

# End of tenancy etiquette

Alex Charlesworth, David Shortall and Saleem Fazal discuss their respective roles as building surveyor, valuer and solicitor in the Dilapidations Protocol process

## EVENTS LEADING UP TO LEASE TERMINATION

### TENANT

- Consider preparation of a dilapidations assessment
- Carry out some or all works, or settle financially?

### LANDLORD

- Serve notice to reinstate
- Issue a terminal Schedule of Dilapidations

## TERMINATION OF THE TENANCY

## SEND SCHEDULE & QUANTIFIED DEMAND

### LANDLORD

- Issue a terminal schedule
- Sign endorsement
- Issue a Quantified Demand
- Disclose supporting documents

## RESPONSE

- Landlord & tenants' surveyors meet
- Tenant issues response and endorsement

← WITHIN 56 DAYS →

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While the Dilapidations Protocol is now commonplace, there is still the perception that it is a rigid inflexible process, with the ever

present danger of court action if it is not followed. However, the reality is that the protocol procedures are far from rigid and the terminology used is very carefully communicated, with the word *reasonable* featuring throughout.

The protocol's objective is actually to avoid court action, and this is done by setting out clear procedures and timeframes in order to reach settlement. There are however, still areas of misunderstanding around the process and demarcation of skills among professionals. It is important to appreciate that as well as the client, building surveyors, valuers and solicitors should be considered as one team, and each skill has its own place.

## The building surveyor

### Before termination

There is no obligation for a landlord to prepare a terminal schedule before the end of the term, but they often do so in order to promote early negotiations. Landlords usually want to reach a financial settlement and so timing of the schedule is often delayed to frustrate the tenant's ability to undertake the works in

time. As a result, tenants approaching the end of the lease term often appoint their own surveyor to assess liability and cost. Forewarned is forearmed.

There is no obligation for a tenant to respond to a terminal schedule served before the tenancy ends. Many surveyors still misquote the protocol, particularly when trying to extract a response from the other side. The simple fact is that the protocol does not apply until termination of a tenancy. The clue is in the full title: Pre-action Protocol for claims for damages in relation to the physical state of commercial property *at termination of a tenancy*".

### At termination

The protocol now applies, and its timeframe gives a landlord up to 56 days within which to issue a Schedule of Dilapidations. This will also include an endorsement stating the landlord's intentions and the Quantified Demand. This timeframe should be taken as a maximum guidance only. While many landlords often state that the intention is to undertake the dilapidation works, it is clear that many will also be exploring alternative options at the same time. If the landlord intends to undertake works that are likely to dilute or supersede parts of the claim, then this must be taken into account. It rests with the tenant to prove the landlord's intention at or shortly after termination of a tenancy, which will be very difficult.

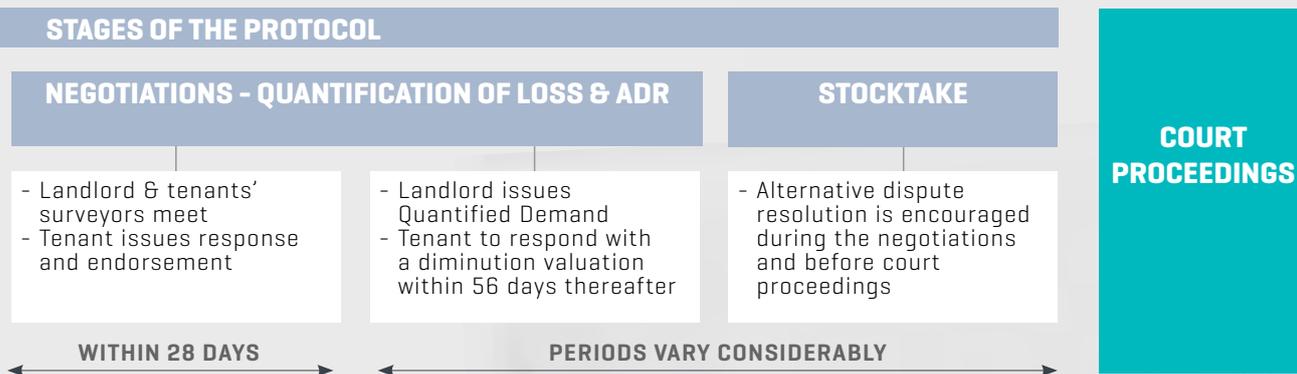
Parties are encouraged to meet before the response to the Quantified Demand is due. Parties should also meet within 28 days after the tenant sends the response with the aim of agreeing as many items as possible, reducing the scope of dispute. It is after this process that the protocol then gives guidance to alternative dispute resolution and quantification of loss. The latter requires a detailed breakdown of issues and consequential losses based on either a formal diminution valuation or an account of the actual expenditure, or a combination of both.

It is clear that where the landlord is intending to undertake works, there is no requirement for a diminution valuation to be prepared. On the other hand, where they are not, then early preparation of a diminution valuation should be considered.

During negotiations, legal disputes often arise, in particular over interpretation of liability. This is where the building surveyor's demarcation of skills lies. It is not their role to pontificate on whether a particular legal case is relevant. Each case has its own unique set of circumstances and is therefore very unlikely to match the subject situation. By all means discuss principles established by such legal cases, but the application or context surrounding them should be dealt with by the legal profession.



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## The valuer

Section 18 (1) of the Landlord and Tenant Act 1927 operates to impose a statutory cap on the amount recoverable in damages for a claim in dilapidations in respect of breaches of covenant in relation to repair.

Under the first limb of Section 18 (1), the measure of damages recoverable is capped at the diminution in value of the landlord's reversion, or interest. The second limb operates to eliminate a claim in circumstances where the landlord intends to pull down the building or make structural alterations that would render valueless the repairs.

The operation of common law, applies the principle of diminution in value to other breaches of covenant, albeit this does not emanate directly from Section 18 (1).

The valuer's input primarily relates to the operation of its first limb. The second limb is largely evidential.

In order to assess the diminution in value of the landlord's interest, the valuer will need to consider the likely future for the building. Using local market evidence, the valuer will draw preliminary conclusions as to whether a purchaser of the building is likely to simply carry out the dilapidations works, or refurbish, improve or upgrade, alter or extend, or perhaps change the use of the building.

These preliminary conclusions are then tested by reference to alternative

valuations, or appraisals, reflecting the alternative futures. The appraisal that produces the highest value is likely to reflect the course of action that a building purchaser would pursue, and result in the highest bidder for the property, which is the true open market value.

In order to determine the measure of diminution in value, the valuer must carry out two valuations. Valuation A – assuming compliance or In repair and Valuation B – in actual state of repair. The diminution in value is that difference between these two.

In undertaking the valuations, the valuer relies heavily on input from the building surveyor and they must work together as a team. The end result will be highly dependent on the quality of the building surveyor's analysis. The process should work as follows.

The valuer must initially determine the likely alternative futures for the building. For each, two additional columns (survival works and superseded works) should be added to the Scott Schedule and analysed jointly by the building surveyor and valuer. Each item of work should fall into one or other of these columns. The valuer will rely on the building surveyor's expertise to advise as to whether a certain item of work will survive a particular future for the building, or if it is to be superseded, the value of any survival works. It is possible that part of the cost may fall into both columns if

part would survive and part would be superseded.

The building surveyor will also need to advise the valuer on the cost of any works of improvement or alterations that might fall within a contemplated future for the building; for example this might relate to upgrading an old office building to Grade A specification, or conversion to an alternative use such as residential or hotel.

The value of the survival works is a key element in the valuer's assessment of diminution in value.

In responding to a Schedule of Dilapidations, building surveyors representing a tenant are sometimes tempted to exclude certain works on the basis that there is a possibility they may be superseded by either the perceived intentions of the actual landlord, or a purchaser of the building in the market. This approach is misguided. The building surveyor should be careful to detail the common law claim by detailing the tenant's breach of covenant, the appropriate remedy, and the cost of this remedy.

## ► The solicitor

Almost 10 years after first being introduced by the Property Litigation Association, the Dilapidations Protocol was adopted by the Civil Procedure Rules (CPR) in January 2012. This means that it must be followed in all terminal dilapidations claims. Various time limits are outlined but the intention is to set out a framework for dealing with the claim – although a party that misses a deadline will not be prevented from bringing or defending a claim. It is all about following a reasonable process leading (hopefully) to an early settlement. A party that fails to heed this advice risks adverse costs orders against them even if they are successful.

Solicitors should be instructed at an early stage, particularly on matters relating to legal interpretation of liability. Following the expiry of the lease, it is sensible in most cases to formally serve a terminal schedule of dilapidations and invoke the timetable set out in the Protocol, which aims to encourage parties to engage in the process.

This applies to both parties. Consequently, a tenant should not play its cards close to its chest and fail to engage, particularly if there is a potential defence under Section 18(1) of the Landlord and Tenant Act 1927.

A clear example of that is seen in the recent case of [Hammersmatch Properties \(Welwyn\) Ltd v Saint-Gobain Ceramics and Plastics Ltd and another](#) [2013] EWHC 2227. In that case, it was found that Saint Gobain as tenant did not set out its defence early enough in the negotiations and for that reason the judge was not as generous as he might have been when deciding the question of costs. The judge said:

*“Saint-Gobain did not, until proceedings were far advanced, properly engage in the detail of the schedule of dilapidations or in relation to the quantum of its case on*

*diminution in value.....the information which had been provided by Saint-Gobain to Hammersmatch, particularly in relation to diminution in value, made it difficult to assess the Saint-Gobain case.”*

The *Hammersmatch* case represents an example of how the court might approach the question of costs following the Jackson reforms on costs. As part of the reforms, changes were made to CPR Part 36, which governs offers to settle and the cost consequences that then apply depending on whether a party beats its offer. One of the changes was to make it clear that a so-called ‘near-miss’ will not help the offeror. There had been some uncertainty about this following the case of [Carver v BAA plc](#) [2008] EWCA Civ 412, in which the Court of Appeal considered that a near miss entitled it to exercise its discretion in the offeror’s favour.

Hammersmatch’s original claim amounted to £7.6m. That sum reduced to £6.8m when proceedings were commenced. Hammersmatch had made a Part 36 offer of £3.2m and Saint-Gobain had made an offer of £1m in December 2011. Following the trial, Hammersmatch only recovered £900,000 plus interest and costs of serving the schedules. Take into account interest on Saint-Gobain’s offer and Hammersmatch only recovered £3,637.90 more at trial than if it had accepted the offer. If Saint-Gobain had offered around £4,000 more, then Hammersmatch would have been liable to pay Saint-Gobain’s costs from January 2012 as well as its own.

The court held that Saint-Gobain had failed to beat its offer. In addition, as mentioned above, the judge found that Saint-Gobain did not set out its defence early enough in the case. However, given that some costs were wasted by Hammersmatch’s apparent intention to carry out the works, the court reduced

Saint-Gobain’s liability slightly and it was ordered to pay 80% of Hammersmatch’s costs. Given the likely level of costs incurred, that is a harsh lesson to a tenant who underbid by £3,637.90.

The courts will penalise parties that do not seek an early negotiation. Indeed, after the exchange of their statements of case, the parties have to lodge an allocation questionnaire. One of the points raised in this is that the parties should make every effort to settle their case. Legal representatives have to confirm to the court that they have advised their client about the need to try to settle, the options available and the cost sanctions that may otherwise apply. Consequently, there is no escape from the rules.

## Summary

While the protocol sets out a procedural guide, the final stage of which is court proceedings, its aim is to encourage early settlement. However, the route can be tortuous, and should only be contemplated with the right team. Early engagement and interaction between building surveyors, valuers and solicitors, and not forgetting the client is paramount. ●

*This article is written in respect of dilapidations in England and Wales only. In circumstances where break clauses are operated which require material or specific performance then specialist advice should be sought.*

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