

# Potential Environmental Liabilities with Industrial Properties in the United Kingdom

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## Abstract:

Implementation of Part IIA of the Environmental Protection Act 1990, on 1<sup>st</sup> April 2000, introduced a new 'contaminated land' regime in England, which has since been extended to the rest of the United Kingdom (UK). This imposes a regime of 'strict liability', in terms of contamination, and brought to the fore issues of fundamental importance for everyone involved in the processes of letting and managing industrial properties. These have implications for the owners, occupiers and managers of such properties; indeed they go to the very heart of land ownership, having potentially adverse effects on both income and value.

The Royal Institution of Chartered Surveyors (RICS) provides its members with guidance as to the valuation of properties affected by the presence of contamination (RICS, 1995) as well as to the role and responsibilities of the surveyor when undertaking property inspections (RICS 2000). By its very nature, the advice given in the RICS guidance is broadly based and does not identify the many 'pitfalls' that may confront a surveyor.

The study examines current practices in the UK and has identified areas where changes may be required, or be desirable, in order to arrive at recommendations as to 'best practice'. The work was undertaken in three phases, a questionnaire survey involving leasing and managing agents, real estate owners, lawyers and bankers; a consultation stage with representative organisations including the RICS, the Environment Agency, British Property Federation, British Bankers Association, British Insurance Association, the Law Society and the Confederation of British Industry (CBI) and interviews with a representative sample of persons from the survey.

**Comment [PS1]:** . The referee suggested inserting the word 'of' before 1990 but the title of the act is the 'Environmental Protection Act 1990' therefore to make the insertion would be incorrect

**Comment [PS2]:** . The referee suggested inserting full stops (periods) after the U and the K, here and throughout the whole paper, however, in normal UK usage this is not done, even in government documents, so this has been left unchanged throughout.

**Comment [PS3]:** . Moved to main text at referee's suggestion

**Comment [PS4]:** . The referee suggested moving this to the main text but it is already in the text.

## Introduction

Although the United Kingdom has a long history of environmental legislation, reaching back into the 19<sup>th</sup> Century, for example the (Public Health Act of 1875), tackling land contamination from the legislative perspective is a relatively new phenomenon. The Control of Pollution Act of 1974 sought to control certain activities that caused damage to the land and to the wider environment, which included the introduction of a system of licensing for the disposal of waste materials to landfills. While the design of landfill sites and the potential for environmental damages or impairment were to some extent encompassed by this legislation, it did nothing to remedy the damage that had been caused by around two hundred years of industrial activity in many of Britain's cities and major towns.

**Comment [PS5]:** . Correct usage in this case

The need for legislation to address the problems caused by historic industrial and other activities that had damaged the land was identified by a Parliamentary select committee during hearings in 1989 (House of Commons Environment Committee, 1990) and the first attempt at introducing legislation occurred in the following year as a section in a piece of major environmental legislation (section 143 of the Environmental Protection Act 1990). This section did not, however, purport to tackle the issues relating to land contamination. Instead, its objective was to establish a register of land that was, or had been at some previous time, used for a potentially contaminative purpose or for a number of such purposes. Local authorities, city and district councils, were to be responsible for compilation of the registers in their areas, using historic map and trade directory data (records of this type for much of the United Kingdom date back to the mid 19<sup>th</sup> Century and in some areas even earlier), town planning and environmental compliance records, as well as anecdotal evidence.

**Comment [PS6]:** The referee suggested that the word 'section' should begin with a capital 'S'. This is not usual practice in the UK where sections of Acts of Parliament are given as 'section' lower case or as the abbreviation 'S' – I have not used the abbreviated form as it may not be recognised by an international readership.

Although the section 143 registers were intended only to contain records as to factual land use, both past and present, without any physical examinations being undertaken, they were widely regarded, by inference, as condemning vast tracts of land as being 'contaminated' on the basis of seemingly little evidence as to fact. This situation led to widespread objections from the real estate industry and especially from those organisations, such as the rail and gas companies who envisaged that their real estate holdings would become valueless as a result of being put on the register. The Asset Valuation Standards Committee of the Royal Institution of Chartered Surveyors (RICS) feared that "registers of contaminated land will result in some property assets of big companies having negative values" (Estates Times, 1991).

These concerns did not relate solely to 'industrial' type premises, as the list of 'potentially contaminative uses' included a number of activities that might be regarded as 'high street' uses, such as dry cleaners, printers and electrical repairers (DoE, 1991), which might have resulted in many shopping centres being included on the registers. Therefore, after two years of debate, at times very public and quite heated, the proposed registers were abandoned in March 1993 and the policy makers promised a review of land contamination, with the intention of returning with new legislation at a later date. This review took place over the ensuing two years.

The second attempt at contaminated land legislation came in section 57 of the Environment Act 1995, which retrospectively introduced a Part IIA into the Environmental Protection Act 1990. Although the legislation was put in place in 1995, it was not implemented in England until 1<sup>st</sup> April 2000, subsequently being extended to the rest of the UK. The legislation imposes a regime of 'strict liability', often referred to as the 'polluter pays' principle, and in terms of contamination, it has brought to the fore issues of fundamental importance for everyone involved in the processes of letting and managing industrial properties. This legislation also includes requirements for local authorities to maintain registers but, unlike the section 143 proposals, these contain details as to fact with regard to land contamination and any treatment undertaken, as against simply recording land uses that are potentially contaminative.

The new legislation also provided, for the first time in the UK, a legal definition of the term contaminated land –

“Contaminated land” is any land which appears to the local authority in whose area it is situated to be in such a condition, by reason of substances in, on or under the land, that -

- (a) significant harm is being caused or there is a significant possibility of such harm being caused; or
- (b) pollution of controlled waters is being, or is likely to be, caused.”

The legislation means that landlords and their leasing and managing agents may have to make important changes to the ways in which they negotiate the leases of industrial premises and the mechanisms they employ in the future management of those buildings. Similarly, tenants and their advisers may have to give closer consideration to the environmental liabilities they may be about to incur; especially where tenants carrying out potentially contaminating activities have previously occupied buildings.

Of particular concern are waste disposal practices of tenants, the previous uses of land developed as industrial estates, which may contain a number of occupiers engaging in a wide range of industrial activities, and the materials used in the construction and maintenance of buildings. In principle the ‘polluting’ tenant is liable for the cost of ‘clean-up’ but, in practice, the problem may not become evident until several years after the tenant has vacated the premises, by which time the firm may no longer exist. There may also have been a number of tenants in the same or adjacent properties and proving liability at a distance of several years may be fraught with many problems.

It should be mentioned at this point that occupational leases of industrial properties in the United Kingdom tend to be for considerable periods of time. Historically, firms would enter into leases for 25 years, with rents being subject to revision (usually to open market value) at every fifth anniversary, usually stipulated in the lease as being capable of revision as being limited to ‘upwards only’ revisions. As the result of market pressure from tenants, primarily American and European companies, the duration of leases has been reduced in recent times but even today, firms will typically enter into leases for 10 or 15 years, most of which do not contain any opportunity for the lease to be broken, although the tenant may have the ability to assign or sub-let. Tenants are usually responsible for repairs, insurance and compliance with legislation.

It can be seen that anything between 10 and 25 years may have elapsed before the landlord regains possession of the property. In some cases, where for example land has been let on 99-year ground leases, even longer periods will have elapsed. Many such leases were granted in the early part of the 20<sup>th</sup> Century and the land will now be reverting to the freeholder, often without the protection of any clauses relating to the condition in which the land is to be returned. If the polluting tenant is no longer in existence then, under the terms of the legislation, the liability for making the land safe falls to the present owner, who may well have had no connection with the property when the pollution took place.

Although the implementation of Part IIA of the Environmental Act 1990 may be regarded as being the main driver in heightening concern over land contamination, another driver is UK government policies on the re-use of previously developed land (PDL). Concerns over meeting demand for new housing, without further encroaching on a reducing supply of ‘greenfield’ land has led to the setting of a national target for 60% of all new housing in England to be built on previously developed land (PPG3, 2000). This target was actually achieved in 2001 and in 2002 but whether this can be sustained in the future is open to debate; for example English Partnerships believes that, at this target level, there is an unconstrained supply of previously developed land equal “to approximately 2-3 years’ supply across England as a whole”(English Partnerships, 2003, p17). This is significant as England contains by far the greatest amount of previously developed land in the UK and the major part of the population.

Given this pressure to reuse land and coupled with the fact that there has been a significant decline in manufacturing industry in the UK since the early 1980’s, it is quite likely that when leases on

industrial premises come to an end the landlord may be unable to find a new tenant and may instead wish to consider the potential for redevelopment. Either that or the land will remain vacant or derelict.

The Urban Task Force, established by government in 1998 under the chairmanship of leading architect Richard Rogers, concluded that, in England alone, there were 45,000 hectares (111,000 acres) of vacant or derelict land, of which 10,900 hectares was considered suitable to be redeveloped for housing, capable of accommodating 314,000 housing units at current density levels (Urban Task Force, 1999). These sites will require differing degrees of treatment before they can be redeveloped.

Against this background one might assume that the result of these government policies would have been to instil a greater awareness of land contamination issues in the minds of individuals and companies working with real estate. Consequently, it might be expected that landlords of industrial real estate, and those responsible for its leasing and management, would take steps to introduce effective management systems. Such systems would need to be able to distinguish between the different types of hazards that might be associated with operations being carried out by tenants and the potential risks associated with those hazards.

### **The need for Environmental Information**

The Part IIA legislation means that landlords and their leasing and managing agents may have to make important changes to the ways in which they negotiate the leases of industrial premises and the mechanisms they employ in the future management of those buildings. Similarly, tenants and their advisers may need to give closer consideration to the environmental liabilities they may be about to incur; especially where tenants carrying out potentially contaminating activities have previously occupied buildings.

The RICS provides its members with guidance as to the valuation of properties affected by the presence of contamination (RICS, 1995) as well as to the role and responsibilities of the surveyor when undertaking property inspections (RICS, 2000). By its very nature, the advice given in the RICS guidance is broadly based and does not identify the many 'pitfalls' that may confront a surveyor. At present the RICS does not issue any advice or guidance to its members aimed specifically at addressing the environmental aspects of leasing or managing industrial premises. However, the Environment Agency does offer some assistance in their guide to good environmental practice for trading estates, business parks and business clusters (Environment Agency 2002). As a consequence of research undertaken in connection with the Environment Agency publication, Jayne (2001) concluded that 'landlords have a greater exposure to risk than would be prudent, suggesting that there is some scope for landlords, and their agents, to improve their letting practices.

The need for Land Quality Statements, prepared at the time of property transactions or to coincide with significant changes in the use of premises, is emphasised in current guidance. This approach was supported by the Urban Task Force in its recommendation that standardised Land Condition Statements should be used "to provide more certainty and consistency in the management and sale of contaminated and previously contaminated sites" (Urban Task Force 1999: recommendation 76).

It has long been UK professional practice for landlords and their letting agents to ask for the financial records of prospective tenants, going back at least three years. These are analysed in respect of the firm's ability to pay the rent and other outgoings (Business Rates [property taxes], service charges, insurance etc.) relating to the property to be leased and in respect of other commitments, such as other premises and hire purchase debts, that may impact the prospective tenants' ability to pay at some time in the future.

In the light of the Part IIA legislation this may be no longer sufficient, given the potential long-term implications of environmental impairment. In future, landlords and their agents may also need to seek information as to the environmental standing of the prospective tenant. This may, for example,

include the firm's environmental mission statement, the names and qualifications of any persons having management responsibilities for environmental matters and environmental compliance records relating to the industrial activities.

The need for environmental information relating to the activities of the occupiers of industrial premises may be summarised under four headings:

- As part of the sale and transfer process - due diligence, in order to ascertain what previous occupiers may have done to the premises;
- As a tool in the process of redevelopment – to ascertain what treatment, if any, may be required in order to prepare the land for redevelopment;
- To assist in the valuation of commercial and industrial properties for asset and bank valuations; and
- As part of the process of effective property management.

(Syms, 2002)

Lawyers are involved in the documentation of almost all real estate transactions, sales, leases and acquisitions, in the United Kingdom but research by Keeping (2001) has shown that many lawyers do not ask appropriate questions when it comes to environmental issues. In some instances they do not even ask about the most recent use of the premises and even fewer lawyers ask about previous uses. When it comes to enquiring about matters such as compliance with environmental legislation the performance of the lawyers becomes still more variable. Even when information is requested about environmental matters, the responses are often inconclusive and, sometimes, even misleading (Syms, 2002).

**Comment [PS7]:** The referee suggested using the word 'correct' but judgements here are subjective and lawyers may disagree about the 'correctness' of some questions, thus 'appropriate' is better.

When it comes to the role of the real estate agent, there is frequently a reluctance to include information as to past uses and environmental records in sales and leasing particulars. In part this may be because prospective purchasers or tenants will regard the information as off-putting but it is also an effect of the legislation relating to the misdescription of real estate, under which the agent may be held liable for any incorrect information issued to purchasers or tenants. As few real estate agents are likely to have received any environmental education or training, they may be fearful of including some information, which they consider to be relevant, but inadvertently omitting other important details. In consequence of this, prudent purchasers and prospective tenants will probably find that they have to make their own enquiries, which may include both historical studies and intrusive investigations, often entirely at risk, before a binding contract is entered into.

### **Socially Responsible Investment**

A further driver for addressing the importance of assessing environmental risk and performance arises from the concept of Socially Responsible Investment (SRI). The 1995 Pensions Act requires UK pension funds to state to what extent environmental and social issues feature in their investment decisions. (ENDS(a) 2001). Trustees have been required, by law, to publish a statement of investment principles on behalf of their pension funds. This must include information on the extent to which their investment policies take into account social, environmental and ethical factors, as well as their approach to exercising voting rights. SRI investment encourages investment institutions to 'evaluate how the companies, in which they invest, deal with issues such as environmental protection, employee welfare and community relations, rather than just restricting themselves to financial considerations'. (Pridham 2001) Banks, pension funds and other investors will frequently undertake an environmental risk analysis of organisations, their operational practices and the sites they occupy, prior to lending or investing directly. Property considerations may involve issues such as records of past pollutions, the future potential to contaminate or the stance on good practice systems on the site in question (direct) and/or on sister sites (indirect).

According to the UK Social Forum, Socially Responsible Investment combines investors' financial objectives with their commitment to social concerns such as social justice, economic development, peace or a healthy environment. (UK Social Investment Forum 2001) They are of the opinion that there are three main categories to SRI,

1. Ethical screening (or simply screening): the use of ethical, social or environmental considerations when deciding whether to include or exclude stocks and shares in unit trusts or other investment portfolios.
2. Shareholder influence (sometimes referred to as shareholder advocacy): the attempt to improve a company's ethical, social and/or environmental actions as a shareholder.
3. Cause-based investing (also called community investing or socially directed investing): the support of a particular cause or activity by financing it by investment. It is important to remember that this is not the same as philanthropy - companies are not simply making a donation. They expect to at least recoup their investment.

SRI has traditionally been a niche market, but the financial community has recently awakened to the fact that social and environmental issues affect financial performance. The resulting demand has led to the emergence of specialist rating agencies such as the FTSE4Good index (ENDS (b) 2001).

Jayne and Skerrat (2003) undertook research into the importance afforded by ethical investors to a range of issues, including those of SRI, when making investment decisions. They found that, while financial aspects emerge as being the most important, ethical investments are considered to be the most important for good business in the long run. This is particularly relevant for real estate, which is generally considered to be a long-term investment with occupiers of premises commonly in occupation over long periods.

**Comment [PS8]:** . Mike, is this now published? If so, can you please update the references.  
DONE

'Ethical' investors were asked to rank the importance they attached to twenty six environmental criteria, on a five point scale, with 5 being the most important. Eight of the top factors directly related to this study and, consequently, were used for investigations. Their respective ranking and means are shown in Exhibit 1:

It can clearly be seen that these aspects are given importance by ethical investors. Consequently, landlords and their property managers might be expected to give them a similar significance when appraising the integrity of prospective tenants.

The study reported in this Study has examined current real estate leasing and management practices in the UK and has identified areas where changes may be required, or be desirable, in order to arrive at recommendations as to 'best practice'. It was supported financially by the property development and the waste disposal industries, as well as by English Partnerships (the Urban Regeneration Agency for England). The RICS and the Environment Agency (for England and Wales) also supported the project. The work was undertaken in three phases, a survey involving leasing and managing agents, real estate owners, lawyers and bankers; a consultation stage with representative organisations including the RICS, the Environment Agency, British Property Federation, British Bankers Association, British Insurance Association, the Law Society and the Confederation of British Industry (CBI) and interviews with a representative sample of persons from the survey. The first two phases of the study have been completed and the consultation phase is currently ongoing. This study reports on the survey phase.

The outcome from the research will be a new guidance document for use by real estate professionals, as well as academic conference and journal papers.

### **The survey**

The survey of practicing professionals was undertaken in mid 2002, with the primary purpose of establishing current practice. A database for the survey was compiled mainly from Freeman's Guide to the Property Industry (2001) – Who's Who section. This ensured that the majority of the larger real estate firms and property law firms received the questionnaire. In many cases questionnaires were sent to more than one individual in the firm, in an attempt to obtain views from people involved with both leasing and management. A small number of bankers were also included in the survey, once again identified from Freeman's Guide. A total of 767 questionnaires were sent out by post. All recipients were asked to respond to broadly the same questions but from their own professional perspective. For example, leasing agents were asked about the information they requested when considering the suitability of prospective tenants, while lawyers were asked to provide information about questions asked at pre-contract stage. The bankers were asked to give their views in respect of the funding aspects.

A total of 79 usable responses were received (a 10.3% response rate). Whilst at first sight this was a disappointing response, it was achieved without any reminders and probably confirms the suspicions held by the study team – that professionals as a whole have not given a great deal of thought to the implications of the Part IIA legislation on the processes of leasing and management. If this sample is viewed as providing information as to the practices of firms dealing with industrial premises, then the response rate is significantly improved, especially since the responses include people from most of the larger industrial real estate firms in the UK.

The respondent sample was well qualified, both academically and professionally. Thirty-nine individuals held bachelors degrees and nine had higher degrees. The sample included 60 people who were engaged in leasing and/or management activities (76% of the sample), of these, 16 were Fellows of the RICS (FRICS) and 33 were Members (MRICS). These real estate practitioners had an average of 17.5 years experience since qualifying or in dealing with industrial properties<sup>i</sup>. The rest of the sample comprised 14 solicitors and five bankers, of whom two were Chartered. The lawyers had an average of 15.9 years experience<sup>ii</sup> and the bankers had an average of 18.5 years experience<sup>iii</sup>.

Only one of the real estate respondents and one of the banker respondents considered themselves to be very familiar with the Part IIA legislation, to the extent of having studied the legislation, its associated guidance and regulations, whereas five of the lawyers classed themselves as being very familiar. Twenty of the real estate practitioners considered themselves to be reasonably familiar with the legislation, whilst 27 had some knowledge, for example from having attended a one or two hour continuing professional development (CPD) session. Once again the proportion of lawyers, fifty per cent, regarding themselves as having a reasonable level of knowledge was higher than for the real estate professionals and two of the bankers also considered that they had a reasonable level of knowledge.

Taken altogether, the respondent sample may be regarded as being fairly well qualified to answer questions as to current practices in dealing with industrial buildings. It should, however, be noted that very few of the sample spent more than 25 per cent of their time working on any one aspect (leasing, management or advising on development) of industrial buildings. This may be attributable to the relatively senior positions held by most of the respondents, resulting in them having overall management responsibilities for different areas of practice.

### *Leasing Industrial Buildings*

The respondents were asked a number of questions relating to their practices when instructed by landlords to obtain tenants for industrial buildings. They were also asked about the procedures adopted when instructed to acquire industrial buildings, for either prospective tenants or owner/occupiers. This section focuses on the responses made by the real estate professionals, with additional information from the lawyers and bankers samples where appropriate.

When preparing leasing particulars, 48 respondents (87.3 per cent of the real estate agents sample<sup>iv</sup>) stated that they did not make any mention of the previous use to which the premises had been put. However, when acquiring premises on behalf of clients, 47 of the respondents said that they did request information as to past uses, including copies of any environmental reports.

Vetting of prospective tenants, so as to ensure that they have the ability to pay the rent reserved under the lease, is a long established practice on the part of United Kingdom real estate practitioners. The most common measure is to request copies of the firm's financial accounts<sup>v</sup>, usually for a minimum of three years, in order to determine the amount of rent 'cover' provided by the net profit on the trading account. The amount of cover required by a landlord will vary, both in respect of the type of property to be leased and the nature of the prospective tenant but, as a general indication, landlords normally might be looking to see the net profit of the prospective tenant company before taxation being between not less than 2.5 and preferably around 4 times the rent payable under the lease. Different criteria would be applied to larger companies operating from a number of locations.

With the introduction of the Part IIA legislation and a general increase in awareness of environmental matters, the study sought to determine what additional information might be requested by landlords and their agents from prospective tenants. The respondents were also asked to provide information about what questions they might ask when acquiring previously occupied premises on behalf of clients. Their responses are set out in Exhibit 2.

The 'other information' requested by the real estate professionals, when leasing industrial buildings, included:

- Details about the delivery, storage and use of raw materials;
- Waste disposal practices;
- Processes to be undertaken, including information about noise, smells or other emissions;
- Details of any licences or consents required;
- Bank references;
- Whether the proposed use has any potential to contaminate;
- Hours of operation;
- Details of any hazardous materials; and
- Company history.

Two respondents stated that they generally only dealt with industrial premises in the town planning B1<sup>vi</sup> and B8<sup>vii</sup> Use Classes, thus implying that they did not consider environmental issues to be of importance. Whilst it may well be the case that such uses are less likely to be of a contaminative nature than, say, engineering or chemicals production, in the experience of the authors the use of buildings within B1 and B8 does not rule out the possibility of an environmental incident taking place, nor does it remove the need for environmental information.

When acquiring industrial premises on behalf of clients the 'other' information requested by real estate professionals includes:

- Details of use, name and operational nature of previous use and occupier;
- Details of mechanical and electrical installations;
- Specification information;
- Information relating to contamination of the landlord's fixtures and fittings;
- Service charges; and
- Details of any pollution incidents and licences.

Three respondents stated that they go into a considerable amount of detail before acquisition, including phase 1 survey, walkover inspection and obtaining specialist environmental advice. One respondent, who would normally ask for comprehensive information about the premises, stated, "often, all this information is not available". The real estate professionals were also asked if, when acting for clients intending to take an assignment of an existing lease, they made any enquiries



regarding the previous occupiers. Only 37 respondents answered this question<sup>viii</sup> and 20 stated that they did make such enquiries.

The advice given by the lawyers to their clients varied significantly between that which they considered appropriate when acting for landlords leasing premises to tenants and that given when acting on acquisitions. Twelve of the 16 lawyers stated that they would recommend their clients to obtain trading [financial] accounts for the last three years from prospective tenants but only four would recommend obtaining this information as part of the acquisition process. Eleven lawyers would recommend obtaining information as to industrial operations when acting on a letting and nine would make a similar recommendation when acting on an acquisition. Five lawyers would recommend their clients to obtain environmental compliance records as part of the acquisition process but only four would make a similar recommendation when leasing. None of the lawyers would recommend seeking any information other than that listed in Exhibit 2, unless requested by the client's surveyor [real estate adviser] to investigate further.

The bankers were asked to consider the same categories of information from the perspective of assessing an application for development funding. Although this subset was very small, there was a clear reliance on the trading accounts of the firm and details of the directors' experience and qualifications.

### *Managing Industrial Buildings*

The survey then addressed the practices adopted in relation to the management of industrial buildings. Once again, this section deals with the responses from the real estate professionals, with additional information from the lawyers and bankers samples where appropriate.

The practitioners were asked about the management tools and regulations they employed, and whether they used them all the time or less frequently. Their responses are shown in Exhibit 3.

One respondent stated that they provide a tenant's handbook and management regulations for each estate, whilst another stated that they relied on the detailed terms of the lease. One respondent organisation provided an environmental 'helpsheet' to tenants and commented that the lease would not be signed until such time as an environmental assessment had been done and the new occupier had agreed to implement any new precautions specified. The same respondent stated that special lease clauses would be drafted for high risk occupations. One response stated "we do not allow outside storage of any kind" and another "if tenant's use considered likely to present environmental risks, then further investigations will be undertaken.

The respondents were asked if, when vetting a prospective tenant, they took into account a number of specific environmental issues. Their responses are given in Exhibit 4.

'Other' issues considered included the nature and quantity of any wastes and whether any vehicle washing is proposed. Thirty-nine out of 50 real estate respondents indicated that they recommended the imposition of environmental controls on tenants through the lease, 15 out of the 16 lawyers also stated that they recommended the imposition of environmental controls via the lease. Controls included covenants not to undertake environmentally harmful processes nor store products that may be harmful. In some cases covenants might be included in order to indemnify landlords against any liabilities. General compliance clauses include control over discharges; requirements to comply with legislation and not to pollute property and adjoining land. Otherwise the respondents tended to rely heavily on standard 'institutional' type lease clauses.

As referred to above, leases of industrial premises in the United Kingdom tend to be for long periods, 10 to 25 years and in some cases very much longer, but at some point they will come to an end and

the land and buildings will revert to the landlord. Standard lease terms in the UK require tenants to 'yield up' the property in good repair at the end of the lease and, if it is not in good repair, the outgoing tenant may be liable to meet the cost of dilapidations. This can sometimes be highly contentious, especially if the premises are likely to be redeveloped or substantially altered, with both landlord and tenant employing surveyors to argue their case. However, the surveyors charged with resolving the issue of dilapidations will focus their attention on aspects of physical disrepair and may well fail to notice any environmental damage that may have been caused. Also, in the experience of the authors, very few building surveyors have received any significant environmental education or training.

With these issues in mind the survey respondents were asked whether or not they recommended that decommissioning audits be undertaken prior to the end of the lease. Eighteen respondents replied that they did make such recommendations but 30 respondents indicated that they did not. Twelve of the lawyers stated that they would be in favour of a lease clause requiring that a decommissioning audit be carried out prior to the end of the lease but four were not in favour of such a clause. Four of the bankers were also in favour, with one opposed.

### *Practice Procedures*

As stated above, the purpose of the survey was to identify current practice in respect of leasing, acquiring and managing industrial real estate. It was clear from the responses that practices differ and, anticipating that this might be the case, the respondents were asked to indicate whether the procedures they followed were ones they had personally developed, or whether they were laid down by the firm or the client.

With regard to the leasing of buildings, 26 of the real estate practitioner respondents replied that they used their own procedures and 27 used their firm's procedures, whilst seven relied on procedures laid down by clients and five used 'other' procedures. So far as property management was concerned, 17 respondents used their own procedures, 23 used their firm's procedures and four each used client's or 'other' procedures.

Only two of the lawyers used their own procedures for both leasing and management. Seven used their firm's procedures for leasing and six for acquiring. Nine lawyers used client's procedures for leasing and six used them for management. One lawyer used 'other' procedures.

None of the respondents were prepared to provide the study with copies of their procedures. The majority of all respondents considered themselves to be reasonably familiar, through to very familiar with the present guidance issued by their respective professional organisations.

### **Conclusions and recommendations**

In summary, new legislation dealing specifically with the legacy of land contamination associated with many different industrial activities has increased the potential for environmental harm to be caused to industrial buildings. This should be of concern to landlords and their managing agents, as there is potential for real estate values, lettable and redevelopment options to be adversely affected. Although the 'polluter pays' principle applies, the environmental damage may remain undetected for many years, by which time it may be impossible to prove liability, or even to find the polluter. This may be especially true if landlords do not exercise their rights to make periodic inspections of leased premises, or if the leases are poorly drafted.

The study has shown considerable variation in how real estate practitioners are responding to the legislation. Whilst most seem to have some knowledge, the depth of that knowledge is frequently very limited. The real estate practitioners would seem to have a tendency to leave 'environmental' matters to the lawyers, or to rely on standard 'institutional' lease terms, but, in some cases, the

lawyers will only investigate environmental issues or draft specific environmental clauses if instructed to so by the landlord or the leasing agent.

Environmental information is essential to many aspects of real estate, including leasing and sale transactions, effective management and development. Yet the study has shown that this type of information is often not obtained, although there may be a more conscientious approach in this regard when acquiring premises on behalf of prospective owners. With increasing importance being paid to socially responsible investment, it should follow that, when entering into arrangements to lease properties, landlords pay greater attention to the environmental performance of prospective tenants, rather than solely relying on their financial ability to pay the rent.

There are no standard procedures for practitioners to follow when leasing or managing industrial real estate and, in many cases, firms do not lay down standard operating requirements, leaving it to individual practitioners to develop their own methods. Whilst it has not been possible for the authors to inspect and comment upon the procedures used by individuals or firms, and without any comment as to the adequacy of those procedures, it does seem that some effort should be made to at least introduce a commonality of approach.

The authors therefore propose that consideration be given to adoption of the following as 'best practice' procedures.

#### *Leasing industrial premises*

- When premises have been previously occupied, reference should be made in the leasing particulars as to the nature of previous activities carried out;
- The leasing agent should prepare a file containing copies of all relevant documents relating to environmental compliance, or non-compliance, in respect of previous occupiers;
- Where information is not available the agent should advise the landlord to commission an independent report as to the environmental condition of the premises and the consultant should be required to give 'duty of care' to an incoming tenant as to the environmental condition of the premises at commencement of the lease;
- Consideration should be given to the recording of environmental information relating to industrial buildings in the form of a Land Condition Record or similar document, which should be updated every time there is a change in the operations in a building and upon changes in occupation.

### *Vetting prospective tenants*

- In addition to the usual financial checks, the landlord or letting agent should request environmental information from prospective tenants including, but not limited to, environmental mission statements, directors' experience and qualifications, environmental compliance records;
- Tenants should be required to provide information as to any potentially hazardous materials to be stored or used on the premises, including information as to maximum quantities or volumes;
- Tenants should be required to provide information as to any potentially hazardous operations to be carried out on the premises, including an assessment of possible risks and hours of operation;
- Tenants should be required to provide information as to their proposed waste management procedures, including any discharge consents that may be required.

### *The lease*

- Consideration should be given to the adequacy of standard lease clauses with regard to possible environmental hazards and, where necessary, specific clauses should be drafted to cover potential risks;
- For all buildings used for manufacturing operations, leases should contain a requirement for tenants to have prepared an environmental audit, by an independent environmental consultant, at least once every five years;
- Consideration should also be given to the need for periodic environmental auditing of buildings used for non-manufacturing purposes but where hazardous materials might, from time to time, be stored – for example general warehouse buildings;
- Provision should be made in leases for tenants to commission, from an independent consultant, a decommissioning audit to be undertaken in the last year of the tenancy and for all recommended works to be carried out before the end of the demised term.

### *Managing industrial buildings*

- All leases should contain provision for the landlord or the managing agent to undertake periodic inspections of the premises upon giving reasonable notice – these inspections should be carried out, preferably twice yearly;
- Consideration should be given to the need to issue an 'environmental rule book', probably more for industrial estates with shared facilities than for solus buildings, but care should be taken to ensure that the rules are not overly restrictive to the extent that they affect tenants' abilities to use the premises;
- Landlords or their agents should approve any proposed alterations to the buildings, including the specification of materials to be used, and frequent inspections should be made during the works so as to ensure that environmental harm is not being caused or concealed.

This is not a comprehensive list of procedures that might be employed as part of 'best practice' and other, more specific, procedures may also be required when dealing with certain types of real estate and tenants. Although this paper has been mainly concerned with the leasing and management aspects of industrial real estate, most of the issues discussed are at least as important, or even more important, when acquiring premises for occupation, investment and redevelopment.

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## **About the research**

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**Exhibit 1 - The relative importance of environmental criteria**

<b>Environmental aspect</b>	<b>Mean</b>	<b>Rank</b>
Environmental performance in other countries	4.2	1
*Environmental prosecution record	4.1	=2
Externally validated EMS	4.1	=2
*Waste management practices	4.0	3
Own environmental management system	3.9	4
*Permitted pollutions to air	3.8	=5
Corporate environmental statement	3.8	=5
Non-environmental prosecution record	3.7	=7

(after Jayne and Skerrat 2003)

**Exhibit 2 – Information requested when leasing or acquiring industrial properties**

<b>Information requested</b>	<b>Leasing</b>	<b>Acquiring</b>
Trading accounts for the last 3 years	50	23
Details of company directors experience and qualifications	10	6
Details of industrial operations and materials to be stored at the premises	36	24
Details of machinery to be installed at the premises	38	13
References from existing/previous landlords	39	11
Environmental mission statements	9	9
Environmental compliance records	9	13
Evidence of an audited environmental management system	7	8
Other information	10	9

**Exhibit 3 – Industrial Property Management tools and regulations**

<b>Tool or regulation</b>	<b>Always used</b>	<b>Usually used</b>	<b>Sometimes used</b>	<b>Occasionally used</b>	<b>Never used</b>
Issue a tenant rule book	5	7	8	3	15
Require tenants to provide details of materials stored	7	9	8	10	5
Require tenants to notify changes in operations	9	8	7	7	6
Require tenants to notify machinery used	2	6	5	8	16
Require tenants to obtain consent for alterations to buildings	35	6	1	-	-
Regular inspections by landlord or managing agent	23	15	3	1	-
Other	2	-	-	2	-



**Exhibit 4 – Environmental issues considered when vetting prospective tenants**

<b>Environmental issue</b>	<b>Number of respondents taking issue into account</b>
Existence of an audited environmental management system	6
Tenant's prosecution record in the UK	10
Where appropriate, tenant's environmental performance in other countries	13
Potential interaction of prospective tenant's activities with neighbouring tenants	30
Hazardous chemicals used in tenant's processes	39
Nature of the authorised discharge consents for tenant's processes	25
Other	8

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- i Two respondents did not answer this question and not all respondents held professional qualifications.
  - ii One lawyer did not answer this question.
  - iii One banker did not answer this question.
  - iv Three respondents did not answer this question.
  - v These have to be filed each year at Companies House – the UK registry for businesses trading with limited liability.
  - vi B1 Use Class – a) offices other than financial and professional services provided for visiting members of the public; b) research and development; c) other industrial premises appropriate in a residential area.
  - vii B8 Use Class – Warehousing and Distribution.
  - viii Most of those who did not respond to this question were employed by property companies and, as such, did not act on behalf of tenants.