

MANAGING COST IN GREEN LEASES – THE “SPLIT INCENTIVE”

WHAT DOES THE TERM “SPLIT INCENTIVE” MEAN?

“Split incentives” refer to any situation where the benefits of a transaction do not accrue to the actor who pays for the transaction. In the context of energy efficiency in buildings, split incentives are linked with cost recovery issues related to energy efficiency upgrade investments due to the failure of distributing effectively financial obligations and rewards of these investments between concerned actors”

*Castellazzi, L., Bertoldi, P., & Economidou, M. (2017). Overcoming the split incentive barrier in the building sector: Unlocking the energy efficiency potential in the rental & multifamily sectors. Publications Office of the European Union. <https://doi.org/10.2790/912494>

HOW WE ADDRESS THE ISSUE OF COSTS IN THE BBP GREEN LEASE TOOLKIT

Principles reinforced in the toolkit



Balanced approach – clauses are mutual where appropriate balancing both owner and occupier needs. The toolkit was developed with input from both owners and occupiers and well as industry stakeholders.



Cost of improvements – While there is no specific drafting on costs in the toolkit, general principles are approved i.e. To contribute to extent of savings and landlord to bear premises sub-metering cost. Some limited-service charge recovery for taking account of Environmental Performance in existing services.



Shades of green – this enables users to consider the right level of ambition for them. (note: shades of green not available for Sustainable Use, Data Sharing and Metering, Smart Tech and EPC protection)



Cost conversations – Heads of Terms guidance reflects that it is so important to have cost conversations early – get the right people in the room at the right time!

Empasis on the shared leasing journey

Drafting aimed at encouraging behavioural change sets the scene for mutual sustainable expectations and collaboration over the long term. Success is framed beyond immediate financial return and ROI can capture successes across E, S and G initiatives.



Service charge

Statement of Intent: *The lease contains some limited cost recovery for services which take account of environmentally responsible approach to services*

Signposts for drafting:

- Costs of express obligations on L are recoverable
- L to act in interests of good and environmentally responsible estate management
- L entitled to have regard to Environmental Performance of Building but ensure any increased cost is economically proportionate
- Otherwise no challenge on costs if increase due to services which promote Environmental Performance (to a limit of a 10% increase)

- Suggested additional services : minimising deliveries scheme, recycling Waste, technology to monitor/control Environmental Performance, metering , steps to reduce water usage, payment of taxes etc in respect of carbon emissions impact of Premises, advice to improve the Environmental Performance, collecting and analysing data

Note: Guidance only on parties expressly agreeing cost contributions to improvement works based which result in savings for tenants

Reference to the statement in the **RICS Professional Statement on Service Charges** in Commercial Property that “improved sustainability . . . measures are factors in any cost benefit analysis justifying improvement costs”

Drafting provided in context of MCL lease – one level only
Read full details here : [Service Charge | Better Buildings Partnership](#)

CONSIDERATIONS WHEN THINKING ABOUT THE SPLIT INCENTIVE

1. The Broad Owner and Occupier Context

Owner and occupier considerations

- Costs and benefits often fall on different parties:
- Owners may fund energy-efficiency upgrades while occupiers receive the bill savings
- Owners may capture higher rental values while occupiers face higher rental costs
- Solving this misalignment requires building a more collaborative owner–occupier relationship and jointly approaching ESG upgrades, so responsibilities and benefits are better aligned. Returns are multifaceted and may be longer term.

Engagement & Upskilling

Parties can collaborate to discuss energy-efficiency benefits, share data, and participate in building-wide sustainability initiatives. This can incentivise improvements to reduce consumption, operating costs, and emissions by creating shared motivation to invest and align incentives.

Green Lease Agreements

- Lease provisions can assign clear responsibility and align financial outcomes for both parties.
- Embedding clear agreements on cost and savings-sharing mechanisms, data transparency, and building-management practices, allows owners and occupiers to collaborate effectively. Making the distribution of effort and benefit aligned.

2. Financial & Economic Mechanisms

- **Uncertain and delayed financial benefits can reduce motivation:** long-term savings from energy-efficiency upgrades are difficult to predict, creating hesitancy to invest.
- **Benefits can be unevenly distributed:** while owners may capture increased property value when upgrades are reflected in valuations, occupiers may pay ongoing utility costs but see limited return, discouraging joint investment.
- **Complexity in tracking benefits:** difficulties in calculating and attributing energy or cost reductions during lease terms make it unclear who benefits, further weakening incentives for either party to act.

Options to consider

On the Bill Financing

- Utility-bill-linked financing aligns payments with savings by tying the repayment of energy-efficiency or renewable upgrades to the occupier's utility bill.
- Occupiers gradually pay through the energy savings they directly receive, while owners can recover investment costs without upfront outlay.

Property Assessed Clean Energy Financing

- Allows property owners to fund energy efficiency upgrades through property tax assessments, which are repaid over time.
- By funding energy-efficiency or renewable upgrades through long-term property tax assessments, owners can invest without upfront costs, while occupiers immediately benefit from lower energy bills.

Service Charge Recovery

- A mechanism that allows landlords to recover agreed costs for building improvements through the service charge.
- Creates a structured, agreed mechanism for investment: both parties have clarity on what will be funded, how costs will be shared, and how benefits flow, this transparency makes it easier to plan, justify, and implement improvements.

3. Legal & Regulatory Context

Lease structures and timing create barriers

Standard lease durations and timing mismatches between investment payback periods and lease terms can delay or block implementation of efficiency upgrades. Negotiating shared arrangements, such as green leases, is often complex and time-consuming, limiting adoption.

Limited government support

In many cases, policies, incentives, or guidance to encourage shared investment in energy efficiency are weak or absent. Without regulatory support, owners and occupiers can lack external mechanisms to align costs and benefits, reinforcing the split incentive.

Approval and compliance hurdles

Legal requirements for planning permission, safety inspections, or lease modifications increase perceived risk and administrative burden, further discouraging investment from either party.

Legislation can create mandatory requirements or incentives

Legislation can create mandatory requirements or incentives for energy performance improvements, or minimum energy standards for commercial properties. This forces alignment of incentives such as a change in lease structure, removal of barriers to data sharing, policy protections.

SOLUTIONS AROUND THE WORLD

USA: Energy-Aligned Clause

- The Energy Aligned Clause (EAC), introduced by the City of New York in 2010 to address the split incentive.
- Allows owners to recover a portion of energy-efficiency investment costs from occupiers, but caps annual recovery at 80% of projected energy savings.
- This provides a buffer for occupiers against potential underperformance.

France: Grenelle II Law

- For larger commercial leases, there is a legal requirement to include a separate environmental appendix, under the 'Grenelle II Law'.
- This legislative approach encourages owners to invest in building energy performance.

Australia: Environmental Upgrade Agreements

- The programme enables property owners to fund energy-efficiency upgrades involving the owner, a lender, and the local council- with repayments made via council rates and occupiers optionally contributing.
- It offers up to 100% project financing, occupiers pay a portion via rates, getting lower energy bills, while owners get asset value uplift, with repayments tied to the property and long terms (up to 20 years).
- This ensures cash flow to positive upgrades, making it easier to fund efficiency projects.

INDUSTRY TOOLS

Green Finance Institute



- Property-linked finance advocacy: developed financing models tied to the property, so the cost of energy-efficiency or retrofit upgrades transfers with the building, reducing barriers for owners and aligning costs with beneficiaries.
- Demonstrator projects and tailored solutions are creating pilot financing and lease models for different building tenures.

Resources:

Greenprint for PLF in the UK: <https://www.greenfinanceinstitute.com/wp-content/uploads/2024/11/A-Greenprint-for-Property-Linked-Finance-in-the-UK.pdf>

Greenprint for PLF in the Scotland: <https://www.greenfinanceinstitute.com/wp-content/uploads/2025/12/Scottish-PLF-Greenprint.pdf>

Link to the Global Property Linked Finance Initiative, which aims to scale PLF into a global asset class: <https://www.propertylinkedfinance.com>

PACE Nation



- A US based organisation, PACE Nation advocates for policies and programs that allow property owners to fund energy-efficiency and renewable energy upgrades with long-term, property-tax-linked financing.
- This works to grow and strengthen the uptake of PACE financing by promoting across jurisdictions, helping shape regulations, and connecting members (governments, financiers, industry) to enable energy-efficiency and clean energy retrofits at scale.

RICS SERVICE CHARGE CODE

Aimed at commercial property managers and occupiers in the UK, *Service charges in commercial property*, 2nd edition, promotes best practice, uniformity, fairness and transparency in the management and administration of service charges in commercial property.



This professional standard aims to help ensure that budgets and year-end certificates are issued in a timely manner and encourages a reduction in the causes of disputes (and where there are disputes, provide guidance on resolution). It provides guidance to solicitors, their clients (whether owners or occupiers) and managers of service charges, in the negotiation, drafting, interpretation and operation of leases, in accordance with best practice. This professional standard also sets mandatory requirements for RICS members and RICS-regulated firms, which will encourage service charges to be managed with greater consistency and due diligence.

[Service charges in commercial property](#), 2nd edition, is effective from 31 December 2025.

Additional resource

[Roadmap to Accelerate Building Decarbonisation and Address Split Incentives | Sustainable Markets Initiative](#)

