

Tools and Best Practices for Implementing Green Leasing

Webinar Questions

3/26/2012

1. **Question:** *Commercial office leases have long included a clause that allows landlords to amortize cost of capital as part of passed back operating expenses if capital outlay results in a reduction in operating expenses. This is true of modified gross leases. So is the subject of “split incentive” truly just an issue with gross and net leases?*

Answers:

- Steve Teitelbaum - In a gross lease, there is no split incentive issue at all because the operating expenses are borne by the landlord, not by the tenant; any capital expense that reduces operating expenses is solely in the landlord's domain. In a net lease, if the net lease contains the same clause referred to in the question, then the tenant will pay for that capital improvement. A net lease is as likely as a modified gross lease to contain such a clause because, conceptually, pass-throughs of operating expenses are the same in a net lease and a modified gross lease (except for the first lease year in the context of a modified gross lease). However, not all modified gross leases and not all net leases contain such a pass-through at all, or they may contain a different version of that clause. The answer is entirely dependent on what the specific lease says.
- Jim Nobil and Alexandra Kosmides - GSA does have 450 leases where they are paying the utilities and they are taking a look at going back and amending the leases to provide for a pass-through of projected energy savings if the tenant were to make capital improvements.

2. **Question:** *Is a major impediment to spread of energy-aligned or green leasing (like NYC effort) unfamiliarity and the need for education? Or do different cities and states have different customary leasing practices or laws meaning that green or energy-aligned provisions must be developed and tailored separately for each major city/metro area or for each state?*

Answers:

- Steve - Education is a big issue, that's why this new Green Lease Library website is important to creating a common source of knowledge.
There are definitely differences in leasing practices and laws in different cities and states. However, those differences rarely apply to “green” or “energy-aligned” provisions found in green leases. Most laws to date that address sustainability are *building* codes; they address how the base building and/or the tenant's premises are built. By definition, building codes generally do not address *operational matters*; the building code's responsibility essentially ends when the certificate of occupancy is issued. Most leases do address the qualitative build-out of a tenant's premises, but few leases address the qualitative aspects of the base building since the base building usually exists before the lease is signed. Local laws and local

leasing practices (or a particular landlord's or a particular's tenants attitude towards green) will affect that kind of build-out or work letter clause.

Some cities and states are beginning to address *operational issues*, but at this point those generally relate only to *disclosing* building performance, not to requiring any particular level of building performance. And, obviously (or not), if a law does require a certain level of building performance, then the building must abide by the legal requirement whether or not it is addressed in the lease. In that situation, the only issue is how responsibility for performance and the cost of performance may be allocated between the landlord and the tenant. The absence of legal requirements affecting operations is why the GSA has such success in imposing its green lease standards in a wide variety of geographical areas. And that's why green lease clauses like those found in the BOMA green lease guides can be applied in all markets without much fear of running afoul of applicable law.

Adam Sledd - The education issue is a major problem. The tenants should really work to get themselves educated. As far as the different laws and customs, the IMT website has some resources that address this question.

3. **Question:** *What is causing the variance in the premiums that green leasing is driving?*

Answers:

- Adam - It depends if you are looking at ENERGY STAR members or LEED members. Everything comes out takes in to account all factors and there is also some premium which may differ depending on the market. More value on the coast than in the mainland, for example NYC vs. Columbus OH.
- Jim and Alexandra - Because of a lack of competition, the rule is that since there are only 6,100 ENERGY STAR office buildings in the country, that the premiums are pushed a little higher.

4. **Question:** *Renewable energy is capital intensive. As part of a green lease, might the federal government buy power from a landlord that has renewable energy available? Can power be part of a federal lease?*

Answers:

- Jim and Alexandra - We encourage landlords to utilize renewable energy as a source for a green building. The State Department specifies that the lessor must buy renewable power for their space. It is important because it reduces our GHG emissions. There is not usually a split incentive issue (over 95% are full-service/gross leases) in the federal government. We are working to affect occupant behavior. However, no preference is given for who wins the lease award based upon renewable power.

- Steve- A warning that many people use the words “green power,” “alternative energy sources,” “renewable energy,” “non-carbon-generated energy” and the like interchangeably. But they can mean many different things, from installing solar panels to installing a co-generation facility to buying wind power. But they can also mean buying nuclear-generated power and hydroelectric-generated power, neither of which produces greenhouse gases but which are not what most have in mind when talking about environmentally friendly power.

5. **Question:** *Is implementing a green lease in an existing lease mid-term possible?*

Answers:

- Steve- I am not aware of anyone doing this, although lawyers love to talk about it at legal seminars.
 First of all, a lease is a contract between a landlord and a tenant, and neither can amend it unilaterally. So to implement a green lease midstream takes mutual agreement to change the existing lease. (That said, there is always discussion in legal circles whether the landlord’s usually unfettered right to create new “rules and regulations” for the building could be a loophole big enough to allow a landlord to unilaterally add significant clauses of this type.)
 Second, it is possible to operate as a green building without the cooperation of tenants, but it is difficult because, by definition, some green matters require the tenants’ cooperation. That certainly includes doing tenant build-out and renovations to green standards and to obtaining energy usage information from tenants who are separately metered (separate metering is usually very strongly “green” but can backfire in this unintended way) so that the landlord can report the building’s overall energy usage to Energy Star, to a local government, to the USGBC for LEED certification, etc. Depending on how the lease is written (see my comments above about the scope of the rules and regulations), this need for mutuality can affect everything from making the building a “no smoking” building (if local law doesn’t already require it) to implementing a recycling program (if local law doesn’t already require it) to adopting green cleaning techniques to performing janitorial services during normal business hours and, as noted in a previous question, in a net lease or modified gross lease it affects the landlord’s willingness to implement green capital improvements.
 Third, for all of the above reasons, and more, it is impossible for a tenant in a multi-tenant building to unilaterally green the entire building midstream without the landlord’s consent. The tenant may be able to green its own physical plant and adopt some green operating practices. But, for example, a tenant that dutifully conserves energy in a building where energy costs are allocated on a pro rata basis and not by separate metering or submetering will find that it is subsidizing wasteful energy practices by the other tenants.

- Adam - The Better Buildings Partnership has an MOU that landlords can use.

6. *Question: Even with LEED-CI which is tenant driven, landlords feel like certifying with LEED is prohibitive and are concerned whether it is worth it. What are some tips or conversation “softeners” for this issue?*

Answers:

- Jim and Alexandra- This is a valid concern, and probably requires a minimum lease term commitment to support the cost in some situations, although under LEED-CI-Certified (version 2009) we are not seeing significant additional cost beyond the USGBC certification fees. This may become a bigger factor with LEED-CI-2012

Steve - The actual design and construction cost premium of building to LEED’s Certified or Silver standards are at most nominal and probably nonexistent, at least in any market where the design and construction professionals are at all familiar with LEED. The feared “cost premium” simply does not exist at those levels. Even at the Gold level, the cost premium is reportedly small, low single-digit percentages, and proponents say that cost is quickly paid back in better operational matters. At the LEED Premium level, yes, there is still a cost premium. All that said, the cost premium, to the extent there is one, can be borne by the tenant. The landlord need not bear any of the cost. And LEED-CI was designed to allow tenant space to be green even if the rest of the building is not. In short, LEED-CI should impose no meaningful burden on a landlord and there is no reason for a landlord to object to a tenant shooting for LEED-CI.

Also keep in mind that the cost of applying for LEED-CI certification can be borne by the tenant. If anyone should be dissuaded by cost from obtaining LEED-CI certification, it should be the tenant, not the landlord. It’s the application cost (the application fee plus the additional fees paid to the applicant’s design and construction team and consultants to assemble and process the paperwork) that is fairly substantial, usually in the low-to-mid tens of thousands of dollars. That’s one reason so many buildings are “registered” with the USGBC in the hopes of one day obtaining LEED certification but only 30% or so are actually “certified;” the remainder may never be built in the first place but most simply don’t pursue certification for cost or other reasons yet may be built to green standards. A less expensive certification option is provided by Green Globes, by the way.

7. **Questions:** *Your added value of ENERGY STAR labeled chart, does it factor out the correlation to the age of the building- will newer buildings be more efficient? Are your premium values isolated to energy efficiency, and have they factored out the “age factor?”*

Answers:

- Jim and Alexandra - Newer buildings are not necessarily more efficient. In fact, there are some LEED buildings that have not been successful in achieving Energy Star. This is because LEED is a design criteria and Energy Star is an operational criteria. Supposedly good design doesn't always turn out the way it was intended for a variety of reasons. Lastly, while I'm not familiar with the details, Energy Star's Portfolio Manager is supposed to take into consideration the type of building systems and their age into the E-Star score. Thus, an older building that's being run very efficiently can supposedly compete against a new building that's not being run very efficiently.
 - Adam - Some of the studies out there do control for building age, and the result is the same-- there's additional value in owning a green building.
 - Steve- Going back to Jim and Alexandra's point, the energy efficiency modeling of buildings is highly controversial. Studies have shown that LEED certified buildings vary wildly in their energy efficiency, from highly efficient to so poor that it is hard to believe professionals were involved in their design. That's why the PlaNYC-REBNY clause we discussed during the seminar allows a 20% margin of error. It's why the USGBC was sued a couple of years ago by a gadfly building energy engineer who claimed the USGBC-commissioned National Building Institute's widely-circulated favorable comparison of LEED vs. non-LEED energy efficiency was, literally, a fraud and, in his view, showed the exact opposite. (The suit was dismissed in 2011 but on procedural grounds, the plaintiff lacked “standing” to sue for that claim. No resolution was reached on the substance of his claims. Interestingly, one of the arguments against the lawsuit was, in plain English, that the study was so forthcoming in explaining its flawed methodology and had been so widely critiqued and criticized that no one took it at face value any longer.)
8. **Question:** *Given new “civilian realignment” and unilateral Congressional actions in reducing lease dollars, how important are EE/RE elements in renewing leasing on existing building? Or, will the government move to new locations based on EE/RE elements available?*

Answers:

- Jim and Alexandra - Not a factor in the case of a renewal lease with an incumbent lessor (unless the lessor refuses to make cost-effective energy efficiency improvements, in which case they would be eliminated from consideration for a succeeding lease). Energy

Star, or the requirement for energy efficiency improvements would be a factor in determining which building benefited from relocation.

9. **Question:** *Are green buildings that generate renewable solar power that is consumed on site addressed in the Green Lease Library?*

Answers:

- Adam - Yes, some of the resources available in the library do discuss renewable power generation. The BOMA lease definitely covers it, and I think some of the other guides single it out as well.

10. **Question:** *If there is a business in a large commercial building that is the primary tenant (75% + occupancy), and this company is taking on significant retrofits to achieve ENERGY STAR, does green leasing help to address the issue that the company may not be able to achieve ENERGY STAR?*

Answers:

- Adam - If I understand the question properly, I think this is definitely the sort of problem green leasing is meant to solve. If you mean that the tenant is helping pay for renovations that result in the building achieving the ENERGY STAR label, then the tenant would want to receive the cost savings associated with the renovations. There are a couple different ways to structure your lease so that the party paying for an improvement keeps the savings that improvement generates.
- Steve - Energy Star ratings apply only to entire buildings, not to tenant spaces. A 75% tenant, or any tenant, cannot obtain an Energy Star rating on its own. A tenant that wants its landlord to pursue an Energy Star rating may indeed want to include such a requirement in its lease. (I address the wisdom of doing so from the landlord's point of view in a later question.) Whether the landlord can successfully obtain a good Energy Star rating – remember, the Energy Star “label” starts at a minimum score of 75 – may depend on the energy usage of the other tenants in the building as well as, of course, the base building infrastructure and operation. Thus, it may be necessary for not only the desiring tenant to perform well but to have the landlord perform well and even to have the other tenants perform well. And therefore, yes, a tenant-driven green lease can help pave the way towards that goal.

11. **Question:** *If information sharing from landlords to tenants is traditionally anathema to landlords, is that not a major obstacle that somehow has to be addressed?*

Answers:

- Adam - Yes, it is. Most of the resources on greenleaselibrary.com discuss sharing utility data between tenants and landlords, but we realize that many parties on both sides are unwilling to do so, whether because of privacy, cost, or other issues. There is some research showing that tenants use significantly less energy when they have consumption information, so if we can combine more case studies with greater tenant demand, I am hopeful that will help drive change.
- Steve – Yes, absolutely. The NRDC material I referred to in my presentation and slides makes that point very clearly. (I even raised the point in our task force meetings that this conceptual shift in attitude might be the single biggest hurdle to overcome. After all, landlords traditionally operate on the sound principle, familiar to anyone who watches crime shows on television, that anything they say can and will be used against them.) Perhaps this is one reason why the PlaNYC-REBNY energy efficiency clause we discussed does not bother with the concept of demonstrating actual energy savings; it only requires a prediction of energy savings. But it's a problem that cuts both ways: as I noted in a previous answer, a landlord may find it difficult to obtain an Energy Star rating or a LEED-EB:OM certification, or to comply with a state or municipal reporting requirement, if it cannot obtain information from its tenants.

12. **Question:** *Other than for government/public leasing/procurement, is there a useful role for federal &/or state policies to encourage green leasing, e.g., benchmarking and labeling policies or rule? submetering? others?*

Answers:

- Adam - I would like to see the private sector market change on its own accord, as leasing is really a private agreement between parties, but there are ways governments can encourage the market. The GSA leasing policies make a serious impression on the commercial market here in the DC area because they impact so much office space. New York City publicizes the REBNY clause and encourages companies to adopt it. DOE, EPA, and ENERGY STAR certainly play a role in providing resources and doing projects like this to help on the education side. Something like benchmarking and public disclosure laws are also helpful, as they encourage tenants to make energy a higher priority during the leasing process. I'd say anything governments can do to make energy a high priority for owners and tenants in general will have a positive effect in the leasing sphere.
- Steve – Yes, although it would be nice if the private sector could move its own commercial market without government intervention. (The residential sector may need

more government intervention because of the inequality of power and knowledge.) There are a slowly growing number of disclosure statutes out there. They don't require any actual level of performance, only that the building owners disclose the energy efficiency of the building. The theory is simply that public shaming will motivate landlords to do better.

Conversely, there are times that laws actually get in the way. There are laws in some places that ban separate metering or submetering, which are the most effective ways of inducing better energy behavior by tenants. There are laws in some places that ban the use of greywater (treated waste water) or even rain water for landscaping, cooling plants, or other uses that do not directly affect human consumption, and thereby inhibit water recycling. There are laws in some places that waterless urinals still must have back-up piping installed in the walls, thereby making the waterless urinal less cost effective than regular plumbing.

13. **Question:** *How does transparency enter into green leasing when submetering does not exist? With corporate mandates to reduce carbon, is transparency necessary or are there ways to implement improvements with green leasing?*

Answers:

- Adam - For tenants, submetering is about leverage. If you are a large public company leasing a lot of space, you will have more leverage going to the owner and saying that you need energy use information for your public reporting. For a smaller company, you may have to make estimates based on other spaces in your portfolio, or the cost of your pro-rata share. As more cities go online with building rating and disclosure laws, that will make it easier for tenants to guess how much energy is being used in their space. Still, information sharing is the best solution, and that will almost certainly require a significant increase in tenant demand for sub or separately metered space.
- Steve – As noted in previous answers, albeit in scattered fashion, there are green things that can be done without transparency. But in the absence of both transparency and submetering (or separate metering), it is hard to provide an incentive to reduce energy usage. A landlord or a tenant can install CFL bulbs and install motion detector light sensors, both of which have rapid payback. And a landlord can require a tenant to buy only Energy Star-rated equipment (to the extent Energy Star rates a particular type of equipment) or, of course, a tenant can unilaterally implement such a purchasing policy for itself. Of course, as noted above, if the tenant is not separately metered or submetered, a conscientious tenant is simply subsidizing the more energy-intensive tenants in the building, although the conscientious tenant may at least have some satisfaction that carbon is being reduced even if it doesn't reap the entire reward. A landlord could unilaterally start the building's HVAC system later and end it sooner or fiddle with temperature outcomes by a degree or two, as long as that doesn't violate an hours-of-operation requirement or a specific temperature requirement in a tenant's

lease. And most leases don't dictate where the landlord buys the electrical power for the building, so a landlord could unilaterally implement a green power purchasing program without transparency.

14. **Question:** *Taking into consideration the higher value of LEED or Energy Star that is being discussed here; does that imply that from a tenant perspective there should be a cost consideration given for a green building bidding, e.g. a LEED Silver building gets a 5% "discount" for proposing to keep its facility competitive??*

Answers:

- Steve – As Adam noted, there is some evidence that LEED-certified and/or Energy Star-labeled buildings earn higher rent rates, even when differences in age and other variables are taken into account. (The striking disparity of degree found in those studies causes the cynic in me to have some doubts about their statistical validity.) However, to my knowledge there is no evidence that tenants – commercial or residential – conscientiously ascribe a rent premium to the LEED certification or the Energy Star label. In fact, a large body of anecdotal evidence from brokers suggests that tenants will not consciously pay more for the LEED certification or the Energy Star label. What seems to be happening is that tenants seeking “Class A” or “trophy” buildings will pay more for the higher quality building, just as they always have, but now it is nigh impossible for a building to be a “trophy” building without LEED certification or a good Energy Star rating and very difficult in many a large metropolitan area for a building to be “Class A” without LEED certification or a good Energy Star rating. What is also happening, for similar reasons, is that prospective tenants doing side-by-side comparisons of buildings will gravitate towards the LEED certified or Energy Star labeled buildings all other things being equal, but not that they will pay a rent premium for them; instead, the landlord's pay-off is simply in a faster lease-up cycle, which itself has tremendous value.

15. **Question:** *Is there any evidence to suggest the most likely timing to introduce green lease provisions between landlords & tenants (i.e. end of existing terms, during retrofit RFPs, in-line with capital budgeting, etc)?*

Answers:

- Steve – Similar to my answer to question 5 above, it is very difficult to amend a lease to include green provisions. The natural time to introduce green lease provisions is during the initial lease negotiation and the earlier the better. Hence Adam's comments about the importance of the letter of intent and my comments about the importance of getting the brokers on board because they have the earliest input with landlords and tenants. That said, it is possible to introduce green lease provisions at other major transition points in the life of a lease, such as a negotiated renewal or expansion or if a landlord proposes some other capital improvement that it wants the tenant to pay for.

16. **Question:** *In regards to Steve's comments on the PlaNYC- REBNY clause and the split Incentive, with the tenant basically paying for capital improvements through the PlaNYC-REBNY clause, does this have any impact on the classification between an operating and a capital lease? In other words, beyond Steve's comments on FASB and gross leases, is there any evidence of impacts on Cap vs. Oper Test 3?*

Answers:

- Steve- Very few space tenants enter into capital leases. In passing through to the tenant a share of the landlord's capital costs as operating expenses, the PlaNYC-REBNY clause is not all that different than many modified gross leases and net leases that also pass those costs on to the tenant. (See question 1 above.) The PlaNYC-REBNY clause simply uses a different methodology to determine whether there are costs to be passed through to the tenant and in what amount those costs are passed through to the tenant. So I don't know if the PlaNYC-REBNY clause will have any different effect on the capital vs. operating nature of a tenant's lease.

17. **Question:** *As an organization that sells energy efficient products, is there a database that we can access on all of the properties/tenants that have green leases?*

Answers:

- Steve – Not that I'm aware of. I suspect that green leases are much like Mark Twain's comment about the weather: everyone talks about it but no one does much about it. I doubt there are that many truly green leases out there, although there are lots of non-green leases in green buildings that many will tout as green leases.

18. **Question:** *Will there be lease language implemented that specifies the landlord's obligation to maintain the rating?*

Answers:

- Jim and Alexandra- GSA is not anticipating the imposition of any such requirement at this time.
- Steve- Obligating a landlord to maintain (or obtain) a particular LEED certification or a particular Energy Star rating is extremely difficult. Maybe a tenant with GSA's clout can pull it off. The problem for the landlord is that the LEED certification and, even more so, the Energy Star rating, is not entirely within the landlord's control. In the case of the LEED certification, the architect, contractor, subcontractors, and USGBC subsidiary that do the certifying all come into play, and for LEED-EB:OM the behavior of building occupants also comes into play. In the case of the Energy Star rating, the score depends not only on base building elements the landlord can somewhat control but on tenant

usage that is largely outside the landlord's control.

Further, consider the consequences of missing the agreed-upon goal. How is the tenant harmed? Unless the tenant is an environmental organization, in which case there is the embarrassment factor, what actual damage does the tenant suffer if the building does not achieve a LEED certification or a sufficient Energy Star rating? (The American system is largely set up to compensate aggrieved parties for actual damages.) And what if the building gets part way there, such as achieving LEED Silver when LEED Gold was required, or an Energy Star score of 74 (a point short of receiving the "Energy Star label")? Can the tenant terminate the lease? Remain in occupancy but not pay some or all of the rent? Sue the landlord and, if so, for what? Can you imagine what the landlord's mortgagee will say when presented with such a clause for its approval? No landlord who is paying attention should commit to obtaining or maintaining a certification or rating that is outside its control.

19. **Question:** *Question for GSA Representative: After lease award and during occupancy, if a Lessor fails to maintain the Energy Star rating, under what policy does GSA address this issue to the Lessor? And how does GSA monitor Lessor's compliance with maintaining the rating?*

Answers:

- Jim and Alexandra - There is no requirement by the lessor to maintain an Energy Star label after lease award. The next time the issue will come up is when it's time for another lease action (e.g., succeeding lease, exercise of an unevaluated option, expansion beyond scope).

20. **Question:** *What does GSA do to educate tenants regarding reduced plug loads and how does the tenant agency enforce it among its employees?*

Answers:

- Jim and Alexandra - GSA has a Green Purchasing Plan that requires, amongst other things, that all equipment purchased for use in occupied space be Energy Star certified. Additionally, since the reduced plug load requirement went into effect last September GSA's leasing specialists have been working with our client agencies to confirm that the agencies are going to be able to live within the new standard whenever possible. In those situations where the agency's requirements will by necessity exceed the new plug load provisions then the agency must pay up front for any upgrades that may be necessitated.

As for enforcement, the tenant agency is responsible, and their methods of enforcement will vary from agency to agency. If circuits are popping due to overloads the agency will have to take whatever action will be necessary with employees to rectify that situation.

21. **Question:** *Agencies have imposed requirements to develop green clause in agency direct leases. Aside from the website, does GSA provide any direct help to agencies to develop these clauses or can agencies just use the green lease clauses GSA incorporate in their leases?*

Answers:

- Jim and Alexandra - On occasion an agency will seek and be granted delegated authority to enter into their own lease under GSA supervision. In these instances the agency must adhere to all of GSA's policies and provisions, including use of GSA's lease forms or their equivalent. Agencies have access to a GSA special software application called DelEgate to assist them in complying with GSA's requirements.