

Financing Deep Energy Retrofits

- Engaging the Private Sector
- CPC's Green Initiative
- Overcoming Financing Obstacles

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Learning Objectives

- Understand Multifamily Finance
- Learn How Best to Finance Multifamily Retrofit
- Consider Ways to Fully Engage the Private Sector in Retrofit to Drive it to Scale
- Consider Ways to Create Awareness Among Owners and Streamline the Retrofit Process

The Community Preservation Corporation (CPC)

- Non-profit mortgage company founded in 1974
- Consortium of 78 NY Banks and Insurance Co.s
- CPC Mission: Provide a private investment platform to spur recovery in distressed communities
- Financed more than 142,000 multifamily units, \$7.2 billion public/private investment
- CPC investment has had a dramatic impact in low income neighborhoods

The CPC Model Works

- “Community” Lender and Leader
 - Evaluate the housing needs of a community
 - Identify the resources to meet those needs
 - Create strategic public/private partnerships
 - Provide our private investment capital
 - Stimulate revitalization and highlight the success

Retrofit of Multifamily Buildings

- An identified need in our communities
 - Low hanging fruit of GHG reduction
- An opportunity to educate the private sector
 - Prove the expense side benefits
- An opportunity to educate owners
 - All properties need to save money
 - Take the focus off the income side of ownership

The Retrofit Financing Challenge

To determine whether or not retrofit can be adequately financed, it is important to understand the economic function of properties and determine if that function will accommodate, and be enhanced by, the benefits of retrofit.

Does the economic benefit of energy retrofit stand on it's own financially?

The “Green” Divide

- One side of the equation (us):
 - Sustainability experts, energy experts, environmentalists, alternative energy advocates and the Government
 - All pushing toward the “Tipping Point”
- Other side of the equation (everyone else):
 - John Q. Public – the everyman
 - Not in tune to saving energy and doesn’t want things to be too difficult

How to Underwrite Retrofit?

- **Lenders don't think about "green"**
 - Many not aware of the planet's future
 - Disconnected from public mandates
- **Lenders think about loans**
 - Current Economic Environment
 - Lenders are suffering from "lender fatigue"
 - How NOT to do a deal
 - Financial creativity is a BAD thing

Let's Do the Math: Rental Housing

- Income:
 - 20 units x \$1,500 = \$360,000 per year
 - Less Vacancy of 5% = \$342,000 per year (Net Income)
- Expenses:
 - 20 x 4,500 per unit = \$90,000
 - 20 X 2,000 per unit taxes = \$40,000
 - Total Expenses = \$130,000
- Net Operating Income (NOI): \$212,000
 - \$342,000- \$130,000 = \$212,000

Rental Housing continued

- Determining the Loan Amount:
 - Net Operating Income: \$212,000
- Apply the Debt Coverage Ratio (DCR):
 - Divide $\$212,000 / 1.25$ – DCR (pretty standard)
 - Available for Debt = \$169,600 a year
 - $\$169,600 / 12 = \$14,133$ monthly payment
 - 30 year loan at 6.5%
 - \$2,236,000 or \$111,800 per unit
- Cash Flow: $\$212,000 - \$169,600 = \$42,400/\text{year}$

Cost of the Retrofit

- 20 Unit Building
 - Typical retrofit \$5,000/unit = \$100,000
 - Deep Energy Retrofit \$10,000/unit = \$200,000
- Solution: Use Property Cash Flow for added debt:
 - \$42,400 per year
 - If you use half the cash flow: \$21,200
 - 10 year loan at 8% = \$150,000
- Problem:
 - First mortgage holder won't allow violation of debt coverage ratio covenant – it would be reduced to 1.125
 - Loan is not saleable to secondary market

Alternative Source of Loan Payment

- Operating Expenses:
 - 20 x 4,500 per unit = \$90,000
 - Say 35% are for utilities: \$31,500
 - 2nd mortgage debt repayment source: savings of 30%:
\$9,450
 - 10 year loan at 8% = \$65,000
 - 20 year loan at 8% = \$94,000
- Problem: Lenders don't have the data
 - Multifamily lenders don't currently monetize the savings to add or allow additional debt
 - Appraisers don't recognize savings toward the value of the property

Current Financing Solutions

- On-Bill Financing
- PACE Financing
- Municipal Second Mortgage Programs
- NYSERDA Energy Smart Loans
 - All of the options add an additional step, add to the cost and complicate the process
 - Will John Q. Public embrace these methods?
 - Some will, most won't

Public Incentive Programs

- Utility Rebate Programs
 - “Cash for Caulkers”
- Alternative Energy Tax Credits
- Weatherization Assistance Programs
 - Good solution for income restricted properties
- Everybody wants something back
 - Spoiled by “Cash for Clunkers”
 - There is not enough public money to address the enormous need
- Incentives will help but will not help everyone

Scale of the Need in NY City

- 3,328,000 Residential Units
- If all units require retrofit at \$3,000/unit
- \$9,984,000,000
- Weatherization for all of NY State
 - \$440 million through the stimulus.
- Less than 4.5% of the money needed

What is a Better Solution?

- Underwrite the savings into the first mortgage
- Expenses:
 - 20 x 4,500 per unit = \$90,000
 - Say 35% are for utilities: \$31,500
 - Projected savings of 30%: \$9,450
 - Added to the 30 year loan at 6.5% = \$125,000
- Need to establish a reliable database
 - Empirically prove that it is prudent to underwrite the savings

How to Change the Mortgage System?

- The majority of buildings have one thing in common:
A Mortgage!
- Make an audit and retrofit part of the loan process
 - Third party report like an Appraisal or a Phase One
 - Can't borrow the money without it
- The Private Sector (money) needs to require and demand the retrofit
 - Legislatively: Green Reinvestment Act
 - Capitalistically: Green Mortgage Backed Security

The CPC Green Initiative: \$1 Billion Program Launched 9/2009

- Construction and Permanent Financing
 - Occupied multifamily properties
 - Require Audits
 - Collect 2 years of usage – heat, water & electric
 - Benchmark the buildings, create a usage database
 - Monitor the retrofits and measure the savings
- Create a Platform for Retrofit Financing
 - Fold in the public incentives
 - Make retrofit part of the mortgage process

It Ain't Easy Being Green!

- Many Obstacles Have Arisen
 - Lack of awareness and education
 - Resistance
 - Frozen Financial Markets
 - Marginal economics – overleveraged properties
 - Capital Costs are high
 - Lack of flexible public programs/incentives

Overcoming Resistance:

- Prove the economic benefits
 - Rely on the math to show the savings
 - Create an objective and empirical database
- Create and provide the tools to drive education
 - Benchmark ballpark device
 - Energy savings resource center
 - Case studies of success stories
 - Marketing, advertising, awareness

Overcoming a Lack of Capital:

- Utilize the CPC risk sharing model
- Keep the loans conservative
 - Existing, cash flowing buildings
 - No speculation
- Identify investors with corporate sustainability policies and an interest in green
- Build a pipeline –prove the model
- Follow the legislative mandates
 - Point out to investors the business potential

Overcoming Perceived High Costs

- Measure the paybacks
 - Show the retrofit pay back from energy savings (SIR)
 - Make it clear and simple
 - Only recommend those things which will pay back
- Point out that waste can be very costly
 - Would you pour 20% of your cleaning supplies down the drain before you store them in the supply closet?
 - Why would you tolerate energy inefficiencies?

Overcoming Complex Process:

- Perception: Audits are complicated and expensive
 - Simplify the audit – short and simple
- Identify the Incentives
 - Define the public incentives and show clearly how to access them
 - Package the incentives (do the paperwork) as a part of the delivery system

Simplify the Entire Retrofit Process

- Provide a range of retrofit costs
- Provide simple specification for each item
- Provide a qualified contractor list
- Identify training locations for owner contractors and their staffs
- Identify suppliers with the best products at the best prices

CPC Green Initiative

- Attempts to do all of this
- Six months into the program
- 3,500 units in the pipeline
- 5 investors signed up

We have a long way to go!

Questions???

- Thank you for your time!

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