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The Real Estate Roundtable

UNITED STATES SENATE
COMMITTEE ON ENERGY AND NATURAL RESOURCES

HEARING ON
“FINANCING EFFICIENT BUILDINGS”

DIRKSEN SENATE OFFICE BUILDING
ROOM 366
WASHINGTON, DC

THURSDAY, JUNE 28, 2012

STATEMENT OF
JEFFREY D. DEBOER
ON BEHALF OF
THE REAL ESTATE ROUNDTABLE



(I) INTRODUCTION

Chairman Bingaman, Ranking Member Murkowski, and Members of the Senate Energy and Natural Resources Committee, thank you for the opportunity to testify at this hearing on “Financing Efficient Buildings.”

I am Jeffrey D. DeBoer, President and CEO of The Real Estate Roundtable (www.rer.org). The Roundtable represents the leadership of the nation’s top privately owned and publicly held real estate ownership, development, lending and management firms, as well as the elected leaders of the major national real estate industry trade associations. Collectively, Roundtable members hold portfolios containing over 5 billion square feet of developed property valued at over \$1 trillion; over 1.5 million apartment units; and in excess of 1.3 million hotel rooms. Participating Roundtable trade associations represent more than 1.5 million people involved in virtually every aspect of the real estate business.

Our nation faces significant economic, employment, and energy challenges. One way to address these challenges is by upgrading the nation’s commercial building infrastructure through energy efficiency “retrofits.” These projects will get Americans back to work with jobs that will stay in the United States, save businesses billions of dollars a year in utility bills, and help secure our country’s energy future. The following “fast facts”¹ from the Environmental Protection Agency, the Energy Information Administration, and other sources confirm that the Committee is correct to consider policies that will leverage private sector financing to retrofit our existing commercial building stock – and spur job growth in the process:

- There are over 5 million commercial buildings and industrial facilities in the U.S.
- As much as 85% of commercial buildings that exist today will still be standing in 2030.²
- Commercial buildings account for about 20% of the nation’s energy consumption, and as much as 80% of energy consumption in urban areas.
- The combined average annual energy costs for U.S. commercial buildings and industrial facilities is \$202.3 billion.
- About \$20 billion can be saved if the energy efficiency of commercial buildings and industrial facilities improves by 10%.
- The basic tools to retrofit buildings – like efficient furnaces, water heaters, and spray foam insulation – are manufactured here in the United States and not in China, Germany, or elsewhere overseas.³
- Saving energy is cheaper than producing energy. Our country must pursue an “all of the above” energy policy, but it is important to recognize that efficiency is the lowest-cost resource available to move our nation towards energy independence. Simply put, the cost of a kilowatt hour of energy saved is cheaper than the cost of an equivalent kilowatt hour of energy produced:

¹ http://www.energystar.gov/ia/business/challenge/learn_more/FastFacts.pdf;
<http://yosemite.epa.gov/opa/admpress.nsf/8b770facf5edf6f185257359003fb69e/1603327c9023eb8c852579dd005e3385>.

² PlaNYC, “Greater Greener Buildings Plan”:
http://www.nyc.gov/html/gbee/downloads/pdf/greener_greater_buildings_plan.pdf

³ <http://green.blogs.nytimes.com/2010/03/12/made-in-the-u-s-a-efficiency-materials/>.

Costs of Saving Energy vs. Producing Energy

Technology	Costs (per kilowatt hour)
Energy Efficiency	2-3 cents ⁴
Wind	9 cents ⁵
Geothermal	10 cents
Advanced Coal	11 cents
Advanced Nuclear	11 cents
Solar PV	21 cents
Offshore Wind	24 cents

All of these technologies have their role in a comprehensive national energy policy, and will keep America globally competitive in the race for innovation, create jobs, and reduce dependence on foreign oil. But in allocating scarce government resources, policy makers should consider that financing programs like tax incentives and loan guarantees get more “bang for the buck” when they are geared to encourage energy efficiency measures, as opposed to assisting new energy production through clean fossil fuel or renewable energy technologies.

- According to a report⁶ released this past Monday by the Building Owners and Managers Association (BOMA) International, the expenditures that sustain office building operations—management, maintenance, repairs, building services and utilities—generate significant, continuous and growing expenditures that support local businesses, create job demand, and contribute significantly to U.S. gross domestic product (GDP):
 - For each dollar of office building expenditures, the U.S. economy gains \$2.57. And for every one of those dollars, nearly 20 jobs not related to the building itself are supported.
 - \$79.7 billion in office building operating expenditures contributed \$205.1 billion to GDP in 2011 – equivalent to the State of California’s annual budget.
 - As a result of the \$79.7 billion expenditures for office operations, 1.6 million *indirect* jobs were created across all sectors of the economy, about the same number employed by McDonald’s worldwide. This is in addition to the estimated 2.2 million jobs *directly* related to the on-site management and operations of buildings.

⁴ Costs of saved energy (“CSE”) per kilowatt hour (“kWh”) for energy efficiency programs range from 2 cents to 3 cents per kWh. See American Council for an Energy Efficient Economy, “Saving Energy Cost-Effectively: A National Review of the Cost of Energy Saved Through Utility-Sector Energy Efficiency Programs” (Sept. 1, 2009), available at <http://www.aceee.org/research-report/u092>.

⁵ Costs for all power generation sources in table provided by U.S. Energy Information Administration, “Levelized Cost of New Generation Resources,” Annual Energy Outlook 2011, available at http://www.eia.gov/oiaf/aeo/electricity_generation.html (provides “Total System Levelized Cost” for various “Plant Type(s)” in dollars per megawatt hour (“mWh”). For purposes of table conversion: mWh / 1000 = kWh).

⁶ “Where America Goes to Work: The Contribution of Office Building Operations to the Economy” (2012), available at <http://www.boma.org/Resources/news/pressroom/Pages/pr062412.aspx>.

The Real Estate Roundtable's members are at the vanguard of innovation in making our built environment more energy efficient. For example, 14 companies represented through The Roundtable are "partners" and "allies" in the U.S. Department of Energy's Better Buildings Challenge⁷ and have agreed to showcase projects that lead the way for successful retrofits throughout the real estate sector. Our members routinely distinguish their buildings as "top of class" performers by receiving the "ENERGY STAR" label and also garner "Partner of the Year" recognition from the U.S. Environmental Protection Agency.⁸ Among our many members who have demonstrated sustained commitments to energy efficiency are Anthony E. Malkin, the Chair of our Sustainability Policy Advisory Committee and the President of Malkin Holdings, who is responsible for the groundbreaking retrofit of the Empire State Building⁹; and T. Patrick Duncan, the President and CEO of USAA Real Estate Company, which recently collected its eighth award from EPA for energy efficiency and has been ranked fifth in the Americas in the Global Real Estate Sustainability Benchmark.¹⁰ The Roundtable thus has considerable experience with retrofit projects and how to finance them, and we appreciate this opportunity to share our perspective.

(II) SUMMARY: SIX STEPS FOR TO SPUR FINANCING FOR EFFICIENT BUILDINGS.

There is no single "silver bullet" to encourage retrofit financing, much less a simple solution to inject more equity capital and encourage more debt financing in the real estate sector. But the Senate can and should take immediate action in this arena. The Roundtable suggests **six steps Congress can take right now** to further the goals of greater energy efficiency in commercial buildings, invigorate real estate activity in markets across the country – and most importantly, boost the optimism of American businesses and workers by making a serious dent in unemployment figures that have been too high, for too long.

The Roundtable's first "four steps" directly address policies to spur more activity in energy efficiency financing. Our last two suggestions will have major, positive impacts to improve the economic condition of U.S. real estate markets broadly, and will have a ripple effect to generate more capital to invest in building retrofits.

- (1) Extend and Reform the 179D Tax Deduction for Energy Efficient Commercial Buildings:** Congress should extend and reform the tax deduction for energy efficient commercial buildings at Section 179D of the Internal Revenue Code. Chairman Jeff Bingaman (D-NM) and Senator Olympia Snowe (R-ME) have carefully studied this incentive for months, and have developed a thoughtful proposal to improve the deduction's use to mobilize more existing building retrofits. When they introduce their bill to extend and modify the 179D deduction, it should be enacted swiftly.

⁷ See <http://www4.eere.energy.gov/challenge/>; http://www.rer.org/2011/PUBLIC-PRIVATE_INVESTMENTS_IN_ENERGY_EFFICIENCY_-_December_2,_2011_Roundtable_Weekly.aspx?terms=better+buildings+challenge.

⁸ See http://www.energystar.gov/index.cfm?fuseaction=labeled_buildings locator; http://www.energystar.gov/index.cfm?fuseaction=pt_awards.showawardlist&year=2012.

⁹ See http://www.esbnyc.com/sustainability_energy_efficiency.asp; http://apps1.eere.energy.gov/news/news_detail.cfm/news_id=12387.

¹⁰ See <http://www.bizjournals.com/sanantonio/news/2012/03/06/epa-to-honor-usaa-real-estate-once.html>.

- (2) **Authorize DOE Retrofit Loan Guarantees:** Congress should enact the loan guarantee provisions in S. 1000, the “Energy Savings and Industrial Competitiveness Act” co-sponsored by Senators Jeanne Shaheen (D-NH) and Rob Portman (R-OH). President Bush signed the Department of Energy’s loan guarantee program into law in 2005, but to date it has focused on high risk (and expensive) solar, wind, and nuclear projects. S. 1000 would specifically authorize DOE loan guarantees for less risky and less expensive building retrofits, with modest federal credit support projected to leverage far greater multiples of private sector funding.
- (3) **Pass Legislation to Encourage Real Estate Appraisals that Value Energy Efficiency:** The Roundtable’s members report that real estate owners, lenders, and appraisers need to be better coordinated when valuing properties to account for energy efficiency attributes. S. 1737, the “Sensible Accounting to Value Energy Act,” is sponsored by Senators Michael Bennet (D-CO) and Johnny Isakson (R-GA). This bill includes important provisions to encourage better information sharing among real estate professionals so that energy efficiency is more consistently, accurately, and fairly valued when appraising commercial and other real estate.
- (4) **Pass Legislation to Align Commercial Landlords and Tenants on the Goals of Energy Efficiency:** A building can be retrofitted with the latest efficiency technologies but still not perform as designed, or result in optimal energy savings as much as those technologies would otherwise allow. This is because leased spaces may be “over built” at the time of new fit-outs to provide more energy capacity than a tenant needs, or because building occupants may have behaviors that unnecessarily waste energy. Senator Bennet is working on important legislation to encourage non-regulatory standards – with no budgetary impact – to get commercial landlords and tenants on the same page when it comes to energy efficiency. Upon its introduction, the bill should be studied by the Committee and enacted as soon as possible.
- (5) **Encourage More Foreign Investment in U.S. Real Estate—FIRPTA Reform and EB-5 Authorization:** Foreign equity capital is a significant and largely untapped source to help increase depressed property values in domestic real estate. Injecting greater foreign investment into U.S. real estate markets may be channeled to encourage retrofits, and help overcome the barrier of up-front capital costs that remains the biggest impediment to energy efficiency projects. Congress should thus pass S. 1616, the “Real Estate Investment and Jobs Act” introduced by Senators Robert Menendez (D-N.J.) and Mike Enzi (R-WY) which has also garnered the support of 25 co-sponsors. S. 1616 would reform the Foreign Investment in Real Property Tax Act (“FIRPTA”) and correct the discriminatory treatment of foreign investment in U.S. real property that presently exists under the tax code. In a similar vein, Congress should pass S. 3245, introduced by Senators Patrick Leahy (D-VT) and Charles Grassley (R-IA), to permanently authorize the EB-5 immigrant-investor regional center program. EB-5 grants lawful permanent residence in the U.S. to foreign nationals who make investments of \$1 million (or \$500,000 in high unemployment areas) in domestic real estate and other business projects. These investments must be demonstrated to create jobs in the U.S. Permanent EB-5 authorization will allow the 225 regional centers across the country that manage this program to coordinate with the real estate community and efficiency advocates so that investment funds can be used to help finance retrofits.
- (6) **Conduct Oversight to Curb the Recent Rise in GSA “Holdover” Leases:** In light of the recent troubles and changes in leadership at the General Services Administration (GSA), Roundtable members are reporting a trend in federal lease “holdovers” whereby the GSA is simply extending leases on a month-to-month basis after they expire.

Congress should conduct oversight to ensure that GSA leasing practices operate efficiently so buildings with departing federal government tenants can be re-positioned in a manner that allows for long-term capital improvements like energy upgrades.

Each of these six steps for immediate congressional action is discussed in more detail below. However, a properly functioning *real estate* financing market is a prerequisite to a functioning *retrofit* financing market. I appreciate this opportunity to provide the Committee with a short overview on the current economic state of affairs in the commercial real estate sector, which will add context for the immediate topic at hand regarding policies to finance efficient buildings.

III. GENERAL ECONOMIC BACKGROUND ON REAL ESTATE CONDITIONS¹¹

Since the start of the Great Recession in 2009, property values have declined to the extent that up to half of all commercial mortgages are estimated to be “underwater,” with outstanding mortgage debt exceeding asset values. Meanwhile, nearly \$1.4 trillion in commercial real estate loans that were originated before the recession will come due in the next three years. As this outstanding debt matures, property owners will have difficulty refinancing in the current tight credit markets particularly in light of decreased property values, with the specter of default facing many properties.

There is anxiety in the real estate and lending sectors as to where all of the debt financing and equity capital will come from to retire this maturing debt. (On-going Eurozone turmoil and its effect on skittish markets here at home aggravates the situation.) Moreover, simply satisfying the outstanding trillion-plus loans would only bring real estate markets to a relative place of normalcy and avoid waves of foreclosures. Vastly greater sums of additional capital are needed to grow the economy and create jobs. There is consensus that a tremendous amount of potential equity investment capital is in the hands of foreign investors. These funds must be brought into U.S. markets now, to staunch the threat of current loan defaults and then help sustain a more accelerated pace of economic growth. Infusions of equity and credit are necessary to re-set the real estate, lending, and capital markets so transactions can move forward to refinance struggling assets.

Political uncertainty is compounding the commercial real estate sector’s wary economic outlook. The business community is concerned that the paralysis on Capitol Hill will continue for the rest of this year and beyond, and that Congress will not deliver certainty and progress to Wall Street and Main Street on tax, spending, budget, health care, and other significant policies. The Senate’s recent bipartisanship on infrastructure and agriculture legislation provides signs for optimism. We strongly encourage this Committee to continue down the path toward consensus energy and fiscal policies to jump-start the lackluster recovery once and for all.

Not surprisingly, executives participating in The Real Estate Roundtable’s most recent, 2Q-2012 “Sentiment Survey”¹² reflect the industry’s economic and political circumspection. While signaling a general lack of confidence in the outlook for the rest of this year, the Sentiment Survey also portrays a bifurcated recovery for commercial properties. So-called “gateway” cities have come back strong while smaller, more mainstream markets still struggle.

¹¹ More detail on the current economic conditions of the U.S. real estate market is described in The Real Estate Roundtable’s 2012 Annual Report, “Managing Risks & Opportunities” (published June 2012), available at http://www.rer.org/Advocacy/2012_Annual_Report.aspx.

¹² See <http://www.rer.org/ContentDetails.aspx?id=12241>.

There is improved access to functioning liquidity and improving values (particularly for “Class A” assets) in cities like New York, Washington, D.C., Boston, San Francisco, and Chicago. Contrast this to still-weak capital formation and lackluster fundamentals elsewhere around the country. Smaller, more mainstream real estate markets across the U.S. continue to face big challenges.

More directly on the topic of today’s hearing and issues surrounding capital investments in building improvements, the sustained financial pressure on property owners and lack of credit availability has led to deferral of maintenance and upgrades on existing properties. Meanwhile, development of new projects outside of urban growth centers has trickled to a standstill – all resulting in national jobless figures that preclude robust recovery. The potential for commercial real estate defaults to derail a fragile economic recovery, particularly in non-gateway markets, and lead to even further job losses, bank closures and business retraction, is very real. The need to address these matters is imperative.

As part of the solution to get Americans back to work while also helping to generate real estate construction and transactional activity, The Roundtable appreciates this opportunity to offer our priorities to encourage financing for efficient buildings.

IV. SIX STEPS FOR CONGRESS TO SPUR FINANCING FOR EFFICIENT BUILDINGS

(1) Extend and Reform the 179D Tax Deduction for Energy Efficient Commercial Buildings.

The tax deduction at Section 179D of the Internal Revenue Code encourages energy efficiency in building design, construction, and operations. 179D covers private sector commercial buildings that generate rents and income like offices, stores, hotels, warehouses, plants, and apartments. It also covers government buildings like schools, hospitals and military facilities. The 179D deduction is a technology-neutral incentive that does not pick “winners and losers.” It encourages retrofit *projects* and not specific *products*. It gives building owners the opportunity to select the best mix among a suite of measures to achieve optimal energy efficiency gains.

Section 179D was first enacted in the 2005 Energy Policy Act, extended in 2008, and is scheduled to expire at the end of 2013. While the deduction has resulted in some success (especially to encourage lighting upgrades), 179D has not yet lived up to its full potential to encourage “deep” retrofits due to the costs and regulatory complexity associated with upgrading multiple building systems including heating and cooling, hot water, windows, and insulation. The Roundtable wholly supports the work of Chairman Jeff Bingaman (D-NM) and Olympia Snowe (R-ME) who have carefully studied the deduction to gain a better understanding of how it has worked in the marketplace, and how it can be improved. Their proposal to reform the Section 179D deduction would, among other things:

- ***Measure energy savings for retrofits compared to the existing building’s baseline.*** For purposes of the tax deduction, the Bingaman-Snowe proposal measures savings by comparing how much energy a building consumed before a retrofit, and then comparing how much energy is consumed after a retrofit. This logical “before-and-after” comparison makes sense for existing buildings with a track record of energy use, where a retrofit plan may qualify for the deduction based on actual and verified reductions in energy usage intensity.

- ***Award performance by linking the amount of the tax deduction to energy savings achieved.*** Under the Bingaman-Snowe proposal, the amount of the incentive would increase with greater energy savings. This “sliding scale” approach will encourage ambitious projects while also rewarding projects that achieve meaningful yet more moderate levels of energy savings.
- ***Make the tax incentive useable for a broad range of building efficiency stakeholders and building types, including REITS.*** Many buildings cannot use the 179D deduction because their ownership structures, like Real Estate Investment Trusts (REITS) and Limited Liability Partnerships (LLPs), cannot make use of conventional tax incentives. The full amount of the deduction that considers such entities’ special tax requirements should be available for REITS and other similar holding structures. Additionally, in order to make the incentive useable for more buildings, the building owner should be allowed to allocate the tax deduction to other parties responsible for the retrofit such as an architect, engineer, tenant, source of financing, or energy services company that may guarantee improved performance.

Of course, extension and modification of Section 179D will get caught up in the broader discussions of tax reform, budget policy, and re-examination of tax incentives generally. As Congress deliberates these important matters, it should keep in mind two points that favor 179D’s extension and modification. First, Section 179D offers a tax **deduction**, and **not** a tax **credit**. As former Senator Don Nickles testified at hearing earlier this month to the Senate Finance Committee on energy tax policy, law makers must carefully distinguish between the need for tax **credits** which may operate as subsidies, compared to more favored tax **deductions** which are expensed as part of ordinary business operations.¹³ Second, 179D corrects a flaw in the tax code whereby businesses are allowed to immediately deduct utility bills as part of their ordinary operating expenses – but retrofits investments can only be depreciated over long periods of time as capital expenses. More inefficient structures with higher utility bills may thus benefit from a larger tax deduction compared to buildings that use less energy. 179D aligns the code so that it awards long-term capital investments to *save* energy, as opposed to the operating expenses deduction that can otherwise be claimed for *wasted* energy.

The 179D tax deduction is a critical incentive not only because it will deploy innovation in energy efficient commercial buildings, but will also lower unemployment. An analysis¹⁴ commissioned jointly by the Natural Resources Defense Council, The Real Estate Roundtable, and the U.S. Green Building Council, estimates that over 77,000 construction and related jobs will be created by the changes to 179D suggested by Senators Bingaman and Snowe. In keeping with their thoughtful reform proposal, The Roundtable strongly encourages extension and modification of the 179D tax deduction.

(2) Authorize Department of Energy Loan Guarantees for Building Retrofits.

Senators Jeanne Shaheen (D-NH) and Rob Portman (R-OH) are to be commended for their bipartisan work on S. 1000, the Energy Savings and Industrial Competitiveness (“ESIC”) Act, which this Committee passed by an 18-3 vote in July 2011. Section 202 of S. 1000 would authorize credit enhancement from the Department of Energy (“DOE”) to support and leverage

¹³ See stream of June 12 Senate Finance Committee hearing, “Tax Reform: Impact on U.S. Energy Policy,” oral testimony of The Hon. Don Nickles, available at: <http://www.finance.senate.gov/hearings/hearing/?id=990f1101-5056-a032-5202-6921d68e8769> (at the 26:53, 75:50, and 102:01 marks).

¹⁴ See Table 8, p. 12 at: <http://c4bb.org/wp-content/uploads/PeriFINALForRelease06-10-11.pdf>

private sector financing for building retrofit projects.¹⁵ The Roundtable has long-advocated that DOE's current loan guarantee program should be used to assist lenders and building owners with the capital expenses associated with energy upgrades. Accordingly, we strongly encourage enactment of the ESIC Act's financing title.

The Roundtable recognizes the controversies associated with DOE's loan guarantee program following the Solyndra investigation. We believe, however, that S. 1000 gets the loan guarantee program back on track as it was initially envisioned and created by both Republicans and Democrats in 2005.¹⁶ Section 202 is carefully constructed so as to limit DOE's exposure to financial risks in the event of a borrower's default on a retrofit obligation, as follows:

- ***S. 1000 does not pick technology “winners and losers” by favoring the manufacture of any particular product or technology.*** Rather, S. 1000 is technology neutral, and supports retrofit *projects* and not *products*. The bill lets building owners in the market decide what types of efficiency measures it should install as part of a retrofit project, as best suited to lower energy consumption in their buildings.
- ***S. 1000 incorporates underwriting and due diligence requirements for retrofit financing.*** The bill directs DOE to develop guidelines that “shall include ... measures to limit the exposure of the Secretary to financial risk in the event of default,” like the borrower's ability to re-pay a retrofit debt and the value of the underlying collateral supporting the loan. To implement the loan guarantee program for retrofits, S. 1000 directs DOE to develop underwriting criteria that assess a borrower's creditworthiness, the building's loan to value ratio, and the building's history and expectations in generating rental and other income, among other factors.
- ***S. 1000 would provide credit support for successful retrofit projects guaranteed to result in energy savings.*** The bill directs DOE to consider private sector, third-party guarantees of energy savings after a retrofit is implemented, and whether those savings will pay for project costs over time. S. 1000 provides that DOE (and taxpayers) do not bear the “performance risk” of whether a project will succeed and result in energy savings. Rather, third-party contractors responsible for the retrofit like DOE-approved energy services companies—but *not* DOE itself—would bear risks that installed energy efficiency measures will perform as designed. In this way, the transaction can be structured so as to amortize retrofit financing through measured and verified energy savings accrued over time.
- ***S. 1000 places an upper limit on the amount of federal credit support.*** The bill states that the maximum amount of financial risk that DOE can bear for any single retrofit project is \$10 million. In contrast, the direct loan (not a loan guarantee) given to Solyndra left taxpayers on the line for \$528 million after the solar company's default.
- ***S. 1000 provides financial support for retrofits through loan guarantees – not through loans, grants, subsidies, or hand-outs.*** Loan guarantees will provide an incentive to leverage far greater amounts of private sector investment in building retrofits, so real estate, lending, and energy services firms have their own “skin in the game.” It has been

¹⁵ Companion legislation (H.R. 4017, the “Smart Energy Act”) is pending in the House, introduced by Reps. Charles Bass (R-NH) and Jim Matheson (D-UT).

¹⁶ The DOE loan guarantee program was created as Title XVII of the 2005 Energy Policy Act (H.R. 6, 109th Cong.). It passed the House on April 21, 2005 by a 249-183 vote, and the Senate on July 28, 2005 by an 85-12 vote. President Bush signed it into law on August 8, 2005.

estimated that a \$200 million federal loan guarantee investment in retrofits would leverage as much as \$2 billion in private sector financing.

- ***S. 1000 would provide credit support for proven building retrofit projects that already have a track record of success.*** We have case studies on the success of retrofits, such as the Empire State Building, showcase projects associated with the Better Buildings Challenge, and the experiences of EPA’s “Partner of the Year” winners, among others.¹⁷ Retrofits pose far lower risks for federal guarantee support compared to unproven manufacture of certain renewable products, where the market may be heavily influenced by subsidies provided by foreign competitors.

Moreover, Congress should consider the impact of S. 1000 as a jobs creator. The Real Estate Roundtable, in conjunction with the U.S. Green Building Council and the Natural Resources Defense Council, estimates that a loan guarantee program like the one authorized by the ESIC Act can create up to 25,000 American jobs.¹⁸

In short, enactment of S. 1000’s bipartisan retrofit loan guarantee title will provide a transformative platform to finance efficient buildings, lower energy consumption, and get construction workers back on the payroll. We urge Congress to pass it.

(3) Pass Legislation to Encourage Real Estate Appraisals that Value Energy Efficiency.

The Roundtable has long advocated for better information sharing between appraisers, building owners, and lenders to ensure adequate and consistent assessment of energy efficiency’s effect on property values. S. 1737, the Sensible Accounting to Value Energy (“SAVE”) Act sponsored by Senators Michael Bennet (D-CO) and Johnny Isakson (R-GA), includes provisions that encourage parties to a real estate transaction to share energy efficiency information in the context of asset valuation. Discussions this spring among The Roundtable, the Appraisal Institute, and other organizations have built wider support for this concept.

High-efficiency equipment and better building operations may increase the value of commercial real estate. Yet stakeholders from all perspectives – lenders, appraisers, building owners and managers, and energy efficiency advocates – suffer from the lack of data regarding the monetary benefits that energy efficiency components can bring to real estate values. Better information sharing will help monetize any added values from efficiency equipment and platforms deployed in buildings, which in turn can spur greater investments in retrofits.

The SAVE Act would establish rules so that appraisers, owners and lenders have timely access to information that may be relevant to the efficiency, conservation, and renewable energy features of real estate. These include: building labels or ratings; installed appliances; blueprints and construction costs regarding retrofit projects; utility bills; energy benchmarking data; third-party verifications of a property’s energy performance; and financial or other incentives regarding installed high-performing components and systems. If such information is consistently shared as an industry best practice, over time a greater number of comparable assets will be available for appraisers to evaluate energy efficiency features when determining market value.

¹⁷ See notes 7-9.

¹⁸ See Table 8 at <http://c4bb.org/wp-content/uploads/PeriFINALForRelease06-10-11.pdf>. The American Council for an Energy Efficient Economy (“ACEEE”) estimates that the total impact of S. 1000 on employment (not just the loan guarantee title) would be 80,000 jobs created by 2020, and 159,000 jobs by 2030. See <http://aceee.org/white-paper/shaheen-portman>.

Banks may thereby assess the financing risks associated with projects that will save money through energy savings, and develop lending products specifically to underwrite retrofit investments.

Accordingly, as another appropriate measure for Congress to spur financing for highly efficient buildings, it should enact the SAVE Act's provisions to provide better information regarding energy efficiency attributes in the process real estate valuation.

(4) Pass Legislation to Align Commercial Landlords and Tenants on the Goals of Energy Efficiency

A commercial building can be retrofitted with the latest efficiency technologies but still not perform as it was designed to achieve optimal energy savings. This is because spaces leased by tenants may be “over built” at the time of new fit-outs to provide more energy capacity than a tenant needs, or because building occupants may have behaviors that unnecessarily waste energy.

Legislation proposed to date has focused on how real estate owners and developers may lower energy consumption. But this is only part of the issue. Office tenants like data centers, law firms, trading floors, financial services firms, restaurants, and retail stores use a lot of energy. Based on the Empire State Building's retrofit experience,¹⁹ tenants can consume between 50%-70% of their structures' total energy. Choices made by office tenants in designing and operating within leased spaces thus have great impact on U.S. energy consumption.

Accordingly, we encourage Congress to consider legislation that gets office landlords and tenants on the same page with regard to energy consumption in commercial buildings. We are pleased that Senator Michael Bennet (D-CO) is developing a bill that will take a market-driven, non-regulatory approach to align building owners and their lessees to cooperatively reduce demands on the grid. Among other ideas, Senator Bennet's legislative concept is developing solutions to:

- ***Overcome Energy Consumption Data Barriers.*** In many cases, commercial property owners are unable to get the data to tell them how much energy their entire building consumes. This is because tenants control access to the energy meters in the spaces they lease. The utility serving the Chicago area, Commonwealth Edison, has overcome this significant data obstacle. An amendment to existing law (Public Utility Regulatory Policies Act [PURPA]) could establish a non-binding standard favoring the ComEd model. Utilities would be encouraged to provide aggregated “whole building” energy consumption information in a manner that fully safeguards tenant privacy concerns in their energy data, without increasing prices on consumers.
- ***Creates Opportunities for Voluntary “Tenant Star” Recognition.*** The Environmental Protection Agency's ENERGY STAR program for commercial buildings has been operating for over a decade and is widely embraced by commercial building owners. It is a huge success, and certified buildings typically use 35 percent less energy than average buildings and cost 50 cents less per square foot to operate.²⁰ Many Roundtable members and other large commercial building owners and managers strive for the ENERGY STAR label to distinguish their assets as “top of class.” Senator Bennet's bill concept would provide EPA with the tools necessary to bring the program to the next level with tenant-

¹⁹ See note 9.

²⁰ See http://www.energystar.gov/index.cfm?fuseaction=labeled_buildings.locator;
http://www.energystar.gov/index.cfm?c=evaluate_performance.bus_portfoliomanager_intro.

oriented certification for leased spaces. Today's ENERGY STAR is based on whole-building recognition. The imminent bill would deliver the data set needed to likewise recognize efficient tenant-leased spaces within a building. The synergy of "Tenant Star" spaces within "ENERGY STAR" buildings could transform – in a non-regulatory way – how commercial real estate owners and their tenants think about energy efficiency and dramatically lower energy use throughout the built environment.

- ***Develop Replicable Standards for New Tenant "Fit-Outs."*** Commercial tenants are most likely to make structural investments in the areas they occupy when they enter into new leases, or renew leases for longer terms. We thus want to encourage high-performance design and construction of leased spaces at the point of new "fit-outs" that suit tenants' needs, but are not "over-built" to encourage or allow wasted energy use. The imminent bill is developing a proposal for industry stakeholders to assist the Energy Department in studying and developing replicable standards for high performance new tenant fit-outs.

Sound energy policy must take a holistic approach by considering the consumption and behaviors of office tenants and other building occupants. The Roundtable applauds Senator Bennet for his leadership to educate and align commercial building landlords with their tenants, so they may cooperate to make even deeper cuts in energy consumption attributed to the commercial real estate sector as a whole. When his bill is introduced, we recommend that the Committee study it carefully and take the necessary steps to move it toward enactment.

(5) **Encourage More Foreign Investment in U.S. Real Estate: FIRPTA Reform and EB-5 Authorization.**

The economic and political stability of the United States historically has attracted foreign investment capital to our real estate markets. The recent decline in the value of the dollar compared to other key currencies has made U.S. real estate even more attractive. Unfortunately, so far in the recovery, new equity investment from both foreign and U.S. sources has been skewed to a handful of urban "gateway" markets and large trophy assets. This propensity has bifurcated property values, with large market, large asset values recovering, while overall asset values have remained depressed and distressed property values have generally continued to slip.

Law makers must consider policies to attract new sources of equity capital from Europe, Asia, and the Americas, which in turn would help bridge the massive "equity gap" complicating the refinancing of hundreds of billions in commercial mortgages (and threatening a new wave of foreclosures). Injections of foreign investment capital in domestic real estate can, incidentally, also be used to finance energy efficient buildings.

To stimulate more foreign investment in U.S. real estate, The Roundtable offers two areas where Congress should act immediately. First, it should enact pending legislation to reform the Foreign Investment in Real Property Tax Act. Second, it should enact legislation to permanently re-authorize the EB-5 program for immigrant investors. Both are discussed in further detail below.

(a) **FIRPTA Reform**

The commercial real estate industry is united in its view that the Foreign Investment in Real Property Tax Act of 1980 ("FIRPTA") dramatically disrupts the rational allocation of foreign capital into the U.S. real estate sector. Commercial real property markets in the United States need an infusion of equity at this time, not a tax regime that deters foreign investment.

FIRPTA is a significant barrier to non-U.S. investors. In contrast to the general U.S. tax law exempting foreign investors' gains from U.S. *stocks, bonds, and other securities*, the United States imposes a high rate of taxation on foreign investment in U.S. *real property*. The U.S. tax rate on gains from such direct and indirect ownership of U.S. real property can exceed 50 percent, particularly when the branch profits tax regime applies to such transaction. Further, a non-U.S. investor who is subject to tax under the FIRPTA regime has a filing obligation with the Internal Revenue Service. Non-U.S. investors view the Internal Revenue Service as a highly intimidating force – much more so than the taxing authorities in most other jurisdictions. Thus, the filing obligation mandated by FIRPTA is a significant burden and deterrent to U.S. investment from the perspective of foreign investors. Indeed, the U.S. commercial real estate market has slipped to third in the race for global funds behind the United Kingdom and now Germany. In the absence of FIRPTA reform, potential foreign investors in U.S. real estate may choose to invest elsewhere – either in real property in countries overseas that have less onerous tax regimes, or in other types of U.S. corporations.

Our nation needs to compete more effectively for global capital, and the tax code should not be a barrier to foreign investment in U.S. real estate. Additional foreign equity investment would greatly assist community banks and other financial institutions now holding mortgages on U.S. properties, help address the ongoing residential housing foreclosure crisis, and directly lead to job creation and ultimately stimulate our economy's overall recovery.

FIRPTA is an idea whose time has come and gone, and, were it fiscally feasible, should be abandoned in its entirety. The Roundtable recognizes, however, that budgetary constraints may make it difficult to repeal FIRPTA at this time. Reasonable, cost-efficient reform is still possible, and The Roundtable strongly urges steps be taken to address the negative effects of FIRPTA. In particular, the “Real Estate Investment and Jobs Act” (S. 1616)²¹ has been introduced by Senators Robert Menendez (D-NJ), Mike Enzi (R-WY) and has support from 25 co-sponsors. It takes a measured approach to FIRPTA reform and would:

- ***Withdraw IRS Notice 2007-55:*** S. 1616 would reinstate an IRS position to allow redemptions and liquidating distributions to be treated the same as sales of stock in the case of a domestically controlled Real Estate Investment Trusts (REITs). Before 2007, such distributions generally were treated as sales of REIT stock, and not subject to U.S. tax. In 2007, The IRS issued Notice 2007-55 which concluded that such distributions should be treated as sales of real estate and therefore subject to FIRPTA. Until the issuance of the Notice, there was no reason for foreign investors to believe that liquidating distributions by REITs, as with the liquidating distributions of any other corporation, should be treated as anything other than sales of stock. The IRS's position has caused considerable consternation in the foreign investor community, has severely constrained continued foreign investment in U.S. real estate, and should be withdrawn.
- ***Increase the amount of stock minority shareholders can hold without triggering FIRPTA tax:*** Presently, a foreign shareholder owning five percent or less of a publicly-traded U.S. real property company, including a REIT, is exempt from FIRPTA on a sale of the corporation's stock. In addition, a foreign shareholder owning 5 percent or less of a publicly-traded REIT is exempt from FIRPTA on the receipt of a capital gain distribution attributable to the sale or exchange of a U.S. real property interest. There are numerous investors around the world who own just fewer than 5 percent of these companies' stock, but despite their willingness to invest in U.S. companies, won't dare to

²¹ Companion legislation (H.R. 2989) is pending in the House, introduced by Reps. Kevin Brady (R-TX) and Joe Crowley (D-NY).

go over that threshold for fear of being ensnared by FIRPTA. S. 1616 would increase from 5 percent to 10 percent the exemption level threshold and apply it to investors in certain widely held investment vehicles.

FIRPTA reform is not far afield from the topic of today's hearing. Increased foreign equity investment in commercial real estate will provide real property owners with much-needed capital to successfully refinance maturing loans and engage in new projects to improve existing assets. The untapped availability of foreign investment capital would be used to invest in our nation's building infrastructure, and provide a source of funding for innovative energy efficiency retrofits. In short, without a functioning real estate finance market we will not have a functioning retrofit financing market. FIRPTA reform and enactment of S. 1616 would help achieve both objectives.

(b) EB-5 Authorization.

Another vehicle to encourage more foreign investment in domestic real estate is the EB-5 "immigrant-investor" program. It is scheduled to expire on September 30, 2012. The Roundtable urges Congress to move on pending legislation that would permanently authorize this program.

Established in 1992, the EB-5 program deploys foreign investment as a means to spur job growth while simultaneously affording eligible foreign investors the opportunity to become lawful permanent residents of the United States. Roundtable members have used EB-5 as an important source to assemble funds for development projects that create well-paying American jobs. The program has grown dramatically in recent years and has nationwide impact; the U.S. Citizenship and Immigration Service has approved 225 regional centers that distribute foreign investment capital in 45 states.²² In 2011, the EB-5 program was estimated to create and/or save 25,000 American jobs and generated direct investment of over \$1.25 billion. Furthermore, EB-5 is revenue neutral, as program costs are offset by the fees charged in issuing permanent residency visas. Because there is no taxpayer impact, EB-5 has been extended with bipartisan support since its inception.

The Roundtable sees potential in EB-5 as a means to aid retrofit financing. Foreign investments received through the program may be directed to assist with the up-front capital expenses to underwrite energy efficiency projects. In considering whether to extend and/or permanently authorize the program, Congress has the opportunity to encourage EB-5 regional centers to distribute investments to projects that do not simply spur economic development, but also make our nation's building stock more energy efficient.

S. 3245, introduced by Senator Patrick Leahy (D-VT) and co-sponsored by Senator Chuck Grassley (R-IA),²³ would make the EB-5 regional center program permanent and thus ensure stability for investors, entrepreneurs, and stakeholders that develop and finance real estate. Congress should pass this bill, and we encourage the Committee to further consider how the EB-5 program may synergistically advance our national goal of energy independence.

²² See

<http://www.uscis.gov/portal/site/uscis/menuitem.5af9bb95919f35e66f614176543f6d1a/?vgnextoid=d765ee0f4c014210VgnVCM100000082ca60aRCRD&vgnnextchannel=fac83453d4a3210VgnVCM100000b92ca60aRCRD>.

²³ Companion legislation (H.R. 2972) is pending in the House.

(6) **Congress Should Conduct Oversight to Curb the Recent Rise in GSA “Holdover” Leases.**

Roundtable members report a growing issue with the largest commercial office tenant in the country – the federal government. The General Services Administration (“GSA”) is responsible for managing the federal buildings portfolio, which includes over 7,100 leased properties. GSA’s actions thus register a significant impact in commercial real estate markets across the country.

When a tenant – in this instance the GSA – continues to occupy its leased premises after the term has ended, it is said to “*hold over.*” While holdovers often result in short term extensions for government convenience, they have a deleterious effect in the marketplace and create uncertainty about the future operations of a commercial building. GSA’s default position as a holdover freezes the ability of landlords to re-position their assets and market their properties to prospective new tenants. Federal leasing uncertainties also place building owners in precarious situations with their lenders, and unnecessarily shift the burden of cost and risk to the private sector. A vacant or severely underutilized building has a limited income stream and lenders may thus harshly assess the asset’s credit worthiness. Making matters worse is the backlog of congressional approval required for prospectus-level leases worth more than \$2.7 million a year.

Holdovers are not standard practice in the commercial real estate industry. In the private sector it is commonplace for tenants to provide several years advance notice of their intention to vacate or renew a lease prior to expiration. As a result of holding over, the GSA immediately pays the direct penalty of higher lease rates as short-term extensions are generally 25-50% above standard market rates. Not only does the GSA pay significantly higher rates for short-term tenancy, but by deviating from standard practices of advance notice of intention prior to lease expiration, it also deprives itself of the opportunities to pursue the full range of options available in the marketplace.

For the immediate issue at hand, an unreliable federal leasing process impedes capital improvements in building efficiency upgrades. Commercial landlords dealing with federal holdover tenancies will lack access to predictable income and financing streams necessary to fund retrofit investments. Moreover, with spaces frozen to accommodate GSA holdovers, there is no chance to design or construct new fit-outs for state-of-the art tenant installations.

Congress’s recent and ongoing investigations into the GSA should also consider solutions to break the holdover backlog. And, Capitol Hill should do its own part by approving prospectus leases as expeditiously as possible. More efficient and predictable federal leasing protocols in line with typical end-of-term notification practices will stabilize and correct commercial real estate markets – and establish the fundamental conditions that are necessary for private sector landlords and tenants to explore long term investments such as retrofit improvements.

V. CONCLUSION

To conclude, The Real Estate Roundtable recommends six actions Congress should take now to spur financing of efficient buildings:

- (1) Reform the 179D tax deduction for energy efficient commercial buildings specifically to encourage existing building retrofits.
- (2) Authorize a DOE loan guarantee program spur private sector retrofit financing.

- (3) Enact legislation to establish information sharing practices so that building owners, appraisers, and lenders can more consistently consider energy efficiency attributes when valuing real estate.
- (4) Enact legislation that creates voluntary programs and recognition platforms to encourage commercial tenants to cooperate with their landlords and achieve lower energy consumption in buildings.
- (5) Lower barriers to foreign investment capital in U.S. real estate by reforming FIRPTA and permanently authorizing the EB-5 immigrant investor program – thereby making more funds available to finance building energy upgrades.
- (6) Conduct oversight of GSA commercial leasing practices to curtail “holdover” tenancies, so buildings can be re-positioned in the market when federal leases expire and attract financing that could be used for capital investments like retrofits.

Thank you again for this opportunity to testify on behalf of The Real Estate Roundtable on the important topic of energy efficiency financing. I look forward to answering the Committee’s questions.