

S.18(1) Landlord and tenant act 1927 - short cuts: recent lessons from the court of appeal

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Introduction

Competent building surveyors and valuers are familiar with s.18(1) of the Landlord and Tenant Act 1927. S.18(1) has the practical effect of limiting or defining the amount of damages that a landlord is able to recover for breach of the tenant's repairing covenants.

It is however surprising how frequently parties to dilapidations claims misunderstand or ignore the effect of the section. This is particularly so in terminal dilapidations claims. Landlords often seem reluctant to ensure that proper s.18(1) valuation evidence is made available, and the belief seems to persist in some quarters that it is possible to disregard the section altogether, or to take short cuts in the preparation of such evidence. This is particularly surprising given the clear advice contained in the dilapidations protocol of the Property Litigation Association which was first adopted as best practice by RICS as long ago as June 2003¹.

This article will examine the continuing relevance of s.18(1) and the extent to which it is possible for a landlord to ignore it and to rely exclusively on the cost of repair as the basis for the claim for damages at the end of the term. It considers recent Court of Appeal guidance to landlords as to whether, and in what circumstances, it is permissible to take shortcuts in the preparation of s. 18(1) evidence.

S.18(1) - Recap

First, a reminder of the terms of the section.

S.18(1) reads:

'Damages for a breach of a covenant or agreement to keep or put premises in repair during the currency of a lease, or to leave or put premises in repair at the termination of a lease.....shall in no case exceed the amount (if any) by which the value of the reversion (whether immediate or not) in the premises is diminished owing to the breach of such covenant or agreement as aforesaid and in particular no damage shall be recovered for a breach of any such covenant or agreement to leave or put premises in repair at the termination of a lease, if it is shown that the premises, in whatever state of repair they might be, would at or shortly after the termination of the tenancy have been pulled down, or such structural alterations made therein as would render valueless the repairs covered by the covenant or agreement'

Although the wording of the section is somewhat obscure, it is generally accepted that the section contains two distinct limbs. The first limb ends after the words "agreement as aforesaid". It is commonly referred to as the "objective" limb. This means that the landlord's actual intentions regarding the disrepaired property after the end of the term are not directly relevant to the question of diminution in value of the landlord's interest. The true diminution in value is instead driven by the market.

The second, "subjective", limb looks at the landlord's actual intentions at the point that the lease expires. To the extent that the second limb applies, it prevents the landlord from recovering damages for any disrepair which is in fact superseded by the demolition or structural alterations that the landlord intends at the term date.¹²

This article deals with the first limb of s.18(1) only.

In order fully to appreciate the contemporary relevance of the first limb, it is important to understand the background to its enactment. The section was included in the 1927 Act primarily to deal with the perceived unfairness created by decisions such as *Joyner v Weeks*¹³. Together with other 19th and early 20th Century cases *Joyner* had effectively created a universal rule that cost of repairs was the correct measure of damage for breach of tenant repairing covenants at the end of the term. This rule would apply even though the actual landlord would never carry out the repairs (and nor would any reasonable person in the position of the landlord). Prior to the coming into force of s.18(1), landlords were therefore often compensated for loss which they had never truly suffered.

The intended effect of the first limb of s.18(1) was therefore to deprive the landlord of a windfall. To achieve this the section poses a purely hypothetical question. It assumes that a sale of the notional reversionary interest takes place at the term date and asks what difference the actual disrepair falling within the covenant makes to the value of that interest. A sale is therefore assumed even if the actual landlord would never have sold, and even if the premises are in real terms 'unsaleable' because of the state of the market at the time¹⁴ or because of the nature of the reversionary interest¹⁵. If the hypothetical market for the landlord's reversionary interest would dictate that something less than the cost of repair would be deducted from the sale price paid by the successful bidder in the hypothetical sale, then it is only this lesser sum, and not the full cost of repair, that the landlord can recover.

Applying the first limb therefore involves the valuer in carrying out at least two calculations. A simple way to apply the section is for the valuer to assume two auction sales at exactly the same time, at which the full range of likely purchasers in the market for that type of property is present. In the first, the valuer assumes an auction sale of the property in repair. He identifies the type of bidder who will pay the most and the amount the bidder will pay. In the second hypothetical auction sale, taking place on exactly the same date (i.e. the term date), the valuer carries out the same exercise but assumes that the property is sold in the dilapidated state which reflects the actual disrepair for which the tenant is liable under the expired lease. The difference between these two valuations gives the valuer the diminution in value attributable to the disrepair for which the tenant is responsible.

Does s.18(1) first limb in fact impose a "cap" on damages?

Commentators and judges have frequently referred to s. 18(1) as a "cap" or "statutory ceiling" on the landlord's recoverable common law damages. This is the conventional way of explaining its operation. Traditionally, therefore, the courts have described s. 18(1) as imposing a limit on the amount of damages recoverable but not as altering the primary method of assessment of those damages. That remains the cost of repair (and any sums for lost rent during the period necessary for carrying out the repairs).¹⁶ In other words the court conventionally applies a two stage approach, whether or not the landlord actually intends to carry out (or has in fact carried out) the repairs. The first stage is to work out precisely what the cost of repair to remedy the breaches would be; the second stage is to see if the diminution in value to the landlord's interest by virtue of that disrepair is less than the cost of repair figure (when added together with any additional sums for lost rent etc.). Damages are thus calculated by reference to that (i.e. the diminution) figure, not the repair figure.

It is arguable, however, that it has become something of a misnomer, and possibly even unhelpful, to explain s. 18(1) by reference to a "cap" on the common law measure of damages. This can lead to the parties focussing too much attention on cost of repair, particularly where (as is so frequently the case) the landlord does not intend to carry out the actual works set out in the schedule of dilapidations, or will only carry out some of them as part of a refurbishment. Focussing too much on repair cost is unsatisfactory and probably unnecessary.

First, it remains seriously doubtful whether *Joyner v Weeks* would be decided in the same way by the higher courts today. When considering the basic principles governing damages awards the courts have sought to develop more flexible rules. Recent damages authorities in other areas of contract law have stressed that the cost of works is only recoverable where it is **reasonable** for the injured party to carry such work out.¹⁷¹

In the recent dilapidations case of *Latimer v Carney*¹⁸¹ (discussed in detail below) the Court of Appeal commented on these changes:

"Parliament enacted the cap in section 18(1) to meet the rigour of the measure of damages for breach of the repair covenant at common law. It may be that the courts would not apply the common law measure of damages in all cases today: I would accept the argument.....that, if the common law measure alone were relevant to a landlord's claim, the courts today might in an appropriate case adopt the measure of damages in section 18(1) in preference to that which has been held to be the measure at common law (see generally Ruxley v Forsyth)"¹⁸².

Secondly, it is becoming an increasingly clear rule of practice in dilapidations claims that, at least where the landlord has no intention of carrying out the repair works, the courts will treat the undiscounted cost of repair as **no guide at all** to the landlord's true loss. Where there is no doubt that the landlord will not incur the actual cost of repair the courts are often anxious, therefore, to divorce the cost of repair issue entirely from the question of what constitutes the landlord's true recoverable loss.

For example, in a now frequently quoted passage, Neuberger J (now Lord Neuberger) said in *Craven (Builders) Limited v Sec. of State for Health*¹⁸³ in relation to the evidence before him in a case concerning a very dilapidated mill complex which the landlord had no intention of repairing:

*"...one cannot say that a costed schedule of dilapidations, of itself, in the absence of any other evidence, constitutes even **prima facie** evidence of the diminution in value of the reversion, let alone that it is any sort of **prima facie** evidence of the actual diminution...."*

Indeed it is arguable that s.18(1) is now altogether redundant, even without *Joyner v Weeks*¹⁸⁴ being overruled. General principles of law regarding how damages are to be assessed have become sufficiently flexible since 1927 not to require any "cap" on common law damages. The assumption inherent in s. 18(1) (that damages will inevitably be assessed under a rigid rule of law, based on repair cost) is perhaps now itself outmoded.

It can even be argued that by impliedly retaining the 'fiction' inherent in s.18(1) (i.e. that in all cases, subject to the operation of the s.18(1) "cap", damages would have to be assessed by reference to the cost of repair) disrepair litigation invariably proceeds from a distorted starting point, based on the assumption that it has to include the two stage process identified above.

The higher courts today could clearly state that the common law in fact imposes no rigid rule as to how damages should be assessed, and that the overriding question is simply: 'what is a reasonable sum for the landlord to recover for the breaches, judged against the landlord's actual intention for the particular building?'. This might encourage landlords to adopt a much more realistic starting point in settling terminal dilapidations claims. The familiar pattern of landlords initially pursuing 'exaggerated' disrepair claims based on unrealistic schedules and, often entirely speculative, estimated costs of repair, and then only in the course of long negotiations adopting a more 'realistic' position (based on diminution in value), might become a thing of the past¹⁸².

An approach that concentrated on the landlord having to prove at the outset of his claim what his real (post-term) intention was and why, and which required the landlord to show that this was objectively reasonable by reference to any proved diminution in the value of his interest, could well lead to earlier settlements. It might also cause landlords to adopt a more candid approach to the question of what information they disclose to the tenant about their intentions for the building.

Furthermore such a shift could lead to a closer focus, for both landlord and tenant, on obtaining clear s. 18(1) diminution in value evidence at the earliest stage of the claim¹⁴³. It might even prevent time being wasted on arguments between building surveyors concerning major items of disrepair (e.g. roofs) that, in diminution in value terms, prove to be entirely irrelevant because they are 'superceded' and therefore form no part of the ultimate damages award.

Two recent Court of Appeal cases also show how dangerous it is for the parties (and landlords in particular) to focus too much on cost of repair - whether actual cost or estimated cost - and thus to attempt to short-circuit the s.18(1) issue. They provide vital lessons to practitioners in this field.

Latimer v Carney¹⁴⁴

Latimer v Carney concerned a familiar situation. A shop lease had expired. The landlord found a new tenant who obtained planning permission to make changes to the property. The landlord refurbished the property to the needs of the new tenant consistent with the planning permission. At the trial of the landlord's claim for damages against the former tenant the landlord failed to prove the actual cost of repairs falling within the lease covenants, relying instead on estimated costs of repair. The first instance judge rejected the landlord's damages claim altogether largely on the basis both that it was unclear what actual repair work had been carried out as part of the refurbishment, and because neither party had called any s.18(1) evidence.

The Court of Appeal reversed the judge's finding. The basis of its decision was that the judge, even without diminution in value evidence as a guide, should have inferred that there was damage to the reversion arising from the estimated costs of remedying those breaches that the judge had found to exist. However, critically, the court reduced the cost of repair of the items by an arbitrary 60% to "*take account of the uncertainty as to the extent that the disrepair affected the value of the reversion*"¹⁴⁵. It therefore found that the failure to adduce s. 18(1) expert evidence as to the value in and out of repair did not preclude a finding of those values by other means. This was because in this particular case the landlord had clearly expended substantial sums on repairs even if he had not isolated them from the refurbishment costs.

The judgment of Arden LJ give some guidance on the circumstances in which an inference of diminution in value might be inferred. It makes the point that diminution might be inferred directly from estimated costs of repairs actually undertaken by the landlord but in relation to other items the estimated cost would have to be heavily discounted to take account of several possibilities. These include the chance that those items may have been superseded by the refurbishment that was in fact carried out.

On the face of it, therefore, the case might provide some comfort to landlords seeking to avoid the expense of obtaining s. 18(1) evidence. It would be wrong to read it in this way. The decision rested largely on the fact that this particular landlord had actually carried out works of repair as part of the refurbishment and that the cost of those works could be reasonably estimated without difficulty, even if the actual cost of the repairs was not known. The court would have taken an entirely different view if no work of repair had been carried out from which the primary inference of diminution could be drawn, even if estimated costs had been available. Furthermore, the arbitrary 60% discount applied to the repair costs shows that there is no way of predicting how the courts would approach the discount calculation in any other similar case. No guidance was given as to what particular factors influenced the discount - and Arden LJ referred approvingly to comments made in an earlier court of Appeal case (Crewe Services & Investment Corporation v Silk¹⁴⁶) that the discount should be "severe" because of the landlord's failure to adduce proper diminution evidence¹⁴⁷.

Finally it is important to remember that, although in Latimer v Carney the court impliedly accepted that there was at least some correlation between cost of repair and diminution in value, on the facts it did not need to consider the contrary argument. On different facts it would have been perfectly possible to make this argument.

Ravengate Estates Ltd v Horizon Housing Group Ltd^[18]

The issues in *Ravengate Estates Ltd v Horizon Housing Ltd* were different. In *Ravengate* the landlord of a block of 6 flats which had been let to the defendant housing association carried out a substantial modernisation of the block after the end of the term, converting it into a block of 12 flats.

The s. 18(1) evidence given at trial was unclear in some respects. The landlord called no proper s. 18(1) evidence. Its valuation evidence was limited to a largely irrelevant exercise of showing how the letting values of the 6 flats were diminished by the disrepair. No direct evidence was called by the landlord as to the difference in the value of its freehold interest caused by the disrepair. The landlord maintained its claim based on cost of repair even though much of the disrepair was in fact superseded by their intended refurbishment. The tenant called valuation evidence but that evidence did not clearly carry out the "two imaginary sales" exercise referred to above. It simply assessed diminution by reference to the items of disrepair that would survive the inevitable (12 flat) refurbishment scheme - a scheme dictated by the market, which was in fact being carried out by the landlord. Furthermore, in cross-examination the tenant's valuer appeared to admit that his calculations showed that the redevelopment that the landlord was in fact carrying out was actually financially unviable. Since the tenant's expert had not provided proper 'existing use' and development value calculations that demonstrated that redevelopment was the inevitable market option, the landlord was able to argue that the court was bound to fall back on cost of repair as the only safe measure of the landlord's loss.

The first instance judge did not make clear findings as to the two valuations required by s.18(1). This was undoubtedly because of the difficulties presented by incomplete valuation evidence. He did, however, make the key factual finding that redevelopment was inevitable at the term date. He also accepted the broad thrust of the tenant's valuation evidence that any hypothetical purchaser at the term date (whether a redeveloper; an investor or an owner-occupier) was bound to carry out a 12-flat type redevelopment of the kind that had in fact been carried out. On this basis he awarded damages by reference to the items that would have survived the landlord's actual redevelopment.

The judge's decision was upheld in the Court of Appeal despite the difficulties presented by the tenant valuer's apparent admission. The court concentrated on the judge's unimpeachable finding of fact that the 12-flat redevelopment was inevitable given the buoyant residential market at the term date. Based on this critical finding of fact, the court found that '*the judge's logic and findings work*^[19]' (i.e. the diminution in value was justifiably equated directly to the cost of items that in fact survived the landlord's actual refurbishment). The landlord's appeal was thus dismissed.

The lessons

Superficially, both cases could be read as providing some comfort to landlords who are unwilling or unable to provide proper diminution evidence to the Court and wish to stake their case on proving the estimated or actual cost of repair only. In *Latimer v Carney* the landlord's challenge to the first instance judge's decision that no damages were recoverable, was successful even in the absence of any proper s.18(1) evidence from either side. In *Ravengate v Horizon* it could be said that the landlord's challenge might have succeeded but for the first instance judge's critical finding of fact that at the term date refurbishment was 'inevitable'.

It would, however, be quite wrong to read either decision in this way. It is clear that if the s.18(1) evidence presented to a court is deficient, or non-existent, the court is bound to be generous to the tenant in determining how to calculate the landlord's loss. The deduction of 60% from the estimated repair costs in *Latimer* might well be exceeded in future cases, because in *Latimer* it was plain that some repair had in fact been carried out and that this repair was necessary in order to effect a re-letting. In *Ravengate* the appeal court did not need to consider how it would have estimated the landlord's loss in the absence of coherent diminution evidence. It is likely, however,

that in circumstances where the landlord had in fact carried out an extensive refurbishment a Latimer-style deduction would have been applied with even more stringency, because only a small proportion of the repair items had in fact survived. Indeed it is not inconceivable that even without diminution evidence of any kind - defective or otherwise - the Court in *Ravengate* would have been persuaded to treat the cost of the 'survival' items as the best guide in any event to the landlord's true loss.

The lessons from these cases might be summarised as follows:

Landlords

- There is a huge risk in relying upon estimated costs of repairs without diminution evidence to back up the claim
- If landlords rely simply on estimated costs and do not call valuation evidence, judges are bound to be generous to tenants in applying swingeing discounts to those costs - particularly if no actual repair has been carried out, or if it is difficult to isolate actual repair costs
- Older authorities²⁰ that suggest that a direct correlation can be assumed between cost of repair and diminution, in the absence of formal diminution evidence are likely to be treated with greater caution by modern judges and confined to their facts
- The burden remains on the landlord to prove diminution in value. It is not for the tenant to prove that claimed disrepair costs do not equate to diminution in value - unless (possibly) the landlord has actually carried out the repairs in accordance with the schedule of dilapidations
- There are significant dangers in assuming that the landlord can by-pass the s.18(1) valuation process, whether or not the landlord has carried out the repair works

Tenants

- The tenant should not assume that a landlord's claim will fail in the absence of diminution evidence - even where the landlord has not carried out any of the works and does not intend to do so.
- In circumstances where the landlord has not carried out the works and produces no diminution evidence, the tenant needs to make a tactical decision whether to rely on a 'Latimer'-type discount on estimated repair costs or to call its own evidence.
- In cases involving refurbishment, it is unsafe to assume that a simple equation will necessarily be made by the court between cost of 'survival' items and diminution in value. The safest course must always be to ensure that two hypothetical residual valuations are carried out in a conventional way.

Furthermore, a clear distinction still needs to be retained in the minds of valuation experts for either side, between, on the one hand, the two hypothetical calculations that are the essence of the s.18(1) first limb exercise, and, on the other, the actual intentions and actions post term of the particular landlord.

Conclusion

Just over 80 years since s. 18(1) was first enacted, its continuing utility in a legal world that is less hidebound by technical damages rules needs to be questioned. The body of case law that has built up around the first limb seems to cause confusion for both landlord and tenant. In part this is because of its implicit assumption that cost of repair is the invariable common law measure. Despite this, s. 18(1) is unlikely to be repealed. Parties to terminal dilapidations disputes are therefore best placed if they focus on providing the two conventional residual calculations that are the essence of the first limb, at the earliest stage of the claim. This is so whether the landlord intends to carry out the work or not, and irrespective of the recommendations of the PLA Protocol. If the sums in the residual calculation do not work (for either party) and they choose or are forced to rely on an arbitrary 'Latimer'-type discount

on basic cost of repair - or some other short cut to a diminution figure - this is unlikely to provide a satisfactory solution for either party. Furthermore, it makes meaningful settlement of claims prior to trial a virtual impossibility.

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[1] See the RICS Dilapidations Guidance Note (5th edition). It is unclear when, if at all, the Protocol (now in its 3rd edition) will be adopted as part of the Civil Procedure Rules.

[2] The second limb is often very difficult for the tenant to prove. The tenant must show that a firm intention to carry out the relevant work existed at the term date and also (arguably) that the alterations or demolition are so extensive as to render valueless the whole of the disrepair that is the subject of the covenant: see e.g. *Firle Investments Ltd v Datapoint International Limited* [2000] All ER (D) 634.

[3] [1891] 2 QB 31

[4] See *Craven(Builders) Limited v Sec. of State for Health* [2000] 1 EGLR 128 per Neuberger J at p.130G-H

[5] See e.g. *Shortlands Investments Limited v Cargill Plc* [1995] 1 EGLR 51 - where the reversionary interest at the term date had a negative value only - whether the premises were in repair or not.

[6] See e.g. *Dowding & Reynolds: Dilapidations - Law and Practice* (3rd Edition, 2004); *Jones v Herxheimer* [1950] 2 KB 106 at 119, per Jenkins LJ and *Shortlands Investments Limited v Cargill Plc* (op.cit) per HHJ Bowsher QC at p.56L-M.

[7] See e.g. *Ruxley Electronics Limited v Forsyth* [1996] AC 344

[8] [2007] 1 P & CR 13

[9] Per Arden LJ at para 60. However, it is noticeable that at paragraph 24 of her judgment Arden LJ still refers to the '*basic measure of damages*' for breach of covenant as being the reasonable costs of executing the repairs - but says that this is '*subject to general principles of law including the principle established in Ruxley v Forsyth*'. See further the discussion in *Dowding and Reynolds: Dilapidations - Modern Law and Practice* (3rd edition 2004), para 29:08.

[10] *Supra*

[11] *Supra*

[12] The PLA Protocol and the RICS Guidance Note aim to prevent this practice - but no one would claim they have entirely succeeded.

[13] Some of these issues are properly addressed (if somewhat obliquely) by the PLA Protocol. In the writer's experience however the Protocol is not yet shifting entrenched views as to how dilapidations claims should be approached.

[14] *Supra*

[15] Per Arden LJ at para 9

[16] [1998] 35 E.G. 81

[17] In the *Crewe* case the discount applied was 75%.

[18] [2007] EWCA Civ 1368

[19] Judgment para 22, per Mann J.

[20] E.g. *Jones v Herxheimer* [1950] 2 KB 106