

Potential “Green” Lease Pitfalls

Whether the result of a landlord’s desire to achieve LEED® (Leadership in Energy and Environmental Design) certification or other sustainability goals, a local municipality’s adoption of a green construction building code, a landlord’s imposition of a mandatory recycling program, or a tenant’s desire to meet its own social, work-environment, employee satisfaction or economic goals, the decision to go “green” affects many aspects of a commercial lease.

Various lease clauses can be expected to be impacted by green lease provisions, including legal compliance, use, alterations, casualty and insurance. While each of these listed lease clauses will likely impact the tenant in some fashion, experience tells us that the three lease clauses that will attract the greatest attention during negotiations and create the most risk-potential for tenants are: (a) building and tenant-space construction, (b) maintenance and tenant operations, and (c) operating expense pass-throughs.

Construction-related issues can run both ways. For example, the tenant may want assurance from the landlord that the entire building, the building core and shell, or (if landlord is performing the tenant build-out work) the tenant’s interior space improvements, will obtain and maintain a particular sustainability certification, such as LEED Core and Shell, LEED Commercial Interiors, or LEED New Construction & Major Renovations. The tenant in that case needs to be sure that the elements of certification that are most important to it are identified and addressed, because the certification programs provide for multiple ways to achieve certification and the path chosen by the landlord may not align with the building and property characteristics most important to the tenant (e.g., bicycle racks and shower facilities for bike commuters, green roof, native low-water vegetation, emphasis on natural lighting of interiors, use of recycled content). On the other hand, the landlord may attempt to require

that the tenant build out (and maintain) its space consistent with LEED Commercial Interior specifications, or require that a LEED-certified professional have a significant role in the tenant space design and construction process. The potential cost and timing delays of these landlord requirements will need to be analyzed and addressed when comparing lease options.

Maintenance and tenant operations provisions may address green issues such as refuse sorting and recycling, the type and kind of light bulbs the tenant is permitted to use in its space, mandatory use of lighting controls, mandatory use of ENERGY STAR®-qualified equipment, mandatory use of U.S. EPA Water Sense® certified products, closing blinds at specified times and locations, turning off and powering down equipment during non-business hours, and the type and kind of kitchen/break room and office equipment cleaning agents and other chemicals the tenant may use. The lease may also include language that requires the tenant to operate within the leased space in compliance with the landlord’s “sustainability practices” or similar terminology, which is often defined very broadly and lacks objective measuring criteria. These provisions require attention by tenants, not only because of the lack of specificity and objectivity but also because of the potential the obligation may change over time as the underlying criteria change.

The allocation of costs and risks will dominate the green lease operating expense pass-through discussion. Part of the issue relates to what might normally be somewhat higher up-front equipment costs that are expected to result in greater operating efficiencies (and therefore lower operating costs) over time, and how to fairly allocate these costs and savings between the long-term interest of the landlord and the likely shorter-term interest of the tenant.

Another issue relates to what expenses are properly classified as capital and what are properly classified as operating, again

focusing on how to fairly allocate the interests of the landlord and tenant. Whether the desired building certification has already been achieved, or is a desired landlord objective in the future, can also impact the tenant’s position, and may necessitate consideration of an expense cap for green expenses. Base year concepts (where only future increases in expenses are paid by the tenant) also require special consideration of how later incurred green expense pass-throughs will be treated. The landlord may want to base its capital cost recovery on projected energy costs savings, and not over the useful life of the equipment. In that circumstance, a major concern of the tenant is that projected energy costs savings will not be realized and the tenant might counter (if it is unsuccessful in reverting to a useful life-based recovery mechanism) that cost recovery be tied to actual, measured savings. The “Energy Aligned Clause” allows for landlord cost recovery based on a prediction of savings as determined by a landlord-tenant approved energy specialist, but provides an underperformance cushion to the tenant by limiting the pass-through to 80 percent of the predicted savings in any given year.

Understanding these and other green lease pitfalls will help keep landlords and tenants from feeling blue.

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