

**On-Bill Repayment Model**

**Multifamily Master Metered Developments**

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We, at the Pennsylvania Housing Finance Agency (PHFA), would like to thank the Commissioners and their staff for providing us the opportunity to submit, for consideration, an On-Bill Repayment (OBR) model targeted to multifamily master metered developments.

By “multifamily,” we are referring to rental properties with five or more units. Both affordable and market rate apartment complexes can qualify, although the primary focus of this paper is on the affordable multifamily industry. We have this focus for two reasons: 1) it is the sector that PHFA has considerable familiarity in and 2) affordable multifamily housing was specifically addressed by the Commissioners in the Act 129 EE&C Phase II Implementation Order.

Our model is for master metered properties, as it has a less complex approach versus tenant metered properties. With tenant metered multifamily properties, there are many more hurdles to overcome when it comes to OBR. These include accounting for the impact of OBR on assistance programs, such as LIHEAP and payment plans; the necessity of 100 percent participation of the residents, and the likelihood of achieving such participation, when major retrofits are needed; and the increased number of customers to monitor under a pilot program.

**The Case for Multifamily**

As we have stated to you in the past, Pennsylvania has over 140,000 affordable multifamily units with at least 70 percent of these units built over 20 years ago. Of these units, fewer than 10 percent are funded by Rural Development of the U.S. Department of Agriculture, of which all are tenant metered properties. The remaining properties were funded by either the U.S. Department of Housing and Urban Development (HUD), or programs administered by PHFA, including the Low Income Housing Tax Credit Program (LIHTC). Approximately half of this inventory is master metered, meaning we have a potential portfolio close to 65,000 units that could benefit from an OBR program.

In addition to its age, there are a few other characteristics to understand about this inventory:

* Rent increases for the affordable multifamily sector have been limited or nonexistent for several years, and changes to this environment are not expected in the immediate future.
* The most common ownership is a limited partnership structure.
* Funding for capital improvements typically comes from operating cash flow.
* Annual distributions to owners are limited

This results in a sector that has deteriorating facilities, limited cash flow, a lack in funding for improvements and a great need for energy upgrades.

Unfortunately, although there is such a need, there is no easy access to funding. We were able to accomplish retrofits on over 8,300 units during the past few years utilizing the ARRA funding of the Weatherization Assistance Program, however, those dollars are no longer available.

Affordable multifamily housing, whether with HUD or under the LIHTC program, has a complex regulatory framework. Most lenders, including HUD and LIHTC investors, prohibit additional debt being added in the form of a lien position on the property. Therefore, owners must either secure grant funds, which are very limited, or borrow unsecured debt, which can be extremely difficult to obtain.

Given this limited access to grants and/or debt, an on-bill repayment program is the only method that may be available to effectively provide resources to affordable multifamily developments for the needed efficiency upgrades.

**Program Structure**

The structure of the program is very similar to that offered by the Sustainable Energy Fund, with the involvement of four entities, instead of five: Energy Users; On-Bill Administrator; EDCs/LDCs; and Capital Pool Participants.

1. Energy Users will be master metered multifamily developments.

2. The On-Bill Administrator will be the Pennsylvania Housing Finance Agency. PHFA will be responsible for all aspects of the program other than the on-bill collection process. Such responsibilities will include the gathering of funding from capital pool participants, outreach to potential energy users, performance and oversight of the energy retrofit process, and monitoring of energy savings post retrofit to ensure anticipated savings are achieved.

3. EDCs/LDCs refers to the local electric or gas distribution utility company. Their primary role is as a conduit for billing and payment processing.

4. Capital Pool Providers, with be the lenders and investors providing the funds necessary to perform the energy retrofits.

Key aspects of the program include:

1. Bill Neutrality – This is the primary goal that must be met in order for this program to succeed. Upon completion of the retrofit, the energy cost, plus the payment of the loan, must be less than or equal to the energy cost prior to the retrofit. Many of the affordable housing developments we will be considering cannot take on additional costs without it having a detrimental effect on the operations.

2. The interest rate for the repayment of the loan and the fees paid to the EDCs/LDCs and On-Bill Administrator cannot be too onerous or they will mitigate the potential realization of energy savings. If this program moves forward, the fees will need to be negotiated.

3. The costs of modifications to accommodate utility billing programs cannot be handled through fees from the model. There are not sufficient resources.

4. For a retrofit to be considered, it must have a savings investment ratio of one or higher.

5. The loan maturity should be less than the expected useful life of the upgrade, but in no case be greater than ten years.

6. All loans may be fully repaid at any time.

7. The loan will work as a tariff, attached to the meter and repaid regardless of change in ownership.

8. Energy retrofits should be aligned with, but not limited by, existing Act 129 rebate programs.

When considering a full energy retrofit of a multifamily building, we believe there are seven components to a successful upgrade that should be performed or monitored by the On-Bill Administrator. These components, all of which PHFA has experience in, are:

1. Benchmarking – When considering energy upgrades of a property, one should start with determining whether or not a development will benefit from the upgrade. This analysis will include the benchmarking of the utility consumption of the property. We utilize EnergyScoreCards© from Bright Power. It not only determines the energy usage, but also compares the usage of the development with like properties in the area.

Along with benchmarking, a determination needs to be made as to whether the property is appropriate for the upgrades. Considerations here include the operating cash flow of the property, the physical condition of the property, and, for OBR purposes, the utility payment history.

2. Energy Analysis and Recommendations – After it has been determined that the development could gain from the performance of energy upgrades, the preparation of an energy audit should be considered. The audit should follow a set of standard protocols, be performed by a BPI certified multifamily analyst, and reviewed to determine which measures would be most beneficial to implement.

3. Low Cost Financing – Obviously, this is where On-Bill Repayment fits in. Providers for the capital pool may include PHFA, banks, particularly those looking for CRA investments, energy funds, etc. As indicated earlier, the rates need to be low enough so bill neutrality can be preserved.

4. Construction and Construction Oversight – It is important that the construction of the upgrades is of the highest quality. The On-Bill Administrator should:

* Assist in developing an implementation plan designed for the specific property. This may include identifying qualified professionals, hiring of an architect and/or engineer, if warranted, and assisting with necessary documentation.
* Solicit and review bids from qualified contractors
* Monitor the installation to ensure quality of workmanship
* Perform disbursement and payout procedures as the work is completed.

5. Post Retrofit Activities – The development needs to be closely monitored to ensure that the savings are maximized. This will include tracking of utility usage for a period of time after the retrofit; reviewing the data on at least a quarterly basis to determine building performance; and resolution and follow up when a building is not performing as expected.

6. Maintenance Staff Training – It is imperative that the maintenance staff of the property understand the upgrades that have been made and the upkeep that is required. The management company’s handbook and training need to be modified to encompass the new maintenance and upkeep requirements.

7. Resident Outreach and Education – No matter the extent of utility upgrades, resident behavior will have a significant impact on the results. PHFA will assist property managers in working with residents; provide periodic training opportunities for property managers and their staff; and prepare specific written and graphic materials for residents to showcase how to maximize the benefits of the energy efficient features of their apartments.

There are several aspects that will impact the potential success of the program and will most likely require a great deal of discussion and consideration. These include:

1. Interest rates of lenders to the capital pool will be lower if disconnection is applicable to the nonpayment of the loan. Since building owners will have a very strong incentive to pay their utility bills, lenders view the OBR mechanism with disconnection possibilities as a key to high quality credit.

2. If disconnection is possible, then partial payments should be allocated on a pro rata basis. If it is not possible, payments should be allocated to utility charges first, with any remaining payment amount being applied toward the loan.

3. If disconnection is not possible, a mechanism will need to be put in place to assure timely payments of the loans to the capital pool providers. One possible solution may be the funding of a capital reserve. Past experience of PHFA has shown that such a reserve should be at least equal to ten percent of the loans from the capital pool.

4. For a more complete and widespread program, an integrated approach with gas utility providers would be most effective.

**Background on PHFA**

The Pennsylvania Housing Finance Agency is a state-affiliated entity created in 1972, and has been providing loans and other funding for the development and operations of affordable multifamily properties since that time. We have funded over 127,000 apartment units and have been involved with the construction oversight, financing, asset management, and property management of these deals. Our experienced staff includes underwriters, financial analysts, architects, engineers, construction overseers, and supportive services providers.

In addition, over the past several years, under our Preservation through Smart Rehab Program, we have provided energy efficiency upgrades to 109 multifamily developments with over 8,300 units.

Through our work with HUD and the LIHTC program, we have access to every owner of affordable rental housing throughout the Commonwealth. Our work with lending institutions should provide us with the ability to bring in resources for the capital pool.