Energy Consumption and the Durable Building Stock: The Capital Vintage Paradox

Matthew E. Kahn
University of California,
Los Angeles and NBER
mkahn@ioe.ucla.edu

Nils Kok
Maastricht University
Netherlands
n.kok@maastrichtuniversity.nl

John M. Quigley
University of California
Berkeley, CA

May 4, 2013

Abstract

The durable building stock plays a key role in determining the urban sustainability of a metropolitan area. While the residential sector has been the primary focus of energy policies, commercial buildings are now responsible for most of the durable building stock's total electricity consumption. This paper exploits a unique panel of commercial buildings to document that electricity consumption and building quality are complements, not substitutes. Technological progress may reduce the energy demand from heating, cooling and ventilation, but the behavioral response of building tenants and the large-scale adoption of appliances more than offset these savings, leading to *increases* in energy consumption in more recently constructed, more efficient structures. This implies that there is an exacerbated externality associated with the rising quality of the durable building stock.

JEL Codes: Q40, Q56, R33
Keywords: energy efficiency, durable capital, technology, human capital, carbon mitigation

Kahn thanks the UCLA Ziman Center for Real Estate for generous funding. Kok is supported by a VENI grant from the Dutch Science Foundation (NWO). We are grateful to Eric Karlson for help in assembling, interpreting, and verifying the data used in this analysis. We thank Jan Bruecker, Richard Green and participants at seminars at the University of Michigan, Ann Arbor, the University of California, Los Angeles, the 2013 AEA meetings and the Homer Hoyt Institute for useful comments. We mourn the passing of John M. Quigley in May 2012. John was a great scholar, colleague and friend, and he was actively involved in crafting this project. We hope that the resulting paper lives up to his expectations.

I. Introduction

Economic research investigating urban greenhouse gas production has mainly focused on the transportation sector's consumption of gasoline, the residential sector's energy consumption, and the power generation sector's carbon emissions (Edward L. Glaeser and Matthew E. Kahn, 2010, Koichiro Ito, 2012, Matthew J. Kotchen and Erin T. Mansur, 2012). But in the service economy, most work activity takes place in commercial buildings and a significant amount of shopping activity occurs in the commercial sector's structures. The commercial sector is thus a major user of natural resources, consuming about 19 percent of total U.S. energy use in 2011.[1]

The durable building stock's share of electricity consumption has been rising over time. As Figure 1A illustrates, the fraction of electricity consumed in residential and commercial buildings in the U.S. has increased from a total of about 52 percent in 1960 (29 percent residential and 23 percent commercial) to about 75 percent in 2010. For comparison, in California the fraction of electricity consumed in buildings has increased from about 65 percent to 81 percent during the same period – the commercial sector currently consumes about a third more than the residential sector in California.

Given that 46 percent of the nation's electricity is generated using coal and 20 percent using natural gas, there is a significant greenhouse gas externality associated with electricity consumption.[2] In the absence of carbon pricing, rising electricity consumption exacerbates the risk of severe climate change. Despite the importance of the commercial property sector as a major consumer of electricity, we know very little about the

[1] See http://www.eia.gov/totalenergy/data/annual/pdf/sec2_6.pdf.

[2] See http://www.eia.gov/totalenergy/data/annual/showtext.cfm?t=ptb0201f.

[3] This contrasts with a large body of literature on energy consumption in residential dwellings, covering, for

environmental performance of its buildings. Lack of access to good data has limited our knowledge of the core facts – for instance, the most comprehensive source of data, the Department of Energy's Commercial Buildings Energy Consumption Survey (CBECS), was last released in 2003; this nationally representative data set offers cross-sectional information on the energy consumption of just 5,000 buildings. There is a small body of research about commercial building energy consumption, mostly conducted by engineers, exploring either macro trends or analyzing small samples of buildings (see Erick Hirst and Jerry Jackson, 1977, for an early analysis).[3]

In this paper, we exploit access to a unique dataset to study the electricity consumption of a large sample of commercial buildings located in a Western electric utility's district. By merging the utility's data on monthly electricity consumption at the building level with detailed information on building characteristics, occupants and macro-economic trends, our data set allows us to track individual buildings' electricity consumption over the past decade. We study commercial building electricity consumption dynamics and the environmental performance of different types of commercial buildings, using the panel data set to test several hypotheses related to how different buildings' respond to changes in outdoor temperature and macro economic shocks. Given that our data set covers the years during the recent great recession, we investigate what types of buildings are most responsive to spikes in the unemployment rate. Importantly, we test how the electricity consumption/temperature gradient differs across buildings.

[3] This contrasts a large body of literature on energy consumption in residential dwellings, covering, for example, the determinants of household electricity consumption (Dirk Brounen et al., 2012, Dora L. Costa and Matthew E. Kahn, 2011) and the price-elasticity of residential energy demand (Peter C. Reiss and Matthew W. White, 2005, 2008).

By estimating separately the temperature response curves based on building type, vintage, and building quality, we document evidence that tenants in newer buildings and tenants in higher quality buildings consume *more* electricity on hotter days than cooler days. This finding implies that peak demand will increase with the rejuvenation of the commercial building stock, exacerbating the impact of climate change on electricity consumption. Using data on the leasing arrangements of space within the buildings, we document that tenants who face a zero marginal cost of energy consume relatively more electricity on hotter days. We interpret this as evidence of how technological progress in building quality is partly offset by the ability to more cheaply achieve ambient comfort, which may indicate a "rebound effect" for commercial buildings (Lorna Greening et al., 2000). This evidence builds on recent work examining how energy consumption responds to energy efficiency progress in other areas. For example, Kurt Van Dender and Kenneth A. Small (2007) study the case of vehicle fuel economy, and Lucas W. Davis (2008) examines the case of clothes washers.

Using the cross-section of the data, we then explore whether new vintages of commercial buildings achieve higher steady-state energy efficiency than observationally similar, older vintages of commercial buildings. Commercial buildings are differentiated products. Energy efficiency is just one indicator of building quality. Other quality dimensions such as providing good lighting, elevator service, aesthetic appeal and ambient comfort may require using more electricity. In the case of trends in automobile characteristics, Christopher R. Knittel (2012) documents that manufacturers have created a new generation of larger vehicles offering more safety and comfort. The vehicle fuel economy of this generation of cars would have been much higher had manufacturers not shifted the attributes bundled into new vehicles. In line with these findings, our results show that the higher quality of newer vintages of commercial buildings actually *increases* the sector's electricity consumption, even though these newer vintages of the building stock are subject to more stringent regulatory building codes.

We also explore the role that tenant behavior and tenant incentives play in determining a building's environmental performance, and we examine the impact of management quality on energy consumption by addressing the effect of on-site human capital (*i.e.*, the presence of an engineer). We document that that tenants whose utilities are bundled into the rent consume more electricity than observationally identical tenants who pay their own bills − similar to findings for residential housing (Arik Levinson and Scott Niemann, 2004). We find that buildings where tenants face a zero marginal cost of energy are more likely to have a building engineer on-site, and more importantly, those buildings have significantly lower electricity consumption as compared to buildings without an engineer. Management quality affects commercial building energy consumption (Nicholas Bloom et al., 2011).

The results in this paper contribute to a growing literature on the environmental performance of the durable building stock, which is primarily focused on the residential sector. For example, Grant D. Jacobsen and Matthew J. Kotchen (2013) document small but significant impacts of changes in building codes on the efficiency of residential dwellings in Florida, whereas Howard Chong (2012) investigates changes in residential energy consumption in response to temperature shocks, finding that new buildings use *more* energy in hot weather. Hunt Allcott (2011) explicitly addresses occupant behavior, documenting that residential customers reduce their electricity consumption when receiving peer comparisons that show how their consumption compares relative to their geographic neighbors.

In the case of commercial real estate, it has been documented that tenants and owners seek to minimize their expected present value of electricity costs, making a tradeoff between upfront durable investments versus operating costs during the occupancy (Piet M.A. Eichholtz et al., 2013). However, it has been unclear to what extend the behavior of commercial building occupants is affected by the pricing incentives they face for electricity consumption, and evidence on the environmental performance of the commercial building sector is scant.

The remainder of this paper is organized as follows: Section II describes the empirical framework and the econometric models. Section III discusses the data, which represent a unique combination of building-level electricity consumption with detailed information on the characteristics and occupants of those buildings. Sections IV and V provide the main results, conclusions, and policy implications of the findings.

II. Empirical Framework

Consider the determinants of a commercial building's electricity consumption at a point in time. The building's square footage and architecture will surely influence its current consumption. Once the building is in operation, its electricity consumption will be a function of core building energy consumption (from the requirements to heat, cool and ventilate the building) and consumption from (unobserved) appliances installed and used by the building occupants. For those buildings that attract tenants who tend to use significant amounts of electricity, such as banks with trading floors and manufacturing companies with energy-intensive equipment, the overall electricity consumption will be higher.

According to national benchmarks for building consumption (*i.e.*, DOE's CBECS data base), heating, cooling, lighting and office equipment account for most of the electricity consumption in buildings, but these estimates are of course heavily dependent on climatic conditions. Figure 2 shows that the heating, ventilation and air-conditioning systems (HVAC) alone account for about 65 percent of energy consumption in commercial buildings. Our sample of commercial buildings from California shows larger expenditures on lighting, about 30 percent, and smaller expenditures on HVAC (also about 30 percent) than the nation-wide averages.

People who work in commercial buildings will seek to be comfortable inside regardless of outdoor climatic conditions. For those buildings that have highly efficient air-conditioning systems, it is unclear how hot summer temperatures affect their electricity consumption. The "price" of summer temperature comfort is lower in buildings that are newer, as these tend to have more recent, efficient HVAC systems. Facing such an incentive, on hot days, tenants in new buildings may set their thermostat lower than tenants who know that their building has an energy inefficient HVAC system. This behavioral response is consistent with a "rebound effect," such that more energy efficient technology is used more due to the substitution effect.[4] The size of this behavioral response hinges on the disutility of working in a hot office building, the energy efficiency of the building's HVAC system and the pricing scheme for whether tenants pay for marginal increases in electricity consumption.

[4] Another possible hypothesis is that new commercial buildings often do not have windows that open, so all cooling and heating comes from the heating and cooling system. Some of the older commercial buildings have windows that open, so they can delay using air-conditioning in the early part of summer and stop using air-conditioning earlier at the end of summer.

Lease contracts identify how the payments for operating expenses (including, but not limited to, energy consumption) are to be allocated between the landlord and the tenants. Lease contracts for commercial buildings commonly take one of three main formats: full service leases, net leases, and modified gross leases. Under a full service lease, the tenant makes one payment that covers both space rent and operating expenses. The individual components are typically not identified. Under a net lease (often referred to as a "triple net" lease), the tenant pays separately for space rent and the tenant's actual or allocated share of the specified operating expenses. Under a modified gross lease, contracts specify a payment for the space rent and require an actual amount to be paid for operating expenses in the first year. For later years, the landlord provides an audit of building expenses, and the tenants pays a prorated share of the realized percentage increase in the building expenses. So, modified gross leases and net leases share the feature that the tenant pays a share of the building's operating expenses, but on modified gross leases the tenant pays a prorated share of the building's total expenses, which are thus are independent of the tenant's actual energy usage. (See Dwight Jaffee et al., 2012, for a discussion.) We test hypotheses about the role of incentives provided by studying the effect on the elasticity of electricity consumption in response to temperature shocks for tenants who pay their own electricity bills versus another set who face a zero marginal cost for consuming electricity.[5]

[5] We assume lease contracting is exogenous and thus uncorrelated with unobserved determinants of electricity consumption. Data access has limited research examining how contractual form affects economic performance. Eric D. Gould et al. (2005) use a unique dataset of mall tenant contracts and show that rental contracts are written to: efficiently price the net externality of each store, and align the incentives to induce optimal effort by the developer and each mall store according to the externality of each store's effort. Arik Levinson and Scott Niemann (2004) document for a sample of residential homes that market rents for full service, utility-included apartments are higher than for otherwise similar metered apartments. This difference is smaller than the cost of the energy used, which indicates that landlords value the contractual arrangement more than the potential additional energy consumption. There is no evidence on

Achieving efficient use of electricity requires certain human capital and expertise. If experts are paid a market wage, then it is unlikely that smaller commercial buildings will employ human capital, because the expected present value of reduced electricity bills is likely to be low. Employing a building manager is expected to deliver significant electricity consumption reductions. Nicholas Bloom et al., (2011) document using a survey of UK managers that manufacturing plants have a lower energy intensity (energy consumption per dollar of value added) at plants featuring more skilled managers. We conjecture that a similar effect plays out for commercial real estate, where the presence of an on-site building manager or engineer might have an effect on how efficiently a property is operated and maintained – especially in those buildings where tenants face a zero marginal cost of energy consumption.

Finally, by calendar year and month, macro conditions will also affect consumption, for example through economic conditions. During a recession, a commercial building's occupancy rate will decline and this will cause a reduction in electricity consumption.

To explain the longitudinal and cross-sectional variation in commercial building energy consumption, we estimate the following models:

(1) $$\ln\left(E_{it}\right) = \beta TEMP_t + \gamma OCC_{it} + \delta EMPL_i + \alpha_i + \beta_y + \tau_m + \varepsilon_{it}$$

(2) $$\ln\left(E_i\right) = \beta X_i + \gamma TENANT_i + \varepsilon_i$$

In equation (1) we estimate a time-series model with building-fixed effects, in which the dependent variable is the logarithm of the average daily electricity

contract form related to tenant energy consumption in the commercial building sector and we assume that profit-maximizing landlords only offer utility-included leases if the expected energy consumption of tenants is lower than the marginal revenue of such a contract.

consumption per square foot in month t (in kilowatt hours) for building i. $TEMP_t$ is a vector of temperature dummies capturing the non-linear relation between outside temperature and building energy consumption, OCC_{it} is the occupancy rate in building i in month t, and $EMPL_i$ is the local unemployment rate (reflecting the business cycle). α_i is a variable capturing building-fixed effects, controlling for the time-invariant characteristics of each property i. β_y are year-fixed effects and τ_m are month-fixed effects, both controlling for unobservable shocks to electricity consumption common to each building i. ε_{it} is an error term, assumed i.i.d.

In equation (2), we estimate a cross-sectional model, with X_i as a vector of the structural characteristics of building i, including building size, vintage, and quality. To control for the impact of occupants on building energy consumption, we also include $TENANT_i$, a variable measuring the percentage of the building that is occupied by each industry, based on the SIC classification. ε_i is again an error term, assumed i.i.d.

While this paper investigates electricity consumption, we do not attempt to estimate a demand curve for commercial electricity. Our data comes from an electric utility whose pricing tiers feature little variation or increases from peak to off-peak. To control for average price variation over the course of the year, we include month-fixed effects.[6]

In studying each of these factors, we use our unique data set that we describe below. Despite the large number of variables that we can access, we recognize that there will be unobserved determinants of building electricity consumption. In estimating equation (1) using a fixed-effects regression, and estimating equation (2) using OLS, we

[6] Ito (2012) documents that residential electricity consumers are more responsive to average prices than marginal prices, estimating a price elasticity of roughly -0.05.

are assuming that the error term is not correlated with the explanatory variables. We will return to this point below after the discussion of the data.

III. Data

Through a research partnership with a Western electric utility, we access monthly electricity consumption for more than 50,000 commercial accounts within the service area. We focus on the subset of buildings that we can match to the buildings identified in the archives maintained by the CoStar Group. The CoStar service and the data files maintained by CoStar are advertised as "the most complete source of commercial real estate information in the U.S,"[7] and has been used extensively in academic studies on the commercial property sector (see for example Piet M.A. Eichholtz et al., 2010). Spanning the years 2000 to 2010, our match yielded 38,906 accounts in 3,521 buildings for which information on occupants, lease contracts and building characteristics could be identified in CoStar. Our sample represents the population of transacted buildings (in either a lease or a sale) over the years 2000 to 2010.[8] The building types in the sample include "Office," "Flex," "Industrial," and "Retail" properties. In this study, we do not consider multi-family residential buildings.

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[7] The CoStar Group maintains an extensive micro database of approximately 2.4 million U.S. commercial properties, their locations, and hedonic characteristics, as well as the current tenancy and rental terms for the buildings. Of these 2.4 million commercial buildings, approximately 17 percent are offices, 22 percent are industrial properties, 34 percent is retail, 11 percent is land, and 12 percent is multifamily. A separate file is maintained of the recent sales of commercial buildings.

[8] One reader noted that this might lead to selection bias, as the thermal quality of owner-occupied properties may differ from "investment" properties. But the direction of the bias is not obvious: owner-occupiers may have a longer holding period, allowing for investments in building retrofits and more energy-efficient equipment, without the requirement of short "payback periods," which is often quoted as a barrier to energy-efficiency upgrades. However, one could also argue that professional property investors are more rational agents when it comes to trading off large upfront investments with savings realized over a longer time period. And well-capitalized institutional property investors may suffer less from liquidity constraints as compared to smaller, private real estate investors and owner-occupiers.

Information on monthly electricity use is available on both consumption and expenditures, including information on the start date of each billing cycle. To account for variation in billing cycles, we transform electricity consumption and expenditures into daily data, by dividing the billing cycle totals by the number of days in the cycle. If data are available for multiple accounts within a single building (there are about three accounts per building, on average), we aggregate the daily energy consumption at the building level.

Data on local daily weather conditions is collected from the National Oceanic and Atmospheric Administration's (NOAA) Climatic Data Center. We calculate the average maximum daily temperature during the billing cycle for each building, averaging across accounts if there are multiple accounts within a single building.[9]

Information on building occupants is gathered from the CoStar Tenant module. For each building in the sample, we collect data on the floor space occupied and the identity of the tenants. The industry of each tenant is classified by a four-digit SIC code, and we aggregate the fraction of floor space occupied into thirteen groups.[10] We include the percentage of space occupied by each industry in model (2).

Table I presents a description of the four types of commercial buildings in our sample (for 2009). Average energy usage varies from about 11,000 kWh per month for industrial buildings to three times that for office buildings. Our sample includes some centrally located, high-rise, and high quality ("Class A") properties, but on average the

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[9] Presumably, commercial properties are occupied mostly throughout the day, so it is the maximum daily temperature that matters for energy consumption, not the average daily temperature. A robustness check using the average daily temperature does not yield significantly different results (results available from the authors upon request).

[10] The thirteen groups are defined in line with the U.S. Department of Labor SIC guide, and include: Agriculture & Mining; Construction; Manufacturing; Transportation; Communication; Utilities; Distribution; Retail; Financial; Services; Non-Profits; Professional Services; and Government.

distance to the city center is some twelve kilometers; the majority of properties are low-rise (about two stories) and fall into quality categories "B" and "C."[11]

The vintage of properties in the sample is fairly young (some 27 years, on average) as compared to the residential building stock – Dora L. Costa and Matthew E. Kahn (2011) report for the same geography that about fifty percent of the residential dwellings were constructed before 1970.

IV. Results

A. Electricity Consumption Dynamics

In this section, we exploit our building panel dataset from 2000 to 2010 to study the role of dynamic factors in determining a building's electricity consumption, *i.e.*, how a building's electricity consumption varies as a function of climatic conditions (the average daily maximum outdoor temperature during the billing cycle) and the business cycle (the occupancy rate and the unemployment rate). We are especially interested in the interaction between these variables and building observable attributes such as building type, vintage, building quality and lease structure. To test for these effects, we estimate stratified regressions, highlighting that our empirical approach is not merely a mechanical engineering exercise, but instead represents a reduced-form relationship capturing choices made by self-interested economic decisions makers. For example, if a building features many tenants who face a zero marginal cost for electricity then we expect that electricity consumption will be more sensitive to temperature spikes.

[11] The Building Owners and Managers Association (BOMA) groups commercial properties into three classes: Class A, Class B, or Class C. These classes represent a subjective quality rating of buildings which indicates the competitive ability of each building to attract similar types of tenants. Factors determining the building quality include: rent, building finishes, system standards and efficiency, building amenities, location/accessibility and market perception. See also http://www.boma.org/Resources/classifications/.

We estimate model (1) for all buildings, and then for each property type separately. In each of the five regressions reported in Table II, we include building-fixed effects, and month and year-fixed effects.

We document a concave relationship between a building's occupancy rate and its electricity consumption – buildings that are partially occupied need to be heated or cooled as well, and there seems to be limited flexibility in "switching on or off" parts of a building. (In an ideal "smart building," the cooling and lighting is such that areas that are not occupied are not receiving such services. In such a building, electricity consumption will be very low when occupancy rates are low.) Beyond affecting occupancy rates, increases in local unemployment are associated with a reduction in commercial electricity consumption. A one percent increase in the unemployment rate decreases commercial building electricity consumption by about two percent.[12] This may reflect the lower use-intensity of space (for instance, corporations having reduced presence of employees in the space they occupy).

Columns (2) to (5) present the results stratified by building type. The regression coefficients indicate that industrial real estate seems to be the most responsive to building occupancy (the slope of the occupancy-electricity consumption curve is least concave). Office buildings are least responsive. Presumably, energy consumption in office buildings is for the largest part determined by whole building heating, cooling and ventilation.

[12] The Federal Highway Administration has documented that total miles driven decreased as the 2008 recession took place (http://research.stlouisfed.org/fred2/series/M12MTVUSM227NFWA?rid=254). Our results complement this work and highlight the aggregate energy consumption consequences of business cycles.

In Table II, we also report the coefficient for a dummy variable that equals one if the building has recently sold. For the full sample, electricity consumption increases by four percent when buildings are transacted. We believe that this variable embodies two offsetting factors. A new owner is likely to make investments to raise the quality of the building. Such investments, including a more efficient HVAC system and more efficient lighting, could make the building more energy efficient. Conversely, improvements in quality that result in better HVAC and lighting systems may induce greater use.

We plot the coefficients on the temperature-fixed effects in Figure 3, estimating separately the temperature response curves based on building type, vintage, quality, and lease structure.[13] Controlling for occupancy, electricity consumption is higher during those months when it is very hot. The differentials are quite large: for office buildings, monthly consumption is 35 percent higher when the temperature is 97F, on average (the ninety-ninth percentile), relative to when the temperature is 65F. For industrial buildings this differential is less pronounced – the energy consumption is 23 percent higher at the ninety-ninth percentile.

Figures 3B and 3C plot the temperature response curves based on building quality and vintage (coefficients are presented in Appendix Table A1). Buildings of higher quality and those that were constructed more recently are more responsive to temperature shocks – controlling for occupancy and unemployment and including building-fixed effects. This finding is consistent with a rebound effect in cooling buildings. If the cost of cooling is lower due to more efficient equipment, a behavioral response may result in new buildings consuming *more* electricity consumption on hot days than older buildings.

[13] Following Anin Aroonruengsawat and Maximilian Auffhammer (2011), we split the temperature distribution into deciles, further decomposing the upper and bottom decile into the first, fifth, ninety-fifth and ninety-ninth percentile.

These findings are also in line with recent evidence on changes in electricity consumption of residential dwellings in response to temperature shocks. Howard Chong (2012) finds for a large sample of homes in Southern California that more recently constructed homes exhibit significantly higher energy consumption during periods of peak temperatures.

Figure 3D shows how variations in temperature affect commercial building electricity consumption in buildings with different lease structures. In buildings with triple-net leases, tenants are directly responsible for energy costs, whereas in buildings with full service lease contracts, tenants pay a lump sum for total housing costs, including energy and other service costs. The curves show that for buildings where tenants face a zero marginal cost for energy consumption, the response to increases in outside temperature starts at lower temperatures and increases more rapidly. One explanation for this finding may be that the indoor thermostat is set at a lower, more comfortable temperature when tenants do not face a marginal cost for energy consumption.

B. Cross-Sectional Variation in Commercial Building Electricity Consumption

In this section, we report estimates of equation (2). These cross-sectional regressions are informative about the association between building attributes, contract incentives, and management human capital. Any cross-sectional energy regression is subject to the criticism that the unobserved determinants of building electricity consumption are correlated with the observed explanatory variables. Our econometric model reported in equation (2) includes a rich set of covariates including indicators for the share of building tenants from 13 different industrial categories.

We recognize a potential concern is that commercial tenants with higher demand for electricity may self select and locate in the most energy efficient buildings. Given that we control for tenant industrial categories, such an argument would have to posit that there is within-industry heterogeneity of tenant energy intensity, and that potential tenants know their type and can distinguish between different building's energy efficiency even though they may have never visited the building. Consider a case in which the commercial real estate pricing gradient is such that more energy efficient buildings and buildings offering a full service lease contract command a price premium. In this case, the most energy intensive tenants in an industry will self-select and choose to locate in the most energy efficient buildings or in buildings for which electricity bills are bundled into the rent.[14]

In Table III, we provide the results from estimating equation (2) using monthly data from calendar year 2009 to explain commercial buildings' electricity consumption. We include month-fixed effects to capture monthly variations in temperature and to account for the peak and off-peak pricing schedule at the utility. We first address how the structural attributes of commercial properties correlate with electricity consumption. Large buildings consume less electricity per square foot. The coefficient on building size indicates that there are economies of scale in heating and cooling buildings, although the squared-term shows that very large buildings behave differently than their smaller counterparts. Presumably, heating and cooling of large structures requires additional

[14] Our information on the distribution of industries across buildings provides some insight into the extent of tenant sorting based on building quality, energy efficiency, and lease contract structure. Appendix Table A2 provides some descriptive statistics on the average percentage of each of the fourteen of industries in our sample of commercial buildings. Although the industry averages mask the underlying heterogeneity in the energy intensity of individual tenants, these simple statistics give some insight into the sorting of tenant types based on observable characteristics. Panel A shows that government tenants are present in some four percent of the commercial office buildings in our sample. Government tenants, as well as financial services, are clustered into higher quality, Class A buildings. Panel B provides more insight into the sorting of tenants based on the energy efficiency characteristics and lease contract type of commercial office buildings. Tenants in the data processing industry are more prevalent in less efficient, non-Energy-Star rated buildings, whereas government tenants and the professional service sector seem to sort into more efficient buildings. Tenants from these industries are also more likely to be present in buildings with full-service lease contracts.

equipment to bridge large vertical distances, offsetting otherwise beneficial economies of scale.

Importantly, we document that newer buildings consume more electricity than older vintages. Buildings constructed before 1960 are slightly less efficient than those constructed during the 1960-1970 period, but buildings that are 40 years or younger consume consistently more electricity than old buildings.[15] These findings contrast with results examining vintage effects for residential housing in the same California county, documenting increased energy efficiency for the most recent vintages (Dora L. Costa and Matthew E. Kahn, 2011). The vintage effect has taken place during a time of declining electricity prices. During the 1960-2010 period, for tenants in commercial buildings, average real electricity prices decreased by fourteen percent.[16]

We note that the electricity consumption of commercial buildings constructed recently (with a vintage less than ten years) is slightly lower as compared to those properties constructed more than ten years ago. (Some have asserted that the recent improvement in energy use intensity is a result of strict legislation, e.g., California's Title 24 building energy efficiency program, but we cannot statistically assess these claims.)

Like vintage, renovation and building quality have a distinct effect on commercial building energy consumption. Renovated buildings feature 27 percent higher electricity consumption than similarly sized buildings. "Class A" real estate consumes some fifteen percent more electricity than "Class C" real estate.

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[15] We recognize that at any point in time year built and building age are collinear. We have exploited the panel nature of our 2000 to 2010 data to test for aging effects. In results available on request, we have estimated versions of equation (1) in which we include building fixed effects and an age of building variable. The age coefficient is 0.027 and is statistically insignificant with a *t*-statistic of 0.53. This finding raises our confidence that the year built coefficients we report represent vintage effects rather than a convolution of vintage and aging effects.

[16] Energy Information Agency. Annual Energy Review 2010. See http://205.254.135.24/totalenergy/data/annual/pdf/aer.pdf.

The findings on building vintage and building quality are consistent with the hypothesis that electricity consumption and building quality are complements, not substitutes. Technological progress may reduce the energy demand from heating, cooling and ventilating the base building, but the increase in appliances and quality attributes (*e.g.*, a nicer lobby, more elevators, the ability of tenants to independently adapt comfort temperature, etc.) actually *increases* energy consumption. This is comparable to recent work on automobiles, which has documented that technological progress in fuel economy has been partially offset by the increase in vehicle weight and engine power (Christopher R. Knittel, 2012).

In Columns (3) and (4), we exploit the rich set of observables in the CoStar database to explore in more detail the role that building occupants, lease structures and human capital play in determining electricity consumption. In column (3), we add a vector of lease contract attributes to the model. The results show that contracting matters for energy consumption: the variable indicating the presence of a triple net lease has a negative coefficient of about 20 percent.[17] This finding is consistent with our hypothesis that tenants facing marginal costs for energy consumption have an incentive to conserve. For occupants with full service rental contracts, energy consumption is significantly higher as compared to occupants with a "modified gross" rental contract, which confirms that energy conservation is negatively affected if tenants do not face the marginal cost of additional consumption.

To control for the heterogeneity of energy-use intensity across industries, we include the tenant composition in each building in all models. Our interest is primarily in

[17] Again, our findings are based on the assumption that lease contract terms are exogenous. If energy-intensive tenants sort into buildings where they face zero marginal cost for electricity consumption, our results reflect a combination of selection and treatment effects, rather than treatment effects alone.

the behavior of government tenants and the efficiency of the buildings of this specific tenant group. If government tenants have "soft budget constraints," then we predict that such tenants should consume more electricity as they can pass on the costs to taxpayers (Janos Kornai et al., 2003). As shown in column (4) of Table III, the variable measuring the fraction of a building occupied by a government tenant dummy is positive. If a building is fully occupied by a government tenant, the energy consumption in that building is about 60 percent higher as compared to a building with commercial tenants. This result is obtained when controlled for building quality, but of course, building maintenance and the quality of equipment and appliances cannot be observed in our dataset.

In column (4), we include a variable measuring the presence of on-site building management. Presumably, human capital is important in building energy efficiency optimization, and having an engineer on-site should be related negatively to commercial building energy consumption. Especially for buildings with a full-service lease structure, owners should be aware of the adverse incentive effects and they should have a greater incentive to invest in costly building management to increase energy efficiency. On-site management is present for some 17 percent of full-service buildings, whereas on-site management is present for just two percent of triple-net buildings.[18] The coefficient for "On-Site Management" shows that building management has a positive effect on commercial building energy efficiency, reducing energy consumption by some 7-8 percent – this finding is in line with the impact of management quality at corporations on

[18] A *t*-test shows that the difference between these means is statistically significant from zero at the 1-percent level.

the energy intensity of manufacturing plants, as documented by Nicholas Bloom et al. (2011).

V. Conclusion

The durable commercial building stock in the United States is a major consumer of electricity. The Energy Information Agency predicts that between the years 2005 and 2030, residential electricity consumption will increase by 39 percent, industrial consumption will increase by 17 percent, and commercial electricity consumption will increase by 63 percent.[19] In the absence of a carbon tax, such increased consumption will have significant greenhouse gas externality consequences because a large share of electricity is generated using fossil fuels such as coal and natural gas.

An ongoing policy agenda seeks to identify cost-effective climate change mitigation and adaptation strategies (Kai A. Konrad and Marcel Thun, 2012, Nicholas Stern, 2008). Our work highlights the importance of focusing on the commercial building stock. In the developing world, a massive capital investment in new commercial buildings is currently taking place. The choices made today (in the absence of a carbon tax) will have consequences for decades.

It is surprising how little we know about commercial building electricity consumption. To fill this void, we partnered with a major Western electric utility and merged information on electricity consumption at the building level with detailed physical attributes of the building. Using panel data on each building's monthly

[19] See page 82 of the U.S. Energy Information Administration's *Annual Energy Outlook 2007 With Projections to 2030*. ftp://tonto.eia.doe.gov/forecasting/0383(2007).pdf

electricity consumption, we test a number of hypotheses seeking to investigate the time series and cross-sectional determinants of electricity consumption.

We document that, since 1970, there is an inverse relation between building vintage (and quality) and electricity consumption. This finding stands in contrast with evidence on energy consumption trends for residential structures. Moreover, newer, high-quality building respond faster to changes in outdoor temperature, leading to increased energy consumption. In commercial buildings with more efficient heating, cooling and ventilation systems, the behavioral response of building tenants may lead to more intensive use of such equipment, as the marginal price of "comfort" is lower – a "rebound" effect for commercial buildings.

Our finding of a positive correlation between commercial building quality and electricity consumption means that the commercial's share of total electricity consumption is likely to rise over time both due to a declining residential share and rising commercial consumption. Unlike with cars, the scrappage of older buildings will actually increase electricity consumption, as they will be replaced with higher quality buildings. The results also imply that peak demand of the commercial building sector will increase as new buildings are added, and the existing stock is improved through retrofits. Managing peak loads is an important aspect of policies that aim to reduce energy consumption. This suggests that there is an exacerbated externality associated with the rising quality of the durable building stock.

Our results on building management offer a more optimistic message. If human capital, reflected in better building management, yields improved environmental performance in commercial structures, then nudging building owners towards having a well-trained, experienced building management team makes the energy decisions auger well for future improved environmental outcomes.

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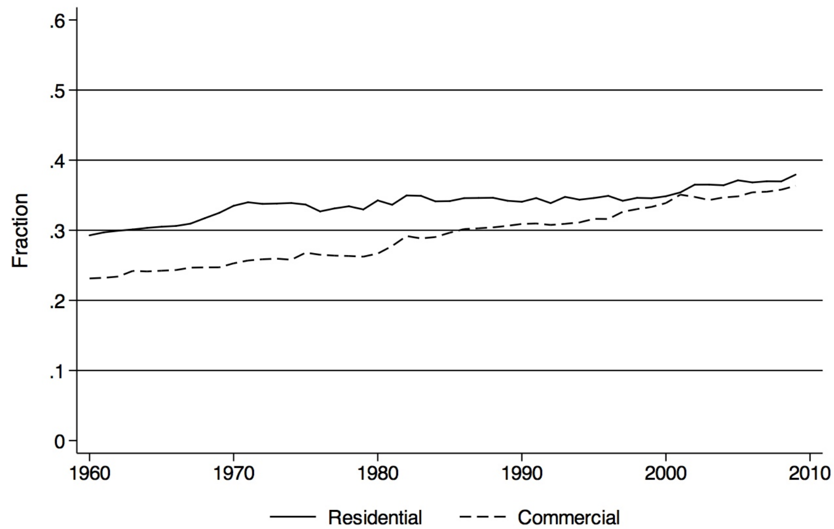
Figure 1
Fraction of Electricity Consumed in Residential and Commercial Buildings
(1960-2009)

A. United States



B. California

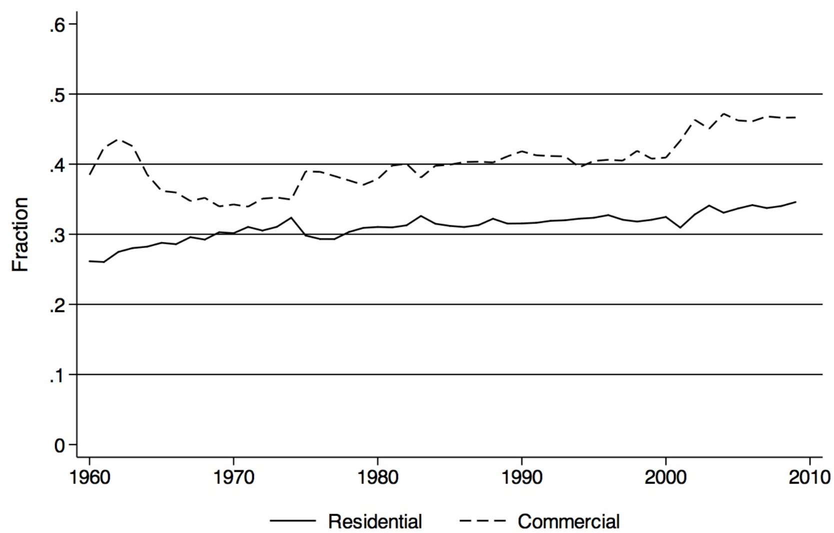


Figure 2
Decomposition of Commercial Building Electricity Consumption

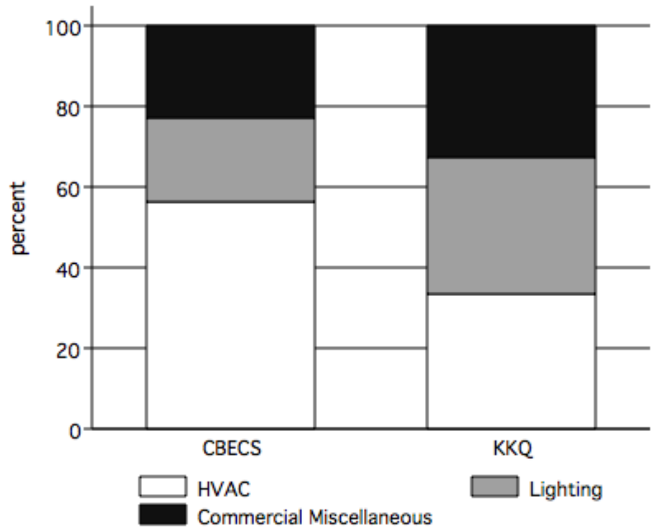
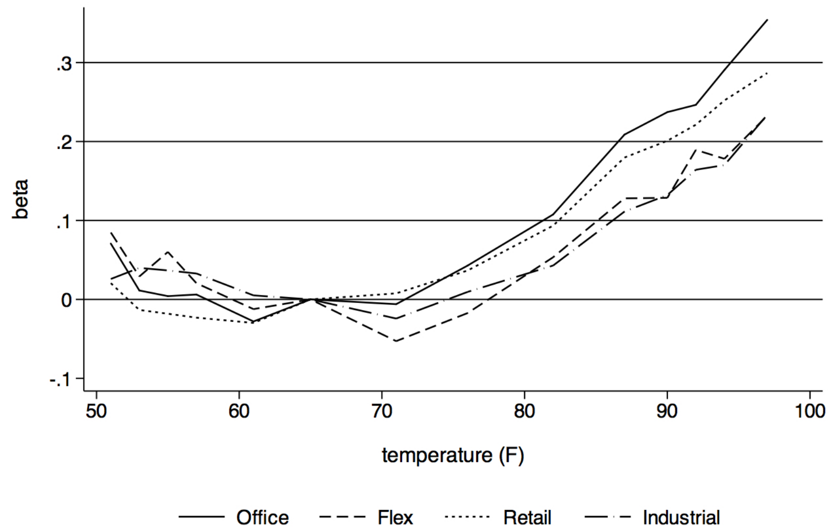
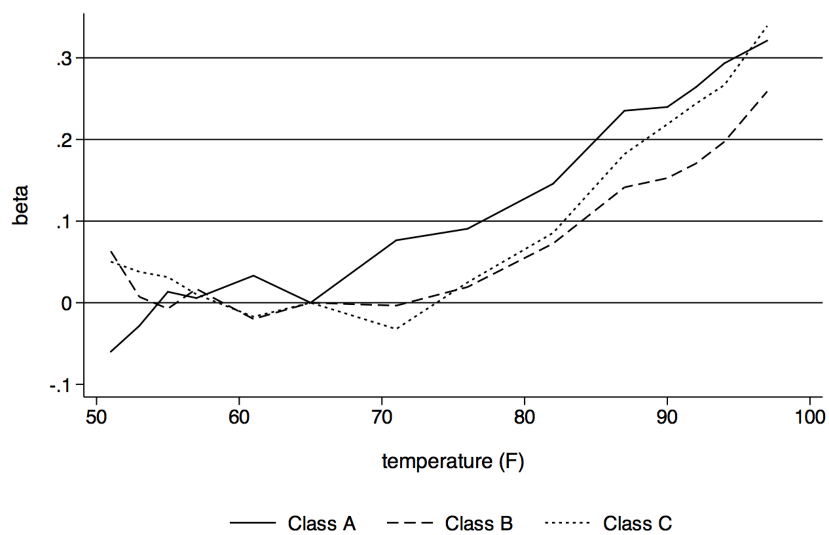


Figure 3
Temperature Response Estimations
(coefficients based on Appendix Table A1)

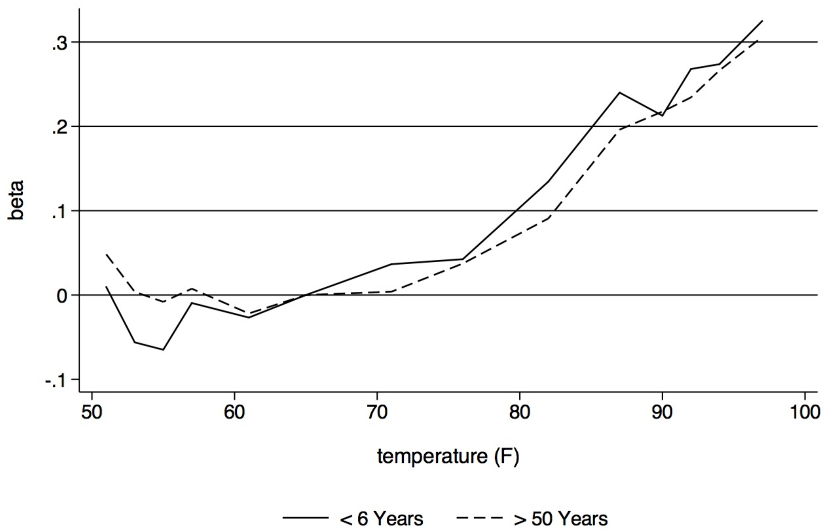
A. Building Type



B. Building Quality



C. Age



D. Lease Contract

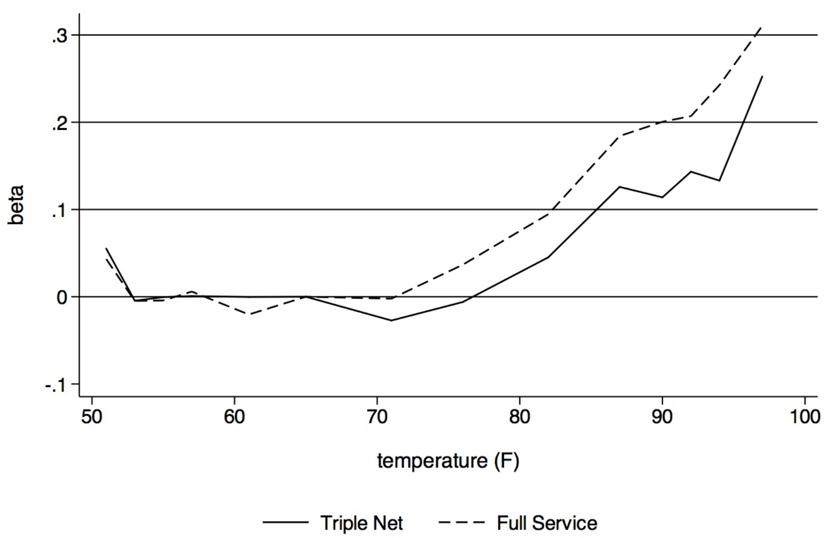


Table I
Commercial Building Energy Consumption
(Office, Flex, Industrial and Retail Properties, 2009)

	Office (n=1,478)		Flex (n=322)		Industrial (n=1,120)		Retail (n=601)	
	Mean	St.Dev.	Mean	St.Dev.	Mean	St.Dev.	Mean	St.Dev.
Energy & Climate								
Daily Expenditures ($)	131.88	(292.02)	95.00	(449.29)	46.24	(99.33)	100.53	(357.43)
Daily Consumption (kWh)	1193.85	(2821.93)	905.13	(5280.95)	383.15	(891.16)	878.96	(3055.12)
Monthly Temperature (F, Maximum)	74.70	(13.60)	74.78	(13.63)	74.75	(13.59)	74.69	(13.58)
Building Characteristics								
Building Size (in thousands of sq.ft.)	27.75	(48.66)	21.88	(19.45)	32.37	(59.82)	16.24	(46.94)
Class A (percent)	6.35	(24.38)	0.00	(0.00)	3.31	(17.88)	-	-
Class B (percent)	39.47	(48.88)	44.78	(49.73)	38.14	(48.57)	-	-
Class C (percent)	54.18	(49.83)	42.47	(49.44)	58.38	(49.30)	-	-
Age (years)	27.42	(20.33)	22.93	(11.88)	24.61	(15.42)	35.63	(25.75)
Renovated (percent)	7.85	(26.90)	2.80	(16.50)	1.43	(11.87)	5.76	(23.30)
Number of Stories	1.90	(2.21)	1.07	(0.26)	1.02	(0.12)	1.16	(0.48)
Distance to CBD (in km)	12.77	(10.01)	12.92	(7.34)	12.75	(7.34)	7.59	(4.73)
Occupancy								
Occupancy Rate (percent)	80.66	(29.73)	73.49	(33.68)	77.86	(34.44)	87.49	(26.70)
Government Tenants (1=yes)	7.85	(26.89)	4.66	(21.09)	1.16	(10.72)	0.31	(5.54)
Space Occupied by Government (percent)	49.09	(36.89)	66.21	(39.37)	-	-	29.02	(13.52)
Rents & Contract Type								
Total Asking Rent ($ per sq.ft.)	20.10	(5.81)	10.40	(3.78)	6.30	(2.65)	19.24	(7.47)
Total Gross Rent ($ per sq.ft.)	21.05	(5.81)	-	-	12.00	(0.00)	22.70	(0.91)
Triple Net (percent)	7.06	(25.61)	37.02	(48.30)	29.63	(45.67)	26.75	(44.27)
Modified Gross (percent)	10.41	(30.54)	16.60	(37.21)	18.27	(38.64)	3.59	(18.60)
Full Service (percent)	34.31	(47.48)	3.17	(17.53)	1.07	(10.30)	1.51	(12.21)
Number of Accounts	3.22	(6.71)	6.10	(8.66)	4.14	(6.08)	5.01	(22.66)

Table II
Time Trends in Commercial Building Energy Consumption
(Dependent Variable: Logarithm of kWh per Square Foot, 2000 – 2010)

	(1) All Buildings	(2) Office	(3) Flex	(4) Industrial	(5) Retail
Occupancy Rate	2.194***	2.310***	1.895***	1.760***	2.465***
(percent)	[0.023]	[0.031]	[0.070]	[0.047]	[0.066]
Occupancy Rate^2	-1.064***	-1.101***	-0.727***	-0.711***	-1.482***
	[0.019]	[0.026]	[0.059]	[0.042]	[0.053]
Unemployment Rate	-0.019***	-0.016***	-0.016	-0.025***	-0.012*
(percent)	[0.003]	[0.004]	[0.010]	[0.006]	[0.007]
Transaction Dummy	0.042***	0.045***	0.022	0.015	0.053***
(1=yes)	[0.005]	[0.007]	[0.018]	[0.011]	[0.012]
Constant	-4.819***	-4.618***	-5.106***	-5.526***	-4.369***
	[0.016]	[0.022]	[0.055]	[0.033]	[0.064]
Temperature-Fixed Effects	Y	Y	Y	Y	Y
Month-Fixed Effects	Y	Y	Y	Y	Y
Year-Fixed Effects	Y	Y	Y	Y	Y
Building-Fixed Effects	Y	Y	Y	Y	Y
Observations	302,186	144,155	21,971	75,078	60,982
R-squared (within)	0.139	0.178	0.215	0.137	0.077
Number of Buildings	2,992	1,439	211	742	600

Standard errors in brackets
*** p<0.01, ** p<0.05, * p<0.1

Table III
Determinants of Commercial Building Energy Consumption
(Dependent Variable: Logarithm of kWh per Square Foot, 2009)

	(1)	(2)	(3)	(4)
Occupancy Rate	2.660***	2.629***	2.230***	2.321***
(percent)	[0.106]	[0.106]	[0.106]	[0.106]
Occupancy Rate^2	-1.403***	-1.361***	-1.009***	-1.127***
(percent)	[0.083]	[0.084]	[0.085]	[0.085]
Building Size	-0.976***	-0.890***	-0.935***	-0.932***
(log)	[0.070]	[0.073]	[0.072]	[0.072]
Building Size^2	0.048***	0.043***	0.044***	0.043***
(log)	[0.004]	[0.004]	[0.004]	[0.004]
Vintage$^{\#}$				
Age < 10 Years	0.120***	0.076***	0.085***	0.086***
(1=yes)	[0.022]	[0.024]	[0.023]	[0.023]
Age 10-20 Years	0.173***	0.155***	0.142***	0.139***
(1=yes)	[0.024]	[0.025]	[0.024]	[0.024]
Age 20-30 Years	0.134***	0.142***	0.119***	0.109***
(1=yes)	[0.020]	[0.020]	[0.020]	[0.020]
Age 30-40 Years	0.001	0.018	0.005	0.004
(1=yes)	[0.023]	[0.023]	[0.023]	[0.022]
Age 40-50 Years	-0.089***	-0.081**	-0.102***	-0.099***
(1=yes)	[0.032]	[0.032]	[0.031]	[0.031]
Renovated	0.212***	0.193***	0.184***	0.168***
(1=yes)	[0.024]	[0.024]	[0.024]	[0.024]
Stories$^{\#\#}$				
2-4		0.238***	0.217***	0.212***
(1=yes)		[0.048]	[0.048]	[0.048]
> 4		0.047***	0.021	0.024
(1=yes)		[0.016]	[0.017]	[0.017]
Building Quality$^{\#\#\#}$				
Class A		0.151***	0.162***	0.166***
(1=yes)		[0.033]	[0.033]	[0.033]
Class B		0.122***	0.127***	0.124***
(1=yes)		[0.015]	[0.015]	[0.015]
Rental Contract				
Triple Net			-0.195***	-0.190***
(1=yes)			[0.018]	[0.018]
Full Service			0.200***	0.208***
(1=yes)			[0.019]	[0.019]
Number of Accounts			0.012***	0.013***
(1=yes)			[0.001]	[0.001]
Fraction Occupied by Government				0.602***
(percent)				[0.040]
On-Site Management				-0.085***
(1=yes)				[0.028]
Constant	-0.355	-0.741**	-0.357	-0.402
	[0.341]	[0.354]	[0.351]	[0.350]
Observations	21,226	21,226	21,226	21,226
R-squared	0.407	0.410	0.418	0.424
Adj R^2	0.406	0.409	0.416	0.423

Notes:

[#] Omitted: “Age > 50 Years,” [##] Omitted: “Single Story,” [###] Omitted: “Class C”
All stratifications include: tenant composition (by SIC), property-type-fixed effects, and year and month-fixed effects. Standard errors in brackets. *** p<0.01, ** p<0.05, * p<0.1

Appendix Table A1
Temperature Response
(Dependent Variable: Logarithm of kWh per Square Foot, 2000 – 2010)

	(1) (Age>50)	(2) (Age<6)	(3) Class A	(4) Class B	(5) Class C	(6) Triple Net	(7) Full Service
Temperature Percentiles							
1st	0.048*	0.010	-0.060	0.063***	0.050***	0.057	0.043
	[0.028]	[0.044]	[0.062]	[0.023]	[0.017]	[0.041]	[0.028]
2-5th	0.004	-0.056*	-0.030	0.007	0.038***	-0.003	-0.005
	[0.019]	[0.030]	[0.040]	[0.015]	[0.011]	[0.026]	[0.018]
6-10th	-0.008	-0.065**	0.012	-0.007	0.031***	0.002	-0.004
	[0.018]	[0.031]	[0.041]	[0.015]	[0.011]	[0.028]	[0.018]
10-20th	0.007	-0.009	0.005	0.017	0.010	0.002	0.006
	[0.014]	[0.023]	[0.031]	[0.012]	[0.008]	[0.021]	[0.014]
20-30th	-0.022*	-0.027	0.032	-0.020*	-0.017**	0.001	-0.020
	[0.013]	[0.021]	[0.029]	[0.011]	[0.008]	[0.019]	[0.013]
40-50th	0.004	0.037*	0.076***	-0.004	-0.032***	-0.027	-0.002
	[0.012]	[0.020]	[0.028]	[0.010]	[0.007]	[0.018]	[0.012]
50-60th	0.037**	0.042*	0.090***	0.019	0.025**	-0.006	0.037**
	[0.017]	[0.024]	[0.034]	[0.013]	[0.010]	[0.023]	[0.016]
60-70th	0.091***	0.134***	0.145***	0.073***	0.086***	0.045	0.095***
	[0.020]	[0.031]	[0.044]	[0.016]	[0.012]	[0.029]	[0.020]
70-80th	0.196***	0.240***	0.234***	0.141***	0.182***	0.126***	0.184***
	[0.023]	[0.036]	[0.052]	[0.019]	[0.014]	[0.033]	[0.023]
80-90th	0.217***	0.213***	0.238***	0.153***	0.219***	0.113***	0.200***
	[0.025]	[0.039]	[0.055]	[0.020]	[0.015]	[0.036]	[0.025]
90-95th	0.234***	0.268***	0.264***	0.170***	0.244***	0.143***	0.207***
	[0.027]	[0.041]	[0.059]	[0.021]	[0.016]	[0.038]	[0.026]
95-99th	0.266***	0.274***	0.293***	0.197***	0.267***	0.132***	0.243***
	[0.027]	[0.043]	[0.061]	[0.022]	[0.016]	[0.039]	[0.027]
100th	0.306***	0.325***	0.322***	0.259***	0.339***	0.251***	0.310***
	[0.035]	[0.053]	[0.072]	[0.028]	[0.020]	[0.052]	[0.034]
Constant	4.182***	3.914***	6.658***	4.933***	4.320***	4.431***	5.951***
	[0.029]	[0.050]	[0.064]	[0.023]	[0.017]	[0.046]	[0.028]
Observations	67,857	24,838	11,303	85,504	141,135	29,984	39,390
R-squared (within)	0.082	0.261	0.169	0.182	0.151	0.142	0.190
Number of Buildings	714	521	119	933	1,310	948	799

Notes:

All stratifications include: building-fixed effects, year and month-fixed effects, and the covariates employed in Table II. Standard errors in brackets. *** p<0.01, ** p<0.05, * p<0.1

Appendix Table A2
Tenants in Commercial Buildings
(Building Type, Energy Star and Lease Structure, 2009)

Panel A. Commercial Building Type

		Building Class				Property Type		
Industry of Tenant	Overall	Class A	Class B	Class C	Office	Retail	Flex	Industrial
Agri/Mining/Utilities	5.18	2.55	6.02	7.14	2.59	0.00	9.22	11.31
Communications	0.94	3.79	1.17	0.90	1.14	0.00	1.70	1.00
Data processing	1.55	3.22	2.64	1.18	2.26	0.00	4.46	0.53
Distribution	8.85	5.34	9.26	12.70	3.00	0.04	10.47	23.23
Financial Services	10.17	17.89	11.34	10.59	19.16	5.84	3.39	1.55
Government	4.30	15.28	6.11	3.52	7.72	0.48	5.29	1.28
Manufacturing	5.93	6.57	6.75	7.68	1.49	0.14	13.03	14.31
Medical Services	6.85	4.57	9.22	8.25	14.27	0.38	5.01	0.40
Non-profits	0.12	0.00	0.14	0.09	0.17	0.20	0.10	0.00
Professional Services	9.50	14.62	12.09	10.74	16.71	0.25	9.00	4.80
Retail	7.79	0.00	0.64	0.24	0.12	39.34	0.37	0.79
Services	17.04	13.43	16.91	19.69	18.08	11.86	20.12	17.91
Transportation	1.44	0.84	1.50	2.14	0.66	0.00	0.54	3.90
Personal Services	13.98	12.75	15.82	18.64	17.82	0.21	17.62	16.13
Other	20.34	11.90	16.22	15.12	12.63	41.47	17.32	18.97

Panel B. Energy Star Buildings and Lease Structure

	Non-Energy Star		Energy Star		Full Service		Triple Net	
Industry of Tenant	Mean	Std.Dev.	Mean	Std.Dev.	Mean	Std.Dev.	Mean	Std.Dev.
Agri/Mining/Utilities	2.60	(13.98)	1.41	(3.87)	2.55	(12.60)	2.08	(12.70)
Communications	1.05	(9.07)	2.91	(8.19)	0.68	(4.82)	0.18	(1.25)
Data processing	2.21	(11.83)	1.04	(5.02)	2.61	(11.60)	0.90	(6.43)
Distribution	2.91	(13.04)	2.74	(6.24)	2.23	(8.54)	6.12	(21.37)
Financial Services	19.41	(32.99)	17.03	(22.83)	23.86	(32.53)	23.36	(38.50)
Government	6.89	(23.22)	30.07	(36.29)	10.24	(25.91)	0.41	(4.16)
Manufacturing	1.51	(10.20)	0.53	(1.29)	1.65	(8.74)	2.15	(13.85)
Medical Services	14.75	(32.25)	0.11	(0.53)	9.62	(24.49)	10.37	(27.39)
Non-profits	0.20	(3.25)	0.29	(1.45)	0.11	(1.37)	0.77	(5.57)
Professional Services	16.43	(30.61)	23.05	(27.17)	19.51	(28.40)	9.28	(23.70)
Retail	0.11	(2.12)	-	-	0.08	(1.49)	0.13	(1.88)
Services	0.28	(3.88)	-	-	0.21	(2.09)	0.15	(2.21)
Transportation	0.71	(7.04)	0.30	(1.50)	0.50	(3.83)	0.09	(1.22)
Personal Services	17.77	(33.24)	8.51	(12.48)	14.64	(26.74)	15.33	(32.36)
Other	13.17	(29.28)	12.02	(26.08)	11.53	(23.46)	28.68	(39.13)