Neutral Citation Number: [2017] EWHC 197 (TCC)

Case No: HT-2013-000071

IN THE HIGH COURT OF JUSTICE
QUEEN'S BENCH DIVISION
TECHNOLOGY AND CONSTRUCTION COURT

Royal Courts of Justice
Strand, London, WC2A 2LL

Date: 14/02/2017

Before :

MR STEPHEN FURST QC
(sitting as Judge of the High Court)

- -

Between :

CAR GIANT LIMITED **ACREDART LIMITED**	**Claimants**
- and -	
THE MAYOR AND BURGESSES OF THE LONDON BOROUGH OF HAMMERSMITH	**Defendant**

- -
- -

Mr Neil Mendoza (instructed by **IBB Solicitors**) for the **Claimant**
Miss Tiffany Scott (instructed by **Browne Jacobson**) for the **Defendants**

Hearing dates: 30th & 31st January, 1st & 2nd February 2017

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Approved Judgment

I direct that pursuant to CPR PD 39A para 6.1 no official shorthand note shall be taken of this Judgment and that copies of this version as handed down may be treated as authentic.

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MR STEPHEN FURST QC

Insert Judge title and name here :

Introduction

1. This is a claim for dilapidations at the end of a lease. The London Borough of Hammersmith and Fulham ("LBHF") were the lessees of a property known as the Triangle Estate, Willesden, London. Its 25 year lease came to an end on 21st February 2011 ("the Valuation Date"). It is common ground that on that date there were breaches of the repairing covenants. The only issue is the diminution in value of the reversion attributable to those breaches.

The Leases

2. Acredart Ltd is the lessee of the property under a lease dated 3rd April 1984 for a term of 125 years from 25th December 1983. Car Giant Ltd is the lessee of the all the individual units within the property under a lease for a term of 125 years, less one day, from 25th December 1983. It is common ground that the two Claimants are, together, to be treated as holding the relevant reversionary interest and that any award of damages is to be made to the Claimants jointly, without distinguishing their different reversionary interests.

3. LBHF's lease is dated the 21st February 1986 under which it was demised the whole of the property (i.e. the units and the common parts) for a term of 25 years from 21st February 1986. This lease contains full repairing covenants including a covenant to yield up the property in good and substantial repair. It is unnecessary to set out the terms of the repairing covenants since the parties have agreed both the extent to which the property was out of repair, and therefore the breaches of the covenants, and the cost of remedying the breaches.

The Property

4. The property occupies a triangular site with a frontage along one side of the triangle onto Salter Street. It has two internal roads called Fortune Way and Enterprise Way. There are 39 units within the property which are used as light industrial or warehouses. The property was built in the 1980's by LBHF (who are the freeholders), as small starter units or "nursery units" for business. They are single storey and primarily of brick construction with low profile pitched roofs. They vary in size from 877 sq. ft. to 2,436 sq. ft. (according to the Claimants' expert valuer) or 881 sq. ft. to 1,367 sq. ft. (according to the LBHF's expert valuer). The photographs suggest that the property is somewhat run-down; it is accepted that it is a secondary or tertiary property, probably attracting tenants who are or might be unable to fulfil their covenants under their leases in full.

5. The property is in an established industrial area, with several nearby properties occupied by Car Giant Ltd. The property is accessed via Hythe Road which in turn is accessed from Scrubs Lane. The A40 lies to the south and Willesden Junction Railway Station is a short walk from the property.

6. Whilst the property comprises 39 units, this action is only concerned with 35 of the units; liability having been settled in respect of three units and Car Giant Ltd having not been the reversionary owner of one unit when the proceedings were commenced.

7. The units were let by LBHF under full repairing leases but as at the Valuation Date, 18 units were occupied either on the basis that the tenants were holding over or pursuant to new leases granted by the Claimants. In this latter case the repairing obligation was limited to keeping the unit in no worse conditions than it was on the first day of the term. 14 units were vacant and four units were unoccupied, presumably on the basis that the tenants had simply decided to leave but without giving notice.

The Defects

8. The Building Surveyors for the parties agreed the common law assessment of the cost of works undertaken by the Claimants as at September 2016 in the sum of £183,897.86 and the common law assessment of the cost of works not undertaken as at that date in the sum of £218,990. In other words the Building Surveyors agreed that the reasonable and necessary cost of remedying the breaches of the repairing covenants as at the Valuation Date was £402,887.86 of which remedial work to the value of £183,897.86 had been executed by September 2016 (including £13,125 as the cost of the preparation of the schedule).

9. The schedule setting out the works was not put in evidence. I have therefore been unable to consider the nature of the breaches or the nature and extent of the works carried out and not carried out. Mr Lenson, LBHF's expert valuer, gave evidence that he had considered the schedule in relation to Unit 5 Enterprise Way. He stated that the work which had not been carried out to that Unit comprised largely cleaning, decorating and painting although there was an item in respect of blocked guttering and for obtaining access to the roof. The only other evidence on the matter is a schedule annexed to Mr Lenson's report in which he has set out, on a unit by unit basis, the sums of money expended on the repairs and the sums yet to be incurred, as derived from the schedule agreed by the Building Surveyors. By way of example, in one case, Unit 11 Fortune Way, £1,180 has been expended and £10,668 remains to be expended. One might therefore deduce from this that the repairs still to be carried out are substantial or that it indicates that the defects are major ones but I do not think this is a safe conclusion. It may be that it simply relates to redecoration of the entire unit or some other one-off expenditure peculiar to this particular unit. In the absence of any further evidence and the failure of either party to bring forward evidence on the matter, all I can conclude is that there were breaches of the repairing covenants and that the cost of remedying those breaches was as set out above.

Diminution in value

10. The first limb of s.18(1) of the Landlord and Tenant Act 1927 provides as follows:

> "*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, whether such covenant or agreement is expressed or implied, and whether general or specific, 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;…."*

11. The only issue in this case is whether the cap set out in the Act limits the recovery to £110,000, as contended for by LBHF, or whether the Claimants can recover the entire

remedial costs (both incurred and not incurred) of £402,887.86 on the basis that the diminution in value is £500,000.

The Valuers

12. The Claimants' expert valuer is Mr Andrew Outterside of Vail Williams LLP, a Chartered Surveyor with over 34 years experience. He was a member of the RICS Working Party that produced the chapter on diminution valuations in the RICS Guidance Note published in September 2016.

13. LBHF's expert valuer is Mr Nigel Lenson, a partner in the firm of Alexander Reece Thomson. He is also a Chartered Surveyor with some 20 years experience.

14. Both experts have extensive experience of dilapidation claims and the considerations relevant to the cap under s.18(1) of the 1927 Act.

15. Whilst both experts endeavoured to assist me, both of them were, to an extent, somewhat partisan in their approach and there are aspects of their evidence which I am unable to accept, for reasons as set out below.

16. Both experts produced valuations of the diminution in value of the Claimants' reversionary interest by comparing the value of the property in good condition with its value subject to disrepair. In carrying out those valuations they adopted different criteria; provided the same criteria appear on both sides of the comparison, then those differences between the valuers do not matter. Thus, for example, Mr Outterside adopts a yield of 10% whereas Mr Lenson's figure is 14%. Since each of the valuers adopt the same yield figure in their two calculations, it is not going to affect the differential figure as between the two calculations which represent, so they maintain, the diminution in value due to the defects. I therefore only consider the differences which affect the diminution in value to the reversion due to the defects.

17. Mr Outterside's approach is to adopt the costs of remedying the defects which are claimed in the Particulars of Claim i.e. £393,548.45 in respect of general remedial works, £50,359.68 for drainage repair works and then add a management fee of 10% (£38,935.84). He adjusts these figures to £450,000, £50,000 and £50,000 respectively to arrive at a total of £550,000. Later in his calculations he adds a further 10% to account for contingency. In other words he ignores the common law assessment agreed by the Building Surveyors even though this was agreed before he finalised his report. Further there is no evidence to support the basic building blocks of his calculation i.e. no evidence was called to support the figures of £393,548.45 and £50,359.68. The only figures put forward are those agreed by the Building Surveyors, as set out above. Mr Outterside argues that a hypothetical purchaser would have asked a surveyor to carry out a survey to quantify the approximate cost of repairs to the estate and that such a surveyor would err on the side of caution since the inspection at this stage would have been considerably less detailed than was carried out for the purposes of reaching the agreement on costings. Mr Outterside has therefore ignored the schedule and costings agreed by the Building Surveyors on the basis that the hypothetical purchaser would not have had the benefit of such a detailed inspection and costings as has now been provided.

18. Whilst Mr Outterside may well be correct in his assumption as to the nature of a pre-acquisition survey that might be carried out by a hypothetical purchaser, in this case the parties have agreed the state of disrepair and the costs of remedying that disrepair. It is this cost which is the basic building block in the diminution calculation, as discussed below. If this is known, as it is in this case, then this is the figure to adopt. Even if it were correct to ignore this agreement, I do not accept that a pre-acquisition survey estimate would be higher than the figure agreed by the Building Surveyors. It is quite possible that such a survey might fail to identify all the work and/or underestimate the cost and/or take a more optimistic view of the disrepair; it is quite possible that a surveyor might come in at a lower figure than has been agreed by the Building Surveyors. Furthermore, whilst such a surveyor who had carried out a pre-acquisition survey might well be cautious in view of the limited nature of the inspection he would have carried out, there is nothing to suggest that the hypothetical purchaser would necessarily adopt the cautious figure. There are no doubt many different considerations which would influence a hypothetical purchaser in his assessment of the sum he would bid for the property, only one of which would be the costs of remedying the disrepair. Thus, in my view, the correct starting point is the agreed figure of £402,887.86.

19. Furthermore, even if I were wrong about that, as I say above, no evidence has been called to support the figures of £393,548.45 and £50,359.68 (to which a contingency of £47,500 is added) or why they should be some £50,000 higher than the figure agreed by the Building Surveyors.

20. Having arrived at the figure of £550,000 Mr Outterside then reduces it by £75,000 to account for the potential recovery from the outgoing tenants of the units of some of the cost of repairs. This figure is arrived at by taking the square footage of the 10 units where the tenants were "holding over" as at the Valuation Date, applying a "repair rate" of £13.56 per sq. ft. (which he derives from his figure of £550,000), and then halving the figure to take account of the likelihood of recovery from such tenants.

21. As I understand it, the "holding over" tenants are those who remained in occupation of their units after the Valuation Date and who had the protection of the Landlord and Tenant Act 1954.

22. By contrast Mr Outterside ignores the vacant units for these purposes, on the basis that it would probably prove impossible in practice to recover sums from those former tenants, and he also ignores the units where new leases were granted with limited repairing obligations, on the basis that it is difficult to see how such tenants could be asked to pay for dilapidations under their former leases when they have been granted leases which simply obliges them to repair the units so that they are no worse condition than they were at the outset of the new leases.

23. Whilst I consider Mr Lenson's approach below, I think it is right that some, limited allowance is made on the basis that the hypothetical purchaser would expect to make some recovery in relation to the cost of repairs. I agree with Mr Outterside's conclusion as to the chances of recovery in respect of vacant units and units where new leases have been granted. Thus I adopt his analysis, but instead of basing it on £550,000 to derive the figure of £13.56 per sq. ft., I adopt the figure of £400,000 (rounded down from £402,887.86) to give an estimated cost of repair of about £106,000 for the 10 units (i.e. reducing Mr Outterside's figure of £146,366 pro rata: £400,000 divided by £550,000).

I then take half that figure, say £50,000, as the likely figure for recovery for dilapidations from the tenants but on the assumption that all the repairs were to be or had been carried out. Although it is extremely difficult to estimate this recovery, as a cross-check an average of £5,000 per unit in respect of the "holding over" tenants seems to me to be reasonable.

24. Finally Mr Outterside adds a figure of £25,000 as financing costs to fund the repair work. He calculates this on the basis of funding the work for one year at a commercial rate of 6% together with fees to set up the loan. I can see that such a cost might be included by a hypothetical purchaser although such costs might be offset or reduced by the rent receipts from the new leases and the tenants "holding over".

25. By contrast Mr Lenson starts by considering the sort of person likely to acquire the reversionary interest in this case. He concludes that the hypothetical purchase is likely to be a speculative investor looking to capitalise on longer-term development opportunities. Such a purchaser is likely to consider carrying out only such repair works as are necessary to achieve a letting of the units at a market value; thus only essential repairs would be carried out i.e. making the units wind and watertight, with heating and lighting in working order and, possibly, some minor cosmetic repairs and any necessary statutory works. He considers that the works in fact carried out are the best evidence of these necessary works amounting to an agreed cost of £93,635 in relation to the vacant units.

26. As regards the occupied units Mr Lenson takes the agreed figure of £71,617 as being the cost of works actually carried out but then reduces it by what he refers to as a "special assumption" related to rent deposits given by some of the unit holders to LBHF. When one of these rent deposit agreements was examined, it was established that the moneys held by LBHF would not pass to the hypothetical purchaser and therefore is to be ignored. This sum (£52,582) therefore falls out of the calculation.

27. However, for the reasons given above, I think is reasonable to assume that about £10,000 would be recovered from unit holders in respect of their breaches of their leases prior to the Valuation Date. I have reduced the figure from £50,000 (as calculated at paragraph 23 above) to take account of the fact that only work to the value of £71,647 was carried out to the occupied units (plus some drainage works), only some of which are the "holding over" units, since I think it is unreasonable to assume that any recovery would be made from unit holders in respect of work not carried out or where there appears to be no intention to carry out such work.

28. As regards the drainage works which related to the common parts, £5,491 was in fact expended on repairing the drains with a further £16,458 yet to be spent. Mr Lenson reduces the figure of £5,491 to £2,778.57 on the basis that the balance would be recovered through the service charge. I do not agree with this analysis. Whilst the precise terms of the obligation to make payments by way of service charge would have to be examined, it would be unusual to require tenants holding under new leases to bear the cost of remedying pre-existing defects and my allowance of £10,000 would include any contribution that might be obtained from occupiers of units "holding over" in respect of all defects, including the drainage defects.

29. Mr Lenson supports the assumption that the highest bidder for this property would be a speculative purchaser by reference to a report dated March 2010 concerning HS2 which suggests that there should be a station at Old Oak Common i.e. close to the subject property. He also relies upon a Department of Transport report dated March 2010 which also refers to the possibility of such a station on the basis that it would provide good connections for HS2, Crossrail, the Great Western Main Line and Heathrow Express. Mr Lenson argues these reports supports his view that this property would be viewed as a development opportunity in the medium term and that a speculative investor would be interested in obtaining market rents, whilst carrying out minimal expenditure, in the hope that a capital gain might be obtained in due course in future development plans.

30. However in the course of his evidence he somewhat modified that view drawing the contrast instead between more cautious investors, who would invest on the basis of the need to carry out more or all of the remedial works, with less cautious investors who might carry out less of the repairs. At least as regards one point in his analysis, there is no dispute. Thus it is accepted that the rents that have been obtained for the units do represent market value; in other words there is no evidence that the rents that have been achieved for the units have been reduced by the fact that not all the repairs have been carried out. Thus the Claimants appear to have carried out such works as are required to obtain the market value for these types of units in this location.

31. However I am very doubtful about his assumption as to the hypothetical purchaser. It is based on an unproved assumption (which is probably unprovable) about the view that the hypothetical purchaser would take about the medium term prospects for this property. It is not suggested that the property is "ripe for development" and whilst no doubt some redevelopment is likely to occur, the timescale is wholly uncertain. In my view the proper assumption is that the hypothetical purchaser is one who wishes to earn the income to be derived from the units and although such a purchaser may well hope that "something will turn up", I do not accept that that possibility is such a real possibility that he would pay a premium. In any event, if I were wrong about that, the hypothetical purchaser would adjust the yield he was looking for rather than discount the presumed cost of repairs.

32. As regards the costs of the preparation of the defects schedule (£13,125), Mr Lenson is correct that this cannot be an ingredient in the calculation of the diminution in value. Whilst a hypothetical purchaser would almost certainly commission a survey, this is a cost which would appear in both calculations of diminution in value (i.e. assuming the property in repair and assuming it in disrepair) and therefore it should be ignored for these purposes. I deal with this cost separately below.

<u>The correct approach</u>

33. It would seem to me that the correct approach in a case such as this is properly summarised in **Hill & Redman's Law of Landlord and Tenant** (December 2016) at paragraph A[3643]:

> *"The first step is to identify what works the tenant should have done and then to establish the breaches and what remedial work is necessary to remedy them. The landlord's interest is then valued as at the date of termination of the lease on two bases: first, on the assumption that the premises are in the state they should have been in if the tenant had*

> *performed his covenant; and secondly on the basis that the premises are in their actual state and condition. The difference between the two valuations is the damage to the reversion. Damages cannot exceed this amount."*

34. In this case the works that should have been done by LBHF and therefore the breaches of the repairing covenants have been agreed, as has the cost of so doing. Where this work has been carried out the authorities establish that this cost is prima facie evidence or a very real guide to the damage to the reversion. (See **Dilapidations: The Modern Law and Practice, 2013 -14** by Dowding and Reynolds, paragraph 30-15.) Equally where the landlord can establish that he really intends to do the repairs then in practice the burden of proving that the damage to the reversion is less than the cost of the works may shift to the tenant (**Hill & Redman's Law of Landlord and Tenant** (December 2016) at paragraph A[3644]).

35. Conversely where the work has not been carried out the position is summarised in **Latimer v Carney** [2006] 3 E.G.L.R. 13 at [48]:

> *"The failure to carry out the repairs would clearly be an indication that the repairs were not necessary as the landlords claimed. Put another way, whether sums were actually spent on doing repairs is relevant to the question whether the repairs were necessary or not. If they were not necessary, damage to the reversion could not be inferred from them. But even where the repairs had not been carried out there could be other explanations for the failure that could satisfy the judge that the indication was not well-founded, as where the landlord decides not to repair the property himself but proceeds to sell it at a lower price than he could have obtained if the repairs had been remedied."*

36. In this case both propositions apply, some work has been carried out and some work has not. I see no reason why I should not accept that, as regards the work in fact carried out, this represents or is equivalent to a diminution in value in the reversion. For the reasons I have already given I calculate this as £93,635, in respect of the vacant units, plus £71,647 for the occupied units, plus £5,491 in respect of drainage; a total of £170,773. I reduce this sum by the amount that the hypothetical purchaser might reasonably assume would be recoverable from the "holding over" tenants i.e. £10,000 as assessed at paragraph 27 above. However this figure has to be increased to allow for financing; once again I allowed £25,000 but this was calculated on the assumption of a budget cost of about £500,000. Taking account of the actual costs expended, I would reduce the financing costs to £5,000. Thus in my view the diminution in value which can properly be deduced from the fact that the Claimants have in fact carried out repair works to the value of about £170,000 is £166,000 (i.e. £165,773 rounded up).

37. As regards the work not carried out, no explanation has been put forward by the Claimants as to why such work has not been done, some six years after the Valuation Date. No evidence has been called to suggest that such work will ever be carried out and I have no evidence before me to suggest that those outstanding works are serious or substantial; indeed to the contrary, the fact that the units have been let at a market rent suggest that what is outstanding is minor or unimportant. It would seem to me therefore that I cannot deduce or assume that this further element of cost should be taken into account in arriving at the diminution of value.

38. There is no other evidence before me to suggest that notwithstanding these outstanding repairs the reversion has been diminished by an amount equivalent to or to be derived

from the cost of remedying these remaining defects. Mr Outterside's valuation makes no special assumption in this regard, he merely assumes that the hypothetical purchaser would derive a value based on remedying all the defects. I see no reason to make such an assumption since Car Giant's actions and inaction after the Valuation Date throw light upon the value of the reversion at that date. (See **Dilapidations: The Modern Law and Practice**, 2013 -14 by Dowding and Reynolds, paragraph 30-37.)

39. I should add that it was suggested by the Claimants' Counsel that the explanation for the Claimants not carrying out some of the works was lack of finance and/or not wishing to disturb the unit holders in occupation and/or that there was a rolling programme of repairs and/or that it was not unreasonable to hold back expenditure when LBHF was resisting payment. These all might be good explanations but none of them are supported by evidence; I cannot assume those matters particularly where, as was common ground, the burden of proving the diminution in value rests on the Claimants.

40. Accordingly I conclude that the common law assessment of damages attributable to the breaches of covenant by LBHF is £402,887.86 however, by reason of s.18(1) of the 1927 Act, the recoverable damages are limited to £166,000.

Defects Schedule

41. In addition to the diminution in value, the Claimants claim the fees for the preparation and service of the schedule, claim summary and drainage report in the sum of £21,416.25. The only evidence I have on these heads of claim is as referred to in Mr Lenson's report where he identifies the sum of £13,125 as being the cost of the preparation of the schedules.

42. It would seem to me this is a head of loss attributable to the breaches of covenant and therefore properly recoverable.

43. The only remaining head of claim is for professional fees in the sum of £38,935.84. No evidence has been called in relation to this matter and I therefore make no award in relation to this claim.

Claim

44. For the reasons given above I therefore assess the Claimants' recoverable damages in the total sum of £179,125 (£166,000 plus £13,125).

Interest

45. Interest is claimed pursuant to s.35A of the Senior Courts Act 1981. It is common ground that the interest calculation should start from the Valuation Date. This seems to me a somewhat generous concession on the part of LBHF since the Claimant was not "out of pocket" as at that date and appears to have expended sums carrying out repairs over a number of months or years. Nevertheless in the absence of evidence and in the light of the concession, interest is to run from the Valuation Date.

46. I have no evidence as to the particular circumstances of the Claimants. I assume that they are normal commercial organisations and probably net borrowers although I have

no evidence as to the rate of interest that they paid. In those circumstances I think simple interest at 1% above Base Rate is appropriate.

47. I would ask the parties to agree the calculation of interest to the date of judgement. That leaves the question of costs on which I will hear further submissions.