



UBS Asset Management

Green leases

Green leases have proved popular among landlords and tenants alike to ensure that properties are being operated in a sustainable manner. What are green leases, how have they evolved, and how can building owners practically implement them in existing real estate portfolios?

Real estate is one of the biggest contributors to climate change, accounting for approximately 40 percent of total global emissions (World Economic Forum, 2022). As real estate managers and owners, it is our responsibility to ensure our assets are managed with appropriate consideration towards a broad range of sustainable issues, based in the belief that an asset managed sustainably will deliver better values and returns for our clients.

To address the greenhouse-gas emissions associated with real estate, governments have slated regulations on minimum building performance requirements, and extensive efforts will have to be undertaken to refurbish and renew existing buildings. For example, in the United Kingdom, the minimum energy efficiency standards (MEES) regulation requires landlords of commercial properties to have a minimum energy performance certificate (EPC) rating of F or G, from April 2023, and B by 2030¹. Thus, there is a strong driving force in the near term to decarbonise the existing building stock.

As landlords, we are only one stakeholder group in the real estate ecosystem. Our tenants, who typically occupy the majority of a property's floorspace on a daily basis, are another important stakeholder group whose actions have significant implications on the environmental profile of our assets.

Unfortunately, landlords and tenants are not traditionally well positioned to collaborate on sustainability initiatives due to the split-incentive dilemma: landlords are often not incentivised enough to undertake long-term capital improvements, which increases operating costs for tenants, while tenants do not want to undertake long-term capital improvements, as they may not occupy the asset long enough to realise the net savings. This short-term perspective of occupiers is further exacerbated by the fact that lease lengths have shortened significantly in certain markets, e.g. from durations of 15 to 25 years to 5 to 10 years in the United Kingdom, Ireland and the Netherlands (Urban Land Institute, 2023).

Green leases are, therefore, a practical and important tool that help to bridge the gap between landlords and tenants, fostering collaboration and aligning both parties' environmental goals and targets through the asset's operation. The importance of green leases is increasing. A 2023 Knight Frank survey among 45 investors – including investment managers, listed property companies and funds – found that 100 percent of respondents are currently using green leases to realise their ESG targets.

What are green leases?

A green lease is a lease agreement that includes provisions designed to encourage the landlord and tenant to work together with the aim to reduce a building's negative environmental impact. In practice, this usually takes the form of an additional "green lease schedule" appended at the end of the contract, which spells out the legal obligations of both parties towards sustainability topics.

The provisions in green-lease terms typically encompass all sustainability topics that are important to both parties, and

often include requirements on how the asset can be sustainably operated (or improved). For example, a green lease could include requirements for low-carbon tenant fit-outs, to minimise the embodied carbon impact of tenants, and they may also mandate data sharing by the tenant so the landlord can track (and possibly identify areas of improvement) the operational emissions in their tenant-controlled spaces.

Evolution of green leases

Green leases have traditionally been landlord-driven initiatives, as they have never had a strong regulatory push. Consequently, green-lease provisions have traditionally centred around landlord requirements on the tenant, and they focus primarily on the tangible and quantifiable environmental aspects of the building. For example, cornerstone provisions prevalent in most green leases include requirements on tenants to regularly share utility data with the landlord, as well as support any green-building certification/rating effort by the landlord. In recent years, the green-lease conversation has evolved in line with the growing prominence of sustainability topics. The scope of green leases has expanded to become more encompassing and holistic, as both occupiers and owners alike develop more comprehensive sustainability goals that cover a broader range of topics beyond climate change, such as biodiversity; diversity, equity and inclusion; wellness; and community engagement.

Drafting a green-lease template

As a global real estate manager, we had a strong incentive to standardise green-lease language across its business, to ensure that material topics identified at a group level are addressed in a consistent manner in the lease agreements across our many markets. Practical implementation, however, is dependent on local regulation, market practice, as well as on the tenants, hence application on the ground will still vary.

Due to the absence of strong regulatory intervention on green leases, asset owners will generally have to rely on industry best practices in drafting their own green-lease templates. There exist many helpful green-lease guidance documents from international organisations, industry associations and government bodies, which asset owners and managers can refer to, e.g. Better Buildings Partnership (BBP), Institute for Market Transformation (IMT) and Building Owners and Managers Association (BOMA) International. These guidance documents list the common types of provisions found in green-lease clauses, explain the rationale behind them and provide sample language, making them a great resource for landlords lacking a template or standard today.

In drafting a green-lease template, asset owners should be cognisant to strike the right balance between breadth and prescriptiveness versus the tolerance of tenants. To operate a building sustainably, the ideal green lease would be comprehensive, using rigid language with no leeway for either party not to comply. Owners must bear in mind that such an overly prescriptive green lease may create an obstacle for prospective tenants, especially those with lesser sustainability ambitions. There is no point in having the "best" green-lease terms if you then can't lease your asset.

Owners should hence identify a short list of core, "must have" provisions, and supplement with auxiliary provisions that are less of a priority. Within all these provisions, care should also

be exercised when drafting the lease language to decide how prescriptive they should be, bearing in mind that each provision that dictates the tenant's behaviour can pile up and become a cumbersome and administrative hassle that strains the tenant's resources. "Must have" provisions from REPM's experience include: a cooperation obligation, data sharing, energy monitoring and green-building certification targets. In the previously mentioned Knight Frank survey, the most common provisions used by the survey respondents include: data sharing (97 percent), collection of occupational use data (70 percent), and restrictions on alterations which may adversely impact energy-efficiency ratings (65 percent).

Because they are typically contracts that span many years, green leases risk falling behind best practice if they aren't ahead of current market standards at the time they are drafted. Owners, when drafting their green-lease templates, can incorporate forward-looking provisions that aren't yet market standard.

Owners can also consider including a provision in the tenancy agreement that allows for contract adjustments, so both parties have the ability to adjust the contractual relationship according to future ESG developments.

Data privacy

As landlords, the data sharing clause is one of the most crucial green-lease provisions, obliging tenants to share their utility data with the landlord on a regular basis. This is especially important where the landlord does not have oversight over tenant areas, e.g. in triple-net-lease models where tenants are responsible for their own utility procurement. These datapoints are necessary for whole-building performance calculation, e.g. GHG emissions intensity, water-use intensity and waste-diversion rate.

Without tenant data, landlords will only have insight into the building common areas, which often only constitute a small or no portion of the whole building's performance. Data-sharing clauses help address the data coverage issue faced by many landlords, creating a legally binding obligation for tenants to share their utility data with the landlord. In the spirit of collaboration, data sharing can go both ways – tenants share their utility data with the landlord, and in return, the landlord can share the whole-building environmental performance of the asset with the tenants, enabling them to understand how sustainably the asset is being operated and use this in their own environmental measurements and strategy.

While the landlord gains access to such private data, such as tenant utilities, it is important to respect each tenant's data privacy and ensure that data collected is used for its intended purpose only. Care should be taken to ensure that individual tenant data is not frivolously shared. Whole-building environmental performance data, when shared, should always be aggregated and anonymised. To further safeguard data privacy, the green lease should include strict requirements on the landlord's rights to share tenant data onwards.

Implementing green leases

After drafting a green-lease template, the next step would be the implementation across all managed assets. This can prove to be a challenge, especially if the owner's portfolio spans multiple countries. A template needs to conform to each locality's regulatory requirements and market standards. Within each market, the template must pass through a legal advisory lens, to make sure that the standardised language does not violate any local regulations and laws, as well as to adapt the language to each market's standards. This can be a long process and requires several iterations

before the green-lease template is truly fit for use in every asset. Even with this template approach, every green lease that is signed with each tenant is subsequently likely to vary too, as each tenant brings different environmental priorities with them to the negotiation, and they, too, will bring in their own legal teams to review the lease agreement once more.

Another consideration during implementation would be for existing properties where current tenancy agreements do not have green leases. It would be difficult to introduce amendments mid-lease, which can be costly and administratively challenging; it would be more practical to introduce green leases during lease renewal. Even then, this may still pose a challenge given that the majority of lease laws provide tenants with the right to renew leases on the same terms, and seeking changes can trigger a costly renegotiation (Urban Land Institute, 2023). Thus, the focus on green-lease negotiations should never be dictatorial; rather, landlords should adopt a collaborative and open-minded approach to achieve a green lease that fulfils the requirements of both parties in an equitable manner.

Conclusion

In summary, these key points are important for any green-lease journey:

- When drafting green leases, there are many online green-lease guidance documents available to landlords, published by international organisations, industry associations and government bodies.
- When drafting green leases, while it would be ideal to have as much breadth and prescriptiveness as possible, bear in mind not to overtax tenants with too many restrictive obligations and requirements. Green leases should also be drafted to protect tenant data and ensure data privacy.
- When implementing green leases, they should be tailored for each market's regulatory requirements. Landlords should also be flexible when negotiating with tenants to achieve a "win-win" scenario for both parties.
- Draft ambitiously; implement cooperatively.

Notes: ¹Expected trajectory, but no confirmation yet. The British government has not released the findings of a consultation on raising the MEEES to B by 2030.

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UBS Asset Management

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