

Decision-Making and Market Segments in the Commercial Building Sector

2002 Decision-Making in Existing Commercial Buildings Workshop

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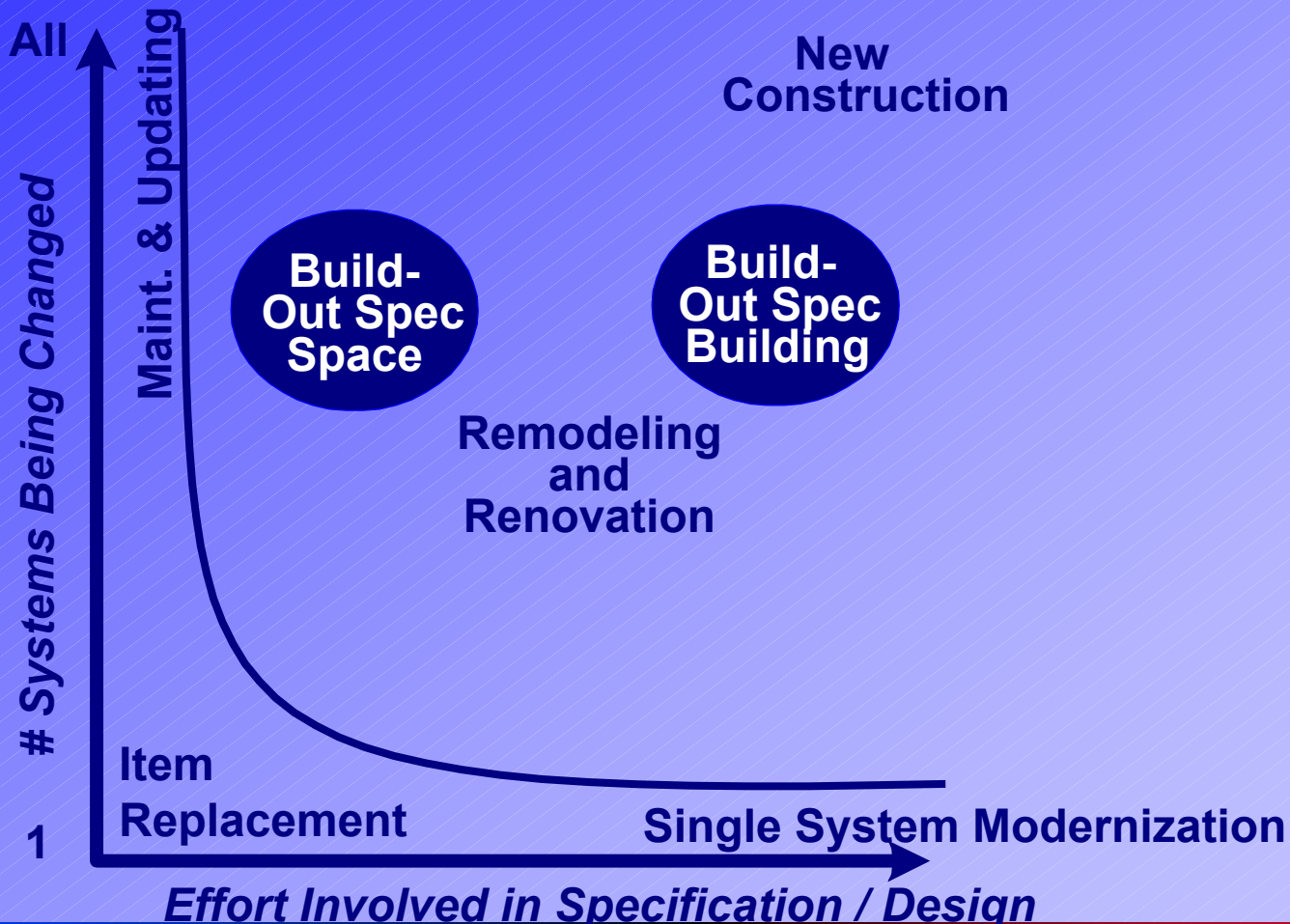
Clients who have sponsored work on which this talk is based

- **The Department of Energy**
- **The New Jersey Working Commercial and Industrial Working Group (PSE&G, Conectiv, JCP&L, Orange and Rockland, NJNG, SJG, NUI Elizabethtown)**
- **California Energy Commission**
- **California Utilities (SCE, PG&E, SDG&E)**
- **Others**

Key topics

- **Define events in existing buildings**
- **Identify the decision makers**
- **Describe four remodeling and renovation segments**
- **Describe how and why the level of interest in energy efficiency varies by segment**
- **Assess the effectiveness of different program strategies in influencing each segment**

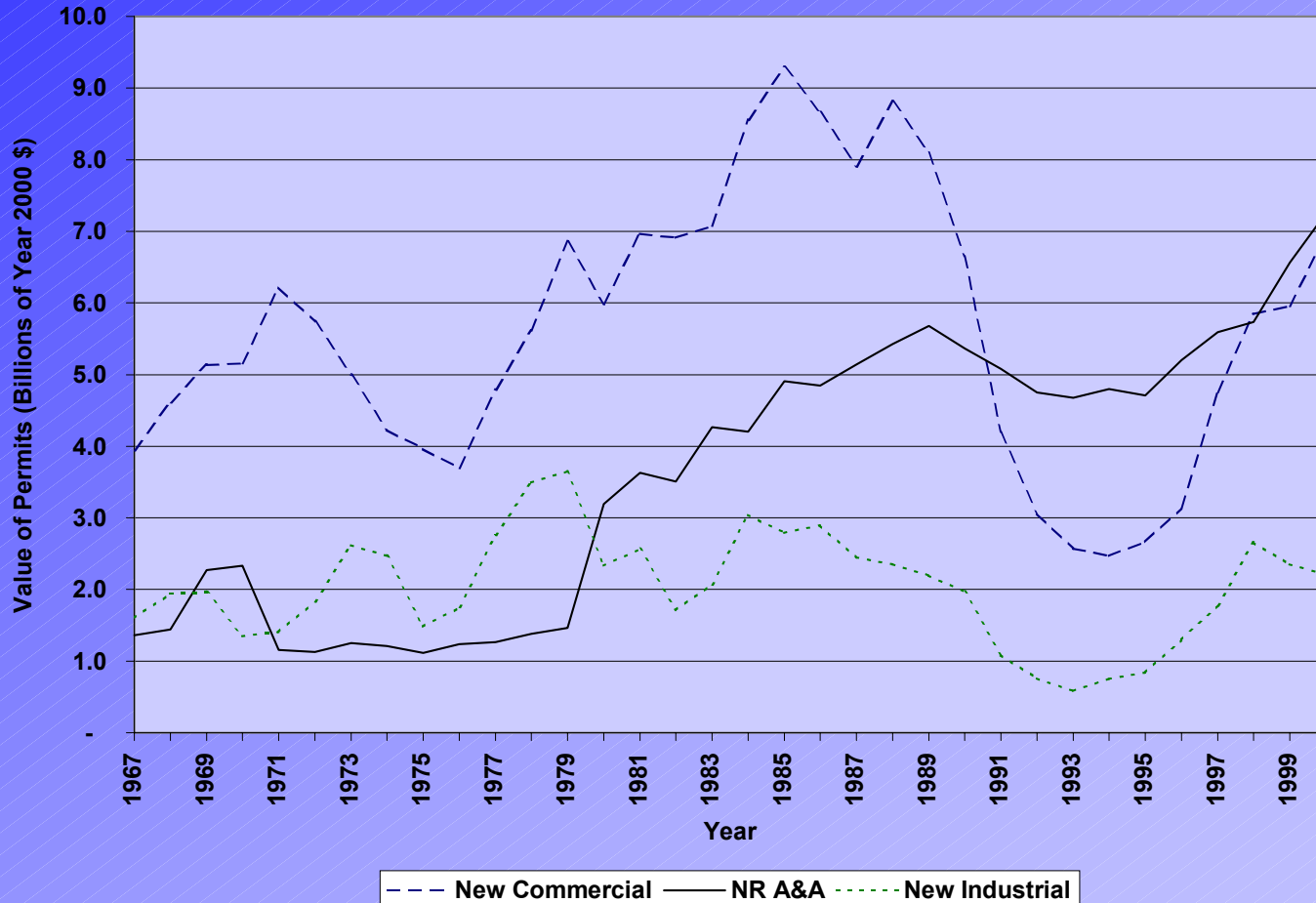
New construction, remodeling, renovation, and replacement



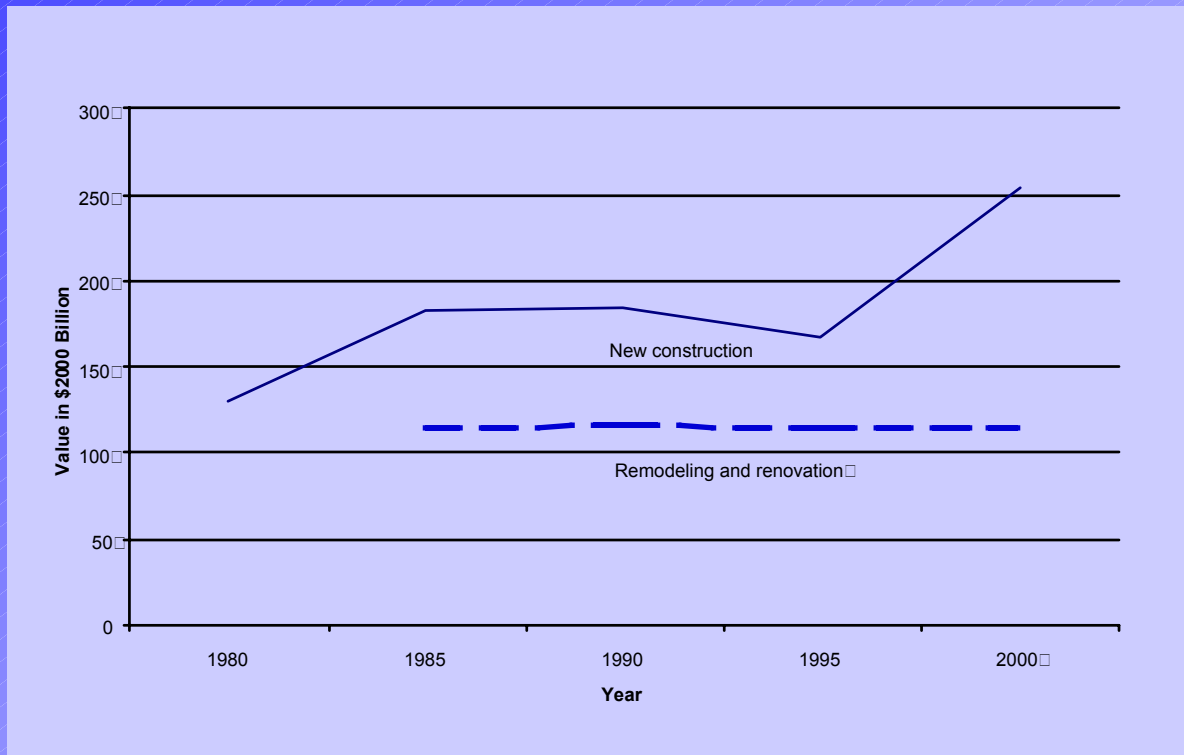
For program and policy purposes terminology is problematic

- Remodeling, renovation, and replacement do not have precise technical meanings
- The label for a project is often the title given to the project by the owner or developer
- Permitting offices typically deal in the Census categories of new construction, alterations, and additions.
- The alteration and additions terminology is utilized by reporting services such as F. W. Dodge
- There is variation in how local permitting agencies apply terminology and variations in application among staff within permitting agencies

At the macro-economic level new construction and remodeling and renovation are different (California data)



New construction and renovation and remodeling national data



Is the remodeling and renovation market different than the new construction market?

- Policy makers and program implementers tend to assume that these are different markets
- Building professionals — **architects, engineers, and contractors**— tell us there are no real remodeling and renovation submarkets in their professions
- **Owners and developers** claim they can readily distinguish among market actors based on type of ownership and investment strategies
- The reality is that owner/developers, especially the large owner/developers, may approach the market with multiple strategies

Energy related decision makers

- **Owners/developers/investors/financiers set the budget limits**
- **An engineering firm typically does most of the analysis associated with code requirements and energy efficiency and frequently makes adjustments to satisfy both the dollar and the energy budget**
- **Architects choose the materials, the layout, and the aesthetics, but generally defer to the engineers on energy related analyses**
- **Tenants who want to manage image may get their own/consulting architects and engineers involved**

Decision makers II

- In replacement situations, owners typically go to a specialty contractor or general contractor who obtains a specialty contractor for them
- Value-engineering is invoked in 25 to 30 percent of buildings
- Value-engineering often results in the reduction of controls and efficient equipment

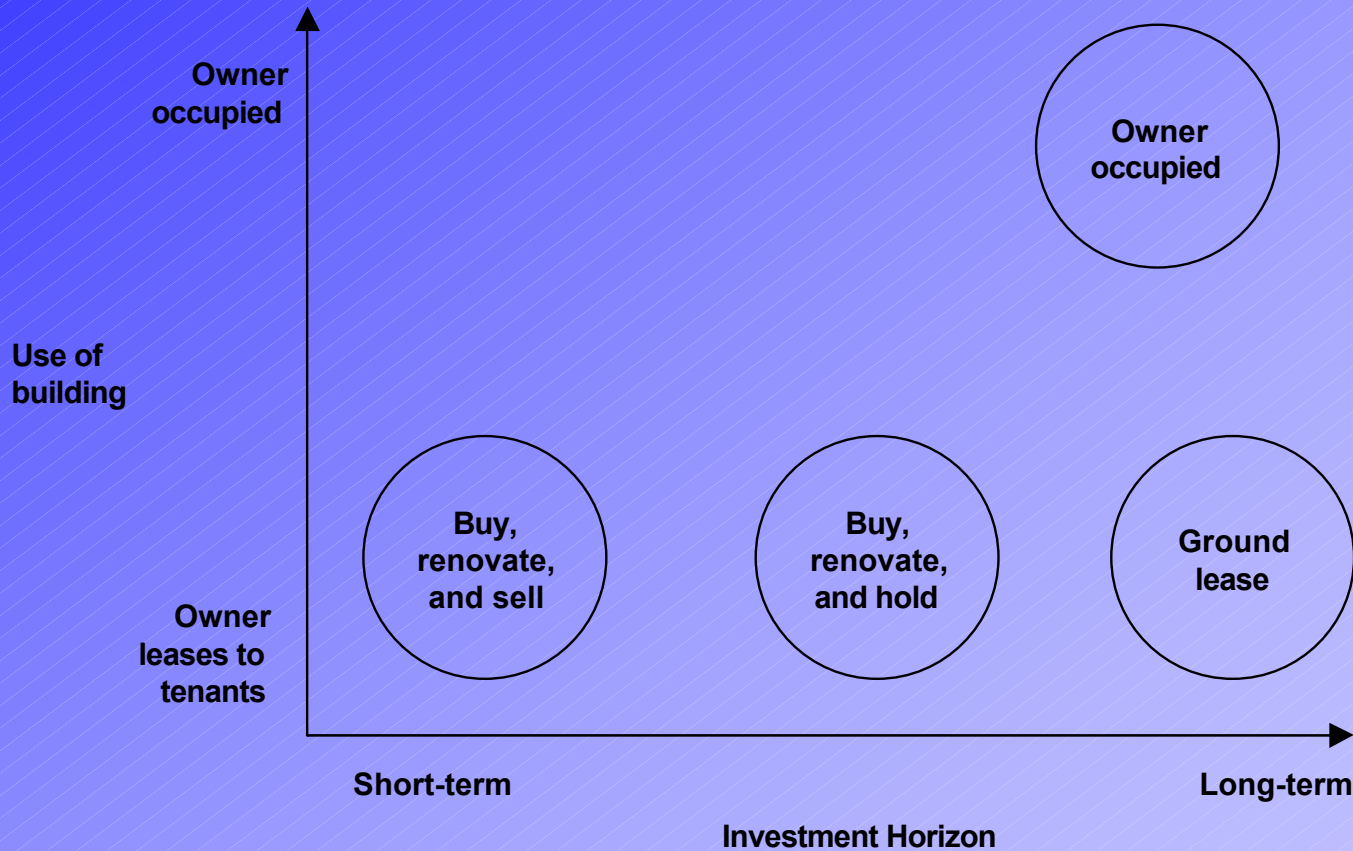
Three types of construction processes

- **Design-bid-build is a traditional approach where the architect and other design professionals design the building and hand-off the plans to a contractor. Still common in the public sector, less so in the private**
- **Design/build is done by contractors and their consultants who design and manage/complete a building or renovation**
- **Collaborative teams are becoming increasingly common**

Focusing on networks of contractors and design professionals

- We are currently examining the networking patterns of design professionals and contractors**
- Target key actors within and between networks rather than targeting all actors**

A two dimensional categorization of market players



Buy, renovate, and sell segment (one form of asset management)

- **Target buildings that have**
 - poor management
 - high vacancy rates
 - run-down condition
 - good location
- **Purchase a building and selectively upgrade the building to increase lease rates and therefore the value of the building**
- **Re-tenant the building with quality tenants**
- **Sell the building at a profit in three months to three years**

Rules of the road or buy, renovate and sell — I

- Focus on upgrades that enhance the lease rate such as aesthetics, revamping the space, fiber optic cabling, re-lamping to improve the quality of lighting, change the management, and distributed generation
- Avoid improvements that do not add to the lease rate unless the payback is within the period in which the developer holds the building

Rules of the road or buy, renovate and sell — II

- **Avoid buildings needing replacement of major systems and focus instead on salvaging and rehabilitation**
- **Modify major systems and add controls when the cost can go into the lease rates and/or the selling price can be increased**

Program strategies that will work with buy, renovate, and sell

Design assistance

X Financial incentives (sometimes)

Information programs

Performance contracting

X Codes and standards

Buy, renovate and hold - I

- Purchase buildings as long-term commercial real estate investments
- Strategy is to make money on the lease while maintaining and/or enhancing capital value
- Focus on attracting and holding tenants
- Tenants may stay six years or more

Buy, renovate and hold - II

- **There are opportunities to recoup investments in energy efficiency**
- **Typically utility costs belong to tenant.**
- **Will do efficiency investments for tenants**
- **Tenants may do their own investments using their own design team**
- **Some upscale tenants now monitor environments as part of their attempt to present a quality buying environment**

Program strategies that will work with buy, renovate, and hold

- ? Design assistance
- X Financial incentives
- ? Information programs
- Performance contracting
- X Codes and standards

Owner occupied segment

- Occupies the property for own use
- Pays the operating costs
- Will consider using capital to minimize operating costs
- Will consider a broader range of criteria in decision making including functionality, comfort, health, safety, image, etc.
- May be willing to accept longer paybacks although projects must compete with other investment opportunities

Program strategies that will work with owners

- X Design assistance**
- X Financial incentives**
- X Information programs**
- X Performance contracting**
- X Codes and standards**

Ground lease segment

- **Tenant leases ground and then builds to suit or has someone build to suit**
- **Leases are long-term, for example, 20 years**
- **Building is the tenant's and the tenant can do as they wish**
- **If the lease is dropped, building reverts to owner of the ground**
- **Typically franchises and national chains**
- **Tenants may act very much like owners**

Program strategies that will work with ground leases (tenants)

- X Design assistance**
- X Financial incentives**
- X Information programs**
- X Performance contracting**
- X Codes and standards**

Some trends over 20 years that may change things

- Increased collaboration among design professions and contractors
- Significant changes in the commercial office, retail, and medical practices that will influence the design and use of buildings
- Buildings may be rapidly recycled (five years or less) in certain sectors (especially high tech)
- Integrated component construction
- Compression in the supply chain that will reduce the influence of middle-market firms such as distributors

Summary and conclusions - I

- Remodeling and renovation are imprecise terms
- Building professionals see few differences in what they do between remodeling and renovation and new construction
- There really are not any building professional sub segments
- There are owner/developer segments that are distinguished by the investment horizon and the owner's use of property

Summary and conclusions - II

- **Owner/developers play an important role in decision-making by setting the parameters of the investment**
- **Owner/developers and engineers are probably the key to decision-making**
- **Investment strategies of different owner/developer segments influence receptivity to energy efficiency equipment and practices**
- **Different program strategies are differentially effective with different segments**
- **There is no one-size-fits-all program strategy for remodeling and renovation**