

Sustainable solutions

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The dilapidations process at the end of a lease can lead to a wasteful and unnecessary amount of work. Simon Brown outlines a potentially more sustainable approach

The majority of commercial leases require tenants to repair, redecorate and reinstate alterations to the premises at the end of a lease term. A tenant failing to comply has breached its contractual obligations and the landlord may be entitled to claim compensation through the dilapidations process.

These reinstatement conditions apply regardless of landlords' long-term refurbishment or redevelopment plans. As such, tenants are contractually obliged to carry out work that may be entirely unnecessary. In such situations it is not unknown for tenants to have to undertake a comprehensive scheme of works to put the premises in a condition that complies with their lease, yet come the expiry of the lease, the landlord still strips out and discards the repaired and reinstated ceilings, lights and carpets, because they do not match its refurbishment plans for the building.

Blank canvas?

There are also many instances in which the fit out left by the outgoing tenant provides a good standard of accommodation that could suit some prospective future tenants. But ironically, open plan buildings are more successful at the marketing stage ? providing a blank canvas enables prospective future tenants to visualise how the space may work for them.

These situations represent additional and unnecessary work, a considerable waste of money, resources and energy, not to mention disregard for sustainability. Many would quite rightly question why this should be the case. But a significant culture shift in the marketing environment and in tenants' mindsets is required to encourage them to take on a building with all ceilings, lights, carpets, interior structures and decoration in place.

Landlords' robust claims can still drive tenants to undertake works that, ultimately, both parties know are not in landlords' refurbishment plans, but tenants comply because this is the most economic route of risk mitigation

And incredibly, because of the legal agreements made, there is rarely an option for the landlord to intervene on a tenant undertaking the works that they are obliged to carry out.

To avoid the tenant completing unnecessary works, it has become commonplace for a

landlord to initiate the dilapidations and reinstatement negotiations regarding a financial settlement towards the end of a lease. However, the onset of early negotiations can see both parties strategise on how to maximise or minimise the claim. Landlords' robust claims can still drive tenants to undertake works that, ultimately, both parties know are not in landlords' refurbishment plans, but tenants comply because this is the most economic route of risk mitigation.

While a financial settlement for dilapidations liabilities is often reached and this avoids waste, there are plenty of occasions where the outcome is financially and environmentally inefficient. Surely reversing this trend would be welcomed by both landlords and tenants?

New approaches

Green leases sought to improve the interface between landlord and tenant in order to cut waste and inefficiency and promote sustainable practice, with landlords being encouraged to waive reinstatement obligations. However it is rare to encounter clients' dilapidations and reinstatement obligations that have differed from the norm due to a lease covenant born out of the intent to be more sustainable.

A potential solution to reducing waste and inefficiency is increased correlation between tenants' obligations and landlords' subsequent action post lease, or more obligation on landlords and tenants to go through this cycle in the most efficient manner possible.

Maybe it is time that an alternative approach is considered by those drafting heads of terms or leases?

- Could the lease include a covenant giving the landlord an option to demand a reinstatement payment rather than have tenants carry out refurbishment works? Once the landlord has exercised this, the tenant would no longer have the option to undertake the works, and the parties agree a financial sum for the dilapidations and reinstatement work. One issue, however, is how diminution in value is considered. Under Section 18 of the [Landlord and Tenant Act 1927](#), landlords' claim for dilapidations damages are currently capped by the loss of value in the building. Tenants will not want to move away from the protection that this statutory cap provides.
- Would tenants welcome the option to make an upfront payment as part of the licensing of alterations if they knew that there was no requirement to reinstate the works at the end of the lease? Tenants could make the payment upfront as part of licensing, requiring no work on their part at the end of the lease and the landlord addresses them as part of their refurbishment. The question in this case is whether damages for addressing disrepair can affectively be dealt with in isolation at lease-end?
- From time to time during a lease, tenants and landlords are prepared to restructure leases so that tenants pay an all-inclusive rent including the cost of repairs and reinstatement of alterations at the end of the term. Could there be a move towards such a structure at the outset of a lease? This can work well for both parties because it offers them certainty that they will not face a dilapidations dispute at the end of the lease. A potential difficulty, however, is that it could be difficult to predict the reasonably contemplated condition at the end of the term and the appropriate level of rent adjustment to compensate the landlord for this.
- Most leases require tenants to return to an outdated Category A arrangement, which typically includes raised floors and suspended ceilings, distribution of mechanical and electrical services, internal surface finishes and blinds. Would it be preferable if leases included landlords' options to require tenants to reinstate the space to shell and core? In this case it would be relatively easy to define the obligations and would prevent tenants needlessly reinstating elements that will ultimately be discarded. However, the sums potentially recoverable would tend to be lower than at present, so this may not appeal to landlords. Landlords may only consider such an option if there is a move towards shell and core for marketing

and what they provide at the commencement of the lease.

Contractual gap

None of these solutions is perfect, but given more careful consideration it may be possible to construct lease covenants that compel both parties to be more aligned in their actions regarding dilapidations, reinstatement and the subsequent refurbishment cycle. At present the principle of reinstatement to a Category A open plan arrangement for marketing purposes is entrenched in UK leasing culture and it is difficult to see this changing quickly. To tackle the current unsustainable system, a new approach would need to be considered in commercial leases and agreed at the outset by those drafting heads of terms and leases. The issue lies in closing the contractual gap between the tenants' obligations at lease end and the potential for landlords' refurbishment plans. The difficulty will be predicting these at the outset of the lease.

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Further information

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