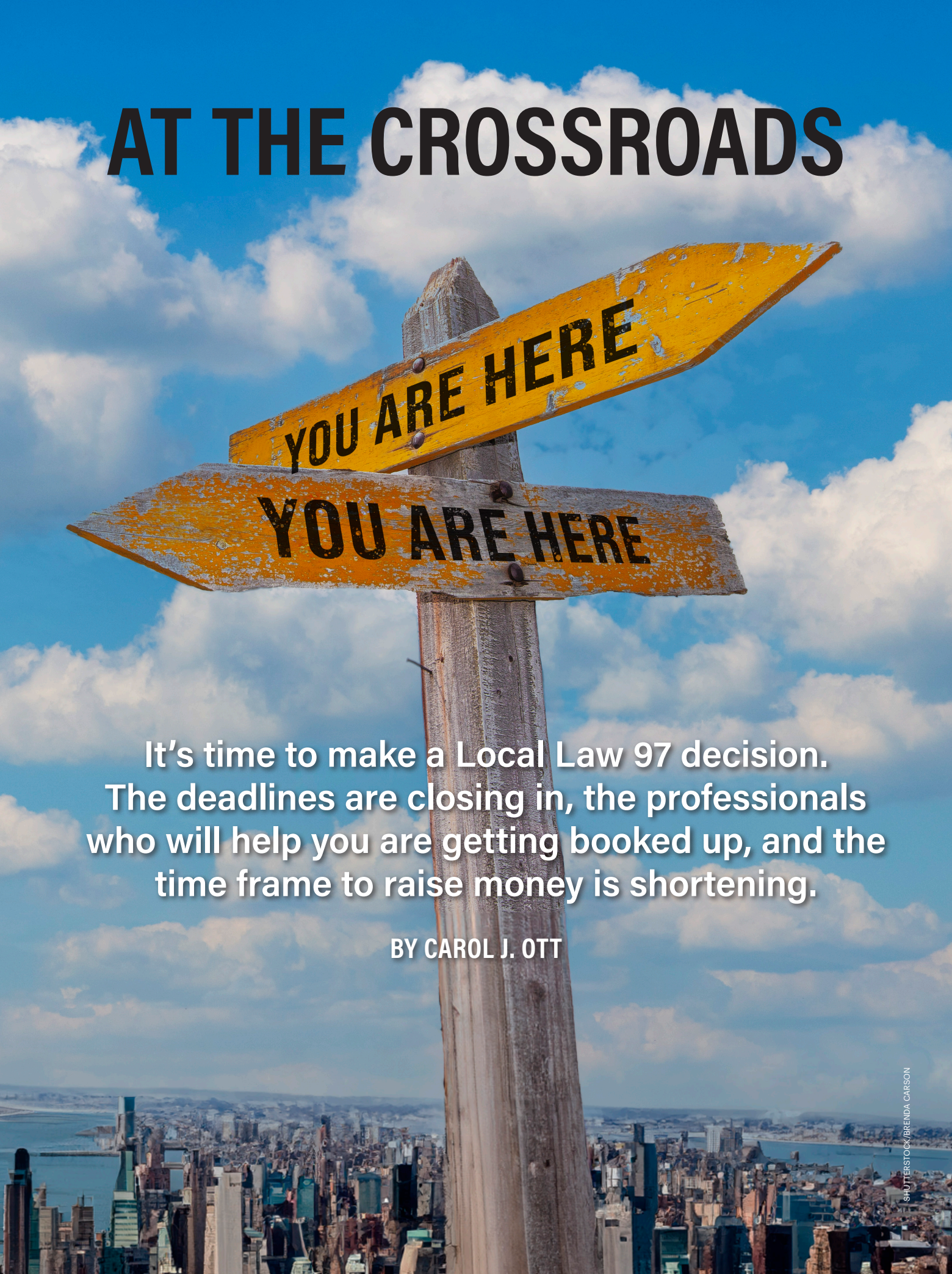
AT THE CROSSROADS



It's time to make a Local Law 97 decision. The deadlines are closing in, the professionals who will help you are getting booked up, and the time frame to raise money is shortening.

BY CAROL J. OTT

SHUTTERSTOCK/BRENDA CARSON

For boards peering down the wellof energy and carbon reduction possibilities, the decision to move forward with anything but what is called "low-hanging fruit" is daunting. Changing out a lightbulb is relatively easy and inexpensive; switching a building's heating and cooling system to a less carbon-intensive one isn't. That said, the date when carbon-emission fines begin for the majority of residential buildings is moving closer, and every board, no matter what it thinks about the Climate Mobilization Act, is going to have to face the questions of what to do and when to do it.

The Lay of the Land

Passed in 2019, the Climate Mobilization Act is a series of local laws, including Local Law 97. The purpose of LL97 is to reduce greenhouse-gas emissions from buildings. It doesn't prescribe how to do that; instead, it places an annual emissions limit on each building. The city calculates emissions based on a building's square footage and types of usage, and if a building exceeds its limit, it will face a financial penalty for every ton of CO_2 equivalent over its prescribed limit. The first compliance report will use 2024 data, and the deadline for submission is May 2025.

When LL97 first passed, the city projected that approximately 20% of buildings would face pen-alties in 2024. Since 2019, that number has dropped by nearly half, according to Department of Buildings (DOB) spokesman Andrew Rudansky. He says the DOB now projects that only 11% of buildings covered under the law will fail to meet the 2024 emission limits and may face penalties.

LL97 is an ever-evolving piece of regulation, and the DOB issued its first major LL97 rule in January 2023. That rule recognized the emission limits of different uses that can occur in a building. For example, a building could have a supermarket as a commercial tenant, and under this refinement its carbon emissions would be calculated separately from the residents above it.

The second major ruling, published in September, addresses a number of issues. It proposes a definition of a "good faith" standard that will be used in determining whether noncompliant buildings are eligible for mitigated penalties, provides a new credit for electrification projects, addresses the prescriptive path that certain buildings will take to meet LL97 goals, and provides guidance on LL88 lighting and sub-metering requirements. The DOB will hold a virtual public hearing on this proposed rule Oct. 24 at 11:00 a.m. (you can join it here *https://tinyurl.com/LL97Art320Meeting*).

We've Done As Much As We Can

Over the past several years, many boards have made investments in energy efficiency and carbon-emission reduction yet will still face fines in the second compliance period, 2030. Take the example of a large, 1970's-era co-op. Built with an electric heating system and a hydronic air-conditioning system, this co-op had become energy-inefficient. It still had its original windows, and the insulation between the building facade and the apartments inside had deteriorated.

The board embarked on two major projects totaling $15 million, funding them with a refinance of the underlying mortgage. All the windows were replaced with argon-gas-filled double-pane windows, and the HVAC system was completely replaced with a cogeneration system that uses gas and generates electricity. Prior to this investment, the co-op had a $2 million annual electricity bill; after the upgrade, the bill dropped to around $700,000.

The question facing this board, and many others in similar shoes, is: What are the feasible projects left to do? "We're working with energy consultants, and we've got our own engineering people working on it," says the co-op's board president (who wished to remain anonymous). "But the real problem is that Local Law 97 has a mandate obviously written by lawyers or politicians with no understanding of the technology that can be utilized to meet these requirements." As someone with a strong financial bent, "I'm very comfortable with the idea of investing in carbon reduction," he says. "The issue is, what do we do? We've got natural gas and electricity. As far as I know, we've got nothing else that makes sense. If we go back to electricity, that's the worst form of economic malpractice."

For the co-op, the financial stakes are high, but LL97 fines can hurt smaller buildings in impactful ways, too. Daniel Wollman, the CEO of the property management company Gumley-Haft, manages a relatively small 38-unit building with an operating budget of around $1 million a year. With limited common space and a gas-fired boiler, this co-op has addressed the low-hanging

fruit of changing out all the lights for energy-efficient LED bulbs. It's had an energy audit done and is projected to pay fines in 2030 of $10,000, or 1% of its current budget. "Off the top of my head," Wollman says, "I can't think of anything that makes sense for them to do."

After meeting with a solar vendor and hearing about energy credits and the small amount of electricity that a few solar panels could generate, "I said to myself, 'This is ludicrous,'" Wollman says. "The city wants to be an electric city, but I don't know how I'm going to take some of my buildings and make them electric. It would cost a ton of money. I'd have to gut half the place just to wire it." Like many, Wollman is asking himself what technology makes sense and where the money will come from.

Decision Factors

Economics and technology aside, weighing the pros and cons of LL97 compliance is complicated. Some of the issues to consider are:

Legal Risk If your board chooses to simply buy its way out of LL97 compliance by paying fines, there is some legal risk. If share-holders challenge the decision, the question of whether it would be protected under the business judgment rule is questionable. In order for a decision to fall under this rule, it has to be made in good faith, with the care that a reasonably prudent person would use, and with the reasonable belief that the director is acting in the best interests of the corporation.

Admitting that this is uncharted territory, Bruce Cholst, a partner at the law firm Herrick Feinstein, poses the argument he would use if he represented the disaffected shareholders. "The business judgment rule does not excuse negligence," he says. "There is a duty of care under this rule, and if everyone in the community is complying with LL97, it becomes a standard course of conduct in the community. If your board makes a decision not to comply because it's too expensive, that could be negligence and therefore inexcusable under the business judgment rule."

Additionally, he points out, one of the exceptions to the applicability of the business judgment rule is if the board's decision is illegal. Because LL97 is an expression of legislative public policy, deciding to absorb the fines and not do anything in the way of compliance may not be a defense your board could use if challenged. Finally, Cholst adds, if a board's decision wound up in court, "it's my gut feeling that a judge can't sanction a board's conscious decision to violate the law by paying a fine for noncompliance."

Insurance Risk Every building needs insurance, and the costs keep rising. Will your decision on how you comply or don't comply with LL97 make your building less insurable? "I can't say right now how noncompliance will affect your building's insurability," says Edward Mackoul, the CEO of the insurance brokerage Mackoul Risk Solutions. "But any time you don't follow the rules, at some point it's going to come back and bite you."

Insurance is reactive, Mackoul adds. Paying fines may not have anything to do with building safety, fire or flood risk, or other things insurance companies are typically on the hook for, but it may make your building less attractive. "Over the last couple of years, building violations have become a problem," he says. "Ten years ago, they weren't an issue, so I don't know how long it might take for LL97 violations to become an issue. Carriers could say, 'Hey, it's been five years, and you haven't even made an attempt to improve your building. We don't like the way it looks.' Sometimes carriers equate one thing with another, and they could come to the conclusion that if you're not doing something about this, you're not maintaining your building well either."

Financial Risk As a result of Florida's Surfside condo collapse, lenders are continuing to tighten their requirements. According to William McCracken, a partner at the law firm Moritt Hock & Hamroff, they're looking at deferred maintenance, climate change, sustainability and resiliency issues when making lending decisions. "Fannie Mae and Freddie Mac (the two associations that support apartment purchases and underlying financing for buildings) have tightened up their lending requirements, and they already have a list of buildings unavailable for lending," he says. "Whether this is the sort of thing they will look at in the future, I don't know." But it's an issue to consider, he cautions.

Moving Forward

"This is a train that's coming down the track," says Peter von Simson, the CEO of New Bedford Management. "I don't think it can be avoided. If a co-op's plan is to pay the fines, I think that's a very bad plan."

While not disagreeing, other professionals suggest taking a wait-and-see position. "This is an investment decision," says Mark

Balsam, the president of ReDocs, an energy-compliance consultant. He cites Local Law 152, which mandates gas-line inspections. "This law has been around almost four years now, and the city hasn't issued a single fine or violation for not submitting the gas inspection report," he says.

That's not to say there haven't been gas shutdowns as a result of inspections, just no fallout for failure to submit the report. "I may be a wild businessman at heart," Balsam says, "and others might see it as a gamble. But I think taking a wait-and-see attitude is a cogent investment point of view."

And what everyone is waiting for is the second major DOB ruling about how the city is going to deal with a building's claim of financial hardship as a factor in penalty mitigation. Until the rule is released, discussed in public hearings, perhaps amended and ultimately adopted, many advise boards to get ready. This means, says New Bedford's von Simson, "getting the information you need and hiring a good consultant to find out where your building stands right now."

McCracken adds: "The city would much prefer that buildings do something to comply other than just pay the fine. So I anticipate that it's going to be relatively easy to comply, that it will be doable. And if it's doable to make some sort of good-faith effort to reduce your building's carbon emissions, then it would be hard to say you should just ignore or blow it off and pay the fine." ■