Forsters

#FORSustainability

Landlord and Tenant ESG Requirements

Environmental, Social,and Governance (ESG) considerations are undoubtedly now integral to the real estate sector;reflecting the increasing emphasis on sustainability and responsible business practices.

When ESG is discussed in the context of leasing, the focus is usually squarely on the "E" of the trio, environmental. But the social and governance issues should not be overlooked.

Why consider ESG?

Legal obligations as well as commercial pressure have driven both landlords and tenants to create more sustainable spaces; with early adopters being able to use their positioning to their advantage to stand out in their marketplace. Those that have still not fully embraced ESG into their real estate strategy risk being left behind.

From the landlord perspective, aside from legal and regulatory compliance, it is established that the best ESG rated buildings generate greater competition and attract better calibre tenants who are prepared to pay a higher rent, while 'brown discounts' apply to buildings that are not ESG-compliant. A clear ESG strategy enables owners to safeguard and develop robust and attractive property portfolios and business structures, and help smooth the path to obtaining investment and green finance.

For tenants, their real estate offering is a means of attracting and retaining talent, increasing staff wellbeing, productivity and engagement – and perhaps, crucially, encouraging staff back into the office in a post-Covid world. Occupiers of efficient buildings can also benefit from lower operating costs.

There has been a shift in landlord and tenant dynamic in recent years, with the move towards "property as a service" enabling tenants more than ever before to shape the landlord offering and demand a collaborative relationship. ESG considerations often form a key part of this.

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>
> Chambers UK Guide

What should be considered?

Energy efficiency

Unless an exemption applies, it is currently unlawful to let or continue to let premises with an EPC rating below an "E" grade. Current expectations are that the minimum level will be grade "B" by 2030. This is covered in more detail in our MEES and EPC briefing note.

With this in mind, many property owners have work to do to improve the rating of their buildings and avoid having a 'stranded asset'. Conversely, tenants should push for more than minimum ratings, and challenge landlords to deliver premises of a minimum grade "B" – or at least be clear as to who bears the cost of bringing the premises up to standard, and incorporate protections against disruption to their occupation.

It is also worth noting that EPCs only measure a snapshot of energy efficiency, and do not show 'in use' ratings. This is where data sharing will be key, as well as the developing application of accreditations such as NABERS, which also assesses the performance of buildings in operation, and not just how well they are designed and built. Adoption of NABERS is at an early stage, but current commentary suggests there might still be some way to go to maintain ratings in operation.

Accreditations

There are a myriad of sustainability and well-being focused building certifications. Examples are BREEAM, LEED, NABERS, and WELL (please refer to our ESG Glossary for more information on these certifications). These accreditations have differing aims and measure differing factors, so key to making the most of them is to understand what they seek to achieve, and how they align with wider business aims.

It is increasingly common to see contractual commitments in leasing transactions to achieve, and maintain, specified accreditations. Before committing, landlords will need to be sure that they can deliver the required accreditation with the relevant rating, and occupiers will need to understand what might be needed to maintain a rating, the constraints that might place on their use and occupation and the cost implications.

The advice of sustainability professionals will be crucial to both property owners and occupiers, before, during and at the end of a lease.

Green leases

Green leases are a key resource enabling landlords and tenants to work collaboratively to develop sustainable practices and to clearly identify the roles and responsibilities of both parties in achieving sustainable occupation and operation of a building.

Green lease provisions can cover everything from data sharing, reducing energy and water use, working to achieve net zero targets, waste management, selection of materials and products (covering cleaning products, as well as building materials), transport incentives, setting up and participating in tenant forums, safeguarding or improving EPC ratings, use of sustainable utility providers and anything else that a landlord and/or tenant can control to have a positive impact on the sustainability of a building.

The level of obligation can vary. Leases may be 'light green' (lighter touch, even statements of intent as opposed to active covenants), 'dark green' (most prescriptive and/or with more stringent requirements), or anywhere between. The requirements may all sit in the lease itself, or in a side letter/document, the latter allowing the flexibility to update (without a formal variation of the lease) to accommodate the rapidly changing environmental landscape. It often comes down to a careful balancing of interests of both landlord and tenant, together with other factors such as the length of the term, the parties involved and the type of property in question.

Landlords may have requirements that they need to impose; driven by corporate, governance, investor and regulatory factors, and as a result of having secured green lending (see our briefing note for more details) - and whilst tenants may have similar drivers, as the ultimate occupier of the space they also need to ensure they can comply in a way that does not unduly impact their ability to operate their business. The anticipated cost of compliance is usually a key, if not the principle, focus of negotiations – particularly in the current period of economic uncertainty. Key to achieving balance is early dialogue and agreement of principles.

For further information about green leases, see our Green Lease Playbook.

Data collection

Buildings are becoming increasingly 'smart' with the introduction of building management technology. This enables them to be run more efficiently as well as deliver an improved user experience (e.g. temperature, air quality, lighting and humidity monitoring and control in real time). It also allows the easy collection and analysis of data, frequently via sensors, to identify trends. This information can then feed into wider ESG reporting and forecasting.

It is usual to see at least some level of data sharing obligations in leases, whether active, or by way of consent to the collection of data at source from the building management systems or direct from utility providers. Tenant's data security and GDPR concerns can usually be mitigated by the incorporation of contractual protections. Data is an essential part of the drive towards net zero, and so a landlord's ability to access this quickly is crucial.

Social and Governance

Specific social and governance requirements are far less common in leasing transactions. However as businesses increasingly publicly commit to their ESG targets, leases are being used as a means of achieving wider ESG objectives.

Commitments might range from community engagement and creation of community spaces, obligations to make charitable donations, to committing to paying staff at least a living wage, anti-slavery promises and supply chains. It's an emerging area, so watch this space.

Conclusion

Albeit established, ESG considerations for landlords and tenants is a rapidly developing area, and we are increasingly seeing requirements on both sides. Given the scope for benefit for all parties, including stakeholders, the environment and society at large collaboration between property owners and occupiers will be key.

Victoria Towers
Partner
Commercial Real Estate
T +44 20 7863 8462
E victoria.towers@forsters.co.uk

Lorna Dolan
Senior Associate
Commercial Real Estate
T +44 20 7863 8374
E lorna.dolan@forsters.co.uk

Louise Irvine
Senior Knowledge Development Lawyer, Commercial Real Estate
T +44 20 7399 4778
E louise.irving@forsters.co.uk

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