FOCUS ON GREEN BUILDING

Selling and Governing the Green Project: Owner Risks in Marketing, Entitlement and Project Governance

BY PAUL D'ARELLI, ESQ.

INTRODUCTION

CRITICAL THINKING ABOUT THE LEGAL AND RISK MANAGEMENT issues related to green buildings is in its relative infancy. With the sustainable development revolution upon us and a general consensus that it is here to stay, attorneys for owners, architects, contractors, lenders and the like are beginning to identify how designing, building, certifying and marketing green buildings could subject the various project participants to liability as well as how to protect their clients accordingly. There are an astounding number of players in the sustainability arena sporting green blinders and operating under the premise that green buildings are better buildings, therefore eliminating or reducing the risks in designing, constructing and delivering certified green buildings to the marketplace. Those of us currently counseling clients undertaking green building projects and pursuing third-party certification find such a premise not only untrue but also irresponsible. When you combine new building systems and technologies, inexperienced players throughout the development chain, and the relentless pursuit of a third-party green building certification with exploitation of its attendant marketing benefits, the result is a perfect recipe for potential legal exposure.

While the first generation of certified green buildings has been around for several years, industry groups are only now working on model green building lease language, tooling green design and construction contract provisions, and beginning to identify the insurance risks, coverage implications and possible new products. Why the delay in focusing on legal and risk management issues? After having the opportunity to meet many participants in the delivery of green buildings over the past few years, I have concluded that many developers, designers and contractors bold enough to embrace sustainable development and pursue third-party certification before it was chic, did not know if green building was a fad or if it was here to stay. Without knowing the longevity of the movement and not truly appreciating or understanding

About the Author

Paul D'Arelli, Esq., *is a shareholder with the international law firm Greenberg Traurig, P.A. He was the fifth attorney in the U.S. and the first in Florida to become a LEED® Accredited Professional by the U.S. Green Building Council. D'Arelli also is co-chair of Greenberg Traurig's Green Building & Sustainability Group. He serves as counsel on two major mixed-use LEED for Neighborhood Development Pilot Projects, and has advised clients on a variety of other green building projects and matters. D'Arelli holds an LL.M. from the University of Miami School of Law in Real Property Development and is a licensed California general contractor. He lectures and writes frequently on sustainable development risk management issues.*

areas of potential exposure, there was little investment made or attention paid to risk management issues such as reworking design and construction contracts, scrutinizing the sufficiency of standard professional liability and property insurance, or implementing marketing and leasing protocols to minimize unreasonable expectations of certification and performance outcomes.

From entitlement, design, construction and consulting to incentives, leasing, marketing and insurance, the delivery to market of a building that is striving for LEED®[1] or some other third-party certification poses a host of legal and risk issues that require deliberate and thoughtful management. Nonetheless, attention to legal and risk management issues for buildings or developments seeking certification under green rating systems significantly lags behind the uptake and utilization of green building rating systems. This author believes that important areas for sound risk management in the delivery of a green building or development must be the marketing and entitlement statements and the project governance.

RISK MANAGEMENT ISSUES FOR CONSIDERATION:

Marketing the Green Project

One of the areas rife with legal exposure is the marketing of green buildings. The genesis of the risk comes from enthusiastic owners and zealous marketing in combination with leasing professionals who are proud and eager to tout the sustainable aspects of the project; the time lag between commencing a green building project and the actual receipt of the certification; a general lack of knowledge or unwillingness to acknowledge or appreciate that all green buildings are not meeting certification or performance expectations; and finally, mismatched incentives for owners, marketers and leasing brokers. When the marketing claims discussed below regarding the certification of the project or the building performance are untrue at the inception or prove to be inaccurate, a tenant, purchaser or other third party with unmet expectations (or the desire to get out of a contract for an unrelated purpose altogether) could allege misrepresentation, fraud in the inducement or breach of contract.

Certification Statements

Let's assume an owner/developer is proposing to build an office building and it is the owner's objective to obtain a LEED Gold certification under the LEED for Core & Shell Green Building Rating System™. Procedurally, the project is registered with the U.S. Green Building Council (USGBC) early in the design process. However, it is not until construction of the building is completed that all final LEED letter templates and documentation are submitted to the USGBC to begin the final certification process. Note that under the LEED Core & Shell program, it is possible to obtain "Precertification" based on an early design document review that is intended to essentially allow the owner (and third parties such as tenants and lenders) to expect that if the building is constructed as designed, it is likely to receive certification. Based on current estimates, it can take from several months to a year after the building is completed and final project documentation is submitted for a final disposition of the rating. It is only upon completion of that final USGBC review and certification decision and exhaustion of any appeal, if applicable, that our hypothetical owner will know if the project obtained the LEED Gold certification. In light of this lag, marketing of the project from its inception until the certification determination is made can be problematic.

It is not uncommon, for example, after merely registering a project with the USGBC in pursuit of certification, for an owner to make statements early on in advertising, project signage and other marketing materials that the building "is LEED Gold," "will be LEED Gold" or "will be the first LEED Gold office building in X Town." The design and construction of an office building involves multiple parties—architects, engineers, contractors, subcontractors, and vendors—who all have the ability to compromise the owner's certification objectives. Combine this with the fact that the ultimate rating decision is made by an independent, non-profit, non-governmental organization which often doesn't confer the level of certification being sought by the owner, and it becomes clearer why it is imprudent to make assertions that the project "is" or "will be" certified or certified at any particular level. Furthermore, just because a building may be the first in a particular jurisdiction to be registered with the USGBC is no assurance that another building will not be registered and actually complete certification first. In fact, the number of buildings registered far outstrips the number actually certified. If a tenant or purchaser ascribes substantial value to a particular building being first in some market based on an owner/developer's marketing claims and this ends up not being the case, the owner/developer could face substantive difficulties. Last, it is important to realize that many in the corporate/tenant community do not clearly understand the difference between "Precertification," "Certification,"

"Registered," "Certifiable," or other locutions devised by marketing departments or currently part of the green building vocabulary. Therefore, developers should take extra care not to promote their building as being certified, or assured of certification, and should be particularly careful about these representations if a prospective tenant or purchaser is drawn to "green" as a differentiating advantage.

Now consider that the risk of promoting but not achieving the rating sought is compounded for a project seeking certification under the proposed LEED for Neighborhood Development (LEED-ND) rating program, and why extra vigilance will be merited in marketing the project. According to the USGBC, LEED-ND is a rating system that integrates the principles of smart growth, new urbanism and green building into the first national standard for neighborhood design. It is being developed by the USGBC in partnership with the Congress for the New Urbanism and the Natural Resources Defense Council. Whereas other LEED rating programs focus primarily on green building practices, LEED for Neighborhood Development looks not only at the buildings but also the location of the project and its site design, and draws largely on new urbanist planning principles such as high-density mixed-use, connectivity and reduced reliance on the automobile. Certified green buildings are not required; however, points are available within the LEED-ND rating system for including LEED-certified buildings and for integrating green building practices within the buildings on the project site. These credits relate to energy efficiency, reduced water use, building reuse, recycled materials, and heat island reduction.

LEED for Neighborhood Development is currently being tested as a pilot program that includes 238 projects in 39 states and six countries. The pilot projects are in the process of gathering documentation based on the rating system, which will be submitted to the USGBC with the goal of becoming certified. After feedback and refinement, the resulting draft rating system will be posted for public comment before it is submitted for final approvals and balloting. It is expected to be released to the public in 2009.

There are three stages in the certification process for LEED-ND: 1) Optional Pre-Review; 2) Certification of an Approved Plan; and 3) Certification of a Completed Neighborhood Development.

- **Stage 1** – Optional Pre-Review is available for projects to use at any point before the entitlement process begins. If pre-review approval of the plan is achieved, the USGBC will issue a letter stating that if the project is built as proposed, it will be eligible to achieve LEED for Neighborhood Development certification. The Pre-Review letter is intended to assist the developer in garnering local government support for the project during entitlement, as well as attracting financing and potential occupants.

- **Stage 2** – Certification of an Approved Plan is available after the project has been granted any necessary entitlements. During this step, any changes to the original plan reviewed during the Optional Pre-Review step are reviewed again by the USGBC for their potential effect on prerequisite or credit achievement. If approved, the USGBC will issue a certificate stating that the approved plan is a LEED for Neighborhood Development Certified Plan.

- **Stage 3** – Certification of a Completed Neighborhood Development occurs when construction is complete or nearly complete. The USGBC will review any changes made to the certified approved plan that could potentially affect prerequisite or credit achievement, and if certification requirements are met, the project will be certified as a completed neighborhood development.

By the USGBC's design, LEED–ND was intended for larger, multiple building projects where the master developer is likely to sell off portions of the project to other developers or owners. While there are projects of all sizes and varieties currently in the LEED-ND Pilot Program, many are large, mixed-use projects with multiple buildings that will be built out over several years. Thus, while the owner/developer could obtain USGBC approval of a Certified Plan after the project is entitled, actual certification of the project could be many years away depending on the final build-out of the project. This additional time lag between project inception and the project certification determination provides more time and opportunity for the owner's rating objectives to be compromised. As discussed below regarding project governance, the potential for multiple owners/developers of parcels within the master development also presents a challenge in ensuring that no one owner or developer detrimentally impacts the master developer's LEED-ND rating objectives, and also should merit extra care in marketing statements.

RISK MANAGEMENT ISSUES FOR CONSIDERATION:

Performance Statements

In addition to the tendency or temptation to make speculative statements in marketing materials regarding the project's desired green building certification, some owners/developers make ill-advised claims about green building performance. With indoor air quality and enhanced efficiency and/or lower consumption of energy and water being some of the driving factors in the decision to pursue a green building, promoting these performance objectives is understandable from the landlord's or tenant's perspective. However, too much credence is being given by owners to the "average" efficiencies that are being achieved with LEED-certified buildings as reported by the USGBC and others, or to the anecdotal evidence that is widely circulated in publications, the Internet and at the myriad of conferences on sustainable development. In reality, while the averages may be true, there are a significant number of certified green buildings that are on the low end of the spectrum and not meeting their anticipated performance metrics.

For example, the executive summary of a recent report by the New Buildings Institute, funded by the USGBC and entitled "Energy Performance of LEED® for New Construction Buildings," studied 121 LEED New Construction certified buildings that have been operational for at least one year and which provided actual energy use data, states that:

> "This study analyzes measured energy performance for 121 LEED New Construction (NC) buildings, providing a critical information link between intention and outcome. The results show that projects certified by the USGBC LEED program average substantial energy performance improvement over non-LEED building stock."[2]

This sounds good, but hold the presses on that project marketing brochure. The report also notes later that:

> "Program-wide, energy modeling turns out to be a good predictor of *average* building energy performance for the sample. However, as with the other metrics in the study, there is wide scatter among the individual results that make up the average savings. Some buildings do much better than anticipated . . . . On the other hand, nearly an equal number are doing worse--sometimes much worse." (Emphasis added)
>
> "At the extreme, several buildings use more energy than the predicted code *baseline* modeling . . . . This degree of scatter suggests significant room for improvement in energy use prediction accuracy on an individual project basis." (Emphasis added)
>
> "Variation in results is likely to come from a number of sources, including differences in operational practices and schedules, equipment, construction changes and other issues not anticipated in the energy modeling process."[3]

Because of the tendency of the media and those with vested interests in furthering the noble agenda of green buildings to publicize the efficiencies that are accruing "on average" more vigorously than publicizing performance failures, owners, tenants and others understandably have a perception and expectation that these "average" efficiencies will accrue to them if they commit to a certified green building. These expectations can easily get translated into a well-intentioned owner's marketing material, creating further expectations in tenants and purchasers. For example, statements made in marketing materials such as "this LEED Gold office building will save 28% in energy and 45% in potable water" or "tenants will save money on operating costs and see higher worker productivity and less absenteeism in this LEED Gold office building" are not unheard of. What happens, however, when the publicized performance metrics or green building benefits are not realized? What happens when a tenant or purchaser acquires information during the due diligence process indicating that a study or data used to make these representations is not credible? Or worst of all, what happens if the tenant or purchaser has poor performance outcomes and comes to realize that the representations made by the owner were questionable or less than credible from the beginning? While owners or developers themselves may take recourse against their design and construction team, they may also have disappointed tenants and purchasers whose financial pro forma is distorted or whose reputation is jeopardized when the operational savings or human resource benefits are not realized. Naturally, this creates a potential for claims of breach of contract, misrepresentation and the like, and potential harm to the developer or owner's reputation in the marketplace.

In addition to the increasing challenge of managing risk when promoting the pursuit of certification objectives, managing risk in the marketing of project performance goals may also become more complicated with new rating

systems addressing larger-scale projects like LEED for Neighborhood Development. For example, the targeted efficiencies for energy use, water use, etc., may extend beyond a single building to multiple building, project-wide goals. As discussed in more detail below, certain credits under LEED-ND could require cooperation or compliance by multiple building owners or developers, increasing the potential for non-attainment.

To protect against potential third-party claims when expectations are not met, owners and developers should be careful to not make statements in their marketing materials regarding building performance that could prove untrue and be alleged as a significant inducement to lease or purchase. While "puffery" or exaggeration of a product's benefits is common in sales, it should probably be avoided in the context of green building performance expectations, as many on the receiving end of the statements may not know them to be speculative. It would be wise to train marketing, sales and leasing professionals involved with the project so that they fully understand the certification process and the attendant risks of making untrue statements or statements of desired performance outcomes which the owner may not have adequate control to ensure. Also, given the frequent disconnect between marketing, management and legal departments, developing a company protocol for review and approval of all green building aspects in project marketing materials, press releases, etc., by counsel knowledgeable in these matters could be a sound component of the project risk management strategy.

ENTITLING THE GREEN PROJECT

Everything discussed above in terms of the need to exercise caution when marketing a green building project should also be taken into consideration when entitling the project. Regarding entitlements, many local governments are interested in increasing the amount of green building stock within their jurisdictions; and regardless of whether the jurisdiction has any green building mandate or formal incentive program, "going green" is increasingly being encouraged. As such, owners or their zoning counsel seeking support for a development proposal, may be inclined to make statements or commitments regarding the project's green building objectives in comprehensive planning, zoning, site plan or other development approval applications, in conversations with local government staff or elected officials or at the dais during a public hearing.

As in the sales context, it is not uncommon for land development counsel or other project advocates to passionately extol the many virtues of their projects in an effort to secure project approval. If that is done in the context of green building objectives, an owner could inadvertently find those statements manifested in the form of development approval conditions. As such, obtaining a building permit or a certificate of occupancy could end up being conditioned on the owner's demonstrating that the green building commitment is assured or was met—a risky proposition if that commitment is to obtain a third-party certification. While this may sound remote to some, an acquaintance of this author recently disclosed that he is involved in a project with which the local government made LEED Silver certification a condition of approval for the project's conditional use permit. With this example in mind, it is suggested that all development approval applications and statements made on the public record during project entitlement be carefully tailored so that mere aspirations to pursue third-party green building certification do not to become approval conditions unless the owner is prepared to accept them.

When the USGBC's pilot program for LEED for Neighborhood Development is completed and LEED-ND is rolled out for general use, any such conditions of approval that are tied to a LEED for Neighborhood Development certification could be particularly risky or constraining. Since LEED-ND includes concepts of new urbanism that affect land planning rather than just building design and construction, a commitment to obtain LEED-ND certification could carry significantly greater risk than committing to build a certified green building. For example, in an effort to meet neighborhood certification commitments or requirements, developers could be compelled to pursue credits that affect such things as solar orientation of lots and blocks; inclusion of affordable housing; residential unit type, mix and density requirements; and project access spacing requirements, to name a few. In fact, one LEED-ND prerequisite, "Neighborhood Pattern & Design Prerequisite 1: Open Community," requires that the developer: "Designate all streets and sidewalks that are built as part of the project or serving the project directly as available for general public use and not gated. Gated areas and enclaves are NOT considered available for public use, with the exception of education and healthcare campuses where gates are used for security purposes." As such, even to be eligible to seek certification under LEED-ND as it currently stands in the

pilot version, the developer could not gate the project. While such concepts of new urbanism may be "good planning," developers may find themselves in a very difficult position. This is particularly so since developers seeking land use or zoning entitlements often do not have enough design detail and information to know exactly how such far-reaching commitments will translate in terms of cost or suitability in a particular market. Owners or developers who make or accept the commitment to obtain LEED-ND certification during early stage entitlement should be prepared to accept the design constraints and potential implementation costs associated with these planning schemes.

PROJECT GOVERNANCE

In addition to marketing and entitlements, project governance also should be revisited to accommodate green building issues. Consider, for example, the project governance complexities in the case of a mixed-use building with residential condominiums, hotel and retail that is seeking certification under the LEED for New Construction rating program. The residential condos are proposed to be sold and there will be a condominium association. The hotel will be sold as a commercial condo and will be operated under a national flag with a green lodging initiative pursuant to a hotel management agreement. The retail will be sold as commercial condos and the owner will cater to retail stores and restaurants whose sustainability commitment drives their decision to locate in a LEED-certified building, including one national retailer with a corporate mandate to locate only in LEED Silver certified space. In addition to attaining LEED certification, the commercial condo owners desire that the building continue to be maintained and operated at the same standard that qualified the project for LEED certification in the first place, so that it can be certified in the future under LEED for Existing Buildings. There will be a master association over the entire project.

As a threshold matter, it becomes imperative to understand and anticipate the objectives and expectations of both the developer, and to the extent possible, each of the end users in mixed-use green buildings. In the example noted above, for at least two of the uses (hotel and retail), the proposed LEED certification is an integral component of the business model for product differentiation and a corporate mandate for one of the targeted tenants. With the objectives identified, project governance needs to be put in place to ensure that the objectives are likely to be met over both the short and long terms. A mere sampling of issues to consider includes:

- How will the green building objectives (certification, performance, maintenance, etc.) be defined and translated into all appropriate project documentation (e.g., condo documents, property owner association documents, CC&Rs, etc.)?
- How does the master developer ensure that each of the owners and end users will cooperate in any requirements necessary to obtain the desired LEED certification?
- How will controls be established (e.g., integrating LEED or other consulting into the architectural review committee process) so no owner, tenant or association can make physical alterations that could compromise the project rating or performance objectives?
- If there are multiple associations, what controls will be put in place to ensure no association could take action to impair the future project certification or performance objectives by amending the association documents?
- How will operational requirements such as green cleaning, green pest control, recycling, etc., be imposed and enforced project-wide?
- How do the project documents provide sufficient assurance to the end users regarding maintaining the integrity of the green building objectives, while retaining flexibility for the master developer to make adjustments based on market conditions, pursuit of the certification, etc.?

Clearly, the project governance issues for a single mixed-use building are already complex. Some of the projects in the LEED-ND pilot program and the types that are likely to pursue LEED-ND certification once it is released to the public include large-scale, mixed-use or "town center" projects that could include multiple residential, office and retail buildings, hotels and other uses. In addition to the governance challenges that accrue just by virtue of the number and types of buildings in the project, there are also certain credits in the LEED-ND rating system that can create issues. Consider the challenge in structuring project documentation to allocate among the various parcels, buildings and owner/developers, the rights and responsibilities to ensure compliance with the following LEED-ND prerequisites and credits:

NPD Prerequisite 2: Compact Development, which requires the developer to build any residential components of the project at an average density of seven or more dwelling units per acre of buildable land available for residential uses, and build any non-residential components of the project at an average density of 0.50 FAR or greater per acre of buildable land available for non-residential uses, with the specified average density required to be achieved by the point in the project's construction at which 50 percent of dwelling units are built, or within five years of the date that the first building is occupied, whichever is longer.

NPD Credit 3: Diversity of Housing Types, which requires inclusion of a sufficient variety of housing sizes and types in the project such that the total variety of housing within the project, or within one quarter mile of the center of the project, achieves at least 0.5 according to a calculation based on the Simpson Diversity Index.

NPD Credit 4: Affordable Rental Housing, which requires inclusion of a proportion of rental units priced for households earning below area median income pursuant to certain standards and requirements for 15 years.

NPD Credit 5: Affordable For-Sale Housing, which requires inclusion of a proportion of for-sale housing affordable to households at or slightly above the area median income pursuant to certain standards.

GCT Credit 1: LEED Certified Green Buildings, which requires projects with up to five habitable buildings to design, construct or retrofit one of those buildings to be certified under one of the specified LEED building rating systems. Additional points (no more than three) may be earned for each additional certified building that is part of the project. For projects with more than six habitable buildings, it is necessary to design, construct or retrofit a specified percentage of the square footage of project buildings for certification under one of the LEED building rating programs.

GCT Credit 2: Energy Efficiency in Buildings, which requires design and construction of **at least 90 percent of all buildings** in the project such that they meet certain energy improvement requirements.

GCT Credit 3: Reduced Water Use, which requires design and construction of **at least 90 percent of all buildings** in the project such that they meet certain water efficiency requirements.

A review of these few credits alone poses such questions as: how will time requirement compliances be assured, such as those for achieving density targets? How will green building certification requirements be imposed and enforced for certain buildings? How will minimum energy and water efficiency requirements be allocated and assured on a per building basis to ensure compliance with project-wide goals? Because there are no form documents available to address these issues, knowledgeable counsel and creative and comprehensive document drafting are required for successful implementation and risk management. It has been this author's experience that many owners and other stakeholders believe there is a simple paragraph or magic contractual provision to insert into their documents to defray the risks. Unfortunately, no such easy prescriptive solution exists. Every project and the objectives and requirements of the parties are unique and require scrutiny. Furthermore, providing form language to those who do not understand the implications of negotiating revisions to the language may not be prudent.

CONCLUSION

Advocates of sustainable development argue that green buildings are "better" buildings for the environment and the health of our planet. Those offering effective criticism, including discussion of the potential for risk, may mistakenly be perceived as anti-environmental. Still, the reality is that while green buildings may very well be better buildings for the environment and the planet, depending on the measure and the particular building, there *are* risks inherent in building certified green buildings.

If we want to encourage more green building, we need to help all project participants understand and manage the project and process risks, including those related to entitling, marketing and governing green projects. ■

ENDNOTES

1. LEED® is a registered trademark of the U.S. Green Building Council.
2. *New Buildings Institute Final Report*, March 2008, "Energy Performance of LEED® for New Construction Buildings," Cathy Turner and Mark Frankel, pp. 1-4. It should be noted that this study was funded by the USGBC.
3. Ibid.