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AB 1103: What Does It Mean for the Industry?

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Introduction & Background

California has for decades been among the leading states in responding to Climate Change. On January 1, 2014, new legislation became effective as to non-residential real estate related to the sale, lease, finance or refinance of such properties, using, in part, the US Environmental Protection Agency's (EPA) ENERGY STAR Portfolio Manager online program.

This new legislation, California AB 1103 and 531, is codified in Section 25402.10 to the California Public Resources Code (the "legislation").

The new legislation currently applies to commercial real properties¹ that have a gross square footage of 10,000 sq. ft. or more and as of July 1, 2014, 5,000 sq. ft. or more. The legislation is focused around the energy use of such properties.

Compliance Requirements

The legislation requires owners and property managers of eligible properties to take required actions at least 30 days before the sale, lease, financing or refinance of the improved property.

If an improved property is within the scope of the statute, the following mandates must be, at least 30 days before the sale, lease, or financing or refinance of the entire improved property:

- A (Assembly), B (Business), E (Education), I-1 and I-2 (Institutional), M (Mercantile), R-1 (Transient – Residential), S (Storage), and U (Parking Garage) are included within the legislation;
- All other occupancy types are exempted from the program requirements, including but not limited to, F (Factory and Industrial), I-3 and I-4 (Institutional), and R-2, 2.1, 3, 3.1, 4 (Residential);
- If a building is subject to the disclosure requirements, the owner must do so, at least 30 days before the sale, lease, refinance or financing of the entire building;
- The owner must Register for a Portfolio Manager account and create a profile within Portfolio Manager for the building;
- The owner must manually update Portfolio Manager with property specific building characteristics including total square footage, operating hours, and parking lot size;
- Identify all sources of energy use data (electricity, natural gas, propane, etc.) for the building;
- Contact the applicable utility or utilities to confirm their procedures for providing the energy use data;
- Request all applicable utilities to upload the latest 12 months of energy use data into the building owner's Portfolio Manager account (utilities may also provide a spreadsheet containing energy use data to be manually uploaded by the building owner);
- Generate a Data Verification Checklist report in Portfolio Manager;

¹ Factories (F-1, F-2), hazard properties (H), some institutional properties (I) and residential properties (R) are exempted from the legislation. Business, educational, institutional, hospitality, storage and parking garages are included in the properties as to which compliance is mandated.



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- Disclose the Data Verification Checklist to a prospective buyer, lessee, or lender at least 24 hours prior to execution of a sale contract or lease, or submittal of a loan application;
- Submit the Data Verification Checklist to the California Energy Commission at AB1103report@energy.ca.gov within 30 days of producing the report.

Risks and Enforcement

The CEC is responsible for the governmental oversight and enforcement of this mandated requirement. For building owners not in compliance the Energy Commission may initiate enforcement proceedings that might include an administrative process that includes a hearing and possible monetary fines. Due to the infancy of the regulations, it is unclear at this time whether and to what extent the CEC will undertake such action.

At this time, the CEC considers AB 1103 a “self- policing” law. Due to the mandatory nature of the disclosure, not providing an AB 1103 report can be viewed as a material fact in a transaction and grounds for voiding the purchase and sale agreement, rental agreement, or loan application. When a deal starts to go sideways all parties involved start looking for missed details to gain negotiating leverage, not complying with AB 1103 opens up building owners to a position of lost leverage.

Moreover, a failure to commence the disclosure process well in advance of the transaction could result in closing delays. Both the former (failure to disclose) and the latter (delay) could result in potential liability to the owner.

Despite the legislation being in its infancy, both loan and sale transactions have already fallen apart because of non-compliance with the legislation.

It is also unclear whether lawsuits by public interest law firms or interested parties to a transaction will result from the legislation or whether local governments will follow the lead of the State in adopting new and independent ordinances and enforcement requirements as to energy and water use. The City of San Francisco appears to already be engaged in this process.

It is unclear whether the burden under the legislation now placed on the property owner can be shifted by an “as is provision” or other contractual provisions in a lease or purchase and sale agreement. Most likely not since the legislation is public interest legislation with a purpose beyond the parties to the contract.

It is also unknown whether this legislation will affect loan underwriting or impact Bank regulators in their audits of Bank loans.

Recommendations

1. Owners and Property Managers should focus on a compliance plan in correlation with the disclosure requirements at the earliest possible stages.
2. In new leases, require tenants to both authorize the landlord to contact and obtain information and documents directly from utility providers and require tenants to provide copies of all utility bills and reports promptly upon receipt. In existing leases, obtain copies of energy bills by making requests of existing tenants under the general lease provision requiring each party to provide the other with documents as reasonably requested.
3. Consult with an expert as to current standards and most efficient way to comply with the requirements and to avoid enforcement issues.



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4. Owners should also consider updating purchase agreements, lease forms, and financing documents to include an express acknowledgment by the buyer, tenant, or lender, as applicable, of receipt of the Data Verification Checklist and acknowledging and accepting it as being in compliance.

Conclusion

AB 1103 as a law is still in the infancy stage. It is unclear whether and to what extent the CEC will enforce compliance, and what formal penalties may be assessed. What is known is that sale, lease, and refinance events can become derailed or even fall apart for building owners that do not comply. This potential for both public and private liability has proven to be enough of an incentive that owners of non-residential buildings are now striving for compliance. Owners are encouraged to be transparent with energy usage data and should, by all accounts, be prepared to provide this information well in advance of the close of any future transaction.



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Eric D. Dean is the Vice Chair of the Commercial & Real Estate Practice Group of The Wolf Firm, a Law Corporation. Mr. Dean has practiced law in California for over 30 years with his practice centered on litigation and transactional matters for regulated and private lenders, loan servicers, hotel developers and operators, contractors and construction managers and commercial and mortgage brokers. Mr. Dean has practiced with both regional and national firms and from 2004 to 2009 served as General Counsel for a national hotel developer and operator. Mr. Dean lectures extensively throughout the country and conducts training in-house for clients of the Firm on a wide range of commercial, real estate and default servicing concerns related to such topics as litigation and non-litigation strategies in responding to loan defaults, options in framing and enforcing the commercial guaranty, due diligence in the purchase or sale of the commercial property, framing and enforcing the contract indemnity clause and the effective use of contract arbitration provisions. His most recent presentation was related to the avoidance of communication traps and hazards pre-litigation. He has also published articles in leading trade journals including *HousingWire* and *DSnews*.



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Abe G. Salen is a Senior Litigation Attorney at The Wolf Firm, A Law Corporation. Mr. Salen has more than 17 years of experience handling complex commercial, employment, and real estate litigation matters, and assists many nationally recognized financial institutions with litigation-related services. Mr. Salen also has extensive experience advising small and mid-sized businesses, including negotiating business-related agreements, from start-up through day-to-day operations, to dissolution. Mr. Salen has served as outside corporate counsel for mid-sized businesses in various industries, with particular emphasis on the staffing industry and real estate industry.



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Jenny Redlin, REPA is one of the founders and a Principal at Partner Engineering and Science, a national environmental, engineering and energy consulting and design firm. She combines her technical background and qualifications with more than 15 years of experience in the environmental consulting industry to provide the best, solutions-driven services to her clients. With experience across all aspects of commercial real estate due diligence, Jenny has become a leading industry educator sharing her knowledge through numerous blogs, speaking engagements and webinars.



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John Rockwell is a Project Manager for Partner Energy, where he is responsible for managing a number of energy efficiency and renewable energy engineering programs for existing buildings and new construction. Starting his career in asset management, Mr. Rockwell understands the unique energy consulting needs of the commercial real estate industry. He is an active member of a number of industry associations, including Urban Land Institute (ULI) and the Building Owners and Manager Association (BOMA).



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Mr. Bennett is very active in the real estate community where he has served as President of various real estate boards and has served two terms as President of the Los Angeles County Board of Realtors (LACBOR). Mr. Bennett has served for two supervisors on the Los Angeles County Tax Appeals Board and served two terms as President. His community involvement includes two, four-year terms on the Board of Directors for the South Central Regional Center for the Disabled, serving as President for two terms and the Crippled Children Society, just to name a few.

Mr. Bennett is currently a Regional Vice President for the National Apartment Association. Mr. Bennett has spoken in front of several congressional committees in Washington, D. C., which included current Vice President Joe Biden and was inducted into the Congressional Hall of Records for outstanding community service in 1994. Mr. Bennett has a highly motivated and talented staff of more than 20 employees led by his General Manager, Ms. Ruth Hayles, a licensed real estate broker, who has been with the firm more than 20 years.