

Greening Leases: The Landlord and Tenant Relationship as a Driver for Sustainability



Research Findings

August 2009

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EXECUTIVE SUMMARY

Aims

This study aims to provide the investment community with an analysis of selected UK landlords' and tenants' views on green leases and their possible use to promote the embedding of sustainability principles within property management practice. The research explores the extent to which the landlord and tenant relationship has been affected by the sustainability agenda and questions whether the relationship, as supported by current leasing practice, provides an appropriate framework to assist the achievement of sustainability goals. It provides recommendations for actions by stakeholders.

Key findings

● Drivers for sustainability

Sustainability is considered important; however the drivers for introducing sustainability aims and goals differ between the parties. For landlords, the case rests primarily on the need for good public relations, future investment returns and risk reduction. For corporate occupiers the need to respond effectively to stakeholders' requirements is key, balanced with a need to simply reduce costs.

● The landlord and tenant relationship

Many landlords reported improving relationships with tenants in recent years but this was not reciprocated amongst tenants organisations in many cases. Developing a culture of trust and communication between landlords and tenants is a pre-requisite to achieving more sustainable asset management and property occupation.

● Measurement and data sharing

Systematic monitoring of energy use, waste and water is being carried out by some landlords and tenants, but such data is not commonly shared between the parties. Monitoring of environmental and social performance is key to green leases and sustainable asset management and it was acknowledged that metrics are needed in order to manage property in line with sustainability principles. Sharing of data by landlords and tenants would assist in creating a case for building improvement and would foster closer working relationships.

● The role of managing agents

Managing agents can have a key role to play in the greening of leases. They can support landlords' efforts to achieve sustainable asset management. Tenants' lack of trust in landlords was linked to the lack of transparency in communication with agents.

● Business Premises Lease Code 2007

The Lease Code is widely considered to be an appropriate means of introducing changes in the landlord and tenant relationship, although it is acknowledged that engagement was largely restricted to major landlord and tenant organisations who are generally familiar with and are using the Code. Using an extension to the Lease Code to encourage sustainable property management met with some support.

● The need to introduce a green lease

Variable knowledge of green leases was found. Some landlords are promoting 'light green' leases but respondents showed little appetite for their widespread or systematic introduction or for 'dark green' (ie strongly worded) green leases. Escalation of the regulatory framework for sustainability performance presents a strong case for the introduction of green leases. However it is important that 'green' is not purely associated with energy but the full range of environmental and social impacts of property management. Incremental evolutionary change, such as the introduction a Memorandum of Understanding would be more effective.

EXECUTIVE SUMMARY

Recommendations

- Property collective bodies are encouraged to work with landlords and tenants to investigate ways in which a sense of trust can be engendered through enhanced communication
- Landlords and tenants are encouraged to consider introducing Memoranda of Understanding relating to sustainable asset management at lease renewal , or before where the possibility arises.
- An industry-driven initiative to develop a national framework for the collection and ongoing monitoring of sustainability data is needed. It is important that the parties involved agree on the appropriateness and use of such a framework.
- As and when the Lease Code is revised it should include a recommendation and guidance on the introduction of a Memorandum of Understanding on sustainability matters.
- An increased provision of short seminars and education for managing agents on sustainable asset management practices.

1.0 INTRODUCTION: OVERVIEW AND AIMS OF THE PROJECT

1.1 Overview and aim

The principles of sustainability, by which is meant the pursuit of positive environmental and social goals in addition to economic return, is of growing importance to many landlord and tenant organisations. However, it has proved difficult to implement in terms of property asset management practice. As the commercial lease is the mechanism through which investors and occupiers inter-act, it has become the focus for many as a vehicle for promoting change in landlord and tenant behaviour. It is therefore useful to understand whether or not the commercial lease is currently in a form that acts as a barrier to more sustainable asset management practices and if change is required.

This research project has been commissioned by the Investment Property Forum Research Programme. It aims to provide the investment community with an analysis of UK landlords' and tenants' views on green leases. It considers, with a specific focus on the landlord and tenant relationship, whether current leasing practice as supported by the 2007 Commercial Lease Code (Joint Working Group, 2007), provides an appropriate framework to support the achievement of sustainability goals, or if not, what actions may be required. The findings and recommendations made are based on a review of literature, a series of interviews with key stakeholder and two focus groups, one held at the beginning of the research to help develop themes for enquiry and the other following conduct of the interviews to present and debate findings and to assist in drawing conclusions. The primary research was conducted between February and October 2008 and the conclusions have been drawn from the research and from subsequent discussions related to a rapidly changing market environment.

1.2 The research objectives

The research investigates the way in which the landlord and tenant relationship is being affected by the developing sustainability agenda and assesses the ways in which current commercial leases might be a help or a hindrance to the achievement of better sustainability performance in managed buildings.

The specific objectives were to assess how the landlord and tenant relationship is:

- Affected by the sustainability agenda;
- Used by landlords to reduce sustainability related risks and achieve corporate social responsibility (CSR) objectives;
- Used by tenants to support CSR objectives; and
- Acting as a driver for more sustainable property management as lease terms modernise.

1.3 Methodology

The findings presented in this report are based on 26 interviews undertaken between February and October 2008 supported by a review of literature both from within the UK and internationally. The interviews sought the views of investors holding substantial property portfolios (landlord representatives) and of large corporate and public occupiers (tenant representatives). In addition two focus groups were held with delegates from the landlord and tenant groups as well as property agents and lawyers to inform the research team and assist interpretation of data. It is acknowledged that since the interviews were conducted the property market has undergone a period of turbulence which could impact on views. Conclusions have been developed to reflect this and the research team are of the view that any such changes observed in the market place do not undermine the research findings which present a picture of longer-terms structural issues within the landlord and tenant relationship.

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The sample was taken across a range of larger and smaller organisations and investigates a relatively new concept. Included in the sample were businesses perceived as being at the forefront of sustainable property investment and/or having a strong commitment to CSR, as well as those who were not so noted.

The strands of investigation were:

- The importance of sustainability to the organisation
- Views on the landlord and tenant relationship
- Implementation of measures to make property ownership/occupation more sustainable
- The use of financial incentives and/or penalties to encourage sustainable asset management or occupation

1.4 The rise of the sustainability agenda and commercial property

In the last two decades the issue of sustainability has been transformed from a movement led by a rise in environmental concerns to one that has been adapted to include social and economic balance to form a so-called Triple Bottom Line (TBL). This approach to sustainability has been adopted by government policy makers and many within the corporate sector and it is now a consideration for many businesses. Within UK property, the commitment to sustainability is noticeable amongst many organisations. An example of a joint initiative is the Better Buildings Partnership which brings together a number of the largest commercial and public property owners in London under one scheme. Their aim is to improve the sustainability of London's existing building stock and accelerate the reduction in CO² emissions from those buildings.

Despite the integration of sustainability principles into the business agenda, it has proved both difficult and challenging to implement these principles within the operational practices of property investors (Ellison and Sayce, 2006). Whilst some investors have developed a strategic approach to investing 'responsibly' in respect of their property portfolios¹, such a public commitment is still the province of few investors. For this research the issue is whether, or not, sustainability principles are hindered or assisted by the lease frameworks currently used by landlords and tenants operating within the UK commercial property market. It recognises that different considerations apply in the case of single let properties and those that are multi-tenanted.

1.4.1 Towards sustainable property asset management

There is no universally agreed definition of sustainable asset management principles (SAM). However RICS (2008) argue that sustainable asset management implies seeking methods to reduce risks to future economic performance; enabling progress towards government environment and social targets and support for delivering services effectively and efficiently. This is consistent with Pivo and McNamara's view that responsible investors should aim to maximize the positive effects and minimise the negative effect of property ownership, management and development on society and the natural environment (Pivo and McNamara, 2005).

¹ Some have adopted a set of over-arching tenets such as those developed by the United National Environment Programme, http://www.unepfi.org/work_streams/property/index.html Interest Group: or the IPF Sustainability work stream <http://www.ipf.org.uk/MainWebSite/GeneralContent8ffa20e881efb5fc2ff2cc1e.aspx?Map=F347274D9ED45DC60CFE98685F7BF037>

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The research acknowledges the view that, even where investors have sought to adopt socially responsible property investment and asset management practice, there have been a number of barriers to achieving change. Many reasons for this have been identified. A lack of robust analytical tools and data sets has meant that it has been difficult to evaluate building performance; indeed the struggle to produce an effective mechanism for the successful implementation of Energy Performance Certificates provides a case in point. Without metrics and the ability to assess performance across a range of environmental and social measures' the ability to build a case for improving buildings and for incorporating sustainability principles in the management and occupation of buildings has been hindered. The cost of incorporating 'green' specifications both for new build schemes and particularly for refurbishment projects has also been perceived to be a barrier, although some evidence now points to moves to low carbon refurbishment being increasingly cost effective (IPF, 2009).

In terms of moving the markets forward, it has been identified that the most potent drivers for change will be increased tenant demand, the strengthening regulatory levers targeting the environmental performance of buildings and increased adoption of corporate social responsibility (CSR) policies by both investors and tenants. As the commercial lease is the mechanism through which investors and occupiers inter-act, the nature of the lease has come under interrogation to establish whether or not it is in a form that acts as a barrier to more sustainable asset management practices. If it is, it raises the question as to whether a new-style 'green lease', as advocated by some (see for example, British Council of Shopping Centres, 2008; Brooks, 2008; Hammonds Built Environment Group, 2008) is indeed the appropriate way for the industry to move forward, or if not, what alternatives may be suitable at this point in time.

1.5 The commercial lease: perceptions of the need for a Green Lease

1.5.1 Developments within Commercial Lease Practice

Commercial leases within the UK and particularly within England and Wales, have developed over many decades. The so-called 'institutional lease', with its hallmark upward-only rent review, full repairing liability and long period of financial commitment by the tenant, was the prevalent interface between these two communities for the period from approximately the mid-1970s until the 1990s and almost to the turn of the millennium. The institutional lease, which was not widely replicated in other countries, created a vehicle by which investment in innovative buildings and sustainable asset management was hindered (Hinnells et al, 2008). Instead it fostered an adversarial landlord and tenant relationship characterised by limited communication and often high levels of dispute between the parties. It also had an in-built lack of incentive on the part of either landlord or tenant to invest in the fabric of the building during the term of a lease. The lease structure, combined with a prolonged period of sustained high demand for commercial premises throughout most of the 1970s and 1980s provided little ability for tenants to negotiate terms other than the standard lease (Crosby et al. 2003). However, during this period many commercial tenants sought long leases, as the presence of inflation within the system and a backdrop of rising rents over this period often enabled them to secure premiums when they had a need to assign their interests. It was only with the reduction of rental values in real terms that the real downside to tenants of long term occupational leases became widely apparent and acknowledged.

Although legislative measures and professional body-supported Codes of Practice have been successively introduced to redress the balance and provide some measure of protection to tenants, the property recession of the early 1990s provided the strongest stimulus for change in lease patterns. Despite threats by government to impose radical change in the form of a ban on upward-only rent reviews, such intervention did not take place. Instead, changing market conditions and moves by the industry to introduce a stronger Code of Practice provided the impetus for the rise in tenant negotiating power resulting in shorter leases to match changing business needs (Hamilton et al., 2006).

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However, although greater flexibility has been introduced in terms of lease length, there has been little observed change to the established covenants relating to rent reviews and repairs, yet these are major items in terms of sustainable asset management. The period since 2000 has seen other potent indicators of change to this stereotype of conflict and lack of engagement such as:

- The introduction of the 2007 Code for Leasing Business Premises (joint Working Group, 2007) sponsored by the property industry and designed to encourage greater interaction between landlords and tenants;
- The passing of a range of legislation impacting on property occupation and owner costs including, but not exclusively confined to, energy and carbon issues;
- The shifting attitudes towards CSR and the need to adopt sustainability principles; and
- The continued market trends towards shorter and more flexible leases.

Accordingly, the research sought to establish whether the recent changes to lease patterns have been sufficient to enable more sustainable asset management to be achieved or whether a more fundamental change to leasing practice is required, in the form of a green lease to suit the UK market.

1.5.2 Incentives for improved sustainability performance

There are numerous reasons why commercial landlords and tenants should consider their responsibilities to improve the environmental and social performance of buildings. There is now a growing body of evidence which suggests that buildings which have good environmental performance measured in terms of energy, waste, water and accessibility are likely to be 'future-proofed' over time and less susceptible to value depreciation (Sayce et al., 2007). It is considered that they will be more likely to remain attractive to tenants and more readily saleable than buildings with weaker environmental credentials. Additionally, such buildings, it is argued, offer tenants revenue savings and provide better working environments, so enhancing staff productivity. Further, recent and possible future legislative changes may place direct obligations on organizations to conform to higher building standards.

The effectiveness by which a commercial lease can fairly proportion the risks and benefits associated with the promotion of more sustainable behavior between landlords and tenants has been questioned (Hammonds Built Environment Group, 2008). It has been suggested that the commercial lease agreement is a systematic barrier to environmental improvement and resource efficiency within the commercial built environment (London Better Buildings Partnership/ London Climate Change Agency, 2007). For example, a tenant who holds on a 5 or ten year term has little incentive to invest in the building, as their security is limited. Although the revenue benefit of any investment would normally accrue to the tenant, the payback period is too short to be an incentive where the unexpired lease term is short. However, unless there is evidence that investment improved environmental performance will lead to a return by way of higher rent or capital value, the case for the landlord to so invest must rest primarily on a reduced risk of obsolescence and greater ease of sale or lettability.

2.0 THE NATURE OF A GREEN LEASE

2.1 What is a green lease?

The combination of factors set out above has led to calls for the introduction of radical changes to UK leases aimed at promoting sustainability via so-called green leases. The concept of a green lease was first realised in Australia as being either a lease of a 'green building' or of a building that was refurbished to 'green' standards (Roussac, 2004; Power, 2004). It was thus as much about the actual building as the covenants within the lease. There is no one standard form of green lease within Australia; however, over time a template has been developed which now provides a set of obligations to be contained within leases. Most commonly, a green lease as practiced in Australia, will relate to tenant behaviour around the issue of energy efficiency, water and waste management (Commonwealth of Australia (2007[a] and 2007[b])).

The typical terms of such leases include:

- An obligation by both landlords and tenants to achieve a rating under the Green Star and Australian Building Greenhouse Rating Scheme, which addresses environmental management as well as design criteria;
- A commitment by both parties to cooperate towards improving the rating of a building during the term of the lease where possible and practicable; and
- A commitment on both parties to abide by an Energy Management Plan in terms of operating the building.

The Australian Green lease was originally driven by tenant demand but has now become quite widely accepted and is promoted by government. Elsewhere, the concept has been less widely developed, but it has recently been advocated in Canada with the recognition that such leases can be either paternalistically driven (ie one party seeking to impose obligations on the other) or cooperatively conceived where mutual benefits have been identified to which both parties sign up via the lease agreement (Real Property Association of Canada, 2008).

Within the UK, there have been calls for the introduction of green leases. Two milestones towards possible implementation of a green lease are marked by the publication by Cardiff University in 2007 of a Green Lease Guide to enable landlords and tenants to incorporate environmental best practice into lease agreements (Centre for Research in the Built Environment, 2007[a] and 2007[b]) and the announcement in April 2008 by Hermes of its intention to sign tenants on to their version of a green lease (Jansen, 2008). Hammerson and Land Securities have since also announced the introduction of a green leases and The Better Buildings Partnership have issued guidance on drafting green leases (Better Buildings Partnership, 2008). The industry wide Code for Leasing Business Premises also now refers to guidance on incorporating sustainability within commercial leases.

One of the mechanisms whereby encouragement is given to both landlords and tenants to enter into lease agreements which provide flexible arrangements to meet the needs of the parties is the Lease Code 2007. Currently, there is discussion of a possible review of the Lease Code with a view to potentially seeking encouragement for landlords and tenants to consider environmental issues within their negotiated arrangements. If such discussion were to come to fruition it would provide another mechanism towards some form of green lease.

The UK literature reveals that there are a number of ways in which attempts can be made to influence and change the behaviour and performance of landlords and tenants in terms of building operation and management. These include:

- Leases which place specific obligations on either or both the landlord and the tenant across a range of covenants. These typically include alterations to industry standard wording in relation to :
 - Specification on fit-out;
 - Repairs and alterations;

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- Assignment and sub-letting clauses;
- Service charges and management operating agreements;
- Changes of use;
- Rent review and rent penalty clauses;
- Monitoring and data collection of environmental and social data;
- Leases to which non-enforceable schedules are attached relating to detailed tenant and landlord obligations; and
- General guidance issued by landlords to tenants at the commencement of the term which may be anything from a statement of aspiration to a detailed code for using effective building management systems.

The content of leases regarded as 'green' is subject to considerable variation. At the most extreme a green lease (a so-called dark green lease) imposes very strict conduct on the tenant even down to specification of furnishings with penalties for non-compliance.

Other types of green leases (light or pale green leases) impose less stringent obligations on the parties. A summary of typical contents of the range of leases is shown in Table 1².

Table 1: Characteristics of green leases

Dark green leases	Light green leases
<ul style="list-style-type: none"> ● an obligation to fit-out and in accordance with strict ecological principles and with use of sustainable materials; ● a requirement for repair shifted from tenant to landlord with possible gross rent payment by tenant; ● a requirement for all alterations and improvements to comply with strict environmental standards; ● restrictions on ability to assign based on CSR credentials; ● a Green Management Plan to be appended to the lease to form the bedrock of management obligations by the parties; ● the ability for the landlord to forfeit the lease for a tenant's failure to manage building in accordance with sustainability principles²; ● an ability for the tenant to break the lease for the landlord's failure to manage building in accordance with sustainability principles²; ● for the service charge to include amortised cost of landlord's improvements to upgrade buildings to sustainability standards ● for changes of use to be only to uses which enhance environmental performance and are socially acceptable as well as compliant with planning requirements; ● for rental penalties for non-compliance by tenant of green leases requirements² or rent abatement for landlord's failure; ● an assumption at any rent review that the tenant has complied with the term of the management plan whether or not this is a reality; ● an obligation on both landlords and tenants to gather and share environmental and possibly social well-being data. 	<ul style="list-style-type: none"> ● to use sustainable materials when carrying out repairs or other works. ● not to reduce environmental performance (including EPC performance) of the building or its sustainability characteristics; ● co-operate with any energy-saving initiatives introduced by the landlord; ● to allow the landlord to upgrade the building's environmental or/and energy performance; ● not to make alterations which could prejudice the EPC rating or other environmental performance; ● for landlord and tenant to share environmental data if it is collected but without necessarily the obligation so to do; ● to disregard at rent review any tenant's environmental improvements and to rentalise landlord's environmental improvements.
Compiled from various sources, including primary data	

² The Table includes information drawn from Brooks, 2008; Centre for Research in the Built Environment, 2007[a] and 2007[b]; Hammonds Built Environment Group, 2008; Hinnells et al., 2008; Investa Property Group, 2006; WSP Environment and Energy/Boodle Hatfield Legal Services, 2007.

2.0 THE NATURE OF A GREEN LEASE

2.2 Perceived benefits of green leases

The benefits of green leases, which have so far largely been associated with office buildings, are considered to be numerous and include improved public relations, revenue savings and the ability to recruit and retain staff. See Table 2³.

Table 2: Benefits of green leases

- Benefit to both landlords and tenants of externally-facing sign of compliance with CSR policies and associated reputational benefits;
- Promotion of building improvements which give rise to revenue savings to the tenant and hence potential investment value to the landlord;
- Ability of tenants to recruit and retain staff due to stated commitment to good working environment and promotion of well-being;
- Ability to market the building as attractive to tenants with strong CSR credentials;
- The provision of an enabling framework for the improvement and alteration of the building to comply with new environmental and social legislation;
- Enabling a framework for better knowledge of environmental and social performance through data gathering and sharing, thus providing a basis from which to improve performance
- Encouragement of closer engagement between the landlord and the tenant and the promotion of mutual trust and understanding;
- Perception that it demonstrates that the parties are in the vanguard of sustainable management and investment practice.

source: compiled from various sources, including primary data

This list of potential benefits must be placed into the context of little practical experience of such leases within the UK. As stated above they represent aspiration rather than actuality and it was these promoted qualities that were explored during the research.

2.3 Perceived disadvantages of green leases

One of the major arguments against the introduction of green leases has been that the imposition of what tenants may regard as onerous clauses could have a detrimental effect on the rental bid due to potential to pay penal rents in the event of non-compliance and the restrictions on assignment.

One of the arguments in favour of sustainable buildings is that they should let or sell more readily; however if they are let on a lease which is perceived to be more burdensome on either or both the landlord and the tenant the impact on investment valuer is likely to be negative. Not only could the rental bid be compromised but, it has been argued, it could lead to a negative impact on investment yields. This is a very particular risk during a period of low occupational demand. A list of arguments against green leases can be seen in Table 3⁴.

Table 3: Arguments against green leases

- Perceived onerous clauses could lead to reduced lettable and reduced saleability;
- Perceived onerous clauses could negatively impact on rental levels achieved or yield achievable;
- A fear on the part of tenants that landlords will seek to 'green-plate' the building at the tenants' expense by claiming back the capital cost through services charges. This is particularly an issue for buildings let on short leases, which is increasingly common;
- A green lease may impose obligations on the tenant without similar burdens being placed on the landlord;
- Concerns by tenants that if the building is improved to sustainability standards all revenue savings they might enjoy will be recouped by the landlord in additional rent;
- Concerns by the tenant that they will not be able to assign or part with the property should they need so to do due to assignment clause requiring assignment only to a tenant with proven CSR credentials.

source: compiled from various sources, including primary data

As with the benefits, at the start of this research, there was little or no empirical evidence as to whether such concerns would be realised within a UK context. Hence the research sought to explore these issues with stakeholders.

3.0 KEY FINDINGS

3.1 Drivers for sustainability

In order to establish whether sustainability factors are currently impacting on lease patterns it was important to explore the extent to which sustainability was embedded into the operational management of respondent organisations. Reasons for their current policy position of the respective respondents was also considered to be important.

The findings suggest that sustainability is now being accepted as important to all those who took part in the research; however the drivers for promoting sustainability differ between the parties; it is seen not as a single issue but as a complex of concerns.

For the landlords, the case for improving the sustainability performance of portfolios rests primarily on two main drivers. The first is the need to promote good public relations: as their client base has grown more aware, so have they. Some of those interviewed have taken matters further by aligning themselves with the principles of Responsible Property Investment, as developed through the United Nations programme, but for most it is a matter of stakeholder awareness.

The second driver is the protection of investment returns. Of the landlord organisations contacted, none stated that they saw sustainability as a means of obtaining higher rents or more competitive yields in the short term. Instead, the view was that sustainability is a matter of risk reduction and future proofing for the longer-term. Several landlords made the point that as lease lengths decreased so it has become more important to ensure that properties remain appropriate to emerging tenant demands.

For corporate occupiers, the case for sustainability lies both in public relations and the need to respond effectively to stakeholders' requirements, in simple cost reduction and in resilience to regulatory exposure.

Both the marked increase in energy costs during 2007–2008 and the ongoing escalation of regulation linked to targets for carbon reduction have had a particular impact on occupiers. Several companies were concerned with wider revenue savings and had gone as far as incorporating such considerations into leasing criteria where such information was available.

3.2 The sustainability agenda - beyond energy?

Much of the literature surrounding the case for sustainable property has concentrated on energy. This is perhaps not surprising given the amount of publicity that has surrounded the implementation of the European Directive of Energy Performance of Buildings (EU, 2002) through the introduction of Energy Performance Certificates which impact on every sale and letting. However, whilst energy was the item most commonly discussed by respondents, the agenda was generally recognised to be far wider; waste management and water conservation were identified as of growing financial and social importance. The recognition of the need to consider and integrate social measures such as the health and well-being of employees into property asset management was also raised by a significant number of respondents. However, there is a large distinction between an awareness of the need to manage such issues and the ability so to do.

One of the pre-requisites to effective management lies in the use of appropriate metrics. Accordingly the research sought to investigate the extent to which both landlords and tenants were compiling data to measure and manage their environmental and social performance. Here a very varied picture emerged, with evidence that some landlords (in the case of multi-let buildings) and lessees are beginning to collect a wide range of data aimed at

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benchmarking and managing performance. In other cases, however, such data collection was not taking place. In no case was evidence found of environmental performance data being systematically shared between landlords and tenants. This evidence was debated during the second focus group and a view emerged that such data sharing could act as a stimulus to better management. There are tools available for data collection, such as LES-TER (Landlords Energy Statement – Tenants Energy Review)⁵, but there is no national standard framework for systematic data collection in occupied buildings and this is a matter that needs to be addressed as a matter of urgency.

3.3 The Landlord and Tenant Relationship

The research questioned the way in which the landlord and tenant relationship is currently viewed and the ways it has been seen to change over the last five years. In particular the research sought to establish whether relationships were improving and if so, why and how.

The picture that emerged was divergent. From the landlord perspective, many saw the relationship as one that had improved within recent years, with the advent of short leases encouraging a more engaged approach; additionally some landlords reported that they were now actively engaging with tenants in order to promote sustainable occupation and management practices.

From a tenant perspective, however, a different picture emerged. Most of those interviewed held leases from a large number of landlords and occupied a range of property types ranging from large, prime office buildings to old industrial units. Whilst most reported that some landlords had made great strides in terms of developing a working relationship, this was not the dominant picture.

A widespread lack of trust was reported by tenants, with a general view expressed by many that landlords were only interested in extracting maximum rents and that the service charges tended to lack transparency. The situation was generally considered to be most problematic in the case of multi-let buildings for which service charges are often the source of tension and financial disputes. At its worst, the relationship was described as 'feudal' and tenants reported that they wished to move towards a partnership model with mutual respect and understanding. Several tenants made the point that the normal commercial lease is drafted to deal legalistically with matters when there was a problem; therefore it was not an appropriate tool to promote collaborative relationships. Once reference to the lease had been made to resolve any misunderstandings or differences of view the vital step of building trust tended to be taken away.

Overall, despite expressing some negative views about the current state of landlord and tenant relationships the majority view was that the lease, per se, is not a barrier to more sustainable property management; it is how it is interpreted that matters and the willingness of parties to work together.

A key theme came through in this discussion, namely the critically important role that managing agents can play, especially in cases of overseas landlords. Again it was acknowledged that some managing agents were very pro-active and well informed and therefore more able to support sustainable asset management practices than others. The education of managing agents was perceived as a pressing need. An incentive which serves to exemplify the importance of agents' engagement with sustainability issues to landlords is the Crown Estate's EPI program⁶ which rates agents against environmental criteria which cover resource use, waste, pollution and relationship with contractors and suppliers.

⁵ www.les-ter.org

⁶ <http://www.thecrownestate.co.uk/cr8business/cr8business-case-1.htm>

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3.4 Lease Code

The research sought to investigate, through interviews with selected landlords and tenants, whether the introduction of the 2007 Commercial Lease Code had led to changes within the landlord and tenant relationship and whether it had, in the opinion of interviewees, led to changes within lease terms they had agreed. In reporting these findings, it must be stressed that the interviewees' views may not be representative of the totality of the industry.

The interviews revealed a positive attitude towards the Code by both landlords and tenants, and it was widely felt that it was the appropriate means of introducing changes in the landlord and tenant relationship. To date the code has served as a means for setting the parameters for lease negotiations even where both parties are well represented. The elements of the code that have gained the widest acceptance are those that make commercial sense for both landlords and tenants.

Tenants' views on the Code were that, to date, it had only been implemented in part. Some landlords expressed the view that tenants remained concerned with bottom line issues whilst tenants had found that flexibility was sometimes interpreted only in terms of lease length rather than other terms – such as responsibility for repairs.

The suggestion that the Lease Code could be extended to encourage sustainable property management met some support but most were of the view that the industry is 'not there yet' in terms of tightening the Code in respect of sustainability issues. However, one interviewee expressed that view that the Occupiers Satisfaction Index, launched in 2007 could become a potent agent for change.

3.5 The case for improvements and alterations

Key to any measure implemented to improve sustainability is that it should meet the business needs of both parties to the lease. It has proven difficult to build a case for improvements that enhance buildings in terms of sustainability performance whilst also supporting the financial aims of both landlords and tenants. Tenants, whilst possibly seeing the potential for occupational benefits, expressed reluctance to accept the responsibility for carrying out such improvements for two main reasons. Firstly, their interest in the property is predominantly short term⁷ and long term advantages would revert to the landlord. Secondly, despite possible protection under the terms of the lease or the extant legislation, concern was expressed that improvement would lead to the possibility of rental increases that would offset revenue savings.

Respondent landlord organisations were of the opinion that, whilst they can understand the argument for taking a long term view, the business case needs to include short term implications. Most landlords required a return on any improvement that they would undertake on a voluntary basis and this would need to be expressed as an increase in rent or a possible reduction in the investment yield. However without robust market evidence, such value increases are hard to quantify and for landlords the chief business case for making improvements is still linked to the prospect of future proofing their portfolios against future potential legislative changes.

Improvements required to fulfil changing legislative requirements, such as those introduced under disability legislation and potentially to meet environmental standards were an important consideration in discussions with both landlords and tenants. Under current leases, where the property is single-let under full repairing terms, the normal provision is that the tenant is liable for alterations required under statute. The view was expressed that in

⁷ In reporting these findings it is acknowledged that some commercial leases are still for longer terms and in these cases tenants are more likely to consider investing in building improvements.

3.0 KEY FINDINGS

such cases, if future legislation were to require alterations to premises to meet compliance, the issue of who is liable needs to be addressed clearly and fairly as otherwise, the result could be that future costs associated with legislation may be unfairly divided between landlords and tenants. It was recognised amongst the respondent organisations that this presents a significant hazard for tenants. The Government has recently stated that if new legislation was introduced, the obligations should not fall on tenants. However what the implications for existing leases would be is unclear. Some of the respondents felt that the lease would be the appropriate mechanism for addressing this issue and it would appear that this concern is the strongest argument for introducing some form of green lease in the UK. Yet the appetite for a UK green lease appeared limited and in the course of the discussions the idea of a more flexible arrangement in the form of a memorandum of understanding was received far more favourably.

3.6 The need to introduce a green lease

The literature had revealed that, within the UK, there is little agreement as to what constitutes a 'green lease'. There are a number of interpretations and it has been found that it is more appropriate to think in terms of a 'spectrum' of leases from a very pale green lease in which simple expressions of intent are written to a deep green lease containing financial incentives and penalties.

The views collected in relation to knowledge of and attitudes towards green leases provoked much discussion and debate. Respondents' knowledge about green leases varied significantly, from those who have developed their own form of green lease to those with little in-depth knowledge. There was also much scepticism, particularly among the tenant community, many of whom viewed it as a landlord driven move designed to form yet another way of imposing more requirements on a tenant. In this respect the views were very different from the Australian experience where green leases have been viewed as a tenant-led initiative requiring landlords to specify buildings to appropriate environmental standards.

Whilst this may seem inconsistent, the context to landlord and tenant relationships in Australia is rather different to that prevailing within the UK. Properties are more likely to be let on leases which place higher liability for repair on the landlord. Within the UK the history of long leases and tenant liability for all repairs and outgoings presents a very different context to the relationship.

In summary, the evidence from this research is that there was no strong support among landlords and tenants for the systematic introduction of green leases. It is important to note that since the interviews were conducted, the occupational property market has weakened, but the case for sustainable asset management has, possibly, hardened as the need to reduce risks becomes even more important.

4.0 CONCLUSIONS

4.1 Green leases: a typology not a single entity

Although the literature demonstrates that the concept of a green lease is gaining popularity in some countries, there is no widespread shared understanding of the term within the UK. Furthermore, there was widely held scepticism about the potential acceptability of a green lease among those who engaged with the research. Some of the scepticism, it is concluded, can be put down to a lack of understanding of how such a lease would vary from a standard commercial lease.

What does emerge is that green leases are best considered, not as a single entity, but as a typology of leases. These range from the very 'light green' in which there is little more than a statement of intent by tenant that they will seek to minimise their energy use and possibly their water consumption and waste production to a 'deep green' lease in which clauses are embedded within the lease which are enforceable and may be combined with financial penalties for non-compliance.

In terms of the scope of a green lease, whilst the Australian model does extend beyond environmental factors to issues of promotion of health and well-being, the understanding within the UK is very much focused on environmental issues, and within that, particularly on energy as an immediate priority. It is concluded that this focus derives from the current concerns over both energy pricing and the introduction in 2008 of energy ratings via the Energy Performance Certificates and, in some cases, Display Energy Certificates.

It was concluded that, in the light of lack of understanding of the term green lease—despite its widespread use—it would be beneficial for the industry for a deeper understanding of such a typology in order to stimulate discussion and understanding of the management and financial implications of such leases. In driving forward such discussion, it is important that 'green' is not purely associated with energy but the full range of environmental and social impacts associated with building occupation and management.

4.2 A matter of trust

By far the most important conclusion to this research is the need to develop a culture of trust between landlords and tenants. This is a pre-requisite to achieving a step change towards the introduction of more sustainable asset management and would represent a substantial shift from current practice.

Whilst there was clear evidence that some landlords are seeking to work pro-actively with their tenants, and that recognition of such incentives have been noted by some tenants, this is not the mainstream experience. Further, the growth in the number of properties that are held in the portfolios of overseas investors make the landlord and tenant relationship in some cases even more remote than in the past. In many of the interviews conducted with major occupiers the call was for a move away from a relationship built on legal technicality and mistrust towards one in which the tenant was acknowledged as a partner to the landlord, but one who does not necessarily have a long-term stake in the building. In order to develop a culture of cooperation and trust it is concluded that two sets of actions would help.

The first is to encourage the early engagement of landlords and tenants in respect of promoting sustainability within the building; this should be achieved at the stage of agreement of Heads of Terms and not seen as a 'bolt-on' extra after rent and other terms are settled.

4.0 CONCLUSIONS

The second is to recognise the critical and vital role played by managing agents, particularly in the case of multi-let buildings and those owned by overseas investors. Given the lack of knowledge about sustainability issues that has been identified through other research as well as through the views of respondents, it was concluded that the education of managing agents in sustainable asset management practices is a pressing need.

4.3 Green leases: moving practice forward

The findings revealed that the majority of those who engaged with the research considered that the standard commercial lease does not, of itself, act as a barrier to sustainability. What is required is a willingness on the part of both parties to instigate sustainable measures.

However, although the lease structure itself is not a barrier, there is evidence that some parties are moving towards the introduction of leases that loosely follow a 'light green' model. Unlike the Australian experience, the evidence pointed to this being mainly landlord led within the UK. Whilst there was significant appetite to introduce sustainable asset management practices, it is concluded that any recommendation that the investment community moves towards the introduction of a mid or dark green lease (which was seen to impose onerous terms on tenants) would be widely resisted.

What was seen as an appropriate way forward is the development of mutual working relationships that enable sustainable practices to be introduced and which support financial advantage to both sides. Currently the model to achieve this is not well served by the detail of many commercial leases, as tenants have little incentive to undertake capital works to improve environmental performance, whilst landlords similarly are not incentivised if they consider that the financial benefit will lie with the tenant in terms of revenue cost savings. What may provide a more effective way forward is the introduction of Memoranda of Understanding to provide a basis for the negotiation of terms that provide a financial, as well as reputational win for both parties.

4.4 Evolution not revolution: first steps in changing lease practice

It was concluded that the market is currently not ready for the introduction of full-scale green leases. Instead, incremental change by a process of evolution is more likely to yield positive results. The first change that could be introduced—and which was supported by the research—would be the introduction, within both existing leases and at renewal or new lettings, of a memorandum of understanding between landlord and tenant to work together to effect change. Whilst it is accepted that such an arrangement would lack enforceability and the research did not go so far as to consider what shape such a standard memorandum could or would take, it is believed that the production of a model memorandum would act as a first step towards changing behaviour.

The grounds for concluding that the introduction of a memorandum of understanding would be a stimulus for behavioural shift are two-fold. First the views expressed by respondents and participants were very positive about such a move; additionally there was evidence that the 2007 Commercial Lease code, which is itself advisory, is beginning to have an impact on behaviour. This suggests that an advisory memorandum of understanding could be a useful stimulus for discussion and change. It could also provide a non-adversarial environment for much needed communication between the parties.

The recommendation of the adoption of a memorandum of understanding does not preclude any other changes to leases being introduced. For example, landlords and tenants could usefully consider whether slight alterations to other terms, such as assignment clauses, could be used to promote sustainable asset management.

4.0 CONCLUSIONS

4.5 Improving and sharing metrics

The research investigated the extent to which data on sustainability measures, such as energy and water consumption and health and well-being, were being systematically collected, analysed and used to inform asset management. The findings pointed to very variable practice within both the landlord and tenant communities. Without such metrics it is very difficult to assess a business case for implementing building improvements. The proposition that both the development and sharing of data would aid cooperation and assist in the creation of a case for building improvement was widely accepted. It is concluded that data collection and management, at the level of the individual building and collectively, in order to develop benchmarking schemes, would both assist in pin-pointing appropriate improvement schemes and foster collaborative working relationships. As the issue of energy consumption is currently perceived as a priority for many landlords and tenants this might be an appropriate first data set to collate and share.

This was seen to be an area in which collective organisations such as IPF and the British Property Federation could have a critical role to play. It is concluded that the establishment of a national framework for data collection is required; however it is crucial that such a framework is produced by and for the property industry in order to accommodate the complexities of the UK market.

4.6 Regulation for sustainability

At the time that this research was carried out, Energy Performance Certificates, were in the process of being introduced. Accordingly they were very much at the forefront of the minds of all those who took part in the research with much attendant speculation as to their impact on the commercial property market.

The research found that, despite previously expressed reservations and concerns about their introductions, there was a view that EPCs would add transparency to the market and potentially stimulate the introduction of physical improvements. Within the body of respondents and participants, the views were largely positive. However, whilst the accompanying reports which set out possible improvements remain advisory, their impact will be muted. It was concluded that, if government wishes to achieve real change, it was likely that such reports might contain mandatory requirements; such requirements, if introduced, could present challenges to the industry. If responsibility for enactment should fall to the landlord, then the costs would either have to be absorbed or reflected through the rental line; if they fell to the tenant then adjustments to the lease would be required in terms of compensation given that tenants frequently have a short-term stake in the building.

The evidence points to the acceptance by participants that regulation for environmental and in time social sustainability is only likely to increase. One example of this is the impending Carbon Reduction Commitment programme, which is likely to be of increasing importance to landlords and tenants alike. It was concluded that, if such measures were combined with incentive schemes which recognises the nature of the landlord and tenant relationship, they could be a driver for improvement to existing stock. What is critical is that any regulation is introduced in consultation with key stakeholder groups.

5.0 RECOMMENDATIONS

Arising from the findings and conclusions are a number of key recommendations. They are:

- **Property collective bodies are encouraged to work with landlords and tenants to investigate ways in which a sense of trust can be engendered through enhanced communication.** The conclusions point to increased trust being a pre-requisite to more sustainable asset management. The collective bodies are best placed to seek to develop this trust through the mechanisms that have been established to communicate with all parties.
- **Landlords and tenants are encouraged to consider introducing memoranda of understanding for sustainable asset management at lease renewal, or before where the possibility arises.** It is suggested that such memoranda could address not only matters concerning day to day resource management, but the introduction of working practices to promote health and well-being.
- **An industry-driven initiative to develop a national framework for the collection and ongoing monitoring of sustainability data is needed.** It is important that the parties involved agree on the appropriateness and use of such a framework. Collective organisations such as IPF and British Property Federation are best placed to initiate the development of such a framework as they have a critical role in leading change within the industry.
- **As and when the lease code is revised, include a recommendation to introduce a memorandum of understanding for sustainable asset management.** Given that the lease code is proving to be such a force for change within the industry the inclusion of such a recommendation would be a welcome addition.
- **Provision of short seminars and education for managing agents on sustainable asset management practices.** The building of trust based on knowledge and understanding between landlord and tenant is critical. Management agents are the intermediaries who bring the parties together; as such their role is critical and they need to be well-informed and proactive. CPD providers, the professional and representative bodies have a key role to play in achieving this.

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20. Hermes
21. Home Office
22. ING Real Estate
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24. L&G
25. LaSalle IM
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29. Morley Fund Managers
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37. Severn Trent Water Authority
38. Shell UK
39. USS Pension Fund
40. Workspace
41. WPP
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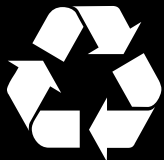
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