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Building Consultancy Monitor
Dilapidations dissected: Hammersmatch v Saint Gobain

Summer 2013

■ The judgements have recently been handed down in the case of Hammersmatch v Saint Gobain. Eagerly anticipated by some and the source of much speculation, there was an air of disappointment as the contents became clear. However, rather than breaking new ground, the case confirmed the Court's approach to dilapidation cases.

■ Full details of the case can be found below, but the salient points can be summarised as follows;

– Dilapidations is a simple process that many tend to overcomplicate. The first step is to assess the nature, extent and costs required to remedy the breaches under the lease. The second step is to assess whether that cost is capped by way of diminution in the claimant's interest.

– When assessing diminution of an obsolete building and for which there is no letting market, the diminution is calculated as the difference between the value of the property in repair and the greater of either the value out of repair or the site value.

– The parties should proceed to agree the cost of works to remedy breaches even if the position adopted by a party is not credible so that the costs of those works can be used as a benchmark.

– Failure to adopt a credible position may jeopordise a party's ability to recover costs.

– Failure to beat a part 36 offer by even the smallest amount prevents the automatic right to recover costs.

Hammersmatch v Saint Gobain

■ In 2008, Edward Shaw of Savills was instructed to act on behalf of Saint Gobain who were tenants of an aged industrial building in Welwyn Garden City. Their lease was due to expire and they were seeking dilapidations advice to control their liability.

■ The case focussed on the expiration of a long lease on a vacant industrial building in an area where there was little or no market for second hand space. In the early 1980's, the owner occupier, who had constructed the site for their own use and occupation, entered into a sale and lease back agreement with the freehold eventually resting with a local landowner developer who redeveloped much of the original site.

■ When the lease expired in 2009, despite partial sub-lets, the property had been empty for a number of years. The fit out specification reflected the interior at the commencement of the term in the 1980's and there was little evidence of refurbishment works having been undertaken since then.

■ There was nothing particularly unusual about the case. It was a relatively standard terminal dilapidations claim on an outdated building in an area where the letting market was depressed. As is the custom with many tenants, no attempt had been made to comply with the dilapidations obligations at the end of the lease.

■ The landlord engaged surveyors who inspected and prepared a claim for remedial works of just over £5m. With consequential losses, including loss of rent, the original claim was nearly £7.7m.

■ The landlord stated that their policy was to undertake the dilapidations works and re-let the building. They maintained that by undertaking the works scheduled in the claim without

Summary

It's a simple process

■ What is the cost to remedy breaches of covenant?

■ Is that cost capped by diminution in the reversionary interest?

■ Be proactive to negotiate agreement.

■ Adopt a credible position or costs will be at risk.

■ Part 36 offers can fail on the smallest amount.

Hammersmatch v Saint Gobain, Welwyn Garden City

■ 1930's bespoke industrial complex.

■ Claim of £7.5m by the landlord considered excessive.

■ Savills provided Expert evidence in proceedings. Found in our clients favour.

alteration or improvement they would be able to re-let the property as grade A office space. This was not accepted by the tenant who said that until the landlord provided more detail about their intentions for the property it was not possible to respond to the claim. It was in these two relatively commonly held positions that the dispute lay.

■ The tenant's assessment was that the property was obsolete and tabled a figure of around £500,000 at mediation to cover demolition plus reasonable costs. The landlord did not agree to this and as a result court proceedings were issued. However, following legal advice Saint Gobain increased their offer to £1m some months prior to the trial commencing (in line with part 36 of the Civil Procedure Rules).

■ Early in the trial the building surveyors agreed that the cost of remedial works for building fabric items was just over £1.7m against a revised claimed figure of £2.4m. The services engineers were agreed in part and the court decided that the services elements of the claim amounted to £613,526 giving a total works cost to remedy the breaches of covenant of just under £2.4m, subject to the effect of diminution in value arguments.

■ The tenant relied on the first limb of section 18 which puts a ceiling on the recoverable damages such that they can not exceed the diminution in the value of the reversion caused by the breaches of covenant. There was much discussion about how that diminution was to be calculated.

■ To that extent, and to quote from the judgement,

"Saint-Gobain says that the question of diminution in value depends on how the notional buyer on the term date would have assessed the value of the premises in and out of repair and, in particular, whether in this case their value for letting following subdivision would have exceeded their site value. In this context Saint-Gobain submits that the notional buyer of the premises on the term date, whether in or out of repair, would have bought them for their site value with a small upward adjustment in price if they had been in repair. Saint-Gobain submits that the central question is whether, and if so to what extent, the value of the Norton Building for letting following the sub-division would exceed the site value."

■ The judge accepted that in its actual condition there was zero value in putting the property back into repair. The reality was that in its actual condition the best value of the property was as a site for reconstruction. That generated a total diminution in value of £900,000. An eighth of the original claim.

■ This case is an example of a total rejection of what is sometimes a tempting approach for a landlord, that is to calculate diminution as if it were equivalent to putting the building back into repair.

■ As already noted the court found that the tenant's liability under the lease was £900,000 plus around £20,000 for fees related to preparing the schedule and interest at 4.5% per annum. This was nearly half the £2m provision as detailed in our original advice to Saint Gobain in 2008.

■ Handing down of the judgement was followed by a costs hearing, one of the first following the revisions to part 36.

■ At the hearing, the landlord argued that the trial and associated cost was due entirely to a lack of negotiation between building surveyors. The tenant argued that it was due to the claim being exaggerated and that the landlord's true intentions were not revealed. They also argued that the court had discretion under the general rules about costs and could waive the consequence of failure to beat the part 36 offer by a miniscule amount.

■ The outcome of the hearing saw the Judge deciding that the part 36 offer had failed, even though the final offer including costs and fees exceeded the £1m offer by only £3,637.80. This is due to the revisions made to part 36 that means that so much as a penny over the offer would cause the offer to fail. As a result there was no automatic right to recovery of costs and Saint Gobain had a liability for Hammersmatch's costs.

■ The decision on apportionment came down to a balance between the tenant's reluctance to engage and the landlord's unrealistic assertion that they would undertake the works as scheduled. The Judge was satisfied

Savills instructions

New Court, London

■ Savills acted for the landlord. Strategy required in order to bring lease to an end and making the building safe. Preperation of the forfeiture notice.

■ Agreement reached with the tenant without proceedings.

Kings Reach Tower, London

■ Strategic liability management.

■ Five year works programme.

■ Potential liability of £20m.

■ Actual cost of £5.5m.

Lincoln Place, London

■ Break option.

■ Full compliance condition.

■ Prepared and priced works schedules.

■ Negotiated settlement on payment of works cost.

however, that the claim was not exaggerated because professional advice had been obtained.

■ However, the Judge was critical of the tenant's pre-action conduct and failure to engage and considered that this would reinforce an order for costs against them. But he also considered that the landlord's assertion that they would undertake the works as scheduled when they did not intend to do so had resulted in significant costs being expended. Consequently the tenant's liability for costs was reduced by 20%.

■ Despite Saint Gobain being liable for Hammersmatch's costs the final outcome was beneficial as the full and final costs associated with the dilapidations were half the provision originally estimated at the start of the process in 2008.

■ Although the Hammersmatch case was not heard under the recently adopted Dilapidations Protocol, the conduct of the parties was reviewed during the costs hearing and had a bearing on the way that costs were decided.

Don't feel threatened by the protocol but use it wisely

■ The procedure for ensuring that when a tenant vacates a demised area at the end of a lease term it returns the property to the landlord in a satisfactory condition, in accordance with the lease, is well established. For instance the RICS have published a number of Dilapidation Guidance Notes over the years with the Property Litigation Association (PLA) producing pre-action Protocols. The Protocol applies to claims for damages in commercial property brought by the landlord against the tenant at the end of the term.

■ But in January 2012 the Protocol was adopted into the Civil Procedure Rules, essentially meaning the adherence to the Protocol is a legal requirement. As a result it gives it authority over the established process of preparing and serving schedules of dilapidations and negotiating the dispute through to settlement.

■ The outcome of this case and the adoption of the Protocol into Civil Procedure Rules has raised concerns. The number of long leases signed in the office boom of the late 1980's heightens this as tenants and landlords have become increasingly aware of a raft of potentially obsolete and/or relatively uncared for properties coming to the end of their lease term.

■ The movement towards shorter leases, which according to IPD/BPF averaged 11.2 years in 2011 down from 14.7 in 2000 (see Graph 1), means that the issue of dilapidations has and will become a more common occurrence.

■ However, while surveyors and their clients need to be aware of its contents, the rules in the protocol are perhaps more reasonable than some might have first thought.

■ With 56 days (eight weeks) to present each case, there is ample time to both serve and respond and the Protocol stipulates that in extreme cases it must be a 'reasonable' length of time. Further, either party's assessment of costs should be reasonable. Also, where the Protocol applies, both the landlord's schedule and the tenant's response should be endorsed to confirm the genuineness of the claims made.

■ Possibly the most contentious statement is that of the landlord's intentions after the end of the lease term as the nature and extent of any works may have a significant impact on the level of the claim.

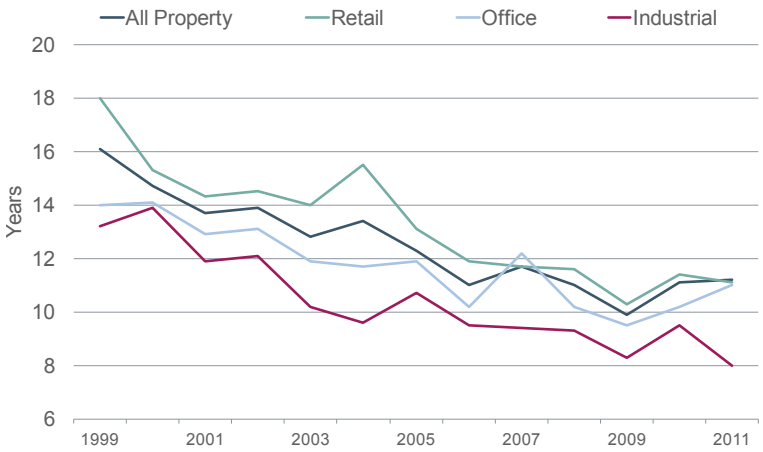
■ However, this should not pose a significant threat as the landlord is required to endorse the schedule to reflect the future of the building. This means that the Quantified Demand should be based on the works to remedy breaches of covenant that survive any works of demolition, structural alteration or improvement undertaken by the landlord at or shortly after the end of the term. It does not give the landlord free license to lay a claim against all improvements to bring the property in line with modern day standards for example.

■ The requirements of the Protocol are not onerous. In the majority of cases the timescales, declarations and endorsements together with the encouragement to negotiate are no more than what surveyors should be doing anyway.

■ Whereas there are sanctions that can be applied to the errant party at trial, so few cases come before the courts that the application of punitive costs awards is likely to be very rare indeed. That does not mean that the Protocol can be ignored, it can not, but if all parties (surveyors, landlords and tenants) act professionally it need not be a threat or a burden.

GRAPH 1

Average lease lengths by sector



Graph source: BPF/IPD Annual Lease Review

Note: Weighted average ignoring any breaks

Savills Dilapidations Team

The Savills Dilapidations team provides consultancy advice and litigation support for all aspects of lease obligations relating to the physical condition and state of repair of occupied commercial property. We have extensive experience of acting for landlords and tenants at all stages of the dilapidations process both during and at the end of the lease term including;

- Preparing and scheduling claims during and at the end of the term.
- Defending claims during and at the end of the term.
- Preparing or responding to diminution valuations.
- Operation of break options.
- Forfeiture.
- Landlord's rights to enter and undertake works to remedy breaches.
- Providing Expert witness support in litigation and all forms of ADR.

We can provide full nationwide coverage from our central London and regional offices and have experience of working on mainland Europe, both directly and through consultants.

Breakfast Briefing

The Savills Dilapidations team will be holding a breakfast briefing on the 10th October to highlight and discuss the key issues around dilapidations. If you would be like to attend please contact Wendy Webb (full details below).

Dilapidations Breakfast Briefing
10th October 2013
8.30am to 10am
Savills, 33 Margaret Street, W1G 0JD

If you would like to attend please contact Wendy Webb (wwebb@savills.com).

Please contact us for further information

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