OCCUPIER INSIGHTS

An Introduction to Dilapidations for Occupiers

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Dilapidations can represent one of the most significant and contentious costs faced by an occupier when leaving commercial premises. A landlord's initial claim may be substantial, but it does not necessarily represent the amount the occupier is legally liable to pay.

The final outcome will depend on the wording of the lease, the condition of the premises, the work reasonably required, the landlord's intentions and the loss the landlord has actually suffered. By reviewing these issues early, occupiers can make informed decisions, retain control of the process and significantly reduce both cost and uncertainty.

What are dilapidations?

Dilapidations are breaches of a tenant's lease obligations relating to the physical state of its commercial premises. Although the term is most commonly associated with a dilapidations claim made at lease expiry, liability can build throughout the lease term and may also be pursued while the lease is continuing.

The relevant obligations are found in the lease and associated documents. They commonly include:

- repairing and maintaining the premises and any tenant-maintained plant;
- redecorating at specified intervals and shortly before lease expiry;
- removing alterations, partitions, cabling, signage and other tenant installations where required;
- reinstating the premises to their previous configuration;
- complying with statutory requirements affecting the condition or use of the premises; and
- meeting yielding-up and cleaning obligations.

The wording of the lease is always the starting point. A full repairing obligation may require an occupier to put premises into repair even if they were in poor condition when the lease began.

Licences for alterations and any requirements governing reinstatement must also be reviewed carefully. It should not be assumed that every alteration must automatically be removed. Depending on the lease and the relevant licence, the landlord may need to request reinstatement or serve notice within a specified timeframe.

Why are tenants often caught out?

Dilapidations liabilities are frequently underestimated because they do not arise from one obvious event. Exposure can accumulate gradually over many years.

Common problems include:

- alterations being undertaken without adequate records or formal licences;
- repairing obligations being broader than the occupier originally understood;
- planned maintenance being deferred during the lease term;
- lease documentation and reinstatement requirements not being reviewed until shortly before the lease expiry;
- insufficient time being allowed for design, approvals, procurement and completion of works; and
- tenants undertaking costly reinstatement works without first establishing whether the landlord actually wants them.

A dilapidations strategy should therefore form part of an occupier's wider lease exit planning rather than being addressed only once the premises have been vacated.

What is a schedule of condition?

A schedule of condition is a detailed record of the physical state of commercial premises at a particular date, normally prepared immediately before the occupier enters into a lease. It usually contains photographs supported by written descriptions of existing defects, damage, wear and the general condition of the building and its finishes.

For occupiers, a schedule of condition can be one of the most effective ways of limiting future dilapidations liability. However, simply preparing the document is not enough. It should be attached to the lease and the repairing covenant should expressly limit the occupier's obligation by reference to the condition recorded in the schedule.

For example, the lease might require the tenant to keep the premises in no worse condition than evidenced by the schedule, rather than requiring the premises to be put into full repair. The precise drafting is critical and should be agreed with the occupier's legal advisers.

Used properly, a schedule of condition establishes an objective baseline and can help prevent an occupier from becoming responsible for putting already defective premises into a better condition than when the lease began.

How does a terminal dilapidations claim usually develop?

A landlord will usually appoint a building surveyor to inspect the premises and prepare a schedule of dilapidations. This document identifies:

- the relevant lease covenant;
- the alleged breach;
- the remedial work said to be required; and

- commonly, an estimated cost for that work.

A schedule may be served before lease expiry, giving the occupier an opportunity to undertake the work, or after the lease has ended as part of a monetary claim.

For commercial property in England and Wales, the Dilapidations Pre-Action Protocol generally expects the landlord to serve a terminal schedule of dilapidations and quantified demand within 56 days following termination of the lease. The occupier will normally have 56 days in which to provide a detailed response, often prepared by its own building surveyor.

The parties' surveyors will then usually inspect the premises, review the lease obligations and negotiate the claim item by item. If necessary, valuation evidence may also be required to assess the landlord's actual loss. The Protocol is intended to encourage the exchange of information and settlement without litigation.

> *"A landlord's schedule is an allegation and negotiating position, not an invoice that the tenant must simply pay."*

The key limits on a landlord's dilapidations claim

1. The lease defines the obligation

Before considering the cost of any work, the landlord must establish that the occupier has breached an obligation contained in the lease or an associated document.

The required standard of repair will be assessed in the context of the premises, including their age, character and the type of occupier likely to take them. The landlord cannot necessarily require an old building to be returned in an entirely new or perfect condition.

The lease may also contain express limitations, a schedule of condition or specific provisions governing decoration and reinstatement. Licences for alterations may impose separate requirements or require the landlord to notify the occupier if reinstatement is wanted.

Each item within a dilapidations claim must therefore be considered against the specific contractual obligation said to have been breached.

2. The cost of works is not automatically the measure of loss

The purpose of damages is to compensate the landlord for the loss caused by the occupier's breach. It is not to provide a windfall or fund improvements to the landlord's property.

The reasonable cost of remedial works can be evidence of the landlord's loss, particularly where the landlord has undertaken or genuinely intends to undertake those works. It is not, however, conclusive.

A claim should be examined for:

- works that go beyond the standard required by the lease;
- improvements or betterment;
- replacement of items that still have an adequate useful life;
- upgrades required by the landlord's own refurbishment plans;

- duplicated or unnecessary work; and
- costs that are not reasonably attributable to the occupier's breach.

Claims for professional fees, loss of rent, business rates, service charges and other consequential losses are also not automatically recoverable. They must be reasonable, properly evidenced and causally connected to the relevant breach.

3. Section 18(1) limits damages for disrepair

Section 18(1) of the Landlord and Tenant Act 1927 places a statutory cap on damages for breach of a repairing covenant.

Repair damages cannot exceed the reduction in the value of the landlord's interest in the property caused by the disrepair. This is commonly known as the diminution in value cap.

> WORKED EXAMPLE — THE DIMINUTION IN VALUE CAP
>
> If the reasonable cost of repair is £500,000 but the disrepair has reduced the value of the landlord's interest by only £200,000, the recoverable repair damages cannot exceed £200,000.

The legislation also prevents the landlord from recovering repair damages where the premises are to be demolished or altered so substantially that the repairs would be rendered valueless.

Section 18(1) applies specifically to breaches of repairing covenants and does not automatically impose the same statutory cap on separate claims for reinstatement or redecoration. However, those claims remain subject to the wider compensatory principles applying to damages, including the requirement for the landlord to establish actual loss. Supersession can therefore produce a similar practical outcome where the landlord's intended works make the occupier's reinstatement or decoration work unnecessary, as discussed below.

4. Supersession and the landlord's intentions matter

Supersession arises when works proposed by the landlord would render some or all of the occupier's remedial work unnecessary or valueless.

For example, a landlord may claim the cost of:

- redecorating walls that it intends to remove;
- repairing ceilings that will be replaced as part of a refurbishment;
- reinstating partitions where the floor will be comprehensively reconfigured;
- repairing services that the landlord intends to replace; or
- returning premises to their former layout before converting them to a different use.

In these circumstances, the occupier's alleged failure may not have caused the landlord the loss shown in the schedule. If the landlord would have incurred the same refurbishment, alteration or redevelopment costs even if the tenant had fully complied with the lease, there may be a strong argument that part of the claim has been superseded.

Supersession can apply beyond repair items and is particularly relevant to reinstatement and redecoration claims. It is not an automatic defence, however. The relevant facts, the landlord's intentions and the evidence supporting those intentions must be investigated carefully.

The landlord's plans for the premises are therefore central to the assessment of a terminal dilapidations claim. The Protocol expects a quantified demand to reflect the landlord's likely loss rather than simply reproduce the theoretical cost of every item in the schedule.

A practical example

> A landlord serves a schedule of dilapidations claiming for repairs, redecoration and reinstatement.
>
> The landlord is also planning a substantial refurbishment before reletting the premises. Its works include removing the existing partitions and ceilings, replacing the lighting and mechanical services, and installing new finishes throughout.
>
> Although the lease obligations must still be examined, a substantial part of the initial claim may be open to challenge because the landlord's refurbishment would have overtaken some of the work claimed. Other items may constitute improvements or may have had little or no effect on the value of the landlord's interest.

The occupier's liability cannot be determined simply by accepting the landlord's estimated cost of works. It requires an assessment of contractual liability, the appropriate remedy, reasonable cost, supersession and actual loss.

What should occupiers do?

Dilapidations should be managed as an exit project, not left until the keys are returned. Ideally, an occupier should review its potential exposure at least 12 to 18 months before a lease expiry or break date.

The practical priorities are to:

- review the lease, schedule of condition, licences for alterations and other relevant property documents;
- commission an early assessment of the premises and likely dilapidations liability;
- compare the current use and configuration with the original lease plans and reinstatement requirements;
- establish the landlord's intentions and whether reinstatement is genuinely required;
- identify work that may be superseded by the landlord's refurbishment or redevelopment proposals;
- compare the cost and risk of undertaking the work with negotiating a financial settlement;
- allow sufficient time for design, landlord approvals, procurement and completion if works are to be undertaken; and
- retain photographs, statutory certificates, maintenance records and evidence of completed work.

Where a lease is being terminated through a break option, the requirements need particularly careful consideration. Compliance with repair, reinstatement or yielding-up obligations may interact with the conditions attached to the break, and specific legal and surveying advice should be obtained well before the break date.

Should the occupier undertake the work or negotiate a settlement?

There is no single answer.

Undertaking the work may give the occupier greater control over scope, procurement and cost. It may also be appropriate where the lease obligations are clear and the landlord genuinely requires the premises to be reinstated.

However, completing extensive work immediately before the landlord strips out or refurbishes the premises can waste money. In those circumstances, an early financial settlement may provide greater certainty, avoid operational disruption and allow the occupier to focus on its relocation.

The decision should be informed by:

- the lease obligations;
- the strength of the landlord's claim;
- the occupier's programme for leaving the premises;
- the cost and practical risk of undertaking the work;
- the landlord's intentions;
- potential supersession;
- the likely impact of the breaches on the property's value; and
- the scope for negotiating a full and final settlement.

Early engagement does not necessarily weaken the occupier's position. When supported by good evidence and a clear strategy, it can create more options and increase negotiating leverage.

Plan early, challenge the evidence and retain control

The headline figure in a schedule of dilapidations rarely tells the whole story. The landlord must establish what the lease required, how the occupier breached those obligations and what loss has resulted.

For the occupier, the objective is not simply to challenge every item. It is to identify the genuine exposure, avoid spending money on unnecessary work and choose the most commercially effective route to concluding the lease.

That work should begin well before lease expiry. An early review creates time to investigate the landlord's intentions, evaluate whether work should be undertaken, assemble the necessary evidence and negotiate from an informed position. Once the premises have been vacated and control has been returned to the landlord, many of those options may be lost.

With early advice and a coordinated legal, surveying and property strategy, tenants can turn dilapidations from an uncertain end-of-lease liability into a planned and manageable part of their commercial property exit.

HOW SPRING4 CAN HELP

Spring4 advises occupiers throughout the commercial lease lifecycle, from negotiating lease obligations and schedules of condition at acquisition through to assessing dilapidations exposure, developing lease exit strategies and negotiating settlements.

If your lease expiry or break option is approaching within the next 18 months, an early dilapidations review can identify potential liabilities, clarify your options and help prevent costly surprises.

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About Spring4

Spring4 is an independent commercial real estate advisory and project management firm focused on representing occupiers. Founded in 2002, we advise organisations on real estate strategy, transactions and consultancy, helping clients acquire the right space and make well-informed property decisions. Alongside our advisory work, we provide project management for workplace fit-outs, guiding clients from initial planning through to successful delivery.

Our independence means we act solely in the interests of our clients, providing clear, objective advice throughout the property lifecycle. Spring4 is regulated by the Royal Institution of Chartered Surveyors (RICS) and is a certified B Corp, reflecting our commitment to high professional standards and responsible business practices.

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- Agency: Acquisition & Disposal
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- Project Management

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