Reimagining the Metropolis

- New York's Green Building Revolution
  - 2005 to 2010
  - What has happened? What have we learned?
- The Community Preservation Corporation
  - Focus on multi-family financing
  - A lender's perspective

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February 2, 2011

Current Sources of Retrofit Financing

- 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, typically commercial
  - Unsecured loans, second mortgages
    - Few and far between
- First Mortgage Financing
  - No Lenders are doing this on a large scale as yet
    - Makes the most sense but there is no customer demand or regulatory requirement for it

Multifamily Financing

- Underwriting History: 2005 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 – 2009
  - 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

- Income (Net Rents) – Expenses = Net Operating Income (NOI)
- NOI / Debt Coverage Ratio (1.25) = Net Available for Debt
- Net Available for Debt /debt constant = loan amount
- Moving parts in the equation:
  - Income, Expenses, DCR and debt constant (interest rate + amortization – term of loan)

Let's Do the Math: 40 Unit Building

- 40 x $2,000 x 12 = $960,000 (Gross Income)
- 40 x $7,000 = $280,000 (Annual Expenses)
- $960,000 x 95% = $912,000 (Net Income)
- $912,000 - $280,000 = $632,000 NOI
- $632,000 / 1.25 Debt Cov. Ratio = $505,600
- $505,600 / 12 = $42,133 for debt
- Loan amount = $7,027,000: 6%, 30 years

Financing Opportunity for Retrofit

Expenses (net taxes) $5,000/unit

- 35% of expenses for utilities
- $1,750 per unit = $70,000 annual energy cost
  - Heat, Hot Water, Common Area Electric
- 20% savings: $14,000 / 1.25 debt coverage
- $11,200 = $155,500 in added debt
  - 6% over 30 years
- $3,890 per unit – covers the cost of most retrofits
- $1,950 per unit if only half the savings are underwritten
  - Most retrofits range from $2,000-$4,000 per unit

What Does This Require?

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

Underwriting Hurdles

- Standard expenses would have to be adjusted down
  - No operating history to show the savings
  - Property always operated at $70,000/year for utilities
  - Underwriters don't adjust downward without empirical data
- Debt coverage ratio is compromised
  - If you leave expenses at $70,000 per year and add debt the Debt coverage ratio goes down
  - This is a red flag and would not clear credit hurdles

Debt Coverage Ratio Impact

- Loan -$7,027,000 - $505,200 – DCR 1.25
- Loan -$7,084,000 - $509,677 – DCR 1.24
- Loan -$7,141,000 - $513,821 – DCR 1.23
- Loan -$7,200,000 - $518,032 – DCR 1.22
- Loan -$7,259,000 - $522,314 – DCR 1.21
- Loan -$7,320,000 - $526,666 – DCR 1.20
  - About $59,000 added per DCR point reduction

Multifamily Financing for Retrofit

- September 2009
  - CPC launches Green Financing Initiative
  - Response to changes in the political climate
  - An effort to shore up value during the recession
    - Focus on the expense side of the equation
  - Attempting to create a financing platform for multifamily retrofit
  - Enable other lenders to include retrofit
    - Work with public partners and incentive programs

CPC Idea: Incorporate Retrofit into the Mortgage Delivery System

- The majority of building have one thing in common:

  A Mortgage

- Make benchmarking & retrofit part of loan process
  - CPC Loan Officers trained to benchmark
  - Audit – 3rd party report like an Appraisal or a Phase One
- Getting to retrofit at scale
  - The money is in the private sector
  - Awareness will increase and demand will grow

Multifamily Financing 2010

- Interest in financing retrofit grew
  - CPC has 3,000 units closed and in the pipeline
- More owners are aware of the process and the need
- Benchmarking regulations in NYC were passed
- Major financial institutions have begun to inquire about how to get it done
  - FNMA is reworking their Physical Needs Assessment (PSA) to include retrofit items
  - Others are approaching CPC for our expertise

Multifamily Financing 2011 and Beyond

- 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 requires it – PlaNYC
  - Oil and utility prices spike and drive conservation