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THE EVOLUTION OF “GREENER” LEASING PRACTICES IN AUSTRALIA AND ENGLAND

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ABSTRACT

Improving the environmental performance of the built environment is a ‘super wicked’ problem, lacking a simplistic or straightforward response. This is particularly challenging where space is rented, in part because the relationships between the various owners, users and managers of the space is regulated – at least in a formal sense - through the lease. Traditional leases largely ignore environmental considerations and present barriers to making energy efficient upgrades. Leasing practices are evolving to become greener. Evidence from a Sydney Better Buildings Partnership (BBP) study, Australian leasing experts, a UK commercial lease study and a case-study of a major UK retailer, Marks & Spencer (M&S), suggests an increasing, trend towards green leases in most of these markets and opportunities for improving environmental performance through green leasing. Further research is needed in both countries to understand the impact that greener leasing has on environmental performance of buildings.

Keywords: energy efficiency, environmental performance, green leases, landlord, tenant.

INTRODUCTION

‘Green leasing’ has become a familiar term in recent years, encapsulating the idea that this is a new form of leasing that will help meet environmental targets. In some respects, this convenient, and catchy, phrase has, however, generated both false fears and false hopes. Fears that it is a radically different, and therefore risky, form of leasing; hopes and expectations it will transform the environmental performance of tenanted buildings. Emerging from early reticence and enthusiasm is a more nuanced understanding of how evolution, rather than transformation, of better,
‘greener’, leasing practices can contribute to improving the environmental performance of rented commercial property. In particular, greener leasing practices have the potential to address a number of widely acknowledged problems with traditional commercial leasing practices, which can be broadly grouped into three classes: a structural problem with the split incentive, an adversarial relationship between landlords and tenants, and lease wording that largely ignores environmental considerations and may have negative environmental impact (Hinnells et al. 2008). Collectively, these account for the ‘landlord tenant divide’ that is said to constitute a major barrier to improving energy performance in commercial property. Greener leasing practices can adjust the incentive structures within leases to facilitate upgrade and retrofit initiatives, promote co-operative dialogue between the landlord and tenant, and incorporate environmentally sensitive wording.

This exploratory paper presents early evidence of the evolution of green leasing practices through comparative case studies of green lease practices in the UK and Australia across the office and retail sectors. It draws on expertise from both the Sydney and UK Better Buildings Partnerships (BBPs), evidence from an Australian property law expert, previous research of the authors, and new qualitative research from an EPSRC funded project investigating energy management in the UK retail sector, called Working with Infrastructure, Creation of Knowledge, and Energy strategy Development (WICKED) (Janda et al. 2013). The acronym WICKED draws on Rittel and Weber’s (1973) conceptualisation of complex problems that defy simplistic or straightforward planning responses as wicked, or tricky. The paper starts with a section on background and context, then explains the reasons for selecting the four case studies discussed. Findings from these studies are presented, illustrating the evolution of green leasing practices in Australia and the UK. The final section discusses broader issues, and the paper concludes with ideas for further research.

BACKGROUND AND CONTEXT
Leases set the legal framework for renting property. In both the UK and Australia the majority of commercial property is rented: 56% in the UK (Property Industry Alliance 2014) and 70% in Australia (T. Crabb, Head of Research Savills, personal communication to Sara Wilkinson, 2015). In the UK, traditional leases reflect their currency as an institutional investment. Altering the familiar form of leases creates risk for landlords and tenants, particularly in relation to the valuation consequences, and, as previous research has found, the commercial property sector is complex in terms of its diversity, building types and its range of stakeholders, and tends to reflect conservatism and risk-aversion (Carbon Trust 2009; Dixon et al. 2014). Further, lawyers play a critical role in finalising lease terms and tend to strike out the unfamiliar in order to de-risk the transaction (e.g. The Fifth Estate 2014). Against this background, Government and industry leadership have been crucial to the emergence of greener leasing.

Early leadership was provided by the Australian Commonwealth and state governments in 2006 with the development of a Green Lease Schedule for use by Australian government agencies when letting or renting buildings. The UK and Sydney BBPs were subsequently established (in 2007 and 2011 respectively) to work collaboratively with leading landlords ‘to develop solutions to improve the sustainability of existing commercial building stock and achieve substantial CO2 savings’ (BBP 2015). Both BBPs developed toolkits providing a menu of ‘green
clauses’ that parties can elect to include in leases and that provide a framework ‘for sustainable operations and collaboration throughout the life of commercial leases right from the on-set’ (Sydney BBP 2013; BBP 2013a).

The UK BBP has also promoted Memoranda of Understanding (MoUs). As they ‘are not legally binding, [and] can be updated … without amending the lease’ (BBP 2013a, p.2), they provide a flexible mechanism for enabling collaboration for buildings already let. MoUs may also be used alongside the grant of new leases in preference to ‘greening’ the leases themselves (Jackman 2010). By contrast, in Australia, MoUs have not been widely used due to the costs of negotiation and non-binding nature.

Industry leadership, particularly through the BBPs, and leadership by the Australian government in its role as tenant, have been key to rolling out greener leasing practices. They are now the norm in the Sydney office sector and amongst BBP members in the UK. This paper considers four case studies on green leases across two countries (UK and Australia) and two sectors (office and retail).

METHODOLOGY
This section describes the reasons behind our international comparative approach, some issues with evaluating leasing practices, and our case selection process. Table 1 summarises the case studies used.

Table 1: Case Studies on green leases

<table>
<thead>
<tr>
<th>Office</th>
<th>Retail</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>Leases for 500+ buildings, Sydney Central Business District. Source: Sydney BBP (Dawson et al.2014)</td>
</tr>
<tr>
<td>UK</td>
<td>17 BREEAM-rated office building leases across the UK (11 in London) Source: Bright &amp; Dixie 2014</td>
</tr>
</tbody>
</table>

Green leases were first adopted in Australia and several of the authors have done comparative research with the UK and Australia (e.g. Bright and Roussac 2012). The property market is global, but commercial buildings are located and operated in particular social and political contexts. In addition, office and retail tenants and business models are different, even in portfolios held by a single property investment firm or real estate investment trust.

Evidencing change in leasing practices is difficult. The agreed final lease will generally be treated as commercially confidential and is unlikely to precisely mirror precedent leases. Searching public registers of leases is not straightforward (Bright and Dixie 2014; Dawson et al. 2014). A mixed methods approach is therefore necessary to investigate leasing practices.

Evaluating greener leasing also requires a classification methodology, which can be contentious. In the absence of any internationally standardised method of classifying leases as ‘green’, any study must develop a methodology for measuring ‘green’.
To some degree, the cases studied represent a convenience sample. However, as better leasing is a developing area of research, the understanding of green leases is necessarily limited to the new research done by a few key players. By working across countries and cases, we aim to triangulate new research (e.g., the WICKED study) within a broader context of existing work to generate additional insights.

**CASE STUDIES**

This section presents insights into Government and industry leadership and the evolution of green leasing provided by the four case studies: (i) a study carried out by the Sydney BBP into Sydney’s commercial office leasing market, (ii) a qualitative assessment of Australia’s retail leasing market, (iii) a small scale review of green clauses in UK office and retail leases and (iv) a case study of a leading UK retailer.

**The Sydney BBP Office Leasing Study**

In December 2014, the Sydney BBP published the first “BBP Leasing Index,” which covers the office leasing market in Sydney central business district (CBD) (Dawson et al. 2014). This index shows how Sydney’s office leasing market is being transformed: over 60% of all leases signed in Sydney CBD in the last two years (financial years 2012/13 and 2013/148) include green clauses, compared to 15% prior to financial year 2008/09.

The BBP analysed leases from the public register in New South Wales (Thomas and Dawson 2014), using Sydney BBP’s Model Lease Clauses (recognised as industry best practice) to define what constitutes a “green” term (see Sydney BBP 2013). The study sampled over 500 of the 7000 commercial office leases across Sydney CBD. Premises were sampled randomly within six segments determined by size of tenancy (small, medium, large) and the quality of the building (non-prime and prime grades), with a target sample size of 100 for each segment. The sample leases were analysed for the presence of one of 22 BBP Model Lease Clauses and a grading system was used to calculate a ‘Model Lease Score’. Gradings were assigned based both on ‘clause breadth’ (the number of green clauses in the lease out of the 22 possible) and ‘clause strength’ (how binding the clause is, depending on whether a dispute resolution process would be triggered by breach). These were given numerical grades and then averaged to a total Model Lease Score for each lease (see Thomas and Dawson 2014).

As an example, a lease with 15 of the 22 possible clauses would have a clause breadth of \((15/22) \times 100 = 68\) (of 100). If 5 of these clauses would trigger dispute resolution, the clause strength would be \((5/22) \times 100 = 23\) (of 100). These scores were then averaged to a total Model Lease Score for each lease. In the example given it is \((68+23)/2 = 46\) (of 100).

Using this method, the BBP study found that the average Model Lease Score pre-2008/09 was 2 but had risen to 15.6 in 2012/13 and 2013/14. There was a quadrupling of some form of green leasing over this period, and on average 27% of the BBP Model Lease Clauses now appear in a standard commercial office lease. Despite this growth, the clause strength still lags, indicating that although parties are

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8 Financial years are July to June.
happy to agree to collaborative frameworks they are still hesitant to risk dispute resolution for breach of sustainability commitments.

The BBP model clauses, designed to be incorporated into standard leases, are grouped under 4 key categories. Table 2 sets out these categories with some illustrative examples (see Sydney BBP 2013).

**Table 2: Sydney BBP Model Lease Clauses**

<table>
<thead>
<tr>
<th>Categories</th>
<th>Examples of model clauses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cooperation and management</td>
<td>To “cooperate with each other and act in good faith to … promote the efficient use of resources in the management and operation of the Services, the Building and the Premises”</td>
</tr>
<tr>
<td>Recycling, waste and consumption</td>
<td>In relation to fit out and works to use reasonable endeavours not to “interfere with or affect any performance rating, NABERS rating or Green Star rating for the Premises or the Building”</td>
</tr>
<tr>
<td>Specifications and standards</td>
<td>Landlord to “ensure that the Current Base Building NABERS Rating is maintained for the Term”</td>
</tr>
<tr>
<td>Costs and compliance</td>
<td>Provisions on expert determination and rent review</td>
</tr>
</tbody>
</table>

The study found that those relating to the first two categories (cooperation and management; and recycling, waste and consumption) were most frequently included. Nearly a quarter of all leases include a clause relating to securing/maintaining a NABERS rating (National Australian Built Environment Rating System – the operational performance rating for buildings). The next most common clauses relate to information sharing, environmental sustainability (a high-level commitment clause) and waste reduction.

The study highlights the importance of leadership in green leasing. It shows that the major private landlords owning the majority of prime grade commercial premises (who were also the first movers in integrating early green leasing concepts in their precedent leases) have made green leasing their standard practice. Over 80% of leases in prime buildings have best practice leasing in 2012/13 and 2013/14, and on average these leases include nearly half of the BBP Model Lease Clauses (44%).

**Evidence of green leases in the Australian retail market**

Early qualitative assessments suggest that green leasing is not usual in Australian retail markets. The Sydney BBP is initiating conversations with retailers but report that there has been no significant greening of retail leases to date. Although further study is needed, it appears this may be partly due to the strong consumer orientation of state retail legislation and the fact that the retail sector is so highly price sensitive and cost conscious (Professor W.D. Duncan, personal email communication with Susan Bright, 4 December 2014). Further, in most Australian jurisdictions the cost of
capital improvements is not permitted to be passed on to retail tenants as outgoings (Duncan and Christensen 2014).

Although a recent industry study of retailers in UK shopping centres found that making retail outlets more sustainable was not a priority for most retailers (Whitson and Crawford 2013), our case studies (below) show there are notable exceptions in the UK and green leasing is found in UK retail property. More work will be needed to explore the differences in policy environments and industry action that may be influencing differences between the office and retail markets in both countries.

Evidence of green leases in the UK

Using a qualitative document analysis approach, Bright and Dixie (2014) examined the content of 26 UK commercial leases (17 office and 9 retail) in detail to develop a categorisation of ‘green clauses’. Sampling relied on leases available on the public land register (registration being compulsory for leases of more than seven years) plus 7 retail leases supplied direct by a tenant. Sampling was also restricted to leases registered in 2008 or later given the first known use of a green lease in 2007. The sampling aimed for a mix of locations, landlords and tenants, but focused on BREEAM (Building Research Establishment Environmental Assessment Method) properties and on parties with public green commitments (including green lease policies), in order to increase the chance of identifying green leases within such a relatively small sample.

Bright and Dixie (2014) defined ‘green clauses’ as those which are ‘designed to facilitate the property being used in a resource efficient manner and which … [take] account of energy efficiency and other sustainability goals and measures’ (Bright and Dixie 2014, p.10). Examples of categories include ‘Sustainability statement’, ‘Environmental plan’, ‘Alterations and Repairs’, ‘Data-sharing’ and ‘Environmental improvements’. Based on their categorisation, they found that of the 26 leases analysed, 15 (12 office leases and 3 retail leases) contained one or more green clauses, varying significantly in their content, scope and legal commitment. The most common clause related to data-sharing (12 leases), followed by those requiring environmental considerations to be taken into account for alterations and/ or repairs (10 leases), and those allowing service provision to take account of environmental considerations (10 leases). Whilst their study identifies some use of green clauses in UK commercial leases, it also highlights the challenge of accessing leases and the difficulty of tracking the use of green leases in a consistent and statistically representative and meaningful way.

The M&S Case Study

Drawing on early evidence from the WICKED project, a case study of M&S illustrates the leadership role M&S and the UK BBP are playing in the roll out of green leases in the UK retail sector. The case study is based on i) interviews of key M&S staff (over the phone and via email, including the Head of Property Plan A, Plan A Project Managers and a M&S property lawyer), and ii) examination of public documents and internal M&S documents.

In 2013 M&S announced a new “green lease policy” - to include green clauses in new leases and introduce green clauses through MoUs for existing stores - a
commitment now incorporated into the M&S Plan A 2020 (M&S 2014a, p.29). The M&S story suggests that strong leadership and concern about climate change are important drivers for the environmental plans that fed into this leasing policy (Vernon 2007). Plan A, launched in January 2007, sets out 100 commitments to help M&S become “the world’s most sustainable retailer” (M&S 2014b) and is an important part of its brand. The leasing policy emerged from a convergence of drivers: that leases should not undermine Plan A; a desire to control the lease drafting process to create more standardisation across the M&S portfolio; an opportunity to save costs through enabling building improvements; and the promotion of green leases by the UK BBP.

There is a key distinction between policy on MoUs and on green leases, which reflects the important role of the UK BBP. Working together, M&S and UK BBP launched an initiative to introduce green MoUs for 70 M&S stores already under lease with BBP landlords (BBP 2013b). This ‘buy in’ from BBP landlords has meant that the scope of the M&S MoU clauses (broadly based on the BBP green lease toolkit (BBP 2013a)) is broader and more ambitious than the green clauses being used in new M&S leases. Green MoUs with UK BBP landlords have now been introduced for 65 existing stores.

By contrast, for new leases M&S has to negotiate with a much greater diversity of landlords. M&S has developed a standard set of green clauses, informed by the BBP “Green lease toolkit” (BBP, 2013). These include a general commitment to carry out lease obligations with a view to promoting environmental best practice, but specific obligations (e.g. for data-sharing and the development of an Energy Management Plan) are limited to the common parts. Between January 2013 and December 2014 M&S entered around 80 new leases. Early indications are that most of these, other than lease renewals, include green clauses (the long lead time for completing some leases after signing agreements for lease means it will take some time for green clauses to filter through to all new signed leases).

M&S’s experience suggests that the “light green” clauses based on the BBP toolkit have proved largely uncontroversial in negotiations, possibly because of the role of BBP in influencing standard industry practice and also M&S’s position in the market, where its brand and size add value to landlords’ premises.

DISCUSSION AND ANALYSIS
The case studies reinforce a picture of industry and Government leadership supporting the evolution of green leasing practices in the UK and Australia, with increasing uptake in both countries. Evidence for this increase is strongest in the office sector, particularly in Australia where the Sydney BBP’s quantitative findings contrast with the absence of any evidence of green leasing in the Australian retail sector. Qualitative feedback from the UK BBP, a recent study of UK retailers (Whitson and Crawford 2013) and Bright and Dixie (2014) suggest that green leasing may also be stronger in the UK office market than the retail sector. In contrast to Australia, however, the UK case studies suggest at least some notable evolution of green leasing practices in the retail sector, with M&S leading the sector in its public commitment to green leases.

It is not yet clear, however, what influence green lease clauses have on energy management practices.
Firstly, it appears that the clauses being used are generally of the ‘lighter green’ variety (Bright 2008). ‘Dark green’ clauses (Bright 2008), especially those that seek to address deeper structural problems and upgrade incentives in leases, meet with stronger resistance. Both M&S and the Australian property company Investa have attempted to include provisions within leases to permit the landlord to make green improvements and recover the costs through some kind of amortisation charge or service charge; but these attempts meet with much greater resistance than other green clauses (Bright and Roussac 2012; personal communication (phone call) from M&S property lawyer on 12 January 2015). The Sydney BBP study (Dawson et al. 2014) shows that binding clauses, those with ‘teeth’, are relatively unusual, and this was also true of the leases examined in the Bright-Dixie study (Bright and Dixie 2014). Moreover, it is difficult to separate the effects of green clauses from other factors that influence energy management practices. M&S highlighted the facts that M&S has a sophisticated energy management system regardless of its leases, and that other developments, in particular new Minimum Energy Efficiency Standards (MEES) being introduced in England from 1 April 2018, are seen by landlords as drivers for increased cooperation (DECC 2015). This view that MEES are a key driver for landlord-tenant engagement is echoed by other anecdotal evidence received under the WICKED project and it has been suggested that green leases may become an effective tool for addressing the risk associated with MEES.

It is too soon to evaluate whether greener leasing practices are enabling more effective outcomes. In any event, there is doubt about the extent to which leases – in the sense of the formal documentation – make any difference to behaviour. The people who manage and occupy space may never see the lease or even have access to it (Bright and Roussac 2012), and C. Botten (Programme Manager, UK BBP) reflects a view commonly expressed, that leases largely ‘sit in a cupboard for the length of the tenancy’ (phone call of 18 December 2014). Nonetheless, green clauses do provide an important framework for enabling conversations to happen in relation to energy and environmental management. The Sydney BBP considers that green clauses are ‘necessary but not sufficient, providing the framework for collaboration and their value may be in the discussions that are held about the lease rather than the lease itself’ (B. Thomas and E. Bailey, Sydney BBP, in a phone call 18 December 2014). This reflects the early experience of M&S where the existence of green clauses has provided a framework and incentive for M&S’s Plan A Project Manager to engage with landlords, meeting with them to discuss priorities for co-operation ‘under the guise of green leases’ (Plan A Project Manager, in a phone call on 12 January 2015).

CONCLUSION
These observations and early experiences indicate an increasing trend towards the adoption of green clauses in commercial leases in Australia and the UK, with a view to addressing the challenges of the ‘landlord-tenant divide’ and improving the environmental performance of rented commercial property. Whilst evidence of uptake in the UK remains patchy and largely anecdotal, the extensive analysis of the Sydney office market for the first time provides data to support anecdotal observations of such a trend.

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9 M&S no longer uses this dark green clause.
Current evidence in both countries and sectors – reflected in the scope of the case studies – appears restricted largely to prime and/ or relatively new buildings. Further research will be needed to extend evidence to other building types. The WICKED project plans to address this gap by investigating a broader spectrum of building and outlet types across the retail sector.

The M&S case study and early work on the WICKED project also highlight potential opportunities for green leases to influence effective energy (and environmental) management in commercial, and specifically retail, property. More work will be needed to evaluate both qualitative and quantitative effects of green clauses, and how they relate to other drivers.

REFERENCES


