



February 11, 2025

The Honorable Brian J. Feldman, Chair
Senate Education, Energy, and the Environment Committee
2 West Senate Office Building
Annapolis, Maryland 21401

Oppose: SB 256 – Environment – Building Energy Performance Standards – Energy Use and Non-Compliance Fee

Dear Chair, Feldman and Committee Members:

NAIOP represents 22,000 commercial real estate professionals in the United States and Canada. NAIOP's membership in Maryland is comprised of more than 700 local firms and publicly traded real estate investment trusts involved in development, construction, and management of commercial, mixed-use, and light industrial real estate.

NAIOP has serious concerns about the cost and feasibility of the Maryland Building Energy Performance Standards. (BEPS) Compliance with the proposed emissions targets, Energy Use Intensity (EUI) and other regulatory requirements present financial and operational challenges that will be insurmountable for a considerable portion of the owners and occupants of covered commercial and multi-family buildings. HB 49 heightens these concerns.

➤ **SB256 Has Two Primary Functions That Expand the Scope and Increase the Consumer Costs of BEPS Compliance**

First, SB 256 would solidify the Maryland Department of Environment's (MDE) authority to set enforceable EUI limits on large commercial and multifamily buildings. EUI is a measurement of building energy use per square foot which would be used to allocate how much energy can be used in buildings regulated under BEPS. EUI regulation would set progressively lower energy use limits that must be met in 2030, 2035 and 2040 then maintained going forward. These EUI energy use limits would be in addition to the existing limits on direct greenhouse gas emissions authorized under the Climate Solutions Now Act (CSNA). EUI greatly expands the scope and complexity of BEPS to regulate all-electric buildings – which have no direct greenhouse gas emissions - and the electricity use of mixed fuel buildings.

Second, the bill provides new authority for MDE to impose "alternative compliance fees" on buildings that use more energy than allocated through the EUI limits. EUI alternative compliance fees would be assessed based on the quantity of energy used in a building. The fee is a powerful policy lever that uses increased energy costs as an enforcement mechanism to accelerate conversion of buildings to meet BEPS performance expectations. The authority for MDE to assess EUI noncompliance fees was not provided in the CNSA and the new EUI fees would be in addition to the existing fees for exceeding greenhouse gas emissions.

➤ **The High Cost of Compliance and Accelerating Annual Non-Compliance Fees**

Energy efficiency and conservation have traditionally been implemented directly through building energy codes and indirectly through utility managed incentive programs like EmPower. The building energy code and the EmPower proceedings at the Maryland Public Service Commission are grounded in a process that puts a high value on technical feasibility and cost effectiveness. Maintaining a balance between upfront capital costs and energy cost savings is crucial to protect energy consumers from escalating compliance costs.

MDE's cost benefit analysis of BEPS determined that between 2025 and 2040 compliance with BEPS will cost building owners and occupants \$15.2 billion and only achieve \$8.2 billion in energy costs savings. The cost of measures necessary to meet EUI targets in BEPS are estimated by MDE to be \$8.8 billion of the \$15.2 billion. MDE attributes \$6.4 billion of the total compliance cost to electrification of fossil fuel systems.

As introduced HB 49 allows MDE to allocate EUI energy use by building type and to set the amount of the noncompliance fee. We don't know what the fee or the targets will be until after energy benchmarking is completed, but based on MDE's previously published EUI limits, and the informally suggested fee of \$0.05 per kBtu/sq ft above the EUI allocation, commercial and multifamily buildings that are subject to the BEPS, could be facing extraordinarily high annual fees for failing to meet EUI limits.

A high-level evaluation of EUI data reported to Montgomery County as part of that county's BEPS program indicates that 89 multifamily buildings and 32 office buildings would be subject to EUI noncompliance fees of more than \$100,000 per year in 2030 and 14 office buildings and 33 multifamily buildings would be subject to fines of \$200,000 or more. In addition to paying the EUI fee, buildings with both fossil fuel and electric systems could also be required to pay the existing greenhouse gas emissions fee.

The structure of EUI compliance means that the target energy use allocation for BEPS regulated buildings is reduced by 30% in 2035. This lower energy use allocation along with built-in inflation factor increases the potential fees considerably – in many cases fees would double between 2030 and 2035.

➤ **FY 2025 Budget Language Set Prerequisites for the Development of EUI Regulations that are Not Complete**

The FY 2025 Budget restricts MDE from expending its budget appropriations for the purpose of "adopting, establishing or enforcing site energy use intensity standards" until the Department submits a confirmatory letter to the General Assembly indicating that specified studies and reports have been completed.

Among those prerequisites is that the department first calculates building benchmarks based on the results of the direct emissions data reported by the owners of covered buildings. Building owners are required to submit energy use data September 1, 2025, covering calendar year 2024.

The budget amendment goes on to require a report containing specific information on the costs of compliance and an analysis of alternatives to regulating EUI as a means to meet greenhouse gas emissions targets. The report is also directed to include:

- An assessment of EUI compliance costs to owners of covered buildings;
- A recommendation for an EUI fee after taking into account financial incentives;

- An evaluation of mechanisms other than EUI to meet greenhouse gas emissions targets;
- An economic feasibility study of meeting EUI standards including consideration of building age, technological limitations and limits of building resources, and;
- Include recommendations addressing under resourced and covered buildings that after considering all possible incentives including avoided penalties, would still result in building noncompliance with greenhouse gas emissions regulations and targets.

The tasks set out in the budget amendment are not complete. Today the uncertainty about the costs of compliance, alternatives and the availability of incentives is more relevant than it was when the budget language was approved. MDE has not met their obligations under the budget language. HB 49 is out of sequence and premature.

➤ **MDE Definition of Economic Infeasibility and on a 25-year Payback Period**

MDE has offered an amendment that defines economic infeasibility as a project that results in *“a simple payback period of longer than 25-years, accounting for all available incentives and avoided alternative compliance pathway payments.”* The 25-year payback period is impractical and the inclusion of avoided EUI noncompliance fees in the calculation will increase compliance costs for the public.

The simple payback period describes the investment performance of an energy conservation measure by calculating the number of years that the measure will pay for itself through the accumulated dollar value of annual energy savings.

It is industry best practice and an element of qualification for state loan programs such as the Jane A. Lawton Conservation Loan program, and the Commercial, Industrial and Agricultural Grant Program that energy practices be cost-effective. With limited exceptions, to be deemed cost-effective each financed building energy modification must achieve full simple payback within its expected useful life and before consideration of any rebates or incentives.

The MDE amendment would consider all modifications with a payback period of less than 25-years to be economically feasible *“accounting for all available incentives and avoided alternative compliance pathway payments.”* Cost-effectiveness / simple payback period in the state energy loan programs is calculated before incentives.

Few mechanical systems required to be replaced by BEPS have a life expectancy of 25-years. State energy efficiency loan programs are based on payback periods of 10-18 years.

By including non-compliance fees in the calculation, the MDE amendment language treats avoided EUI non-compliance fees as if they were owners’ equity or a cash grant from the state. Treating them as spendable funds only serves to put more pressure on regulated entities to take on building modifications that have long payback periods.

Finally, the MDE amendment would add a definition of *“Energy or Emissions Reduction Measures”* that contains the qualifier, at *“lowest practicable cost.”* This phrasing replaces references to cost-effective which have defined federal and state managed energy conservation and efficiency programs and still form the foundation of utility run programs like EmPower. Lowest practicable cost does indicate a need for BEPS to be cost-effective or technically feasible.

➤ **Financing Building Renovations for BEPS Compliance**

The 25-year payback is unrealistic expectation that is also inconsistent with bank underwriting standards. Most commercial real estate loans have a maximum term of 10-years. Conventional sources of financing, whether bank, life insurance company or pension fund are unlikely to consider lending on an investment with a payback period that runs as long as 15 years. The 25-year period is also longer than the typical lifespan of the equipment being financed.

The rise in remote work and decline in office utilization following the COVID-19 pandemic has been well documented and is causing a freeze in the lending market for office buildings. Vacancy, lower effective rents, and interest rate increases have impacted all commercial real estate asset classes, reducing property values, limiting the amount of equity available for reinvestment and in many cases, reducing cash flows which significantly restricts the borrowing capacity of building owners.

Whether electrification projects can be financed will be determined by the strength of the building's rent roll and the ability of the net operating income to cover debt service with an adequate margin of safety. Electrification projects that increase debt loads and lower net operating income will be extremely difficult to finance with conventional commercial loans, put further downward pressure on building valuations and shrink the commercial tax base.

For these reasons, NAIOP respectfully requests your unfavorable report on SB 256.

Sincerely,



Tom Ballentine, Vice President for Policy

NAIOP – Maryland Chapters, *The Association for Commercial Real Estate*

cc: Education, Energy, and the Environment Committee Members

Nick Manis – Manis, Canning Assoc.