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A reminder that green buildings need green leases

Real Estate Law Update

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Thanks to the 800-pound gorilla, otherwise known as government, the green building movement has traction making it essential that attorneys representing building owners and tenants know about "green buildings" and "green leases." The green building movement has changed how buildings are built, renovated, operated and maintained. It is also changing the relationship between landlords and tenants.

While there is no definitive definition of a "green building," most people equate a building with a LEED (Leadership in Energy and Environmental Design) rating as being a green building. LEED developed by U.S. Green Building Council (USGBC) is not the only rating system for buildings but is the one that is widely recognized.

From a real-estate perspective, green is really all about reducing energy usage and thus saving money. Saving money is the impetus for retrofitting existing buildings to make them "green." After all, the first "E" in LEED refers to energy.

Those leasing space in buildings with LEED ratings should expect that the building will be using a lease with provisions specifically included to address green issues. In 2009, USGBC published "Green Office Guide: Integrating LEED Into Your Leasing Process." In the preface, USGBC describes this guide as "focused on helping tenants and landlords collaborate." In the pre-green world, the world "collaboration" was not an element in the landlord-tenant relationship.

Green leases for newly built green building are not the "big" challenge facing building owners because the leases for these buildings will be entered into with tenants who have made the decision to lease space in a green building and have "bought into" the fact that their lease will have "green" provisions.

The same is not true when a landlord determines to retrofit or "green" an existing building occupied by tenants who signed a traditional space lease. A successful retrofit calls for a lease amendment which changes some of the standard terms of office building leases.

A green retrofit requires capital expenditures by the landlord for new and improved building systems, which often result in immediate costs savings for the tenants but not the landlord. Installing energy efficient systems cost the landlord money and result in reduced energy costs. This benefits the tenants as operating expenses passed onto them decrease. This is a clear win for the tenants but may not be a win for the landlord. The landlord's win will come only if and when space in its retrofitted building can be leased more quickly and for higher rents.

Existing building leases give landlords little or no incentives to green an existing building. New York energy consultant, Sean Neill described the recently adopted New York City requirement that landlords audit their buildings' energy use and publish the results as being a requirement that will not result in landlords expending money to achieve energy savings UNLESS the costs are shared with tenants.

Without an ability to pass along the costs for changes in building systems, landlords have no incentive to upgrade building systems. The traditional office lease needs to be greened to give landlords an incentive to spend money to green existing buildings.

A green building lease is not the traditional office lease printed on recycled green paper. A green lease is one where the parties have rethought the relationship between landlord and tenant. The old "standard" office lease provisions are revised to address the issues of operating and maintaining a green building and to facilitate the retrofitting of existing buildings. Most importantly it must include provisions which obligate tenants to share in the costs of building system improvements that reduce operating costs.

The focus on changing existing building leases to encourage and support building retrofits is starting to gain traction as more high profile large buildings such as the Empire State Building and the Merchandise Mart are retrofitted and achieve a LEED rating.

Unless tenants appreciate that the payment of additional costs for a retrofit will result in energy-cost savings sufficient to cover their portion of the additional costs of the retrofit, they have no incentive to enter into an amendment to their existing lease.

The portion of the green building movement that involves retrofitting existing buildings will be successful only if a new "partnership" between landlords and tenants can be achieved where tenants pay for costs incurred for capital improvements which are not passed through to tenants in standard office leases.

Communication is a key element in achieving this partnership. Often the first step is for the landlord to provide tenants with information about the building's current use of energy and water and the costs currently incurred which tenants pay. The next step is to show the reduction in usage and more importantly the cost savings that tenants can expect to achieve following a retrofit. The final step is to explain how the proposed retrofit will reduce the rent paid by the tenants. Retrofits that result in cost savings that cover the costs of the retrofit in a year or less are likely to prove acceptable to tenants whose lease have a few years to run.

The concept of a partnership or collaboration between a building owner and its tenants is a major change in the traditional relationship between landlords and tenants. For the landlord the idea that it must disclose information about building costs, operating practices and maintenance schedules to tenants is contrary to most landlords' view of how the world works. The concept of collaboration implies that tenants — in exchange for paying costs not previously passed onto them — would have rights to review and approve landlord's plans for building system improvements.

As the green building movement continues, green lease provisions will become more standardized and will address issues critical to maintaining and operating a green building and delineate a new relationship between building owners and occupants.