Using Incentives to Promote Green Building Practices

Summary notes from the "Incentives for Green Development Working Meeting"
Thursday, July 31, 2008

Purpose: Examine parameters to consider when creating financial incentives and develop a framework for organizations that are looking to develop an effective green incentive/lending program, primarily for affordable housing.

To accelerate the adoption of green development, public and private sectors nationwide provide monetary and non-monetary incentives. Monetary incentives include tax expenditures, grants, vouchers and rebates. Non-monetary incentives include technical assistance, business planning assistance, marketing assistance, expedited permitting, regulatory relief, preferred loans, guarantee programs, and dedicated green management teams in building and planning departments.

When is a green building/development incentive needed?

- To correct a market failure
- To assist in overcoming a learning curve by providing more time or funds
- To eliminate market barriers of constrained pre-development time and higher up-front costs
- To help advance local/regional/state green development agenda
- To minimize risk of implementing new, emerging technologies and green building practices

A green building/development incentive could be appropriately designed:

- To maximize pre-development "window of opportunity." Considerations:
  - Ensure appropriate mix of design team professions at project beginning to save money, time down the line;
  - Encourage increased planning time to allow for integrated green design;
  - Provide technical assistance in the form of green consulting, coordination and facilitation throughout design and construction:
    - Realize project synergies and save on costs
    - Green project leader/consultant must have long-term commitment to project and decision-making authority
  - Expedite government permitting process for green projects.
- To encourage building commissioning, ensuring green building features work as advertised
- To encourage periodic evaluation of building operations and maintenance over the life-cycle of the building, ensuring appropriate asset management

Designing a green building/development incentive

- Develop set of incentive standards to achieve outcome

  - Avoid incenting only process—need to incentivize outcome
  - Set up-front priorities regarding green, so as not to inadvertently reward green-washing and to instill public confidence in standards
  - Provide developers with clarity of standards to help minimize their risks
- Tie the use of public monies (monetary incentives) to specific project requirements and outcomes, with appropriate contracts and legal consequences when requirements not fulfilled
  - Opt for back-loaded incentives
  - Include non-performance provisions
  - Consider combining financial instruments to achieve desired outcome; e.g., match a grant with a reasonable loan program
  - Require leveraging, matching funds or in-kind contributions
- Use non-monetary incentives, such as providing regulatory relief or direct technical assistance, to expedite the permit process while helping to decelerate a developer's compressed, front-loaded planning schedule
- Market incentive to development community and consumers
- Adjust incentive parameters and requirements as needed to achieve the specified outcome
- Continue incentive until the market barrier to green development practice no longer exists

Public finance mechanisms & creation of barriers to green development

Public finance mechanisms subsidize private investment and promote a certain type of development. They can either promote or deter developers and property owners from adopting green building practices into their development. Economic development practitioners have an opportunity to simultaneously achieve multiple goals: provide incentives that fulfill greater policy objectives (e.g., infill development, affordable housing) through the use of subsidies, and also decrease the cost differential of green development.

Pitfalls to avoid

- Bottlenecking the government approvals process when requiring green building practices via city/local government ordinance
  - Government must be prepared for demand generated by the incentive
  - City staff unfamiliar with new technology can hold up process during project review
  - City departments not used to cross-program coordination will cost valuable time to process
- Negotiating green design between government approver and developer undermines process certainty and does not help developer mitigate risks
- Do not create an incentive prior to sorting out confusion underlying unclear policies
- Be wary about writing an existing national green building standard into local or state building code; be informed about the risks, costs for third party certification
- Do not inadvertently provide awards to developers for requirements they already have to meet

Recommendations to build local green building/development capacity

- Government should provide:
  - Trained and educated staff in green building practices, so as not to present additional barriers
  - Interdisciplinary point people to coordinate green projects amongst various city departments
    - Reduces permitting time
    - Clarifies project's adherence to appropriate standards, minimizing developer's risks
  - Coordination of green standards within local codes and ordinances (green criteria should complement existing standards, rather than compete with them)
- Local practitioners with green development technical expertise should establish a network and inventory of local professionals to encourage information sharing and technical assistance, specifically tailored to the needs of the local area
  - Run a focus group of developers to understand their perspective, concerns
- Utility companies, non-profit energy auditors, and Energy Services Contracts (ESCo) may be good partners in promoting energy efficiency measures and incentives

Crafting a green building/development incentive: help for local governments

The Ideal Deal handbook provides a framework from which economic development practitioners can create attractive incentives which require accountability. The keys to structuring an appropriate incentive are to fully value the public costs and benefits, ensure appropriate performance standards, and set up systems for information disclosure, incentive oversight, and enforcement.

Valuing public costs and benefits: practitioners should estimate how much the public benefits are worth relative to the amount of the subsidy, and be knowledgeable about the true cost burden for the entity providing the incentive.

Performance standards: explicit performance standards should be included in legal documents. It is in the best interest of the practitioners to define breach-of-contract agreement, should the recipient fail to achieve the performance standard(s), and explicitly define exceptions and other provisions.

Disclosure: relevant corporate information pertaining to the structure and amount of incentive should be required and disclosed to the local government as needed.

Oversight: specify monitoring practices to hold the recipient accountable to the contractual agreement. Incentives may be "back-loaded" such that recipients only receive the incentive upon achieving the specified performance benchmarks.

Enforcement: include non-performance provisions if the incentive is provided up-front to protect against situations where the performance standards are not met. The contract may require payment of fees and costs, or other forms of damages and relief (such as expectation damages, reliance damages, restitution and liquidation), to hedge against risk of a contract breach.

Weber, Rachel and David Santacroce. The Ideal Deal: How Local Governments Can Get More for Their Economic Dollar. March 2007. Good Jobs First and the University of Illinois at Chicago Center for Urban Economic Development. <http://www.goodjobsfirst.org/pdf/idealdeal.pdf >.

- Public and private entities should partner on education and outreach efforts to broaden community understanding and interest; possibly do a joint demonstration project to showcase green building/development process and features to public

Greening affordable housing development considerations

- Project size:
  - Larger projects (above 24 units) are generally funded over smaller projects
  - A green premium can often be absorbed over a larger project (e.g., multi-family) but not always by a smaller project
  - Strong local and political opposition tied to most larger projects
- Paying utility bills—who pays, building owner or tenant?
  - When developers pay, they experience the cost savings tied to green features
  - Tenants/residents likely to be more conservative with resources if they are pay; however, developer is more unable to recoup costs
  - Shared savings: when developer pays a percentage (e.g., up to 50%) and then resident pays the balance over that amount
- Larger affordable housing developers are better capitalized and may have more ability to pursue integrated design and pay for green project consultants
- Project financing and affordability
  - Affordable housing brings lots of lenders to the table; if standards differ amongst lenders, developer has to meet the highest standard
  - Most green affordable housing development is only occurring via the use of low-income housing tax credits
  - Total costs, including operating costs, need to be considered for long-term affordability

Which criteria should be considered for developing a green affordable housing development incentive?

- Numerous national, state, regional, local, and programmatic green building standards exist; difficult to know which to use for each project
  - Over 80 different green building standards exist across country
  - Energy Star (federal program) v. LEED v. regional/local standard
    - Different certification and/or commissioning costs associated with each program, which critically affects an affordable housing project's bottom line
    - How to ensure a green building built via an incentive can actually achieve certification? What is the follow-up process?
    - Recognize good standards—it is important to give developers flexibility to work with local people, meet area needs and develop local technical capacity, but also to pursue recognition from a national standard.
  - Other codes must be factored in, such as state energy and development codes
  - Standards need to complement, not compete, with other standards

- LISC Green Development Center is considering five top categories for social and environment that each projects need to have addressed at the front end, to tie into loan fund, reduced rates/fees:
    1. energy efficiency
    2. water conservation
    3. siting/location/access to public transportation
    4. indoor air quality
    5. materials selection
- Enterprise Community Partners has created Green Criteria for classifying projects potentially eligible for Green Communities grants and funding

Normalizing green requirements into loan eligibility v. creating an incentive

- Normalizing green requirements into all grants and loans (such as requiring Energy Star appliances and use of low VOC paint) allows for integration and consistency across programs
- What are the risks to the project funder if certain green standards are made blanket requirements?
    - Not everyone is knowledgeable enough with green building practices to force participation
    - Quantification data on long-term green building performance is not widespread
    - Funders in certain parts of the country are more comfortable with providing incentives over requirements
- Outcomes, not process, should be awarded—if green building is the goal, why have two parallel tracks of financing for conventional projects and green projects?

Challenges particular to green affordable housing building retrofits:

- Retrofitting an existing affordable housing development to be a green building can be more difficult than starting from the ground up with new construction
    - Making the retrofit construction financing fit the cash flow of the property, given the payback time periods of certain technologies, makes retrofits challenging
    - Retrofitting existing buildings which used tax credits to finance the project can be difficult because there are limitations to how the funds can be used and restrictions on additional layers of financing
    - Since each retrofit property requires individual assessments and different improvements, it becomes a more difficult proposition to guarantee certain cost savings when financing via traditional bank loans
- Matching a grant with a loan has worked well in making some retrofits work
- Some success in using ESCos (Energy Services Contracts) to improve energy performance in existing buildings
    - EsCos can provide energy for a length of time (e.g., 10 years) under contract
    - Energy company owns all the energy equipment in the building
    - Creates more certainty for the property owner, e.g., flat energy costs

- EsCos more effective for larger buildings; they not necessarily make financial sense for small projects (6-8 units) where the system will not pay for itself

Trends and key areas of governmental impact

Currently, the majority of public finance mechanisms focus on energy efficiency and "clean energy", while also focusing on affordable housing, water conservation, waste management, and pollution and emission reduction.

Government and municipalities of all levels are certainly able to impact the adoption of green development. To successfully invest in green development it is important that government agencies set end dates for programs, establish minimum and maximum dollar amounts (or minimum and maximum percentages of the total cost), evaluate program effectiveness, and integrate strategies to ensure recipients of subsidies meet performance standards.

Appropriate green building incentives targeted at affordable housing developers should offer:

- Flexibility
- Resources
- Lower fees, reduced interest rates
- Assistance
  - Technical help to "figure it out"—pass on resources, do outreach
  - Marketing and creating demand for green building
- Green building requirements for both construction phase and long-term operations
- Non-performance provisions/"teeth" for not meeting requirements
  - Require payback of incentive
  - Pay penalties
  - Not allow application for future incentives
- Ability to assemble smaller projects into loan funds
- Combining financial instruments, e.g., matching grants with loans
- Target loan to match green technology payback periods

What can non-profit development lenders (e.g., community loan funds, LISC, etc) do to promote green building practices in affordable housing development?

- Preferentially fund green development over conventional development
- Assume some of the pre-development costs (risks) and allow access to funding earlier
- Offer an increase in the funding up-front for doing green
- Incent developers to employ a knowledgeable green building development team by providing a preference list of vetted professionals
- Have a dedicated staff person who can guide developer through the process and facilitate green charrettes
- Consider creating a "package deal" for funding to ensure green throughout all aspects of the project, i.e. require a green consultant, green building manager, and asset management specialist.
- Study local energy and development goals and incorporate them into the non-profit incentives
- Be educated and share information on the anticipated payback periods of certain green building features

    - Which green technologies offer the most bang for the buck in each locality? (e.g., should you choose solar photo-voltaic v. solar thermal panels for use in IL?)
    - Which green building elements have a payback of 7-10 years, and which have much longer paybacks?
- Provide training and education to local affordable housing development community
    - Convene a working group/forum of professionals to network, share lessons learned
    - Form local partnerships with the broader development community and benefit from their green building experiences
    - Facilitate communication amongst cities in the same region
- Target outreach to the larger community to increase local capacity and generate demand for green design, with a strong focus on the social and public health benefits
- Formalize a financing program with green building requirements or incentives and provide the technical expertise to back it up
- Invest in both small and large green projects; document their results and make case studies available
- Assist developers in sorting through existing incentives; collect all the applicable federal, state, municipal, etc incentives so that developers will know where to apply for funds
    - LISC and Energy Star developed an Energy Star home guide for local LISC offices, with listing of all local incentives; meant to prompt people to ask the right questions. Web-based guide due out in September
- Look for process, law, or policy barriers in federal and state programs; be an advocate for changing the way

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Meeting Attendees:

Christopher Choi, EPA Region 5
Beth Dufek, Milwaukee Local Initiatives Support Corporation (LISC)
Madeline Fraser Cook, Green Development Center, LISC
Kindy Kruller, Delta Institute
Mark Fick, Chicago Community Loan Fund
Taylor McKinley, EPA Region 5
Kevin O'Brien, Cleveland Environmental Finance Center
Aimee Storm, EPA Region 5
James Van der Kloot, EPA Region 5
Audrie Washington, EPA Region 5
Rachel Weber, University of Illinois at Chicago