

# Significant Savings



## HUD's New Green Incentives



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Mortgage financing is the last thing anyone gets excited about. Still, here at PEG's Department of Sustainability and Multifamily Construction there is an unusual excitement about the topic. The buzz surrounds HUD's release of the 2016 Multifamily Accelerated Processing (MAP) Guidelines. Specifically, the release of the Federal Register Notice detailing significantly reduced premium rates on mortgage insurance. Termed 'MIP Reductions', the change in rates for this year is what caught our eye.

After reviewing the long anticipated incentive for energy efficient and green housing we were admittedly shocked at how robust the incentive turned out to be. The roll out reveals that HUD has a great deal of confidence in those committed to high performing residential and the buildings they are creating. The incentive isn't much of a surprise, however, when you consider that HUD's portfolio spends \$7 billion annually subsidizing energy and utility costs for their residents last year. Despite enormous costs like subsidies, HUD has more than enough room to safely extend their confidence. The agency's properties and holdings famously perform very well yielding a default rate of only %.15, and are known to perform consistently during volatile periods in the market. To the credit of their diligent and calculated lending approach, an incentive this large is quite the badge of confidence for the green and high performance building industry. So as you can see, the team here at PEG is very excited about mortgage financing.

### **Housing and Urban Development (HUD)**

The housing agency is wrapping up a mandated transition period over the last 4 years this January which culminated in several streamlined initiatives. The accelerated processing (MAP) guide, consolidating satellite and field offices, and review of the maturing building performance industry are all products of this process. The largest effort had been refining the processes for mortgage and insurance program applications. Currently HUD has managed to reduce the process time by an average of 45 days. The improvement was achieved by relying on the building performance industry's commitment to 3rd party verification and quality assurance methodologies. By sharing the burden of diligence, a handful of financing products were perfected helping advance HUD's other less known directive: Energy efficiency.

Most professionals associate HUD with affordable and LIHTC-type housing programs. But few realized, until now, the role the green and efficiency industries played in achieving that HUD mission initiative. The role has been so integral that developing energy efficient and high quality housing stands as a separate, more inclusive directive. A new construction project that is pursuing an industry recognized green standard, and demonstrates their efficiency commitment in the design is not held to affordable housing requirements. Additionally, existing properties can refinance under the new rates if they benchmark the property's performance, and through consulting and verification, implement recommended measures and benchmark the improvements over a year.

### **Why the fuss?**

Also included in the Federal Register release is a table of current insurance premiums and the effective qualifying mortgage insurance rate through green projects. If a project qualifies under one of the 7 financing programs through green adoption, the mortgage insurance rate drops to a flat .25%. Current rates range between .7% to .45%. The products went into effect April 1st of this year, 2016. If approved, the rates are locked, and spell the potential in massive returns first through reduced premium payments, and second from O&M expenses. HUD does this through a few different financing packages listed in the MAP guide to help cover different scenarios. Options like refinancing existing apartments through (207 or 223F), to multifamily new construction and substantial rehab (207), elderly housing (231) and supplemental loans for co-ops (241a). There are 7 products addressing green and efficiency improvements in all. HUD has ensured that virtually any property is covered by a product, which means there is money on the table.

### **How It Works**

Each program is a variation of one fairly simple work flow. Benchmark current performance, design for green certification and improved target performance, implement/build, certify, and finally verify by benchmarking utility usage. For new construction the project must design to 2009 International Energy Conservation Code (IECC), commit to a green certification and a benchmark target score of 75+ for firm application. Once approved the project is built, certified, and benchmarked for fifteen months after occupancy. Substantial rehabs require the historical meter data up front as a baseline for design submissions.

The objective of benchmarking is to achieve a 75 Energy Star Portfolio Manager Score or higher. The emphasis on energy performance by green programs and design modeling ensures performance score of 75 can be easily achieved for new construction. Working with PEG, HUD understands no estimate is 100% perfect. Therefore, early adopters are encouraged to rest easy in the unlikely event a building performs under 75. The agency will work with any cases to reward their commitment to quality, especially early adopters. Additionally, firm submission is due before construction where the energy modeling produces a Statement of Energy Design Intent (SEDI). This document projects the target score using modeling predictions. While supplementing the design process with modeling, the SEDI also serves to compliment the project commitment letters HUD needs to approve locking the mortgage and premiums.

As an exercise, let us compare the new and old routes HUD uses for a multifamily new construction project as an example. Other project types can qualify, but to demonstrate the fundamentals, a NC project works best.

A market rate new construction project that would have financed through FHA will be subject to the longer traditional application process (TAP) and likely payed a mortgage insurance premium rate between .45-.7%. That rate is determined by HUD approved lenders and appraisers documenting the built project through Capital Needs Assessments and Physical Condition Assessments throughout different phases of construction. Or CNAs and PCAs respectively. The quality of construction and design would be dictated by the project owner who classically does not pursue an "over-code" program like NGBS, LEED, or Energy Star. They build to code-minimum specs, and pay whatever Insurance rates and mortgage they've achieved. Those rates, at times, are also adjustable incase HUD finds reasons to hedge its bet from default.

*INSTEAD*, the project decides to get NGBS certified at the minimum certification level. During design phases, before they apply, they reach a minimum energy efficiency level also. They come up with an accurate project-wide estimation of energy use and add a few low cost measures to safely target their project at 80 with Energy Star's Portfolio Manager. Using the SEDI generated, they include a letter emphasizing their commitments with their application. HUD reviews, and approves their insurance rate at .25% and, with help from their lender, an increased principal to help cover many energy efficiency measures. Measures that include the performance consulting already solicited at design. The project moves forward with construction, verification, certifications, and occupancy. Lastly meter data is collected for the final 75+ score no more than 15 months after break-even occupancy. Management can enjoy accurate building feedback, decreased maintenance costs, high occupant satisfaction, and a great award story for marketing and leasing to show off to prospective tenants.

## **Challenges**

So far the MAP process relies on HUD approved lenders to collect and make sense of the various consultants for composing many facets of the application for a given project. With housing finance and green building industries now teaming up in such a major way, a lot can be lost in translation. Lenders and their staff don't classically speak or think "green". Many especially struggle understanding the mechanisms, complexity and priorities inherent of 3rd party Green Programs and the dynamics of high performance building design. Just as many energy professionals still confuse Fannie Mae and Freddie Mac for elderly rural farmers too. For lenders to moderate the conversation between stakeholders over the whole process is still an impressive feat. However, this early after MAP's introduction, projects are scrambling to fit sophisticated performance modeling in before submitting. Most are hoping to nab an early advantage of the large savings, leaving finance professionals pressured to still keep this simple for clients.

Professionals depending on PEG are all experiencing the same thing. Yet, our service model has proven perfectly up to the task. Projects needing accurate and quick feasibility checks and design teams thinking long-term rely on us equally. Our roles span from guiding design, consulting on green programs, liaising with authorities having jurisdiction (AHJ's), and all the way to inspecting and certifying the end product. All PEG's clients breathe easier having found someone who can provide the MEP, optimize for 75+ performance, recommend a program, verify and credential that program, and still manage the required benchmarking. When we say from start to finish, we haven't left anything out. We don't go it alone always either. PEG relies on a proven network of experts and professionals to help overcome obstacles perceived or real. After all, we think our clients rest easiest knowing the project is in a team's hands.

## Conclusion

HUD has created a far reaching incentive to adopt green standards and energy efficiency in the residential construction industry. Not relegated to affordable housing, multifamily projects committed to energy efficiency have the opportunity to reduce their Mortgage Insurance Premiums to a locked .25% over the life of the mortgage. The cost of consulting, design, and installation are also all mortgageable. Through commitments to national green certifications and proven benchmarking, HUD has ensured the consistent and steady conservation of the nation's affordable and high quality rental stock. Many energy professionals have risen to the challenge to help lenders and new stakeholders navigate the foreign green building industry. However, few have the advantage of experience with the entire process from design to benchmarking. PEG is excited to partner with HUD to provide our expertise helping pioneer this program. Even more exciting are the opportunities to help return value to our clients and colleagues in upcoming projects. PEG is putting in the effort to connect with our client's lending professionals or HUD approved lenders to ensure everyone knows what is available. PEG's teams have a proven track record, and all while providing a rare truly turnkey operation. HUD's MAP guide and premium reductions could not be better suited.

## About the Authors

The heads of PEG's department of sustainability and multifamily construction regularly engage and consult on major trends in the residential building performance industry. Managers Evan Auld and Ann John alone represent a combined 15 years green construction and program development experience in the residential construction industry. Combined with degrees and extensive credentialing in sustainable development and renewable technology, Evan and Ann help PEG guarantee clients are advised and handled with uniquely field hardened savvy.

### Further Resources

[Federal Register- Mortgage Insurance Reduction \(MIP\)](https://www.gpo.gov/fdsys/pkg/FR-2016-01-28/pdf/2016-01511.pdf)

<https://www.gpo.gov/fdsys/pkg/FR-2016-01-28/pdf/2016-01511.pdf>  
[2016 MAP GUIDES](#)

[http://portal.hud.gov/hudportal/HUD?src=/program\\_offices/administration/hudclips/guidebooks/hsg-GB4430](http://portal.hud.gov/hudportal/HUD?src=/program_offices/administration/hudclips/guidebooks/hsg-GB4430)  
[MIP- press release](#)

[https://portal.hud.gov/hudportal/HUD?src=/press/press\\_releases\\_media\\_advisories/2016/HUDNo\\_16-008](https://portal.hud.gov/hudportal/HUD?src=/press/press_releases_media_advisories/2016/HUDNo_16-008)  
[HUD 2014-18 Strategic plan](#)

<http://portal.hud.gov/hudportal/documents/huddoc?id=hudstrategicplan2014-2018.pdf>