DILAPIDATIONS CLAIMS FOR RETAILERS

SECTION 18 APPLICATION

1.0 REASON & PURPOSE

1.1 This brief document is provided "*to help retail property managers understand the key principles of Section 18, and when to use it*".

2.0 DIMINUTION VALUATIONS

2.1 Section 18 (1) as to repairing covenants, along with similar common law provisions as to reinstatement and decorations, caps the landlord's loss due to dilapidations to the lower of the cost of the works, or the impact (if any) upon the otherwise full reversionary value.

2.2 Dilapidations are led by the **building** surveyor who must identify all breaches (of covenants to repair, decorate and reinstate), propose (appropriate and proportionate) remedies, and price accordingly.

2.3 It is then for the **valuation** surveyor to apply two "filters" to this Response document thus:-

(i) **Supersession** – To remove items which are known actually will be – or most probably will be – superseded in terms of upgrading, modernising, and otherwise evolving the Property to its most marketable state going forwards;

and

(ii) **Items "*Not Value-Affective*" ("*NVA*")** – For most second-hand properties, one reaches a point in expenditure beyond which one can keep on spending, but no more will be added to (or recovered in) the reversionary value. In other words, the "*law of diminishing returns*" invariably applies.

2.4.1 The above are applied in the context of the commonly cited judgement in *Proudfoot -v- Hart*[1], namely that the impact (if any) of breaches on value must be considered in the context both of the "*age, character and locality*" of the property in question, as well as the likely "*calibre*" of subsequent occupier.

2.4.2 Moreover, as per the case of *Commercial Union Life Assurance Co -v- Label Ink Ltd*[2] "*good repair*" is not the same as "*perfect repair*" and in fact "*relates only to the age of the building. Good repair is different in old and new premises…*".

2.5.1 In practice, the impact of breaches of all three covenants (to repair, decorate & reinstate) on **value** is all but always far less than the lowest reasonable common law (Cost of Works) assessment.

2.5.2 This is because, in the context of the two "filters" briefly described at 2.3 above, almost every vacated property (especially offices and bespoke Bank branches) would have a weak, or no, market if only the breaches were remedied.

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[1] *Proudfoot -v- Hart* [1890] L.R.25 Q.B.D. 42, CA

[2] *Commercial Union Life Assurance Co -v- Label Ink Ltd* [2001] L. & T.R.29, Ch D

2.5.3 At the very least, offices require modernising to optimise relettability, which works supersede much of what is claimed.

2.5.4 More often, and especially with bespoke branches, the building is now functionally obsolescent i.e. there is no market for it as is. It requires significant repurposing works to meet modern demand (e.g. conversion of upper floors to residential, and ground floor to restaurant/shop). Again, significant supersession, whether or not the Landlord "admits" it.

2.5.5 It is the Valuer's role in effective application of Section 18 to reflect what the open market would likely do to the property, unfettered by what the landlord conveniently claims is "intended". Intentions change, usually after settlement!

2.5.6 Further, per 2.3 (ii) above, not all breaches affect value. Expensive items to remedy like scaffolding for, and attending to, shrunken pointing, spalled/dirty brickwork etc. are commonly irrelevant to lettability/value.

2.6.1 **Reinstatement**: Landlords often claim erroneously, in that subsequent lease renewals have in fact made all that is seen on site part of the demise when vacated. This often includes the full Bank fit-out.

2.6.2 Whilst *your* role as Building Surveyor is then to cost remedies to leave "in repair", the Valuer will reason why this must all be removed (as no market for old fitted banking halls) and made good by the landlord, such essential repurposing works also serving to supersede otherwise legitimate claims (e.g. internal decorations).

2.7.1 **No works done** by the landlord, which is common, means that any "loss" is to be assessed by a DV and not on Cost of Works (*Protocol,* at paragraph 9.4).

2.7.2 Tactically, it usually pays to pre-empt as tenant and lead with a DV, both because landlords rarely then go on to get their own and because it will usually temper the scale of any works then done.

2.8.1 **Re-letting** by landlords, no works done, often leads to the claim that loss is now evidenced by reduced rent, longer rent-free period and/or having a Schedule of Condition.

2.8.2 This is rarely true in practice, once fully examined by a specialist valuer by reference to comparable transactional evidence.

2.9.1 **Landlord "does the works"** inevitably leads to the claim that loss is now "proven" in the sum spent and so a DV is not necessary.

2.9.2 However, closer examination usually reveals significant supersession/betterment, with the Valuer uniquely maximising what would be legitimately struck out on the basis that the "hypothetical purchaser" would also have replaced with new even if "in repair".

3.0 LOSS OF RENT

3.1 Whilst often claimed, rarely if ever should this succeed.

3.2 Limited, more or less, to cases where it can be proven a new tenant is contractually committed to taking up occupation the day after lease expiry, but cannot do so solely due to dilapidations (as distinct from other enabling works required).

4.0 VAT

4.1 This should be robustly resisted.

4.2 Case law counters against what will usually be a "*windfall gain*" for landlords[3]. Moreover, the Valuer focuses on the "hypothetical purchaser" who can be reasonably taken to be able to recover VAT or if not, would instead elect the property.

4.3 The crux is that because most to all vacated properties do, in reality, require more works doing than just dilapidations – to modernise/repurpose – which is of course at the landlord's expense, it is thus illogical to accept that the hypothetical purchaser would willing pay 20% over the odds for those works, and therefore any dilapidations remedies.

5.0 WHEN TO USE DVs?

5.1 By the above, it should be appreciated that every settlement is at risk of being excessive, without a DV.

5.2 Especially in **Shopping Centres** where DV usually achieves at or about NIL damages (contact us for explanation)

6.0 FEES

6.1 Per the Schedule below for a DV to supplement your own Building Surveyor's negotiations.

(In the alternative,if you instruct us through DILAPSOLUTIONS,you will pay much the same fee as you do to another Building Consultancy,with one of our Building Surveyors working in tandem with one of our specialist Valuers from the outset.Certain lowest settlement sum,without the extra cost and hassle of sourcing the DV input elsewhere.)

- Claims of < £200k = £4,000
- £200k - £399,999 = £4,500
- £400k - £599,999 = £5,000
- £600k - £799,999 = £5,500
- £800k - £999,999 = £6,000
- > £1m = £7,000

[3] *Elite Investment Ltd -v-T I Bainbridge (Silencers) Ltd* (No. 2) (1986) 2 EGLR 43
Drummond -v-S & V Stores Ltd (1981) 1 EGLR 42)

7.0 FURTHER INFORMATION

7.1 Case Studies, Webinars, Articles etc. at:

- www.radius-consulting.com
- www.dilapsolutions.com

8.0 KEY RADIUS CONTACTS

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November 2022