

# Financing Energy Efficiency in Low-Income Multifamily Rental Housing: A Progress Update from the Low Income Investment Fund

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Bringing energy efficiency to our nation's building stock is an attractive triple bottom line proposition, and a critical one—for addressing global climate change, improving environmental quality and health, and delivering cost savings to owners and tenants. Although markets for retrofitting commercial properties and single-family homes are developing, many low-income people are still waiting on the sidelines to partake in benefits. This trend is particularly worrisome because the least fortunate are more likely to live, attend school, and work in older, less energy-efficient buildings; as a result, low-income households consume about one quarter more energy per square foot of living space than their higher-income counterparts, and a larger share of their paychecks are dedicated to utility costs.<sup>2</sup> Poorer communities' limited ability to pay for retrofits has caused energy efficiency markets designed for wealthier settings to bypass them.

In this context, we at the Low Income Investment Fund (LIIF) interpret the considerable challenge of delivering energy efficiency to low-income families and low-wealth communities as crucial not only for environmental sustainability, but also for addressing social inequality.

We have taken this challenge head-on. LIIF has made more than \$170 million in front-end loan and grant capital investments for energy efficiency in multifamily housing, schools, child care centers, and other community facilities. Our work has delivered real benefits, but it has also revealed important lessons for how to finance retrofits for these underserved borrowers and their tenants. One example of a program that served this dual purpose was the California Preschool Energy Efficiency Program (CPEEP), which provided energy audits and retrofits to 2,065 child care centers serving more than 95,000 children in California. Although this program was grant-based, it demonstrated considerable savings and helped establish an evidence base for future energy efficiency financing.

LIIF is currently focused on solving the puzzle of financing energy retrofits for low-income multifamily rental housing. Most state and federal programs designed for single-family homes are inadequate for this purpose, but the solution is unclear and challenges to incorporating private capital are substantial. For example, loans for individual properties are

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2 "Income, Energy Efficiency, and Emissions: The Critical Relationship," Energy Programs Consortium (February 26, 2008).

unattractive to most investors because they are typically small, complex, unsecured, and non-recourse. In addition, ideal moments for retrofits, such as recapitalization, are infrequent, calling for models that work outside these points in time in order to reach scale. Finally, ease of use is difficult to achieve but critical, given that economic incentives for owners are weak. LIIF's approach has been to test multiple promising strategies in the form of pilots, which address these challenges in different ways.

Our expertise and appetite for experimentation has not gone unnoticed. LIIF was the first community development financial institution (CDFI) to become a "Financial Ally" for the President's Better Buildings Challenge when the U.S. Department of Housing and Urban Development (HUD) and the U.S. Department of Energy (DOE) jointly announced in December 2013 that the program would expand from commercial buildings to include multifamily housing. In this role, LIIF has committed to providing innovative financial products to help owners and managers reach ambitious energy reduction goals, as well as to sharing lessons and data with other stakeholders. We are thrilled about this new partnership, and hope that other CDFIs join us in working with leaders in the federal government to advance such an important agenda.

Although LIIF is working hard, making the pieces fit is difficult. Every day, we learn more about what does and does not work—and move closer to identifying the best vehicles for scaling up multifamily energy efficiency. We are joined in this effort by numerous other CDFIs, including Boston Community Capital, Enterprise Community Partners, and Craft 3. This article is a chance to share some of LIIF's successes and challenges to date, and also to describe what we currently see as key lessons from our work and important next steps.

In brief, we believe the two models LIIF is currently helping design and implement could be viable platforms for at-scale multifamily energy retrofit finance—in one case by reducing transaction costs and increasing ease of use, and in the other by setting the stage for portfolio-level transactions. But to leverage the power of these models and others to create functioning markets, the field should prioritize the following areas:

1. *Better data* on energy and cost savings are needed to achieve the predictability necessary for underwriting at scale; and
2. *Smart subsidies* from government agencies and utility regulators are needed to allow for pooling and leverage, and to encourage flexible and effective use of funds.

## **BAM Fund**

LIIF's first major effort to finance stand-alone energy efficiency retrofits for multifamily properties was the Energy Upgrade California: Bay Area Multifamily Fund (BAM), which launched in 2010 in partnership with the San Francisco Mayor's Office of Housing and Enterprise Community Partners. The \$4 million fund provided affordable loans to property owners to finance energy upgrades, and then use savings resulting from new efficiencies to pay debt service.

Administering BAM was challenging on several fronts. Transactions were complex and costly, and relying on energy efficiency savings for repayment restricted loan sizes to such an extent that they could not cover the full scale of properties' retrofit needs. On the other hand, BAM loans were more successful when paired with other subsidies, such as federal weatherization funds and locally administered Community Development Block Grants.

Ease of use for all parties also left much to be desired. For example, energy audits were useful but at times not user-friendly or well integrated into properties' larger capital needs assessments and recommendations. In the end, this confluence of sometimes unforeseen challenges translated to only four properties participating in the fund.

Our experience with BAM revealed a key lesson that has continued to define our green financing efforts: Without the right model, financing multifamily energy efficiency retrofits is just plain difficult, and will remain unattractive to all but the heartiest and most mission-driven lenders. Not being in our nature to give up so easily, the lessons we learned from BAM pushed us to innovate and try new approaches designed to be more user-friendly for owners, less costly and risky for lenders, and more likely to achieve scale. We have fortunately had such an opportunity in two additional pilots that are currently underway.

### **Energy Performance Contracting Pilot**

The Energy Performance Contracting (EPC) pilot is a partnership between LIIF and Stewards of Affordable Housing for the Future (SAHF), a membership organization of sophisticated nonprofit housing developers and owners. Under the pilot, LIIF provides stand-alone, fully amortizing loans to support retrofits in HUD-assisted multifamily properties owned and operated by SAHF members. LIIF originally committed up to \$8 million for the effort, with support from Bank of America's national Energy Efficiency Finance Program in the form of low interest, long term capital and a grant. However, the program was recently scaled back to approximately \$2 million.

The EPC pilot is innovative for two main reasons. First, it addresses the "split incentive" issue in HUD-assisted properties with rental assistance contracts, where the agency recoups extra cash flow instead of the owner—a rule that has discouraged owners from implementing cost-saving efficiencies and precluded lenders such as LIIF from making loans payable from cash flow generated by energy savings. HUD's cooperation in removing this regulatory obstacle was critical and demonstrated the agency's desire to creatively lower barriers to energy efficiency financing.

Another feature that distinguishes the EPC pilot from the BAM Fund is that an Energy Services Company (ESCO), in this case Johnson Controls, Inc., is providing an energy savings guarantee for each property, which will mitigate risk for LIIF's non-recourse loans. Although the ESCO model has been used for public housing, the EPC pilot is the first time it is being applied to HUD-assisted, privately owned affordable housing at scale.

We have encountered some of the same challenges in navigating complex, stand-alone transactions as we did with the BAM Fund, but the EPC pilot has begun to bear fruit. LIIF

closed its first two loans in first quarter 2014—retrofits of a 204-unit property and a 56-unit property in Rhode Island that are both owned by Preservation of Affordable Housing, Inc. SAHF has identified and screened several other properties for participation in the program later in the year.

Looking forward, the EPC pilot is promising because its structure and early successes have laid the groundwork for potentially scaling up via a Pay for Success financing model, which could allow for larger transactions that could cover multiple properties—avoiding the need to do individual security interests for each one, and making it possible for harder-to-serve smaller properties to be included. In its fiscal year 2014 budget, HUD has requested funding for a Pay for Success demonstration for energy efficiency retrofits of properties with rental assistance contracts. We believe this initiative holds much promise, and we are sure that CDFIs would be willing partners as investors in this model.

### **On-Bill Repayment Pilot**

LIIF's third and earliest-stage experiment in multifamily energy efficiency finance is the Ratepayer Integrated On-bill Payment Program (RIOPP) Pre-development Pilot, a partnership with SAHF, the California Housing Partnership Corporation (CHPC), and the MacArthur Foundation. RIOPP differs from BAM and the EPC pilot by incorporating an on-bill repayment (OBR) mechanism, which adds the owner's debt service to his or her monthly utility bill. Although the pilot maintains the basic principle of underwriting retrofits based on energy savings, OBR could be groundbreaking by lowering transaction costs and substantially improving ease of use for all parties—owners, lenders, and utilities. This process innovation could make it possible for smaller properties to undergo retrofits, as well as for owner participation to increase across the board.

As of January 2014, LIIF is planning to invest \$1.5 million for a “pre-pilot” of five properties in early 2014 to provide fully amortizing loans to finance energy retrofit costs after borrowers take advantage of various utility company incentives and rebates. We are working closely with CHPC and SAHF to launch this pre-pilot in Southern California Gas Company's (SoCalGas) territory. SoCalGas is one of four investor-owned utilities in the state that the California Public Utilities Commission has mandated to offer OBR for affordable multifamily properties as part of a larger, two-year Energy Efficiency Financing Pilot (the full pilot). The full pilot will offer up to 10 percent ratepayer credit enhancement, subsidies for audits, and an automated billing system to track and collect OBR payments. The full pilot will also be available in all four investor-owned utility territories and will launch later in 2014, covering 5,000 units in properties of 20 units or more across the state. LIIF also hopes to be part of the full pilot.

RIOPP illustrates the important role that states and utility commissions can play in enabling better approaches to multifamily energy retrofit finance—especially with the help of strong advocacy, which CHPC and others have provided in California. Oregon and Illinois have also authorized OBR for multifamily housing, and several others are moving in this direction. Meanwhile, OBR has already proved successful as a tool for financing retrofits of

single-family homes in the Pacific Northwest. As such, the RIOPP model has the potential to scale up not only in California but around the country. If successful, it could become the preferred mechanism to finance large-scale retrofitting of the nation's privately held, multi-family housing portfolio.

## Escape Velocity

LIIF and other CDFIs can play a significant role in helping markets for energy retrofits in affordable multifamily housing take off. To deliver on this potential, we must embrace our entrepreneurial roots and take on the work of innovation—first by collaborating with other skilled partners such as SAHF and CHPC to determine what works, and then by leveraging private capital, subsidy, and policy solutions to achieve scale.

The good news is that we are on the right track. Despite some early bumps, LIIF is helping to design and implement pilot strategies that have real market potential—and we are pleased that HUD and DOE want to support this work. Stepping into our new role as a Financial Ally to the President's Better Buildings Challenge couldn't have come at a better time, and we look forward to leveraging this role to not only advance such an important agenda, but to invite other CDFIs to join us as Financial Allies and increase our sector's capacity and engagement in this area.

As we look beyond our own programs and scan the broader multifamily energy efficiency landscape, we see two important priorities for the field. First, we need better data on energy and cost savings in order to build an evidence base and achieve the predictability needed to do any underwriting at scale. We are excited by the Better Building Challenges' focus on data sharing and are heartened by other examples, such as Bank of America's engagement of EnergyScoreCards—a subsidiary of the energy consultant Bright Power, Inc. EnergyScoreCards will collect pre- and post-retrofit data to measure program outcomes in conjunction with providing capital to CDFIs for multifamily energy retrofit lending via its Energy Efficiency Finance Program. As with other areas of community development, demonstrating success is sometimes the hardest thing to do, but it's incredibly important.

Second, we should continue to promote the “smart subsidy” concept with federal and state agencies, as well as with utility commissions. To date, most subsidies directed at energy efficiency have not allowed for pooling or leverage—characteristics that encourage the most flexible and effective use of funds, and which we believe will be central to any strategy with a chance to achieve scale. Government agencies and regulators have been willing partners in enacting crucial policy changes that have enabled the current wave of pilots, but the private sector needs to work with them on crafting the next set of tools and reforms.

LIIF and other CDFIs always return to the mission. If something is worthwhile for advancing opportunities for low-income people and places, how do we make it work? We think we are well on our way to answering that question for multifamily energy efficiency finance, and we hope that the experiences we shared in this article will provide fodder for discussions among those trying to do the same.

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