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Incentives For Midwestern Developers To Go Green

Law360, New York (November 09, 2009) -- Buildings in the U.S. use over one-third of the world's energy consumption, and account for 40 percent of both the country's energy consumption and the nation's greenhouse gas emissions, plus over 70 percent of the U.S. consumption of electricity.

Despite common assumptions that today's environmental concerns stem from automobile emissions and industrial pollution, buildings actually have a comparably greater impact on the planet's environmental dilemma.

Significantly, a mere 8 percent of a building's environmental impact occurs during construction, while the remainder happens throughout the building's operational life; therefore, environmentally conscious real estate professionals should focus their efforts on energy-efficient buildings.

Sustainable development can take on many forms and may include various features, from recycled carpeting to low-flow faucets, and from an energy-efficient furnace to water-saving gutter systems.

Leadership in Energy and Environmental Design (LEED), established by the U.S. Green Building Council, serves as the preeminent rating system for environmentally friendly buildings. LEED awards its endorsement — either certified, silver, gold or platinum — to commercial buildings that meet its various standards. Projects earn points for meeting certain green building criteria; the number of points earned determines the overall level of certification.

The real estate industry views LEED certification as a reliable gauge to evaluate buildings that purport to be "green," and developers and owners alike are finding that obtaining such an endorsement produces both immediate and long-term returns.

Commercial real estate developers increasingly find themselves within the emerging trend of green building. Still, many developers hesitate to commit to environmentally

friendly goals because of the sensed sizeable increase in startup costs for new buildings.

Such reluctance, however, remains misguided, as many financial incentives are available for the opportunistic developer in the Midwest.

Furthermore, the ultimate reward to going green today may likely be that developers can use the “green” designation as a marketing advantage to distinguish their projects from the competition, particularly at a time when the overall demand for new construction has dropped sharply.

How Going Green Helps Developers and Owners: Prestige and Marketing

Increasingly, companies, as part of their corporate policies and initiatives, are mandating that their operations comply with various sustainability objectives, and as a result, many entities now function in a more eco-friendly manner.

Companies are realizing the many benefits of going green, including increased productivity of employees, improved recruiting of new hires, powerful marketing strategies, and prestige, in addition to simple altruism and the obvious environmental advantages.

Indeed, studies show that employees work more efficiently with, and are absent less, when their offices feature natural daylight and improved indoor air quality.

Operations in green spaces experience a 15 percent reduction in absenteeism; studies estimate that improved air quality could save U.S. businesses up to \$58 billion in time lost due to illness each year, and could save American companies \$200 billion more in increased work performance.

Increased ventilation, more daylight, comfortable temperatures and lighting controls have all been significantly connected to increased employee productivity, and a 16 percent improvement in worker productivity in green buildings shows the collateral benefits of an environmentally friendly workplace.

Developers and owners can market their green facilities to company executives as a means for those tenant-companies to increase their productivity and obtain the other benefits of operating in an environmentally sound facility.

In addition to the intangible benefits, many tenants are willing to pay increased rent for space where their employees will work more efficiently. For example, retail sales can increase up to 40 percent in buildings with natural lighting.

Surveys illustrate that business people, especially young professionals, seek out environmentally conscious companies; customers and clients desire to work with eco-

friendly entities, too. Moreover, the real estate industry views developers and occupants of green buildings as prominent innovators and responsible pioneers.

The Perceived Negative Aspects of Going Green: Startup Costs

Developers fear that the initial costs of constructing a green building are too high to make any new project sufficiently profitable to pursue. However, the actual additional cost of green construction is only between 3 and 5 percent. Of course, this figure depends upon how environmentally efficient a developer endeavors to make its building.

Moreover, developers and property managers can recoup these minimal costs through reduced operational expenses over the building's life, often in the first five to seven years.

In fact, green buildings could actually cost less than traditional buildings: an initial investment of 2 percent in green design results in lifecycle savings of 20 percent of total construction costs. For instance, installing solar panels costs a green developer \$25,000, yet after five to 10 years — because the panels produce energy and reduce demand for electricity — the owner recoups the initial payment.

Additionally, evidence suggests that, once constructed, green buildings have higher sales prices of as much as 30 percent more per square foot than traditional real estate.

Generally, once a green building's construction is complete, owners save on water, gas and electricity. Green buildings also require smaller mechanical systems, leaving more profitable space for tenants and operations. Going "green" nets a substantial return.

In the meantime, to ease the minimal increased startup costs, many federal, state and local government subsidies can provide financial incentives to those developers endeavoring to go "green."

Incentives to Ease Startup Costs

Federal Incentives

The Energy Policy Act of 2005 provides financial incentives for developers to go "green." For buildings "placed in service" (i.e., ready and available for use) prior to 2014, the legislation offers a federal income tax deduction equal to energy-efficient commercial building property expenditures made by the taxpayer of up to \$1.80 per square foot.

To qualify for the full deduction, the building's energy-consumption must be at most half that of a standard building (one meeting requirements of the American Society of Heating, Refrigerating, and Air Conditioning Engineers, Standard 90.1-2001).

If the building's energy consumption does not meet the 50 percent threshold, an owner may still qualify for a deduction based on the building's (i) interior lighting systems, (ii) heating, cooling, ventilation and hot water systems, or (iii) building envelope (the systemic separation of a building's interior and exterior environments, such as foundation, roofs, walls and windows).

If the subsystems described in subsection (i) or (ii) above reduce energy costs for that subsystem by 20 percent, or if the subsystems described in subsection (iii) above reduce energy costs for that subsystem by 10 percent, then the owner receives a deduction equal to energy-efficient commercial building property expenditures, up to \$0.60 per square foot.

State Incentives

— Illinois: First, through its Green Neighborhood Grant Act, Illinois offers qualifying developers a reimbursement of up to 1.5 percent of the total development cost of a selected project that achieves "LEED-ND" certification — an extension of the LEED certification outlined above. The Department of Commerce and Economic Opportunity may offer up to three grants each year.

Second, Illinois offers the Illinois Recycling Grants Program, which helps businesses collect and process materials for recycling through financial assistance. Commercial collection projects — including recycling programs for offices, retail/wholesale establishments, hotel/motel operations and recreational and health care facilities — that can show a minimum of three different types of eligible post-consumer recyclable commodities (fiber, metal, glass, plastic) are being collected and recycled, may receive a grant award up to \$60,000.

— Michigan: In Michigan, loans of up to \$400,000, at a 5 percent or less interest rate, are available to small businesses that use the money for "green" building. Through the state's Small Business Pollution Prevention Loan Program, a company that either reduces waste at its location, reuses or recycles its generated wastes, or conserves energy or water on-site may qualify for the funding.

The organization, which may employ at most 500 people, may use the financing for any number of endeavors that relate to pollution prevention, including construction and equipment.

— Wisconsin: The Wisconsin Energy Conservation Corporation (WECC), through its Focus on Energy initiative, rewards developers and businesses that implement green building features in their projects. When developers opt to include certain eco-friendly pieces of equipment and processes, WECC provides a cash rebate, relative to how energy efficient the measure purports to be. The program caters mostly to the health care, hospitality, food service and grocery markets.

Local Incentives

— Chicago: The Chicago Department of Buildings (DOB), through its Green Permit Program, offers an expedited permit process for projects that incorporate innovative green building strategies, including LEED certification. Successful developers can receive permits in fewer than 30 business days, and in as little as 15 business days, depending on how many green building elements are incorporated in the developer's plans.

Additionally, the DOB will waive consultant code review fees when a developer demonstrates an extraordinary level of green strategy.

— Northbrook, Ill.: The village's Department of Building & Development promotes eco-conscious development through its Green Building Initiative. Projects that achieve LEED recognition will receive a rebate on their permits; developers will receive a 10 percent rebate for certification, 20 percent for silver, 30 percent for gold, and 40 percent for platinum. Such developers will also enjoy expedited permitting and review, as their projects will be prioritized over all those not enrolled in the Green Building Initiative.

— Cincinnati, Ohio: Developers of newly constructed commercial properties that achieve LEED certification receive up to a 100 percent real property tax exemption of the assessed property value. For 15 years, projects classified by LEED as certified, silver or gold can receive a maximum tax abatement of \$500,000; projects categorized by LEED as platinum may receive total tax abatement.

Case Study: Four Times Square

In January 2000, the Durst Organization completed construction of Four Times Square, the first green office tower in New York City. This \$500 million building, designed by Fox & Fowle Architects, embraced standards for energy efficiency, indoor air quality, sustainable materials and responsible operations.

The project included energy-efficiency measures, such as fuel cells, which are nonpolluting electricity generators, and photovoltaic panels, for converting sunlight directly into electricity, along with occupancy sensors, LED signage and large-scale glass windows, plus environmental-improvement measures, such as floor-by-floor air-handling systems, biodegradable materials, low water-use equipment and recycling guidelines.

Marketed during its development as an energy-saving, state-of-the-art green office facility, Four Times Square became over 80 percent leased more than three years before its scheduled completion date. Large anchor tenants — Conde Nast Publications and Skadden Arps — quickly signed up for the opportunity to do business from a prestigious new landmark.

Additionally, statistics now show that this building uses 40 percent less energy than the same building built to state code, saving, among other things, 20,841,269 kilowatts per

year. This energy-efficiency translates to actual annual energy cost savings of \$1,760,000.

This project epitomizes the powerful tools associated with green building. The Durst Organization immediately realized the marketing power of green building by leasing with tenants well before completion and continues to enjoy operational savings made available by the facility's green design.

Conclusion

Presently, the industry consensus is that green buildings are financially sustainable. Green developers may often capitalize on governmental financial support for their eco-friendly projects. The Midwest, often viewed as lagging in the nation's race to better the environment, is home to some of the best opportunities for commercial real estate to go green.

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