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FINANCING AERS: INNOVATION AND COMMERCIAL INVESTMENTS

TRENDS IN COMMERCIAL REAL ESTATE FINANCING

Tags Policy | Retrofit-Finance

Organized by Dr Susan Wachter Professor at the University of Pennsylvania's Wharton Finance and Real Estate Department and in conjunction with the Wharton Small Business Development Center Penn Institute for Urban Reserach and the EEB Hub

The EEB Hub's Finance and Real Estate Platform gathered once again on December 16, 2013 to delve into the topic of innovation and commercial investment opportunities delivered through the expertise and experience of the assembled panelists. This platform engagement was the third installment of a series of panel discussions on the topic of financing energy efficiency. The first event revealed the market barriers that have prevented financing for small- and medium-sized commercial buildings. The second event began an exploration of real financing solutions available to the market, a theme that was continued in the latest event, which took on a more optimistic tone than the former.

The latest event was a moderated discussion, allowing the panel experts to freely share their experiences and touched on a variety of topics with a focus on two themes: the proliferation of energy benchmarking ordinances and their expected effect on the market; and a more specific examination of existing financing tools. The event concluded with the panelists sharing their perspectives of the commercial building market's future trajectory.

THE PANEL INCLUDED:

Duane Desiderio – Senior Vice President and Counsel The Real Estate Roundtable
Brad Molotsky – Executive Vice President General Counsel, and Secretary Brandywine Realty Trust
Catherine Pullen – Corporate Managing Director Studley Brokerage
Matthew E. Weko – Sr Vice President and National Director of Project & Development Services Jones Lang LaSalle

Distinguished panel speakers (left to right): Duane Desiderio, Brad Molotsky, Catherine Pullen, Mathew Weko

BENCHMARKING

The most notable characteristic of this event was the immediate focus on benchmarking, prompted by EEB Hub Deputy Directory Laurie Actman's question, "what's new in the market and what are we seeing in terms of financing options?" All the panelists agreed that the increased data that will become available from benchmarking laws will have an impact on the market, but lacked consensus on what that impact will be and how long it will take to arrive. We are already seeing great data out of New York City and others have begun publishing their data, but it will take a few years for info to become digestible and useful. As this data becomes available, platforms like the EEB Network will make the data available to the public.

When asked to name areas that have great tools or programs for owners, the panel consensus was that major west coast cities – San Francisco, Seattle - and the state of California as a whole are leading in environmental policies. The NY benchmarking law's provision requiring regular retro-commissioning and Washington, D C 's mandate for all new construction larger than 50,000 sf to meet LEED standards stand out as especially high-impact programs. Philadelphia, in contrast, is only now getting some legs.

It was agreed that, as quality energy data becomes available, it will be used as a metric in tenant decision making. Catherine Pullen from Studley pointed out that before benchmarking – and even still today – all buildings were compared on even ground when it came to energy. It was assumed that energy use wouldn't make a difference in one's decision of settling on a building. Large institutional players are already making energy use data available, and organizations like

Map of Disclosure Ordinances around the US (source Institute for Market Transformation)

those that Matt Weko at Jones Lang LaSalle works with are already looking for this kind of information when leasing space. Brad Molotsky of Brandywine Realty Trust used an example of a commercial intersection in Philadelphia. All buildings at this intersection are likely to be of the same era, offer the same amenities, and are obviously geographically identical, but if one building's ENERGY STAR score is a 30, while another's is a 90 and their rental rates were identical, a tenant is clearly going to choose the 90, knowing that this will likely yield lower utility bills. Molotsky also explained that when you look at the pattern of cities that have passed benchmarking laws, you find major regional economic bases. Brokers don't just stick to the major cities, so if RFPs are requesting energy data, this will impact the surrounding regions as well.

One oft-cited concern for building owners when discussing benchmarking their buildings is the expected pushback from tenants when requesting data. Molotsky noted that he has not had any issues when adding lease provisions for disclosing energy use. The lease language allows Brandywine to install a meter to measure use and requires the tenant to share the submeter data. The panel's view is that this policy is generally good for the tenant, who in the business-as-usual case pays an equal proportion of utility bills, regardless of use. Sub-metering means that energy use can be charted and more fairly priced. Weko noted that some tenants are already requesting sub-metered spaces.

THE PEOPLE PIECE

Duane Desiderio from the Real Estate Roundtable pushed the group to think about one of the critical considerations when discussing benchmarking, that is, engaging tenants, without whom energy use changes (and better building performance) will not be feasible. Molotsky, again, presented an apropos example of discussing energy use with a tenant upfront: "You know you're paying $x/sf over so many sf, what if we can introduce you to some people that can help you bring that cost down and for almost no upfront cost, just by doing basic things like turning off lights when no one is around ... would you do it?" This is essentially what has been documented in a case study being published by NRDC about Reed Smith who is expected to save $1.4M with small tweaks. A second case study looking at Tower Companies also shows that big energy savings are possible even in buildings that are already very energy efficient by engaging with tenants.

FINANCING MECHANISMS

The other major theme of the event was a discussion of specific financing mechanisms. Pulen explained that, in her experience, the availability of financing for energy efficient projects is practically the same as it has been over the last few years. However, the speakers described a variety of available financing options and how the landscape is expected to change moving forward.

Molotsky led this discussion, putting a set of existing financing methods on the table, but also pointing out that for a well-capitalized portfolio owner like Brandywine, the question is not one of available capital, but of whether to employ an internal line of credit or an external financing option. The answer to that question often comes down to the scale of the retrofit; for example, a fleet-wide deployment of smart meters would likely necessitate some external financing.

Companies like OPower are offering on-bill financing [RD Report] programs in cooperation with utility lenders and recoup lending directly from customer utility bills.

Energy Service Companies (ESCOs) are offering privately funded energy service performance contracts wherein the ESCO funds and executes retrofits, and recoup lending through energy savings. ESCOs appear to be more active in the health care, governmental, and school markets, but not as much in the commercial building market. That said, new policies are being deployed to allow the U.S. General Services Administration, the largest property owner in the country, to enter into energy service performance contracts. This move could lead the way for the private commercial sector to follow suit.

The website DSIRE keeps a current list of public-sector energy efficiency programs, many based on tax rebates. Two programs that are relevant to the region are Pennsylvania Act 129 and New Jersey Clean Energy, both of which still have available funding. The federal program, known by its tax line 179(d) and is set to expire this year, appropriated $1.80/sf for energy efficiency improvements in tenant spaces. Unfortunately, this deduction was not well utilized, despite its high yield, suggesting that tax-rebate based incentive strategies are not what the market is looking for. Laurie points to the fact that this failure suggests the importance of local action and locally available resources that are easier to penetrate for building owners.
National Trajectory

Four years ago, energy policy discussions did not include energy efficiency, but the dialogue is now changing. The Shaheen Portman bill that has been moving through congress contains two important provisions: it clarifies the DOE's role in shaping building energy codes, allowing DOE to dictate energy efficiency targets, and it formalizes the TENANT STAR program, which certifies energy efficient tenant spaces. The bill would also help to standardize the appraisal methodology for energy efficiency improvements.

To see a recording of the event live stream, please visit the Platforms page.

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