Repair or improvement?

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Occupiers frequently misunderstand the full extent of their liabilities and obligations under a repairing lease ? which can be a costly oversight, as Rob Burke explains

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One of the questions we address on a regular basis as a commercial property specialist is 'What is the exact meaning of repair?'

The Oxford English Dictionary definition is 'restore (something damaged, faulty, or worn) to a good or sound condition after decay or damage'. In the context of a commercial lease, however, the words 'good condition' may be ambiguous. Repairing obligations can be cited in terms that are open to interpretation.

The obligation to repair is set out in the Landlord and Tenant Act 1927 and covenants can be expressed by using wording such as 'put the property into repair' or 'keep the property in repair'. Sometimes, covenants are also modified by the use of words such as 'forthwith' or reference to a specific date or period of time.

Some leases link the repairing covenant to the tenant being given notice of the disrepair. Where this is the case, the tenant will not be in breach unless such notice has been given ? occasionally with a specific time frame ? and repairs have still not been carried out. Some covenants also provide for the landlord to enter the premises, carry out work and recover the cost from the tenant.

All this can lead to expensive misunderstandings. As a result, it is important that tenants are fully familiar with the terms of their own lease and whether or not it is limited in extent in some way, for example by reference to a schedule of condition or a side letter.

Identifying disrepair

Identifying whether or not a building has fallen into disrepair is arguably the most complex aspect of dilapidations. In Dilapidations: The Modern Law and Practice ? something of a Bible for dilapidations practitioners ? authors Nicholas Dowding and Kirk Reynolds set out 5 steps that can be used to establish the existence of disrepair. These come in the form of the following questions that owners, occupiers and their advisors should ask themselves.

- What is the physical subject matter of the covenant?
- Is the subject matter in a damaged or deteriorated condition?
- Is the nature of the damage or deterioration such as to bring the condition of the subject matter below the standard contemplated by the covenant?
- What work is necessary in order to put the subject matter of the covenant into the contemplated condition?
- Is this work nonetheless of such a nature that the parties did not contemplate it would be the liability of the covenant party?

A common misconception is that, if a particular part of a property is in disrepair at the start of a lease, repairs are not required for that element of the building: this is rarely the case, and a tenant is sometimes required to make good that element or put it into repair. Wording will vary depending on a number of factors, but particularly the age of the lease.

Repair or betterment?

Unfortunately, putting an element into repair may not be as simple as it sounds. Tenants should therefore be alert to the difference between repair and improvement, and know which of these is required for their lease.

As Simon Allison, a barrister specialising in landlord and tenant issues with Hardwicke Chambers says, 'the motive for landlords carrying out many works that might go beyond repair has changed over time, with the advent of changes in insurance terms, Building Regulations, health and safety, government grants and litigation culture'.

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He also makes the point that 'building technologies have advanced significantly, particularly in the past 10?20 years ? new forms of roofing systems, and vast increases in energy-efficient products such as glazing, insulation and cladding being most notable'.

Repair can for example unthinkingly become improvement when it comes to the concrete elements of a building. Take an industrial premises: the concrete floor slab has, over time, become damaged by spills and wear and tear, and at lease-end, the property must be put into repair.

This does not mean replacement of the whole slab but rather repair of the concrete. So is patching up the damaged areas enough, or should a new screed be laid? Suppose the Building Regulations have changed, though, and the new screed is of a higher specification than the old one?

Of course, the appropriate approach depends on the extent of damage, the lease terms and the type and use of the building. The tenants will almost certainly be obliged to ensure that the finished flooring is suitable for any incoming tenant?s use. Compliance with the current regulations is generally necessary as well.

Dowding and Reynolds recognise that on occasions such as this repair may, by necessity, include an element of 'improvement' or 'betterment'. That is, if a modern material is the only way to 'repair' because previously used materials are no longer available, tenants cannot usually avoid responsibility by merely claiming the remedy is inappropriate because it would result in improvement or betterment.

Roof coverings are another instance where tenants may be forced to make improvements, because the Building Regulations now call for insulation and coverings of a better quality than those previously required; *Postel Properties Ltd v Boots the Chemist Ltd [1996] 2 EGLR 60* illustrates this point.

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However, the reverse may be true when considering possible obligations under the Minimum Energy Efficiency Standards (MEES) , which came into effect on 1 April.

A tenant who has obligations to repair under their lease may be able to show that the landlord would need to make such significant changes to the property to satisfy the MEES that any repairs for which the tenant would be responsible would become null and void. Repairs would thus be a waste of time and money with no value under the new regime, so any works would be superseded.

Despite relating to a residential block rather than commercial premises, the recent case of Waaler v London Borough of Hounslow [2015] UKUT 0017 (LC) raises many of the same issues, and demonstrates the range of grey areas between repair and improvement.

Grey areas

The case of De Havilland Studios Ltd v Peries [2017] UKUT 322 (LC) illustrates just how difficult it is to negotiate these grey areas, even for legal experts.

At a factory converted into 41 flats, the windows were in need of work. The lease allowed for either repair or replacement, and the dispute arose over which was more appropriate. The freeholder opted for repair because it was cheaper, but the leaseholders disagreed and wanted new windows. When the freeholder refused, the leaseholders took the matter to the First-tier Tribunal (Property Chamber).

The tribunal initially determined that replacement was the most reasonable option due to the long-term benefit of new windows. However, on appeal the Upper Tribunal ruled that, while either option was reasonable, replacement rather than repair was ?more reasonable?.

This is a perfect example of how complex an issue repair can be, and where professional advice comes into its own; although assessing the legal costs against the costs of simply replacing the windows is perhaps the subject of another article.

One theoretical situation that illustrates the issues surrounding repair concerns a grade II listed residential block that also includes a single commercial unit.

In this case let?s assume the block is in receivership. The top-floor penthouse is being sold at the same time as negotiations are under way to agree a new lease on the commercial unit. The leaseholders are largely not permanent residents and mainly let their flats via an online hospitality platform.

Each party to the lease clearly has a part to play in ensuring that claims are avoided at lease-end

They are still paying service charges, but the landlord is not meeting its obligations to undertake repair work while it tries to keep expenditure to a minimum, finalise the lease on the commercial unit and sell the vacant penthouse.

As a result, the standard of internal and common parts is poor and the building doesn?t look the way the leaseholders wish so they can promote it to potential tenants. The landlord is clearly failing in its contractual obligation to keep the building 'in repair' so the receiver may find it has to fill the gap in the block?s finances, at least in the short term.

Limiting liability

Each party to the lease clearly has a part to play in ensuring that claims are avoided at lease-end. Occupiers should familiarise themselves with the repairing obligations, and landlords should also ensure they are fully and correctly advised and cognisant of what the lease as a contract obliges their tenants to do, how they plan to enforce this, and indeed whether this is what they intend.

Both parties should fully understand their liabilities, and property advisors could usefully suggest that tenants do the following.

- The property?s state of repair prior to the lease commencement should be recorded in a schedule of condition, agreed by both parties and annexed to the lease. However, it is important to note that the level of detail provided by this schedule and subsequent deterioration during the term will determine liability in line with the wording of the lease.
- When drafting schedules of condition, project yourself towards the lease-end date and ensure that they are as detailed and as useful as you or another surveyor would want to see them at that time.
- Plan for repairing obligations ahead of lease expiry. Develop a proactive approach to managing repairs before lease-end by establishing a planned preventative maintenance schedule and keeping the property in good repair for the duration of the lease.
- Clarify whether any surfaces require specialist cleaning to maintain finish or warranties. Respond to a quantified demand within the 56-day period that the Dilapidations Protocol recommends.

Occupiers need to decide how much money it would be prudent to set aside during the term of the lease to finance repairs on termination. Dilapidations are a relevant matter under International Accounting Standard 37 and International Financial Reporting Standard 12 , which is being updated and currently allows for future repairing liability to be treated as an expense. This means it can be included in the firm?s profit and loss account and will be excluded from its tax computation until it is incurred.

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Further information

- Related competencies include: Legal/regulatory compliance
- This feature was taken from the RICS Building Surveying journal (July/August 2018)
- Related categories include: Landlord and tenant