

# Northeast Sustainable Energy Association 2011 Conference

- Greening Multifamily 360 Degrees
- Financing Multifamily Retrofits
  - Private Capital in One Simple Step
  - Let's Do the math
  - How to Make it Happen

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# Multifamily Financing for Retrofit

- Public Incentives (WAP, NYSERDA, Utilities)
  - Limited amount of dollars
  - Often come with restrictions
- Private Financing
  - ESCO Financing – Leverage the savings
    - Works best on large projects, public housing
  - Unsecured loans, second mortgages
    - Few and far between
- First Mortgage Financing
  - Lenders are not doing this on a large scale as yet
    - Makes the most sense

# Opportunities in First Mortgages

- It's all about the Underwriting
- What is Underwriting?
  - A financial AUDIT of the property
  - Evaluation of Income and Expenses
    - What is the certainty of those numbers
    - What is available to carry debt
  - It is more Art than Science
    - Recent History: many artistic and creative underwriters

# Multifamily Financing

- Underwriting History: 2002 through 2007
  - Underwriting was aggressive
  - Properties were fully leveraged, some were over leveraged
  - Many properties cashed out their equity
    - Great opportunity to require cash out towards retrofit
    - Retrofit at scale had not emerged
  - Where did the money go?
    - Into other investments
    - Sometimes back into the properties
    - Into an owner's pocket

# Multifamily Financing

- Underwriting History 2008 – 2010
  - The financing world changed
  - Debt was harder to come by
  - Credit Depts tightened underwriting standards
  - Underwriting was severely restricted
    - Opportunities for leveraging retrofit in first mortgages never have a chance to emerge
    - Financing for retrofits, by and large, remained limited to public incentive programs

# The Basics of Underwriting

- $\text{Income (Net Rents)} - \text{Expenses} = \text{Net Operating Income (NOI)}$
- $\text{NOI} / \text{Debt Coverage Ratio (1.30)} = \text{Net Available for Debt}$
- $\text{Net Available for Debt} / \text{Debt constant} = \text{loan amount}$
- Moving parts in the equation:
  - Income, Expenses, DCR and debt constant (interest rate + amortization – term of loan)
- Underwriting is more of an art than a science

# Let's Do the Math: Bronx Buildings

- 4 contiguous properties
- 173 units total
- Retrofit Scope: lighting, heating systems, pipe insulation, windows, low flow water devices, bulkhead doors, roof replacement and insulation, exterior lighting, weather-stripping, apartment lighting
- Total Cost: \$747,000 - \$4,318 per unit

## Let's Do the Math: Bronx Building – 173 Unit Subsidized Mod Rehab

- $173 \times \$794 \times 12 = \$1,648,858$  (Gross Inc.)
- $173 \times \$5,977 = \$1,034,004$  (Annual Exps.)
- $\$1,648,858 \times 95\% = \$1,566,415$  (Net Inc.)
- $\$1,566,415 - \$1,034,004 = \$532,411 = \text{NOI}$
- $\$532,411 / 1.30 \text{ Debt Cov. Ratio} = \$409,547$
- $\$409,547 / 12 = \$34,129$  monthly for debt
- Loan amount = \$5,289,000: 6.7%, 30 years

# Financing Opportunity

## 173 Bronx Moderate Rehab

Expenses \$5,977 per unit x 173 = \$1,034,004

- \$2,617 per unit = \$452,770 annual energy cost
  - Heat, Hot Water, Common Area Electric
- 44% of expenses for utilities
- 20% savings: \$90,554 / 1.30 debt coverage
- \$69,657 (15% of savings) = \$899,600 in added debt
  - 6.7% over 30 years
- \$5,200 (added debt) per unit underwritten at 20% savings
- \$4,318 (added debt) per unit = 17% savings required in underwriting to cover full cost

# Long Island Building

- 7 Building garden complex
- 88 units total
- Retrofit Scope: boiler room ventilation, exterior wall insulation, heating systems, pipe insulation, windows, exterior doors, electricity controls, lighting, ACs, appliances
- Total Cost: \$264,410 - \$3,005 per unit

## Let's Do the Math: Long Island Building – 88 unit HUD Property

- $88 \times \$1,486 \times 12 = \$1,569,216$  (Gross Inc.)
- $88 \times \$7,565 = \$665,721$  (Annual Exps.)
- $\$1,569,216 \times 95\% = \$1,490,755$  (Net Inc.)
- $\$1,490,755 - \$665,721 = \$825,034$  in NOI
- $\$825,034 / 1.30$  Debt Cov. Ratio =  $\$634,642$
- $\$634,642 / 12 = \$52,887$  monthly for debt
- Loan amount =  $\$9,850,000$ : 5%, 30 years

# Retrofit Financing Opportunity Long Island HUD Property

Expenses \$7,565 per unit = \$665,721 annual exps

- \$3,212 per unit = \$282,689 annual energy cost
  - Heat, Hot Water, Common Area Electric
- 42% of expenses for utilities
- 20% savings: \$56,538 / 1.30 debt coverage
- \$43,491 = \$675,000 in added debt
  - 5% over 30 years
- \$7,671 per unit
- \$3,004 needed = underwrite 8% savings

# Why is this Opportunity Attractive

- Works for all properties types seeking a mortgage
- No added step to access capital for energy related work
- Considers the entire building holistically
  - Retrofit part of overall physical needs
  - Doesn't pull energy out as a separate unit
- Downside
  - People want and need to retrofit when they don't need a mortgage

# What Does This Require?

- Demand from Owners or Lenders
- Lenders, Appraisers, Credit Departments and Regulators Need to Recognize Savings
  - Incorporate it into the underwriting
  - Can this be done?
    - Data is required
    - Benchmarking training is required
    - Awareness and education are needed
  - The math doesn't lie
    - The savings can pay for most retrofits

# Retrofit Financing Solution: Make it part of Mortgage Delivery System

- The majority of buildings have 2 things in common:
  - They all use energy
  - They all have a mortgage
- Make benchmarking & retrofit part of loan process
  - Train Loan Officers to benchmark
  - Audit – 3rd party report like an Appraisal or a Phase One
- To get to retrofit at scale – financing is key
  - The money is in the private sector
  - Awareness will increase and demand will grow
    - Just like Phase Ones

# How Do We Get There?

- Demand for retrofit has to increase
  - Owners are not going to independently do this on any large scale
- Need to overcome “retrofit apathy”
  - Lenders require it (like a Phase One)
  - Government regulation
  - Oil and utility prices spike permanently and drive conservation



