



REAL ESTATE LAW & INDUSTRY



REPORT

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Leasing

Green Leasing Still Uncommon Practice, But Can Yield Landlord, Tenant Benefits

Although green building standards such as the U.S. Green Building Council's (USGBC) Leadership in Energy and Environmental Design (LEED) standard have become a prominent feature in new commercial building construction over the past decade, another green building practice—green leasing—has yet to catch on.

Green leasing, or green building operation, incorporates environmentally sustainable practices into a tenant's lease contract in a building. A lease can be classified as "green" without being in a green or LEED certified building, and likewise, a lease in a green building is not by definition a green lease. Some examples of lease provisions that can appear in green leases are:

- Sub-metering energy usage in spaces instead of billing tenants for a flat percentage of the building's overall energy use;
- Requirements to use low volatile organic compound (VOC) build-out materials like drywall, carpets, paints, and wallpaper;
- Requirements for use of recycled, recyclable, or sustainable build-out materials like bamboo flooring or recycled drywall;
- Requiring tenants to use products from no more than 500 miles away;
- Using green cleaning products in the building;
- Mandating the use of recycled or recyclable furniture;
- Banning smoking on the premises; and
- Reserving parking spaces closer to the building for hybrid or electric cars, or carpools.

Number of Green Leases Remains Small. So why are green buildings flourishing and green leases floundering? Steven Teitelbaum, a green lease expert and real estate partner at the Washington, D.C., office

of Jones Day pointed to the lack of financial incentives for green leases comparable to those given for green building practices as one reason. "If you do a green building, some states and cities will give you real estate tax abatements, or income tax credits, some will make funds available or have faster permitting. There really isn't anything like that [for green leasing] because operations have not yet reached that point of prominence; it's not a sexy topic," said Teitelbaum. "So that's why they don't incentivize, and they're really missing the boat. They're focusing on green buildings and not operations."

Even without financial incentives from state and local governments, there are still good reasons for having a green lease. Teitelbaum said a primary motivator is reducing building energy costs during tenancy. "You can get your costs down by being energy efficient in a non-green building," said Teitelbaum.

Other, more subjective factors for engaging in green leasing practices may also come into play. Teitelbaum said there is some evidence that green buildings enhance worker productivity. And an employer's green practices may give it an edge when going after new hires. "Prospective employees now often ask about the employer's green practices . . . as a differentiator," said Teitelbaum.

However, Teitelbaum said that these potential benefits have not yet generated green leases in any significant number. "The adoption of green leasing has been minimal," Teitelbaum said. "There are more green buildings out there that do not have green leases by far, in my experience, than those that have green leases. Most people think that you're done with green once you've delivered the building."

Government, Corporate Policy Pushing Green Practices. One of the major drivers of green leases though comes not from any costs savings a tenant envisions when signing a green lease in a specific space, but from institutional tenants such as government agencies and corporations that mandate green practices.

Some federal, state, and local government agencies have directed private companies doing business with them to engage in green practices, which brings green leases into play. “There are requirements imposed by some government agencies that their government contractors—it might be defense contractors or it might be widget suppliers—engage in green operations,” Teitelbaum said. “To some extent it’s a green-washing, check the box thing. But green leasing is a way to satisfy some of these desires to be green, needs to be green.”

Green Leasing: ‘De Rigueur’

Marie Coleman, spokesperson for the United States Green Building Council (USGBC) discusses green leasing.

BNA: How would you define a green lease?

Coleman: There is no industry consensus or mutually agreed-upon template for what a green lease should look like. USGBC has created an integration guide entitled *Green Office Guide: Integrating LEED (Leadership in Energy and Environmental Design) into Your Leasing Process*, which focuses on having tenants and landlords collaborate and integrate green decisionmaking.

Under these guidelines, we have determined a green lease to be one that considers, but is not limited to:

- Building site selection;
- Office suite and/or building build-out;
- Operations and maintenance policies (including custodial practices and waste management); and
- Energy, water, and resource use.

BNA: We understand that a green lease should have a gross lease format, with an appropriate escalation clause and expense stop clause to reward landlords for operating a high-performance building.

Coleman: Yes, probably the most important part of the green lease is [to ensure] that both the landlord’s and tenant’s needs and wishes are being met, with compromises made in support of environmental and financial benefits.

BNA: How can a green lease increase a building’s value?

Coleman: Even having one tenant . . . [with] a LEED-certified space can increase the value of the building. Green buildings have higher occupancy and rental rates. It [allows the landlord to earn] a premium on rental rates, [and] is an incentive to implement some green upgrades throughout the building, all of which have returns associated with them. Additionally, in today’s socially conscious climate, minimum levels of green operations and maintenance [are] de rigueur for companies and buildings.

BNA: Will green leasing become mandated, and if so, how soon?

Coleman: Most likely not.

Mandates and policies also have induced government agencies that need to rent space in privately owned buildings to sign green leases, but Teitelbaum said it is not always clear what those policies mean. “There are government agencies that are required as tenants in private-sector buildings to lease only in buildings that are green. Does that mean it has to be operated green or only certified built green? That’s an issue too,” said Teitelbaum.

Private companies are also getting into the act with their own green policies and practices. “There are some companies, like, ironically, Honda and Toyota, British Petroleum, who are building green facilities for themselves. And now they have corporate policies that they want to be green,” Teitelbaum said. “Much of the impetus has been coming from the tenant side because there are institutional tenants that, as a matter of corporate or governmental policies, require it.”

Capital Expenses in Green Leases. Teitelbaum said that for the most part, integrating green provisions into leases for tenant or landlord clients should not pose any more difficulty than writing up a standard lease contract. “Mostly it’s just adding these concepts to a regular lease,” he said.

The question of who pays for green capital improvements, which normally fall to the landlord, when the upgrades create significant savings for tenants is generating discussion.

Teitelbaum gave one example that might come up: “Normally, if the landlord puts a new roof on the building, the tenant doesn’t pay. That’s a capital expense for 20 or 30 years. What if the landlord says, ‘I want to put in a new roof but it’s going to be a green roof,’ or a white reflective roof instead of the standard black tar.” In such a case, a green or white roof would generate significant savings to the tenant through decreased air conditioning usages. “Does the tenant pay for that roof because it’s green, or is that a capital improvement that the tenant does not pay for? Or they are going to replace all the bathroom fixtures with low-flow fixtures. Not only who pays for it, but who reaps the benefits from the presumed costs savings that come from more efficient operations.”

Teitelbaum said lease provisions to address these issues, called “split-incentives,” could raise significant issues during negotiations between tenants and landlords.

More Education on Green Leasing Needed. A lack of landlord and tenant education is also a significant impediment to the adoption of green lease provisions. Teitelbaum said energy usage caps that some green building landlords try to implement end up being “meaningless” because that tenants demand the caps be set far in excess of what they will ever need.

He gave one example: “For office lighting, the LEED guidelines call for 0.85 watts per square foot. I saw a lease in a green building which said the tenant would be restricted to 2 watts per square foot for lighting, more than double the guidelines, and apparently they had a big fight about that because the tenant thought that was ridiculous.”

Teitelbaum said this situation will change in time, as more landlords and tenants are exposed to the practice. “Right now there is a lot of leasing in green buildings, but not necessarily green leasing. They are using the same lease forms that they use for their standard build-

ings, and their attitude is that it's a green building and I'm done with green," explained Teitelbaum. "There is a lot of educational [deficit], and you say to yourself, without being an electrical engineer, how do you debate this? And people will learn it over time, I will assume."

One area that seems to be moving faster toward making green leasing the norm sooner than everyone else is Washington, D.C.

In cities like Washington, Teitelbaum said, "You see more people being interested in it because it's a competitive market where everyone is trying to one-up the other. And so the landlords are getting interested in it because it's something they see coming at them," Teitelbaum said, noting that the District government requires office and commercial buildings to report their Energy Star rating.

"It's a bit of a public shaming technique, because then they'll publicize it and everyone will know," Teitelbaum said. "So then the landlords will be motivated to reduce energy usage so their Energy Star rating goes up, and they'll look better in the comparison list."

But Teitelbaum said most other cities are lagging far behind Washington in adopting green leasing practices. "In other cities, no one has even heard of this. It's not

even a glimmer on the horizon, they're just not ready for it yet."

Possible Incorporation of Green Leasing to LEED. Teitelbaum also said the possibility that the USGBC will begin to incorporate a building's continuing energy usage into its LEED standards might start to spur more green leasing efforts.

"[USGBC] is thinking about now tracking energy use in newly certified buildings, and then they're going to evaluate the data, because they've been roundly criticized that these buildings are not energy efficient," Teitelbaum said. The Council will evaluate the data and decide whether LEED buildings should provide a requirements for compliance with certain energy standards, he said.

Teitelbaum stressed that landlords should be thinking about incorporating green provisions into their leases now because after a lease's execution, it will be very hard, if not impossible, to enforce green practices that aren't already included in the lease contract. "This is possibly coming, and if you don't anticipate it, and it is implemented, it is too late to foist it on your tenants," Teitelbaum said. "Their leases don't require them to cooperate."

By ERIC TOPOR