

Energy Policy Priorities for the Commercial Real Estate Sector

JUNE 2024

Introduction

NAIOP NJ commends the Murphy administration's commitment to addressing climate change and offers the expertise of New Jersey's commercial real estate industry on energy issues to both the administration and the legislature.

For the benefit of the New Jersey Board of Public Utilities (BPU) and state leaders, this position paper examines the potential impact on New Jersey's commercial real estate industry if the state transitions to a 100% electric-powered future. It also offers recommendations for ensuring New Jersey's path to a cleaner energy future while also preserving the viability of the commercial real estate sector as a driver of economic development and job creation.

NAIOP NJ POSITION

A balanced evolution away from fossil fuel dependence toward cleaner energy is critical for the Energy Master Plan. Unrealistic timelines coupled with mandates for unproven technologies will shock our economy, produce significant adverse effects, and prove to be counterproductive to the Energy Master Plan's stated goals.

Economic Impact of NAIOP NJ Members

NAIOP NJ, New Jersey's Commercial Real Estate Development Association, has represented the state's commercial real estate industry for more than 50 years. New Jersey's leading organization for developers, owners, and related professionals in office, industrial, warehouse, and mixed-use real estate, NAIOP NJ advances responsible and sustainable development policies that create jobs and benefit our state.

In 2023, the commercial real estate (CRE) sector contributed \$14.3 billion to New Jersey's gross domestic product, generating \$5.2 billion in wages and salaries, and creating and supporting more than 79,000 jobsⁱ.

NAIOP NJ represents more than 800 members and its

approximately 300 member companies own and invest in 426 million square feet of office space, 634 million square feet of multifamily space, 512 million square feet of retail space, and nearly 1.9 billion square feet of industrial and warehouse propertyⁱⁱ. Although not all New Jersey CRE asset owners are members, NAIOP NJ provides a voice for the entire industry.

2035 Electrification Mandate's Impact on New Jersey's Commercial Real Estate Industry

The state needs to consider the unintended adverse economic impacts that will arise from the proposed Energy Master Plan:

- The burdensome levels of capital required to comply with new regulations to accelerate building electrification will financially strain developers and tenants. This additional cost will make office building viability more tenuous and increase the risk of abandonment, which will lead to lower municipal property tax revenue.
- Requiring a complete and total reliance on electric power will increase building energy costs. Depending on office building HVAC and lighting systems configuration, projected capital expenditures will range from \$6.23 to \$14.64 per office square footⁱⁱⁱ. When proportioned across five years beginning with BPU's Triennium II program, the required capital expenditures for the estimated 426 million square feet of office capacity across New Jersey will range from between \$531 million to \$1.247 billion^{iv} annually depending on office building HVAC and lighting systems configuration.
- Utility rate increases fund Triennium incentive programs. By way of example, a 10% utility rate increase across 426 million square feet of office capacity is estimated to increase landlord and tenant operating costs by almost \$100 million annually^v.
- New capital requirements to comply with expected regulations plus landlord's share of projected utility rate increases will reduce investment in new commercial building development by \$938 million^{vi}, translating into a

POSITION PAPER

\$2.1 billion projected reduction in New Jersey's GDP, and reducing wages and salaries in the state by more than \$750 million per-year, eliminating 11,000 jobs^{vii}.

- Continuing to reel from reduced office utilization due to hybrid and remote work arrangements, office owners are directing capital investments to amenity upgrades to attract and retain tenants and avoid default.
- Utility rate increases risk some office building owners' debt service coverage ratios dropping below two times net income^{viii}, which could tip the buildings into default. Should buildings go dark, every resulting \$1 million reduction in operating expenditure would reduce New Jersey GDP by \$2.0 million per year, reduce salaries and wages in the state by \$630 thousand per year, and eliminate 15 jobs^{ix}. In some cases, lenders may be unwilling to take ownership of an unprofitable property and choose to surrender it to a local municipality rather than pay the associated property taxes, reducing revenue to local governments.
- New Jersey's electricity supply Renewable Portfolio Standard (RPS) at present imputes approximately two cents per kWh* (a 15% adder) in New Jersey's 2023 average electricity rate of 15.41 cents/kWh^{xi}. The Board of Public Utilities needs to acknowledge that this burden exists and will steadily increase as New Jersey approaches 100% carbon neutral electricity.
- Increases in warehouse and multifamily operating costs are typically paid by tenants and utility rate increases are more readily absorbed by the tenants^{xii}.
- Lack of electric grid capacity with increasing demand from electric vehicles and other energy intensive development will decrease availability of connection approvals and/or limit local economic growth opportunity.

Priority #1 – Ensure Reliable Access to Energy

Power reliability is paramount for New Jersey's commercial real estate industry. Business tenants require uninterrupted access to power, especially in an increasingly technology-driven and energy-reliant economy. Reliable power is a key selling point, attracting and retaining tenants by fostering business continuity, tenant satisfaction, and operational efficiency. Conversely, unreliable power can lead to lost revenue, frustration, and ultimately, businesses seeking alternative locations, potentially outside New Jersey. Reliability is essential for many spaces, and it cannot be compromised. Refrigeration and data management and critical facilities such as health care and communications centers cannot function without reliable power.

NAIOP NJ POSITION

Reasonably priced, reliable power is necessary for a functional and competitive commercial real estate industry in New Jersey.

While NAIOP NJ applauds the Murphy administration's commitment to climate change, we believe the ambitious 2035 target for eliminating fossil fuels and the exclusive use of electric energy threatens New Jersey's access to power and is neither feasible nor realistic. Until the state builds a robust power delivery infrastructure that meets current and future demands, and in-state electric generation is developed to meet the same capacity needs, the commercial real estate industry will continue to need autonomy over energy choices. This ensures tenants have reliable, affordable, and predictable access to power. Among the reasons for our position, several are related to safety:

- Natural gas-fueled generators provide backup power for life-safety facility loads, such as exit lighting and elevators, and
- Natural gas-fueled boilers protect pipes from freezing and bursting during electric power outages.

The commercial real estate industry needs to retain the freedom to choose an energy source until proven, reliable, and reasonably priced clean energy technologies are developed to ensure a smooth transition. As things currently stand:

- The operating cost for electric-powered baseboard heating is four to five times higher than natural gas fueled baseboard heating^{xiii},
- Electric resistance heating systems require substantially more electric service capacity and utility distribution capacity, which increases development capital requirements and makes retrofitting existing buildings financially unviable, and
- Electric heat pumps remain a questionable option for industrial buildings and other commercial real estate, especially in very cold climates. Emerging technologies can be considered as they become more viable.

The overly ambitious 2035 deadline for eliminating fossil fuels jeopardizes New Jersey's uninterrupted access to power, eroding business confidence in the state's ability to supply reliable electricity. We must avoid creating a crisis of business confidence that could threaten future economic development, especially for technology-intensive industries like [fintech](#) and [insurtech](#), which rely heavily on power-intensive artificial intelligence.

An unproven and hasty conversion to electric power will also threaten New Jersey's cold storage warehouse sector, which provides climate-controlled storage for meat, dairy, frozen food,

POSITION PAPER

pharmaceuticals, and other items. These multi-million-dollar inventories are at risk from an interruption in electrical power without a reliable, natural gas-fueled backup generator. Lack of access to natural gas infrastructure will increase reliance on other fossil fuels and will offset emission reduction.

We've seen a crisis of confidence already appear, especially in South Jersey. Utilities have told developers planning data centers and cold storage warehouses that there is insufficient power for these facilities.

RECOMMENDATIONS

- Allow New Jersey's commercial real estate industry to retain autonomy over its energy source choices until 1) New Jersey builds an energy delivery infrastructure sufficient to satisfy current and future demands and 2) new, proven, and reasonably priced clean energy technologies are developed.
- Adjust the timetable for converting New Jersey to 100% clean energy to 1) preserve business confidence, 2) study if such a conversion will equip New Jersey to reliably supply enough electric power—now and in the future—to meet the uninterrupted demands of residents and business, 3) determine the cost to convert New Jersey to an all-electric powered state, and 4) determine who will pay for the conversion.
- Use integrated distribution plans to provide hosting capacity maps, heat maps, and restricting maps for forecasting distributive energy resource (DER) capacity and developer needs.
- Explore new methods to fund grid improvements.
- Improve building energy conservation inducements to make them easy to access and financially attractive to developers.
- Expand utility-managed incentives and programs.
- Expand financing to include more technologies to transition reasonably to DER i.e. EV chargers, storage, and demand response/curtailment.

- Pilot demonstrations of innovative emission reduction projects such as but not limited to hybrid heating, carbon capture, networked geothermal, microgrids, fuel cells and data sharing of recent conversions.

Priority #2 – Solutions for Commercial Real Estate Buildings

Feasibility Assessment

New Jersey should assess the feasibility—determining the costs, threats, engineering demands, and upheaval—of electrifying the commercial real estate sector before imposing a mandate for electrification. Developers and electric utility companies face significant financial and engineering hurdles to meet the 2035 deadline:

- Upgrading the grid, which is insufficient to handle the additional demand from a fully electrified commercial real estate sector, will be costly and time-consuming.
- Reliable access to electricity is critical to commercial real estate tenants. Concerns exist about the grid's ability to ensure consistent power, especially during peak usage times or extreme weather events. Backup generators are necessary, adding additional costs.
- While some electric heating and cooling technologies exist, they may not be as mature or cost-effective as traditional gas-fired systems in all applications.
- The cost of electrification will be passed on to tenants through higher rent, making New Jersey's commercial real estate less competitive with other states.
- Electrification may require significant time to adequately train contractors and in-house building managers to install, maintain, and repair new technologies.

Incentives for New Construction

Clean energy investments differ between new and existing buildings. For new buildings, obstacles to integrating clean energy can be identified and addressed during the design phase. Financial incentives to incorporate clean energy technology into new buildings should include a clean energy PILOT program so developer investments in clean energy can be recouped through lower tax payments.

Incentives for Existing Buildings

For pre-existing buildings, the challenges of retrofitting them for electrification are significant and prohibitively expensive.

The negative impacts of an electrification mandate—especially one as soon as 2035—on existing buildings will be most felt by New Jersey's suburban-based office sector, which is already reeling from the work-from-home trend. Considering the now

POSITION PAPER

questionable viability of these buildings, owners will balk at oversized investments to convert them to electric power.

- Electrifying existing buildings would require major and cost prohibitive upgrades to electrical wiring, heating systems, and potentially ventilation systems to accommodate increased electrical loads.
- Retrofitting pre-1970 construction will involve more than strictly replacing wiring; it will require removing walls and exposing interior asbestos, which is expensive to abate.
- The cost of retrofitting existing buildings will be difficult for building owners to justify, especially given the potentially lengthy energy savings payback periods.

An electrification mandate on these buildings will cause their value to plummet, creating not only losses for owners, but lost property tax revenue for municipalities as suburban office parks become relics.

It is not practical to convert all existing properties to 100%

electricity. The Energy Master Plan should focus primarily on new commercial buildings—not existing—to meet electrification goals.

RECOMMENDATIONS

- Conduct a thorough statewide assessment to determine the feasibility of New Jersey's commercial real estate industry—industrial, office, warehouse, and mixed-use buildings—meeting the 2035 electrification deadline considering the significant financial and engineering hurdles involved.
- Before imposing unrealistic mandates that will risk New Jersey's access to reliable power and seriously strain the existing office sector, the state should encourage and incentivize the commercial real estate industry to make clean energy investments.
- Continue to support growth of community solar and the installation of solar on warehouses.

POSITION PAPER

- ⁱ Lewandowski, Brian, et al. "Economic Impacts of Commercial Real Estate, 2024 U.S. Edition." NAIOP Research Foundation, Feb. 2024, www.naiop.org/globalassets/research-and-publications/economic-impacts-of-crer/state-cards/state-fliers-2023-newjersey.pdf and Table 2.
- ⁱⁱ Russo, Mark, Internal Research, Savills. 16 Apr. 2024 see Table 1.]
- ⁱⁱⁱ Grant, Jeffrey. "New Jersey Large Energy Users Coalition - November 8, 2019 - Members Meeting - Law Offices of Giordano, Halleran & Ciesla, PA." <http://gofile.me/76GS2/Cvu9XiuPh>. Accessed 2 June 2024 also Table 5.
- ^{iv} Energy Plus Solutions, <https://tinyurl.com/3w8e8smu> Table 3a.
- ^v Energy Plus Solutions, <https://tinyurl.com/3w8e8smu> Table 3a.
- ^{vi} Energy Plus Solutions, <https://tinyurl.com/3w8e8smu> Table 3a.
- ^{vii} Energy Plus Solutions, <https://tinyurl.com/3w8e8smu> Table 3a.
- ^{viii} Energy Plus Solutions, <https://tinyurl.com/3w8e8smu> Table 4.
- ^{ix} Energy Plus Solutions, <https://tinyurl.com/3w8e8smu> Table 3b.
- ^x Grant, Jeffrey, PE, CEM, CEP (Certified Energy Procurement Professional), Typical Commercial Account Retail Electricity Supply Pricing Model. EnergyPlus Solutions. January 8, 2024.
- ^{xi} "U.S. Energy Information Administration - EIA - Independent Statistics and Analysis." Electricity Data Browser, <https://www.eia.gov/electricity/data/browser/#/topic/7?agg=1,0&geo=g0fvvvvvvvvo&endsec=g&freq=A&start=2022&end=2023&ctype=linechart<ype=pin&rtyp%20e=s&maptype=0&rse=0&pin=>. Accessed 21 Apr. 2024.
- ^{xii} Russo, Mark. Internal Research, Savills. 16 Apr. 2024.
- ^{xiii} NJ DEP Proposed New Rule: N.J.S.C 7:23F - Control and Prohibition of Carbon Dioxide, 6 Dec. 2021, www.nj.gov/dep/rules/proposals/20211206a.pdf. Accessed Apr. 16, 2024.

General Endnote: Complete tables are available for download at <https://tinyurl.com/3w8e8smu>.