



Dilapidations – When Time is Money

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Lease end dilapidations frequently reveal substantial costs, taking businesses by surprise and hitting the bottom line hard at a crucial time for management teams considering their property options. Knowing your liabilities in advance can lead to significant financial benefits. TFT’s Seth Love-Jones and Adrian Clarke of Baker Tilly, an independent firm of chartered accountants and business advisers, discuss the importance of dilapidations liability assessments as part of your business and property strategy.

For small businesses sound advice on the level of dilapidations costs attached to their property will save money and time. Identifying liabilities well in advance of a lease end will ensure that the costs of occupying or moving premises don’t detract from the main business activity.

For large scale occupiers, with complex leasing arrangements on multiple sites, identifying, accounting for and managing such costs, needs close attention. Accurately accounting for dilapidations liabilities will give long term benefits and help avoid the impact of surprise property occupancy costs on reported results.

A Dilapidations Liability Assessment (DLA) will enable an occupier of leasehold property to accurately identify the most cost effective way to account for dilapidations. It involves an assessment of the property or representative sample of properties on large portfolios, the calculation of a projected liability and focussed advice on how best to account for the identified liabilities by making appropriate financial provision over any remaining lease term.

The provision for any future liability resulting from dilapidations can be accounted for in either the initial asset or the fit out costs of the occupancy. If, as an occupier, the dilapidations can be charged to the profit and loss account over the lease life, and at the end of the lease have a provision to cover the cost sitting on the balance sheet, big one-off hits to profit can be avoided. This can be significant in maintaining the financial strength of a business.

In order to recognise a financial provision three conditions need to be met.

Firstly, there is a need for a present legal obligation arising from a past event. In effect if a lease contains a clause, which can be legally enforced, obligating the occupier to return the premises to the original state this satisfies a past event driving an obligation at the end of lease term.

Secondly, it needs to be almost certain that the obligation will result in an outflow of economic benefits. Following on from the existence of reinstatement provisions there is an unavoidable cost which will constitute an outflow of economic benefits.

Thirdly, you need to be able to estimate the cost, for example of reinstatement of alterations, reasonably reliably.

Should all three of the above conditions be met, a financial provision in the company accounts may well be required. It is essential, if made, that this provision will stand up to increasingly robust inquiry by auditors under Financial Reporting Standard 12. Various options will need to be considered in setting the provision, for example the building condition will deteriorate so timing of the provisioning will be important, such as greater emphasis on providing toward the end of the lease. Or there may be an obligation to replace carpets or redecorate irrespective of condition; this will exist in full from the beginning of the lease rather than increasing over time.

Where an obligation exists that relates to a specific asset, for example the cost of removing some partitioning, then it may be appropriate to add the cost of removal and include it as part of the original asset cost. In this way the initial provision is effectively capitalised as part of the asset and depreciated over the lease life. Similarly if some plant and machinery is installed that needs to be removed at the end of the lease, you would add the removal cost to the asset cost.

Commenting, Adrian Clarke, Chairman of Baker Tilly's Southern Region Real Estate & Construction Group said:

“Accountants and Surveyors are in the front line when it comes to advising occupiers on such liabilities, ensuring that their clients’ property strategy is a recognised component of their overall business strategy. When it comes to dilapidations identification and accounting, a good relationship between both sets of advisors and a co-ordinated approach can result in the inevitable costs of leasing property being managed to the occupiers advantage.

Whether a large or small scale occupier of property, understanding what future costs will impact on a business is essential and if well managed the dilapidations liability can be appropriately apportioned across the term of the lease in the same way that regular planned maintenance to a property and building services will avoid inconvenient breakdowns or surprise costs.

This is where professional property and accountancy advice is required in order to provide a DLA which is true to the actual costs and will stand up to financial scrutiny. It can be a complex process for both larger companies with lots of leasehold property and smaller companies where the costs could be material to the accounts, it is an important consideration, well worth the investment in time and expertise in a robust DLA.”