

**THOMPSON  
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**CLIMATE CHANGE AND  
SUSTAINABLE BUSINESS  
SOLUTIONS UPDATE****Climate Change and Due Diligence: Impact on Real Estate Transactions**

Before acquiring or leasing real property, parties to any residential, commercial, or industrial real estate transaction must now consider whether climate change issues impact the transaction. While federal requirements applicable to GHG gases from buildings, which exacerbate climate change conditions, do not yet exist, there are a growing number of state and local provisions that should be considered in due diligence reviews associated with purchasing or leasing residential, commercial, or industrial property.

Climate change is emerging as one of the most important and complex policy areas in the United States and internationally. The climate change phenomenon arises from the growing scientific consensus that the earth is warming, human activities are causing or contributing to such warming, and calamities (such as flooding, droughts, famines and substantial social disruption) will occur if global warming is not curtailed.

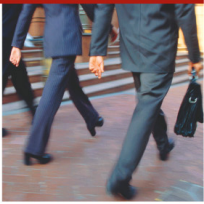
The science has in turn led to a growing public consensus that GHG emissions must be reduced. Many countries are already regulating emissions of carbon dioxide, the most prevalent GHG. In the United States, with the election of Barack Obama, who supports climate change legislation, and a Democrat-controlled Congress, the debate has shifted from whether legislation is necessary to when and how the inevitable control of carbon emissions will occur.

**DUE DILIGENCE IN REAL PROPERTY TRANSACTIONS**

Purchasers, tenants, and lenders involved in a real estate transaction often perform Phase I environmental assessments in accordance with the ASTM E1527-05 standard. (See "New Standards for Due Diligence: Rule Takes Effect November 1, 2006," April 3, 2006 *BLR's Environmental Manager's Compliance Advisor*.) Also, before acquiring a property, buyers of commercial and industrial real estate must conduct "all appropriate inquiries" to obtain any of the landowner liability defenses under CERCLA. However, a Phase I assessment will not address climate change issues covered by mandatory local or state regulations.

**CURRENT REGULATORY FRAMEWORK**

Under President Bush, the federal approach to climate change primarily relies on voluntary emission reductions and tax credits. The administration has persisted along this avenue despite a landmark decision by the U.S. Supreme Court in May 2007 whereby the Court found that under the CAA, EPA has the authority to regulate GHGs emitted by new automobiles. While Barack Obama and the Democratic-controlled Congress favor climate change legislation, it remains to be seen if a



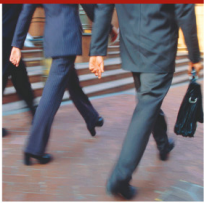
mandatory GHG emissions control program will emerge initially from the existing statutory authority or through new legislation.

### **STATE AND LOCAL REGULATION AND POLICIES**

When determining whether buildings in a real estate transaction may be impacted by climate change regulation, it is now critical to review whether there are any state, local, or city laws or programs that impact the transaction. If these programs impose requirements to decrease GHG emissions, associated costs may increase substantially, and the requirements must be considered as part of the overall diligence assessment of the transaction.

It is important to check with each state and locality to determine applicable regulatory requirements that should be considered prior to constructing a building or purchasing an existing building. EPA has a website (<http://www.epa.gov/climatechange>) that links to 21 state and regional programs, some of which impose requirements pertaining to GHG emissions. Following is a summary of several major actions taken by state and local governments.

- 902 mayors from across the United States signed the U.S. Conference of Mayors Climate Protection Agreement. The mayors agreed to strive to meet the Kyoto Protocol's GHG-reduction targets in their own communities, urge their state governments and the federal government to reduce GHG emissions to targets contained in the Kyoto Protocol, and urge the U.S. Congress to pass bipartisan GHG reduction legislation to establish a nation emission trading system. The agreement and policies of this organization can be found at <http://www.usmayors.org/climateprotection>.
- As with most environmental issues, California is one of the leading states when it comes to climate change regulation. The California Global Warming Solutions Action of 2006 requires that all GHG emissions be reduced by 2020. The California Air Resources Board has authority to adopt rules to reduce GHG emissions.
- King County in Washington State has issued executive orders requiring county agencies to consider climate change impacts as part of project reviews. Currently, proposed legislation would allow King County to exercise substantive authority under the State Environmental Policy Act to condition or deny proposals that would have a significant adverse impact on the environment due to their GHG emissions.
- On August 4, 2008, an ordinance was passed in San Francisco to impose strict green building requirements on newly constructed residential and commercial buildings and renovations to existing buildings. The ordinance specifically establishes an unprecedented level of green building requirements for newly constructed commercial buildings over 5,000 square feet; new residential buildings; and renovations to areas over 25,000 square feet in existing buildings that are undergoing major structural upgrades or mechanical, electrical, or plumbing upgrades.



Many other cities, including New York, Los Angeles, Boston, Atlanta and Seattle, have adopted green building ordinances.

### **BEFORE YOU ACT**

The first step before entering a lease, constructing or renovating a building, or purchasing a building is to review local ordinances, guidance, and regulations. Many cities have enacted rules for new construction based on the Leadership in Energy and Design (LEED) standards. The LEED standards are the most common certification tool, but there are other standards that are applied throughout the country. LEED programs include standards for new construction, existing buildings, commercial interiors, core and shell development, schools, retail, homes, and neighborhood development. LEED addresses the following areas: sustainable site development, water savings, energy efficiency, materials selection, and indoor environmental quality.

Remember that local and state regulations and polices vary across the country. Some triggering factors include the size of the building, whether it is public or private, and whether the use is residential, commercial, or industrial. Building codes and zoning laws may also have provisions that address reduction of GHG emissions. Some cities can issue stop work orders or revoke building approvals if certain climate change requirements are not met.

Also, many cities offer tax incentives, funding, and other inducements to encourage green building and implementation of sustainable building design.

### **WHO IS RESPONSIBLE FOR COMPLIANCE?**

If a state or local climate change program applies, it is essential to determine which party to a transaction must comply with the program. For instance, in a situation where climate change standards relating to the construction or use of a building are triggered, should the tenant, owner, or contractor or other professional bear the costs of compliance? If there are climate change standards that apply to a project, the allocation of risk regarding who needs to ensure compliance must be clearly drafted in the contract. If there are legal requirements in place regarding climate change, purchasers, lenders, and lessees will need a way to ensure that the building involved in the transaction meets applicable requirements.

Attorneys working on lease documents will now need to carefully identify who is responsible for ensuring compliance with mandatory and/or voluntary climate change standards. Many tenants are demanding that the space they lease be environmentally friendly and, in some cases, ask for certain green certifications.

Parties must also consider who should be responsible for meeting climate change requirements if the building is later renovated. If a lessee is allowed to make renovations to a building, a lessor will want to ensure that the lessee conducts the renovation in accordance with any applicable green building standards.



Additionally, if there will be ongoing costs to meet compliance with GHG regulations, the contract documents must clearly set forth which party will bear those costs. The lease should clearly address which party is responsible for ensuring that the certifications are met and identify who should pay for associated costs.

### **RISK AND OPPORTUNITY ANALYSIS**

Though climate change requirements may increase the costs of a transaction, they may also present opportunities. Proactive companies can gain competitive advantages and will attract new customers and investors. Companies that have implemented strategies for energy and raw material efficiency will fare better than competitors who have not.

There is a growing market in GHG allowances with current trading levels in the billions of dollars. The market is expected to grow into the trillions in coming years. Energy-efficient companies in the U.S. may benefit from the sale of allowances in future carbon markets created by federal and state legislation (or in the growing voluntary markets such as the Chicago Climate Exchange). Investors are pouring money into green or clean technologies such as alternative and renewable energy, green buildings, and water and wastewater treatment technologies. Companies that manage and mitigate their exposure to climate change risks while seeking new opportunities for profit will gain advantages over their competitors.

Therefore, it is likely that purchasers, lenders, and lessees to a transaction will regularly assess climate change issues as part of routine environmental due diligence. In some cities and states, the process will be required as a matter of law. However, there are advantages, economically, politically, and socially, to reducing emissions and the carbon footprint of the real estate in any transaction, and such an assessment may start impacting purchase and lease prices in real estate deals.

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### **FOR MORE INFORMATION**

For more information, please contact Heather Austin at [Heather.Austin@ThompsonHine.com](mailto:Heather.Austin@ThompsonHine.com) or 216.566.5927, or contact your primary Thompson Hine lawyer. For a list of our lawyers, please go to [www.ThompsonHine.com/practices](http://www.ThompsonHine.com/practices).

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