NATIONAL HOUSING TRUST

March 4, 2021

Attention: Building Performance and Enforcement Branch
Department of Energy & Environment
Government of the District of Columbia
1200 First Street, N.E., 5th Floor
Washington, DC 20002
Via Electronic Mail: info.BEPS@dc.gov

Re: National Housing Trust Comments on the Notice of Proposed Rulemaking, Application of the Building Energy Performance Standards (BEPS) for Privately-Owned Buildings

The following comments are provided on behalf of National Housing Trust (NHT) and relate to the potential impact of BEPS on affordable housing owners and residents. NHT is a non-profit that creates and preserves affordable homes to provide opportunity, advance racial equity, reduce economic disparities, and strengthen community resilience through practice and policy. NHT is among the largest affordable housing owners in the city with a portfolio of 1,134 affordable apartments.

NHT appreciates the steps DOEE has taken in the design of BEPS to accommodate the unique challenges affordable housing owners encounter in making energy-efficient upgrades to their buildings. NHT recommends additional flexibility than what is currently proposed in the rules to reflect the realities uniquely experienced by affordable housing building owners. Challenges encountered by affordable housing owners include tight property cash flow and margins, a lack of upfront capital, limited access to financing to pay for energy efficiency upgrades, and multiple lenders and investors.

NHT recommends that DOEE make the following changes to the proposed rules to accommodate compliance challenges in affordable housing:

- Expand the criteria for granting compliance delays to affordable housing owners; and
- Exempt affordable housing owners from paying the alternative compliance penalty if they can demonstrate a good faith effort to achieve 20 percent energy savings but fall short.

NHT also respectfully urges DOEE to publish as soon as possible the supplemental BEPS Compliance Guidebook to give building owners certainty about how BEPS will be implemented and provide an opportunity for the public to comment on the Guidebook.

Background

The District is in an affordable housing crisis that has been exacerbated by the economic impacts of the COVID-19 pandemic. Climate policy must be implemented equitably to alleviate, not contribute to, the economic burdens of under-resourced communities while providing a clean and safe environment.

The District's Climate and Energy Action Plan ("Clean Energy DC") underscores the importance of planning for equity when enacting and implementing climate policies. The plan cites several potential risks to equity from climate action if strategies are not carefully executed. Risks include increasing financial burdens carried by low-to-moderate income residents and reinforcing structural inequality by increasing social equity gaps in the District. To combat risks to equity, Clean Energy DC recommends that the District "create actions to directly support at-risk communities including low-to-middle income populations and populations of color" when developing and implementing climate and energy policies, including mitigating potential added pressure on rents from the costs of complying with energy retrofit requirements.[1]

The cost to comply with BEPS in affordable housing will be significant. NHT conducted a preliminary analysis of affordable multifamily buildings with 2019 ENERGY STAR scores below the multifamily BEPS.[2] Approximately 20,000 affordable rental units in 108 properties will require energy efficiency upgrades in the first BEPS compliance cycle. The cost of upgrading all of these buildings could exceed $172 million[3], an amount that far surpasses current funding available to assist affordable building owners with making energy efficiency upgrades to their buildings.

Absent significant additional resources to defray the costs of upgrades, DOEE should provide affordable housing owners flexible approaches to comply with BEPS to minimize costs to owners and residents and the potential loss of affordable housing. To illustrate the potential impact of compliance costs on building owners and renters, presented below is a case study of the financials of an affordable housing property in the District that is typical of all affordable housing.[4]

Property Case Study

The multifamily rental building is in a high-demand neighborhood convenient to downtown and nearby amenities, including public transit, shopping, and restaurants. It has 63-rental units affordable to families making no more than 60% of Area Median Income. The property was financed using Low Income Housing Tax Credits (LIHTC), and the owner is restricted from raising rents until at least 2044. The building is approximately 55,000 square feet and has an ENERGY STAR score well below the multifamily median.

The limited revenue generated by the lower rents and the property's ownership structure results in no net proceeds available to the non-profit developer to re-invest in the property. The non-profit affordable housing developer is the general partner (GP) with a .01% ownership interest in the property and is responsible for the building's day-to-day operations. The limited partner (LP) has a 99.9% ownership interest.

[1] Clean Energy DC: The District of Columbia Climate and Energy Action Plan, August 2018.
[2] For this analysis, buildings were considered "affordable" if they receive public subsidies, are subject to D.C.'s rent control law, or are assumed to be naturally occurring affordable housing as defined by CoStar. Due to the lack of publicly available renter income information, this is an approximate number of affordable buildings.
[3] To estimate total compliance costs, the buildings' square footage was multiplied by $10 per square foot. $10 is the low end of the range of alternative compliance penalties that building owners will be assessed for non-compliance. DOEE set the amount of the alternative compliance penalty to be commensurate with the cost of complying (See BEPS Task Force Meeting transcript – December 15, 2020).
[4] While the information provided in this case study is based on an actual property in D.C., we have chosen not to disclose the property name and address.

The table below summarizes the property's 2019 financials and illustrates the lack of proceeds available to the non-profit housing developer. After accounting for operating expenses, mortgage debt payments, and expenses due to the limited partner, the property generated approximately $143,000 in surplus cash flow in 2019. However, all surplus cash flow was used to pay cash flow contingent expenses, including a soft loan payable to DHCD[5], partnership administration fees, and the investor services fee. No distributions were paid to the GP (the affordable housing developer) or LP (the LIHTC investor).

2019 Annual Property Revenue	$807,005
2019 Annual Operating Property Expenses:	$(444,033)
2019 Net Operating Income:	$364,972
Other non-GAAP Expenses (e.g interest expense, related party fees, annual fee to L.P., miscellaneous)	$(221,426)
Total Surplus Cash Before Depreciation and Amortization	$143,546
Cash Flow Contingent Expenses	$(143,546)
Cash Distributions to the G.P. and L.P.	$0

The property does not generate any net cash distributions to put towards the cost of building upgrades that will be necessary to meet BEPS compliance. The non-profit housing developer's options to raise funding from other means are also limited for several reasons.

A potential source of funding is the property's operating reserves. Operating reserves cannot be withdrawn without the limited partner's consent and are dedicated to property expenses, such as maintenance, property management, utilities, insurance, etc., if the property generates insufficient revenue to pay for such expenses. Developers of regulated affordable housing must fund replacement reserves annually to pay for capital repairs and renovations, such as roofs, heating, HVAC, etc. Any withdrawals require the consent of the limited partner and lender(s). The amount of reserves is often insufficient to fund needed improvements fully. Also, reserves in regulated affordable housing are typically only allowed to replace equipment at the end of its useful life, not for the early retirement of equipment.

[5] Soft loans are an important source of gap financing in affordable housing provided by federal, state, and local governments that is paid back only when there is net cash flow.

Affordable housing owners are limited in taking on additional debt to pay for building upgrades for several reasons. Net operating income is often insufficient to sustain additional debt due to the property's limited revenue and the typical operating costs. Taking on additional debt would also require approval from existing lenders and limited partners. Securing consent is typically a lengthy process.

Affordable housing owners can more easily finance energy efficiency upgrades when they are refinancing their debt and can fold in the cost of energy efficiency improvements into new first mortgages. However, there are limited funding sources available to affordable multifamily building owners to recapitalize and rehabilitate a property. Two prominent sources accessible to affordable housing owners are the Low Income Housing Tax Credit program and the District's Housing Production Trust Fund (HPTF). Both programs are highly competitive.

If affordable housing owners cannot overcome these barriers and therefore fail to comply with BEPS, the resulting alternative compliance penalty would likely be impossible for the owner to pay. The non-profit affordable housing owner of the building described above would be subject to an alternative compliance penalty of one million dollars for non-compliance, **equal to 1.24 times the property's annual revenue.**

Recommendations on the Proposed BEPS Rules

Expand the criteria for granting compliance delays to affordable housing owners to reflect the capital constraints described above.

Section 3520.6 of the proposed rules specify why DOEE will grant a building owner a delay in compliance, including financial distress. DOEE should take an expansive view of financial distress and grant affordable housing owners an extended delay in compliance beyond three years if they can demonstrate the impracticality of complying due to the challenges stated above. Building owners should be required to demonstrate that they made a good faith effort to identify potential funding sources to qualify for the extended compliance delay.

DOEE should also consider granting an extended compliance delay if the building owner has a plan to recapitalize the property to finance the cost of energy efficiency improvements but is unable to do so for one to three compliance cycles, depending on the requirements of the building's existing financing partners and the availability of the financial resources needed to recapitalize and rehabilitate the property adequately. DOEE should also consider providing additional flexibility to building owners that pursue a recapitalization but are not successful in securing new financing due to the limited availability and competitiveness of funding sources.

Exempt affordable housing owners from paying the alternative compliance penalty if they can demonstrate a good faith effort to achieve 20 percent energy savings.

Section 3521 of the proposed rules specify that building owners could be subject to an alternative compliance penalty even if they implement energy efficiency building upgrades but fall short of reducing energy usage by 20 percent. Affordable housing owners should not be subject to penalties if they can demonstrate that they have made a good faith effort to achieve the required energy savings.

There are several reasons why an energy retrofit may not result in the expected energy savings, including the challenge of accurately predicting savings from an energy efficiency measure, improper installation of efficiency measures, and unexpected changes in tenant behavior. DOEE should allow for flexibility when assessing penalties to reflect these uncertainties so that building owners are not penalized for not meeting the 20 percent energy savings requirement for reasons outside of their control.

Under DOEE's proposal, if the owner of a building between 50,000-100,000 square feet chose to follow the performance pathway and achieved a 15 percent reduction in energy usage, instead of a 20 percent reduction, the owner would be subject to a $250,000 penalty. As demonstrated by the case study above, a penalty of that amount would be extremely detrimental to an affordable housing property's financial sustainability. DOEE should consider exempting affordable housing from penalties if the owner makes a good faith effort to implement an energy efficiency plan modeled to achieve a 20 or more percent reduction in energy use but does not achieve the required threshold.

Conclusion

Thank you for considering our comments and for DOEE’s continued efforts to work with affordable housing stakeholders to ensure that BEPS is implemented equitably in affordable housing.

Sincerely,

Priya Jayachandran, CEO
National Housing Trust