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Risks and Rewards for Building Sustainable Hotels.

Before the economic recession began dominating media coverage in late 2008, consumers and businesses were keenly focused on promoting environmental sustainability in consumer products, energy, automobiles, buildings and the hospitality sector. The government responded with targeted financial incentives to promote these initiatives. Since existing buildings contribute almost 80% of the carbon emissions in some cities through their energy use, a major focus of these efforts has been on sustainable construction.[1] While the recession may dampen economic growth, it has not reduced the number of federal, states and local incentives for developers willing to build sustainably.

Travelers are also increasingly considering sustainability in making travel plans. A recent survey by Deloitte indicates that business travelers increasingly consider a hotel's sustainability in making their selections and 40% of those surveyed were willing to pay a premium for it.[2]

Together, financial incentives and consumer demand are likely to encourage the hospitality industry to continue developing more environmentally friendly hotels, resorts, spas and convention centers. This article briefly summarizes the risks and rewards for those that choose to build more sustainably.

Sustainability 101

The term "sustainable development" was first coined in 1987. The United Nations appointed the "Brundtland Commission" in 1983 to study concerns about the lasting impact of human development on the environment. The commission's 1987 report, "Our Common Future," defined sustainable development as follows: "Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs."[3] This definition immediately caught on. In the business world, it is sometimes referred to as a triple bottom line, capturing the concept that investments are profitable, good for people and protective of the environment.

Economic incentives and legal requirements for sustainability have developed in fits and starts in the United States. But notwithstanding the inconsistent approach by federal, state and local governments, sustainability has clearly taken on a life of its own in the past few years. This has led to a demand in the private sector for standards that measure corporate sustainability. There are several voluntary programs available, including "ISO 14001" certification, which provides a framework for corporations to reduce waste, energy consumption, pollution and be recognized for these efforts.[4]

The U.S. Green Building Council's voluntary standards for sustainable buildings, "Leadership in Energy and Environmental Design" or "LEED," have become the widely-accepted standard in the construction industry.[5] There are now LEED guidelines for several categories of buildings:

- New Construction
- Core & Shell
- Commercial Interiors
- Existing Buildings: Operations & Maintenance
- Schools

To deal with the perception that only new buildings can be sustainable, the U.S. Green Building Council recently re-formulated its LEED certification for operation and maintenance of existing buildings, which may help hotel operators obtain certification for their existing facilities.

LEED certification allows buildings to "earn" points in a variety of categories, including:

- Sustainable sites (such as redevelopment of brownfields[6] and location near public transportation)
- Water efficiency (typical water efficiency measures can reduce water consumption by 30%)
- Energy and atmosphere (lower energy use will reduce emission of air pollutants and greenhouse gases)
- Materials and resources (using recycled building products and recycling discarded renovation materials)
- Indoor air quality (building materials and furnishings that emit air pollutants are linked to a variety of health problems)
- Design innovation (rewarding use of new technologies to reduce energy usage or achieve other forms of sustainability)

The above are just examples and there are many ways to achieve LEED certification for both new construction and renovations in both urban and non-urban environments.

One might expect these forms of construction to increase costs substantially. But most studies indicate that early planning can ensure that new LEED-certified buildings cost no more than 0% to 5% more than their standard counterparts. Energy efficiency, government incentives and premium room rates can help hotel developers recapture these initial costs.[7]

LEED-certified buildings still constitute only a small fraction of overall construction in the United States. Chicago and Portland contain the highest number of certified buildings, about 70 each.[8] Nationally, there were about 1,200 LEED-certified buildings by the end of 2008, most new rather than renovated buildings. But that number grows substantially each year, with thousands of projects registered to achieve certification.

Travelers' Appetite for Sustainable Lodging

There were about eighteen LEED-certified hotels[9] sprinkled around the United States and Canada, including California, North Carolina, Georgia, Missouri and Maryland. But there are hundreds of hotels registered to achieve certification.[11] Even with some projects threatened by the economic recession and failure to stay on track for LEED certification, it is expected that there will still be many new LEED-certified hotels in the United States over the next few years. These numbers don't include, of course, the many hotels that have sustainable features (like solar panels, organic food offerings, sustainable personal care products, etc.) but that are not formally certified.

Although only a small number of hotels are currently LEED-certified, companies in the lodging industry, like other industries, have taken an active role in committing themselves to addressing climate change and sustainability. Lodging companies have realized that environmentally sound practices not only help the environment, but can lead to cost reductions, business expansion, and profit growth as consumers increasingly seek environmentally sustainable products and services. New companies are constantly being formed to service the hospitality industry in this area. For example, EnviRelation, a D.C. based company, has created tools that are specifically intended to help hotels calculate their greenhouse gas emissions, determine their carbon footprint and identify ways to offset these impacts.[11]

A number of social and economic factors are also driving the demand for sustainable initiatives. An April 2008 Deloitte survey[12] of business travelers reports that 95% of respondents believe the hotel industry should be undertaking "green" initiatives. Additionally,

- 38% of respondents made efforts to identify "green" hotels before traveling

- 60% of respondents voiced concern about global warming

- 40% of respondents would be willing to spend more to stay at a "green" hotel

These results suggest that consumers want and expect sustainability in their travel plans. In response to these trends, many lodging companies and on-line travel agencies have even begun offering their consumers an opportunity to purchase carbon offsets to reduce the environmental impact of their trips.

Consumer expectations of sustainability efforts in the lodging industry are likely to grow. Such consumer influence has grown so significantly in the past few years, that these consumers now have their own acronym – Scuppies – socially conscious upwardly mobile persons. Scuppies are likely to seek out sustainable properties for travel choices as they demand higher standards for themselves and the companies they do business with. Moreover, several lodging companies are even developing brands focused at the Scuppie market. These properties are specifically designed and marketed to offer their guests amenities that are environmentally responsible. The movement is trickling down — Cornell University's School of Hotel Administration recently created a course that focuses specifically on this issue, "Sustainable Enterprise Practicum in the Hospitality Industry."

Even without taking the bold step of seeking LEED certification, sustainability may provide a number of cost-saving opportunities for companies in the lodging business. Very basic initiatives that focus on reductions in energy and water use, such as light bulbs that use less energy or bathroom fixtures that limit water flow, can result in measurable savings. As costs of energy and construction materials increase over time, companies can realize the benefits of sustainability.

Companies that integrate sustainability efforts in their operations can also benefit from improved branding and recognition by the public. This can become a particularly effective advantage as large buyers (such as corporate travel departments) may specifically direct their employees to choose certain hotels due to their sustainability efforts.

In certain instances, however, even the best intentioned hotels may be resistant. For example, high-end luxury brand hotels might be hesitant to undertake certain sustainability efforts - such as offering that sheets/towels be changed less frequently or adjusting room temperatures when guests are not in the room - if they perceive that these factors could potentially affect the image of the hotel and an official five-star rating.

Incentives for Sustainable Buildings

There are a growing number of governmental incentives for sustainable construction, which the lodging industry has been slow to take advantage of. A few key developments are summarized below.

Federal Incentives

The federal government offers a variety of lower-cost financing, tax credits and tax deductions for sustainable development. While none of these incentives are specifically targeted at the hospitality sector, many would apply.

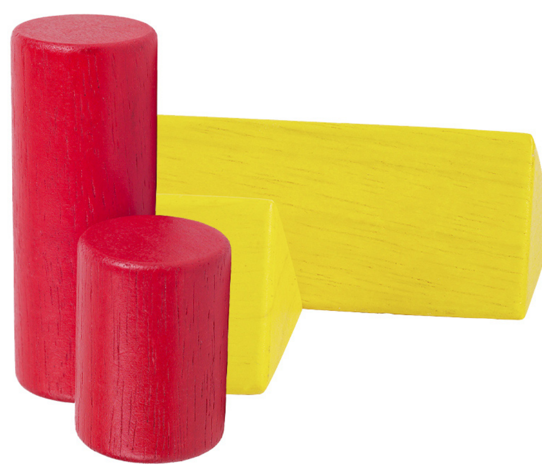
Developers of sustainable buildings may be able to seek lower-cost financing from states or cities through their issuance of tax-free bonds. The federal American Jobs Creation Act of 2004 authorized states and local governments to issue up to two billion dollars in tax-free bonds to fund environmentally sustainable projects. This funding is likely to become more important in today's restricted credit market, but will be most useful for large-scale developments including mixed-use projects, large resorts and convention centers. Projects must have the following characteristics: LEED certification, brownfield redevelopment, state or local financial support, one million square feet of development space or 20 acres, use of proceeds only for the sustainable component and creation of at least 1,500 full-time jobs.[13]

A similar federal law allows states and cities to issue tax-free bonds to raise money for energy conservation. The 2008 and 2009 economic stimulus laws allow states and cities to issue up to 3.2 billion dollars in tax-free bonds to finance any "qualified conservation purpose," which includes reducing energy consumption in public buildings, renewable energy and implementation of "green" community programs.[14] There is no bar on use of these funds for promoting sustainable development in the private sector.

This funding may also be used in conjunction with the IRS' tax deduction for "the cost of energy efficient commercial building property".[15] In order to qualify for the deduction, a building's annual energy performance must be reduced by 50% or more when compared to a baseline standard established by American Society of Heating, Refrigerating, and Air-Conditioning Engineers (ASHRAE) 90.1-2001. Partial deductions may also be available for a building's operating systems such as a HVAC/hot water heating system.

Restoration and preservation of a historic building is a great way to promote sustainability and create a distinctive lodging destination. Hotel operators seeking to retrofit historic buildings (whether for a new hotel or an upgrade of an existing hotel) can take available of the federal historic preservation tax credit. Developers can claim a tax credit of (a) 20 percent of the qualified rehabilitation expenditures with respect to any certified historic structure on the National Register of Historic Places or within a register district; or (b) 10 percent of the qualified rehabilitation expenditures for other buildings "placed in service" before 1936.[16]

Another great way to achieve LEED certification and promote sustainability is to locate new buildings near public transportation. But chic urban locations often come with an unwelcome expense — remediation of existing site contamination. The Internal Revenue Service allows an income tax deduction for certain environmental remediation costs. These costs may include remediation of petroleum and lead in soil, which are common conditions for urban sites. Thousands of developers of residential and commercial properties have taken advantage of this federal incentive (and its state counterparts) in the past decade.[17]



State Incentives

Some states have offered their own tax credits for sustainable buildings, most of which are rather modest. The New York State Department of Environmental Conservation, for example, will be allocating up to $25,000,000 in tax credits for new buildings constructed to LEED standards from 2005 through 2009. (Already constructed buildings may be eligible but the state is still working on the final regulations.) Applicants can claim up to $2,000,000 in credits each, perhaps enough to offset the costs of meeting LEED standards.

New York allocated $25,000,000 in its first round of funding for buildings constructed from 2001 to 2004. The seven selected projects included a mix of residential and commercial buildings, but no hotels.[18]

While most states don't have tax credits for sustainable buildings, many do have incentives focused specifically on energy efficiency, including tax credits for developers that install renewable energy features on their buildings such as solar panels or geo-thermal heating and cooling systems.

Local Incentives

As of June 2008, dozens of major U.S. cities provided incentives for sustainable buildings. Some provide technical assistance in meeting LEED standards, some provided expedited review by building departments and some provide property tax abatements. Notably, Cincinnati provides a 100% property tax exemption for achieving LEED platinum status.[19] (Most municipalities are not so generous.)

The principle local incentives for sustainable buildings are density bonuses that allow LEED-certified buildings to be bigger, taller, etc. For example, Portland allows more building floor area in exchange for landscaped roofs. Since landscaped roofs are a nice amenity for tenants or guests, this incentive is increasingly popular. There are, however, significant engineering considerations in constructing landscaped roofs on existing buildings.

Chicago, Nashville, Pittsburgh and Seattle and other cities provide a height or other density bonus for achieving LEED standards (usually reserved for silver, gold or platinum level rather than for the lowest "certified" level.)

Private Incentives

In addition to the federal, state, and local incentives for sustainble hotel construction, lodging companies should also be aware of several private incentives, specifically in the finance arena. For example, certain lenders may provide interest rate discounts[20] or longer payback periods[21] for sustainable projects. Other lenders may provide other incentives to the hotel operator such as the purchase of carbon offsets in the borrower's name or the planting of trees and installation of other eco-friendly amenities at the property.[22]

Sustainability Requirements

More states and localities are requiring new public buildings to achieve LEED-certification. For example, in 2008, Maryland passed its High Performance Building Act, requiring all new public construction and major renovation projects of inhabited spaces of 7,500 sq ft or greater to earn LEED silver certification.[23] New York City now requires new municipal buildings that cost over $2,000,000 to meet LEED requirements, "certified" for schools and hospitals and "silver" for all other buildings.[24]

But local requirements for private developers are likely to come as a bit of a surprise for some hotel operators. Nevertheless, a growing number of municipalities now require new buildings above a certain size threshold, usually 50,000 square feet or more, to obtain some form of LEED certification. These cities include Los Angeles, Washington D.C., Boston, Baltimore and Albuquerque.[25] New York City recently proposed a law requiring owners of existing buildings of 50,000 square feet or more to conduct energy audits, upgrade energy efficiency and comply with a new local energy code.[26]

Many building owners have objected to the new requirements and argue that voluntary measures are more efficient and are occurring without government mandates. But many larger municipalities in the United States are members of the U.S. Green Building Council and are keenly focused on reducing their carbon footprints. These types of programs are therefore likely to multiply.

Legal Concerns

These economic incentives and legal requirements for sustainable buildings will present some unusual legal issues for hotel developers. Millions of dollars in incentives or compliance with laws may be at stake.

For example, a recently-settled lawsuit in Maryland involved a dispute between a developer and its contractor over the developer's failure to obtain hundreds of thousands of dollars in state-issued tax credits that were tied to achieving LEED silver certification. The construction contract apparently did not specifically address the state-issued tax credits sought by the developer. The owner sued when the building didn't meet LEED silver standards and the project became ineligible for tax credits. The parties ultimately settled the case.

These lawsuits have so far been rare but are certain to increase. Managing these new risks will require some common sense solutions like hiring the right professionals and making sure contracts specifically allocate responsibilities for achieving sustainability standards. Environmental consultants can also help to assess risk, avoid missteps and analyze issues related to environmental conditions. Warranties for energy-efficient building products and insurance will also be important. Finally, owners should allocate responsibility for continued oversight of sustainability commitments; most government incentive programs have "claw-back" provisions if LEED certification is not obtained or not maintained.

In addition to the litigation risk surrounding a contractor's failure to comply with LEED certification and the other requirements for obtaining federal, state, and local incentives, there is also heightened litigation risk surrounding potentially misleading green marketing claims. If these marketing claims, such as being "LEED certified" or being "carbon neutral" turn out to be untrue, lodging companies put themselves at risk.

As consumer demand for sustainability increases, the government is getting tougher about regulating environmental marketing claims. The U.S. Federal Trade Commission has recently launched a review of its guidelines for environmental marketing claims, known as the "Green Guides."[27] These guides outline general principles for all environmental marketing claims and provide specifics about certain environmental claims, such as degradability, compostability, recyclability, recycled content, and ozone safety. Companies may consider developing a disclosure committee to assess and monitor the level of environmental marketing claims to mitigate such risk.

Risk Management Issues for Lodging Companies

To deal with these risks, lodging companies should develop a risk management framework that focuses on achieving accountability and transparency in planning and designing sustainable hotels. A key component of such framework is independent project oversight. An oversight task force can monitor projects to assess whether or not sustainable construction goals are being met within budget and schedule. In addition, all parties involved in the construction should have a consistent understanding of what is meant by sustainable construction. Lodging companies should also consider monitoring the construction to manage the realization of the expected benefits.

If the building contractor fails to comply with the respective sustainability goals and the project ends in dispute, companies should seek legal counsel, capital project consultants and other financial and forensic specialists to assist in the resolution. Working together, the attorneys and consultants can help evaluate potential liability, causation and damages, develop litigation strategies, and assist with alternative dispute resolution efforts, including mediation and arbitration.

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[1] New York City's "Mayor's Office of Operations Office of Long-Term Planning and Sustainability" commissioned a study of greenhouse gas emissions in the City in 2007. The resulting report, "Inventory of New York City Greenhouse Gas Emissions," estimated that energy consumption by buildings contributed 79% of the City's overall greenhouse gas emissions.

[2] The Staying Power of Sustainability, Deloitte Publication, 2008. The survey included in this publication was commissioned by Deloitte LLP and conducted online by an independent research company between April 8 and April 9, 2008. The survey polled a sample of 1,155 business travelers, defined as having taken at least one business trip in the past year that involved staying overnight at a lodging facility. The survey has a margin of error of +/- three percentage points.

[3] The Brundtland Commission was formally known as the World Commission on Environment and Development. The original report is available at http://www.un.org/Depts/dhl/resguide/specenv.htm.

[4] The International Organization for Standardization ("ISO") is a nongovernmental organization that promotes the adoption of consistent standards and measures by businesses and governments around the world. ISO has created consistent standards for use in engineering, medicine and other economic sectors.

[5] The U.S. Green Building Council (www.usgbc.com) is a nonprofit organization composed of builders, municipalities, individuals and others interested in sustainable construction.

[6] Brownfields are properties that are or may be impacted by contamination. These include sites where manufacturing or other polluting uses may have been located. Despite the complications involved in reusing these sites, they are often located in the heart of U.S. cities, on the water and in other attractive locations.

[7] http://www.nyserda.org/programs/Green_Buildings/default.asp.

[8] Amanda Fung, "NYC Buildings Less Green Than Most," Crain's New York Business, April 29, 2009.

[9] Lisa Krieger, "How Green is Your Hotel", www.siliconvalley.com, April 24, 2009.

[10] Jessica Downey, "In the LEED", Lodging Magazine, February 2009.

[11] EnviRelation, LLC; www.envirelation.com.

[12] The Staying Power of Sustainability, Deloitte Publication, 2008.

[13] It may be possible to aggregate projects to meet this requirement. The law originally required issuance of bonds by September 30, 2009. The Emergency Economic Stabilization Act of 2008 now permits issuance of such bonds for sustainable projects through September 30, 2012. This extension may allow states and local governments to raise funding for private or public projects to the extent the two billion dollars is not already allocated.

[14] The original bond program is provided by H.R. 1424, 110th Congress, § 301 (2008) created IRS Code Section 54(D), "Qualified Energy Conservation Bonds." The American Recovery and Reinvestment Act of 2009 substantially increased the original limit. H.R. 1, 111th Congress, § 1112 (2009) ("Increased Limitation on Issuance of Qualified Energy Conservation Bonds").

[15] 26 U.S.C. § 179(D).

[16] 26 U.S.C. § 47(a).

[17] This federal deduction originally expired on December 31, 2007, but the Emergency Economic Stabilization Act extends it to expenses incurred through December 31, 2009. Most states also offer their own incentives for cleanup and reuse of contaminated properties.

[18] More information on New York's program is available at www.dec.ny.gov/energy/218.html.

[19] More information about Cinncinati's property tax abatement program for LEED-certified buildings is available at http://www.cincinnati-oh.gov/cdap/pages/-3521-/.

[20] Tomek Rondio, "Going Green from the White House to Your House" Green Money Journal, Spring 2009

[21] Leanne Tobias, "Green Real Estate Finance Going Mainstream," Urban Land Green, Spring 2008.

[22] Tomek Rondio, "Going Green from the White House to Your House," Green Money Journal, Spring 2009.

[23] Maryland High Performance Building Act of 2008, Chapter 124, Senate Bill No. 208.

[24] New York City Charter § 224.1. The law took effect in 2007.

[25] Albuquerque's law is subject to legal challenge. A federal judge recently ruled that the law, which in part regulated efficiency of HVAC equipment, violated federal law. The court decision is Air Conditioning, Heating and Refrigeration Institute v. City of Albuquerque, 2008 U.S. Dist. LEXIS 106706 (D. N.M. 2008).

[26] Andrew C. Revkin, "City Plans to Make Older Buildings Refit to Save Energy," N.Y. Times, April 22, 2009.

[27] The "Guides for the Use of Environmental Marketing Claims" are found at 16 CFR §§ 260.1 to 260.8.