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Sustainability offers an opportunity for revenue growth and tenant retention

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Unsteady for a variety of economic reasons, the commercial real estate market is also showing minimal commercial real estate development activity. Property owners will need to focus on alternatives for growing revenues and retaining tenants. Environmental sustainability performance is one area where commercial real estate owners can capture additional market value. According to the U.S. Department of Energy, commercial buildings account for 35% of U.S. electricity consumption. Existing commercial buildings on average spend about 30% of their operating budgets on operating costs, including energy and resource use. Sustainability is exercising ever-increasing influence over investors' and customers' commercial property decisions. Additionally, local governments expect sustainability considerations to be built into development plans, and some are imposing green considerations in updated building and zoning codes.

Financial tools, products, tax credits and other incentives to facilitate underwriting the economic benefits of retrofitting are becoming more mainstream. Proving the value of retrofitting projects is also becoming easier, unleashing additional capital to finance projects. In addition, existing financing structures are becoming more user-friendly and include numerous options serving different segments of the marketplace from traditional debt, to energy performance contracts, to property assessed clean energy bonds. Sustainability improvements may enable commercial real estate owners and operators to reduce operating costs, increase revenues, and attract and retain tenants with improved value. Capturing the value of green improvements to existing real estate is not always simple. In an occupied building, restricted lessor rights of entry, inability to temporarily relocate tenants, and limitations on the pass-through benefit of capital improvements can all be problematic for green retrofitting. Without being able to access the space, retrofitting can be impractical. In addition, the way in which operating expenses and capital expenditures are handled in existing leases can affect the economics of engaging in a retrofitting project. For example, standard lease terms may limit a lessor's ability to recover capital expenditures from tenants, especially during the final years of a lease. Lease terms may also affect what, if any, savings in operating expenses will benefit ownership. Specifically, in a triple net lease, where the base year is established prior to retrofitting, the savings in operating expenses may benefit the tenant, despite the building owner's funding of the improvements. The opposite may be true under a gross lease. These factors have to be balanced because the more value the building owner can capture the better its chances are for obtaining traditional financing.

Commercial real estate is a profit-driven market. Accordingly, the time horizons for realizing a return on investment from a retrofitting project have to be considered for commercial real estate owners. More frequent building turnover, as compared to the municipal, state and federal government market, can discourage certain projects where the payback period may be longer than the anticipated ownership term. Many commercial real estate owners also express concern over whether sustainability improvement costs can be recouped on sale. These factors should be addressed at the outset of any sustainability improvement plan and have to be baked in to an overall strategy. Successfully implementing sustainability initiatives requires identifying the strategic opportunities, goals, and partners early. Aligning interests between, owners, tenants and lenders can incentivize cooperation to achieve energy efficiency goals and better economic performance overall. The conditions for these types of improvements are getting better. Sustainability initiatives are likely to increase during 2013.

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