

Dilapidations in commercial premises – ten points to consider

Dilapidations are seen by some as being a black and white issue. However as with so many aspects of the landlord and tenant relationship the position is not always so straightforward.

1 The wording of the obligation

Repairing covenants in commercial leases can oblige the parties to 'repair', 'keep in repair' or 'put and keep in repair'.

A covenant requiring a landlord or a tenant 'to put and keep in repair' imposes no additional burden than a covenant 'to repair'. The repairing obligation is, unless the subject matter of the covenant specifically suggests otherwise, an overarching covenant to repair that imposes a continuous obligation. The obligation being continuous, to repair is to keep in repair, and premises cannot be kept in repair without first being put into repair.

2 Qualifying words

What about the use of qualifying words and phrases such as 'good', 'good and substantial', or 'good and tenantable'? Do these words add anything to the meaning of the obligation?

The answer (and you may say that in a publication written by a lawyer what else would we expect?) is that it depends; on one hand the approach to the interpretation of any contract or clause in a contract is that the words have been used for a reason. If therefore the draftsman used the words 'good and substantial' he must have intended them to add something to the clause 'to repair'. The approach that the courts have tended to take in the interpretation of repairing covenants is nevertheless to treat adjectives of this sort as not having any significant effect on the scope of a repairing obligation.

This is not however to say that all qualifying words in a repairing covenant can be ignored. A covenant to repair, rebuild and renew clearly imposes a wider obligation on a tenant than a covenant just to repair. If unsure as to the meaning of a repairing covenant it is important to seek legal advice and/or that of a surveyor as the implications for either party can be significant.



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3 The standard of repair

Covenants to repair are not covenants to put into and thereafter to keep premises in perfect physical condition. If not perfect physical condition, what standard of repair is required?

As explained above, the effect of qualifying words such as 'good' and 'substantial' do not add anything to help identify the required standard of repair.

The standard of repair under what might be seen as the general repairing covenant is judged by answering the question 'what is needed to make these premises reasonably fit for occupation by a reasonable tenant of the class that would take it, factoring in the age of the premises, their location and character?' But what does this mean? There is no one hard and fast rule to apply because each set of premises can be unique in so many ways. There are however some general principles of application:

- The standard of repair for an old building will necessarily be different from that to be applied to a building which is new. Matters which might be seen as breaches in respect of a new building may not be seen as such in an old building.
- The location of the premises is relevant. Premises within a brand new state of the art building will necessarily require a higher

standard of repair than premises in secondary commercial areas. The example often cited is that the state of repair for a house in Grosvenor Square would be wholly different from the state of repair necessary for a house in Hackney.

- The likely use of the premises is relevant; premises that are used for scientific research may well require a host of different considerations to a warehouse.

All of these factors are judged objectively so the fact that specific premises are in high demand does not mean that the standard of repairing obligation is reduced. The identity or means of an outgoing tenant does not affect the standard of repair either.

4 Taking action during the term of a lease

The remedy of specific performance, that is forcing a tenant to carry out repairs, is available before the lease comes to an end, as long as damages would not provide the landlord with a suitable remedy (damages are considered below).

However, in the case of a lease of upwards of 7 years with more than 3 years unexpired, a landlord will usually be unable to rely upon the remedy of forfeiture or even to sue for damages as the availability of these remedies in such cases is severely curtailed.

In addition to the restriction on damages as an available remedy, the level of damages that a landlord is entitled to receive is subject to certain statutory caps (to which see below).

It is to overcome these difficulties that most modern leases contain a covenant entitling the landlord to re enter the premises, carry out the works of repair and to recover the cost of the same from the tenant as a debt, in the same way as rent (as opposed to damages).

5 Damages

Damages for breach of a tenant's repairing covenant are not assessed by reference to the cost of the works, although this may be highly relevant. Instead, damages are limited to the diminution, or loss, in value to the landlord's reversionary interest between (a) the premises as they actually are and (b) the premises in the condition they should be in had the lease covenants been performed. During the currency of the lease this can be significantly less than the cost of repairs, especially if the lease has many years left to run.

If bringing a claim for damages for breach of repairing covenant either during the currency of the lease or at the end of the term landlords should not rely solely upon the total figure quoted in a schedule of dilapidations as the basis of its claim. A separate 'diminution', or 'section 18' (as it is known) valuation should be obtained as well.

6 Continuation tenancies

A lease protected by the security of tenure provisions of the Landlord and Tenant Act 1954 will continue on expiry, unless it is terminated by a method prescribed by that Act, which means that the repairing covenants also continue. Normally it is accepted between landlord and tenant that a new lease will be granted and that the tenant's repairing obligations will be rolled over into the new lease. For this reason landlords do not always commission terminal schedules of dilapidations at contractual expiry.

This may be a costly mistake. Take the scenario of a landlord and tenant who negotiate for some twelve months over a new tenancy. The tenant then withdraws from the negotiations due to financial difficulties and is placed into administration or wound up. As against the tenant the landlord may only recover a few pence in the pound. The landlord may be able to look to a former tenant or guarantor in these circumstances. It is however almost always the case that the liability of a former tenant or guarantor will come to an end upon contractual expiry of the term. If a schedule is commissioned some twelve to eighteen months after contractual expiry how does the landlord show what condition the premises were in at contractual expiry? This is nigh impossible if a schedule was not prepared at that time.

7 Options to determine

Options to determine, or break clauses, are often subject to the condition of compliance by the tenant of its covenants in the lease, including the covenant to repair. Such covenants are strictly interpreted. Therefore unless the covenant is qualified in such a way as to require only 'material' compliance, minor items of non compliance can defeat the otherwise proper exercise of a break clause.

Non compliance does not mean anything less than perfect physical condition. It means that the standard of repair (to which see above) has not been met.

Most options require 'material' or 'substantial' compliance. As with many adjectives describing the scope of repairing covenants, the words 'material' and 'substantial' are interchangeable and are intended to exclude minor non compliances from preventing the operation of a break clause.

On the basis of the above the question of whether an option to determine can be avoided by reference to the repairing covenant must therefore be considered in four stages:

- 1 What is the scope of the repairing covenant?
- 2 Has there been compliance with the repairing covenant?
- 3 If not, to what extent has there been a failure to comply with a repairing covenant?
- 4 Is the extent of non compliance such that the terms of the option have not been complied with?



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If the exercise of a break clause depends on compliance with a repairing covenant it is essential that any necessary works are carried out in good time before the lease ends; the approval of the landlord should then be obtained, the condition of the premises monitored and on the last day of the lease a record of the condition of the premises taken. This should help prevent any dispute as to whether the tenant has complied with its obligations. From the landlord's point of view the same steps should be taken because if it wishes to challenge the validity of the exercise of a break clause evidence will be needed to back this up.

8 Reinstatement

Licences for alteration will inevitably contain provisions to reinstate. In a claim relating to dilapidations at the end of the term the parties must not forget to consider the terms of any licences granted by the landlord permitting alterations, as these will normally contain reinstatement provisions. For a tenant (especially a tenant as assignee) to be unaware of its obligations under licences to alter may result in an unwelcome additional liability.

9 Dilapidations: forward planning

Landlords and tenants should always keep an eye on dilapidations. A dilapidated property may adversely affect insurance coverage. It may result in a breach of health and safety at work legislation. A system of regular inspections and maintenance in accordance with leasehold covenants ensures both compliance with those covenants and also a spreading of the cost. So far as terminal dilapidations are concerned the landlord should be looking to identify areas of repair /reinstatement and advise the tenant of the same in good time for the tenant to carry out the repairs or alternatively to pay a sum of money in lieu. Leaving matters to the end of the lease or beyond may save the initial cost of a surveyor but this often turns out to be a false economy.

10 Leaving things too late

Far too often questions of disrepair are only considered after a lease has expired. This can be particularly unfortunate for a landlord needing to prove claims against a former tenant or guarantor.

More fundamentally, if a tenant disappears at the end of a lease or is in financial difficulty the landlord is left with no option but to meet the cost of putting premises into repair itself, and to absorb the lost rental income. This can often add significant expense which could have been avoided with early action.

This series of briefings is aimed at landlords and tenants of commercial property and future editions will focus on other aspects of the lease renewal process as well as common problems that are experienced during the course of the landlord and tenant relationship.

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