

The Jolly Green Giant is Here to Stay

Leasing Sustainable Buildings

by David S. Gordon

Sustainable or so-called 'green' considerations affect design, construction, renovation, maintenance and operation of real estate. Driven initially by government criteria for facilities that would be occupied by public agencies, enactment of legislation providing incentives such as tax rebates and prioritized governmental approvals, and the increasing use of mandates for sustainability in development and operation provide additional impetus to the movement toward green. With the support coming more frequently from corporate users and institutional investors, the momentum gains strength.

Sustainability encompasses any development that meets the need of the present without compromising the ability of future generations to meet their own needs. It promotes the use of resources in a manner that meets human needs today while preserving the environment for present and future generations.

As the conscience of a younger generation growing into positions of authority in government and corporate policy makes itself heard, one can be certain that the concept of sustainability is here to stay. Moreover, the design, construction, operation and maintenance of facilities based on sound environmental practices and energy efficiency is a blueprint to the future that will produce environmentally and economically sustainable assets.

The standards for sustainable development are many and varied. They are currently established by private organizations with varying levels of governmental support.

The leading standard in the United States is the U.S. Green Building Council's Leadership in Energy and Environmental Design (LEED) Program. LEED's criteria and wide range cover the gamut of environmental and energy conservation concerns of facility and development types: new construction; existing building; core and shell; commercial interiors; exist-

ing building operation and maintenance; homes; neighborhood development; schools; retail and healthcare facilities.

Energy Star® is a program of the U.S. Environmental Protection Agency and the U.S. Department of Energy that focuses solely on energy efficiency. The name became known as a result of its early branding of energy efficiency in household appliances, and has grown in scope. Green Globes is used in Canada under the name of Go Green, and in the U.S. under the Green Building Initiative. Other systems are used in Australia, China and the U.K. There are also specialty standards such as Green Restaurants™ (focusing on sustainable operations within the restaurant industry), and proprietary standards are being developed by special interest groups such as the insurance industry.

The cost of sustainable building practices will vary depending on the level of sustainability desired. As sustainable technology develops, costs will decrease, and the cost of sustainable construction versus the cost of previously existing technology will become less of an issue. As an example, the cost of energy-efficient lighting (ballasts and bulbs) has dropped over the past several years, and will continue to do so as demand increases. Conversely, the cost of replacing traditional florescent ballasts and bulbs will increase as they are phased out of use in new fixtures and demand decreases.

While the cost of sustainable construction has decreased (and continues to be lower than the alarmist rates quoted by many of the opponents of governmental regulation) the market, especially among corporate and governmental users, is starting to adjust to sustainable buildings, and is supporting increased rental rates needed to amortize the additional construction costs. Similarly, corporate environmental responsibility is allowing, if not demanding, large corporate users to justify the increased occupancy costs of sustainable design and construction.

But sustainable design, construction and renovation is just a

start. Important to the topic of leasing a sustainable facility is the fact that 'built green' does not mean 'forever green.' A building designed and constructed for environmental and energy efficiency must be operated and maintained in an effective and efficient manner to continue to reap the intended benefits.

Operational and maintenance requirements of an environmentally and energy-efficient design directly impact operating costs, frequently making them higher, and may or may not generate off-setting reductions. This is especially true in a multi-tenant building where one tenant's business operations can be counter-productive to the goal of efficiency and adversely affect the entire building's overall sustainability rating. Thus, the landlord needs to be able to exercise control through its lease over what happens within a tenant's space, perhaps to the point of being considered to be intrusive on the management and operation of the tenant's business.

This is just one example of the many tensions that will challenge real estate professions in creating documentation for the leasing of a green facility.

However, it is likely, in fact inevitable, that the provisions of a so-called green lease will find their way into, and eventually totally supplant, existing lease documentation. This is because existing buildings will eventually require conversion to energy and environmental efficiency, due to governmental mandates and the competitive demands of the marketplace. As a result, landlords need lease documents that anticipate the costs of conversion/renovation and the need for sustainable operation and maintenance.

This leads to the underlying question: What is a green lease?

Lawyers are taking their first baby steps along the uncharted path of developing forms for green or sustainable leases. There are currently two forms that have gained recognition as a starting point and as guideposts along the route.

A form lease promulgated by the Building Owners and Managers Association (BOMA)—BOMA's Guide to Writing a Commercial Real Estate Lease, Including Green Lease Language—provides a landlord-oriented document with commentary relative to tenant concerns. Another lease form for a sustainable facility was developed by the Real Property Association of Canada (REALpac) under the REALpac national standard green office lease for single building projects and the REALpac environmental management plan, which is an attachment to and an integral portion of the REALpac Green Office Lease.

There are several approaches to drafting a lease for a sustainable facility, principal among which are documents that: 1) establish guidelines and goals only, 2) encourage or require some minimal level of sustainable development and operation, and 3) mandate increased levels of sustainable development and operation.

The BOMA form deals directly with issues of who pays for both capital expenditures and operating costs incurred in achieving the objectives of sustainability, and incorporates traditional U.S. leasing approaches to the obligations of the parties and remedies for failure to comply.

The REALpac lease takes a more general approach, setting mutual goals for sustainability to be achieved through a cooperative effort between landlord and tenant. It is a more 'touchy-feely' lease, with an emphasis on cooperation in the attempts or endeavors of the parties to achieve stated goals.

Given the early stages of development of sustainable leasing, the following discussion on green leasing issues is a broad-brush outline only, presenting more issues than solutions.

Default

Traditional default provisions involve notice, cure, landlord remedy of eviction and tenant remedy of self-help.

It is suggested that in an environment where both the criteria defining sustainability and the technological advances supporting sustainability are changing rapidly, and the determinations regarding qualification for rating or certification are made by third parties many times after the sustainable features have been completed, the inability of a party to meet a stated goal is not appropriate for traditional default remedies. A document that encourages compromise, and perhaps takes issues of noncompliance with environmental standards out of the scope of traditional default provisions, is a reasonable approach.

More 'kind and gentle' language that includes use of an alternate dispute resolution process is advisable. The use of an alternate dispute process presents its own questions related to the unique issues addressed, the frequency of technological advancement and whether special qualifications of a mediator or arbitrator are needed.

Term

Current thinking is that a lease better serves the promotion of 'sustainability' if it has a longer term. A longer lease term has environmental benefits in the form of less waste to be recycled when premises are remodeled for new tenancy and less use of energy in the manufacture of new materials needed in connection with the releasing of the premises, production of new furniture, transportation of construction materials and tenant equipment, etc. While this may seem to some to be a stretch, it is considered important to the people who write the standards governing sustainability, especially to the LEED criteria. In this instance, it may not be so much what the actual impact will turn out to be, but who is assessing the situation and making the rules.

Net Versus Gross Lease

A net lease creates no incentive for a

landlord to make capital improvements that will achieve savings in operations or energy efficiency unless the landlord can recover some or all of its costs. Conversely, a gross lease does not give the tenant the benefit of any efficiencies or savings. Striking the balance between the landlord's recovery of capital expenditures and the tenant's control of leasing cost is always difficult, and will be affected by the desire, and willingness to pay, for a sustainable facility.

Use

Any permitted use must comply with the objectives of an applicable environmental management plan¹ and the conditions of any applicable certification or rating system (such as LEED). Efforts to make a building sustainable can be seriously impeded by the operational activities of any of the users or occupants within their respective leased spaces. Accordingly, the nature of the use and the manner in which the tenant operates within its premises require the attention of the draftsman.

Operating Costs

Other than energy costs, which are now generally recognized as an area for tangible savings, the operational costs of a sustainable building are likely to be higher than those of a traditional facility. Examples of the kind of improvements or operational activities that may result in higher costs include, but are not limited to:

- special facilities for separate handling of recyclable materials and the additional time and expense required in handling recyclables;²
- special maintenance requirements for technically advanced building systems and equipment;³
- costs for monitoring the systems that render the facility sustainable;
- costs of maintaining and renewing applicable certifications;
- costs of commissioning or certifying

existing or new sustainable building systems, including renovations and tenant fit-outs

The imposition of sustainability through building codes and other governmental mandates are becoming more frequent and more coercive. A landlord will want or require the ability to pass on to tenants the costs of sustainable development and operation, or at a minimum the ability to amortize these costs and pass them through over a useful or depreciable life. While some traditional lease forms provide for a pass-through of costs to the extent of demonstrated savings, for a sustainable building, especially an existing building being upgraded gradually, this traditional clause is simply not sufficient because some of the goals of environmental efficiencies will not result in cost reductions. Also, mandatory retrofitting of existing facilities is becoming a much more common occurrence.

Maintenance and Repairs

The lease of a sustainable facility, or one being converted to sustainability, should require that all work within the building, including tenant interior spaces, comply with the conditions of applicable certifications and the environmental management plan. This will affect the selection of contractors, the materials used for construction and for the tenant's fit-out, the means and methods of construction and disposal of debris, the inspection, commissioning and approval of work, and maintenance of records and processing of documentation, for governing certifying organizations.

Standards, governmental regulations and technology are all moving targets, and what is required or cutting-edge today may be old hat by tomorrow, so crafting language that will adapt itself to this reality will be a challenge.

Assignment and Subleasing

This topic is always among the most important and contentious provisions in a lease negotiation, and the impact of sustainable development and operational criteria should be factored into the process of determining when an assignment or subleasing is permitted. Providing that an assignee's or subtenant's ability to comply with the provisions of an environmental management plan, or the requirements of an existing sustainability certification, should certainly be a reasonable basis for the landlord to withhold or condition approval. On the other hand, the unknown impacts of environmental concerns have the potential to make it more difficult for a tenant to control an exit strategy that may be needed in good times or bad.

Insurance

Several insurance carriers are in the process of developing products that are purportedly tailored for sustainable buildings. Property insurance issues that have the ability to impact both owners and occupants include, but are not limited to, whether ordinance and law coverage is applicable to new green building requirements (*i.e.*, will it cover: 1) increased costs of construction and energy efficient equipment and certification as green construction; 2) increased costs of sustainable methods of disposal of debris in the event of a casualty; 3) the increased cost of design and re-certification for damaged building that had an established certification but for which the criteria that have been enhanced over time and an outcome of certification is not guaranteed).

Similar issues apply to the loss of a tenant's personal property, such as interior finishes, furniture, office equipment, etc., where the tenant's interior carried a certification and either the standards or technology resulted in increased costs of replacement.

Also, where a tenant's finishes pre-date the green era and newer codes mandate sustainable fit-out and furnishing, will the tenant's insurance be sufficient to allow it to resume business (a concern for both landlord and tenant)? Standards developed by the insurance carrier as applicable under its coverage may not meet the criteria of other rating or certifying organizations, and if there is a casualty in an existing building and the landlord wants to reconstruct to certifiable sustainable standards, these issues are compounded.

There is no simple answer to these questions, and, as with all insurance issues, it is imperative that the client have a knowledgeable insurance advisor with experience in issues relating to insuring a sustainable building and the issues that can arise when a traditional building is damaged and desired to be restored using sustainable technology and criteria.

Compliance With Laws

Increasing governmental regulation and mandating of sustainable development is a major issue for existing buildings, and thus for the leases on existing buildings. State and local governments are becoming increasingly active, and have seemingly little concern for the financial impact of their mandates. Issues relating to the respective obligations of the parties for payment of the costs of compliance will create additional problems in dealing with these impacts. In existing leases, the compliance with laws has the potential to wreak havoc to a tenant's ability to control its leasing costs as an existing building is led forcibly to greener pastures (pun intended) by the mandates of governmental regulation.

Relocation

The traditional list of issues raised when a landlord insists on having the

right to relocate a tenant (within an existing building; assuring comparable size; assuring comparable access; assuring comparable visibility; reimbursement for costs) is now increased by concerns relating to matching sustainable standards and quality of current tenant space, including, but not limited to, the necessity to obtain certification, if applicable.

Rules and Regulations, Cleaning Standards

The rules and regulations of a standard office lease are frequently considered as boilerplate, but are fertile breeding grounds for hidden dangers relative to the control of environmental conditions and criteria, and should be carefully examined. The same concerns and advice relates to a review of cleaning standards and specifications.

Reservation of Landlord Rights

In an era where sustainability is a growing concern, owners of existing buildings must maintain the flexibility to impose and revise the standards of an environmental management plan in order to maintain the competitive position of a property in the marketplace. Similarly, existing tenants may be susceptible to changes to the building forced upon the landlord by a major new tenant that is able to demand high sustainable standards as a condition of coming to the building.

Utilities

Commercial buildings in the United States are said to account for a full 50 percent of all U.S. electrical demand. The ability of either a landlord or a tenant to control or influence supply of electricity, and to a lesser extent other required utility services, can be very important.

Signage

Restrictions of sustainable develop-

ment and design aimed at reducing energy consumption and light pollution run head-on into the needs of retail, and in some instances commercial, properties for visibility and brand recognition.

The tension between the landlord and the tenant in the negotiation of a lease for a sustainable facility will vary based on the desire of each party to achieve sustainable goals, and the willingness of each party to pay the associated costs. Although many factors are impacted, the key objectives of the sustainable lease will be to establish an environmental management plan that sets forth goals or obligations, monitoring guidelines and accountability, to determine who will pay for what expenses, and to provide for a mechanism for control of the decision making process regarding what costs will be incurred.

The pace of changes and additions to these issues will increase exponentially in the years to come, as technology, and our experience in the construction and operation of sustainable buildings, continues to evolve. Accordingly, periodic research of current sources, including the BOMA and REALpac lease forms as they continue to evolve, is strongly recommended.⁴ ☞

Endnotes

1. The term "environmental management plan" is used as a general reference to the stated goals of a particular lease document and not to the environmental management plan that is part of the REALpac green office lease form.
2. Municipal ordinances in Los Angeles require separation of materials for recycling and convenient methods for tenants to access those separate facilities. Accordingly, no recycling bin can be used, and the cleaning service needs multiple collection containers or must provide for the additional time necessary for its personnel to physically separate

materials.

3. If the building is constructed with a grass roof for energy efficiency there will be increased costs for “mowing the roof.”
4. Some examples of resources include: www.BOMA.org/pages/greenlease.aspx, www.Realpac.ca/splash/asp, www.usbc.org, www.greenglobes.com, www.energystar.com, Google search “green lease.”

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