

**GREEN LEASING**  
**or**  
**THE GREENING OF REAL STATE<sup>1</sup>**

Allen H. Fox, *Partner*  
1875 Pennsylvania Avenue, NW, Washington, DC 20006  
Phone: 202-663-6087  
allen.fox@wilmerhale.com

**Introduction**

Whether or not you believe that the Earth is warming, or that humans caused this change in climate, or that they can reverse it, there is no denying that “Green” is “IN”: green lifestyles, green councils, green buildings, green leases! We are way beyond the days when a somewhat sarcastic developer faced with a Tenant asking, “Is your building ‘Green?’” might respond, “We’ll paint it any color you would like.”

Today we all must take the question seriously, whether the questioner is a potential tenant, an investor, a lender, a governmental agency or a new employee. Green is the wave of the future. AND “Green” in real state means, at one point or another, “Green Leasing,” because leases dictate much of the understanding between landlords and tenants when it comes to the construction and operation of buildings.

**I. What Is a Green Lease?**

- A. A Green Lease is a lease (whether office, retail, mixed-use or other) that:
  - 1. Sets goals or standards for (and eliminates barriers against) the following:
    - a) Reduced consumption of energy. Technically, reduced energy consumption/carbon footprint is the primary goal of green leasing, as reducing climate change and eliminating our dependence on foreign oil is the cause which seems to have the greatest resonance in this field. But most green leases (though not all) also address “sustainability” as a general goal. Sustainable development also addresses:
      - i) Conservation of water and other resources
      - ii) Use of recyclable equipment and products (encouraging reuse of existing facilities when practicable) to reduce or minimize waste and divert waste from landfills

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<sup>1</sup> With apologies to Charles Reich.

- iii) Indoor and exterior environmental quality
    - Use of environmentally friendly cleaning products – low levels of VOCs (volatile organic compounds)
    - No smoking
    - Encourage use of bicycles, mass transit, car pooling, etc.
  - b) Green Leases also provide for commissioning building systems (to assure that they perform at design specifications) and data collection and sharing so that the parties can measure their success or failure to achieve goals
2. Establishes covenants for conformance with the set standards and goals
  3. Creates economic incentives for sustainable practices so, where possible, the party bearing extra cost for achieving sustainability goals realizes cost savings, credits or other benefits of the program.

## II. Why a Green Lease?

- A. There is a growing political awareness of global warming/climate change, which many now believe is caused by greenhouse gases. Reduction of greenhouse gases is also tied to energy independence. Many employers are being pressured by employees to be more environmentally proactive, and many now believe that a green workplace is healthier and improves productivity.
- B. Local jurisdictions are imposing sustainability rules in building codes: dictating conformance with LEED, ENERGY STAR or similar standards for design.

For example, the DC Green Building Act of 2006 and the Clean and Affordable Energy Act of 2008:

1. Set a time table for new publicly owned or leased buildings to achieve ENERGY STAR ratings
2. Set a time table for new privately owned, nonresidential buildings to achieve LEED ratings
3. Permit submetering of electricity



4. Require buildings to benchmark their energy performance

Also consider the new cap and trade legislation being considered on Capital Hill. According to data published by the US Green Building Council, buildings consume 39% of the energy used in the US. Hence, buildings will likely be affected by any new cap and trade program.

Leases of new properties will need to address the rights and obligations arising under these new laws and regulations.

- C. For landlords, there is also the belief, perhaps not yet proven (in part due to economy), that green buildings will realize higher rents and values over the long term.

See Cascadia Green Building Council/Value Study ([www.cascadiagbc.org/news/GBValueStudy.pdf](http://www.cascadiagbc.org/news/GBValueStudy.pdf)); also see RICS (Royal Institute of Chartered Surveyors) Doing Well by Doing Good ([www.rics.org/NR/rdonlyres/44F67595-7989-45C7-B489-7E2B84F9DA76/0/DoingWellbyDoingGood.pdf](http://www.rics.org/NR/rdonlyres/44F67595-7989-45C7-B489-7E2B84F9DA76/0/DoingWellbyDoingGood.pdf))

- D. For tenants, there is a belief that conservation can reduce certain costs of operation.

### III. How Do You Measure Carbon/Energy Reduction and Sustainability?

- A. There are a number of commonly used measures
  1. U.S. Green Building Council's LEED Certification (Leadership in Energy and Environmental Design) ([www.usgbc.org](http://www.usgbc.org))
    - a) LEED is most common in U.S.
      - i) LEED-NC for new construction
      - ii) LEED-EB for existing buildings
      - iii) LEED-CI for commercial interiors
    - b) Sets goals for design of new construction or rehabilitation and provides complying projects with LEED certification: silver, gold, platinum. If the project is over a certain size, a certified professional must be involved.



2. Green Building Initiative's Green Globes ([www.thegbi.org/green-globes-tools](http://www.thegbi.org/green-globes-tools))
  - a) An online program allowing for goals in a number of measures
  - b) Developed in Britain and common in Canada as well, but becoming more common in U.S.
  - c) Does not require participation by a certified professional
3. ENERGY STAR ([www.energystar.gov](http://www.energystar.gov))
  - a) Program created by U.S. Department of Energy and EPA
  - b) Sets standards and measures for conservation of electricity and water
  - c) Certifies equipment
4. BREEAM (BRE Environmental Assessment Method) – U.K.-Based System ([www.breeam.org](http://www.breeam.org))

Like Green Building Council, a nonprofit which administers a set of performance standards for sustainable design

5. NABERS (National Australian Built Environment Rating System ([www.nabers.com.au](http://www.nabers.com.au)))

Administered by the Government of New South Wales, Australia

6. State and County/Federal Standards

Many states and counties are adjusting building codes to require their own standards for sustainability.

#### IV. Key Considerations

##### A. The Burden of Being Green

1. The parties need to be comfortable that environmental performance/energy conservation standards imposed by the lease are reasonable. If the intent is to bind parties to existing ratings or standards, it is fairly straight forward to agree on what those will be. What if the intent it to conform



to possible new standards in the future? The lease needs to be clear on what those standards might be and who can impose them. For example, can the landlord unilaterally impose a new standard (not required by law) because it enhances the buildings standing as a first class building or to achieve a voluntary rating or certification or to earn a tax credit?

2. Both Landlord and Tenant must realize that compliance often comes with a cost, as well as a potential benefit or savings. For example, a Landlord may get credit toward a LEED or Green Globe rating by using alternate energy sources (solar or wind) for some of building electricity. This reduces the building's carbon footprint, but alternate energy sources may be more expensive. Moreover, a new (future) standard for energy conservation will need to be reconciled with inconsistent covenants in the Lease. For example, to achieve new required energy efficiency rating, Landlord may not be able to run HVAC as needed to achieve temperature ranges required by the Lease or after normal building hours of operation.

Tenants concerned about preserving existing standards for electricity/HVAC or the like will have to focus on limiting the Landlord's discretion and preserving the benefit of grandfather provisions in new regulations.

3. The Tenant may want the Landlord to warrant the building LEED/Green Globe/ENERGY STAR status, or to covenant that the Landlord will achieve and maintain agreed upon goals. Landlord wants to know it can pass costs through to tenants. Also, performance may be affected by the conduct of other tenants or requirements of other leases in a multi-tenant building.
4. Green leases typically provide environmental management plans and impose strict standards for new construction and rehabilitation projects by the Landlord and the Tenant. These might include covenants to purchase ENERGY STAR certified equipment; local or recycled products to reduce transportation; and covenants to engage in recycling of wastes, etc. These factors will often dictate a more costly solution (though building to LEED standards is becoming cheaper as it becomes more prevalent). Note typical leases require tenants to install all new materials, whereas LEED/Green Globe, etc. may give credit for recycled materials and equipment.

B. Cost/Benefit of Being Green:

1. Converting existing buildings to more energy efficient equipment (HVAC systems, elevators, , etc.) costs money upfront and saves operating costs over time. Big Questions: Who pays the upfront cost when an existing building upgrades its systems or operations to achieve and energy rating or the like? Who benefits from cost savings? How do you address carbon credits or costs in a cap and trade program? Tax reductions or credits?
2. Many believe leases should be net and all utilities submetered (to the extent permitted), so that costs and benefits are all passed through to tenants. In net lease Tenant pays all utilities and operating costs. None are baked into base rent.
3. Typical leases prohibit landlords from passing through capital costs to tenants as an operating cost, but if the landlord upgrades a building system (a capital cost) the reduction of operating or energy costs will benefit the tenant by reducing its additional rent.
4. Landlords will want the freedom to upgrade their buildings for environmental/energy saving reasons and will want to pass through the cost (amortized with interest over the life of the upgrade if not a shorter period). I think most tenants would concede that a Landlord should be able to recoup the capital costs for energy efficiency improvements (so long as they are amortized and spread over the useful life of the upgrade and do not exceed anticipated savings).
5. What if the landlord pays a cost to upgrade the building which it cannot pass through to the tenants? Should the Landlord keep the operating cost savings (creating a profit incentive to make the building upgrades)?
6. Some argue that a modified gross lease which increases the Landlord's NOI when it reduces operating costs, is a better model for a green lease because it gives the Landlord an incentive to reduce its carbon footprint.
7. What if they reduce the carbon footprint or achieve some other "green" goal, but do not reduce operating costs? Should the cost be chargeable to tenants as an operating cost?
8. Others would argue that landlords rightly expect their buildings to be more valuable when they are green and they don't need any other incentive.

C. Enforcement

1. The REALpac (Canadian Association of Property Owners) promotes two alternatives: In one, environmental and conservation covenants are hard and fast, and breach is a default. In the other; a breach of the environmental management plan is not a default, but the parties agree to use commercially reasonable efforts to fix it.
2. Most US leases take the hard covenant approach, but leases typically proscribe consequential damages against the Landlord, and many proscribe it against tenants as well. So when crafting remedies, you may want to consider alternate remedies.
3. If Landlord breaches a covenant to achieve a LEED certification level or Green Globe performance threshold, consider instead:
  - a) Specific performance may not be practical or possible
  - b) Can agree upon a remedy
    - i) Rent reduction until Landlord achieves rating
    - ii) Liquidated damages
4. If the Tenant breaches a covenant which costs the building a certification or rating, a similar issue exists, should the Landlord be entitled to damages for loss of reputation or value? What about loss of a tax credit. Most tenants would object. Other possible remedies: self-help, termination or a fixed liquidated damage.
5. Tenants and landlords will also want to consider “greening” their contracts with architects and engineers to assure design and construction obligations with respect to sustainability and resource conservation and any goals (LEED certification, etc.) are passed down to these vendors.

V. **How to Make Sustainable Design/Operation Part of Your Leasing Program**

A. For Tenants

1. You might look at California Sustainability Alliance on Line Tool Kit ([www.sustainca.org/content/leasing\\_toolkit](http://www.sustainca.org/content/leasing_toolkit)). It provides:



- a) A list of questions to assist in considering sustainability in site selection
- b) A form RFP (Request for Proposals)
- c) Due diligence checklist
- d) Sample lease provisions

**B. Available Forms – Typically landlord oriented**

- 1. BOMA (Building Owners and Managers Association) ([www.boma.org](http://www.boma.org)) published a “Green Lease” model which can be purchased online at the BOMA website (<http://shop.boma.org/showItem.aspx?product=GL2008&session=744B3A85CFB34F418FECF1FA8BFCF10E>).
- 2. REALpac, a Canadian association of property owners ([www.realpac.ca/splash.asp](http://www.realpac.ca/splash.asp)), also has published a form “Green Lease” which is currently available without charge at the REALpac website ([www.realpac.ca/s\\_223.asp](http://www.realpac.ca/s_223.asp)). Investor Property Group publishes a green leasing guide related to NABERS ([www.eco-efficiency.management.dal.ca/Files/Green\\_Lease\\_Guide.pdf](http://www.eco-efficiency.management.dal.ca/Files/Green_Lease_Guide.pdf)). Though these are Canadian or Australian leases, they can be adjusted to U.S. markets, or they might give you insights when developing your own form.
- 3. Corporate Realty Design Management Institute ([www.squarefootage.net](http://www.squarefootage.net)), a private institute which sponsors programs and publishes materials on building sustainability and green leasing, has published sample provisions and is working on a model green lease.

**VI. Conclusion**

The conservation movement is clearly in its infancy. We can expect government regulation and public awareness to increase over time. Just as standard operating procedures will likely change over the coming years, so too leases must change to meet the challenge.