

## **Green Leases: Evolving Legal Issues for Commercial Landlords and Tenants**

Negotiating and Drafting Cost-Effective and Environmentally Friendly Lease Terms

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# Green Leases: Evolving Legal Issues for Commercial Landlords and Tenants

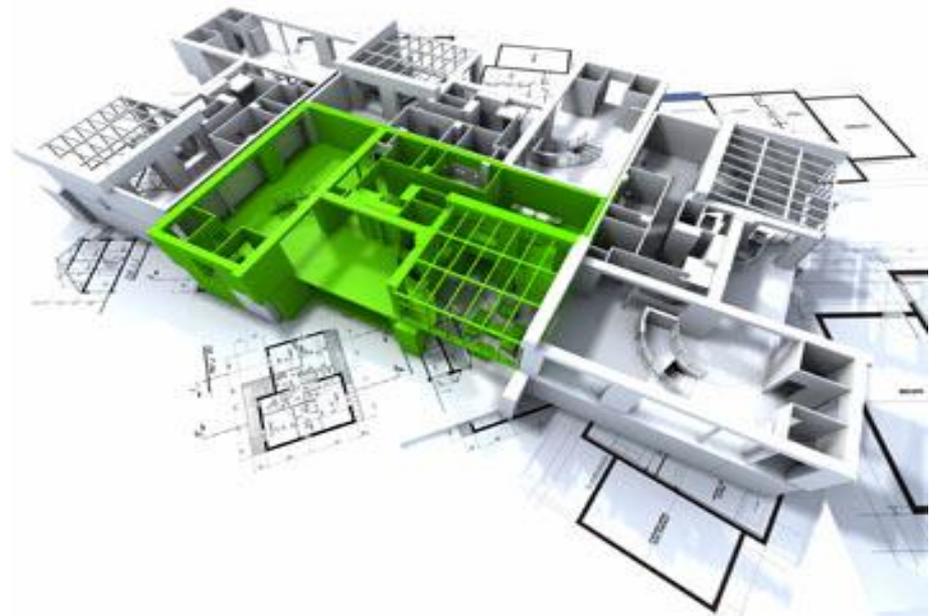
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# Importance of Green Leases



# Why Do You Need To Know About Green Leasing?

- Understand the economics of green leasing or lose in negotiations
  - Green building capital improvement cost allocations
  - Green building operating expense allocations
  - Cost efficient utility arrangement
  - Economic impact of changing green building laws and regulations

# Current Trends in Green Leasing

- West



# Current Trends (West Coast)

- Increased market driven demand for sustainable spaces
  - Green work spaces are a core objective of corporate sustainability policies
  - Green work spaces are an employee expectation in the Technology sector
  - Government Commitment to Green Building
  - [http://www.whitehouse.gov/the\\_press\\_office/President-Obama-signs-an-Executive-Order-Focused-on-Federal-Leadership-in-Environmental-Energy-and-Economic-Performance/](http://www.whitehouse.gov/the_press_office/President-Obama-signs-an-Executive-Order-Focused-on-Federal-Leadership-in-Environmental-Energy-and-Economic-Performance/)
  - <http://www.energy.ca.gov/greenbuilding/>
- High performance driven investment in green building retrofits
  - The Empire State Building Story.  
[http://www.esbnyc.com/documents/press\\_releases/2012\\_05\\_31\\_esb\\_year\\_one\\_press\\_release.pdf](http://www.esbnyc.com/documents/press_releases/2012_05_31_esb_year_one_press_release.pdf)
  - The Transamerica Tower Story.  
[http://www.transamericapyloncenter.com/green/images/LEED\\_PressRelease.pdf](http://www.transamericapyloncenter.com/green/images/LEED_PressRelease.pdf)

# Current Trends in Green Leasing

- East
  - Northeast
    - New York's PlaNYC
      - Split Incentive Problem
      - Model Energy Aligned Lease Provision
  - Southeast
    - National tenants leading the way



# Current State of the Law and Regulations related to Green Buildings

- West



# Law and Regulation Update (West Coast)

- Widespread municipal green building laws impacting new office construction and tenant improvements
- Emerging laws governing existing building energy performance
- CALGreen, first state green building construction code – CALGreen.
- International Green Construction Code published in March 2012.

# How SF Green Building Laws Impact Commercial Leasing

- SF Green Building Ordinance requires commercial build outs of 25,000 square feet or more to meet LEED Gold standard.
  - SF Building Code Section 13C.101.10 et seq.
- SF Existing Building Ordinance requires building owners to conduct standardized energy audits, benchmark building performance and report energy data to City for public availability.
  - SF Environment Code, Chapter 20. Section 2000 et seq.
  - New York, Seattle, Austin and other cities have similar laws.

# How CALGreen Impacts Commercial Leasing

- CALGreen is codified at 2012 California Building Code Part 11
- Mandatory measures for Commercial new construction and for remodels in excess of \$500,000 or 2,000 square feet. \$200,000 or 1,000 square feet after 1/1/14
  - Water use reduction
  - Indoor pollution control
  - Swppp
  - Commissioning
- Voluntary compliance with higher “Tier” standards, but these are tomorrow’s requirements
- Local jurisdictions may use a local green building ordinance that is more restrictive than CALGreen
  - More than 75 local amendments are already in place.
  - Localities may adopt more stringent requirements, and over 75 have done so. <http://www.bsc.ca.gov/codes/localfilings.aspx>

# Current State of the Law and Regulations related to Green Buildings

- East

- A. Northeast

- New York's PlaNYC

- a sustainability initiative of the City of New York launched in 2007.
      - since launch, reduction in greenhouse gas emissions 13% below 2005 levels.
      - 2/3rds of 2009 milestones were achieved or mostly achieved.
      - Green Codes Task Force legislation

# Current State of the Law and Regulations related to Green Buildings

- East
  - A. Northeast (continued)
    - Philadelphia
      - new law, effective June 1, 2013
      - applies to commercial buildings over 50,000 sf
      - annual disclosure of energy and water consumption
      - online program allows property owners, tenants, prospective purchasers, and the public to compare energy and water usage among comparable buildings.

# Current State of the Law and Regulations related to Green Buildings

- East

- A. Southeast

- Growing regulation

- Green rules incorporated into building codes and zoning and land use regulations
      - Applies to both public and private projects.

# Current State of the Law and Regulations related to Green Buildings

- East

- A. Southeast

- City of Atlanta ordinance

- applies to city-owned facilities of 5,000 sf or more or which cost more than \$2,000,000
      - Applicable facilities must designed, built and operated to green standards using the LEED® rating system

# Current State of the Law and Regulations related to Green Buildings

- East

- A. Southeast

- Georgia's Energy Efficiency and Sustainable Construction Act of 2008 (O.C.G.A. §50-8-18)
      - covers any state-funded “major facility project” (includes any building exceeding 10,000 square feet or a renovation that exceeds 50% of the replacement value)
      - requires design, construction and operation to specific green sustainability and efficiency standards.

# Current State of the Law and Regulations related to Green Buildings

- East

- A. Southeast

- City of Chamblee, Georgia (Atlanta area)
      - LEED® checklist completed by an accredited professional and documenting the proposed project's compliance with LEED® certification requirements.
      - Applies to any development in excess of 50,000 square feet
      - “LEED® analysis is for information purposes only and is intended to aid the city in facilitating the awareness of better-building practices within the city.”

# Elements of an Effective Green Lease

- A. Establishment of Sustainable Goals
- B. Pre-Lease Negotiations
- C. Due Diligence (site selection guidelines)



# Elements of an Effective Green Lease

## A. Sustainable Goals

- Incentives for green practices derive from many sources.
- National Tenants
- Investors

# Elements of an Effective Green Lease

## A. Sustainable Goals

- Long term holders of property
  - governmental entities, schools and universities
  - do not require immediate returns; often willing to wait for benefits to be realized
- Incentives
  - tax credits, grants, financing and other incentives
  - Database of State Incentives for Renewables & Efficiency (DSIRE) at [www.dsireusa.org](http://www.dsireusa.org).

# Elements of an Effective Green Lease

## A. Sustainable Goals

- Major focus of “green” buildings: minimizing the energy consumption.
- Low tech quick fixes / great impact on energy efficiency:
  - increased insulation
  - energy efficient windows
  - usage controls on HVAC
  - timers on lights lighting upgrades
  - Energy Star rated appliances and equipment.

# Elements of an Effective Green Lease

## A. Sustainable Goals

- Passive and automated
  - automatic lights
  - window blinds
  - computer auto sleep features
- Recycling

# Elements of an Effective Green Lease

## A. Sustainable Goals

- Metering
  - standardized and detailed
  - energy consumption patterns and fluctuations in usage
  - results disclosed and compared to develop best practices



# Elements of an Effective Green Lease

## A. Sustainable Goals

- Sustainable practices
  - Minimizing the environmental impact
  - Landfills – limiting the disposal of land-clearing, demolition and construction materials
- Use of sustainable and local materials
  - rapidly renewing materials (bamboo)
  - Materials that contain recycled content or are themselves recycled or recyclable at the end of their life cycle.

# Elements of an Effective Green Lease

## A. Sustainable Goals

- The Lifecycle Building Center (Atlanta)
  - devoted to assisting in the use of recycled materials.
- Avoiding high-VOC emitting materials and furniture.

# Elements of an Effective Green Lease

## B. Pre-Lease Negotiations

- Establish “green” criteria upfront
  - Include in all solicitations and information
  - RFPs and letters of intent
    - schedule of requirements
    - required lease provisions.

# Elements of an Effective Green Lease

## C. Due Diligence

- Confirming “green” criteria during due diligence.
- Location:
  - mass transit
  - convenient vehicular arteries
  - alternate transportation options (walking or biking to work).
- Nearby sources of energy and water
  - Cisterns / water collection devices
  - Solar energy panels

# Key Provisions of a Green Lease

- A. Sustainability and Energy Efficiency Standards
- B. Covenant of Cooperation
- C. Allocations of Operating Expenses
- D. Utilities
- E. Auditing Rights
- F. Reporting Requirements
- G. Insurance
- H. Construction/work letter

# Key Provisions of a Green Lease

## A. Sustainability and Energy Efficiency Standards

### 1. LEED<sup>®</sup>

- acronym for Leadership in Environment and Energy Design.
- LEED<sup>®</sup> certification is earned by accumulating points in the following categories: sustainable sites; water efficiency; energy and atmosphere; materials and resources; indoor environmental quality; innovation and design process; and regional priority credits.
- projects can qualify for one of four ascending levels of LEED<sup>®</sup> certification – Certified, Silver, Gold and Platinum.
- LEED<sup>®</sup> certification programs can, and often are, used in combination.

# Key Provisions of a Green Lease

## A. Sustainability and Energy Efficiency Standards

### 2. ENERGY STAR®

- ENERGY STAR® program is jointly sponsored and administered by the U.S. Environmental Protection Agency (EPA) and the U.S. Department of Energy.
- Program initiated in 1992 in an effort to reduce greenhouse gas emissions.
- Whereas LEED® is often geared toward design and construction of “green” projects, the ENERGY STAR® designation is earned through building operations that yield energy efficiencies.

# Key Provisions of a Green Lease

## A. Sustainability and Energy Efficiency Standards

### 2. ENERGY STAR®

- Buildings are graded on a scale of 1 to 100, and a grade of 75 or better earns a building the ENERGY STAR® designation, which indicates that the energy performance of the building is in the top 25% of similar buildings in the United States.

# Key Provisions of a Green Lease

## A. Sustainability and Energy Efficiency Standards

### 3. Green Globes

- Green Globes originated in Canada but is now used in the United States thanks to the Green Building Initiative (GBI), which acquired the U.S. rights to the Green Globes program in 2004.
- Less popular than LEED<sup>®</sup>, but the two rating systems are similar.
- Green Globes uses an online questionnaire-driven assessment and automated reporting.

# Key Provisions of a Green Lease

## A. Sustainability and Energy Efficiency Standards

### 4. Standard 189.1.

- Standard 189.1 is found in the 2012 International Green Construction Code™ (IgCC) published by the International Code Council.
- Provides a “total building sustainability package” for those who strive to design, build and operate green buildings, from site location to energy use to recycling.
- Addresses site sustainability, water use efficiency, energy efficiency, indoor environmental quality, and the building’s impact on the atmosphere, materials and resources.

# Key Provisions of a Green Lease

## A. Sustainability and Energy Efficiency Standards

### 4. Standard 189.1.

- IgCC regulates construction of both new and remodeled commercial buildings.
- Standard 189.1 sets forth minimum criteria for green building practices in a form that can be incorporated into building codes.

# Key Provisions of a Green Lease

## A. Sustainability and Energy Efficiency Standards

### 5. CMP Green Value Score.

- Score is derived from the National Consensus Green Building Underwriting Standards for Commercial Buildings and the National Green Building Underwriting Standards for Residential Buildings, which are ANSI standards, developed by the Capital Markets Partnership.
- Goal is to allow lenders, private equity investors, developers and real estate owners to rate green buildings as an indicator of investment risk and long-term asset value.

# Key Provisions of a Green Lease

## B. Covenant of Cooperation

- Necessary because concepts and requirements for green buildings and green leases are evolving.
- Expression of mutual desire and intent of landlord and tenant to embrace sustainable practices.
- Important to protect landlord with ability to react to governmental entities imposing utility resource reduction targets and other requirements through building codes.

# Key Provisions of a Green Lease

## B. Covenant of Cooperation

- Important for tenant to have landlord acknowledge options for evolving energy efficient processes.
- For a landlord that does not have concrete green measures in place but wants to preserve the possibility for the future, the lease should provide such measures as an option of landlord without any obligation on the part of landlord.

# Key Provisions of a Green Lease

## C. Allocation of Operating Expenses

# Common Area Maintenance Charges

- Costs a LL may seek to collect include:
  - Building certification costs
    - LEED consultant, application fees, physical plant retrofit, etc.
  - Sustainability practices costs
    - Recycling and composting and other sustainable program costs, green supply costs, etc.
  - Green law compliance costs
  - Alternative energy costs
    - Including wind and solar improvements, power purchase agreements, etc.
  - Alternative transportation
    - Shuttle transportation, bike racks and showers, EV charging stations and parking
  - Insurance endorsements

# Common Area Maintenance Charges, Cont'd

- Tenant's dilemma and hot button issues:
  - Capital improvement costs
    - Amortized over useful life?
  - Landlord's elective improvements (above code)
    - Negotiate to pay to code standard?
  - Rebates, credits and other incentives
    - Negotiate for shared benefit or reduction in CAM

# Key Provisions of a Green Lease

## D. Utilities

# Utilities

- Building energy performance as a matter of public disclosure
  - AB1103 and SF EB
- Critical cost component to LL and T
- Inefficiencies of the full service lease model
  - Tenants are not incentivized to control cost or conserve
- Sub-metering model
  - LL retains control of overall utility relationship and resulting cost economies
  - Tenant pays for:
    - Actual electricity used by the Tenant
    - Pro rata share of common area expenses
    - Note regulatory complications, e.g. need for eamon demon

# Utilities, Cont'd

- **Separate Metering Model**
  - Tenant has direct contractual relationship with utility as to its premises, landlord's leverage with utility is diminished, especially if building wide.
    - Tenant pays actual cost of energy use
    - Pro rata share of common area energy charges
    - Ideal for single tenant lessees
- **Other Tenant Utility Concerns**
  - Total allowable watts, environmental controls included in the lease (temperature ranges, controls, ventilation, climate, water)

# Key Provisions of a Green Lease

## E. Auditing Rights

# Tenant Operating Covenants

- The Landlord of a high performance building will want the following operating covenants:
  - Compliance with green building laws
  - Disclosure of energy use
  - Use in a manner that does not jeopardize green building certification
  - Sustainable use of premises, e.g. lighting fixtures, daylighting, conservation, energy star equipment, etc.
  - Mandatory compliance with recycling, composting and waste management programs required by certification or law.

# Key Provisions of a Green Lease

## F. Reporting Requirements

- Green lease should provisions for data monitoring, collection and reporting
- Auditing and monitoring compliance with green covenants.
- Milestones.

# Key Provisions of a Green Lease

## F. Reporting Requirements

- Allocation of costs for the installation and monitoring of meters.
- Confidentiality

# Key Provisions of a Green Lease

## F. Reporting Requirements

- The Atlanta Better Buildings Challenge (“Atlanta BBC”)
- Atlanta was one of three initial pilot cities, including Seattle and Los Angeles (program now includes more than 30 cities, municipalities and school districts).
- Goal -- reduce energy and water consumption by at least 20% in participating buildings by 2020
- Primary focus -- Downtown central business district.

# Key Provisions of a Green Lease

## G. Insurance

# Insurance

- Landlord insurance covering reconstruction to specific LEED Certification or other verifiable standard.
  - Include in CAM charge?
- Tenant insurance covering reconstruction of tenant improvements to LEED CI or other verifiable standard.
- New insurance products are emerging to meet demand.  
<http://www.greenbuildinglawblog.com/articles/insurance/>

# Key Provisions of a Green Lease

H. Construction/ work letter

# Construction Work Letter

- When the Tenant is in charge of construction, LL should:
  - Approve design standards to building requirements
  - Specify construction practices and standards (demolition, reuse, indoor air quality, materials and finishes) taking into account EBOM or building standards
  - Specify contractor rules and regulations
  - Require a LEED consultant
  - Require green building law compliance
  - Require warranty as to certification

# Construction Work Letter

- When the LL is in charge of construction, Tenant should:
  - Approve design standards
    - Use of LEED CI Checklist or other specific criteria
  - Approve construction practices and standards
    - Materials and finishes
  - Require LL Compliance with green building laws
  - Require Landlord warranty as to green certification
  - Negotiate for Tenant improvement allowance to meet LL requirements
  - Require system commissioning

# Build Outs

- Early coordination of project team
- Integrated project delivery, integrated design build or other delivery methods
- Design to agreed upon standard
  - Use of building information modeling for complex projects
- Construction contract needs to carry through design standards; warranty?
- A commissioning agent is now legally required for most projects and will assure high performance benefits.
- When the Landlord is in charge--