



Model Green Lease Lands in New York City at Urban Green Expo

By Stephen Del Percio • on September 29, 2009

Last Wednesday, I had the opportunity to join a panel discussion on green leasing at the Urban Green Expo here in New York City. The session, which was titled “Green Leases: Aligning the Incentives of Landlord and Tenant,” presented the results of four projects which aim to provide brokers, landlords, tenants, and their attorneys with guidance towards creating more sustainable leasing structures. The projects, which may be familiar to you, were the Real Property Association of Canada’s (REALpac) Green Office Lease, the BOMA Green Lease Guide, and the NRDC’s Green Lease Forum, which aimed to create a set of principles for lease negotiations and other recommendations for making existing leases more energy efficient. I presented the Model Green Lease Task Force’s Model Green Lease- an effort which, as you may know, was spearheaded by green leasing guru Alan Whitson (who has contributed here at GRELJ previously in an insightful response to an article that we wrote on environmental performance objective clauses).

Unlike the BOMA Green Lease Guide (created by Jones Day partner Steve Teitelbaum, who also participated on the panel), the Model Green Lease is an extremely compact document, drafted from scratch, which is fundamentally based on the theory that, in order to make a more compelling business case for green buildings, leases must be crafted as gross (i.e., the landlord is responsible for building operating expenses, unlike in a net lease, where the tenant pays for its own share of those costs). The document, which also includes a corresponding reference guide, comprises just 17 pages plus exhibits and incorporates ten essential elements that aim to support a specific definition of a green building created by the Task Force for purposes of the project: “[a] building that is environmentally responsible, profitable and a healthy place to live or work.”

The ten essential elements of the Model Green Lease as developed and subsequently drafted by the Task Force are as follows:

- Environmental performance objective clauses (broad aspirational provisions that purport to provide context and clarity to the lease, which also recognize

that the parties who draft the lease may not be the parties that ultimately operate the building);

- Gross lease rent structure (acknowledging that the landlord is in the best position to optimize building performance, provided it has the financial incentive to do so);
- A fixed per square foot energy allowance for tenants;
- Objective building performance standards;
- An annual building performance reporting requirement; and
- Provisions related to green cleaning and recycling, building rules and regulations, tenant fit-out guidelines, and a tenant manual and development guidelines.

With respect to the gross lease rent structure and addressing the split incentive, defining the scope of building operating expenses is a major green leasing challenge, particularly with respect to landlord-initiated capital improvements to the building’s infrastructure during the term of the lease. The Model Green Lease addresses this issue by including within its definition of building operating expenses the amortized cost of any capital expenditures that reduce those expenses, but only to the extent that they create actual savings for the tenant. One important related point which we did not delve into on the panel is whether the ongoing costs of certifying the building under a third-party green building rating system - such as LEED-EB: OM, Green Globes or Energy Star - should be included in the definition of building operating expenses; the Model Green Lease does not include these costs, the BOMA Green Lease does (within its Section 4.2 definition of building operating expenses).

One of the many interesting issues that were raised during the course of the panel discussion that followed the presentation of each leasing effort was a hypothetical proposed by one of our audience members. Suppose Tenant A leases space in a multi-tenant LEED-certified or Energy Star-rated building. Tenant A’s lease is green, Tenant B’s is not. In the course of conducting

its business, Tenant B does something that jeopardizes either the building's LEED rating (under LEED-EB: OM or with respect to one of the new Minimum Program Requirements under the LEED 2009 system) or pending Energy Star application (by using an increased amount of energy over what is contemplated by the lease). Now suppose that Tenant A is a public company with a shareholder mandate to occupy space in a LEED-certified building, or for similar reasons relied on the landlord's representations regarding Energy Star. Could Tenant A sue the landlord for Tenant B's actions based on violating certain provisions in its green lease?

As the panel pointed out in response, it's rare that a lease would obligate either party to perform in a certain manner with respect to other third parties, but a broadly drafted environmental performance objective clause might provide the tenant's attorney with, at a minimum, the ability to assert a claim that might either assist the tenant in renegotiating more favorable lease terms, or rescinding the lease outright. Nevertheless, as we noted previously here at GRELJ, the Model Green Lease puts the onus on the landlord in Section 5.02.3 to "use its reasonable efforts to cause other tenants of the Building to conduct their operations in the Building and their premises in conformity with the Environmental Performance Objective." Accordingly, everyone on the panel stressed that form green leasing documents are tools and not designed for imminent signature; it's clear that these types of issues will need to be discussed and vetted in detail as green leasing practices continue to disseminate.

I also thought that the discussion on enforcement of green lease provisions was particularly insightful; the panel discussed whether certain breaches might be more egregious than others from a sustainability perspective. The Model Green Lease, for example, provides tenants with an allowance for electricity. If the tenant exceeds that allowance, it is required to reimburse the landlord the extra per kilowatt hour cost; the landlord, however, is not given the right to terminate the lease. (Of course, a significant boost in energy consumption might be indicative of the tenant violating the lease's use provision (Section 4.01 in the Model Green Lease), which would give the landlord the right to terminate). Little consensus was reached during this line of discussion.

However, one final thought about enforcement struck me as particularly noteworthy; Michael Brooks of REALpac explained that while studying green leasing practices in Australia, he met a landlord whose form lease included a variety of green provisions which- if breached- entitled it to terminate the lease and evict the offending tenant. Although this is a drastic remedy, and the panel agreed that most landlords would likely not want to create such a self-imposed gap in their building's net operating income, it could suggest the direction in

which green lease enforcement might head in a rapidly shifting domestic regulatory climate.

The legal issues associated with green leasing are fascinating, emerging, and present an opportunity for the real estate community to make a major contribution to the more efficient operation of commercial and industrial buildings. As energy efficiency continues to rank as a high priority, and retrofit work expands as the economy slowly turns around, the four green leasing tools presented at last week's Urban Green Expo will become increasingly important for landlords and tenants alike to review, implement, and build upon. Simultaneously, the requirements of LEED 2009 and other third-party systems will need to be translated into or otherwise sufficiently addressed by such documents in order to safeguard the rights and remedies of the parties. We're looking forward to continuing the discussion here at GRELJ about these critical issues, with particular continued emphasis on the legal implications of various green lease provisions.



Stephen Del Percio
Attorney

Arent Fox LLP
1675 Broadway
New York, NY 10019-5820
212.457.5542 DIRECT
212.484.3990 FAX

delpercio.stephen@arentfox.com

www.arentfox.com