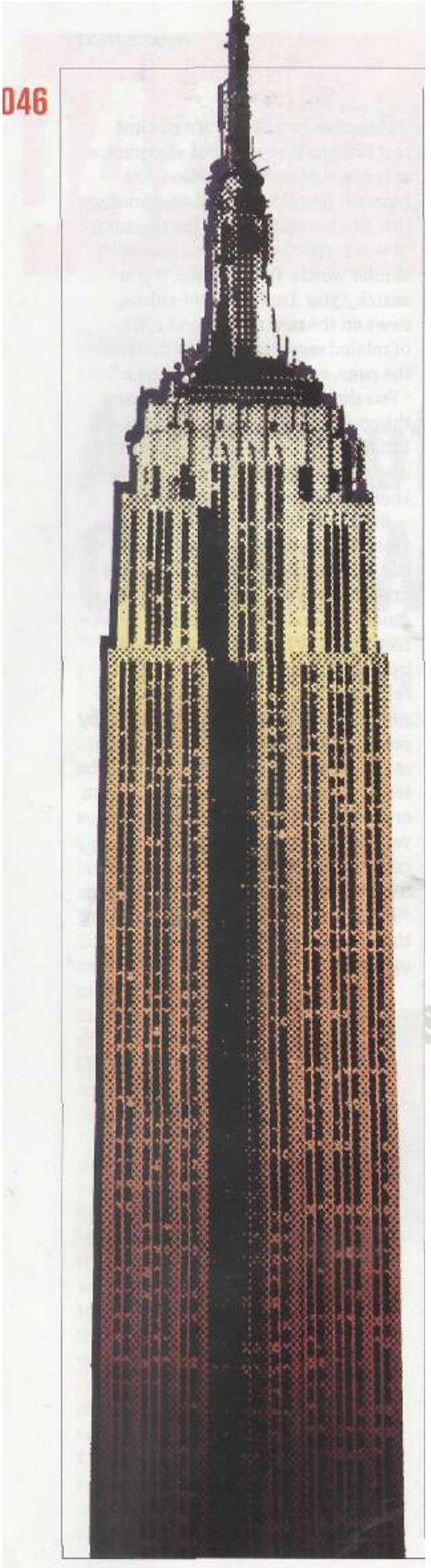

GREEN BIZ

Why Should Landlords Save the Earth?

Commercial building owners may get in the way of cities' eco-friendly ambitions

By Adam Aston

On Earth Day last month, Mayor Michael Bloomberg announced the latest step in New York's ambitious campaign to green the Big Apple. The proposal, likely to become law, calls for 22,000 of the city's biggest buildings—from iconic office towers to humble apartment blocks—to undergo detailed energy audits. Guided by the findings, building owners will then be obliged to invest in upgrades such as insulated windows or more efficient boilers.

To soften the burden on landlords, they'd only be forced to bankroll changes that would pay for themselves over five years through reductions in energy use. The mayor says the plan will deliver $750 million in annual savings on utility bills, add thousands of new green jobs, and cut the city's greenhouse gas output by 5%.

One tricky problem: The financial benefits of these retrofits flow mainly to tenants in the form of lower electric, water, and gas bills, not to the building owners who are expected to cover the costs. This leaves the owners facing a regulatory stick but no carrot. Without a better reward on the table, the landlords will drag their feet, predicts Jennifer Henry, real estate sector manager at the Natural Resources Defense Council, a nonprofit green advocacy group.

The obstacle is slowing eco-upgrades beyond New York, just when the nation needs them most. A McKinsey & Co. study suggests energy efficiency upgrades in buildings and appliances are the most cost-effective green strategy for the U.S., where buildings consume about 35% of all the energy used each year. That's why President Barack Obama has made retrofits a priority, setting aside $2.8 billion in the federal stimulus package to promote them. "You have to fix existing structures," says Marc Heisterkamp, director of commercial real estate at the U.S. Green Building Council, a standard-setting trade group.

CHILLY RECEPTION

In New York, Bloomberg is trying to jump-start the process, but he got a chilly reception from big property owners, the group he expects to pay for the upgrades. It's not for lack of interest in energy savings. Rather, the current situation and the mayor's proposal offer too few financial rewards.

The snag with paying for retrofits mainly affects major upgrades in large leased properties, especially multitenant buildings, which make up the bulk of the 5 million commercial properties in the U.S. In these buildings, widely varying rental terms—depending on the amount of leased space, market conditions, and lease duration—can make the financing of ambitious retrofits "seem almost byzantine," says NRDC's Henry.

Consider a routine upgrade to common-area lighting systems. Occupancy sensors that turn out lights when no one is around can pay for themselves in a few years. But landlords generally pass on operating expenses such as electricity, including for shared areas. So their costs wouldn't fall because of the upgrade, and they have little pecuniary incentive to pay for improvements. "If

a building's systems are inefficient but still fully functional, the owner won't bother [with a green upgrade]," says Sean Patrick Neill, principal of Cycle-7, a New York consultancy that focuses on green-building financing.

BALKING BY BANKS

Such barriers lead to a second problem: Without a clear way to make money from energy savings, "banks have found it difficult to finance big retrofits " says Mike Pedersen, group head of corporate operations at TD Bank Financial Group. Up front, there's the catch-22 that banks want to see "track records of proven savings resulting from the retrofits," he adds. That's tough to provide if the projects can't get financing. Banks are also uncomfortable with fuzzy arrangements, such as lending to an owner backed by hypothetical savings drawn from multiple tenants.

A determined landlord can find novel financing models. New York's Empire State Building is trying to cut energy use by 38% as part of a $500 million planned rehab. Carrying little debt, its owners can use the building, rather than energy savings, to back the loan. In Chicago, Vornado Realty Trusts' Merchandise Mart, the world's largest commercial building, has paid for eco-irnprovements from its own ongoing operating budgets, eking out incremental savings by updating mechanical systems, windows, and maintenance routines.

And in Toronto, TD Bank works with owners, tenants, and other banks to identify and finance retrofits. With the right market-based solution, "tenants will see energy cost savings, and owners can monetize a share of those savings to finance investment," says David Pecaut, a senior partner at Boston Consulting Group and co-chair of the Greening Greater Toronto initiative. "Then green retrofits will take off" BW

GREEN UPGRADES

In big buildings, energy-saving renovations bring paybacks over time:

LIGHTING	Payback 1 to 3 years	Sensors that turn off lights in empty rooms can cut power bills by up to 30%. Simply swapping in more efficient bulbs can pay for itself in one year.
ELECTRIC MOTORS	Payback 1 year	It takes a lot of energy to pump water and circulate air to high floors. Switching to motors that automatically vary their speed saves electricity.
WINDOWS	Payback 2.5 years	Caulking gaps around old window frames keeps heated (or chilled) air from leaking. Bigger savings come from replacing single-pane windows with multipane designs.

Data: Investment Property Forum (U.K.); New York State Energy Research & Development Authority; *BusinessWeek*

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