000 sq. metre unit, but a 500 sq. metre unit may cost twice that of a 250 sq. metre unit.

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

The following is included for illustrative purposes only:

The first 500 m ²	@ 100%
The next 500 m ²	@ 80%
The next 2,000 m ²	@ 70%
The next 2,000 m ²	@ 60%
Excess over 5,000 m ²	@ 50%

In this example, a 1,000 m² unit has a weighted floor area of 900 m² [i.e. (500 x 100%) + (500 x 80%)] whereas a 10,000 m² unit will have a weighted area of 6,000 m². Although 10 times larger in floor area, the 10,000 m² unit pays approximately six and a half times the service charge of the smaller unit.

Similarly, the floor area of ancillary basement and upper floors accommodation, or 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.

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

Section 3:
Appendices

Appendix A: Best practice compliance checklist

The compliance checklist is included below as a basis to enable owners, managers and occupiers to self-assess compliance with the core principles as set out in this Code. However, ‘ticking the boxes’ does not of itself constitute full compliance with the Code, which also includes the further recommended best practice supporting the core principles.

Core principle	Evidence	Comply
<p>Value for money Procure an appropriate level of service for the occupiers in the building. Demonstrate that services offer good value for money.</p>	<p>Competitive tender Other market testing Cost benchmarking</p>	
<p>Transparency All costs, apportionments and policies explicit and open to any scrutiny by occupiers or their agents.</p>	<p>All apportionment schedules published All policies outlined in budget packs Detailed explanations provided in year end statements where costs have materially varied from budget Landlord bearing cost of all voids and concessions</p>	
<p>Timeliness of reporting All reports issued within timeframes required by the Code.</p>	<p>Budgets issued at least one month prior to the start of the service charge year Year end statements of actual expenditure issued within four months of the service charge year end</p>	
<p>Management fee The management fee reflects a reasonable cost to undertake necessary work to manage and operate the services and administer the service charge.</p>	<p>Fixed fee (not % of service charge) Meets Code guidelines on what can and cannot be charged for management</p>	
<p>Duty of care to occupiers – consultation and approval All costs are recoverable in accordance with leases. Occupiers consulted, where appropriate to gain agreement to levels of service and services to be offered.</p>	<p>All occupiers given the opportunity comment on the budget Occupiers consulted on levels of service and/or the introduction of new services</p>	

<p>Standardised financial reporting Budgets and statements of actual expenditure reported in line with the Code's cost categories. Where appropriate, separate schedules prepared to allocate costs to reflect availability, benefit and use of different services.</p>	<p>Standardised cost categories used Separate schedules included as appropriate</p>	
<p>Interest income and expenses Separate interest bearing accounts operated for each building, with all interest income and expenses credited or expensed within the service charge.</p>	<p>Bank statement of interest income and expenses</p>	
<p>Code compliant terms in new leases New leases have adopted Code compliant terms.</p>	<p>Standard lease terms</p>	
<p>Support for alternate dispute resolution (ADR) ADR is supported and recommended as the basis to resolve service charge disputes</p>		

Appendix B: Standard industry cost classifications

B.1 Overriding principles

B.1.1 Transparency

- State fee basis.
- Explicitly show management fees and site resourcing costs.
- State whether figures are given inclusive or exclusive of VAT. Industry benchmarking will be undertaken exclusive of VAT.

B.1.2 Flexibility

- The cost descriptions are not intended to represent an exhaustive list, but are used for illustrative purposes only.
- Owners and managing agents are encouraged to include additional cost descriptions where this will facilitate greater transparency and clarity with regard to the expenditure incurred or proposed. However, to maintain industry standards and to facilitate benchmark comparison, it is suggested that the cost class and cost category structure is not altered.

B.1.3 Level-handedness

- Distinguish between base operational costs (management, utilities, soft services, hard services), income and exceptional expenditure to allow benchmarking on a like-for-like basis.
- Where income is being yielded to the service charge, separately identify any associated overhead and analyse this alongside the corresponding income to derive a net income. The true benefit of any 'commercialisation' can thereby be clearly identified.

B.1.4 Additional notes

- Where reasonable and appropriate cost should be allocated to separate schedules and separate cost categories are not to be used to describe activities provided across different elements of a subject property, e.g. 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, e.g. estate cleaning costs and car park cleaning costs.

B.2 Cost class

Cost category	Cost description	Notes
MANAGEMENT		
1 Management fees		
	Management fees	Owner or managing agent fees for managing and administering building services excluding rent collection, etc.
2 Accounting fees		
	Service charge (S/C) accounting fees	Fees for preparation of year end service charge statement and reconciliation
	S/C independent accountant's fees	Independent accountant's fees to review the year end service charge accounts
	S/C audit fees	Auditor's fees to audit the service charge

3	Site management resources	
	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 provision of reception and concierge staff, including associated administrative and training costs
	Site accommodation (rent/rates)	Rent, service charge and rates associated with site management accommodation
	Office costs (telephones/stationery)	Costs of equipping and running site management office
	Petty cash	Miscellaneous minor expenditure incurred in relation to site management duties
	Help desk/call centre/information centre	Operational costs for providing helpdesk/call centre/information centre facilities
4	Health, safety and environmental management	
	Landlord's risk assessments, audits and reviews	Consultancy fees and other costs associated with provision and review of owner's health and safety (H&S) management systems
5	Electricity	
	Electricity	Electricity supply to common part and retained areas and central plant, excluding occupier direct consumption
	Electricity procurement/consultancy	Consultancy and procurement fees for negotiating electricity supply contract and auditing of energy consumption [author query: entry duplicated]
	Fuel (standby electrical power)	Fuel oil to run any standby electrical power systems
6	Gas	
	Gas	Gas supply to owner's central plant, excluding occupier direct consumption
	Gas procurement/consultancy	Consultancy and procurement fees for negotiating gas supply contract and auditing of energy consumption
7	Fuel oil (heating)	
	Fuel Oil	Fuel oil supply to owner's central plant, excluding occupier direct consumption
	Fuel oil procurement/consultancy	Consultancy and procurement fees for negotiating oil supply contract and auditing of energy consumption
8	Water	
	Water and sewerage charges	Water supply to central plant, common part and retained areas excluding occupier direct consumption
	Water consultancy	Consultancy fees incurred in reviewing water usage

SOFT SERVICES

9 Security

Security guarding
Direct employment or contract costs incurred in providing building security guarding

Security systems
Servicing and maintenance of building security systems (e.g. CCTV, access control, intruder alarm)

10 Cleaning and environmental

Internal cleaning
Cleaning of internal common part and retained areas

External cleaning
Cleaning of external common part and retained areas

Window cleaning
Hygiene services/toiletries
Cleaning and servicing of common parts' toilet accommodation

Carpets/mats hire
Provision of dust and rain mats to common part areas

Waste management
Refuse collection and waste management services provided for building occupiers

Pest control
Pest control services provided to common part and retained areas

Internal floral displays
Providing and maintaining floral displays within the common part areas

External landscaping
Provision and maintenance of external landscaped areas and special features

Snow Clearance/gritting
Costs incurred in snow clearance and supply of snow clearing equipment and gritting salt

Seasonal decorations
Provision and maintenance of seasonal decorations to common part areas

11 Marketing and promotions

Events
Promotional events

Marketing
Marketing and advertising in accordance with marketing strategy

Research
Research into local market conditions, customer surveys, etc.

Staff costs
Direct employment or contract costs for provision of marketing and promotional activity

Landlord's contribution to marketing
Financial contributions made by landlord towards marketing and promotions

Local authority contribution to marketing
Financial contributions made by local authority towards marketing and promotions

HARD SERVICES

12 Mechanical and electrical services (M&E)

M&E maintenance contract
Planned maintenance to the owner's M&E services, including contractor's H&S compliance

M&E repairs	Repair works to the owner's M&E services
M&E inspections and Consultancy	Auditing quality of maintenance works, condition of M&E plant and H&S compliance
Life safety systems maintenance	Planned maintenance works to the owner's fire protection, emergency lighting and other specialist life safety systems, including contractor's H&S compliance
Life safety systems repairs	Repair works to the owner's fire protection, emergency lighting and other specialist life safety systems
Life safety systems inspections and consultancy	
13 Lifts and escalators	
Lift maintenance contract	Planned maintenance works to lifts in the common part and retained areas, including contractor's H&S compliance
Lift repairs	Repair works to common parts' lifts
Lift inspections and consultancy	Auditing quality of maintenance works, condition of lift plant and H&S compliance
Escalator maintenance contract	Planned maintenance works to escalators in the common part and retained areas, including contractor's H&S compliance
Escalator repairs	Repair works to common parts escalators
Escalator inspections and consultancy	Auditing quality of maintenance works, condition of escalator plant and H&S compliance
14 Suspended access equipment	Suspended access equipment includes all forms of high-level access equipment maintenance, i.e. hatchways, eye-bolt, fall address and cradles
Suspended access maintenance contract	Planned maintenance works to the owner's suspended access equipment, including contractor's H&S compliance
Suspended access repairs	Repair works to the owner's suspended access equipment
Suspended access inspections and consultancy	Auditing quality of maintenance works, condition of suspended access equipment and H&S compliance
15 Fabric repairs and maintenance	
Internal repairs and maintenance	Repair and maintenance of internal building fabric, common part and retained areas
External repairs and maintenance	Repair and maintenance of external building fabric, structure, external common part and retained areas
Redecorations	Redecoration and decorative repairs

INCOME

16 Interest

Interest

Distinct activities that yield a true income to the service charge account

Interest received on service charge monies held within owner's or agent's bank account

17 Income from commercialisation

Car park income

Vending machine income

Other

Operational expenses

Contract charges

Income yielded from any facilities installed and/or maintained at the occupier's expense

Overheads, expenses and operational costs incurred in providing any of the commercialisation facilities

Repairs and maintenance

Staff costs

INSURANCE

18 Engineering Insurance

Engineering insurance

Engineering inspections

Landlords engineering insurances

19 All risks insurance cover

Building insurance

Loss of rent insurance

Public and property owner's liability

Landlord's contents insurance

Landlord all risk insurance costs

20 Terrorism insurance

Terrorism insurance

Landlord's terrorism insurance cover

EXCEPTIONAL EXPENDITURE

21 Major works

Project works

Refurbishments

Plant replacement

Major repairs

Exceptional and one-off project works, over and above routine operational costs

22 Forward funding

Sinking funds

Forward funding of specific major replacement projects (e.g. plant and equipment replacements, roof replacements)

Reserve funds

Forward funding of specific periodic works to even out fluctuations in annual service charge costs (e.g. internal/external redecorations)

Depreciation charge

Depreciation charge in lieu of sinking/replacement fund contribution of major plant and equipment

Appendix C: Example reports

C.1 Example service charge reconciliation and expenditure report

[Property Name]
Service Charge Reconciliation and Expenditure Report
Period: **[dd/mm/yyyy]** to **[dd/mm/yyyy]**

Property Address

[xxxxxxxxxxxxxxxxxxxxxxxxxxxxxxxx]

[xxxxxxxxxxxxxxxxxxxxxxxx]

[xxxxxxxxxxxxxxxxxxxxxxxx]

[xxxxxxx]

Date [dd/mm/yyyy]

Service Charge Reconciliation and Expenditure report

[Property name and address]

[dd/mm/yyyy] to [dd/mm/yyyy]

Total Service Charge Expenditure

£

1.0 Introduction

This report has been produced by [manager's name] on behalf of [owners 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 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 Appendix I with a variance report showing percentage charge year on year at Appendix II.

2.0 The management team

[Insert names and contact details of management team i.e. Property Managers, Building/Centre Manager, Accounts manager]

3.0 Explanatory notes

A full copy of the budget is enclosed at Appendix I in both summary and detail 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 heading detailing service provided, cost if appropriate and comment on 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.*

3.1 Management

Management Fees

Accounting Fees

Service Charge Audit Fees

[Empty text box for Service Charge Audit Fees]

Site Management Resources

Staff Costs

[Include details of on site management team]

[Empty text box for Staff Costs]

Reception/Concierge/Operation Staff

[Explanation and detail of support staff directly employed]

[Empty text box for Reception/Concierge/Operation Staff]

Site Accommodation

[Explanation as to costs of site accommodation]

[Empty text box for Site Accommodation]

Office Costs

[Empty text box for Office Costs]

Petty Cash

[Empty text box for Petty Cash]

Help desk/call centre/information centre

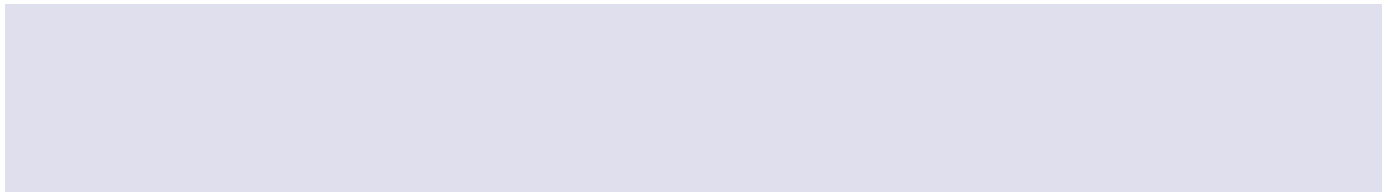


Health & Safety and Environmental Management

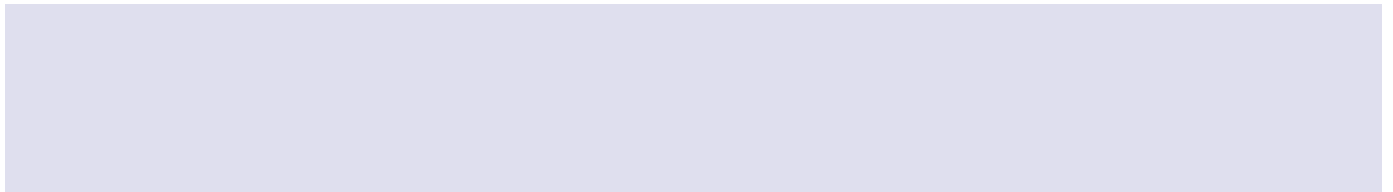
3.2 Utilities

Electricity

Electricity

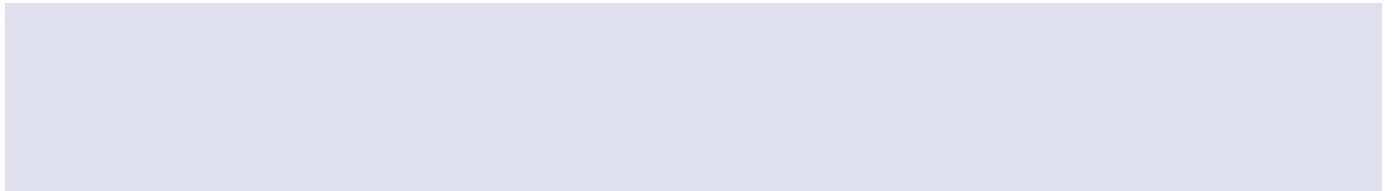


Electricity procurement/consultancy

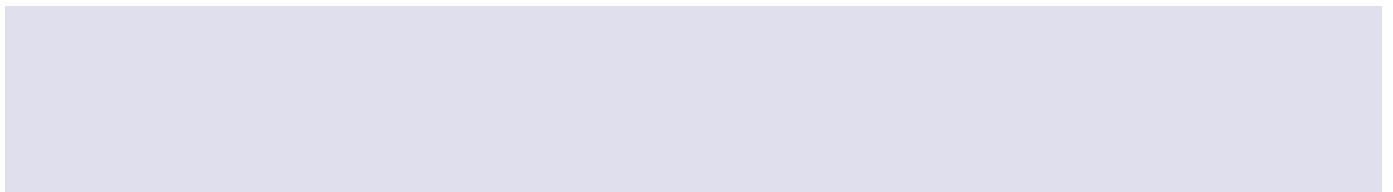


Gas

Gas

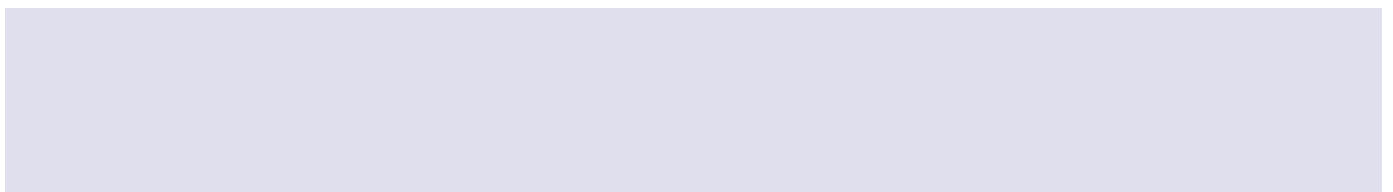


Gas procurement/consultancy



Fuel Oil

Fuel Oil



Fuel Oil procurement/consultancy

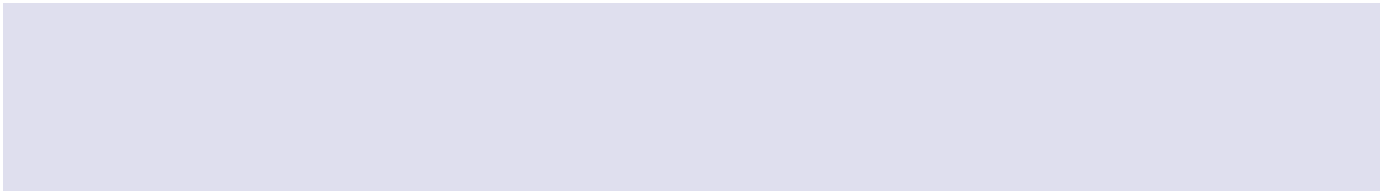


Water

Water and sewerage Charges



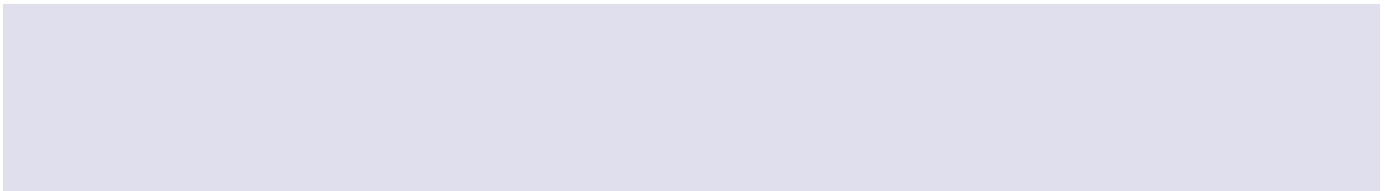
Water consultancy



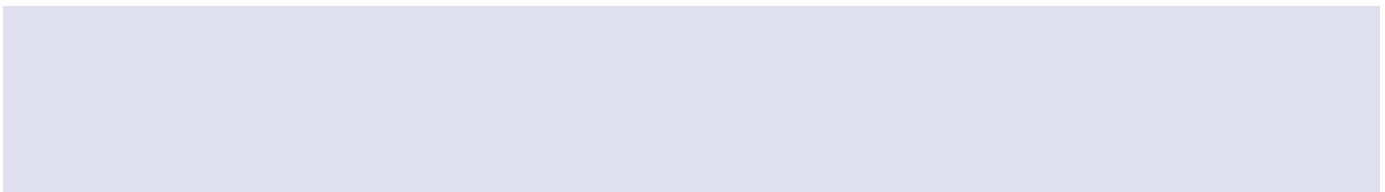
3.3 Soft Services

Security

Security Guarding

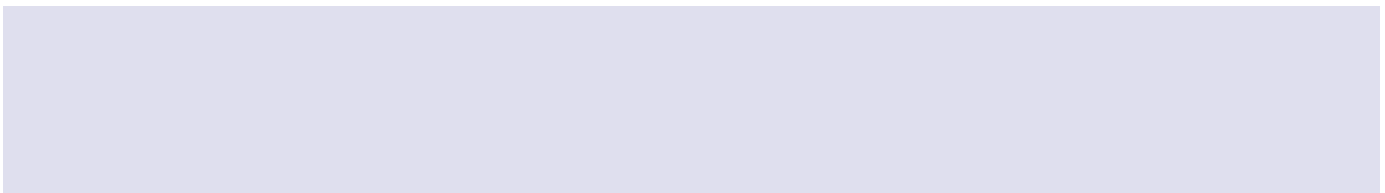


Security Systems



Cleaning and Environmental

Internal Cleaning



External Cleaning

Window Cleaning

Hygiene Services/Toiletries

Carpets/Mats Hire

Waste Management

Pest Control

Internal Floral Displays

External Landscaping

Seasonal Decorations

Marketing and Promotions

Events

Marketing

Research

Staff Costs

Landlord's Contribution to Marketing

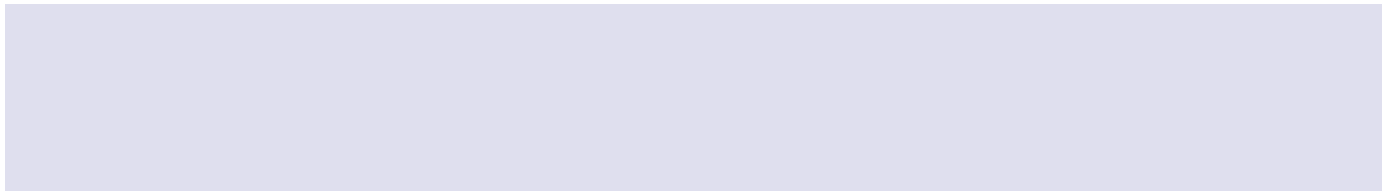
Local Authority Contribution to Marketing



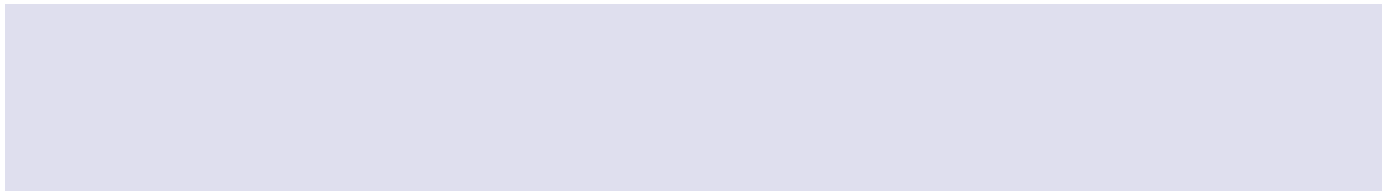
3.4 Hard Services

Mechanical & Electrical Services (M&E)

M&E Maintenance Contract



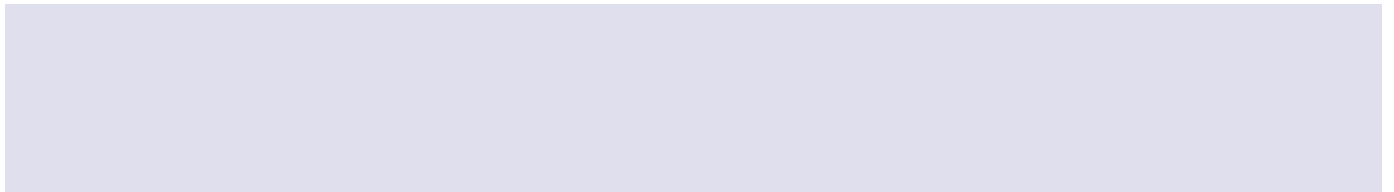
M&E Repairs



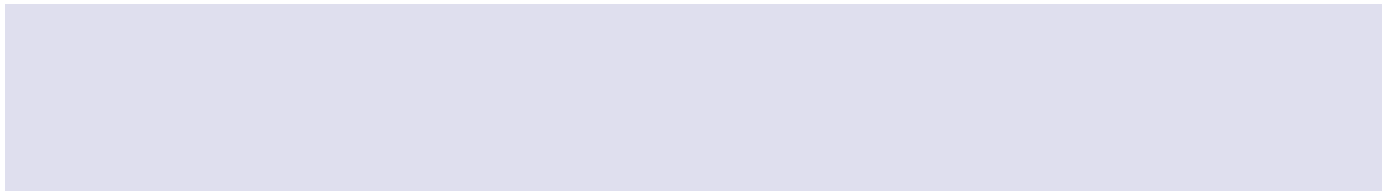
M&E Inspections & Consultancy



Life Safety System Maintenance

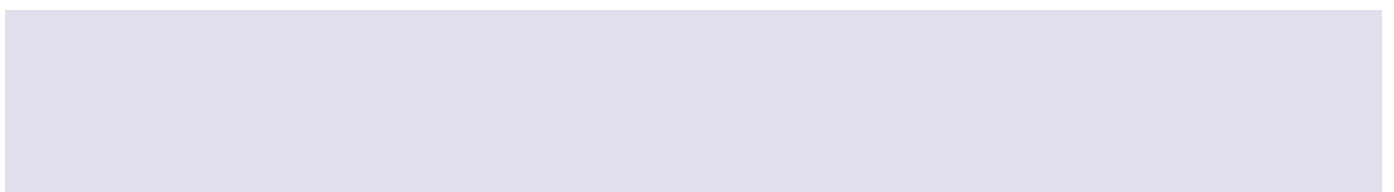


Life Safety System Inspection & Consultancy

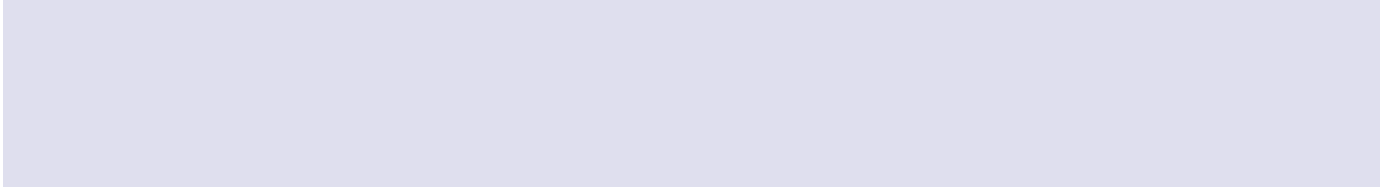


Lifts & Escalators

Lift Maintenance Contract



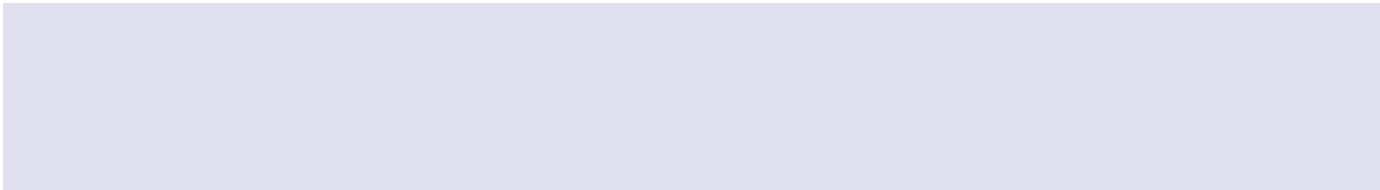
Lift Repairs



Lift Inspections & Consultancy



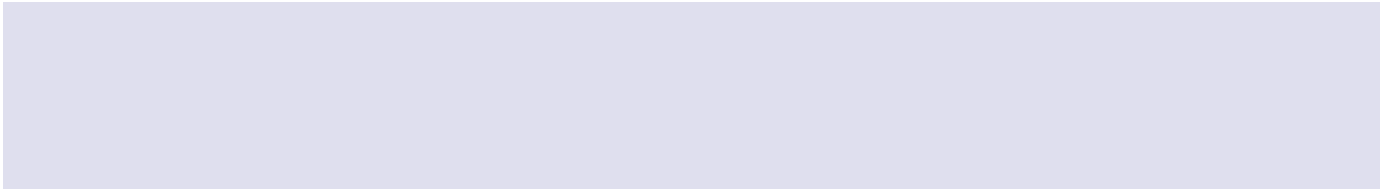
Escalator Maintenance Contract



Escalator Repairs

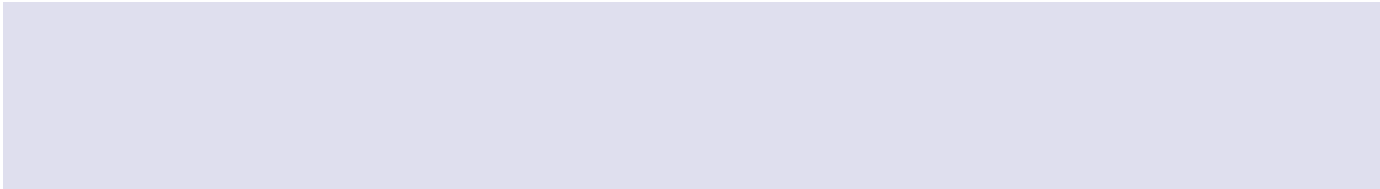


Escalator Inspections & Consultancy

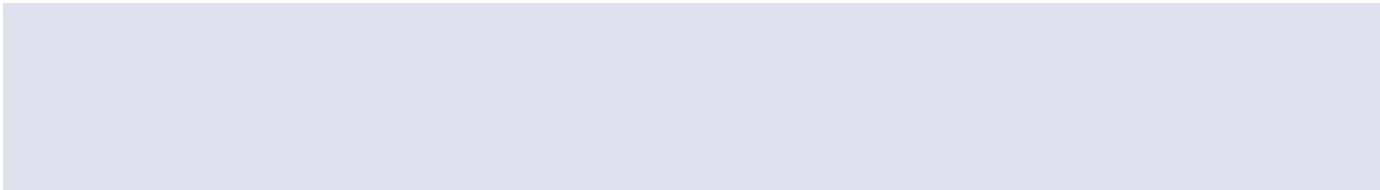


Suspended Access Equipment

Suspended Access Maintenance Contract



Suspended Access Repairs

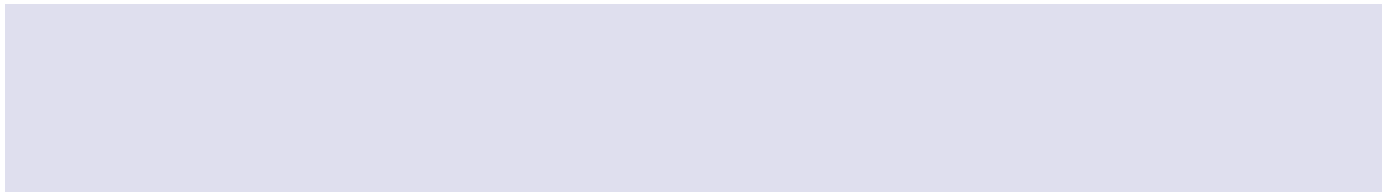


Suspended Access Inspections & Consultancy

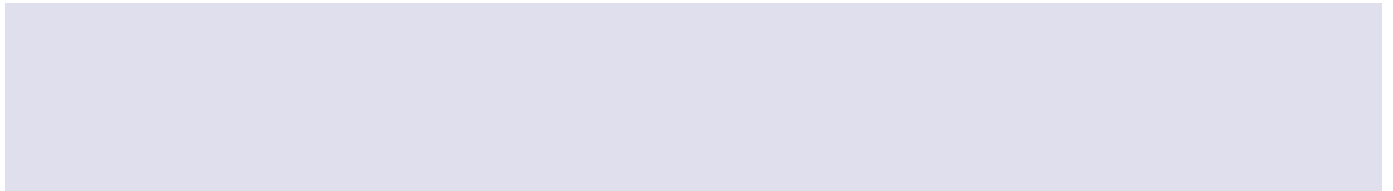


Fabric Repairs & Maintenance

Internal Repairs & Maintenance



External Repairs & Maintenance

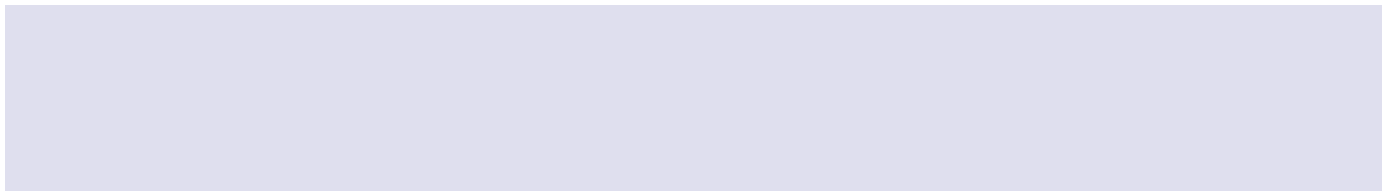


Redecorations

3.5 Income

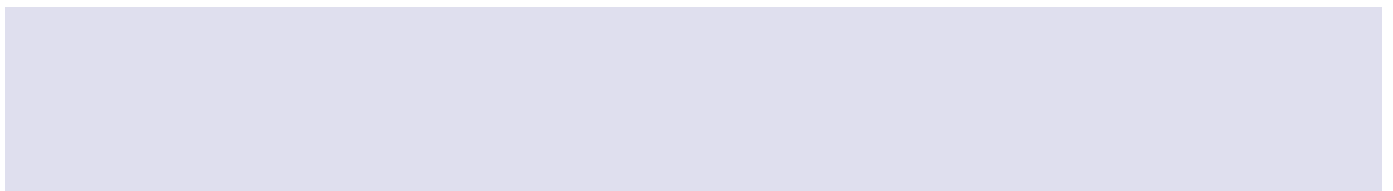
Interest

Bank Interest

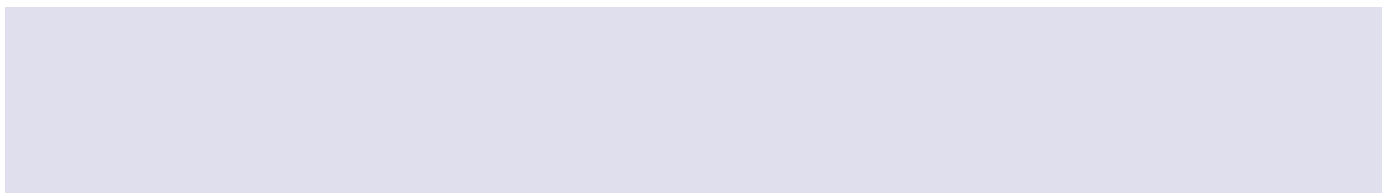


Income from Commercialisation

Car Park Income



Vending Machine Income



Other



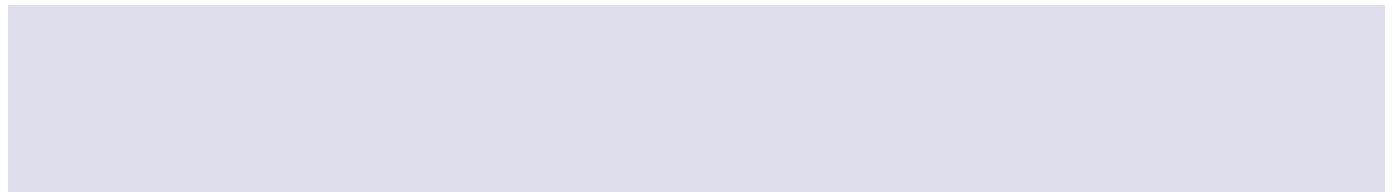
Contract Charges



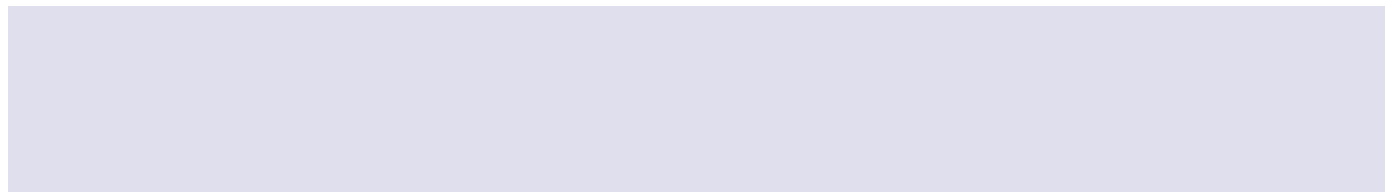
3.6 Insurance

Engineering Insurance

Engineering Insurance

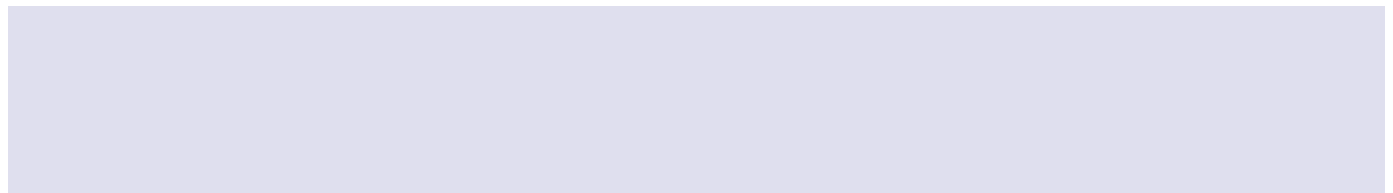


Engineering Inspections

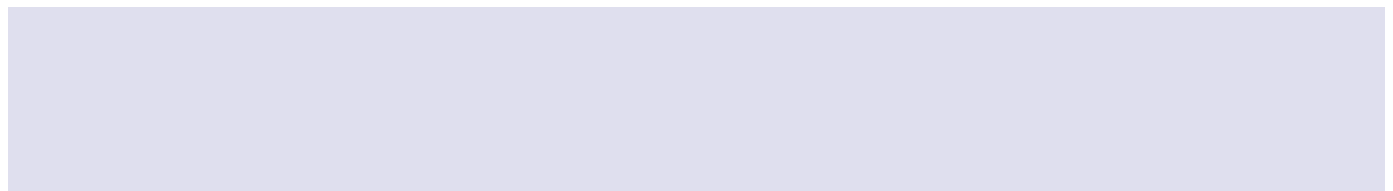


All Risks Insurance Cover

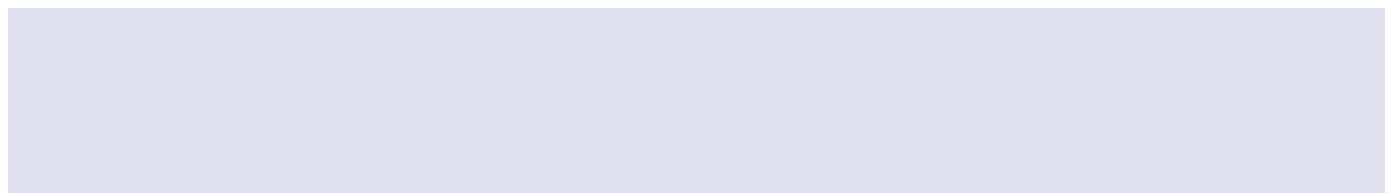
Buildings Insurance



Loss of Rent Insurance



Public & Property Owner's Liability Insurance

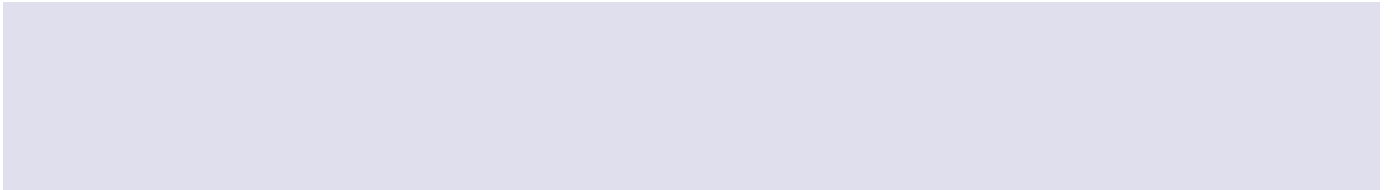


Landlord's Contents Insurance



Terrorism Insurance

Terrorism Insurance



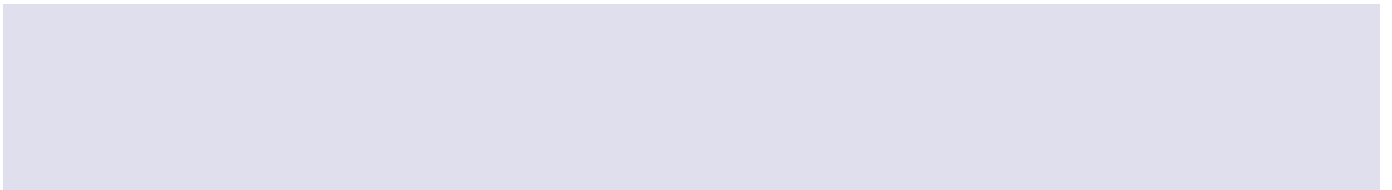
3.7 Exceptional Expenditure

Major Works

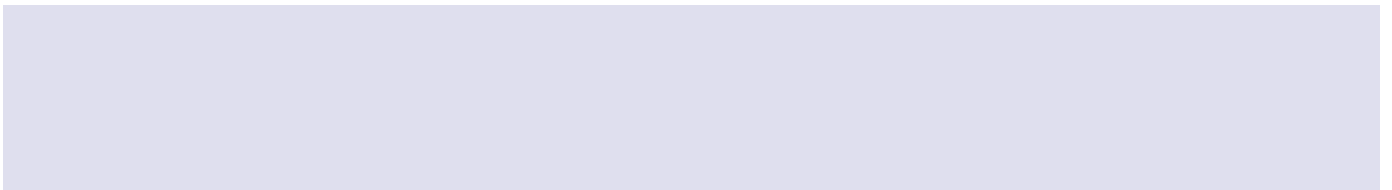
Project Works



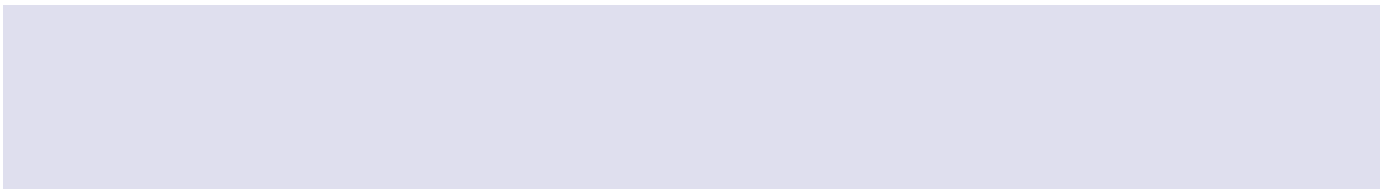
Refurbishments



Plant Replacement



Major Repairs



Forward Funding

Sinking Funds

[Redacted content]

Reserve Funds

[Redacted content]

Depreciation Charge

[Redacted content]

4.0 Service charge allocation and apportionment

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 3

Schedule 1 – Estate

[Insert detailed description of schedule and basis of allocation]

Schedule 2 – Building 1

[Insert detailed description of schedule and basis of allocation]

Schedule 3 – Building 2

[Insert detailed description of schedule and basis of allocation]

Apportionment

The service charge costs are apportioned in line with occupational leases. The method of apportionment is [detail apportionment method used].

A full apportionment schedule for the [property / estate / centre] is attached at Appendix III.

5.0 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.

6.0 Service procurement

[Insert statement as appropriate with regard to the owner/manager's procurement policy and contractor selection criteria, frequency of contract tendering, benchmarking of costs etc.]

7.0 Notes on accounts

7.1 Accounting principles

[Include appropriate notes as to accounting principles adopted in the preparation of the accounts and whether the statements are prepared on an accruals or cash basis]

7.2 VAT

With effect from [dd/mm/yyyy] the Landlord elected to waive the exemption from Value Added Tax (also known as an Option to Tax). Therefore all service charge expenditure is shown exclusive of VAT. VAT will be charged at the appropriate rate on all service charge payments invoiced by the Landlord and shown as a separate item on a VAT invoice.

OR

The Landlord has not elected to waive the exemption from Value Added Tax. Therefore all service charge expenditure is shown inclusive of VAT where applicable.

[Delete as appropriate]

7.3 Sinking fund and reserve fund

[Include 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.]

7.4 Interest

A separate interest-bearing account for occupier on-account payments is operated by the owner/manager and all interest earned and late payment interest is credited to the service charge account. Bank charges and account operating costs are off-set against the interest.

8.0 General notes

[Insert any other relevant information]

9.0 SERVICE CHARGE CERTIFICATE

Model Landlord Surveyor's certificate

Certification Period: [dd/mm/yyyy] to [dd/mm/yyyy]

Landlord:

Managing Agent:

Building:

[**Manager Name**] is the Managing Agent responsible for the production of the service charge certificate for the period [dd/mm/yyyy] to [dd/mm/yyyy] in respect of [**Property Name**]

I can confirm that this service charge certificate has been produced in compliance with the terms set out in the lease and, where this does not deviate from the lease, in accordance with the RICS Service Charge Code of Practice (current edition).

I hereby certify that, according to the information available to me, the attached statement of service charge expenditure records the true cost to the landlord of providing the services to the property for the period.

Signed

[**Name and Qualifications**]

Position

For and on behalf of [**Manager Name**]

C.2 Example Summary Expenditure Report

SUMMARY EXPENDITRE 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
MANAGEMENT				
1 Management Fees	£60,000	£10,000	£25,000	£25,000
2 Accounting Fees	£1,600	£1,600		
3 Site Management Resources	£71,135	£21,135	£26,600	£23,400
4 Health, Safety and Environmental	£10,000	£10,000		
Sub Total	£142,735	£42,735	£51,600	£48,400
UTILITIES				
5 Electricity	£229,900	£5,900	£112,000	£112,000
6 Gas	£11,050	£1,050	£5,000	£5,000
7 Fuel Oil (Heating)	£0			
8 Water	£7,000		£3,500	£3,500
Sub Total	£247,950	£6,950	£120,500	£120,500
SOFT SERVICES				
9 Security	£144,100	£137,500	£3,500	£3,100
10 Cleaning & Environmental	£185,730	£52,250	£58,300	£75,180
11 Marketing & Promotions				
Sub Total	£329,830	£189,750	£61,800	£78,280
HARD SERVICES				
12 Mechanical & Electrical Services	£187,970	£32,750	£74,750	£80,470
13 Lift & Escalators	£24,500		£14,000	£10,500
14 Suspended Access Equipment	£5,300		£2,800	£2,500
15 Fabric Repairs & Maintenance	£99,325	£36,850	£40,700	£21,775
Sub Total	£317,095	£69,600	£132,250	£115,245
INCOME				
16 Interest	-£1,068	-£332	-£373	-£363
17 Income from Commercialisation				
Sub Total	-£1,068	-£332	-£373	-£363

INSURANCE

18	Engineering Insurance	£900		£500	£400
19	All Risks Insurance Cover				
20	Terrorism Insurance				
	Sub Total	£900	£0	£500	£400

EXCEPTIONAL EXPENDITURE

21	Major Works	£92,483		£92,483	
22	Forward Funding	-£90,000		-£90,000	
	Sub Total	£2,483	£0	£2,483	£0
	Grand Total	£1,039,925	£308,703	£368,760	£362,462

C.3 Example service charge detailed expenditure report

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
MANAGEMENT				
1 Management fees				
Management fees	£60,000	£10,000	£25,000	£25,000
2 Accounting fees				
S/C audit fees	£1,600	£1,600		
3 Site management resources				
Staff costs	£15,000	£15,000		
Receptionists/concierge	£50,000		£26,600	£23,400
Site accommodation (rent/rates)	£4,335	£4,335		
(telephones/stationery)	£1,800	£1,800		
4 Health, safety & environmental				
Risk assessments & audits	£10,000	£10,000		
Subtotal	£142,735	£42,735	£51,600	£48,400
UTILITIES				
5 Electricity				
Electricity	£224,000		£112,000	£112,000
consultancy	£5,600	£5,600		
Fuel (standby electrical power)	£300	£300		
6 Gas				
Gas	£10,000		£5,000	£5,000
Gas procurement/consultancy	£1,050	£1,050		
7 Fuel oil (heating)				
8 Water				
Water & sewerage charges	£7,000		£3,500	£3,500
Subtotal	£247,950	£6,950	£120,500	£120,500
SOFT SERVICES				
9 Security				
Security guarding	£132,000	£132,000		
Security systems	£12,100	£5,500	£3,500	£3,100
10 Cleaning & environmental				
Internal cleaning	£91,200		£38,400	£52,800
External cleaning	£15,500	£15,500		
Window cleaning	£22,800		£9,600	£13,200
Hygiene services/toiletries	£8,180		£4,500	£3,680
Waste management	£9,050	£9,050		
Pest control	£1,600	£700	£500	£400
Seasonal decorations	£1,000		£500	£500
Internal floral displays	£9,400		£4,800	£4,600
Estate cleaning	£18,000	£18,000		
External landscaping	£9,000	£9,000		
11 Marketing & promotions				
Subtotal	£329,830	£189,750	£61,800	£78,280

HARD SERVICES**12 Mechanical & electrical services**

M&E maintenance contract	£151,250	£20,000	£63,000	£68,250
M&E repairs	£16,250	£2,150	£6,750	£7,350
M&E inspections and consultancy	£7,500	£7,500		
Life safety systems maintenance	£11,350	£2,350	£5,000	£4,000
Life safety systems repairs	£1,620	£750		£870

13 Lift & escalators

Lift maintenance contract	£21,000		£12,000	£9,000
Lift repairs	£3,500		£2,000	£1,500

14 Suspended access equipment

Maintenance contract	£5,100		£2,700	£2,400
Repairs	£200		£100	£100

15 Fabric repairs & maintenance

Internal repairs & maintenance	£50,000		£35,000	£15,000
External repairs & maintenance	£6,775			£6,775
Redecorations	£5,700		£5,700	
Estate repairs & maintenance	£32,100	£32,100		
Car park repairs & maintenance	£4,750	£4,750		

Subtotal	£317,095	£69,600	£132,250	£115,245
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INCOME**16 Interest**

Interest	-£1,068	-£332	-£373	-£363
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17 Income from commercialisation

Subtotal	-£1,068	-£332	-£373	-£363
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INSURANCE**18 Engineering insurance**

Engineering insurance	£900		£500	£400
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19 All risks insurance cover**20 Terrorism insurance**

Sub Total	£900		£500	£400
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EXCEPTIONAL EXPENDITURE**21 Major works**

Plant replacement	£92,483		£92,483	
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22 Forward funding

Sinking funds	-£90,000		-£90,000	
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Subtotal	£2,483	£0	£2,483	£0
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GRAND TOTAL	£1,039,925	£308,703	£368,760	£362,462
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C.4 Example service charge variance report

EXPENDITURE VARIANCE REPORT

Period [dd/mm/yyyy] to [dd/mm/yyyy]

Property Address

		Previous year actual	Current year budget	Current year actual	Actual v Budget	Current v previous actual
MANAGEMENT						
1	Management fees	£60,000	£60,000	£60,000	0.00%	0.00%
2	Accounting fees	£1,500	£1,600	£1,600	0.00%	6.67%
3	Site management resources	£66,000	£70,000	£71,135	1.62%	7.78%
4	Health, safety & environmental	£5,000	£15,000	£10,000	-33.33%	100.00%
	Subtotal	£132,500	£146,600	£142,735	-2.64%	7.72%
UTILITIES						
5	Electricity	£218,700	£236,000	£229,900	-2.58%	5.12%
6	Gas	£9,700	£12,500	£11,050	-11.60%	13.92%
7	Fuel oil (heating)					
8	Water	£6,880	£7,500	£7,000	-6.67%	1.74%
	Subtotal	£235,280	£256,000	£247,950	-3.14%	5.39%
SOFT SERVICES						
9	Security	£144,100	£144,100	£144,100	0.00%	0.00%
10	Cleaning & environmental	£176,543	£180,000	£185,730	3.18%	5.20%
11	Marketing & promotions					
	Subtotal	£320,643	£324,100	£329,830	1.77%	2.87%
HARD SERVICES						
12	Mechanical & electrical services	£193,750	£180,000	£187,970	4.43%	-2.98%
13	Lift & escalators	£24,500	£24,500	£24,500	0.00%	0.00%
14	Suspended access equipment	£5,300	£53,000	£5,300	-90.00%	0.00%
15	Fabric repairs & maintenance	£34,500	£50,000	£99,325	98.65%	187.90%
	Subtotal	£258,050	£307,500	£317,095	3.12%	22.88%
INCOME						
16	Interest	-£989	-£1,000	-£1,068	6.80%	7.99%
17	Income from commercialisation					
	Subtotal	-£989	-£1,000	-£1,068	6.80%	7.99%
INSURANCE						
18	Engineering insurance	£800	£1,000	£900	-10.00%	12.50%
19	All risks insurance cover					
20	Terrorism insurance					
	Subtotal	£800	£1,000	£900	-10.00%	12.50%
EXCEPTIONAL EXPENDITURE						
21	Major works		£90,000	£92,483	2.76%	
22	Forward funding	£25,000	-£90,000	-£90,000	0.00%	-460.00%
	Subtotal	£25,000	£0	£2,483		-90.07%
	GRAND TOTAL	£971,284	£1,034,200	£1,039,925	0.55%	7.07%

C.5 Example Apportionment Schedule

APPORTIONMENT SCHEDULE

Period [dd/mm/yyyy] to [dd/mm/yyyy]

Property Address

Unit/Address	Tenants	Area (m ²)	Schedule 1 Estate	Schedule 2 Building 1	Schedule 3 Building 2
Building 1 (Tower Block)					
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%	
Total Building 1		101,600		100.00%	
Building 2					
Ground Floor & 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%
Total Building 2		41,500			100.00%
Grand Total		143,100	100.00%		

Section 4:
Additional information

1. Glossary and terminology

Accrual Accounting	This is considered to be the standard accounting practice for most service charges, with the exception of very small operations. This requires that costs are 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.
Accruals	These are expenses incurred in a period for which no invoice has been received at the period end. As the cost relates to the period, it must be charged to the service charge account for that period.
Adjudication	Adjudication is a simple and efficient method of settling disputes, whereby an adjudicator uses his/her own knowledge and investigations, while weighing the evidence presented by the parties, in order to reach a decision that is legally binding until such time as the original dispute is referred to arbitration or the courts, or is settled between the parties themselves.
Administration charges	The managers costs in procuring services direct (i.e. not through a contractor) and 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, HR etc) and are recorded to the cost category where they are incurred, as they would be if the service were contracted.
Alternative dispute resolution (ADR)	The collective description of methods of resolving disputes other than through the normal trial process.
Allocation	The splitting of costs of a service and allocating them to a specific schedule or cost category.
Apportionment	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.
Arbitration	Arbitration is a procedure whereby two parties in 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, though the procedures are often less formal and an arbitrator is usually an expert in his/her own right.
Balancing charge	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.
Commercial property	All property that is not residential or agricultural, includes retail, office, industrial and leisure properties.
Depreciation charge	The 'cost' to the owner representing the measure of the wearing out, consumption or other reduction in life of an asset.
Direct charges	Any expenditure that is charged directly to individual occupiers and not funded via the on-account service charges.
RICS dispute resolution service (DRS)	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.

Early neutral evaluation (ENE)	ENE is an alternative dispute resolution 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 dispute.
Gross internal area (GIA)	The area of a building measured to the internal face of the perimeter walls at each floor level in accordance with the RICS Code of measuring practice.
Independent expert determination	Independent expert determination in the UK, and other territories, is a process in which 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’).
In trust	Money kept in a separate named account held in trust to the account of its owner.
International Total Occupancy Cost Code (ITOCC)	ITOCC from 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 costs of occupancy, not just those in the common parts.
Mediation	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 upon them.
Manager	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).
Management Charge	The management charge is the reasonable price for the total cost of 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 service charge.
Management fees	<p>The remuneration of the manager (including his 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 owner approvals, income generation or rent collection.</p> <p>Where the subject property/site management team is not sufficiently large to justify specific service managers (e.g. Health & Safety manager or building surveyor) additional specialist fees may be charged to the relevant cost category for the ‘manager provided’ service.</p>
Marketing and promotions	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).
Matrix	An array of costs set out in rows and columns used as a system of methods and principles used in the allocation and apportionment of costs between occupiers.

Net internal area (NIA)	The usable area within a building measured to the internal face of the perimeter walls at each floor level in accordance with the RICS Code of measuring practice.
Not for profit, not for loss	Description 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.
Occupier	A person in possession or occupation of premises and usually responsible for payment of the service charge to the owner.
Office service charge analysis report (OSCAR)	Produced by Jones Lang LaSalle, OSCAR is an industry-leading benchmark. The industry cost classifications set out in Appendix 1 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.
On-account service charge	An estimated charge raised in advance and in anticipation of the final service charge liability, calculated from the service charge budget.
Owner	The person who receives or is entitled to receive the rent. This person is usually responsible for the provision of, management of, and administration of the services and the service charge.
Prepayments	Expenses paid in a given period that relate to the following period in whole or part.
Rateable value	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 let from year to year if the occupier undertook to pay all the usual occupier rates and taxes and bear the cost of repairs and insurance and other expenses (if any) necessary to maintain the property in a state to command that rent.
Re-branding	The upgrading of house style, logos, names badges, etc.
Re-launching	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, e.g. a shopping centre following refurbishment in which case agreement should be reached as to how the re-launch costs are split between the parties.
Reserve fund	A fund intended to equalise expenditure in respect of regularly recurring items to avoid fluctuations in the amount of service charge payable each year.
Retail prices index (RPI)	Retail Prices Index or such other comparable national statistic published from time to time.
Services	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.
Service charge account	The service charge funds held for a specific property.
Service charge apportionment	The method and details of apportioning liability of the tenants for contributing to a service charge.

Service charge reconciliation	A complete comparison of all service charge income demanded to service charge expenditure (including accruals and prepayments), for a given service charge accounting period) that enables the calculation of any balancing charges and credits due from tenants and/or landlords.
Schedules	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.
Sinking fund	A fund intended to meet the cost of repair and replacement of major items of plant and equipment and fabric.
Void liabilities	The share of the agreed service charge expenditure for any service charge accounting period that is attributable to vacant lettable accommodation.

2. Further Reading

Forrester, P., *Case in Point: Service Charges* (2nd edition), RICS Books, Coventry, 2008

Forrester, P. and Gibb, C., *Residential and Commercial Service Charges: A Surveyor's Handbook* (1st edition) RICS Books, Coventry, 2008

Freedman, P. et al, *Service Charges: Law and Practice* (3rd edition), Jordan Publishing Ltd, 2002

Tanfield Chambers, *Service Charges and Management: Law and Practice* (2nd edition), Sweet & Maxwell Ltd, London, 2009

Bannister, E. *Commercial Leases 2009: A Surveyor's Guide* (2nd edition), RICS Books, Coventry, 2008

Joint industry publication, *A Good Practice Guide: Shopping Centre Marketing and Promotions* (endorsed by BCSC, BRC, PMA, BPF and RICS)

The Code for Leasing Business Premises in England and Wales 2007

Service charges in commercial property

2nd edition, code of practice

This new Code has been produced as part of a cross industry initiative in light of ongoing concerns about disputes over service charges and their alleged lack of transparency. Its stated aims are:

- To improve general standards and promote best practice, uniformity, fairness and transparency in the management and administration of services charges in commercial property.
- To ensure timely issue of budgets and year end certificates.
- To reduce the causes of disputes and to give guidance to resolving disputes where these do occur.
- To provide guidance to solicitors, their clients (be they owners or occupiers) and managers of service charges in the negotiation, drafting, interpretation and operation of leases in accordance with best practice.

This Code recognises the lease as paramount and advises owners, occupiers and professional advisers to interpret leases as far as possible in line with the Code, and to modernise leases when opportunities arise, such as during new lettings or renewals.



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