

# WHAT MAKES A GOOD DILAPIDATIONS ASSESSMENT?

*In the absence of any common understanding as to what a dilapidations assessment should be, the Dilapidations Association has been considering the problem. Simon Hartley and David Blackmore explain the project*

Amongst its other activities, the Dilapidations Association intends to assist professionals, regardless of their background, who are producing (or instructing others to produce, or even being asked to comment on someone else's) terminal dilapidations/reinstatement assessments.

Formed in 2017, the Association is a not-for-profit group of dilapidations practitioners created to promote discussion, debate and encourage best practice. Membership is not limited to a particular profession or level of experience and is open to anyone involved in dilapidations disputes or interested in the field. Current members include surveyors, valuers, solicitors, mediators, barristers, graduates and others engaged in this busy area of real estate activity.

In the absence of other specific guidance, the Dilapidations Association decided to form a working group to produce a guidance note on dilapidations assessments. The multi-disciplinary working group includes the two of us plus Edward Shaw of Savills and Richard Douglas of Colliers (building surveyors), Simon Allison of Landmark Chambers (a barrister), Simon Green of Green Building Design (a services consultant) and Andy Crook of Mercer & Hole (an accountant). We have been looking into the benefits and risks of different forms of assessment and have been developing a structure that may be adopted, along with suggestions of common issues that should be considered during their preparation.

## What are assessments?

Dilapidations assessments are opinions of a tenant's probable lease end repair/reinstatement liability and normally consist of a single figure or range with an explanation of how it was arrived at. The process used to produce those numbers can range from thorough, highly-detailed assessments, involving a full lease document analysis, site inspections, 'terminal schedule' level works breakdowns and even specialist services and valuation advice; at the other extreme, a number may be plucked out of the air over a five-minute telephone call. Assessments are often needed by the vendors and purchasers of individual or portfolio investment properties and on the acquisition of businesses with one or more leases.

Surveyors who produce dilapidations assessments for a living know the 'rubbish in rubbish out' principle applies here. Allowing or ignoring issues related to reinstatement, VAT, loss of rent, the ability to break, supersession etc. will have an enormous impact on the eventual numbers generated, which others then rely on.

Our goal is to produce guidance for a standardised, indicative assessment layout along with guidance to inform their creation. The level of detail needed will vary and not all the suggested sections will need to appear in every document, as is the case with terminal schedules of dilapidations, which have been standardised by the Pre-Action Protocol for Claims for Damages in Relation to the Physical State of Commercial Property at Termination of a Tenancy (the Protocol). Whilst the figures set out in a lease end Quantified Demand prepared in accordance with the Protocol should be restricted to the landlord's likely loss, assessments prepared before or during the term may be prepared on several alternative bases; for example, the landlord's probable or reasonably enforceable initial claim; the most likely level of a negotiated settlement; and/or the cost for the tenant of doing the repair work before lease expiry.

## **One size does not fit all – Edward Shaw on good assessments**

Whilst there is a common aspect to assessments of dilapidations, there are potentially a number of variable circumstances in which assessments are required and each will have an effect on the information contained therein and how it is presented. A “one size fits all” approach is not appropriate.

Further, there are external factors that must be considered, such as whether the assessment is a discloseable document; a simple provision for a dilapidations liability could in the future be used by the landlord to support its assertion of liability and prejudice an eventual settlement, so those preparing assessments should consider both the other party and the Court as a potential recipient.

Additionally, there are future unknown factors, such as technological developments in relation to services or the future condition of the letting market, which could influence if, or the extent to which, the cap on liability to the diminution in the value of the landlord’s interest provided by section 18 of the Landlord and Tenant Act 1927 would apply.

From an accounting perspective, whilst accounting for provisions have been around for a long time, the rules regarding leases introduced by accounting standard IFRS16 are relatively new and have perhaps changed the landscape with regards to accounting for dilapidations. They set out two types of dilapidation costs which should be accounted for; restoration costs and maintenance costs. Restoration costs should be accounted for at the commencement of the lease by creating a provision for the estimated liability. Fixed assets are increased by the same amount at the same time (debit fixed assets, credit provisions). These assessments are, in concept, very different to those which indicate potential lease end liabilities for either landlords or tenants and are focused on the cost of works so typically a different form of assessment will be required.

There is no set form or layout of an assessment of potential lease end liabilities based on the cost of works. 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 what level of detail is required, will depend on the client’s requirements. This is also true of the form and level of detail in the written reporting of the assessment. As there are a large number of variables that could apply when considering an assessment, the extent to which they are included will depend largely on the individual client. It may be advisable to expressly state how these potential variables have, or have not, been dealt with and why.

In terms of offering guidance to practitioners, ‘less is more’ is frequently the rule, as the surveyor retains the ability to be flexible in the nature of the advice given. However, undergirding that are various principles of good practice that would be applicable to any assessment and would form a starting point from which the advice can develop. Further, the specific advice enabling strategic and financial planning to be made requires a sound base to which the variables can be applied.

All-in-all providing dilapidations assessments and giving strategic advice is not a straightforward consideration but guidance can be given by breaking it into its component parts and showing the specific applications of those components.

*Edward Shaw is a director at Savills*

## The use of assessments

Landlords and tenants have required assessments of their contingent lease liabilities for centuries, usually for strategic or budgetary purposes. Assessments are made and made again from the time a party considers taking a new tenancy through to lease end. Continuing financial uncertainty coupled with a near 5-fold reduction in average lease lengths over recent years and the introduction of new accounting standards has increased the market for dilapidations assessments.

Although IFRS16 only applies to listed companies requiring them to report dilapidations provisions when accounting for the cost of their leasehold properties, this standard helped to clarify dilapidations' treatment for non-listed companies who account under FRS102 and must also include these provisions in their financial statements.

## Information to include

We believe it would be helpful for there to be a general understanding of what information a well-considered assessment should contain. The list will be long but could include:

- The background to the assessment;
- The names and relationships of the parties involved;
- A list of the documents on which the assessment is based and their potential impact;
- If appropriate, a list of missing documents and their potential impact;
- The floor areas used and their source;
- The relevant and any assumed dates, including that of any inspection;
- Some reference to the relevant lease obligations;
- If costings have been included, what they were based on;
- Whether loss of rent, rates or service charge has been included;
- Any assumptions or disregards that have been made;
- How inflation and Value Added Tax have been addressed; and
- Meaningful and tested caveats.

## Request for feedback

We have taken initial feedback from the Association's members on a first draft of the guidance following a webinar launching the initiative on 27 October 2020. Our initial dilapidations assessment white paper is available at <http://dilapidationsassociation.com>.

This is only a draft and, therefore, practitioners should satisfy themselves of the appropriateness of its contents before acting upon it. The Association would welcome any comments and would be grateful if these could be provided by the end of February 2021. The results of this consultation will be considered by the working group and a final draft of the guidance will be published at the end of the first quarter of this year.

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