Supplemental Information on the Proposed High Performance Building Tax Credit for Existing Buildings

The following provides supplemental information on questions raised by the Mayor and Council.

1. **Whether similar tax credits elsewhere have a mechanism for recapturing some of the investment made in private business property (for example, if the building owner saves 10% on their electricity bills as a result of the green building upgrade, the City and its taxpayers could reclaim a percentage of that savings).**

Commercial high performance building tax credit programs administered by Maryland, Baltimore County, Carroll County, Howard County and Montgomery County do not have a mechanism for recapturing the investment through energy savings. If the City were to recapture some of the savings accruing to the building owner or tenant, it would push the ultimate payback period further into the future and thereby serve as a disincentive to making the improvements in the first place. Further, such an approach will be difficult to administer since the cost of electricity may fluctuate. Similarly, the use of energy could also fluctuate should a building tenant move in or out; which would not have a bearing on whether the building occupants are using energy more efficiently. While tax credits may have up-front costs in terms of lost revenue, City Staff continues to anticipate long term benefits to the City when it recapture some of its investment through higher assessments and tax revenues once the credits expire (see the additional discussion on this topic included under item #2).

If the goal of the program was limited to energy savings instead of comprehensive green building improvements, then two financing options, Property Assessed Clean Energy and Energy Performance Contracting, function similar to the mechanism suggested. However, due to the complexity of these financing options, they would involve considerable more specialized legal, financial and administrative resources.

- **Commercial Property Assessed Clean Energy (PACE) programs** may be used by local governments to finance the up-front costs of commercial energy improvements. The local government issues low interest bonds to lend funds to property owners for energy improvements. The property owner repays the loan as a surcharge on their property tax bill. The surcharge remains attached to the property upon a change in ownership and is limited to the amount needed to recover costs associated with issuing bonds, financing the loans, and administering the program. In May 2009, Maryland enacted legislation permitting counties and municipal corporations to adopt resolutions or ordinances establishing clean energy loan programs based on the "PACE" model. Mortgage holder consent is required before PACE applications are approved and assessments are placed. Given the legal, financial and administrative expenses to establish such a program, scale is required to reduce costs and therefore it may not be a suitable option for smaller jurisdictions.

- **Energy Performance Contracting (EPC)** is a financing option where a property owner enters into an agreement with a performance contractor who accesses private capital markets to obtain competitive financing to complete building energy improvements. The cost of the project, administration and financing are included in the contract and the costs are paid back through the annual energy savings. Given the significant costs of organizing and administering financing, EPCs generally focus on large projects. Commercial property owners may be reluctant to utilize this vehicle, as any long-term debt obligation might hinder the ability to resell buildings.

It is also important to note that PACE and EPC programs primarily focus on energy and may not address the full breadth of green building improvements and innovations supported by the proposed tax credit (such as water and sewer, stormwater management, indoor air quality, transportation, recycling, greenhouse gas emissions, green cleaning, landscaping, etc.).

2. **The tax credit provides City funds to benefit private land owners and taxpayers do not share in the benefits of the investment.**

Maryland Code, Tax-Property Article, § 9-242 expressly allows county and municipal corporations to grant property tax credits for "high performance buildings." Maryland and at least 7 other jurisdictions have adopted some form of a tax credit incentive for commercial and residential property owners that implement green building or energy improvements. Rockville has a precedent for adopting a property tax credit for businesses. Section 22-12 of the City Code (New and Expanded Property Tax Credits for Businesses) provides for a stepped-down system of property tax credits for new and expanding businesses. The City has also provided rebates or grants to homeowners and neighborhoods.

In the long term, the tax credit could provide benefits to the City and taxpayers in terms of increased tax revenues, economic development and environmental benefits. As indicated in the attached chart, a study by Costar found that LEED office buildings consistently have higher rents per square feet than non-LEED buildings through the U.S. Several other studies have compared U.S. LEED-certified space and ENERGY STAR certified commercial space to conventional building and have reported the following financial benefits of green building:

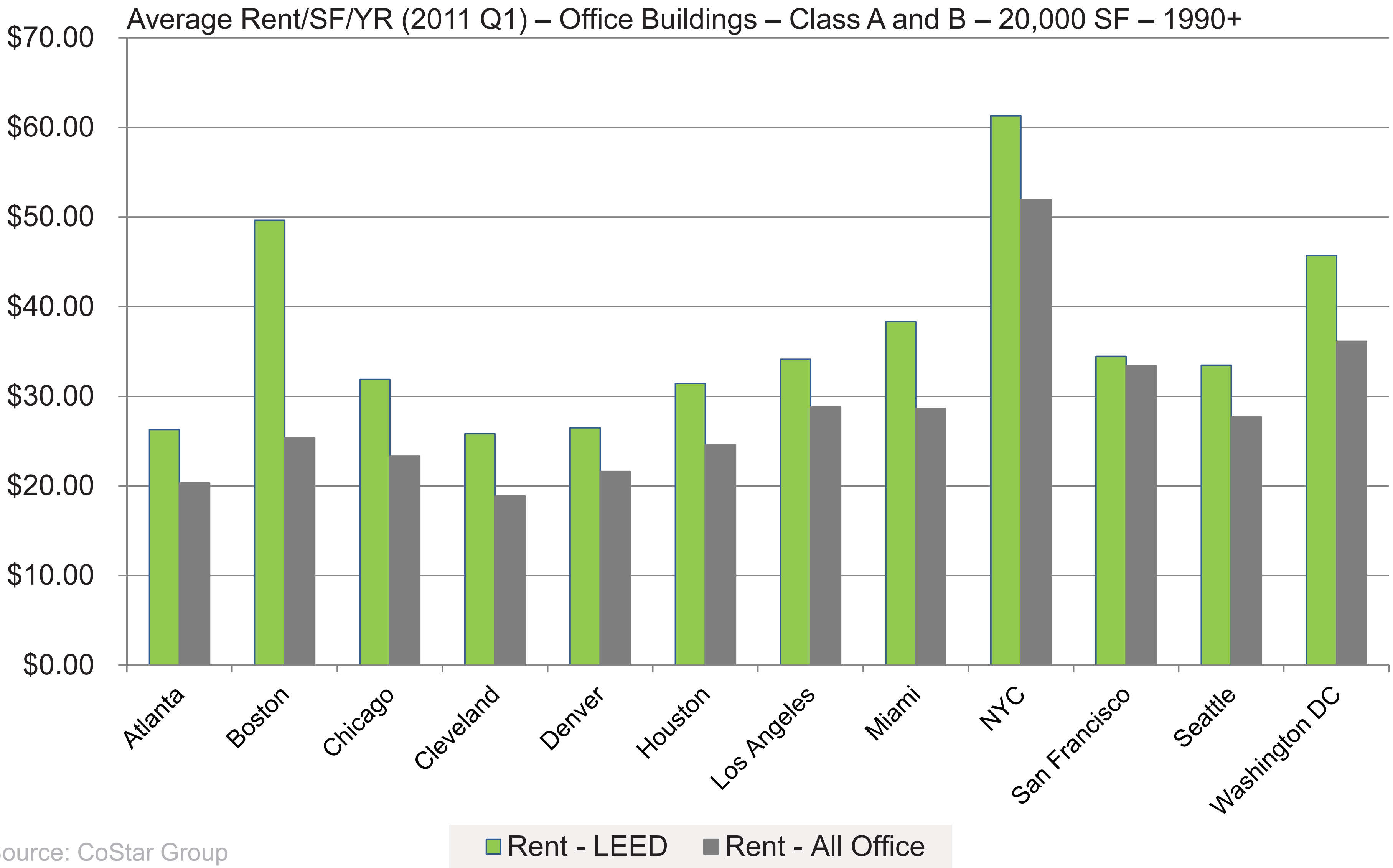
- Increased rental rates (2-17%)
- Improved resale value (5.8-35%)
- Higher occupancy rates (2-18%)
- Lower operating expenses (9.8-30%)

According to the Montgomery County State Tax Assessment Office, rents are a key factor in commercial property valuation/assessment. Therefore, in the long term the tax credits could lead to increased property values and revenues for the City.

In terms of economic development, the tax credit could give the City a real estate competitive advantage. The tax credit would provide property owners an additional incentive to invest in Rockville buildings, which may be an important factor for firms that are thinking of relocating or own multiple buildings in Montgomery County. In addition, buildings that are eligible for the tax credit would also meet Federal green leasing requirements that went into effect on Dec. 19, 2010. *Federal agencies are now required to sign leases only in energy-efficient buildings* as designated by the U.S. Environmental Protection Agency's Energy Star program.

Furthermore, green improvements provide ancillary benefits to the City, tenants and taxpayers related to transportation, water and sewer, stormwater, recycling, energy and air quality. For example, in the case of improved water conservation and on-site stormwater management, these private investments may reduce the need for future City investments in water and stormwater infrastructure to service that property.

Office Rent – LEED v. non-LEED



Source: CoStar Group