

RICS Practice Standards, UK

Commercial property service charge handover procedures

Information paper



RICS

the mark of
property
professionalism
worldwide

[rics.org/standards](https://www.rics.org/standards)



Commercial property service charge handover procedures

RICS information paper

1st edition

Acknowledgment

Cover image © iStockphoto.com/studiovision (image no. 3646611)

Published by the Royal Institution of Chartered Surveyors (RICS)

Surveyor Court

Westwood Business Park

Coventry CV4 8JE

UK

www.ricsbooks.com

No responsibility for loss or damage caused to any person acting or refraining from action as a result of the material included in this publication can be accepted by the authors or RICS.

Produced by the Commercial Property Professional Group of the Royal Institution of Chartered Surveyors.

ISBN 978 1 84219 667 0

© Royal Institution of Chartered Surveyors (RICS) March 2011. Copyright in all or part of this publication rests with RICS, and save by prior consent of RICS, no part or parts shall be reproduced by any means electronic, mechanical, photocopying or otherwise, now known or to be devised.

Typeset in Great Britain by Columns Design XML Ltd, Reading, Berks

Printed in Great Britain by Annodata Print Services, Dunstable, Beds

Contents

RICS guidance notes	1
1 Introduction	2
1.1 Scope of the information paper	2
2 Service charge accounts – handover procedures	3
2.1 Sale of property	3
Procedures	3
2.1.1 Property financial information	3
2.1.2 Tenant financial information	4
2.1.3 Financial transfer	4
2.1.4 Sinking and reserve funds	5
2.1.5 Depreciation charges	5
2.1.6 Security deposits	5
2.2 Change of manager	5
Introduction	5
Procedures	5
2.2.1 Property financial information	5
2.2.2 Tenant financial information	5
2.2.3 Financial transfer	5
2.2.4 Service charge accounts	6
2.2.5 Sinking and reserve funds	6
2.2.6 Depreciation charges	6
3 Supplier information	7
Appendices	8
A Glossary	8
B Example reconciliation statements	10

Acknowledgements

RICS would like to thank the following individuals for their contributions to this information paper:

Kevin Townsend, Director, Commercial Property Management (Savills Commercial Ltd)

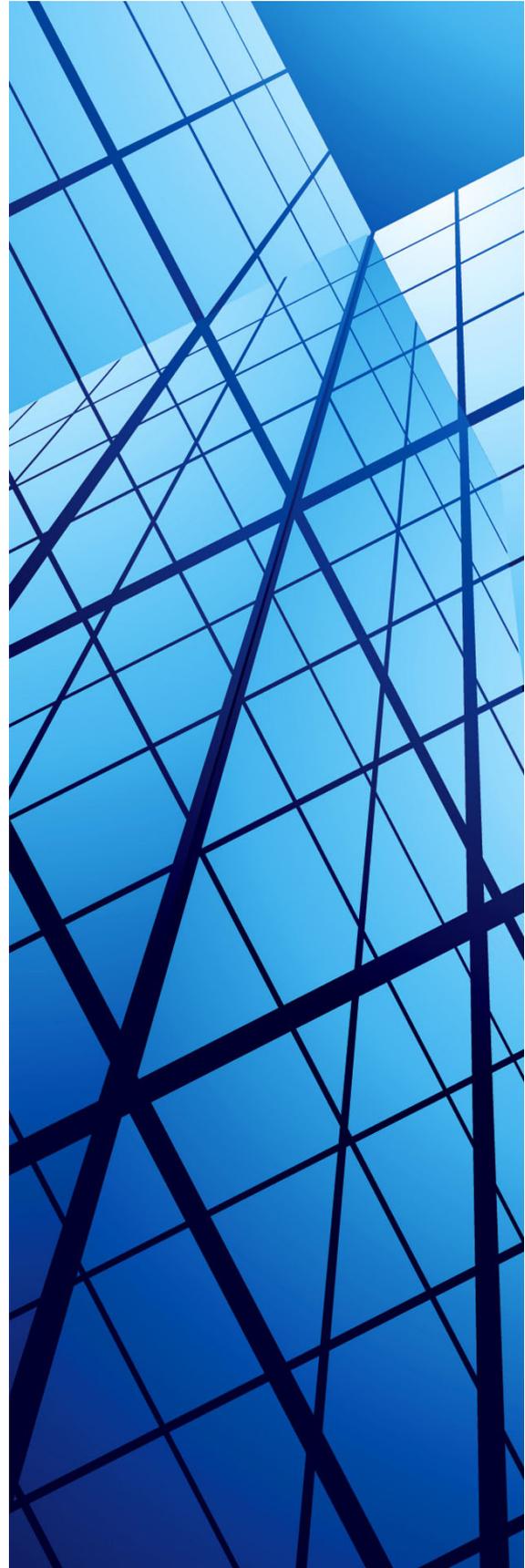
Peter Forrester, Director, Service Charge Consultancy (Savills Commercial Ltd)

RICS information papers

This is an information paper. Information papers are intended to provide information and explanation to members of the RICS on specific topics of relevance to the profession. The function of this paper is not to recommend or advise on professional procedure to be followed by surveyors.

It is, however, relevant to professional competence to the extent that a surveyor should be up to date and should have informed him or herself of information papers within a reasonable time of their promulgation.

Members should note that when an allegation of professional negligence is made against a surveyor, the court is likely to take account of any relevant information papers published by the RICS in deciding whether or not the surveyor has acted with reasonable competence.



1 Introduction

Unlike demands for the payment of the principal rent reserved under a lease, which are usually charged as a fixed quarterly amount, interim or on-account service charge demands are usually based either on a budget or historic costs and may not be a true reflection of a tenant's ultimate liability. A tenant's ultimate liability will usually be calculated based on their proportion of the actual costs incurred in a given year in the provision of services to the property. A balancing charge, or credit, will be issued to the tenant when the annual service charge reconciliation compares the tenant's ultimate liability with the on-account service charge demands in the relevant year.

As a result of this requirement for annual service charge reconciliations, it is recommended that those responsible for drafting sale or management contracts recognise service charges as an important area, and have regard to the general duty of care owed to occupiers, to ensure that the service charge continues to be managed and administered in accordance with industry best practice, through and beyond the date of sale or management transfer.

This information paper is aimed at property owners and managers and their legal advisers. Its intention is to set out a series of procedures during the handover period to improve the quality of service to the industry's customers.

Handovers are required for two main reasons; the sale of a property and a change of manager. The sale of a property may not always involve a change in manager, whilst some properties are managed directly by owners. This paper is intended to cover all situations.

At present, there are no published guidelines or information papers on transfer procedures. In more recent years, there has been a trend for commercial property to change ownership more frequently due to shorter leases and the pressure on property owners to extract increasing returns from their investments. When a property changes hands, delays in handing over information often lead to delays in the issuing of service charge statements and reconciliations. In extreme instances, this can result in service charge statements being held up for many years, with the resultant difficulties for owners in recovering all costs and expenses, and tenants having to carry forward potentially onerous contingent liabilities.

This paper aims to improve the current situation and to comply with the service charge Code, which requires service charge reconciliations to be completed within **four months** of the end of the service charge period.

1.1. Scope of the information paper

This paper covers commercial multi-let property where there is a service charge. It deals with the handover of financial and supplier information between owners and/or managers.

The requirements of a handover of service charge information would generally be specified within a sale contract, or (and more rarely), within a manager's contractual agreement. In practice, the timetable and requirements of such documents are not always adhered to so this document aims to assist the overall process and ultimately lead to an industry standard, the terms of which can then be incorporated into management and sale contract documentation.

2 Service charge accounts – handover procedures

2.1 Sale of a property

On the sale of a property, the onus will be on the seller (either themselves or via their manager), to provide to the buyer (or their manager), reconciled service charge accounts in a timely manner. Sale contracts and the associated completion statements usually exclude specific details as to the quantification of service charge monies but there is often a written statement setting out the requirement to reconcile and hand over service charge funds within a certain period. Often these contract clauses lack detail.

Commercial service charges generally fall into two categories:

- (i) those where the landlord recovers costs periodically, say quarterly, based on actual expenditure incurred; and
- (ii) those where the landlord collects on-account sums in advance, usually quarterly, and reconciles the service charge at the end of the service charge year, comparing actual expenditure against the on-account payments demanded and then producing certificates detailing the resultant credit or debit due on the account.

The service charge code of practice states that the annual service charge reconciliation should be achieved within four months of the year end.

The sale of a property can occur at any point during the service charge year.

Most leases specify the service charge year end. It is recommended best practice that, even where leases permit a change to the service charge year end, this should only be altered in exceptional circumstances and not simply as a result of a sale or change of manager.

It will therefore continue to be the responsibility of the appropriate person, in accordance with the lease, to certify and reconcile the service charge at the appropriate date.

In order to enable the new owner/manager to properly account to tenants for the service charge income and expenditure, it is essential that the seller, or their manager, provides full information within a relatively short timeframe of the sale.

For the avoidance of doubt, it is recommended that the onus should be on the seller, or the manager, to fully reconcile any outstanding service charge accounts for prior years. These reconciliations will also be completed as early as possible but in any event no later than within four months of the sale or handover date. It is anticipated that the new owner or agent will be responsible for issuing the historic balancing charges/credits and certificates to the existing and previous tenants promptly on receipt from the seller or their manager.

Where possible, buyers will ensure that sale contracts contain reasonable enforcement action in the event of information certification and/or service charge funds not being provided within the time frames set, e.g. liquidated damages.

Procedures

2.1.1 Property financial information

The following information would usually be requested under standard enquiries before contract. If not, it is suggested that such information is passed to the buyer (or their agent) prior to completion, or within **seven days** of the completion date:

- service charge accounting period
- service charge apportionment basis
- details of void areas, landlord's liability and landlord's funding
- details of any tenant direct charges
- current service charge budget
- copies of the last three years' reconciled service charge accounts

- details of commercialisation income and interaction with the service charge accounts
- details of any sinking funds, reserve funds or depreciation charges, including current valuation statements, assets, contribution, schedules and expiry dates of funds; and
- a statement of funds currently held in the service charge account along with a list of creditors.

2.1.2 Tenant financial information

The following will also be provided to the buyer within **seven days** of the completion date:

- demand addresses, agency arrangements, trading names and contact details
- tenancy details, including occupancy and vacancy dates, and an up-to-date tenancy schedule
- details of all tenant arrears including disputes, payment plans and breaches
- details and copies of the last tenant on-account demands both for service charges and direct charges
- for direct charges involving utilities, the basis of collection and up-to-date meter readings should be provided; and
- an interest summary showing credits to the service charge account.

2.1.3 Financial transfer

This is the physical movement of funds between the buyer and seller in the sale process. Upon completion, the service charge bank account will contain funds of zero or above. The value of these funds will depend on the level of service charge tenant arrears and the amount owed to suppliers for services rendered. It is therefore conceivable that the value of funds available to transfer is minimal.

Prior to completion, the seller shall provide a full statement of tenant service charge arrears. Within **seven days** of completion, the seller shall provide an updated statement of arrears as at the completion date and the buyer will then be responsible for collecting any on-account payments or balancing charges from the tenants covering the current open service charge year. Unless specifically agreed in the sale document, the seller

shall continue to be responsible for arrears for previous service charge years. If the buyer is unhappy with the level or extent of historic arrears, this will be dealt with in the sale price and completion statement.

The seller shall ensure, so far as is practicable, that all supplier invoices and credit notes are issued and paid from the service charge account prior to completion. The seller may, however, continue to pass supplier invoices to the buyer, for payment from the service charge account for works carried out prior to completion, post completion.

The buyer may be required to fund the service charge account for an interim period, i.e. between the completion date and until the service charge account is credited following the transfer of funds from the previous owner/manager, or payment of tenant on-account sums.

As previously stated, the former owner or their manager will reconcile previous service charge years within a prescribed period. It is recommended that part year service charge reconciliations are also produced in a timely manner.

Within **four months** of the completion date the seller (or their agent) will provide a service charge statement from the start of the current accounting period up to the completion date. The information required is as follows:

- statement of service charge on-account income, with copy demands
- statement of expenditure with copies of vouchers/invoices
- analysis of seller landlord's liabilities and tenant direct charges, marketing and commercialisation accounts
- service charge cash reconciliation (calculated as detailed in Appendix A)
- up to date arrears statement (if changed from the statement issued seven days after completion), together with explanatory notes on disputes; and
- explanatory notes on major variations from the original budget.

Where the closing balance on the service charge cash reconciliation is a positive sum, the seller shall transfer an interim float within seven days of

completion, with the balance being transferred within seven days of the issue of the service charge cash reconciliation

Where the closing balance on the service charge cash reconciliation at the date of transfer is negative (this will occur when the expenditure exceeds the income), the buyer will reimburse such negative balance to the seller within seven days of the issue of the reconciliation.

The new buyer or their manager will then be responsible for completing the full year service charge reconciliation. This will include getting the accounts independently audited and certified, where required, in accordance with the latest available code of practice.

The buyer will then issue the statement of expenditure and any balancing service charges to the tenants at the end of the service charge year in the usual way.

2.1.4 Sinking and reserve funds

In all instances where the seller operates sinking or reserve funds, information will normally be provided in preliminary enquiries before contract.

Consequently, the following information should be provided **before the completion date** but in any event no later than **seven days** after completion:

- details of all funds and assets covered
- details of the term of the fund, expiry date and life expectancy of the assets
- full statement showing fund values broken down between each asset and details of landlord and tenant contributions, tax and interest
- a statement of expenditure from each fund, if applicable; and
- details of tax liability and any trust status.

2.1.5 Depreciation charges

Where applicable, details of depreciation charges will be provided to the buyer with the following information **before the completion date** but in any event no later than **seven days** after completion:

- details of all assets covered by the charges
- details of the period of cover including start date and cost of asset; and

- final book value of each asset, and details of the charges recovered from each service charge year, from each tenant up to the completion date.

2.1.6 Security deposits

There has been a growing trend over recent years for utility companies to request a security deposit from owners as a condition of the supply agreement. Where a security deposit has been paid, this will be disclosed to the buyer and, where a supply contract is not to be novated, reimbursement will be obtained by the seller and included as part of the financial transfer procedure as set out in 2.1.3 above.

2.2 Change of manager

Introduction

A change of manager will often occur as a result of a sale of property, in which case, the procedures previously outlined should be adopted. Where a change in manager occurs for any other reason, the following procedures apply.

Procedures

2.2.1 Property financial information

The same information listed in 2.1.1, together with VAT election paperwork where applicable, will be provided to the new manager before the date of handover. It is recommended that such information is provided no later than **three weeks** before the official date of handover, i.e. the date the new manager has responsibility for the management of the property.

2.2.2 Tenant financial information

Again, the same information listed in 2.1.2 will be provided no later than **three weeks** before the handover.

2.2.3 Financial transfer

On the management handover date, the previous agent shall provide a full service charge arrears list, together with tenant history reports and details of disputes, payment plans and bad debts. It is

recommended that an interim float be provided within seven days of the management handover date. A final service charge cash reconciliation (calculated as detailed in Appendix B), together with a transfer of funds equating to the cash balance analysed in the service charge cash reconciliation, will be provided within two months of the management handover date.

2.2.4 Service charge accounts

A change of manager is likely to be known in good time, unlike completion of sales which can take place at short notice. Consequently, there is a rationale for the transfer timetable to be quicker for a change in manager. However, it is recommended that the same timetable is adopted as in a sale in 2.1.3.

2.2.5 Sinking and reserve funds

The same procedures apply as in 2.1.4, but all statements and transfers will be made to the new manager no later than **the date of the handover**.

2.2.6 Depreciation charges

The same procedures apply as in 2.1.5, but all statements will be issued to the new manager no later than **the date of the handover**.

3 Supplier information

A lack of communication between buyer and seller, and new and previous manager concerning suppliers, can lead to a failure to terminate or novate supplier contracts and result in unauthorised work being carried out and incorrect invoices being issued.

At the contract stage, a buyer would normally ask for details of the supplier contracts and, in particular, the novation or termination provisions. The buyer can then decide whether to request novation or termination of individual contracts.

Where a contract is to be terminated, supplier invoices might continue to be payable after the completion date or handover date, due to there being a notice period to serve. Consequently, it is important to deal with supplier contracts in a timely manner during the sale process or manager change.

All supplier contracts will be either novated within one month of the completion/handover date, or terminated to end no later than one month after the completion date or handover date. Any contract that is incapable of novation or which requires a notice period of longer than one month will be disclosed to the buyer prior to completion. The buyer will then decide, upon completion, whether to terminate or seek to novate the contract himself.

If any supplier contract is not disclosed, the seller or previous manager will be responsible for any costs following completion of the sale.

Upon completion, no further instructions or works will be ordered by the previous manager. Where there is a change of manager, and the client remains the same, supplier contracts would normally transfer to the new manager, as the supplier contract would normally be in the client's name.

It is accepted that there are certain global supplier contracts with managers that cover multiple clients. In this case, the termination procedures outlined above will apply when transferring between managers.

Appendix A

Glossary

Accrual accounting	This is considered to be the standard accounting practice for most service charges, with the exception of very small operations. This requires that costs are recognised in the accounts when incurred, not when the invoice is actually paid. This is different to cash accounting, which accounts for transactions only when there is an exchange of cash.
Accruals	These are expenses incurred in a period for which no invoice has been received at the period end. As the cost relates to the period, it must be charged to the service charge account for that period.
Arrears statement	A transaction list of all unpaid charges demanded by the landlord from the tenants, collated on a tenant by tenant basis.
Balancing service charge	The resulting difference between an individual tenant's apportionment of expenditure and the on-account service charges demanded from that tenant for any specific service charge accounting period, also having regard to any service charge concessions that may have been granted.
Buyer	The buyer is the new/prospective owner of the property.
The Code	The RICS Code of Practice on Service Charges in Commercial Property.
Commercial property	All property which is not residential or agricultural, including retail, office, industrial and leisure properties.
Completion date	The date of the sale of a property.
Depreciation charge	The 'cost' to the owner representing the measure of the wearing out, consumption or other reduction in the life of an asset.
Direct charges	Any expenditure that is charged directly to individual occupiers and not funded via the on-account service charges.
Landlord	The current beneficiary of the leases granted to the tenants and the party responsible for the provision of common services within the subject property/portfolio. (NB. In this context, the landlord will be either the seller prior to the completion date or the buyer after the completion date.)
Management handover date	The date on which the responsibility to manage the property transfers from one property manager to another.
Manager	The person or team that budgets, forecasts, procures, manages and accounts for the services that comprise the service charge, whether they are the owner, an in-house team, a management company or a managing agent (including any wholly or partly owned related companies).
On-account service charge	An estimated charge raised in advance and in anticipation of the final service charge liability, calculated from the service charge budget.
Prepayments	These are expenses paid in a given period that relate to the following period in whole or part.
Rent deposit	A sum of money advanced by a tenant as security or collateral against a lease.

Reserve fund	A fund intended to equalise expenditure in respect of regularly recurring items to avoid fluctuations in the amount of service charge payable each year.
Sale contract	The contract setting out the terms on which the subject property is to be sold and transferred between the seller and buyer.
Seller	The seller is the previous/current owner of the property.
Service charge account	The service charge funds held for a specific property.
Service charge apportionment	The method and details of apportioning liability of the tenants for contributing to a service charge.
Service charge arrears	Any on-account service charge or balancing service charge owed by tenants to the seller.
Service charge budget	The expenditure estimated by the owner or their manager that will be incurred in a given service charge accounting period.
Service charge contribution summary	A list of the names and contact information for all contributors to the service charge (both former and current), and the contributions they have made, aligned to their periods of occupancy/liability.
Service charge reconciliation	A complete comparison of all service charge income demanded to service charge expenditure (including accruals and prepayments), for a given service charge accounting period that enables the calculation of any balancing charges and credits due from tenants and/or landlords.
Sinking fund	A fund intended to meet the cost of repair and replacement of major items of plant and equipment and fabric.
Statement of service charge expenditure	A transaction listing of items of expenditure paid from the service charge account for a service charge accounting period.
Statement of service charge income	A transaction listing of all income (on-account service charge/balancing service charge/direct charges/landlord's funding), paid to the service charge account for a service charge accounting period.
Tenants	The immediate tenants of the landlord holding leases granted in respect of lettable accommodation within the subject property.
Void liabilities	The share of the agreed service charge expenditure for any service charge accounting period that is attributable to vacant lettable accommodation.

Appendix B

Example reconciliation statements

1. On completion of sale

Income received from tenants for current open service charge year	£
Less: Expenditure accrued for current open service charge year	£
Add: Vendor's liability up to date of sale for the current open service charge year	£
Add: Accruals	£
Service charge cash handed over on sale	<u>£.....</u>

2. On handover

Income received from tenants for current open service charge year	£
Less: Expenditure paid for current open service charge year	£
Less: Historic service charge arrears	£
Service charge cash handed over on transfer	<u>£.....</u>

Commercial property service charge handover procedures

Information paper

This information paper is aimed at commercial property owners and managers and their accountants and legal advisers.

The paper aims to improve the current situation regarding service charge accounts handover procedures and to comply with the RICS Code of practice: *Service charges in commercial property*. It sets out a series of procedures during the handover period to improve the quality of service to the industry's customers.



RICS

the mark of
property
professionalism
worldwide

[rics.org/standards](https://www.rics.org/standards)