



# REAL ESTATE LAW & INDUSTRY



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**REPORT**

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## **SUSTAINABLE DEVELOPMENT**

*An expert in the application of energy finance and efficiency to real estate development says he sees a green lining to the currently clouded economic climate. He believes the combination of a progressive incoming administration, the need for practical solutions to construction finance problems, and changing sensibilities about building methods will soon open up unforeseen opportunities in commercial real estate.*

### **Green Building Advocate Sees Environmentally Sound Practices as Growth Industry**

**C**ommercial real estate is poised for transcendent changes along a wide spectrum of factors that influence it, from building standards, to federal regulations and tax policy, to market demand, to financial practices, according to Michael J. Zimmer, of counsel at Thompson Hine LLP who specializes in energy efficiency and “green building.”

“We are at a transformational point on a number of fronts in our country, from a budget perspective, from a financial perspective, from an energy policy perspective, and I think the real estate industry is part of that transformation,” Zimmer told BNA in a Nov. 12 interview.

Like many other industries, commercial real estate responds to inducements made available to it through the public policymaking process, and Zimmer regards the incentives that prevail today as inadequate or even counterproductive.

“The incentives up until now have been predominantly voluntary and market-based,” he said. “They have yielded certain results over the past 10 years that have been limited in scope, protracted in time, and not necessarily effective” in promoting desirable policy outcomes.

Benefits to developers have come primarily in the form of tax concessions that have had limited effects on energy conservation and other moderate incentives allocated through the housing government-sponsored enterprises, the Department of Housing and Urban Development, the Energy Department, Environmental Pro-

tection Agency, and state and local governments, he said. In response, almost 80 percent of the current green building market has a nexus to the public sector.

**More Aggressive Policies.** But these meager initiatives are about to be overshadowed by a far more ambitious set of policies that Zimmer expects to see emerge from the newly elected Congress and the Obama administration that will also move the private sector. They will be predicated not only on the political leanings of the new leadership in Washington, D.C., he said, but on the stark realities of the current financial climate.

“I think what we’re seeing in this transformational environment is an array of market factors in the real estate sector—the declining value of existing portfolios, the inability to finance both equity and debt in terms of new projects under development, difficulty in refinancing short-term debt on a going-forward basis,” Zimmer said and added that all of these conditions may be converging to create “both a need and an opportunity for maybe a more robust set of programs and incentives.” Patience and foundation-building during the prior decade may now be rewarded, he said.

Under the Obama administration, Zimmer said he expects to see a policy that would establish an economy-wide cost for carbon emissions, with allowances auctioned off to fund energy efficiency or improvements. Also, he envisions full-scale implementation of a new carbon-neutral standard for all new buildings in the fu-

ture. The Energy Department unveiled the new standard in August.

**States to Play an Active Role.** Some of the anticipated advancements in upgrading and coordinating building standards will be adopted and implemented by the states, according to Zimmer.

“There’s a wide array of different standards of implementation of building codes at the state level,” Zimmer said, “and I think we’re likely to see a major and further coordinated push there.”

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Additional state-mandated incentives for achieving higher building energy efficiencies are likely to be prompted by public utilities that will provide financial support and assistance to building owners. Zimmer also anticipates the prospect of federal efficiency standard for utilities, which could amount to “goals and objectives for the utilities to work toward using market-based approaches.”

One example of the kinds of measures utilities might take to reach these goals would be to move away from master metering of buildings and toward increased sub-metering that encourage more conservative use of electric power.

**Evaluation of Infrastructure Needs.** The United States has not really addressed its infrastructure needs since 1986, according to Zimmer, and if the new administration carries through with its announced intentions to do so, that could mean improvements that significantly affect building owners.

“It’s going to affect your transportation; it’s going to affect the hardening of the grid, in terms of the smartening of the grid and transportation/distribution systems to provide time-of-day pricing signals and better market-based signals to manage energy, electricity, and water consumption more effectively,” Zimmer said.

Other transportation infrastructure improvements could have a profound effect on the location and types of commercial structures, he said.

“We’re starting to see as part of a sustainability review support for increased densities as more efficient use of land,” Zimmer said. That means more incentives for buildings that give residents convenient access to public transportation.

Zimmer’s perspectives on future directions for commercial real estate derive in part from his role with organizations that are influencing both building efficiency standards and the underwriting of commercial structures. He serves both as an adviser to the Capital Markets Partnership Green Building Underwriting Committee and as a member of Energy and Atmospheric Technical Advisory Group Committee of the U.S. Green Building Council. He is also national co-chair of the American Bar Association Renewable Energy Resource Committee.

**Support for Green Building Investment.** The CMP Underwriting Committee is a consensus-based group that was founded to support green building investment. Zimmer described their mission as linking value to increased cash flow and reduced expenses that can be associated with sustainable development decisions in real estate and mortgage-backed lending. Its goal is to help attract capital to green building projects and to help assemble pools of investment to support those kinds of activities.

The CMP comprises a Who’s Who of more than 70 major financial institutions, non-governmental organizations, and federal agencies, including the Treasury Department. This summer the group unveiled its underwriting standards for green building projects for national peer review. They were presented in their final form at a meeting at TIAA-CREF in New York on Oct. 8.

Zimmer noted that the CMP is working with financial institutions to adopt the standards as part of their underwriting review processes and is planning to launch a national educational program on them in January 2009.

“A number of forces on Wall Street think that the development of sound underwriting guidelines and standards as well as a review and linkage to the proper value proposition on green buildings is a critical element among several for the rejuvenation of mortgage-backed securities and real estate lending activities on Wall Street over the next several years,” Zimmer said.

In a separate and unrelated capacity, Zimmer works with the U.S. Green Building Council EA TAG Committee, which has developed the Leadership in Energy and Environmental Design (LEED) Green Building Rating System. That organization has been in existence since 1998 and offers a set of standards for certifying environmentally sustainable construction.

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The Green Building Council and Capital Markets Partnership play complementary but totally independent roles, with the Council devising technical standards for sustainable building practices and CMP focused on “transforming those principles and that hard work into the development of market-based financial products, services, and tools to access capital to support green building objectives,” Zimmer said.

**Opportunities to Take Near-Term Actions.** As the executive branch begins its transition to the Obama administration, Zimmer said it would likely consider several

near-term initiatives that could promote environmentally sound development practices while benefiting the real estate sector.

Among the high priorities, he said, should be to “set a determination of the value of carbon in our economy on a going-forward basis to remove that uncertainty, to capture the economic value of that in our marketplace.” That alone would help end many of the delays in deciding a rational energy policy, he added.

To help integrate those values into the market, he said, the federal government should develop a special green building carbon credit possibly as part of a cap-and-trade program. Zimmer noted that buildings account for 70 percent of all electric power consumption in the United States and almost 40 percent of all energy use.

He also would suggest legislation that would provide special investment tax credits and accelerated depreciation for equipment, systems, and technologies that help to improve energy efficiencies in buildings. Rollover and modernization of existing capital stock must be accelerated. Incentives also should be offered to shorten the period for leasehold improvement depreciation, he said. Such a benefit was included in the recently enacted Emergency Economic Stabilization Act (EESA), but Zimmer said the time horizon for that incentive was limited and should be extended to promote improved planning on the part of building owners, especially as Treasury develops its implementing regulations.

Zimmer also would recommend loosening current restrictions on issuance of tax-exempt municipal bonds to help encourage local governments to make needed infrastructure improvements and to modernize aging support for national real estate investments.

In regard to the Troubled Asset Relief Program (TARP) he recommends expanding the list of institutions that would be eligible to receive federal capitalization to real estate investment trusts. The program initially was envisioned for the major investment banks and depository institutions, but it has been gradually relaxed to involve other kinds of enterprises.

Finally, he said, “There is a lot that can be done under existing law that does not score on budget, that does not create a budget deficit challenge for our country.” Much of this involves removing existing impediments to implementation of existing energy, environ-

mental, and tax statutes that would better serve sustainable economic development policies, he said.

Many laws that were adopted over recent decades “do not reflect the current transformational market pressures that we are now confronting in 2008,” and contain provisions or have been implemented in ways that only serve as barriers to development in today’s demanding environment for more high-performance building investment, Zimmer said, adding, “A lot of people fall in the trap of thinking we need new legislation. What we need is smart leadership and administration; there’s a lot that can be done by executive order, a lot that can be done by rulemaking, a lot that can be done by following up on inconsistent policies that already have been enacted in our departments and agencies.”

In spite of the clear challenges that face the economy and the national leadership, Zimmer said, we are at a juncture that may also present unique opportunities to effect needed changes to make the country competitive for the 21st century.

“We don’t see a period like this arise in our country but every 25, maybe 50 years,” Zimmer said. “I think it’s clear that we’re going to see a more active government role in these areas to encourage and accelerate the movement to higher performance building investment.”

**Trends Toward Sustainability.** More indications of the ongoing viability of such practices will be borne out over the next year or two as the U.S. economy recovers from the current downturn. The great majority of those in the real estate industry say they see more growth ahead for green building and sustainable development practices, and Zimmer noted that 60 percent of real estate industry professionals today believe that demand for green buildings will create a new asset class.

“So I think our industry sees the trend coming,” Zimmer said. “I think there’s a question of whether it’s going to be transformative. Is it a fad or is it going to be real and based on sound economic principles for the long term? I think many in the industry do feel that because a majority believe that companies will ultimately pay a premium for a sustainable property.”

BY RICHARD COWDEN