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The Commercial Classroom: Green leases, part 1

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Energy consciousness in this country only really started in the 1990s, first with Energy Star ratings and then the Leadership in Energy and Environmental Design (LEED) Certification system. Development of actual "green leases" has only recently begun. In the beginning traditional leases would contain agreements between the landlord and tenants about "green" concepts and procedures, mostly on a best efforts basis. Today the benefits of "green" are well known, operating cost savings and healthier work environments. A new concern also has evolved, after a landlord or tenant has achieved a LEED rating they need to maintain it.

Landlord and tenants increased knowledge of green has caused traditional relationships between them to change. Tenants want landlords to perform their operations and maintenance duties in specific ways. Landlords are dictating types of materials and equipment tenants can use in its office space and requiring compliance with recycling and conservation programs.

Actual "green leases" that address building performance, building materials and supplies and sustainability have been developed. The Building Owners and Managers Association (BOMA) published in 2008 "Guide to writing a Commercial Real Estate Lease, including Green Lease Language." It gives alternative wording if the lease is triple net or a gross lease. In 2009, the Real Property Association of Canada issued "National Standard Green Office Lease for Single Building Projects." An actual model lease, designed as a net lease. Also in 2009, the "model green lease" was created by the Corporate Realty, Design and Management Institute based in Portland, Oregon.

This form is basically a modified gross lease.

Each type of lease has certain pluses and minuses. Gross leases encourage landlords to reduce their operating expenses from energy improvements and increase their return on investment. But, this gives no incentive to the tenant as their rent is fixed.

The modified gross lease, as used in the green leases is more like an expense stop lease. The tenant pays base rent plus their pro-rata share of operating expenses and taxes over a base year, or pay operating expenses in excess of an expense stop.

It is to everyones advantage to lower the operating expenses.

In the triple net lease the landlord pays for the capital improvements and the tenant receives the benefits of the energy savings when they pay their utility bills. Lower operating costs may help keep the building rented, or landlords may charge more rent as a result on those savings. But the landlord is not recovering the cost of those improvements. We will examine these "payback" issues next month in part 2.

Traditional lease clauses are being modified. For example, "assignment and subleasing" may be worded as: The landlord may insist that its consent to a proposed assignment or sublease can reasonably be denied in the event the proposed assignee or subtenant will or could cause part or all of the building not to conform in accordance with green aspects of the lease, including the third-party certification system.

Next challenge, how do we enforce compliance with green practices and policies, especially if non-compliance by a tenant could cause the landlord to lose their green rating?

Part two of this article will appear in the July 31st edition of the Long Island section.

Edward Smith, Jr., CREI, ITI, CIC, GREEN, RECS, is the eastern regional director of Coldwell Banker Commercial NRT, Syosset, N.Y.