

COMMERCIAL PROPERTY SERVICE CHARGE SEMINAR

Change we can all believe in

THE EFFECT OF THE ECONOMIC SITUATION ON THE COMMERCIAL PROPERTY SECTOR

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**London
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Sponsored by  **PROPERTY
SOLUTIONS**
managing service charges



Agenda

- Project Background & Objectives
- Primary Research (Interviews)
- Impact of Crisis
- Changes in Past 12 Months
- Key Service Charge Issues & Options
- Conclusion & Recommendations



Project Background & Objectives

- 2007 – 2008: Options for Change study carried out by 2 other LBS MBA Students
 - Key Message: Enforce the Code
- 2008 – 2009: The industry faces twin shocks of the credit crunch and economic downturn
- Current research commissioned by Property Solutions to:
 - Evaluate the crisis impact
 - Highlight changes that have occurred since the last study
 - Review service charge issues and identify options to reduce conflict of interest



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Interviews

RICS	3
Tenants	7
Managing Agents	11
Owners	7
Other*	5
Totals	33

*consultants, media, lawyers, IPD

In-depth interviews lasting 1-2 hrs

All stakeholders fairly represented

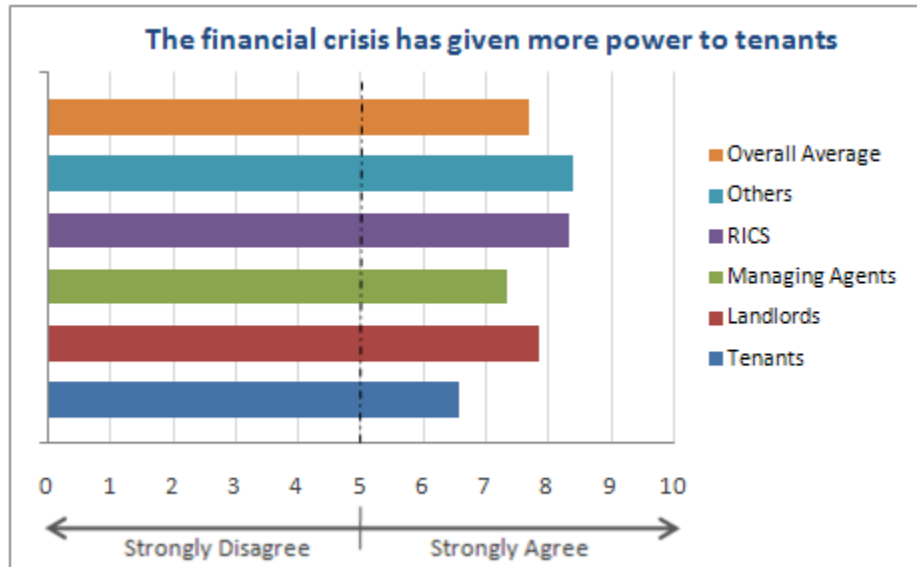


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Impact of Crisis

1. Balance of power has shifted from landlords to tenants



All stakeholders in agreement

2. More Dialogue between landlords & tenants (retail)
 - Landlords interested to ensure tenants don't go bust
 - Else, risk empty floors and pay empty rates

“Focus on service charges has been intensified... there is a lot more scrutiny on service charges now.”



Agenda

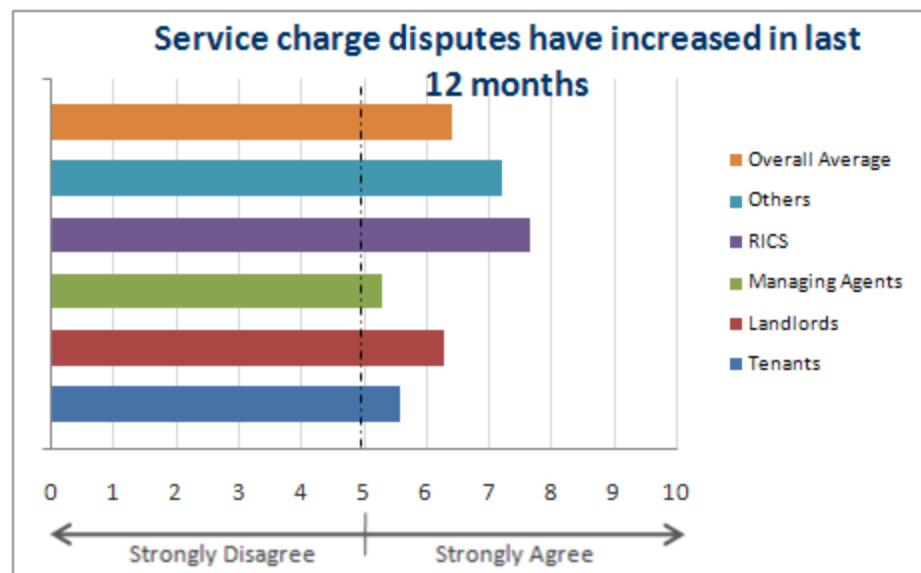
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Changes in Past 12 Months

1. Better Code awareness and signs of better adherence

- *“There appears to be more compliance – more cautious eyes”*
- *“There has been better communication and transparency due to the Code...”*

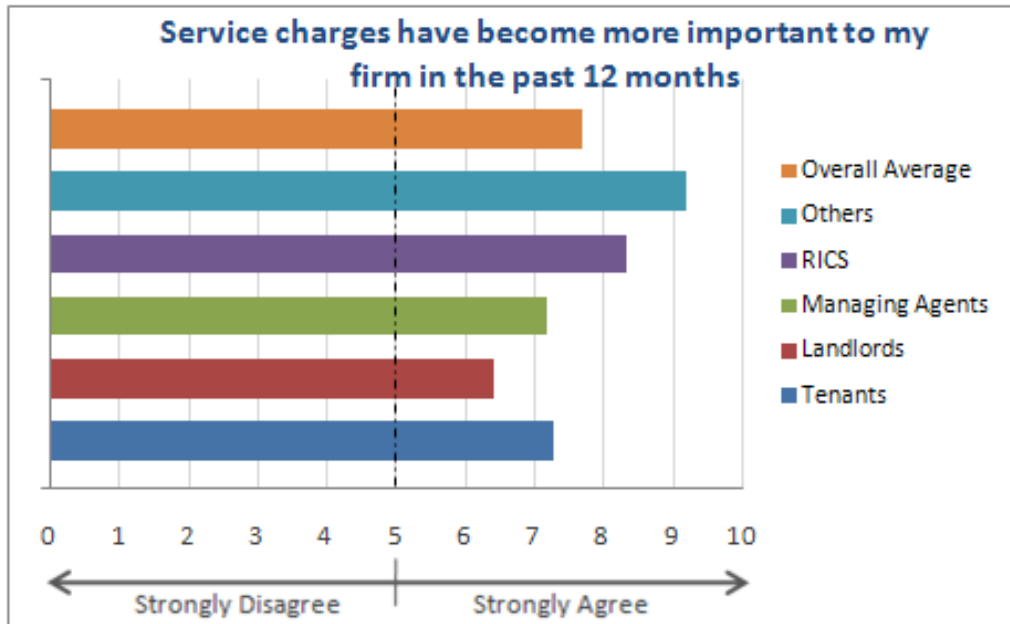
2. Increased tenant landlord disputes



Stake-holders agree that disputes have increased

Changes in Past 12 Months (Cont)

3. Service Charges have moved up the priority of occupiers



Stake-holders agree that service charges have become more important in recent months



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Key Service Charge Issues & Options

1. Leases don't state compliance with the Code & the Code has no teeth

"Many leases are old and are governed by old provisions when the market was more buoyant... There was less focus on service charge issues and more on getting the deal done."

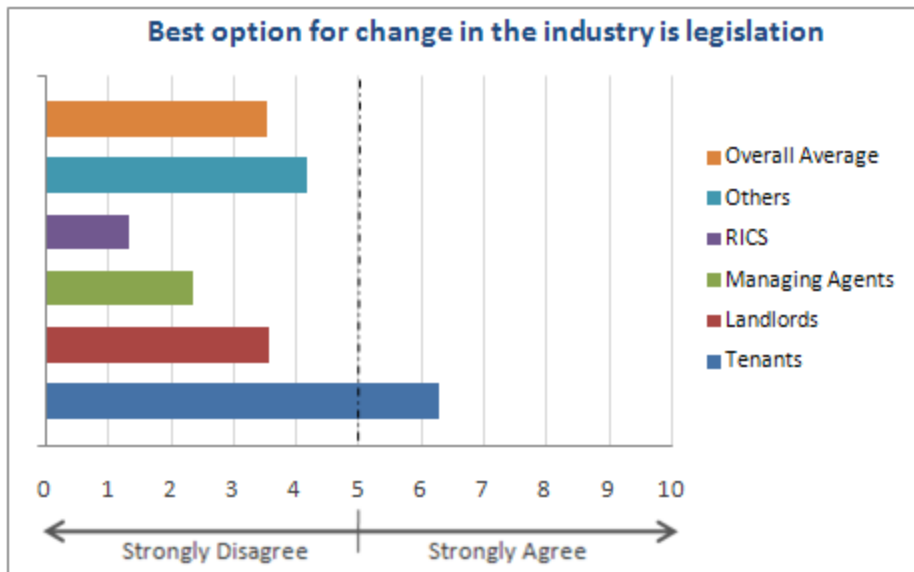
"The Code has no teeth at all... no occupiers sit in position of power in the RICS."

Proposal 1: High level legislation (i.e. key rules that override all leases) needed if Code not enforced

"I am wary of legislation but the government could take the lease Code and translate it to 10 recommendations and make it legislation... not nit picking detail"

Key Service Charge Issues & Options (Cont)

– However, strong feelings against legislation:



Stake-holders
generally
against
legislation

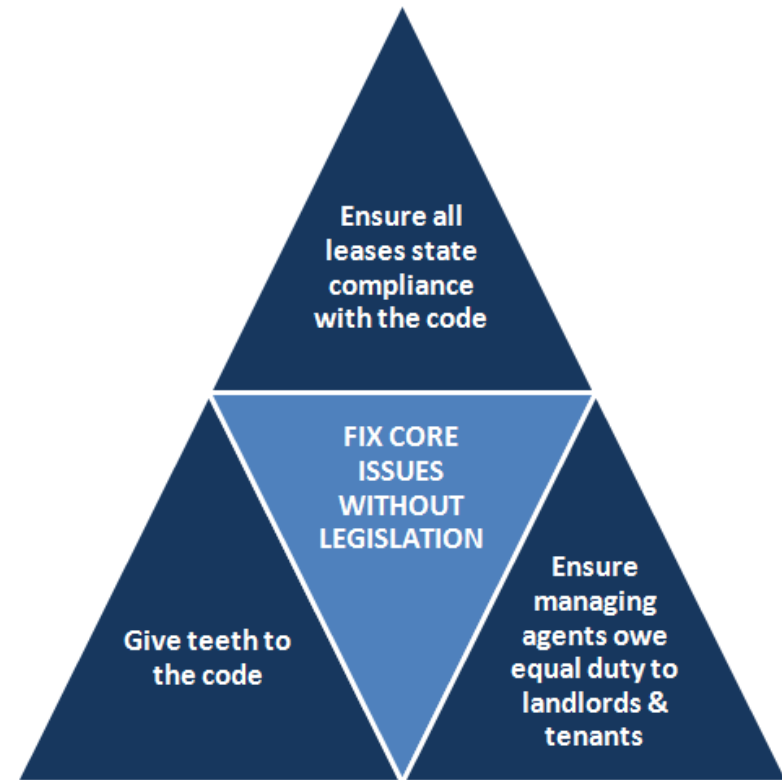
“It is like using a sledge hammer to crack a nut”

“The residential legislation is a dog’s breakfast”

Key Service Charge Issues & Options (Cont)

Proposal 2: A 3-pronged approach by the RICS

1. Give teeth to the Code: Promote from Guidance Note to Practice Statement
“RICS could play harder ball with members not following the Code.”
2. Enforce Compliance: RICS and Law Society agree that all commercial leases state compliance with the Code
3. Mandate dual duty: RICS mandates managing agents to owe equal duty of care to both landlords and tenants





Key Service Charge Issues & Options (Cont)

2. “Broken” nature of industry

“The industry is broken!”

- Tenants bear inappropriate burden of financial risk
- Tenants not in the property business, but take both risk of own industry and of commercial property
- Issue more important given shortening leases and confusion with sinking funds / depreciation charges

Proposal: Ask for an all-inclusive rent option (with SLAs)

“It would be good if tenants have a choice between all inclusive rent and the normal approach.”

“Key is that the price for the risk is not too high.”



Key Service Charge Issues & Options (Cont)

3. Landlord/Managing Agent issues

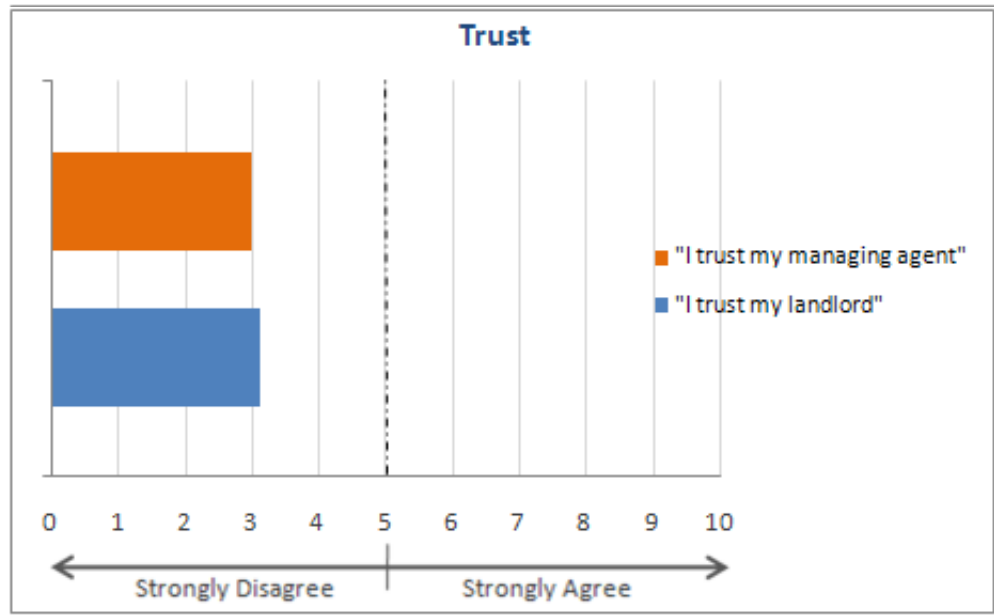
- Perception amongst many occupiers that:
 - Service charges don't provide value for money
 - There is insufficient transparency/communication
 - There is lack of trust towards landlords and managing agents
- Managing agents are not incentivised or measured to perform better

*“[Service charges are] very **poorly administered**. **Costs are higher than need to be** because no rigour is implemented in procurement of services...*

*“There **isn't enough clarity and communication**... It is a boiling point in landlord and tenant relationships.”*



Key Service Charge Issues & Options (Cont)



Do not trust your landlord or head of managing agent



Key Service Charge Issues & Options (Cont)

Proposal: Improved processes & performance

a. More/better communication with tenants

“Just asking ‘would you be happy with that’ would go a long way.”

“Visible scheduling of costs and work would be highly beneficial. It would work to everyone’s advantage.”

b. Understand consequence of shorter leases and advantages of providing better value for money and flexibility

Better tenant retention → Lower costs → Higher profits

“High service charges make a building less attractive to tenants – therefore it is in the interest of the landlord to keep these down”

“It is much cheaper to retain a tenant than to go out and find a new one”



Key Service Charge Issues & Options (Cont)

Proposal: Improved processes & performance (Cont)

- c. Use better processes and systems to ensure timely reconciliation of costs

“Reconciliation is not always timely but there is every incentive for a landlord to do it on time: 1) to keep tenants happy, 2) to avoid disputes a long way down the line, 3) it is not good to have service charges outstanding when selling a building...”

- d. Incentive system for managing agents to reward good performance and penalise bad performance

- e. Landlords and managing agents work together/harder to drive costs down (e.g. Making a distinction between life expectancy and condition)

“Boilers don’t suddenly stop working in 15 years – sometimes they last for 25”



Key Service Charge Issues & Options (Cont)

4. Tenant issues

- Many tenants not sufficiently knowledgeable in service charges and don't seek professional advice early enough
- No leadership among office tenants to give them a common voice
- Service charges not a priority for tenants in good times

“Tenants are up to sign for things so why should landlords change?”

Proposal: Leadership & education

- A tenant organisation to fight for tenant rights
- Treat service charges seriously – Read the RICS Occupiers Guide



Key Service Charge Issues & Options (Cont)

5. Benchmarking issues

- Current benchmarks (OSCAR & Loughborough) don't have sufficient coverage – largest one only covers 5% of the market
- Also not sufficiently granular to cater for services, size, location, etc.

“...there is a tendency in the market to overdramatize to attract attention... be over the top with the message”

Proposal: Improved benchmarking

- Better coverage, integrity, transparency and granularity
- RICS is ideal organisation to partner with one of existing benchmarks or set up new one

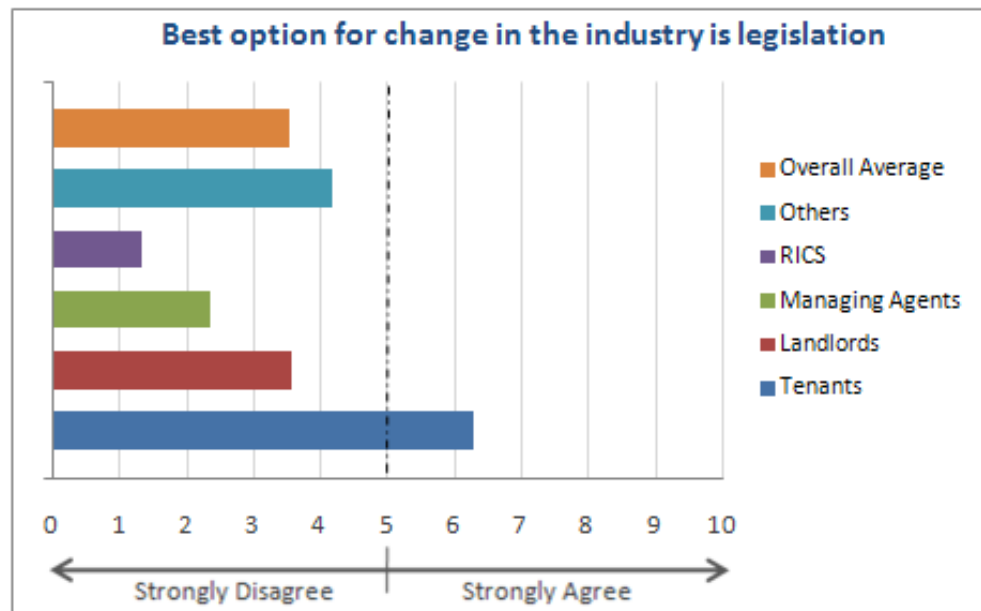


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- Changes needed in this industry or tenants may be right about legislation being the best option





Conclusion & Recommendations (Cont)

- In Summary:
 1. 3-Pronged approach by RICS
 2. An all-inclusive rent option
 3. Enhanced tenant knowledge and tenant organisation
 4. Enhanced communication & processes by landlords & managing agents
 5. Enhanced benchmarking
- RICS is the best organisation to drive key changes required in the industry:

“It is the role of RICS to ensure best practice... As RICS has many members this should ensure dissemination throughout the system”