

Implementing Green Leases Requires Overcoming Faulty Assumptions

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Abstract The lease document is a key element in the environmental and financial performance of a multi-tenant office building. It defines the contractual relationship between landlord and tenants, i.e., who does what, when, how, and who pays. It also covers a host of esoteric legal issues such as financing, insurance, and destruction of the building and premises. As the Green Lease Revolution continues grow, more people are turning to the web for information about green leases. Yet many of the tweets, blogs and websites are riddled with misconceptions, faulty assumptions, and oversimplification of the leasing process. This paper examines five building operating issues and how a properly written green lease differs from a lease that maintains the status quo.

Every day I get a Google Alert on green leases, which I dutifully read and then click on the various tweets, blogs and websites listed in the alert. Sometimes there will be a well-researched nugget. Unfortunately, the typical item is riddled with misconceptions, faulty assumptions, and oversimplification of the leasing process. Far too often the authors exhibit little if any understanding of the commercial real estate lease negotiation process. Further, they are guilty of failing to understand basic real estate economics, building operating practices, or the current state of building technology.

The lease document is a key element in the environmental and financial performance of a multi-tenant office building. The lease document defines the contractual relationship between landlord and tenants, i.e., who does what, when, how, and who pays. It also covers a host of esoteric legal issues such as financing, insurance, and destruction of the building and premises. While a landlord may own bricks and mortar, it is the tenants' leases that create the economic value.

Six years ago, many considered it revolutionary when I wrote the *Ten Essential Elements of a Green Lease*. The 10 elements were based on using the proper rent structure, suitable technology, performance standards, coupled with measurement and verification to create a financial incentive for green buildings rather than some platitude about saving the planet. Many believe that copying language from an LEED reference guide into an existing lease document will create a green lease. While this may give a lease a green tint, it does not result in a green lease. Early on the Model Green Lease Task Force decided that this copy and paste strategy was not viable. To create an effective green lease, not only requires adding language, it also demands addressing the issues buried inside various clauses and exhibits that hindered operating the building and tenant premises in an environmentally responsible manner. A further complication is the fact that real estate is a local business with wide variations in local practices. For example in Manhattan a

lease document for a credit tenant in a multi-tenant office building can easily run 150 to 170 pages; in San Francisco 70 to 90 pages is common, in Cincinnati 40 to 50 pages would be the norm.

Let's examine five building operating issues and see how a properly written green lease differs from a lease that maintains the status quo.

1. Energy

This is a simple case of follow the money. Only real estate taxes top energy as the largest operating cost for an office building. The key to controlling and reducing energy use in an office building is for the landlord to profit from doing so. Tenants in multi-tenant buildings have little financial incentive to reduce energy consumption. People account for 80% of the tenant's cost of doing business. Rent is next at 8%. The energy portion is 0.6% of the tenant's total cost of doing business. If a tenant cut energy use by 40%, the savings wouldn't buy employees a daily cup of coffee at Starbucks given current energy costs and usage. The practice of using pro rata share as an allocation method prevents the tenant from seeing any economic benefit from reducing energy consumption. Under the Model Green Lease a landlord is responsible for all energy costs up to the stated energy allowance. This creates a powerful financial incentive to seek out energy savings and to keep the building in top condition. This encourages a whole building approach to energy management and using the appropriate technology such as the lighting system installed in the New York Times Buildings. The current building code in New York limits lighting to 1.1 watts per square foot. The lighting system used in the Times Building has cut the energy used for lighting to 0.36 watts per square foot. This equates to a combined energy savings from lighting and cooling of \$1.00 per square foot. The use of sub-meters brings over allowance energy use to the forefront quickly. How you may ask? Somebody within the tenant's organization will have to budget for it. Also if excess energy use or after hours charges are billed to department's P&L, those responsible for that P&L will inspect that expense closely. Experience has shown a 30 percent reduction in over allowance and after hours use after installation of sub-meters.

Green Lease Modified Gross Lease with Expense Stop or Base Year; Realistic Energy Allowance for tenants and sub-metering for tracking each tenants energy use, and separate sub-meters for high-energy uses such as server rooms; Control Building Operating Hours

Status Quo Net Lease, Pro-rata Share Allocation of Operating Cost promotes the status quo

2. Operating Performance

A few years ago the National Institute of Science and Technology did a survey of 100 office buildings and found that half of them were taking in less than the minimum amount of fresh air as required by ASHRAE 62.1. Moreover, 25% of the buildings were operating at less than half the minimum air intake rate. Over-ventilation was just as rampant as under-ventilation. Both can have a negative impact on tenant comfort, indoor air quality and energy use. Comfortable temperatures and indoor air quality are the

second and third most important issues for tenants trailing only rental rate. Yet these two issues are the greatest source of tenant dissatisfaction with a building.

Green Lease The lease should state the building's HVAC system will be operated in compliance with ANSI/ASHRAE Standard 55-2004, Thermal Environmental Conditions for Human Occupancy and ANSI/ASHRAE Standard 62.1-2004, Ventilation for Acceptable Indoor Air Quality. In addition to stating the performance standard, the lease should state in plain English terms the operational limits of the HVAC. Including this reference in the lease provides a measurable performance metric. It also, provides a metric for handling "It's Too Hot" or "It's Too Cold" calls.

Status Quo General terms such as "reasonable" or "comparable with other class "A" office buildings located in the area" are used to describe how a building will be operated.

3. Recycling, Daytime & Green Cleaning, Green Pest Management

What's not to like about this? You get a cleaner building with fewer complaints, lower operating costs, while protecting the health and safety of the janitorial staff and tenants. Tenants won't object unless you make the process too complicated. A major bank in Canada decided to introduce a corporate recycling program. When the program was rolled it out, they could not find a branch bank in their system that didn't already have a recycling program started by the employees. Daytime cleaning program have shown to reduce complaints, and cut energy use 4% to 10%.

Green Lease Appropriate Lease Clauses, Lease Exhibits, Building Rules & Regulations such as those in the Model Green Lease make implementation a straightforward task.

Status Quo If the lease does not address these topics – It's not a green lease.

4. Annual Environmental Performance Report

The idea of the annual environmental performance report comes from management guru Peter Drucker, who says "What gets measured, gets managed." When the Model Green Lease Task Force first raised the idea of the Annual Report, there was some resistance. California and a growing number of jurisdictions are now requiring an annual report. Also an increasing number of corporations now require such reports from their supply chain for their Corporate Social Responsibility (CSR) reporting. Since the landlord operates the building and pays all the bills it is reasonable for the landlord to collect, analyze and report building performance data to the tenants along with the annual operating budget and annual expense reconciliation. After the Model Green Lease was released, Andy Fuhrman and Alan Edgar of OSCRE asked the Model Green Lease Task Force to work with the OSCRE Green Lease Advisory Board to set up the data exchange standards. This newly released standards makes the collection, analysis and reporting of information quick and easy for the landlord and provides transparency to the tenants.

Green Lease A lease clause with appropriate lease exhibit detailing the information the landlord will provide the tenant each year on operating hours, energy use, renewable energy, water use, and recycling.

Status Quo If the lease doesn't require an annual report – It's not a green lease

5. Interior Construction

The initial fit-out of tenant space coupled with the subsequent tenant turnover can have a significant impact upon the environment and indoor environmental quality of a building. The interior construction should comply with requirements for low VOC content, dust control, proper material handling and storage, and recycling of construction waste whether the tenant is seeking certification such as LEED for Commercial Interiors or not.

Green Lease Tenant Workletter Agreement and the Contractor Regulations contain language that defines sustainable product requirements and construction practices to be used in constructing the tenant improvements.

Status Quo If the lease and its exhibits do not specify the sustainable product requirements and construction practices to be used in construction of the tenant improvements – It's not a green lease.

This spring the Model Green Lease Task Force will release the latest update to the Model Green Lease including three new tenant workletter agreements and a LEED-CI checklist.

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