

Insights

ADOPTION OF GREEN LEASES IN HONG KONG SAR – PART 2

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Leases which contain provisions on sustainable obligations for landlords and tenants are becoming more commonplace in various markets. In Part 1 of this series, we reviewed the key issues for landlords and tenants to consider when preparing the broad terms of a green lease in an office or retail context, including:

- the sustainability standards to be adopted,
- method of incorporation of green terms and
- the types of obligations which may be imposed on tenants.

We also noted that there is now a much stronger market trend recognising the need for parties to incorporate more substantive obligations to promote more sustainable operations. A core part includes monitoring obligations which are essential for collecting data that enable the parties to track environmental performance and action sustainability strategies accordingly. In connection with such strategies, market players have also recognised that negotiation and cooperation between landlords and tenants is crucial, especially considering that measures for environmental management can be highly fact-sensitive and dependent on particular features of the premises and the needs of the parties.

In this article and based on experiences in HK SAR and overseas, we will consider some specific drafting considerations and best practices for leasing documentation, such as monitoring of environmental performance, obligations relating to fit-out, alterations, renovations and reinstatement. It is our view that an ideal green lease in the local market should involve collaborative dialogue to include as many of these best practices as possible. As you will see from our analysis below, we are seeking to present both landlord and tenant considerations.

MONITORING OF ENVIRONMENTAL PERFORMANCE AND PERFORMANCE TARGETS

We strongly suggest including provisions on the specific “monitoring” of the use of utilities and waste management in a green lease. Such information is critical for the landlord to assess the

consumption and emission patterns of the relevant building and premises. Based on the data collected, landlords and tenants should then develop sustainability targets, based on which the parties (mainly the tenants) should adjust their energy usage and/or waste disposal habits. Generally, lease terms relating to monitoring of environmental performance and performance targets are likely to include “reporting” and/or “behavioral” provisions:-

- a. “Reporting” provisions refer to requirements for the tenant to keep a record of and provide information on its use of utilities and/or waste management over a given period at regular intervals or at the landlord’s request. A common reporting obligation would be collection of metering data, which will be further considered in paragraph 3.2. As an alternative, other best practices for measurement of energy performance include the following:
- Electricity: Tenants may be required to provide their electricity bills at regular intervals
 - Water: Tenants may be required to provide their water bills at regular intervals and/or report the number of water taps in the premises and their respective efficiency ratings
 - Waste: Tenants may be required to request their cleaning contractors to record and provide data on the amount of waste that has been collected (which is usually measured by weight). Tenants may also be required to report the percentage of waste that has been recycled rather than sent to landfill
- a. “Behavioral” provisions refer to requirements for tenants to comply with targets for improvement in environmental performance. For example, tenants may be required to ensure that electricity usage in a given period meets fixed targets, or to ensure that such usage is lower than a preceding period by a certain percentage.

We have seen a broad range of drafting options for both reporting and behavioral provisions. In particular, we suggest parties in the Hong Kong SAR market to consider the following issues:-

1. Opt-in mechanism:

In the local market, we note that some major commercial landlords have begun adopting an “opt-in” mechanism for green performance obligations. For example, landlords may invite tenants to join an optional green scheme and provide rewards for tenants who are able to meet the targets stipulated in the scheme. Indeed, this may be a welcome approach as green leases remain relatively novel in the market – a “soft” launch of green obligations with positive incentives might be more attractive to tenants. From a drafting perspective, schemes of this type should clearly set out how compliance with sustainability targets are to be measured and the manner in which the data should be reported to the landlords (e.g. type of evidence required and frequency of reporting). Needless to say, the scheme should also set out the criteria for providing rewards to tenants including the time limit in which certain targets should be achieved.

Drafting considerations for tenants: For tenants, assuming that this is an opt-in scheme, they should preferably also look for language that the scheme is voluntary and clarify if any failure to achieve the sustainability targets will not amount to a breach of the underlying lease. Further, if the rewards are genuinely beneficial to the tenant community, then tenants will want to know exactly how it can “win” and share the benefits with the occupants who strive to achieve the relevant targets.

2. Extent of collaboration between landlord and tenant:

Parties may consider including provisions on consultation or collaboration on the development of sustainability targets. The extent of collaboration between the parties may vary, ranging from stipulating regular meetings to discuss sustainability performance to more ad hoc arrangements. Provisions of this type should typically cover the platform for collaboration (e.g. designation of tenant representatives and meeting arrangements), frequency of meeting, the objectives of collaboration (e.g. annual targets) and the information to be shared in these meetings.^[1]

Drafting considerations for tenants: Tenants should carefully consider whether the method of collaboration between the parties is aligned with its corporate strategy as well as its resources. For example, some tenants may in fact favour more stringent sustainability obligations and therefore prefer more involvement in formulating the sustainability targets and strategies for their leases, as a result of third-party requirements such as the terms of a sustainability-linked loan. On the other hand, some tenants may not have sufficient resources to designate a representative to review relevant data on their sustainability performance and have regular discussions with the landlord on related issues.

3. Confidentiality of data collected:

It will be preferable for parties to clearly set out the purpose for which the data relating to use of utilities and/or waste management will be shared and used.

Drafting considerations for tenants: Tenants may prefer ensuring the confidentiality of such data so that it is not openly shared with other tenants without their prior consent.^[2]

INSTALLATIONS AND ALTERATIONS

1. General installations and alterations

The fit-out of premises may affect the environmental performance of the premises and/or the building. For example, the landlord may wish to install new items in the premises with sustainable features, and/or ensure that certain existing installations will not be altered by tenants. Query also if a landlord’s building management manuals can encourage the use of modular fittings and less “built-in features” to maximise opportunities for re-cycling or re-using. It is perhaps complex in

practice but a new challenge for interior designers.

In view of the above, lease terms relating to installations and alterations may cover the following:-

a. **Alterations by tenants:** Tenants tend to be generally prohibited from altering the premises unless certain sustainability-related criteria are complied with. In the local market, office/retail leases already tend to contain some form of general restriction against installations, alterations and major renovations. The restrictions against alterations in green leases may follow a similar formulation – it can simply be added as a criterion for the landlord’s approval of alterations and/or fit-out plans.

Drafting considerations for tenants: For this type of drafting, as the concept of “sustainability” is potentially wide, tenants may wish to narrow down this criterion, for example with reference to specific sustainability standards which are set out in the fit-out guide of the landlord. On the other hand, some green leases contain blanket prohibitions against the use of specific types of materials – for this type of drafting, tenants should carefully consider whether it will be able to work with the landlord’s strict requirements.

b. **Alterations by landlords:** Landlords usually insist on provisions entitling themselves to enter the premises in connection with improvement of environmental performance. As an example, a landlord may insist that it has the right to do the following:-

- carrying out works that serve to improve environmental performance, including installation of equipment and technologies at the premises;
- measuring consumption of utilities at the premises and/or carrying out energy audits; and
- doing anything in compliance with relevant environmental legislation and regulations.

Drafting considerations for tenants: Tenants should generally ensure that it receives prior notice of any inspection of or installation at the premises – understandably, having quiet possession and enjoyment of the premises is often crucial for a tenant’s operations. Tenants may consider negotiating with the landlord for an appropriate notice period for the landlord to advise the tenant of the details of the installation(s) to be made and the timing of such installations in advance. Tenants may also consider including a proviso to ensure that the landlord shall not disrupt the business and operations of the tenant at the premises while making the relevant installations.^[3]

2. Installation of metering equipment

The availability of metering equipment will have an impact on the type of environmental performance data collected. Assuming that the relevant buildings do not currently have separate meters for the tenant premises, we suggest including provisions which contemplate the installation of metering equipment by the landlord or by the tenant.

Drafting considerations for tenants: The drafting of this installation clause will depend greatly on whether the landlord or the tenant is responsible for carrying out the installation works. Either one of these positions is possible though installation by the landlord is more common:

- a. Where the landlord is responsible for installing metering equipment, the drafting considerations here will be similar to those of general installations by the landlord as discussed in paragraph 3.1(b) above. In addition, another issue for tenants' consideration is how the "trigger" event for installation by the landlord may be formulated: tenants may wish to negotiate for a right to request the landlord to install the relevant equipment so as to facilitate the tenant's data collection and sharing obligations. However, for installations initiated or requested by the tenant, the tenants are generally expected to bear the landlord's (reasonable) costs of installation.
- b. Where the tenant is responsible for installing meter equipment, as the equipment facilitates data collection and can be considered mutually beneficial to the parties (if not more beneficial to the landlord), tenants may seek to negotiate for more pro-tenant drafting for this clause when compared to the general installation and alteration clauses in a lease. For example, the tenant may negotiate for a right to access common parts of the building to facilitate the installation.^[4]

REINSTATEMENT

At the expiry of a lease, tenants generally have an obligation to hand back the premises in a condition stipulated by the landlord (often bare-shell condition), which also typically involve reinstatement and removal of any installations made by the tenant and its fittings. Reinstatement is not only potentially costly to tenants, but may also create unnecessary waste. We therefore suggest including wording in the yielding up and reinstatement clause of a lease to take the following into account:^[5]

- a. Prospective use of the premises: In the event that the current fit-out of the premises is in line with the intended use of the premises by prospective tenants, the existing tenants should initially not have an obligation to remove the current fit-out. However, there should be discussion on whether the landlord can seek an alternative tenant who will adopt substantially all of the existing fit-out. The outgoing tenant may then be relieved of its obligation to reinstate. If, however, after a set period of time, reinstatement is required, there should be clear obligations to maximise any recycling options for construction waste and re-use of certain fixtures. Please note our further comments on this topic in item (c) below.
- b. Impact of reinstatement on environmental performance: Where the removal of certain installations at the premises will be detrimental to the environmental performance of the premises and/or the building, such as the removal of equipment that enhances the monitoring of environmental performance or promotes energy efficiency, the tenants should not have a right or an obligation to remove those installations.

c. Sharing of risks between the parties: Another option for a landlord to consider is to agree a set contribution amount (payable by the tenant) and a period of time for limited reinstatement which shares the risks between the landlord and the tenant. This approach allows the landlord to exercise its judgment on what needs to be done in preparation for the next tenant. The outgoing tenant leaves this exercise entirely in the hands of the landlord and walks away having “paid its agreed contribution”. The landlord then must do what is the most environmentally appropriate reinstatement as needed in the circumstances. If the fit-out obligations have required sensitive use of materials or modular type features with less “built-in” furniture, then perhaps there will be less waste and greater re-use or recycling on a termination or expiry of the lease.

Drafting considerations for tenants in respect of reinstatement obligations: As a tenant’s installations at the premises may be valuable to its business, there might be considerable difficulties in aligning the interest of landlords and tenants in relation to the landlord’s right to retain a tenant’s installations for the purpose of sustainability. The drafting of this provision is therefore fact-sensitive depending on the types of fittings and installations which the tenant intends to install at the premises. For example, tenants may negotiate for limitations to the landlord’s right to retain the tenant’s installations by way of:

- a. exempting certain items which are specified by the tenant from the retention provision; and/or
- b. ensuring that the landlord’s discretion regarding the installations to be retained shall be exercised reasonably and with prior notice.

RENEWABLE ENERGY

Hong Kong SAR has an unusual characteristic which does not offer a choice of power provider to tenants. At this stage, it is hard to impose transformational obligations on a tenant to use renewable sources of energy or for a tenant to impose such obligations on the landlord! That being said we are starting to see some use of solar panels and energy embracing technology which uses renewable sources of energy. Hong Kong SAR has a long way to go in this regard but hopefully we will see significant improvement in the medium term.

SUMMARY

As green leases remain relatively new in the Hong Kong SAR market, it remains to be seen how sustainable obligations will be entrenched into local leases and how best practices will evolve. We hope that the above observations will serve as a reference point for parties to open up dialogue on how they may incorporate sustainable obligations into their leases.

Creative collaboration is key.

- [1] Better Buildings Partnership (UK) 2013, Green Lease Toolkit, accessed 22 August 2022, <https://www.betterbuildingspartnership.co.uk/sites/default/files/media/attachment/bbp-gltk-2013_0.pdf>
- [2] Hong Kong Green Building Council 2014, Green Tenancy Driver for Office Buildings, accessed 22 August 2022, < <https://www.hkgbc.org.hk/eng/engagement/guidebooks/green-tenancydriver/index.jsp> >.
- [3] Better Buildings Partnership (UK) 2013, Green Lease Toolkit
- [4] Better Buildings Partnership (UK) 2013, Green Lease Toolkit
- [5] Better Buildings Partnership (UK) 2013, Green Lease Toolkit

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