February 10, 2025

The Honorable, Marc Korman, Chair
House Environment and Transportation Committee
250 Taylor House Office Building
Annapolis, Maryland 21401

Oppose: HB 49 – Environment – Building Energy Performance Standards – Energy Use and Non-Compliance Fee

Dear Chair, Korman 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 and other regulatory requirements presents 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.

- **HB 49 Has Two Primary Functions That Expand the Scope and Increase the Consumer Costs of BEPS Compliance**

First, HB 49 would solidify the Maryland Department of Environment's (MDE) authority to set enforceable Energy Use Intensity (EUI) limits on large commercial and multifamily buildings. EUI is a measurement of building energy use per square foot which would be used by MDE to allocate how much energy can be used in buildings regulated under the Maryland Building Energy Performance Standard (BEPS). EUI limits would set progressively lower energy use limits that must be met in 2030, 2035 and maintained from 2040 and beyond. 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 expands 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.

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- **<u>The High Cost of Compliance and Accelerating Annual Non-Compliance Fees</u>**

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 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 establish both the EUI energy use limit and the amount of the noncompliance fee. We don't know what the fee or the targets will be, 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 Maryland Building Energy Performance Standards (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 programs 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 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 fees considerably – in many case fees double between 2030 and 2035.

- **<u>FY 2025 Budget Language Set Prerequisites for the Development of EUI Regulations that are Not Complete</u>**

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 EU I standards including consideration of building age, technological limitations and limits of building resources, and;
- Include recommendations addressing under resourced and covered buildings that would 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, 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. making HB 49 premature.

➢ **Financing Building Renovations**

It is our understanding MDE intends to offer amendments that define economic infeasibility as a simple payback period of longer than 25 years. This is an unrealistic expectation that should be reconsidered.

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 25 years, and the 25-year period is 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 HB 49.

Sincerely,

T.M. Ballentine

Tom Ballentine, Vice President for Policy
NAIOP – Maryland Chapters, *The Association for Commercial Real Estate*

cc: Environment and Transportation Committee Members
Nick Manis – Manis, Canning Assoc.