In demand

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Mark Hampson explains how vital the role of the specialist dilapidations surveyor now is

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It is a common misconception that dilapidations work levels increase during a recession and lag in the boom time. In fact, the situation is quite the opposite. While the buoyancy or otherwise of the property market affects both the number and the nature of dilapidations instructions in different ways, there are many other factors that create opportunities for building surveyors carrying out such work.

Many of the long leases agreed in the 1990s and 2000s are now coming to an end. Because of these lengthy leases, the buildings to which they relate may now require substantial upgrading to attract new tenants or purchasers. Service installations, in particular, may not fulfil modern expectations, and the building itself may fall short of the incomingminimum energy efficiency rating.

Determining who is to pay for these big-ticket items is where the building surveyor with specialist dilapidations experience comes in. Over the past few years the importance of dilapidations has received increasing recognition from property stakeholders, not just at the end of leases but right through the property lifecycle, particularly in acquisitions, rent reviews and asset management:

Acquisitions

A competitive market means that those who purchase property with residual lease terms now want to price in accurate dilapidations recovery figures during the acquisition process. Take, for example, the buyer of a 100,000 sq. ft office with a residual lease term: the difference between a recovery rate of ?10/sq. ft and ?20/sq. ft will amount to ?1m for the whole building. The numbers really stack up, so landlords need to know what atenant may be liable for and factor that in to their bidding price or refurbishmentappraisal options.

But how is an accurate recovery rate formulated? The answer, again, lies with instructing a specialist dilapidations surveyor who has a thorough grasp of all of the relevant issues. Factors such as knowing what dilapidations items and costs will survive in the event of a refurbishment are critical, and require a comprehensive understanding of the lease and dilapidations law.

Rent reviews

Generally, rent reviews are carried out on the assumption that, at the review date, the tenant has complied with their covenants and that any of their improvements will be disregarded. This can cause difficulties.

Say the tenant has replaced a suspended ceiling system. They may argue this is an improvement and should therefore be disregarded at rent review. The landlord, on the other

hand, mayhold the view that the tenant was simply complying with their covenant to repair.

Without clear evidence of the damage to the old system, which would demonstrate whether or not the covenant to repair had been triggered, it will be difficult for the valuer to make an assessment. Had a record been taken of the physical condition of theoriginal ceiling at the time of lease commencement in an annexed schedule of condition ? perhaps in conjunction with covenants worded to limit liability ? such arguments could be properly assessed by the dilapidations surveyor, so the subsequent rent review would be a truereflection of the condition at that time.

Asset management

As capital value growth slows and property yields are squeezed, landlords and their advisors are exploring a range of asset management options to create value. Cost recovery is high on the list, and dilapidations considerations are more and more important to decision-making.

What dilapidations generally boil down to is determining what liability a tenant has for outstanding repairs. This is often far from straightforward as there are many issues to grapple with: debates around repair or replacement, whether the landlord will do the work or not or even opt for more extensive works or improvements, to name but a few.

Repair versus replacement

Unsurprisingly, a plethora of court cases have explored the issue of repair versus replacement. Invariably, tenants will prefer the cheaper, patching-up repair option,while for landlords replacement will be more appealing. But precisely when does patching-up become an unacceptable method of repair, leaving wholesale replacement, at the tenant?s expense, the only viable option?

Sometimes, the only practical and economic way of dealing with disrepair is replacement, as for instance where the claimant can produce credible evidence that repairs are not reasonable or possible. Incidentally, just because a building element has exceeded its indicative life-expectancy does not automatically validate a claim for its replacement, unless replacement would be both cheaper and lease-compliant.

Take an ageing air-conditioning fan coil unit, for example. Its motorised controls or fan decks may not be working, so replacement may be cheaper compared with continued, piecemeal repair, given the increasing difficulty of sourcing salvaged components, and the associated labour costs.

There may also be external influences to consider such as bye-laws or the Building Regulations, which may dictate that a higher or more up-to-date standard is required. The ever-tightening regulations governing the use of CFCs and other gases in air-conditioningsystems are a good example of this.

The precise wording of the lease is also key. Where the covenant to repair extendsto keeping the property in good condition (as in *Credit Suisse v Beegas NomineesLtd* [1994] EGLR 76), this can foster the expectation of a higher standard of repairthan clauses without the stipulation. While the argument is surprisingly little used innegotiations, it could be employed more widely in the current climate.

Landlord claims

Landlords sometimes have to go beyond the scope of the tenant?s remedial works and carry out enhancements and improvements to present the property to the market in a desirable condition. But what impact does this have on the dilapidations claim against the former tenant? Will it negate their ability to recover some of their costs?

In Sunlife Europe Ltd v Tiger Aspect Holdings Ltd [2013] EWHC 463 TCC, it was found that, where a tenant leaves a building in disrepair and the landlord decides to carry out improvements rather than simply repair it, the latter can still recover the original cost of repairs. But this can only be done if a landlord can prove that, had the premises been left in reasonable repair, they would not have replaced the disputed elements.

Putting Sunlife to one side, there are numerous cases where it has been found that the tenant only has to pay for dilapidations if the landlord has carried out ? or has demonstrated their intention to carry out ? the necessary repairs.

However, in @sipp Pension Trustees v Insight Travel Services Limited [2015] CSIH 91, the Inner House of the Court of Session ? the Scottish equivalent of the Court of Appeal ? upheld a lease provision allowing the landlord to recover the cost of dilapidations without proving that it would actually carry out the work.

The court found that a clause in the lease, which stated that at the lease?s end the tenant would pay the landlord for the cost of putting the premises into a good and substantial state of repair, was in fact a payment provision and not a claim for damages for breach of contract; therefore, the issue of whether or not the landlord intended to carry out the work was irrelevant. Accordingly, the landlord was entitled to payment as the tenant had failed to carry out the required repairs.

This case reverses the trend that has emerged in the courts over recent years in dilapidations cases and will, no doubt, be welcomed by commercial landlords.

Dilapidations are an issue not just at lease-end but practically throughout a building?s lifecycle, whether this concerns pursuing or defending interim dilapidations, service charge disputes, property acquisitions, rent reviews or broader asset management.

Specialist building surveyors appreciate the technical assessment of a building?s physical condition and the remedial works required to put defects right, and are ideally placed to deal with the complexities of dilapidations law. With large sums often at stake, the case for instructing a specialist is clear cut.

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Further information

- RICS Dilapidations Forum Conference will take place on 22 September in London. Book early to avoid disappointment
- Related competencies include Legal/regulatory compliance
- This feature is taken from the RICS *Building surveying* journal (May/June 2016)