

DILAPIDATIONS ASSESSMENT GUIDANCE

Intention

The following paper outlines our intention to assist members of the Dilapidations Association who are producing (or instructing others to produce, or even being asked to comment on someone else's) terminal dilapidations/reinstatement assessment.

We plan to provide a structure that may be adopted and suggesting common issues that should be considered during the preparation and drafting of dilapidations assessments.

The Dilapidations Association would like to hear members views on this draft paper via a Zoom Seminar at 5.00 PM on Tuesday 27 October 2020.

Introduction

The Dilapidations Association is a focus group of practitioners created to promote discussion and debate on lease obligations relating to the physical nature and condition of building fabric. Usually, these debates and discussions are held at meetings and seminars, however, the social distancing requirements of the Covid-19 pandemic have prevented face to face meetings and seminars occurring. Consequently, Zoom seminars and short papers have replaced the face to face meetings for the time being.

Background

Landlords and tenants have required assessments of contingent lease liabilities for some time, usually for strategic or budgetary purposes. Although the client demand is not new, the level of requirement has increased in recent years. One reason is the introduction of IFRS 16 which became effective for most companies since 1 January 2019 and requires contingent provision for lease liabilities to be made in company accounts.

Accounting for dilapidations

Whilst accounting for provisions have been around for a long time, 'IFRS 16 Leases' is relatively new and has perhaps changed the landscape with regards to accounting for dilapidations. It sets out two types of dilapidations which should be accounted for: Restoration Costs and Maintenance Costs.

- **Restoration costs:** This is the estimate of costs to be incurred by the lessee in dismantling and removing the underlying asset, restoring the site on which it is located or restoring the underlying asset to the condition required under the terms of the lease. These costs should be accounted for on the recognition of the lease by creating an estimated liability (provision). Fixed assets are increased by the same amount at the same time (debit fixed assets, credit provisions). The provision remains for the life of the lease, but the amount added to fixed assets is written off to the profit and loss account over the life of the lease (depreciated).
- **Maintenance costs:** This is when lessee is required to maintain the leased asset in good condition. A provision should be built up over the life of the lease as the wear and tear occurs.

Although these rules come primarily from IFRS 16 which should only apply to listed companies (non-listed companies use FRS102) the treatment is acknowledged to be the one we use under UK GAAP. In other words, all companies should apply these accounting rules if the numbers are material to the accounts.

Taxation implications

When accounting for restoration costs, no tax relief is given when either the provision is set up (at the start of the lease) or from the write off of the asset to the profit and loss account during the life of the lease. At the end of the lease when the restoration payments are made, those relating to repairs will receive tax relief. No relief will be given for payments made relating to capital items. Tax relief should be given for maintenance costs accrued during the life of the lease so long as they are for repairs as opposed to capital expenditure.

Disclosure

Documents, including emails, texts and other instant messages and recordings, are potentially disclosable in litigation even if confidential, commercial sensitive or prejudicial. However, if privilege can be asserted in relation to that document it will not need to be disclosed.

Legal advice privilege is available to confidential written and oral communications between a client and their lawyer. This only includes individuals authorised to seek and receive the advice. These communications must be made for the purpose of giving or receiving legal advice.

Litigation privilege is available to confidential communications between a client/lawyer and a third party, including a client's surveyor or employees. It comes into existence once litigation is actual or reasonably contemplated. The communication must be made for the dominant purpose of obtaining information or advice in connection with such litigation. In relation to dilapidations disputes, litigation privilege is usually only available once a party has stated its initial position and the other has responded to disagree.

Accounts are not privileged, and indeed are often publicly available. The information and advice which sits behind an entry is also accessible.

It is, therefore, very difficult to avoid assessments being disclosable in subsequent dilapidations litigation. Those preparing assessments should have this in mind and consider both the other party and the Court as a potential recipient of any assessment. Anything which may provide embarrassment, or which may make it difficult for the person preparing the assessment to explain any differences in their later position, should be avoided. Express reservations regarding issues such as s18 may assist.

It may be possible to communicate certain matters so as to avoid disclosure, if they are, for example, an intrinsic part of legal advice or discussed verbally, but any protection is easily lost, for instance, by such advice being widely circulated within a client organisation or by a note being taken or a Zoom meeting recorded. Legal advice should be taken in relation to this issue if there are concerns about the disclosure of anything in an assessment.

Current lack of guidance

There is no current set form or layout of an assessment. Unlike schedules of dilapidations there is no formal guidance or regulation as assessments are generally used to inform a position rather than present a claim. Whether the advice is formal or informal, and to what level of detail will depend on the client's requirements. This is also true of the form and level of detail in the reporting of the assessment.

So, the question is what should be in a good dilapidation's assessment?

There are many variables that could apply when considering an assessment. Whether they are included will depend largely on who the client is and what detail they are after behind the headline number(s). Whilst the examples below are not an exhaustive list, it does give an indication of the variety of things that can be relevant. We welcome your comments:

1. **Background and brief:** Confirm who has asked for the assessment and to what use it will be put.
2. **The high or low aim:** Does the assessment need to represent a reasonable landlord's fullest initial claim or the probable negotiated settlement taking account of known variables?
3. **Documentation provided:** Produce a list of the lease documentation and other records used to base the assessment on
4. **Floor areas:** State where the numbers used came from
5. **Dates:** State break and lease end dates
6. **Inspection:** State the date the inspection(s) was carried out
7. **Specialist support:** List who else inspected, i.e. M&E consultants etc
8. **Lease obligation analysis:** Provide a summary of the key dilaps related lease obligations and explanation on how they may impact n the landlords claim
9. **Photos:** Inclusion or not of relevant photos.
10. **Oncosts:** State whether fee (supervision, schedule creation and service) are allowed for
11. **Consequential losses:** State whether loss of rent, rates and service charge is included.
12. **VAT:** State if the building is VAT registered and whether VAT is claimable by the landlord
13. **Costings:** State where you got your costings from, i.e. Spons, Laxtons, BCIS or they were based on similar claims for buildings in similar condition, in similar locations.
14. **Inflation:** State how inflation is to be dealt with, i.e. if on a 'Day One' basis, therefore, ignoring potential tender price inflation
15. **Landlord's intentions:** State whether the Landlord's intention at lease-end have been ignored or considered
16. **Ongoing repair/maintenance:** Consideration should be given to the level of anticipated ongoing maintenance
17. **Supersession/s18:** State whether supersession or s18 issues have been considered or ignored
18. **Strategy:** Should strategies be suggested?
19. **Caveats:** Meaningful, tested caveats should be included

What have we missed?

Our intention

Our goal is to produce a set form or layout of an assessment along with guidance to inform its use. The level of detail needed will vary and not all sections will appear in every document (as is the case with schedule of dilapidations, which, as noted above, have been standardised).

We feel it's essential that there be a general understanding of how a well-considered assessment should differ from - at one extreme a full lease end terminal schedule, and at the other a bare undated 6 line spreadsheet that basically multiplies the floor area by £15.

Next steps

Join the panel on the Zoom call at 5.00 PM on Tuesday 27 October 2020.

Disclaimer:

- This paper is correct as at 23 October 2020
- This paper is intended to assist members of the Dilapidations Association who are producing terminal dilapidations and reinstatement assessments by providing a structure that may be adopted and suggesting common issues that should be considered during the preparation and drafting of dilapidations assessments by promoting debate and discussion.
- The Dilapidations Association do not accept any liability whatsoever for the contents of this paper.
- This paper should not be taken as formal guidance or as an indication of good practice and practitioners should satisfy themselves of the appropriateness of the contents before acting upon it.
- Members dealing with these issues should also refer to the relevant professional standards and guidance notes, case law, textbooks and practice guides.
- This paper is in no way intended to act as a substitute or a complete and exhaustive guide of the issues. Please note that practices/procedures will vary from firm to firm.