

Completion complications – part 2

Property investment In their second article on buying investment property, Anthony Judge and Rachel Wevill consider issues that arise in respect of apportionment of service charge

In part one (*EG*, 12 March 2016, p127), a scenario was posed where an investor is buying a multi-let shopping centre. That article explored the various ways in which rent and rent arrears can be apportioned in the sale contract.

On sale of a property, it is even more difficult to apportion service charge than rent because, depending at what stage in the process of gathering in service charge the selling landlord may be, it is probable that the amount payable will not even be known.

The Standard Conditions (8.3.6) envisage a fairly straightforward position on service charge. However, the reality is often more complex and it is common for a contract to delete SC 8.3.6 and specify how individual payments are to be allocated. Some of the issues the parties and their advisers will have to consider are:

- depending where in the service charge year completion takes place, the process of reconciliation will be at varying stages;
- the current service charge balance to be paid to the buyer will be uncertain at completion;
- as with rent payments, some tenants will be better at paying service charge on time so there may be current and historic arrears;
- there may be – and usually are – void areas in a shopping centre for which the landlord has to account and these will have to be taken into consideration on assignment; and
- there may be a sinking fund to hand over.

Reconciliation of previous years

In the normal course of business, where the property is not being sold, the RICS Service Charge Code of Practice states that the annual service charge reconciliation should be achieved within four months of the year-end. As the sale of a property can take place at any point during a service charge year and it is not considered best practice to change the year-end just because the property changes hands, it continues to be the responsibility of the appropriate person to certify and reconcile the service charge at the appropriate date in accordance with the relevant lease.

The Commercial Property Service Charge Handover Procedures (“CPSCHP”) paper, also published by RICS, places the onus on the seller or manager to fully reconcile any outstanding service charge



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accounts for prior years as promptly as possible, but in any event no later than within four months from the sale or handover date.

Current service charge balance

The buyer will expect to receive the current service charge balance and any sinking fund on completion; but it takes time to assemble this information. Completion takes place on estimated figures, and the contract will usually require the seller to provide verified accounts within two to three months, at which point there will be a balancing payment.

Buyers will want to ensure that sale contracts contain reasonable enforcement action in the event that the seller fails to deliver this information or make these payments in time. The seller's agents will be under some pressure to demonstrate and account for every payment on account of service charge from tenants and any top-ups/reimbursements that need to be made following reconciliation of the service charge estimate.

Arrears

The CPSCHP suggests that within seven days of completion, the seller should provide an updated statement of arrears and the buyers will then be responsible for collecting any on-account payments from the tenants covering the current service charge year. Unless otherwise agreed, it is usual for the seller to be responsible for arrears for historic service charge years.

This can be a source of contention between the parties, especially if the shopping centre in question has been ill-managed or the tenants not especially diligent in paying up. If the buyer is unhappy with the level of historic arrears,

this is usually dealt with by requiring the seller to fund them.

Void areas and sinking funds

If there are void areas for which service charge is irrecoverable, the seller will have to provide the buyer with evidence that it has funded the void areas itself. One of the issues is that because service charge paid quarterly on account is only estimated, the seller will not know on completion quite how much it is going to have to self-fund in respect of void areas.

Where there is a sinking or reserve fund, information will normally be given in pre-contract enquiries as to the details of the funds and assets covered, the tax liability, expenditure from each fund and any trust status. The Standard Conditions require the seller to hand over the balance of any service charge reserve fund as soon as practicable after completion, allowing time for interest and any bank or other charges to be calculated.

Money sent to the wrong party after completion

It is not unusual for tenants to pay money after completion to the seller (especially if completion is close to a quarter day); and the buyer may have agreed to collect rent apportioned to the seller. The contract should require the money to be paid to the correct party and will state that the sums are being held on trust for the party to whom they will ultimately be sent.

If the buyer or seller is an overseas entity, it is worth checking that the concept of “holding on trust” is applicable in their jurisdiction. Even if the governing law for the contract in question is that of England and Wales, if one of the contracting parties does not have the ability, because of its local law or constitution, to hold monies on trust, this mechanism may fail if the party goes into an insolvency procedure.

Co-operation is key

One of the most important factors to ensure a smooth handover in the midst of all these potential service charge irregularities is early and complete information-sharing from buyer to seller and early co-operation between the parties' managing agents.

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