

The Property Line: Bright Deals: Rooftop Solar Leases

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Welcome to the Property Line, a commercial real estate podcast brought to you by Seyfarth Shaw's Real Estate Department. The Property Line is a brief discussion of current market trends, bringing you insights from our acclaimed, national team of real estate attorneys. Each episode focuses on a key takeaway for the busy real estate professional. Now, on to this week's discussion.

Chris Palmese

Hello, and welcome back to The Property Line. My name is Chris Palmese. I'm a partner in Seyfarth's Real Estate Department. I'm joined today by Josh Newell, Senior Vice President of Project Delivery at SolarKal. SolarKal is a leading solar advisor and marketplace for commercial real estate, helping property owners and businesses maximize solar revenue through competitive bidding and project management. Josh, thanks for joining us today.

Josh Newell

Absolutely Chris. Glad to be here.

Chris Palmese

Can you give us a brief overview of rooftop solar leases, including what types of buildings that seem to be most popular—and how the economics generally work?

Josh Newell

Yeah, sure. So, a solar lease in a lot of ways is just the same as a typical tenant lease, right? So it's having a developer, what they're doing is they're leasing building owner's rooftop, they're then installing solar panels on the roof and selling the power. So they're really just another tenant at the building.

What's great about these solar releases is that the solar developers are fully responsible for everything going on, right? Just like a normal tenant would be. They have to maintain their equipment, they pay for everything, they track everything. So the building owner, you know, it's essentially a triple net lease. Generally, these solar leases are also long term, often 20 year leases with fixed annual payments, so low risk.

The panels are sitting up there producing power and they're paying the landlord to fix these payment. The reason they're able to do this is solar companies are generally selling that power off site to some sort of long term contract that's typically governed by a state regulation of some sort.

So they have this low risk long term contract to sell the power and that's why they can do a long term fixed rate lease with the landlord. So it's very high credit tenant in that regard.

I know you asked specifically about what types of buildings. Solar can go on pretty much any type of building. There definitely are better or worse or easier properties to do this with. So, I'd say generally warehouse industrial properties are ideal. Big, flat, clear roofs are ideal for solar. It could be 50 thousand square feet roofs. In some markets, I'd say, if you're over a hundred thousand square feet, that's ideal. And, you know, we certainly go all the way up to five, six, seven thousand square feet roofs, which are great.

Chris Palmese

And I think what's great about this is that for a lot of buildings and building owners, they seem to be using what, before now, was really an unused space on the roof.

Josh Newell

Yeah, absolutely. Yeah, these are underutilized, especially these flat roofs, they've got some HVAC and RTU equipment up there, but otherwise, yeah, no one's up there. And so, utilizing that that space is a great way to just add some additional NOI to the to the building.

Chris Palmese

Now, I think what I've seen personally and generally in the market happen over the past several years, solar rooftop leases for solar farms have seem to become more popular. Why do you think that is? And for our listeners out there, how do you think commercial real estate owners can really benefit from this popularity?

Josh Newell

Yeah, yeah. So I'd say I can break it up into two different things going on here. One is just the macro fact that solar is getting more popular, you know, so the price of solar has fallen by about 90% in the last decade, and with that institutional investors have really stepped in They've realized that this is a low risk, high return project, so that's pushed solar's cost of capital down.

Meanwhile, the cost of traditional power—this is a very common topic, *The Wall Street Journal* is writing about this all the time—the cost of traditional power is going up while the cost of solar has been going down. So, there's those macro factors that are just making solar more popular, but then specifically why rooftop solar leases? That's a bit of a different story. It really comes down to the state programs.

So, more and more states are incentivizing solar and they're putting in regulations that allow power to be sold off site. We typically call it community solar. So, states like New Jersey, New York, Maryland, Massachusetts, Illinois, just to name a few, they have all

established really solid programs over the last five years. And so, as those programs, you know, this is the power industry and regulation is everything, as those regulations have come into place, it's allowed us to do this.

And then, real estate owners, they they love it. Their existing tenants don't have to be involved, right? The power's just going straight to the grid. Those, those existing tenants can opt in and buy the power if they want, but they don't have to get involved here. Like we talked about earlier, underutilized space, all of that, so real estate owners have just come to realize, hey, here are these new programs, and the economics have just penciled really well to allow for these lease payments.

Chris Palmese

Talking a little more about the leases specifically, solar leases I think are a little bit different than regular leases. They're even different in many ways than regular rooftop leases or other types of leases on rooftops. If you could talk a little bit about pitfalls or any specific aspects of solar rooftop leases that you think owners might want to be aware of or might be interested in.

Josh Newell

Yeah, absolutely. That's a great question, Chris. We spent a lot of time on this because it is the 20 year lease, right? So you want to get that lease right. It's a long term contract. So, I would break it up really. There's the what we call the development period or due diligence period, and then there's the operating period. And so of course there are just different things going on in those different periods.

So, first with the development period, my understanding—and, of course, Chris, you're probably the expert here comparing it to traditional leases—but my understanding is that, with solar, that that DD period, the due diligence period is a bit longer. These real estate developers, sorry, these solar developers, they have to go through utility applications and studies.

They have to get into these programs that I was talking about earlier, these state programs, these incentive programs. Often, they're only open once or twice a year. They've got to get access to that and still go through the permitting and go through the equipment procurement and all that.

So, that lengthens the DD period, and so what that means is that real estate owners have to be a little more comfortable with some uncertainty during that period. I think compared to if you're just a logistics company moving in, there's just less permitting going on, less unknowns.

Chris Palmese

I think that's right. In traditional spaces, much of the diligence is really done before you sign a lease while you're negotiating. And, in many ways, it's easier because more of the information is available before you sign the lease. There is no need to do post

execution diligence on whether the roof can support the exact type of system that gets approved.

Once you get into the program, I have seen the development type of due diligence period on these solar leases really extend a bit of time to allow time for things like getting into programs, getting certain approvals, interconnections, things like that.

Josh Newell

Yeah. And these are capital heavy projects and so that's why solar developers typically ask for a lease to be signed a little earlier because they do have to deploy a good amount of capital, so they just want that certainty that the building, the space is going to be theirs.

On the positive side of it being a capital heavy project is, again, once they're on the roof, they're only coming on site once or twice a year, right? They don't need parking, there's a lot of things they don't need, but they do need a little bit more flexibility early on.

And then if I could just jump over to the operating period cause that's, of course, again, this is a 20 year lease and they're up there on your roof for 20 years. So you want to make sure you're well protected there. You want to make sure you've got language on covering roof repairs. How does that work? If you need to add an RTU five years down the line, how does that work?

So, there are contractual ways to deal with this, of course. Chris, you and I have worked virtually on some of this. There are also operator operational ways, right? Leaving a little bit of extra open space on the roof or, of course, always ensure the roof is new and it's well maintained. So these are the types of things you want to consider that kind of factor into the lease.

Chris Palmese

Now, before we wrap up, I want to talk a little bit about where you see the industry evolving in the near future. Do you have any thoughts?

Josh Newell

Yeah. So, one very kind of nuts and bolts answer is we're working just to standardize lease terms. This may seem kind of simple, but this is not an industry that's been around for decades and decades, so if we can standardize that lease, transact more quickly, that's a specific thing we'd love to see evolve and then that's something we're working quite closely on.

More broadly though, you know, we're seeing a couple things, a couple of trends really. One is what we call tenant involved deals, where maybe the tenant is actually buying the power. The solar developer still leases the roof, but sells the power to the tenant. This is more complex. The tenants are beginning to ask for this, especially if they have their own ESG goals and that type of thing.

So, figuring that out is something we're working a lot on. And then, this is a little outside the lease realm, but it's just interesting. We're seeing more real estate owners who are interested in owning the solar projects themselves as opposed to having a third party developer. There's good returns, low risk profile, but they're also complex tax issues, REIT related issues. So, that's another trend we're seeing both from some small real estate local developers who have flexibility as well as some large national players.

Chris Palmese

It's interesting you mentioned standardizing lease terms. It's almost like trying to get the parties that are involved to speak the same language, and I find that, even still, you're right. It is very new and there are a lot of folks that just kind of don't speak the language yet. And so, a lot of this is very new while trying to negotiate lease terms.

There is some, I've found, educating that has to sort of go on during the negotiation process.

Josh Newell

Yeah, absolutely. We do spend quite a bit of time on these leases, but it's improved quite a bit over the last few years. Real estate owners are getting more comfortable with it, but then also the solar developers I think are realizing they just can't ask for the moon. You know it's something we help a lot with, right? Just making sure that lease is fair. So, that's something.

We see leases of all the different solar developers across the country. We see, we talk to a lot of different real estate clients. So, I think we're working, just being in our unique position, we're working to standardize those terms and hopefully we get it to a point where we can transact quickly and get some extra income for the building.

Chris Palmese

Absolutely. Well I think that brings us just to the end of our time. Josh, is there anything you want to say as parting words?

Josh Newell

No, Chris, again, I really appreciate the invitation and I can talk solar leases with you all day. But, if anyone listening does have more questions or you know wants to find out more information, you can look us up at solarkal.com and happy to talk through any specific projects, specific questions that anyone has.

Chris Palmese

Thank you, Josh, and thank you so much for taking the time today to share your input and a special thanks to our listeners for tuning in. Please keep an eye out for future episodes.

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