

Green Lease Fundamentals for Tenants

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Landlords are adopting green provisions in standard leases to advance business and sustainability goals. Tenants and their brokers now need to understand green leasing issues for the same reasons, or risk losing in these green lease negotiations. The prepared tenant will have a working command of fundamental green leasing issues, including common area maintenance charges, utility cost-sharing arrangements and green building law compliance to assure its legal and economic interests are protected and its own sustainability goals are realized. This article examines from a tenant's perspective fundamental green leasing issues that arise in the context of lease and tenant improvement work letter negotiations and premises build-out.

A. Lease

- 1. Common Area Charges.** For many multi-tenant buildings, the tenant will be required to pay a pro rata share of certain costs, or the increase of these costs from a base year, incurred by the landlord in maintaining the common areas of the building or development, so called common area or "CAM" charges. The astute landlord will seek to collect from tenants the costs of maintaining a green building, including building LEED® or other standard certification costs, green building law compliance costs, alternative energy generation or purchase costs (including power purchase agreements and third party purchase agreements), alternative transportation costs, insurance costs, waste management costs, landscaping costs, insurance endorsement costs and elective building improvement costs. In the negotiation of these costs, the tenant faces a dilemma. Should it agree to pay its share of those costs that improve overall building performance and sustainability, or negotiate to remove some or all of them to improve its own bottom line? When large capital improvement costs are involved (such as the cost of a building systems retrofit) the tenant should assure at a minimum that the costs are spread over their useful life. With regard to elective building changes, i.e., changes that are designed above specific code or certification requirements, the tenant may want to pay only a portion of the cost passed through or none at all. When improvements paid for through CAM charges result in the landlord receiving rebates, credits or incentives from the government or utility providers, the tenant should assure that these are credited against maintenance charges or shared in some other way.
- 2. Utilities.** A tenant's utility charges in a multi-tenant building will either be included in CAM charges for the entire building, charged separately to tenant in a sub-metering or separate metering arrangement, or included within the overall base rent (so called "full service" leases). How the tenant is charged for its electricity is critical to incentivizing conservation and improving building performance and overall sustainability. A green tenant will want to have the right to pay the actual costs attributable to it through a sub-metering or separate metering arrangement. In a sub-metering arrangement, the landlord will arrange, through its utility provider, for the tenant's electricity usage to be tracked and allocated to the Tenant. In a separate metering arrangement, the Tenant will have its very own account with the providing utility. Large enterprises may prefer separate metering arrangements if they can use their own economies of scale to purchase alternative energy and reduce cost. In either case the Tenant should expect to pay its share of utility charges for the common area. In the case of a full service lease, overall building performance and sustainability is an issue, as there is no direct accountability for utility usage. The tenant should assure that environmental controls included in the lease (temperature ranges, controls, ventilation, climate, water) are adequate for its uses.

3. **Operating Covenants.** A tenant with significant negotiating power may seek to require the landlord to undertake certain sustainability related activities during the lease term, including obtaining or maintaining a green building certification (LEED[®], Energy Star), periodic building retro-commissioning, alternative energy purchases, alternative transportation program maintenance, etc. Conversely, tenants should be aware that the landlord of a green building may require the tenant to regulate its use of the premises as to sustainability matters. These regulations may require the tenant to comply with green building laws applicable to the premises, refrain from using the premises in a manner that would jeopardize the landlord's building certifications, employ sustainable methods in its use of the premise, etc.
4. **Auditing.** A tenant should always negotiate for a right to audit the landlord's records to verify CAM charges. In the green leasing context, tenants should assure that this auditing right includes verification of sub-metered electrical costs and other CAM charges discussed above.
5. **Mutual Covenant of Cooperation.** By the time the lease is negotiated, the green tenant should have satisfied itself that the landlord and its property manager have a process in place for addressing green building and sustainability issues that arise during a lease term. The green tenant should look to assure that this mechanism is embodied in the lease, whether as a covenant to consider in good faith adoption of sustainable management practices proposed by either party, the establishment of a stakeholder committee, or in some other form.
6. **Reporting Requirements.** San Francisco and many other large cities are adopting laws that require landlords to report overall building utility usage and other building performance metrics on a periodic basis. LEED[®] existing building and other certification standards are moving toward verification of ongoing building performance data as well. For these reasons, landlords may require the tenant to report utility usage, especially when premises are separately metered. A tenant that is concerned about the confidentiality of the data required to be disclosed should negotiate for appropriate confidentiality within the limits of the law.
7. **Marketing.** The tenant should negotiate the terms and conditions by which a landlord can use information about the tenant's sustainable premises, for example, that the premises is LEED[®] certified to a certain standard in marketing materials. The tenant should obtain the right to review proposed materials, protect necessary confidentiality information and limit entry onto its premises for marketing purposes.
8. **Remedies.** Most commercial leases will significantly limit the tenant's remedies against a landlord. Still, a tenant in a green lease should seek to reserve its right to proceed against the landlord for fundamental breaches of sustainability covenants, such as the failure to obtain or maintain a building certification. These will not be easy negotiations. With regard to the tenant's own breaches of sustainability provisions, the tenant should negotiate for reasonable rights to cure performance.
9. **Building Rules and Regulations.** The landlord will often impose its day-to-day regulations as to use of the building/campus and leased premises, including those applicable to sustainable operations, in rules and regulations attached to the lease as an exhibit. The tenant should review these rules and regulations carefully to understand the landlord's

sustainability practices and to negotiate appropriate modifications that will advance the tenant's own sustainable objectives.

B. Work Letter

A tenant work letter is a legally binding agreement between the landlord and tenant that governs the build-out of your premises. The work letter will provide that either the tenant or the landlord will construct the necessary improvements. A tenant that completes its own improvements will have the greatest control over achieving its sustainability objectives, but may not have the experience to do so, and will assume greater risk. When a landlord controls the build-out, the work letter should establish a specific sustainability standard, and assure that landlord will design and construct the premises to achieve the agreed upon standard.

In the case of a tenant build-out, a tenant should consider the following green leasing issues when finalizing its work letter:

1. **Design Standards.** The work letter should establish the specific sustainability standard the tenant plans to achieve, whether that is a LEED® Commercial Interior ("CI") certification or some other agreed upon sustainability goal(s). Use of a LEED® CI checklist or other well-defined metric to establish the specific attributes required, whether or not a certification is to be obtained, is an effective tool to minimize disagreement later on.
2. **LEED® Consultant.** When the tenant seeks to oversee a green build-out, the landlord may require a specified LEED® certification, the landlord may also require the tenant to engage an accredited consultant to manage the sustainability aspects of the project.
3. **Landlord Approval/Participation.** The landlord may seek to impose its own building sustainability standards in the work letter, especially if the building is LEED® certified or has gone through a green retrofit process. These standards may include required construction practices (use of recycled and salvaged materials, air ventilation and flush out during construction, waste diversion and construction waste management, etc.), resource efficient lighting and plumbing fixtures and sustainable finishes. The landlord will reserve the right to approve the plans for compliance with its sustainability requirements.
4. **Green Building Laws.** The work letter will likely also require that tenant's work comply with all applicable green building and other laws. Tenants should be aware that jurisdictions (cities and/or states) may require construction of tenant premises to LEED® CI or other sustainable standards. San Francisco, for instance, requires LEED® CI or equivalent development standards for premises in excess of 25,000 square feet. A single user tenant building out a new or recently constructed facility should be aware of the California laws pertaining to storm water pollution prevention plans ("SWPPP"). CALGreen, California's new green building code, does not generally apply to tenant build-outs.
5. **Landlord Warranty.** If landlord has marketed its building claiming specific green attributes or LEED® CI or equivalent certification points, the work letter should include a warranty that these points will be achieved by the Landlord and available to tenant in its build-out/certification process.
6. **Insurance Endorsements.** When building out its premises, the tenant should consider whether to obtain insurance endorsements as may be needed to rebuild the premises to the agreed upon sustainability standard in the event of a casualty.

7. **Tenant Allowance.** If the tenant is responsible for the build-out, and if the landlord is requiring either a certification or a specific level of sustainability, the tenant may be able to negotiate a higher tenant allowance to cover the costs of compliance and use the funds toward achieving that certification.

In the case of a landlord build-out, the tenant should consider the following green leasing issues when finalizing its work letter.

1. **Design Standards.** As with a tenant build-out, the work letter should specify the sustainability standard to be delivered by the landlord (see discussion above). The tenant should review and approve the final plans that will achieve this standard prior to commencement of construction.
2. **Construction Standards.** By clearly establishing tenant's sustainability standard, the tenant can regulate how its premises are finished (by requiring air quality during construction, sustainable materials, etc.). The landlord may object to these requirements if they are not part of standard protocols.
3. **Landlord's Warranty.** The work letter should contain a warranty from landlord that it will achieve the agreed upon design standard/certification. If the tenant's certification for the premises is conditioned upon the Landlord's maintenance of a certain building certification, the warranty should include a covenant to maintain the certification.
4. **Commissioning Agent.** The tenant should negotiate to include a provision requiring the landlord to conduct basic and perhaps enhanced commissioning of any building systems installed in connection with the build-out, and assure that the systems perform to specified minimum standards.
5. **Remedies.** The tenant should negotiate for a meaningful remedy for landlord's failure to achieve the agreed upon sustainability standard. A lease termination right will be difficult to achieve, but Tenant could seek to receive free rent for a period of time, a self-help right, or liquidated damages as an appropriate remedy.

C. Build-Out.

A tenant that is responsible for building out its own premises will act like a real estate developer in many respects. A tenant wanting to build-out green will have substantial control over achievement of its sustainability aims, but will also bear the financial risk of cost overruns, usually above a stated landlord allowance. A tenant interested in achieving a green build-out may want to consider the following perspectives.

1. **Project Team.** The tenant's single most important function is to form a team of design and construction professionals that are qualified to complete the project. This team could include an architect, general contractor, LEED® AP or sustainability consultant, interior designer, and a landlord representative if required by the terms of the lease. Careful consideration should be given to sustainability qualification criteria specified in requests for proposals and relevant experience of proposers.

2. **Delivery Methods.** The tenant may choose to use alternative project delivery methods to improve collaboration and align financial reward with sustainability objectives. These delivery methods include the design/build approach, in which the architect works collaboratively with the contractor through the design process, and integrated project delivery. Integrated project delivery is a contractual arrangement among the tenant and all team members in which they identify project objectives/success and agree to compensation based on relative achievement of those objectives. Regardless of the delivery method selected, the team should be engaged early in the process to assure applicable sustainability standards are mutually understood and incorporated into the design process, before commencement of construction.
3. **Design.** The tenant's contract with its architect should assure that the architect's design complies with all applicable green building laws, the landlord's sustainability requirements and tenant's own sustainability objectives (collectively, "Sustainability Standards"). If the tenant is seeking to achieve LEED® certification, a design charrette could be conducted early in the process to finalize an overall design strategy to achieve the desired objective. Tenants that are building-out premises with complex infrastructure (e.g. a manufacturing process or healthcare use) may want to consider building information modeling or BIM as a tool. BIM is a computerized three dimensional design platform that constructs a virtual premises taking into account all wiring, fixtures, etc. If BIM is a viable alternative, the tenant should assure that its architect and contractor are equipped and capable in its use.
4. **Construction Contract.** The tenant's agreement with its contractor should include a warranty that the premises as designed will be constructed to comply with the Sustainability Standards. It should also assure that the contractor will undertake construction in accordance with sustainable methodologies specified by the Tenant (including landfill diversion, material reuse, use of recycled and locally sourced materials, air quality during construction, use of low VOC materials, etc.), Many of these methods will also garner credits for the tenant in the LEED® certification process.
5. **Commissioning.** The tenant should arrange for commissioning of any newly installed or renovated building systems by an independent commissioning agent. Use of a commissioning agent that is independent of the contractor, though more expense, would give the tenant relative comfort that the systems will perform in accordance with agreed upon specifications.
6. **When the Landlord is in Charge of Construction.** The tenant's role is significantly diminished when the landlord is responsible for build-out. The tenant is reliant on contractual discussions included in the green lease and work letter to assure its sustainability objectives will be achieved. The tenant may have limited inspection rights during construction and ongoing participation in materials selection and other sustainability related matters. On completion of construction, the tenant may consider engaging a consultant to inspect the premises prior to acceptance to verify achievement of Sustainability Standards.