

Guidance for Overcoming Split Incentives



February 2016

Contents

- Introduction..... 2
- Best Practices for Overcoming Split Incentives 3
 - Engagement and Collaboration 3
 - Collaborate on rating and reporting energy use 3
 - Coordinate energy use reduction efforts 3
 - Create a tenant council 4
- Lease Terms 4
 - Review existing lease terms 4
 - Incorporate green leasing clauses 4
 - Leverage tenant fit-outs..... 6
- Incentives..... 6
 - Utilize financial incentives 6
- Resources..... 7

Introduction

The City of Boulder's [Building Performance Ordinance](#) requires building owners to: 1) **annually rate and report** the energy consumption of their buildings; 2) **perform energy assessments** every ten years; 3) **perform retrocommissioning (RCx)** every ten years and implement cost effective RCx measures within two years of the study; and, 4) **implement one-time lighting upgrades**. The ordinance and associated [City Manager Rules](#) includes requirements for both building owners and building tenants, as shown below.

Building Owners are required to:

- Annually, rate and report building energy use.
 - Collect whole building energy use data for the calendar year.
 - Enter data into [ENERGY STAR Portfolio Manager](#).
 - Share ENERGY STAR Portfolio Manager data with the City of Boulder
- Implement energy efficiency measures within the required timeline.
 - Amortize costs of upgrades over the length of the predicted payback period, or frequency of the requirement (in the case of energy assessments).
- Share any energy report of the building with all tenants, within 60 days of receipt.

Building Tenants are required to:

- Work with the building owner to share energy bills and allow access to space within 30 days of the request.
- If a tenant owns the lighting or HVAC systems, it is still the responsibility of the owner to ensure that all requirements are met. Depending on the lease arrangements, the financial responsibility for the upgrade may fall to the tenant. In cases where multiple tenants in a single building own distinct HVAC systems, please contact the city's Program Administrator for alternate compliance paths that could better suit this unique situation.

The new requirements outlined by the ordinance may be complicated by split incentives between owners and their tenants. **Split incentives** refer to transactions where the party who incurred the expense does not receive the benefit of the investment. With regard to energy efficiency, traditional lease structures cause split incentives between the owners and tenants.

With net leases, tenants are responsible for energy and operating costs in addition to the monthly rent. In this circumstance, owners have little incentive to invest in energy efficient capital improvements because the tenant will be the sole beneficiary of the reduced operating costs.¹

With gross leases, the tenant's monthly rent includes a predetermined amount to cover energy and operating costs. With these leases, tenants have little incentive to save energy because the owner receives the benefits of those efforts. This split incentive often inhibits improving the energy efficiency and sustainability of commercial buildings.

¹ It is important to note, most leases include clauses that allow owners to pass through costs resulting from regulation. In addition, many leases treat energy assessments and efficiency as "operating expenses," which can be passed through to tenants. Owners should closely review their leases for these types of clauses.

Best Practices for Overcoming Split Incentives

Best practices have been identified for owners and tenants to overcome split incentives. These best practices are discussed below in three main categories: tenant and owner engagement and collaboration, lease term considerations and agreements, and utilizing available incentives including rebates and financing.

Engagement and Collaboration

Collaborate on rating and reporting energy use

Rating and reporting (R&R) is the process of quantifying the energy consumption and associated costs of a specific building and comparing those metrics to similar buildings. R&R is the first step in aligning incentives as it provides all parties with a picture of how the building is performing and how it compares to similar buildings in the market.

R&R data collection often necessitates tenant engagement, as the tenants are familiar with the use of the space and often receive and pay the energy bills. **Tenants must respond to owner requests for data and information within 30 days** per the ordinance requirements. The ordinance also requires building **owners to rate and report using the EPA's [ENERGY STAR Portfolio Manager](#)**, which is a free tool that is the industry standard in R&R. In most cases, Portfolio Manager will request information on the use of the space, such as how many computers are operated. These questions are best answered by the tenants in the space. Therefore, the owner should engage with the tenant to collect this data, and may find it useful to use the City of Boulder's [Tenant Information Request](#) to do so.

In addition to conducting rating and reporting, the ordinance requires **the owner to share any energy report of the building with the tenant within 60 days of receipt**. This includes sharing the Statement of Energy Performance from Portfolio Manager, any custom report received from the city, and any energy assessment or RCx reports. Sharing the energy performance information can promote discussions between parties to help set expectations and prioritize opportunities.

Coordinate energy use reduction efforts

The Building Performance Ordinance has several energy efficiency requirements, including energy assessments, lighting upgrades, and RCx. The building owner and tenants should coordinate on:

1. The implementation timeline of required upgrades, including access to space and equipment;
2. Reviewing the additional cost-effective actions recommended from the assessments (the ordinance requires the **owner to share any building energy reports with tenants within 60 days of receipt**); and
3. Developing a plan to capture these efficiency opportunities.

The capital investment needed to meet these requirements is the responsibility of the building owner. If a tenant owns the lighting or HVAC systems, it is still the responsibility of the owner to ensure that all requirements of the ordinance are met. Depending on the lease arrangements, the financial responsibility for the upgrade may fall to the tenant. In cases where multiple tenants in a single building own distinct HVAC systems, please contact the city's Program Administrator for alternate compliance paths that could better suit this unique situation. In the case of multiple tenant spaces in the building, the building owner should facilitate coordination among all tenants in an effort to capture economies of scale and to ensure consistency across the upgrades.

Create a tenant council

Owners and/or tenants can organize a tenant council with regular meetings to coordinate and evaluate initiatives beneficial to all occupants. Creating such a forum causes tenants to elect a “champion” for energy efficiency and will help to create buy-in from occupants on energy management and behavioral issues. If needed, the City will provide energy efficiency experts to attend periodic meetings to help guide these discussions.

Lease Terms

Review existing lease terms

The ordinance requires building **owners to implement certain efficiency improvements** and many owners will choose to pass the costs of these upgrades through to their tenants. Many net leases include pass-through or operations clauses which allow owners to pass through the costs resulting from regulation. Additionally, many leases treat energy assessments and efficiency as “operating expenses,” which can also be passed through to tenants. Owners should closely review their leases for these clauses if they choose to pass through the costs for compliance.

If an owner chooses to pass the costs of complying with the required efficiency upgrades through to their tenants, the City Manager Rules require those **costs to be amortized over the length of the predicted payback period** (as determined by the service professional), or over the frequency of the requirement (in the case of energy assessments), rather than passed through in a bulk assessment in a single year.

Incorporate green leasing clauses

Green leasing integrates sustainability objectives for both owners and tenants throughout the leasing process. For the building owners and managers (BOMs), green leasing provides specific clauses that define sharing the costs and benefits for energy efficient capital upgrades, other sustainability projects, and efficient building operations with the tenant. Common green leasing clauses include: pass-through, sustainable purchasing, operations, data sharing, and reporting clauses and are further described below:

- **Pass-through clauses:** These clauses include terms for owners to pass capital costs of energy efficient upgrades onto tenants while guaranteeing tenants receive financial benefits based on projected energy savings. These clauses often include amortization language. The following language is used in a sample green lease to address capital cost amortization:

Pass-through Clause Example

“Cost of any capital improvement to the Building that reduces Building Operating Costs, the costs of such improvements to be amortized over the minimum period acceptable for federal income tax purposes, and only the yearly amortized portion thereof shall be treated as a Building Operating Costs. In no event shall this charge for yearly amortization be more than the actual reduction in the Building Operating Costs.”

Cited from: A Better City. [Green Leasing An Effective Tenant/Landlord Strategy for Energy Efficiency](#). (Page 5). December 2014.

Landlord may include in Operating Expenses a portion of the aggregate costs of such Capital Improvement equivalent to eighty percent (80%) of the Projected Annual Savings, so that the aggregate costs of such Capital Improvement will be fully amortized over one hundred twenty-five percent (125%) of the simple payback period (such period of time, the “Adjusted Payback Period”).

- **Sustainable purchasing clauses:** These clauses set requirements on purchases to support purchasing of specific materials or to maintain certifications. These clauses often cover purchased of green cleaning supplies, pre- and/or post-consumer products, ENERGY STAR® certified appliances, and low-VOC products. These clauses can also include specific sourcing requirements, such as requiring purchases of locally produced or harvested products.
- **Operations clauses:** These clauses set operational parameters for buildings to ensure efficient operation and high performance of the building. These clauses may restrict operating hours, set temperature ranges, and manage trash and recycling procedures. Some of these practices may require additional efforts or improvements to monitor and enforce, such as sub-metering. Further, some items commonly included in operations clauses could instead be included in the building rules and regulations rather than the lease.
- **Data sharing clauses:** The ordinance requires **tenants to respond to owner requests for utility data within 30 days**. Including lease terms that authorize the owner to request and obtain sub-meter or meter data directly from the applicable utility provider will facilitate data sharing for R&R purposes. These terms may also include an energy management plan that defines how energy for specific spaces and facilities will be monitored. Requiring tenants to install sub-meters is another way to encourage collaboration and transparency between owners and tenants.
- **Reporting clauses:** The ordinance requires building **owners to share building energy reports with tenants**. However, owners and tenants may choose to incorporate this reporting requirement into lease terms as well through reporting clauses. Reporting clauses indicate an agreement that owners will share energy use and rating and reporting results in order to track progress towards energy and sustainability goals. These clauses can dictate the format of the data and the frequency of which it is shared

Operations Clause Example

“The Landlord shall provide HVAC in quantities and at temperatures required to maintain conditions within a reasonable temperature range in the Premises during Business Hours. [Optional: HVAC and lighting supplied to the premises outside of Normal Business Hours requested by the Tenant shall be at the Tenant’s cost at the rate equal to the then prevailing rate for such service or utility plus the Landlords 15% administration fee.]”

Cited from: A Better City. [Green Leasing An Effective Tenant/Landlord Strategy for Energy Efficiency](#). (Page

Data Sharing Clause Example

“Landlord is hereby authorized to request and obtain, on behalf of Tenant, Tenant’s electric consumption data from the applicable utility provider.”

Cited from: “Brandywine Realty Trust Overcomes the Split Incentives Barrier and Obtains Tenant Utility Data”, Case Study, U.S. Department of Energy Building

Green leases should also include a resolution process for sustainability and energy management issues that may arise. Additional information, guidance, and examples of language to include in these and other clauses can be found at the [Green Lease Library](#), listed under Resources. Companies that successfully implement green lease language into new leases, or renegotiate existing leases to add green lease language many also be eligible for recognition through the [Green Lease Leader program](#), which was developed by the Institute for Market Transformation and the Department of Energy.

Though green leasing opportunities are limited to when leases are being re-negotiated or being negotiated for the first time, compliance with the Building Performance Ordinance is a good reason to consider green leasing options at the first available opportunity.

Leverage tenant fit-outs

Prior to finalizing lease terms, the owner and potential tenants can collaborate to identify energy efficiency measures to include in the design and lease terms. Tenant fit-outs are an ideal time to implement energy efficiency measures because the cost and benefits to both parties can be defined in the lease terms, and the measures can be implemented during the fit-out with minimal disturbance to the tenant. In addition, tenant fit-outs offer opportunity to consider certification of a space, such as ENERGY STAR or LEED certification. It is important to note that if a fit-out is initiated, the building owner must also ensure to comply with the [City of Boulder's energy code](#).

Lease Term Example for Tenant Fit-out

“Any and all Tenant Improvement Work and/or Alterations will be performed in accordance with Landlord’s sustainability practices that NYU has accepted as part of the lease agreement, including any agreed upon third-party rating system concerning the environmental compliance of the Building or the Premises, as the same may change from time to time. Tenant further agrees to engage a qualified third party LEED or Green Globe Accredited Professional or similarly qualified professional during the design phase through implementation of any Tenant Improvement Work and/or Alterations to review all plans, material procurement, demolition, construction and waste management procedures to ensure they are in full conformance to Landlord’s sustainability practices, as aforesaid.”

Cited from: A Better City. [Green Leasing An Effective Tenant/Landlord Strategy for Energy Efficiency](#). (Page 8). December 2014.

Incentives

Utilize financial incentives

Building owners (and tenants in cases where tenants own and maintain the HVAC equipment of a building) are responsible for the costs of compliance. However, there are several financial incentives available to help offset these costs.

[Xcel Energy](#) and the City of Boulder’s [Partners for a Clean Environment \(PACE\) Program](#) offer both guidance and incentives for energy efficient upgrades. While compliance with the ordinance

requirements is the building owner’s responsibility, and therefore these incentive opportunities will assist owners with compliance, tenants are also eligible for rebates and advising in efficiency options they control, such as lighting, plug loads, thermostats, and employee energy use behavior.

In addition, a newly launched program by the Colorado Energy Office, the [Commercial Property Assessed Clean Energy](#) (C-PACE) program, provides 100% financing to assist building owners with implementing energy efficiency and renewable energy improvements. This would allow owners to amortize their costs of the upgrades at competitive rates with repayment terms up to 20 years.

Finally, new rebates are under development by the city to assist with offsetting the costs of implementing custom efficiency measures not covered by current rebates, as well as to offset the upfront cost of receiving a Level II energy assessment. The application and requirements for these rebates will be listed on the [website](#) once finalized.

Resources

Boulder Building Performance Ordinance Resources		
Ordinance	Adopted ordinance language	https://www.municode.com/library/co/boulder/codes/municipal_code?nodeId=TIT10ST_CH7_7COINENE
City Manager Rules	Rules and regulations interpreting, defining, and implementing provisions of the ordinance.	www.BoulderBuildingPerformance.com
Guidance	How-to guides, tools, forms	www.BoulderBuildingPerformance.com
Program Administrator	Kimberlee Rankin, City of Boulder	Email: Rankink@bouldercolorado.gov Phone: 303-441-4227
Green Lease Resources		
Green Lease Library	This online library houses tools and resources to aid in developing and implementing green leases.	http://www.greenleaselibrary.com/
NYC Sample Green Lease Clause Language	Sample lease clauses for capital improvements to energy efficiency.	http://www.nyc.gov/html/gbee/downloads/pdf/eac_&_overview.pdf
Better Buildings Energy Aligned Lease Webinars	Extensive training information from beginning the process of implementing green leases to benefits of specific technologies.	https://www4.eere.energy.gov/alliance/events/past-webinars/#32612
Green Lease Leaders	Recognition program of companies that successfully implement green lease language	http://www.greenleaselibrary.com/green-lease-leaders.html
Incentive Resources		
PACE	City of Boulder’s Partners for a Clean Environment - Offering free expert advisor services, financial incentives and a certification program.	www.Pacepartners.com
Xcel Energy	Xcel Energy’s Business Solutions - Offering business energy advising and rebates.	https://www.xcelenergy.com/Energy_Solutions/Business_Solutions/Rebates_&_Energy_Savings
CO-PACE	Offers 100% financing to building owners to implement efficiency and renewable upgrades	http://copace.com/
City Rebates	Upcoming rebates for Level II energy assessments	https://bouldercolorado.gov/lead/boulder-building-performance-training-assistance-rebates