Green Building Leasing Issues

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Commercial leases aren't very green yet. But they will be, so be ready for the change.

THE PAST FEW YEARS have witnessed an exponential growth in green buildings. According to recent studies, total green building space has been growing at a 50 percent compound rate since 2000. At the end of 2008, there were 1750 "certified" green buildings and another 13,500 projects underway that were committed to achieve green building status.

The momentum toward green buildings is a result of local government mandates, aspirational goals of corporate tenants, and the growing number of institutional investors looking to invest in green buildings.

In many ways, green buildings may become as important to the real estate industry as elevators and air conditioning were in the 20th century. Green buildings are slowly redefining what constitutes a "Class A" office space. As a result, owners and investors of conventional buildings have become concerned that they may soon be perceived as holding obsolete or inefficient buildings that will be at a competitive disadvantage as green buildings become the preferred choice of tenants.

Environmental benefit is not the only reason why building owners and tenants are turning to green buildings. Because of greater efficiencies, green buildings have lower operating and maintenance costs over the life of the building. At the same time, studies have shown that

Leadership in Energy and Environmental Design (LEED)-certified buildings were able to command rent premiums of $11.24 per square foot over conventional buildings and had a 3.8 percent higher occupancy rate. Moreover, LEED-certified buildings sold for an average of $171 more a square foot than comparable conventional buildings.

Most of the earlier green buildings were owner-occupied. The past few years have seen a trend toward investor-owned buildings. This trend toward non-owned occupied green buildings brings with it a host of novel legal contractual issues that are not customarily addressed in commercial leases. This article will review some of the more common issues that need to be covered in leases for green buildings.

The building sector is the largest source of carbon emissions when direct emissions and energy-related emissions are taken into account. Buildings also consume the most energy in the United States of any sector, with residential and commercial buildings responsible for 39.4 percent of the total energy consumed in the United States.

WHY GREEN BUILDINGS? • Since the advent of environmental regulation in the 1970s, the focus of federal and state environmental programs has been primarily on industrial and manufacturing facilities that emit significant quantities of pollutants. To the extent that commercial and residential buildings came under the regulatory microscope, it was usually due to the presence of damaged asbestos, lead-based paint, or leaking underground storage tanks.

Buildings Consume Most Of The Energy

Buildings, though, have a significant impact on the environment. The building sector is the largest source of carbon emissions when direct emissions and energy-related emissions are taken into account. Buildings also consume the most energy in the United States of any sector with residential and commercial buildings responsible for 39.4 percent of the total energy consumed in the United States. Residential buildings account for 54.6 percent of the energy consumed by the building sector. Annual Energy Review 2005. DOE/EIA-0384 (2005). Energy Information Administration, U.S. Department of Energy, July 2006, available at http://tonto.eia.doe.gov/FTPROOT/multifuel/038405.pdf. Most of the energy used for residential buildings is for space heating (30 percent), followed by water heating (12 percent), lighting (12 percent) and air conditioning (11 percent). Energy Information Administration 2004, 2001 Residential Energy Consumption Survey: Housing Characteristics Tables, available at www.eia.doe.gov/emeu/recs/recs2001/detail_tables.html. In the commercial sector, most of the energy is used for lighting (21 percent), followed by space heating (12 percent), air conditioning (9 percent) and office equipment (8 percent). Energy Information Administration 2002, 1999 Commercial Buildings Energy Consumption Survey: Consumption and Expenditures Tables, p. 124, table C1, available at www.eia.doe.gov/emeu/cbecs/pdf/C1.pdf.

Buildings Use Most Of The Electricity

Buildings also account for 67.9 percent of the electricity consumed in the country with residential structures responsible for 48.8 percent of the total electrical demand. 2003 U.S. DOE Buildings Energy Data Book, available at http://buildingsdatabook.eren.doe.gov/docs/DataBooks/2003_BEDB.pdf. The energy used to heat and power buildings leads to the consumption of large amounts of energy, primarily from burning fossil fuels with 58 percent of the building end-use energy coming from fuel that is burned on-site.

Buildings Responsible For Much Of The CO2

The large amount of energy required by buildings generates significant amounts of carbon dioxide (CO2). Nationwide, commercial and residential buildings account for 38.1 percent of the nation's CO2 emissions (approximately 2,521 metric tonnes). EIA Annual Energy Review 2005, U.S. Energy Information Administration, U.S. Department of Energy. Residential buildings are responsible for 20.6 percent of the total CO2 emissions. U.S. Environmental Protection Agency, Inventory of U.S. Greenhouse Gas Emissions and Sinks: 1990-2006. It is estimated that CO2 emissions from buildings will grow at a rate of 1.8 percent annually until 2030, faster than any other sector. *Emissions of Greenhouse Gases in the United States*, U.S. Energy Information Administration, U.S. Department of Energy, November 2007, available at www.eia.doe.gov/oiaf/1605/archive/gg07rpt/pdf/057306.pdf.

In densely populated cities, buildings can be responsible for close to 80 percent of total GHG emissions. Indeed, a 2007 study by the New York City Office of Long-Term Planning and Sustainability calculated that the city's 950,000 buildings are responsible for 79 percent of the city's total greenhouse gas emissions.

Buildings Responsible For Other Greenhouse Gases

Buildings may be associated with the release of other GHGs. For example, buildings are estimated to be responsible for seven percent of methane emissions from disposal of construction and demolition debris in landfills and incomplete combustion of wood in fireplaces and stoves. EIA, 2003 Emissions of Greenhouse Gases in the United States 2002, DOE/EIA-0573 (2002), available at www.eia.doe.gov/oiaf/1605/archive/gg03rpt/pdf/057302.pdf. The extraction and manufacturing of building materials may also generate greenhouse gas emissions. Buildings also require enormous amounts of raw materials. It is estimated that buildings use 40 percent of raw materials globally (three billion tons annually). Lenssen and Roodman, 1995, *Worldwatch Paper 124: A Building Revolution: How Ecology and Health Concerns are Transforming Construction*, Worldwatch Institute. It is estimated that 49 percent of sulfur dioxide emissions, 25 percent of nitrous oxide, and seven percent methane come from buildings.

Water Consumption And Waste

Building-related environmental impacts are not limited to GHG and energy, though. Moreover, buildings use 12 percent of the potable water, with residences responsible for 74.4 percent of that total. *See* www.epa.gov/oaintrnt/projects. EPA estimates that 136 million tons waste is generated from the construction, remodeling and, demolition (C & D) of buildings which accounts for approximately 35 percent of all non-industrial waste. Available at http://www.epa.gov/osw/nonhaz/municipal/pubs/msw07_rpt.pdf. *See also* U.S. EPA Characterization of Construction and Demolition Debris in the United States, 1997 Update Of the three waste streams, 48 percent of C & D comes from demolition, 44 percent from renovation, and only eight percent from new construction. Forty-three percent of the C & D waste is generated from residential sources. The most recent statistics suggest that between 20 and 30 percent of C & D debris is recovered for processing or recycling. The most common building materials that are recovered or recycled are concrete, asphalt, metals, and wood. *Characterization of Building-Related Construction and Demolition Debris in the United States.* EPA Office of Solid Waste, June 1998, available at www.epa.gov/osw/hazard/generation/sqg/c&d-rpt.pdf.

Runoff

Buildings and the transportation infrastructure that serves them replace natural surfaces with impermeable materials, creating runoff that washes

pollutants and sediments into surface waters. Urban runoff constitutes a major threat to water resources, as it has been identified as the fourth leading source of impairment in rivers, third in lakes, and second on estuaries.

Indoor Air Pollution

According to EPA, Americans spend approximately 90 percent of their time indoors yet levels of indoor air pollutants typically average two to five times the concentrations found in the ambient or outside air. EPA also estimates that one out of every 15 homes have radon concentrations exceeding the recommended action level. *A Citizen's Guide to Radon* (Jan. 2009), www.epa.gov/radon/pdfs/citizens-guide.pdf.

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LOCAL GREEN BUILDING INITIATIVES • It is projected that approximately 15 million new buildings will be constructed by 2015 and that if just half of new commercial buildings used 50 percent less energy the reduced CO2 emissions would be equal to removing 1 million cars from the roads each year. *Landmark Program to Reduce Energy Use in Buildings,* William J. Clinton Foundation. See www.clintonfoundation.org/news/news-media/051607-nr-cf-fe-cci-extreme-makeover-green-edition. It is not surprising, then, that state and local governments that have announced ambitious goals to reduce their greenhouse gas emissions and mitigate the impacts of climate change have turned their attention to the environmental impacts of buildings. However, these emission reduction initiatives will not achieve their objectives if they simply focus on newly constructed public buildings.

The Need For Retrofitting

According to the latest census data, there are over 120 million residential buildings and over five million office buildings. Approximately 1.8 million residential buildings and 170,000 commercial structures are constructed annually while 44,000 commercial buildings are demolished each year. The vast majority of buildings in existence today will still be in use in 2015. At the current pace, 85 percent of the existing building stock will still be in existence by 2030. By mid-century, half of the building stock will still be in use. Thus, retrofitting and upgrading the efficiency of building mechanical systems will be necessary to achieve significant improvement.Marilyn A. Brown, Frank Southworth, and Therese K. Stovall, *Towards a Climate-Friendly Built Environment,* Pew Center on Global Climate Change 2005, available at www.pewclimate.org/docUploads/Buildings_FINAL.pdf. The first wave of local green building programs focused on new public buildings. As cities have begun to implement their green building initiatives, they have begun to realize that they will be unable to achieve their greenhouse gas reduction goals by imposing green building standards on new construction projects. As a result, the newer local green building initiatives are starting to require retro-commissioning or retrofitting of existing private buildings. The thresholds and performance standards vary with the jurisdiction.

Initiative Mechanisms

The local green building initiatives are implemented using a variety of mechanisms including local ordinances or regulations, guidelines, executive orders, resolutions, building codes, energy

codes, zoning as well as CCRs for planned development communities. The local green building programs vary on thresholds, level of green compliance, implementation schedules, documentation and certifications. Likewise, the remedies for non-compliance can range from stop orders to loss of financial benefits.

Some local governments have voluntary or incentive-based programs instead of mandatory green building programs. The local incentives include expedited permitting or review of discretionary entitlements, density or floor area ratio bonuses, fee waivers or rebates, utility or energy efficiency rebates, technical assistance, leasing assistance, and public recognition. Many local governments have also enacted financial incentives such as property tax abatements, grants, and loans. Likewise, many states have enacted varying types of corporate and personal income tax credits and deductions, as well as sales tax exemptions, to incentivize the use of energy efficient or renewable power equipment. Some states also offer a variety of grants or low-interest loans to encourage the use and development of renewable energy technologies.

GREEN BUILDINGS STANDARDS • Sustainable or "green building" refers to the practice of designing, constructing, operating, maintaining, and replacing buildings in ways that cut energy use, conserve natural resources, and reduce greenhouse gas emissions. There are no uniform federal or state standards for what constitutes a "green building" or "high performance building" (HPD). A number of private consensus standards systems have been developed over the past few years that serve as performance standards for green buildings. These consensus standards vary in scope and certification procedures. The most widely accepted green building rating systems are the following:

- Building Research Establishment's Environmental Assessment Method (BREEAM);
- Comprehensive Assessment Systems for Building Environmental Efficiency (CASBEE);
- GBTool;
- Green Globes U.S.;
- Leadership in Energy and Environmental Design (LEED), and
- Green Communities Criteria 2008.

The federal, state, and local governments' green building programs tend to reference one or more of these consensus standards. Approximately 75 cities incorporate the LEED rating system by the United States Green Building Council (USGBC). Under the LEED system, commercial and residential developers register their buildings and obtain certification upon completion of the projects. There are a number of LEED rating systems. The ones most relevant to this article are new construction (LEED-NC), existing buildings operation and maintenance (LEED-EBOM), commercial interiors (LEED-CI), and building core and shells (LEED-CS).

LEED Certification

There are four levels of LEED certification that are based on the points accumulated:

- For LEED Certified, the project must achieve 26-32 points;
- The LEED Silver designation requires 33-38 points;
- LEED Gold requires 39-51 points; and
- LEED Platinum requires 52-69 points.

Certification is based on a point system for achieving benchmarks in six areas:

- Sustainable site development;
- Water savings;
- Energy efficiency;
- Materials selection;
- Indoor air quality; and

- Innovation and design.

Each category contains a range of various points that are available. Depending on the particular LEED rating system being used, projects must achieve certain minimum performance standards known as prerequisites for which no points are awarded but that must be achieved to satisfy the category. The project may earn points for various subcategories that go beyond the required prerequisites for the particular environmental category.

Green Globes And ENERGY STAR

Some local programs also use the Green Building Initiative's Green Globes program. Users may achieve from one to four "globes" of certification based on points accumulated in seven categories.

Another option for building owners interested in receiving environmental recognition is ENERGY STAR program for new homes and commercial buildings. (The program is jointly administered by the EPA and the U.S. Department of Energy.) The program scores the performance of industrial and commercial buildings on a scale of 1 to 100 based on similar types of buildings. A rating of 50 indicates that energy performance is average compared to similar buildings, while a rating of 75 or better indicates top performance and makes a building eligible to earn the ENERGY STAR label. This rating system accounts for weather variations as well as changes in key physical and operating characteristics of each building. Many local green building programs require the use of ENERGY STAR appliances and consumer products.

Incorporating Green Building Standards Into Building Codes

Another approach many local governments are using is to incorporate green building standards into their building codes. Most of the codes adopted by state and local governments set minimum standards for safe occupancy and to protect individuals from substandard living and working conditions. All building codes generally reflect a consensus of current design and construction practice.

Establishing Energy Codes

Because the greatest opportunity for making buildings more efficient is during the construction stage, many states have imposed energy efficiency requirements in building codes or have adopted energy codes.

Unlike building codes, energy codes are not established to protect the immediate health and safety of the building occupants. Instead, they provide general benefits by reducing energy consumption. Energy codes most commonly address wall and ceiling insulation, window and doors specifications, lighting fixtures and controls, as well as Heating, Ventilation, and Air-Conditioning (HVAC) equipment efficiency. The codes will refer to standards developed by professional organizations such as the Standard 90.1 jointly developed by the American Society of Heating, Refrigerating, and Air-conditioning Engineers, Inc. (ASHRAE) and the Illuminating Engineering Society of North America (IESNA).

Energy Code Compliance

Energy code compliance is measured in two ways:

- The most common is the prescriptive approach where a building must be constructed to the prescribed insulation and other values found in the code. Trade-offs may be allowed between certain building components that have different energy performances to provide a degree of flexibility;
- The alternative method of compliance is a performance standard that gives the building an energy budget (total allowable energy use), and uses (for example) a combination of different insulation values and equipment efficiencies to achieve this budget. The overall energy perfor-

mance of the building is what is measured. For example, a builder can use less insulation but a more efficient furnace to meet the allocated energy budget for the particular structure.

Under the Energy Policy and Conservation Act (EPCA), states are required to adopt the most recent version of ASHRAE Standard 90.1 that the Department of Energy (DOE) has determined will save energy. Alternatively, states can follow the commercial building provisions of the International Energy Conservation Code (IECC). Many state building or energy codes reference the ASHRAE/IESNA Standard 90.1 or the IECC. ASHRAE Standard 90.1 applies to all buildings except residential buildings less than three stories and provides minimum energy efficient design for new buildings as well as major remodeling or renovation in existing commercial buildings. ASHRAE Standard 90.1 is itself written in "code language" so that it is suitable as a mandatory code document. The first edition of ASHRAE Standard 90.1 was published in 1975 and revisions were approved in 1980, 1989, 1999, 2001, and 2004 (ASHRAE Standard 90.1-2004).

A "green lease" is a commercial lease that has been revised to clarify the specific green building requirements that are to be attained, to allocate the obligations and rights for achieving and maintaining the green building requirements, and to identify remedies or consequences for failing to comply with the various green building requirements.

The International Energy Conservation Code (IECC) is part of the family of International Codes developed by the International Code Council, a widely recognized building code development organization. The IECC is applicable to all residential and commercial buildings and provides the minimum energy efficiency provisions for residential and commercial buildings. The code contains building envelope requirements for thermal performance and air leakage while making allowances for different climate zones. Because it is written in mandatory, enforceable language, state and local jurisdictions can easily adopt the model as their energy code. The first IECC was released in 1998, followed by versions that produce even greater energy savings: the 2000 IECC with its 2001 supplement and the 2003 IECC with its 2004 supplement. The most current version is IECC 2006. The IECC commercial building energy codes are based on ASHRAE/IESNA Standard 90.1.

It has been estimated that the IECC 2006 could increase energy efficiency by 30 percent in residential and commercial buildings while ASHRAE 90.1-2004 could reduce energy consumption in commercial buildings 30 percent below current standards. As of July 2008, though, less than half the states have adopted the most energy-efficient codes for commercial or residential buildings.

Be Careful About What "Green" Really Means

It should be noted that because of the flexibility of most green building rating systems, a building with poor energy efficiency can be certified as "green." Since energy-related points may not be required by a particular green rating system, it is important to evaluate how the property was rated on energy. Additionally, since green recognition is often given to a building before it is fully occupied and commissioned, it is important to determine if the fully commissioned building actually operates at or achieves its design efficiency.

GREEN BUILDING LEASE ISSUES • Commercial leases govern the relationship of the landlord and tenant, and impose standards governing

the conduct of the parties. The landlord who controls the building shell, common areas, and operations is usually required to operate a "first class" building or act as a prudent landlord.

A "green lease" is a commercial lease that has been revised to clarify the specific green building requirements that are to be attained, allocate the obligations and rights for achieving and maintaining the green building requirements, and to identify remedies or consequences for failing to comply with the various green building requirements. Some building owners incorporate the green building provisions in an exhibit to their standard form commercial lease while others have revised the body of the standard form leases on a clause-by-clause basis.

Identification Of Green Building Requirements

The first generation of green building agreements often adopted a simplistic approach and usually just referred to a particular LEED standard. However, LEED is not the only acceptable green building standard. Moreover, green building standards are rapidly evolving. In addition, a building owner or tenant may have adopted certain sustainability or green building policies that may go beyond or incorporate only aspects of the green building consensus standards. As a result, a green lease should clearly define the specific green building requirements that must be met:

- **Specific LEED points.** Since the LEED ratings have mandatory and voluntary points, there are numerous paths to achieve a particular LEED rating. Accordingly, it may not be sufficient for a lease to simply provide that a building or tenant space will achieve LEED Silver. Instead, the lease should refer to the particular mixture of points that will satisfy the particular needs or goals of the parties. For example, the federal General Services Administration (GSA) green lease solicitation for offers (SFO) specifies eight LEED non-mandatory points that must be achieved. For LEED-CI tenant spaces, the building must achieve an ENERGY STAR Score of 75 or higher. In addition, the GSA SFO has specific language involving building proximity to public transportation and amenities, recycling of categories of construction waste, landscaping materials meeting specified recycling content, specifications and prohibitions for certain building materials, use of biodegradable cleaning products, etc;
- **Renovations.** The lease should also set forth the thresholds for renovations that will trigger compliance with green building requirements such as square footage of a tenant build-out. In many cases, this will be governed by a local green building program. For example, the GSA SFO requires compliance with LEED-NC for all leases construction and renovations of 10,000 rentable square feet. The SFO provides that tenant spaces that are to comply with LEED-CI must obtain certification within nine months of occupancy;
- **Design elements.** The lease should specify any design elements that are considered essential. If these features involve common area improvements, the lease should obligate the landlord to maintain them throughout the lease term;
- **Local standards.** It is important to know that the building standards increasingly being incorporated into local legal requirements are often amended to reflect local environmental priorities. Many western states concerned about water supply constraints have imposed minimum water usage, recycling, or stormwater runoff requirements that may exceed minimum LEED requirements. Likewise, some jurisdictions are requiring more stringent energy efficiency;
- **"Permitted use" restrictions.** Many green leases have provisions in the "permitted uses" clause that prohibits the tenant from using the

leased premises in a manner that does not conform with the building owner's green building requirements, its third-party certification, or sometimes for uses that consume excessive energy or other demands on the premises or common areas;

- **Withholding consent.** Standard commercial leases provide that a tenant is prohibited from assigning or subleasing its space without obtaining landlord consent, which consent may not be unreasonably withheld. Some green leases amend this clause to provide that the landlord may withhold consent if the proposed tenant would not comply with the green building requirements;
- **Eligibility for tax credits.** When a building owner or tenant is seeking tax credits or qualifying for carbon credits, the lease should specify the level of design or operating requirements that would be necessary to maintain eligibility for that benefit. Accordingly, it is critical to be familiar with the specific requirements of any local green building program and to incorporate any local modifications into the lease;
- **Agreed-upon "certification."** In some cases, the parties may not want to pursue the costs of third-party certifications. If such certifications are not required by a local building code or green building program, the parties could agree that the building or tenant space be "certifiable" to a certain standard.

Operating And Capital Expenses: The Split Incentives Problem

Typical commercial leasing arrangements do not do much to encourage green practices. Most multi-tenant commercial leases are structured as "net" leases, in which the tenant pays a base rent plus separate charges for operating costs such as utilities and taxes. Because the net lease effectively transfers the risks of operating costs to tenants, landlords have little incentive to make energy efficiency or other environmental investments in the building. Likewise, tenants may have little incentive to reduce energy because monthly utilities often represent a very small part of a tenant's expense. Since operating costs are shared by all tenants, a tenant might not enjoy financial benefits from implementing energy efficiency measures if other tenants are not being efficient.

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Landlords Usually Can't Pass Along Costs Of Green Improvements

Under traditional net leases, landlords are usually responsible for paying for capital expenses though some newer forms of leases may allow a landlord to pass through capital improvement costs that lower operating expenses or are required by law. However, standard leases do not normally authorize building owners to pass along the costs of investments that simply improve the environmental performance of the building, comply with nonmandatory government sustainability "guidelines," or achieve a private consensus standard.

There has also been some concern over the "green cost" premium and how that impacts a building owner's return on investment (ROI). It is generally true that green buildings are initially more costly than conventional buildings. The split incentives problem can cause both building owners and tenants to focus on the so-called "first-cost green premium" and not consider "total life-cycle costs." Even if a lease allows a landlord to pass along such costs as a permitted capital cost, it would be unable to recover its costs in the year they

were incurred because most leases typically require the capital costs to be prorated over some period of time. Moreover, it likely does not allow recoupment of operating and maintenance costs associated with LEED-EBOM. Thus, landlords usually do not have incentive to make these improvements especially when the tenant would benefit from any resulting efficiencies.

Questionable Benefits For Tenants

According to a recent McKinsey report, market distortions provide disincentives for building owners and occupants to make energy-efficient investments in residential buildings. For example, a person renting an apartment may use appliances that consume a lot of electric power but the landlord has little incentive to buy more efficient appliances because the tenant pays the electricity bills. Likewise, renters have little incentive to buy energy-efficient appliances that will have to be left in the apartment upon vacating it.

One Solution: The Gross Lease

A green leases tries to better align the financial interests of both the tenant and landlord. One way to accomplish this is to return to a gross lease in which the operating costs are built into a lease so that owners would have an incentive to lower operating costs since this would increase net operating income.

Re-Thinking The Net Lease: Operating Expense Provisions

Since net leases are used in most jurisdictions, landlords will need to revisit the operating expense provisions in their leases to determine whether the language must be revised to enable them to pass along costs associated with the proposed legislation. An approach to incentivize owners of existing buildings to undertake retro-commissioning or retrofitting would be for the parties to agree that the capital costs of energy-efficient or other environmentally related improvements be allocated to the operating expense component or otherwise be passed along to the tenant. This could be acceptable to tenants looking to secure a five- or ten-year leases or leases with options to renew.

Individually Meter Tenant Spaces

Perhaps the better approach, though, may be to provide for individual metering of tenant spaces so that the building owner and tenant could each obtain the benefits of lower energy consumption. Building owners may find this arrangement impractical unless all tenants are to be separately metered. Non-metered tenants may resist individual metering because of the costs and because such a change might increase the proportionate costs of non-metered tenants. Tenants that are individually-metered should seek the right to audit the landlord's energy records.

Amortize Other Green-Related Costs

A landlord may incur other costs associated with operating a green building, such as certification or recertification fees associated with green building rating systems, commissioning costs, and the cost of insurance policy premiums and deductibles for the replacement of damaged building components related to the green building requirements of the lease. Other costs that could be amortized could include those associated with modifying or upgrading energy and water conservation equipment and systems as well as developing, modifying, and operating the building to achieve the objectives of the environmental management plan.

Carbon Offset Credits For Landlord

Some green leases provide that a landlord will be entitled to all carbon offset credits that may be created or recoverable because of activities inside the building unless applicable law limits the credits to the tenant. The lease could also allow the land-

lord to pass along any carbon tax as an operating expense.

Amortize Costs Passed Along To Tenant

From a tenant's perspective, any such costs that are passed along should be amortized so that the tenant pays only the portion of the cost for the period of time that it occupies the premises and enjoys the benefit of the improved efficiency or enhanced environmental performance. The tenant may also want to limit its obligation to pay for improvements that actually result in lower energy use as opposed to systems that are intended to do so but may not actual achieve the projected savings. Once again, this re-emphasizes the need to be able to audit the owner's records.

Benchmarks And Performance Targets

The lease should describe specific performance-related benchmarks or targets that should be attained. These typically involve setting targets to reduce energy consumption, water consumption, and increased waste recycling In many cases, the specific requirements may be set forth in an separate exhibit to the lease or in the building rules and regulations (see below). The lease could establish procedures for retaining a qualified consultant to independently verify compliance with the targets and benchmarks.

Tenant Alterations And Repairs

Commercial leases will allocate responsibility for initial build-outs to either the tenant or the landlord. To the extent that the owner or a tenant has established internal green building goals, the standard that has to be achieved (e.g., LEED-CI) should be clearly described.

Standard leases also provide that a tenant shall not make alterations or additions to the leased space. Often, the leases may impose requirements on tenants that would prevent compliance with green building standards such as requiring new materials as opposed to recycled materials.

One of the difficulties encountered by building owners is that they may not have control over tenant build-outs that could affect certification. Thus, a building owner may want to require the tenant to comply with its green building requirements. For example, the lease could require that building materials contain a certain percentage of used recycled or recyclable materials, that the space meets certain natural sunlight minimums, or uses low-VOC emitting materials. Often, the landlord will seek a pre-work statement from the tenant that describes how the proposed work will comply with the green building requirements.

Likewise, when the landlord is doing the build-out or a renovation, a tenant will want to ensure that the work complies with its green building requirements such as LEED-CI.

Landlord Right Of Entry And Inspection

Most commercial leases limit the right of the landlord to access the leased premises to such situations as emergency, to inspect building systems on prior notice, and to carry out any repairs to the premises deemed necessary or desirable by the landlord. A green lease should not limit the landlord access to situations in which damage has occurred but to allow the building owner to gain access to verify environmental compliance with mandated green building requirements.

Building Rules And Regulations

In general, landlords cannot unilaterally amend lease terms without consent of the tenant. However, commercial leases typically require tenants to comply with building rules and regulations and may allow the landlord to change the rules and regulations without first obtaining the tenants' consent. In theory, such a clause could allow a landlord to implement green building requirements that would apply to existing leases by changing its rules

and regulations. However, like all contracts, owners have an obligation to act reasonably under their leases and imposing costly new green requirements that do not benefit the tenant through the building rules and regulations could be challenged by the tenants.

One way for a landlord to get around this issue would be to insert a reservation of rights that would allow the landlord to create and implement a building green building or sustainability plan in the future that would apply to existing tenants.

Green leases attempt to address this issue by specifying specific restrictions and compliance with minimum green building requirements. The building rules and regulations can be used to specify the particular design and operating requirements that must be met. Typical issues that are covered include:

- Complying with building procurement policies for low-impact environmentally friendly products;
- Use of waterless urinals and low-flow faucets or taps;
- Energy conservation/efficiency targets including use of ENERGY STAR appliances;
- Specifications for HVAC systems;
- Use of renewable energy;
- Use of screens to shield sunlight;
- Compliance with building recycling practices;
- Indoor air quality standards;
- Scheduling janitorial services to be performed during normal work hours to save lighting costs or providing for a premium charge for cleaning services cost performed after normal business hours.

Defaults, Breaches, And Remedies

If a third-party certification will be required, the lease should specify a time period for obtaining such certification. The lease should also indicate if the certification is a one-time obligation (e.g., obtain LEED-CI within nine months of occupation) or an ongoing covenant. If the obligation is ongoing, the lease will have to specify the frequency of recertification (e.g., obtain LEED-O&M certification five years after LEED-CI certification).

It is also important to define what constitutes a default of a green building requirement and the consequences of such a failure. For example, a project could lose its financing, eligibility for tax credit or grant, a zoning variance, or be unable to obtain a certificate of occupancy if a certain green standard is not achieved within the timeframe set forth in the lease.

It is important to determine the materiality of a breach. If the primary concern of a tenant was to achieve an energy-efficient space, then the failure to obtain a certain LEED rating may not necessarily be a material breach since the building may still be energy efficient. In most cases, the "nuclear option" of lease termination is probably not a reasonable remedy, and self-help may be impractical. The best solution may be a negotiated economic penalty such as a rent abatement or increased rent if a tenant space exceeds certain energy demands or water consumption.

The parties may want to negotiate "cure" provisions to provide a reasonable time period to correct the deficiency. For example, if a project does not obtain its LEED targeted points, the registrant can appeal under USGB protocols. Counsel should also review grace and appeal periods in government green rules and regulations especially when a local program simply refers to the LEED standard but does not provide specifics.

Disclosure And Diligence Issues Associated With Green Buildings

Following the old adage that "sunshine is the best disinfectant," many local green building programs are requiring building owners to disclose the energy efficiency of their buildings. Perhaps the most far-reaching or at least most significant local disclosure requirement to date is California's AB

1103, Cal. Pub. Res. Code §25402.10, which becomes effective January 1, 2010. This law not only requires building owners to participate in the ENERGY STAR program for commercial buildings but also mandates building owners and their agents to disclose the energy performance of the building to buyers, lessees, and lenders.

Two sources of energy efficiency information will be available:

- First, building owners will be required to maintain records of energy consumption. The information is to be uploaded in a format compatible with the EPA's ENERGY STAR Portfolio Manager (Portfolio Manager);
- Second, owners must provide certain building-specific information such as the type of building structure, type of activity in the building, gross floor areas, number of workers occupying the building, percentage of air-conditioned space, operating hours, description of particularly heavy energy-using equipment (refrigeration, large electrical equipment), and other items. The Portfolio Manager will use this information to create the building energy star rating.

Disclosure of environmental issues is always a concern of property owners so it is not surprising that building owners are concerned about mandatory green building disclosure. The most obvious concern is the impact on the value and marketability of a building, especially for less energy-efficient buildings. On the other hand, owners of green or energy efficient buildings may find that the lower operating costs and higher rents that green buildings are attracting could result in more favorable financing — a particular concern in these challenging economic times.

Do The Disclosure Requirements Create Liability For Sellers?

It is unclear if these disclosure requirements create any additional liability for sellers. In some jurisdictions, these laws specifically state that they do not enlarge or alter the liabilities of building owners or their agents for non-disclosure or misrepresentation. In other jurisdictions, the mandatory disclosure may simply serve as a run-of-the-mill building code violation or result in specific statutory violations. It should be noted that the Phase 1 environmental site assessments that are frequently used for real estate transactions are focused on liability associated with releases of hazardous substances and petroleum, and will not take climate change into account unless specifically required in the scope of work.

Other Disclosures And Inquiries

Additional areas of inquiry and disclosure include the following:

- Particularly for existing buildings, purchasers, tenants, and lenders may want to determine if a local government has established green building requirements, if the particular building is subject to local GHG requirements or will be subject to such standards in the future, the implementation schedule of the future requirements, and evaluate the costs of such compliance to determine if the purchase price should be adjusted to reflect those future costs;
- Purchasers or tenants of buildings marketed as a green building will want to verify the certification;
- Owners of buildings that will be subject to renovation upgrades who either plan to modify their buildings after the closing or who have tenants planning substantial renovations will want to ensure that the modifications comply with the applicable green building requirements;
- Lenders will want to know the anticipated costs of such future upgrades so that appropriate building reserves may be established. Building owners will also want to calculate any savings in operating expenses to determine if the pro-

jected savings can result in more favorable loan terms or reduced insurance premiums;

- If a building is not located in a jurisdiction that has adopted a climate change program, the lender might as a condition of the loan require the borrower to make capital investments to reduce the carbon footprint of the building. These costs may not only involve energy efficiency measures but possibly boiler retrofits and pollution control technology;
- For construction loans, lenders or anchor tenants may require developers to covenant that the building will meet certain sustainability standards or certifications, and require third-party verification that the building achieves the intended standard. Already, some banks are starting to provide better loan terms to owners of green buildings. These more favorable terms can include lower interest rates and larger loans as a result of lower operating costs and lower building reserves;
- Landlords may start to inquire about the energy needs of tenants and require energy-intensive tenants such as medical offices to take measures to reduce their energy consumption. Shareholders and members of co-ops and condos may want their buildings to reduce their carbon footprints.

With the growing public and private pressure to reduce GHG emissions and the demand for green buildings, it is would not be surprising if purchasers and their lenders start requiring evaluation of a building's carbon footprint during due diligence. In the not-too-distant future, we may begin to see lenders and building owners performing Climate Impact Assessments or including GHG issues as a non-scope item in the Phase 1 like other environmental issues or perhaps addressing compliance with local climate change requirements in the property condition assessment reports

CONCLUSION • In their current form, most commercial leases do not do much to give landlords or tenants serious incentives to go green. However, as more federal, state, and local regulation moves in the green direction, things that were once optional will become necessary and there will be no choice but to adapt. The net lease model, in which the risks of operating costs are shifted to tenants, gives landlords little incentive to make green investments in their buildings. Likewise, since these leases spread operating costs around to all tenants, individual tenants are not likely to benefit from implementing energy efficiency measures unless other tenants implement such measures. For a commercial lease to be green-friendly, it should be on the gross lease model, in which the operating costs are built into it; or a modified net lease that increases net operating income through green savings, and gives landlords an incentive to invest in them. This creates a long list of new issues that would have to be part of the lease. We have discussed several of them in this article. No doubt there will be many more as we gain more experience with green buildings and local mandates continue to evolve. One thing is certain, though: With a shift in priorities that has assured the future of green buildings, green leasing is a certainty.

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PRACTICE CHECKLIST FOR
Green Building Leasing Issues

• Think about some of the ways to make a commercial lease greener:
__ Individually metering tenant spaces;
__ Amortizing other green-related costs;
__ Providing carbon offset credits for the landlord;
__ Amortizing costs passed along to tenant;
__ Providing environmental benchmarks and performance targets in the lease (e.g., targets to reduce energy consumption, water consumption, and increased waste recycling);
__ Specifying the standard that has to be achieved (e.g., LEED-CI) for tenant improvements and build-outs (e.g., that building materials contain a certain percentage of used recycled or recyclable materials, that the space meets certain natural sunlight minimums, or uses low-VOC emitting materials);
__ Providing the landlord with a right of access and inspection specifically to determine compliance with environmental benchmarks and standards;
__ Inserting a reservation of rights that would allow the landlord to create and implement a building green building or sustainability plan in the future that would apply to existing tenants;
__ If a third-party certification will be required, specifying a time period for obtaining such certification;
__ Defining what constitutes a default of a green building requirement and the consequences of such a failure;
__ Negotiating "cure" provisions to provide a reasonable time period to correct the deficiency.

• Think about areas of disclosure and inquiry in creating the lease:
__ Determine if a local government has established green building requirements, if the particular building is subject to local GHG requirements or will be subject to such standards in the future, the implementation schedule of the future requirements and evaluate the costs of such compliance;
__ Verify that "green" buildings are certified (and that "green improvements" are likewise certified);
__ Calculate any savings in operating expenses from green improvements to determine if the projected savings can result in more favorable loan terms or reduced insurance premiums;
__ For construction loans, require developers to covenant that the building will meet certain sustainability standards or certifications, and require third-party verification that the building achieves the intended standard;
__ Inquire about the energy needs of tenants and require energy-intensive tenants such as medical offices to take measures to reduce their energy consumption. Shareholders and members of co-ops and condos may want their buildings to reduce their carbon footprints.