DILAPIDATIONS (ENGLAND & WALES ONLY)

NFRN Federation of Independent Retailers

The issues related to dilapidations can be somewhat complex hence the 'health warning' at the end of this fact sheet.

There is an important distinction between dilapidations and reinstatement. 'Reinstatement' refers to a tenant's obligations to return a property in repair, reinstated and redecorated in accordance with the lease terms at its own expense at the lease end (however so determined).

'Dilapidations' refers to breaches of lease covenants that relate to the condition of a property during the term of the tenancy or when the lease ends. The landlord's claim is for damages which is in turn limited by the provisions of S.18(1) of the Landlord and Tenant Act 1927 as appropriate. There is formal guidance available on line such as Dilapidations RICS consumer guide.

This guide provides information for tenants and landlords on things to consider when dealing with a dilapidations claim made by a landlord at or near the end of the lease term. It focuses on the basics of the dilapidations process only and does not deal specifically with leases which end because of the exercising of a break clause.

This guide relates to the law and procedures for commercial property in England and Wales, other parts of the UK have their own law and processes which can be different to the information in the guide. Whilst the Dilapidations Protocol only applies to commercial disputes, it is likely that its procedures will also be regarded as best practice in residential disputes.

Prevention can be better than cure:

A tenant should obtain early advice to consider whether it is more advantageous commercially to undertake reinstatement before lease end or negotiate a cash settlement after expiry. A tenant can minimise a claim for dilapidations by carefully negotiating terms at the outset and by keeping the property in repair in accordance with the lease.

It is important; that a tenant records the condition of the premises when acquired, that any schedules of condition, including for the plant and building services, are attached to the lease, that responsibility for works undertaken are similarly documented including any tenant alterations. As well as the fabric of the property, plant should be maintained, tested and serviced during the term of the lease. These records, including Test Reports and Asbestos Register, should be made available to the landlord, as required.

Improvements and redevelopment:

A tenant should not be expected to return the property in better condition than when let unless the lease obliges the tenant to 'put and keep' the property in repair. There are areas for argument regarding improvements when a roof area, for example, is 'life expired'. It is expected replacement will be in line with current statutory or Building Regulation requirements.

Equally, if the building or premises is to be, or likely to be, redeveloped or substantially refurbished after the end of the lease, then there should be no dilapidations liability. Case law on the matter of refurbishment is, however, complex and so formal advice is needed.

Forfeiture and re-entry:

Whilst dilapidations will arise during a lease term, unless the breaches are severe, a landlord will generally be cautious about invoking the forfeiture provisions of a lease and S.146 of the Law of Property Act 1925 for items of general repair because it could allow a tenant a get out from the lease. A lease may provide for the landlord to re-enter and recover the cost of work plus incidental fees and costs if a tenant fails to repair. Such events are, however, relatively rare because there is a risk that the costs may not be successfully recovered.

Dilapidations Protocol:

If a Schedule of dilapidations is prepared it should have regard to the dilapidations protocol: http://tinyurl.com/nz7h2t9

It should set out what the landlord considers to be the breaches, the works required to be done to remedy those breaches and, if relevant, the landlord's costings. The schedule should be endorsed either by the landlord, or where it is prepared by a surveyor, by the landlord's surveyor.

If the schedule has been prepared by the landlord's surveyor, then in endorsing the schedule, the surveyor should have regard to the principles laid down in the Royal Institution of Chartered Surveyors' Guidance Note on Dilapidations.

The endorsement should confirm that in the landlord's or the landlord's surveyor's opinion:

1. **The works detailed in the response are all that were reasonably required for the tenant to remedy the alleged breaches of its covenants or obligations;**
2. **Any costs set out in the response are reasonably payable for such works; and**
3. **Account has been taken of what the tenant, or tenant's surveyor, reasonably believes to be the landlord's intentions for the property.**
4. **If the tenant or tenant's surveyor considers that any items in the schedule are likely to be superseded by works to be carried out by the landlord, or are likely to be superseded by the landlord's intentions for the property then:**

    a. this should be stated in the response;

    b. particulars should be given of the material on which the tenant or tenant's surveyor relies; and

    c. the items to which this view is relevant should be identified.

    There should then be a period of negotiation, generally expected within 28 days, and a disclosure of documents to try and resolve the claim having regard to S.18(1) of the Landlord & Tenant Act 1927, commented on below.

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Types of Schedule

The lease will generally set out how a landlord may serve an' Interim' Schedule of Dilapidations including recovery of costs which is permissible at any time up to three years before a lease expiry. It should relate to those items that impact on the value of the landlord's interest.

Closer than three years to expiry, a landlord may serve a 'Terminal' schedule of dilapidations. This will be 'un-costed' and will cover all items the landlord expects the tenant to address at expiry, including redecoration and reinstatement. There is no obligation on a landlord to prepare a claim before the lease has expired and an advised tenant will obtain its own independent assessment and programme to complete the work before vacation.

Costs

It is incumbent upon a landlord to mitigate its loss so, if there is a financial loss accruing due to the property remaining unlet, then a landlord would be expected to progress the works to have the property let and income producing. Under the dilapidations protocol there are timeframes set out by which the parties should serve and respond to schedules of dilapidations to reach a settlement.

This is important in relation to the issues of costs if the matter was to go to court. The parties need to be seen to have acted reasonably and timely in their conduct of the matter to prevent costs being awarded. As part of this the parties or their surveyor should complete a 'stock take' or 'Scott' Schedule of costs to narrow down the area of dispute.

The Landlord & Tenant Act 1927 S.18 (1)

This applies in that the section provides a cap to the damages a landlord can claim for an alleged breach of a covenant to repair but only for repair. S.18(1) does not relate to decoration or reinstatement works.

Breaches of other covenants in the lease, such as to decorate or reinstate, are dealt with by common law which provides that the landlord cannot recover more than its actual loss. Section 18 (1) of the Landlord and Tenant Act 1927 has two limbs:

The First Limb of section 18(1) places a limitation on all the damages arising from the breach of the repairing covenant; not only the cost of the works themselves but also professional fees and mesne profits. This limitation is the diminution of the reversionary value of the building, or to put it plainly: the amount by which the sale value of the freehold of the building is reduced as a direct consequence of the disrepair.

For example, if there were, say, £120,000 worth of repairing works required, but the value of the building is in fact reduced by only £50,000, then the part of the claim that refers to repairs is limited to £50,000 - regardless of what works are actually required.

Note that if the freehold value of the building has fallen owing to market conditions, this limitation is less effective; but if it is simply due to the state of disrepair in the building, then the limitation bites.

The Second Limb of Section 18(1) refers to supersession. It says that, where the building will be demolished or altered to a significant extent, then no damages can be claimed, as no loss has been incurred.

It can therefore sometimes provide the tenant with a total defence against the claim - although the burden of proof is on the tenant and it can be very difficult to prove if the landlord has not done anything to indicate such intent, for example, by applying for planning consent.

There is a cut-off date for the intended demolition or substantial structural alterations - the date of the termination of the lease. It is the landlord's intentions for the property at expiry that matters; any subsequent change of mind of the landlord is not relevant in assessing his intention, so a landlord will often play his cards close to his chest.

Therefore unless you carry out a S.18 valuation then you may be unaware of the potential cap on your dilapidation claim (landlord) or the extent of any repairing liability (tenant), which is gauged by the diminution in the landlord's reversionary interest.

It should be noted that it is not the intentions of the actual landlord which should be considered, but those of the reasonable hypothetical landlord. It is possible to consider the approach of an investor, developer or an owner occupier in bidding for the property.

So, what would the market deem to be a reasonable course of action for the property given its fundamental characteristics and the state of the local market at the relevant date? For example, consideration needs to be given to the occupational market and the potential to let the property in the current market in good repair.

Often a landlord will ultimately be interested in a commercial or cash settlement and therefore these issues need to be considered in order to achieve the lowest cost settlement, which may involve the tenant doing work to its standard of workmanship.

This fact sheet is for guidance only and should not be relied upon.

You are strongly recommended to seek independent professional advice from a suitably qualified surveyor, solicitor or other relevant professional in any matters related to a property contract.