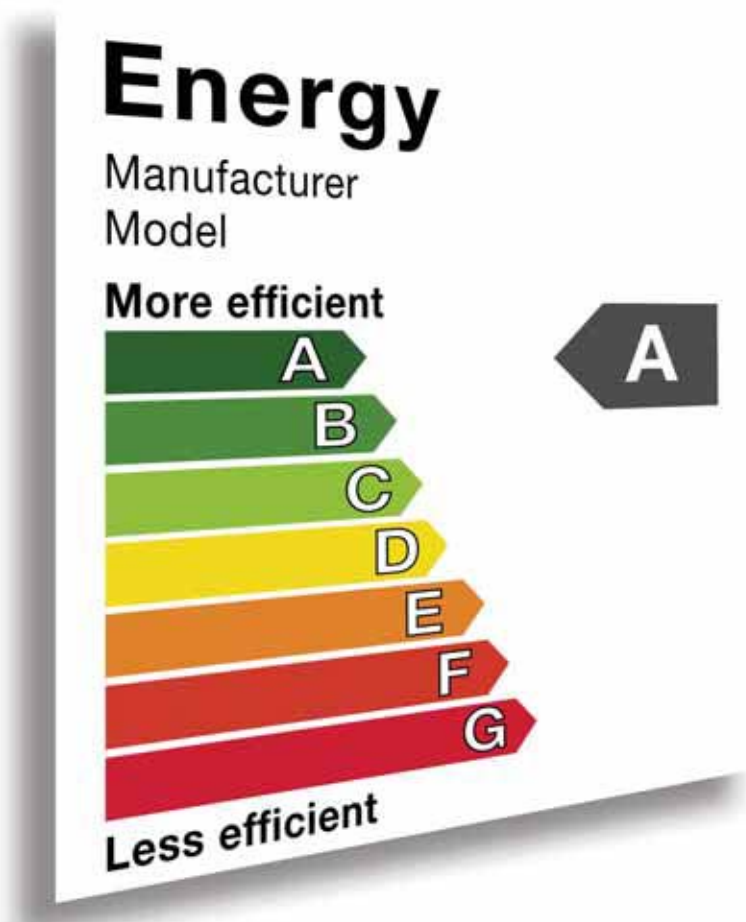


Sustainability

BULLETIN

current issues in the real estate
and construction industry



Environment:
Beyond Compliance –
a Strategic Issue

The “Merton Rule” -
How will it affect
the construction and
development industry?

Planning for Climate
Change - once there
were Two, now there
are Three

Is the FRI Lease
turning green?

Sustainability in the
Construction Industry

It’s not just about
the Buildings...

Show me the money

Contents

page 4

Environment: Beyond Compliance – a Strategic Issue



page 7

The “Merton Rule” - How will it affect the construction and development industry?



page 9

Planning for Climate Change - Once there were Two, now there are Three



page 12

Is the FRI Lease turning green?



page 15

Sustainability in the Construction Industry



page 17

It's not just about the Buildings...



page 19

Show me the money





Welcome

There is no doubt about it – sustainability is a hot topic in the construction and development industry.

Welcome to our bulletin on the subject, which we think is most timely. Even a very cursory reading of the press since the beginning of the year reveals the high level of interest in the topic – for example:

- the letter of 28 January from the Construction Industry Council – signed by no less than 27 of its 31 Full Members - concerning the industry's commitment to the conclusions of the Bali conference and the Government's targets to reduce carbon emissions;
- the publication of a report "Delivering the Low Carbon Economy - Business Opportunities for UK Manufacturers" by Deloitte and EEF, which finds e.g. that the market for wind farms off the British coast could generate revenues of £2bn p.a. and the carbon capture storage market could be worth £20bn p.a. by 2030. This follows hard on the heels of the EU's publication of a proposed Directive to regulate CCS and the introduction of the Energy Bill (which also deals (amongst other things) with CCS) into the legislative procedures at the beginning of the year;
- the second reading of the "Merton Bill" (which we talk about in Liz Graham's article "*The "Merton Rule" – How will it affect the Construction and Development Industry?*").

The question of how to define sustainability is an issue in its own right. There are several available definitions although the 1987 Brundtland Report definition seems to be the most generally accepted one. Nonetheless sustainability plainly extends well beyond minimising climate change and includes more general corporate social responsibility issues as well. Paul Smith looks at this in more detail in his article "*It's not just about the Buildings...*"

Of course, there always have been companies with an interest in sustainable development. At the most basic level, for example, even decades ago there were developers who used to prohibit use of tropical hardwoods in their developments. Things have moved on since then and most companies of any size will have environmental and sustainability policies with which they will want their partners in the supply chain to comply. The question of what developers and contractors can and should do is something Francis Ho looks at in more detail in his article "*Sustainability in the Construction Industry*".

Increasingly however, sustainability is not just an optional extra – it is mandatory. We are all aware of, for example, the requirements of Part L, the EU Directive and related UK Regulations relating to energy certification of buildings, and (in the pipeline) the Climate Change Bill. We must not forget about the impact of planning requirements concerning sustainability on proposed developments and this is something Alistair Watson addresses in his article "*Planning for Climate Change: Once there were Two, now there are Three*".

Nonetheless, sustainability has obvious commercial as well as legal impacts. For example, the Corporate Real Estate Study published last month by the CBI and GVA Grimley indicated that approximately three fifths of those questioned would pay more rent for an environmentally friendly building – mostly because it would help cut energy costs, but also because it would help them achieve their CSR objectives. Pranai Karia looks at green issues in landlord/tenant relationships in his article "*Is the FRI Lease turning green?*"

The economic aspects of sustainability and consideration of the long term impact it can have on companies' brands and reputations is something Paul Sheridan considers further in his article "*Environment: Beyond Compliance – A Strategic Issue*".

Our final article in this Bulletin (Ian Insley's "*Show me the money*") raises the question of how sustainability measures are going to be funded in the short term.

Sustainability affects all aspects of our businesses and there are myriads of issues to consider. We hope you find this bulletin interesting and thought provoking. If you'd like to discuss any of the topics covered please do give any one of us a call.



Victoria Peckett

victoria.peckett@cms-cmck.com
T 020 7367 2544

Environment:

Beyond Compliance – a Strategic Issue

Whilst environment is one of the three pillars of sustainability, currently it dominates the sustainability agenda and may do for some time to come. Questions explored in this article are why has environment become so dominant and what are the major commercial consequences of the most recent legal and policy developments?

Environment policy is rapidly producing an immense amount of law which we would like to explore but unfortunately size constraints prohibit this in this single article.

Environment Law – third phase

It is helpful to understand a little of the background to the current explosion of environment law and policy. Environment law has developed in roughly three phases, corresponding to the perceived immediate needs and willingness of legislatures to pass legislation in the particular phases. Those deeply involved in environmental law will readily appreciate that the first phase of modern environment law (say from the mid 1970's) was primarily concentrated on end of pipe pollution control. The second phase concentrated on regulating and permitting those activities most immediately dangerous to the environment. These phases tended to leave an impression that harm to the environment was a heavy or intensive industry issue; it was someone else's problem.

We are now in a third phase. It is radically different. Unlike the first two phases which were essentially liability based, this phase is an utterly pervasive commercial and behavioural change

regime. Leaders of governments, commerce and industry share a similar view, namely that this is an across the board issue, where all are culpable and all are victims. No business sector will remain untouched. Those with vision appreciate, in short, that it is this phase which is the platform for the end of "business as usual".

Macro Drivers – dramatic change

Those aware of the environment agenda have known for quite some time that the twin dangers of climate change and unsustainable resource consumption would ultimately prove much too powerful to allow commercial and political inertia to continue. Well advised commercial and political leaders have known that anthropological climate change is and was, using a legal term, foreseeable from 1990 (at least). Whilst debate on anthropological climate change still occurs this debate tends to be at the margins. In real terms the debate is over and a well advised organisation would not think otherwise. In the media, resource consumption tends to be overshadowed by climate change but the more visionary commercial and political leaders are acutely aware that current global consumption of many materials is



Paul Sheridan
paul.sheridan@cms-cmck.com
T 020 7367 2186

unsustainable and that climate change and resource consumption are interlinked. Some commentators calculate that we are consuming the earth's resources at a rate as if we had three planets rather than one planet.

Convergence of Drivers

The dangers of climate change and unsustainable resource consumption have not been enough by themselves to cause the legal and policy changes that we are currently seeing. Other drivers, or vehicles, were also required. I would suggest that three of the most important of these are:-

Security of energy supplies

Climate change and energy resource supplies are very closely linked with the major debate on security of energy supplies. Reliance by the West on potentially unstable overseas supplies of oil and gas is a clear danger. The two drivers have forced governments to consider laws and policies looking at both encouraging energy generation from non fossil fuel sources (such as nuclear and renewable energy) and energy efficiency (witness the Energy Performance of Buildings Directives and various instruments dealing with energy using products).

Monetisation

This is a tremendously important development. Readers will recall the Stern Report which stated that climate change was the "greatest market failure the world has ever seen". The Stern Report was the first major work to seek to cost climate change risk. Notably, whilst the Report has been criticised in part by very influential academic economists, such criticism has related to application of accounting principles and not the basic concepts of the need economically to address climate change before it gets much worse.

Across the Western world there are now numerous legal, fiscal and economic instruments directed at "internalising the externalities" (i.e. costing the harm to the environment) into products and services (including real estate and construction). Many of these instruments work well, others are rudimentary, some are poorly designed and are no further along than the stage of initial drafting. Importantly, we have merely seen the tip of these potential instruments; a whole lot more is yet to come.

The message to commercial and corporate strategists is loud and clear. Harm to the environment is being monetised.

Cleantech

Much of the most recent domestic and EU legislation relating to the environment (including for instance the Energy Performance of Buildings Directive and the Water Framework Directive) include two potentially very important concepts, both of which are beloved by the environment movement. These are (a) mandatory periodic reviews of the effectiveness of the legislation by the domestic or EU legislatures, and (b) a requirement in such reviews that developments in cleantech be taken into account (i.e. if cleantech develops so that, for instance, renewable energy or better materials, are economically, technically or environmentally feasible, then such developments may become legislative requirements – put another way, legislation should keep abreast of state of the art cleantech). It is notable, for instance, that the EU is already

"No business sector will remain untouched. Those with vision appreciate, in short, that it is this phase which is the platform for the end of "business as usual"."



“The Sector is growing very strongly and is attractive to governments and finance. It is fairly easy to appreciate that a sector such as this, which virtually all governments see as a win win sector, will have a powerful influence over policy and legislation.”

reviewing the Energy Performance of Buildings Directive and appears to be strongly of the view that many Member States have not implemented the Directive appropriately.

When looking at cleantech some words of warning are appropriate. Cynicism abounds in relation to the performance and reliability of renewable energy and generally the costs of cleantech. It might be advisable to test this cynicism. Potentially very impressive cleantech developments, using for instance nanotechnology, are occurring and costs of certain cleantech products are coming down or are appearing more attractive as costs of the traditional increase. Further, the implications of some of the current and planned environment laws are aimed at shifting some of the current emphasis on capex, to a mixture of capex and opex with internalisation of carbon costs.

As a sector itself, the environment sector (which includes the cleantech) is huge (conservative estimates put the size of this sector at US\$700 billion annually by 2010). The Sector is growing very strongly and is attractive to governments and finance. It is fairly easy to appreciate that a sector such as this, which virtually all governments see as a win win sector, will have a powerful influence over policy and legislation.

Commercial consequences

This may be an unusual comment for a lawyer. Whilst compliance with this third phase of law and policy is, of course, important, in truth commercial risks and opportunities are far, far more important than mere compliance.

Maintenance and enhancement of brand, reputation and asset value are clearly at risk. Those who fail to keep up with the agenda may find both patent and latent commercial impacts on the business. The greening of procurement is a very noticeable trend, as is green benchmarking.

In real terms, the current environment agenda is shifting from being a compliance/ operations/CSR issue, to being a commercial and corporate strategic issue. The best run corporates are looking to ensure that not only are their businesses future proofed (to the extent reasonably possible) but also that such businesses can benefit (where relevant) from the numerous commercial opportunities which are arising from this phase.

For a convenient example of the above, let's look at one relevant aspect that will arise for CMS Cameron McKenna. Our firm has approximately 14 offices in the UK and overseas. A recent carbon footprint audit revealed that approximately 79% of our CO₂ emissions arise from just one of our buildings, namely our HQ in London. In 7 to 8 years time, our lease of this building will come up for renewal. In this intervening period our firm will be caught by the proposed cap and trade Carbon Reduction Commitment scheme. As 79% of our emissions arise from this one building, clearly for the first time, emissions issues are likely to play a part in our deliberations on the lease renewal. For our firm, this will not be a compliance

issue. It will be a commercial issue. From the perspective of the landlord, again the landlord will have to address commercial issues, which had not previously arisen. The landlord is likely to need to have developed a commercial strategy to cater for these discussions. This one example will be replicated many times over. It is not merely existing buildings which will be examined in this way but new buildings may be best designed for the future and not merely the current.

Uncertainties

Finally, a word about uncertainties. This third phase will give rise to numerous uncertainties and, no doubt, a fair number of surprises in the implementation and interpretation of the laws and policies. Whilst this is no different from the implementation of many new laws in any area, I suspect that there will probably be more uncertainties and surprises in this arena than is comfortable. For the real estate sector, commercial risks will arise if only because of the long-term nature of built assets. I do not see any particular comfort that can be given in relation to these uncertainties. What I think we need to be clear about, however, is that implementation of this phase will not stop in order to allow for clarification of all such uncertainties and surprises. Corporate and strategic planners would be advised to work on the premise that implementation will carry on.



Liz Graham

liz.graham@cms-cmck.com

T 020 7367 2903

The 'Merton Rule'

How will it affect the construction and development industry?

At the end of last year a group of cross party MPs introduced a Private Member's Bill to Parliament seeking to reinforce the "Merton Rule" in an Act of Parliament. This Bill passed its second reading on 25th January 2008 - although whether or not the Bill becomes law is a matter of pure guesswork at this stage.

However, the "Merton Rule" does seem to be here to stay. So what is the "Merton Rule" and how will it impact on the construction and development industry?

What is the "Merton Rule"?

In simple terms it is a requirement that in relation to all non-residential developments above a certain size at least 10% of the energy to be generated by those developments should be provided on site from renewable sources. This 10% rule was first pioneered by the London Borough of Merton in 2003 in its then Unitary Development Plan.

Wider endorsement

To date approximately 140 local authorities have now adopted the "Merton Rule". For one local authority to instigate a change that has become a national change is ground breaking.

The Rule has also not only been endorsed by Government Ministers but also the recent Planning Policy Statement ("PPS") on climate change (to which Alistair Watson refers in more detail in his article in this Bulletin) actually requires councils to adopt the "Merton Rule" style policies in order to procure greater renewable energy use in non-residential developments.

The PPS does not refer to a specific percentage. Instead local authorities will have autonomy to negotiate their own local targets (and obviously there are different number of variables which need to be considered in relation to each individual area and whether certain types of renewable energy would actually be workable in that area).

Conversely some local authorities have actually gone further when adopting the "Merton Rule" and have gone on to demand a target of 15% rather than 10%.

How does it work in practice?

Basically a developer will need to look at the likely energy consumption per square metre for the buildings being constructed. There is then a calculation of the likely carbon emissions from the scheme. This will differ depending on whether the heating is produced with gas or electricity. Electricity supplied heat produces more carbon dioxide emissions than gas so the amount of renewables required to generate 10% of the development's raw energy need would increase.



The focus is therefore on a development's lighting and heating requirements. In fact in the first development where the "Merton Rule" was implemented in 2004 it was only possible to assess the lighting requirements at the time planning permission was granted. The 10% target was met by the developer installing micro turbines and solar panels to deal with the "lighting emissions". The developer was also required to provide a cash fund as part of the section 106 agreement with this pot being made available to occupiers so that they could install energy efficient systems in due course once the heating requirements were known.

"Conversely some local authorities have actually gone further when adopting the "Merton Rule" and have gone on to demand a target of 15% rather than 10%."

Issues for developers to think about

There are a wide range of issues including:

- How will the 10% target be met on any particular development?
- Persuading local authorities to adopt a different and more specific target for a particular scheme in accordance with the PPS (for example is the site more appropriate for wind turbines than some other form of renewable energy)?
- Will the developer be installing the wind turbine or other appropriate equipment or will this need to be undertaken by a specialist third party? If a specialist third party is to be used, what are the consequences for the developer in the event of that party defaulting on its contractual obligations?
- Who will be responsible for ongoing maintenance and repair of the renewable energy source? Will there be separate "supply contracts" between occupiers and the supplier or will this all be dealt with under the service charge regime with the developer/landlord being primarily responsible for making sure energy is supplied?
- What sort of back-up facility should be installed to cater for the possibility of the energy to be supplied being interrupted and to what extent can occupiers be granted step-in rights where their businesses might be particularly adversely affected in the event of non-supply of the energy.
- Will local authorities accept that some form of "off site" provision is acceptable instead of the "on site" provision required by the "Merton Rule"?
- What will be done with any excess energy generated?

Why should developers embrace the Merton Rule?

Firstly there may well be a number of advantages including the obvious in terms of greater community benefit and corporate social responsibility. Secondly, in any event, developers are unlikely really to have any choice in the matter!



Planning for

Climate Change

Once there were Two, now there are Three



Alistair Watson

alistair.watson@cms-cmck.com

T 020 7367 3890

“In planning terms, the construction and development industry is of fundamental importance in delivering sustainable development.”

There are many certainties in the construction and development world. In the wider world, perhaps there were only ever two: life and love. We should now add a third to those two – Climate Change.

In publishing its Planning Policy Statement (PPS) on Climate Change in December 2007, the Government chose to bring to the fore a statement issued by the then Prime Minister, Right Honourable Tony Blair MP in 2005. “Climate Change represents a potentially catastrophic threat, but it is within our control to address it – and address it we must.”

That particular quote brings the reader’s attention to the role that society has to play in preparing for the effects of climate change. The PPS on Climate Change is the Government’s national planning policy statement which explains the role that the development industry, with its stakeholders (whether land owners, developers, construction companies, investors, or tenants) needs to play in planning for and delivering sustainable development.

In planning terms, the construction and development industry is of fundamental importance in delivering sustainable development. It provides new homes and new buildings; it supports business development which is necessary to create jobs and prosperity; and it delivers infrastructure which provides transport, energy and water. Government policy in the PPS recognizes that the United Kingdom and its economy must continue to evolve and prosper. Climate Change does not mean, and Government policy does not mean, that we stop development. It does not mean that we stop building. It does not mean that investment should stop. What it means is that the construction and development industry must operate and plan in a different way. Put simply, a development’s impact on climate change is not a reason for refusal of planning permission; rather, a proposed development’s failure to take into account Government policy in PPS



on Climate Change may be a reason for refusal.

The PPS makes two particular points: planning and development should contribute to reducing emissions and stabilizing climate change, and take into account the unavoidable consequences of climate change. Secondly, applicants for planning permission should consider how well their proposals contribute to a low carbon economy, and how well adapted buildings are for climate change. For the industry, the need to consider the entire life of a building from cradle to grave, or from concept to build and beyond, is now more important than ever. The need for team members with differing disciplines (project managers, quantity surveyors, building surveyors, real estate, construction and planning lawyers, investors and developers) to continue to work as, what Sir Clive Woodward commonly called, “One Team”, is paramount. The One Team approach has a single objective – for example, to develop a building which in itself is carbon neutral and is built to be able to adapt the changing weather patterns and those effects (e.g. increase in solar gain from hotter weather, less rain which leads to the increased importance of water harvesting technology). In order to develop land or buildings in accordance with national policy, the industry has to plan, adapt and evolve. This has a significant

advantage – you take into consideration PPS on Climate Change in planning your scheme, you should get permission to develop land and buildings quicker.

Taking the approach in different stages:

Site Selection

Whether it is a new (greenfield) site or an existing (brownfield) site, or the building is for redevelopment in which case your site is chosen for you, we need to consider a number of matters in the site selection process.

For example, could the planned development link into de-centralised/ renewable/low carbon energy supplies? The fact that this may be redevelopment of a site in the middle of the City of London should not prevent that development from plugging into an energy supplier which is able to source energy from renewable sources. What are the known physical environmental constraints on the development of the land? Is there a flood risk? What impact will a drier climate have on the stability of the land; whilst large parts of North London’s buildings are built upon London clay, which when drying up can lead to instability, those buildings are already in place. Local planning authorities in considering proposals for new development need to consider the extent to which climate change will affect land stability and what can be done to combat that. In

“The One Team approach has a single objective – for example, to develop a building which in itself is carbon neutral and is built to be able to adapt the changing weather patterns and those effects.”

addition, if you are developing in an area of “water stress” – the new term for water shortage – then what provision can be made for water harvesting technology on the building or buildings for water to be reused and so potable water demand is subsequently reduced! What contribution can the development on that site make towards urban cooling (the principle of incorporating open space into the development and built up areas so that heat peaks in cities are lessened)?

Finally, what impact does this assessment exercise have on the price of land and its attractiveness as a development site? The site selection process, by its status in the PPS on Climate Change, is elevated to one of significant importance – if you pick a poor site that fails to measure up to what planning policy requires you to assess, then the development is poorly

“There will, inevitably, be some gaps between what developers will want to provide and what the planning authorities will be expecting to receive.”

sited in the first place and may well fail to get planning permission for development.

Scheme Design

The issues here are similar to the site selection process but they will require further and considered thought with “One Team” as to what design and future proofing is incorporated into the building. For example, how can the use of natural light during daylight office hours be incorporated into the running of the building so that the energy use is reduced? Is there room within the scheme or on the site for a combined heat and power plant? What water harvesting technology is suitable for the building and how can that be incorporated into the design of the building so that, for example, it is prevented from becoming a visually dominant feature that requires maintenance at great expense? Does the site provide the space for facilities for re-use and re-cycle? Can all of this kit be easily replaced and who would pay for it? Once it is established as a design principle, can that kit be rolled out across a property portfolio so that the technology is then a commodity?

There will, inevitably, be some gaps between what developers will want to provide and what the planning authorities will be expecting to receive. There is still the natural tension between “theory” or the “wish list” versus what is practical and feasible. Fortunately, PPS on Climate Change places weight upon the fact that planning authorities will have to

consider precisely what is feasible and practical. As such there is no “one size fits all”; planning authorities will still have to take into account the scheme on its own merits and what is practical or feasible on that site.

Mitigation

Site selection and scheme design are now part of the planning mitigation process – the way in which a development scheme can be mitigated is fundamental in obtaining the confidence of the planning authority which then results in planning permission. By the time a development scheme gets to the point where it is submitted to a planning authority then the site selection and scheme design processes should illustrate that, along the way, PPS on Climate Change has been “built in” to that design. The resulting planning conditions, and planning obligations if necessary, should then reflect the fact that the scheme’s ability to react and be resilient to climate change has been built in. The resulting mitigation package at the planning permission stage may well be, as a result of site selection and scheme design, less complex and easier to manage as part of the build out process.

Is the FRI Lease

turning green?

The requirement for Energy Performance Certificates and, in relation to public buildings, Display Energy Certificates has resulted in a greater focus on the relationship between landlords and tenants and the use of energy in buildings in the context of climate change.

Over 40% of energy consumed in the UK is used in buildings (and therefore a considerable proportion of carbon emissions derives out of the energy used in buildings). The Government intends to consult on the introduction of DEC's to the private sector.

With this background there is increasing debate about the nature of commercial leases and whether they assist or discourage green initiatives.

A reminder

Energy Performance Certificates will apply to larger buildings (over 500 square metres) and to all newly constructed commercial buildings from 6 April 2008, and then to all non residential buildings from 1 October 2008. EPC's give an asset rating that will last for ten years showing (as in relation to white goods) the energy efficiency and environmental impact of the building in terms of carbon dioxide emissions. Grade A will be the most efficient and Grade G the least. A certificate will be required for every building that is built, sold or let. There are questions that still need to be clarified, for example, is a certificate required for a whole building where the tenant of one floor is intending to assign its lease?

Display Energy Certificates show an operational rating for a building. This is derived from meter readings showing the consumption of energy during the occupation of a building over a twelve month period.

Air-conditioning systems in a building with a collective cooling capacity of more than 12kw must be inspected at regular (at least five yearly) intervals by an accredited energy assessor. Again this is being introduced in stages. For systems of more than 250kw the first inspection must have occurred by 4 January 2009 with all remaining systems inspected by 4 January 2011.

Assessors who produce EPC's or DEC's or inspect air-conditioning systems have to be approved through an accreditation scheme and will produce recommendations/ advisory reports on how the performance of the building might be improved.

The government is due to introduce the Carbon Reduction Commitment to large commercial and public sector organisations. Such occupiers will be keen to see their emissions cut, and where they occupy as tenants will want commitments from landlords to assist them in achieving their CRC targets.



Pranai Karia

pranai.karia@cms-cmck.com

T 020 7367 2742

Why leases?

The Centre for Research in the Built Environment (CRiBE) has cited that through its research, commercial lease agreements are often considered a systemic barrier to environmental improvement and resource efficiency, but particularly in multi-tenanted buildings. It has produced a Good Practice Guide providing model lease clauses and recommendations. The aim is to help landlords and tenants to incorporate a sustainable method to assist in reducing resource consumption and waste generation whilst improving the environmental performance and energy efficiency of buildings.

Green Clauses

Examples of the areas which might be covered by green clauses:

- An ability for the landlord to introduce separate metering for individual tenants in a multi let building.
- An ability for the landlord to control or regulate tenants' fit outs and alterations by reference to the impact they might have on the energy performance of the building.
- Requirements on both the tenant and the landlord to implement energy saving initiatives for a building

“The aim is to help landlords and tenants to incorporate a sustainable method to assist in reducing resource consumption and waste generation whilst improving the environmental performance and energy efficiency of buildings.”

(for example turning off air-conditioning/lighting/hot water/PCs during agreed hours) or implementing initiatives to use natural daylight where possible.

- Encouraging the recycling of office waste.
- The use of environmentally friendly cleaning equipment/chemicals.
- Service charge provision to allow for the implementation of green initiatives, including recommendations made by energy assessors.
- Requiring adherence to pre-agreed environmental policies for the building, including reporting data on performance.

- Landlord/tenants meetings to discuss and encourage adherence.

All of these initiatives will require some resource and time from landlords and tenants and some agreement on how the cost will be funded or shared.

What are the barriers?

The FRI lease will generally impose an obligation on the tenant to comply with all statutory requirements to repair and maintain the building, either directly or through the payment of a service charge. Green initiatives on existing buildings are considered expensive and could constitute an improvement for which tenants may be reluctant to pay. Landlords will be reluctant to incur the costs unless the value of their building is improved or they are able to recover the costs.

There are no current agreed industry standards, nor standardised ways of measuring the actual performance of a building. Anyone taking initiatives to introduce clauses may be taking a leap in the dark (at this stage) without fully appreciating the consequences of the relevant provisions on value, rent review and saleability.

Neither landlord nor tenant is likely to wish to enforce against failure.



“A clear industry wide understanding as to the implications for rent review and dilapidations for landlords and tenants respectively is needed.”

What are the benefits?

It is inevitable that climate change will feature increasingly in commercial relationships. If nothing, then European directives and Government legislation will force commercial building owners and occupiers to reduce their carbon emissions. Taking the initiative now can have the following major advantages:

- It can show both landlords' and tenants' commitment to sustainability, as part of their corporate social responsibility programmes. This has significant wider implications for the organisation beyond just the energy performance of the building. It can be a differentiating factor, not only for occupiers when selecting buildings, but also for employees when they join an organisation.
- Taking initiative now can assist in future proofing, anticipating new legislation in due course.
- The cost of insuring buildings as well as a risk of additional taxes or financial penalties may be averted by planning and implementing initiatives now.
- For landlords it may make their buildings more attractive and subject to valuation

methodology changes, more valuable both in terms of rent and overall returns.

- An environment strategy for a building will inevitably require the landlord to meet with the tenants providing an opportunity for better and more enhanced relations.
- It is inevitable that energy costs will rise in the future and will become a more significant cost of owning and occupying a building. This in itself may become a sufficient commercial driver to reduce energy consumption/carbon emissions through building efficiencies.
- Green leases could be a way of achieving differentiation in what is otherwise a competitive occupational market.

The Australian experience

The Australian Government has produced a series of green lease schedules that can be added to a normal lease contract. The schedules provide a legal basis for monitoring and improving energy performance. The advantage in Australia is that there are set targets in the Australian Building Greenhouse Rating system which constitutes an industry recognised method of reflecting the sustainability of buildings and acts as a benchmark to allow for the assessment and comparison of building efficiency. DEC's could provide the missing link.

What should happen?

Detailed prescriptive provisions are unlikely to be attractive to landlords or tenants. A clear industry wide understanding as to the implications for rent review and dilapidations for landlords and tenants respectively is needed. Most commentators advocate green lease schedules that are relatively simple and standardised, preferably used and endorsed by recognised industry bodies to create a market norm.

Any clauses that seek to penalise landlords or tenants for failure to adhere to carbon reduction are unlikely to be attractive; therefore clauses will need to be fair and cost effective, providing known and ascertainable advantages to both landlord and tenant.

The most important aspect would be the implementation and monitoring of initiatives, particularly in multi tenanted buildings.

A number of the institutional landlords and property companies are now considering green lease clauses. Public authorities are already encouraged by central Government to do the same and Display Energy Certificates will bring pressure on public bodies to become more visibly efficient in their use of energy within buildings.

Conclusion

It is inevitable that green leases will start to feature in the UK commercial leasing market. It is not clear yet what the shape of these provisions is likely to be. What is clear, however, is that green leases are firmly on the agenda and whether through Government regulation or through a recognised industry standard, they will arrive.



Francis Ho
francis.ho@cms-cmck.com
T 020 7367 2975

Sustainability

in the Construction Industry

What is sustainable development?

In the last few years, sustainable development has emerged as one of the key concerns facing the construction industry, the largest in the UK economy. Browse the website of any major developer, consultant or contractor and there will inevitably be a link to its sustainability or environmental policy plus examples of implementation. However, there is great variance also; some proudly proclaim hundreds of pages of sustainability brief whilst others have only a few paragraphs of vaguely-drafted principles.

This disparity is not entirely surprising. It is not so much that there is a shortage of information and guidance regarding sustainability but that the industry is drowning in it.

The first step in understanding involves understanding what sustainable development means. It does not lend itself to easy definition. The Commission on Environment and Development (better known as the Brundtland

Commission) explained that sustainable development "is development that meets the needs of the present without compromising the ability of future generations to meet their own needs."

That concept is the most commonly accepted one (although not one without criticism). It can be rationalised into three broad areas of sustainability: environmental, economic and political. These areas are not mutually exclusive and there is a high degree of overlap between them.

The Construction Perspective

The Environmental Agency has stated that the UK construction industry consumes 420 million tonnes of materials each year, generating 19% of UK waste. The energy used by buildings is responsible for about 50% of greenhouse gas emissions. According to the Brundtland definition, this current level of usage is unsustainable.

The scientific consensus is that human activity contributes to global warming. Even "climate sceptics" cannot ignore the issue of sustainable development

because of related political and economic factors which will affect their business.

The Government and the European Union concur with the scientific consensus and their policy impacts on all those involved in construction and development in the UK. Their influence ranges from legislation to planning consent and guidance.

Sustainability and Development

For developers seeking planning permission for a new development, the impact on the environment could be an important factor. Alistair Watson looks at planning issues in more detail in his article in this Bulletin.

Environmental sustainability is significant for developments in which a public body is a stakeholder. The Code for Sustainable Homes is an assessment scheme in England and judges performance levels of new homes according to energy and CO₂ emissions, water efficiency, surface water, waste management, pollution, health, management and ecology, giving each issue a score between 1 and 6 stars.



The British Research Establishment's BREEAM offers similar rating methods to the Code for evaluating non-housing developments.

The Code is voluntary at present, however English Partnerships and the Housing Corporation already require their developments to achieve a minimum of Level 3 on the Code or the equivalent for BREEAM. Local authorities (and other government departments with an interest in developments) are beginning to prescribe similar targets.

Then there are economic factors to weigh up. The Prime Minister announced last July that he wanted the number of new homes built in the UK to rise to 260,000 per year by 2016, the same year that the Government wants all new homes to be zero-carbon (rated as Level 6 under the Code). There is significant cost of building a new home to even Level 3 depending on the house type and technologies incorporated. Whilst this does need to be offset against savings from improved energy conservation and water efficiency, it is a sum that homebuyers will need to pick up in an

increasingly difficult property market. On the other hand, delay in adapting to the market trend of greater sustainability could mean damage to a company's brand, loss of commercial opportunities and the risk of being left behind.

What should Developers do to achieve greater sustainability?

For developers, a commitment to sustainable development involves first looking at their own organisation and then at their supply chain and contractual processes. Developers should encourage contractors to adopt sustainability strategies that align with their own values. This may involve actively assessing sustainability at tender stage and using key performance indicators to benchmark performance. Developers should consider making sustainability a key part of the design and construction process, with regular reviews, assessments and reporting on performance. Purchasers and tenants and project financiers also have their part to play.

A major role in promoting sustainable development may belong to the JCT. It suggested last year that it might consider making sustainability a contract term. Perhaps aware of its status as a

pan-industry organisation, it has decided to begin cautiously with a consultation paper issued earlier this month. This asks for responses on questions relating to whether contracts should deal with sustainability and, if they should, what aspects should be covered. Responses are due by 29 February 2008. A policy lunch held by the organisation elicited a surprisingly positive response so the signs are promising. The JCT is not generally known as an organisation which reacts rapidly to shifts in construction practice so the fact it is addressing the issue shows its importance.

In the meantime, developers can of course voluntarily impose sustainability requirements on their construction team in their contracts – and often do.

“For developers, a commitment to sustainable development involves first looking at their own organisation and then at their supply chain and contractual processes.”

It's not just
about the

buildings

While we have talked a lot about sustainability in the context of development in this Bulletin, we shouldn't ignore the "bigger picture."



Paul Smith
paul.smith@cms-cmck.com
T 020 7367 3475

The World Commission on Environment and Development seem to have summed it up well by saying that sustainability is "a process of change in which the exploitation of resources, the direction of investments, the orientation of technological development and institutional change are all in harmony and enhance both current and future potential to meet human needs and aspirations."

Wise words and at CMS Cameron McKenna we take this very seriously and invest a significant amount of resource putting into effect our sustainability strategy; whether it relates to investment in our local community through membership of the East London Business Alliance, mentoring schemes with local schools, implementing our "green" policy or working with our nominated charities. Historically, this investment has been driven by our desire to live by the values of the firm, its partners and staff. While this still remains a key factor

today, over recent years we have noticed that the dynamics are changing and "being sustainable" is increasingly becoming a key element in the success of our business.

Purchasers and Procurers of Services are taking the lead

Just over a year ago, we joined forces with a major international developer / investor to create a "forum" to consider the corporate social responsibilities of a variety of businesses that provided services to the developer. So far, we have grown to a "membership" that includes banks, contractors, architects and facilities managers (as well as us as lawyers).

We all share a common view; that sustainability is an essential thread that runs through all of our businesses.

We know that the forum must not just be a "talking shop". To that end, it has a values driven objective supported by a serious business agenda. The members understand that the ongoing success of their businesses requires in some cases a radical rethink on the way that they "do" their business and the forum provides us with an opportunity to work out what that actually means in practical terms.



“Our focus on “doing sustainability” is our attempt at integrating sustainable behaviours into our everyday life.”

for current practices to be shared; whether it relates to new legal or regulatory developments (for example, the new PPS relating to Planning for Climate Change), new construction techniques (for example, reducing waste on site), the issues to consider in the use of combined heat and power and the availability of investment for sustainable development.

Many procurers of services are also demanding evidence of sustainable behaviour from their suppliers. The forum is extremely tuned into this and we take time to consider our collective offering and look to ways of improving it. Evidence of this is being seen in proposals made in relation to the Building Schools for the Future procurement.

Managing the Social Impact of our Businesses

We are particularly keen to focus on this aspect of promoting sustainability. At CMS Cameron McKenna, we engage in a number of activities in our community, for example through our membership of the East London Business Alliance, the Hackney Schools’ mentoring programme, reading and numbers “partnering” at a local school, participation with Centrepoin as well as the provision of free legal advice through the Islington Law Centre, Bristol Prohelp and the Solicitors Pro Bono Group.

Our CSR Manager, Melanie Beskin, assists the forum by providing advice and ideas relating to community activities as well as engaging with other members on their good work to identify where synergies may exist.

By taking the time to think through where we can provide value, we have created an offering as part of our contribution to our clients’ Building Schools for the Future bids, that includes extending our community affairs programme to include schools and communities that fall within the scope of the BSF programme.

The forum will be engaging on a programme of activities during the next year which, by pooling resources and ideas, will provide some real value to our local communities; the key objective being to leave some form of legacy, whether by transferring skills or by creating a lasting asset, ideally with a sustainable theme.

So where do we go from here?

The words of the Dorset Education for Sustainability Network seem particularly relevant here, i.e. that “We cannot just add sustainable development to our current list of things to do but must learn to integrate the concepts into everything that we do.”

Our focus on “doing sustainability” is our attempt at integrating sustainable behaviours into our everyday life. As providers of services, we support the demand placed upon us by our customers and make similar demands of our suppliers.

A sustainable strategy supported by empirical evidence remains a differentiating factor and while we can enjoy the benefits that this gives us today, it should actually be the “norm”. Legislation may help but like quality management accreditation we might expect something similar for sustainability and as businesses, we may need to be prepared for this and expect to be required to be accredited if we wish to continue to grow.

Keeping it simple, the forum’s agenda tends to focus on three key elements of sustainability: (1) the use of resources; (2) providing sustainable services; and (3) managing the social impact of our businesses.

Use of Resources

We all have ideas on how to reduce energy consumption, reduce waste etc. and the forum provides an opportunity for those ideas to be shared. New technologies appear to be coming to market all the time. For instance, we are looking at software that automatically turns off computers that have been left on for too long and we can share the outcome of those trials with the forum who may then wish to adopt a similar approach; best practice thus being distributed much quicker than would otherwise be the case. Others have discovered innovative recycling methods, sources of local produce and impressive water saving devices.

Providing Sustainable Services

Clearly, there is a community of interests within the forum relating to creating and investing in sustainable development. The diversity of the forum again provides



Ian Insley
ian.insley@cms-cmck.com
T 020 7367 3345

Show me the money

I popped into my local supermarket at the weekend and noticed by the exit that there was a man handing out low energy light bulbs. Never one to pass up a freebie, I asked what was happening and was told, "It's a government initiative - to raise awareness of the need to save energy". Fine, I thought, but here's the rub: you got a free light bulb only if you spent more than £10.

That seemed to me to highlight two issues. First, sustainability itself and, secondly, the cost factor. Sustainability is defined as a characteristic of a process that can be maintained at a certain level indefinitely. To make sure that development can continue as a process that has a future beyond our children's, children's children – and no-one is suggesting that it cannot or should not – there has to be recognition from everybody that sustainability is not an "add on" or "nice to have": it is a must.

There is plenty of encouragement to "go green" but how does this encouragement actually translate into support? If sustainability is such an important issue then we ought to expect a lead from government in deeds (or cash) rather than just words.

If you type "sustainability" into a well-known search engine, you find very near the top the Government's sustainable development website. The page headed "Latest News" is datelined 13 March 2007. Most of the other pages are similarly long out of date. The BERR web site proudly proclaims that in 2006 it topped the Sustainable Commission's league table on Government estate management performance.

Sustainability (as I hope this Bulletin demonstrates) is too important an issue to be left as a competition between government departments. The Stern Report (to which Paul Sheridan refers in his article in this Bulletin) tells us what might happen to the global economy if we fail to take steps (and pay for them) now.

"This does not mean that the industry should simply sit back and wait for handouts but it should be able to look to government to provide a lead."

This does not mean that the industry should simply sit back and wait for handouts but it should be able to look to government to provide a lead. Having trawled the Government websites quite extensively, I can see nothing which resembles a coherent, well thought out policy. There is plenty of material to read. Some is along the lines of "motherhood and apple pie" but there are many



examples of specific initiatives that apply across the board. What I could not find is evidence of how these are to be implemented, or, more particularly, who is going to pay for all this.

There have been financial incentives to encourage development in different areas of the country. These do not have to be direct subsidies but tax benefits and other indirect financial assistance could assist by priming the pump. Areas such as Docklands show what can be achieved by a combination of government help and private enterprise. The construction industry is a robust animal and, having accepted the need to embrace sustainability, is going about it with some vigour. But some joined up thinking and positive action from Government might actually help the process along.

In the construction industry there is much that could be done if the right incentives were there. "Building" magazine recently demonstrated that the time taken to get returns on the cost of ground heat pumps and solar panels is measured in

decades. I was discussing similar issues with a developer recently. Their residential development was required to have a combined heat and power (CHP) unit – undoubtedly more efficient than individual units. However, the costs meant that it was viable only if all the owners of the residential units bought their power from the same supplier. They cannot impose that on the owners and so – reluctantly – had to shelve the proposal.

Sustainability will involve all of us putting our hands in our pockets (whether directly or indirectly) but the willingness to do so will be greater the more everyone is seen to be doing the same. It is too important an issue for everyone to ignore.

The construction process itself should be helping sustainability by not treating materials as coming from an inexhaustible supply. That includes electricity – hence the light bulb analogy. There are now plenty of examples of responsible sourcing of materials going well beyond the obvious example of timber. The Construction Products Association and the Building Research Establishment have both set up responsible sourcing units. Requiring timber to be from a sustainable source is fine, but not if the design causes a high degree of wastage or if it is used as formwork and then discarded. Processes are being developed that do away with some of the wet trades. Why? Because water is also a resource that is not inexhaustible and

“Sustainability will involve all of us putting our hands in our pockets.”

uses resources to produce the resource itself (while not directly relevant, I note it takes seven litres of water and a litre of oil to produce a litre of bottled water). I pass a substantial development in the City on my way to work each day and I see the amount of polythene being used as protection. Will it all be recycled at practical completion or will it be stripped off and discarded?

These are issues for the industry itself but the more that leadership is shown from the top in joined up thinking and positive action in sustainability the more it will filter down and become part of the norm for all industries, including construction.





Printed on 80% recycled paper.

About Law-Now

Law-Now is our free email alert service

Law-Now gives you expert commentary and analysis on key legal developments affecting your business. Choose from a selection of topic areas for your email alerts and access the full Law-Now archive on our website

www.law-now.com

Law-Now

- reaches you first with the legal news you need to know
- explains complex issues clearly and simply
- spares you the irrelevant details
- has invitations to our seminar and training programmes
- is PDA and BlackBerry friendly for users on the move.

Separate Law-Now services are available for the UK, Bulgaria, Czech Republic, Hungary, Poland, Romania, Russia, Slovakia and Ukraine. For some legal issues, we offer a comparison of law or practice across jurisdictions.

“Law-Now is extremely useful and is the best service of any law firm.”

Law-Now subscriber

“Law-Now is the best in the market by a long way.”

Law-Now subscriber

Register online today for free email updates on the law affecting your business at www.law-now.com/register.

