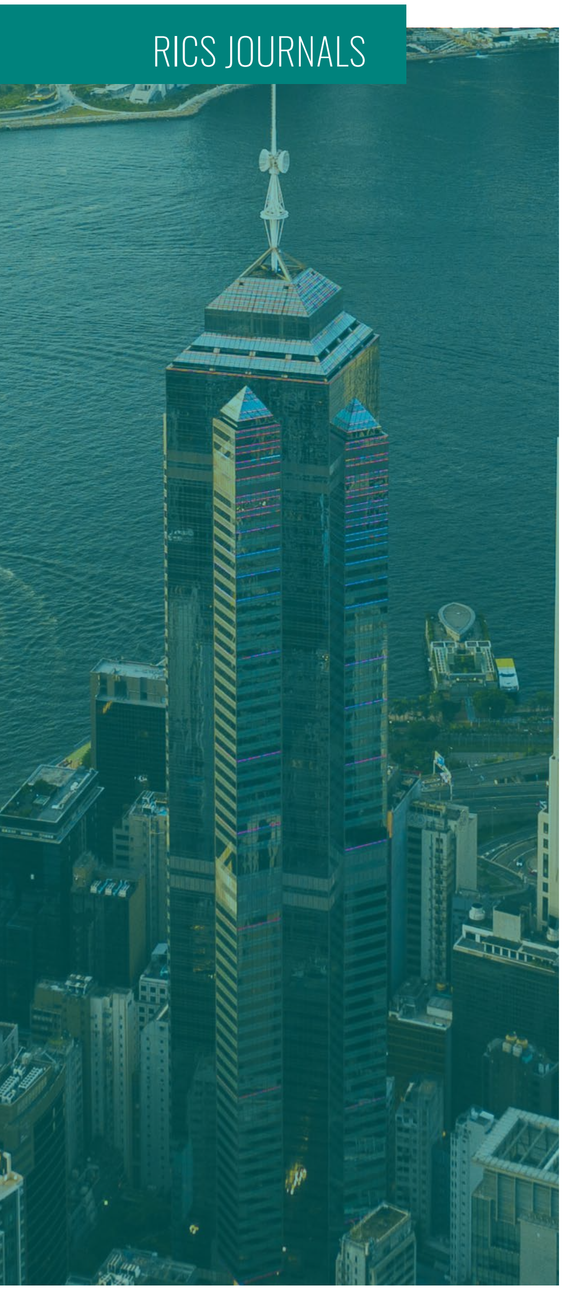
Property Journal

Editor’s choice

MARCH 2022 –
MAY 2022

RICS JOURNALS



Welcome to RICS Journals Editor’s choice (March 2022 – May 2022)

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We will produce a pdf collection of journal articles every quarter and we would welcome any feedback journals@rics.org.

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Japanese knotweed – new guidance comes into effect

PROPERTY JOURNAL
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As the latest RICS guidance on Japanese knotweed becomes operative, its technical author reflects on key considerations for property valuers and surveyors

By Philip Santo FRICS

On 23 March 2022, the new RICS guidance note Japanese knotweed and residential property comes into effect. By complete coincidence, that date is exactly ten years since its predecessor, the information paper Japanese Knotweed and Residential Property was launched.

That paper introduced the first formal process for assessing Japanese knotweed risk with the so-called 'seven-metre rule', which has become a touchstone across the whole residential property market.

Before that, there had been no agreed way of assessing the risk posed by the plant; subsequently it provided a straightforward route through to mortgage finance for most affected sales.

Directly addressing concerns

Increasingly however, experience confirmed early suspicions that seven metres was a conservative measure of the distance that might be affected by the growth of Japanese knotweed. Also, valuers and surveyors never encountered properties where Japanese knotweed had actually caused damage to substantial structures, even when growing in close proximity. Although Japanese knotweed is undoubtedly capable of causing damage to garden walls and lightweight structures such as conservatories, this begged the question: if it was not damaging residential buildings, what risk was the assessment process attempting to mitigate?

Eventually, academic **research** confirmed these reservations and reported three metres as being a more appropriate distance to use for the likely spread beyond visible evidence of an infestation. In 2019, the House of Commons Science and Technology Committee, **describing** the seven-metre rule as a 'blunt instrument', called on RICS and residential lenders to introduce a more nuanced and evidence-based assessment process.

The new guidance directly addresses these concerns by introducing an assessment process, which replaces the crude distance-based measure by reflecting the actual impact of an infestation at a property. The assessment process is still easy for valuers and surveyors to apply when Japanese knotweed is seen during site inspections, and it gives a straightforward categorisation of infestations.

This retains simplicity, which is essential for the residential property market, so the actions needed to make an affected property mortgageable will still be clear to all parties. The guidance has stimulated great interest since its launch, including in the media, and to date has had over 2,000 unique downloads from the RICS website.

The assessment process is still easy for valuers and surveyors to apply when Japanese knotweed is seen during site inspections, and it gives a straightforward categorisation of infestations

New guidance in practice

So what does the guidance mean for the residential practitioner? Whenever Japanese knotweed is seen within the boundaries of a property, it should be categorised at one of three levels.

- **Management Category A**: Action means that Japanese knotweed is present and is causing visible material damage to a significant structure. This is likely to affect value because repair and remediation costs will be incurred.
- **Management Category B**: Action means there is no material damage to structures, but that Japanese knotweed is likely to prevent use of or restrict access to amenity space. This may still affect value, but that will be related more directly to the cost of remediation because no structural repairs will be needed.
- **Management Category C**: Manage means that Japanese knotweed is present, but it is not causing damage or affecting amenity. Consequently, the impact on value will be much lower because the structures and amenity of the property have not been adversely affected, and any remediation costs will be at the discretion of the owner.

When an assessment is Management Category A or B, most lenders are expected to impose retentions on mortgage advances pending receipt of a remediation specialist report – hence the word 'Action' in the category title. By contrast, when the assessment is Management Category C: Manage, the expectation is that no retention will be imposed because the infestation has not directly affected structures or amenity at the property.

When infestations are seen off-site, the previous assessment process required categorisation if they were within seven metres of the boundary. Responding to the latest research, this distance has now been reduced to three metres as **Management Category D: Report**. Mortgage lenders are not expected to make a mortgage retention for such cases because the property owner or mortgage applicant has no control over adjoining land. Infestations more than three metres beyond the boundary are not categorised or reported to lenders, although a record should be made in site notes.

The requirements of property owners are obviously different from those of lenders, and when reporting to clients for non-lending purposes, surveyors and valuers will still use one of the same four categories whenever Japanese knotweed is seen. In all cases however, there will be a recommendation for the client to obtain advice from a remediation specialist. When an infestation is seen more than three metres beyond the boundary, the detail of any reporting will depend on the type of inspection and report being provided, and the nature of the infestation.

Advice on specific remedial action is not required. As with many other potentially significant issues affecting property value or ownership, the objective for the surveyor or valuer is to identify and report the matter to the client, but then for an appropriate specialist to provide advice on what action to take. In this, there are clear parallels with problems such as dry rot, defective services or structural failure.

Also in line with other property defects, the guidance acknowledges that there are many legitimate reasons why an infestation of Japanese knotweed might not be seen during a competent inspection. Nevertheless, if Japanese knotweed is clearly visible on site during the normal course of an inspection, it is reasonable to expect, all other things being equal, that it should be identified and reported to the client.

There were initially some queries about whether these changes might increase potential liabilities. However, the guidance clarifies that the requirements for inspections are no greater than, but equally no less than, those outlined in the RICS Valuation – Global Standards 2017: UK national supplement, UK VPGA 11 Valuation for residential mortgage purposes (Red Book) or in RICS' Home survey standard for private surveys. In particular, the guidance stresses that the change in the assessment process to a three-metre distance beyond a boundary does not imply any greater inspection requirement than under the previous seven-metre distance.

Recognising that its readership will be far wider than RICS members, the guidance explains the difference between mortgage valuations and surveys, and points out that valuations and pre-purchase surveys by RICS me http://www.philipsanto.co.uk/ mbers should not be regarded as equivalent to, or substitutes for, an inspection by a specialist remediation company.

PCA supporting guidance

In addition to the RICS guidance note, residential practitioners are strongly recommended to download the parallel publication by the Property Care Association (PCA): Japanese Knotweed – Guidance for Professional Valuers and Surveyors. The PCA guidance is specifically designed to support the new RICS guidance and advises property valuers and surveyors on all aspects of knotweed surveys, including identification, indicative costing for remedial treatment and remediation options.

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Related competencies include:
Valuation
Valuation reporting and research

Don't expect too much from leasehold reforms

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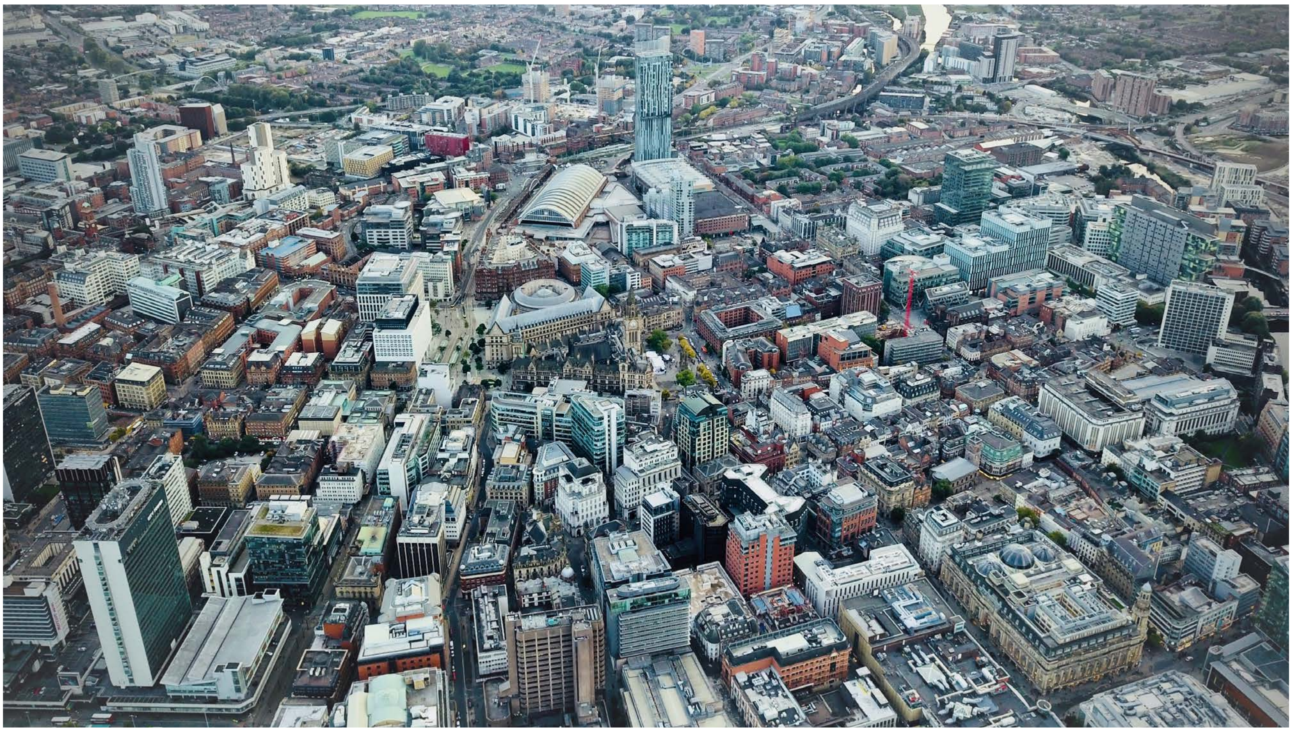

The Leasehold Reform (Ground Rent) Act 2022 will abolish ground rents for most new residential leasehold properties – but how the UK government's proposals will work in practice remains to be seen

By Robert Bryant-Pearson FRICS

In announcing government proposals in January 2021 for 'fundamental change to English property law', the then Housing, Communities and Local Government secretary Robert Jenrick said the creation of new ground rents would be prohibited.

He added that existing ground rents would be capped at 0.1% of capital value, while the enfranchisement process for both leasehold extensions and freehold acquisitions would be brought into line and simplified by enabling use of an online calculator. Marriage value would be abolished, and rates for calculations would be prescribed.

At a stroke, therefore, we would no longer need to argue about applicable rates, which graph of relativity is more relevant, or have to discover the rateable value of a house in 1965.

Mixed tenures delay legislative implementation

The first of these reforms is the Leasehold Reform (Ground Rent) Act 2022. When implemented – by regulations that have yet to be published – this will prohibit ground rents of anything more than a peppercorn being legally chargeable in new long leases for residential property. There are a few specific exceptions, such as statutory lease extensions for houses and flats, community housing leases, and home finance plan leases.

Controversially, an earlier amendment to the bill proposed that retirement home developers should be given an extra year to continue to sell leases with ground rents. Retirement home developers had argued for this on the basis that some sales with ground rents in many of their schemes had already completed. If the remaining units in these schemes were still unsold after the implementation date these would not be subject to ground rent, meaning there would be mixed tenures in the same scheme.

However, mixed tenure in blocks is not uncommon. Leaseholders extend at different times and thus the original co-terminus termination dates have disappeared – agreements are often made outside the Leasehold Reform, Housing and Urban Development Act 1993, so the lengths of extensions and ground rents differ anyway.

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By Paul Hackett

Despite the irrelevance of mixed tenures thus having been accepted, the provisions of the act will not apply to retirement homes until at least April 2023. However, regulations could be introduced sooner for the remaining types of residential development. Clearly, therefore, no allowance should be made for the capitalisation of future ground rent income in development appraisals.

How ground rents became overexploited

Mortgage valuation reporting has been responsible, at least in part, for the apparent creation of value where logically it should not exist. The causes of this are the twin assumptions that leases with more than 85 years unexpired are as valuable as 999-year leases, and that annual ground rents of £250 or so – even with retail price index (RPI) escalators – do not have a significant impact on value.

These assumptions didn't seem to matter to mortgage lenders, as inflation would ensure the mortgage debt would always be less than the lease value. Thus, blind eyes were turned to leases being created for only 99 years and to ground rent escalators incorporated in leases.

Once the cash-cow investment value of ground rents had been spotted, the margins of reasonableness were tested with stepped increases. These were followed by RPI increases or ground rents and service charges being doubled every ten years, as well as hefty consent charges for everything from garden sheds to satellite dishes. The possibilities appeared to be endless.

Ironically, several developers had sold freeholds subject to ground leases on new houses at a small fraction of their appreciable value, and certainly for a lot less than the subsequent cost of early enfranchisement to leaseholders. Thanks to the Competition and Markets Authority (CMA), though, Taylor Wimpey, Persimmon and others have been forced to make costly concessions to leaseholders.

Government intervention will not be straightforward

Although the CMA has interceded on what may be considered unfair contract conditions, future government proposals to intervene in existing, freely agreed 'fair' contracts between represented parties will perhaps prove less easy.

When the Leasehold Reform (Ground Rent) Bill was originally introduced in May last year, it was prefaced, in the context of the European Convention on Human Rights, by the then Chancellor of the Duchy of Lancaster Michael Gove, who assured Parliament that 'the provisions of the bill are compatible with the convention rights'.

This enabled the bill to pass through Parliament relatively easily. Changing the parameters for new contracts merely means that market forces will be disrupted slightly. In theory, if new leases carry no ground rent then the sale prices should increase correspondingly. In reality, that will not necessarily be the case.

However, the follow-up bill, to make future enfranchisement easier for existing leaseholders, will be exposed to rigorous analysis to ensure it satisfies human rights legislation. It is the rights of the freeholders that will be the bone of contention. Leaseholders who have held off enfranchising in the hope of an easy ride after further legislation may well be disappointed.

Although marriage value is likely to disappear, we should not expect that the process of calculating the value of the freeholder's or superior lessor's interest to be any less robust in capitalising the term rent and the reversionary value.

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Similarly, to compensate for the loss of marriage value, the reversionary interest calculation could have a stepped change in the deferment rate. This could mean that the value at 80 years unexpired may remain something of a cliff edge. It is highly likely that capitalisation and deferment rates will be fixed by regulation, as this will enable the cost of enfranchisement to be set using a ready reckoner available online.

Imposing commonhold will cause delay

Hopes of an early follow-up bill may be dashed if the government feels committed to incorporate provisions for a transition from leasehold to commonhold in interdependent buildings. A considerable amount of work will be required to create a statutory framework for commonhold, if this form of tenure is to be imposed. Furthermore, assuming such a tenure is to be unassailable and provide freehold-like security, then it will prejudice the enforceability of covenants.

Such a move would be likely to be resisted by MPs such as Theresa Villiers, who has **advocated** the advantages of retaining so-called 'professional freeholders'. Ms Villiers suggests that independent freeholders offer some external discipline, and commonhold would mean that disputes over, for instance, choosing between higher maintenance standards or lower service charges, would remain to be settled, sometimes acrimoniously between neighbours.

However, given the existing rights for collective enfranchisement and the provisions of the 2022 Act, many are struggling to identify the advantages of commonhold over leasehold, especially if it becomes standard practice for the freehold to be transferred to the building's management company.

As the flaws of leasehold are being fixed by the 2022 Act and subsequent reforms, why ditch it for a new form of tenure, the nuances and consequences of which are untried and untested?

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Related competencies include:
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What the investment valuations review means for you

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As RICS begins implementing the recommendations of the Review of Real Estate Investment Valuations, how will valuers' choice of method and model be affected?

By Nick French

The findings and recommendations of the RICS Review of Real Estate Investment Valuations, chaired by Peter Pereira Gray, were published in January.

The report had been commissioned by the RICS Standards and Regulation Board (SRB) in 2021. The brief was to recommend a framework that would ensure confidence in property valuations in today's markets. This would apply in particular to valuations on which third parties rely.

The SRB has accepted all 13 recommendations from the review, including the two-part recommendation 8, and RICS is currently working to implement these. All the recommendations were pertinent and considered, but the first part of recommendation 8 is of the greatest interest here as it relates directly to the use of the appropriate valuation methods and model for investment valuations.

> It is about using the appropriate valuation model or models for the task in hand

Clarifying the use of discounted cash flow

Recommendation 8(i) says: 'The valuation profession should incorporate the use of discounted cash flow as the principal model applied in preparing property investment valuations.'

Forgive my pedantry – I was an academic for 38 years – but the review has here fallen into the trap of using 'discounted cash flow' (DCF) to refer specifically to explicit discounted cash flow models. While the profession often uses the term this way, it is wrong to do so.

All investment valuations are based on the present value of a projected cash flow, which means that all such valuations are, in fact, DCF, regardless of the model used. The actual distinction between valuation models is whether they are an implicit capitalisation model or an explicit DCF model.

Implicit models reflect any expectation in the growth of market rents or capital value in the yield. Explicit models on the other hand allow for any growth expectation in the cash flow and discount this at a required rate of return, which is usually higher. The role of the valuer is, and always has been, to use the most appropriate model to estimate market value; that is, the expected price in the market.

There is an old adage that one should value as one analyses, and this can be applied perfectly here. If a market analyses the attractiveness of an investment by simple heuristics such as the initial yield and market rent, then the appropriate valuation approach will be an implicit capitalisation model.

The market value will be derived by multiplying the market rent and, in some cases – according to term and reversion or layer – by the rent passing by the reciprocal of the capitalisation rate or yield. These two factors, the rent and the yield will be derived from an analysis of the market. In the UK, we refer to the capitalisation rate used as the all-risk yield (ARY), or equivalent yield if used for a reversionary property.

However, if you value in a market where the main players analyse the property by explicitly projecting forward the likely rents over time – say ten years – and allowing for specific expenditures, before discounting all net rentals back to a present value using an overall required rate of return, then the appropriate valuation model may reflect this. Valuers will thus use the explicit DCF model.

In such markets, the appropriate model will become the principal model. Recommendation 8(i) is therefore only affirming the natural movement towards using more explicit valuation models, and will simply accelerate this transition.

Exclusive use of DCF will not be prescribed

RICS members' responses to the review have on the whole been positive. However, some articles and social media comments have picked up on the apparent implication that investment valuations should exclusively use explicit DCF models, and move away from implicit ARY models.

The FAQs on the **Valuation Review homepage** directly addresses this concern.

In explaining what the review suggests about the use of explicit DCF models, it says there is no call for a particular valuation model to be prescribed. Rather, the review says different methods and models may be used, and it supports the use of cross-checking the results of one with the use of another where both models are used and the market values reconciled.

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Learning to work with AVMs

By Claudia Conway

The review also highlights that clients are less and less likely to accept implicit valuation inputs, assumptions and outcomes. Instead, the models should be explicit, to achieve the required levels of transparency, understanding and education.

The review also noted that DCF could better consider operational factors and the impact of time. The call for evidence for the review also saw substantial support for wider use of DCF.

There will thus be no prescription for using explicit DCF modelling alone. The appropriate valuation model or models should be used for the task in hand. Implicit models shouldn't be abandoned in the desire to make everything explicit; the capitalisation model still has the advantage of being based on market evidence.

In other words, the use of the implicit ARY models will continue where appropriate. Maybe it will be a way of double checking an explicit DCF model, or maybe it will be the principal valuation model, depending on the asset type. If you are valuing a single unit high street shop then, unless it is on a turnover rent, there is no need to use an explicit DCF model. The point of the review is to highlight that many asset types that investors buy – such as shopping centres, student accommodation or multi-occupancy offices – where there are multiple tenants and cash flows, then these are the assets that will be analysed by explicit DCF models. The principal valuation model for such assets should therefore also be an explicit DCF model.

Some valuers explicitly state the cash flows over a five- to ten-year period but still keep rental figures in today's terms. This is not an explicit DCF model in the normal sense. Instead, it is an elaborate implicit term-and-reversion model. Care should be taken not to refer to these as DCF models. If they only use the ARY or equivalent yield as the discount rate, they are still implicit models, identifying any growth expectation as part of the yield rather than in the cash flow

The greater use of explicit DCF models will require that the valuer looks at, and has access to, other comparable evidence

Greater use of DCF will rely on data availability

All valuations rely on comparison. In the case of implicit investment valuations, this normally involves the analysis of comparables to determine net initial yields and the market rent. One of the advantages of implicit models is that they price to market with reference to only those two variables.

The greater use of explicit DCF models will require that the valuer looks at, and has access to, other comparable evidence. This may include discount rates used in the investors' analyses, the information that underpins the increased use of turnover-based rents, or a better insight into how clients price risk.

Valuers can only provide valuations on an explicit basis if this data is available to them. This may be from aggregated third-party data, or valuation teams may have sufficient confidential information direct from the principal investors in the market.

Using explicit DCF will require clients to share details of their current required rate of returns – target rates – with the valuation profession as a whole. At the moment, this happens on an ad hoc basis, and it could be that the predominance of implicit models in some markets has endured this long because more explicit information has not been shared particularly information on the target rates that investors in the market are seeking

Internal rate of return information is readily available in real time in the stock market, but this tends not to be the case in the property market. **MSCI**, previously IPD, provides data on historic performance measurement which can help to anchor estimates of target rates, but what is really needed is regular surveys of investors' target rates by property type in real time as this would greatly support the transition to explicit DCF models, as the review recommends.

But the main advantage of moving towards explicit modelling is that information and assumptions are revealed and justified to a much greater extent than when using implicit models. While implicit models recognise the previous market pricing of similar assets, explicit models disclose the market expectations used in the valuation.

Implementing recommendations will increase transparency

In working to implement all the recommendations, RICS is making changes to the Valuation Global Standards – Red Book Global Standards – and the UK national supplement.

However, I expect that recommendation 8(i) will be dealt with mainly by a revision to the current edition of Discounted cash flow for commercial property investments, RICS guidance note. This will rely on advice and comments from and consultation with all the principal stakeholders, including valuers.

More broadly, any move toward the greater use of explicit DCF models will be for investment properties, where investors look at the asset as a cash flow. Other assets that investors buy and sell on initial and reversionary yields will still be valued using the ARY. The baby will not be thrown out with the bathwater.

In essence, the review will ensure that investment valuations are provided to clients with increased transparency. That can only lead to the greater confidence in property valuations that everyone wants.

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Why an updated EPC is vital to hitting net zero

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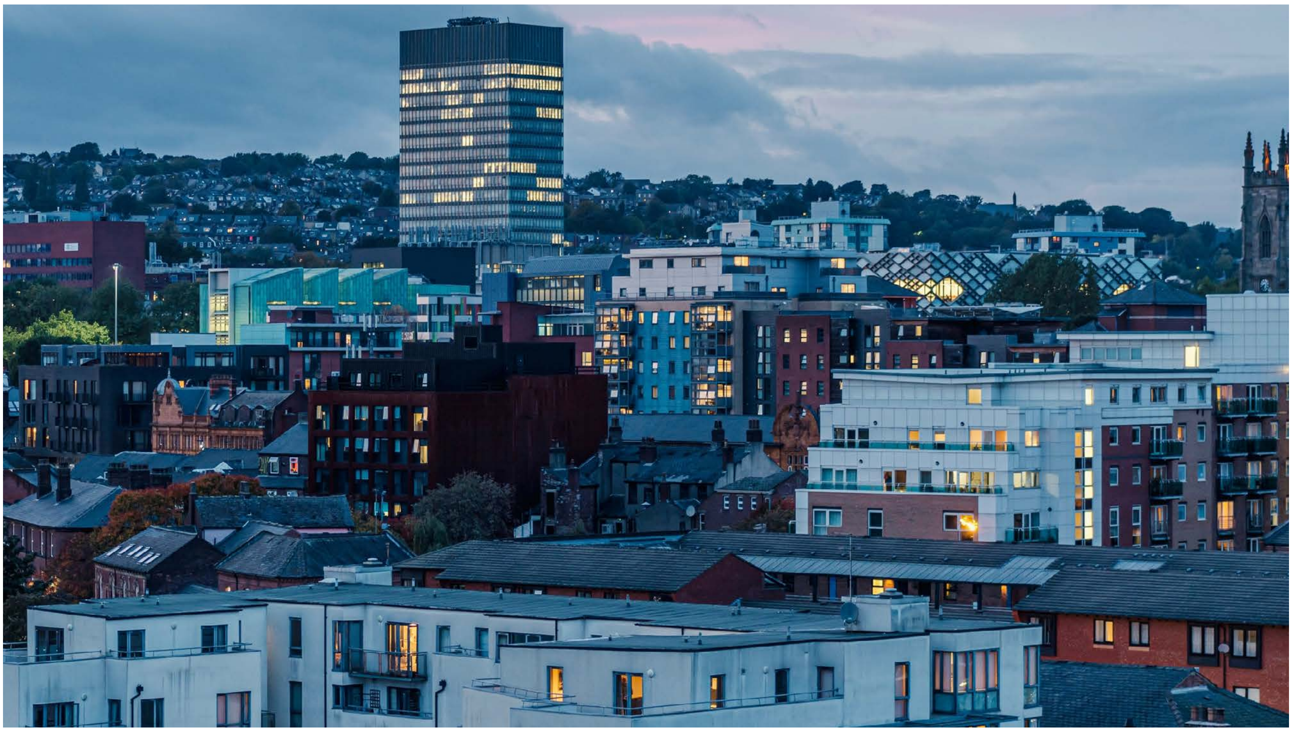

Energy performance certificates are now used for far more than their original purposes, but can remain a vital tool in making properties more efficient if they are brought up to date

By Catherine Garrido

The past six months have seen a sharp rise in the number of government consultations on energy policy that require participation from across the construction industry. Policymakers are recognising the need to collaborate with specialists to improve the energy efficiency of domestic and commercial properties in the effort to meet net-zero carbon targets.

Many would argue that future policy must focus on renewable energy, electricity storage and grid management. However, this will be pointless if properties are still inadequately insulated and a high percentage of occupants are living in fuel poverty.

The UK has some of the oldest buildings in Europe; many are poorly constructed and not fit for purpose. Future homes will need to be better insulated, adequately ventilated and less reliant on gas.

Given that existing properties represent so much embodied carbon, we cannot just demolish them and rebuild. So, we need a mechanism to compare them and recommend the most suitable improvements that reduce their carbon emissions and energy bills. Despite its flaws, the energy performance certificate (EPC) can do this – if its methodology is updated, as is likely according to the government's EPC action plan.

Updating EPCs to bring them into line with multiple uses

EPCs were introduced with the purpose of benchmarking the performance of buildings across the UK and providing cost-effective options for improvement. However, as EPCs now have many other uses, such as linking properties to energy efficiency improvement funding, they must be updated to ensure they remain fit for purpose.

The construction industry and the government both recognise the need for EPC methodology to be revised to not only consider fuel cost as its main metric, but also look to use the other metrics available on the EPC such as environmental impact rating (carbon emissions) and primary energy. Doing so will not only make EPCs more accurate, but also ensure the public clearly understand what the certificates mean and respect their value.

As EPCs now have many other uses, such as linking properties to energy efficiency improvement funding, they must be updated to ensure they remain fit for purpose

The update must also reflect the move from domestic gas consumption to electricity, which will lower carbon emissions and primary energy use as efficiency improves. However, the transition will also see increased fuel costs associated with electricity on which the current Standard Assessment Procedure (SAP) rating is largely based and this is where the current issues lie.

At its heart, the calculation becomes a ratio between the total floor area of the property and the total fuel costs for the property. Therefore, the more you increase fuel costs, the more likely the SAP rating will go down. This means properties which use more expensive fuel such as electricity are likely to get a lower rating compared with mains gas, unless said electricity is served by renewables such as photovoltaics. Honest public engagement will be needed to explain the reasoning for this change, and show that it will better reflect energy usage in our buildings.

Engaging and educating the public and stakeholders

Ultimately, the EPC can thrive by educating and informing the public and stakeholders alike on its benefits, such as explaining EPC ratings and bandings. As legislation is linked with EPCs – in particular the **Minimum Energy Efficiency Standard Regulations** – each band could have a definition in line with metrics such as environmental impact rating, primary energy and SAP rating to make it a truly representative, informative and easy-to-understand document.

These changes would affect the way our properties are measured and result in a more accurate assessment that is fit for future policy usage. It would also ensure that homeowners and tenants are more engaged, and therefore more likely to make improvements of their own accord.

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Offering meaningful EPC advice in home surveys

By Tim Kenny

Stakeholder engagement and education can also be improved. The new central EPC register has a plethora of open data available to consumers and professionals. This could be used more positively, perhaps to help local authorities determine how they can make more localised improvements, and motivate them to hit targets early in a cost-effective way.

The possibilities for a more accurate and representative EPC are vast. But the message is clear: they remain a key player in improving the energy efficiency of buildings. By working across the industry, educating the general public about their usefulness, we can all take the steps required to achieve net-zero carbon emissions while also reducing fuel poverty.

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Energy and renewable resources
Management and regeneration of the built environment
Sustainability

Taking care when surrendering leases

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Landlords surrendering a lease, and those advising them, should ensure that they don't unwittingly release tenants from obligations and lose the ability to recover any payments they may be otherwise entitled

By Rachel FitzGerald

The fallout of the pandemic has prompted many commercial landlord and tenants to explore the suitability of a lease surrender; perhaps because the tenant's need for space has diminished or the landlord, in the face of accruing rent arrears accompanied by recovery challenges, has been motivated to cut a deal with its tenant which includes the return of its premises.

Parties negotiating terms should pause to check that the landlord is actually able to grant the surrender sought

The basis of a surrender is that it will bring a lease to an end, releasing both the landlord and tenant from their covenants and liabilities from that date onwards. In the absence of express drafting, the parties will remain liable for any past breaches.

This expected preservation of liability for existing breaches and the frequent commercial pressures of completing the deal often force parties to rush through a surrender without due consideration of its terms. This article considers some of the pitfalls which parties can encounter on a surrender.

Can the landlord grant a surrender?

Parties negotiating terms should pause to check that the landlord is actually able to grant the surrender sought. In **Co-operative Bank plc v Hayes Freehold limited (in liquidation) and others [2017] EWHC 1820 (Ch)**, the head lease was charged to the bank, and the terms of that charge required its prior consent for any surrender. The tenant failed to obtain such consent, and the attempted surrender of the head lease was ineffective.

Unfortunately for the tenant, a simultaneous surrender of its undertenant's lease was effective. The failure of the tenant's advisers to identify the bank charge left the tenant itself in the undesirable position of remaining liable under the head lease of a premises it did not require, and with the loss of the surrendered underlease's income.

Will existing repair and reinstatement liabilities remain?

In **Baroque Investments Ltd v Heis & Ors [2012] EWHC 2886 (Ch)**, leases were surrendered on standard terms. The surrender released both landlord and tenant from the leases' liabilities for any breaches arising on or after, but not before, the date of the surrender.

The tenant had covenanted under a licence for alterations of the leased premises to 'dismantle and remove the works and reinstate the premises', 'before the end of the lease'. The court considered that the licence meant the tenant had the whole of the lease term to carry out the requisite reinstatement works. As the potential reinstatement liability therefore occurred after, and not before, the date of surrender, this covenant was released on surrender.

Turning to the tenant's repair liability, the parties agreed that its obligation 'to yield up the same at the expiration or sooner determination of the term' did not, on the terms of the leases, survive the surrender. Instead the landlord relied on the tenant company's breach of its covenant 'to keep the premises … in good and substantial repair and condition'.

While the liquidator accepted that the company was liable for its breach of this repair covenant, the liquidator argued that the landlord had failed to properly calculate its claim. The court agreed with the liquidator.

The landlord's surveyor had failed to carry out a proper assessment of the difference in value between the landlord's reversion in repair and its actual state, pursuant to section 18(1) of the Landlord and Tenant Act 1927. Instead the surveyor had considered that this value was equal to the loss suffered by the landlord for the rent-free period, and for the reduced rent it had given to a new tenant that took a lease of the premises shortly after the surrender. However, this was not the proper process for calculating the damages so no provable debt was established.

If a proper section 18 valuation had been undertaken, the court considered that the damage would have been assessed on the day before the date that the leases were surrendered. The landlord argued that the court should consider events after this date, but the court was unwilling to do so.

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By Emma Vigus

As a result, a valuation of the landlord's reversion would have been a valuation of its freehold, subject to the leases. This was despite the fact that the leases were surrendered the next day, meaning that the landlord may have struggled to evidence any diminution in value to its reversion.

In **Dreams Ltd v Pavilion Property Trustees Ltd & Anor [2020] EWHC 1169**, the terms of the agreement for surrender provided that, on completion, the tenant would pay all money due to the landlord and the parties would be granted a full release of all liabilities.

Although a schedule of dilapidations had been served, the claim had not been settled before the surrender completion date. Because no sum had fallen due by this day, the tenant could not be required to pay the dilapidations liability to satisfy the terms of the surrender. The tenant would also be able to rely on the full release to be granted by the surrender and escape its dilapidations liabilities completely.

RICS resources

Commercial rent review appointment service

If you are due to undergo a rent review on a commercial property but you cannot agree the new rent with your landlord or tenant, there is often a rent review clause in the lease which stipulates a procedure for third party dispute resolution.

RICS is named in 99% of commercial leases, so you can apply to us to appoint an Arbitrator or Independent Expert from the President's Panel on your behalf.

Find out more

Code for leasing business premises 1st edition

Download the professional statement

Can the landlord pursue a rent review after the surrender?

If the review date has passed before the date of the surrender and the landlord is not required to take any action to initiate that review – or it has taken whatever action is necessary to do so – the accrued right to review the rent will be preserved.

The tenant will remain liable to pay the balance of any uplifted rent, notwithstanding the surrender of its lease, as per **Torminster Properties v Green [1983] 1 WLR 676**.

Liability for service charge balancing payments

Unless the terms of the surrender expressly preserve the landlord's ability to recover a service charge balancing payment that will fall due after the date of the surrender, the tenant will be released from this liability. The landlord will then be unable to recover the payment from its former tenant.

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Related competencies include:
Conflict avoidance, management and dispute resolution procedures
Leasing and letting

Practical measures to try to avoid pitfalls

- Establish that the landlord is able to grant the surrender offered. Secure any necessary consents before granting any releases to subtenants.
- Review the lease and any licences for alterations to establish when the tenant's reinstatement liability occurs. If the liability will be released on a surrender, consider whether the landlord will require a payment to cover the cost of the reinstatement works as a condition of that surrender.
- Consider precisely what claims are to be released as part of the surrender, and be wary of sweeping releases – as demonstrated by Dreams.
- Attempt to resolve any claims, including dilapidations, before completing the surrender, and collect the monies on completion.
- Consider what other payments are to be collected on the surrender. This may include outstanding sums such as rents owed to the landlord, any service charge balancing payment, and any uplifted rent sum that may arise once an outstanding rent review is completed. If acting for the tenant, consider if there are any apportioned rents – including insurance rent – beyond the surrender date to be repaid to the tenant, and to which it might otherwise not be entitled.

Delivering confidence

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