

Putting a squeeze on valuations

Section 18 of the LTA 1927 limits the amount that landlords can obtain for disrepair, and this cap is affected by the recession. *By Simon Edwards*

As the recession deepened, the number of dilapidations claims served by landlords against former tenants increased. The economic situation has limited the redevelopment of commercial premises, particularly office buildings. Whereas in a stronger market landlords may have demolished office premises or sought a change of use to residential or hotel use, values are such that they now choose to repair and redecorate.

Dilapidations claims involving an alleged breach of repair are capped, by section 18 of the Landlord and Tenant Act 1927, to the loss that the landlord is alleged to have suffered. The recession has led to a change in the way in which the cap affects landlords and tenants. This article considers these effects from the point of view of the surveyor/valuer.

Diminution in a recession

Practitioners concerned with dilapidations disputes will be familiar with the two valuations that are produced by the valuer advising on the landlord's alleged loss.

The first (valuation A) is an initial market valuation of the premises at lease end, assuming that the tenant has not breached its repair and decorative repair covenants under the lease. The second (valuation B) represents the market value, with adjustments arising from the tenant's breaches, that would survive a hypothetical purchaser's intentions for the premises at lease end. The difference between these two valuations constitutes the landlord's diminution in value.

In the current recession, valuers have to take into account the lowering of both capital and rental values following from the weaker demand for commercial premises. They therefore have to make a number of changes to the two valuations to reflect these reduced values.

Assuming that the market has no unusual features, valuation A will be lower in the recession than it was when the market was stronger. However, because the cost of the building items required to repair the premises will have remained static or increased during the recession (*EG* 26 September, p105), there will be a "squeeze" between valuation B, leading to a lower diminution loss to the landlord.

This has the practical effect of producing caps on landlord's losses that are lower, other things being equal, than those that applied before the recession.

This has a twofold effect on landlords: their plans for changing the use of 1970s and 1980s office buildings close to lease end to that of residential or hotels have been quashed and they face lower valuations.

Tenants that are close to lease end may, during the recession, decide not to carry out the repair and decoration works contained in a landlord's schedule of dilapidations. In a strong commercial property market, a tenant may, for instance, have commissioned survey reports from its own surveyors prior to lease end.

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As a result, landlords are serving more and more schedules of dilapidations, and these are being vigorously contested by the parties.

Another aspect that the landlord's surveyor needs to bear in mind when compiling a section 18 valuation during the recession is the growing obsolescence of premises constructed in the 1970s and 1980s.

Supersession in a recession

Under the supersession rule, there may be no requirement for the tenant to return, say, a 1970s office building in full repair. The tenant may be able to argue that it is for the landlord to carry out the necessary works prior to seeking a future tenant on the ground that the premises are unable to incorporate modern office equipment and would therefore require complete refurbishment.

A 1970s office building would not, for example, have been planned to provide a computer on every desk and the heat generated by such equipment would need to be dissipated. The former tenant's valuer, when responding to a section 18 valuation,

could argue that even if repair works had been carried out, they would have been rendered useless where substantial works, such as the installation of air-conditioning or IT equipment, were required.

So, although the tenant contracted in the lease to return the premises to the landlord in repair at lease end, landlords may have to carry out unplanned refurbishment works in order to attract a new tenant.

Lower values

As evidence of lower capital and rental values come to light and the more the effects of the recession are noticed by landlords and tenants, the better the position becomes for tenants and the worse it is for landlords. A tenant served with a section 18 valuation during the recession would have acted to its detriment had it settled before valuation evidence came to light illustrating how weak the commercial property market had become.

A section 18 valuation can be compiled only by a valuation expert who has the required expertise in the market in which the premises are located. He or she will be aware of the changes in capital and rental values during the recession and how these lower figures affect the sums produced by valuations A and B for the landlord to pass to the former tenant. The latter should delay settlement of the claim where its expert valuer has advised that more evidence is coming to light, as the recession continues, of a further weakening of the commercial property market, producing even lower capital and rental values.

Lack of evidence

With so few dilapidations being litigated (fewer than 1% of schedules served by landlords) there is little or no evidence from recent court cases on the effect of section 18 valuations during the recession.

However, a landlord that has been adversely affected by the squeeze referred to above may be in a better position if it has carried out the repair works. This will demonstrate its loss to the tenant and, if need be, to the court. It is preferable than hoping to receive the costs from the former tenant – in which case, the section 18 cap will limit the amount.

Simon Edwards is a consultant at GKS Building Consultants and co-author of Dilapidations and Service Charge Disputes – A Practical Guide, published by EG Books