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Energy-Disclosure Laws: The Wolf at the Door?

California's AB 1103 is in effect, but many are unprepared

The problem with crying wolf when there's no wolf in sight is that people stop listening.

California Assembly Bill 1103 (AB 1103), the mandatory energy-disclosure law for nonresidential buildings, commenced this past January. But as in the fable of the "boy who cried wolf," the law was announced as imminent and then delayed so many times that the commercial real estate industry stopped taking the warning seriously. Now that the law is here, many commercial mortgage professionals are alarmingly unprepared to comply.

With an increasing number of jurisdictions around the country adopting similar energy-disclosure laws, it's a good time for mortgage brokers, bankers and their clients to brush up on the requirements of these laws and their implications for transactions.

Energy-disclosure laws

California is one of many jurisdictions to implement requirements about commercial buildings' energy usage to be disclosed either before a transaction or on a regular time frame (e.g., yearly). The idea behind these laws is to lead market forces by rewarding the construction and maintenance of more energy-efficient buildings. This will provide more transparency in real estate transactions, enabling buyers to make an "apples to apples" comparison of the energy performance of like buildings, much as they can compare miles per gallon information on different car models.

In addition to California, the following locations have mandatory disclosure laws in place: Austin, Texas; Boston; Chicago; Washington, D.C.; Minneapolis; New York; Philadelphia; San Francisco; and Washington state. Many other areas have proposed

laws that are not yet in effect. The disclosure requirements vary from location to location, and some locales go beyond disclosure to require periodic energy audits, as is the case in San Francisco, or Leadership in Energy and Environmental Design (LEED) certification, as is the case in Washington, D.C.

California's law, the most recent to be implemented, is required for nonresidential buildings before a sale, lease or financing of the entire property. The first phase of AB 1103 implementation began this past January for buildings greater than 10,000 square feet. The next phase for buildings greater than 5,000 square feet will begin on July 1.

Benchmarking

Energy-disclosure laws typically require the use of Energy Star's Portfolio Manager for benchmarking and reporting. The tool is free and online, and it contains a large database of buildings for comparison. The system generates a score for a building from 1 to 100, with 100 being the most energy efficient.

The Energy Star Portfolio Manager is not the only way to benchmark, however. Energy benchmarking is more about a process than any particular tool or software; it's the measurement of energy performance, comparing performance metrics to those of similar buildings. It often includes ongoing tracking of performance after initiatives are undertaken to reduce energy consumption, which helps determine if goals are being met.

Simple awareness drives action. It's like losing weight — regular measurement is needed to chart progress. Benchmarking makes it easy to identify whether practical changes, such as setting controls and timers for thermostats and lighting, are

reducing consumption. Tangible results also can encourage buy-ins and cooperation from tenants, which help further implement these changes.

Compliance

Many commercial real estate professionals see opportunity for return on investment in energy efficiency, but some people in the industry don't think about the subject until they're told that they have to, as they now do with California's AB 1103. A large number of people across the industry aren't ready to comply, leading to a late scramble by those with little to no prior knowledge of AB 1103 seeking to find out what they should do.

In many jurisdictions with mandatory disclosure laws that apply to real estate transactions, compliance failure opens up the potential for significant delays to closing, price negotiations, missed deals or the loss of hard-money deposits. Mortgage professionals should note two types of possible issues encountered by AB 1103 noncompliance:

1. **A client needs an emergency energy-disclosure report** because the buyer refuses to close without it. Because the

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seller hasn't taken steps to complete compliance requirements, the deal may be delayed or even killed, and the intervention of an attorney or another third-party professional may be required.

2. An owner who has not complied with AB 1103 requirements is suddenly advised by legal counsel to obtain an energy-disclosure report to eliminate any excuse for the buyer to back out of a purchase once that buyer enters escrow and hard money is deposited.

With AB 1103, there is no specific financial penalty for noncompliance, but the California Energy Commission (CEC) may initiate enforcement proceedings. The California Code of Regulations authorizes a complaint to be filed by a person seeking remedies for an alleged breach of statutes or regulations enforced by the CEC.

Benefits

In the case of energy-disclosure laws like AB 1103, it turns out that the wolf at the door is more like a sheep in wolf's clothing. Compliance is not difficult, and the benefits outweigh the negatives. Compliance just takes time and education to do properly. It's possible to do a bad job of compliance that causes more problems and fails to capitalize on its potential benefits.

The many virtues of energy-efficient buildings are well-known: Energy costs are a significant but controllable expense of commercial buildings when utility rates are constantly increasing; energy-efficient buildings command higher sales prices and rent premiums and have higher occupancy levels and lease rates; and tenant demand for energy efficient space is increasing, just to name a few benefits. Many industry professionals are realizing these benefits and view disclosure laws as a good opportunity to evaluate their portfolios.

Taking a proactive approach to AB 1103 compliance may lead to tangible gains. Take the case of a real estate investor with a portfolio of commercial office properties who monitored the energy performance of several buildings before AB 1103 guidelines becoming law. By constantly monitoring energy efficiency and notifying the building engineer and property manager to take corrective

steps when poor-performing buildings were identified, the investor realized a 5 percent reduction in energy costs that equaled a \$600,000 reduction in savings. This worked out to an increase of \$7.5 million in portfolio value at an 8 percent cap rate.

Consultants

Although many energy-disclosure laws allow building owners to self-report, the process can be time-consuming, especially if the property has multiple tenants, which means much more data to collect and report. Many real estate professionals simply don't have the time to learn about and deal with all the ins and outs of energy disclosure and prefer a consultant to handle it for them.

Many energy consultants are available that offer reasonably priced disclosure-reporting services. Typically, these consultants collect all the building data, operating characteristics and utility bills, make some sense of the information, and ensure that it is reported accurately per legal requirements.

Building owners also may want their consultants to go beyond reporting and use the collected information to track or improve the energy performance of their assets.

Roles

Although the onus to comply is on building owners, all parties in a commercial real estate transaction have a stake in the compliance process. The job of the broker is to match buyers and sellers of real estate and to get deals closed in a timely fashion, so having an understanding of AB 1103 and other disclosure laws will minimize transaction risks.

Buyers have an interest in understanding the energy performance of their assets. Owners are incentivized to reduce energy consumption, and compliance protects them against purchasers backing out of a deal. Attorneys may act as an enforcing entity for either party.

When all the costs associated with marketing, selling and closing a real estate transaction are considered, the fee of an energy-disclosure report is a small drop in the bucket for peace of mind and the potential benefits of compliance. It remains to be seen how the implementation of AB 1103 will unfold, but energy-disclosure laws are not going away and will become more common. As the commercial real estate industry adjusts, people are likely to stop crying "Wolf!" and start thinking, "This is a good opportunity." ●

CA AB 1103 Requirements

To determine if your commercial building needs to comply with California Assembly Bill 1103's energy-disclosure requirements, answer the following questions. If the answer to all three questions is "yes," compliance is required under the provisions of the bill.

- 1. Is your entire nonresidential building offered for sale, lease, finance or refinance?**
- 2. As of this past Jan. 1, is the total gross building square footage greater than 10,000 square feet, and as of this coming July 1, will the total gross building square footage be greater than 5,000 square feet?**
- 3. Is the building type one of the following?**

- Assembly (A)
- Business (B)
- Educational (E)
- Institutional: Assisted living (I-1, R-1)
- Institutional: Nonambulatory (I-2)
- Mercantile (M)
- Residential: Transient (R-1; for example, hotels)
- Storage (S)
- Utility: Parking garage (U)

For more information, visit energy.ca.gov/ab1103.