British Property Federation

1. The BPF represents the commercial real estate sector – an industry with a market value of £1,662bn and which contributed more than £94bn to the economy in 2014. We promote the interests of those with a stake in the UK’s built environment to government, and our membership comprises a broad range of real estate owners, managers, developers and supporters. Their investments help drive the UK’s economic success; provide essential infrastructure and improve society by creating great places where people can live and work.

2. The UK’s commercial real estate sector contributes about 5.4% of GDP, and directly employs 1 million people, or 6.8% of the labour force. It provides the nation’s built environment and is diversifying from its core investment in the nation’s offices, shops, leisure facilities and factories, to support the new economy through investments in logistics, healthcare, student accommodation, infrastructure and residential housing.

3. This is a response to the RICS Professional Standards and Guidance document on the Commercial Service Charge Code. We welcome this review by RICS and remain fully supportive of a code that promotes greater transparency.

4. We would be delighted to provide further information on any aspect of this paper. Please contact Raja Hanna, rhanna@bpf.org.uk, 020 7802 0121.

5. We welcome the fact that key aspects of commercial service charge code have been given a mandatory status, something which is made clear from the outset and which should serve to provide greater depth and clarity in comparison to its earlier edition.

6. The proposals set out in the core principles are encouraging. We are supportive of principles particularly concerning owners being unable to extract more than 100% of the supply of the services, owners needing to provide clear documentary evidence for payments and the implementation of organised annual service charge appointments between landlords and occupiers. Furthermore, we are also encouraged by the constant references to greater transparency, greater communication and coordination between landlords, occupiers and managers and fair allocation of costs. These will provide greater coordination to service charges and greater consistency in the way that service charges are managed throughout the industry.

7. We are particularly encouraged by the code’s effort to recognise duty of care and imply this for both landlords and occupiers in how service charges operate and how organisational policy is managed. The consideration to apply a ‘value for money’ service is welcome, helping to make customer service a key output from the code.

8. Finally, the proposals which explicitly state that no additional unwarranted costs shall be included in service charges are welcome. We believe that inducting a transparent pricing system is an organic way of improving quality of service throughout the industry and will inspire greater trust between landlords, occupiers and property managers.

9. Whilst we support the changes that have been made to the 4th Edition, we consider that the document is still too long and could be clearer. We would recommend an “at a glance” table of key differences at the
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start of the new code, highlighting the key differences against the old code. The code would benefit from a glossary to be set out at the start to ensure clarity on defined terms such as ‘value for money’, what implies ‘failure’ in the contexts that it is used and what form of communication is constituted as ‘consultation’. The code should highlight the core principles at the start, rather than separating them and stating which principles are applicable for each section. Having the core principles located at the start will ensure that the reader is able to refer to them quickly and easily when required. The document’s structure is also at times questionable. There are references to reasonable and proper cost in the section on allocation and apportionment, however that would be more appropriate if located in the section on service costs.

10. There are references to an “owner” being “his or her”, generally they will be a corporate or a company, therefore the references to his or her should be replaced with “their” or “they”. This also needs to be gender neutral.

11. Core principles which are noted at the start need to be relevant throughout otherwise it is not really a ‘core’ principle. Advertising and marketing materials are mentioned amongst the core principles, however then are only covered in a general capacity in section one and two.

12. Issues with the code’s practice include:

   12.1. Whilst the Professional Statement is mandatory for owners and managers, there seems less of a duty for a tenant or their advisers to comply with the Professional Statement. If a tenant/occupier does not comply with the code, what are the sanctions?

   12.2. Despite the document making some of the code mandatory, there is a lesser responsibility on an Occupier ‘who should ensure prompt payment’, rather than ‘must’. You cannot have a different set of standards applying to occupiers who may be RICS qualified.

   12.3. The code’s guidance states that all leases are to contain provisions for when disputes are resolved by Alternative Dispute Resolution (ADR). However, ADR is an alternative method to resolve disputes away from courts, therefore most leases are silent of them.

   12.4. There is frequent reference to ‘sinking funds’ throughout the code, however with leases becoming shorter, their practicability is questionable. Given that leases are likely to remain more flexible for the foreseeable future, a more cost effective and practical solution is required, such as the potential for amortisation of agreed planned maintenance costs.

   12.5. We would recommend that core principle 7 is amended to only become applicable in instances where there is a material underspend in the service charge budget against which on account payments have been received. It should be amended to be a guidance provision only. This avoids convoluted operations, in relation to the apportionment of potentially low levels of interest being earned back to the tenants, which would need to reflect the variety of payment terms (e.g. monthly / quarterly), impact of tenant arrears and offset of landlord funding when required for volatile expenditure patterns.

   12.6. There is a requirement to pay interest and credit this back to the service charge; however, this is not practical as many accounts, although designated client accounts, are non-interest, especially now with base rates being so low.

   12.7. Core principle 8 states that RICS members must advise their client that the sum held back should reflect the actual sum in dispute. However, most tenants are advised by service charge consultants who
are not RICS members, what authority does this document have over them? Are they still required to comply? What are the sanctions if they do not?

12.8. The code refers to excluding any initial costs (including leasing of equipment) on the initial construction, but there should be flexibility if a service charge, not originally envisaged, was added later. These include future major refurbishment costs over and above those relating to normal day to day and periodic maintenance, repair or replacement.

12.9. There has to be some flexibility in the ‘exclusions’ section, where if the owner/manager is called upon to address issues and complaints, from members of the public, tenants or the local authority, and the owner addresses these issues, they then should not then be potentially saddled with the full cost.

12.10. The proposal to keep client capital in a designated account is not practical as there are additional costs that landlords will incur when performing this procedure.

12.11. The section on ‘right to challenge & ADR’ should specify that the ‘right to challenge’ is only for subjects of genuine dispute and with full written details of the dispute which will enable an individual to respond to the issue. Otherwise the number of ‘challenges’ can become overwhelming and trivial.

12.12. With regards to managers needing to provide ‘facts and figures to vindicate a decision for improvement costs above the costs of normal maintenance, repair or replacement’ (1.2, point 24), there should be a note to highlight that this is in the context of an occupier ‘supporting’ the decision. This would provide further clarity for when this is applicable.

12.13. In section 2.4.2, there is a need to ensure that asset management and rent collection costs are excluded from the management fee.

12.14. Also in section 2.4.2, there is useful clarification: “Where a lease includes a cap on the amount of management fee chargeable it is the general intention that it refers to the fee the manager receives and not the total cost of management”. However, this should be widened for additional clarity, that it DOES NOT include the cost of employing staff, SMR costs, accountants audit fees and other professional fees.

12.15. In section 2.7.1, there is a requirement for owners to insure on fair and reasonable terms and achieve ‘value for money’, however there is no clarity for how this should be monitored?

12.16. While we recognise that the code highlights that ‘rateable values’ are no longer recommended as an appropriate method of calculating service charge apportionments, occupiers may still require more certainty if this method is proposed.

12.17. The code also suggests that apportionments resulting from alterations is a consideration in improving a tenants’ applications (3.9), which is confusing and needs clearing up. The code should note that practices around mezzanines are far from settled. We require clarity on a number of levels including whether weightings are applicable to mezzanines based on area and/or use, that adjustments should be carried out once per year at the time of the year end reconciliation and relate to current periods only with no back dating or opening of previous certified periods, confirmation that the overriding intention of the parties that all reasonable costs should be recoverable from occupiers i.e. all affected tenants should be required to accept the amended apportionment regardless of whether they are ‘winners or losers’ and whether garden centres should be included in service charge apportionments for similar reasons as they are also trading areas and, if so, should weightings be applied.
12.18. There is reference to an ‘industry accepted best practice in the field of service charges’ (5.2), however this is a presumptive. Renewal leases are hampered by restrictions on updates and it may be helpful for the code to state this in its professional statement, otherwise it will be challenging for the industry to get any updates to service charges.

12.19. Section 6 should give greater guidance on VAT treatment and the best practice to adopt in mixed use commercial and residential properties where VAT may be recoverable on the commercial element and not recoverable on the residential element.

12.20. Section 9.3.4 needs to allow for the fact that some owners will not forward fund any works where the leases provide 100% recovery, with no voids or caps. In such, circumstances if the manager has fully complied with their obligations to provide information to the occupier, then the occupier must be obliged to pay the costs.

12.21. Section 9.3.5 has a provision regarding payment plans to spread exceptional spend costs over more than one service charge year, however it is not appropriate to include this here as this will normally be a decision taken up by the owner or the client.

12.22. In 10.1 there is referencing to undertaking cost benefit analysis, however it is not clear what the context of this analysis is for. There must also be consideration in the analysis for medium-long-term ‘value for money’, as lease lengths can be considerably lengthier in commercial properties.

12.23. In 11.1 there is reference to the ‘recent emergence’ of green leases, even though they have now been available for some time.

12.24. There is a section allocated to the ‘Carbon Reduction Commitment (CRC) Energy Efficiency Scheme’ in 11.2, even though CRC is coming to an end after the 2018-19 credit trading year.

12.25. Chapter 12 states that rebranding is not a marketing cost and agreement on costs should be borne by both parties. However, given that landlords are already “recommended” to contribute 50% of marketing costs, it seems unwarranted that a very important element of the marketing budget is essentially up for debate again. At the very least a scheme refresh, and associated replacement signage, should be a listed marketing cost in situations whereby the landlord is contributing 50%.

12.26. In ‘Appendix A- Compliance checklist’, the checklist refers to a series of core principles, which are not the core principles set out elsewhere in the document, nor do they necessarily tie in with what the stated principles are. This point of this checklist needs to be made clearer in-order to avoid confusion. Also, compliant terms in leases are not necessarily advisable as this would bind landlords to all elements of the code, which would complicate matters when properties change hands.

13. There is references to the City of London Law Society and to Practical Law Company, but no reference to the Model Commercial Lease (MCL). The reason for this is unclear as MCL is seen by the industry as the primary guide to market practice.

Conclusion

14. We agree with most of the codes principles and support (other than point 7 in 12.5 as above) the equitable mandatory provisions but would caution against any further mandatory interventions in operations in future development of the Code. We are also very encouraged that the code seeks to increase
communication and transparency between landlords and occupiers. However, our major issue with the
code is that the document can lack clarity. Definitions to key terms should be articulated at the start of the
document and there should be greater consistency with regards to what these terms imply throughout the
document. Nevertheless, we are very encouraged by the core principles stipulated within the document and
the way that the document seems to provide more depth to commercial service charges. We ultimately feel
this code will add more professionalism to the industry and will ensure a better quality of service.

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