Handling dilapidation claims

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Introduction

Jersey's commercial property market, until recently had been seen as one which tended to be particularly favourable to the landlord. If a building fell vacant usually there was someone eager and willing to move in and replace the outgoing tenant. On that basis a landlord's strategy for re-letting a building did not need to be too complex or aggressive and consequently the landlord's demands made upon the outgoing tenant tended to be limited.

In the last few years however local market conditions have changed significantly and the landlord of a twenty plus year old building now finds there are far fewer potential tenants searching for such space yet plenty similar space is available. All of a sudden it has become essential for the landlord to ensure that his building is in the best possible condition to secure a replacement tenant. To such end a landlord should look very carefully to see whether his outgoing tenant has fully complied with all his obligations under his lease to leave the building in a condition which accords with the tenant's repairing obligations. Are there wants of repair (or "dilapidations") for which the tenant is responsible? This is a question which in this changing market neither landlord nor tenant can afford to ignore.

The lease which the tenant originally entered into will very frequently make the tenant responsible for maintaining the whole of the building in good repair. A landlords' claims for failure to maintain the building in the appropriate condition can initially start at a level as high as the equivalent of about 2 years' rental. This can come as a very unpleasant shock to a tenant that has carefully planned and budgeted for a move into newer larger premises. Clearly with such sums at stake it makes sense for both the landlord and the tenant to be fully prepared to address the dilapidations claims process. Sometimes appreciation of the magnitude of the landlord's claim is enough to persuade a prospective outgoing tenant to stay put and cancel his plans to move to new

premises.

The landlord’s position

The landlord faced with a departing tenant needs to plan for that departure and carefully consider what his plans for the building are to be. He then needs to settle his strategy. Fundamental to that strategy will be the landlord’s view of what condition the building needs to be in to secure a new tenant.

The precise nature of an obligation to repair is a complex area of law and the nature of that obligation varies given the particular circumstances of each letting and each building. As a starting point no obligation to 'repair' can arise unless something is damaged or is in a state of disrepair. Further a straightforward repairing obligation does not oblige a tenant to render up a building in a brand new modern format or in pristine condition. Indeed if there are various ways of complying with a repairing obligation it is open for the tenant to choice the cheapest method if that is a competent and satisfactory way of effecting the repair.

Another frequent misconception is that the condition of the building at the commencement of the lease is the bench mark for the tenant’s repairing obligations. That will usually only ever be the case if the landlord and the tenant agree by reference to a schedule of condition that the tenant is not obliged to put or yield up the building in any better state or condition than it was in at the commencement of the lease as detailed in the schedule of condition. A standard sort of repairing obligation however usually has the effect of obliging the tenant to put and yield up a building in a good state of repair even if it was not in such state at the date the lease commenced.

If the landlord feels that his best chance of re-letting is to carry out a significant up-grade of the building this might well be a reason for him to seek to achieve a cash settlement with the tenant and thereafter undertake and have control of the works himself. This is because as indicated the tenant’s obligation to repair might not produce a building in the desired upgraded state so that the money spent by the tenant will be wasted when the tenant’s repairs are ripped out and replaced by the landlord’s upgraded fit out. On the other hand if the landlord is confident that the building will readily re-let if the outgoing tenant simply undertakes the repairs he is contractually obliged to undertake upon termination of his lease without any up-grades being undertaken, it is that much more likely that the landlord will prefer the tenant to actually undertake the works rather than seek a cash settlement from the tenant although a cash settlement would provide the landlord control over the quality of the works.

Having settled on his plans for the building the landlord will then be better placed to consider when he should serve a schedule of dilapidations upon the tenant setting out the landlord’s contentions as to what repairs the tenant needs to undertake in order to discharge his obligation to render up the building in a good state of repair. There is no obligation on the landlord to serve the schedule of dilapidations before the end of the lease. If the landlord feels he will be best

served by reaching a cash settlement with his tenant he will probably arrange for the schedule to be served well before the expiry date of the lease so that it can form the basis of negotiations between the parties.

If the landlord's building is a building let to several tenants with the landlord undertaking the repairs throughout the leases himself and recovering the costs by way of a service charge paid by the tenants the position is very different. In respect of those items of repair which the landlord is obliged to undertake he needs to actually undertake and complete the relevant works before the lease expires and issue the relevant demands for repayment of the costs incurred by him under the service charge provisions. Landlords (or their advisors) sometimes erroneously think the proper course with such a multi let building is to serve a schedule of dilapidations upon the tenant in respect of items which are under the terms of the lease the landlord's responsibility to undertake. If such an approach is adopted the landlord can find himself faced with the assertion that the tenant is only liable to contribute by way of the service charge for repairs actually completed by the landlord before the expiration of the lease. Huge sums can be lost to the landlord in such circumstances and the need for pro-active and proficient management of such buildings is high-lighted.

Even if, in the case of a multi let building the landlord undertakes and bills works before the end of the term he might still find that his tenant can justifiably in certain instances refuse to pay for certain large capital items on the basis that the works involved amount to the renewal of an item which will be of no benefit to the tenant. A classic example (in respect of which there are English court decisions) is that of the replacement of air conditioning plant. Landlords who have sought to replace such systems in the last year or so of a lease and recover the cost from their tenant by way of a service charge item have at times been left very sorely disappointed – and out of pocket. Given the need to ensure all air conditioning systems using R22 gases are replaced before the end of 2014, this is clearly an issue for all landlords to check, consider and if appropriate endeavour to manage with immediate effect. One possible solution for the landlord is to utilise a 'sinking fund' to spread the capital cost of significant capital replacements.

One further issue a landlord might consider is taking steps to position himself as well as possible to pursue a loss of rent claim if the tenant vacates without undertaking his repairing obligations. In a market where there is limited demand for the type of building which the landlord has to offer he will struggle to recover damages for loss of rent if it is established that the market conditions are such that it would be unlikely that the building would be re-let during the time, that the landlord will need to undertake the necessary repairs himself. A landlord could possibly improve his position in this regard by making enquiries as to the state of the market and seeking a new tenant in advance of the expiration date of the existing tenant's lease.

The tenant's position

As with the landlord the tenant needs to consider his exposure to a dilapidations claim well in

advance of the termination of the lease. Preparation and good management of the tenant's obligations from the commencement of the lease will by itself do an enormous amount in most cases to greatly limit the tenant's eventual dilapidations liabilities.

As a first step someone within the tenant's organisation should take responsibility for ensuring that all relevant documentation relating to the premises is kept together in a secure and organised manner. This collection of documentation should include any agreed schedule of condition recording the state and condition of the building at the beginning of the lease. It should also contain any side letters, copies of consents and licences for alterations (which read together with the lease should indicate whether alterations effected by the tenant during the term of the lease need to be re-instated when the lease expires), relevant maintenance records for electrical, air conditioning and other systems, health and safety records and copies of any notices served upon the tenant in respect of the building.

Almost invariably a well-drawn modern lease will place a tenant under an obligation to comply with statutory obligations relating to the building in addition to obligations to repair. Such obligations to comply with statutory provisions can impose very considerable obligations in addition to the standard repairing obligations, for example those relating to fire precautions and the removal of unsafe substances such as asbestos from the building. In considering the tenant's exposure at the expiration of the lease it is obviously important that regard also be had to the effect of any relevant statutory obligations.

In addition someone needs on a regular basis to check the state of repair of the building. A proper regime for the maintenance of the building needs to be put in place and adhered to. If small items of disrepair are left they can with time develop into large capital items of repair or even replacement. Inspection of many schedules of dilapidations reveals that there is a frequently recurring list of items which although on the face of it may appear cumulatively trivial can mount up and become very significant.

Well before the expiration date of the lease the tenant should seek his lawyer's advice and his surveyor's advice as to what items of disrepair he should be addressing and what the likely costs will be. The tenant can then consider his own strategy and endeavour to open up negotiations with the landlord as to a cash settlement. If it seems early on that the landlord is not prepared to negotiate a cash settlement then the tenant needs to be organised so that he can undertake all his dilapidation obligations well before the end of the lease. Actually undertaking the works if a sensible cash settlement cannot be achieved offers the tenant the prospect of doing the works himself and controlling the costs.

Sometimes the schedule of dilapidations that is served by the landlord is costed. Frequently the landlord's surveyor will have costed the items to be repaired item by item apparently on the basis that each item is dealt with in isolation and is the subject of a separate "call out". This safeguards the landlord if many items are subsequently removed from the schedule but does have the effect

of inflating the quantum of the landlord's claim. In addition if the schedule has been costed, in addition to the gross estimated cost of the actual works, items such as works administration and supervision, scaffolding, preliminaries, contingencies, legal fees and costs of preparing the schedule of condition for the landlord can increase the total claim by at times almost 50%. In addition if a negotiated cash settlement is to be achieved the surveyors acting for the landlord and the tenant may each charge up to 5% of the total agreed settlement sum.

Clearly if a sensible cash settlement cannot be achieved it will very frequently be in the financial interests of the tenant to ensure he can undertake the dilapidation works himself and do so for a far lower cost. The down side however for the tenant in undertaking the works himself is that there is always the risk that the landlord will contend once they have been completed by the tenant that they do not fully discharge the tenant's contractual obligations or that once they are completed the landlord serves a further schedule highlighting the need to do more remedial works than were provided for in the initial Schedule of Dilapidations.

The lingering risk of a dispute subsisting notwithstanding completion of works is one reason why a tenant might well be attracted by the certainty of a cash settlement in full and final settlement of the landlord's claims against him. In addition, if the landlord's dilapidations claim is settled on the basis of an agreed cash payment the tenant can remain in occupation of the building until the end of the lease and not be disrupted by the works. It is perhaps for these reasons that something in the order of 60% of all dilapidations claims are resolved by way of a cash settlement.

A final issue which the tenant should seek to ascertain are the landlord's intentions for the building once the lease has come to an end. Although there is no clear legal authority in the island the better view is that a landlord is not entitled to recover the cost of works which the tenant is contractually obliged to undertake if those works are going to be rendered futile as a result of an upgrade of the premises which the landlord intends to implement once the tenant has left the building. Sometimes the landlord will have made it very obvious that such is his intention by marketing the building prior to the end of the existing lease on the basis that a significant upgrade is to be undertaken. Often however, landlords are not so forthcoming although professional guidelines for the proper conduct of dilapidations disputes do call for full and frank disclosure of the landlord's intentions.

Conclusion

It is clear that dilapidation claims have become a feature of the local commercial letting market and that dealing with such claims can be a very tricky and costly matter. It is suggested that the best way of dealing with such claims from the perspective of either the landlord or the tenant is to take good advice and to plan and prepare well in advance. Indeed such process should start at the very outset of the dilapidations process which is when the lease itself is originally negotiated and drafted.

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Meet the Author

Jonathan Hughes

Partner

Jersey

E: jonathan.hughes@ogier.com

T: +44 1534 514336

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