

# Improving environmental performance through innovative commercial leasing

## An Australian case study

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### Abstract

**Purpose** – The purpose of this paper is to illustrate, by reference to practical examples, how leases of commercial buildings can be more responsive to environmental issues.

**Design/methodology/approach** – The paper explains how difficult it is within the structure and content of conventional leases to reduce the environmental impact of the tenanted commercial built environment. It explores the interplay between the content and structure of commercial leases and the behaviour of building owners, managers, tenants and occupants, illustrated through the experiences of a large Australian-based commercial office building owner/operator.

**Findings** – With reference to practical examples it shows how conventional leases stifle innovation and illustrates the difficulties in drafting leases that enable a responsive approach to building management to be adopted. It shows how more fundamental changes that align and reward owners and tenants for working together for mutual benefit are required.

**Practical implications** – The paper presents a number of “model clauses” for encouraging best environmental practices and concludes with a suite of recommendations.

**Originality/value** – Although there have been conversations about green leases in recent years, there is little detailed evidence of their use in the marketplace. This paper remedies that deficiency by taking a case study approach that: illustrates the opportunities and difficulties in negotiating green leases; and shows how attempts to provide innovative building management can be hindered or supported by lease terms.

**Keywords** Australia, Leasing, Commercial property, Commercial leases, Environmental performance, Leasehold innovation, Energy efficiency, Thermal comfort, Green leases Paper type Case study

### 1. Introduction

This paper illustrates some of the opportunities and challenges involved in adapting tenanted commercial space to improve environmental performance and reduce energy consumption. Through a focus on the experience of a large Australian-based commercial office building owner and operator, Investa Property Group<sup>1</sup>, we illustrate the complexities of improving the environmental performance of tenanted space.

Commercial property has a substantial impact on the environment and the operation of buildings is a major contributor to greenhouse gas emissions, accounting for approximately 18 percent of emissions in the UK and approximately 10 percent in Australia (Allen Consulting Group, 2010; Carbon Trust, 2009). It is crucial, therefore, that a better understanding is developed of the interplay between the technical possibilities of the building itself, the content and structure of leases, and the behaviour of the various actors involved in letting and using that space (owners, managers, lawyers, landlord and tenant agents, occupiers, and customers). Although in recent years there has been much talk, internationally, around the topic of “green leasing” (Christensen and Duncan, 2007; Hinnells *et al.*, 2008; Oberle and Sloboda, 2010) there is little evidence as to what is happening in the marketplace, what the process of negotiating green leases is like and the extent to which green leases are able to make a difference. With some rare exceptions, letting practices – in the UK, the USA and Australia – have remained largely untouched by the green agenda and both landlords and tenants are resistant to entering into commitments to work together to improve the environmental performance of the rented space (Estates Gazette, 2010).

A green lease has no fixed form, it is simply one that provides a leasehold structure that will facilitate and support the property being used in an environmentally efficient way. This can relate to any or all of energy use, water management, waste disposal, travel plans and the use of sustainable materials. It can flavour the whole leasehold relationship and include binding environmental performance targets, or can adjust usual provisions to encourage environmentally sensitive behaviour (Bright, 2008). It is clear that “green transformation” of the letting market is not going to happen easily, but by telling the story of Investa’s experience and drawing on other models available, we demonstrate the role leases can play in facilitating innovation within commercial office buildings and encouraging responsible operating practices.

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<sup>1</sup> One of the co-authors, Craig Roussac, works for Investa Property Group as General Manager – Sustainability, Safety and Environment.

Investa's experience is of value beyond Australia. Although there are detailed differences in the policy and regulatory environments of the major developed nations, and in the content of commercial leases, the essential issues faced are the same in the UK and in the USA. The central challenge is the "split incentive", referred to extensively in legal and policy literature in each of these nations as a major barrier (Carbon Trust, 2005; UNEP Finance Initiative Property Working Group, 2009, November). The majority of investment grade property in these countries is let on a "net rent" basis, which means that the tenant pays for the energy costs. As the landlord has responsibility for the building structure and equipment there is little financial incentive for the landlord to improve the energy efficiency of plant and equipment. The disincentive effect is compounded by the fact that the cost of any equipment upgrades will usually fall to the landlord who may be unable to pass the capital costs through the service charge. But there are other common features of leases, which likewise inhibit change; such as the length of leases, the rigidity of leasehold language, and the approach to "fit out". The problem is not confined to the wording of the lease itself. It extends beyond this to the whole process of letting – the role that agents play in agreeing "heads of terms", how the occupied space is managed, and the way that the space is used.

Although it may be difficult to develop a standardised response to the challenge given that the nature of the issues is so complex and property specific, various models and toolkits are being developed that will assist (BPF, 2009; Investa Property Group, 2007a; REALpac, 2010). It is important that the various responses support innovation – in the way parties approach negotiations, define their self-interests and deal with each other throughout the lease term and at expiry. These principles can apply to all commercial lease arrangements and, importantly, can be addressed not only at the time of initial let but also through amendments to lease arrangements where a building's environmental performance or services to occupants are falling short of what might be defined as "best practice".

## 2. The lease relationship and its limitations

The relationships between the owners (/landlords), occupiers (/tenants) and operators of tenanted commercial office buildings are largely defined by leases. A typical office building lease protects the interests of the landlord and tenant without expressly dealing with matters of broader community concern, such as greenhouse gas emissions from operating the premises, waste recycling, water use, etc. Despite a growing awareness of the need to reduce environmental impacts from the operation of commercial office buildings – expressed in community concern, emerging rating schemes, tenant requirements, staff expectations, and emerging regulations, including disclosure regulations – the structure and content of commercial leases can impose significant constraints on the ability of buildings to be adjusted/updated.

In addition to the problem of the split incentive outlined above, there is the fact that leases tend to be very rigidly drafted and do not allow flexible responses to new situations. The length of leases means that these problems can persist over considerable time frames. In the UK, although two-thirds of new leases entered into in 2008/2009 were for five years or less these short leases were more common on units with lower rental values. For the higher value properties, the proportion of leases less than five years in length is notably smaller, at 38 percent, and the proportion of leases longer than 16 years is 9 percent. Tenants who occupy larger units tend to sign longer leases (IPD, 2009). Leases may also contain extension options exercisable upon expiry, and in the UK there may be a statutory right to renew which can make it difficult to change leasehold terms even when the contractual term expires<sup>2</sup>. There is no public data on lease length in Australia but Investa's experience and (slightly dated, and limited) research suggests that the pattern is similar (Crosby, 2006).

The quickening pace of policy, regulatory and technical change in relation to environmental understandings of commercial space means that leases need to allow greater flexibility in order to maximise the opportunities available. The story of the implementation of the CRC Energy Efficiency Scheme (CRC<sup>3</sup>) in the UK provides an illustration of the difficulties of lease language. The CRC is intended to encourage carbon savings within large organisations by requiring those who receive supplies of energy to purchase permits (CRC allowances) to emit the resulting carbon dioxide. Many landlords are required to be participants in the scheme. This increases the cost of supplying energy to tenanted space and, in tune with the idea of the net rent, several landlords intend to pass the cost of CRC participation onto tenants. The difficulty is that leases have not built the language of CRC into the service charge and general outgoings clauses so it is doubtful in many cases as to whether landlords can legitimately pass on the costs.

Furthermore, there is a real risk that leases will not be "future proof". The property industry invested much time and debate into consideration of how to accommodate CRC into new lease drafting throughout 2009 and 2010, only to find that the new UK Coalition Government moved the goalposts significantly in its *Comprehensive Spending Review* of Autumn 2010, leaving the details of the scheme in a state of flux for some time thereafter (for fuller discussion see Bright and Highmore, 2010).

In Australia, leases often set detailed specifications about management issues, often with reference to standards in the Property

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<sup>2</sup> Landlord and Tenant Act 1954, part II. If the parties cannot agree the terms of the new lease, the court requires there to be a "good reason based [...] on essential fairness for the court to impose a new term not in the current lease [...] against" the will of one party *O'May v. City of London Real Property Co Ltd* [1983] 2 AC 726 (HL) 741.

<sup>3</sup> This was formerly known as the Carbon Reduction Commitment.

Council of Australia's *Guide to Office Building Quality* (PCA, 2006). This level of detail would be highly unusual in the UK. In Australia the rigidity of this approach makes innovation difficult. A practical illustration is the standard provision for thermal comfort which provides for a fixed temperature range – this prevents building operators from making adjustments outside of this range even where that may promote greater comfort for the occupiers and be less energy intensive. Investa has been exploring how thermal comfort can be achieved with less energy use, but doing this has often involved breach of lease terms. This experience is explained in Section 4 below, but for now the point to draw from this is that it shows how conventional leases stifle innovation.

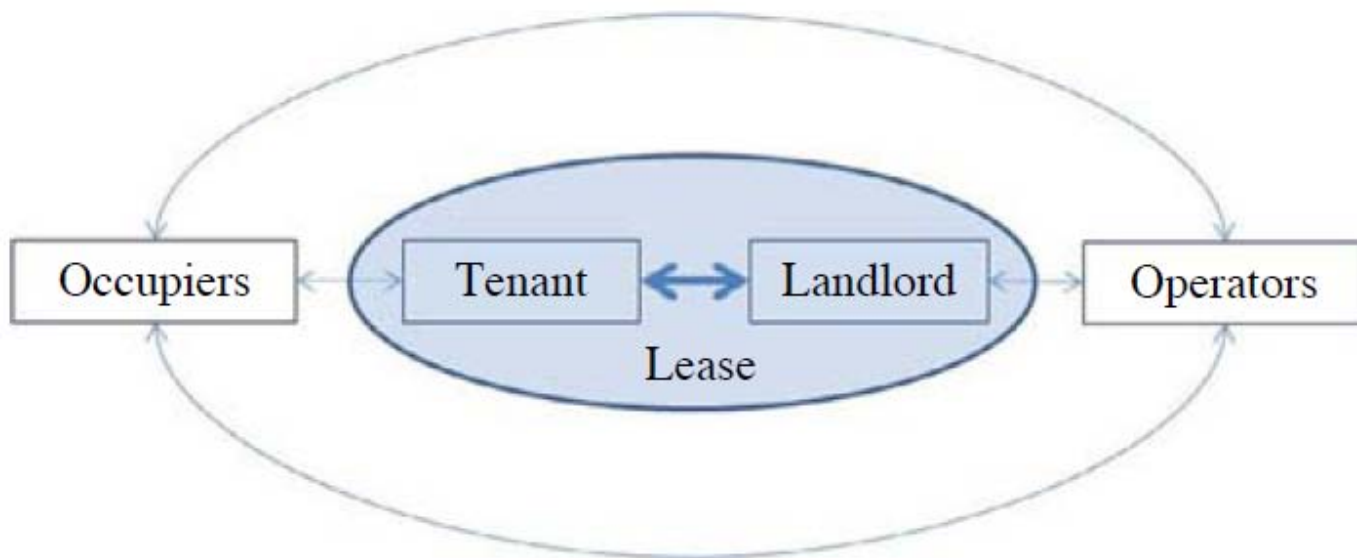
### 3. Crucial relationships function outside the lease

“Green” provisions must be built into the expectations of the parties at the start of negotiations. In late 2010, the Northwest Energy Efficiency Alliance (NEEA) moved into a building in Portland, USA, on the basis of a green lease. NEEA explains how important it was to the leasing process that its brokers continually communicated NEEA's environmental goals to the landlord and, indeed, only introduced NEEA (2011) to landlords that shared its sustainability vision. In practice, most negotiations are conducted through landlords' and tenants' agents (Figure 1) who are focussed primarily on getting a deal done, and if environmental goals are not introduced early on it will be difficult to build them into the lease itself. Research conducted in the UK by Crosby *et al.*, shows that the heads of terms agreed have a significant impact on the resulting lease (Crosby *et al.*, 2005, pp. 167, 172). This has also been the experience of Investa; unless key “green lease terms” are discussed as part of the initial heads of terms, there is considerable resistance to their inclusion in the resultant lease.



**Figure 1.**  
Lease negotiations are largely conducted through intermediaries

Various actors who play important roles in relation to how the space is used are not in fact party to the lease itself (Figure 2). Property management is often outsourced to building operators who do not have a direct contractual obligation to the occupants/tenants even though they are crucial to the delivery of services described in leases and have a pivotal role in achieving environmental objectives.



**Figure 2.**  
Once signed, the lease is the central relationship, yet it does not define or encourage broader engagement

The building manager may in turn subcontract elements of the building's operations (mechanical services maintenance, lift maintenance, cleaning, security, etc.) to specialist providers, or act as agent for the landlord who contracts their services directly. Regardless of the contractual structure, the landlord is unlikely to maintain a close or direct working relationship with the service

providers. Even in the case of landlords that internally manage their buildings<sup>4</sup>[4], the majority of specialist functions will be performed by people who have no direct connection to the lease. Furthermore, employees of the landlord with responsibility for operating a building will not usually have been involved in negotiating a lease and may not even have access to it.

The situation is similar for tenants. Negotiations between landlords and tenants take place at a corporate level, generally before the tenant occupies the demised premises. The users of individual buildings may be employed by tenants, but they are not themselves tenants. Most staff and employees have neither access to a copy of the lease, nor awareness of the obligations of landlord or tenant.

Given that operators and occupiers of commercial office buildings are often not familiar with the contents of leases between landlords and tenants, it begs the question: can commercial office building leases effectively facilitate innovation and encourage responsible operating practices? Put another way, does it matter whether leases prohibit or promote improved environmental performance if the people on the ground do not know what the leases say? This identifies a broader challenge. It is simply not possible to address environmental performance in the commercial built environment without understanding how the various communities using the building engage – with the space, with legal documentation, and practice manuals, and with other owners, occupiers, building managers, customers, employees and so on.

Clearly these questions are fundamental to determining whether leases can provide a basis for improving the environmental performance of commercial buildings.

We believe they can and they should. However, it is clear that fundamental changes that align and reward owners and tenants for working together for mutual (and community) benefit are required. It will be necessary for innovative approaches to be adopted within leasing practices that take account of how occupiers behave and what occupiers want out of buildings. Operators need to be free to innovate in the way they run buildings, to be incentivised to do so, and to engage meaningfully with occupants regarding these kinds of issues. Furthermore, the content and structure of agreements between landlords and tenants will need to be understood by this wider group of stakeholders.

#### **4. Some challenges illustrated through practice**

The limitations and challenges mentioned above have profound implications for the operation of buildings and the wellbeing of their occupants in practice. Often landlords are compelled to instruct building operators to meet requirements that are not in the best interests of occupants and in doing so they waste energy and resources that could be put to better use. In other situations landlords must sit by as tenants make poor fit out decisions which impact their staff wellbeing and productivity. Some illustrations follow.

##### *4.1 Thermal comfort*

Office buildings exist to provide productive workplaces for their occupants. Insofar as it affects productivity, comfort is obviously important; however, there is no absolute standard for human “thermal comfort”. The internationally-accepted definition states that “thermal comfort is that condition of mind which expresses satisfaction with the thermal environment” (ISO, 1994). Everyday experience of office environments tells us that different people have different perceptions of thermal comfort at different times. Furthermore, those perceptions are impacted by a range of environmental and human variables (Fanger, 1970).

With the increasing prevalence of air conditioning in commercial offices, there has been a trend to codify in leases what constitutes acceptable thermal conditions. In Australia, where air conditioning is universal, this has led to the prescribing of internal air temperatures of 20-24°C ( $21.5 \pm 1.5^\circ\text{C}$  in winter and  $22.5 \pm 1.5^\circ\text{C}$  in summer) in typical commercial leases. For reasons yet to be understood, these prescriptions are significantly cooler than the 23-26°C recommended by leading international authorities on the subject (ASHRAE, 2010; ISO, 1994). Furthermore, these specifications take no account of other influences on human thermal comfort such as air velocity and the temperature radiating from windows. This inconsistency between leases and established comfort benchmarks is significant because energy use is directly proportional to the differential between internal and external temperatures (Ward and White, 2007). Also, because people adjust clothing to dress for the weather, so is occupant comfort weather and seasonally dependent (Morgan and de Dear, 2003; Ove Arup & Partners Ltd, 2008).

Landlords in Australia who attempt to provide air temperatures above 24°C during summer run the risk of breaching leases and incurring penalties, even though the conditions are likely to be more comfortable for occupants than those prescribed by the leases. A study by Investa through the Australian summer 2009/2010 (where such lease boundaries were pushed on the basis of scientific rather than contractual advice!), found that a 1°C increase in thermostat settings was associated with a 6 percent reduction in daily air conditioning energy use (Roussac *et al.*, 2011). Furthermore, an analysis of data recorded via the company’s tenant “helpdesk” for a follow up trial (2010/2011) found a 16 percent reduction in the frequency of “complaints” related to air conditioning relative to other building issues (Roussac *et al.*, 2012). These results demonstrate significant potential for greenhouse gas emission reductions and comfort improvements, if only the leases would not preclude it!

##### *4.2 Fit out churn*

Fit outs and refurbishments consume large volumes of resources, much of it associated with “churn”. Churn refers to the replacement of building elements throughout the life of a facility. Using Investa’s portfolio as a guide (Investa’s is the largest portfolio of office buildings in Australia), it is estimated that each year between 10 and 15 percent of commercial office leases expire. At expiry tenants generally have the choice of whether to stay or go. It is common for landlords to offer incentives to stay and these are normally in the form of fit out contributions or cash. While Investa does not keep precise statistics, prior to the global financial crisis they estimated that 75 percent of expiries led to fit out contributions (to both renewing and new tenants) and the other 25 percent took cash and retained their fit out. So, from Investa’s experience, the annual churn range is probably between

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<sup>4</sup> Investa Property Group operates an internal model. A directly employed “property supervisor” is based at each building and oversees the work of contract service providers.

7.5 and 11.5 percent and the average life of a typical office fit out is just over ten years (Terry and Moore, 2008)<sup>5</sup>.

Fixtures, fittings and furniture are replaced even more frequently and have larger impact. Treloar *et al.* estimated that the total life cycle energy consumption of fixtures, fittings and furniture at a churn rate of 5.6 times over 40 years (i.e. a life of just over seven years) was close to, if not more than, the operational energy use for the case study building (Treloar *et al.*, 1999).

The implications of these figures are significant. It is clear that fit outs are more likely to be replaced because they become unsuitable than because they “wear out”. In many cases, fit out decisions at the commencement of lease impact negatively on indoor environment quality (IEQ) and occupant wellbeing by reducing the penetration of daylight and limiting the circulation of air, as found in a study by a team working at Cardiff University (CRiBE, 2007, p. 9). Landlords are often powerless to intervene in these decisions. Alterations clauses in leases commonly permit the tenant to install demountable partitioning and carry out non-structural work (subject to the landlord’s consent, not to be withheld unreasonably), again without reference to the environmental impact. It has also become standard for leases to require departing tenants to “make good”, i.e. remove all of the tenant’s property from the premises and repair or reinstate to a condition which is satisfactory to the landlord. Although this (partially) protects landlords from misconceived fit out decisions it increases waste yet further.

#### 4.3 Excessive demand for building services capacity

A commercial office building’s quality is measured according to a range of criteria, including its capacity to provide tenants with services such as mechanical and electrical capacity. A high quality building is therefore generally one which boasts significant capacity to handle tenant loads, in addition to providing prestigious accommodation and views. The Property Council of Australia’s *Guide to Office Building Quality* is an example of a document which classifies office building quality, setting out minimum performance criteria which the market then uses to determine a building’s status.

Understandably, perhaps, tenants presented with benchmarks will typically seek performance towards the upper end of the scale in each of the categories for any given amount of rent, perceiving that greater service represents better value. This challenge was expressly acknowledged by the PCA in the 2006 version of its guide, noting that “higher, bigger, larger is not necessarily better” and that excessive demands often lead to negative environmental and financial consequences (p. 7).

### 5. Significant innovations occurring outside leases

Even without effective green lease arrangements there are numerous factors driving the creation of more environmentally and socially responsible office accommodation, both via new construction and refurbishment. Corporate responsibility has become a significant factor in the decision making of large organisations and this desire to project an image of good corporate citizenship is influencing accommodation choices, particularly among larger institutions (Colliers International, 2010). Likewise, major property owners are competing to demonstrate “sustainability” leadership credentials to their array of stakeholders, notably tenants, investors and staff. These demand and supply side factors are being brought together by growing evidence that environmental performance is associated with asset “quality” and is contributing to higher investment returns (IPD, 2011).

Governments too are encouraging this change. The City of Melbourne (2011), for example, now offers building owners the opportunity to recover the cost of financing environmental retrofit works from tenants through a charge linked to the city’s rates collection. Likewise, the state of NSW has passed legislation – The NSW Local Government Amendment (environmental upgrade agreements) Act 2010:

[...] to allow local councils to enter into environmental upgrade agreements with owners of buildings and finance providers as a way of funding works to improve the energy, water or environmental efficiency of those buildings (Office of Environment & Heritage (NSW), 2010).

The Green Deal in the Energy Bill currently before the UK Parliament adopts a similar approach<sup>6</sup>. Again, the aim is to make it easier to fund energy efficiency measures with no upfront costs, with costs recovered by a charge on utility bills.

The hope is that landlords will voluntarily make use of these funding opportunities. This may be optimistic. The UK Government, in a signal that more forceful measures may be required, has made provision for a review to be undertaken of private rented properties (both domestic and non-domestic) by 1 April 2014 to compare the energy efficiency of rented properties with non-rented<sup>7</sup>, and power to make non-domestic energy efficiency regulations which could compel landlords to upgrade properties prior to letting (but this power can be used only if it will not materially decrease the number of properties available for rent)<sup>8</sup>. It is early days for the financing arrangements in Melbourne and NSW; however, there are indications that barriers, particularly in relation to the requirement for tenant consent and the accounting treatment of liabilities, are limiting the schemes’ effectiveness: there has been no evidence of take-up to-date.

These various approaches all work to provide either an incentive to improve environmental performance or easier access to

<sup>5</sup> Investa’s data for disposal of construction and demolition waste indicates a 56 percent reduction in fit out churn between 2008 and 2010, the period corresponding with the global financial crisis (Investa Property Group, 2011). Tenants were choosing to retain fit out and stay in premises as a means of conserving capital during the economic downturn.

<sup>6</sup> Energy Bill [HL] 2010-11.

<sup>7</sup> Energy Bill [HL] 2010-11 cl 39, as at 3 June 2011.

<sup>8</sup> Energy Bill [HL] 2010-11 cl 46, as at 3 June 2011.



capital to fund technical improvements. But none of them address the problem of what you do in the face of leases that prevent technical changes being made, nor do they address behavioural issues. Furthermore, in the majority of cases, owners can only take up the opportunities if the building is currently unlet, or if the leases allow flexibility.

## 6. The case for broader engagement via the lease

Earlier we suggested that relationships between building operators and occupiers are largely defined by leases, and yet those parties tend to be unfamiliar with the contents of the leases that affect them. This is a problem, of course. The benefit of making changes to the structure and content of leases between landlords and tenants will be limited if changes do not focus on improving communication and collaboration with this broader group of stakeholders. What is needed is a broader and more collaborative approach to the defining of objectives, drafting of agreements and administration of duties. As mentioned above, intermediaries involved in the leasehold negotiations have a crucial role in setting the framework.

A further step is to increase the transparency of building performance. The most eco-efficient commercial office buildings exhibit a combination of excellent design and appropriate technology, together with highly competent and committed operators. Yet a building's eco-efficiency is not readily observable to occupants (who themselves also have an influence on building performance) and other stakeholders in the way that attributes such as views, location and finishes are. The EU's Energy Performance of Buildings Directive requirements for display certificates and the Australian Government's recently enacted Commercial Building Disclosure legislation are both designed to address this information gap. Both schemes, however, only require annual updates.

Raising awareness about buildings' operational performance was a key motivator behind the development of *Investa's 2009 Sustainability Report*, the first of its kind to incorporate an interactive data visualisation tool (Figure 3) (Investa Property Group, 2010). This "bare all" approach, which provided insights into detailed monthly performance statistics at an individual building level, was expected to be popular with those staff associated with well performing buildings and less so with those operating the others<sup>9</sup>. Feedback from Investa employees was somewhat surprising. In response to the question: "what do you think the consequences of publicly disclosing detailed building-level performance statistics will be for the future performance of Investa-operated buildings," 70 percent ( $n = 52$ ) from a sample of 74 staff (representing approximately 1/3 of Investa's workforce) surveyed upon their first exposure to the online data visualisation prototype rated them as either "very good" or "extremely good." Interestingly, the proportion was higher among those working directly within buildings at the "property supervisor" level (9 of 12). About 55 percent of staff ( $n = 41$ ) rated the public disclosure of detailed building-level performance statistics as being "very good" or "extremely good" for them "personally and/or professionally". Unsurprisingly, property supervisors working on buildings that had demonstrated significant eco-efficiency improvements were found to respond most favourably to that question, whereas those from poorer buildings were more cautious; though all were more than "slightly positive."

Lease obligations that require building operators to disclose detailed performance data in a form where "good/bad" performance can be easily distinguished by building occupants may therefore be welcomed or resisted, depending on the performance leading up to disclosure. It is widely accepted that people are most productive in an organisational setting when they combine high levels of competence and commitment, where commitment is defined as a combination of an individual's motivation and confidence on a goal or task (Hersey *et al.*, 2001). Clearly the existence of an "audience" can help to increase competence and commitment levels and drive better building performance. On the flipside, it has been found that "if either motivation or confidence is considered low or lacking, commitment as a whole will be low" (Hersey *et al.*, 2001).

Disclosure of poor operational performance without adequate support from a landlord willing to invest in the systems, training and tools to help building operators address that performance may therefore be counter-productive. Furthermore, to a poorly informed audience, more information is unlikely to deliver greater understanding or better behaviour (Janda, 2011). For these reasons it is crucial that initiatives be implemented as a suite that combines education with useful information, technology and a forum that facilitates working together.

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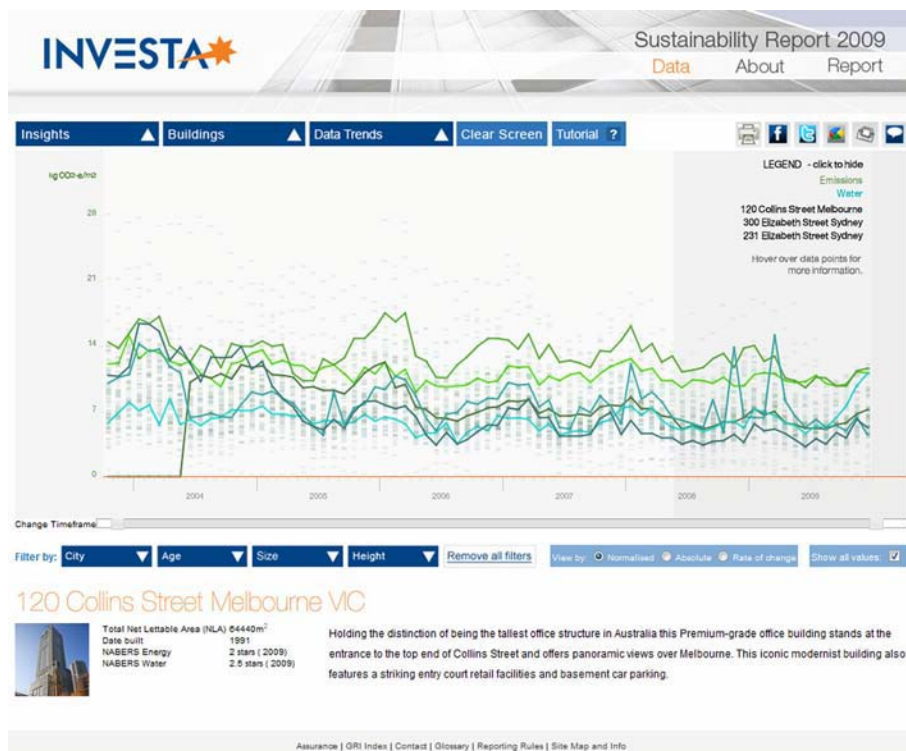
<sup>9</sup> Investa wanted to respond to feedback that previously reported aggregated portfolio performance data was of limited use for independent analysis because it masked much of the detail. Concerns about poorer performing buildings being perceived negatively were offset by the fact that most buildings would present well and that the publication of such data would be an "industry first".  
**Source:** Investa Property Group (2010)

## 7. A suite of examples for how we might do better

This section suggests a variety of ways the structure and content of leases can be improved to encourage better alignment between the stakeholders that influence the environmental performance of commercial office premises.

### 7.1 Green lease schedule

It is possible to promote environmental performance in a flexible way by agreeing a “green lease schedule” which can be attached to a standard lease. This can be comprehensive, or sketchy, depending on how much detail the parties wish to put in.



**Figure 3.** Snapshot of the Investa 2009 Sustainability Report's interactive data visualisation tool showing monthly data trends

Likewise, it can be aspirational (setting non-binding goals) or more prescriptive (setting binding goals and the consequences of breach).

An example of this approach is the Investa precedent lease, extracts from which follow:

#### 16.1 Green Lease Schedule

...

- (a) The Landlord and the Tenant agree that:
- (i) the objectives outlined in the Green Lease Schedule are established to positively contribute to the working environment of the occupants of the Building and promote the efficient use of resources in the Building's operation;
  - (ii) they will each use reasonable endeavours to meet the objectives outlined in the Green Lease Schedule and to use the Premises and operate the Building in the spirit of progressively improving environmental performance as measured against the objectives outlined in the Green Lease Schedule;
  - (iii) they will consult with each other on issues or circumstances that may enhance environmental performance and will consider undertaking all such opportunities which are expected to have a positive impact on the work environment subject to an analysis of the costs and benefits;
  - (iv) they will constructively consult with each other on issues or circumstances that may detract from attaining the objectives outlined in the Green Lease Schedule (Investa Property Group, 2009).

The landlord commits to annual measurements, and the tenant to providing the landlord with information necessary to enable environmental reporting. The commitments are not binding and breach will not constitute a breach of the lease. Future landlords are not required to adopt the green lease schedule. The problem of fit out churn discussed earlier is reduced by a tenant promise to incorporate energy, water and indoor environmental quality performance criteria into fit out design and equipment selection.

The green lease schedule referred to in the Investa lease is a 12 page document containing checklists used to indicate the landlord's and tenant's wide-ranging “green lease” commitments (Investa Property Group, 2007b). Each of the checklists is reproduced from the *Green Lease Guide*, a publication developed by Investa in collaboration with the cities of Melbourne and Sydney and the NSW Government to educate the parties about the benefits and costs of various commitments. The guide is used in conjunction with the lease and schedule and summarises the impact of each commitment in terms of: financial cost, employee wellbeing, and corporate reputation (Investa Property Group, 2007a). The schedule is attached to every Investa lease.

### 7.2 Building management plans and committees

The green lease schedule discussed above differs from the green lease schedule developed by the Australian Government under its Energy Efficiency in Government Operations (EEGO) policy. That policy requires, for the majority of office leases the Australian Government enters into, a formal commitment to energy efficiency, including an agreement between landlords and tenants to commit to a minimum ongoing operational building energy performance standard, measured by the National Australian Built Environment Rating Scheme. The schedule sets out the requirement for the creation of a Building Management Committee (BMC) and how it functions, including the Energy Management Plan the committee is required to develop, how building

performance is to be monitored and periodical reporting on the outcomes (Australian Government, 2010). A key advantage of this approach is the formalisation of the ongoing role of the BMC in developing, monitoring and implementing the EMP. Participants need the necessary skills to “meet the landlord or tenant’s needs and obligations”, however “they will not need to be accredited building or energy experts or hold specialist qualifications” (Australian Government, 2010).

Under the EEGO model, the BMC must include the landlord’s and tenant’s “energy representatives” (Australian Government Solicitor, 2011, p. 21). There is no requirement that the committee include other stakeholders (although they are not excluded). We understand the BMC is a feature of the schedules used for larger tenancies where the government tenant has greater bargaining power (p. 20), however, we have not found evidence that government tenants are widely using the policy to drive “effective operational management” (Australian Government, 2010).

In the UK, there are few publicised examples of green lease provisions in use. The Better Buildings Partnership (BBP, a collaboration of London’s leading commercial property owners and allied organisations) produced a “green lease toolkit” during 2009, but there is little evidence as to what impact it is having. This toolkit also promotes the use of a BMC which is tasked, *inter alia*, to set up and review an environmental management plan for the building, including specific targets (BBP, 2009, pp. 9, 13, 14, 20, 21).

### 7.3 Green improvements

Under a “net lease” the “split incentive” means that the landlord has limited financial incentive to install eco-efficient plant and machinery because the cost of servicing the building is borne by its tenants. A survey conducted as part of the New York City Office of Long-Term Planning and Sustainability PlaNYC (2011) initiative found that 60 percent of NYC building owners believed the split incentive was an impediment to their investing in retrofits. Approaches that overcome this “significant disconnect between those owning/managing buildings and those paying the energy bills” (All Party Urban Development Group, 2008, p. 25) may be crucial, therefore, in improving the environmental performance of buildings leased on a net basis.

In light of this challenge, Investa amended its precedent lease to permit the recovery of costs associated with capital works directly benefiting the tenants through a special amortisation charge applied to the rent. The concern that the landlord will be able to upgrade its buildings at the tenant’s cost (expressed by tenants during the consultation process) is addressed by limiting the application to projects that will reduce outgoing costs to tenants and also reduce the environmental impact of running the property (i.e. energy and water saving projects, and some projects to enhance IEQ). The tenant’s outgoing costs are not permitted to increase (due to the improvements charge) above the amortised cost of the project without written approval from the tenant. Subject to the improvement not causing an increase in the tenant’s outgoing costs, the landlord can carry out a green improvement after a consultation period. The tenant must then allow the landlord to do “all things reasonably required” to this end, even if “quiet enjoyment” or access to the premises is affected.

Similar approaches have been adopted under the models recently legislated by the Victorian and NSW Governments, and also for the model lease language in the PlaNYC “Energy Aligned Lease”. Under the PlaNYC model, a building owner’s capital expense pass-through is limited to 80 percent of the predicted savings in any given year. This provides the tenant with a cushion to protect against underperformance and the owner still receives the full reimbursement, however, the payback (recovery) period is extended by 25 percent (PlaNYC, 2011).

Investa’s experience negotiating these clauses has been mildly positive, with the provisions making it through the negotiating phase on approximately 50 percent of occasions since they started being introduced in 2009. A large proportion of tenants has been willing to accept the fact that there may be free-riders in buildings where not all tenants have signed up to the new green improvements clauses, noting that their expense is always in proportion to their benefit. In some instances, however, particularly where government tenants are involved, tenants have expressed the view that the capital reimbursement provision is not justified because the landlord has the benefit of the asset improvement and a greater likelihood of retaining tenants at lease expiry. The (landlord’s) counter to this argument is that it is invariably cheaper and more effective to conserve capital and offer a substantial tenant incentive payment instead.

### 7.4 Sustainability incentive (lighting controls)

As mentioned in the earlier section on fit out churn, it is common practice for landlords to offer financial incentives to new and renewing tenants. Depending on the level of demand, this may amount to 20-30 percent of the total rent payable over the term of the lease. Tenants are generally free to use the incentive at their discretion; however, it generally offsets the rent or contributes to the cost of fitting out the premises. Although conventions vary from market to market, it is usual in Australia for the landlord to provide floor and ceiling finishes, air conditioning and fluorescent lights as base provisions and the tenant fits out from there (often removing part of these components and reinstating at expiry). It is a tenant’s decision whether or not lighting controls that automatically switch off lights based on occupancy should be installed.

In 2005 Investa introduced an initiative called the Investa Greenhouse Guarantee (Investa Property Group, 2005) designed to give tenants access to quality office lighting systems and expertise, with guaranteed environmental and investment benefits. While some tenants were motivated to take up the offer, it was found that many simply lacked the time and inclination to invest in lighting controls even though they would, in typical cases, deliver guaranteed returns on investment of 30 percent and better. In response to this inertia, the company decided to introduce a “sustainability incentive” that can only be used to pay for lighting controls. An arrangement was agreed with the partner company delivering the Greenhouse Guarantee to provide the controls for a fixed rate per square metre equivalent to the incentive being offered. The controls specification and all associated details are described in a schedule to the lease. Under this arrangement, where tenants must introduce automatic lighting controls if they are to receive the incentive, take-up is now in the order of 70 percent.

### 7.5 Re-work counter-productive clauses

Many clauses designed to protect the parties’ interests have unfortunate side-effects. Examples discussed throughout this paper include “make good” requirements that oblige tenants to return premises to the state that existed prior to their fit out, even when



this might involve stripping out still valuable materials, alterations clauses that pay no attention to environmental impact, and temperature control bands that take no account of the weather outside or occupants' clothing choices. These things can be changed by amending standard lease clauses to take account of environmental impact. So, for example, the NEEA green lease specifies that all tenant improvement work must be performed in accordance with sustainability practices and maintain Leadership in Energy and Environmental Design (LEED) certification for Commercial Interiors certification (LEED is an internationally recognised green building certification system, developed by the US Green Building Council) (NEEA, 2011). Likewise, a model clause in the BBP green lease toolkit provides that if proposed tenant alterations adversely impact on energy and water efficiency the tenant "will consider, [and, where reasonable, implement]," the landlord's suggestions to minimise this impact (refer to BBP toolkit, p. 23). The cautious approach advocated by BBP reflects the commercial challenge in agreeing changes to standard leasing practices.

Investa's lease, as well as emphasising the role of the schedule and the broader collaboration that entails, also seeks to eliminate some of the more problematic "industry standard" clauses:

Some of these anomalies can alternatively be addressed by negotiating a green lease schedule. However, if the schedule is not binding, as is the case with the Investa example provided above, this may leave an unsatisfactory degree of uncertainty. This was the motivation for the NEEA (2011, p. 6) when it recently negotiated the inclusion of a variety of green aspects into the lease itself for its new premises in Portland's Commonwealth Building. The advantage, as described by NEEA, is that "if the building sells, the next owner will be required to stick to their predecessor's commitments".

## 8. Concluding remarks

"Green leasing" has become the catchphrase to represent new approaches to leases that aim to promote improved environmental performance. Although we also use this language, it carries the risk of becoming stereotyped. In sum, what we argue for is an approach to leasing and managing let space that enables and encourages innovation, co-operation and collaboration. This involves not simply a re-examination of the structure and content of the lease itself but also the relationships between the landlord and tenant, building operators and users of the space so that practices take account of how occupiers behave and what occupiers want out of buildings. Operators will need to be free to innovate in the way they run buildings, to be incentivised to do so, and to engage meaningfully with occupants regarding these kinds of issues. Furthermore, the content and structure of agreements between landlords and tenants will need to be understood by this wider group of stakeholders. The following recommendations suggest ways of encouraging innovative leasing that put environmental concerns at the core of the relationship:

- start the discussions early in the negotiating process, make sure that agents understand the environmental goals, but do not leave it only in the hands of agents;
- express clearly what constitutes good environmental design and performance (e.g. in green lease schedules);
- consider whether to use language that gives enforceability and will also bind future owners;
- commit to transparency and accountability for performance that goes beyond regulatory requirements;
- develop processes, such as a BMC, noticeboards, etc. that enable all stakeholders to be actively involved in the pursuit of, and commitment to, environmental goals for the duration of the lease;
- if it is a net rent lease, use clauses that enable environmental improvements to be made in a way that overcomes the problem of the split incentive;
- review standard lease terms to consider their potential impact on environmental performance (particularly the alterations, making good, and rent review clauses);
- consider how control and responsibility are aligned within the lease, as in the lighting controls example considered above; and
- build in adaptability for changes in technology, occupant expectations and legislation.

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