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Green leases

Real Estate briefing September 2008

Can the real estate business put sustainability at the heart of the leasing process? John Staheli looks at some of the issues.

Buildings account for some 40% of carbon emissions in the UK. It is therefore not surprising that the Government is looking to the real estate industry to play its part in the battle against climate change. Property managers, developers and valuers are already learning to live with Energy Performance Certificate ratings, revised BREEAM standards and tougher building regulations. On the horizon are Display Energy Certificates, mandatory air-conditioning inspections and the Carbon Reduction Commitment. The planning regime encourages the use of on-site renewables (sometimes without regard to practicalities or cost). The market remains difficult and energy prices continue to soar.

But the property business presents challenges because the people who construct and own buildings are often not the same as those who maintain and occupy them. The environmental credentials of a “green” building can quickly be eroded by “brown” behaviour. This realisation has led to a re-examination of the landlord/tenant relationship. Academics have identified the traditional arms’ length relationship as a “systemic barrier” to green outcomes. Why should an occupier with only a short-term interest contribute to capital improvements which benefit the owner’s investment value? Why should an owner pay for energy-efficiency measures which will reduce the occupier’s bills?

The landlord and tenant relationship exists at many levels, and with various degrees of formality – between facilities managers and managing agents, between procurement managers and contractors, between MD’s – but at its heart is the lease. So should landlords and tenants be entering into green leases? And should real estate lawyers be changing their draft documents?

A number of fundamentals need to be considered, starting with the building itself. Is it new or old? Is it intended to be multi-let? Will the landlord retain common parts and run a service charge? Is its use office, retail, industrial or other? Is it town-centre or green-field?

The client must also think about what it means to be “green”. Sustainability embraces much more than just energy efficiency and carbon emissions – it includes transport, habitat, heritage, community, waste management and water. How many of these aspects can sensibly be addressed in a lease?

Then there is enforcement. How seriously do the parties take the green commitments? What consequences should flow from breach of a green covenant? A dark green lease will treat the sustainability clauses in the same way as any other obligation, and attach the same remedies. A lighter green lease may treat the green provisions as aspirational rather than mandatory, perhaps adapting a stand-alone dispute resolution procedure for green issues.



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Once the parameters are established, the draftsman and client will look at the detail of the lease covenants. Tenant's obligations which can be "greened" will include alterations, repair and decoration, waste and recycling. If the landlord retains parts of the building and provides services, then it too should be prepared to make commitments. And there will be new obligations on both parties, for example to share information about energy use and to meet regularly to agree environmental targets, such as waste reduction.

However, both parties will want to ensure that their wider commercial interests are not compromised. The tenant will not want its operational requirements affected (it has a business to run), nor its freedom to assign the lease; the landlord will be concerned about rent review and valuation.

There will be problems. The Lease Code is difficult to reconcile with some aspects of a green lease (for example, the Code places few restrictions on a tenant's alterations, whilst being green may imply constraints upon the types of materials used or the effect of the alterations upon the building systems). The Service Charge Code focuses on value for money – but traditional cost/benefit analyses may not apply where the parties have broader sustainability objectives. In multi-let buildings carrots and sticks will be needed, to ensure that the measures taken by the landlord and the compliant majority are not undermined by a non-compliant minority. And security of tenure is likely to slow down the greening of a portfolio – when considering the terms of a renewal lease, will the Courts regard green lease amendments as "reasonable updating"?

There will be solutions too. At a practical level, landlords may include sustainability objectives in a tenant's handbook, or in estate regulations, rather than in the body of the lease. This will allow greater flexibility to adjust the objectives as practices and norms develop, technologies improve and payback calculations standardise.

Can leases become green? Of course. Is it happening? Yes – up to a point. Major property companies are leading the way. Occupiers, too, have corporate social responsibility agendas, including sustainability, which they are pushing down their supply chains. After all, property is a service industry and the consumers of property want to know what their suppliers are doing. But for the time being, with the market in the doldrums, the emphasis is on collaboration and partnership, light green not dark green.

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