

## The Dilapidations Conundrum

### Occupiers be warned! Your lease covenants could result in an unpleasant surprise for your P&L.

Landlords of commercial properties are increasingly using a strict interpretation of lease provisions to force occupiers to comply with their obligations, especially those relating to repairs and maintenance. We are aware of instances where landlords' advisors have gone into properties on a "no win, no fee" basis – resulting in unplanned work and expense for the occupier. In addition, compliance with accounting protocol (FRS 12) means that you must consider your liabilities in this regard and accrue accordingly.

But it doesn't have to be all bad news. If properties are managed properly, occupiers can enjoy the benefit of a property in good repair, whilst complying with their lease obligations and spreading expenditure over a number of years.

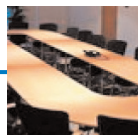
#### WHAT'S CURRENTLY HAPPENING?

A schedule of dilapidations can be served any time during the term of a lease or even several months after the tenancy has expired. Once a schedule of dilapidations has been served it sets in motion a chain of events which can ultimately lead to court action. Also, and most importantly, accounting standard FRS 12 states that dilapidation liabilities should be accurately assessed and accrued to comply with UK GAAP.

If faced with a dilapidations claim, The Civil Procedure Rules (CPR) dictate that "reasonable failure" by either party to comply with the "pre-action protocol", in the settlement of dilapidation disputes, will be taken into account by a court when, for example, assessing damages.

#### HOW CAN YOU PROTECT YOURSELF?

- **Before taking on your lease** – agree a schedule of condition with your prospective landlord. This becomes the benchmark against which repairs and reinstatement can be assessed in the future. Alternatively, if a full repairing lease is the only option available, survey the building, including plant and machinery, to understand where costs are likely to arise in the future – and don't forget that the landlord may seek to recover some costs indirectly through a service charge provision. So look to agree a cap on expenditure.
- **During the term of your lease** – plan and budget for ongoing repairs. Whilst this incurs costs, it does reduce disruption and void time at the end of a lease – i.e. where you have to leave the premises early to undertake the works before the lease expires or face a claim for damages.
- **Make provision in your accounts** – accounting standard FRS12 states that dilapidations should be accurately assessed and accrued. They should be sufficiently accurate, reliable and periodically re-assessed to ensure that they are keeping pace with changing costs and the condition of the premises. Failure to do so means you could be overstating your profits!
- **At the end of your lease** – anticipate that the landlord will seek to serve a dilapidations schedule on the occupier. This should reflect the works that have to be done to the property to enable it to meet the standards set by the lease. Human nature says that the landlord will be more pedantic during period of weak tenant demand and the chances of securing a new tenant are low.
- **Exercising a break option** – this is a special case. In most cases, the break will only be effective if the tenant has complied with its lease provision including repair and reinstatement obligations. If this hasn't happened, then the break provisions have not been met and the lease will continue to run until the next break date or its expiry. To avoid this risk, begin planning for the break 18-24 months before the break date.



## WHAT DO THE CIVIL PROCEDURE RULES MEAN FOR YOU?

- The objectives of the CPR are to deal with cases more quickly, cost effectively and justly. In essence, they adopt a position of independence and truthfulness.
- The CPR also encourage the early exchange of full information about a prospective legal claim. Whilst this means that more time is spent at the beginning of a claim, it should result in a more concise and accurate claim being made.
- The CPR exist to enable parties to avoid litigation and extra costs by agreeing a settlement of the claim before the commencement of Court proceedings. If litigation cannot be avoided, the CPR support the efficient management of proceedings.

## HAYWARDS' VIEW

From an occupier's perspective, not enough is being done on the planning of expenditure to satisfy leasehold obligations. On the flip side, landlords are terrified of inheriting properties in poor condition and are using lease covenants and service charge provisions to force occupiers to undertake repairs. We do not see this type of strategy changing in the foreseeable future, particularly given the slack market conditions and excess of property stock which is likely to prevail over the next 3 to 5 years.

The good news is that there is legislation and extensive case law in place that seeks to create a balance between landlord's and tenant's interests. However, no schedule should be accepted unchallenged.

There is little doubt that careful planning, backed by expert advice from technical people with business management expertise, forms a large part of a successful strategy. Such action will save money, time and help the business plan its property affairs more efficiently. It will also help avoid costly disputes. Your stakeholders will also enjoy your premises far more!

*Haywards is an independent consultancy working with occupiers to help them focus on real estate, capital projects, facilities management services and their workplace infrastructure issues. We have extensive experience in helping businesses maximise value and improve their bottom-line performance through efficient use of their physical assets. To discuss how Haywards would be able to help you, please call Tony Oxford on 01494 488 493 or email [tony.oxford@haywardsltd.co.uk](mailto:tony.oxford@haywardsltd.co.uk).*

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