

Green Leasing: Implementing Sustainability Concepts in Commercial Leases

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Everyone wants to own or occupy a green building. Unfortunately, traditional full service and net leases are seriously deficient in fostering sustainability practices. Current commercial leasing practices and documents can have numerous undesirable consequences when used in a green project. Traditional full service and net leases result in inappropriate allocation of the costs and benefits of going green, are deficient in describing the ongoing responsibilities of landlord and tenant in maintaining green certifications and fail to create a relationship between landlord and tenant that will foster compliance with sustainability goals. Green leasing demands new approaches to meet the needs of both landlord and tenant.

The Green Building

Buildings are major consumers of resources. In the United States, commercial and residential buildings use almost 40% of our total energy, 70% of our electricity, 40% of our raw materials and 12% of fresh water supplies.¹ A green building is one that is constructed (or retrofitted) to minimize this impact.

Making a building green requires consideration of:

¹ U.S. Department of Energy, Energy Efficiency and Renewable Energy Network, Center of Excellence for Sustainable Development, 2003

“...a gamut of topics from site designs through water and energy efficiency, material and resource conservation, indoor environmental quality and construction techniques. The goal is to properly balance sustainable features and their costs to give building owners the best overall performance.”²

Different organizations have developed their own concepts of what constitutes green building. The U.S. Green Building Council is the nonprofit organization that developed and administers the LEED® (Leadership in Energy and Environmental Design) Green Building Rating System. The Council focuses on “design and construction practices that significantly reduce or eliminate the negative impact of buildings on the environment and occupants.” These practices include “sustainable site planning, safeguarding water and water efficiency, energy efficiency and renewable energy, conservation of materials and resources and indoor environmental quality.”³

The United States Environmental Protection Agency (EPA) administers the Energy Star® program that focuses on energy use. According to the EPA:

“Energy Consumption represents 30 percent of a typical commercial office building’s operating costs, making it the single largest controllable cost of operations....a 30 percent reduction in energy use (commonly achievable in the average commercial office building) can yield the equivalent of a five percent increase in net operating income and overall asset value.”⁴

Other building certification programs include Green Globes®, administered by the Green Building Initiative, and the Federal Sustainable Buildings Principles. The General Services Administration’s (GSA) green leasing practices address re-use of building materials, maintenance of indoor air quality during and after construction, use of recyclable and recycled content products and use of environmentally friendly building products and materials.⁵

The Greening of the Lease Marketplace

The old conventional wisdom was that building a project in accordance with sustainability concepts was too expensive and that tenants would not pay the higher rents necessary to make such a project profitable.

A new wisdom has emerged. In 2003 a group of 40 California state government agencies, banded together as the “Sustainable Building Task Force,” commissioned a study of cost data from 25 office and eight school projects that were LEED® certified.⁶ The study was a net present value analysis of the stream of current and future benefits and costs, quantified in then-present-day dollars. The study assumed a discount rate of five percent, an inflation rate of two percent annually and a term of 20 years.

² Ken Pientka, Commercial Investment Real Estate, *Investing in Sustainable Design*, www.ciremagazine.com/article_id=80

³ *Green Building Specifics: Costs, Benefits and Case Studies*, U.S. Green Building Council Spring 2005
Pollution Prevention Workshop for Healthcare

⁴ U.S. EPA Energy Star Program’s E-Newsletter Covering Energy Management for the Financial Markets, Summer 2006

⁵ GSA *Acquisition Letter to Implement Executive Orders 13101 and 13123* issued July 2000

⁶ *The Costs and Financial Benefits of Building Green*, Gregory Kats, Capital-E (2003) available at <http://www.ciwmb.ca.gov/greenbuilding/Design/CostBenefit/Report.pdf>

The findings were a revelation. The average initial cost premium associated with obtaining LEED® certification was about two percent, averaging about \$4 to \$5 per square foot. However, the 20-year net present value of financial benefits accruing from the practices leading to certification was in the range of \$49 to \$65 per square foot. The study reported benefits including reduced energy, water and waste costs, reduced emissions, lower operating and maintenance costs, lower insurance and risk costs, increased productivity and improvements in the health of the work force.

Another, even more comprehensive, study was reported a year later.⁷ This study compared the construction costs of 45 projects for which LEED® certification was sought with 93 projects that did not seek certification, evaluating the costs of pursuing each LEED® point and entire green projects. The report concluded that there was no statistically significant difference between LEED® and non-LEED® project costs.

The U.S. government has thrown its considerable weight behind the green building movement. Based on a study it commissioned,⁸ the GSA has adopted a program that requires all new construction and major modernization projects to be certified through the LEED® program with an emphasis on achieving a Silver rating. In order to achieve such a rating, GSA budgets for projects include allotments varying from 2.5 percent to 4 percent to cover the anticipated additional cost.

The leasing marketplace has reacted positively to green building practices. A recent study by CoStar Group analyzed more than 1,300 LEED® and Energy Star® buildings representing about 351 million square feet and assessed those buildings against similar non-green properties.⁹ The study reveals that buildings receiving LEED® or Energy Star® certification command higher rents and have higher occupancy rates than their non-certified peers. The same study found that the Energy Star® certified buildings in the study sold for an average of \$61 per square foot more than their peers, and that the LEED® buildings examined sold for a premium of \$171 per square foot over their non-certified competition.

The General Services Administration presented a program in December 2007 for its Real Estate Acquisition Division entitled “Green Lease Policies and Procedures for Lease Acquisition.” The program described the government’s progression toward green property acquisition practices beginning in September 1998 with Executive Order 13101 (“Greening the Government through Waste Prevention, Recycling and Federal Acquisition”). That executive order was followed in June 1999 by Executive Order 13123 (“Greening the Government through Efficient Energy Management”), and by the Energy Policy Act of 2005, the Federal Leadership in High Performance and Sustainable Buildings Memorandum of Understanding in January 2006 and Executive Order 13423 issued on January 24, 2007 (“Strengthening Federal Environmental Energy and Transportation Management”). The process culminated in Realty Services Letter-2007-12 (“Green Lease Policies and Procedures for Lease Acquisition”).

Most landlords, brokers and office managers would now agree that for a project to be competitive in the leasing market place, it must be green.

An International Movement

⁷ *Costing Green: A Comprehensive Cost Database and Budgeting Methodology*, Lisa Fay Matthiessen and Peter Morris, Davis Langdon Adamson, (July 2004)

⁸ *GSA LEED Cost Study: Final Report*, Steven Winter Associates, Inc. (October 2004) available at <http://www.wbdg.org/ccbref/ccbdoc.php?category+gsa&docid+280&ref=1>

⁹ As reported online by Andrew C. Burr in USGBC “In the News” April 26, 2008

Australia has been leading the charge for adoption of green leasing practices. In 2006, the cities of Sydney and Melbourne, the Department of Environment and Conservation of New South Wales, the Institute of Sustainable Futures and the University of Technology Sydney sanctioned the “Green Lease Guide for Commercial Office Tenants” published by Investa Property Group (the “Green Lease Guide”).¹⁰ In that same year, templates for use in lease transactions by government entities were developed by the Australian Government Solicitor for the Commonwealth of Australia.

Other countries are following Australia’s lead. Canada, Sweden and other countries are in the process of developing green leasing models.¹¹ In Great Britain, the British Property Federation (“BPF”), Usable Buildings Trust and the Carbon Trust have jointly developed the Landlord’s Energy Statement and the Tenant’s Energy Review as government recognized tools for understanding energy use.¹²

As noted above, property owners and tenants in the United States, as well as various government entities, are jumping on the green leasing bandwagon. One of the many challenges facing those who want to do well by doing environmental good is how to adapt the landlord/tenant relationship to conform to the growing spirit of environmental stewardship.

The Benefits of Green Leasing

The Green Lease Guide (see Footnote 10) describes the following principal benefits of a green lease:

1. Enhancement of reputation;
2. Attraction and retention of talented employees;
3. Enhancement of employee wellbeing and productivity;
4. Enhancement and protection of organizational knowledge;
5. Reduction of liability; and
6. Increased profitability¹³

Commercial Investment Real Estate, the magazine of the CCIM (Certificate of Commercial and Industrial Mastery) Institute adds increased market demand and lower operating costs to the above list.¹⁴

Current Leasing Practices

In general, commercial leases fall into two broad categories, gross and net. In the purest form of the gross lease, the landlord is responsible for all costs and expenses relating to the structure and its underlying real property and the tenant pays a fixed rent. In the purest form of the net lease (sometimes called an “absolute net” lease), the tenant pays a fixed rent and all costs and expenses, even structural repairs and costs that are commonly deemed capital improvements.

¹⁰ www.investa.com.au/Common/PDF/Sustainability/GreenLeaseGuide.pdf

¹¹ Linda Fletcher, *United Kingdom: The “Green” Lease-How Concerns about Sustainability are being Reflected in Contractual Arrangements*, United Kingdom, Environmental & Energy, the Green Lease-Bird & Bird-10-07-2008, Environmental Law.htm.

¹² www.les-ter.org/page/home

¹³ *Green Lease Guide*, pp 4 and 5

¹⁴ Ken Pientka, Commercial Investment Real Estate, *Investing in Sustainable Design*, www.ciremagazine.com/article_id=80

Hybrids of these “pure” forms are conventionally used. Frequently seen are leases where the landlord is responsible for capital improvements and structural repairs, while the tenants pay pro rata shares of operation expenses of areas of common use (frequently referred to as “common area maintenance” or “CAM” charges). The variants are endless, and leases vary dramatically from one another in defining the relative responsibilities of landlord and tenant for improvements, repairs, replacements and ongoing operational expenses. However, all commercial leases have the same purposes: to recover costs, yield a profit, and make the property attractive to potential investors or buyers.

Over the years, the net lease has come into increasing favor. Landlords who remember the extreme inflationary rates of the 1970s want to pass on increases in operating expenses to their tenants. Such leases also customarily include upward rent adjustment clauses, frequently based on percentage increases from year to year in Consumer Price Index figures or providing for fixed rent increases.

As noted in studies previously cited, some of the goals and quantifiable benefits of green building practices are reduced energy and water use, with concomitant savings in utility and other charges. Often, these goals are attained by use of materials, equipment and practices that allow for certification of a building project in accordance with LEED® or Energy Star® (or both) criteria.

Deficiencies in Current Lease Practices

In a net lease situation, the cost of new construction, or retrofitting of existing improvements, to comply with such criteria is a capital cost customarily borne by the landlord, while the benefits of lower utility and other common area costs are passed through to tenants in the form of lower common area maintenance charges. Benefits for the landlord may not accrue unless and until the building is sold, and there is no certainty that a particular building may achieve the value premium described by the CoStar study previously cited.

In addition to the foregoing, very few existing leases discuss construction or maintenance in accordance with LEED® or any of the other accepted green certification systems. Provisions dealing with tenant improvements may be lacking in descriptions of acceptable materials that are acceptable under the criteria of a particular rating system. Landlord approval criteria for alterations or additional improvements that may be requested by a tenant will also likely not reference conformity with LEED® or other specific green criteria as a ground for granting or withholding approval.

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Taken as a whole, commonly used leases are seriously deficient in properly rewarding the landlord for implementing sustainability practices, fail to adequately inform the tenant as to standards that must be maintained, result in an inappropriate skewing of benefits from sustainable practices, and fail to create a “partnering” relationship between landlord and tenant designed to assure uniform application of green practices through the life of the building.

Alan Whitson asserts the landlord’s position in describing why the net lease does not work for green leasing:

Proponents of the net lease say this creates a more transparent lease arrangement, and creates an incentive for tenants to use less energy. While good in theory, it doesn't always work in practice. In the average office building, energy costs approximately \$1.59 per square foot a year, which is 16 percent of the total operating costs, according to the Building Owners and Managers Association's 2005 Experience Exchange Report (BOMA EER). However, energy only represents 0.6 percent of an office tenant's cost of doing business.

If the average tenant with a net lease could reduce their energy usage by 40 percent—the average for EPA Energy Star® buildings—the savings would be \$1.00 per day per employee. Clearly this is a miniscule reward for the cost and effort needed to reduce energy usage....

For the owner of an office building with gross leases, it's a different situation. Reducing energy costs in the average office building by 40 percent would save \$0.64 per square foot. If these savings were capitalized at 7.75 percent this would increase the building's value by \$8.26 per square foot.¹⁵

The net lease format also has potential pitfalls for tenants when used in the green lease context. According to Mr. Whitson, the net lease:

...transfers operating risks from the landlord to the tenant. Doing so reduces the landlord's incentive to apply efficient management or sustainable principles to cut operating costs, since these costs are now excluded from calculating a building's net operating income (NOI); this is the basis for calculating a building's economic value.¹⁶

Resources for Crafting a Green Lease

From the viewpoints of both the landlord and tenant, the common form of net lease does not work well in the context of green leasing. A modified form of gross lease is far more likely to satisfy the green leasing requirements of both landlord and tenant, and should be used whenever possible. Tenants must be informed of their obligations in operating their space within a green project, including descriptions in the lease of materials to be used in tenant improvements and implementation of air quality, recycling, energy efficiency and other practices consistent with sustainability principles and green certification criteria. In turn, tenants may want to share in operational savings as a reward for their commitment to green practices in construction of improvements, materials and products used, recycling and energy efficiency. Neither a traditional gross nor net lease does the job.

In response to these perceived deficiencies in traditional lease documents, various groups and organizations have created their own lists of green leasing issues, and a number have published sample lease provisions.

California Sustainability Alliance

The California Sustainability Alliance is a group of public and private organizations having the goal of helping to meet California's "aggressive energy, climate and other resource and environmental goals by increasing and accelerating energy efficiency in combination with complementary green measures and strategies."¹⁷ As part of its mission, the Alliance has

¹⁵ www.edcmag.com/copyright/cc0c0b5scale7c010VgnVCM1000000f932a8c0

¹⁶ www.sustainableindustries.com/commentary/1736004.html

¹⁷ www.sustainca.org

drafted its Leasing Toolkit that describes myriad green goals, purposes and strategies, and offers short sample lease provisions on topics including building certification, alternative transportation, water use, energy use, building operations and maintenance, recycling and toxic material source reduction.¹⁸

Experienced commercial leasing practitioners may find the Leasing Toolkit to be a valuable checklist of matters to consider in the drafting of a green lease. However, in the opinion of this author it provides little in the way of usable lease provision language.

Australia's Green Lease Guide

The Green Lease Guide (See Footnote 10), although crafted primarily for tenants, contains substantive discussion and checklists that will likely prove to be of assistance to both landlords and tenants in considering almost every aspect of building operations, including indoor air quality, energy use, transportation options, water use, cleaning services and recycling of office waste. The checklists will suggest matters to be addressed in the lease, and may provide starting places for the drafting of specific provisions.

Federal Government

Anyone dealing with the federal government on leasing matters would be well served to review GSA directive RSL-2007-12 dealing with the implementation of environmental policies in leasing matters. The attachments to the document are of particular note and suggestive of lease provisions that should appear in government leases.¹⁹

In addition to the foregoing, interested persons must review the "Federal Leadership in High Performance and Sustainable Buildings Memorandum of Understanding".²⁰ The Memorandum emphasizes five guiding principles:

1. Integrate Design through use of a collaborative planning and design process that establishes performance goals for siting, energy, water, materials and indoor environmental quality, considers all stages of the building's lifecycle and employs total building commissioning practices.
2. Optimize Energy Performance through establishment of whole building performance targets to earn Energy Star® targets and reduce energy cost budgets by 30 percent for new construction and 20 percent for major renovations with ongoing monitoring of actual performance.
3. Protect and Conserve Water by employing strategies that in aggregate use a minimum of 20 percent less potable water than the indoor water use baseline calculated for the building, by use of water efficient landscape and irrigation strategies to reduce outdoor potable water consumption by a minimum of 50 percent over that consumed by conventional means, and by reducing storm water and polluted site water runoff.
4. Enhance Indoor Environmental Quality by meeting ventilation and thermal comfort standards, moisture control mechanisms to prevent building damage and mold contamination, providing for significant daylighting of interior spaces, use of low pollutant emitting materials, and use of air quality controls during construction.

¹⁸ www.sustainca.org/content/leasing_toolkit

¹⁹ Available through use of the "Search" feature [at www.gsa.gov](http://www.gsa.gov)

²⁰ www.wbdg.org/references/mou.php

5. Reduce Environmental Impact of Materials by use of recycled content, bio-based and certified sustainable wood products, programming design to recycle or salvage at least 50 percent of construction, demolition and land clearing waste, and elimination of the use of ozone depleting compounds during and after construction.

Building Owners and Managers (“BOMA”)

Perhaps the most comprehensive resource for green leasing currently available is BOMA’s “Guide to Writing a Commercial Real Estate Lease Including Green Lease Language.”²¹ The Guide contains a draft lease with specific provisions and commentary on newly included green provisions as well on the more commonplace provisions of an office lease. The Guide was prepared with input from the EPA (administrator of the Energy Star® program), from the U.S. Green Building Council (administrator of LEED®) and from the Green Building Initiative (administrator of Green Globes®).

Despite input from three organizations involved in certification programs, the Guide does not adopt any particular rating system. The purpose of the Guide is described in the introduction:

“It is designed to work off the sustainable practices that a company or building has implemented, and not to dictate what those practices are or should be. To this end, we did not seek to define the terms green, sustainable or high performance, but to create a lease that would facilitate the ongoing management and operations for the features, policies, amenities or management practices of a particular building – and thereby to also facilitate the continual improvement of that building.”²²

Essential Elements of a Green Lease

The resources described above will assist persons in adapting lease documents for green leasing purposes. A synthesis of some of the basic considerations that must be covered in a green lease is as follows:

1. Consider use of a gross or modified gross lease that rewards the landlord for capital improvements necessary to obtain green certification, lists building standard materials and practices that further sustainability goals and provides incentives to the tenant for its employment of green practices.
2. If the building has been or is intended to be certified, state the certification granted or sought (e.g. LEED®, Energy Star®, etc.).
3. Incorporate building rules and regulations that encompass ongoing certification requirements. Consider inclusion of a smoking ban.
4. Incorporate specific tenant improvement requirements that conform to certification requirements or the building standard, including descriptions of allowable and prohibited materials, and require certification of tenant work as conforming to standards.
5. Define annual operating expenses to include a sharing of costs related to green practices.

²¹ Copyright 2008 Steven A. Teitelbaum, Jones Day. Published by Building Owners and Managers Association International, Suite 800, 1101 15th Street, NW, Washington, DC 2005

²² *Id.*, at page vii

6. Include provisions describing or promoting transportation options.
7. Conform use provisions to certification requirements.
8. Describe special conservation systems (e.g., gray water, lighting) and the relative duties of landlord and tenant as to their operation and maintenance.
9. Include requirements for use of green products and materials (e.g., cleaning products).
10. Provide for sub-metering when possible.
11. Include landlord inspection rights to monitor compliance with green standards and practices.

As each building and lease negotiation is different, no list of considerations can cover every situation. The foregoing is intended as a very basic checklist that should be used in conjunction with a careful consideration of specific building systems and processes, and the needs of each particular landlord and tenant. Reference to the resources described earlier in this article will likely yield other insights that should be reflected in a particular green lease.

Conclusion

Awareness of the need to conserve and manage natural resources is now firmly imbedded in the collective psyche of the business community. Green leasing is just a part of the greater picture of responsible business practices being embraced by businesses large and small around the world. As our understanding of the interaction of people, buildings, technology and the environment continues to grow, the commercial sector will embrace new concepts and approaches we cannot predict. Green leasing practices and documents need to reflect our current understanding, but must also be flexible and adaptable to take advantage of new and better ways of dealing with buildings and their environmental impacts that are certain to develop.