SCOR 2018

OFFICES

SERVICE CHARGE OPERATING REPORT

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INNOVATIVE. TRANSPARENT. COMPLIANT.

CONTENTS

1. INTRODUCTION

Welcome to the 2018 edition of the Service Charge Operating Report (SCOR) for Offices which is the 8th edition in the series. This introduction describes the current state of the industry and provides details of a continued research focus that will assist the debate over the future regulation and governance of service charge management and accounting. In terms of regulation, the RICS Code of Practice on Service Charges in Commercial Property was first issued in 2000. The 2014 Code acts as a guidance note, so compliance with its provisions is largely voluntary, and its requirements cannot override the terms of lease. The Code's provisions are supplemented by a Technical Release issued by the Institute of Chartered Accountants in England & Wales (ICAEW) that sets out a mandatory framework to be followed by professional accountants when carrying out a review and accounting sign-off of the service charge accounts.

While the RICS Code and ICAEW Technical Release both seek to improve practices within the commercial service industry, they each have their limitations. Compliance with the Code is voluntary, even for RICS members. Compliance with the ICAEW's guidance is only required where the landlord/managing agent engages the services of a professional accountant. Following industry consultation, in September 2018 the RICS published the 1st edition of its Professional Statement (PS) for commercial service charges, entitled Service Charges in Commercial Property. An RICS PS sets out the requirements of practice for RICS professionals and for firms that are regulated by RICS. Unlike the existing RICS Code, certain requirements of the new PS 'must' be complied with, and other sections 'should' be complied with unless an RICS professional can explain the decision to adopt an alternative course of action. The new RICS PS is effective for all service charge periods commencing from 1 April 2019, and the RICS should be congratulated in its latest attempt at developing and fostering best practice within the industry.

Despite its new-found status, the requirements of the new 2018 RICS PS remain subservient to lease provisions, since the lease provides the contractual grounds upon which a tenant occupies the space in a landlord's asset. However, in situations where the lease is silent on a particular issue regarding the service charges and their management, then the RICS PS will establish mandatory best practice. In 2017, Property Solutions (UK) Ltd, part of Bellrock Group, undertook research into the legal and contractual framework embodied within commercial office leases to better understand the barriers to the adoption of best practice. In the absence of overriding industry legislation, it is the individual lease contract that sets out the rights and obligations of each party. In only 11% of the leases reviewed was the RICS Code even mentioned. It will be fascinating to see if, with the advent of the Code as a PS, its lack of formal recognition within commercial leases will be outweighed by its new-found mandatory status.

The new 2018 RICS PS explicitly states that regular cost benchmarking is essential to demonstrating that services offer good value for money, and the use of standard cost classes and categories in industry-standard format are essential if benchmarking is to be effective. SCOR provides the UK's only yearly benchmarking information about service charge costs and monitors whether service charge certificates comply with RICS professional requirements for presentation and transparency.

As in previous years, this year's SCOR results on Code compliance suggest that progress towards best practice and good governance is still, at best, fragmented.

2. THE COMMERCIAL OFFICE LEASE RESEARCH PROJECT

While the RICS Code attempts to foster the adoption of best practice within the management and financial reporting practices for commercial service charges, issues arise when the provisions of the underlying lease conflict with the Code's requirements or are silent as to the exact nature of the management, accounting, certification and auditing requirements for the service charge process. As a result, it is critical that modern leases are drafted with provisions that comply with the Code, and now the PS, to facilitate the adoption and dissemination of best practice. At present, little is known about the degree to which UK commercial leases comply with the RICS's requirements for accountability and management transparency, or whether these documents provide adequate guidance in these key areas. However, in 2017, Property Solutions (UK) Ltd and Professor Andrew Holt from MSU Denver, reviewed specific provisions within a representative sample of leases at 90 UK multi-let commercial office buildings to determine whether they provided the contractual guidance and clarity necessary to support the best practice requirements of the RICS. A discussion paper on the findings from this research is already available, and an academic paper is currently under review. Suffice to say that the results of the research were disappointing, but hardly surprising, as most leases analysed did not conform to the Modern Commercial Lease (MCL) template commissioned by the British Property Federation (BPF, 2017), which incorporates many of the RICS's reporting requirements. As a result, many leases failed to include provisions supporting the RICS's best practice requirements in a number of areas.

3. METHODOLOGY

The data for SCOR's core cost benchmarking is obtained from analysis of the service charge documents supplied to occupiers at 197 UK multi-let office buildings/developments. As this year's data is drawn from the commercial service charge information prepared for and by 183 and 80 different landlords and managing parties, respectively, the dataset provides an unbiased and representative basis for reviewing the level of costs and RICS compliance within the UK commercial multi-let office market. For the yearly compliance analysis, service charge certificates prepared during the latest available financial year are used for analysis.

While the majority of SCOR's data collection and analysis is performed by a research team at Property Solutions (UK) Ltd, the work is closely monitored by an independent academic supervisor. Professor Andrew Holt has held this position since the inception of the SCOR Report and has helped to establish its methodology and ensures the neutrality and independence of the reported results.

As part of this verification process, during the preparation of each year's report, the academic supervisor conducts a comprehensive audit of the data collection, analysis and archiving process. In terms of data verification, a random sample of the documents used for SCOR's cost and compliance analysis are selected in order to determine the accuracy of the data input, analysis and results.

3.1 The Dataset

The geographical spread of these buildings as per their Government Office Region (GOR) is given in Figure 1. This shows that just over a third of buildings are located within London, another fifth or so being in the South East and South West combined and only 15% located in the other home countries and Ireland.

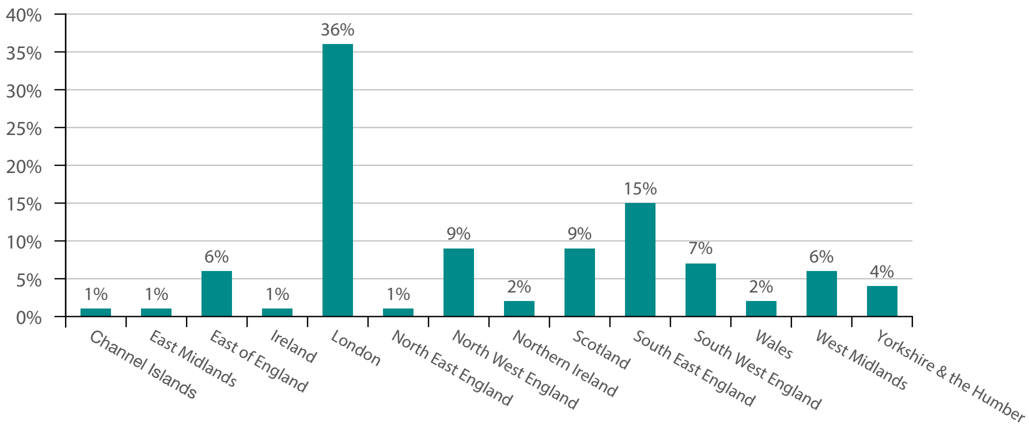

Figure 1: Geographical spread of the properties in the dataset, classifying them by their UK Government Office Region (GOR).

The analysis is split into buildings which fall within the London GOR and those which lie in the "Rest of the UK" (this will include, for the sakes of this research, the 1% of buildings located in Ireland). In addition, for parts of the analysis, the dataset within these two geographical classifications are then divided further based on their total floor areas. Figures 2 and 3 illustrate the way in which each geographical classification has then been sub-divided showing the number of properties in each area division. The area divisions are not the same in both geographical classifications as buildings tend to be larger in the capital.

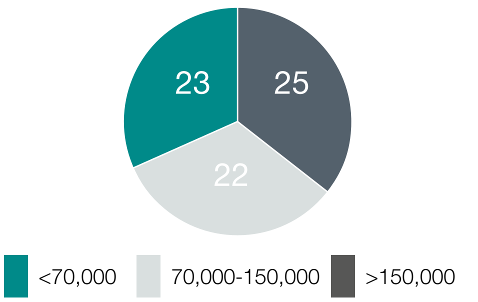

Figure 2: Sub-division of London properties as per total area in sq. ft.

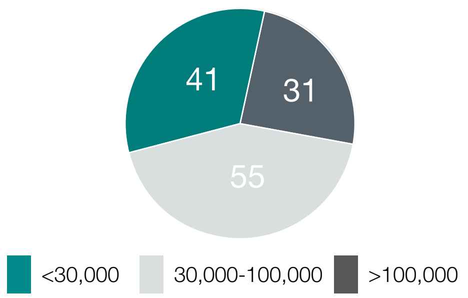

Figure 3: Sub-division of Rest of the UK properties as per total area in sq. ft.

4. FINDINGS AND ANALYSIS: COST BENCHMARKING

4.1 Cost benchmarking of the most recent year

The core data for SCOR was obtained from the analysis of service charge documents supplied by occupiers from 197 multi-let offices. The 197 buildings had a total service charge expenditure of £221 million per annum, and included a total floor area of over 35 million sq. ft. The characteristics of the cost analysis dataset are described in Table 2.

Years	No. of Buildings	Types of Documents	Total Service Charge Cost	Total Floor Area
2016-2018	197	Certificates/Budgets	£221,077,227	35,637,829 sq. ft.

Table 2: Characteristics of the core dataset used for the main cost analysis

Overall service charge costs by geographical classification

Figure 4 and Table 3 show that the service charge costs per sq. ft. were significantly higher in London than the Rest of the UK – the London median being 57% higher than its equivalent in the Rest of the UK. This is what we have come to expect but it is more marked this year.

In terms of costs in London, this year's figures show a rise in costs, with costs increasing more in the more expensive locations; the lower quartile rising by just 1% while the upper quartile seeing a 6% increase. For the Rest of the UK, the costs remained largely the same with the median experiencing a mild uplift while the lower and upper quartiles saw a drop.

Further discussion of these cost trends can be found in the Longitudinal Cost Benchmarking section of this report.

Table 3: Total service charge costs compared between properties located in London and the Rest of the UK

£ per sq. ft.	London	Rest of the UK
Lower Quartile	8.54	4.86
Median	10.01	6.35
Upper Quartile	12.80	8.44

Figure 4: Total service charge costs compared between properties located in London and the Rest of the UK

Service charge cost categories by geographical classification

Table 4 shows the service charge expenditure across ten RICS cost categories split by geographical classification. The highlights to be drawn from this table are:

- Total Cost of Management (defined as the Management fees plus the Site management resources) ranges from 8% to 17% of total costs and is a higher proportion of the overall cost in the costlier buildings.
- Security costs are a higher proportion of the total costs in London compared to outside the capital although the discrepancy decreases in the costlier buildings.
- There are similar levels of expenditure – as a proportion of the total - on Major Works across the geographical classifications but these proportions increase in the higher cost properties.

£ Per sq. ft.	Lower quartile		Median		Upper quartile	
Cost Category	London	ROUK	London	ROUK	London	ROUK
Management fees	0.55	0.30	0.76	0.46	0.94	0.64
Site management resources	0.32	0.11	0.63	0.41	1.08	0.79
Electricity	0.60	0.27	1.30	0.83	1.81	1.26
Gas	0.22	0.23	0.33	0.39	0.49	0.55
Security	1.14	0.12	1.93	0.67	2.44	1.23
Cleaning & environmental	0.97	0.69	1.16	0.97	1.46	1.32
Mechanical & electrical (M&E) services	1.08	0.43	1.65	0.83	2.37	1.50
Lifts & escalators	0.13	0.08	0.20	0.13	0.38	0.19
Fabric repairs & maintenance	0.22	0.20	0.42	0.43	0.87	0.76
Major works	0.45	0.40	1.04	0.72	1.85	1.26

	Lower quartile		Median		Upper quartile	
	London	ROUK	London	ROUK	London	ROUK
Quartiles of Total Costs	**8.54**	**4.86**	**10.01**	**6.35**	**12.80**	**8.44**

Table 4: Service charge expenditure across ten RICS cost categories by geographical classification

Overall service charge by geographical classification and by size of building

Service Charge costs are analysed by splitting buildings in the capital and beyond into three size categories. These size thresholds are different for the two geographical classifications as buildings in London tend to be larger.

The overall service charge cost information is shown in Figures 5.1 and 5.2, giving lower quartiles, medians and upper quartiles.

Of note is the far higher median cost of larger buildings in the capital, the median a full 17% higher than mid-sized buildings. In the rest of the UK it is the mid-sized buildings in the sample that were more expensive.

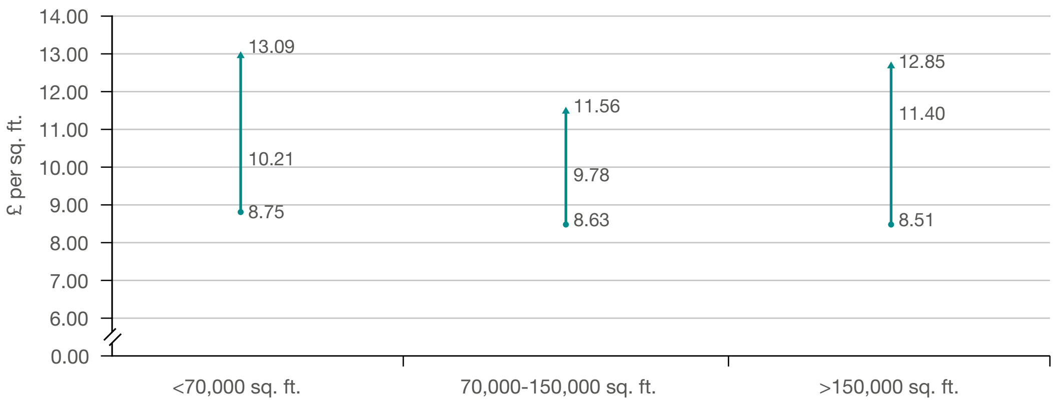

Figure 5.1: London service charge expenditure quartiles split by total building area

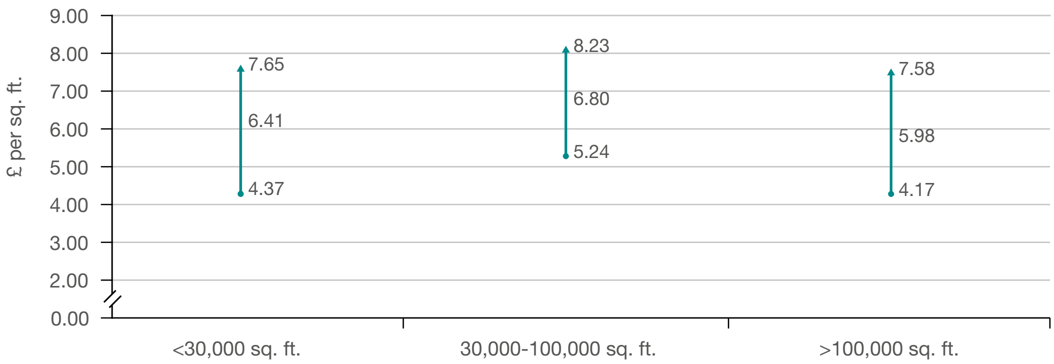

Figure 5.2: Rest of the UK service charge expenditure quartiles split by total building area

Service Charge cost categories by geographical classification and by size of building

Tables 5.1 and 5.2 show median costs for the ten chosen cost categories split by building size in London and the Rest of the UK, respectively together with details of the median of all cost categories for the buildings.

In London the categories that contribute most to the higher cost larger buildings are Security, M&E Services and Major works.

In the Rest of the UK it is difficult to pick out categories that show a specific trend, based on building size.

Table 5.1: London service charge expenditure across ten Cost Categories split by total building area

Median Costs (£ per sq. ft.)	London		
RICS Cost Category	<70,000 sq. ft.	70,000 -150,000 sq. ft.	>150,000 sq. ft.
Management fees	0.82	0.72	0.65
Site management resources	0.63	0.58	0.69
Electricity	1.28	1.40	1.22
Gas	0.40	0.35	0.24
Security	1.76	1.97	2.23
Cleaning & environmental	1.35	1.27	1.06
Mechanical & electrical (M&E) services	1.37	1.82	1.90
Lifts & escalators	0.22	0.14	0.23
Fabric repairs & maintenance	0.78	0.25	0.33
Major works	0.13	0.24	0.48

	London		
	<70,000 sq. ft.	70,000-150,000 sq. ft.	>150,000 sq. ft.
Median of total costs (£ per sq. ft.)	**10.21**	**9.78**	**11.40**

Table 5.2: Rest of the UK service charge expenditure across ten Cost Categories split by total building area

Median Costs (£ per sq. ft.)	Rest of the UK		
RICS Cost Category	<30,000 sq. ft.	30,000-100,000 sq. ft.	>100,000 sq. ft.
Management fees	0.57	0.47	0.36
Site management resources	0.23	0.52	0.43
Electricity	0.66	0.83	0.88
Gas	0.49	0.39	0.23
Security	0.25	0.80	0.71
Cleaning & environmental	1.19	0.90	0.93
Mechanical & electrical (M&E) services	0.83	0.80	0.99
Lifts & escalators	0.19	0.12	0.11
Fabric repairs & maintenance	0.59	0.52	0.22
Major works	0.82	0.26	0.18

	Rest of the UK		
	<30,000 sq. ft.	30,000-100,000 sq. ft.	>100,000 sq. ft.
Median of total costs (£ per sq. ft.)	**6.41**	**6.80**	**5.98**

Service charge costs by geographical classification and whether the buildings benefit from Air Conditioning (AC)

Tables 6.1 and 6.2 show the quartiles for overall service charge costs and the median costs for ten cost categories within the service charge, respectively.

Table 6.1: Service charge costs compared between air-conditioned (AC) and non AC properties by geographical classification

Quartile costs (£ per sq.ft.)	London		Rest of the UK	
	AC (64 buildings)	Non AC (6 buildings)	AC (93 buildings)	Non AC (31 buildings)
Lower Quartile	8.59	8.00	5.20	4.28
Median	10.12	9.50	6.56	6.02
Upper Quartile	12.85	10.68	8.54	7.62

Table 6.2: Service charge expenditure across ten RICS cost categories compared between AC and non AC properties by geographical classification

Median costs (£ per sq. ft.)	London		Rest of the UK	
RICS Cost category	AC	Non AC	AC	Non AC
Management fees	0.77	0.51	0.46	0.45
Site management resources	0.63	0.23	0.45	0.39
Electricity	1.31	0.38	0.92	0.42
Gas	0.33	0.37	0.37	0.45
Security	1.94	0.33	0.71	0.45
Cleaning & environmental	1.16	1.20	0.97	0.95
Mechanical & electrical services	1.74	0.78	0.99	0.60
Lifts & escalators	0.20	0.29	0.12	0.16
Fabric repairs & maintenance	0.40	0.65	0.37	0.71
Major works	1.00	1.60	0.64	0.83

	London		Rest of the UK	
	AC	Non AC	AC	Non AC
Median of total costs (£ per sq. ft.)	**10.12**	**9.50**	**6.56**	**6.02**

As expected, the costs of running a building with AC are higher than a building which does not benefit from AC. The stand-out costs that account for this difference are Electricity and M&E Services.

4.2 LONGITUDINAL COST BENCHMARKING

Longitudinal cost analysis for four continuous years (2015-2018) was also undertaken on 91 office buildings. These buildings were selected from the total population of 197 buildings based on the availability of source documents for each of the four years. This analysis was performed to identify cost trends and provide greater insight into the changing nature and magnitude of service charge costs over time. We believe this year-on-year comparison is fundamental to understanding service charge expenditure.

Table 7: Characteristics of longitudinal cost analysis dataset

Years	No. of buildings	Type of documents	Total SC cost for 2018	Total floor area
2015-2018	91	Certificates/budgets	£92,614,120	10,254,495 sq. ft.

Figure 6 shows the total annual service charge cost per sq. ft. for all 91 properties, regardless of geographical location. After a drop in service charges between 2015 and 2016, there has been a steady increase in 2017 and 2018.

The greatest rise has been between 2017 and 2018 when the median costs rose by 13% and upper and lower quartile experienced increases of 9% and 10% respectively. These are rises greater than in previous SCOR longitudinal comparisons and the main driver may be the rise in the Minimum Living Wage.

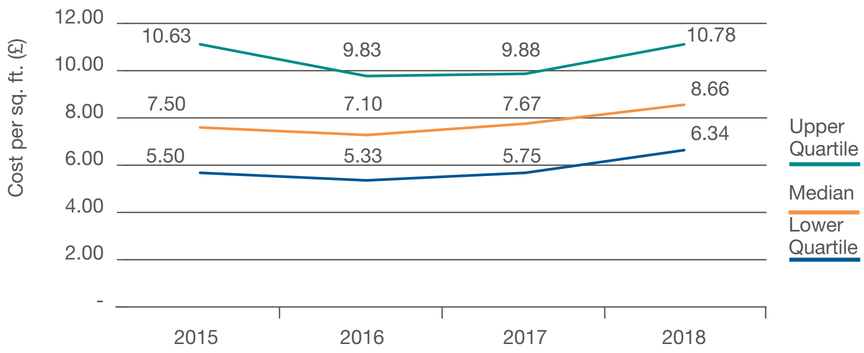

Figure 6: Total service charge cost trends for the years 2015-2018

As with the main cost analysis, the annual median costs per sq. ft. for ten cost categories were compared year on year as shown in Table 8.

The largest increase between 2017 and 2018 has been in the Major works cost category with most of the others showing more modest increases.

Table 8: Service charge expenditure across ten RICS cost categories compared over four years: 2015-2018

Median costs (£ per sq.ft.) **RICS Cost category**	**2015**	**2016**	**2017**	**2018**
Management fees	0.56	0.58	0.57	0.60
Site management resources	0.42	0.46	0.46	0.54
Electricity	0.93	0.93	0.97	0.93
Gas	0.38	0.32	0.33	0.36
Security	0.90	0.91	0.99	1.03
Cleaning & environmental	0.92	0.95	1.12	1.18
Mechanical & electrical services	1.31	0.96	1.23	1.30
Lifts & escalators	0.12	0.12	0.15	0.15
Fabric repairs & maintenance	0.36	0.35	0.39	0.47
Major works	0.43	0.42	0.88	1.24
	2015	**2016**	**2017**	**2018**
Median of total costs (£ per sq.ft.)	7.50	7.10	7.67	8.66

The results for the longitudinal analysis, split by geographical classification - London and the Rest of the UK – are shown in Table 9 and Figures 7.1 and 7.2.

These show that the reduction in the second year was largely driven by buildings outside of the capital and that in London there has, in general, been a steady increase across the 4 years albeit with the last year showing a more marked increase.

Table 9: Total service charge cost trends for the years 2015-2018 by geographical classification

Quartiles (£ per sq.ft.)	**London**				**Rest of the UK**			
	2015	2016	2017	2018	2015	2016	2017	2018
Lower Quartile	7.96	8.58	9.13	9.73	4.58	4.80	5.55	6.05
Median	9.94	9.89	9.84	10.76	6.07	5.77	6.33	6.77
Upper Quartile	11.33	11.54	12.00	13.06	7.84	7.08	7.68	8.67

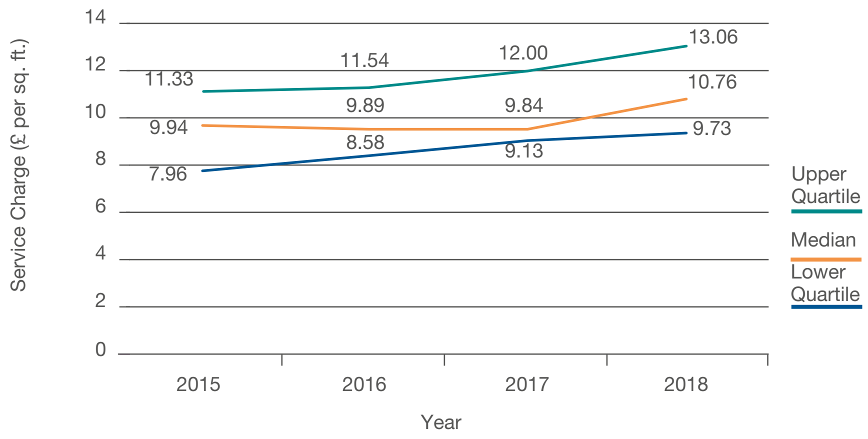

Figure 7.1 Total service charge cost trends for the years 2015-2018 in London

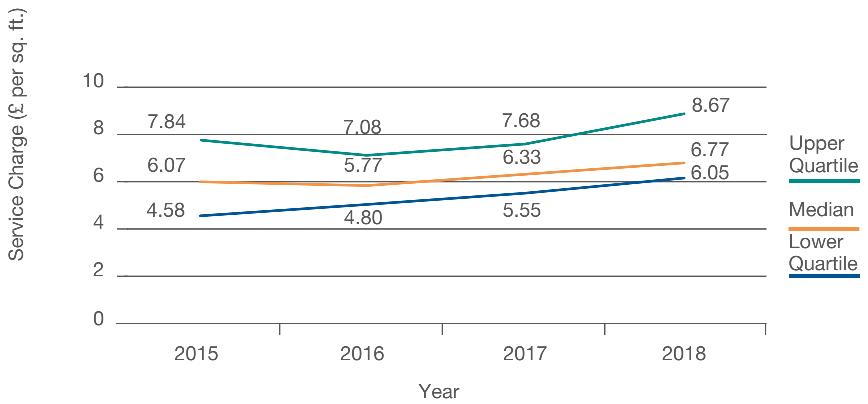

Figure 7.2 Total service charge cost trends for the years 2015-2018 in the Rest of the UK

Table 10 provides longitudinal cost analysis for the ten RICS cost categories highlighted over the four years.

Over the 4 years those categories that have seen the highest increases are: Security (London 18% and ROUK 14%), Cleaning & Environmental (London 19% and ROUK 20%) and M&E Services (ROUK 26%).

In terms of percentage increases, however, it is the sums spent on Major Works that have risen most.

Table 10: Longitudinal comparison across ten RICS cost categories over four years split between London/Rest of the UK

Median costs (£ per sq.ft.)	**London**				**Rest of the UK**			
RICS Cost category	2015	2016	2017	2018	2015	2016	2017	2018
Management fees	0.72	0.72	0.76	0.72	0.45	0.46	0.47	0.50
Site management resources	0.68	0.64	0.60	0.76	0.34	0.39	0.38	0.43
Electricity	1.16	1.22	1.28	1.33	0.83	0.74	0.80	0.79
Gas	0.30	0.32	0.25	0.34	0.39	0.32	0.34	0.37
Security	1.62	1.79	1.97	1.91	0.43	0.47	0.66	0.60
Cleaning & environmental	1.17	1.13	1.28	1.39	0.85	0.82	1.01	1.02
Mechanical & electrical services	1.74	1.80	1.66	1.79	0.87	0.82	1.06	1.10
Lifts & escalators	0.13	0.13	0.18	0.17	0.10	0.10	0.12	0.13
Fabric repairs & maintenance	0.33	0.30	0.38	0.49	0.43	0.39	0.39	0.46
Major works	0.51	0.71	1.04	1.49	0.36	0.33	0.50	0.69

5. FINDINGS AND ANALYSIS: RICS CODE COMPLIANCE

5.1 Code Compliance 2018

This section reports on the level of compliance that 100 certificates demonstrated against select presentation and transparency requirements of the RICS Code. For the last eight years, SCOR has monitored compliance with the Code's requirements for the preparation and issuance of reconciliation certificates, and additional metrics are added as new versions of the Code are published. For this present report, the level of compliance with ten specific accounting requirements of the 2014 RICS Code were evaluated, and the characteristics of the dataset used for this analysis is described in Table 11.

Table 11: Characteristics of the dataset used for the compliance analysis 2018

Years	No. of buildings	Type of documents	Total Service charge cost	Min no. of property owners represented	Min no. of Managing Agents represented
2017-2018	100	Service Charge certificates	£67,638,412	95	51

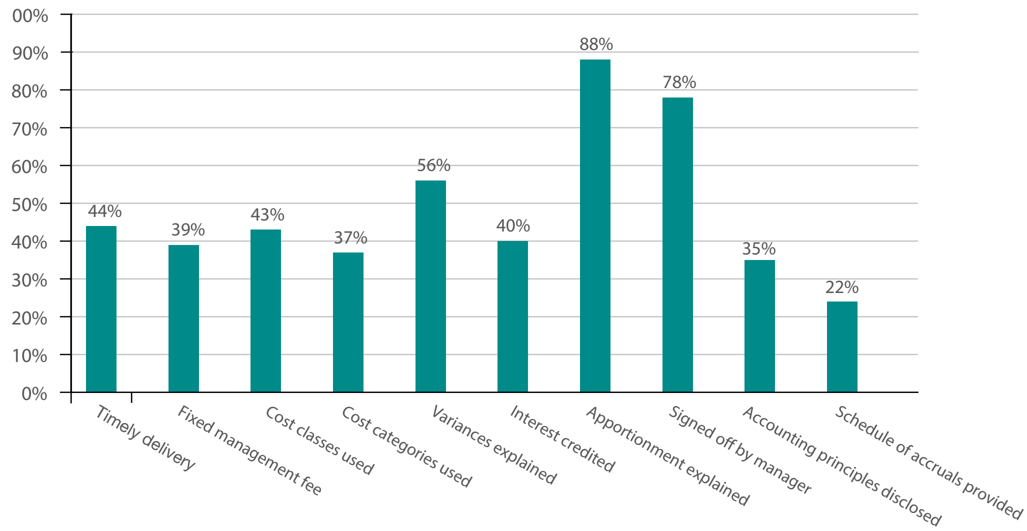

Figure 8: RICS Code compliance 2017-18 results

Figure 8 presents the overall compliance results for this year. 88% of certificates provided an adequate explanation of the apportionment basis used (SCOR 2017 – 93%) , and 78% were certified and signed-off by a qualified manager (SCOR 2017- 81%). The requirement to include a schedule of opening and closing accruals and prepayments was introduced by the 2014 Code, and 22% of certificates provided this information (17% in SCOR 2017, and 8% in SCOR 2016). Compliance with the requirement to disclose information about the accounting principles used, such as whether the accounts are prepared on a cash or accrual basis, was marginally down on last year at 35% (SCOR 2017 – 36%).

During the preparation of SCOR 2016, the researchers introduced a more rigorous method for determining whether a fixed management fee was charged on each building. This change was necessary as even though many certificates included copious pages of explanatory disclosures that often hinted at a fixed fee, many did not conclusively explain or state the basis of the fee charged. This year, only 39% of certificates clearly described a fixed management fee (SCOR 2017 – 37%), which is poor performance against a long-standing requirement of the Code.

Of the remaining six compliance requirements only one – "Variance explained" – achieved a compliance score of over 50%, which may indicate why the new 2018 RICS Code has just been issued as a mandatory PS. The fact that 56% of certificates are not issued within the period allowed by the Code (4 months from year-end) is a key problem area, and the poor adoption of RICS approved cost classes and cost categories are long-standing problematic issues for occupiers wishing to compare service charges between buildings. The crediting of interest received to the service charge account is another minor requirement to satisfy, as it simply needs to be recognised as a cost category under income and be accompanied by a disclosure comment that highlights that interest, if any, has been credited to the service charge account.

Figure 9 provides details of the overall compliance scores for each of the 100 certificates analysed. This year, nine certificates achieved a maximum score of 10 out of 10 (SCOR 2017 – 6%). 32% of certificates achieved a ranking of 7 or better, which is almost unchanged from last year (SCOR 2017 – 33%). As per last year, over 50% of certificates received a ranking score of 4 or less, which again supports the need for a mandatory PS. Overall, the results show an ongoing trend where the good are getting better but the mediocre are slipping further down the performance scale.

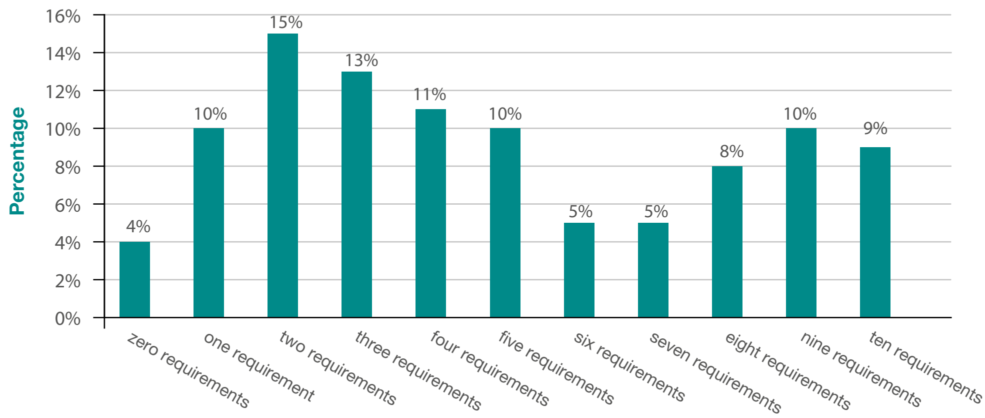

Figure 9: Certificate compliance "scores"

5.2 Longitudinal Compliance Comparison

The levels of yearly compliance with each of the ten requirements of the Code between 2010 and 2017 are shown in Figure 10. While these results illustrate general compliance trends for each metric, they must be viewed with care. Since the 100 or so buildings included within each of SCOR's eight years of annual compliance data have changed over the monitoring period, Figure 10 incorporates a high degree of data churn, which suggests that the results may not be generalisable to all certificates being produced for UK multi-let office buildings. In addition, only three years of data is available for the "schedule of approvals provided" metric, as this was only introduced by the 2014 RICS Code. Despite these limitations, SCOR's year-on-year compliance is invaluable, as it provides the UK's only annual benchmarking of RICS Code compliance. To date, SCOR has now monitored compliance for certificates produced between 2010 and 2017, and the results indicate no significant year-by-year increase in compliance with each of the Code requirements.

While some observers may suggest that the data indicates that real change in the standard of service charge accounting transparency and reporting can only be brought about through legislation, the RICS has taken an alternative route by reissuing the Code as a mandatory PS. While compliance with this PS is only mandatory for RICS professionals and firms regulated by the RICS, it should, in theory, improve the level of compliance with each of the ten metrics monitored by SCOR.

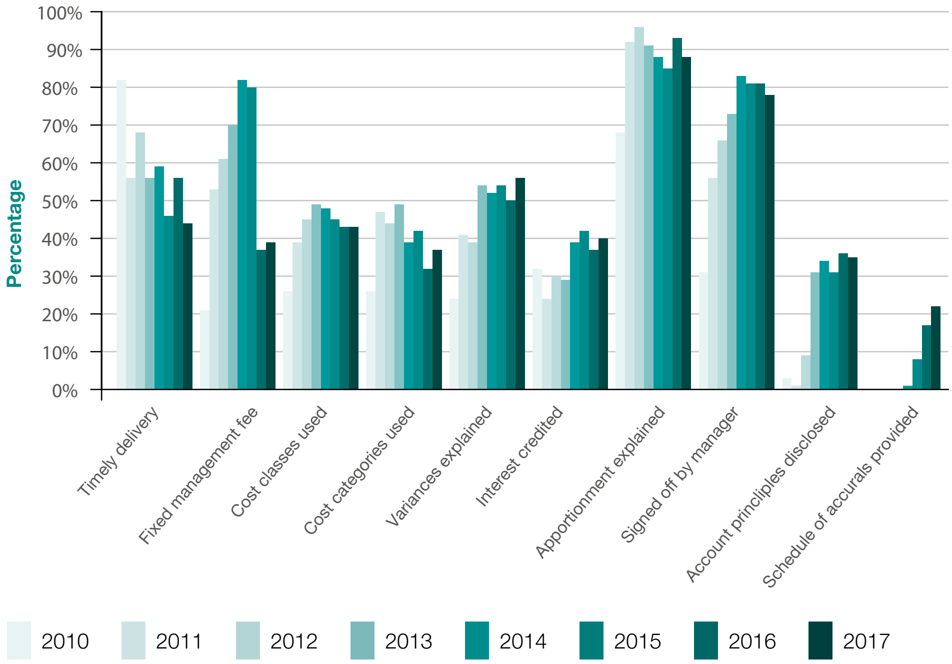

Figure 10: Comparison of individual metrics over the last six years

Two-year longitudinal compliance comparison (57 buildings)

In order to provide more accurate longitudinal benchmarking of Code compliance, the annual compliance results for 57 buildings included in both SCOR 2018 and SCOR 2017 are shown in Table 12. The total annual service charge liability for these 57 buildings in 2018 amounted to just over £44 million. Of the 57 locations, 17 buildings showed an improved annual score this year, 22 were unchanged, and 18 achieved an inferior compliance result. These inconsistent results suggest a problematic path to improved levels of best practice within the industry but might be partially explained by any changes in the managing and/or owning parties for each building. Irrespective of these explanatory factors, it is concerning that there has been little improvement in compliance during the last twelve months, and four years on from the introduction of the 2014 Code.

Table 12: Two-year compliance comparison for certificates at 57 identical buildings

	SCOR 2017 Certificates		**SCOR 2018 Certificates**	
"Compliance score"	Number	% of total	Number	% of total
0	0	0%	2	4%
1	4	7%	5	9%
2	7	12%	8	14%
3	10	18%	7	12%
4	5	9%	6	11%
5	9	16%	6	11%
6	4	7%	4	7%
7	2	4%	1	2%
8	4	7%	5	9%
9	8	14%	6	11%
10	4	7%	7	12%
Total	**57**	**100%**	**57**	**100%**

Figure 11 provides a comparison of the yearly compliance rankings from SCOR 2018 and SCOR 2017 for the 57 buildings and suggests that higher quality certificates are getting better and mediocre ones are worsening in terms of compliance. In both years, the median compliance ranking for the 57 buildings was 5 out of 10, with an unchanged yearly mean ranking score of 5.1 out of 10. At the bottom end, performance appears to have deteriorated as 26% and 19% of certificates achieved a rank of 2 out 10 or less in SCOR 2018 and SCOR 2017, respectively. At the top end, 32% and 28% of buildings were given a rank of 8 out 10 or higher in SCOR 2018 and SCOR 2017, respectively.

These longitudinal results, combined with those earlier in the compliance section, suggest that certain managing parties are in danger of being left behind by those who are adopting best practice within their service charge accounting practices. Ignoring best practice guidelines may soon be a luxury that the industry does not have, as having the Code as a PS will make compliance mandatory on RICS professionals. Should this step lead to improved Code compliance, the only remaining solution would then be legislation, and formal regulation of the commercial service charge industry.

Figure 11: Two-year longitudinal compliance comparison for certificates at 57 buildings

5.3 Pockets of best practice - The apportionment matrix

The 2014 RICS Code states that “the basis and method of allocating and apportioning the service charge expenditure is to be transparent and clearly communicated to all” and “the rationale for the apportionment between occupiers should be set down in writing” with the use of separate schedules to reflect the availability, benefit and use of services by occupiers (RICS, 2014, p. 12).

This year’s compliance results found that 88% of certificates clearly explained the apportionment basis for the service charge expenditure (SCOR 2017 – 91%), with the best disclosure incorporating a clear apportionment matrix and cost schedules, together with an explanatory note that detailed whether:

- expenditure allocated across schedules is apportioned in accordance with the provisions in the various leases in place.
- costs within schedules are apportioned in compliance with the provisions in the leases. For instance, based upon each occupier’s gross internal area, etc.
- the accounting treatment for void or empty premises is clearly set out.
- tenants have any concessions, and how these are accounted for by the landlord.

Figure 12: Illustrative example of "best practice disclosure" of an apportionment matrix

Description of Schedules:		
Schedule 1	Estate Charge	Apportioned as a % of the combined area of Buildings 1&2
Schedule 2	Building 1	55,172 square feet
Schedule 3	Building 2	33,046 square feet
Combined Area of Buildings		88,218 square feet

Occupier	Demise	Area Occupied		APPORTIONMENT MATRIX (%)			NET LIABILITY FOR THE PERIOD (£)			
		Leased Area of Building 1 (sq.ft.)	Leased Area of Building 2 (sq.ft.)	Estate Charge Schedule 1 (%)	Building 1 Schedule 2 (%)	Building 2 Schedule 3 (%)	Estate Charge Schedule 1 (%)	Building 1 Schedule 2 (%)	Building 2 Schedule 3 (%)	TOTAL (£)
Red Financial Services	Ground & 1st	14,378	-	16.30%	26.06%	0.00%				
Green & company	2nd	8,258	-	9.36%	14.97%	0.00%				
Blue and Purple Ltd	3rd	8,258	-	9.36%	14.97%	0.00%				
Lime Suppliers Ltd	4th & 5th	16,268	-	18.44%	29.49%	0.00%				
White Ltd	6th	8,010	-	9.08%	14.52%	0.00%				
Orange Ltd	1st	-	4,854	5.50%	0.00%	14.69%				
Cream and Violet Plc	2nd & 3rd (Part)	-	7,281	8.25%	0.00%	22.03%				
Yellow & Pink Ltd	3rd (Part), 4th, 5th & 6th	-	16,290	18.47%	0.00%	49.29%				
Brown & Indigo Plc	7th	-	4.621	5.24%	0.00%	13.98%				
Totals		**55,172**	**33,046**	**100%**	**100%**	**100%**				

An illustrative example of what we regard as best practice disclosure for "apportionment explained" is shown in Figure 12 above. This provides a complete apportionment matrix that incorporates cost schedules and would ideally be accompanied by explanatory text addressing the bullet points set out opposite.

6. RECOMMENDATIONS

Based on the findings set out in SCOR 2018, the conclusions and recommendations are that:

1. New leases must include provisions that comply with the best practice requirements of the RICS Professional Statement. Occupiers should demand this, and ask landlords to explain why a lease fails to do so.

2. Occupiers must be familiar with their lease terms and, in particular, the service charge provisions. If there are costs appearing within the service charge accounts that are not compliant with their lease terms they should raise queries with the landlord/their managing agent.

3. Those managing properties – whether self-managing landlords or managing agents employed by landlords – must implement the requirements found in the RICS Professional Statement when handling service charges. This will bring much needed accuracy, efficiency and transparency to the service charge accounting piece.

4. Timely delivery of service charge documents (budgets and certificates), RICS cost classes and categories, explaining variances adequately and the disclosure and listing of material accruals must become priorities.

Should you wish to discuss any aspects of this analysis, or, if you would be interested in including your properties in future studies, please do not hesitate to email us at research@bellrockgroup.co.uk.

We would like to take this opportunity to thank Olisa Pal, who left Property Solutions (UK) Ltd in July of this year. She was a tremendous help with the SCOR research, completing much of the analysis.

Olisa will be sorely missed.

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