ML Strategies Legislative Update

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MARCH 4, 2013

Congress considers increasing incentives for commercial and multifamily building energy efficiency retrofits

The case for commercial building energy efficiency

Commercial buildings consume 36 percent of all U.S. electricity each year. This consumption costs $190 billion and is responsible for 18 percent of U.S. carbon dioxide emissions. Moreover, the Environmental Protection Agency estimates that 30 percent of the energy used in commercial buildings is wasted, on average.

Unfortunately, the market is not aligned to encourage efficiency savings. Landlords usually pass along utility charges to tenants, and tenants often have little incentive to make investments impacting the long-term performance of a building. And while businesses can immediately deduct utility bills as ordinary and necessary operating expenses, any such energy efficiency investments in buildings must be depreciated over a period of years.

An existing federal tax deduction—Section 179D of the tax code—provides building owners with a tax incentive to help offset the costs associated with increasing the energy efficiency of commercial buildings. By allowing businesses to expense capital improvements for energy efficiency as part of their ordinary operating costs, Section 179D rewards capital investments to save energy. However, the current 179D credit is set to expire in 2013, is insufficient to incentivize retrofits, and cannot be utilized by a wide range of taxpayers. Various stakeholders, including the Real Estate Roundtable and US Green Building Council, have developed legislation to address the weaknesses of the current law.

What would this reform do?

A bipartisan group of Senators introduced the “Commercial Building Modernization Act” or CBMA, in the previous Congress. The CBMA makes Section 179D more effective by:

- Using an existing building’s own consumption as a baseline for energy savings and improvements instead of reference to a one-size-fits-all national standard. The

CBMA tags the 179D deduction amount to a "before and after" comparison of how much energy savings a retrofit project is designed to, and does, achieve.

- Provides for a sliding scale that increases the amount of the deduction for investments with greater energy savings. This encourages more ambitious projects while also rewarding projects that achieve meaningful yet more moderate levels of energy savings. The scale ranges from deductions of $1.00 per square foot for investments resulting in energy savings of 20% to $4.00 per square foot for energy savings of 50% or more.

- Makes the incentive useable for real estate owners like real estate investment trusts (REITs) and limited liability partnerships (LLPs) that cannot benefit from conventional tax incentives. The bill provides parity so public, private, and non-profit building owners can allocate the incentive to other parties that can benefit from the tax deduction who are also primarily responsible for the retrofit project. These other parties include contractors, tenants, engineers, architects, or the source of financing.

- Expands the scope of the provision to include multifamily buildings.

Who benefits from this reform?
Real estate property owners (including REITs and LLPs), tenants, architects, contractors, and energy efficiency equipment manufacturers.

Why now?
The 179D deduction is scheduled to expire at the end of 2013, so work must begin now to reintroduce and enact CBMA. Congress will reconsider the fate of incentives like 179D as part of an upcoming debate on tax reform.

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