BUILDING UPGRADE FINANCE

The State Government has established the Building Upgrade Finance mechanism in South Australia to help unlock investment in building retrofits and realise the associated economic and environmental benefits.

WHAT IS BUILDING UPGRADE FINANCE?

Building Upgrade Finance is an innovative way to finance a building upgrade. It allows building owners to access longer-term fixed-interest finance, as well as share the costs and benefits of the upgrade with their tenants.

The mechanism can help building owners to improve the environmental performance of their property assets without the risks and negative cash flow implications of traditional finance, as well as reduce operating costs, increase yields, help attract and retain tenants, and increase asset value.

Simply put, Building Upgrade Finance is a new tool for improving the performance of a property asset. It provides an opportunity for commercial building owners and tenants to work together to improve the performance of their buildings, realise financial savings, and achieve win-win outcomes.

BENEFITS OF BUILDING UPGRADE FINANCE

1. NO UPFRONT CAPITAL OR SECURITY

Upgrades can be made at zero upfront cost to the building owner, and with no additional security required. Traditional finance often requires additional security, and will usually not cover all project costs.

2. REDUCED RE-FINANCING RISK

Competitive interest rates are available, fixed for 10 years or potentially longer. This reduces the re-financing risk and allows building owners to plan with more certainty. Traditional finance is generally only available for terms of 2-5 years.

3. IMPROVED CASH FLOW

Longer finance terms mean lower annual repayments, delivering immediate cash flow benefits to the owner. Under short term traditional finance, capital intensive upgrades may be unattractive due to the significant impact on cashflow.

4. WIN-WIN FOR OWNER AND TENANTS

Both owners and tenants benefit from building upgrades, through lower operating costs, a better working environment and a more valuable asset. Building Upgrade Finance provides a secure and transparent mechanism for owners and tenants to share the costs in proportion to the benefits they receive. Without this mechanism, it can be difficult for upgrades to be negotiated until the end of a lease.

Source: Sustainable Melbourne Fund

HOW DOES IT WORK?

Under the Building Upgrade Finance mechanism, a local council, a building owner and a financier can voluntarily enter into a building upgrade agreement. Under such an agreement:

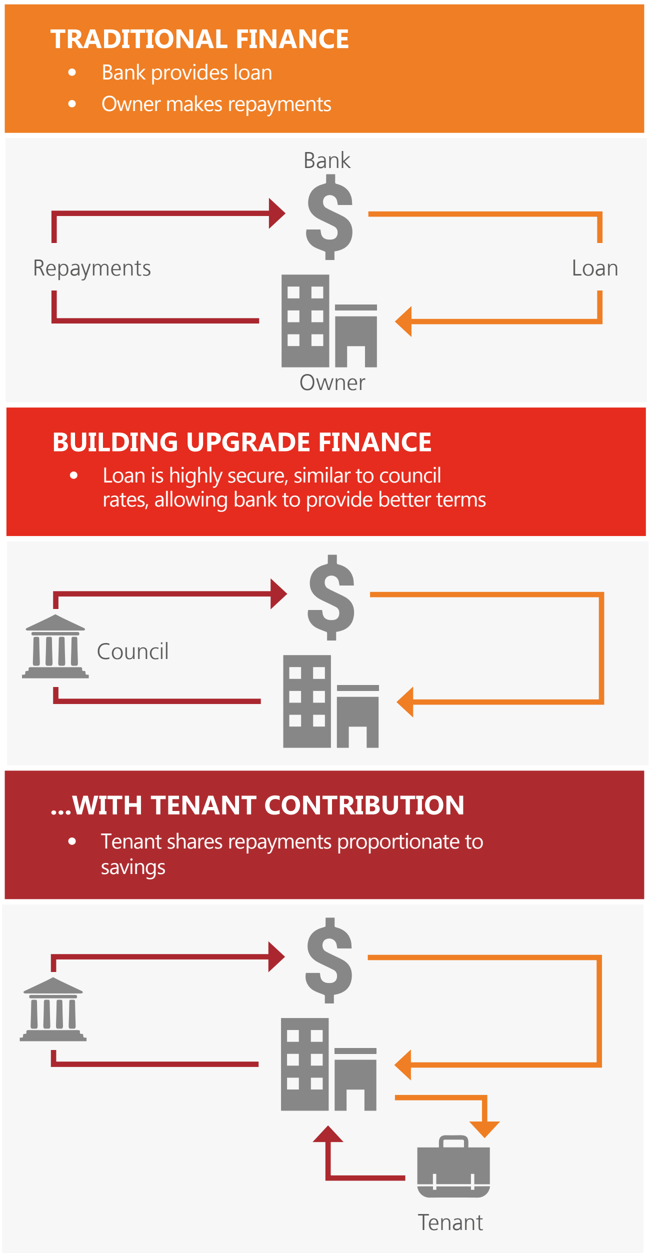
- the building owner agrees to undertake upgrade works to their building;
- the financier agrees to finance the upgrade works; and
- the local council agrees to declare and levy a building upgrade charge against the land on which the building is situated:
    - o this charge is then paid by the building owner to the council as a repayment of finance;
    - o the council then passes the payment on to the financier once received from the building owner; and
    - o the local council should use reasonable endeavours to recover the payments but is not financially liable for any non-payment by the building owner.

As a result of this arrangement, the loan is effectively tied to the property rather than the property owner. In the event of the transfer of property ownership, the charge can remain with the property if the purchaser agrees.

The building upgrade charge effectively secures the loan, being ranked in priority to mortgages, taxes and other charges on the property in the event of a default. This provides heightened security to the financier, allowing finance to be offered to the building owner on more attractive terms such as a longer term and fixed interest.

Under many commercial leases, tenants pay local government charges. Provided certain tenant-protection conditions are met, the mechanism provides an avenue for building owners to recover tenant contributions toward the charge and share the building upgrade costs and resulting utility savings with tenants.

Consequently, the mechanism addresses two barriers that often impede building upgrades from going ahead. These are access to capital and the split incentive between landlords and tenants in leased buildings, where the building owner incurs the cost of the upgrade, but the tenant receives the benefits through reduced energy and/or water costs, and improved accommodation.



Source: Sustainable Melbourne Fund

KEY RESPONSIBILITIES UNDER THE BUILDING UPGRADE FINANCE MECHANISM

BUILDING OWNER	FINANCIER	LOCAL COUNCIL
• Enters into a building upgrade agreement • Undertakes upgrade works • Makes payments towards a building upgrade charge to the local council • May recover tenant contributions to the building upgrade charge, provided the provisions of the Act[1] and Regulations[2] are complied with	• Enters into a building upgrade agreement • Finances the upgrade • Receives repayments from the local council	• Enters into a building upgrade agreement • Declares and levies a building upgrade charge • Issues the payment notices and collects repayments from the building owner • Passes payments to the financier when received from the building owner • Can charge service and late payment fees • Not liable for any non-payment by the building owner • May sell land for non-payment of the building upgrade charge (or any amount of it) in accordance with the Act and Regulations

WHAT BUILDINGS CAN BE UPGRADED USING THIS MECHANISM?

To qualify for the mechanism, a building must be:

- predominantly non-residential - this comprises a broad range of commercial and industrial buildings, including office buildings, shopping centres, hotels and factories, warehouses, wineries and chicken sheds, and so on. Residential properties are not eligible to access the mechanism;
- at least two years post-construction.

The building should also be located in a municipality that participates in this voluntary mechanism.

A building does not have to be located on rateable land to be eligible for Building Upgrade Finance.

A building located on Crown land may enter into a building upgrade agreement provided a user of this land has received consent to do so from the Minister in accordance with the Act.

1 *Local Government Act 1999*, Schedule 1B

2 *Local Government (Building Upgrade Agreements) Regulations 2017*

WHAT UPGRADES QUALIFY FOR THE MECHANISM?

Upgrades must be undertaken in respect to an existing predominately non-residential building. Eligible upgrades fall into the following two categories.

ENVIRONMENTAL UPGRADES		HERITAGE WORKS	
Works that improve the energy, water or environmental efficiency or sustainability of a building	Examples of envisaged environmental upgrades include: • solar photovoltaic systems (with or without energy storage) • double glazing • energy efficient lighting • cogeneration and tri-generation systems • replacement of inefficient air conditioning plant and equipment • water efficient fixtures • waste infrastructure systems • ‘end-of-trip’ facilities.	Works that maintain, repair, upgrade or reinstate heritage significance Works associated with Building Code and disability access compliance Works that facilitate the heritage building’s ongoing occupation	Examples of envisaged heritage works include: • repair or replacement of decaying building fabric of heritage significance • reinstatement of missing fabric where considered to enhance the heritage significance • removal of later additions unsympathetic to the heritage significance • works associated with the ongoing protection and preservation of fabric • equitable access upgrades in accord with the Commonwealth Government’s *Disability Discrimination Act 1992* and associated standards • seismic upgrades • services upgrades, where triggered due to regulatory requirements.

SHARING THE COSTS AND BENEFITS OF THE UPGRADE WITH TENANTS IN LEASED BUILDINGS

One of the key differences between financing an upgrade through the Building Upgrade Finance mechanism, compared with a traditional loan or a self-funding approach, is that the mechanism has the capacity to unlock tenant contributions towards the capital cost of the upgrade.

This can occur via two pathways:

- a tenant may consent to pay a contribution to a building upgrade charge (‘consent’ pathway); or
- a building owner may require the tenant to pay a contribution provided the owner has demonstrated, using an approved methodology published in the Government Gazette, that such a contribution will not exceed the tenant’s cost-savings that would result from the upgrade (‘no worse off’ pathway).

BUILDING OWNER REQUIREMENTS UNDER THE 'NO WORSE OFF' PATHWAY

Under the 'no worse off' pathway, the building owner will be required to:

- notify the tenant of the contribution and a schedule of payments;
- include in the notice the estimate of cost savings for the tenant resulting from the upgrade.

To protect tenants, the Regulations specify annual building owner reporting requirements and 'make good' provisions which apply to the 'no worse off' pathway.

In summary, the building owner is required to:

- use the Government-approved methodology to report annually to the contributing tenant on cost savings made by the tenant and;
- credit or refund the tenant with the exceeded amount if tenant cost savings were not achieved, and reduce the future tenant contributions to this lesser amount.

To ensure that the mechanism provides for flexibility, the building owner and the tenant will be able to agree that the above requirements do not apply or are modified.

METHODOLOGY FOR ESTIMATING TENANT COST SAVINGS

If the building owner chooses the 'no worse off' pathway to recover tenant contributions towards the building upgrade charge, the building owner is required to use the Government-approved methodology to estimate tenant cost savings.

The methodology has been developed to provide a robust pathway to estimate tenant cost savings whilst minimising the costs associated with its application. It uses a number of ways to suit a wide range of environmental upgrades which give rise to gas, electricity and water utility savings. For example, a simple approach may be applied for upgrades with more 'predictable' performance (e.g. a lighting upgrade). More complex options are specified to suit more complicated upgrades requiring engineering models (e.g. an upgrade of an air-conditioning system).

To assist the understanding of the methodology, a Guide has been developed, targeting property stakeholders with technical knowledge, consulting engineers and service providers.

For more information regarding Building Owner requirements and Tenant Contributions refer to the *Local Government (Building Upgrade Agreements) Regulations 2017*.

For more information

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