

# Commercial Property Solutions

Practical And Professional Commercial Property Comment  
From The Culshaw Partnership

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## Squeeze On Terminal Valuations



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As the recession deepened, the number of dilapidations claims served by landlords against former tenants increased. The economic situation has limited the redevelopment of commercial premises, particularly office buildings. Whereas in a stronger market landlords may have demolished office premises or sought a change of use to residential or hotel use, values are such that they now choose to repair and redecorate.

Dilapidations claims involving an alleged breach of repair are capped, by section 18 of the Landlord and Tenant Act 1927, to the loss that the landlord is alleged to have suffered. The recession has led to a change in the way in which the cap affects landlords and tenants.

**Diminution in a recession**  
The two valuations that are produced by the valuer advising on the landlord's alleged loss are: the first (valuation A) an initial market valuation of the premises at lease end, assuming that the tenant has not breached its repair and decorative repair covenants under the lease. The second (valuation B) represents the market value, with adjustments arising from the tenant's breaches, that would survive hypothetical purchaser's intentions for the premises

at lease end. The difference between these two valuations constitutes the landlord's diminution in value.

In the current recession, valuers have to take into account the lowering of both capital and rental values following from the weaker demand for commercial premises. They therefore have to make a number of changes to the two valuations to reflect these reduced values.

Assuming that the market has no unusual features, valuation A will be lower in the recession than it was when the market was stronger. However, because the cost of the building items required to repair the premises will have remained static or increased during the recession, there will be a "squeeze" between valuation B, leading to a lower diminution loss to the landlord. This has the practical effect of producing caps on landlord's losses that are lower, other things being equal, than those that applied before the recession.

Tenants that are close to lease end may, during the recession, decide not to carry out repair and decoration works contained in a landlord's schedule of dilapidations. In a strong commercial

property market, a tenant may, for instance, have commissioned survey reports from its own surveyors prior to lease end. However, the recession may persuade the tenant that the resulting lower values are such that the landlord may be unable to demonstrate that it has suffered any loss. Alternatively, the loss suffered might be sufficiently low that the tenant may decide not to return the premises in repair in the current market. Another aspect that the landlord's surveyor needs to bear in mind when compiling a section 18 valuation during the recession is the growing obsolescence of premises constructed in the 1970s and 1980s.

### Supersession in a recession

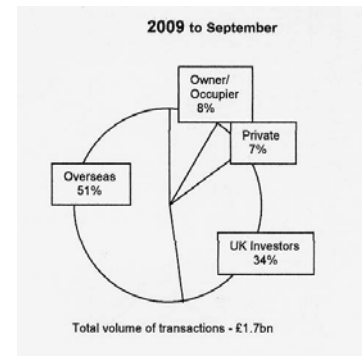
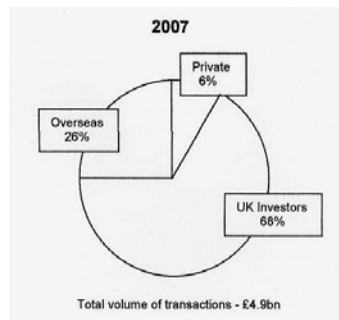
Under the supersession rule, there may be no requirement for the tenant to return, say, a 1970s office building in full repair. The tenant may be able to argue that it is for the landlord to carry out the necessary works prior to seeking a future tenant on the ground that the premises are unable to incorporate modern office equipment and would therefore require complete refurbishment. A 1970s office building would not, for example, have been planned to provide a computer on every desk and the heat generated by such

*(Continued on page 2)*

## Deals Of Optimism ?

Property investors in the West End certainly seem to have been on a buying spree recently. But does this mean the market is recovering? Tony Thesiger, partner at Strutt & Parker, believes it is. "The market is very healthy," he says. "We've gone to best bids on almost everything sold, which is no different to May 2007." Prime yields have hardened since Easter from 6% to 5.5%, in line with the 10-year average. The low value of sterling, low interest rates worldwide and the rapid re-pricing of assets in the West End have driven cash-rich overseas private investors into the market. They have accounted for 51% of transactions since January

this year - a sharp increase from their combined weight at the height of the market in 2007, when they were involved in only 26% of deals. Meanwhile, UK institutions and property companies accounted for 34% of deals this year, compared with 68% in 2007.



But stock is running out and this, combined with high demand, could cause a temporary blip or "dead cat bounce", as some in the market like to call it, the idea being that even a dead cat will bounce if dropped from a great height. Damian Corbett, head of West End markets at Jones Lang LaSalle,

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## Squeeze On Terminal Valuations - Cont. From Page 1

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equipment would need to be dissipated. The former tenant's valuer, when responding to a section 18 valuation, could argue that even if repair work had been carried out, they would have been rendered useless where substantial works, such as the installation of air-conditioning or IT equipment, were required. So, although the tenant contracted in the lease to return the premises to the landlord in repair at lease end, landlords may have to carry out unplanned refurbishment works in order to attract a new tenant.

### Lower values

As evidence of lower capital and rental values come to light and the more the effects of the recession are noticed by landlords and tenants, the better the position becomes for tenants and the worse it is for landlords. A tenant served with a section 18 valuation during the recession would have acted to its detriment had it settled before valuation evidence came to light

illustrating how weak the commercial property market has become. A section 18 valuation can be compiled only by a valuation expert who has the required expertise in the market in which the premises are located. He or she will be aware of changes in capital and rental values during the recession and how these lower figures affect the sums produced by valuations A and B for the landlord to pass to the former tenant. The latter should delay settlement of the claim where its expert valuer has advised that more evidence is coming to light, as the recession continues, of a further weakening of the commercial property market, producing even lower capital and rental values.

### Lack of evidence

With so few dilapidations being litigated (fewer than 1% of schedules served by landlords) there is little or no evidence from recent court cases on the effect of section 18 valuations during the recession.

However, a landlord that has been adversely affected by the squeeze referred to above may be in a better position if it has carried out the repair works. This will demonstrate its loss to the tenant and, if need be, to the court. It is preferable than hoping to receive the costs from the former tenant - in which case, the section 18 cap will limit the amount.

*Estates Gazette 17th October 2009*

### C. P. Comment:

For the landlord there is a risk in waiting to the end of the lease, when the tenants liability might be watered down by the "diminution" argument.

For the tenant this is a very useful way of limiting your liability at the end of your lease.

## Deals Of Optimism - Cont. From Page 2

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adds: "If value of sterling increases and other markets re-price, there will also be a risk to yields in the future." Market fundamentals have also been a concern, and a reason why UK funds have remained on the sidelines. Scott Rowland, fund manager at Grosvenor, says that current investors have not considered the occupational market, which he calls "the bedrock of any investment decision." Richard Womack, senior director at CB Richard Ellis, says that rents will have fallen 30% by the end of this year, and 8% next year. With many seeing declines slowing, some in-

vestors are considering dipping their toes back into the market. However, these falls still leave many buildings sold in the West End over-rented.

Gregor Wallace, associate director at BNP Paribas RE, believes that multilet buildings could come back to the market in three or four years' time. "Lease expires will come up at different times and, if tenants exercise those, losses of income could result in a need to sell, which would cause yields to move out," he says. So there might well be more market activity and signs of an improvement to market

figures, but whether this is indeed the recovery will be proved only if those figures are sustained.

*Estates Gazette 19th September 2009*

### C.P. Comment :

Time will tell, but we are waiting hopefully with clients money "burning a hole in our pockets" for yields to move out a bit and a bit more stock to hit the market.

## How We Can Help You

### Property Management

The Culshaw Partnership are investment managers and the asset we manage is commercial property. This is our bread and butter.

We act as a buffer between landlord and tenant, a useful "arms length" arrangement that many of our clients value.

With our clients safely insulated we ensure that the tenant abides by the provision of the lease, primary of which is the payment of rent, in full and on time.

We operate a computerised Rent

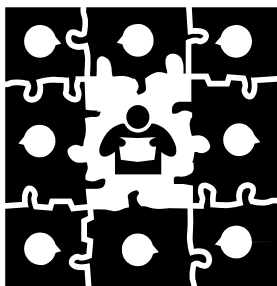
Demand system which provides the utmost clarity for both landlord and tenant of all the monetary transaction that the lease provides for. All costs to the landlord which are recoverable are included and collected including insurance premiums.

In doing this we ensure not only that the tenant does what is expected of them but also that the landlord's obligations whatever they maybe are discharged.

Can you afford not to use us??

### Main Features of our Property Management :

- Rent Collection/ Distribution
- Landlord/Tenant Buffer
- Repair & Maintenance
- Insurance



The Culshaw Partnership  
one company for all your

### Property Management

Rent Reviews/Lease Renewals

Investments ~ Sales & Lettings

Dilapidations ~ Rating

Planning ~ Survey & Valuation

Landlord & Tenant Disputes

The services we offer are listed here please contact us to see if we can be of assistance with any property issues you may have. See page 4 for all our contact details .

## Break Notices

**Take care not to leave it too late** - any time limits should be strictly complied with when serving break notices.

Over the past decade, tenants' break provisions have become increasingly important. Their incidence has risen dramatically as part of the move towards greater lease flexibility.

### Breaks and the law

Tenant' break provisions have, over the years, provided numerous legal challenges. Preconditions to the right to break - notably compliance with the lease obligations - have cost many tenants since the law has always insisted on a total absence of any current breaches, a standard that is almost impossible to achieve in practice.

These problems have largely been solved in modern leases by omitting preconditions altogether, or by modifying the strict compliance

requirement to substantial, material or reasonable compliance. However, one area has always been straightforward; break clauses' time limits are strict.

*Estates Gazette 25th April 2009*

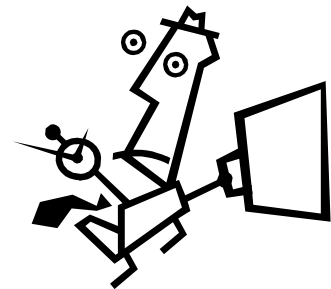
### C.P. Comment :

It is a fact of life these days that landlords face having to grant leases which contain tenants break options. It is a given that these clauses act against the landlords interests so what can be done to mitigate the effect?

Well, firstly it is fundamental to the break option that Notice is given in writing and vagaries of human nature being what they are the tenant may omit to diary a reminder, 2, 3 or more years into the lease. If they miss the date they cannot break.

Most leases will stipulate that there be no breaches of covenant existing at the time the Notice is

required, therefore rent arrears will frustrate a validly served Notice. As a prudent landlord you should ensure that your lease makes provision for the tenant to pay as an integral part of the Notice, the full rent to the break date. If they fail to do this the Notice will be invalid and if they do then at least you have all that you are entitled to rather than having to depend upon a vacating tenant. Often landlords have to grant tenants substantial rent free periods, as well as offer breaks. It is not unreasonable to insist in the event the break is activated the tenant pay, in advance as part of the Notice, a sum equal to the rent free they enjoyed.



## Market Indicators

If you rely solely on the national press you think that rents have fallen across the country.

Whereas our experience is that this is not the case and certainly market town retail rents have remained surprisingly robust in many (not all) towns in which we operate.

As discussed on page 2 Investment returns are also surprisingly strong although there is a wide consensus of opinion that this is fuelled by a great shortage of supply and may differ or drop in the short to medium term.

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