The Real Estate Roundtable

March 27, 2013

The Honorable Dave Camp
Chairman
Committee on Ways and Means
1102 Longworth House Office Building
Washington, DC 20515

The Honorable Sander Levin
Ranking Member
Committee on Ways and Means
1106 Longworth House Office Building
Washington, DC 20515

The Honorable Kevin Brady
Unites States House of Representatives
301 Cannon House Office Building
Washington, DC 20515

The Honorable Mike Thompson
Unites States House of Representatives
231 Cannon House Office Building
Washington, DC 20515

Re: *Tax Incentives for Energy Efficiency in Commercial and Larger Multifamily Buildings*

Dear Chairman Camp, Ranking Member Levin, and Representatives Brady and Thompson:

As Chairman and Ranking Member of the House Ways and Means Committee, and as the co-chairs of the Committee's Working Group on Energy Tax Reform, we wanted you to know that The Real Estate Roundtable supports reforming the nation's tax to unleash entrepreneurship, investment, capital formation, job creation and sustain overall economic growth. Moreover, we want to express our view that energy tax incentives can play a major role to help achieve these objectives. In this arena, our priorities are to extend and improve the 179D tax deduction for energy efficient commercial and multifamily buildings, and make the 15-year leasehold depreciation schedule a permanent fixture of the tax code.

1. 179D Tax Deduction

The specific energy incentive of priority to the commercial real estate industry is the Section 179D tax deduction for energy efficient commercial and larger multifamily buildings. 179D, first enacted in 2005, is scheduled to expire at the end of this year. A bill that would extend and enhance the usefulness of 179D was introduced last fall in the Senate (S. 3591). This bill garnered widespread support from real estate, industry, manufacturing, and contracting stakeholders. That stakeholder letter is attached for your reference.

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Measures like 179D are needed now more than ever to leverage greater private investment in U.S. real estate, create American construction and manufacturing jobs, save businesses billions of dollars in utility bills – and help make our nation more energy secure. While we are in favor of an "all of the above" energy policy, it warrants emphasis that incentives which focus on *saving* energy as opposed to *producing* energy get more "bang for the buck" – particularly given limited federal resources. Simply put, it costs less to save a kilowatt of energy than to create a new one (whether through fossil fuel or renewable technologies). For this reason alone, 179D must be at the fore when crafting sound policy in the energy tax incentives arena.

We also believe that *deductions* like 179D – which allow businesses to expense capital improvements as part of their ordinary operating costs – must be considered in a different light compared to tax *credits,* which may function more like subsidies that finance energy creation.

The Ways & Means working group focusing on energy tax matters should closely consider 179D reform to make *existing* buildings (as opposed to *new* construction) more energy efficient. It is estimated that 80% of the structures that stand today will still be part of our landscape in 2050. The Roundtable thus suggests that among the soundest tax policies are incentives that save energy across the vast stock of the nation's private and public commercial buildings. In fact, 179D extension and reform was ranked by the American Council for an Energy Efficient Economy (ACEEE) as meriting high priority consideration by Congress this year. ACEEE's report is available at: http://aceee.org/research-report/e132.

Any energy incentives must be **"performance-based"** and **"technology-neutral."** The 179D deduction — particularly as improved by the recent reform proposal — furthers both of these goals. It is performance-based because it would reward building retrofit projects that achieve actual and verifiable energy savings; the better the performance, the higher the award. And, 179D is technology-neutral because it supports *projects*, not *products*. It does not specify any particular type of equipment or material that must be deployed in a building retrofit project. Rather, private sector building owners and their contractors can decide among the best suite of efficiency measures that will achieve optimal energy performance in their assets.

More detail on the "performance-based" and "technology neutral" qualities of the 179D reform proposal is as follows:

- ***Measures energy savings and improvements by reference to the existing building's own consumption baseline.*** 179D can be improved by basing awards of the deduction on a logical "before and after" comparison regarding how much energy savings a retrofit project is designed to, and does, achieve. The internationally renowned, whole-building retrofit project at the Empire State Building (ESB) could not meet 179D's current targets, even though that project is guaranteed to reduce the ESB's energy consumption by about 38 percent. Last year's Senate bill corrects this issue. It would enables existing buildings to qualify for the deduction by reference to measured and verified energy savings over the baseline of that structure's energy performance prior to the retrofit project.

- ***Linking the amount of the enhanced 179D deduction to energy savings achieved.*** 179D reform should include a sliding scale that increases the amount of the incentive for retrofits with greater energy savings. This approach will encourage ambitious projects while also rewarding projects that achieve meaningful yet more moderate levels of energy savings.

- ***Making the tax incentive useable for a broader range of real estate owners and other stakeholders.*** Currently, many buildings are unable to access 179D because they are owned by entities like real estate investment trusts (REITs) and certain limited liability partnerships (LLPs) that cannot benefit from Section 179D as currently drafted. Last year's Senate bill would improve current law by allowing REITs to deduct Section 179D expenses for taxable income and dividend calculation purposes, both to avoid shareholder double taxation and to ensure that the REIT is able to distribute the majority of its income as a dividend, which is legally mandated. Further, the CBMA would give the private sector the same advantage that presently exists for government-owned buildings. The bill levels the playing field so all building owners – public, private, and non-profit – may allocate the incentive to other parties that can benefit from the tax deduction who are also primarily responsible for the specific retrofit project at issue (such as the contractor, tenant, engineer, architect, or source of financing).

The Roundtable thus urges your support to retain and improve the 179D tax deduction for energy efficient commercial and multifamily buildings.

2. <u>Depreciation for Leasehold Improvements</u>

In the commercial real estate sector, it is also important to help ensure that the end-users of energy – in this case, commercial building tenants – design, construct and operate within leased spaces as efficiently as possible. Thus, while the 179D deduction is based on "whole-building" systems, Congress should address the leasehold depreciation schedule for improvements to encourage high-performance "tenant build-outs."

In this regard, The Roundtable strongly supports making the 15-year schedule for qualified leasehold improvement depreciation a permanent feature of the tax code, and urges Congress to include it in comprehensive tax reform legislation.

Leasehold improvements, also known as tenant improvements (TI), are the customized alterations a building owner makes to rental space as part of a lease agreement, in order to configure the space for the needs of that particular tenant. These include changes to walls, floors, ceilings, and lighting, among others. In actual practice, these customized tenant improvements usually have a useful economic life of 5 to 10 years, which spans the average commercial lease term.

In terms of treatment under the tax code, the precise leasehold depreciation period should ideally be tied to the life of a commercial lease. In fact, this was the law prior to 1981 when this system was replaced with a much shorter depreciation life (15 years) for income producing buildings and the improvements to them. That "composite" depreciation life has been lengthened dramatically over the years and is now 39 years. As a simple "proxy," Congress has enacted and extended (most recently through H.R. 8, § 311) a 15-year period for leasehold depreciation – which more closely reflects the economic reality of the commercial real estate sector than the typical 39-year depreciation schedule that would otherwise apply to TI as a "capital improvement."

The 15-year leasehold improvement depreciation provision expired at the end of 2011, but was extended retroactively for 2012 and through the end of 2013 when Congress passed The American Taxpayer Relief Act of 2012 on January 2, 2013. Unless the provision is made a permanent feature of the tax code, it will need to be extended again before the end of 2013. The current 15-year depreciation schedule for qualified leasehold improvements must be reauthorized. Allowing 15-year depreciation to revert to 39 years would result in higher capital costs for tenant improvements, creating a disincentive for building owners to upgrade, modernize, and make spaces more energy efficient for their tenants.

We appreciate this opportunity to provide The Real Estate Roundtable's priorities on energy tax reform to the Committee. In conclusion, we support extension and sensible reforms to the 179D tax deduction for energy efficient commercial and multifamily buildings, and permanent authorization of the 15-year depreciation schedule for leasehold improvements. Please contact me if I can provide additional information on these and other tax issues arise during the discussions on comprehensive reform.

Sincerely,

Jeffrey D. DeBoer
President and Chief Executive Officer

cc: The Honorable Charles Boustany
The Honorable Lloyd Doggett
The Honorable Tim Griffin
The Honorable Bill Pascrell
The Honorable Tom Reed