Original Article

Greening leases: Do tenants in the United Kingdom want green leases?

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Sarah Sayce

is Head of the School of Surveying & Planning at Kingston University, a post that she has held for many years. She writes and researches extensively in the field of property valuation and currently specialises in the impact of sustainability on the property markets. She is a member of several editorial boards including the Journal of Retail and Leisure Property and she was a founder member of Leisure Property forum. She also sits on various RICS committees including the Valuation Professional Group.

Anna Sundberg

graduated from Kingston University in 2004. She spent two years in a private general practice firm where she specialised in property valuation work and rent reviews. Anna re-joined Kingston University in 2006 initially as a Research Assistant working on a range of research projects included those related to sustainability in the property sector. She has since been appointed as a lecturer and she now leads the degree in Property, Planning & Development but continues to undertake research.

Philip Parnell

is a valuation partner at Drivers Jonas, responsible for a wide variety of assignments including the valuation of large portfolios for accounts purposes. In addition to mainstream valuation work, Philip has developed a strong expertise in the relationship between valuation and the sustainability agenda. He was on the RICS Sustainability Commission and chaired the RICS response to the Vancouver Valuation Accord – which aims to embed the principles of Sustainability into Valuation standards and methods. Philip is also a Chartered Environmentalist.

Eddie Cowling

at the time of the research for this project, Eddie was a research assistant in the School of Surveying & Planning working in the C-SCAIPE (Centre for Sustainable Communities Achieved through Integrated Professional Education) team. He has now moved into private practice as a research consultant.

ABSTRACT The current rise in the sustainability agenda among both corporate occupiers and institutional investors has given rise to discussion about the landlord and tenant relationship. Within Australia this has resulted in tenant-led moves towards ‘green leases’, and in Canada too the green lease has gained momentum. Within the United Kingdom, however, there has been little evidence of widespread adoption of green leases. This article reviews the case for green leases in the light of research conducted for the Investment Property Forum. It reports on the result of interviews conducted with a range of occupiers and concludes that, currently, the market is not ready for the introduction of green leases; instead it advocates that a more dynamic relationship between landlord and tenant is required.

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Correspondence:

Sarah Sayce
Head, School of Surveying &
Planning, Chair, C-SCAIPE, Kingston
University, Penrhyn Road, Kingston
Upon Thames, Surrey KT1 2EE, UK
E-mail: S.Sayce@kingston.ac.uk

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INTRODUCTION: OVERVIEW

The principle of sustainability, by which is meant the pursuit of positive environmental and social goals in addition to economic return, is of growing importance to many corporate occupiers and their landlords; none less so than many retail organisations, epitomised, for example, by Marks & Spencer's move to 'green' both their organisation and their supply chains. However, although the growth of corporate social responsibility (CSR) has been well charted in the business literature (see for example Banerjee, 2009), it has proved difficult to implement in terms of property asset management practice. It is therefore useful to understand whether or not the commercial lease is currently in a form that acts as a barrier to more sustainable asset management (SAM) practices and, as it is seen as being a vehicle for promoting change in Landlord and Tenant behaviour, if change is required.

This article reports on part of a research project undertaken by a team of researchers¹ during 2008, which aimed to provide the property investment community with an analysis of UK landlords' and tenants' views on green leases. It focused specifically on the landlord and tenant relationship and sought to establish whether current leasing practice, as supported by the 2007 Commercial Lease Code (Joint Working Group, 2007), provides an appropriate framework to support the achievement of sustainability goals, or, if not, what actions may be required by the stakeholders. Although the overall project was focused on providing advice to the property investment community, this article concentrates on the view from the tenant perspective. Findings and recommendations are based on a review of literature, a series of interviews and two Focus Groups, one held at the beginning of the research and the other following conduct of the interviews to present and debate findings and to assist in drawing conclusions.

The research investigated the ways in which the landlord and tenant relationship is being affected by the developing sustainability agenda and assesses the ways in which current commercial leases might be a help or a hindrance to the achievement of better sustainability performance in managed buildings. The specific objectives of this article are to assess, from literature, how the landlord and tenant relationship is affected by the sustainability agenda and to report the views of tenants in relation to potential changes to leases and the possible introduction of the so-called 'green leases'.

BACKGROUND: THE RISE OF THE SUSTAINABILITY AGENDA AND THE CALL FOR GREEN LEASES

In the last two decades, the issue of sustainability has been transformed from a movement led by a rise in environmental concerns to one that has been adapted to include social and economic balance to form a so-called Triple Bottom Line (TBL). This approach has been adopted by government policy makers and many within the corporate sector and is now a consideration for many businesses.

Despite the integration of sustainability principles into the business agenda, it has proved both difficult and challenging to apply these principles to the commercial property arena (Ellison and Sayce, 2006). For this article, the issue is whether or not corporate occupiers are hindered or assisted by the lease frameworks currently used by landlords and tenants operating in the United Kingdom. It recognises that different considerations apply in the case of single let properties and those that are multitenanted.

Towards sustainable property asset management

There is no universally agreed definition of SAM principles. However RICS (2008) argue that SAM implies seeking methods to reduce risks to future economic performance enabling progress towards government environment and social targets and support for delivering services effectively and efficiently. This is consistent with Pivo and McNamara's (2005) view that responsible property owners should aim to maximise the positive effects and minimise the negative effect of property ownership, management and development on society and the natural environment.

In terms of moving the markets forward, Pivo and MacNamara (2005) identified that the most potent drivers for change will be increased tenant demand, the strengthening regulatory levers targeting the environmental performance of buildings and increased adoption of CSR policies. As the commercial lease is the mechanism through which investors and occupiers interact, the nature of the lease has come under interrogation to establish whether or not it is in a form that acts as a barrier to more SAM practices. If it is, it raises the question as to whether a new-style 'green lease', as advocated by some (see for example, CRIBE, 2007a, b; WSP Environmental Energy/Boodle Hatfield Legal Services (2007) British Council of Shopping Centres, 2008; Brooks, 2008; Hammonds Built Environment Group, 2008) is indeed the appropriate way for the industry to move forward, or if not what alternatives may be suitable at this point in time.

The commercial lease: Perceptions of the need for a green lease

Commercial leases within the United Kingdom have developed over many decades. The so-called 'institutional lease', with its hallmark upward-only rent review, full repairing liability and long period of financial commitment by the tenant, was the prevalent interface between these two communities for the period from approximately the mid-1970s until the 1990s and almost into the millennium. The institutional lease created a vehicle by which investment in innovative buildings and SAM was hindered (Hinnells *et al*, 2008), fostering an adversarial landlord and tenant relationship characterised by limited communication and often high levels of dispute between the parties with an in-built lack of incentive on the part of either landlord or tenant to invest in the fabric of the building during the term of a lease. This lease structure in particular provided little ability for tenants to negotiate terms other than the standard lease (Crosby *et al*, 2003).

It was only with the reduction of rental values in real terms that the downsides to tenants of long-term occupational leases became widely

apparent and acknowledged. Despite threats by government, it was changing market conditions and moves by the industry to introduce a stronger Code of Practice that provided the impetus for the rise in tenant negotiating power resulting in shorter leases to match changing business needs (Hamilton *et al*, 2006).

In particular, the period since 2000 has seen other potent indicators of change such as:

- the introduction of the 2007 Code for Leasing Business Premises (Joint Working Group, 2007) sponsored by the property industry and designed to encourage greater interaction between landlords and tenants;
- passing of a range of legislation impacting on property occupation and owner costs including, but not exclusively confined to, energy and carbon issues;
- shifting attitudes towards CSR and the need to adopt sustainability principles; and
- continued market trends towards shorter and more flexible leases.

Incentives for improved sustainability performance

One of the reasons why commercial landlords and tenant should consider their sustainable responsibilities is the now growing body of evidence suggesting that buildings that have good environmental performance measured in terms of energy, waste, water and accessibility are likely to be 'future-proofed' over time and less susceptible to value depreciation (Sayce *et al*, 2007). These buildings, while remaining attractive to tenants and more readily saleable, offer tenants' revenue savings and provide better working environments, and therefore, enhancing staff productivity. The effectiveness by which a commercial lease can fairly proportion the risks and benefits associated with the promotion of more sustainable behaviour between landlords and tenants has been questioned (Hammonds Built Environment Group, 2008). It has been suggested that the commercial lease agreement is a systematic barrier to environmental improvement and resource efficiency within the commercial built environment (London Better Buildings Partnership/London Climate Change Agency, 2007).

THE NATURE OF A GREEN LEASE

The concept of a green lease through which either or both parties agree to environmental issues within the occupation and/or management of the building was first realised in Australia (Power, 2004; Roussac, 2004). Although no one standard form of green lease exists, over time a template has been developed which now provides a set of obligations to be contained within leases. Typically, an Australian green leases places both parties under an obligation to achieve environmental ratings for the building and to cooperate in its management Commonwealth of Australia (2007a), (2007b) and Investa Property Group (2006). The focus is on energy management. Crucially, the green lease concept was a tenant-driven initiative, but it has now become quite widely accepted and is promoted by government (Australian Conservation Foundation (2007)).

The concept has recently been advocated in Canada with the recognition that such leases can be either paternalistically driven (that is, one party seeking to impose obligations on the other), or cooperatively conceived where mutual benefits have been identified to which both parties sign up through the lease agreement (Real Property Association of Canada, 2008).

Two milestones towards possible implementation of a green lease in the United Kingdom are marked by the publication of a green lease guide to enable landlords and tenants to incorporate *Environmental Best Practice into Lease Agreements* (Centre for Research in the Built Environment, 2007a, b), followed by guidance from the Better Buildings partnership (2008) and the announcement in April 2008 by Hermes of its intention to sign tenants on to their version of a green lease (Jansen, 2008a). Hammerson and Land Securities have since also announced the introduction of their own versions of a green lease. The key question, however, is: do tenants want green leases?

The content of leases regarded as 'green' is subject to considerable variation. At the most extreme, a green lease (a so-called dark green lease) imposes very strict conduct on the tenant even down to specification of furnishings with penalties for non-compliance.

Other types of green leases (light or pale green leases) impose less stringent obligations on the parties and indeed may be little more than an agreement to cooperate on improving energy standards and to disregard at rent review any tenant's environmental improvements.

Perceived benefits and costs of green leases

The benefits of green leases, which have so far largely been associated with office buildings, are considered to be numerous and include improved public relations, revenue savings and the ability to recruit and retain staff. See Table 1.²

This list of potential benefits must be placed into the context of little practical experience of such leases within the United Kingdom. As stated above, they represent aspiration rather than actuality, and it was these promoted qualities that were explored during the research interviews.

Against these perceived occupational benefits has been the suggestion that green leases impose onerous clauses on a tenant leading to difficulties, for example in assigning leases, as set out in Table 2.³

At the start of this research, there was little or no empirical evidence as to whether such concerns would be realised within a UK context. Hence the research sought to explore these issues with tenants.

Table 1: Benefits of green leases for tenants

- Benefit of externally facing sign of compliance with CSR policies and associated reputational benefits.
- Promotion of building improvements that give rise to revenue savings to the tenant.
- Ability to recruit and retain staff due to stated commitment to good working environment and promotion of well-being.
- The ability to alter the building to improve occupational needs without paying for improvements at rent review; enabling a framework for better knowledge of environmental and social performances through data gathering and sharing, thus providing a basis from which to improve performance.
- Encouragement of closer engagement with the landlord and the promotion of mutual trust and understanding.

Source: compiled from various sources, including primary data.

Table 2: Costs of green leases for tenants

- Onerous clauses, for example, requirement to assign only to others with good CSR credentials could lead to reduced ability to assign.
- A fear that landlords will seek to 'green-plate' the building at the tenants' expense by claiming back the capital cost through services charges. This is particularly an issue for buildings let on short leases, which is increasingly common.
- A Green lease may impose obligations on the tenant without similar burdens being placed on the landlord.
- Concerns that if the building is improved to sustainability standards, all revenue savings they might enjoy will be recouped by the landlord in additional rent.

Source: compiled from various sources, including primary data.

METHODOLOGY

The findings presented in this report are based on 26 interviews undertaken between February and October 2008 supported by a review of literature both from within the United Kingdom and internationally. The interviews sought the views of large corporate and public occupiers (tenant representatives). Alongside this, a series of interviews with landlord organisations were also held to test their views. The two Focus Groups contained representatives of both landlord and tenant organisations and their advisors. These were held to inform the research team and assist interpretation of data. It is acknowledged that since the interviews were conducted, the property market has undergone a period of turbulence, which could impact on the views of research participants; however, it is thought that the changes observed in the market place do not undermine the research findings, which present a picture of longer-terms structural issues within the landlord and tenant relationship.

Interviews were a mixture of face-to-face and telephone and comprised a range of semi-open and open-ended questions aimed at providing a deep insight into both practices and attitudes. The average duration of each interview was a little under one hour. Tenant organisations were chosen on the basis that these were large organisations that occupied multiple properties from a range of landlord organisations. They comprised both public and private sector organisations, but primarily they were office-based occupiers. Additionally, two consultant organisations were interviewed. Although the majority of interviewees were in the office sector, the issues raised have application to all business occupiers.

KEY FINDINGS

In the interviews, tenants' views were sought in relation, not just to green leases, but about the nature of their relationships with landlords. They were also asked about their views on sustainability and the CSR agenda.

Drivers for sustainability

The findings suggest that sustainability is now being accepted as important to all tenant organisations who took part in the research, and this was confirmed by advisors through the focus groups; however, the drivers for promoting sustainability are not a single issue but a complex of concerns.

To tenants, CSR was confirmed as important both financially and for public image. The increasing importance placed on the sustainability

agenda by organisations follows what literature has suggested, namely that there is increasing interest in sustainability matters raised by tenants. Among sustainability issues, energy efficiency was confirmed as the key consideration. Given the marked increase in energy costs during 2007–2008 and the ongoing escalation of regulation linked to targets for carbon reduction, including the implementation of the European Directive of Energy Performance Buildings (EU, 2002) through the introduction of Energy Performance Certificates, this was expected.

However, respondents recognised the agenda as being far wider; waste management and water conservation were identified as of growing financial and social importance. Health and well-being of employees were also viewed by most respondents as related to their corporate property asset management strategies.

One of the prerequisites to effective management lies in the use of appropriate metrics. Accordingly, the research sought to investigate the extent to which tenants were compiling data to measure and manage their environmental and social performances. Evidence indicated that, in some cases, they are beginning to collect a wide range of data aimed at benchmarking and managing performance. However, unlike in Australia where such data are frequently shared, under the terms of a green lease, in this research no such evidence emerged, despite the presence of tools, such as LES–TER (Landlords Energy Statement–Tenants Energy Review),⁴ which provide the start point for such activity.

The landlord and tenant relationship

During the interviews, tenants were asked a series of questions to probe the nature of their relationships with their landlords. In particular, the research aimed to find out whether shorter leases had led to greater landlord engagement and whether CSR was promoting greater cooperation. Most interviewees held leases from a large number of landlords and occupied a range of property types ranging from large, prime office buildings to old industrial units. Although most reported that some landlords had made great strides in terms of developing a working relationship, this was not the dominant picture.

A continuing and widespread lack of trust was reported by tenants, with a general view expressed that landlords were only interested in extracting maximum rents and that the service charges tended to lack transparency. This was considered to be most problematic in the case of multilet buildings for which service charges are often the source of tension and financial disputes. The relationship was described as ‘feudal’ and respondent organisations reported that they wished to move towards a partnership model with mutual respect and understanding.

However, despite expressing some negative views about the current state of landlord and tenant relationships in many cases, the majority view was that the lease, *per se*, is not a barrier to more sustainable property management; it is how it is interpreted that matters and the willingness of parties to work together that is key.

The critically important role that managing agents can play, especially in cases of overseas landlords, was emphasised in acknowledging that

while some managing agents were very proactive and well informed, and therefore, more able to support SAM practices, others were not.

The researchers also explored whether the introduction of the 2007 Commercial Lease Code had led to changes within the landlord and tenant relationship and whether it had led to changes within lease terms they had agreed. In reporting these findings, it must be stressed that the interviewees' views may not be representative of the totality of the industry.

Interviewees revealed a positive attitude towards the Code, and it was widely felt that it was the appropriate means of introducing changes in the landlord and tenant relationship. To date, the code has served as a means for setting the parameters for lease negotiations even where both parties are well represented.

The suggestion that the Lease Code could be extended to encourage sustainable property management met some support, but most were of the view that the industry is 'not there yet' in terms of tightening the Code in respect of sustainability issues. However, one interviewee expressed the view that the Occupiers Satisfaction Index, launched in 2007, could become a potent agent for change.

The case for improvements and alterations

Any measure implemented to improve sustainability should meet the business needs of both parties to the lease. This has proved very difficult in building a case for improvements in terms of sustainability performance. Tenants see the potential for occupational benefits, but expressed reluctance to accept the responsibility for carrying out such improvements for two main reasons. First, their interest in the property is predominantly short term,⁵ and long-term advantages would revert to the landlord. Second, despite possible protection under the terms of the lease or the extant legislation, concern was expressed that improvements would lead to the possibility of rental increases that would offset revenue savings. Any environmental improvements, therefore, were viewed as problematic.

Despite this, tenants are undertaking a range of environmental improvements, as far as their leases will allow without putting them under financial penalty. Examples of changes being introduced included increasing occupation intensity, increasing use of recycling and ensuring employees use energy efficiently. Mainly these are small steps that are not impeded or constrained by the lease. In the majority of cases, the driver was revenue saving and financial benefits, rather than to promote their corporate responsibility policies.

The other aspect of improvements concerns those required to fulfil changing legislative requirements, such as those introduced under disability legislation and potentially to meet environmental standards. Under current leases, where the property is single-let under full repairing terms, the normal provision is that the tenant is liable for alterations required under statute. Although this could be addressed through careful lease drafting, the implications for existing leases are unclear. Yet, as the government is likely to further increase moves towards legislating for building upgrades, the matter needs to be addressed. This could provide

the most powerful argument for introducing some form of green lease in the United Kingdom.

The need to introduce a green lease

The views collected in relation to knowledge of and attitudes towards green leases provoked much discussion and debate particularly as there is little agreement as to what constitutes a 'green lease' and because of the fact that respondents' knowledge about green leases varied significantly. Among tenant respondents, the appetite for a UK green lease appeared limited; however, they would support a much looser arrangement, such as a memorandum of understanding, but their main concern is to break down what is seen as an arena for conflict and lack of trust. There was much concern that, unlike the Australian experience, the introduction of green leases would be a landlord driven move designed to form yet another way of imposing more requirements on a tenant.

In summary, the evidence from this research is that there was no strong support among tenants for the systematic introduction of green leases. It is important to note that since the interviews were conducted, the occupational property market has weakened, but the case for SAM has, possibly, hardened as the need to reduce risks becomes even more important.

CONCLUSIONS

The findings above relate to only one part of this research project, namely the tenant perspective. However, they point towards some emerging conclusions that are being triangulated with wider landlord opinion, and which will be reported separately.

Green leases: Not yet understood

The research pointed to a lack of real understanding of what constitutes a green lease. This is not unexpected given that they are new to the United Kingdom and that tenants have little, if any, experience of them. In particular, the fact that there is no single set of terms that constitute a green lease provides a reason why tenants would not wish to sign up to them. Unless and until they are viewed as a mechanism to aid tenant's effective management of their occupation, any green lease, which goes beyond a simple memorandum of understanding, is likely to be resisted on the grounds that it is a means of passing further liabilities on to the tenant. What will be important moving forward is that a shared understanding is developed to break down the scepticism that was observed. Fundamental to this is to build up a greater trust between landlords and tenants, as lack of trust was a key feature of currently held tenant opinion.

Accordingly, it would be beneficial for the industry for a deeper understanding of such a typology in order to stimulate discussion and understanding of the management and financial implications of such leases. In driving forward such discussion, it is important that 'green' is not purely associated with energy but with the full range of environmental and social impacts associated with building occupation and management.

Green leases: Moving practice forward

The research indicated that the standard commercial lease does not, in itself, act as a barrier to sustainability. Nor, however, does it promote sustainable behaviour. What is important is that both parties are willing to instigate sustainable measures, and for this, some form of agreement to work together written into the lease could be advantageous. Currently, the model to achieve this is not well served by the detail of many commercial leases, as tenants have little incentive to undertake capital works to improve environmental performance, although landlords similarly are not incentivised if they consider that the financial benefit will lie with the tenant in terms of revenue cost savings.

What may provide a more effective way forward is the introduction of Memoranda of Understanding to provide a basis for the negotiation of terms that provide a financial as well as reputational win for both parties. Such a memorandum could be introduced both within existing leases and at renewal or new lettings. The grounds for concluding that the introduction of a Memorandum of Understanding would be a stimulus for behavioural shift are twofold. First, tenants were very positive about such a move; in addition, there was evidence that the 2007 Commercial Lease code, which is itself advisory, is beginning to have an impact on behaviour. Since this research has been conducted, such a Memorandum has been developed and published (Better Buildings Partnership, 2009).

The recommendation of the adoption of a Memorandum of Understanding does not preclude any other changes to leases being introduced. For example, landlords and tenants could usefully consider whether slight alterations to other terms, such as assignment clauses, could be used to promote SAM.

Improving and sharing metrics

The proposition that both the development and sharing of data would aid cooperation and assist in the creation of a case for building improvement was widely accepted by tenants. They are currently collecting a wide range of data that could be utilised to provide deeper understanding between the parties and act as a basis for developing benchmarking schemes, which would, in turn, assist in pinpointing appropriate improvement schemes and foster collaborative working relationships. As the issue of energy consumption is currently perceived as a priority for many tenants, this might be an appropriate first data set to collate and share.

It is concluded that the establishment of a national framework for data collection is required; however, it is crucial that such a framework is produced *by* and *for* the property industry in order to accommodate the complexities of the UK market.

Regulation for sustainability

The evidence points to the acceptance by participants that regulation for environmental and in time social sustainability is only likely to increase. One example of this is the impending Carbon Reduction Commitment Programme, which is likely to be of increasing importance to landlords and tenants alike. The research also found that, despite previously expressed reservations and concerns about the introduction of Energy

Performance Certificates, there was a view that they would add transparency to the market and potentially stimulate the introduction of physical improvements. However, it was concluded that, if government wishes to achieve real change, it was likely that such reports might contain mandatory requirements. If they do, then the industry must find ways of building in requirements for compliance into leases in ways, which do not impede the ability of tenants to operate efficiently. From the interviews conducted for this research, such measures should be built on incentives – not penalties and tenant liabilities. What is critical is that any regulation is introduced in consultation with key stakeholder groups.

Final remarks

In conclusion, the tenant perspective on green leases that emerged from this research is that, currently, only very light green leases would meet with favour but tenants are open to dialogue and would like to be regarded as true partners toward achieving more sustainable stock. It was concluded that, if such measures were combined with incentive schemes that recognises the nature of the landlord and tenant relationship, they could be a driver for improvement to existing stock. As a result of the research, a number of recommendations have now been put forward to the industry through the Investment Property Forum.

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NOTES

- 1 The research team comprised the authors, together with colleagues from industry in DTZ and Hammonds.
- 2 Ibid.
- 3 Ibid.
- 4 www.les-ter.org.
- 5 In reporting these findings it is acknowledged that some commercial leases are still for longer terms and in these cases tenants are more likely to consider investing in building improvements.

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