



In Focus – MIP Reduction Notice and How to Achieve an Energy Score of 75 - REVISED

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Federal Register Vol. 81, Num. 18, Thursday, January 28, 2016:

(F.R. excerpts in *italicized Times New Roman*):

“Rate reductions are now proposed to promote two of HUD's mission priorities: Affordable housing and energy efficiency. In response to the President's Climate Action Plan, the recent global agreement to combat climate change, and in line with the Department's and Administration's goals to reduce energy consumption and utility costs throughout the building sector, rate reductions are also proposed to promote energy efficient housing.”

D3G's Interpretation: These are very exciting times at HUD with the release of the Mortgage Insurance Premium (MIP) reduction notice, as well as release of the 2016 MAP Guide. The affordable and green emphasis of the newest FHA guidance should come as no great surprise for those of us that heard Carol Galante (former FHA DAS) speak at the MBA-CREF conference in 2010, combined with the joint agency 2011 Federal Rental Alignment Administrative Proposals ([link](#)). The recently released MIP reduction notice and 2016 MAP Guide complete the roadmap for HUD on how they are to achieve the goal of a predominantly affordable and green portfolio.

“Annual MIP will change from current rates generally between 45 and 70 basis points, to 25 basis points for all multifamily FHA-insured loan types. The lower rate will incentivize owners to implement measures that result in projects with greater energy and water efficiency, reduced operating costs, improved indoor air quality and resident comfort, and reduced overall impact on the environment.”

D3G's Interpretation: HUD spent over \$7 billion in utility expenses to subsidized housing last year, so they have a vested interest in making housing more energy efficient to save taxpayer dollars. Recent census data showed that more than 1 in 4 U.S. renters have to use at least half their family income to pay for housing and utilities, and for the elderly the problem is exacerbated. Combine these housing issues with the recent climate talks in Paris, and HUD has a significant obligation to incentivize multifamily owners and developers to reduce utility expenses and the carbon-footprint of properties in their portfolio.

“Upon application for FHA mortgage insurance, the owner must evidence that the project has achieved, or the owner must certify that it will pursue, achieve and maintain, an industry-recognized standard for green building. Further, the owner must certify that it has achieved, or will pursue and achieve a score of 75 or better on the 1-100 ENERGY STAR score, using EPA's Portfolio Manager.”

D3G's Interpretation: There are two (2) parts to this section: (a) Green Building Certification and (b) achieving an energy score of 75 or greater using EPA's Portfolio Manager. Since issuance of the MIP Reduction Notice, I have been inundated with the question "How do I get to an energy score of 75?" The answer to that question is not as simple as it may sound, and the qualification process applies differently to existing construction versus new construction.

Existing construction with two (2) years of utility consumption data could conceivably process a Statement of Energy Performance (SEP) in the EPA Portfolio Manager and with a score of 75 or greater apply for ENERGY STAR certification under the performance path. However, if an existing property scores less than 75, then a qualified green building professional needs to determine how best to raise the score through energy modeling. Energy retrofits would need to be written into a scope of work and most likely the prescriptive path would be followed to achieve green building certification and the required energy consumption score. Post construction, the property would be required to maintain the 75 score, as evidenced by logging utility consumption records into the EPA Portfolio Manager system.

New construction and substantial rehabilitation would have to follow one of the listed green building certifications, the most common of which is the ENERGY STAR prescriptive path requirements. This would require energy efficient design, energy modeling, and post construction diagnostic testing to show the required energy score would be obtained. Post construction, the property would be required to demonstrate a 75 score within the EPA Portfolio Manager system.

Federal Register Vol. 81, Num. 62, Thursday, March 31, 2016:

(F.R. excerpts in *italicized Times New Roman*):

The reasonableness of achieving and maintaining the specified, independent green building standard, and the score of 75 or better in Portfolio Manager, must be verified by the independent conclusion of the qualified assessor preparing the physical condition assessment, and supported by the physical condition assessment report and recommendations, ASHRAE level II energy audit (required for existing structures only), and plans for new construction, or rehabilitation, repairs, and operations and maintenance. The physical condition assessment report submitted with the mortgage insurance application must include a certification from the architect, engineer, or energy auditor that the planned scope of work is reasonably sufficient to achieve and maintain the specified certification. Additionally, the owner must submit to HUD evidence that the specified, independent green building standard has been achieved, and provide a copy of the Portfolio Manager report showing building performance at or above 75, when those standards have been achieved, and no more than 15 months after completion of new construction, substantial rehabilitation or renovations or 15 months after break-even occupancy. If not achieved, HUD may impose protocols to ensure the owner brings the property into compliance, similar to protocols used by REAC for unacceptable property standards. The owner must submit the Portfolio Manager report annually to HUD showing that the property has maintained its efficiency performance.

D3G's Interpretation: If a borrower wants to achieve the MIP reduction to 25 basis points for green buildings, they must engage a needs assessor and energy auditor with the

qualifications listed in the 2016 MAP Guide. But that is not all, because no more than 15 months after completion of construction or sustainable occupancy, the property must provide evidence of an acceptable energy score. So what recourse does HUD have if the 75 value is not achieved post-construction? I don't think we know for sure, but HUD hints at "*protocols to ensure the owner brings the property into compliance*" and they mention REAC. Does this mean a borrower's Previous Participation Certificate (Form 2530) could be flagged because of non-energy score compliance? Does this mean that HUD could require additional retrofits post construction to achieve the pledged energy score? Both of these reactive actions could be very costly to a borrower, and therein lies the greatest risk with the MIP reduction notice. Lenders and borrowers should consider using highly-qualified and HUD experienced energy auditors for the assessment, because a pencil-whipped score of 75 just to get the lower MIP on the front-end may create a house of cards waiting to fall once the project exits construction. Lenders that buy loans and servicing need to be aware of the inherent liabilities in the 75 score and carefully qualify the energy auditor who verified the presumed score at the beginning of a transaction.

New Items in the FINAL MIP Reduction Notice:

The Final MIP Reduction Notice, published on March 31, 2016 and effective April 01, 2016 contained the following changes as it concerns the energy efficiency incentives:

1. Properties of less than 20 units may qualify for this MIP rate by achieving an industry-recognized standard for green building but are exempt from the requirement to achieve a score of 75 or better on the 1–100 ENERGY STAR score. This is important in the future HUD small loan program and to accommodate PRAC refinancing.
2. The time frame for compliance was broadened to 15-months post construction or sustainable occupancy to allow for sufficient time to complete repairs and benchmark the property in Portfolio Manager. This may appear to be a small change, but it was necessary to accommodate Section 223(f) transactions in the MIP reduction program.
3. HUD provided some clarification to the Public Comment regarding the future applicability of REAC to transactions that do not achieve the prescribed energy score. HUD response was "The intent is not to be punitive, but to ensure compliance with the specified green building certification and efficiency performance standards. Properties that fail to achieve their designated green building standard or the 75+ Portfolio Manager score will be required to submit to HUD a compliance plan and timeline for achieving the required certification and performance, acceptable to HUD. An owner working in good faith and demonstrating progress toward compliance in HUD's discretion will not be flagged in HUD's 2530 previous participation system."
4. Clarification was provided regarding the requirement for achieving and maintaining an energy score. HUD's response was "A property accessing the Green/Energy Efficient MIP rate will be required to maintain its efficiency performance. The property owner will submit its 1–100 ENERGY STAR score from EPA's Portfolio Manager report to HUD, annually."
5. HUD added two (2) new green building certification programs to the list (now there are nine (9) qualified programs), as well as detailed the process for additional green building certification program approval.

6. HUD published the official MIP Reduction Owner Certification Form (92013-D) which is a required pledge by an Owner/Developer seeking the MIP reduction program.

D3G's Conclusion to the MIP Reduction Notice:

The MIP Reduction Notice will be a great catalyst to additional leveraged dollars for energy reduction construction, as well as preservation of affordable rental housing with lower tenant utility costs. However, lenders should be advised these strategies will not work for all properties, and there will be some apartment complexes that just cannot get to a score of 75. Below are a few helpful hints that D3G's Green Team put together upon review of the MIP reduction notice:

- a. The ENERGY STAR score is based upon energy consumption measured in British thermal units per square foot (kBtu/SF). Therefore, an accurate square foot value is incredibly important and any distortion of size can affect the score.
- b. Projects which have natural gas heating systems are generally more efficient and score better in the EPA Portfolio Manager.
- c. Projects with electric resistant heat will have difficulties achieving a score of 75 without HVAC system replacement.
- d. If you have a property that was designed to the 2012 International Energy Conservation Code (IECC), then a score of 75 should be obtainable with fewer modifications.
- e. In the absence of a significant rehabilitation or green retrofit, we estimate that less than 75% of Section 223(f) transactions will have a low-cost approach to achieve an energy score of 75. Most properties will require some level of retrofit and rehabilitation to achieve the standard.
- f. Costs of green retrofits to achieve a presumed score of 75 need to be balanced against the age of building systems. If a large energy system (e.g. HVAC) is nearing the end of its useful life, then efficiency upgrades to replaced equipment is relatively inexpensive. But if building systems have significant remaining economic life, then early replacement just to achieve a lower MIP may not be advisable. A quality ASHRAE Level II energy audit should assist with decisions concerning early payback, life-cycle cost analysis, and saving to investment ratios.
- g. If you have a pending 223(f) transaction, our recommendation is to first get a Statement of Energy Performance (SEP) completed. If it is equal to or greater than 75, then awesome! But if the score is less than 75 don't necessarily have despair, because a qualified and competent energy auditor should be able to do some prescriptive system modeling to evaluate the best course to achieve your goal.
- h. Section 221(d)(4) New Construction of market rate properties should take advantage of the green building certification process and achieve the lower MIP. Going green at the time of initial construction has been shown to be cost effective, as opposed to expensive retrofits in existing buildings.

- i. If you have a pending 221(d)(4) transaction, our recommendation is to first get a Statement of Energy Design Intent (SEDI) analysis completed to see where the property scores. The SEDI is much more complex than a SEP, and requires advanced consumption energy modeling. Once an energy auditor has assembled the energy model, it can be tweaked with different lighting, heating, and insulation scenarios to make cost-effective recommendations to get to a 75.
- j. Green building certification programs via the prescriptive path can be expensive for the developer; however, HUD has confirmed that consulting and diagnostic testing fees are mortgageable expenses.
- k. Stakeholders need to understand some of the basic principles of SEDI modeling, and that modeler assumptions can greatly affect scores. For example, simple liberties in changing the heating or cooling set point of a model (e.g. how hot do you like it in the winter? How cool in the summer?) will have profound implications on the initial score. But beware, future occupant use may not mimic the modeled expectation and final energy use could increase - whereby an original modeled 75 is now really a 65. Therefore, BE CONSERVATIVE in your models as you don't want to take the risk of having to do expensive energy upgrades 15 months after construction!
- l. And finally, our in-house green building project managers have outlined the “**Steps to a Successful Green Building Project and Desirable SEDI Score**” for new construction projects going down the prescriptive path of certification. You can access this reference sheet [here](#).

D3G has been involved in energy benchmarking and scoring of the HUD assisted housing stock for greater than 9 years. Our experience with the M2M Green Initiative, the Green Retrofit Program, SPRAC, and RAD has built a highly skilled and qualified workforce at D3G. Please put our experience to use for the benefit of your borrowers and their tenants. www.d3g.com