

CURRENT DEVELOPMENTS IN GREEN LEASING

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Overview

“The birth of the green lease” was one of the top ten events in CoStar Group’s annual listing of significant events for sustainable buildings -- and that was back in 2008. Yet, more than a year later, relatively few have heard of “green leasing” and, while some have negotiated leases in green buildings, few have negotiated or seen a “green lease.” What are we to make of this dichotomy?

There actually have been many new developments in green leasing over the past couple of years, some imposed by new laws, some derived from changes in LEED (discussed below), some market-driven. But the lease form itself, as a document, has been slow to adapt. To some extent this may be the result of the design-and-construction orientation, not operational orientation, of most LEED certifications and the consequent misunderstanding that green obligations end once the space is delivered. Even when a landlord has more savvy than that, the slow adaptation of green provisions to leases may be a reflection of the overall economy: with leasing activity itself slow, few landlords want to impose unfamiliar new terms and conditions, with presumed (rightly or wrongly) cost implications, on skittish prospective tenants lest they lease elsewhere.

But the growth of LEED-EBOM (LEED for Existing Buildings: Operations and Management), the increasing legal and competitive pressure to run more energy efficient buildings, and potential market demand for the higher quality-of-life aspects of green buildings, combined with the long lead-time (and money) necessary to retrofit a building or to green building operations, could mean that failing to get ahead of the green leasing curve will lead to a competitive disadvantage once the economy turns upward again. Consider the following developments that have occurred while, to paraphrase a popular movie title, you were sleeping:

- The U.S. Green Building Council (USGBC), the private organization that promulgates LEED, substantially overhauled all of its LEED ratings and in early 2009 introduced LEED 3.0.
- Debate has raged over whether LEED-certified buildings really are more energy efficient than non-certified buildings, whether LEED-certified buildings actually operate as efficiently as expected, and whether LEED-certified buildings push energy efficiency far enough. In response to these concerns, in late 2009 the USGBC announced that it would require newly-certified buildings to report back on their actual energy operational efficiency so that the USGBC could amass sufficient data from which to determine what to do next, if anything.

- Not waiting for the USGBC -- or, for that matter, the Federal Government -- and probably often without understanding the consequences, many municipalities, counties and States have begun to mandate that new buildings be certified green. These laws usually require that the buildings meet LEED standards but occasionally also allow some rival certification such as Green Globes or the popular residential standards promulgated by the National Association of Home Builders or a more regionally or locally popular standard.

- In addition to, or in lieu of, the green certification for new buildings noted above, some municipalities now are beginning to require that buildings comply with certain energy efficiency guidelines. Other municipalities have begun to require that buildings report their energy ratings, essentially using public shaming as a behavior-modification device. These energy efficiency requirements often adopt the ENERGY STAR rating jointly created by the U.S. Department of Energy and the U.S. Environmental Protection Agency.

- ASHRAE, the American Society of Heating, Refrigerating and Air-Conditioning Engineers, has proposed new energy efficiency ratings that go beyond the ENERGY STAR rating by separately evaluating a building's "design" efficiency and its actual "operating" efficiency. The International Code Council has published its own proposed International Green Construction Code. Proposed Federal legislation addressing energy efficiency has similarly proposed a new, more sophisticated and more universally applied, energy efficiency rating system.

- Many government agencies -- from the U.S. General Services Administration to some States, counties and municipalities -- have announced either requirements or preferences for green buildings in their own leasing activity, trying to move the market through their own buying power. Some corporate early adopters, as tenants, have done likewise.

- Trade organizations within the private sector have responded to these stimuli by promulgating various "green lease" forms. Some are better than others and there already is concern that the proliferation of forms may confuse rather than lead the market. The following materials prepared by the ABA's Section of Real Property, Trust and Estate Law's Leasing Group via its Green Lease Task Force attempt to expand on the existing forms by providing commentary and context that will enable practitioners to adopt the existing forms or adapt their own preferred lease forms to green concepts.

A Very Brief Introduction to LEED (and Its Competitors)

LEED -- an acronym for Leadership in Energy and Environmental Design -- is a green standard for buildings promulgated by the USGBC. LEED holds probably a 90+% market share for certifying green buildings in the United States. Although there seems to be a widespread assumption that "LEED" is synonymous with "green," that is not the case.

Another rating system is the Green Globes system operated in the United States by the Green Building Initiative. Green Globes is an offshoot of a popular system in Canada and the BREEAM system widely used in the United Kingdom and much of Continental Europe. (There are many times the number of BREEAM-certified buildings as LEED-certified buildings.) In the United States, you also may hear references to ENERGY STAR, ASHRAE, ASTM, NAHB, Green Communities and other systems that evaluate green, either in part or more holistically, and that exist independently of LEED and Green Globes. There also are other rating systems popular in Australia, Japan, Germany and other industrialized countries.

LEED has various levels of qualitative ratings, starting with Certified and moving up to Silver, Gold and Platinum. Green Globes similarly grants 1 to 4 globes. A building's qualitative rating depends on the number of points accumulated by the building out of the points smorgasbord used by the rating system. Thus, the relative "greenness" of LEED-certified or Green Globes-certified buildings can vary wildly.

Also, it is important to realize that there are separate LEED ratings for (i) the building core and shell when both are built as part of one common project, often the case in build-to-suits, (ii) the base building only, useful in multi-tenant office buildings, and (iii) the tenant space only. Remember that these ratings are all somewhat backward-looking in that they are based on the design and construction aspect of the project, not on operational issues going forward.

There is one LEED category that relates to building operations. It's called LEED-EBOM, an acronym for LEED-Existing Buildings Operation and Maintenance. Green Globes has its own equivalent. LEED-EBOM only applies to buildings that have achieved a certain percentage of occupancy (reduced in late 2009 from 75% to 50%) and that have an operating history before they are certified. LEED-EBOM does not require as a prerequisite that one of the design-and-construction oriented LEED ratings be achieved, which makes LEED-EBOM attractive to existing buildings as well as to new buildings.

A Very Brief Introduction to ENERGY STAR

LEED-certified buildings are not necessarily inherently "energy efficient," nor are they necessarily less costly to operate than non-green buildings. It is quite possible to have a green building that is not energy efficient at all, or that is no more energy efficient than a non-green building. One reason for this is that, until recently, LEED ratings did not require assembling any points from categories relating to energy efficiency. That has changed, but even current LEED standards do not require significant energy efficiency or significantly reward more energy efficient buildings.

A tenant looking for energy efficiency should instead consider looking at the building's ENERGY STAR rating, not at a more comprehensive "green" rating.

ENERGY STAR is a Federal program jointly administered by the U.S. Department of Energy and the U.S. Environmental Protection Agency. It relies on building owners to self-evaluate their building's energy efficiency using the ENERGY STAR modeling system. A score of 75 or higher qualifies for an ENERGY STAR plaque. But keep in mind that ENERGY STAR has a monomaniacal focus on energy usage. ENERGY STAR is not a synonym for "green." Also keep in mind that ENERGY STAR is entirely separate from LEED: a LEED-certified building is not necessarily scored highly by ENERGY STAR, nor is an ENERGY STAR-labeled building necessarily LEED-compliant.

Governmental Mandates and Incentives

The legislative push to encourage, and increasingly mandate, sustainable buildings continues to expand at a breakneck pace. Federal, state and local governments have gotten in on the act. It remains to be seen how the various implemented, pending and proposed laws and regulations will affect green leasing.

Traditionally, green building legislation focused on new building construction and major renovations, rather than the ongoing building operations. Thus, past legislation had not mandated or particularly encouraged the development and implementation of green leases. Lately, however, governments, perhaps taking their lead from the USGBC, have begun focusing on the actual performance of buildings as well as their initial construction. If this trend continues, as it appears it will, landlords and tenants will need to structure their leases accordingly to comply with federal, state and local requirements.

Federal Mandates and Incentives

There is no federal statute or regulation requiring green building by the private sector. The federal government does, however, generally require its own buildings to be sustainable pursuant to the Energy Policy Act of 2005, the Energy Independence and Security Act of 2007, and a series of Executive Orders and agency-specific rules promoting green building and sustainable practices since the early 1990s. For example, all new General Services Administration construction and renovation projects must obtain a LEED Silver (or higher) certification.

The lack of current federal legislation should not suggest, however, that there have not been efforts to require high performance buildings on the federal level. The American Clean Energy and Security Act, also known as the federal Cap and Trade Bill, was passed by the House in 2009 and currently is stalled in the Senate. This imposing legislation would place mandatory limits on the emissions of greenhouse gases by setting a series of caps on emissions of greenhouse gases through a system of permits and allowances. Companies would be permitted to buy and sell those allowances. The bill would require existing commercial, residential and government buildings to be retrofitted to increase energy efficiency, but leaves it up to the states to determine exactly how to do this. There is no indication that this bill will be passed into law any time soon, and given

the current climate in Washington, it is difficult to predict if any federal mandate for energy efficient building operations will pick up steam in the near future.

In addition to the foregoing, there are tax incentives for constructing or retrofitting a building with specified sustainable features in the private sector. For example, there is a tax deduction of up to \$1.80 per square foot for improvements to a building's lighting, HVAC systems and envelope. This deduction is available for either landlords, tenants or both; whichever party incurs the actual expenses for the improvements is entitled to the deduction.

State Mandates and Incentives

Most states have some type of incentive programs such as grants or tax incentives encouraging green buildings in the private sector. In addition, many states have tried to lead by example by enacting regulations requiring high performance and energy efficiency for state government buildings or for buildings constructed with state dollars. Many of these regulations could also be referred to as "LEEDing by example" because they incorporate LEED and other third party certification systems into the laws themselves. By way of example, the pending Ohio House Bill 7 would require any building constructed using any state funds (with certain specified exceptions), to both (i) achieve a certification of LEED Silver, Green Globes two globes level, or some other accepted equivalent standard, and (ii) achieve specified energy efficiency benchmarks.

Many of these state regulations fail to address what happens to projects that ultimately do not achieve the specified third party certification. Since certification is controlled by an independent third party such as the USGBC or Green Globes, how the certification process operates and is administered is well outside of the government's control (and due process and antitrust questions are also implicated). Furthermore, many of these laws fail to address the fact that these certification systems remain dynamic and are constantly being updated and revised. For example, many laws and regulations passed prior to the implementation of LEED Version 3 in 2009 may cross-reference obsolete LEED standards. Some of the laws and regulations have dealt with this by referring to the LEED (or other certification system referenced) "then in effect."

Until recently, there has not been a great push among the states to mandate green building in the private sector. This may have changed with the application by the District of Columbia (which is a city but also a state-equivalent) and the State of California of LEED standards to new private construction via their building codes. The District of Columbia Green Building Act of 2006 incorporates LEED into the building code effective 2012 for large buildings and then phases in smaller buildings over time. Although the statute is not without its flaws and uncertainties, the Class A office development market in Washington, D.C. has already eclipsed the Act's goal by creating a de facto market-driven minimum of LEED Silver. However, the Act addresses only building code requirements, does not address operational issues, and has not had any discernible effect on the rarity of green leases themselves.

California's new "Calgreen" statute, which will take effect January 1, 2011, revises California's building code to incorporate sustainable building practices into private construction. Calgreen requires, for example: new buildings to reduce water consumption by 20 percent and divert 50 percent of construction waste from landfills; the use of low-pollutant paints, carpets and floorings; the use of separate water meters for indoor and outdoor water use in commercial buildings; mandatory inspections of HVAC and other energy systems; and building commissioning and post-occupancy systems management. Thus, Calgreen not only requires sustainable buildings in the private sector, but it also shifts much of the government's focus to the operation and maintenance of a building, which may have a significant effect on the prevalence of green leases.

Local Regulations

There are a myriad of local ordinances and regulations encouraging or mandating green buildings. A 2009 study published by the American Institute of Architects (AIA) took a survey of green building legislation by studying American cities with populations greater than 50,000 that contained programs that either mandated or encouraged the construction of green buildings. The study found that 21% of the cities surveyed, or 138 cities with over 53 million residents, have green building programs. Not surprisingly, the West Coast states, led by California, overwhelmingly had the greatest percentage of sustainable building regulations (47 cities in California alone have green building regulations). The study also noted that there are significant numbers of green building ordinances appearing in the Eastern United States and in the Rocky Mountain region and that we are increasingly seeing more programs in the Midwest. The USGBC maintains an authoritative listing and summaries on its website.

The scope and sophistication level of these regulations are as diverse as the regions they cover. The traditional and most commonly enacted approach has been to require city or municipal buildings to meet the designated sustainability standard, while encouraging private development to meet these standards by way of incentives. Perhaps even more than state laws and regulations, municipalities appear to lean heavily on LEED (and at times list Green Globes as the alternative).

For example, NAIOP (National Association of Industrial and Office Properties) has created and published a Legislative Toolkit for Sustainable Building Ordinance. The Toolkit provides that all new buildings or major renovations to city buildings shall be built in accordance with a certain specified LEED or Green Globe standard, as determined by a designated city compliance official. The Toolkit further contemplates incentives for private commercial developers to meet the same standards, including a density bonus, property tax reductions and credits, and expedited and reduced cost permits. The Toolkit does not require actual registration and certification with the specified system – rather just compliance with the standards as determined by the designated city official.

Going beyond public buildings, a number of ordinances are mandating actual LEED certification for private buildings, especially in relation to commercial buildings.

For example, Los Angeles requires commercial buildings constructed with greater than 50,000 square feet and multifamily properties with at least 50 units to obtain a specified LEED certification. Boston amended its zoning code to reference LEED for New Construction credits.

But not even the USGBC, which promulgates the LEED system, intended that LEED be used as a statutory minimum or baseline. LEED was intended to set a leadership standard for the top 25% or so of buildings to move the market. Nor is LEED, which scores buildings based on their aggregate point scores amassed from a smorgasbord of separate sustainability factors, with the decision of which points to amass being left to the developer, intended to be compatible with standard building code concepts.

In an acknowledgment that LEED certification standards are not intended to be codified or incorporated into laws, ASHRAE (the American Society of Heating, Refrigerating and Air-Conditioning Engineers) and the USGBC are jointly developing Proposed Standard 189.1, Standard for the Design of High-Performance Green Buildings Except Low-Rise Residential Buildings. ASHRAE's current Standard 90.1-1099 is the energy conservation standard that provides the baseline for most building codes in the country. Proposed Standard 189.1 will replace Standard 90.1-1099. Proposed Standard 189.1 will more broadly provide minimum requirements for the design of sustainable buildings to balance environmental responsibility, resource efficiency, occupant comfort and well-being, and community sensitivity in a format more conducive to local building codes.

Somewhat in parallel with ASHRAE Proposed Standard 189.1, but separate from it, is a March 2010 proposal by the International Code Council to promulgate a new International Green Construction Code. The proposal is somewhat like ASHRAE 189.1 in that its goal is to provide standards that can readily be incorporated into building codes. Like LEED, the IGCC contains both mandatory sustainability requirements (like metering and commissioning in the case of the IGCC) and electives (such as ongoing energy reporting); unlike LEED, however, the choice of which electives to adopt under the IGCC is made by the government, not by the developer, and the adopted electives become mandatory in that jurisdiction. The IGCC also allows the government to adopt ASHRAE 189.1 as an alternative compliance path, and if that path is followed then most of the IGCC no longer applies.

Unlike the ASHRAE and IGCC proposals referenced in the preceding paragraphs, until recently most of the local ordinances, regulations and incentives that have actually been enacted appear to have focused heavily on the initial construction or renovation of buildings, rather than ongoing operations and maintenance. Lately, however, there seems to be more local focus on the operations of a building (perhaps not coincidentally in tandem with the USGBC's recent focus on LEED O&M and the foregoing proposals).

A prime example is New York City, which recently passed an energy audit and retro commissioning bill that requires most large privately-owned properties to conduct

energy efficiency audits and undergo retro commissioning (i.e. testing and recalibration of building systems to ensure as-designed performance) once every 10 years. Properties covered under the legislation would be required to undertake identified capital improvements that would, either individually or in combination, achieve simple payback in seven years or fewer. The District of Columbia Energy Act requires all buildings, new and existing, public and private, to benchmark themselves against the ENERGY STAR rating system, and to report their ENERGY STAR rating to the DC Government. The DC Government plans to make all ratings publicly available.

But few other state or local ordinances currently exist that require disclosure of energy efficiency for buildings. The States of California and Washington require disclosure to buyers, tenants and lenders in transactions involving nonresidential property. Austin, Texas and Seattle, Washington require disclosure to certain private parties in transactions involving nonresidential buildings or multifamily residential buildings. Seattle also requires annual public disclosure for both building types, and Austin also requires public disclosure for multifamily buildings.

For the most part, these first-generation energy efficiency laws do not require that buildings achieve a particular standard of efficiency or that buildings be upgraded. Rather, these laws are “sunshine” statutes, mostly predicated on the assumption that more information and public shaming will incentivize improvements. Green leases may have a role to play in enabling landlords to achieve these improvements.

The new focus on the operations and ongoing maintenance of buildings through legislation, coupled with the continuing and renewed focus on green building construction, if continued, will eventually result in landlords and tenants addressing their various responsibilities, rights and remedies as to compliance with federal, state and local law in the lease document itself.

“Green Lease” Forms in the Marketplace

Among the early adopters of green are various trade associations and entrepreneurs who have created “green lease” forms or conceptual guidelines for use by the private sector. These vary considerably in their approach and utility. If anything, they prove that there is no one answer to “greening” a lease and that the expansion of knowledge, not merely the propagation of forms, is the key to success.

The shared concept of these projects is that green operations, not merely green design or construction, are critical elements in achieving energy efficiency and an overall healthier and more productive environment for building occupants. It is important to note that it is not essential that a building be designed and constructed green in order to be operationally green. While green design and construction give a building a head start -- as discussed previously, how much of a head start depends on how the particular building achieved its level of greenness in the first place -- it is possible to green the operations

of a non-green building, just as it is possible to operate a green building in a non-green manner.

Beyond that, each of these lease forms assumes, consciously or not, that one party or the other -- the landlord or the tenant -- is the driving force in greening the particular building and imposing its green will on the other, and therefore has to address the allocation of responsibility and cost incident to that.

Some of the better-known entrants in the field are the following. They are presented essentially in the order in which they were issued so as to avoid any implication that the order in which they are listed is qualitative.

- Early out of the gate was a “Green Leases Toolkit” issued by the California Sustainability Alliance, available at no charge at www.sustainca.org. This product assumes that the tenant is the driving force in being green. The Toolkit includes a “Green Request for Proposal” that asks the landlord for a very thorough explanation of the green elements of its building, a “Due Diligence Scorecard” to compare how different buildings fare on various green criteria, and a “Lease Provision Database” that provides sample lease clauses. Perhaps because these materials were early adopters, however, much of the material is aspirational or makes open-ended statements -- such as the parties “will work together” or “mutually establish an energy optimization plan” or “pursue commissioning programs.” While the sentiments may be admirable, most leasing practice in the U.S. prefers hard-and-fast commandments and covenants and does not rely on the parties working together in the future on collaborative efforts. Thus, the Green Leases Toolkit is probably of more value in issue-spotting than in crafting an actual lease.

- A more formal lease effort is provided via the Real Property Association of Canada’s “National Standard Green Office Lease for Single-Building Projects.” This ground-breaking work is available for free on the internet at www.realpac.ca. The REALpac green lease attempts to green a traditional lease form largely by adding a green rider, although there also are some green provisions incorporated into the body of the document. What is perhaps most interesting about this particular green lease is its rapid evolution from an extremely and expressly aspirational model in the initial 2008 version, quite similar in that regard to the California Sustainability Alliance’s materials, to a hard-nosed and extremely pro-landlord form upon re-issuance in March 2009. REALpac issued a re-revised version in February 2010, but the changes between the 2009 and 2010 versions are evolutionary, not revolutionary.

- Shortly after the first REALpac lease was issued in 2008, the Building Owners and Managers Association International (more familiarly known as BOMA) issued its own “Guide to Writing a Commercial Real Estate Lease, Including Green Lease Language,” more commonly referred to as the BOMA Green Lease Guide. The BOMA Green Lease Guide greened an already-existing BOMA lease form by incorporating its green provisions directly into the text of the lease document, instead of simply adding a green rider to the existing form. As a result, the BOMA Green Lease

Guide is a bit less adaptable to other lease forms -- although its green provisions are printed in green ink so they can be easily spotted and utilized -- but probably is more comprehensive in its green clauses and its overall approach. It also is arguable that the integrative BOMA approach avoids the simplistic response of non-green tenants to a green lease rider, i.e. simply deleting it. Not surprisingly given its source, the BOMA Green Lease Guide assumes the landlord is the driving force behind going green and adopts a pro-landlord approach. On the other hand, the BOMA Green Lease Guide contains its own internal and extensive commentary on its provisions, thus critiquing its own terms, so it is useful to tenants as well. The BOMA Green Lease Guide can be purchased on BOMA's websites, www.boma.org and www.shopboma.org.

- The Natural Resources Defense Council (NRDC) attempted to come up with its own green lease rider. The effort quickly ended amid a Tower of Babel debate among the several dozen committee members as to what subjects should be addressed and how. This object lesson in the non-monotheism of green gave rise instead to a project focused on lease clauses that could address energy efficiency. The NRDC's "Lease Energy Efficiency Guidance" issued in 2009 advocates greater transparency and greater information sharing between landlords and tenants, traditionally an anathema to many landlords but a direction in which the USGBC seems to heading with its new requirement of energy efficiency reporting. Although the Lease Energy Efficiency Guidance doesn't provide actual lease language, it does raise interesting concepts and attempts to strike some balance between the parties by allowing landlords more favorable amortization of capital costs incurred in saving energy. The Guidance is available at http://cycle-7downloads.com/Downloads_files/Energy%20Efficiency%20Lease%20Guidance%203-18-09.pdf.

- The "Model Green Lease Reference Guide" followed in the summer of 2009. Somewhat similar to the REALpac green lease, this attempts to create a lease form with most of the green provisions contained in riders attached at the back. The chief selling point of this product is its attempt to promote gross leases as the greenest lease because the gross lease incentivizes the landlord, who controls about 70% of the building's energy use, to reduce building operating expenses for its ultimate own profit. Unfortunately, the Model Green Lease itself doesn't follow through on its marketing: the Model Green Lease is actually a "modified gross" lease, also sometimes known as a "full-service" lease, not a true gross lease, and therefore is probably financially closer to the net lease than to the true gross lease. Also, the Model Green Lease achieves its admirable brevity by omitting the nuance and commentary found in the REALpac and BOMA products; the Model Green Lease is not as thorough a non-green lease document as its peers. Finally, although the Model Green Lease's marketing materials imply that it is a balanced document, it is actually quite pro-landlord. (There is one glaring exception to that: in the key provision on the amortization of capital improvements that save operating expenses, the Model Green Lease suggests an amortization schedule that is so pro-tenant that it is hard to imagine that any landlord or landlord's attorney would accept it.) The Model Green Lease Reference Guide is available for purchase at www.squarefootage.net.

- The most recent entrant, late-summer 2009, is the USGBC's own "Green Office Guide." (A parallel "Green Retail Guide" is in development and should be issued in 2010.) This is more of a gentle "how-to" guide for the uninitiated tenant, demystifying the process of greening space. Like the California Sustainability Alliance material, it includes questionnaires, language for requests for proposals, and scorecards. Like the REALpac green lease, the BOMA Green Lease Guide and the Model Green Lease, the USGBC's Green Office Guide provides sample green lease language. Unlike those peer products, however, the provisions in the USGBC's Green Office Guide are provided on a stand-alone basis, not as part of an entire lease, so it is harder to assess and understand them in context. Also, this Guide assumes that it is the tenant who is the driving force in going green so it suggests more pro-tenant clauses than do its peer products. One result is that its lease clauses are occasionally somewhat more aspirational and, as the introductory language to the lease provisions states, there is no expectation that an alert landlord will agree to a significant amount of this. The Green Office Guide can be purchased on the USGBC's website, www.usgbc.org.

Summary

Thus, the standards and expectations of green buildings and green leasing are still in their relative infancy and evolving rapidly. There are many different approaches, most of which have at least some merit and no one of which seems to represent absolute truth. Blindly parroting whatever any of the forms and guides say will not successfully implement green on a building-by-building basis. An understanding of the nature of the particular building and of the interests of the parties to the lease is necessary. With that in mind, the remainder of this report attempts to address some common situations that arise in preparing and negotiating a green lease and to provide guidance for dealing with those situations.