radius
consulting

Diminished Value

- In England & Wales, with similar in Ireland and IOM (none in Scotland and Northern Ireland), statute exists to cap dilapidation settlements at the lower of the cost of doing the works <u>or</u> the impact if any on the freehold reversionary value of not doing so.
- In E & W , this is Section 18 (1) of the LTA 1927. The very fact that pre-existing common law was codified in this way, informs that there must be every likelihood that 'costs' and 'value' are <u>not</u> necessarily one and the same!
- Indeed, in *Landau v Marchbank* (1949) it was noted that '*the fact that repairs are necessary is not in itself* (conclusive) *evidence of damage to the value of the reversion*'.

First Limb

- "Damages for a breach of covenant or agreement to keep or put premises in repair during the currency of a lease, or to leave or put premises in repair at the termination of a lease, whether such covenant or agreement is expressed or implied, ***shall in no case exceed the amount (if any) by which the value of the reversion*** (whether immediate or not) in the premises ***is diminished owing to the breach of such covenant*** as aforesaid."

- **<u>Objective</u>** test.

Second Limb

- "…and in particular, no damage shall be recovered for a breach of any such covenant or agreement to leave or put premises in repair at the termination of a lease, if it is shown the premises, in whatever state of repair they might be, would at or shortly after the termination of the tenancy have been or be pulled down, or such structural alterations made therein as would render valueless the repairs covered by the covenant or agreement."
- **Subjective** test.
- Section 18 caps repairs only. Similar common law principles do however also serve to cap both Reinstatement and Decorating obligations.

- Depending on the ‘*age, character and locality*’ of the property and likely ‘*calibre*’ of tenant (after *Proudfoot -v- Hart* 1890), certain bone fide repair (or reinstatement) items might have little or no impact upon lettability, hence value

- But how do valuers ‘objectively’ articulate and explain their conclusions?

- For there is no rule book. No RICS Practice manual

- *Dowding & Reynolds* provide helpful worked examples and guidance. There are very few Section 18 specialists.

Common Approach

- Two valuations, one 'in' and the other 'out' of repair.
- This process becomes a nonsense if the Landlord's Section 18 deducts the entirety of their (higher) B.S's costs (plus assumed mesne profits) and the Tenant's deducts their lower costs (with no mesne profits). Whether or not they have widely different 'in repair' valuations is obviously irrelevant
- The two valuation approach is <u>not</u> actually what Section 18 seeks. Rather, it enquires as to a <u>single</u> figure, being '*the amount (if any) by which the value in the reversion is diminished*'.
- In practice, two distinct valuations can only be reliably achieved if <u>each</u> has perfect comparables.
- As such, courts have criticised the customary approach (of deducting all costs, absent scrutiny) as designed to prove what is claimed, namely that the Landlord's (estimated) cost of works etc is the Landlord's actual loss. See *Simmons v Dresden* (2004).

Traditional Approach- The Two Valuation Mantra

- The application of Section 18 (1) theoretically requires two valuations, namely:-

The value of the landlord's interest on the assumption the Property is in its covenanted state (condition) on that date (**Valuation A – Assuming Compliance**)

and

The value of the landlord's interest in its actual state (condition) on the Valuation Date (**Valuation B - In Actual Condition**)

- Only possible if have open market comparable evidence in each distinct state
- Fundamentally a DV therefore comprises cost of 'value affective works' plus provable loss of rent

Our Approach – Two Filters

- Valuer applies experience to ‘filter’ out works unlikely to survive (be ‘value affective’) due to:
  - Likely use going forwards
    - Supersession
  - What is salient to recovery of value
    - What local market expects
    - “Age character and locality”
    - Likely calibre of Tenant

Loss Of Rent

- Either specifically 'quantified' in the common law assessment or incorporated within the valuation by a longer void period

- Such only applies if it can be '*demonstrated* (that) *on the balance of probabilities the carrying out of those repairs* (immediately) *after the term prevented the letting of the premises for that* (works) *period'*

Scottish Mutual Assurance Society Limited -v- British Telecommunications plc

VAT

- VAT should only be added if it is judged that there is a realistic possibility that the landlord will do these works in their entirety, provided that he cannot reclaim it as input tax (after *Drummond – v – S & V Stores Ltd* (1981) 1 EGLR 42). See also *Elite Investment Ltd – v – T I Bainbridge (Silencers) Ltd* (No. 2) (1986) 2 EGLR 43.

- Whether VAT is reclaimable depends also on the landlord's own tax position, and/or whether the Property currently is, or is likely to be, elected for VAT.

- Whether or not the Property is already elected, it follows that the landlord would elect it upon cash settlement, hence securing both the recovery of his own expenditure and to secure a "windfall" gain (after *Elite*) insofar as any purported VAT paid to settle this claim.

Jasper House, London

- CLAIM - £1.2 million
- SECTION 18 (1) FOR T- £250,000
- RESULT (Mediation) - £380,000
- As vacated, the specification of the offices needed to be upgraded to meet modern requirements
- Section 18 assisted in settlement – in particular to dismiss LL's claim for loss of rent (large amount of secondary offices on market nearby) and 'value affective works' – limited to strip out and externals

Scimitar House, Romford

- SECTION 18 (1) FOR LL - £550,000
- RESULT - £475,000
- T's OFFER - £Nil
- T's main argument – offices need to be significantly upgraded (supersession) or converted to residential
- Analysis of local office market disputed this and assisted in securing nearly whole of common law claim

Darley St, Bradford

- AGREED B.S COSTS - £840k
- RADIUS S.18 (1) - £580,000
- SETTLEMENT - £615,000
- £400k related to asbestos removal – strict requirement
- Majority of Darley St vacant
- Landlord likely to have to split - supersession

High Street, Banbury

- CLAIM - £112,383
- LL's S.18 (1)- £63,750
- T's B.S Assessment - £70,000
- RADIUS S.18 (1) - £36,750
- RESULT - £41,500
- Large amount of claim related to dilapidated upper floors
- Of no valuation benefit, even if in repair

Greyhound Retail Park, Chester

- S.18 (1) for LL – common claim assessment £229,000
- T's Offer - £nil
- LL agreed reletting
- Analysis of HoT's concluded a S.18 cap £195 - £200,000
- Settlement £150,000

Rowland House, Chesterfield

- Section 18 (1) for Landlord
- LL's Claim - £595,000
- T's Response - £432,000
- T's S.18 (1) - £60,000 – claimed no market for property as vacated – likely residential conversion
- Our Section 18 (1) – supported LL's claim and provided evidence that the offices could be let if in repair
- Settlement - £515,000

Longmead Ind Estate, Epsom

- 50,000 sq ft former distribution centre
- Common Law Claim - £500,000
- Our Section 18(1) on behalf of T - £310,000-£320,000
- Office part of building outmoded:
  - No air con
  - Dated heating system
  - Poor specification
- Needed to be improved in order to relet
- Settlement - £330,000

Landlord Works/Cost=Value?

- Common view – if LL has done the works then he has crystallised his claim
- Not always the case, especially in such a weak market
- Crucially, it overlooks – as do anti-section 18 propagandists – that ‘Cost’ and ‘Value’ are <u>not</u> the same thing
- By reverse analogy, imagine adding a £50k *Amdega* oak conservatory to a 1930’s semi ex-Council house in Wigan?
- *Landau -v- Marchbank* features eminent common sense in noting that

“the fact that repairs are necessary is not in itself (conclusive) evidence of damage to the value of the reversion.”

Canterbury

- Landlord had undertaken works and relet to a new tenant. Seeking cost of works to justify Claim
- Cost of Works - £150,000
- Section 18 (1) for T - £70,000.
- Had done considerable decorative works to upper parts – not used by new tenant
- Settlement - £75,000

Tunbridge Wells

- Landlord spent £400k and relet
- Claim - £195,000
- Section 18 (1) for T - £110,000
- Relet at £12.63 psf
- Local evidence suggested that rent of £14 psf could be achieved on basis of new carpets and redecoration <u>only</u>
- Settlement - £120,000

Schedule of Condition

- Scenario – Landlord relets property on market terms without undertaking any works <u>but</u> with a schedule of condition

- Effect on reversionary value?
  - Each case on their own merits
  - Schedule of condition may relate to areas that have no value – extensive upper floors for example
  - Because of SoC, full rent as if in good order most likely achieved
  - By fact of reletting, 'breaches' in SoC not severe to prevent occupation
  - If Tenant vacates in no worse condition, LL should be able to relet
  - In any event, the earliest date the SoC comes into effect is at the end of the new agreement – therefore the cost of works are 'deferred'

Dispute Resolution

- Less than 1% go to Court.
- Primary defence is to formally offer to Mediate.
- 85% success rate (67% on day) – CEDR May 2016 Audit.
- If offered Mediation and either reject or ignore, heavily penalised on costs at trial, even if the 'winner'. See *Dunnett v Railtrack* (2002); *Halsey v Milton Keynes NHS Trust* (2004); *PGF II SA v OMFS Company Space 1 Limited* (2013).
- Simply 'going through the motions' is not an option either – *Earl of Malmesbury v Strutt & Parker* (2008).
- Considerably cheaper than court, and zero risk.
- The key to success is to 'manage your pole'.

D.V's– Effectiveness ?

- Not appropriate for <u>every</u> case; 'honest overviews'.
- But is very effective in most cases.
- Should the B.S judge if s18 is necessary?
- The report is best <u>used</u> by the B.S, sent direct to his opposite number, as a key weapon in his armoury.
- The (not CPR compliant) report is deliberately designed to discomfit the other side.
- The substantial majority of cases settle at, or below, the tenant Building Surveyor's (tactical) Response position, therefore being successful.
- The fact of our longstanding blue chip client base testifies.

Dilapps