Incorporating Building Energy Performance and Sustainability Into Traditional Environmental Due Diligence: The Advent of Green Building Due Diligence and All Appropriate Disclosure

This article takes a look at recent trends related to climate change and sustainability and their impacts on environmental due diligence. The authors say quantifying a building's energy and sustainability condition, performance, and potential will become commonplace and now is being incorporated into routine commercial real estate transactions. In addition, they say commercial real estate industry professionals increasingly are becoming knowledgeable and sophisticated in these areas to adequately represent their respective transaction stakeholders. As such, the authors believe commercial property sellers should consider expanding the scope of what they might traditionally consider "material" to the condition of the property to include energy consumption and cost data as well as building sustainability characteristics that could affect such consumption and costs.

231.2155 Introduction*

Green building and sustainable development initiatives rapidly are taking hold throughout the finance and real estate industries. A confluence of decreasing green building costs and escalating energy expenses now provide compelling and multiple rationales for the identification of sustainability-related opportunities and risks. These economic drivers now are intersecting with the adoption of energy and sustainability transactional energy disclosure and building labeling statutes and regulations. Further, "green enhancements" to local building codes triggered by an ownership change or as a condition to obtaining construction permits are creating new challenges. These regulatory developments in part are motivated by obligations undertaken by the states as part of their receipt of state Energy Office funding under the American Recovery and Reinvestment Act of 2009 (Recovery Act)[1]. Accordingly, traditional environmental due diligence now is evolving to incorporate new procedures—often referred to as green building due diligence—that require the industry and its legal counsel to adapt to a new era. These two processes now are merging into an integrated scope of work to support commercial real estate transactions and the requisite stakeholders.

Arguably the most notable statutory development in this area, acting as a catalyst for the real estate industry, is legislation in California, A.B. 1103,[2] which mandates disclosure of a building's energy consumption history upon a sale, financing activities, and certain lease transactions. Initially signed into law by Gov. Arnold Schwarzenegger (R) in October 2007, the statute has been flying "under the radar" until recently when the California Energy Commission released draft regulations for implementation of the law in 2010. Largely seen as a harbinger for state-level legislation nationally, A.B. 1103 already has spawned a similar statute in the state of Washington signed by Gov. Chris Gregoire (D) that became effective July 26, 2009.[3] It is important to distinguish transactional disclosure requirements, such as A.B. 1103, from building labeling regulations,[4] such as those adopted by the District of Columbia,[5] those contained in Section 204 of the recently passed Waxman-Markey legislation in the House (H.R. 2454),[6] and arguably the most comprehensive program of its type as outlined in New York's PlaNYC.[7] These regulations in part have been inspired by the European Energy Performance Directive on Buildings,[8] adopted in 2002, which was developed under the Kyoto Treaty and now is rolling out through the European Community. However, transactional disclosure requirements, because of their ability to forestall a real estate transaction or financing, have been

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[1] The American Recovery and Reinvestment Act of 2009, H.R. 1 Title IV, Section 410.

[2] *See* http://www.energy.ca.gov/ab1103/index.html.

[3] *See* http://apps.leg.wa.gov/documents/billdocs/2009-10/Pdf/Bills/Session%20Law%202009/5854-S2.SL.pdf.

[4] *See Institute for Market Transformation—Benchmarking and Disclosure Program* on the Web at http://www.imt.org/benchmarking-and-disclosure.html.

[5] *See* http://www.dccouncil.washington.dc.us/images/00001/20080819161530.pdf.

[6] *See* http://energycommerce.house.gov/Press_111/20090701/hr2454_house.pdf and http://energycommerce.house.gov/Press_111/20090515/hr2454_summary.pdf.

[7] *See* http://www.nyc.gov/html/planyc2030/html/home/home.shtml.

[8] *See* http://www.diag.org.uk/key-information/key-documents.aspx.

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identified as a more immediate and urgent priority by the industry. California's A.B. 1103 requires commercial building owners to provide standardized information on the energy efficiency of their properties to prospective buyers, lenders, and tenants responsible for the financing. More specifically, the California law mandates owners to disclose the building's U.S. Environmental Protection Agency's ENERGY STAR Portfolio Manager benchmarking data and ratings for the most recent 12-month period. The ENERGY STAR program provides a resource for comparing a building's energy performance to its peer group based on analogous building characteristics, such as occupancy, property type, square footage etc. However, as the California Energy Commission (CEC) has begun the regulatory drafting process, challenges posed by U.S. EPA's ENERGY STAR system, including the realization that more than 80 percent of California's commercial real estate properties cannot be rated by the system (e.g., buildings < 5,000 square feet and various property types are not included in the ENERGY STAR system), have lead to modifications that now are being finalized. Accordingly, CEC now is considering developing its own ENERGY STAR-type program for the state of California.

What does this mean for building owners in California and nationally as A.B. 1103-type regulations begin to propagate? Energy-efficient buildings presumably will command a higher lease and sales price as well as invite favorable loan terms from a lender. This "energy-valuation nexus" relies on the fundamental formula of real estate valuation that determines value using a capitalization rate applied to net operating income (NOI) of the property. As energy expense directly affects NOI, it directly affects building valuation. Many questions now are being contemplated by the commercial real estate industry. Do California building owners and operators only need concern themselves with U.S. EPA's ENERGY STAR compliance? Should building owners and operators in other states begin gathering data connected to their energy performance? Should this type of information-gathering be incorporated into a standard environmental risk property due diligence inquiry? What green-based industry standards should be relied upon when evaluating the data (e.g., The American Society of Heating, Refrigerating and Air-Conditioning Engineers; Capital Markets Partnership; U.S. EPA ENERGY STAR; U.S. Green Building Council's Leadership in Energy and Environmental Design, etc.)?

(a) ASTM International Committee E50 Steps Forward

ASTM International Committee E50 on Environmental Assessment, Risk Management and Corrective Action currently is developing a new proposed standard to address the concerns mentioned above. This proposed standard, ASTM WK24707,[9] *Guide for Building Energy Performance Disclosure*, will assist commercial lessors and sellers involved in real estate transactions in the collection and disclosure of energy use and sustainability information associated with buildings. ASTM WK24707 also may be used by professionals conducting due diligence inquiries on behalf of commercial buyers and lessees. Essentially all stakeholders in the transaction will be working from a standardized body of information upon which they can conduct their business and legal risk assessment. With a membership of more than 200 professionals from a diverse group of industry stakeholders, including attorneys, consultants, government officials, and lenders, the group is scheduled to meet in Atlanta Oct. 22, 2009, with the first ballot on the draft standard expected by the end of 2009. Based on the current pace, it is widely expected the standard formally will be adopted by mid-2010. Accordingly, industry participants now are beginning to consider the implications of the ASTM standard and requisite policy and procedural changes that will need to be implemented.

The legal subcommittee of the ASTM Building Energy Performance Disclosure Task Group is responsible for identifying the criteria necessary for disclosure under the new standard. It is focusing on an approach incorporating all appropriate disclosure regarding the energy-efficiency and sustainability performance of the property consistent with prevailing industry standards and local regulations. The manner in which the process should be conducted also is a focal point of the subcommittee. The legal subcommittee is comprised of attorneys with extensive commercial real estate transaction, environmental due diligence, and finance experience all across the country, from California to Washington, D.C., many of whom were active in the development of ASTM's *Standard Practice for Environmental Site Assessments: Phase I Environmental Site Assessment Process*[10] in the early 1990s, which had as its original mission creating the legal definition of envi-

[9] *See* http://www.astm.org/DATABASE.CART/WORKITEMS/WK24707.htm.
[10] *See* http://www.astm.org/Standards/E1527.htm.

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ronmental due diligence. It is a given that climate change, energy, and sustainability initiatives have evolved more rapidly than traditional environmental due diligence standards drivers. Therefore, the diverse makeup of the subcommittee is a starting point for formulating an information-gathering and disclosure standard flexible enough to be consistent with legislation such as A.B. 1103 but not too far ahead of less progressive states or federal regulation. Given the nascent stage of statutory and regulatory development in this area, the primary goal is for the standard to be flexible enough to incorporate new local regulations and marketplace customs as they are promulgated.

(b) Inspired by All Appropriate Inquiry

ASTM WK24707 is not about the Comprehensive Environmental Response, Compensation, and Liability Act. Its purpose is to identify prevailing industry standards and local regulations for conducting a due diligence inquiry of a commercial real estate parcel with respect to identifying and disclosing a building's energy- and sustainability-related opportunities and risks. The analogy to "all appropriate inquiry" and the apparent historic parallels have become useful tools for the real estate industry to envision how energy and sustainability issues will be incorporated on an efficient and practical transactional basis into the current environmental due diligence process. In fact, some providers of Phase I environmental site assessments and property condition assessments already are expanding their services to address green building due diligence requirements. Under the now-evolving definition, a property due diligence inquiry today should consist of an economical and routine means of performing "***all appropriate disclosure regarding the energy-efficiency and sustainability performance of the property consistent with prevailing industry standards and applicable local regulations***" that the buyer may perceive as impacting value. There are no statutory requirements for conducting "all appropriate disclosure" akin to conducting "all appropriate inquiry." Rather, the practice that constitutes all appropriate disclosure refers to an honest and sincere intention to assess a property's energy-efficiency and sustainability performance in accordance with prevailing industry standards and local regulations. As A.B. 1103 and its progeny reach the enforcement stage, professionals knowledgeable and sophisticated enough and prepared to perform green building due diligence will be in higher demand than their peers. As was the case with traditional environmental due diligence, lenders likely will evolve into a "gatekeeper role," requiring the completion of all appropriate disclosure prior to closing a commercial real estate loan.

The emerging interest today in regulating energy and sustainability compliance parallels the development of ASTM E 1527 for Phase I Environmental Site Assessments (ESAs). In the 1986 amendments to CERCLA, Congress set forth an "innocent landowner" defense for landowners who acquired property without notice of any pre-existing contamination.[11] To invoke this defense, the user had to have "undertaken, at the time of acquisition, all appropriate inquiry into the previous ownership and uses of the property consistent with good commercial or customary practice."[12] At the time, there was little legislative guidance for determining what qualified as "all appropriate inquiry" or otherwise defining "good commercial or customary practice." In response, ASTM drafted a standard to conduct all appropriate inquiry in 1993 that widely was accepted by the finance and real estate industries.[13] The ASTM E 1527 standard subsequently was republished in 1997 and 2002 (E 1527-00).

The 2002 Small Business Liability Relief and Brownfields Revitalization Act, which amended CERCLA, created two new liability protections, the contiguous property owner and bona fide prospective purchaser defenses, and required EPA to draft regulations that would satisfy the "all appropriate inquiries."[14] From a legal liability perspective, one of the primary motivations behind the development of the environmental due diligence standard was the desire to create an economical and routine means of performing "all appropriate inquiry" to avoid landowner liability under CERCLA. By the time EPA finally established the first federal standard for "all appropriate inquiry" in 2005,[15] ASTM E 1527 had been the norm in the marketplace for conducting AAI for over a decade. The EPA regulation actually referenced the newly-revised ASTM E 1527-05 standard as being in full compliance with the federal "all appropriate inquiry."[16] As this historical example shows, voluntary

[11] 42 USC 9601(35).
[12] *Id.*
[13] ASTM *Standard Practice of Environmental Site Assessments: Phase I Environmental Site Assessment Process* (E 1527).
[14] 42 USC 9607.
[15] *Standards and Practices for Conducting "All Appropriate Inquiries" Under the Comprehensive Environmental Response, Compensation, and Liability Act*, 70 FR 66070 (11/1/05), codified at 40 CFR 312. EPA's final rule references ASTM E 1527-05 as being in full compliance with "all appropriate inquiries."
[16] 40 CFR 312.11.

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consensus standards can be critical to industry when little direction otherwise is available (or slow to arrive).

(c) Evaluating Prevailing Industry Standards and Local Regulations

In defining a disclosure process consistent with prevailing industry standards and local regulations, the goal is to identify recognized energy and sustainability regulations and customs applicable to a certain market and its related properties. The term "recognized energy and sustainability initiatives" means the presence or likely presence of attributes on or part of a property under conditions that could impact the energy efficiency of the property. This could include state and local regulations as well as ordinary commercial practices as conducted by typical commercial real estate professionals in a local market. The term is meant to include property attributes that pose opportunities for enhanced valuation to a prospective buyer. Identifying such opportunities may not be the subject of a traditional phase one environmental site assessment concerned with threats to human health or the environment.

There is minimal consistency within the environmental industry to guide the degree of due diligence necessary to identify "recognized energy and sustainability initiatives." What is appropriate in terms of energy or sustainability disclosure as determined by the federal government or local regulations in State A may not be "appropriate" in accordance with the local regulations in State B. The appropriateness of all appropriate disclosure cannot be determined by satisfying one prevailing industry standard or local regulation.

The next question is what specific level of inquiry is required to satisfy all appropriate disclosure? A buyer or lender will want to weigh the potential valuation opportunities and risks posed by these recognized sustainability initiatives. The success of this process depends in part on the seller's all appropriate disclosures. Therefore, the "reasonable person" test should be considered as the basic level of inquiry to satisfy all appropriate disclosure. The lessor or seller must act in an honest and commercially prudent manner in responding to evolving green-based industry standards and local regulations in effect at the time and under the circumstances of the inquiry while not otherwise seeking an unfair advantage against the other party to the transaction. The reference to valuation opportunities is a significant departure from traditional environmental due diligence, which strictly focuses on identifying liabilities that negatively could impact property value. In the green building due diligence process, failure to identify a local energy-sustainability economic incentive such as a municipal LEED-related grant program, tax incentive, or utility rebate could result in loss of economic value in the transaction.

As stated above, the appropriateness of an all appropriate disclosure due diligence inquiry cannot be determined by satisfying one prevailing industry standard and local regulation. A.B. 1103, for example, requires owners of nonresidential buildings in California to disclose the ENERGY STAR performance data and ratings of any building they intend to sell or (whole building) lease. Certain language in A.B. 1103 also appears to insulate said owners from providing any information in addition to the ENERGY STAR rating: "if the data is delivered to a prospective buyer, lessee, or lender, a property owner, operator, or their agent is not required to provide additional information, and the information shall be deemed adequate to inform the prospective buyer, lessee, or lender." As noted above, however, the California Energy Commission has determined the U.S. EPA ENERGY STAR system can not be utilized at more than 80 percent of the commercial real estate properties in the state of California due to limitations around buildings < 5,000 square feet and certain property types. Thus, transaction participants must identify an alternate means of fulfilling their obligations. California's selection of ENERGY STAR as its green building standard could engender some debate whether other comparable green standards should be considered in the due diligence analysis. A.B. 1103 goes on to say that "nothing in this section . . . alters the duty of seller, agent, or broker to disclose the existence of a material fact affecting the real property." This language in the statute, as pointed out by Steven Hoch, an attorney practicing in Los Angeles, Calif., and a member of the ASTM WK24707 Legal Subcommittee, suggests there may be other green information the seller needs to provide over and above the ENERGY STAR data and ratings in order to meet its statutory obligation.[17] As such, there could be properties in some states, including California, where it may be appropriate to rely on more than one green-based industry standard to perform all appropriate disclosure of a building's energy-effi-

[17] Steven L. Hoch, *Commercial Building Energy Rating Disclosures and Its Impact on Real Estate Transactions* (7/6/09), available on the Web at http://www.bhfs.com/portalresource/lookup/wosid/contentpilot-core-2301-11202/pdfCopy.pdf.

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ciency and sustainability performance. Even if an ENERGY STAR rating is available, an argument presented by Paul D'Arelli, Stephen Jones, and Douglas White of Greenburg Traurig (also members of WK24707) in their recent Alert entitled *The 2010 California Energy Star Requirement* suggests it may not be sufficient, saying, "As such, it would apparently be insufficient to merely disclose the ENERGY STAR score alone (e.g. 'This building has an ENERGY STAR score of 91') but would require the underlying energy consumption and other 'benchmarking' data to be disclosed as well."[18] In essence, an ENERGY STAR score is necessary but not sufficient even under A.B. 1103.

(d) Best Available Benchmarking System

As referenced above, the California Energy Commission has discovered the U.S. EPA ENERGY STAR system cannot be utilized in the majority of commercial real estate transactions in the state of California. Accordingly, the best available benchmarking system including the most current property-level information, whether it be a new California ENERGY STAR system or perhaps an existing commercially available system, arguably would become the new minimum standard for performing all appropriate disclosure in the state of California. The same rationale would apply in any local market as its participants determine what benchmarking systems and information should be used in defining all appropriate disclosure to be applied to transaction in their respective local markets.

This type of context-sensitive standard is not new in the environmental regulatory area. For example, the federal Clean Air Act relies on the best available control technology (BACT) standard and derivatives thereof (reasonably available control technology (RACT) and lowest available control technology (LACT)) as a means of determining the appropriate pollution control measures required at a particular facility consistent with the uniqueness of its operations and the availability of equipment in the marketplace. As noted below, the Clean Air Act could play a significant role in the eventual regulations of greenhouse gas emissions. In an analogous fashion, utilization of the best available benchmarking system (BABS) standard could become the basis upon which a seller's compliance with all appropriate disclosure is determined.

(e) All Appropriate Disclosure Checklist

The practice that constitutes all appropriate disclosure must be able to evolve consistent with the expansion of relatively new green-based building standards (e.g., ASHRAE,[19] Capital Markets Partnership (CMP) Green Value Score™,[20] LEED®[21]). Furthermore, the motivations for conducting a property due diligence inquiry also may vary, ranging from satisfying a state disclosure regulation to fairly gaining the upper hand against the opposing side in a real estate transaction. If ASTM E 1527-05 sought to set forth specific criteria for meeting all appropriate inquiry, WK24707 seeks to create a flexible checklist to satisfy all appropriate disclosure. Areas that could be covered on the checklist include:

- Property and building characteristics (e.g., air conditioning system, building age, date of last major renovation, heating system, occupancy, property type, square footage, etc.);
- Electrical consumption and cost (minimum prior 12 months);
- Oil, natural gas, and steam consumption and cost (minimum prior 12 months);
- Benchmarking against peer buildings as determined by green building certification and rating systems (CMP Green Value Score, LEED, U.S. EPA ENERGY STAR, etc.);
- Water consumption and cost (minimum prior 12 months);
- Carbon dioxide emissions, carbon footprint, carbon neutral potential;
- Energy audit history;
- Green building certification/rating;
- Applicable energy efficiency ordinances/codes (local, state, and federal); and
- Applicable credits, economic incentives, and grants for energy efficiency improvements (federal, state, local, utility).

(f) Recent Federal Legislation Enhancing Environmental Due Diligence

Both the American Recovery and Reinvestment Act of 2009 (Recovery Act) and the U.S. House of Representative's passage of the Waxman-Markey bill introduced economic incentives and compliance costs that may motivate building owners and operators to reevaluate their carbon output and improve energy

[18] *The 2010 California Energy Star Disclosure*, available on the Web at http://gtlaw.com/NewsEvents/Publications/Alerts-?find=116777.

[19] *See* http://www.ashrae.org.
[20] *See* www.capitalmarketspartnership.com.
[21] *See* http://www.usgbc.org.

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efficiency. As the demand for green building practices and low-carbon fuel sources continues to increase, it makes sense for property due diligence inquiries to include environmental considerations for reasons beyond establishing a defense to CERCLA liability. Business decisions to buy, sell, or invest not only can depend on the likelihood of contamination on the property but also on the property's carbon footprint or relative access to renewable energy.

The federal government is expanding the parameters for future environmental due diligence inquiries. The House passed the Waxman-Markey bill (H.R. 2454) (albeit barely) June 26, 2009. Waxman-Markey primarily is known for seeking to establish a cap-and-trade system for greenhouse gas emissions (GHGs) that would reduce emissions in the United States 17 percent below 2005 levels by 2020, and 83 percent below 2005 levels by 2050.[22] However, H.R. 2454, as originally written, contained a plethora of programs to promote energy efficiency in buildings as well. One of these programs involved the creation of a model building energy label for commercial properties and homes. The label would display the building's achieved energy usage as compared to its ideal potential.[23] Some of the legislators theorized that prospective buyers, many of whom are becoming increasingly aware of rising energy costs, would want access to a building's energy use profile in an easily understandable medium akin to the miles-per-gallon stickers on new cars.[24] States would not be required to adopt such labeling, but those that agreed to participate in the building label exercise would be eligible for extra funds from the cap-and-trade bill to implement the program. Amid concerns the bill itself did not have enough votes for passage as well as certain special interest influence, a "midnight amendment" was passed limiting the labeling program to new construction. However, debate in the Senate to date suggests the final compromise could contain much of the original building labeling language in H.R. 2454.[25] It is important to note that the Senate and eventual conference committee are operating under the guise of U.S. EPA and its *Proposed Endangerment and Cause or Contribute Findings for Greenhouse Gases under the Clean Air Act*.[26] Without definitive congressional action on GHG issues, it is expected EPA will begin enforcement under newly promulgated provisions of the Clean Air Act, which are expected to be significantly more complicated than a congressionally mandated program.

Local green building regulations also are expanding significantly due in part to the "green strings" attached to the $3.1 billion flowing to state energy offices under the Recovery Act. Under the act, states and local governments can receive additional grants if they implement commercial building energy codes that meet or exceed "the ANSI/ASHRAE/IESNA Standard 90.1-2007" and residential building energy codes that meet or exceed "the most recently published International Energy Conservation Code."[27] Moreover, these states and local governments also must develop individualized plans for achieving the aforementioned commercial and residential codes within eight years of the Recovery Act's enactment "in at least 90 percent of new and renovated residential and commercial building space."[28] Finally, the Recovery Act offers financial incentives in the form of prioritized funding or tax breaks "to support renewable energy projects."[29]

Similar "green strings" attached to climate-related government funding can be found in H.R. 2454. As passed by the House, Section 201 of H.R. 2454 sets building code energy-efficiency targets for commercial and residential buildings. More specifically, Section 201 mandates new codes by 2012 requiring new and renovated buildings to be 30 percent more efficient than they would have been under current regulations relative to a baseline code.[30] By 2014 (residential) and 2015 (commercial), buildings built or renovated to a code meeting the national target will have a 50 percent reduction in energy use, with percentage increases scheduled through 2030.[31] The baseline codes are the ASHRAE Standard 90.1-2004 (commercial) and 2006 IECC (residential) codes.[32] The bill authorizes the secretary of Energy to establish national energy–efficiency building codes sufficient to meet the energy reduction targets. States that refuse to comply will not be eligible for carbon allowances as well as a portion of all funding under the bill.[33] Given the focus on building efficiency and renewable energy shared both by the Recovery Act and

[22] For more information about the American Clean Energy and Security Act (H.R. 2454), visit the Web at http://www.pewclimate-.org/acesa.
[23] H.R. 2454, Section 204 and amendments.
[24] *Id.*
[25] *Id.*
[26] *See* http://epa.gov/climatechange/endangerment.html.
[27] Congressional Record H1316 (Feb. 12, 2009).
[28] *Id.*
[29] *Id.*
[30] H.R. 2454, Title II, Subtitle A, Section 201.
[31] *Id.*
[32] *Id.*
[33] *See also* http://www.washingtonpost.com/wp-dyn/content/article/2009/06/06/AR2009060601797.html on the Web.

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H.R. 2454, real estate investors and lenders safely can assume energy efficiency will be a critical component to assigning value to commercial assets in the future.

(g) Energy Usage History "Material" to Real Estate Industry

Estimation and analysis of building energy usage is becoming (and probably already has become in some states) a material term in commercial real estate transactions. Energy efficient buildings can offer tangible economic benefits to prospective purchasers. Buildings equipped with energy-saving measures, such as effective insulation, efficient cooling and heating equipment, or high-performance windows will require less money to own and operate. A detailed review of a seller's energy efficiency and GHG-related practices could impact the property's short-term value (in the form of tax breaks) and long-term value (steadily increasing value in the marketplace). The incorporation of an eventual cost of carbon, which likely will result in increased local energy costs by way of utility pass-throughs, further highlights the need for accurate usage history. Accurately determining the carbon content of local electric utility sources serving a particular building, referred to as the "emission factor," is in its nascent stages due to the dated and incomplete nature of such information as gathered by government agencies. Such inaccuracies can have significant financial implications resulting in a requirement to purchase carbon offsets that may not actually be required.

Concerns about whether a building is equipped to take advantage of renewable energy resources also may be addressed in the green building due diligence process. H.R. 2454 will require electric utilities to meet 20 percent of their electricity demand through renewable energy sources and energy efficiency by 2020. Even if cap-and-trade legislation does not pass the Senate this fall, more than 29 states already have established renewable portfolio standards that would require electric utilities to supply a specified minimum amount of electricity to consumers from renewable energy sources (e.g., solar, wind). Several are even considering increasing the renewable energy proportional requirements. Green building due diligence inquiries need to include an analysis of the annual benchmarks, which may vary from state to state, that utilities will be required to meet to fulfill the renewable portion of their particular state's portfolio standard.

An interview with the operator of the building's utility (and concurrent review of the utility's records) also may become part of the green building due diligence process. Such an interview could yield information indicating the utility's historical usage of alternative energy in connection with the building and whether the utility even is equipped to access alternative energy resources in the future. Such access as well as the costs associated with alternative energy usage will impact the building's operational costs and, in turn, overall value.

With cap-and-trade on the horizon and EPA eyeing carbon disclosure requirements for properties,[34] the cost of carbon most likely is on the rise. Under the House bill's version of cap-and-trade, EPA would establish a nationwide cap on GHGs and require companies covered under the bill to have an allowance for each ton of carbon dioxide or its equivalent released into the atmosphere that exceeds the cap.[35] Approximately 85 percent of the available allowances in the House bill would be given away in the early years of the cap-and-trade program, with the remaining 15 percent to be auctioned to the highest bidder. Once the allowances are distributed, recipients will be able to buy, sell, and/or trade allowances at a cost determined by the marketplace.

If a building is successful in reducing its carbon footprint, it could position itself to sell the allowances for a profit to operations unable to reduce their carbon reliance as easily. Carbon offset credits and renewable energy credits (RECs) are popular options to lowering a building's carbon footprint. Disclosure of these and other carbon-reduction efforts can assist the potential buyer in understanding the historical measures employed by the owner to prepare for a low-carbon future. Moreover, a low-carbon building can be more financially attractive to a potential buyer concerned about future carbon emissions compliance issues, including the yet-to-be determined cost of cap-and-trade allowances. H.R. 2454 recognizes energy efficiency as a means of utility compliance for between 5 percent and 8 percent of the utility's over-

[34] 18 EDDG 23, 3/19/09. If made final, this proposed rule would require fossil fuel suppliers, industrial gas suppliers, and direct greenhouse gas emitters that emit more than 25,000 tons of carbon dioxide or carbon dioxide-equivalent greenhouse gases annually to report their greenhouse gas emissions. On Aug. 18, 2009, EPA sent a draft final rule to the White House Office of Management and Budget (OMB) for review. OMB review usually is the last step before EPA issues a final rule.

[35] Cap-and-trade will not apply to entities that emit less than 25,000 tons of carbon dioxide.

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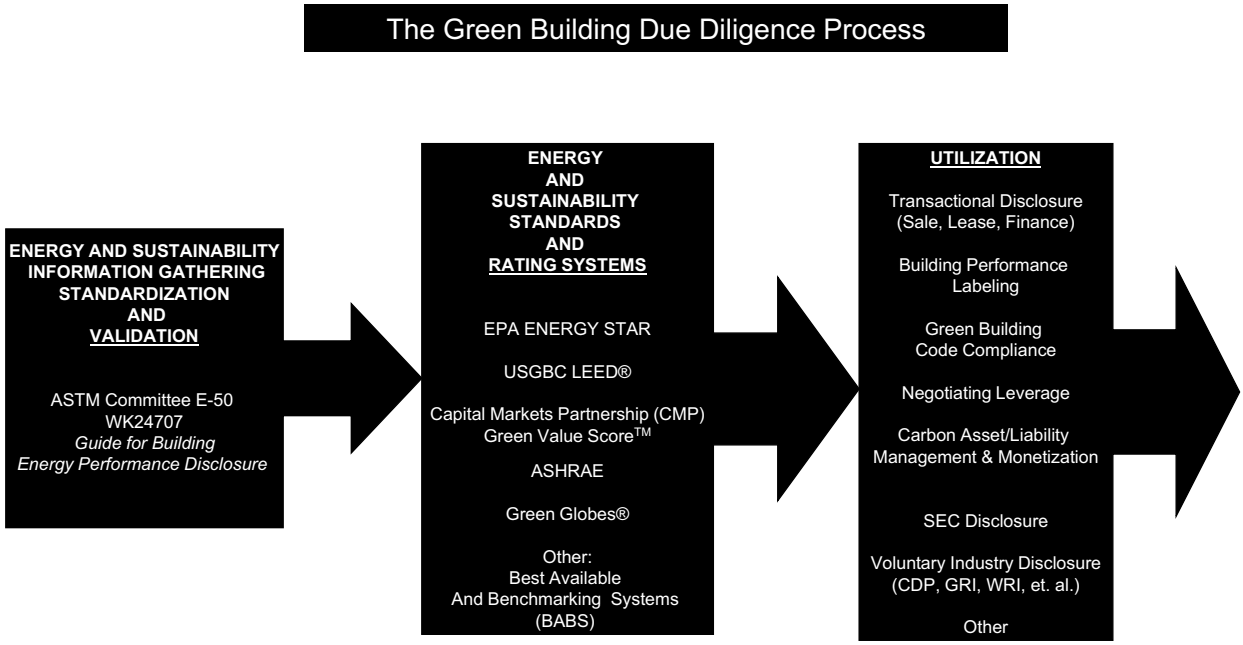
all requirement.[36] Thus, building occupant energy-efficiency measures could be monetized and need to be considered as an element of valuation and a property right to be addressed in the sale transaction as well as the evolving green lease.

(h) Conclusion

Quantifying a building's energy and sustainability condition, performance, and potential will become commonplace and now is being incorporated into routine commercial real estate transactions. Commercial real estate industry professionals increasingly are becoming knowledgeable and sophisticated in these areas to adequately represent their respective transaction stakeholders. Commercial property sellers should consider expanding the scope of what they traditionally might consider "material" to the condition of the property to include energy consumption and cost data as well as building sustainability characteristics that could affect such consumption and costs.

Well-established property law requires the commercial seller to disclose all material facts affecting the real property to a potential buyer. With a few exceptions in highly progressive areas of the United States, the law currently does not stipulate the disclosure of a building's energy-efficiency performance (or any other equivalent climate-related data). However, given California's A.B. 1103, the U.S. House's passage of H.R. 2454, and President Obama signing the Recovery Act into law, commercial buyers and lenders likely will accelerate the expansion of environmental due diligence inquiries to account for a building's energy efficiency and sustainability performance. In turn, commercial sellers who engage in all appropriate disclosure will make it easier for environmental professionals to render reliable conclusions about the energy efficiency and sustainability performance of their property, and concurrently provide themselves with post-transaction liability protection against nondisclosure claims by the purchaser resulting in diminution of property value.

[36] H.R. 2454 Title I, Subtitle A.



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