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Green Buildings/Green Leases

by Mario J. Suarez, Esq., Thompson Hine LLP

INTRODUCTION

Sustainable, or “green,” buildings offer the opportunity to create a healthy workplace while, at the same time, reducing recurring energy, water and waste costs, and other building operation and maintenance costs, during the life cycle of a property. As a result, the design, development and operation of green buildings have been embraced by federal government, state and local agencies, and by institutional real estate investors, financiers and end-users throughout the world.

An understanding of sustainable building development and operations is essential to real estate practitioners everywhere.

The interplay between a green building and the traditional legal relationships covered by commercial real property leases forms the nexus of this article.

BACKGROUND

In the commercial real estate industry context, the term “green” refers to the practice of maximizing the use of resources in buildings while reducing corresponding impacts on human health and the environment.

Although the dawn of the environmental movement may be traced to the first Earth Day in the early 1970s, the focus on the application of environmentally responsible principles to the commercial building industry may be more accurately traced to the establishment of the Sustainable Buildings Industry Council in the 1980s and to the 1992 Earth Summit (formally known as the 1992 United Nations Conference on Environment and Development), which was followed by the seminal 1993 Chicago convention, *Architecture at the Crossroads*, and its “Declaration of Interdependence for a Sustainable Future.”

The green building movement gained traction with the founding of the United States Green Building Council and the promulgation by the Clinton administration of Executive Order 12852 (1993), which established the President’s Council on Sustainable Development and recommended the establishment of a “national sustainable development action strategy that would foster economic vitality.”

More recently, acceptance of the green agenda has accelerated with the enactment by the Bush administration of the Energy Policy Act of 2005, and the implementation of President Bush’s Executive Order 13423, which requires governmental agencies to reduce greenhouse gas emissions and water consumption and promote sustainability strategies.

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THE GREEN MARKETPLACE

From its beginnings in the environmental movement of the 1970s, green building design and development has gained acceptance in the last decade, with the trend accelerating in the last five years. The dramatic increases in energy prices in 2007-2008 have made the economics of green building design and development more palatable to investors and users, and this enthusiasm has not been dampened by the recent collapse of oil prices.

The green building market is driven by a number of factors, the most prominent of which is the demand for green building design by corporate tenants and governmental and not-for-profit institutions.

Large institutions have found that the development and occupancy of green buildings achieve a number of widely accepted corporate goals. These goals include the adoption of socially responsible practices promoted by corporate stakeholders and employees; the attraction of younger workers, particularly in the knowledge industries; and the projection of an image of social responsibility and good works. Institutional owners and tenants recognize that the American public embraces green goals and the companies that adopt these goals as their own. Green buildings also yield considerable efficiencies in terms of energy savings and worker productivity. The latter is particularly critical because, although facility costs are not one of the predominant cost centers for many institutions, employee expenses related to hiring, retention, worker satisfaction and productivity rank high on the list of the issues that concern institutions.

Federal, state and local governments—not only in the United States but throughout the world—have also been instrumental in driving sustainable design and development through the requirements and specifications established by these governments for buildings in which they are occupants, as well as for projects in which these governments provide financing or incentives, and through laws and regulations.

GREEN STANDARDS

The green movement has been furthered by the establishment of rating standards and benchmarks by which the efficacy of green building design and development is judged. These standards include the Leadership in Energy and Environmental Design (LEED) standard and Energy Star in the United States; the Building Research Establishment and Environmental Assessment Method (BREEAM) in the United Kingdom; Green Star in Australia; the Comprehensive Assessment System for Building Environment Efficiency (CASBEE) in Japan; and others.

Although this article will focus on LEED, since it is the system most relevant at the present time to the development and construction of buildings in the United States, other green reference standards will be mentioned in passing.

LEED, a third-party certification program promulgated by the U.S. Green Building Council (USGBC), a not-for-profit organization whose mission is to promote sustainable design, development and operation of buildings, is the predominant certification benchmark in the U.S. sustainable building market. As a standard for evaluating sustainable design and development practices, LEED has surged from its inception in the late 1990s to cover more than 15,000 projects throughout the United States.



LEED is intended to be a transparent, publically reviewable, points-based system in which design and development projects can accumulate LEED points if they conform to certain adopted green building design elements and criteria. The level of LEED certification depends upon the number of points achieved. LEED's transparent and uniform standards permit developers, owners and tenants to understand the green goals to be achieved with respect to specific projects so as to permit the standardization of sustainable building elements. In essence, LEED certification is a tool for measuring how green a building or development is. LEED has been extensively revised and will be rolled out starting in February 2009.

There are now many alternative versions of the LEED rating system that have been developed for specific types of projects, including:

- *LEED for New Construction.* The LEED for New Construction rating system (LEED-NC), the most common of the LEED rating systems, is intended to guide the construction of high-performance commercial and institutional projects, including office buildings, high-rise residential buildings, government buildings, large recreational facilities, manufacturing plants and laboratories. The LEED-NC standard also covers major renovations of existing buildings.
- *LEED for Existing Buildings.* The LEED for Existing Buildings standard (LEED-EB) is intended to assist building owners and operators to adjust building operations, alterations and maintenance in a consistent manner with the goal of maximizing operational efficiencies while minimizing environmental impacts. LEED-EB addresses, among other matters, building cleaning and maintenance issues, including the use of chemicals; recycling programs; exterior maintenance programs; and system upgrades. LEED-EB can be applied to existing buildings seeking LEED certification for the first time and to projects previously certified under LEED for new construction.
- *LEED for Commercial Interiors.* The LEED for Commercial Interiors standard (LEED-CI), is a benchmark standard for the performance of tenant improvements. LEED-CI provides a framework for the certification of high-performance green interiors that offer healthy, productive places to work, are less costly to operate and maintain and have a reduced environmental footprint.
- *LEED for Core and Shell.* The LEED for Core and Shell standard (LEED-CS) offers a green building rating system for builders, developers and new owners who want to address sustainable design for new core and shell construction (*i.e.*, base building elements such as the building envelope, basic building structure and building working systems).

Together, LEED-CS and LEED-CI establish a consistent framework for the collaborative development of a green building for owners and tenants alike. LEED-CS effectively addresses the limitations experienced by developers of spec buildings while encouraging green design and construction practices in areas over which the developer has control if the interiors are going to be improved by the tenants, whose improvements can be guided by LEED-CI.

The LEED certification process commences with the registration of a particular project online at the USGBC web site. Once the project is registered, the applicant will receive information, tools and communication to navigate the LEED certification process.



The LEED certification fee ranges from just under \$2,000 for USGBC members developing small buildings encompassing under 50,000 square feet to \$22,500 for USGBC non-members developing buildings encompassing more than 500,000 square feet (buildings between 50,000 and 500,000 square feet pay a fee based on the square footage of the building). A certification request can be submitted as a Combined Design and Construction Review, which are only available for projects that have achieved substantial completion, or a Split Design and Construction Review. Whether the review is conducted as a Combined Design and Construction Review or a Split Design and Construction Review, the process includes a preliminary review by the USGBC staff, a response by the project team to the preliminary review and a final review. The process can take up to 65 business days without any appeals by the applicant of particular decisions. An expedited review, which generally cuts the time by more than half, can be requested; however, due to the constraints on the USGBC staff, the expedited review process is sought after but not readily available.

LEED incorporates a detailed scoring system that is based on a set of scientific criteria consisting of prerequisites and credits applicable to a number of major categories, including the sustainability of the site, the efficiency of water utilization, energy and atmosphere, materials and resources used and indoor environmental quality. Under LEED 2009, a LEED-certified building requires a minimum score of 40 to 49 points; a LEED Silver-certified building requires a score of 50 to 59 points; a LEED Gold-certified building requires a score of 60 to 79 points; and a LEED Platinum certification requires a score of 80 or higher. All of the LEED certification schemes will have 100 base points; however, LEED 2009 will provide for innovation and regional bonus points in addition to the base points, permitting a maximum potential point total of 110 for each certification scheme. The LEED credits will be weighted based on the following categories, which are in order of significance under the LEED scheme: greenhouse gas emissions, indoor environmental quality, fossil fuel depletion, particulates, water use, human health, ecotoxicity, land use and others. LEED 2009 will also provide for regional credits that are designed to be responsive to environmental priorities in several areas of the United States. For a complete description of LEED 2009, please visit the USGBC web site at: <http://www.usgbc.org/DisplayPage.aspx?CMSPageID=1849>.

To date, the vast majority of LEED projects have been certified under the LEED-NC program. However, USGBC filings appear to indicate a trend toward a reduction in the lower LEED certification levels and a corresponding increase in the higher LEED certification levels, indicating that the market is “going for the gold” and gravitating toward a more aspirational green standard.

LEED certification has a number of significant advantages, including the validation of a building’s green design and development achievement by third parties that carry out a thorough and transparent review of the building’s design and construction, thereby permitting the marketing of the project with the LEED *imprimatur* to governmental and high-quality institutional tenants. LEED certification also permits a project to qualify for federal, state and local governmental incentives that are awarded based on the achievement of LEED scoring criteria.

Critics complain that the LEED certification process requires considerable time and expenditure as a result of the perceived need to retain members of the growing cottage industry of LEED consultants, compiling the necessary project information and taking the time for reviews and redesign required in order to achieve LEED certification. It is also said that the point system that weighs certain factors in



LEED-certified design can encourage applicants to “game” the system, although this element will be ameliorated under LEED 2009.

Of course, without the transparent and readily ascertainable criteria established by the LEED certification process, there would be no accurate way to determine if a given development has, in fact, complied with green goals or if it’s merely paying lip service to these goals.

As may be expected due to the growing acceptance of sustainable development around the world, national and regional rating systems have proliferated. In addition to the systems mentioned above, other green rating systems in acceptance throughout the world include GBAS (China), HQE (France), DGNB (Germany) and Verde (Spain).

Special mention should be made of the Green Globes rating system, which is gaining in popularity due to the perception by many that it offers a more streamlined (read: developer-friendly) assessment tool for gauging green building compliance than LEED. Green Globes is operated by BOMA in Canada and in the United States by The Green Building Initiative, a not-for-profit organization. In many respects, Green Globes is smoother, less expensive to use and perhaps better for the typical smaller project. Green Globes may some day rival LEED as the rating system of choice. However, it is not currently a standard in common use throughout the U.S., nor one recognized by most U.S. and state governmental initiatives.

GREEN BUILDING ELEMENTS AND CHARACTERISTICS

In order to understand the context in which green leases operate, one has to first appreciate what a green building is. Although the term is susceptible to a number of interpretations, the elements common to all green or sustainable buildings are effectively embodied in the LEED rating criteria. Accordingly, one may say that a green building is one that adopts healthier and more resource-efficient models of construction, renovation, operation, maintenance and demolition; that is sited and designed in an environmentally sensitive manner; that promotes the conservation of energy and the reduction of greenhouse gas emissions; that makes efficient and environmentally sensitive utilization of water and reusable materials; and that offers a healthy and comfortable indoor environment to its occupants.

It may be instructive in this context to consider a few representative projects, including several that were profiled in a recent issue of *Portfolio*, NAREIT’s real estate journal:

- *New York Times Headquarters*: New York City’s New York Times Headquarters building is among the most prominent green buildings in the nation. The building’s design incorporates a number of features to maximize energy efficiency. The all-glass curtain wall with a ceramic sunscreen, for example, maximizes daylight while blocking the heat generated by direct sunlight and reducing cooling loads. The Times, with financial assistance from the New York State Energy Research and Development Authority (NYSERDA), was able to create a highly advanced dimmable lighting system and a dynamic shading system with real energy savings of well over 50 percent. The lighting system—the first of its kind in the world—uses daylight harvesting to maximize natural light so that electric lighting is used just as a supplement. The Times has stated that each of the more than 18,000 electrical ballasts (a ballast limits the amount of current flowing in an electric circuit) in the lighting system contains a computer chip that allows it to be controlled individually. This means that lighting



levels can be adjusted to meet the needs of different spaces operating at maximum efficiency with varying levels of light. An on-site natural gas cogeneration plant provides 40 percent of the electrical power to the Times' space within the building. The plant's heat by-product is used to heat the Times Company's space during the winter and to provide cooling during the remainder of the year. As the Times notes, "this is a more efficient use of the electrical generation equipment than is typically found in a utility company, as the heat by-product is used." Floors occupied by the New York Times utilize a versatile underfloor air distribution (UFAD) system designed for comfort and efficiency. With this underfloor air system, the Times Company is able to air condition 10 degrees warmer than a typical system—at 68°F—and gently pump this chilled air up from the floor rather than pushing air down from the ceiling at high velocity. The building also makes extensive use of recycled materials. For example, in excess of 95 percent of the building's structural steel was recycled.

- *Forest City's Northfield Stapleton Center*: The Northfield Stapleton Center was developed by Forest City Enterprises, Inc. in Denver, and is a part of Forest City's master Stapleton project. As a result of years of work, attention and commitment to that goal, Northfield was awarded LEED-CS Silver certification from the USGBC at Northfield's grand opening celebration. Northfield is also the first Forest City-developed property to be LEED-certified. Northfield Stapleton was awarded Silver certification for its outstanding commitment to sustainable practices, including high energy efficiency, selection of building materials and advanced construction techniques, and ongoing commitment to water management and indoor environmental quality. Forest City established for the Northfield Stapleton Center a Sustainability Tenant Incentive Program consisting of a set of green recommendations and requirements providing for a total of 51 points. The program requires each tenant to achieve at least 17 points in tenant participation as an enforceable requirement under the terms of its lease. Initially, all of Forest City's new developments are required to submit a sustainability report card as part of an internal review process based on the LEED rating system. Forest City has also brought in consultants with respect to its existing buildings to try to make them more sustainable and to reduce energy consumption. Forest City Enterprises, one of the largest developers in the United States, and, incidentally, a significant client of Thompson Hine, ranks sustainability as one of its core values, along with community involvement, entrepreneurial spirit, teamwork, diversity and integrity.
- *ProLogis' Sainsbury Warehouse*: ProLogis' U.K. distribution warehouse for Sainsbury's, one of the U.K.'s leading retailers, has the lowest carbon footprint of any such facility in Europe. ProLogis' award-winning, 624,000-square-foot facility at Pineham, Northampton, sets new standards for sustainable development with an ultra-low carbon design that exceeds U.K. building regulations by 40 percent. According to *Portfolio*, a carbon management system recorded the carbon footprint of every aspect of the construction process, including emissions associated with the production of raw materials and construction components, carbon associated with transport to the site and energy used on site. The carbon footprint was further reduced through a waste management plan to reduce and recycle construction waste. The building also has significantly reduced operational carbon emissions. A combined heat and power plant drives the refrigeration system, warms rainwater harvested from the roof and generates electricity for use on the site. Air tightness levels exceed U.K. regulations by 75 percent, while a solar wall and wall-mounted photovoltaic panels generate renewable electricity and provide passive warehouse heating. Carbon credits were purchased to offset the embodied carbon by 110 percent, creating a net reduction in emissions equivalent to that of more than 440 homes. As of



January 2008, ProLogis has committed to register every newly designed development for LEED certification in the U.S. and BREEAM certification in the U.K.

GREEN BUILDING ECONOMICS

Although there is insufficient data at this time to support the blanket proposition that green buildings have relatively higher operational performance levels, it is generally accepted that the benefits of developing, owning or leasing in a green building are considerable. According to CoStar, buildings that carry a LEED or energy efficiency certification have a higher occupancy rate and lease for more rentable dollars per square foot than peer buildings.

Green buildings achieve considerable operational efficiencies that are outside of the reach of ordinary buildings and reduce the lifecycle of operating costs and resulting return on investment. For example:

- Construction methods that limit the radiation of heat retained in the building to the outdoors create an energy savings throughout the life of the building.
- The expansion of the use of daylight reduces the need for electric lights and reduces the emission of heat, thereby resulting in a reduction in cooling requirements.
- The efficiencies achieved by using green materials are obvious. Products made with salvaged, recycled or waste content can save resource materials, and the recycling of existing materials reduces building demolition costs.
- The use of high-efficiency HVAC with optimized control systems and the use of Energy Star appliances and office equipment result in considerable heat load savings.
- The collection and re-use of water for non-drinking and cleaning purposes and, in suburban and exurban settings, the use of vegetation for filtration, reduces water costs. Of course, as in the residential context, additional efficiencies—up to 30 to 40 percent by some estimates—can also be achieved by selecting low-flow sink and bathtub faucets, showerheads and toilets.
- The higher productivity associated with green buildings is a generally acknowledged fact. Green buildings have been demonstrated to promote employee productivity gains and lower health care and health care insurance costs. It bears noting that employee salaries and benefits are among the highest costs incurred by an owner over the life cycle of a building, and studies have documented that the resulting savings in employee compensation are equivalent to approximately \$2 per square foot per year as a result of reduced turnover and lower absenteeism. Other studies have established that employees who work in sustainable buildings suffer fewer allergies and other sicknesses.
- Other green human resources innovations, such as promoting telecommuting alternatives in order to reduce overall carbon emissions, can generate increased productivity, lower real estate costs and generate higher morale for employees who can spend more time with their families. The same is true for company-managed or -sponsored transit programs that provide employees with a calmer, greener and faster means of getting to and from work, and reduce carbon pollution and traffic congestion.



As a result of these and other elements, green buildings have been shown to generate a higher return of investment over the building's life cycle.

- A recent study conducted by McGraw Hill, "The McGraw Hill Construction's Smart Market Report," found operating costs 60 percent lower than a similar study in 2005, and the perceived value of green buildings among architects, engineering firms, contractors and owners up 45 percent over the last two years. The same report, which predicted the tripling of the green building industry to as much as \$140 billion by 2013, stated that companies have been seeing green buildings provide an attractive return on investment.
- A recent study for the Royal Institute of Chartered Surveyors based on the cost data of 33 green projects and financial benefits data from over 100 buildings in the U.S. concluded that minimal increases in up-front costs of about 2 percent to support sustainable design would on average result in life cycle savings of 20 percent of total construction costs. For example, an initial upturn investment of up to \$100,000 to incorporate sustainable building features into a \$5 million project would result in a savings of \$1 million today (this, of course, is not as true with respect to LEED Platinum designations because of the significant mechanical, electrical and cost retrofits required to install these systems, which are necessary for LEED Platinum certification).

Of course, a certain degree of skepticism exists in the private sector, and certainly, some elements of green building construction lend themselves more easily than others to a payback analysis (generally those involving energy, ventilation and lighting). It is true, however, that most of the benefits are achieved over a relatively long life cycle, which is why it has been remarked that many of the most sustainable buildings are those of public entities at the federal, state and municipal levels that have benefitted from the low-cost government bond financing available for these projects in which the time horizon is long and the benefits can be reaped over that period.

FINANCING SOURCES

Major banks are active in the financing of green projects, although they treat green projects much like other commercial projects. For example, Wells Fargo has loaned more than \$1.5 billion for approximately 35 LEED projects, including construction loans. A number of local banks have specific green lending programs.

Boutique investment banks have been established that maintain relationships with the full range of temporary and permanent debt financing providers, including traditional sources such as life insurance companies, pension funds, commercial banks, quasi-government agencies and others focused on the environmental attributes of green buildings.

Equity financing can include a mix of traditional sources such as sponsor equity, local private equity and institutional joint venture equity with green building grants.

Recently, the Capital Markets Partnership (CMP) nonprofit coalition of investors; investment banks; insurers; city, state and federal governments; countries; and NGOs have come together to create the Green Building Underwriting Standard that, together with the CMP Green Value Score, offers a straightforward,



easy-to-implement tool allowing lenders, private equity investors, developers and real estate owners the ability to rate an asset's "greenness" at the time of financing or acquisition. The tool is structured as an underwriting overlay that "enhances current underwriting practices, increases transparency, and serves as an indicator of investment risk and long-term asset value" (See <http://www.capitalmarketpartnership.com/>).

There are a number of federal resources available through the public sector for the financing of green buildings, including:

- *Federal "Green Bonds."* Up to \$2 billion of tax-exempt private activity green bonds were authorized under the American Jobs Creation Act of 2004 to be issued by state or local governments for qualified green building and sustainable design projects. These require approval of the Secretary of Treasury in consultation with the EPA administrator. The provision is effective for bonds issued after December 31, 2004 and before October 1, 2009. The qualifications for the project are somewhat limiting since they require at least 1 million square feet of building or 20 acres of land and should include the cleanup of brownfield sites. State and local government participation in the financing is required.
- *Renewable Electricity Credits (the Renewable Electricity Production Credit or REPC).* A per-kilowatt-hour tax credit for electricity generated by qualified energy resources. Section 710 of the American Jobs Creation Act of 2004 expands REPC to include additional eligible resources that were formerly applied only to wind energy, closed-loop biomass and poultry waste energy products, but now also apply to solar energy, small irrigation power and municipal solid waste. The REPC provides a tax credit of \$0.015 per kilowatt-hour for 10 years.
- *Business Energy Tax Credit.* Provides a 10 percent tax credit for the purchase of or investment in solar or geothermal energy property. This includes equipment that generates electricity, heats or cools using solar energy or any equipment used to produce or distribute energy from a geothermal source. The maximum credit is \$25,000 per year plus 25 percent of the tax balance to be paid after the credit is applied.

State tax credits are also available. For example, New York has authorized \$25 million in green building tax credits to be issued from 2005 to 2009.

GREEN LEASE TERMS

Once the decision has been made to embrace green principles in the development and construction or retrofit of a commercial building, agreements to carry out the sustainable goals of green design must be put in place between the parties involved. In the landlord-tenant context, these agreements are embodied in the "green lease."

The Capital Markets Partnership has defined the green lease as "a legally binding contract ensuring that its tenants will adhere to green building practices in build-outs, utilities, and operations, thus adding value to the building and enhancing rents, tenant retention, and faster lease-up." In its simplest terms, a green lease is a lease of a green building or of a conventional building that is proposed to be retrofitted as a green building.



Although green leases can offer many variations, they generally have certain common themes. These include the fostering of a collaborative relationship between the landlord and tenant in the integrated design of the building or its space; the establishment of a benchmark according to a readily ascertainable standard such as LEED certification to be achieved by the landlord or the tenant; and the inclusion of economic incentives for the parties to properly allocate and control the green operation and maintenance of the building by managing operating expense-related provisions. Green leases also incorporate provisions that relate to the ongoing operation and maintenance of the building, as well as closely tailored green operational and maintenance requirements that are often included in a tenant handbook or an operations manual for the building.

Because green buildings are rated—and ratings are incorporated into financing assumptions and requirements for major leases—it is important for the landlord to establish a legal framework that will prevent any slippage in the green rating of a property.

From a purely financial perspective, a key element of the green lease is the treatment of green practices cost-sharing by tenants through the provisions relating to operating expense pass-throughs.

Equally important is promoting the efficient use of energy through direct metering or sub-metering, which fully places the onus of saving energy within the tenant space (the vast bulk of the energy building costs) on the tenant, and effecting other resource conservation methods, such as reducing water use by installing equipment that conserves water in lavatories and kitchens, and by mandating caps on or percentage reductions in the use of resources such as water, expressed in gallons or liters of water per square foot per year and electricity in kilowatts per square foot per year.

As may be expected, the mandating of green development principles and regulations is highly technical in nature and requires the use of consultants, including electrical engineers, mechanical engineers and architects, by both parties to make sure that the lease has been properly drafted and negotiated.

The following section highlights a number of green provisions found in contemporary lease forms in the general sequence in which they are often found in leases. For ease of organization, the following tracks the BOMA lease form (discussed later) and its associated commentary:

Lease Term

As is perceptively noted in the BOMA model lease, the lease term itself is a significant and often overlooked green component. Although the length of a lease term depends on market factors and the desires of the parties, as well as the existence of options or other rights on the space in question, all things being equal, a longer lease is more environmentally friendly because of the lower likelihood of significant demolition or construction activity during its term. LEED for Commercial Interiors provides a LEED credit for leases greater than 10 years, so, in all respects, a longer lease term is greener than a shorter one.

Operating Expenses

Green building operating expense pass-through clauses should generally permit the recovery of the annual amortization of the costs of green building capital expenditures and repairs to the extent of the savings



achieved, as well as the recovery of the landlord's costs of maintaining, managing and repairing the building in accordance with LEED or Green Globes. The clause should also provide for the recovery of the cost of applying for the building to achieve certification under a green standard. Other costs incurred in connection with the achievement of carbon reduction targets should also be recoverable.

If the building will be greened during the term of the lease, the operating expense pass-through clause should permit a reduction in base year operating expenses in order to recapture savings achieved as a result of the greening of building systems, particularly with respect to energy efficiencies achieved.

Finally, it would even be worth exploring whether tenants might be offered incentives to contribute to achieving agreed green rating targets. For example, tenants could receive operating expense (or even rent) reductions if they achieve a certain percentage of waste recycled or a reduction in energy consumption, or if the landlord fails to do so. Conversely, it could be agreed that there should be an increase in rent or additional rental charges if tenants fail to achieve rating targets.

Utilities

All utilities should be sub-metered or directly metered whenever possible in order to incentivize the conservation of energy and water resources and to promote environmental accountability. Tenants should be required to submit copies of utility bills to the landlord in order to benchmark energy consumption patterns against a baseline, provide transparent reporting of the building's energy performance and monitor tenant compliance with established energy reduction goals. Utilities should not be shared or charged on a floor area proportion of costs aggregated for the building.

Uses

The use section of the lease should provide that the tenant will not operate the premises in a manner that will cause the building to fail to conform to the green rating standard adopted in the lease or to fail the certification of the building or premises for the green standard in question. The use section should further address the obligation of the tenant to abide by any state or local environmental laws and impose those same requirements on subleases or licenses of the space in question.

Green Building Standard

The green lease should expressly adopt a green rating standard, such as LEED or Green Globes, and the tenant conduct provisions of the lease should track these rating requirements in order to provide a single point of reference and conform to the green rating requirements adopted in the financing and equity documents. For that reason, the BOMA green lease provides that, because the building is or may in the future become certified under a green scheme, the landlord's and tenant's practices will address the building operations and maintenance issues in compliance with that scheme, including those relating to chemical use, indoor air quality, energy efficiency, water efficiency, recycling programs, exterior maintenance and system upgrades. The BOMA lease also requires the tenant to use proven energy and carbon reduction measures, including energy efficient bulbs and task lighting, the use of lighting controls, day lighting measures to avoid over-lighting interior spaces, closing shades on the south side of the building to avoid overheating the space and purchasing Energy Star-qualified equipment as well as water



saving and related equipment. Extensive covenants on compliance with recycling laws and regulations and the landlord's particular recycling requirements including the sorting and separation of trash and recycling are also provided.

Maintenance and Repair

The maintenance and repair section should provide for the tenant complying with the landlord's sustainability practices (or in the case of a large lease, vice versa). This may change from time to time. The maintenance and repair provisions should also require the reporting of environmentally sensitive purchases by the tenant or the audit of the same by the landlord or vice versa.

The landlord should be permitted to install energy saving equipment in the building and to use portions within the walls and above the hung ceiling to accomplish the foregoing.

In connection with the performance of maintenance and repair functions, the lease should mandate adherence to green construction rules and regulations by building construction contractors, including with respect to construction and the review of all work projects for potential impact to reduction targets and environmental programs. A LEED- or Green Globes–certified consultant may be retained at the landlord's or tenant's expense to evaluate the degree of tenant compliance.

Alterations

The alterations portion of the lease should specify the use of green materials, including recycled materials, green products such as Energy Star–rated appliances and equipment, lighting sensors, floor finishings and coverings, paints, sealants and adhesives and bathroom fixtures such as waterless urinals and water-efficient toilets.

The tenant should not be permitted to make alterations that may prejudice the LEED rating or environmental performance of the building and, without limiting the foregoing, work practices related to alterations should specify the use of sustainable practices including rating systems such as LEED. Also, the lease may require that the tenant agree to maintain LEED for Commercial Interiors certification for tenant improvement work and alterations.

If alterations are permitted or required to be removed at the end of the term, the lease should provide that the tenant will dispose of these alterations in an environmentally sustainable manner. Alterations that are going to be demolished should be recycled whenever possible.

Cleaning

Cleaning should be performed in accordance with the sustainability practices, which may require that cleaning be performed during office hours using environmentally acceptable materials.

Building/Construction Rules and Regulations

As previously mentioned in the context of maintenance and repairs, the building and construction rules and regulations should require that the tenant and its contractors, at a minimum, adhere to sustainability



guidelines, including the use of environmentally acceptable products and materials and adherence to recycling guidelines.

Carbon Offset Credits

The lease should provide that, in the event that the tenant is unable to achieve certain energy saving guidelines, it will be required to purchase carbon offset credits (as discussed below) in order to offset its failure to achieve these guidelines.

For the same reasons, carbon taxes incurred by the landlord should also potentially be included in operating expenses.

A good deal of the debate over the economic structure of the green building lease revolves around whether the lease should be structured as a so-called “gross” or a so-called “net” lease.

In the gross lease format, the landlord pays for the building’s operating expenses and real property taxes incurred during a “base” year, and the tenant pays for increases in operating expenses and real property taxes over those incurred during the base year. Several commentators argue that the gross lease format is more capable of achieving green incentives because it encourages the landlord to minimize the expenses for which it is responsible, and that the tenant as a result is only responsible for increases in those expenses.

Other commentators suggest that the net lease format is better because the tenant directly absorbs the building’s operating expenses from the outset, providing incentives to reduce energy consumption and to persuade the landlord to minimize building expenses.

Although the net lease has gained considerable popularity in recent years, tenants in approximately 60 percent of U.S. office buildings occupy their premises under a gross lease. Clearly, while each of the structures has its benefits and disadvantages, neither is preferred and it may be a decision that is resolved in terms of the economics of a particular market. What is certain is that the metering of utilities and facilities should be required whenever possible so as to properly account for the consumption incurred by the landlord and the tenant and thus create a structure for reducing energy consumption.

The optimal structure in this writer’s opinion is a gross lease in which the landlord—who is in a better position to evaluate the baseline building costs—establishes a base operating expense framework that provides for the recovery of capital costs incurred to achieve the green rating benchmarked for the building and requires the tenants to pay for increases in these benchmarked expenses. Of course, the lease may further be refined by establishing a “green pass-throughs” category in much the same way that gross leases in certain markets incorporate several different types of escalations for energy costs, insurance expenses and the like.

Although the greening of a particular older building may be problematic because of the existence of standard leases without green provisions, the landlord can gradually insinuate green provisions as leases are amended or rolled over, or, as an alternative, the landlord can gradually modify the lease through the promulgation of new building rules and regulations that cover green topics, many of which, like recycling, are covered by contemporary leases.



GREEN LEASE FORMS

There are a number of green lease forms that have been promulgated by national and international real property organizations.

The first is the REALpac Model Lease, which is promulgated by Real Property Association of Canada (REALpac). The green elements of the REALpac Lease, as stated in its operating manual, contemplate a “landlord-centric” structure, with the landlord driving the green objectives, green decision-making and compliance. However, the lease form contemplates that the green elements of the lease may be easily transposed to a tenant-focused model, and can be negotiated into a shared responsibility model as well. The REALpac Lease makes use of an extensive and highly detailed environmental management plan that is appended as an exhibit to the form. Some of the concerns addressed in the environmental management plan include energy conservation/efficiency targets; water conservation measures; comprehensive landlord and tenant procurement guidelines; requirements for natural or low water consumption landscaping; indoor air quality standards; the use of environmentally friendly carpet cleaning products by the landlord and tenant; the use of day lighting and related use of screens to shield the sun’s rays; and the purchase and use of efficient appliances and fixtures, including waterless urinals, low-flow faucets and taps, and Energy Star–rated photocopiers and printers that reuse paper or print double-sided. Many sections of the REALpac form, such as alterations, maintenance and repairs, restoration and other typical provisions refer to the tenant’s obligation to comply with the applicable provisions of the environmental management plan. The advantage of the structure adopted by this lease form is that it coordinates and consolidates all of the relevant green provisions in a single exhibit so as to avoid inconsistent provisions and permits a simpler way to change the green elements of the lease by promulgating changes in the environmental management plan.

Another, in many respects more sophisticated, lease form is the model lease promulgated by the Building Owners and Managers Association (BOMA). The BOMA lease form is malleable and may be adapted to a number of rating schemes. The BOMA form makes extensive use of provisions that are integrated throughout the lease document and are not merely cross-references to an environmental management plan incorporated in an exhibit to the lease. This approach results in a lease that is a more carefully integrated document; however, in other ways, it makes the lease form more prone to potential inconsistencies as individual provisions are negotiated if corresponding adjustments to other related provisions are not made. The outline of green lease provisions set forth above is tracked directly from the BOMA green lease form and summarizes its principal provisions. The BOMA form is available in the book *The Lease Guide to Writing a Commercial Real Estate Lease (Including Green Lease Language)* with an accompanying CD.

Particularly detailed green provisions have been authored by U.S. governmental institutions. The GSA requires green provisions in lease solicitations (*See* http://159.142.162.71/gsa/cm_attachments/GSA_DOCUMENT/RSL2007-12_R2-y08-1_0Z5RDZ-i34K-pR.pdf).

States have also joined the green bandwagon. A particularly comprehensive model has been authored by the commonwealth of Pennsylvania (*See* http://www.gggc.state.pa.us/gggc/lib/gggc/documents/greensburg_leased_facilities1.pdf).



In the international arena, several governments have promulgated their own forms. An example is the Australian government's model Green Lease Schedule (available with explanatory commentary at <http://www.environment.gov.au/settlements/government/eego/publications/pubs/glsguidancenotesv10.pdf>).

Of course, there are also many proprietary forms of green leases in existence, such as the ones that have been developed by a number of prominent developers, and those that we have developed for our clients.

CONCLUSION

Prodded by governmental mandates and incentives and the aspirational goals of corporate institutional users and developers of space, green buildings have now reached a tipping point where they will constitute more than a market niche.

Green buildings and green leases will become the market standard, and buildings that do not fit within the green framework will be comparatively disadvantaged in much the same way that "smart" buildings ready for the Internet age vanquished older properties. The green lease as a tool for achieving the goals of sustainable building development and operations will grow in importance and sophistication and will be a driver for the growth of green buildings.

Mario J. Suarez, Esq.
Thompson Hine LLP
335 Madison Avenue, 12th Floor
New York, NY 10017
212.908.3930
Mario.Suarez@ThompsonHine.com



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