Inflation Reduction Act Doubles Tax Credits for Building Retrofits

Proptech VC fund says $5/SF deduction will spur energy-saving fixes previously deemed too costly.

By Jack Rogers

The Inflation Reduction Act (IRA) signed into law by President Biden this week includes expanded tax credits that are expected to spur building owners and developers to make energy-efficient improvements that speed the decarbonization of commercial real estate.

Under the IRA, the maximum allowable benefit for the 179D Energy Efficient Buildings Tax Deduction will expand in 2023 from $1.88 per square foot to $5.00 per SF.

For an eligible 250K SF building, a $470K deduction at the 2022 rate now potentially increases to a $1.25M deduction. To qualify, new construction projects and renovated buildings must meet specific energy-reduction requirements.

The 179D deduction has a tiered system of energy-use reductions that are required for the full deduction; it also allows fractional deductions for partial compliance. To be in full compliance, buildings have to reduce the energy and power cost of interior lighting, HVAC and hot-water systems by 50% or more.

According to Jameson Hartman, VP at Real Estate Technology Ventures (RET), a proptech investment firm, the expanded 179D tax deduction will spur building owners to make energy-efficiency retrofits they previously deemed too costly.

“Energy upgrades cost more for retrofit properties because they require working around existing infrastructure,” Hartman told GlobeSt.com. “Because the incentive boost now tips the scale in terms of justifying the costs of the retrofit, we’ll likely see a relatively large uptick in owners committing to make those sorts of renovations.”

The IRA specifies that architects, engineers and design-build contractors of tax-exempt buildings owned by private schools and universities, religious organizations, non-profits, charitable organizations, private foundations, political organizations and Native American tribal governments now are eligible to receive the expanded 179D deduction.

Park City, UT-based RET specializes in multifamily and single-family rental properties. The early-stage venture capital fund has more than 40 strategic investors who own or operate $600B AUM encompassing more than 2.4M rental units, according to the company’s website.

Hartman says RET expects the IRA to fuel the growth of new building technologies and proptech platforms.

“We should see substantial growth of technologies and platforms that fall under the energy efficiency landscape, including investments in solutions that improve a building's envelope, HVAC systems and interior lighting systems," Hartman said.

"This bill is likely a tipping point for envelope solutions—roof, floors, walls, etc.—utilizing new material improvements that were too costly before," he added. "Developers can now test out these solutions and see substantial savings."

Hartman said a new insulation technology, including materials and structural redesigns could result in $500K in additional deductions for a 300+ SF property. Improvements also might include energy-efficient glass that reduces heat absorption within the property, he said.

Hartman cited a platform offered by Parity Go, a proptech startup based in Toronto, which evaluates properties with central systems and retrofits them with I0T sensors that automatically adjusts building lighting and HVAC based on a range on monitored values, including outside weather, open doors, occupancy and mechanical efficiency.

Parity Go says it can reduce energy consumption in a building by 30% without sacrificing tenant comfort.

The IRA requires certification by a "qualified individual" that energy consumption in a building has been reduced 50% compared with the minimum industry standard. Hartman said he expects the news law to generate a boom in platform partners that offer certification services to contractors and development partners.

The IRA also increases the value of 45Q tax credits for carbon capture and sequestration projects, extending the credit to cover any carbon capture, direct air capture or carbon utilization project that begins construction before January 1, 2033.

The IRA, which includes massive new spending on climate-change initiatives, aiming to reduce US carbon emissions by 40% from 2005 levels by 2030.