

Dilapidation Claims Under a Lease in Jersey



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Introduction

This briefing note is intended as an overview of some of the legal issues which should be considered when a lease is nearing its expiry, by both the tenant and the landlord. More detailed advice is available on request.

Overview

Jersey's commercial property market has seen an increase in disputes between landlords and tenants upon termination or expiry of leases. In addition, due to the current economic climate, a landlord in possession of an older building may find there are fewer potential tenants searching for such space. It is therefore essential for the landlord to ensure that its building is in the best possible condition to secure a replacement tenant.

As a result of the landlord's need to quickly secure a replacement tenant, tenants are finding that landlords are demanding more of them at the termination or expiry of a lease and this can give rise to expensive dilapidation claims.

This briefing examines the issue of dilapidations claims and discusses how best both parties can protect themselves.

Schedule of Dilapidations

Prior to the termination or expiry of a lease, the landlord usually has the right (under the lease) to enter and inspect the premises to ensure that the tenant has adhered to its obligations under the lease and will be leaving the premises in a condition which accords with the tenant's repairing and decoration obligations.

It is important to note that there will be no obligation on the tenant to repair the premises unless something is damaged or is in a state of disrepair or otherwise in breach of the terms of the lease.

Another frequent misconception is that the condition of the premises at the commencement of the lease term are the benchmark for the tenant's repairing obligations. This is only the case if the parties have agreed to limit the tenant's repair obligations by reference to a Schedule of Condition.

In the event that the landlord identifies any defects on its inspection of the premises prior to expiry or termination of the lease term, a surveyor will be asked to prepare a Schedule of Dilapidations. The Schedule will document the state of repair of the premises and will usually include the cost of the repairs or redecoration required. It is normal for the cost of the preparation of the Schedule to fall to the tenant, under the terms of the lease.

The tenant may want to have its own surveyor check the Schedule to ensure that it doesn't include liability for matters which are not the tenant's responsibility. The tenant's surveyor can also advise the tenant on its position and negotiate settlement of any dilapidations with the landlord on the tenant's behalf.

Schedule of Dilapidations

The landlord's primary concern is: what condition do the premises have to be in to attract a new tenant?

Dependent upon the plans the landlord has for the building, it may be more prudent for the landlord to seek a financial settlement from the current tenant to enable it to undertake and have control of the dilapidation works itself. For example, if the landlord feels that the best way of re-letting the premises is to carry out a significant upgrade a financial settlement would be preferable.

This is because the tenant's obligation to repair may not put the premises into the desired upgraded state so any money spent by the tenant will be wasted when the landlord replaces those works with its own, upgraded fit out.

On the other hand, if the landlord is confident that the building will be readily re-let provided the outgoing tenant undertakes the repairs it is contractually obliged to undertake, without any upgrades, it is likely that the landlord will prefer the outgoing tenant to undertake the works rather than seek a cash settlement from the tenant.

Dilapidations Claims Under a Lease in Jersey

A cash settlement does, however, provide the landlord with control over the quality of the works.

Once it has come to a decision on its plans for the premises, the landlord can decide when to serve the Schedule of Dilapidations. There is no obligation on the landlord to serve the Schedule prior to the expiry or termination of the lease. However, if a financial settlement is the landlord's preferred way forwards, the landlord will probably arrange for the Schedule to be served prior to the expiry or termination of the lease term, so that it can form the basis of negotiations between the parties.

The Tenant's Position

Like the landlord, the tenant should consider its exposure to a dilapidations claim in advance of the expiry or termination of the lease. Preparation and good management of the tenant's obligations can do an enormous amount to reduce the tenant's dilapidation liabilities.

The tenant can manage its exposure to a dilapidations claim by appointing someone to check the state of repair of the premises on a regular basis; small items of disrepair can, with time, develop into large items of repair or even require replacement. Cumulatively these expenses may seem trivial but with time they can mount up and result in significant expenditure for the tenant. The tenant could also go as far as carrying out an interim assessment of dilapidations during the course of the lease term and/or setting aside a fund to cover potential exposure to dilapidations.

At least 6 months prior to expiry or termination of the lease, the tenant should seek advice from its lawyers and surveyors as to what items of disrepair should be addressed and to get an estimate of the likely costs involved. The tenant will then be in a position to liaise with the landlord to agree what is required to release the tenant from its dilapidations liabilities.

If it seems early on in the negotiations that the landlord is not prepared to negotiate a sensible financial settlement, or if the tenant does not wish to agree the landlord's proposals to settle dilapidations by way of a financial settlement, it is clearly in the tenant's interests to undertake such works itself to control the costs.

These works must be undertaken whilst the tenant still has access to the premises, otherwise the tenant will be in breach of its obligation to provide the landlord with vacant possession of the premises at the end of the term.

However, if the tenant does undertake the works itself, there is always a risk that the landlord will contend that the works done do not fully discharge the tenant's contractual liability or, once the tenant has completed the works, the landlord may serve a further Schedule of Dilapidations highlighting further remedial works required.

The lingering risk of a dispute subsisting notwithstanding the completion of the works is one reason why a tenant might be attracted by the certainty of a financial settlement in full and final settlement of the landlord's claims against it. Another advantage of a cash settlement is that the tenant can remain in occupation of the premises until the end of the term and not be disrupted by the works.

Once an agreement has been reached with the landlord on either the works to be conducted or a financial settlement, the tenant should ensure that a legally binding document is drawn up releasing the tenant from all liabilities under the lease, subject to the agreed works being completed or the financial settlement being paid. This will ensure that the landlord does not have the right to sue the tenant in the future for alleged breaches once the tenant has vacated the premises.

Dispute

If the tenant refuses to carry out the works or agree a financial settlement, the terms of the lease should be closely examined and legal advice taken in order that both the landlord and the tenant fully understand their respective legal obligations under the terms of the lease.

The lease usually includes a dispute resolution clause in the event that agreement cannot be reached by the parties themselves.

Multi-Tenanted Premises

Many properties in Jersey have more than one tenant and the landlord is responsible for maintaining, repairing and redecorating the common areas shared by the tenants occupying the building. These costs are normally recovered by way of a service charge paid by the tenants.

Dilapidations Claims Under a Lease in Jersey

In this situation, the landlord actually needs to undertake and complete the dilapidation works before the expiry or termination of the lease and issue the demand(s) for repayment pursuant to the service charge provisions in the lease. Even if the landlord does undertake and complete such works prior to the expiry of the lease term, an outgoing tenant may refuse to pay for certain large capital items on the basis that the works involved amount to the renewal of an item which will be of no benefit to that tenant. Landlords seeking to replace large items in the final year of a lease (ie. the replacement of an air conditioning plant or lift) and recover the cost from their tenants need to be aware of the potential for dispute with the outgoing tenant(s) and consider how best to manage the issue in advance of carrying out the work, otherwise the landlord could end up seriously out of pocket!

It is therefore imperative that a landlord ensures that all of its tenants in a multi-let property fully understand the service charge costs and what areas these service charges cover.

This briefing is only intended to give a summary of the subject matter. It does not constitute legal advice. If you would like legal advice or further information, please contact us using the contact details below.

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