


11-2014

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Real Estate Documents Turn Green

By Richard J. Sobelsohn

Sustainable development is now commonplace. In his second-term inaugural address, President Barack Obama promised to respond to climate change by supporting sustainability through a greater adoption of renewable energy, including solar power and natural gas development, and through other measures. The real estate market has pushed green building to a new level, and as a result, in the near future most agreements will need to address sustainability initiatives (for the purposes of this article, “green” and “sustainable” are used interchangeably). This is not only true for those contracts relating to commercial buildings but also agreements for multi-family projects, government-owned and leased properties, renewable energy device installations, and even single-family homes.

Even with the built environment’s rapid race to sustainability, however,

all agreements drafted today for the purchase, construction, borrowing, leasing, cleaning, management, professional services, insurance, and other products and services for the green building world have not necessarily caught up with the trend. Luckily for the property owner, this is starting to change.

With the advent of more attorneys representing parties that provide products and services to the green building industry, the market is forcing attorneys to learn the new sustainability language. And the contracts under which an attorney’s clients must perform are beginning to reflect this new nomenclature. For example, it was not long ago that commercial office leases were entirely void of any references to sustainability. But now that many Class A building landlords have embraced sustainability, the leases they sign with their tenants require compliance with the landlord’s sustainability requirements (“Landlord’s Sustainability Practices”). It is therefore important for attorneys to learn this subject matter or they will (1) fail to understand what protective language needs to be included in contracts

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affecting their clients and (2) be left behind in the green building world.

Many types of agreements now include sustainability provisions. These include construction agreements—owner and architect/owner and contractor (the American Institute of Architects (AIA) and ConsensusDocs have them); office, retail, and industrial lease agreements; sub-leases; assignment and assumption agreements; commercial purchase and sale agreements; acquisition loan and construction loan agreements; real estate brokerage agreements; property management agreements (office and multi-family residential); and others.

As more and more properties turn green, the contracts affecting them will have to become green as well. There are now too many players in the sustainable building world to ignore this any longer. A closer look at some of these agreements reveals what sustainability-related provisions an attorney should expect to see.

Design Professional and Contractor Agreements

One of the first real property-related contracts to turn green was related to construction and design professionals. The AIA and ConsensusDocs were early adopters of sustainability provisions and guidance, as reflected in the AIA form B-214-2007 and the ConsensusDocs 310 Green Building Addendum (2009).

Although many architects, engineers, and contractors embraced sustainable construction methods early on, it took a while for the contracts under which they were obligated to perform to reflect green property ownership issues. One reason for this delay was that even though the design professional or contractor may have known what sustainable design and construction meant, ownership counsel may not have had the same knowledge and may not have known what should be included in the relevant agreements. Missing from contracts was an obligation on the part of the design professional or contractor to obtain certification for the property, and if

Although many architects, engineers, and contractors were early adopters of sustainable construction methods, it took a while for the contracts under which they were obligated to perform to reflect green property ownership needs.

such a reference was included in the instrument, it was not drafted with the specificity required for the parties to truly understand their respective responsibilities.

Design professional and construction agreements began to turn green starting in the mid-to-late 2000s. In 2007, the AIA introduced AIA B214, which was the first time the organization specifically addressed sustainability in one of its agreements. In 2011, it went a step further in issuing AIA D503-2011, the Guide for Sustainable Projects (including agreement amendments and supplementary conditions), which was later updated in 2013 as D503-2013. In 2012 the AIA, breaking from its more than century-old tradition of releasing new iterations of agreements every 10 years, in the seventh year of the decade announced that “The Industry Standard is now the green standard,” American Institute of Architects, *Sustainable Design and Building Now Comes with an Added Layer of Protection*, www.aia.org/contractdocs/aiab093903 (last visited Aug. 30, 2014), and started releasing forms specifically relating to sustainable projects, such as A101-2007 SP, A132-2009 SP, A133-2009 SP, A134-2009 SP, A201-2007 SP, A232-2009 SP, A401-2007 SP, B101-2007 SP, B103-2007 SP, B132-2009 SP, C101-2007 SP, C132-2009 SP,

C401-2007 SP, B214-2012, E203-2013, G201-2013, and G202-2013.

The other main supplier of architect/engineer/contractor form agreements, ConsensusDocs, focuses on green building projects as well. In 2009, with the ConsensusDocs’s “310 Green Building Addendum,” ConsensusDocs released what it advertised as the “construction industry’s first comprehensive standard contract document addressing the unique risks and responsibilities associated with building green projects.” See Associated Gen. Contractors of Am., *ConsensusDOCS 310 Green Building Addendum*, Environmental Observer (Oct. 28, 2009), <http://newsletters.agc.org/environment/2009/10/28/available-november-10-2009-consensusdocs-310-green-building-addendum>. Some practitioners even saw this agreement as preferable to AIA’s B214-2007 form because it addresses allocation of risk for the parties, is rating-system neutral, and incorporates the new “building facilitator” position in a green project. Stephen Del Percio, *Risk Allocation Provisions Prominent in ConsensusDOCS 310 Green Building Addendum*, Green Real Est. L.J. (Jan. 21, 2010), www.greenrealestatelaw.com/2010/01/risk-allocation-provisions-prominent-in-consensusdocs-310-green-building-addendum. In short, whether an attorney employs the AIA agreements or ConsensusDocs forms, the documents now make a point to address sustainability.

Lease Agreements

Lease agreements also have become important documents incorporating sustainability provisions. Both landlords and tenants are pushing for development and maintenance of green buildings, and the pivotal instrument to effectuate this type of sustainability is the commercial office lease. For a comprehensive green lease, the sustainability clauses are found in the following lease provisions: operating and real estate tax expenses, capital expenditures, permitted uses, services, alterations and improvements, surrender, repairs and

maintenance, assignment and subletting, insurance, default, training, access, rights for termination relating to the loss or a downgrade of certification level, rules and regulations, construction rules, and possibly a Landlord's Sustainability Practices exhibit.

Interestingly, the request for sustainability provisions in a lease can come from either the landlord or the tenant. The tenant with a corporate mandate to locate itself in a green building could (especially if it has enough leverage in the negotiation) have as much interest in directing sustainability measures for the overall property as a landlord.

Examples of green terminology in a typical office lease might include such defined terms as "alternative energy generation features," "Landlord's Sustainability Practices," "green rating," "carbon offset costs," and "carbon tax." Similarly, many other provisions within the lease could take on a green hue. For example, in the "permitted use" provision, the tenant could be required to comply with Landlord's Sustainability Practices and the building's green rating. If representing a green tenant, a landlord may be obligated to deliver the premises certified by a green rating agency or to secure such certification within a certain time after the lease execution date. If representing a green landlord, a tenant may need to obtain certification by a green rating agency for the tenant's premises. When it comes to alterations, a tenant in a green building would clearly have to comply with Landlord's Sustainability Practices as well.

The "operating expense" provision for a green building could include the costs for green insurance endorsements, the engagement of a green-accredited professional (LEED AP or GGP), green roofs, storm water containment (where jurisdictionally permitted), air exchange or air-quality systems, alternative energy generation system installation/maintenance, commissioning and re-commissioning of systems, carbon offset, carbon taxes, green rating costs, water, resource conservation systems, and

generally any other of the landlord's sustainability practice-related costs. As for capital expenditures, the concept of "split-incentive" also might be part of the lease. Here, to the extent that the annual net cost savings is achieved, the cost of an energy-related capital expenditure is partially borne by the tenant.

In the "building/landlord services" section of a green lease, a landlord may have the right to procure energy from a company generating electricity from renewable energy instead of fossil fuels, and submeters would be a standard inclusion as well. Similarly, a landlord could have the right to use reclaimed, or "gray," water in the building. A typical green subprovision in this section may permit the landlord to provide routine janitorial services during the day so that lights are not left on in the building all night. Furthermore, a tenant may be required to track, assess, and make reasonable efforts to conserve energy to comply with Landlord's Sustainability Practices.

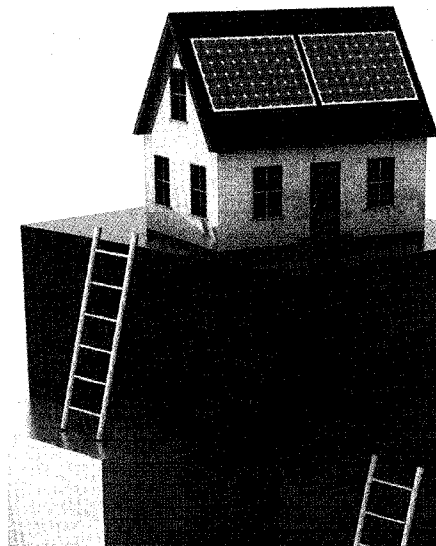
Both the "repairs and maintenance" and "alterations" provisions would contain sustainability-related language as well. For example, the tenant would be required to make repairs and maintain the premises in conformance with Landlord's Sustainability Practices and the green rating of the property. Especially in the alterations provision, there could be specific construction guidelines

that limit what the tenant can and cannot do, and a laundry list of what the tenant's contractor must do to comply with the Landlord's Sustainability Practices and the building's green rating.

In the "insurance" clause, the landlord may require the tenant to obtain green endorsements to its insurance policies. In many cases, insurance carriers will offer coverage to rebuild the premises to a certified level after a casualty, and the landlord wants to make sure that this happens after a tenant's loss. Conversely, tenants with leverage in their lease negotiations are requiring landlords to have similar endorsements for the entire property so that the property will be rebuilt to the appropriate level of certification after a major casualty.

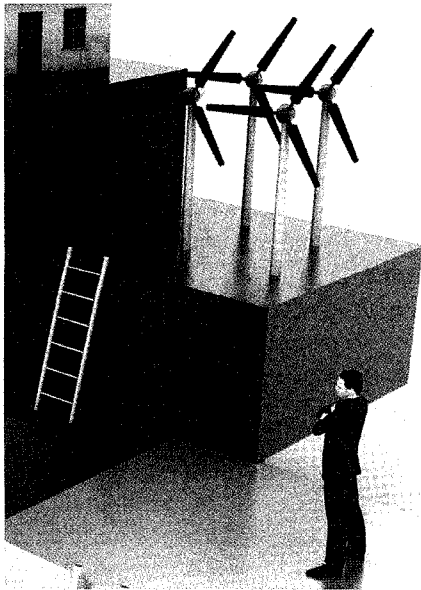
"Assignment and sublet" provisions also have sustainability-related requirements. Not only must an assignee or sublessee acknowledge and agree to comply with a Landlord's Sustainability Practices, but also the lease may prohibit the assignee's or sublessee's use of any special or energy-hogging equipment. The landlord also might retain the right to withhold consent to a potential assignee or sublessee if it reasonably believes that the intended use of the premises would violate the Landlord's Sustainability Practices or the building's green rating.

If an assignment takes place, green leasing adds another element to the assignment and assumption of lease agreement between the tenant and assignee. In a green lease assignment, it is not unusual for the assignee to acknowledge and agree to all of the Landlord's Sustainability Practices. In addition, the assignment and assumption agreement should require that assignee's use be consistent with the premises' environmentally friendly uses, green certification, conservation objectives, and sustainability operations and practices. The assignee's failure to comply with the above could compromise hard-won ratings, building reputation, tenant relations, cost savings, and the quality of the building environment (such as if the assignee



pollutes the interior air quality). The tenant should be cognizant that an assignee default (particularly one relating to the Landlord's Sustainability Practices) could affect the tenant if the assignor tenant is secondarily liable under the original lease.

As to the "default" provisions, rules and regulations, and tenant work letters, these have obvious sustainability-related provisions. A provision in which one might not expect to see certain green aspects, however, is the "surrender" provision. In many leases a tenant is generally required to surrender its premises to the landlord in the same condition as on the commencement date (subject to wear, tear, and casualty). In a green lease, the tenant has an additional obligation to recycle what is being demolished to restore the premises. Furthermore, there may be a reporting requirement relating to the demolished materials so that the landlord can show that it has complied with its own green rating requirements.



"Parking" provisions require the landlord to make available spaces for alternate fuel vehicles and car-pooling vehicles, and even to make charging stations available for electric vehicles. Lastly, the green lease may have tenant-training requirements in recycling procedures to comply with the Landlord's Sustainability Practices. See generally Leslee M. Lewis, *Office Lease Agreement*,

Green Lease (Sustainability) Drafting Notes and Provisions, Lexis Practice Advisor (2014), <https://advance.lexis.com/GoToContentView?requestid=f85e843e-ca92-f396-5e85-8e6a017f914b&crd=842fe5b5-a6de-a50a-5853-0a287c6ec7a8> (discussing green terminology and optional green requirements within specific provisions for both tenant and landlord).

Purchase and Sale Agreements

Purchase and sale agreements are also beginning to include seller representations and warranties about green certifications. When representing a commercial real estate purchaser who values sustainable buildings, the purchase and sale agreement may require the seller to state that the property complies or could comply with certain green measures and certifications (such as Three Green Globes or LEED Gold certification). In some cases, the agreement would state that the property is "certifiable" and set forth the characteristics that would meet those certification requirements.

In addition, a purchaser of a sustainable-certified property could require the seller to assign to it any and all rights of the seller to certification ratings and any other incentives (whether tax credits, carbon credits, renewable energy credits, or other benefits), renewable energy device warranties, and other sustainable capital features from which a warranty has been obtained. Similarly, any reports and data relating to the property's certification or rating, local law compliance, benchmarking, metering, monitoring, or retrofitting, should be made available to the purchaser during the due diligence phase and at closing and be included in a schedule attached to the bill of sale. The buyer may also want to know of any sustainability-related promises that may have been made to tenants that the buyer will be obligated to perform as the new landlord. In the purchase and sale agreement, a purchaser will often require the seller to include a detailed description of any equipment installed on the property

to meet the Landlord's Sustainability Practices (these may include, for example, bike racks, photovoltaic panels, turbines, other alternative energy devices, and charging stations for electric cars).

Many purchase and sale agreements include a definitions section that can include the following terms: carbon credits, carbon offset costs, carbon tax, green elements, green rating, and incentives. Similarly, when computing adjustments, the agreement should apportion carbon taxes, carbon offsets, sustainability-related tax credits, rebates, incentives, energy credits, carbon credits and surcharges, and yet-to-be-paid green-certification fees. Relating to due diligence and property inspections, a seller could be required to deliver to the purchaser any energy audits, useful life studies, information relating to carbon taxes, credits, or offsets, and any unique expenses relating to sustainability enhancements to the property. Closing adjustments also should include any applicable carbon taxes and offsets, recycling removal costs, additional tenant rents paid in advance for landlord's sustainability practices, income from renewable energy devices, and outstanding costs relating to certification or recertification (if certification or recertification has not yet been received).

The "representations and warranties" provision could include a statement detailing the seller's payment of all outstanding costs for (1) maintenance of any certification, (2) municipal requirements relating to sustainable buildings, (3) incentive requirements, (4) carbon taxes, (5) carbon offsets, and (6) any other sustainable landlord practices for which a fee (or fees) are due and payable. This may include any reimbursements to third parties and tenants for energy saving-related capital expenditures. Furthermore, the seller may be required to represent that no bonds or letters of credit are required to obtain or maintain any incentives. Similarly, all indemnifications should include any fees for a sustainability consultant, if required, to defend a purchaser for

certification-related issues. Lastly, all applications for certification and a description of actions taken could be set forth in an exhibit to the agreement.

In any purchase and sale agreement, the seller typically covenants to do certain things between the contract execution date and the closing date. Sustainability-related covenants could include maintenance of certification of the property, regularly scheduled sustainability-related systems maintenance, and maintenance of green insurance endorsements for the property in the case of a casualty.

The tenant estoppel certificate might include that all landlord billings for the following have been paid by the tenant: carbon taxes, carbon offsets, and reimbursements for capital expenditures relating to sustainable element build-outs or rating agency-related expenses. The tenant's representation that the premises are being used for the purposes described in the lease could similarly include "compliance with green ratings" for the building/premises. If a bill of sale is attached as an exhibit, that bill of sale also might set forth as part of the personal property being conveyed "Carbon Credits, Carbon Taxes, Green Elements," including definitions of all three. See generally Leslee M. Lewis, *Purchase and Sale Agreement, Sustainability Drafting Notes and Provisions*, Lexis Practice Advisor (2014), <https://advance.lexis.com/GoToContentView?requestid=6cc454d5-fcdc-d641-2586-6e729990a620&crd=2eb11e51-bf3f-f5ae-8b07-eae3de5b9861> (discussing green terminology and optional green requirements within specific provisions for both purchaser and seller).

Financing Agreements

There are two main places in which sustainability language is important in financing real property. One is in the underwriting materials for the lender. The other is in the loan documents. Until recently, lenders underwrote sustainable projects with "side note" comments in underwriting checklists. Sometimes the

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"green factor" was the deciding criteria on whether the property was financed by a particular lender or not. In many cases today, however, the underwriting process has parsed out sustainability as a set of points to be awarded for a potential loan. See Scott R. Muldavin, *Value Beyond Cost Savings: How to Underwrite Sustainable Projects* (2010).

When drafting loan documents, the transactional real estate attorney has the opportunity to insert specific sustainability-related borrower representations, warranties, and covenants. Similarly, any green certifications applicable to the property should be included in the loan agreement. After all, if the property is being afforded a favorable rate or being financed in part for its sustainability factor, these concepts are important.

New green-defined terms are now appearing in loan agreements as well. For example, commissioning, retro-commissioning, and benchmarking are all terms directly related to sustainable-building projects, and most borrowers are obligated to comply with these actions. It therefore makes sense that the mortgage document for a sustainable property includes a reference to certification of the property (and at what level) and the rights to all contracts and green-consultant reports of the property. See generally Kristin M. Boike, *Acquisition Loan Agreement, Sustainability Drafting*

Notes and Provisions, Lexis Practice Advisor (2014), <https://advance.lexis.com/GoToContentView?requestid=37a10f89-728f-90f2-04a8-8a366b899725&crd=2b92e696-e304-8902-d960-eb09f103d932> (discussing green terminology and optional green requirements within specific provisions for both borrower and lender).

In construction loan documents, when providing for hard and soft costs, green building certification fees are becoming acceptable as "soft costs." "Substantial completion" could be defined to include an architect's certificate stating that the improvements (as designed and constructed) would likely achieve green building certification. The borrower's representations and warranties now state that the plans and specifications will comply not only with all applicable laws but also with the anticipated green building certification requirements. The borrower's maintenance obligations similarly incorporate maintaining the property in a manner that supports the sustainability features of the improvements and maximizes energy efficiency. See generally Kristen M. Boike, *Construction Loan Agreement, Sustainability Drafting Notes and Provisions*, Lexis Practice Advisor (2014), <https://advance.lexis.com/GoToContentView?requestid=f37825b0-f9c4-591f-1f43-a3d979221395&crd=f5922b8c-f6cb-dce5-2da9-5dea2bb11697> (discussing green terminology and optional green requirements within specific provisions for both borrower and lender).

In a loan transaction involving a green property, the borrower's insurance obligations define "full insurable value" as including all the sustainability features of the property and the need to obtain the same green building certification awarded or expected to be awarded to the improvements, before any casualty. In a green loan agreement, record keeping includes maintaining the data for the sustainable-building certification and the borrower's duty to track energy and potable water usage. The lender's approval for alterations after substantial completion would also include that such alterations may

not decrease the likelihood of the improvements obtaining or retaining green building certification. In addition, the default provision would now include the loss or downgrading of any green building certification (subject to an appropriate notice and cure period).

Because it is paramount for a borrower under a green loan agreement to maintain the greenness of its property, the borrower as a commercial landlord needs to require its tenants to comply with its sustainability practices through use of a green lease. In this regard, the lender may require that the borrower's form of lease be a "green lease" that reflects both the landlord's and the tenant's rights and responsibilities for enjoying and maintaining the sustainable features of the improvements and the green building certification.

In a typical substantive loan agreement, one of the many ancillary documents important to the transaction is the assignment of leases and rents (ALR). The ALR gives the lender the right to the leases and their related rents, either at the commencement of the funding or after an event of default. In the ALR, when the borrower's allowable expenses are enumerated, a green loan would permit the borrower to include those costs relating to obtaining or maintaining the green building certification. See generally Kristen M. Boike, *Assignment of Leases and Rents, Sustainability Drafting Notes and Provisions*, Lexis Practice Advisor (2014), <https://advance.lexis.com/GoToContentView?requestid=d3a38230-3192-9f2f-b747-1e9c-47cef403&crd=6c197861-6d98-4cd0-65ce-4df7da6a00f8> (discussing green terminology and optional green requirements within specific provisions for both borrower and lender).

Green Property Management Contracts

A property owner with certain sustainable or "green" aspects to its property will want its manager to protect the green nature of the property and to acknowledge that it is aware of them. New green optional

A property manager may be required to promote the property's sustainability features to tenants and work with tenants to use and comply with rules, regulations, and policies relating to the property's sustainability goals.

provisions are now included in this type of agreement, whether in the body of the agreement or in a rider, both of which detail the manager's obligations as they relate to the sustainable building features.

A property manager, for example, may be required to promote the property's sustainability features to tenants and work with tenants to use and comply with rules, regulations, and policies relating to the property's sustainability goals. In furtherance of such endeavors, the manager may be obligated to organize training sessions (for both the owner's employees and tenants), demonstrations of routine sustainability practices, tenant meetings, and other activities designed to familiarize tenants with, and encourage them to participate in, the owner's property sustainability plan. The manager would need to undertake all of these tasks with an eye toward maintaining the property in a manner similar to (if applicable) other LEED or Green Globes-certified buildings in the area where the property is located, and consistent with obtaining any recertification of the existing certification (which could be explicitly stated as LEED, Green Globes, or other rating and the actual level of such certification).

The owner may want to call out specific legal requirements with which the manager must comply, such as mandatory energy conservation codes, or to identify voluntary programs such as local green building challenges. In addition, the manager would need to acknowledge that the property is designed to provide a healthy indoor environment, conserve energy resources, and use certain sustainability-related features (list specific features if applicable, for example, wind turbine, solar panels, and so on), and that the manager will perform its obligations in a manner that protects and promotes the property's sustainability aspects. See generally Kristen M. Boike, *Property Management Agreement [Office Space], Sustainability Drafting Notes and Provisions*, Lexis Practice Advisor (2014), <https://advance.lexis.com/GoToContentView?requestid=d3a38230-3192-9f2f-b747-1e9c-47cef403&crd=6c197861-6d98-4cd0-65ce-4df7da6a00f8> (discussing green terminology and optional green requirements within specific provisions for both manager and owner).

Green Brokerage Listing Agreements

Because a real estate broker could be a major factor in the leasing or sale of a property, the listing agreement needs to reflect broker-specific sustainability issues. For example, a listing agreement might state that the broker shall not make any representation or warranty to any party regarding the physical (including environmental) condition of the property or—except as publicly available—any sustainability features of the building (including pending third-party certifications) without the written consent of the owner. In some situations (for example, when a tax certiorari proceeding or green tax credit is pending but not yet finalized), a seller may want to make the tax refund/credit owed to it survive the closing of a sale. The same concept is applicable to the extent that the owner has applied for or is otherwise eligible for a monetary rebate or related incentive correlating to the

owner's construction or rehabilitation of the property. The owner may want to specify this item to the broker so that the broker can negotiate the point as part of the presentation of the property for sale to third parties. See, e.g., Kristen M. Boike, *Open Listing Agreement, Sustainability Drafting Notes and Provisions*, Lexis Practice Advisor (2014), <https://advance.lexis.com/GoToContentView?requestid=4b30f68a-e88b-fb65-920d-7b79297f0ada&crd=597169e3-f579-b713-818a-5fe182389d3a> (discussing green terminology and optional green requirements within specific provisions for both broker and owner).

The listing agreement typically has certain representations and warranties made by the seller/landlord to the broker so that the broker can rely on them in marketing the property. If applicable, the seller should represent whether any buildings on the property have been certified (inserting the particular certification) and that all actions to maintain such certification have been performed by or on behalf of the seller. If the property is not certified, however, the broker also should agree to not make any representation that it is certified unless the broker receives written consent from the seller/landlord. In a lease listing agreement for a sustainable property, the broker should be required to consult with the property owner in case certain lease sustainability provisions should be included as part of its marketing.


Conclusion

The real estate market has pushed for green building in a big way, but the contracts relating to the sustainable building world have not yet caught up with this trend. Green building agreements are not just limited to those concerning commercial buildings but also include those for multi-family projects, government-owned and leased properties, renewable energy devices, and even single-family homes. Therefore, attorneys should now address sustainability issues when drafting contracts for real estate purchases, construction, borrowing, leasing,

cleaning, management, professional services, insurance, and obtaining other products and services supplied to green-property owners. The property owner, design professional, and contractor, all of whom were the original players in the green building world, are now only a few of the many parties expected to perform under agreements that require sustainability results. With green

contracts requiring such performance, attorneys now have a duty to ensure that their clients who are subject to those agreements understand the new pitfalls and obligations with which they must comply and new types of liability. Sustainable development is becoming the norm, and it is only a matter of time before green agreements also become the norm. ■

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