The Real Estate Roundtable

May 26, 2021

The Honorable Ron Wyden	The Honorable Mike Crapo
Chairman	Ranking Member
Senate Finance Committee	Senate Finance Committee
219 Dirksen Senate Office Building	219 Dirksen Senate Office Building
Washington, D.C. 20510	Washington, DC 20510

Re: **Mark-Up of the *Clean Energy for America Act* – Incentives to Retrofit Commercial Buildings**

Dear Chairman Wyden and Ranking Member Crapo:

On behalf of The Real Estate Roundtable (www.rer.org), please consider these comments regarding proposed changes to the section 179D tax deduction for energy efficient commercial buildings, as described in the Chairman's Mark for the *Clean Energy for America Act.* The Finance Committee is scheduled to mark-up the bill this afternoon.

- **The Chairman's Mark does not make a serious investment in U.S. commercial building infrastructure, and in this regard fails to advance the "retrofit" and climate goals of the *American Jobs Plan.***

The Chairman's Mark devotes $240 billion to boost and expand a number of clean energy tax incentives. Of that amount, unfortunately only 1/5 of 1 percent ($525 million) is dedicated to promoting greater energy efficiency in America's nonresidential buildings (*e.g.*, shopping centers, hotels, office buildings, health care facilities, industrial properties, etc.). Such a scant amount of investment to improve energy efficiency in U.S. commercial real estate is out of sync with the Department of Energy (DOE) data frequently cited by Congress. Commercial buildings – and the behavioral choices of the tenants and other occupants who live, work, shop, and recreate in them – account for 18% of U.S. primary energy use; 35% of electricity consumed in the U.S.; and 16% of all U.S. CO_2 emissions. Failure to re-imagine section 179D and reform the tax code to scale the market for private construction "retrofits" is a regrettable, lost opportunity to make headway on the climate crisis.

Insignificant investment in section 179D and failure to include reforms to make it useable for building retrofits are hard to justify because it is cheaper to *avoid* using watts of energy than to *create* new watts of energy. According to the American Council for an Energy-Efficient Economy (ACEEE), taxpayers get the most "bang for the buck" in achieving beneficial climate policies through efficiency measures as the least-cost energy resource. Dollar for dollar, investments to generate new power

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(whatever the energy source) cost more per kilowatt hour than investments in an asset to avoid consuming an equivalent amount of energy in the first place. In this regard, Congress should allocate at least as many resources for broad scale energy avoidance tax incentives as it would for renewable energy investment and production credits.

Moreover, President Biden's *American Jobs Plan* announced a goal to retrofit millions of U.S. buildings. Respectfully, the changes proposed for section 179D will not make significant progress towards leveraging private sector capital for this goal. The bill's unprecedented expansion of Davis-Bacon requirements would annul any potential value that a private building owner might otherwise receive from the 179D deduction. As discussed in more detail below, the extra added "hard" costs from prevailing wage and other labor law compliance burdens will more than outweigh the dollar amount of any deduction that might be awarded for a 179D qualifying project.

- **Three topline suggestions to improve the Chairman's Mark.**

We greatly appreciate that the Chairman's Mark offers a special rule to reduce a REIT's earnings and profits by any deduction for energy efficient commercial building property placed in service in the taxable year. We agree that earnings and profits "conformity" is a key policy change to make any such incentive usable by the growing REIT sector. However, this change alone will not go far enough to entice many REITs – or other non-governmental property owners – to use section 179D. Our overriding concerns with the Chairman's Mark fall into three categories:

(1) The section 179D "baseline" to measure energy efficiency improvements remains relevant for new construction – not existing building retrofits.

Any energy efficiency tax incentive should focus on modernizing older, private-sector buildings. Seventy-five percent of U.S. buildings were built before the turn of the century, with a median year of construction as 1982. Yet, the Chairman's Mark continues to peg section 179D's performance baseline to the ASHRAE 90.1 standard – which applies to construction built ***today***. Measuring efficiency improvements against the most recent ASHRAE 90.1 standard is too lofty a stretch for buildings constructed decades ago, before the advent of modern energy codes and advances in building technologies.

While the Chairman's Mark lowers 179D's performance threshold on a sliding scale down to 25 percent improvement "over ASHRAE" (and scaling up to 50 percent improvement), we do not believe this will encourage private sector retrofits in a consequential fashion. This is because the "year version" of each subsequent ASHRAE 90.1 standard gets progressively more and more stringent and costly. The current ASHRAE standard from 2019 (that serves as section 179D's present performance baseline) is itself 37.6% more efficient than the 2007 version.[1] In

[1]

- 2019 version of ASHRAE 90.1 is 4.7% percent more site energy efficient than the 2016 standard. (DOE preliminary determination April 21, 2021).
- 2016 version 6.8 percent more site energy efficient than 2013 version. (DOE Oct. 2017 determination.)

other words, a retrofitted building originally constructed ***in 2000*** must first perform ***up to the 2019 baseline*** – and then ***go 25% beyond the 2019 baseline*** to even qualify for the lowest incentive under the sliding scale. Such extreme gains in energy efficiency improvements are impracticable for the overwhelming majority of retrofit projects. The modest incentive amounts of the 179D deduction are not enough to make most "deep retrofit" projects economically viable and for construction costs to "pencil-out."

To encourage rehabs of older buildings, a retrofit tax incentive should abandon the ASHRAE 90.1 baseline. **We recommend the solution offered by Senator Cardin for today's mark-up. "Cardin Amendment #1" would allow a retrofit tax deduction for energy improvements measured against a building's *own* energy consumption baseline that is particular to *that* asset – not relative to the most recent ASHRAE 90.1 baseline that pertains to new construction.** This solution was also part of section 179D reform provisions suggested by Senators Cardin, Feinstein, and Schatz in prior legislation.

(2) A meaningful "accelerated depreciation" period is needed to motivate installations of high-performance HVAC, lights, windows, and other building components.

Award of the 179D deduction is limited to "whole building" improvements. That is, the tax deduction applies where an owner pays the costs for a "deep retrofit" that moves the ***entire*** asset to elevated efficiency levels far exceeding the ASHRAE baseline. The energy modeling and engineering costs alone to support this kind of retrofit are very expensive, aside from the costs for the equipment itself and the labor to install it. Much more frequently, a building owner might replace a specific piece of equipment that fails – such as when central air conditioning is on its last legs, or when a roof starts to leak – rather than to re-position and retrofit an entire building.

The Roundtable recommends that any section 179D reform provisions should be joined with an "accelerated depreciation" period for highly efficient (and expensive) building equipment that is swapped-out on a component-by-component basis. We recommend inclusion of the bipartisan *E-QUIP Act* (H.R. 2346), which offers a 10-year, straight-line, "accelerated depreciation" period for new HVAC, lights, windows, roofs and other building equipment. To qualify for accelerated depreciation the new equipment must meet the "high performance" specifications set forth in the bill itself. *The E-QUIP Act* would also simplify the tax code because it cuts across the confusing patchwork of depreciation periods for the same equipment that can range from 15, 20, 27.5, 30, 39, and 40 years under a number of variables.

ACEEE has prepared a fact sheet and analysis that estimates the climate, energy, and jobs benefits of retrofit projects induced by the *E-QUIP Act*:

- ✓ 130,000 net additional job-years;
- ✓ $15 billion energy bill savings; and

- 2013 version 7.6% more site energy efficient than 2010 version. (DOE Aug. 2014 determination.)
- 2010 version 18.5% more site energy efficient than 2007 version. (DOE Oct. 2011 determination).

- ✓ 100 million tons of carbon dioxide emissions avoided – or the equivalent emissions from 560,000 rail cars full of coal or taking 22 million cars off the road for one year.

A unique coalition of environmental, manufacturing, real estate, and other business groups supports the *E-QUIP Act*. The Roundtable recommends revisions to the Chairman's Mark to include this accelerated depreciation incentive.

(3) The unprecedented expansion of prevailing wage policies into the tax code would inhibit section 179D's use in the private sector and undermine climate policy goals.

Any modest improvements to section 179D will be erased by the new prevailing wage mandates proposed by the Chairman's Mark. The added "hard" costs and paperwork compliance burdens from Davis-Bacon and apprenticeship requirements will swallow even the enhanced amounts offered by the modified 179D sliding scale.

A March 2020 report from U.C. Berkeley estimates that apartment building construction projects in California with prevailing wage requirements "cost an average of $30 ***more*** per square foot than those without wage requirements" (p. 14). The amount of the enhanced section 179D deduction in the *Clean Energy for America Act* would range from $2.50 per square foot to a maximum of $5.00 per square foot. A rational taxpayer would not seek to use section 179D if the labor costs alone amount to ***six times more*** than the incentive amount's upper limit. Because labor costs will more than offset the deduction's amount, we do not believe that private sector building owner will find this tax deduction useful as proposed.

Davis-Bacon has ***never*** been applied simply because the Internal Revenue Code provides a deduction to lower a private entity's taxable income. The prevailing wage law has always been restricted to projects supported by a federal government contract, an affirmative award of federal grant money, or extension of a federally-backed loan or insurance. The Roundtable recommends that the *Clean Energy for America Act* avoid unchartered territory that would transform the Internal Revenue Code into a "Davis-Bacon Related Act."

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Thank you for the opportunity to provide these comments. For more information, please contact Duane Desiderio, The Roundtable's Senior Vice President for energy policy (ddesiderio@rer.org); or Ryan McCormick, Senior Vice President for tax policy (rmccormick@rer.org).

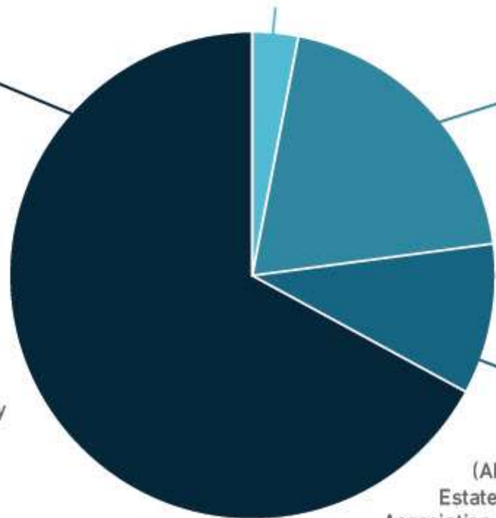
Sincerely,

Jeffrey D. DeBoer
President and Chief Executive Officer

Cc: Members of the Senate Finance Committee

About The Real Estate Roundtable

Who We Are



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