



A good opportunity

RICS service charge code came into force on 1 April. In the first of three articles, *Chris Edwards* provides a positive overview of its aims

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The budgetary requirements of the *RICS Code of Practice: Service Charges in Commercial Property* came into effect on 1 April. The code addresses communication, transparency and timing and sets out best practice in the management of the charges. It will bring a consistency of approach and thus enable better measurement of service and performance in all sectors.

In *Princes House Ltd v Distinctive Clubs Ltd* unreported 25 September 2006, Jonathan Gaunt QC, in a coda to his judgment, said: "Tenants who agree to service charge clauses under which they contract to pay against a surveyor's estimate or an accountant's certificate rely upon the professional people... performing their roles with professional scrupulousness... such reliance can be misplaced."

The code targets all managers of commercial property, together with owners, occupiers and any business occupying a commercial property that carries a service charge. When drafting leases, account must be taken of the new code and its provisions. Code compliance and code-compliant documents are essential and genuinely add value; older, less comprehensive documents will reduce both value and lettability.

Code's objectives

The code has four key objectives:

- Reduction of conflict: Working as partners will deliver effective business solutions for both owner and occupier.
- "Not for profit, not for loss": Managers and contractors that provide services are entitled to a reasonable profit on the services that they provide, but the service charge is neither a profit- nor a loss-making business. It is the means of recovering the costs of operating a property.
- A budgeted/forecastable part of the occupier's overhead: Lessors must recognise that they are spending another party's overhead.
- Cash-neutral to the owner's income stream: Properly drafted documents will, save for individual concessions granted by the landlord, make the service charge 100% recoverable from the occupiers. However, owners should be recompensed for funding a service charge "in the last resort" in the form of a return on the funding supplied.

By improving communication and transparency, managers will improve owners' and occupiers' performance and their own business by spending less time on lengthy and expensive disputes.

In terms of service standards and provision the code suggests that "the aim is to achieve value for money and effective service rather than lowest price".

What is new?

The code provides for alternative dispute resolution (ADR). One advantage of this is privacy. Also, the determination of disputes will be quicker and more cost-effective. Moreover, under the Civil Procedure Rules, it is necessary to tell the court why court action has been chosen over ADR. The judge may award punitive costs if he feels that the court's time has been wasted.

Service charges also lend themselves to "evaluation" or "mediation". Here, an experienced service charge surveyor will facilitate negotiation to achieve an agreed settlement. One major difference between service charge and rent review disputes is the effect of the determination upon others. If an apportionment amount is varied for

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one tenant, others will be affected, whereas the determination of a rent on a unit does not (directly) affect others. Mediation can include more than one occupier or even a group of tenants, thus enabling agreement to be reached by all parties together.

Finally, there is arbitration (permitted in some leases). An arbitrator is limited to the evidence before him and cannot apply his expertise and experience beyond that evidence. Arguably, a determination by an independent service charge expert will be more effective.

Following the first letting of a new property, the expiry dates of the initial occupational leases may fall on the same date. As time goes by, though, it will become more difficult to re-lease the property on new documents in a "model" form that reflects modern business practice. The need to modernise the service charge during the term of a tenant's lease will sometimes arise. One way of doing this is by the use of interim schedules, which allows for a change of service charge operation at a date

in the future, while allowing, through the original schedule, for the service charge to be operated in its previous form. Once sufficient leases have been modernised, the new "model" can be implemented.

Leases must facilitate changes to the apportionment methodology when changed circumstances so require.

The code sets down clear timescales: tenants must receive budgets at least one month prior to commencement of the service charge year and accounts are to be completed and produced to the occupiers within four months of the year end. The growth in investment transactions has led to the industry being overrun in terms of handing over service charges following sales. The code requires accounts to be balanced, reconciled and handed over within four months of completion of a sale or on a change of manager.

Managers' fees should no longer be a percentage of the spend, but be converted into a cash sum as part of the budget. So, an overspend resulting from bad management will not increase the fee. If additional work is due in any one year, the fee can be negotiated to reflect it. The code requires the fee to "have due regard to the work necessary to fulfil the principles of the code". This is not to drive down fees, but to ensure that effective service and value for money results in proper remuneration.

Some budgets, as of Christmas quarter day, were issued in accordance with the new industry standard cost classifications. This will provide clearer benchmarking throughout the industry and will benefit owners and occupiers alike (see p96).

A chance to improve

The steering group is working on a series of papers to provide improved information and advice. Among other things, it is looking at sinking and reserve funds, the Landlord and Tenant Act 1954, commercialisation and traditional property management contracts as opposed to SLAs. The industry has the opportunity to improve management standards and cost-effectiveness. Government intervention would make it more difficult to do this and should be avoided if at all possible.

The code is available at www.servicechargecode.co.uk

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