

June 3, 2008

## Memorandum

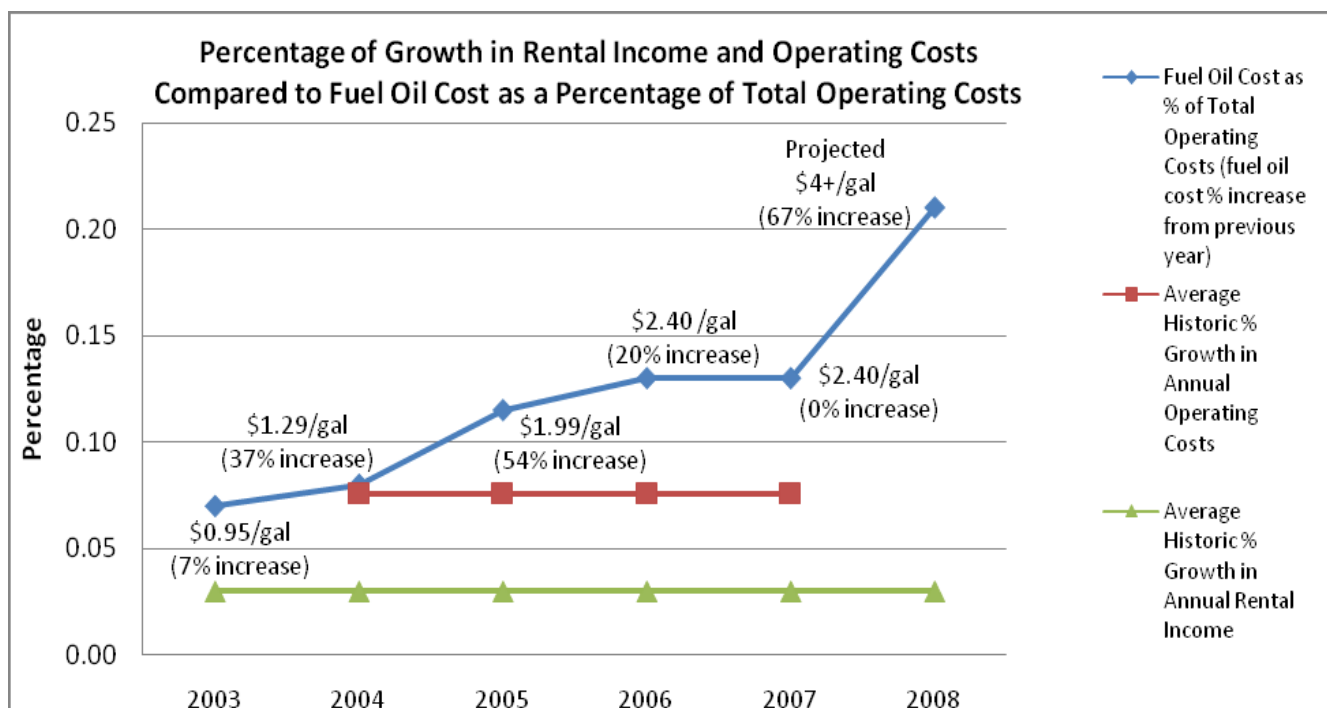
RE: Rising energy costs & VT affordable rental housing portfolio

From: Craig Peltier, Vermont Housing & Conservation Board

Over the past several decades, Vermont has built and rehabilitated some of the most innovative and successful affordable family and senior rental housing in the country. Many of these properties have been key components to revitalizing Vermont's downtowns, village centers and rural communities. In addition, Vermont's affordable housing development has often provided national models for the integration of development objectives with the goals of both the historic preservation and land conservation communities. As a result of these efforts, Vermont's combined network of housing providers today manage over 12,000 units of rental housing which provide safe and affordable housing options to many of Vermont's most vulnerable populations.

Some of the results of the integration of the above goals and strategies are reflected in the fact that Vermont has the lowest average development size in the country and the highest percentage of rural units in the country. Although much about Vermont's affordable housing development past is to be admired, the small and rural nature of its housing has come with various operational challenges which on some level magnifies the structural challenges experienced by all affordable housing providers across the country. Primary among these are the large number of smaller, older rehab. buildings in the statewide portfolio, which although renovated to the standards of the time, do not reflect where properties should be with regard to their building envelope efficiencies in today's challenging energy environment.

Although VHCB has had energy efficiency guidelines since the early 1990's the time may have come for a substantial review of the way affordable housing is built and renovated. The "Energy star" standards may need to evolve into one in which building envelopes are built to much smaller energy load requirements. In addition alternative energy generating technologies may also begin to provide options that housing providers are operationally comfortable with and that help mitigate inflation risk going forward.



The developing operational energy challenges are summarized in the graph above taken from a representative sample portfolio. Although other sources of heating fuel are used in Vermont, the predominant fuel is oil, and oil is the fuel commodity best able to reflect upon the developing challenges to operational budgets. Heat is typically included in the rent payment and is thus the responsibility of the housing provider. The triangle line marks the average rate of rent increases and thus revenue growth in the portfolio, approx. 3%/yr. The square line represents average percentage growth in operational budgets. Although growth in operating costs is quite variable from property to property, on average it has been increasing at over twice the rate of revenue growth. Growth in operational costs has been substantially impacted by the growth in oil prices as reflected in the diamond line. For example, in this sample portfolio, the 2004 vs. 2005 oil contract price jumped 54% to \$1.99/gal. This increase resulted in fuel oil alone representing nearly 12% of total operating costs vs. 8% in 2004. Going forward fuel oil contracts, after being stable for the past year, are expected to jump sharply again in summer '08 as contracts are signed for the '08-'09 heating season.

The impact on tenants and housing providers can be illustrated through the following example: At \$.95/gal. a unit of housing that historically uses 500 gallons of heating oil per year would represent \$475 in cost to a properties operating budget. At \$4/gal. this same 500 gallons would cost \$2,000, an increase of over \$1,500/yr. (300%). Over the past five years, a property with 20 units has thus experienced an increase in annual operating costs of over \$30,000/yr. (\$1,500/unit x 20 units). With over 7,000 units of housing in the statewide portfolio being heated with oil (or propane, which has experienced similar price spikes) the combined annual statewide impact to operating costs is over \$10M/yr.

Compounding the increase in costs to housing providers is the growing number of rent collection delinquencies. As lower income tenants struggle to pay for rising gasoline, food and other living expenses they are finding that making their rent payments is becoming more difficult. Even tenants with rental assistance, whose rent contribution is capped at approx. 1/3 of their income, are experiencing increased rent payment delinquencies. Recent studies have also shown that Vermont's lowest income citizens are experiencing income growth at less than the rate of inflation further compounding this difficult economic environment.

Going forward VHCB will work with our statewide partners in order to develop strategies to address this challenging operational environment. Some of the ideas we wish to pursue include the following:

- \*Develop short term subsidies to housing providers to help mitigate operational budget shortfalls likely to develop during the '08-'09 heating season.

- \*Develop revenue sources to allow VHCB/VHFA to continue to expand upon their work with Efficiency Vermont, housing providers, VT weatherization agencies and others to continue to target properties for weatherization upgrades and possible transition to alternative energy generating systems where appropriate. In '06-'07 VHCB/VHFA began this targeting process based upon total utility costs per unit. Efficiency Vermont has been working for many years to reduce demand on the electrical side throughout the statewide housing portfolio. The targeting process for the VT affordable housing portfolio involved having Efficiency Vermont analysts perform comprehensive energy audits which targeted all systems in the building and most importantly the building envelope itself. Housing providers have begun to work with VT weatherization agencies and others to fund and implement these recommendations. There is currently limited funding for this effort however, and expanding this funding should yield substantial long term savings.

- \*Provide for changes in federal, state, local and private funding methodologies to implement long term operational life cycle cost analysis as an integral component of the development budgeting process. With likely permanently higher fossil fuel energy prices, the up front additional cost of more advanced weatherization as well as alternative energy generation systems should be analyzed from a complete life cycle cost perspective.

- \*Initiate conversations with historic preservation community to explore mutually acceptable alternatives to current preservation protocols particularly related to the enhancement of the energy efficiency of windows and building envelopes.