Controlling The Spiralling Costs of Dilapidations Before You Sign The Lease

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The increase in dilapidations claims led to a recent report into terminal dilapidations claims for core commercial properties across the UK, commissioned by the RICS. The findings make worrying reading for commercial landlords and occupiers alike.

The report provides a useful benchmark for companies calculating their occupational costs during the term of a lease, as well as for dilapidations settlements at the end of the lease. It found the average final settlements for each type of property were as follows.

1. Offices - £9.54 per square foot.
2. Industrial - £7.27 per square foot.
3. Retail - £21.54 per square foot.

The adjusted average dilapidations final settlement for the three main property types is £9.35 per square foot. When you consider that the front end fit-out costs could be £30.00 per square foot it is obvious that every chance to control these costs should be taken. Sadly the best opportunity is the one least used.

The data above demonstrates that waiting until the lease end to consider dilapidations is a mistake. The best opportunity to make a real impact on the Landlords claim is before you sign your lease. Experience proves that there are many inconsistencies and errors, along with clauses and wording that disproportionately benefits the landlords, that find their way into leases and licenses which can impose penalties and costs on a tenant at lease end and which only become apparent once the opportunity is passed. These inconsistencies can be catastrophic when applied to break clauses.

An experienced dilapidations practitioner with knowledge gained from defending and prosecuting claims for Landlords and tenants can provide invaluable advice at the start of the process. The emphasis would be on clearing up and redrafting the inconsistencies to ensure that the lease end negotiation is more streamlined and, certainly, surprise free.

A sample of some of the issues that can find their way into your lease and license are provided below. Our experience confirms only too often that a seemingly insignificant error can be magnified when viewed through the prism of a landlord’s terminal claim.

New premises

- Ensure the lease contains an exclusion for latent and inherent defects and/or
- Assignment of developer’s and contractor’s warranties
- Ensure obligation at lease end matches the building condition at lease start, i.e. if no carpet was installed, don’t be obliged to leave one behind. Ensure that the lease obligation is clear as to what will be left at lease end
- Ensure the air conditioning is certified as balanced and in full working order. Do not assume that it is because it’s new, for example.

Existing premises

- Ensure the lease plan is new, and records the actual internal layout, i.e. position of partitions etc. If the premises are not open plan, then record every difference; do not accept a copy of the plan from the last lease
- Consider specific exclusions in lieu of the more traditional schedule of condition to exclude the obligation to replace elements like carpets and ceilings, air conditioning etc, if the condition at lease commencement is poor
If a schedule of condition is to be agreed, this MUST be fully descriptive, backed by photographs. Not photographs only. It should include the roof and mechanical and electrical systems validation. A visual inspection will not limit mechanical and electrical systems. The additional upfront costs of a full survey will be negligible compared with the costs of these items at lease end. For mechanical and electrical systems specific exclusions are the safest course.

Break clauses

- Breaks are not the same. Ensure that the conditions of the break are limited. Breaks that contain obligations to ensure full compliance with the lease are virtually impossible to achieve. These expose the tenant to additional premium payments from the landlord or significant overspend on the premises to ensure the break is effective.
- Breaks that require vacant possession should be carefully considered also. This obligation will require all tenant alterations to be removed and the premises returned to its original layout for the break to be effective. Detailed records of the original layout and performance of plant and machinery are essential.

Fees/costs

- If you are a tenant be clear on what you are required to pay in terms of the Landlords' fees. Fees for preparation and service of the schedule are reasonable, but paying the Landlords negotiation fees may not be. Make sure the wording is clear.
- Pay attention to clauses which specifically entitle the landlord to recover amounts equal to the annual rent for the period that it would take to put the property into repair. These clauses are increasingly appearing in leases and can add very significant sums to the landlords claim and may not be limited by Section 18, valuation protocols.

Alterations

- Limit the requirement for consent from the landlord to structural alterations only.
- If the landlords mechanical and electrical plant is to be altered or amended then ensure that evidence is available that record the system's operation prior to the alterations, i.e. temperature range etc.
- Apply a time limit to the lease end notice from the landlord requiring that alterations are to be removed. This will ensure that the tenant can manage the process. Alternatively ensure the lease is specific requiring for all tenant alterations to be removed at lease end.
- Remember Tenant licensed alterations, are not the tenant's property. Once alterations are fixed they belong to the landlord and consent is required to remove them. Tenants that remove alterations without notice from the landlords risk being required to put them back. This could prejudice your right to break as well as adding to cost.

The above is a summary of some of the issues of which a tenant should be aware. At Haywards (acquired by Avison Young in April 2014) we encourage our clients to be pro-active in managing dilapidations. To save time and costs this means looking at the issue of dilapidations before the lease is agreed and as early as the agreement of the heads of terms.

Whatever the situation, “dilapidations” is a complicated area. It is far more legally and operationally orientated than people think. As such, top level surveyors are both skilled in the application of the law and are operationally aware which can create far more value. They can also mitigate exposure to risk by a significant margin.

For more detailed advice on entering into a lease please contact Tony Oxford on +44 (0)20 7101 0200

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