

## Environmental Law

### A Primer on Green Leases

Special considerations that permeate the negotiation process

By Vincent Mangini

The introduction of green building principles and the heightened interest in energy efficiency and cost savings has begun to influence the negotiation and operation of commercial leases and the build-out of tenant improvements. This article will present a short summary and analysis of a few of the things that commercial landlords and tenants should be aware of and build into their due diligence when dealing with a high-performance green building.

#### Defining Green: The Green Standard

The first task to be performed when negotiating a green lease is to define what it means to be “green” and to establish the manner in which the parties are to achieve and maintain that standard. Sometimes this green “standard” is preordained by circumstances. For example, if a landlord already owns a high-performance green building that has been newly constructed or substantially renovated under the U. S. Green Building Council’s Leadership in Energy and Environmental Design (LEED) Green Building Rating System, it would be sensible for the tenant to design, construct and operate the premises in

---

*Mangini is a shareholder in the real estate, zoning and land use group of Stark & Stark in Lawrenceville.*

accordance with LEED for Commercial Interiors. However, if rental space is not in a high-performance green building certified under LEED or under one of the other green building certification protocols, then settling on a green standard may prove to be more challenging. This is especially the case when portions of the building are already occupied by or reserved to other tenants. In such instance, the parties may have to develop a green standard that focuses on conservation measures, which do not require changes to base building systems, such as the use of materials with recycled content, low-flow restroom fixtures or low-emitting paints and carpeting.

Moreover, even when landlord and tenant agree upon a particular green building certification protocol to be the basis for their definition of green, the parties may find a host of finer points that they need to discuss before they can finalize the green standard under the lease. Open issues may include the rating level to be achieved, the specific building materials and equipment to be used in fitting out or altering the tenant space, or the division of responsibility for the care and maintenance of energy-saving devices. In any event, the importance of setting goals, objectives and expectations relating to the use of energy-efficient technologies and green design in a commercial tenant space and bringing them together into a coherent green standard cannot be overemphasized.

On the contrary, this is a threshold matter that can influence the resolution of other contract provisions, such as lease term, operating expenses and assignment or subleasing of the leased premises.

#### Lease Term

If waste reduction is an integral part of the contractual definition of “green,” then the parties may want to consider a longer rather than a shorter lease term. Long-term leases tend to be more “environmentally friendly” than short-term leases. This is so because short-term leases increase the number of tenant moves and fit-out construction within a tenant space over a given span of time and, therefore, may increase construction waste and create the need to manufacture and/or transport equipment and fixtures causing other environmental impacts. LEED 2009 for Commercial Interiors encourages long lease terms and awards one point to applicants who commit to remain in the same location for at least 10 years.

Of course, in order to preserve the environmental benefits associated with a long-term lease, landlord and tenant may have to agree upon additional terms and conditions. Certainly, if a tenant rearranges its rental space one or more times during the lease term requiring the installation of new fit-out improvements or a landlord seeks to relocate its tenant to substituted space, the reduction in waste and consumption that the parties thought they had achieved will be lost. When the parties anticipate either of these scenarios coming to fruition, short of prohibiting them altogether, the parties can discour-

age their occurrence or mitigate their impact.

In addition to reducing construction waste and other environmental impacts, a longer lease term may facilitate the recovery of costs associated with the installation of energy conservation measures within the rental space.

### **Operating Expenses**

The parties' interest in greening their lease may also affect the payment and assessment of operating expenses. Generally, the payment of operating expenses under a commercial lease may be structured in one of several ways. One approach is the "net" lease. Under this lease form, the cost of operating and maintaining the building where the rental space is located is charged separately from and in addition to rent, placing the risk of increases in operating costs squarely upon the tenant and divesting the landlord of any financial incentive to invest in energy-saving improvements. For this reason, the net lease makes little sense from an energy conservation perspective, especially since it is usually the landlord who is in the best position to control costs and improve efficiencies.

Another method for paying operating expenses is found in the "gross" lease, which provides that the cost of operating and maintaining the leased premises shall be included in the rent charged to tenant. As such, the gross lease is the exact opposite of the "net" lease inasmuch as it places upon the landlord the risk of increases in operating costs, thereby diminishing whatever motivation the tenant might have to conserve energy. Therefore, the gross lease — like the net lease — fails to provide both landlord and tenant with a financial stake in energy conservation. However, when a gross lease form is modified to require the tenant to pay for increases in operating expenses over and above the expenses incurred by landlord in a particular year of the lease, often referred to as the "base year," or some other predetermined amount, it provides both parties with an incentive to curtail energy consumption. This third lease form, sometimes known

as a "modified gross" lease, may make the most sense for the environmentally conscious landlord and tenant.

The establishment of a green standard in a commercial lease will likely also influence the nature and scope of operating expenses. For instance, a landlord may endeavor to add to the list of reimbursable operating expenses the cost of green initiatives and related expenses, such as (i) commissioning or certifying the building where the rental space is located or complying with operational or maintenance requirements and/or (ii) insurance endorsements that provide coverage to repair, replace, re-commission or re-certify the building in the event it is ever damaged or destroyed due to fire or other casualty. Interestingly, there are now a number of insurers that offer green enhancements to their standard property insurance forms or specific green insurance policies.

Similarly, a green-minded landlord may wish to devise building-wide policies related to operation of maintenance that promote energy conservation measures and seek to incorporate them into proposed rules that will apply to all tenants. One such policy might be the provision of daytime janitorial services. Indeed, although such arrangements require careful coordination with each tenant's business operations, the performance of routine building maintenance activities during the day may reduce nighttime lighting requirements and, in turn, save energy.

From the tenant's perspective, it is important for the landlord to provide comprehensive operating and maintenance services that are both energy-efficient and responsive to the tenant's needs. As such, unless the parties are using a gross lease form, it is in the tenant's best interest to obtain a right to audit operating expenses and to monitor actual savings from energy saving equipment. As for responsiveness, a tenant who has particular needs or expectations relating to building maintenance or output, should communicate these points early in the lease negotiation process. For example, a tenant who desires to implement a special recycling program or who wants a landlord's cleaning crew to use specified green cleaning products, may find that

in order to accommodate such requests, the landlord has to alter its rules or make other changes to its method of operations that require advance planning and evaluation. Additionally, a tenant who requires a certain standard of building performance, such as ANSI/ASHRAE 55-2004, Thermal Environmental Conditions for Human Occupancy, should seek to include this in the lease expressly as a continuing obligation of the landlord.

### **Assignment and Subleasing**

In light of the landlord's interest in safeguarding the green standard that it negotiated and agreed upon, the landlord may wish to restrict a tenant's right to assign the lease or sublease the rental space by prohibiting any such transition if the use or occupancy by the assignee or subtenant, as applicable, would (i) cause the building to violate any continuing operational or maintenance obligations that the landlord may have under any green building certification obtained by landlord for the building or (ii) otherwise offend or compromise any of the goals, objectives or expectations outlined in the lease's green standard. Obviously, the tenant also has a stake in maintaining the green standard and, therefore, should consider trying to secure from the landlord a commitment not to sell or otherwise transfer its interests in the building, unless the transferee has the requisite expertise and the financial wherewithal to manage a high-performance green building.

The foregoing represents just a small sample of the special considerations that permeate the negotiation of green leases and shows how the development and implementation of a green standard within a lease can impact the landlord-tenant relationship. Indeed, the race to become ever so green and the opportunities and challenges it presents will require both landlords and tenants to gain a firm understanding of the policies, methodologies and technologies behind energy efficiency and conservation and to keep abreast of the many changes that are likely to occur in the future. ■