DILAPIDATIONS : QUICK-GUIDE TO

SECTION 18 (DIMINUTION) VALUATIONS IN PRACTICE

1.0 REASON & PURPOSE

1.1 This brief document is provided "*to help both in-house teams and consultant Building Surveyors 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(i) **Supersession** – To remove items which are known actually will be – or most probably will be – superseded in terms of upgrading, modernising, and otherwise evolving the Property to its most marketable state going forwards;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.

[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,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.**It is the Valuer,not the Building Surveyor,whose arena informs the cases where if the landlord was to do just the remedial works as claimed,the Property would still be unlettable** as it is of a size/configurations/spec of a bygone era.Recreating it as something lettable these days,will involve works which snuff out (supersede) much of what is claimed.

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 fit-out.

2.6.2 Whilst the Building Surveyor's role is to then cost remedies to leave that fit-out "in repair", the Valuer will reason why this must all be removed by the landlord as part of the works to repurpose going forwards (thus overriding/superseding other items the building surveyor may otherwise accept eg redecs which would be ruined by the landlord's strip-out).Or in the alternative,that the most likely market is to a new start/temp tenant,who will reuse old shopfit;a shell unit would be unlettable due to the prohibitive cost of fitting out from scratch.

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 The Building Surveyor's expertise is in costs/remedies only.It is the **Valuer who knows "the market" and so how to maximise use of the "filters" explained at 2.3 above.**

5.3 The facts and figures evidence that it is a false-economy to "save" on the fee for an expert D.V.

6.0 FEES

6.1 Less for volume,but individual cases guided by the Schedule below (instructions to our sister business ***Dilapsolutions*** – which provides both Building Surveyors & Valuers together – are inclusive of section 18/DV at no additional charge) :

- Claims of < £200k = £3,750
- £200k - £399,999 = £4,500
- £400k - £599,999 = £5,000
- £600k - £799,999 = £5,500
- £800k - £999,999 = £6,000

[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)

- > £1m = £7,000

7.0 FURTHER INFORMATION

7.1 Case Studies, Webinars, Articles etc. at:

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

8.0 KEY RADIUS CONTACTS

- **Paul Raeburn** BSc (Hons) DipArb MRICS FCIArb RICS Accredited Mediator
  E: paul@radius-consulting.com
  M: 07970 512313

- **Neil Burridge** BSc (Hons) MRICS ACIArb
  E: neil@radius-consulting.com
  M: 07904 166545