

RICS CODE OF PRACTICE

Service Charges in Commercial Property



Service Charges in Commercial Property: RICS Code of Practice

In compiling this Code the steering group recognises the best practice as described here and suggested for adoption is not intended to override existing leases. However, the steering group does expect managers to emulate the Code and match their delivery as closely as possible to the Code, despite any lease constraints that might exist.

There are certain current practices with which owners and occupiers have issues. When constrained by existing leases, these issues can only be satisfactorily resolved by mutual agreement.

The current trends in commercial property show that leases are now being granted for shorter terms. Consequently, the opportunities and challenges for all owners, occupiers, managers, drafters and precedent providers, either when renewing existing or agreeing new leases, are to ensure that the agreed documents adhere to this Code and thus promulgate best practice. Given the prevalence of shorter lease terms the constraints on the delivery of this Code will quickly fall away.

This Code represents the most desirable structure for service charges, which the steering group recommend be appropriately implemented in all new leases.

This Code will come into effect for service charges commencing on 1 April 2007 or any date thereafter.

This Code has been designed with larger properties in mind and its application to smaller properties therefore requires both managers and occupiers to apply common sense as to the scale and applicability of the Code particularly in terms of cost benefit issues.

This RICS Code of Practice is based on the second edition of *Service Charges in Commercial Property: A Guide to Good Practice*. Compliance with the Guide, although supported by cross-industry bodies, was voluntary. This Code, for RICS members, has more prominence by virtue of its status as official RICS material. The Code supersedes the Guide and has the same status as a guidance note. For further information on this see *RICS guidance notes*, page 2.

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Produced by the *Service Charges in Commercial Property* industry steering group.

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Foreword

I am delighted to have been asked to introduce the new Code of Practice for *Service Charges in Commercial Property* which supersedes the existing Guide to Good Practice. The new Code has been designated a guidance note by RICS which recognises just how important service charges are in today's property market.

I am equally delighted that RICS has led the cross industry group in identifying best practice in what hitherto has sometimes been something of a confused area.

Poorly managed service charges are a frequent cause of disputes between landlords and tenants, owners and occupiers, and whilst the Code cannot override existing leases it provides the property industry with a clear set of recommendations which if implemented will benefit all sides. When agreeing new lease documents, as owner or occupier, I do recommend that you ensure your advisors have taken the opportunity to align the new lease with the Code.

It is especially pleasing to see the leading property bodies working so closely together to provide clear guidance to property professionals and I thank both the organisations and their representatives for their diligence and perseverance in completing this substantial task.

I wholeheartedly commend this Code to you.

Graham Chase

President RICS, 2006–2007

RICS guidance notes

This Code 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'. In the opinion of the approving professional bodies, this Code represents best practice.

Practitioners are not required to follow the advice and recommendations contained in the Code. They should however 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 acted with reasonable competence.

A practitioner conforming to the practices recommended in this Code 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 Code. 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. This Code uses the words will and must to indicate best practice. 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 promulgation.

This Code will come into effect for service charges commencing on 1 April 2007 or any date thereafter and is applicable in England and Wales only.

A Terminology used in the Code

Administration charges – are where the manager procures services direct (i.e. not through a contractor) and is recovering the actual cost of the service (e.g. the site management team). The manager may charge an administration charge to compensate the indirect costs (e.g. payroll, HR, etc.). Administration charges are recorded to the cost category where they are incurred, as they would be were the service contracted.

ADR (Alternative Dispute Resolution) – is the collective description of methods of resolving disputes otherwise than through the normal trial process.

DRS (Dispute Resolution Service) – is the Dispute Resolution Service of RICS and offers a complete range of methods for resolving disputes, as outlined in section D8 *Dispute resolution*.

In trust – money kept in a separate account held in trust to the account of its owner.

ITOCC (International Total Occupancy Cost Code) – 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 occupancy cost 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.

Manager – in the context of this Code, the manager is the person or team who budgets, forecasts, procures, manages and accounts for the services that comprise the service charge whether they be an in-house team or a managing agent.

Management fees – the remuneration of the manager (including the manager’s profit element) for managing the services comprised in the service charge.

Marketing and promotions – refer to *A Good Practice Guide – Shopping Centre Marketing and Promotions* which is a publication endorsed by:

- RICS (www.rics.org),
- BCO (www.bco.org.uk),
- BCSC (www.bcsc.org.uk),
- BPF (www.bpf.org.uk),
- BRC (www.brc.org.uk), and
- PMA (www.propertymanagersassociation.com).

Not for profit, not for loss – A service charge is the means by which the costs of providing the services to a property are recovered from the users of those services. The total costs recovered will not be inflated for profit (although the individual services within the costs will contain their individual suppliers’ profit element). Similarly, there should be no residual loss (assuming a fully-let property with no concessions on service costs to specific occupiers) left for the owner to pay.

OSCAR™ (Office Service Charge Analysis Report) – from Jones Lang LaSalle, is an industry-leading benchmark. Businesses purchasing for service charges through scale, seeking cost reductions through environmental planning or adding value through marketing and well-negotiated M&E contracts, find OSCAR™ provides a measure of the effectiveness of those initiatives. The new industry standard OSCAR™ cost codes are set out in section D7 *Cost code analysis*. These 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. OSCAR™ is a trademark of Jones Lang LaSalle IP Inc.

Owner – the person who receives or is entitled to receive the rent. This person is usually responsible for the provision, management and administration of the services and the service charge.

Rebranding – the upgrading of house style, logos, names badges, etc.

Relaunching – 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 relaunch costs are split between the parties.

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.

B Introduction

The recommendations contained in this Code represent the property industry's view of the most desirable structure for service charges, which will be appropriately implemented in new leases. Existing leases may contain service charge provisions which differ from the latest thinking within this Code. Where this is the case, existing service charge clauses will 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.

At lease renewal, leases will (as far as is permitted by law) be brought up to the standard as set out in this Code. Best practice requires owners and occupiers to ensure their advisers have done this. If it is required, both to meet best practice and in the interests of compatibility with other occupiers, that an occupier is required to pay for services not previously included in his or her lease, an adjustment may be made to the rent to reflect this.

The document setting out the detail of how the service charge is to be operated for the property is the lease. This Code can not 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 services management. It benefits all users of property if those who draft lease documentation follow this Code.

Service charges as a means of recovering cost have been in existence for some time. Older leases often do not reflect current best practice. As new leases are granted and older leases renewed, it is essential to bring service charge clauses up to modern standards. This ensures all users of the property can operate transparently. If this modernisation of the service charge provision of the lease results in an increase or decrease in the amount payable by the occupier, this would usually be reflected in the rent payable. It is unlikely that all leases will fall for renewal on the same date. Modernising the service charges on an as and when basis may lead to a 'dual' service charge. Interim measures may therefore be necessary to ensure the practical operation of the services and the recoverability of the service costs during the intervening period.

Service charges are the means that enable the sharing of costs of common services in properties between more than one occupier. There will be a manager who administers these services (for which he or she will receive a fee). Best practice requires services to be procured on a value for money basis and that competitive quotations are obtained for the supply of these services.

The service charge will be on a 'not for profit, not for loss' basis. This does not mean suppliers of services cannot make a reasonable profit on the services they provide (or manager(s) cannot make a profit on their management services) but the costs will be transparent so that all parties, owners, occupiers and managers, are aware of how the costs are made up – management fees will be transparent with no hidden markups.

The manager will issue budgets to occupiers with an explanatory commentary at least one month prior to the start of the service charge year and reconciliations following the year end to all users within four months of the year end.

Occupiers are entrusting their business overheads/operating costs to an external manager and are entitled to be notified of any significant variances to the forecast as soon as possible. Prompt notification of unforeseen variances, e.g. of more than 2% above RPI, in the total annual spend must be made to all occupiers with an explanation as to how this is being mitigated.

The service charge will be apportioned using one of a series of recognised methods among the users of the services (see D4 *Common methods of apportionment* and D5 *Apportionment schedules*). Whatever method is used for apportionment, the principle will be that it reflects the benefit of the services for individual occupiers. It will be transparent and known to all. Any inducements to attract occupiers to a property will be borne by the owner and not spread among other occupiers. Allowances can be given for scale. Services that benefit only a few occupiers should be apportioned in a separate schedule. Above all, the rationale for the apportionment between occupiers must 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.

While property is physical, the use of the services within it and the demand for those services by individual users could vary over time. 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.

Service charges that are poorly managed are a cause of frequent dissatisfaction between owners and occupiers. Implementation of best practice will minimise disputes between manager and occupier. **The biggest single issue causing this is poor communication. Managers need to create the means to ensure excellent communication opportunities so that not only are services delivered effectively for the benefit of all but occupiers also need to be able to understand what they can expect to receive and how much they are required to pay.**

Finally by way of introduction there are two areas where the steering group hopes there will be further progress during the life of this Code: lease renewals under the *Landlord and Tenant Act 1954* and mezzanine floors.

Lease renewal under the *Landlord and Tenant Act 1954*

The steering group recognises the constraints to full modernisation of service charge clauses where leases are being renewed under the *Landlord and Tenant Act 1954* Part II and the further limitations set out in *O'May v City of London Real Property Company* [1982] 1 All ER 660.

Modern documents with appropriate service charge clauses are essential to reducing the conflict and subsequent disputes between owner and occupier. The trend to shorter lease terms means that renewals will be more frequent and opportunities to apply best practice will occur more often.

The steering group hopes that during the life of this Code, whether by practice direction, pre and post action protocols or common practice, the norm will be to fully modernise leases at renewal in terms of full service charge clauses that allow for appropriate revision and alternative dispute resolution (ADR) to the benefit of owners and occupiers alike.

Mezzanine floors

The recent spate of mezzanine floor building due to the planning changes may have caused some distortion in the apportionment of service charges. The steering group is not aware of any research as to the effect of these floors in terms of rent or service charges and asks that the necessary market research is carried out to enable clear best practice to be drawn up in this context to assist owners, occupiers and managers to address this area.

C The Code

Management

1. The owner has the duty to manage the property and the responsibility to administer and account for the tax properly due on the service charge that ownership brings. Whether management is provided in-house or by an agent or contractor, best practice requires both owner and manager to recognise 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).
2. Best practice requires occupiers to have the right to reasonably challenge the propriety of expenditure. Each party will bear their own costs unless agreed or determined otherwise. See section D8 *Dispute resolution*.
3. The owner will ensure 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.
4. Management policies will be established that define the procurement, administration and management of services provided. These policies will be communicated to the occupiers where required.
5. Owners will operate sound management procedures to ensure the respective obligations of owner and occupier are discharged and services are provided efficiently and economically. A summary of these will be available for inspection where appropriate by any party (e.g. owner, occupier, manager, site team, service provider).
6. The owner will inform occupiers of the plans for the property in so far as they have an implication on the service charge.
7. On-site management staff need to have a sound knowledge of modern business practices and be adequately skilled to provide best and agreed performance standards. They will have appropriate skills in general management, employment and health and safety matters and necessary training costs should be borne by the service charge.
8. Occupiers will promptly amend their records when advised of changes by the owner or managing agent, i.e. revised budgets, new payee, new agents, etc., and advise the owner or manager of their organisational changes.

Communications

Occupiers often complain about how little communication there is from the managers who are spending their money in service charges. Managers cannot afford to underestimate the significance of communication. Progress can only be made through regular communication between everyone involved in the service charge chain.

9. Communication and consultation between owners 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.

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

11. Communication needs to be continuous. Best practice needs to cover planning, implementation and review.

12. Owners and occupiers will deal with each other's reasonable enquiries and reciprocal obligations promptly and efficiently.

13. Feedback from occupiers on the performance management standards and service delivery will be sought and actioned where appropriate.

14. Best practice requires owners and/or their managing agents to hold regular meetings with occupiers, where appropriate, who will do their best to participate. Occupiers will advise owners who in their organisations deals with service charges and what the allocation is of responsibility between site and head office. A clear communication structure is needed. Owners will make available the names and points of contact i.e. Management Surveyor, Credit Controller, Accounts Clerk, etc. and the names of on-site staff, and their roles and responsibilities.

15. The management policies referred to in 4. above will contain standard information about how the property is managed and the aims of the management team (manager and site team).

16. When significant variances (e.g. of more than 2% above RPI) in actual year-on-year costs against budget are likely, the owner will notify occupiers promptly, within the current service charge year. It is the manager's duty to identify quarterly whether there are unforeseen variances and notify accordingly. Best practice is to confirm the half year forecast on an un-audited basis.

17. When substantial works are planned, summary details of the results of tenders and the process gone through will be communicated to the occupiers (if requested), together with full information on the programme of works, costs and the process to be adopted for keeping occupiers informed.

Transparency

Transparency is one key to improving communication. By being transparent both in the accounts and the explanatory notes the manager will prevent disputes. Prompt notification of variances to plans or forecasts ensures better relationships between owner and occupier.

All would benefit from easy comparison to other service charges. (It should be borne in mind that all properties are bespoke and there will be differences in operating costs). By adopting the cost code structure (set out in section D7 *Cost code analysis* and Appendix E1 *Industry standard cost headings*), owners, occupiers and managers can compare cost effectiveness more easily. Further, these cost codes are largely compatible with OSCAR™ and ITOCC, which will facilitate benchmark comparison of costs. The main difference of approach lies

with the exceptional expenditure which is a separate line item in OSCAR™ but in ITOCC is allocated to specific cost categories.

18. Service charges are usually ‘reserved as rent’ in the lease. In reality the service charge is, after year end balancing charges/credits, neutral in income and expenditure terms. Many owners now hold on-account service charges separately from other monies recognising their obligations to the occupiers. Best practice supports this.

19. Where service charge payments are kept in a separately identified account any interest earned can be easily identified and, after any appropriate deductions made (bank charges, tax, etc.), credited back to the account.

20. If the occupiers are paying for an item through the service charge, transparency requires that the manager shares the detail about and information from the contract with all, e.g. pedestrian flow data, crime statistics, etc.

Service standards and provision

All the services should be provided both commercially and professionally. Non-compliance with the procedures, recommendations and guidelines as laid out here does not accord with best practice. However on occasion there may be sound reasons for implementing alternative procedures, which the manager should be able to justify and explain.

21. Contractors and suppliers of services, including site management teams and managing agents will be required to perform according to written performance standards. (See Appendix E1 *Industry standard cost headings*).

22. Performance will be regularly measured and reviewed against these defined performance standards. Best practice recognises, where appropriate, that a relevant proportion of their budgeted remuneration may be subject to achieving (or surpassing) the agreed standards and paid as an incentive when these standards are met.

23. The services provided will be beneficial and relevant to the needs of the property, its owner, its occupiers and their customers.

24. The aim is to achieve value for money and effective service rather than lowest price.

25. The levels and standards of service provided for each property will be different depending on the nature, type and complexity of the property. 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.

26. Sufficient staffing of the right type and calibre will be provided to operate the services efficiently and cost effectively. The total costs for staff include wages, NI and tax, statutory requirements, training, other appropriate benefits and the manager’s administration charges, which should be declared.

27. Where contracts are reviewed it is reasonable that costs associated with achieving beneficial change, such as termination of contracts, will be 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.

Service charge costs

28. Service charge costs will be restricted to charges and associated administrative costs properly incurred by the owner in the **operational management** of the property. This will include reasonable costs of maintenance, repair and replacement (where beyond economic repair) of the fabric, plant, equipment and materials necessary for the property's operation.

29. Service charge costs will not include:

- (a) any initial costs (including leasing of initial equipment) incurred in relation to the original design and construction of the fabric, plant or equipment (see section D2 *Initial provision, improvement and refurbishment of equipment*);
- (b) any setting up costs that are reasonably to be considered part of the original development cost of the property;
- (c) improvement costs above the costs of normal maintenance, repair or replacement (see section D2 *Initial provision, improvement and refurbishment of equipment* and paragraph 30 below);
- (d) future redevelopment costs;
- (e) such costs which are matters between the owner and an individual occupier, for instance:
 - enforcement of covenants for collection of rent;
 - costs of letting units;
 - consents for assignments;
 - subletting;
 - alterations;
 - rent reviews;
 - additional opening hours, etc.;and
- (f) any costs arising out of the failure/negligence of the manager or owner.

30. 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. Owners will provide the facts and figures to justify such a decision.

Value for money

31. Service quality will be appropriate to the location, use and character of the property.

32. The owner will procure quality service standards to ensure that value for money is achieved at all times.

33. Occupiers will be proactive in assisting owners with operating and using services on a value for money and quality standards basis, e.g. separating waste to facilitate appropriate and cost effective recycling.

34. The owner will keep costs under review and where appropriate (e.g. every three years) require contractors and suppliers to submit competitive tenders or

provide competing quotations. If owner and occupier are happy with the existing service standards, rather than go to tender, the owner will benchmark the prices.

35. Owners will require major service providers to continually review methods and processes that produce further value and efficiencies.

36. The owner will be entitled to use a procurement specialist to obtain these services so long as the purpose is to achieve greater value for money and cost effectiveness (the fees being declared and charged to the service charge).

37. When contracts and remuneration packages are performance related where appropriate, best practice requires that they be benchmarked to market rates.

Administration

Management fees

The fee for the management service is the reasonable price for the total cost of managing the provision of the services at the location. This total price will not be linked to a percentage of expenditure. Such linkage is no longer appropriate and a disincentive to the delivery of value for money. The total price for the management service will be a fixed fee for a reasonable period of time (e.g. three years) and may be subject to indexing which will constitute an important part of the regular tendering and benchmarking of the service in the market economy.

It is not for this Code to prescribe operating business models. Nevertheless best practice does require that whichever business model is used transparency prevails and through the budget explanatory notes these costs, be they provided by the on-site team or through the manager's central team, are clearly identified.

38. Best practice requires that there will be transparency in the management fee charged, which will be reasonable for the work properly done in relation to the operation and management of the services and have due regard to the work necessary to fulfil the principles of this Code.

39. The management service will be regularly tendered or benchmarked against the market. There need be no tendering if the owner and occupier are happy with the service benchmark.

40. The provider of the service will operate within defined quality standard procedures for the property. Expenditure and income receipts will be shown separately in the service charge account with income being credited to the service charge after calculation of the management fee. The terms of the lease cannot be overridden. Owners will ensure that the management fee being charged to the service charge relates only to work carried out in managing the service charge.

Apportionment

The most common bases of contribution for each occupier's proportion of the total service charge costs for the property are: a fixed amount; a fixed percentage; rateable value; floor area; weighted floor area; or a fair and reasonable proportion. Whatever the method being used, it needs to be demonstrably fair and reasonable and there needs to be a rational

commentary on how the apportionment has been worked out. See sections D4 *Common methods of apportionment* and D5 *Apportionment schedules*.

41. Apportionment of costs to each occupier will be fair and reasonable and applied consistently throughout the property having regard to the physical size, nature of use, and benefits to and use by the occupier(s).

42. An apportionment schedule will be made available to all occupiers showing the total apportionment for each unit within the property/complex.

43. The occupiers will not be charged through the service charge or otherwise collectively toward the costs attributable to unlet premises. The owner should meet the cost of any special concession given to any one occupier. A properly constituted weighting formula is not regarded as a special concession.

44. The owner will bear a fair proportion of costs attributable to his or her use of the property e.g. where an on-site management office is used in part as the owner's regional office.

45. 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 staff or services that form part of the service charge are used then the cost/profit centre will be incorporated into the service charge matrix. See also paragraphs 72, 73 and 74, and section D4 *Common methods of apportionment*.

46. Where services are provided for the benefit of specific occupiers only, these costs will be allocated only to the specific occupiers that benefit from them.

47. 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.

Budgets/accounts

See also Appendices 1–4.

48. The owner will provide an estimate of likely service charge expenditure and appropriate explanatory commentary on it to the occupiers, together with their proportion of the costs, one month prior to the commencement of the service charge year.

49. The owner will submit certified accounts to the occupiers in a timely manner and in any event within four months of the end of the service charge year.

50. The accounts will 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.

51. The budgets and accounts will be issued with a report that provides the following minimum information:

- (a) a reasonably comprehensive level of detail to enable occupiers to compare expenditure against estimated budget;
- (b) explanations of significant individual costs and of variances from the previous year's budget/accounts;

- (c) comparison against the previous two years' actual costs where appropriate;
- (d) information on core matters critical to that account (e.g. levels of apportionment, contracts, report on tendering, etc.);
- (e) the achieved and/or targeted measures of improved management performance (e.g. successes in delivering improved quality services and greater value for money);
- (f) separately identified on-site management team costs;
- (g) details and results of the last previous and forthcoming tendering exercise (occupiers will be advised of the contractors who are providing the services); and
- (h) a statement detailing how income generated from operating the property (sometimes known as 'commercialisation' or 'mall income') is dealt with and how shared services are charged, setting out how they impact on the service charge and what reimbursement has been made to the service charge for these.

In conjunction with OSCAR™ and ITOCC, a set of industry standard cost codes has been drawn up. See section D7 *Cost code analysis* and Appendix E1 *Industry standard cost headings*.

52. Where the owner or manager has demonstrably complied with the provisions of the lease and this Code of Practice, the owner will allow occupiers a reasonable period (e.g. four months from issue) in which to raise enquiries in respect of the certified accounts. Owners will 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 have been supplied, an appropriate fee will be charged.

53. If the account is certified by an auditor, such costs will be charged to the service charge account. (Owners will not use an external audit as a means of giving credibility to the charge at the occupiers' cost.)

54. If an occupier requests an independent audit, the owner will agree and the audit fee will be charged to the occupier.

55. If the lease requires the accounts to be independently certified, an appropriately qualified person from the owner or managing agent will issue the certificate and the costs of such certification will be recovered through the service charge. Transparency requires that the status of the person issuing the certificate is clear.

Change of owner or agent

56. The budget will be issued in such a way that it provides sufficient information to enable occupiers to compare it with the last issued certified accounts. Details of how swiftly accounts will be closed and handed over will be made available at completion. Where the owner or managing agent was not responsible for the earlier years, they will convert the data into a consistent format for comparison.

57. As soon as practicable, but not later than four months following the date of completion of a sale of a property, the seller will provide the buyer with full details of all service charge expenditure, accruals, prepayments, etc. for all outstanding service charge years up to the date of sale.

Sinking, replacement and reserve funds

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, replacement fund or reserve fund, rather than charging the whole cost to the current occupiers in the year in which the equipment is replaced. See section D6 *Sinking and reserve funds*.

Sinking, replacement and reserve funds

58. Any monies accumulated in a sinking fund, replacement fund or reserve fund will be held in an interest-bearing account, held in trust for the occupiers and separate from the owner's own monies.

59. The owner or manager will act reasonably in estimating the amount of the sinking, replacement or reserve fund contributions to be included within the service charge which will relate to specifically identified expenditure only (e.g. roof, boiler plant, lift, etc.) rather than other unidentified future expenditure.

60. The owner or managing agents will provide a clear explanation of the basis of calculation of the sinking, replacement or reserve fund contribution and the items to which it relates and have regard to a realistic assessment of the anticipated life cycle of the item in question and the funds accumulated from previous service charge periods (including interest).

61. The owner will make all payments into the sinking or reserve fund account for void premises.

62. The annual budget and reconciliation accounts will state clearly contributions to and expenditure from the sinking fund account together with the account opening and closing balances and the amount of interest earned and tax paid in the relevant period.

63. On completion of the sale of a property, the seller will pass all sinking fund monies held, together with all accrued interest, to the buyer. Advice should be taken to ensure that any tax liability on the fund is appropriately mitigated and accounted for.

Interest on service charge accounts

64. Interest earned and late payment interest should be credited to the service charge account. Bank charges and account operating costs will 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.

65. Above average monthly expenditure, e.g. high energy costs during winter months, may be balanced by non-monthly expenditure (e.g. maintenance and repair works) being carried out at other times.

66. 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. 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.

67. Where a managing agent is employed to manage a property and separate client bank accounts are maintained to comply with RICS client accounting rules, advance service charges received will be separately identifiable.

68. Unless specifically laid down in the lease, owners are under no contractual obligation to retain advance service charge payments in separate bank accounts. Many owners manage their own property portfolios directly, or through a management company, where RICS accounting rules do not apply.

69. A separate client account does not oblige owners to credit interest earned to the benefit of occupiers but best practice does require this after making due deduction for tax.

70. Where there is a contractual obligation by the owner to hold advance service charge payments in a separate interest-bearing account, the lease requires to be precisely drafted.

71. Interest charged to, and received from, occupiers for late payment of service charges should be credited to the service charge account net of any tax.

72. Costs incurred between the owner and individual occupiers are not usually regarded as costs that should be included in the service charge account.

73. Owners have to fund the contribution from void units, and will 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 should be provided.

74. HM Revenue and Customs regards on-account payments received as direct landlord income and deals with VAT and tax accordingly.

75. Management fees can reflect the additional administrative costs of operating separate bank accounts.

76. Many of the requirements regarding interest on service charge accounts are voluntary. When communicating with occupiers through budget and expenditure reports, best practice requires owners to unambiguously state their policy concerning the crediting of interest to the service charge.

Additional shopping centre services

This section relates principally to shopping centres, retail and leisure parks.

Marketing and promotions

77. The funding of marketing and promotional activities is recognised as a shared cost to be borne by both owners and occupiers in partnership and in such cases, consultation is considered essential. At the lease negotiation stage an agreed contribution from the owner is likely to be written into the lease. How much each party contributes will depend on the commercial factors at each centre. Full partnership clearly provides for owner and occupier sharing the costs on a 50:50 basis.

78. Service charge budgets will state what the gross expenditure on marketing is and how much is contributed by the owner thus establishing the net marketing cost.

79. Marketing plans (including promotions) will be prepared and presented to occupiers in advance of the period to which they relate. See 'Marketing and promotions' in Part A *Terminology used in the Code*.

80. Marketing plans (including promotions) will be agreed, monitored and reviewed with occupiers to analyse their effectiveness. All pedestrian flow data collected will be issued to owners and occupiers, as a matter of course. See 'Marketing and promotions' in Part A *Terminology used in the Code*.

81. Separate owner or developer budgets will fund the marketing of vacant units in the scheme.

82. The costs of launching, and rebranding are to be borne by the owner. Relaunching a centre should be discussed between owner and occupiers and an appropriate split of the expenditure to each party agreed.

Non-core income

This is also known as 'commercialisation' or 'mall income'.

83. There will be a clear statement of policy on how costs and income generated from services and activities in centres or malls are allocated. Transparency is required at all times.

84. Income derived from the provision of a service or activity, the finance for which is included in the service charge, will be treated as a service charge credit, e.g. photocopy and fax reimbursements, etc. (note where there are BT or other public telephones and the owner receives a share of the income, that income would not be credited back to the service charge). Income derived from promotional activity will be credited to the marketing expenditure budget.

85. 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 will be included in the service charge apportionment matrix or appropriate equivalent credit given for the costs of that space.

86. For less substantial fixtures, a sum will be credited to the service charge to reflect a contribution towards the benefit of the services enjoyed. Owners will estimate and declare a contribution to the service charge depending on services utilised and how permanent a fixing the item represents.

D Technical support

D1 Performance contracts

D2 Initial provision, improvement and refurbishment of equipment

D3 Treatment of non-core income

D4 Common methods of apportionment

D5 Apportionment schedules

D6 Sinking and reserve funds

D7 Cost code analysis

D8 Dispute resolution

D9 Management charges

The purpose of these technical notes is to provide those charged with managing and administering service charges with some more detail and background to the thinking behind the Code itself.

These notes are not exhaustive but are intended to add depth and clarity to the Code's bullet points.

While they are targeted at practitioners, we hope the notes will assist all those who choose to read them.

D1 Performance contracts

Performance contracts are also known as Service Level Agreements (SLAs). The Code focuses on the need for service charges to deliver effective service as well as delivering value for money. Service suppliers and the manager's performance will be measured against transparent criteria and good work will be appropriately recognised and rewarded. The ensuing value for money will become apparent.

Traditionally, service contracts are based on a detailed specification detailing what services are required, how these services are to be performed and at what frequency.

For example, a cleaning specification may detail what surfaces are to be cleaned, how the cleaning is to be carried out, how often and at what times. However, this may not always result in value for money being achieved.

The contractor may adhere rigidly to the detailed specification but this may result in a higher or lower standard of cleaning than required. The higher standard of cleaning may carry with it an unnecessarily high cost, while the lower standard may be achieved at a lower cost but will not meet the customer's requirements and expectations.

Performance contracts are a contracting methodology designed to meet the specific needs set down by the user, and where achievement against set performance standards can be measured and reflected in the cost incurred for the level of service actually provided.

By specifying the standards to be achieved, rather than the process, it is the contractor's responsibility, particularly in a competitive tendering situation, to ensure the most cost-effective processes and procedures are utilised to meet the customer's needs. In this way, value for money is achieved by ensuring the optimum price is obtained for the standard of service required.

Setting performance standards

There are various methods of setting performance standards, which depend on the asset type, the service provided, the needs of the customer, and the facilities to record and monitor the standards to be achieved, such as:

- establishing periods during which equipment will be operational;
- providing and maintaining a specified minimum standard of service;
- limiting the number of faults allowed in a period;
- setting specific response targets for attending to repairs, etc.

Once established and agreed, the level of performance achieved will be measured and reviewed regularly.

Remuneration for the delivery of the service is linked to the performance achieved against the target performance standards set. If performance falls below the agreed standard there would be a reduction in cost. Similarly, the remuneration might be increased if target performance standards are exceeded. If a contract is let at £x, a base fee might be established at x*90%, which becomes the monthly billing amount. The additional 10% is awarded and paid on the results of regular performance surveys. Occasionally the contractor will be offered further incentives by increasing this bonus fund from 10% to, say, 15% of the original contract price.

Contractors have been known to 'risk price' such contracts thus negating the benefits to the owner where targets are not achieved. Tenderers may wish to offer the contract on both a traditional basis as well as a performance-based contract so as to benchmark the true base price.

Performance management focuses on the needs of the business, individual and customer. Performance contracts vary in style and content but where implemented successfully drive continual improvement in the delivery of services and improve value for money.

D2 Initial provision, improvement and refurbishment of equipment

Often service charge clauses in the lease do not permit the initial provision of equipment to be charged to the service charge. The owner is expected to provide these. Custom and practice allows some items to be leased through the service charge. This section gives clear advice as to what is best practice when dealing with equipment that is used to provide the services that serve a development.

Initial provision in a new development

Many leases contain provisions for the owner to include a notional rent within the service charge for management accommodation. Notional rents were

originally included to provide developers with a return on otherwise unlettable space and to defray the initial provision costs for management accommodation.

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

Generally, occupiers object to the inclusion of such provisions in leases because the accommodation is either incapable of beneficial occupation for any other purpose, or that it would be inconceivable if, for example, a modern shopping centre did not include provision for centre management accommodation as part of the original design specification. In these cases it will not be a cost to be borne by the occupiers.

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.

Occasionally the owner will seek to recover the costs of fitting out and equipping the on-site management offices through the service charge.

It will be evident when there is a necessity for an on-site management team. Therefore, it will be reasonable to assume that the on-site staff will require furniture, equipment and various necessary facilities to perform their tasks.

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 will not be included as part of the service charge.

Improvement to existing equipment

Example: *A new piece of equipment is added to an existing boiler to better control fuel consumption. This will result in a saving on fuel bills and a reduction in maintenance costs.*

Occupiers benefit from the 'improvement' through reduced energy bills and maintenance costs. It is reasonable to expect the cost of the 'improvement' to be recovered through the service charge providing a reasonable payback period on the investment can be justified.

However, this would be an improvement under the terms of the lease and the lease would need to provide for these costs to be recoverable. It is unlikely that such work constitutes a repair.

An owner who is unable to recover the costs of this 'improvement' to the heating system may choose not to proceed with the works. The occupiers would continue to pay higher fuel bills and maintenance costs than necessary. The owner or agent should explain the situation to the occupiers and discuss all the alternatives.

Through proper communication, owner and occupiers can agree to expenditure being incurred and recovered through the service charge.

Replacement with enhancement

Example: *A heating system that has reached the end of its life requires replacement. However, an identical replacement heating system is no longer available due to technological advances since the original equipment was installed and therefore the replacement system is an ‘improvement’ on the old.*

To consider whether the costs are recoverable through the service charge, ask if the intention is to improve or repair the existing equipment.

It is common sense to include the cost of minor ‘improvements’ in the service charge when replacing components of a property, even though the lease may only provide for the cost of repair. Lord Denning supported this view in *Morcom v Campbell-Johnson* [1956] 1 QB 106:

‘If the work which is done is the provision of something new for the benefit of the occupier, that is, properly speaking, an improvement; but if it is only the replacement of something already there, which has become dilapidated or worn out, then albeit that it is a replacement by its modern equivalent, it comes within the category of repairs and not improvements.’

If the replacement works go beyond the minimum specification necessary to effect a repair, and this additional cost can be justified in terms of reduced maintenance costs, etc. (as above), the cost can be recovered through the service charge. Again, communication with occupiers will achieve a practical solution.

Innovation – the provision of new equipment in an existing development

Innovation enables the introduction of new products or practices to an existing property that will improve service levels and/or value for money.

Example: *A new CCTV system is installed in a property that, at the time of its original construction, pre-dated CCTV. It is assumed that the introduction of CCTV will result in a decrease in manned security costs, an increase in the level of service provided to occupiers and improved value for money in terms of the overall service charge costs.*

If a new piece of equipment is installed, where no equivalent previously existed, it is considered an improvement. To recover the costs of this new equipment, the lease needs to allow for the costs of providing new equipment.

Many leases do not preclude the provision of further services not contemplated when the lease was granted. The cost of providing new equipment may be recoverable under the terms of the lease.

But, as before, if the additional cost of carrying out the improvement can be justified on a cost-benefit basis, e.g. a reduction in the cost of manned security, reduced insurance premiums, etc. communication will achieve a common-sense result.

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.

How much 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 will 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 the improvements. When refurbishments result in higher rental values, costs are usually the owner's responsibility.

The need to carry out extensive repairs or to replace services is also considered in the decision to refurbish. Before 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.

Communication

If it is proposed to include the cost of improvements in the service charge, that fact must be communicated to occupiers before any expenditure is committed, to ensure agreement.

With a refurbishment, the owner's proposals will be communicated to all occupiers before the refurbishment to explain which costs are to be the responsibility of the occupiers through the service charge. It is also best practice to establish regular communication between owner and occupiers to monitor the refurbishment and what will be considered as service charge costs. This avoids acrimony over any unexpected costs following completion of the works.

D3 Treatment of non-core income

Non-core income may also be known as 'commercialisation' or 'mall income'. Increasingly owners are finding additional non-core income streams from their investments. It is clear they are entitled to receive this income from the investments 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 will 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 will be made. Best practice is for the owner to clearly state the 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.

Owners usually seek to optimise the income from their investments. Occupiers will typically object to income generated from common areas being retained by the owner when it is the occupiers who pay for those areas' cleaning, lighting and other costs.

Records need to be maintained of income receipts from different sources and activities. The nature of such activities generally indicates whether owners or occupiers will receive the benefit of the income.

Owners will 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 and does not use any services, the income goes to the owner 100%;**
- **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, will be made to the service charge.**

Any income derived from the provision of a service or activity, the cost of which is included in the service charge, will be treated as a service charge credit, e.g. income from vending machines, photocopying, etc. Similarly, for shopping centres, income derived from promotional activities is normally credited to the promotional expenditure budget.

If the use of space is permanent or semi-permanent, e.g. barrows or kiosks located within shopping malls, it is common practice for the owner to retain the income as rent. In these circumstances, the letting is regarded in the same way as any letting of a standard shop unit and so bears a proportion of the service charge. Alternatively, an appropriate sum can be credited to the service charge to reflect a contribution to reimburse the benefits of the services enjoyed.

D4 Common methods of apportionment

The costs within a service charge are apportioned among the occupiers using formulae set down in a matrix. Specific services (perhaps only provided to some occupiers) can be set out in additional specific schedules apportioned only to those who benefit from the services.

Best practice requires this apportionment matrix to be shared with the occupiers, ensuring transparency.

Care should be taken to limit the number of specific schedules. This is because the cost of operating these often substantially outweighs the benefits received by the occupiers from such detailed cost analysis and apportionment.

Where an owner owns adjoining property that uses services from the subject property (e.g. a car park) the adjoining property should be included in the apportionment matrix or the appropriate schedules that apportion the services used. Appropriate allowance will be made to reflect the benefit of the services enjoyed.

Most modern leases give the owner the right to vary the apportionment nearly always on the proviso that the substituted methodology is fair and reasonable. Best practice requires regular reviews to be undertaken to ensure that the

apportionment matrix remains fair given any changes to the occupation or use of the property. This is best illustrated by the amount of property being redeveloped as 'mixed use'.

When the apportionment matrix is created or amended it is best practice to ensure there is a commentary that explains the rationale behind the matrix. This ensures that when the apportionment methodology is reviewed, the circumstances and use prevailing at that time can be compared to the commentary. Similarly when circumstances cause alterations to take place (e.g. mezzanine floors) the matrix can be adapted to reflect the new build (as appropriate).

The method or combination of methods used to apportion the service charge must be fair and reasonable.

Leases vary in the way they define an individual occupier's proportion of the total service charge costs for the property. The most common bases of contribution are:

- a fixed amount;
- a fixed percentage;
- floor area;
- weighted floor area;
- a fair and reasonable proportion; and
- rateable value.

A fixed amount

This provides certainty for both owner and occupier and is simple to apply. However, a fixed amount is inflexible and can cause under or over recovery. The fixed amount is advantageous for short leases where costs are unlikely to vary significantly, or where limited services are to be provided with little risk of unforeseen expenditure.

A fixed percentage

The percentage of the overall service charge costs the occupier pays is fixed at the time the lease is granted. The fixed percentage offers certainty and simplicity but is inflexible and will only be used where the owner's premises are unlikely to be altered. Provision is often included to review the fixed percentage if the property is altered or extended.

Floor area apportionment

This is the most common and 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. Definitions of the calculation of service charges are:

- **Gross Internal Area (GIA)** – applied to industrial and warehouses (including ancillary offices);
- **Gross External Area (GEA)** – alternatively applied to industrial and warehouses (including ancillary offices); and
- **Net Internal Area (NIA)** – applied to offices and shops.

Weighted floor area apportionment

In many larger properties or mixed use developments a 'weighted floor area' formula reflects the different costs involved in servicing different sized units. A 5,000 sq. metre unit will 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.

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.

There is no standard weighting formula. Each should be devised to reflect the particular circumstances and use of the development being serviced.

For example:

The first 500 sq. metres	@	100%
The next 500 sq. metres	@	80%
The next 1,000 sq. metres	@	60%
The next 1,000 sq. metres	@	50%
The next 1,000 sq. metres	@	40%
Excess over 4,000 sq. metres	@	30%

Here, a 1,000 sq. metre unit has a weighted floor area of 900 sq. metre, i.e. (500 x 100%) + (500 x 80%), whereas a 10,000 sq. metre unit will have a weighted area of 4,200 sq. metre. Although ten times larger in floor area, the 10,000 sq. metre unit pays approximately 4.5 times the service charge of the smaller unit.

Similarly, basement and upper floors accommodation can be 'weighted', e.g. by dividing the floor area by a factor of two, to reflect the benefit derived from the services as distinct from the ground floor retail space.

Weighted floor areas are also used to provide a discount to an anchor tenant to reflect the benefit the anchor tenant brings to the shopping centre. Such weightings need to be treated cautiously as the weighting is sometimes calculated to provide a 'concession', to spread the cost of the concession among the remaining occupiers. The owner should meet the cost of any special concession given to any one occupier.

A reasonable and fairly administered weighting formula for apportionment of the service charge cannot usually be considered a concession.

Fair and reasonable proportion

The lease will usually incorporate a provision for the proportion to be determined by the owner's surveyor. This provides flexibility and, for the owner, full recovery. Unless coupled with a statement about how the occupier's apportionment is to be calculated, the lease can give rise to disputes. The term 'fair and reasonable' requires the owner to ensure no occupier is disadvantaged.

Rateable value apportionment

The lease may state the occupier's proportion of the service charge is to be calculated as the percentage that the rateable value of the premises bears to the total rateable value of the lettable parts of the property (i.e. excluding common areas and management accommodation). The lease usually provides for recalculation as rateable values change.

Rateable values may be changed over time with the occupier having the right to appeal against any assessment by the Valuation Officer. Such appeals can take many years to be resolved which could result in recalculation of the occupier's service charge apportionment for previous years. Unless the lease makes specific provision to the contrary, on successfully appealing a rateable value, an occupier could insist on reimbursement of any overpayment of service charge. The owner could thus seek to recalculate the service charge apportionment for all other occupiers, and recover further balancing charges. This could occur every time an occupier successfully appealed a rateable value, giving rise to unwanted administrative problems for owner, manager and occupiers.

Many owners use the rateable values in the rating list on the last day of the service charge year. Subsequent variations to the list are used for calculating apportionments for future years. This could mean the apportionments matrix changes annually. Thus, by using the list at the year end date, the manager avoids continual retrospective adjustment as individual rateable values are appealed. Many occupiers accept this as a common sense approach. This Code considers this approach to be best practice.

There are other problems associated with this method of apportionment, usually only found in old leases, as other methods of apportionment are easier to apply and more accurately reflect the fair apportionment of costs to be borne by each occupier. **Accordingly this method of apportionment is less and less used.**

D5 Apportionment schedules

In many cases (e.g. in mixed-use buildings such as offices with retail shops located on the ground floor), not all occupiers will benefit from the owner's services to the same extent. Office occupiers may benefit from a full range of services including a lift and an independent central heating system while retail shops may only benefit from general repairs and maintenance to the exterior of the property, and maintenance of a fire protection system. It may be necessary to divide the service charge into separate parts (or schedules), with the costs apportioned between occupiers according to usage.

Apportionment example

Basis of calculation

Service charge apportionments are calculated on a weighted floor area basis.

The weighted floor area is calculated by reference to the net area of ground floor space added to the internal area of the upper floors multiplied by 0.5.

All costs of refuse disposal are recovered under Schedule 2 excluding the supermarket which has its own dedicated facilities.

Apportionment matrix

Unit	Ground floor area (sq. ft)	First floor area (sq. ft)	Total area	Total weighted floor area	Schedule 1 All tenants %	Schedule 2 Waste removal %
1	940	585	1,525	1,232.50	2.1489	3.3085
2	830	500	1,330	1,080.00	1.8830	2.8991
3	900	495	1,395	1,147.50	2.0007	3.0803
4-6	6,355	3,290	9,645	8,000.00	13.9482	21.4751
7	2,550	2,110	4,660	3,605.00	6.2854	9.6772
Supermarket	16,255	7,695	23,950	20,102.50	35.0493	0.0000
9	1,170	620	1,790	1,480.00	2.5804	3.9729
10-11	2,500	1,155	3,655	3,077.50	5.3657	8.2612
12	1,295	775	2,070	1,682.50	2.9335	4.5165
13	2,195	655	2,850	2,522.50	4.3980	6.7714
14	945	1,820	2,765	1,855.00	3.2342	4.9795
15	1,590	850	2,440	2,015.00	3.5132	5.4090
16	780	435	1,215	997.50	1.7392	2.6777
17	720	340	1,060	890.00	1.5517	2.3891
18	690	515	1,205	947.50	1.6520	2.5435
19	625	550	1,175	900.00	1.5692	2.4159
20	485	240	725	605.00	1.0548	1.6241
21	1,175	550	1,725	1,450.00	2.5281	3.8924
22	1,670	1,190	2,860	2,265.00	3.9491	6.0801
23	1,265	470	1,735	1,500.00	2.6153	4.0266
Totals	44,935	24,840	69,775	57,355.00	100.0000	100.0000

Schedule

Unit description	Floor area (sq. ft)	Schedule 1 (All tenants)	Schedule 2 (Offices only)
Shop 1	1,000	5.0 %	
Shop 2	1,000	5.0 %	
Shop 3	2,000	10.0 %	
First floor	4,000	20.0 %	25.0 %
Part second floor	1,600	8.0 %	10.0 %
Part second floor	2,400	12.0 %	15.0 %
Third floor	4,000	20.0 %	25.0 %
Fourth floor	4,000	20.0 %	25.0 %
Total	20,000	100.0%	100.0%

The two tables above have been kept simple to aid dissemination of the principle.

D6 Sinking and reserve funds

Care should be taken not to confuse sinking and reserve funds.

Sinking funds

A sinking fund is a replacement fund where the owner builds up a fund to pay for repair and replacement of major items of plant and equipment.

Sinking funds are theoretically sound. The funds' advantages are that occupiers are not faced with disproportionately expensive bills (so minimising the risk of tenant insolvency) while the owner has funds available to meet any necessary but unexpected expenditure.

Occupiers may not see the benefit of contributions to a sinking fund if leases have been assigned or premises vacated at the expiration of the term, and there has been no need for major expenditure. Sinking funds are also expensive to administer and the occupier is at risk of becoming an unsecured creditor if the owner becomes insolvent and the sinking fund is not held 'in trust'.

Reserve funds

A reserve fund is a fund built up to equalise expenditure with regularly recurring service items to avoid fluctuations in the amount of service charge payable each year.

Occupiers are wary of such funds as the owner is not obliged to hold the money as a provision against future large expenditure. Sometimes owners may not have sufficient funds available when major expenditure is necessary and would be in breach of contractual obligations in failing to replace equipment when required.

Key issues

Occupiers, especially major contributors to service costs, are interested in the way funds accumulated to provide for plant or other replacements are dealt with by owners. Many major occupiers prefer to pay for large items of expenditure as they occur rather than see their funds locked away in a trustee investment over which they have little or no control. Consequently, despite offering advantages, sinking, reserve and depreciation funds are becoming rare in practice due mainly to the associated tax and administrative issues.

D7 Cost code analysis

In Appendix E1 *Industry Standard Cost Headings*, there is a list of cost codes used by Jones Lang LaSalle to prepare its OSCAR™ service charge analyses. With the publication of this Code, the cost code categories and subcategories have been revised and modernised and are now largely (apart from exceptional expenditure) compatible with ITOCC (the International Total Occupancy Cost Code from IPD which not only looks at service charge costs but also all other costs of occupation including those within the demise).

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 OSCAR™’ is not necessarily proof of service efficiency and value for money. OSCAR™ provides an excellent guide but managers will wish to reflect further on how their specific property is performing from a value for money perspective.

D8 Dispute resolution

RICS Dispute Resolution Scheme

1. Summary

In the light of an increasing culture change in the civil judicial system, which is encouraging people to resolve their disputes without the intervention of the courts, RICS intends that the Code provides access to alternative dispute resolution (ADR) for parties involved in disputes about service charge matters.

2. Introduction

Alternative dispute resolution as industry best practice

The glossary of terms in the *Civil Procedure Rules* 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 must now take into account whether the parties have given proper consideration to the use of Alternative Dispute Resolution (ADR). 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.

It follows that parties to disputes about service charges must consider ADR before taking legal action. If an appropriate ADR procedure is available, and the parties have failed to use it, the court will want to know why. It is now much more likely that the court will penalise a party who has refused to engage in ADR without a very good reason.

Purpose of this section

This section provides information about the Royal Institution of Chartered Surveyors (RICS) Dispute Resolution Service. It also includes a proposal for a two stage dispute resolution process which includes consensual mediation and expert determination. One or both of these processes can be used to resolve issues and full blown disputes arising out of service charges. The objective of the process is to encourage agreement and avoid disputes escalating. Where disputes are inevitable, the process is designed to resolve them quickly, discreetly and effectively by an impartial expert’s decision. The process avoids the need for court action.

Credentials

With over 110,000 members, the Royal Institution of Chartered Surveyors is the largest organisation for professionals in property, land, construction and related environmental issues worldwide. RICS is regulated by royal charter and is dedicated to:

- acting in the public interest;
- maintaining the highest educational and professional standards;
- protecting consumers through a strict code of practice; and
- providing impartial advice, analysis and guidance.

The RICS Dispute Resolution Service is the UK's largest dispute resolution provider for property and construction disputes. It currently deals with around 9500 disputes per year. The department has 14 dedicated staff, some of who are legally and technically qualified in dispute resolution procedures.

RICS is able to draw on the experience and knowledge of the surveying profession, including members who are skilled in resolving all types of property disputes. RICS develops and manages dispute resolution processes on behalf of clients in commerce, industry and government. It is able to create and implement bespoke services that help particular parties to resolve particular types of disputes. RICS dispute resolution services are relentlessly impartial and dedicated to integrity and professionalism.

3. The dispute resolution process

Evaluative mediation

Disagreement on one or two issues early in the negotiation process can have a knock-on effect and delay agreement on everything that follows. The involvement of an evaluative mediator in the early stages of some negotiations can:

- prevent misunderstanding and minor disagreements from escalating;
- bring parties closer together through communication and transparency;
- provide understanding and empathy from both sides;
- avoid the need for constant or sporadic fire-fighting throughout the negotiation process;
- ensure smooth progress of objectives in a consensual environment; and
- avoid creating a culture of disputes.

Evaluative mediation involves intervention by an impartial person whose function is to bring about quiet and effective resolution of disputes. This is done by providing evaluative and impartial guidance to both parties at the same time. An evaluative mediator is more proactive and will, on the basis of his or her evaluation make proposals for settlement.

Though mediation can be used at any time, it is particularly useful when negotiations have stalled, or are about to stall, or there is a disagreement which may prevent further discussions on other matters.

Evaluative mediation is also capable of being used in situations involving multiple parties, such as where there may be several tenants and one landlord.

Mediation helps parties who wish to avoid confrontation and are prepared and able to compromise. It is also useful where liability is admitted and issue is limited to deciding quantum or agreement on alternative remedies.

Expert determination

Sometimes parties are able to agree on most matters, but face a stumbling block when there is a point on which both have opposing views. The dispute can often be represented as a question on which the parties depend on the answer in order to continue with their relationship. Where consensual settlement is not possible, expert determination can bring a quick and final end to a dispute via a decision from an impartial and expert third party.

Expert determination involves the introduction of an independent third party who has a high level of expertise in the subject matter of a dispute. Typically, an independent expert will make a binding decision. The decision will be an evaluative opinion based on:

- the persuasiveness of argument and evidence submitted by the parties;
- the results of the expert's own investigations; and
- the application of the expert's knowledge and experience in the subject matter.

The benefits of expert determination are that the dispute is resolved relatively quickly. It is informal and private, the decision is made by an impartial expert who knows the subject matter intimately, the procedure and timetable is flexible and can be decided by the parties and the decision is binding.

The RICS Dispute Resolution Service (DRS) maintains and manages panels of trained independent experts and mediators. DRS can provide access to highly qualified mediators and independent experts who are appropriately experienced in service charge issues. DRS acts as an impartial referral body and is able to quickly identify and nominate suitable mediators and independent experts as and when requested.

Lease renewal

PACT

PACT stands for Professional Arbitration on Court Terms. In more simple terms it is 'lease renewal arbitration', though parties can also opt for expert determination. It is a process that offers opportunity for all type of disputes arising at lease renewal to be resolved without the necessity of going to court.

The PACT scheme, which has been in existence for over nine years, gives greater choice to both landlords and tenants, and is in line with CPR requirements for using litigation as a last resort.

PACT would be particularly useful in situations where there are disputes about modernisation of service charge clauses at renewal.

RICS can act as an impartial referral body to identify and nominate appropriately qualified experts as and when requested.

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D9 Management charges

Best practice requires that fees are on a cash basis rather than being calculated as a percentage. Nevertheless those responsible for setting such fees should ensure that the fee agreed reflects the extent of the required work. Best practice recognises the need for the manager to charge supervisory fees (as part of the management fee) where others (e.g. HR teams or building surveyors) are involved. These other fees should be allocated to the cost category of the service charge where the work occurs rather than within the Management fees cost category. The manager's own supervisory fees will then reflect the actual reduction in work and responsibility of the manager and be calculated accordingly.

Typically these charges include 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 will not include property management work separate from the service charge such as landlord approvals, income generation or rent collection.

Where the subject property/site management team is not sufficiently large to justify specific service managers (e.g. HSAW manager or building surveyor) additional specialist fees may be charged to the relevant cost category for the 'manager provided' service. Occupiers are likely to be interested in benchmarking the total cost of management.

E Appendices

The appendices provide examples of what is considered best practice and illustrate how some of the principles outlined in the Code can be achieved.

Guidance notes and examples provided are:

- E1 Industry standard cost headings
- E2 Example landlord's surveyor's service charge certificate
- E3 Example service charge detailed expenditure report
- E4 Example service charge variance report

Appendix E1: Industry standard cost headings

Overriding principles

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.

2. Flexibility

- The cost codes 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 codes 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.
- If required, further differentiate between 'estate' and 'car park' expenditure within appropriate categories e.g. 'security', 'cleaning and environmental' and 'fabric repairs and maintenance' cost categories.

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 any 'commercialisation' can thereby be clearly identified.

COST CLASS

Cost category

Cost code

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

S/C audit fees

Auditor's fees to review the year end service charge reconciliation

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 help desk/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

UTILITIES

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
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
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	Auditing quality of maintenance works, condition of plant and H&S compliance
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 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

Repairs and maintenance

Staff costs

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 above facilities

INSURANCE

18 Engineering insurance

Engineering insurance

Engineering inspections

19 All risks insurance cover

Buildings insurance

Loss of rent insurance

Public and property owner's liability insurance

Landlord's contents insurance

20 Terrorism insurance

Terrorism insurance

Landlord's engineering insurances

Landlord's all risk insurance costs

Landlord's terrorism insurance costs

EXCEPTIONAL EXPENDITURE

21 Major works

Project works

Refurbishments

Plant replacement

Major repairs

22 Forward funding

Sinking funds

Reserve funds

Depreciation charge

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

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

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

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

4. Additional notes

- Separate cost categories are **not** to be used for single service activities provided across different elements of a subject property e.g. estate, car park, etc. Where multiple schedules are not used, it may be necessary to repeat certain cost codes to make a clear distinction between costs,

- i.e. fabric repairs and maintenance/security/cleaning and environmental costs might include duplicate codes for estate and car park charges.
- Suspended access equipment includes all forms of high-level access equipment maintenance, i.e. hatchways, eye-bolt, fall arrest and cradles.

Appendix E2: Example landlord's surveyor's service charge certificate

SERVICE CHARGE CERTIFICATE

Expenditure summary report for the period [date from] to [date to]
[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 & environmental	£10,000	£10,000		
Subtotal	£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)				
8 Water	£7,000		£3,500	£3,500
Subtotal	£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				
Subtotal	£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
Subtotal	£317,095	£69,600	£132,250	£115,245
INCOME				
16 Interest	–£1,068	–£332	–£373	–£363
17 Income from commercialisation				
Subtotal	–£1,068	–£332	–£373	–£363
INSURANCE				
18 Engineering insurance	£900		£500	£400
19 All risks insurance cover				
20 Terrorism insurance				
Subtotal	£900		£500	£400
EXCEPTIONAL EXPENDITURE				
21 Major works	£92,483		£92,483	
22 Forward funding	–£92,483		–£92,483	
Subtotal	£0		£0	
GRAND TOTAL	£1,037,442	£308,703	£366,277	£362,462

I hereby certify that, according to the information available to me, the attached statement of the service charge expenditure records the true cost to the landlord of providing the services to the Property for the period [date from] to [date to], in accordance with the terms of the lease.

Signed: Date:

For and on behalf of:

As agents for:

Appendix E3: Example service charge detailed expenditure report

DETAILED EXPENDITURE REPORT

Detailed expenditure report for the period [date from] to [date to]
[Property address]:

	Expenditure 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		
Office costs (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
Electricity procurement/ 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
	<u>HARD SERVICES</u>				
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
	Inspections and consultancy				
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
	<u>INCOME</u>				
16	Interest				
	Interest	−£1,068	−£332	−£373	−£363
17	Income from commercialisation				
	Subtotal	−£1,068	−£332	−£373	−£363
	<u>INSURANCE</u>				
18	Engineering insurance				
	Engineering insurance	£900		£500	£400
19	All risks insurance cover				
20	Terrorism insurance				
	Subtotal	£900		£500	£400
	<u>EXCEPTIONAL EXPENDITURE</u>				
21	Major works				
	Plant replacement	£92,483		£92,483	
22	Forward funding				
	Sinking funds	−£92,483		−£92,483	
	Subtotal	£0		£0	
	GRAND TOTAL	£1,037,442	£308,703	£366,277	£362,462

Appendix E4: Example service charge variance report

EXPENDITURE VARIANCE REPORT

Expenditure summary report for the period [date from] to [date to]
 Service charge variance report for the period [date from] to [date to]
 [Property address]:

		Variance %				
		Previous year's 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	-£92,483	2.76%	-469.93%
	Subtotal	£25,000	£0	£0		-100.00%
	GRAND TOTAL	£971,284	£1,034,200	£1,037,442	0.31%	6.81%

Acknowledgements

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Service Charges in Commercial Property

RICS Code of Practice

This Code of Practice, based on the second edition of *Service Charges in Commercial Property: A Guide to Good Practice*, has been written in the light of UK government concerns about disputes over service charges and their alleged lack of transparency. Also, since the second edition of the Guide was published in 2000, expectations of services have increased, and owners and occupiers are favouring a more consensual approach rather than the adversarial positioning that was formerly the case.

In addition to setting out best practice for commercial service charges, the objectives of this new Code of Practice are to:

- remove service charges as an area of conflict
- deliver a budgetable and forecastable part of occupiers' overheads
- ensure service charges that are 'not for profit, not for loss' and that are cash neutral to the owner's income stream
- encourage transparency and communication in the relationship between landlords and tenants.

The new code recognises the lease as paramount and advises owners, occupiers and professional advisors 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. As the trend is towards increasingly short leases, it is hoped that it will not take long for service charges to become compliant with the code's best practice guidelines.



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