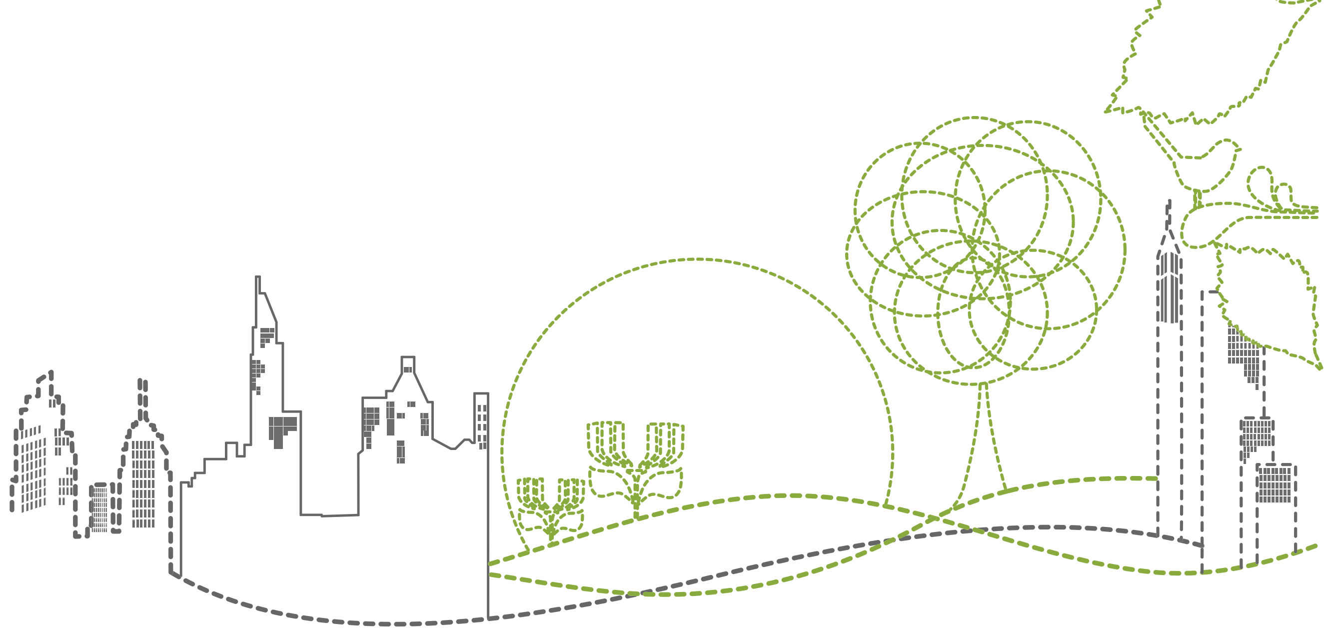

Gone Green?

What to Consider When You Build to the Changing Environmental Standards

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As commercial real estate markets begin to recover from the economic downturn, many developers and operators will be surprised to learn that building codes and laws on energy efficiency and sustainability may have changed the playing field dramatically. In the past few years, 13 federal agencies, including the GSA (U.S. General Services Administration), 33 state governments and 190 local governments, have adopted sweeping new "green" laws and regulations.

Many of these new laws and regulations require or encourage some level of compliance with LEED® standards. LEED (Leadership in Energy and Environmental Design) is a system developed and administered by the U.S. Green Building Council for certifying a building's overall sustainability, using a wide range of criteria in five categories: sustainable sites, water efficiency, energy & atmosphere, materials & resources and indoor environmental quality. Buildings that satisfy certain prerequisites and earn a sufficient number of optional points are awarded LEED certification on a 100-point scale, ranging from Certified (40–49 points), to Silver (50–59 points), Gold (60–79 points), to Platinum (80 points or more).

In California, for example, Executive Order S-20-04, known as the "Green Building Initiative," requires all new and renovated state-owned buildings to meet LEED Silver standards. The accompanying Green Building Action Plan requires all state-owned buildings to reduce energy consumption by at least 20 percent by 2015, and encourages private sector buildings to reach the same goal. Many localities have adopted regulations that impose strict green standards on private as well as public buildings. In July 2008, the California Building Standards Commission adopted the California Green Building Standards Code, which mandates sustainable design standards and construction practices applicable to a wide range of building types in the state of California.

Real estate operators nationwide should be assessing now how new green laws and regulations will impact their future development and operations. Sustainable thinking should be integrated into the entire development process.

LEED-related issues cannot be left solely to the architects, as some decisions that can have a critical impact on LEED certification, such as site selection, are made even before design professionals are hired. Some low-cost or no-cost LEED credits can be achieved simply by having certain policies and good recordkeeping in place, and requiring tenants, property managers and other contractors to comply with these policies. Smart businesses will begin to anticipate necessary changes in operations in their budgets and business plans. Measures to reduce water and energy consumption can be less costly, for instance, if they are implemented strategically over a period of time, before benchmarking regulations require such reductions.

Real estate operators should also reassess their insurance coverage. The insurance industry is poised to provide coverage for a wide range of risks associated with the design, construction and maintenance of buildings designed to meet specific benchmarks of energy efficiency, comply with updated building codes and obtain specific certifications of energy efficiency. As is generally true with insurance for construction projects, the time to consider a green building coverage program is before construction. Such insurance can also facilitate transactions by addressing stakeholder concerns. In other words, risks associated with financing or purchase and indemnity commitments can be managed using insurance in order to reassure potential participants in a development deal.

As with other legal contracts, an insurance audit designed to assess green building risks should involve all participants in the construction project. Ensure that the entire development and risk management team — including the disciplines that are not directly impacted by LEED — is aware of the LEED objectives. Identify the disciplines that are impacted by LEED and see that relevant policy language reflects the LEED requirements. Becoming an additional insured on other people's insurance policies is an economical way to manage risk. The package of contracts that is entered into for the project represents an opportunity to share the risk of LEED-certification failure with all participants — such as the architect, LEED consultant and constructors — whose acts and omissions can make the difference between success and failure. Contractors and other project participants also need to remember that policyholders may not be able to rely on commercial general-liability insurance to respond to claims that acts and omissions, or those of subcontractors, caused the project to fail to receive certification, or to reach the target certification level or incentive-qualifying goal.

Inevitably, the uncharted nature of green building risks will give rise to disputed claims. Policyholders can reduce such disputes by consciously assessing the risks that green building commitments entail. Coverage must be molded and underwritten to fit the unique green building risks and scenarios outlined below.

A growing number of insurance companies are beginning to offer "green" insurance policies that provide specific green building replacement coverage and, for buildings that are not yet green, "upgrade" coverage that will cover the costs of upgrading damaged non-green products with green products. At least one insurance company provides specific business interruption coverage to cover lost income and increased energy costs resulting from damage to renewable energy generation systems.

While specialty insurance products may prove to be a prudent purchase, an insurance audit should begin by considering the extent to which a company's existing insurance program covers green building risks. Even when new technology or code-compliance replacement costs are not specifically addressed in insurance-policy language, coverage for such costs may still be available under traditional forms of insurance. Just because coverage was not specifically contemplated should not mean that it does not exist. Some holes may be plugged or ambiguities resolved by negotiating policy language or purchasing endorsements.

An Overview of Green Building Risks

The most basic green building risk for which developers must make sure they purchase insurance coverage is the risk that green technology will not function properly and save costs. Such failure may give rise to risk transfer and coverage issues involving both general and professional liability. These include:

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- Policyholder rights against contractors and/or architects when construction projects fail to obtain LEED certification or yield the benefits envisioned. Failure of new technologies to yield cost saving or perform as promised can significantly undermine the initial success and future viability of green construction projects.
- The scope of property coverage if and when additional costs associated with obtaining LEED certification or with increased or supplemental energy-related construction costs are incurred.

> *“Property insurance policies for green buildings should be worded to cover the costs to replace sustainable materials in a fire or as a result of some other natural or man-made calamity.”*

Property insurance policies for green buildings should be worded to cover the costs to replace sustainable materials in a fire or as a result of some other natural or man-made calamity. Most standard property insurance policies may not cover loss or damage to, or resulting from, some of the most common green building features. For instance, a policy may cover roof replacement, but not the landscaping, dirt, irrigation equipment, waterproofing, additional load support and specially trained labor necessary to replace a vegetated green roof. By the same token, a policy may not cover water damage to a building resulting from storm water runoff or faulty irrigation associated with a green roof installed by the owner.

Insurance should also be tailored to cover regulatory liabilities associated with green building. Legal challenges to municipalities' new municipal codes and ordinances can create ambiguity, which in turn may lead to liability. For example, a federal judge has already granted a preliminary injunction barring enforcement of such laws pending the outcome of a lawsuit brought by HVAC contractors and distributors against the city of Albuquerque, New Mexico. In *The Air Conditioning, Heating and Refrigeration Institute v. City of Albuquerque,* the plaintiffs allege that Albuquerque's 2008 Energy Conservation Code, which requires more insulation in single-family houses, outlaws electric water heaters and imposes high efficiency standards for heating and cooling equipment, is preempted by existing federal law. The Energy Policy and Conservation Act sets efficiency standards for HVAC equipment and may preclude states, municipalities or other entities from taking independent action. Where there is litigation, liability insurance should be available to offset defense costs.

Not all green insurance innovations are addressed to new risks. Due to *lower* risk factors and more prudent and carefully monitored property management associated with green design and operation, some property insurance companies are beginning to offer premium discounts for green buildings.

Real estate operators, lenders and investors should review the terms not only of their insurance contracts, but of all their standard legal documents. As with any change in laws, building standards and market expectations, the greening of the built environment compels us to reexamine our contracts and legal strategies to address emerging issues. Contracts, leases and other documents should be updated to address and take advantage of green issues.

In commercial real estate, the playing field is becoming much greener. New laws and regulations create new burdens, new liabilities and new opportunities. ▲