

Green Leasing

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I. Green Lease.

A Green Lease is a lease of space in a newly constructed green building or an existing conventional building that is to be renovated as a green building.

II. Green Building.

A. Ecologically Sustainable Development (ESD). A green building incorporates ecologically sustainable development principles to ensure that the ongoing operation and maintenance of the building minimizes environmental impacts.

B. ESD Goals. A Green Building is a building that is designed, constructed and operated to achieve some or all of the following ESD goals:

1. Sustainable Site.
2. Water Efficiency.
3. Energy and Atmosphere.
4. Materials and Resources.
5. Indoor Environmental Quality.

C. Impact of Goals. Goals impact building development and design in numerous ways:

1. Sustainable Site - Pursue brownfield redevelopment. Provide access to mass transit. Minimize environmental impacts on site.

2. Water Efficiency - Incorporate water sensitive designs. Minimize water use with high efficiency fixtures. Use rainfall and reuse grey water.

3. Energy and Atmosphere - Reduce energy use or use renewable energies. Use efficient building systems to minimize energy demand. Use renewable energy including passive solar design or solar panels or windmills.

4. Materials and Resources - Use recycled building materials. Minimize use of endangered species. Use locally sourced materials to minimize transportation of materials. Provide for integrated waste management. Reduce the amount of waste delivered to landfill. Maximize recycling and composting opportunities.

5. Indoor Environmental Quality - Maintain healthy internal environments. Incorporate operable windows to allow fresh air. Design building and space to allow daylight into interior spaces. Use non-emitting, non-toxic materials and finishes. Use high performance HVAC systems. Provide for high air change rates.

D. Impact on Lease. Green features affect numerous provisions in lease document.

III. Rating Systems.

A. Rating Systems. ESD Goals are reflected in building rating systems.

B. U.S. Green Building Council.

1. Leadership in Energy and Environmental Design (LEED) Green Building Rating System (1995).

2. LEED Rating Systems for:

New Construction and Major Renovations
Existing Buildings
Commercial Interiors
Core & Shell
Retail (among others)

3. LEED is a third party certification system. LEED's Ratings based on a points system.

4. Certified ratings of Certified, Silver, Gold, Platinum based on number of credits earned.

C. Other Rating Systems. There are other rating systems. One of the best known is the Green Globes Program begun in Canada in 1996. Program distributed in U.S. as Green Globes program through Green Building initiative.

D. Local Codes. Many local governments are now incorporating ESD principles in local development code and building code.

IV. Impact of ESD Goals.

ESD Goals impact lease document in three major ways:

A. Design and Construction;

B. Economic; and

C. Operations and Maintenance.

V. Design & Construction Issues.

A. Typical Lease. Typical lease obligates landlord to deliver possession of the premises with Landlord's Work substantially complete. The details of Landlord's Work and the Tenant Work are set forth in a work letter. Work letter requires landlord to build shell and core and the tenant to build (or at least pay for) part or all of the tenant improvements. Establishes process for developing and approving plans and specifications for tenant improvements. The interaction between landlord and tenant in the design process is limited. Either landlord or tenant may be responsible for the actual construction of tenant improvements.

B. Design and Construction of Building. Green building requires an integrated design of landlord's work and tenant's work. Traditional work letter may not adequately reflect coordinated process. The tenant who wishes to lease space in a green building should require landlord to represent and warrant that the building will achieve a LEED's or other specified rating. Require description of shell and core that incorporates green building elements. These could include reuse of waste water or rainwater, high efficiency building energy systems, or use of on-site renewable energy. Tenant needs to consider what its remedies will be if the landlord breaches the representation and warranty. Termination of the lease may not be a viable option. Liquidated damages or a specified rent reduction may be a more reasonable option.

C. Design and Construction of Tenant Improvements. The landlord should condition approval of tenant plans and specifications for tenant improvements on compliance with rating criteria. Require that tenant's design deliver natural light into interior spaces. Require use of green materials: recycled materials, non-endangered species, nontoxic carpet and paint. Require use of energy efficient equipment and lighting. Reduce foot candle requirement for lighting. Condition approval of tenant's contract on compliance with ESD goals.

VI. Economics of Green Lease.

A. Initial Investment. Initial cost of constructing green building is higher than a conventional building. Most developers view that premium as being in the range of 2% of construction costs. Higher the rating being sought, the higher the cost. From landlord's perspective, how will that increased cost be recovered?

B. Ongoing Operating Expenses. Green Building reduces operating expenses. Who captures benefits of that reduction?

C. Property Tax Exemption. Certain elements of a green building may be exempt from property taxes. Would not be surprised to see an expansion of property tax exemptions relating to sustainable development.

D. Economic Structure. To have a meaningful discussion of these issues, need to have an understanding of the economic structure of the basic lease forms.

E. Types of Leases.

1. Gross Lease. Gross Rent with no pass through of operating expenses and taxes.

2. Modified Gross. Base Rent plus prorata share of increases in operating expenses and taxes over base year or operating expenses in excess of expense stop.

3. Triple Net. Base Rent plus prorata share of operating expenses and taxes.

F. What Form Best for Green Building? Much discussion in literature regarding what form of lease is best used for green buildings. Some writers have argued that a gross lease is best for a green building because it creates an economic incentive for landlord to reduce operating expenses. However, market forces push landlords using net leases to keep operating expenses as low as possible to keep building competitive with other buildings. Lower operating expenses permit landlord to charge a higher base rent. Neither form inherently better.

G. Setting the Base Rent. Landlord will want to set base rent high enough to recover initial investment in green technologies over a reasonable amortization schedule. Tenants faced with that argument in negotiations should be aware that tax benefits of green building technology shorten pay back period for landlord. Cost to landlord may not be as great as straight amortization schedule would suggest.

H. Reduced Operating Costs. If landlord recovers initial investment through higher base rent, tenant can fairly argue that it should receive the benefit of reduced operating costs. If landlord fails to recover initial investment through higher base rent, landlord could take the position that it should receive the benefit of lower operating costs. This can be accomplished through a triple net lease or a modified gross lease where the tenant pays its proportionate share

of increases in operating expenses over a base year. Conversely, if landlord does not recover the increased cost of construction through a higher base rent, the landlord may legitimately expect to retain the benefit of lower operating costs. This can be accomplished through a gross lease.

VII. Maintenance and Repairs.

A. Typical Maintenance and Repair Provision. Typical lease requires landlord to maintain and repair building structure and common area. Requires tenant to maintain premises.

B. O&M Manual. Green building systems have detailed operating and maintenance requirements. Landlord may prepare O&M Manual for the building and require tenant to comply with it.

C. Operation in Conformance with Green Standard. Tenant may wish to impose obligations on landlord to operate and maintain building in accordance with Green standards. Require landlord to comply with green building operational standards and attach them to the lease as an exhibit. Require monitoring of indoor air quality (carbon dioxide and ventilation).

VIII. Utilities and Services.

A. Typical Utilities and Services Provisions. Typical lease obligates landlord to furnish water and electricity at all times and heating, ventilation and air conditioning at building standard levels during normal business hours established by landlord. May require landlord to provide janitorial service in accordance with the regular schedule for the building. May require landlord to provide electrical service of a specified capacity. May also require landlord to provide lights at a specified foot candle level. May allow landlord to impose a charge if tenant uses excessive amounts of utilities and services. Green lease might reduce normal business hours. For example, some buildings provide HVAC for 1/2 a day on Saturday - Green lease might eliminate that.

B. Separate Metering. To encourage energy efficiency, landlord may separately meter tenant space. Tenant will be motivated to reduce consumption if paying directly for usage.

C. Reduction in Requirements. Tenant may reduce requirements for electric power in space and foot candle level of required lighting to reduce energy consumption and heat load. Some leases incorporate operating specifications for HVAC systems. Green lease might expand that range of acceptable temperature.

D. Cleaning Materials. Both parties may agree to use environmentally friendly cleaning materials.

IX. Alterations.

A. Typical Alteration Provision. Typical lease prohibits alteration without landlord consent. May prohibit alterations that adversely affect building structure or systems. Require landlord approval of tenant contractors.

B. Landlord Requirements. Landlord may withhold consent to proposed alterations that are inconsistent with design, construction and operation of green building. Require tenant's contractors to comply with green building requirements in construction.

C. Tenant Requirements. Tenant may obligate landlord to consent to alterations that promote ESD goals.

X. Recycling and Waste Management.

A. Typical Janitorial Provision. Typical lease assigns responsibility for providing janitorial service. May require tenant to dispose of waste in approved containers.

B. Landlord Requirements. Landlord may require tenant to participate in recycling and waste management program. Require tenant to sort waste. Refuse to collect unsorted waste.

C. Tenant Requirements. Tenant may require landlord to adopt and implement recycling and waste management program.

XI. Transportation.

A. Typical Transportation Provision. Typical lease silent on mass transit. Rules and regulations frequently prohibit bringing bicycles into tenant premises.

B. Bicycle. Tenant may require landlord to provide bicycle storage and showers. May require landlord to permit bringing bicycles into tenant space.

C. Use of Mass Transit. Landlord may create program to encourage tenant use of mass transit. Both parties can deemphasize use of parking by reducing parking ratios.

XII. Reservation of Right to Use Space and Right of Entry.

A. Typical Right of Entry Provision. Typical lease authorizes landlord to enter the premises to perform necessary services, maintenance and repairs.

B. Landlord Reservations. Landlord must contemplate changes in technology and the need to retrofit space. Landlord should reserve right to use and access premises for upgrade.

C. Cost of Future Alterations. Landlord needs right to include cost of upgrades as operating expenses in pass-through clause. There are often capital improvements. Tenant may require that they be amortized over useful life and only the annual amortization charge including interest should be passed through in any year.

XIII. Surrender.

A. Typical Surrender Provisions. Typical lease requires tenant to surrender premises at end of term in good condition. Requires tenant to remove personal property. May require tenant to remove alterations made by tenant.

B. Recycling of Personal Property. Landlord may require tenant to recycle disposable personal property.

C. Reuse of Materials. Tenant may reserve right to remove recyclable materials paid for by tenant.

XIV. Special Issues Relating to Refurbishing Existing Buildings.

A. Difficulty of Refurbishing Existing Building. Landlord who contemplates refurbishing an existing building as a green building faces significant challenges.

B. Limits on Right of Entry. Lease may not give landlord right of entry in tenant spaces for these purposes.

C. Strategies for Refurbishing. As a practical matter, landlord may have to relocate tenants, negotiate lease termination or wait for lease rollovers to complete project.

D. Limits on Pass Through of Cost. Operating expense clause may not permit landlord to pass through costs.

E. Comparison to Asbestos Abatement. Process comparable to process landlord went through in asbestos abatement.

F. Recommended Provisions. Landlords who contemplate this process should begin including relocation provisions or options to terminate, broad rights of entry and cost recovery provisions.

XV. Conclusions.

- A. ESD principles impact numerous aspects of lease.
- B. Drafting of Green Lease provisions still in infancy.
- C. Market allocation of risks and rewards still to be determined.
- D. Numerous opportunities for creativity.
- E. Description of affected provisions is comprehensive, but by no means definitive.
- F. Expect to see many new lease provisions proposed in coming months and years.