



Industry standard for the future?



In the institutional real estate market, green buildings and certificates for green buildings, such as LEED, DGNB, BREEAM, ÖGNI, are already market standard. Due to the already visible impact of the climate change and the ESG regulations enacted by the EU Commission, also the green operation of a building and green leases gain increasing importance. This raises the question of what specific provision can be regulated in such “green leases”.

In December 2019, the EU Commission introduced the “Green Deal”. Based thereon the EU Commission adopted three eminent regulations¹ that form the framework for the implementation of environmental, social and governance (ESG) criteria. One of those regulations is the Taxonomy Regulation that provides that only those economic activities are “green” which significantly contribute to the achievement of environmental objectives. The relevant six environmental objectives are:

1. Climate change mitigation
2. Climate change adaptation
3. The sustainable use and protection of water and marine resources
4. The transition to a circular economy
5. Pollution prevention and control
6. The protection and restoration of biodiversity and ecosystems

Also driven by these environmental objectives, green lease agreements gain major importance for financial market participants (thus, also banks and institutional investors), and companies of public interest, i.e. large, listed real estate companies (with more than 500 employees on an average during a financial year)², for whom the Taxonomy Regulation mandatorily applies. Green lease agreements are not only relevant for financial market participants that own or rent such properties, but also for financial institutions that finance real estate properties.

According to a research by Savills Investment Management³, 73 per cent of institutional investors expect green lease clauses being universally incorporated between tenants and real estate investment managers by 2029.

For several reasons, green leases are not only relevant for financial market participants and large, listed real estate companies, but also for other property owners. Such reasons are, for example:

- i. They expect a higher purchase price when selling the property, or more favorable financing conditions when financing a property
- ii. They intend to develop the property with the purpose to later transfer it to an institutional investor, where not only real estate certifications (such as LEED, DGNB, BREEAM, or in Austria ÖGNI) are important, but also green leases will play a major role

- iii. They expect higher letting rates, or higher rents when letting premises, as modern, sustainable buildings often attract tenants of a higher income class
- iv. They voluntarily want to comply with ESG objectives
- v. They expect that the scope of applicability of the Taxonomy directive will be extended also to further property owners
- vi. They will have to comply with the taxonomy objective if they want to establish or maintain business relationship with such financial market participants and companies of public interest.

Thus, it is to be expected that “green leases” will be market standard in the near future.

What is the content of such green leases?

Green leases are lease agreements that aim to ensure the sustainable construction/fit-out, usage and maintenance of the property.

In several countries, such as the Anglo-Saxon countries, Sweden, the Netherlands, or France uniform standards that could serve as a reference framework for green leases do already exist. Also in Germany, Zentraler Immobilien Ausschuss e.V. (ZIA) has published a compilation of sustainable clauses under lease agreements.⁴ There is, however, no common European standard, or definition of a “green lease”.

¹ i) Regulation (EU) 2019/2088 of 27 November 2019 on sustainability-related disclosures in the financial services sector (Disclosure Regulation)

ii) Regulation (EU) 2020/852 of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088; (Taxonomy Regulation); the first delegated act on [sustainable activities for climate change adaptation and mitigation objectives](#), that was adopted on 4 June 2021; and the Delegated Act Supplementing Art 8 of the Taxonomy Regulation, adopted on 6 July 2021;

iii) Regulation (EU) 2019/2089 of 27 November 2019 amending Regulation (EU) 2016/1011 as regards EU Climate Transition Benchmarks, EU Paris-aligned Benchmarks and sustainability-related disclosures for benchmarks (Benchmark-Regulation)

² Directive 2013/34/EU, as amended by the Directive 2014/95/EU of 22 October 2014; amending Directive 2013/34/EU with regards disclosure of non-financial and diversity information by certain large undertakings and groups.

³ Savills Investment Management LLP, Annual Sustainability Report, 2019.

⁴ Zentraler Immobilien Ausschuss e.V. (ZIA), “Green Lease – Der grüne Mietvertrag für Deutschland”.

Which clauses might be relevant for a property will to a certain extent depend on the purpose of the lease and the circumstances of each individual case. When drafting a lease agreement, these circumstances will have to be carefully assessed.

The most important clauses that might be incorporated in green lease agreements are, for example, the following:

Use, supply and management of the property

Lease agreements might provide for a right of the landlord to supply the building (predominantly) with sustainable energy, such as power, heating, cooling, and to use only sustainable cleaning products. It is very important to regulate this right in the lease agreement, as the cost for such sustainable products and supply might be higher than non-sustainable products, and to specifically regulate that the landlord may charge on to the tenants respective higher cost. Otherwise, the landlord runs the risk that these cost may be challenged by the tenants under the service charge reconciliations.

In addition, an obligation, or at least a best effort commitment of the tenants may be incorporated into the lease agreement to also purchase sustainable energy, such as power, or cleaning products.

Leases might provide for an obligation, or best effort commitment of the tenant to (i) separate waste collection to the extent possible, or to (ii) use to the extent possible recyclable products. In order to achieve this goal, it might also be beneficial if the building already provides for facilities for such separate waste collection.

Moreover, regular sustainability workshops between landlord and tenant, and sustainability guidelines for the property might be useful in order to maintain, or improve the sustainability efforts for both, landlords and tenants.

Construction, fit-out and maintenance

Of course, already prior to and during construction of a property, the property owner can foresee a lot in order to facilitate a sustainable use of the property by the tenants: The building might already provide for sustainable heat or cooling facilities, for waste disposal areas that allow separate waste collection facilities to the extent possible. There might, e.g., be storage rooms for bikes and e-bikes, or car parking areas with e-supply facilities.

In respect of core-and-shell lease agreements, there might be an obligation/ best effort commitment of the tenant to equip or fit-out the premises with sustainable products only.

Beyond that leases might provide for an obligation/best effort commitment of the parties to perform maintenance works with sustainable products, and to consider contractors that adhere to certain sustainability standards.

Moreover, it would also be possible that the landlord and the tenant develop a sustainable use concept for these premises.

Transparency, data exchange, monitoring

Important are also clauses according to which the parties are obliged to exchange data and information, especially regarding energy supply, water supply and waste disposal, or data for the determination of the CO₂ balance of the leased premises.

Moreover, the leases might provide for an obligation to implement monitoring concepts.

Other individual regulations

Depending on the individual situation, there might be other regulations that could be considered in the lease agreements.

How to ensure the enforcement of such clauses?

Thus far, green lease agreements are according to our experience not yet that common. Nonetheless, due to the growing importance of ESG criteria, we expect that “green clauses” will also be implemented into lease agreements in the near future. As already mentioned above, lease agreements might contain obligations by the parties, or merely best effort commitments. Especially such best effort commitments are, however, difficult to enforce.

With respect of important sustainability clauses, penalties, or monetary incentives could be provided in the lease agreement. However, also national mandatory tenant protective legal provisions or court decisions might be relevant to consider. Under mandatory national tenancy acts it might, e.g., be uncertain whether higher operating cost due to higher prices for green power, or green cleaning equipment, may validly be shifted to the tenants. In this respect, clarification by the governmental authorities might be beneficial, where required.

Summary

Summarizing, as green leases will play a major role in the future, building owners and tenants should analyze the specific need for sustainable clauses, and consider the implementation of such green clauses into their lease agreements. This might have benefits during the use of the building, but also with respect of financing or intended sale of the property.

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Published 08/2021