GOLENBOCK EISEMAN
ASSOR BELL & PESKOE LLP

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ATTORNEYS AT LAW | 711 THIRD AVENUE | NEW YORK, NY 10017 | 212 907 7300 | WWW.GOLENBOCK.COM

New York City Local Law 97 – Landlord Considerations in Dealing with Their Tenants

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As part of the national and global push to reduce greenhouse gas ("GHG") emissions to combat the effects of climate change, New York City passed the Climate Mobilization Act (the "Act"). Local Law 97 ("LL97"), enacted in 2019, forms a crucial component of the Act. Specifically, the goal of LL97 is to reduce GHG emissions from certain larger buildings by a set amount by 2030 with even further reductions by 2050. It is estimated that buildings in New York City are responsible for sixty-eight percent (68%) of all citywide GHG emissions[1] and LL97 should play a vital role in achieving the desired reductions. To reach these goals, LL97 sets annual limits on GHG emissions that each covered building may emit and if those permitted emission levels are exceeded in any given year, the building's owner will incur a fine for such year.

In addition to the obvious concern about the considerable expenses building owners may incur to modify or retrofit their buildings in order to reduce GHG emissions and make them more environmentally friendly as well to avoid any fines resulting from non-compliance, building owners will need to consider how to navigate relationships with their tenants in attempting to shift responsibility for some of these expenses to tenants and/or to adopt other viable strategies. The purpose of this Article is to provide a brief overview of LL97 and discuss how the aforementioned issues may be addressed to landlords' satisfaction.

Local Law 97

LL97 applies to most buildings (both commercial and residential) larger than 25,000 square feet[2] and aims to reduce GHG emissions of such buildings by forty percent (40%) by 2030 and eighty percent (80%) by 2050. Although enacted in 2019, LL97 not does not take effect until 2024 and it is the owners, not the tenants, of buildings that are responsible for compliance with the law (although tenants' energy use will directly factor into the amount of GHG a building emits).

LL97 seeks to achieve its reduction goal by assigning a GHG emissions limit (which factors in various energy sources and converts same into units of "metric ton of carbon dioxide equivalent"

[1] "New York City's Roadmap to 80 x 50" (accessed August 2022)

[2] Numerous types of buildings are exempted from LL97, including, without limitation, places of worship, city owned buildings, rent regulated housing, multifamily dwellings of 3 stories or lower, with no central HVAC or hot water system, etc.

(tCO2e)) to measure annual compliance for covered buildings. Emission limits vary depending on the type of use class for the building and those limits will be reduced over time in furtherance of the goal of achieving ever greater GHG emission reductions. As of 2019, it is estimated that approximately twenty-four percent (24%) of buildings were not compliant with 2024 limits and seventy-five percent (75%) of buildings were not compliant with 2030 standards.[3] Building owners will have to submit an emissions report (which has to be certified by a registered design professional) with the City of New York by May 1st of each year (starting in 2025 for the 2024 calendar year) showing compliance or non-compliance with the emissions standards. If the emissions limit is exceeded, the owner of the building will have to pay an annual fine equal to $268 per tCO2e in excess of the emissions limit. The fine is an annual, reoccurring fine and is understood to be calculated based on the estimated cost that an owner would otherwise have incurred to bring its building into compliance with emissions standards. The goal of the fine is therefore to encourage compliance with the emissions standards as opposed to simply accepting the fine.

For purposes of illustration, assuming a 100,000 square foot office building has GHG emissions equal to 0.01173 tCO2e/sf and the emissions limit is 0.00846 tCO2e/sf, then the fine would equal $87,636 for such year [(0.01173 - 0.00846) x 100,000 x $268]. Since this is a reoccurring annual fine, penalties can quickly accrue and, if anything, will only increase over time as permitted emission limits are lowered if building emissions are not reduced. However, LL97 does provide for certain mitigating or aggravating factors that allow for a reduction or increase in the penalty, such as evidence of good faith efforts to comply with LL97, history of compliance, whether the owner had access to financial resources, etc.

Each owner of a covered building will need to undertake an in-depth analysis to evaluate the measures that may be implemented to reduce a building's emissions. Some of the measures and strategies taken may be simple and affordable (e.g., installing LED lighting) while others may require a significant investment in both time and financial resources (structural improvements to better seal the building's envelope or upgrading HVAC systems). The scope of the required upgrades will also be influenced by how much needs to be done to meet current and future permitted emissions limits in light of a building's current emissions. Further, LL97 already requires building owners to ensure that certain enumerated energy conservation measures are taken by December 31, 2024, including, but not limited to, (i) adjusting temperature set points to reflect appropriate space occupancy and facility requirements, (ii) repairing all heating system leaks, (iii) maintaining the heating system in good operating condition, (iii) insulating all pipes for heating and/or hot water, (iv) upgrading lighting, (v) weatherizing and air sealing, (vi) installing timers on exhaust fans, and (vii) installing radiant barriers behind all radiators.

An additional strategy that building owners – especially owners whose buildings are far from LL97 compliance or where the cost of upgrades would impose severe financial burdens – may consider is the purchase of renewable energy credits or greenhouse gas offsets. The purchase of these credits or offsets allows for a deduction from the emissions a building actually generates in a given year.

Landlords' Local Law 97 Considerations with their Tenants

The potential expenses an owner may incur to upgrade its building to reduce GHG emissions to

[3] Citizens Budget Commission – Balancing Incentives to Maximize Emission Reduction (August 26, 2021 (accessed August 2022)

comply with LL97 (and/or the incurrence of resulting penalties if emissions are not sufficiently lowered) are in itself alone a potential tremendous burden. However, coupling this fact with the additional reality that a building's tenants are responsible for an estimated fifty percent (50%) to seventy percent (70%) of a given building's energy consumption – an item that landlords do not traditionally control or have the ability to limit – presents a considerable problem that landlords must attempt to mitigate. The most obvious mitigation strategy is to provide for cost sharing in lease agreements with tenants, but there are also other viable options.

Operating Expense Considerations

Commercial leases may contain an operating expense provision whereby tenants pay a proportionate share (usually based on the square footage of the tenant's space relative to the square footage of the entire building) of the building's operating expenses (utilities, costs of landlord's employees, cost of repairs, insurance, etc.). One of the items generally covered under such operating expenses provisions are expenses incurred by landlords to comply with applicable laws governing their buildings. Depending on the exact language of the provision, a landlord may be able to pass on to its tenants their respective shares of the expenses landlord incurred to make changes to a building to comply with LL97 (although it would be prudent to now specifically reflect in leases that costs of improvements required or designed to reduce emissions will be included as part of operating expenses so as to avoid any ambiguity or argument by a tenant that the operating expense provision does not apply to LL97 compliance costs). It should be noted, however, that penalties for failure to comply with laws (such as penalties if LL97 emission standards are not satisfied) cannot usually be passed on to tenants by standard operating expense provisions. Certain improvements made to buildings in connection with LL97 may have to be capitalized under the Internal Revenue Code. A tenant may suggest that capitalized improvement costs do not fall within the purview of operating expenses – however, it is usually fair and customary that the expenses of such capital improvements are amortized over the useful life of such item (e.g., if the improvement has a useful life of twenty (20) years, then one-twentieth (1/20) of the cost of such item can be included in operating expenses in a given year). One potential pitfall that landlords need to avoid is that tenants will often request that compliance with law costs (which are included as part of operating expenses) only applies to laws that are enacted after the date of the lease. With such language, LL97 costs would arguably not be included as part of operating expenses for leases executed after 2019 since although the law takes effect in 2024, it was enacted in 2019.

In the event a lease does not contain an operating expense provision (or even if the lease does include such a provision), a landlord could either factor such compliance costs into the base rent that it charges a tenant (the same way a landlord factors in the amount of (base year) real estate taxes into base rent) and/or have a separate standalone provision that in event a penalty is assessed against a building for failure to meet LL97 requirements, then the tenant with pay a share of such penalty. Unlike operating expenses where a tenant's share is based on the square footage of a tenant's space, it would be more equitable to determine the share of the penalty payable by a given tenant based on the amount of such tenant's energy consumption and resulting GHG emissions relative to the building since ultimately emissions and resulting penalties are based on usage and not size of the space leased. The potential down-side is that landlords will have to monitor each tenant's energy consumption which might involve certain administrative and technical challenges to determine a given tenant's share of the penalty (although lease agreements could shift the burden

by requiring tenants to provide landlord with their energy consumption data – although landlords would still need a method to verify the accuracy of such data).

Although landlords undoubtedly desire to pass on as many LL97 compliance costs and penalties to tenants as they are able, ultimately the market will dictate these decisions. Therefore, in a "softer" rental market or where a given tenant has more leverage, landlords may not be able to shift responsibility for such costs (or as much of such costs) as they otherwise could if market conditions were more favorable to landlords. Further, if a building is already in compliance with LL97 or requires minimal upgrades to reach compliance, it is important to note that such building might be more appealing to a potential tenant since such tenancies might result in less significant LL97 compliance costs.

Green Lease Clauses

As an additional option, landlord may seek to incorporate "green lease clauses" in lease agreements. These types of clauses generally require tenants to comply with various "green" policies and practices established by landlords from time to time such as conservation, use and recycling requirements, as well as requirements that tenants abide by landlord's sustainable building practices, which could include practices relating to achieving energy and water efficiency, meeting green building energy goals and lighting performance standards. The language of these types of clauses is fairly broad and vague with the intent of providing landlords with maximum flexibility to meet, and cause their tenants to meet, green goals for the building. From a tenant's perspective, these clauses are often too vague and broad and tenants will primarily be concerned that compliance will not result in burdensome expenses. Accordingly, tenants may want to include a provision that they will comply with such provisions so long as they do result in an additional material expense to the tenant. Further, similar to "caps" on general operating expense provisions, tenants may insist on a "not to exceed" amount on all type of costs that landlords seek to shift to tenants in connection with LL97 (whether such costs are paid as part of operating expenses, share in LL97 penalties, etc.).

Alteration Provisions

Landlords should also consider reevaluating tenant alteration provisions in lease agreements in light of LL97 to promote green and energy efficient improvements by their tenants. This could be achieved via landlord consent standards. In commercial leases, landlords generally have consent rights over tenant alterations whereby some alterations are subject to landlord's "reasonable consent" (generally reserved for interior non-structural alterations) while others follow a more stringent criteria of being subject to landlord's approval in landlord's "sole and absolute discretion" (such as exterior or structural alterations or alterations that impact building systems). Alteration provisions could be modified to reflect that landlords have the right to approve (and therefore reject), in landlord's sole and absolute discretion, alterations which, in the opinion of landlord, negatively impact GHG emissions goals for the building or which may result in excessive GHG emissions.

Existing Leases

The inclusion of the aforementioned provisions in lease agreements is primarily intended for future tenants and future leases. But what can be done for existing leases to mitigate landlord's exposure against LL97 compliance expenses and penalties? If a lease already contains an operating expense provision, then, depending on the actual language of such provision, landlords may already be covered and have the ability to pass a portion of the LL97 compliance costs to their tenants. Otherwise, landlords should consider including such provisions as part of any negotiated amendment, modification or extension of the lease. Landlords might offer incentives to tenants (both new and existing) such as passing through utility and other governmental incentives to pay

for efficiency upgrades or offer improvement allowance dollars to upgrade existing utility systems to make them more efficient (the cost of which is factored into rent and spread out through the term of the lease). The economics of each tenancy will have to be evaluated on a case-by-case basis.

Collaboration

Finally, and maybe most importantly, landlords and tenants need to establish a close working relationship and share mutual goals to meet LL97 requirements since tenants' energy consumption accounts for such a substantial portion of a given building's emissions. Many potential tenants may not even be aware of LL97 implications, and it would be prudent for landlords to make their tenants mindful of emission requirements. When evaluating potential tenants, landlords' focus is often primarily on the reputation, history and financial strength of a tenant. This focus should be extended to evaluate energy related matters and goals (the amount of energy the tenant is anticipated to consume in light of its use and what energy efficient improvements tenant intends to incorporate into their space to limit GHG emissions) and the parties should engage in an open dialogue to explore methods to achieve carbon reductions. Ideally, this dialogue should continue after the lease is signed to constantly evaluate and implement new and/or additional GHG emission reduction methods from time to time.

In summary, considering that LL97 takes effect in less than two (2) years, it would be most prudent for owners to engage professionals to conduct an energy audit of their respective buildings to evaluate and then urgently implement strategies to reduce GHG emissions, bring their building into compliance with LL97 emission standards and/or evaluate the purchase of renewable energy credits or greenhouse gas offsets to reduce their liability. Further, landlords should work with their tenants to implement emission reduction strategies and consider incorporating provisions in their lease agreements that would allow landlords to recover from their tenants a share of the expenses incurred by landlords to make improvements to comply with LL97 requirements and/or a share of any fine assessed against their buildings due to LL97 non-compliance.

Should you wish to discuss LL97, please contact your primary GEABP attorney, or the attorney listed below:

Florian Ellison, Partner (212) 907-7339
Email: fellison@golenbock.com

GOLENBOCK EISEMAN ASSOR BELL & PESKOE LLP

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