Dilapidations

No easy answer

The RICS Dilapidations Forum recently held its inaugural Speakeasy event in London to discuss commercial lease end dilapidations and landlord's claims for loss of rent. Patrick Stell and Andrew Tugwell summarise the debate

“There is little consistency among surveyors in terms of deciding when the grounds for a loss of rent claim exist”

A standard lease end schedule of dilapidations lists breaches of tenant covenant and appropriate remedial works, with a cost for each item. The claim will often also include ‘consequential losses’, i.e. a costed detriment suffered by the landlord as a direct result of the initial tenant breach, for example loss of rent (plus rates and service charges).

There is little consistency among surveyors in terms of deciding when the grounds for a loss of rent claim exist, and therefore when a claim should be included. However, there is very little case law on the subject, with only minimal comment in the leading text books, the RICS Dilapidations Guidance Note and professional journals.

In our experience, there is an anomaly between the high levels claimed for loss of rent in schedules served on tenants (up to 50% of the total claim) versus the very low sums paid in settlement. If the claim is included, the landlord's surveyor often agrees to its omission at the very early stages of negotiation.

On the basis that surveyors settle approximately 80% of all schedules served, without involving the lawyers, it is highly important for surveyors that they get this right. It is also important that surveyors know when to recommend a lawyer's input to clarify this ambiguous area of the dilapidations dispute.

A leading case?

Scottish Mutual v British Telecom [1994] is quoted in most text books and articles as the leading case for loss of rent claims.

The experts for the landlord and tenant suggested a marketing period of two years and four years respectively. Importantly, both parties accepted that the contract period for the remedial works was just 20 weeks, considerably less than it would have taken to let the property. Following the lease end, the case was litigated with judgement given on a number of areas of dispute, including loss of rent.

The case established that where the tenant was in breach of covenant, the principal factor required for a loss of rent claim to succeed was that the remedial works procured by the landlord actually prevented the re-letting of the premises during the contract period.

The Judge in Scottish Mutual stated “Where loss of rent during the period required to carry out the repairs is to figure as a head of damage it is an essential prerequisite that it should be demonstrated on a balance of probabilities that the carrying out of those repairs after the end of the term has prevented or will prevent the letting of the premises for that period.”

In our experience, landlords have subsequently struggled to recover damages for loss of rent in situations where a tenant is not actually lined up to take a new lease during the contract period. This is generally viewed as a helpful judgement for tenants and may be why such a high proportion of the loss of rent claims served on tenants fail.

The legal view

The Scottish Mutual case concerned the hypothetical letting of a ‘white elephant’ building in a non-existent market. It is hardly surprising that the court struggled to see an adverse impact on immediate letting prospects due to disrepair.

In the context of today's improved market, however, there is no legal reason why loss of rent claims should not succeed. From a legal perspective, the practical issue is evidencing the loss. This was impossible in the case of Scottish Mutual but surely a better chance exists today? Surveyors rely on

Strategies for surveyors when acting for the landlord

• landlord’s works must relate to the breach – additional works could complicate the claim
• the burden is on the landlord to prove their loss – the market must support the claim
• the landlord must mitigate his loss and start works as soon as possible after lease end or even start preparations before then
• the property should be marketed as soon as possible
• offering a rent-free inducement to a new tenant specifically to remedy specified items of disrepair may work but this must be evidenced to be repair specific
• obtain good contemporaneous agency evidence on the state of the market at the lease end
• if instructed at the start of the lease, consider whether an unambiguous loss of rent recovery clause could be inserted in the lease.
Scottish Mutual at their peril if circumstances exist to show a bona fide loss taking into account prevailing market conditions. A complete disregard or capitulation in respect of loss of rent claims might even be negligent.

The legal advice must be to uphold the traditional starting point and consider a claim corresponding to the estimated loss arising for the period of works, but then consider some reality checks:

• Do you intend to carry out all of the works?
• How strong is the letting market? Is it more likely than not that a tenant could be found now? Can you evidence this?
• Will the dilapidated condition of the property affect/prevent marketing? Have you delayed the works or marketing unreasonably?
• Is the loss of rent period due to non-dilapidation factors such as other works?
• Do not mix a loss of rent for works period with rent-free incentives.

Of course, loss of rent is just one head of claim. It is logical that this part of the claim might be reduced or even disappear as part of a commercial negotiation. A good lawyer should spot a schedule of dilapidations without a loss of rent claim and send it back to check that this has been investigated.

The evidence
Landlords who have to carry out works in default of the tenant after lease end are often advised by their letting agents that marketing of the space is impossible until the works are complete, in all but the strongest market. In the case of office space, this would mean that the space had to be reinstated, repaired, redecorated and re-carpeted, i.e. until Practical Completion is achieved. Prospective tenants have repeatedly shown that they do not have the vision to see the potential in dilapidated premises, and that consequently the best rents can only be achieved when the property in repair. But is this enough?

If the landlord can show by arms-length advice from his letting agents that local market conditions or the nature of the building are such that the property is effectively unlettable until the works are completed, then a claim could be justified provided the landlord mitigated his loss by acting quickly and not including other works beyond remedies of the breach.

While some surveyors feel that the law needs clarification, part of the problem at least is a lack of appreciation that there is no easy answer. A building surveyor needs to look beyond the state of the building and to take into account other evidence, often from an unfamiliar area.

A good lawyer will also understand that, in practice, this kind of claim can be difficult to prove. Before pursuing a claim for loss of rent through the courts, a lawyer should help the surveyor conduct an examination of the evidence but, perhaps, should not be too quick to rule it out.

Maybe another case following Scottish Mutual will come along in the current market leading to a different comment from the courts and giving landlords a stronger position in negotiations. In the meantime, building surveyors need to understand the subject and work more closely with marketing agents and lawyers to prove any claims.

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For more information about the RICS Dilapidations Forum and its Speakeasy events, please contact Sarah Hunt at dilaps@rics.org.

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Strategies for surveyors when acting for the tenant

• complete the works prior to lease end
• offer the landlord vacant possession prior to lease end for the period of time that the works will take
• put the landlord on notice that there will be a breach, giving time to prepare the specifications and tender the works
• obtain contemporaneous agency evidence regarding the state of the market at the date of the lease end
• scrutinise the landlord’s works to see if there are additional works over and above those to remedy the breach
• carefully document the full extent of disrepair with photographs.

A lack of vision will prevent clients from seeing the potential of a dilapidated office.