

WHERE TO FIND A NEW EXIT

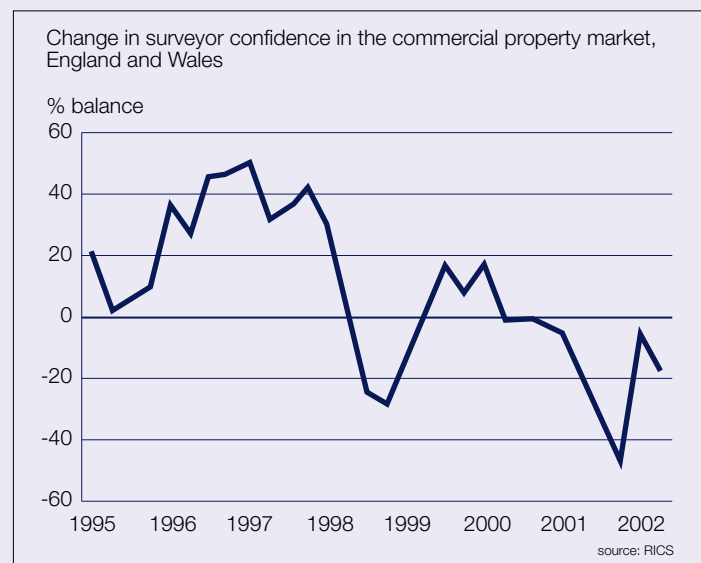
A survey in July from the Royal Institution of Chartered Surveyors suggests that confidence in the commercial property market is in decline.

After indications at the beginning of the year that the market was stabilising, the second-quarter survey shows that 12% more chartered surveyors are reporting a decline in new sales and lettings than reported a rise. There are also increases in the amount of unoccupied space and the value of inducements offered to potential occupiers and a slight shortening of lease terms (though the survey gives no details on what sort of terms these leases are being negotiated). The survey notes, however, that "the favourable swing towards tenants' terms and conditions is, so far, mild".

As the market weakens, there are a number of things that corporate occupiers can do to extract maximum value on exiting surplus property. Moreover, there are ways of extracting more value from property that companies don't intend to vacate at all.

Anthony Lorenz, a partner in property consultancy Dunlop Heywood Lorenz, says many companies are "incredibly naive" with regard to their property. He cites a survey showing that 30% of corporates have not discussed their property holdings at board level in the past three years.

Often, companies sit on vacant properties that they are simply unable to sell, when the better tactic would be to enter into negotiations with the landlord. If an unlettable, unoccupied property still has, say, seven years left to run on the lease, it might make more



sense to approach the landlord, suggesting that they take back the property two years from now – giving the landlord time to work out what to do with the site – in return for four years' rent. The landlord may then have the opportunity to develop the derelict site and earn four years' rent over a two year period – a "double whammy" for the landlord, Lorenz says. "You can usually do a deal with them so you pay less than you would have paid but you get a surrender."

On vacating a property, Lorenz points out that many companies make a fundamental mistake with regard to the dilapidations clause in lease contracts. Leases invariably require tenants to maintain properties in good order, undertake normal repairs and maintenance and periodic decorating. Complying with these terms will prevent any dilapidations claim when the property reverts to the landlord. But most commercial tenants wrongly believe that if they fail in their duty to do so, then the

amount of the dilapidations claim at the end of the lease is equal to the cost of doing all the work that the occupier failed to do.

However, the landlord's only valid claim in damages is *not* the cost of the works; the damage is the difference between what the freehold value would have been if you had left the property in perfect condition and what it is based on the way you actually have left it.

The thing to bear in mind is that the property may have come to the end of a 20 or 25-year lease, and may be in need of serious modernisation or full refurbishment anyway. The fact that the tenant has not properly maintained the premises is more or less irrelevant in such circumstances, so the dilapidations claim should be reduced commensurately.

Lorenz recalls an instance when a client tenant challenged the landlord's dilapidations claim because he discovered that the landlord intended to knock down the building and replace it with a

completely different structure: a £1m-plus dilapidations claim was settled for just £8,000.

Tenants can also extract value even when staying put. Take a lease with a break clause and a rent review in December 2003, with a six-month notice period: most tenants won't start doing anything until April or May, by which point time is against them. But, by entering into negotiations with the landlord now, it may be possible to negotiate a rent-free period in exchange for getting rid of the break clause.

Equally, if a company intends to remain a long-term occupier of a site with a lease that expires in 2006, it may pay to approach the landlord today – rather than in 2005 – proposing that the remaining four years of the lease be renegotiated now as a 14-year lease: this gives the landlord a better-quality contract, while enabling the client to remain *in situ* as planned. It also provides the opportunity to negotiate a benefit-sharing deal by which the tenant may get six or 12 months rent-free.

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www.financialdirector.co.uk/briefing

Useful links

- The survey is available from www.rics.org.uk
- Dunlop Heywood Lorenz's website is at its pre-merger web address, www.bakerlorenz.co.uk