OP-ED

Financing Energy Savings in Apartment Buildings

Local Solutions to a Global Problem

By Michael Lappin

Today's low interest rates provide a window of opportunity for urban communities to take a bold step to increase the energy efficiency of their privately owned apartment buildings. Maturing 5- and 10-year mortgages can now be refinanced at interest rates that are 100 to 150 basis points lower, creating the potential for additional investments in these properties. At the same time, local government incentive programs can be designed to direct these investments in energy efficiency improvements to buildings, thus producing green jobs and a cleaner environment. New York City has shown a path of how this might be achieved, a model that can be replicated in other communities.

Significant Energy Savings Possible

In 2009, New York City adopted legislation mandating that each building larger than 50,000 square feet measure its energy use yearly, and once every 10 years do an energy audit and fine-tune its energy systems to be more efficient. A number of cities have enacted or are considering similar legislation.

In its first year, New York surveyed millions of square feet of large buildings of all types subject to the law (residential, commercial, retail). The results showed a wide disparity in common area energy usage. Among apartment buildings, of which almost 900 million square feet was surveyed, the 5% least efficient buildings used 4.4 times as much energy per square foot as the 5% most efficient buildings. The survey's key finding was that if the least efficient buildings (of all categories) could make appropriate investments to slash their energy consumption to the median level for all buildings, they could cut their energy usage by roughly18%. Typical energy conservation investments include air sealing and improved insulation, water conservation, staff training, etc. – a treasure trove of living wage jobs. This potential for savings in residential buildings has been supported by other reports (Deutsche Bank January 2012 study and anecdotal experience). These survey results might be reflective of multifamily properties in other urban areas.

The goal should be to jump start energy improvements in buildings with above-average energy usage when their mortgages are refinanced.

A Local Stimulus Program

The easiest way to pay for such energy measures might be the additional funds generated by refinancing apartment properties at lower mortgage rates. However, owners and lenders are generally skeptical about actually achieving projected future energy savings from such improvements, claiming there is insufficient data to make the case between such investments and savings. Many multifamily owners view New York's energy audit and fine-tuning requirements as an unfunded mandate; they focus more on minimizing their costs to comply with the law and less on the substance of efficiency. And lenders are reluctant to ask owners to make additional energy investments, lest they lose customers in a highly competitive loan origination market. Projected energy savings are generally not incorporated into loan underwriting today despite the presence of new data.

New York City has a local incentive program (J-51), currently being reviewed for possible enhancement, under which multifamily properties making defined energy savings investments (e.g., improved insulation, boiler replacement) have their real estate taxes reduced over a period of about 11 years. Thus, the certainty of the tax savings can bridge in part the uncertainty of the energy savings. The key elements of the city's program are that it is simple, widely known in the real estate/banking community, has an extensive processing infrastructure, and is non-discretionary. Such a program can be modeled in other communities, with appropriate local variations.

Weaving Energy Savings into Investment Decisions

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typical New York City buildings, the combination of lower current refinancing rates and the certainty of local tax subsidy produce impressive results, even assuming just a fraction of the projected energy savings. In this scenario, the payback period for owners is fast (4 years or less), because much of the cost of the energy investments can be financed, and debt service coverage for lenders is improved. Moreover, if the predicted energy savings are actually or nearly achieved, the financial savings are much greater, alongside a cleaner environment.

A local subsidy program such as New York's can be of limited duration, sunsetting after a period of years during which the results can be studied to determine if the program should be continued. An established record of energy savings can be documented. This can help lenders and owners to more confidently and routinely incorporate such findings into their investment/underwriting decisions.

The benefits for the overall community are multiple: cleaner air, green jobs, and more energy-efficient buildings. The time to act is now while interest rates remain low. TCA

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