

RICS code of practice: commercial service charges

We are pleased the RICS has taken action to address the issue of service charges in commercial property. We have been calling for a review of industry practices and greater regulation since the publication in February 2005 of Loughborough University Business School's five year study into service charges.

The Code goes a long way to setting up the right framework for implementing a transparent set of performance standards for the industry, with the ultimate aim of securing best practice and value for money for all occupiers.

However, whilst a welcome first step in setting out where the industry should be, there is no measurable view of where the industry is today. For example, the extent of compliance would be helpful to understanding the scale of action which might be required in order to ensure adoption of these recommended standards and practices. This is an important issue. There is widespread anecdotal evidence of poor practice in a number of areas supported by measurable evidence from the September 2005 Loughborough Update in the poor provision of financial data.

We also note that the status of the Code is intended as a guidance note for RICS members, and that it is intended that its principles are to be introduced for new leases and lease renewals commencing April 2007. This is also of concern since there is no guidance given in relation to existing leases.

With these issues in mind, we have extended our sponsorship of the annual work on the service charge sector by Loughborough University Business School. This work will measure the compliance of specific code items within our database with the RICS Code's recommendations covering, specifically, financial controls, transparency, value for money and management. Loughborough plans to publish the results of this new study in the autumn, 2006.

Previous research by Loughborough has called for greater regulation of the industry, now estimated to be worth in excess of £3.6bn annually. The RICS Code of Practice is in our view an essential first step towards achieving this.

It is important to understand the extent of current industry non-compliance to this Code and how, in turn, the RICS will support the sector in self-regulation. Whether through training, incentives or educational initiatives, the appropriate programmes should be determined from a clear analytical assessment in order that we see maximum benefit.

There are several other points we feel are important to comment on at this time that have implications for the industry, notably:

Management

The Code outlines how service charges should be managed but does not go far enough in detailing how its recommendations will be put into practice or enforced. Without fair and visible enforcement the updated Code would be groundless.

The abolition of management fee charging as a percentage of the overall service charge costs is recommended in order to promote best practice in applying these charges. Whilst the motive is commendable it does not provide sufficient detail on how fixed fees will be calculated. Nor does it comment on the impact that this change will have on smaller buildings. It is imperative that this issue is debated and a transparent scale is adopted to ensure managing agents are fairly and properly remunerated.

Refurbishment

This can be a most significant area influencing the variability in annual service charge costs. It is also often an area where conflicts of interest arise, with the potential for the landlord to improve the building at the tenants' expense. We support the provision of clear guidelines including advance communications of refurbishment projects supported by clear interpretation of expenditures in accordance with lease terms.

Clear budgets should be made available to all parties to ensure complete transparency. Practical measures should be developed to facilitate the resolution of disputes in advance of the commencement of works and to encourage open discussions in relation to any planned major expenditures.

Financial controls

The success of the Code very much depends on bringing about change that can benefit businesses in allowing them to budget accurately with the right information. The timeliness of certificates and budgets has been one of the core criticisms levied at the service charge sector and strict regulations should be in place to ensure compliance.

Transparency

The complexity in the administration of service charges means that tenants are not always party to essential information. The Code needs to be strengthened by the formulation of clear policies to ensure its proposed measures on apportionment, costs incurred and service contracts are effectively adopted.

Value for money

'Value for money' is recommended by the Code but this requires direction on acceptable cost levels, performance monitoring and benchmarks on the charges tenants are actually paying.

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