

Make Good - The Gathering Storm during a tenancy

Make Good, it's like a gathering storm that hangs over a company during their lease and reaches a crescendo just as the company is looking forward to moving to new premises. When the fit out is being planned and carried out there is little consideration, but as the years of the lease go by the clouds build up and close to the end of the lease the storm is close.

So is it a one way street, does the Landlord hold all of the cards and aces?

Well, it depends if you did your careful homework and it also depends on the location of your tenancy.

Shelter from the Storm

Make Good is a tenant's obligation that forces them to return the premises they have been occupying back to a particular condition by the end of the lease, it is in the majority of commercial property leases.

The cost of a full Make Goods cost as a minimum is about \$250 per square metre and can go as high as many hundreds depending on the extent to which the fit out has altered the premises, and how onerous the lease conditions that the tenant has agreed to - it can be the equivalent of another year's rent.

Make Goods are often contentious and can be acrimonious, they frequently leave a sour taste in the tenant's mouth.

So what can you know and do to save you much angst:

At Lease Agreement and Commencement

If you are entering a new lease:

- * Have a Schedule of Condition prepared by an independent party to record the condition when you take possession and before you start fit out;
- * Try not to agree to onerous clauses, such as agreeing to replace the carpet at the end of the lease - this will add about \$60 per square metre in today's money;
- * Avoid agreeing to the words in the lease such as 'put', eg. to 'put' the premises into a particular condition. At best 'keep' in the condition at the beginning of the lease.
- * Make sure that there is a 'fair wear and tear' clause, which allows for the tenant to use the premises for the intended purpose, so you won't be liable for normal wear and tear. But be aware, you will still be liable for damage.

When briefing your fit out team:

- * Tread lightly - Try to minimise damage to the Landlord's equipment and finishes (your interior designers may take some convincing). Typical high make good cost areas include:
 - * Replacing the ceiling with a set plaster ceiling. This will not only need to be removed, but it will have caused the mechanical air conditioning, lights and sprinklers to be altered. They may all need to be reinstated;
 - * Avoid replacing the standard building carpet with your own carpet, or stone floors;
 - * Use workstation that are self supporting and do not require walls to be built to support them; Minimise the built areas, ie. for offices, utilities, reception. Better to use workstations where possible;
 - * Avoid changing lift lobby wall and floor finishes, these can be really expensive to replace and matching ones may not even be able to be sourced at lease end, resulting is an even bigger job.
 - * Avoid installing supplementary air conditioning, this is not only expensive, but due to the changes to ceilings, base building services and controls, the make good cost can be huge. Consider a cloud based system.
 - * Avoid hard wiring - go wireless.

At the time of fit out have an assessment of the likely cost of make good and account for the funds.

Approaching Lease End

So you have set the scene and minimised damage. Towards the end of the lease the clouds are forming and you need to take action to protect yourself.

- * Start in good time - Ask the Landlord for their assessment of your make good liability. For a large tenancy 12 months out is not too close to start talking to the landlord, for smaller tenancies you can leave it a little later.
- * Ask the landlord "What is our Make Good Liability?", do not allow time to slip, the sooner you know the better you can be prepared. Some less scrupulous landlords can try to leave the discussions to as late as possible in their belief that it will put them in a better position.
- * Keep a record of your attempts to contact the landlord.

Reversionary Value

The law in New South Wales, Queensland and the Northern Territory are similar to those in the UK where the concept of Make Good, or Dilapidations as it is known there, was thought up. They all have laws that limit the amount the Landlord can claim to the amount of his actual loss and they override the lease clauses.

- * NSW - Section 133A of the Conveyancing Act 1919
- * Queensland - Section 112 of the Property Law Act 1974
- * Northern Territory - Section 123 of the Law of Property Act

In the other States and Territories the wording in the lease stands.

The calculation of the loss of Reversionary Value is particularly interesting when the building is about to be refurbished or even demolished. If the Landlord's intention is to strip out the premises at lease end, as is often the case, or if they plan to demolish and redevelop, then the additional cost to the landlord of removing the old fit out and returning the premises to their original condition is greatly reduced, and may almost be negligible.

In technical terms by planning refurbishment, upgrade, alterations or demolition the Landlord is said to have Diminished their Reversionary Value, in other words they have reduced the amount that they can claim..

Landlords often budget that the money from a make good claim will be used for all or part of their refurbishment, this is wrong. If a landlord is planning on a refurbishment and the ceiling, lights and carpet will be replaced, then the tenant's liability in those areas is diminished or has gone away.

Tricks, Naivety or Porkies

Many Landlord and their representatives are notoriously poorly trained in make good. They sometimes believe that whatever they write into fit out guides or generic make good scopes are binding on the tenant, when the tenant may not have agreed to them when they signed their tenancy documentation; so they might not be bound to them; they are generally unenforceable.

Landlords and their representatives

- * Many do not know of the Laws limiting the claim to the loss of Reversionary Value. You may have to explain them.
- * They might pretend that they have no plans to do any work, when they do;

- * They might try to string you out so that the lease expires before agreement, leaving the tenant no option to carry out the work.

Information is King

Be armed with good information:

- * Know your lease;
- * Know the Law;
- * Act in good time and keep a record of all correspondence;
- * Try to find out the Landlord's intentions for the premises. If all other floors in the building have been upgraded and they are targeting high energy efficiency, there is a strong likelihood that the old energy inefficient space with the old toilets and lift lobby is going to be refurbished. You might even check council records to see if refurb plans have been submitted, check to see if the premises are on the market as refurbished space;
- * Have an assessment of the likely cost of making good. This will probably not be a builder alone, as they will need advice on how the lease and Make Good law affects the Tenant's obligations. The amount of the liability can be quite different from the costs to return the premises to their original condition.

If you would like more information:

The RICS (Royal Institution of Chartered Surveyors) has published their Guide to Make Good

This may be downloaded at: www.rics.org

or attend one of the RICS Training Courses on Make Good in Sydney, Brisbane and Melbourne.