

Service Charges - the new RICS Service Charge Code

Cautious Welcome for Service Charge Provisions

New and existing tenants on serviced estates should be cautiously optimistic that lease provisions dealing with service charge costs may soon become more standardised and, arguably, fairer. The recent publication by RICS of its second edition of the Code of Practice for Service Charges in Commercial Property (the "Code") should be heralded by all tenant occupiers as a small step towards improving their position when it comes to negotiating, paying and particularly querying service charge costs arising under their lease.

Tenants taking up leases on estates or in multiple-occupier buildings will often find themselves subject to service charges. When negotiating the Heads of Terms of a new lease, the details of the service charge arrangements are often glossed over. Then when it comes to signing the actual new lease, tenants may find that they have little or no room to argue with a landlord as to the kinds of things which they are expected to contribute towards, how and when. Once a lease has been signed, a tenant on a serviced estate can sometimes find it extremely hard to object to the level of the service charge to which it must contribute, even where a lease might give it a right to query spending.

So the Code gives tenants an easy frame of reference to insert into the Heads of Terms early on in the negotiation process to try to narrow the landlord's bargaining position. Once a landlord has agreed to use a "Code compliant" lease, it will be more difficult for it to back away from that position when it comes to the detail of the drafting of the lease itself.

Service Charge Code - History

Whilst there is little doubt about the benefits that are afforded to both tenants and landlords by including the provision of services in any lease arrangements, there can also be pitfalls. Tenants sometimes feel that they don't have sufficient control over the levels and types of spending incurred as part of the service charge. The landlord's spending and recovery of costs can become an area of contention - sometimes to an extent which far outweighs the actual time and costs incurred by either side. The revised Code - which came into effect on 1 October this year - is intended to try to address this problem to some extent.

RICS introduced a Code of Practice for Service Charges back in 2006. Take-up of the recommendations and guidance in the first edition of the Code was patchy. Most in the industry would argue that the use of the Code was limited because few tenants knew of its existence and the benefits which it could offer, and therefore didn't insist upon it when negotiating initial terms with their potential new landlord. Many tenants are still unaware of the potential protection which the Code offers at the negotiating and drafting stages or through the term of the lease itself.

The second edition of the Code has been published by RICS both to update the contents of the original edition and also to generate additional publicity for the Code.

Contents of the Code

The detailed contents of the Code can be downloaded from http://www.rics.org/site/scripts/download_info.aspx?fileID=9649&categoryID=455.

Whether or not a lease formally acknowledges that the Code (first or second edition) applies to its contents, it is always worthwhile for a tenant to be aware of and to understand the underlying tenets of the Code. Where there is any doubt between the parties to a lease, there are a number of core principles which should provide landlords and tenants with useful guidance to assist drafting and interpreting any service charge provisions.

The Code broadly outlines that any service charge should represent value for money, be not-for-profit and transparent.

In order to fulfil those core principles, costs should be incurred competently and fairly in consultation with the tenant (who should have a right to challenge) and ultimately should be accurately certified and allocated between occupiers. Unless a lease formally acknowledges that the Code applies to it, both parties to it should however be wary of trying to apply the more specific details that the Code outlines as there is nothing in principle stopping a landlord from adopting any number of contradictory approaches to the service charge which it intends to recover.

The Code goes into more detail about what is and what is not a "reasonable" service charge cost which a landlord should be entitled to recover. Parties to any new lease (or having to interpret an existing lease) are encouraged by RICS to either include the Code provisions or acknowledge that the Code should be the basis of interpretation where necessary but there is no compulsion to do so.

Applying the Code to a New Lease

Where a new lease is being granted on an estate and there are existing leases in place and already functioning to the parties' satisfaction, it can be difficult for a tenant to persuade a landlord and/or its solicitor to change the drafting to include new or altered arrangements where these might be needed to accommodate the Code. Landlords are cautious about inserting any changes which may give rise to contradictions between the costs recoverable from existing tenants and new tenants and thus give rise to potential voids. The Code deals with this by suggesting that leases can contain "provisional" arrangements to allowing old and new provisions to dovetail into each other over time.

When renewing a lease further to the Landlord and Tenant Act 1954, reasonable updating is authorised but in the event that the renewal terms are contested, case law determines that any "substantive" changes to the terms of the lease will need to be justified. Although the point will probably only be finally determined by a Court, reference to the Code as an increasingly accepted tool might be sufficient to argue that justification.

Using the Code in Existing Leases

Where the service charge provisions in a lease specifically state that the Code applies to the lease, it should be interpreted in light of that fact. Applicability of the Code will not override specific lease clauses which may contradict the contents of the Code so it is important that any wording is checked for compatibility before costs are challenged on that basis.

Non-Code Negotiations

Tenants can use the Code as a starting point for negotiations in respect of the service charge. If a landlord refuses to acknowledge it or include it in the lease terms, there are still a few fundamental points which a tenant should try to get included in their service charge arrangements. Service charge caps are a good and simple way of effectively limiting exposure to unwanted or unwarranted costs. A "Code-feel" to the drafting of any clauses will also help and specific exclusions of certain costs may also be considered.

For additional guidance on best-practice as regards service charge provisions, parties can look to the City of London Law Society website at <http://www.citysolicitors.org.uk/Default.aspx?SID=923&IID=0> where two sets of example service charge provisions (one for an office building and one for a retail centre) can be downloaded.

It remains to be seen how effectively the Code will be incorporated into new leases or used to interpret existing ones. When negotiating the details of any new (or renewal) lease transaction or considering challenging the service charge costs which have been demanded, any tenant should consider first familiarising itself with the Code.

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This briefing note is intended merely to provide a summary of the law in this area and is not a comprehensive guide. It is not intended to provide legal advice for specific cases. The law and practice in this note is stated as at October 2011.