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CONDO COMMENTARY

GREEN LOANS AND ENERGY EFFICIENCY UPGRADES FOR CONDOS

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There is a trend happening in the condo industry centered on energy cost savings and conservation. We've heard buzz words such as, "Green Loans" and "Energy Retrofit Financing" being bounced around, but what is the difference between these terms? How does a developer-initiated Green Loan work? How does a Condo Board go about paying for energy efficiency upgrades? This article will provide a high-level overview of financing green energy initiatives in both new and existing condos.

Green Loans for New Condos

Let's first take a look at developer-initiated Green Loans for new condos. The concept of Green Loans for condos is becoming increasingly popular among condo developers. In recent years, a number of developers have been building condos that surpass building code standards for energy efficiency. While the intention is to create significant energy savings that will benefit unit owners during the life of the installed equipment, the predicament developers are faced with is how they will pay for these extra energy-efficient upgrades, while continuing to be sensitive to pricing new units.

An effective way to solve this developer's dilemma is a "Green Loan". Green loans for condos are an innovative financing tool for developers looking to finance energy efficiency upgrades, which are over and above building code requirement. The developer's desire to enter into a Green Loan (on behalf of the proposed condo corp.) with a lender is fully disclosed in the condo documents (the Disclosure and the proposed Declaration), so that potential condo purchasers are made aware of this loan before making their buying decision.

Here's how the Green Loan works: The Disclosure and Declaration clearly spell out the developer's intention to incorporate energy-efficient equipment, building materials and systems in the construction of the condo. On, or shortly after the registration of the condo, the newly formed condo corporation enters into a loan agreement with the lender, and the loan proceeds for the green loan are advanced directly to the developer in order to reimburse the developer for any incremental costs incurred as a result of its acquisition of any energy-efficient equipment. Payments of the Green Loan are included in the common expenses of the condo, and are reflected in the annual operating budgets of the condo corporation during the term of the Green Loan.

A key characteristic of Green Loans is that in order for the loan to be advanced by the lender, the developer must obtain and provide to the lender a third-party authentication (typically from an engineer) of the condo's energy performance from a third-party agency. The purpose of this is to demonstrate that the condo has been designed and constructed to meet the level of energy reduction, which the lender has established as a condition for making the Green Loan.

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The Green Loan concept is a win-win for both developers and unit owners. From a developer's viewpoint, constructing an energy-efficient building is creating a higher quality building with greater long-term capital appreciation. From a unit owner's perspective, funds that would have otherwise gone towards paying rising utility bills can instead be applied to paying down the loan and the unit owners will benefit from the ongoing savings on their utility bills. Once the green loan if fully paid, unit owners will continue to benefit from the cost savings. The environment is also a "winner" as a result of the reduced utility consumption.

Energy Retrofit Financing for Existing Condos

While new condo developers are effectively using Green Loans to finance the installation of energy efficient equipment, older condos are faced with a different type of challenge with respect to how they pay for energy retrofits and improvements in order to achieve energy cost savings and conservation.

As energy costs continue to escalate, many condo boards are seeking ways to save on their energy bills.
Some older condos are enlisting the services of engineers or energy management firms to conduct an energy audit of the facility and identify measures to save on energy costs. Quite often, the energy savings will exceed the implementation costs, making payback periods well under ten years in some cases. Although the costs may be partially offset by government financial assistance programs, the dilemma for condo boards is how to pay for the up-front costs of these energy efficiency projects.

There are essentially three methods for financing a retrofit project in a condo:

1. Reserve Fund
2. Special Assessment or Operating Budget
3. Financing (borrowing)

(i) **Reserve Fund:** Section 93 of the Condo Act states that the reserve fund shall be used only to fund "major repairs and replacements of the common elements and assets of the corporation". While it is quite noble of a Board to want to pay for energy retrofits through existing reserves, the reality for many condos is that funds are not adequate for a Board to embark on a large energy retrofit project because the funds are simply not available, or that the reserve funds are needed for other "non-energy" related major repairs and replacements (e.g. roof replacement or underground garage waterproofing).

(ii) **Special Assessment or Operating Budget:** Funding all or a portion of an energy retrofit project can be achieved through a special assessment levied against all owners or an existing accumulated surplus from the operating fund. It is also possible to fund an energy retrofit project through the annual operating budget but this would likely involve a substantial increase to the annual budget, depending on the size of the energy retrofit project. Although the decision to fund an energy retrofit by way of a special assessment or through a large increase to the annual budget is within the Board's sole authority, such a decision would likely be highly unpopular with the owners and could result in a significant backlash against the Board and property managers. With this funding option, prior consultation and communication with the owners is critical.

(iii) **Financing (borrowing):** A common and generally accept way of funding all or a portion of large energy retrofit projects is to borrow money from a third party lender (such as a bank or other financial institution specializing in *condo lending). The borrowed money used for energy retrofit projects may be used for both major replacements and improvements to the common elements. Pursuant to Section 56(3) of the Condominium Act, a borrowing by-law specifically dealing with the energy retrofit financing must first be passed by the Board of Directors and then approved by a majority of all owners (50% + 1) at a meeting duly called for that purpose.*

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The new by-law must set out all of the basic details of the proposed loan: the principal amount, interest rate and term of the loan. As a condition of the loan, most lenders require the Corporation to enter into a Loan Agreement and a General Security Agreement which set out all of the basic terms and conditions relating to the funding and repayment of the loan. As well, the condo corporation must comply with s. 97 of the Condominium Act which deals with situations where the condo is considering making a "change" in the common elements or assets of the corporation (as maybe the case with an energy retrofit).

This article was co-written with Paul Pittana of Equitable Bank and will be published in an upcoming Condo Business Magazine.