Unfortunately, too many building owners and managers continue to regard utilities as a “noncontrollable” cost that is passed through to the tenants when, in fact, there are many no-cost/low-cost measures to improve energy performance that can yield potentially significant returns in NOI and tenant satisfaction.

The goal of this IREM Key Report is to motivate real estate practitioners to understand that reducing energy consumption increases profit potential and property value, lowers operating costs, and extends the life of building systems while reducing atmospheric pollutants. Studies have shown that energy consumption can be reduced by 30% in office buildings without compromising occupant comfort levels.

Energy Management Yields Financial Rewards

Building owners and managers often have the option to recover energy efficiency upgrade costs by recouping those costs from their tenants. Many leases, especially in multitenant buildings, have provisions for the landlord to recover from tenants monies that are spent to benefit all tenants. In the case of an energy-efficiency upgrade, such as installing energy-efficient lighting in common areas (hallways, lobbies, bathrooms), tenants benefit from improved comfort levels, improved security, and savings achieved through reduced energy costs. We’ve included some sample lease language pertaining to capital cost recovery for energy efficiency improvements (Exhibit 3).

Energy efficiency upgrades with short payback periods, such as lighting upgrades, offer immediate and recognizable benefits and are straightforward to propose to tenants. Voluntary retrofits or upgrades with longer payback periods are often more difficult for landlords to justify, especially to tenants whose lease terms are nearing expiration.

While capital cost recovery, also known as tenant cost recovery, provides building owners and managers a cost-effective avenue to improve the efficiency of a building, there are situations where they may not choose to exercise that right. In a weak market, for example, tenants may decide to move elsewhere rather than pay their portion of the upgrade costs. In this case, building owners and managers may be more willing to pay for the upgrades than to incur the expense of recruiting a new tenant. In a strong market, however, tenant resistance to subsidizing energy efficiency improvements will likely be lower, as the cost of finding a new location and mov-
ing would most likely outweigh their proportionate cost of the improvement. In either case, a seasoned negotiator should always be used to discuss capital cost recovery with tenants.

Building owners and managers may also choose not to invoice a tenant for an efficiency improvement if the tenant’s lease is about to expire. In fact, many times landlords will use this opportunity as a discussion point to extend the term of a lease. Landlords may offer to waive the charge if the lease is extended.

Capital cost recovery can be a viable and attractive option for landlords to finance the costs of energy efficiency upgrades that can provide a myriad of benefits to all tenants within the building.

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**Exhibit 3**

**Sample Lease Language for Capital Cost Recovery of Energy Efficiency Improvements**

Operating Expenses shall include…the cost of capital improvements or other costs incurred in connection with the Premises and/or Building that (1) are intended as a labor-saving or energy-saving device or to effect other economies in the maintenance of, or stability of services to, all or part of the Premises and/or building, including but not limited to those capital improvements necessary to establish and/or maintain an ENERGY STAR® rating for the Building equal to or greater than ____ and/or (2) are required under any government law or regulation but that were not required in connection with the Real Property when permits for the construction of the Building were obtained. All permitted capital expenditures shall be amortized over their useful life, as reasonably determined by Landlord.

Adapted from *Office Leasing: Drafting and Negotiating the Lease*, Continuing Education of the Bar (CEB), California, 2001.