SUSTAINABLE DILAPIDATIONS: SHIFTING TRENDS IN THE GREEN AGENDA

The real estate industry is slowly shifting more towards retaining and repairing as opposed to demolishing and replacing. Whilst financial pressures continue to drive dilapidations, the real estate industry is on the journey to ensure sustainability is at the forefront of dilapidations.

A recent decision by the Secretary of State to reject M&S wholesale development of their London flagship store at Marble Arch and whilst it has been challenged, it does highlight the attitude to planning, where redevelopment can no longer be taken for granted as pressure grows to prioritise adapting and reusing existing buildings. When making a case for a redevelopment, the whole life carbon impact will need to be considered alongside that for reuse options.

We are also seeing similar patterns where landlords undertaking dilapidation works are retaining and refurbishing suspended ceilings, raised access floors and central mechanical and electrical systems in particular HVAC. As a result, landlords are finding it easier to recover costs from outgoing tenants for repairs as opposed to seeing greater savings where landlords previously were undertaking improvements for which the outgoing tenants are not liable for.

The landlord and tenant relationship needs to move away from focusing purely on financial and working more closely together with a more sustainable agenda.

Dilapidation liabilities represent a significant opportunity to help reduce the impact on the environment where both landlords and exiting tenants can work more closely for a mutual benefit to reduce the environmental impact and meet respective net zero targets.

The lifecycle of occupation requires stripping out the outgoing tenant's alterations (in the case of offices reinstating to open plan Cat A standard) ready for marketing the space before being fitted out by the new incoming tenant. The cycle of waste is significant. The lease liability plays a large part in this, where outgoing tenants are legally required to reinstate the premises. Whilst most tenants settle the liability financially, some undertake works before the end of the term removing alterations which could be of use to a new tenant.

Landlords with net zero targets may see outgoing tenants argue and defend against claims on the basis that removal and reinstatement of alterations which are in good condition will have a negative impact on net zero targets.

The industry must bring all stakeholders together to formulate a far more efficient and sustainable approach to dilapidations, including landlord's, tenants, letting agents, lawyers, valuers, as well as manufacturers and the wider supply chain.

The industry will achieve significant improvements to sustainable dilapidations by adopting the following:

BEFORE LEASE COMMENCEMENT

- A huge amount of waste and environmental impact occurs where a tenant strips out recently completed CAT A to install their CAT B fit out. Landlords should consider adopting assumed Cat A specifications appended to leases which documents the state the tenant needs to leave the premises in, yet physically has not actually been undertaken. Landlords are then in a better position to make capital contributions towards the tenants fit out. Dilapidations at lease end will be benchmarked against reinstating back to the CAT A specification.
- Leases should be amended to mandate responsible sourcing of construction materials, furniture and finishes with specific targets in line with recognised standards (i.e. BREEAM/LEED).
- Amend the lease to give tenants an option to settle dilapidations financially rather than undertake strip out works. This should also apply to break clauses.
- Landlords must consider placing greater emphasis on requiring tenants to ensure their fit out considers future reuse. For example, specifying partitioning should consider easy disassembly and re-erection in a different location. Another example is to ensure materials used allow for end-of-life recycling. Lawyers must consider amending the lease clauses to allow for these considerations. This approach really does require landlords and tenants to work together to create a longer-term sustainable strategy for the premises.
- Licences to Alter can play a greater part in controlling the impact the tenant's fit out will have on the environment.

END OF LEASE

- Require the tenant to undertake an environmental audit to assess the impact of removing and reinstating their fit out at least 12 months before the end of the term, giving an opportunity to assess elements which could be retained, reused, or upcycled which would include the furniture.
- Landlords should be encouraged to market the space with the existing tenant's fit out presenting an opportunity for incoming tenants to adopt some or all the fit out.
- Incoming tenants struggle to imagine already fitted out space being utilised for their own occupation. They prefer open plan visually clear space. Technology is now so advanced that digital twins of both open plan and fitted out space can capture and present back through virtual reality interfaces to help identify areas where parts of the old fit out can be retained and reused.
- The speed of re-letting the premises is dependent on the market. Often landlords will not want to risk trying to re-let the premises with an existing fit out in-situ. There is a risk of not being able to let the premises and further delay by then having to reinstate back to the original state. Landlords will want to undertake works as soon as the lease has terminated, both to support the dilapidations claim and create the most favourable market conditions to re-let the space, having undertaken the works presenting the space in the best possible circumstances. It is therefore important that landlords and tenants work together to encourage early marketing of the fitted-out space. Adaptable lease terms will need to be adopted to allow more flexibility where landlords have agreed to retain the fit out leaving the door open to their removal where best intentions have not been fruitful.

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END OF LEASE CONT.

- Embed waste management into the dilapidations process. Works being undertaken should be done with a more sustainable approach including careful separation and aggregation. Materials such as plasterboard, carpet, ceiling tiles, glass, metals and furniture can all have a viable second life in another tenancy or reprocessed into something new, significantly improving environmental outcomes and avoiding landfill and its expense. Recommendations include:

    1. Prepare a pre-refurbishment audit setting specific targets for reuse/recycling of materials and non-hazardous waste to be diverted from landfill;
    2. Careful fit out design can significantly improve the achievable recycling rate at end of life. A life cycle assessment (LCA) tool or a building information model life cycle assessment (BIM LCA) should be undertaken prior to the fit-out works to measure the life cycle environmental impact of the project;
    3. Agree stakeholder responsibility for re-homing and recycling;
    4. Document a furniture inventory and market this early. Divert unwanted furniture using the reuse and recycle method. Early engagement with charities or other re-use firms is essential;
    5. Appoint the contract specifying the resource recovery plan and material separation plan.
    6. Hold the contractor accountable, providing evidence of delivering to the resource recovery plan.

The process of preparing space for letting, fitting out for occupation, and reinstating at lease end presents a cycle of waste at each stage, and environmental impact is significant.

The real estate industry has a genuine opportunity to bring all stakeholders together and adopt changes to meet respective net zero carbon commitments. Sustainable dilapidations is part of this process, but the opportunity extends to all stages of the marketing, occupation and end of lease life-cycle.

Clearly this is an evolving issue and too early to be supported by case law. Our dilapidations team will continue to research and monitor the shifting trends in the green agenda.

"Forewarned is Forearmed"

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