

Repair – FRI/IRI/SOC

what does it all mean?

The importance of understanding your repairing obligations in a lease cannot be overstated. Whilst tenants are usually concerned with the extent of the financial obligations for rent and rates liabilities when agreeing terms, the potential financial impact of repair obligations is often misunderstood or overlooked entirely.

FRI

Most commercial leases in the UK are granted on a full repairing and insuring basis (FRI Lease) which means that the tenant is responsible for all costs of repairing and decorating a property and insuring the property. This may be because the tenant is occupying the whole of the building (and therefore the tenant's repairing clause relates to the interior and exterior of the building) or, where it is occupying part of a multi let building, it is responsible for carrying out repair of the area demised to it (where what is let is effectively only the internal airspace of each unit, with the tenant's repairing clause relating only to internal surfaces and finishes), but it is also responsible for reimbursing the landlord for a share of the costs the landlord incurs in repairing the remainder of the building (not let to the tenant or other tenants) being the structure, exterior, common parts (internally and externally) by way of paying a service charge. In both cases the tenant will also have to reimburse the landlord for (its share of) the landlord's insurance premium for the building.

A commercial tenant will normally be obliged to keep the property (the area demised to it) in "good and substantial repair and condition" but what this actually means is often misunderstood by first time tenants. This is not a requirement to keep the property in the condition that it is in on the date the lease is entered into, rather it is an arbitrary level of repair that a good tenant would keep the property in and would expect a property to be in, when entering into a lease. This liability extends beyond day to day maintenance to major structural repairs which may include the overhaul of the roof. As such, a requirement to keep a property in good and substantial repair may actually impose a positive obligation on a tenant to put it into that standard, even if it is in significant disrepair at the start of the Term. e.g. if there is an issue with the roof at the beginning of the lease and the repair clause obliges you to keep the property in repair a tenant will immediately be contractually liable to do so, at its cost.

SOC

Whether a lease is FRI or IRI it may be possible to water down the repair liability by limiting the tenant's repair obligation to only keeping the property in the condition it is in at the date the lease is granted. This is done by reference to a Schedule of Condition (a set of photos and narrative highlighting the condition of the property and in particular any areas of disrepair/defects) which is prepared by the tenant and approved by the landlord and then attached to the lease. This then records the condition that the property must be handed back in by the tenant at the end of the term.

It is however worth pointing out that a schedule of condition does not take account of any deterioration of the property throughout the term of the lease. Limiting your repair liability by reference to a schedule of condition does not therefore mean that you will not have to carry out any repair or decoration during the term. Furthermore, there is no concept of "fair wear and tear" in English property law, therefore any such deterioration in the condition of the property below that shown in the Schedule of Condition will need remedying by the tenant. A photographic schedule is also a two dimensional reference point and generally only goes to the state of repair and decorative condition of the property. It will not therefore pick up any underlying defects in the property, which may cause the current condition of the property to deteriorate over the term of the lease, nor is it likely to encompass any plant and machinery within the property for which the tenant is responsible, (a separate mechanical and electrical (M&E) schedule would need to be prepared to deal with these items). If there are items

of plant and machinery in the property that are coming to the end of their useful life, a tenant may have to spend money replacing them during the term, in order to hand the property back with the relevant plant and equipment in working order.

We would always advise a tenant to not only seek to limit their repair liability by reference to a Schedule of Condition (unless the property has been recently constructed and is in pristine order), but also to commission a survey of the property before the lease is entered into, to highlight any areas of disrepair or any potential items which may deteriorate during the term of the lease. These matters can then be put to the landlord and either the landlord can be asked to remedy them before the lease is entered into, or there can be a carve out in respect of liability included in the lease. For example, an acknowledgement that if a particular item of plant or machinery stops working, the tenant will not be required to replace it during or at the end of the term.

These limitations are useful, however a tenant should be aware that excluding liability for an item does not necessarily place a reciprocal obligation on the landlord to pick up such liability, unless specifically stated in the lease. If, for example, the roof of a building is in substantial disrepair and liability to repair it is carved out of the tenant's repair liability but no obligation is placed on the landlord to repair it, then it is likely that during the term the roof will continue to deteriorate which may result in leaks into the property. These will affect areas that the tenant does have to repair and as such, the tenant may find that they have to carry out repair works to the roof (notwithstanding they are not obliged to) in order to protect the rest of the property. Ideally therefore, any items of disrepair or concern identified by a survey should be remedied by the landlord prior to the lease being entered into.

It is also worth noting that whilst a schedule of condition goes to the question of what state of repair the property is in, it is not necessarily used to identify the "decorate state" of the property and as such, unless specifically limited by reference to the Schedule of Condition, a tenant will normally be under an obligation to redecorate the property throughout the term (either at regular intervals or as and when required) and in the last few months of the term.

If a property is newly constructed, it is important to be aware of the potential for latent or inherent defects due to issues with the design or construction of the unit. Some landlords may be prepared to offer an exclusion from liability for any such issues for the first few years of the lease. It is however more common for the landlord's professional and construction team to grant a set of "collateral warranties" to the tenant. These state that they have acted with due skill and care in carrying out the works. If any repair issues emerge within a 10 year period of completion of the works, due to faulty design or construction, liability for repair can be passed back to them.

IRI

Some leases may be granted on an IRI basis. In this case the tenant will only be responsible for maintenance of the interior of the property. Maintenance of the exterior will fall on the landlord and the landlord will not be able to recharge the costs of this to the tenant. The extent of the landlord's obligations in respect of maintenance of the exterior can range from an obligation to keep the property wind and watertight to a full maintenance obligation. Again, this is a question of negotiation between the parties and should be considered in light of the current condition of the property and whether the property is, for example, a listed building.

Why is this important?

In reality, most commercial tenants will not carry out any major repair or redecoration during the term, other than their initial fit, so the extent of the repair liability only really comes into question at the end of the term of the lease. Most leases will require a tenant to hand the property back to the landlord in the state and condition required by the terms of the lease. This includes not only the repair obligation but also compliance with statutory requirements such as having up to date service records for plant and machinery, an up-to-date asbestos management plan (if applicable) etc.

Failure to hand the property back in the condition required by the lease will entitle the landlord to bring a claim in respect of what is known as “dilapidations” against the tenant. This may result in a substantial financial liability for the tenant as the landlord is entitled to serve a schedule of dilapidations on the tenant following expiry of the term, setting out the items of disrepair, alterations which the tenant should have removed but failed to do so and statutory requirements which the tenant has failed to comply with, and the associated cost of the landlord dealing with these matters. The landlord can then seek to recover that sum of money from the tenant.

It is therefore important that the question of dilapidations is considered right at the start of any transaction and ideally a tenant should make an allowance in its accounts/an accrual in respect of any potential dilapidations liability that it may incur at the end of the term so as not to be faced with the huge financial bill that it is unable to meet.

It is therefore vitally important to consider the extent of the repair obligation at the start of any transaction and before you sign the lease to ensure that you are not left with a very large dilapidations liability when you leave the property at the end of the term.

Moorcrofts’ commercial property team provides legal advice to owners and occupiers of commercial property. We specialise in tenant representation and have extensive experience advising corporate occupiers on all aspects of leasehold acquisitions and disposals. If you would like legal assistance with your commercial property needs, please contact our Partner and Head of Commercial Property – Julia Ferguson.



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