Green Building: Balancing Fact and Fiction
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When it comes to pursuing sustainable building initiatives, who has a clearer motivation to pursue enhanced sustainability: owner-occupants or income-property owners?

First you have to agree on a definition of "sustainability." Are you talking about superior energy efficiency, which has a direct impact on operating costs, or more subtle elements, such as "green cleaning" or the presence of bike racks and showers to accommodate occupants who wish to leave their cars at home and cycle to work instead?

In the case of owner-occupants, the costs and benefits of pursuing sustainability are calibrated in both dollars and what one might call "PR points." In other words, it's not always as simple as "They invest incremental dollars to yield incrementally lower operating costs." Many owner-occupants build a "green" trophy asset so that they can telegraph the message "I am an environmental leader" to various audiences from Wall Street to Main Street. It's unfortunate, but sometimes you see a real disconnect in decision-making – for example, when a CEO invests buckets of shareholder capital in a new, high-profile LEED Platinum-rated headquarters while many of company's other office buildings ignore even the lowest-hanging fruit, such as grossly inefficient lighting systems controlled by one light switch per floor.

On a related note, you're seeing more and more income-property owners and managers taking the same "trophy" approach to sustainable building, particularly in high-profile markets where tenants are starting to demand "green" attributes as they lease new space.

Before long, you come face to face with the old "stock" versus "flow" question: If you focus all of your "greening" resources on the flow of new buildings, what do you do with the stock of grossly inefficient ones that you already own?

Who has a greater motivation to take a portfolio-wide approach to sustainability, owner-occupants or income-property owners?

Well, that depends. However, one would think that income-property owners would be more highly motivated than owner-occupants when it comes to venturing beyond the "trophy" mentality and pursuing at least certain elements of sustainability (especially the ones that influence net operating income) portfolio-wide. After all, every dime of higher rental income or lower unreimbursed operating expense per year holds the *potential* to support an extra dollar (or more) of incremental asset value (assuming a capitalization rate of 10%). If "green" attributes do, in fact, make space easier to lease and/or less expensive to operate, landlords should be very motivated to jump on the sustainability bandwagon to make *all* of their properties more competitive, profitable and valuable….not just the "green" trophy building they currently have in development.

Of course, before you begin to harvest that increased net operating income and asset value, you have to determine how your existing leases would allocate the costs and benefits of doing so. And that is where so many landlords get stuck. Instead of actually benchmarking their existing buildings' energy performance (e.g., using the ENERGY STAR portfolio manager tool), studying the expense-sharing provisions in their existing leases, and doing the calculations, they take the easy way out and make decisions based on myths: "Our properties are already as efficient as they can be." Or, "Our 3rd-party property managers already have energy under control." Or, "Energy is a pass-through." Or, "It doesn't make sense to invest dollars in improving energy efficiency in mid-lease because the tenant would get all the savings."

Once you decide to base your decisions on math instead of myths, you should find plenty of motivation to apply at least some sustainability initiatives across your entire stock of existing income properties. Sure, you'll have to look at which leases are gross, net or fixed-base. And in the case of the fixed-base leases, you'll have to figure out where expected savings would be enjoyed by the tenants, the landlord, or both (see diagram). You'll also want to know which leases have language permitting the landlord to assess tenants for the cost of capital improvements that reduce operating expenses. In the end, though, the research and math will give you the confidence to invest time and capital in sustainability initiatives. That homework will help you answer the questions, "Who should pay?" and "Who would benefit?"

How should a landlord approach quantifying the sustainability value proposition?

As I mentioned earlier, you have to ask, "What are the costs and benefits of increased sustainability, and how are they allocated between the parties – i.e., the landlord and each tenant?" And in this context, "costs" and "benefits" include not only investments made to support enhanced efficiency and the resulting savings in operating expenses (e.g., lower utility bills). You also need to consider indirect effects, such as the "cost" of increased vacancy when a building fails to compete in a world where a certain level of efficiency becomes "market," or conversely, the "benefit" of improved tenant attraction and retention if that same building's innovative energy-efficient systems, operating practices and/or other "green" attributes are admired in the marketplace.

Why do you think that rating systems such as LEED and ENERGY STAR have become so popular, and what influence have they had on the commercial real estate market?

We live in a culture where 30-second sound bites play a large role in influencing decisions, even if the underlying issues are complex – think global warming, or the Presidential election. Property management roles are over-tasked and under-staffed. When it comes to hot button topics like "environmental," "green," and "sustainable," managers gravitate toward easy-to-understand proxies for "making the grade," or, in keeping with the hyper-competitive spirit of commercial real estate, "being better than the next guy" so that your building gets and keeps the best tenants. The ENERGY STAR label for buildings is 10 years old this year, and I would say that over the last decade it's had a profoundly positive effect on making the concept of *normalized building energy*

performance accessible for a wide variety of real estate decision-makers. It really has become the "miles per gallon" sticker for buildings.

That said, in the case of ENERGY STAR, the fact that a building scores in the 75th percentile (or higher) and receives the label does *not* mean that that building has no room for improvement on the efficiency front. As an example, our engineers have identified plenty of cost-effective energy-conservation measures for buildings with scores of 90 and higher. So, one downside of the ENERGY STAR label is that some managers think of it as something that they hurry up and get so that they can focus on other things. It's important that buildings owners don't think getting an ENERGY STAR label means, "No Potential for Further Efficiency Improvements Here."

By the way, unless a building scores 75 or higher and wishes to receive the label (which requires verification by a 3rd-party), you can't be sure that the right data points were entered into the benchmarking tool. I can assure you that there are plenty of buildings out there that have erroneous scores due to overstated operating hours and other specious inputs. Just because a building claims its ENERGY STAR score is 74 doesn't mean it is.

Using a LEED rating as a proxy for efficiency presents additional challenges. As you may know, LEED grades a building on many dimensions of sustainability, only one of which is energy efficiency. In the most recent version of *LEED for Existing Buildings: Operations and Maintenance*, if a building has enough points in categories other than energy, that building could attain "LEED Certification" with an ENERGY STAR score of only 69. Remember, a building must score at least a 75 to qualify for the ENERGY STAR. LEED provides a well thought-out and systematic approach to gauging a building's sustainability. However, if your main interest is enhanced operating efficiency, you'll want to have more than a "30-second sound bite" level of understanding when leasing, buying or selling commercial real estate.