By Tony Liou
President
Partner Energy

Hit the Mark With Energy Efficiency

Energy-disclosure laws guide buildings toward greater efficiency and better fundability

Demand for energy-efficient buildings has increased significantly in the past few decades, spurred by concerns over higher energy costs, aging energy infrastructure, global warming and dependence on foreign oil. In addition, cities and states across the country have been leading a charge to create a market for energy-efficient buildings.

To create this market, two things are needed: transparency and information. Brokers, owners, property managers, purchasers, tenants and lenders must be armed with information about each property's energy usage and how it stacks up against similar buildings to make sound purchasing, leasing and financing decisions. This then creates an incentive for building owners to improve a building's energy performance, thereby reducing operating costs, increasing net operating income, improving marketability, increasing tenant satisfaction and reducing the building's carbon footprint.

When these goals are achieved, energy-efficient properties will have better property performance and income-stream stability — and likely will have a better standing with lenders.

With the need for improved energy efficiency in mind, many local jurisdictions are enacting energy benchmarking and disclosure laws that require building owners to quantify and report their buildings' energy performance. California has enacted a disclosure law — the nonresidential building energy-use disclosure program (Assembly Bill 1103) — that takes effect this year. Other cities and states that have enacted or implemented similar laws include Minneapolis; San Francisco; Philadelphia; Seattle; the state of Washington; New York City; Washington, D.C.; and Austin. In addition, Portland, Ore., and Massachusetts have pending disclosure laws that have not been enacted yet.

Illustration: Dennis Wunsch

The specific requirements of these policies vary from one jurisdiction to the next and are subject to change, but they primarily aim to accomplish the same thing — provide an incentive for building operators to reduce their building's energy consumption by requiring disclosure of the energy performance of commercial, multifamily and government buildings.

Because this trend is likely to continue to gain popularity, commercial mortgage brokers should be prepared to help clients become familiar with these laws, the reporting methods required, and any possible effects the reports can have on value and financing.

continued ››

Tony Liou is the president of Partner Energy, a national energy-efficiency-engineering consultancy. Liou began his career as an engineer at Northrop Grumman and Siemens Building Technologies, and later worked at a private-equity company underwriting real estate acquisitions and developments. His background in engineering and commercial real estate affords a unique understanding of clients' perspectives and goals. Liou regularly speaks and writes on energy efficiency, regulations, financing and incentive programs. Reach him at tliou@ptrenergy.com or (888) 826-1216.

Reprinted from *Scotsman Guide* Commercial Edition and scotsmanguide.com, July 2013

‹‹ continued

CALIFORNIA AB 1103

California's Assembly Bill 1103 (AB 1103) was passed in 2007. As of press time, it was expected to take effect either on Aug. 1, or Sept. 1, 2013. AB 1103 mandates energy benchmarking and disclosure for all nonresidential buildings before a sale, lease or financing of the entire building. It does not apply to multifamily buildings, or partial sales, leases or financing. Given the number of nonresidential buildings in California, the impact of this legislation is expected to be significant.

AB 1103 requires building owners or property managers to disclose the energy performance of their building to:

- **Buyers and lessees:** Disclosure should be made to prospective buyers or lessees of the entire building no later than 24 hours before executing of the sales contract or lease.
- **Lenders:** Prospective lenders financing the entire building should receive the disclosure no later than the submittal of the loan application.

Although there is no penalty on the books for not complying with AB 1103, the information could be considered material, and not disclosing it upfront could present closing delays or open up the potential for price negotiations and lawsuits.

SCHEDULE OF IMPLEMENTATION FOR CA AB 1103

CALIFORNIA'S ASSEMBLY BILL 1103 IS SLATED TO BEGIN IMPLEMENTATION THIS YEAR ON A STAGGERED SCHEDULE. AB 1103 MANDATES ENERGY BENCHMARKING AND DISCLOSURE FOR ALL NONRESIDENTIAL BUILDINGS BEFORE A SALE, LEASE OR FINANCING OF THE ENTIRE BUILDING. DEPENDING ON THEIR SIZE, BUILDINGS MUST BEGIN TO DISCLOSE ENERGY BENCHMARKING DATA ON THE FOLLOWING SCHEDULE:

1. ON AND AFTER AUG. 1, 2013, OR SEPT. 1, 2013, FOR A BUILDING WITH TOTAL GROSS FLOOR AREA MEASURING MORE THAN 50,000 SQUARE FEET
2. ON AND AFTER FEB. 1, 2014, OR MARCH 1, 2014, FOR A BUILDING WITH A TOTAL GROSS FLOOR AREA MEASURING MORE THAN 10,000 SQUARE FEET AND AS MUCH AS 50,000 SQUARE FEET
3. ON AND AFTER AUG. 1, 2014, OR SEPT. 1, 2014, FOR A BUILDING WITH A TOTAL GROSS FLOOR AREA MEASURING AT LEAST 5,000 SQUARE FEET AND AS MUCH AS 10,000 SQUARE FEET

FOR MORE INFORMATION, VISIT ENERGY.CA.GOV/AB1103.

ENERGY BENCHMARKING

Energy benchmarking is the first step in understanding and reporting a building's energy performance. It allows a building owner or manager to accomplish three things:

1. **Performance measurement:** A building's current performance is measured by quantifying key performance metrics, like energy consumption, energy cost, emissions or Energy Star rating.
2. **Comparison:** A building's key performance metrics are compared to similar buildings to determine a building's cost-reduction, energy-reduction or green-label potential.
3. **Tracking:** Improvements are tracked to key performance metrics as projects are implemented to determine if goals are being met.

PORTFOLIO MANAGER

The Environmental Protection Agency's Energy Star Portfolio Manager is one tool used for benchmarking and is the required method of calculation for many energy-disclosure laws.

Commercial mortgage brokers may be familiar with the Energy Star rating system used on all sorts of energy-efficient products. This label also can be applied to buildings. The Portfolio Manager is an online tool used to calculate a building's national energy rating. It also allows continued tracking of energy and water consumption for a building or portfolio of buildings. The rating is based on a scale of 1 to 100 (100 being the highest), and scores are relative to similar buildings nationwide. The rating system uses numerous building-specific inputs — like kilowatt-hours, therms, square footage, hours of operations and number of occupants — to compare the subject building to a national database of similar buildings. To qualify for the Energy Star label, a building or manufacturing plant must earn a score of 75 or higher on the energy-performance scale. To apply for the Energy Star label, the building's data must be certified by a licensed professional engineer or registered architect.

Use of the Portfolio Manager tool often is the minimum requirement, but owners may want to consider a more thorough benchmarking. Even if the building is not seeking the Energy Star label, having an architect or engineer review the data will ensure the most accurate score.

continued ››

‹‹ continued

ROLES

Commercial mortgage brokers with knowledge of energy-disclosure laws can help their clients understand the benefits of pursuing and implementing these requirements. Brokers and owners alike also will benefit from a firm grasp of the implications of these laws for all transaction parties.

For property owners, compliance generally requires gathering the data and supporting documents needed to report the building's energy performance. For California's AB 1103, this includes requesting the most recent 12-month data from the building's utility provider(s), which is submitted directly to the Energy Star Portfolio Manager. Owners should leave ample time for this because utility companies can take as long as 30 days to provide this data.

For mortgage brokers, investors and lenders, this information will become a regular part of due diligence, but it should be done earlier than other physical due diligence like the environmental or engineering assessments, which are typically done during escrow. Energy-performance information should be included as part of the purchase-and-sale agreement.

The results of energy disclosure may affect decisionmaking significantly — which, of course, is the point of having these requirements in the first place. For example, investors looking at two assets with different scores may choose the more energy-efficient building. On the other hand, they may recognize an opportunity with the less efficient building to negotiate the price down or ask the current owner to make improvements. There is also an opportunity to make investments to improve the building's energy efficiency, reduce operating costs and improve the marketability of the building. If the score is low enough, it could become a deal killer, however.

Commercial mortgage brokers also should understand that although it is not yet clear how lenders will view the results of AB 1103 and other disclosure laws, the information certainly will be useful to their decisionmaking. A low score likely means there is old equipment at the asset, which factors into the capital reserves needed. High energy costs also could affect the debt-service-coverage ratio.

Mortgage brokers should keep in mind that if the use of the building changes, the previous energy score doesn't count. Energy performance of a building is highly dependent on its usage. If a manufacturing building will be used for warehousing only, the prior energy score won't mean much.

IMPROVING SCORES

Commercial mortgage brokers can help their property-owner clients understand the benefits of taking a proactive approach to energy benchmarking. They also should encourage them get their Energy Star score early — so that if it is low, they can take steps to improve it and track the results.

The owner can identify these steps through a feasibility study — typically an energy audit or a retro-commissioning study, depending on the owner's goals. An energy audit also will identify a range of energy-efficiency measures that can be taken, including capital-intensive projects, and their associated payback period. A retro-commissioning study solely focuses on improving a building's energy performance through optimizing its operations and maintenance.

There are many financing and incentive programs available to offset the costs of completing these studies and to implement the recommended improvements, if needed. With the help of their mortgage brokers, owners also can consult utility providers to learn more about available incentives.

• • •

With the growing popularity and focus on energy performance, commercial mortgage brokers who understand the benchmarking and disclosure process and how this information will affect transactions will be best positioned to advise their clients. They also will be better equipped to anticipate and handle any potential fallout from these disclosures. ●