

Ask the Expert...

GREEN OFFICE LEASING STRATEGIES FOR THE NEXT DECADE

(If You're Brown, You're Goin' Down)

By Byron F. Mellberg

The green building movement is fundamentally altering real estate market dynamics. Brown building owners will need to adapt, or risk major market discounts relative to green buildings. Green building certification will become an essential component of Class A properties and institutional quality real estate. The move to greener buildings is being driven primarily by (1) the prospect of permanently higher energy costs, (2) widespread concerns about global warming, (3) regulatory mandates, (4) government incentives, and (5) some positive speculation about return on investment.

What's behind it all? Buildings in the U.S. presently account for approximately 30% of greenhouse gas emissions -- 14% more than transportation and 34% more than industry. Buildings are responsible for consuming roughly 39% of U.S. primary energy, 70% of U.S. electricity, 12% of all U.S. potable water, and 30% of U.S. raw materials use.

In the office building arena, tenants are responding to sustainability concerns from their customers, shareholders, workers, business partners, and local and state government. At this time, tenant demand for green buildings may not be perceptible to many building owners. The market is down and most tenant leasing decisions seem to be based on traditional notions of location and pricing.

For now, government is leading the way. The State of California has mandated a 30% reduction in statewide business-as-usual greenhouse gas emissions by 2020, with interim requirements to be established in 2010. California is implementing an action plan for benchmarking all commercial and public buildings. This effort will enable owners and tenants to compare a building's energy performance to similar buildings and establish a baseline to evaluate changes in building performance over time.

While major property owners like RREEF may have determined that "the risks of not moving quickly enough almost certainly will outweigh the risks of moving too quickly," many other prudent office building owners will wait and see. A big problem with the wait-and-see strategy is that brown building owners continue to write brown leases that lock in brown building operations for 5 to 10 years or more. When those owners decide to switch strategies, their brown buildings are not going to turn green until their brown leases turn green. By the time all those brown leases expire, many office building owners are likely to discover that they have inadvertently plunged their buildings into product obsolescence.

So, how does a brown lease turn green? Here are a few basic concepts:

1. Define "Green Building." The two essential components of a green building are operational efficiency and minimal environmental impacts.
2. Adopt a Green Building Operating Plan. The plan should be based upon sustainable building operating standards such as LEED for Existing Buildings. Plan requirements should be stated as lease covenants.

Don't make them part of the building Rules and Regulations. Rules and Regulations tend to be second class covenants, dependent upon the basic lease provisions and subject to unilateral change by the landlord. Clearly state that breach of a Green Building Operating Plan covenant is an event of default under the lease.

3. Create a green "reasonableness" consent standard. Stipulate that it is commercially reasonable for landlord to deny its consent based upon a bona fide, non-discriminatory plan to implement a Green Building Operating Plan. Apply the green consent standard in connection with all landlord approval rights, including the tenant's request to (a) make alterations to the leased premises, (b) transfer the lease, and (c) change the permitted use.
4. Use alternate dispute resolution to resolve disputes over green lease provisions. Provide for expedited mediation/arbitration of disputes relating to green lease provisions. Recite that the mediator/arbitrator shall be a LEED Accredited Professional. The lease language should address the possibility that judges may be reluctant to evict a rent-paying tenant based upon breach of a green lease covenant unless the breach is habitual or supported by an ADR determination and final opportunity to cure.
5. Green up operating expense provisions. Provide for separate metering of utilities and services to allow or require the tenant to pay for actual usage instead of its pro rata share of the building expenses. Provide that any future carbon tax is included in operating expenses. Include green retrofitting capital expenditures in the definition of operating expenses.
6. Provide for possible relocation of tenant to allow green retrofitting.

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7. Expand the landlord right of entry provisions to allow for benchmarking and periodic green audits of the tenant's compliance with the Green Building Operating Plan.
8. Require the tenant to participate in green building recycling programs and parking area incentive programs.

Now is the time to lay the foundation for a green building program. The first step is to review existing lease forms to determine where they contain brown problem areas. When the basic form turns green neutral, green lease provisions should be written into all new leases for brown buildings. Existing leases should be revised by green amendment. Amendments could be negotiated in the context of a tenant request for discretionary approval, a request for modification of lease, or for other consideration.

We urge all brown building owners to be on the lookout for and take advantage of opportunities to turn brown leases green.



Byron F. Mellberg is an attorney with the San Jose-based law firm of Hoge Fenton Jones & Appel, where he chairs its Commercial Leasing Group and is a member of its Green Building & Technology Group. Byron focuses his practice on commercial real estate transactions, particularly leasing, purchase and sale, and finance. He has reviewed and negotiated thousands of commercial leases, including those for major shopping centers and

other retail facilities, office buildings, R & D premises, and other commercial properties.

Byron can be reached at 408.947.2409 or bfm@hogefenton.com. www.hogefenton.com

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