

# low carbon leases

## climate change policy for landlords and tenants

This report has been commissioned by MITIE from Oxford Carbon Consultants, as part of a series on climate change, energy and real estate. The series provides a straightforward guide to the present position and likely future developments, for owners and occupiers of commercial and public sector buildings. These reports have been prepared by Dr Mark Hinnells, who has been involved in policy advice to government and industry for 15 years and is a senior researcher at the University of Oxford. The series comprises:

**Report 1** Climate change policy

**Report 2** EPCs and DEC's

**Report 3** CRC energy efficiency scheme

**Report 4** Low carbon leases

**Report 5** The energy market

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### Background and overview

In policy and law, the leasehold relationship between landlord and tenant is treated as a private contract between consenting parties, and has been subject to only very light regulation from Government: for example, in the form of codes of practice.

However, the Government, with its commitment to reduce carbon outputs, is now strengthening policy with requirements for information, like Energy Performance Certificates (EPC) and Display Energy Certificates (DEC); incentives such as Carbon Reduction Commitment (CRC); and regulation, including zero carbon new build. This means that energy use, energy costs and emissions are coming higher up the agenda in the relationship between landlords, tenants and facilities managers.

The following case studies demonstrate ways in which the different parties involved are responding to changing policy.

### Case studies - tenant led

- **A major retailer** with several thousand UK stores has many different types of lease in place, with both large and small landlords - from shopping centres to the high street. Whilst energy cost and carbon output are important, the

biggest issue for this retailer is Corporate and Social Responsibility (CSR). This includes making sure they outperform their competitors in the CRC league table. The company manages energy centrally from headquarters, even turning off lighting and other in-store processes outside store opening hours. Store managers have to request additional operating periods (such as night-time restocking) in advance. Because of this heavy central control, the company does not need or particularly want significant landlord intervention. Discussions about green issues are therefore managed not through lease changes, but through non-binding 'charters'.

- **A major public company**, has most of its several thousand premises with the same landlord on long-term leases. The company's high CSR profile includes an objective of an 80% reduction in carbon emissions in 10 years. This will require £hundreds of millions of investment to replace heating, cooling, ventilation, and lighting equipment, which the company would prefer to be off balance sheet. It is in discussion with the landlord, facilities management providers, and energy services companies (ESCOs) who could make the investment on its behalf and recover the costs through a service or energy charge.

Depending on the final decision, there may need to be significant change to facilities management or lease contracts.

## Case studies - landlord-led

- **A major retail landlord** has leases ranging from 3 months (start-ups and seasonal shops) to 125 years (anchor stores). Some stores are responsible for their own energy purchasing and management, while in shopping centres the central supply of heat and/or chiller systems has to be covered in the lease. In most cases a facilities management provider manages the common parts, but store energy management is seen as largely a tenant's issue. The main demand is for lighting and equipment, rather than space heating and cooling: almost all stores use much more light than guidelines say is necessary for comfort, as a way of attracting shoppers. This can have a major impact on the energy performance of the centre itself. The landlord is leading an occupier engagement programme and a 'green lease' has been under development since July 2007, but has yet to be widely rolled out. The interaction between the lease arrangements and energy management is complex and will take time to evolve.

- **A large property services agent** provides consultancy and asset management services to its landlords, including a major portfolio landlord. On the majority of properties managed, the purchase and consumption of utilities is undertaken solely by the tenants. However, on multi-let sites, utilities are managed by the agent and consumption is sub-metered to individual occupants. In 2007, a target was set of at least 5% energy saving across the portfolio of one

major landlord, and an information-gathering exercise showed significant consumption outside business hours. Annualised savings of approximately 7% have been achieved by measures such as installing passive infrared sensors to lighting in the common parts of multi-let sites, wherever they are safe to use. However, in most cases, tenants are responsible for around 80% of energy consumption. In order to achieve further reductions, it is therefore essential to engage tenants in exploring next steps: for example, whether lighting and IT equipment is left on unnecessarily.

## Implications for landlords and tenants

Action can be landlord or tenant led. Tenants are particularly interested in CSR issues, landlords in ensuring their stock remains competitive. Some tenants work with landlords and facilities management providers; others drive change themselves. The most common approach at the moment seems to be relationship building, collaboration and knowledge sharing. A key example of this is the London Climate Change Agency's Better Building Partnership Guidance on Green Leases<sup>1</sup>.

This approach may suffice for moderate energy reduction targets (10-20%), but government policy will require much stronger measures. Over time, it will become more attractive to achieve higher and higher targets.

This will demand changes in design, operation, use and management of the built environment, with significant investments not only in energy efficiency, but also in lower carbon forms of power and heat generation, including renewables. Much of this investment may be off the balance sheet of tenants, and possibly for

landlords too, leading to a more significant role for facilities management or energy partners.

Under the CRC in particular, landlords and tenants face particular complexity. The British Property Federation have issued very useful guidance<sup>2</sup> for landlords and tenants:

- Advice on how costs should be apportioned between landlords and tenants.
- What should happen when a building is bought or sold to/from a party outside the scheme.
- How landlords can use the CRC recycling payments to make their whole portfolios more energy efficient, for everyone's benefit.

## Actions for landlords and tenants

In order to manage this changing relationship, there are a number of issues to consider.

- Organisational – who has leadership of this issue?
- Are data on energy consumption and metering being pulled together, in readiness for CRC?
- For developers, what development plans are in the pipeline, and for occupiers, what are space needs going forward?
- What opportunities might an occupier, a landlord or FM contractor have to reduce energy use or install CHP or on-site renewables?
- Would outsourcing help to manage the combination of risks and obligations?
- Might it be useful to work with the partners in your facility to develop marginal cost abatement curves?

## More information

Leases vary hugely between different landlords and tenants, in different sectors, drawn up at different times, and with significant regional variation. Advice should be sought from your solicitors and Facilities Management partners.

1 Better Buildings Partnership: Guidance on Green Leases, [www.lcca.co.uk/upload/pdf/LDALIVE-%232376492-v1-BBP\\_Green\\_Lease\\_Guidance\\_Nov\\_2008.PDF](http://www.lcca.co.uk/upload/pdf/LDALIVE-%232376492-v1-BBP_Green_Lease_Guidance_Nov_2008.PDF)  
 2 [www.bpf.org.uk/topics/document/23672/carbon-reduction-commitment-crc---a-guide-for-landlords-and-tenants](http://www.bpf.org.uk/topics/document/23672/carbon-reduction-commitment-crc---a-guide-for-landlords-and-tenants)