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Coops, Condos and COVID-19

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Green Leasing—It's Not Just About Capital Expenditures

By Richard J. Sobelsohn

Before 2007, very few leases included sustainability references. This changed, however, when tenants began to receive mandates to rent space in green buildings and when landlords began to offer sustainable properties for rent, and now it is more commonplace to see "green" provisions in leases. But what makes a lease "green"?

To begin with, a green lease incorporates sustainability provisions, making it environmentally friendly. Although the first green leases may have contained only one short provision that referenced sustainability

(the first green lease the author negotiated included just one sentence devoted to the landlord's sustainability measures), as time went on and parties became more sophisticated about sustainability, more leases began to incorporate sustainability rights and obligations pertaining to both landlords and tenants. With many well-known property owners (SL Green, Brookfield, Vornado, Westfield, CBRE, TIAA-CREF, GE Capital, LaSalle, RREEF, Paramount, Hines) now incorporating sustainability practices into their portfolios, it is also becoming the norm to include green clauses in first-class office leases.

Practitioners need to delve deeper, however, into exactly what makes a green lease green and to watch out for "green lease wannabes."

For example, in May 2011, New York City Mayor Michael Bloomberg announced that the law firm of Wilmer Cutler Pickering Hale and Dorr LLP had signed a lease with Silverstein Properties for space in 7 World Trade Center, which he referred to as a "pioneering model for commercial leases" and which many thought was one of the first

New York City green lease agreements. Press Release, Office of the Mayor, Mayor Bloomberg Announces First Ever Lease for Commercial Office Space That Contains Ground-breaking Language That Incentivizes Energy Efficiency, City of N.Y. (Apr. 5, 2011), available at www.nyc.gov/portal/site/nycgov/menuitem.c0935b9a57bb4ef3daf2f1c701c789a0/index.jsp?pageID=mayor_press_release&catID=1194&doc_name=http%3A%2F%2Fwww.nyc.gov%2Fhtml%2Fom%2Fhtml%2F2011a%2Fpr109-11.html&cc=unuse d1978&rc=1194&ndi=1. Called the "Energy Aligned Lease" (EAL), it was designed to satisfy a landlord's desire to make energy efficient improvements to the building, but not to incur the entire cost of such retrofits (which is the case under typical leases). Because tenants are the immediate beneficiaries of the bulk of the reduced energy costs resulting from the improvements, a landlord has little incentive to make such improvements without tenants sharing in the costs. The EAL solves this problem. The EAL, however, is green only in a relatively small (albeit important) portion of the document. A comprehensive green lease has sustainability provisions permeating the instrument.

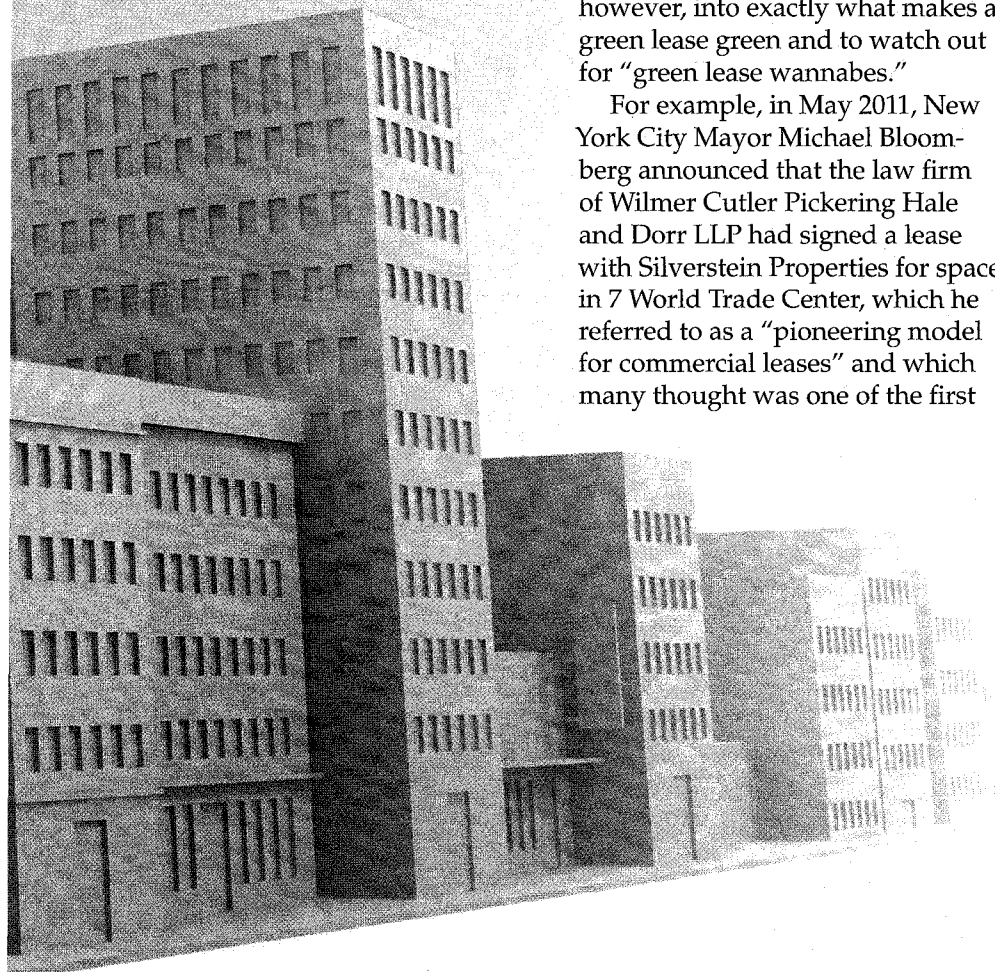
Permitted Use

In the author's green lease, sustainability obligations begin with the "Permitted Use" clause, wherein the tenant is in default under the lease if it

uses, occupies or operates the Premises . . . in any manner that will cause the Building, the Property, or any part thereof

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not to comply with Landlord's Sustainability Practices and its certification from the U.S. Green Building Council's Leadership in Energy and Environmental Design ("LEED") rating system (see www.usgbc.org/DisplayPage.aspx?CMSPageID=1988), the Green Building Initiative's Green Globes™ ("Green Globes") rating system (see <http://www.thegbi.org/green-globes/ratings-and-certifications.shtml>), the U.S. EPA's Energy Star®

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("Energy Star") rating system (see www.energystar.gov/index.cfm?c=evaluate_performance.bus_portfoliomanager_intro), Living Building Challenge (see <https://ilbi.org/lbc>), ASHRAE ("ASHRAE") certification (see www.ashrae.org/education-certification/certification), or similar system or program under which Landlord is obligated.

The beginning of the lease should state that the landlord's sustainability practices are so important that any material deviation from the lease on the tenant's part (especially one that might jeopardize a property's certification) will be grounds for terminating the lease.

Operating/Capital/Real Estate Tax Expenses

Most commercial lease forms include a clause devoted to capital expenditures and operating/tax costs. This is the appropriate location in the lease to list other

sustainability-related costs that a landlord may wish to pass on to its tenants. Tenants wishing to occupy sustainable buildings understand their many benefits, both direct and non-direct. For example, studies show that green buildings can save an average of more than 30% in operating costs over conventional buildings. See *Green Buildings—A Niche Becomes Mainstream*, RREEF Research, 7 (Apr. 2010), www.rreef.com/content/_media/Research_Green_Buildings_A_niche_becomes_mainstream_4_10.pdf. There are non-direct economic benefits as well to leasing space in sustainable buildings. Research shows that employees in a sustainable building take fewer sick days per year than their counterparts in nongreen buildings (see Chris Palmeri, *Green Buildings: Fewer Sick Days, Higher Rents*, Bloomberg Bus. Wk. (Nov. 19, 2009), www.businessweek.com/the_thread/hotproperty/archives/2009/11/green_buildings.html) and are more productive (see *Study Finds Green Buildings Improve Company Financial Performance and Lower Operational Costs*, PRWeb (Apr. 11, 2012), www.prweb.com/releases/2012/4/prweb9390881.htm) (discussing Notre Dame study reporting that bank employees are more productive in a sustainable premises).

But with all the advantages of being in a green building, tenants should appreciate that there may be associated costs to the landlord. A landlord can incur the following costs related to building or retrofitting a green building and keeping it green: insurance endorsements specifically related to replacement of sustainability components (of which Fireman's Fund, Chubb, ACE, and Zurich all offer coverages, some of which provide for rebuilding to LEED certification after a casualty even if the original building was not LEED-certified); certification applications, re-applications, commissioning, and re-commissioning; carbon taxes or carbon offset costs (which may not yet be in place, but should be addressed in case they are

applicable later during the lease term); energy optimization plans; recycling programs; irrigation systems; water capture cisterns (where local law permits); data gathering costs; and general mercury content reduction. A landlord also may wish to require the tenant to obtain LEED or Green Globes certification for its commercial interiors, in which event the landlord may have some tangential operating costs associated with such certification (which will probably be included in operating expenses), but the tenant will be required to bear the cost of procuring and maintaining its own certification of the premises.

Services: Cleaning and Electricity

In the "Services" provision of a green lease, the landlord can include "routine janitorial services to be performed during Normal Business Hours (NBH) in accordance with Landlord's Sustainability Practices and with minimum disruption of Tenant's business and use." The benefit of routine cleaning during the day is to have most of the building's lights off after NBH. Otherwise, typically lights are left on for janitorial crews, and the crews do not turn the lights off after their work is done. Similarly, if the tenant has the option to use its own janitorial service company, the landlord probably will require it to be a "green cleaning" company with additional training, equipment, cleaning products, and reporting duties. In addition, landlords may soon require electricity consumption data reporting by tenants, even if the tenant obtains electrical power directly from the utility. This duty to report might be rating-agency driven or local law mandated. For example, New York City Local Law 84-2009 requires benchmarking, metering, and monitoring energy and water use in commercial buildings of 50,000 square feet and greater. See NYC 311, NYC.gov, www.nyc.gov/apps/311/allServices.htm?requestType=service&levelOneId=3B3E9720-05BC-11DE-AC9C-EF5AFBC474DE&levelTwoId=3B3E9720-05BC-11DE-AC9C-EF5AFBC474DE-2&serviceName=Benchmark+Requirement+++Local+Law+84-2009&fin

alSubLevel=2&intentId=E9E66310-8137-11DE-8E9F-96DAE110FEB8. If electricity is supplied by the landlord, the landlord may wish to have the option of obtaining electricity generated from renewable energy sources including hydropower, solar, wind, and biomass, which can include additional costs not typically charged by traditional fossil-fuel energy suppliers. For an example of such suppliers, see NY's Green Power Program: *The Natural Choice for New York's Future*, Ask PSC, The NYC Public Service Commissioner's Consumer Web Site, www.askpsc.com/askpsc/page/?PageAction=renderPageById&PageId=a8022193f892947a1d26b67506005183#top.

Alterations/Improvements

In most commercial leases a tenant has a right to make alterations after the original build-out of the premises. Typically, alterations may not be made without the landlord's consent, which is "not to be unreasonably withheld, conditioned or delayed." In a green lease, however, the alterations must not only have landlord's consent but also must comport with the landlord's sustainability requirements; for example, the lease could require the "contractor to utilize only recycled materials for all improvements and Tenant to recycle all materials, both in conformance with this Lease and with any certification requirements of the Building." Depending on the scope of work, it would not be unusual for the landlord to require the tenant to hire a LEED-accredited professional or its equivalent to oversee the alteration. The landlord does not want a tenant to affect the building's certification status by failing to meet the sustainability protocols for construction, so in a case in which the proposed alteration does not meet these goals, it would be reasonable for the landlord to withhold its consent.

Surrender

The "Surrender" clause is another sometimes intensely negotiated lease provision, which now includes tenant sustainability duties. Many leases

require the tenant to surrender the premises to the landlord at the end of the lease term in the condition it was delivered at the commencement of the lease term, "reasonable wear and tear and casualty excepted." The sustainability hue to this clause is the requirement that the tenant "salvage, reuse or recycle whatever alterations that were made subsequent to commencement, and which are pursuant to Landlord's Sustainability Practices." This might include having the tenant "report to Landlord, in a format determined by Landlord, all methods used by Tenant to salvage, reuse or recycle Tenant's Property, Non-Structural and Structural Installations." Clearly, this additional burden on the tenant is something to consider when negotiating a long-term lease in which additional alterations to the premises are a possibility.

Repairs and Maintenance

Although not as hotly debated as the surrender provision, the green lease "Repair and Maintenance" clause will include language such as: "All maintenance, repairs, and replacements made by Tenant must comply with Landlord's Sustainability Practices, including but not limited to any third-party rating system requirements applicable at such time for the Building, the Premises, or the Property." For example, when a tenant needs to replace an existing heating ventilation air conditioning (HVAC) unit within its premises, a low Energy Star-rated one typically will not do based on the foregoing requirements.

Assignment and Sublet

When most practitioners think of assignment and sublet provisions, sustainability does not immediately come to mind. After all, how might an assignment or sublet affect the physical makeup of the premises, which would in turn affect the building's greenness? It would, however, if the tenant wanted an unfettered right to sublet all or a portion of the premises or to assign the lease to a party that did not want to be obligated to operate the premises in

conformance with landlord's then-current sustainability practices. For example, if the proposed assignee or subtenant wanted to use high-energy consumption lighting or high volatile organic compound (VOC) products in its furniture, this would not comport with a sustainable landlord's protocol. The emphasis on *current sustainability practices* is important because the landlord may seek to upgrade its sustainability require-

When most practitioners think of assignment and sublet provisions, sustainability does not immediately come to mind

ments after the lease commencement date (for example, if a building were LEED Silver-certified at lease execution but LEED Gold at the time of the assignment or sublet). As a result, the proposed subtenant or assignee might have a higher "green bar" to jump over to gain landlord's consent to the transaction.

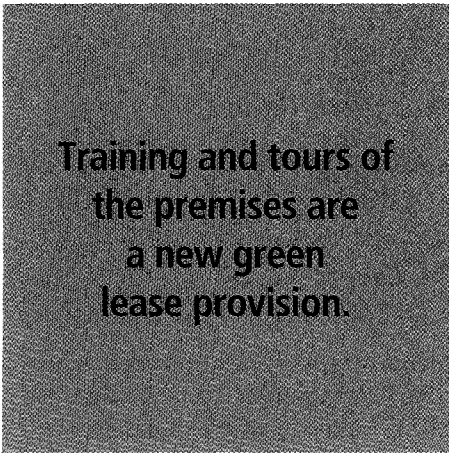
Insurance

The "insurance" clause can have "green-specific" references too. If the premises were LEED-certified for Commercial Interiors (or its equivalent) before a casualty, the landlord would likely mandate that the tenant's insurance policy for replacement of the premises to that pre-casualty certified status. Accordingly, a lease might require that tenant's property insurance coverage include, "to the extent available, Green Property endorsements."

Default

The all-important "Events of Default" provision is the clause that describes what types of breaches of the lease afford the landlord the rights to terminate the lease and to dispose of the tenant, either immediately or after a

notice and cure period. In most green leases, any violation of (1) the landlord's sustainability practices, (2) the certification of the building, and (3) lender sustainability requirements under the mortgage or deed of trust could be an Event of Default under the lease. From the landlord's perspective, if the property's certification or certification level were jeopardized because of a tenant's act or failure to act, the consequential damages suffered could be catastrophic. Imagine a landlord with a 10-story building in which a tenant occupies half



Training and tours of the premises are a new green lease provision.

the space (the "Major Tenant"). If the Major Tenant's lease requires the landlord to have and maintain LEED Gold Certification for the building throughout the lease term and, because of one of the landlord's other tenants, the landlord loses its certification, the Major Tenant might have the right to terminate its lease. If this Major Tenant had a 20-year lease with four five-year extension options, and the loss of the required certification level occurred in year two of the original lease term, the landlord may suffer extensive damages. Accordingly, one can see that having strict tenant sustainability compliance duties in all green leases would be important for a green landlord.

Training/Access

Training and tours of the premises are the subject of another new green lease provision. Here, the tenant and its employees are obligated to participate in "any training relating to Landlord's Sustainability Practices, with at least seventy-two (72) hours

prior written notice." Because the landlord may need to bring parties into the tenant's premises to see the certified space, this issue presents another drafting concern. Although it is not uncommon for the landlord to have the right to show a tenant's premises to potential purchasers of and lenders to the property (and even potential tenants toward the end of a lease term), the type of inspection described here has nothing to do with those parties. It is merely to show the sustainability aspects of the premises. A green lease must permit additional inspections in connection with obtaining or maintaining the building's certifications.

Additional Sustainability Requirements

The preceding discussion of the green lease covered many sustainability modifications inserted within traditional nonsustainability-related provisions. A clause entirely devoted to sustainability requirements is included at the end of the author's green lease. To make things easy, this clause is titled "Additional Green Building Tenant Requirements" and begins with a general acknowledgment that the tenant is aware that the building is or may become certified. In this section there is a covenant providing:

Tenant shall use Landlord's recommended energy, mercury and carbon level reduction methods which may include purchasing Energy Star® rated equipment; occupant station lighting controls; the use of energy efficient bulbs; daylighting methods; closing shades and/or other window treatments; turning off equipment and lights at the end of each work day; and purchasing U.S. EPA's Water Sense® program certified products and Energy Star® rated equipment (the "Installed Equipment"). Tenant shall deliver to Landlord all documentation relating to the Installed Equipment, including but not limited to manufacturer, model, make,

type, wattage (if applicable), mercury content (if applicable), Energy Star® rating, and other documentation reasonably requested by Landlord.

In addition, this provision includes other tenant obligations with specific reference to the building's certification (although in this case it relates to LEED, the certification could be for any type of certification of the property). For example, the clause requires the tenant to comply with the following purchasing requirements for:

1. furniture (including cubicles and workstations) that is made from recycled, salvaged, or rapidly renewable materials;
2. ongoing consumables that are from materials that are post-consumer, post-industrial, rapidly renewable or harvested and processed within 500 miles of the premises, and including rechargeable batteries;
3. alterations and additions that reduce air quality impacts and are from recycled, salvaged, rapidly renewable or harvested and processed materials within 500 miles of the premises; and
4. low VOC content materials including paints, coatings, non-carpet finished floors, carpets, and composite panels.

Right to Terminate

Although a landlord-favored sustainable lease has numerous tenant-directed green obligations, it also can contain a provision benefiting the tenant with tenant remedies (depending on market conditions or the tenant's leverage) if the building loses its certification level or certification altogether (a "Certification Issue"). This is not to be confused with the discussion above in the "Events of Default" section that relates to the tenant causing the loss of certification and what rights the landlord may have against the nonconforming tenant. As an accommodation to the many institutional and non-institutional tenants with leased premises certification

mandates (for example, the GSA, TIAA-CREF, and Deutsche Bank), it is not unusual also to include a mechanism for tenants (in the event of a Certification Issue) to either terminate the lease or to reduce rent while the Certification Issue exists.

Rules and Regulations

Once the lease form itself has been "greened," sustainability references must be included where relevant in the lease exhibits. The "Rules and Regulations" section (which is typically an exhibit to most commercial leases), should be modified to include tenant's acknowledgment that the "Building, the Premises and the Property shall be operated in a manner which is consistent with Landlord's Sustainability Practices." Similarly, the Rules and Regulations can prohibit the use of "space heaters or other energy-intensive equipment," require that the tenant use HVAC equipment only "in conjunction with sensors or timers that limit operation to hours of actual occupancy (on a day-by-day basis), provide that there shall be "no smoking allowed in the Building or within twenty-five feet of any exterior portion of the Building," and state that "subject to revision by Landlord, Tenant is responsible for recycling within the Premises in conformance with Landlord's Sustainability Practices, which shall include but not be limited to using separate trash receptacles for food and wet garbage, for glass and metals, and for all paper."

Work Letter

Another common exhibit to a commercial lease is the "Work Letter" relating to the initial build-out of the premises. A sustainability-oriented Work Letter might include the following language:

All Tenant Improvements shall be reviewed for any potential impacts to Landlord's Sustainability Practices and Landlord's reduction goals (carbon, mercury, waste or otherwise), and comply with Landlord's environmental programs and be

in conformance with Landlord's Sustainability Practices. For any project estimated to cost more than \$10,000, Tenant shall have its general contractor agree to engage a third party LEED-Accredited Professional or similarly qualified Green Globe Professional (approved by Landlord prior to such project) to oversee and validate that the project has met the standards for Landlord's Sustainability Practices. The general contractor shall acknowledge that the building is or may be in the future certified/rated pursuant to the U.S. EPA's Energy Star® Portfolio Manager, the Green Building Initiative's Green Globes™ for Continual Improvement of Existing Buildings (Green Globes™-CIEB), the U.S. Green Building Council's LEED Rating System, or similar system or program under which Landlord is obligated. All construction and maintenance methods and procedures, material purchases, and disposal of waste must be in compliance with minimum green building standards (including the Landlord's Sustainability Practices and the specifications as more fully defined in the

Contractor Rules and Regulations and with the latest version of the rating system for which the Building, Premises and/or Property has received certification or for which it is awaiting certification).

Conclusion

A green lease can be either landlord-driven or tenant-driven. If the entire property is certified and the landlord has concerns about initial certification or certification maintenance, a well-drafted green lease will incorporate many of the concepts addressed in this article. Because part of the reason a landlord makes a building sustainable is to attract more creditworthy tenants, the landlord's bottom line may be directly related to such certification and the loss thereof could result in a major decrease in income for the landlord. Similarly, if the lender's loan agreement with landlord refers to the building's certification as a borrower covenant, then the loss of certification (or lowering of a required certification level) could constitute a default under the loan. With the above in mind, practitioners need to be fully invested in understanding sustainability issues for landlords and tenants alike. Without such knowledge, if a "greening effect" is necessary, practitioners will be unprepared to appropriately counsel their clients as to lease provisions. Sustainability is here to stay, and although the term for leases incorporating sustainability principles is "green leases" at present, in the near future they will be called simply "leases." ■

