

**Testimony of Mark Wagner
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**Before the United States Senate Committee on Finance
Energy, Natural Resources, and Infrastructure Subcommittee**

**Hearing on Tax Reform and Federal Energy Policy: Incentives to Promote
Energy Efficiency**

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Chairman Bingaman and Ranking Member Cornyn, I appreciate the opportunity to testify today on tax incentives for energy efficient investments in commercial and multifamily buildings. My name is Mark Wagner, and I am Vice President of Government Relations at Johnson Controls.

Johnson Controls is a Fortune 100 company with 170,000 employees world-wide and \$42 billion in sales. Our three business units focus on automotive interiors, automotive batteries, and building efficiency. Our building efficiency business has 1,300 branch offices in 148 countries. Our energy solutions have generated savings of over \$7.5 billion since 2000 for our clients, and we are the largest energy services company in the world. We also manage over 1.8 billion sq feet of commercial real estate for some of the world's largest companies.

For decades, energy services companies like Johnson Controls have been in the business of saving energy for our customers. We save taxpayer dollars when federal, state and local government buildings are renovated and upgraded using private-sector financed energy savings performance contracts.

The 179D federal tax deduction has been a valuable tool that allows a private commercial, and multi-family, or public sector building owner to receive a \$1.80 per square foot deduction for an energy efficiency upgrade. It is set to expire at the end of 2013. The current deduction also allows government buildings at the federal, state and local level to pass on this tax incentive to the designer of the efficiency project enabling lower overall project costs, since public entities themselves do not pay taxes.

Public Sector Examples

Johnson Controls has designed and carried out 85 government-owned projects nationwide that have been completely certified by a 3rd party certifier under the 179D deduction. Another 80 projects are waiting to be certified.

In Maryland, for example, we performed a guaranteed energy savings project in seven Caroline County public schools to save the school district \$4.1 million over the next 15 years. And we upgraded the Kent County Courthouse/Government Center, Public Works building, and the detention center.

In Texas we performed efficiency upgrades in dozens of buildings in the City of El Paso, with a total measured cost avoidance of over \$4.7 million in the first two years. In San Antonio we performed lighting, HVAC, and building envelope upgrades for the city's three largest facilities, the Convention Center, the Alamodome and the San Antonio International Airport, totaling 5.4 million square feet. This \$9 million project is expected to generate savings of \$15.6 million dollars within the first two years.

That is great news for the public sector, where our federal, state and local governments, schools, and hospitals are investing to become more energy efficient. Even though efficiency investments have upfront costs, they result in lower operating costs over time, freeing up our schools and hospitals to use their limited operating budgets on teaching, on health care excellence and other mission critical operations.

Private Sector Challenges

However, 179D has a different story in the private commercial building sector where it is significantly underutilized. President's budget for FY 12 estimated expenditures of \$200 million for the program, and yet only a fraction has been used. Despite the large potential market opportunity, private sector commercial buildings such as office spaces, shopping malls, historical buildings, and multi-housing units lag behind the public sector in energy efficiency upgrades. Upgrading commercial buildings needs to be a national priority as the majority of these buildings will still be standing, and wasting significant energy resources, for decades to come.

In part, commercial sector retrofits lag behind due to structural challenges. Namely:

1. Unlike the public sector, private sector building owners seldom commits to owning their facilities for decades, which limits the time scale in which an energy efficiency investment must "pay-back" to 2-3 years.
2. Many commercial buildings belong to large real estate owners with the legal ownership structure as a Limited Liability Corporation (LLC). LLC's are non-credit rated, meaning that there is no credit history, and no assets which can be held as security against the mortgage. This fact makes banks wary of making energy efficiency loans.

3. Often there is no alignment between the owner and the tenant in a commercial building – the owner makes the investment, but it is the tenant who would like to see lower electricity bills.

Feedback from Building Owners

Johnson Controls conducts an annual survey of executive decision-makers responsible for making investments in energy efficiency. In 2012, we surveyed over 1100 Energy Efficiency US executives and found that in one year there was a 20% increase in those who saw energy management as significant or very significant to their organization. Funding was cited as the most significant barrier to energy efficiency investment followed by an inability to meet return on investment requirements.

Significantly, when asked to prioritize which government policies would drive greater investment in energy efficiency, tax incentives and rebates were deemed by far to be the most important, with 42 percent of the executives finding those to be the highest priority for public policy action. And yet, Section 179D is the only tax incentive for commercial building efficiency.

The S. 3591 Solution

In order to address the unique needs of the commercial building sector, financing structures and incentives need to be performance-based, technology-neutral and based on actual, verified performance.

These elements are all present in S. 3591, the Commercial Building Modernization Act (“CBMA”) introduced by Senators Snowe, Bingaman, Feinstein and Cardin. Recently, Johnson Controls joined forty seven organizations from the real estate, construction, lending, manufacture and supply and efficiency communities in support of the extension of 179D and modifications proposed in S. 3591 (*see attached*).

CBMA improves upon the existing 179D deduction in several key ways:

1. It does not specify the technology, materials, or equipment to be used. Every building has a unique design and history of construction, operation and improvement. Building owners and contractors can determine which efficiency measures are most cost-effective for each individual building at each stage of its life. This gives building owners the freedom to install traditional as well as state-of-the-art technologies to meet a variety of operational and tenant needs.
2. It rewards building owners for deeper energy savings and implementation of more improvement measures. Consistent with a performance-based approach, the allowable deductions proposed by CBMA allows for a \$1 per square foot deduction for 20-24

percent of source energy savings at the low end scaling up to \$4 per square foot for 50% or more source energy savings.

3. It incentivizes verified energy savings, splitting the deduction into a “design deduction” of 60 percent, and a “realized deduction” of 40 percent after a professional engineer calculates actual energy consumption reductions against a baseline considering occupancy, climate, and other factors.
4. It changes the current law from a retrofit of 50 percent savings against ASHRAE code to a sliding scale of options for energy savings benchmarked against the individual building’s energy consumption for the previous year. Under current law, for example, upgrades to the iconic Empire State Building that Johnson Controls recently completed does NOT qualify for the incentive, even though we are projecting 38 percent energy savings as compared to the building’s previous performance, and guaranteeing our portion of the project. Under CBMA, the Empire State Building project would qualify, because savings are compared to the building’s baseline energy consumption.
5. It restructures the deduction to give a better incentive to Real Estate Investment Trusts (REITs) and certain limited liability partnerships (LLPs) to participate. In current law, because REITs distribute all of their earnings, these earnings are taxed as a dividend and cannot be passed on to their shareholders as a benefit.

179D deduction will expire at the end 2013. We believe it is important to extend and improve the deduction. Extension and changes as outlined in CBMA are particularly important in light of the fact that there aren’t many other financing mechanisms or incentives available that target commercial building efficiency.

Other Policies and Programs

I would also like to briefly mention a few other policies and programs which the 179D tax deduction can be packaged with to help create demand and stimulate further private sector investment in the commercial building sector. Several cities are making great progress in adopting policies to benchmark and disclose energy use in large commercial buildings. The Department of Energy has signed a Memorandum of Understanding with the real estate Appraisal Institute to create a “green appraisal” template which would provide credit in building valuations for energy efficiency improvements. Energy Star and the Energy Star Portfolio Manager are important government programs for assessing commercial building performance along with LEED® and other private-sector voluntary rating systems. The White House/DOE Better Buildings Initiative challenges building owners to retrofitting buildings across their portfolio or enterprise. Finally, the Green Button initiative defines standards for utilities to be able to easily provide energy use data to their customers securely over the Internet.

Also important are financial models and mechanisms that address the challenges of attracting third-party financing for commercial building upgrades. Standardization of the energy performance contracting procurement, measurement and verification methodology, as was done by the U.S. Federal Energy Management Program, had a very positive impact on scaling energy efficiency upgrades in government facilities. Similar standardization of energy services agreements, utility-bill based repayment approaches and Property Assessed Clean Energy (PACE) financing could have similar positive impacts in the commercial buildings sector. Johnson Controls and others in the industry are committed to working with government and the commercial building sector to increase energy efficiency investments in this underserved market.

A combination of policies and programs that create market demand and provide commercial building owners with enhanced incentives, standardized processes, and financial models that attract private-sector funding can make a large impact with only a modest public investment. Performance-based, technology neutral tax incentives that reward the achievement of actual, verified energy savings are a key component of the solution. We are glad to support CBMA as a very important step forward in that process.

Thank you for holding this important hearing and allowing me to testify before you today.