"Green" Leases Pose New Issues for Businesses

Michael Hockley and Andrew Brought

Eco-considerations are changing the way commercial leases are written.

In a rapidly-changing environment, businesses are becoming more focused on the interplay of energy and environmental issues and how they impact both short-and long-term costs. As with many endeavors, "green" concepts have spilled over into commercial real estate through the development of green buildings and green leases.

This trend should not be surprising, since an office lease can represent a substantial portion of a company's overall costs, and buildings account for a significant percentage of energy use in this country (nearly three-quarters of the nation's consumption of electricity and nearly forty percent of the country's energy usage and carbon dioxide emissions, according to the U.S. Green Building Council). As such, businesses that lease commercial office space must understand the risks and rewards of green leases, particularly when commercial leases typically extend upwards of five to twenty years.

A green lease, in short, is any lease agreement that incorporates an agreed-upon approach by a landlord and tenant to commit to practices that reduce environmental impacts and improve sustainability. There is, however, no one-size-fits all approach; they can take many forms. But provisions in a green lease likely will touch upon some or all of the following:

(1) Green building standards. Is the building certified through the U.S. Green Building Council's LEED program or through other similar programs such as EPA's ENERGY STAR program or the Green Building Initiative's Green Globes program? And are there commitments that the landlord, tenant, or both must make to ensure such certification, including renovations and repair/maintenance?

(2) Energy use. Does the lease contemplate individually-metered utility usage (electric, gas, and water) or the use of efficient heating/cooling and lighting systems or appliances?

(3) Materials procurement. Are there comprehensive procurement guidelines (both during the construction and operation phases of the building) or provisions that require the purchase of sustainable or environmentally-preferable products, such as energy efficient office equipment or the use of low-VOC paints or carpets?

(4) Recycling and waste reduction. Are there lease provisions with recycling mandates or that set specific targets for waste recycling (paper, cardboard, plastics, and aluminum).

(5) Water usage. Are there low-flow or waterless bathroom fixtures and requirements for landscaping with natural or low water usage.

(6) Incentives and credits. Are there incentives and credits, such as tax credits and potential future carbon offset emission credits, that accrue to the landlord, tenant, or both?

For a green lease to be effective, the landlord and tenant must identify and agree upon specific obligations and standards. For example, will the lease focus on one or two "green" measures as a start point, such as recycling mandates and the use of energy-efficient lighting (CFLs, LEDs, sensor lighting, etc.) or will the parties agree upon a comprehensive system to reduce environmental impacts?

Equally important, how will the parties monitor and enforce the green lease provisions? For example, does the lease identify specific targets or require compliance with performance standards or building certification requirements? To facilitate enforcement of the lease terms, the lease agreement should include measures such as a landlord right of entry and inspection and a process to ensure that alterations and repairs fully comply with applicable green building standards. Likewise, a tenant may seek to include enforcement measures such as the right of self-help and rental reduction if the landlord does not meet the lease requirements.

As with any other lease agreement, green leases are subject to risks and rewards. Landlords need to ensure that the lease specifies that capital improvements and upgrades for environmental reasons may be passed on to tenants if the landlord so desires because many traditional leases do not permit a landlord to pass such capital improvements through to the tenant. A landlord may choose, however, to pay the entire cost of the upgrades to enhance the landlord's reputation, minimize vacancy, protect assets, and qualify for incentives and credits.

On the other hand, landlords should ensure that the costs of building-wide environmental and efficiency upgrades are passed through to tenants on a fair basis. Are costs amortized over time and spread across the overall lease space and number of tenants in the building in fair manner? Tenants need also to ensure that the environmental goals are well-defined and not left to solely the landlord's discretion.

Considering the long-term nature of commercial leases, the successful businesses of tomorrow will have planned for the environmental and energy considerations in those lease agreements today through the development of green lease provisions.

Published in Ingram's magazine, May 2010