SEE Action
STATE & LOCAL ENERGY EFFICIENCY ACTION NETWORK

High-Performance Leasing for State and Local Governments

What is High-Performance Leasing?

High-performance leasing refers to strategies to overcome barriers between owners and tenants that inhibit energy efficiency improvements in existing commercial buildings. State and local governments can model the use of high-performance leases in publicly leased buildings and promote their use in the private sector. High-performance leasing is a subset of green leasing which encompasses leasing documents and practices designed to reduce the environmental impact of leased buildings in areas such as energy and water use, purchasing, and waste disposal. Also addressed is access to transportation alternatives to reduce the number of employees driving alone.

Why Encourage High-Performance Leasing?

High-performance leases help overcome the "split incentive" problem faced by tenants and property owners. This problem occurs when the tenant pays the utility bills, leaving the owner with no incentive to reduce operating costs by undertaking capital improvement projects. Most lease terms do not allow owners to pass through costs for building improvements in lease payments, so most owners are motivated to spend only what is necessary per the lease terms. If a heating system breaks, for example, the owner is obligated to pay for its repair but normally cannot raise rent to cover the cost. Thus, most owners are willing to pay only the minimum needed to keep energy systems working, not working optimally. High-performance leasing is designed to bridge this barrier by incorporating benefit- and cost-sharing practices into lease terms that are acceptable to both parties.

The majority of office space that will be used for the next decade already has been built.[1] High-performance leases can play a critical role in transforming this market into a more sustainable system. State and local governments can be effective agents of change in driving wider use of high-performance leases—and can start with their own leased spaces.

Like most individual policies or practices, high-performance leasing alone is not sufficient to realize the full efficiency potential of the commercial buildings market. To most reliably achieve greater savings, high-performance leasing can be packaged with benchmarking; rating and disclosure efforts; retro-commissioning; and broader energy management policies and programs.

Who is Affected?

High-performance leasing can involve key stakeholders, including:

- Public and private building owners and managers and tenants (all must be willing to negotiate high-performance leases)
- Interest groups that represent property managers, real estate professionals, tenants, and energy service providers, which can help educate landlords and tenants
- Utility companies, which can provide technical assistance and incentives for identified energy efficiency projects enabled by high-performance leases.

Key Points

- High-performance leasing enables landlords and tenants to benefit financially from energy efficiency investments.
- High-performance leases can enable efficiency investments that improve the value of buildings and protect tenants from high energy prices.
- Governments can lead by example by requiring high-performance leases for all government leases.
- Government can encourage the use of high-performances leases by the private sector in ways that benefit owners and tenants, and which creates jobs installing energy-efficient equipment.

About SEE Action

The State and Local Energy Efficiency Action Network (SEE Action) is a state and local effort facilitated by the federal government that helps states, utilities, and other local stakeholders take energy efficiency to scale and achieve all cost-effective energy efficiency by 2020.

About the Working Group

The working group is comprised of representatives from a diverse set of stakeholders; its members are provided at www.seeaction.energy.gov.

How Does It Work?

High-performance leases are structured to enable both tenant and landlord to benefit from efficiency investments through the process outlined in Figure 1. State and local governments can facilitate this practice by assisting in the development of mutually agreeable lease language and requiring its use in the leases to which the government is party.

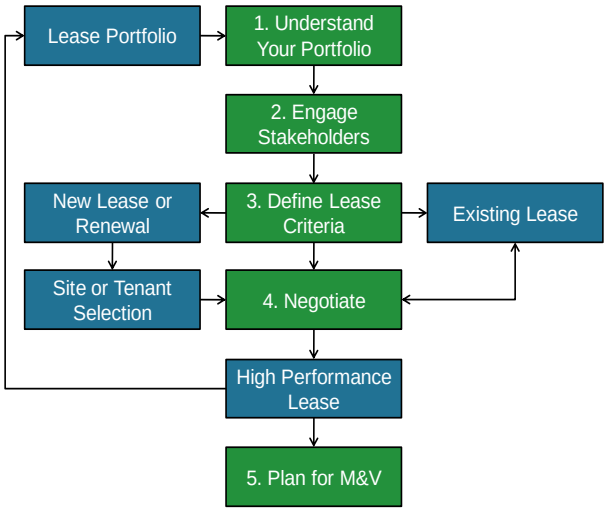

Figure 1. Step-by-step illustration of the high-performance leasing process
Source: Adapted from California Sustainability Alliance, *Greening California's Leased Office Space: Challenges and Opportunities*, 2009

Implementing High-Performance Leases

Tenant demand is most likely to drive initial interest in high-performance leasing. Thus, a "lead by example" approach in which government agencies demand high-performance leasing practices can be an effective way to stimulate the market. Using guidance provided by the California Sustainability Alliance[1] and the U.S. General Services Administration's Green Leasing Policy,[2] the steps listed below outline the considerations a tenant—whether a public agency or a private entity—could include in pursuing high-performance leasing. Each real estate transaction is unique, so appropriate adaptations might be necessary.

1. **Understand the building portfolio.** Prior to negotiating a high-performance lease, the potential landlord and tenant must assess the basic requirements for the space that is to be leased. Requirements can include individual rental units or a larger portfolio of properties. Variables to consider include the percentage of total leased space that tenants occupy or seek to occupy; building age and condition; lease term and structure (e.g., gross lease in which landlord pays operating expenses, including utilities, or a net lease in which the tenant pays some or all operating expenses); presence of other tenants (including the property owner or manager) in the building; and the property owner's or manager's experience with sustainability.

2. **Engage key stakeholders.** Including relevant stakeholders in the design and negotiation of a high-performance lease can increase the likelihood of its acceptance and successful implementation by all parties. Key stakeholders likely include:

   - **Real estate owners and managers.** These groups, typically represented by associations or other networks, are critical to the development and execution of benchmarking policy.
   - **Real estate brokers.** Brokers are important because they arrange the purchase and sale of most properties.
   - **Tenant organizations.** As a primary proponent of high-performance leasing, tenants can collaborate to outline lease terms that can be used by others.
   - **Electric and gas utilities.** These energy suppliers can provide valuable technical assistance and incentives to undertake energy efficiency projects facilitated by high-performance leases.
   - **Energy services experts.** Engineers, consultants, contractors, and service firms that work in the local buildings market are key players in identifying sticking points in traditional leases. They can provide support for high-performance leases and can help educate clients on their benefits and implementation strategies.

3. **Define High-Performance Criteria.** A high-performance lease strategy—at a macro level—can include specifications that the space must meet third-party certification standards (e.g., ENERGY STAR®). The lease also could define an energy-cost or cost-savings sharing agreement for energy efficiency improvement projects undertaken by the property owner or tenant, and could include the "energy aligned" lease language developed by New York City. The tenant or owner also could choose to define required energy-efficient practices, such as providing automated building controls (e.g., occupancy sensors; heating, ventilation, and air conditioning controls) in leased space, or requiring that janitorial services be provided during the workday, thus eliminating unnecessary energy use for nighttime lighting.

4. **Prepare to negotiate.** Commercial real estate leases typically are long-term (5- to 10-year) transactions, and the evolving field of high-performance leasing can add new wrinkles to the process, therefore negotiation should be expected. Tenants and owners should be clear in communicating goals and criteria for the lease process, weighing these key factors:
    - **Type of lease.** New leases likely will be most flexible, enabling involved parties to ask for more energy-efficient provisions. Renewing or adding to a lease typically will be a less-flexible process, but might be easier if the established relationship is positive and collaborative.
    - **Economic conditions.** A "buyer's (lessee's) market" tends to make building owners and brokers more willing to negotiate new or unconventional provisions in lease structures.
5. **Plan for measurement and verification.** An effective measurement and verification (M&V) plan can document the benefits of high-performance leases and enable involved parties to correct unsuccessful leasing practices and replicate successes. The parameters and measurement methods will vary depending on the types of measures included in the lease.

After government agencies become familiar with the many facets of high-performance leasing and have conditioned the market to this set of practices, governments can develop voluntary or mandatory approaches that spread the use of high-performance leasing into the private real estate market. New York City, for example, convened a group of property owners and managers, tenants, and energy engineers to develop model high-performance leasing language. The city will use the language in all of its leases and encourages private entities to do the same.

Existing Policies and Programs

U.S. General Services Administration (GSA): Green Lease Policies and Procedures[3]

Adopted: Green Lease Policies and Procedures for Lease Acquisition (December 2007); ENERGY STAR Requirement for Lease Acquisition (September 2010, effective December 2010).

Affected Property Types: All properties leased by the federal government.

Key Requirements: Incorporates energy and environmental requirements of existing policies (e.g., Executive Order 13423, Energy Policy Act of 2005) as applicable to leased properties. Identifies specific lease language to be included in various types of leases and locations. Restricts entering into new leases for buildings larger than 10,000 rentable square feet (ft^2) that have not earned ENERGY STAR certification in the most recent year. Requires Leadership in Energy and Environmental Design® (LEED®) Silver certification for lease new construction and major lease renovation projects for buildings that have rentable space of 10,000 ft^2 or more when the federal government is the sole occupant. Provides optional lease solicitation language to require LEED for Commercial Interiors certification.

State of Washington: Senate Bill 5854[4]

Adopted: 2009 / Effective: 2010.

Affected Property Types: All properties leased by the state of Washington.

Key Requirements: Restricts the state from entering a new lease or renewing an existing lease for a building with an ENERGY STAR energy performance score of less than 75, unless efficiency measures are implemented within the first two years of the lease. A score of 75 is required to receive ENERGY STAR certification; however, the state does not require certification, just an acceptable score.

New York City, NY: Model Energy Aligned Lease Language[5] (part of the Greener, Greater Buildings Plan[6])

Adopted: 2011.

Affected Property Types: Commercial property operating under a commercial gross modified lease; all applicable properties leased by New York City.

Key Requirements: Applies to commercial gross modified leases for energy used in base building systems. Assigns energy-efficiency investment costs and cost savings to the landlord and tenant according to the following schedule.

- **Tenant.** Pays 0% of up-front investment costs. Receives 20% of energy cost savings immediately upon project completion and 100% of energy cost savings once landlord has recovered project costs and until the lease expires or is terminated. The 20% up-front energy-cost savings benefit is intended to safeguard against projects that do not generate the expected energy savings.
- **Landlord.** Pays 100% of up-front investment costs. Receives 100% of cost recovery (minus financing costs) at a rate of 80% of projected annual energy cost savings. The reduced repayment rate extends the payback period by 25% to account for the up-front energy cost savings recovered by the tenant.

Energy cost savings payments are calculated monthly, using projected annual energy savings (as determined by a professional energy specialist), minus any third-party or tax incentives received for undertaking the project.

Complementary Policies and Programs

High-performance leasing can be a key mechanism for addressing the split-incentive barrier that keeps owners of leased space from justifying efficiency investments in their buildings, and prevents tenants from modeling sustainable behavior. Like most individual policies or practices, however, high-performance leasing is not sufficient for realizing the full efficiency potential of the commercial buildings market. To complement high-performance leasing, state and local governments should consider these approaches:

- **Energy benchmarking and disclosure.** By making energy performance more visible in the market, state and local governments can help drive interest in high-performance leasing as a way to improve building energy performance.
- **Retro-commissioning.** Retro-commissioning is a widely applicable and typically low-cost way to improve energy performance in the near term, and which could be incorporated in a high-performance lease. State and local governments can encourage this type of inclusive approach by developing similar linkages in their own high-performance leases and encouraging equivalent retro-commissioning requirements in model lease language and in demonstration projects.
- **Organization-wide energy management programs.** High-performance leasing could become part of organizations' energy management programs.

For access to related SEE Action resources, visit www.seeaction.energy.gov/existing_commercial.html.

Other Resources

Building Owners and Managers Association. *Guide to Writing a Commercial Real Estate Lease, Including Green Lease Language.* http://shop.boma.org/showItem.aspx?product=GL2011.

California Sustainability Alliance. "Green Leases Toolkit 2.0." http://sustainca.org/green_leases_toolkit.

Institute for Market Transformation. Green Leasing Website. http://imt.org/green-leasing.html.

National Resources Defense Council. *Energy Efficiency Lease Guidance to Address the "Split Incentive"* (prepared by Sean Patrick Neill, Cycle-7). www.cycle-7.com/pdf/download.php?file=1297629475.pdf.

U.S. Green Building Council. *Green Office Guide: Integrating LEED Into Your Leasing Process.* www.gbci.org/Libraries/Credential_Exam_References/Green-Office-Guide-Section-2-4.sflb.ashx.

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[2] U.S. General Services Administration. *Green Lease Policies and Procedures for Lease Acquisition.* www.gsa.gov/portal/content/101755#grn07-12.

[3] U.S. General Services Administration. Sept. 7, 2011. *Green Lease Policies and Procedures.* www.gsa.gov/portal/content/103656.

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