



## Building Upgrade Finance Factsheet

On 12 March 2018 the Property Council of Australia (WA), the City of Perth and CitySwitch hosted an industry seminar on Building Upgrade Finance with speakers from organisations playing a leading role in this space across Australia, including:

- Scott Bocskay, CEO, [Sustainable Melbourne Fund](#)
- Richard Day, A/Director Low Carbon Economy Unit, [South Australian Department of Premier & Cabinet](#)
- Fairlie Delbridge, Director, [Cminus \(consultancy based in South Australia\)](#)
- Michael di Russo, Associate Director, [Clean Energy Finance Corporation](#)
- Shay Singh, Executive Manager, [Better Building Finance](#)
- Rachael Scott, Environmental Finance Manager, [Eureka Real Assets](#)
- Sarah Wigley, Sustainability Advisor, City of [Adelaide](#)
- Tim Wong, Senior Policy Officer, [NSW Office of Environment & Heritage](#)

The seminar offered attendees the opportunity to hear the learnings from NSW, Victoria and South Australia where Building Upgrade Finance is already in place. Presenters at the seminar drew from their experiences to provide advice on the advocacy opportunities and benefits associated with Building Upgrade Finance, and on legislation and policy design considerations pertinent to WA.

From the seminar, it is clear that Western Australia is ideally placed to capitalise on lessons learnt by other states and to ensure that any processes put in place to roll-out Building Upgrade Finance are optimised to take advantage of existing resources and mechanism.

### What is Building Upgrade Finance?

Building Upgrade Finance (BUF) is an innovative way to finance commercial building upgrades. BUF allows building owners to access competitive fixed interest, flexible funds to upgrade buildings, driving down operational costs, increasing rental yields and improving tenant retention / lower vacancy rates.

BUF has advantages over conventional finance because building owners can access up to 100% of their upgrade cost. It also allows owners to borrow up to 80% of the value of their asset.

Tenants and owners can share in the costs and savings associated with BUF, making BUF a win-win for both parties.

From energy efficiency upgrades in commercial buildings in metro areas to light industrial applications in regional and rural areas, BUF is a tool for all types of local governments to collectively pursue improved outcomes in their built environment.

Parties to a Building Upgrade Agreement:

- **Building Owner** – defines the project(s), applies for finance, repays the loan.
- **Lender** (financier) – conducts financial due diligence, provides the funding (loan).
- **Local Government** – registers and maintains security of the loan, collecting payments through rates from the building owner and forwarding to financier.

### Who can use BUF?

Most building types are eligible, including commercial, industrial, agricultural, retail and heritage buildings.

The range of eligible works is quite extensive and includes things such as water, waste and energy efficiency, HVAC, lighting replacements, solar PV, glazing, external shading, and green infrastructure such as green walls and ground cover - in fact even things like end of trip facilities can be included.

## How does it work and who does it work for?

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

- The building owner agrees to undertake upgrade works to their building.
- The financier agrees to finance the upgrade works.
- The local government agrees to declare and levy a building upgrade charge (BUC) against the land on which the building is situated.
  - This charge is then paid by the building owner to the Council as a repayment of finance;
  - The Council then passes the payment on to the financier once received from the building owner, less any Council administration fees; and
- BUF allows a loan for building upgrade works to be tied to a property, rather than a property owner.
- The BUC effectively secures the loan, being ranked as a priority against mortgages, taxes and other charges on the property in the event of a default.
- Councils are not financially liable for any non-payment by the building owner, however are required to use reasonable endeavours to recover any unpaid payments.

BUF has multiple stakeholders, however its key beneficiaries are building owners, tenants and local governments.

The mechanism has the potential to:

- stimulate jobs and investment in the property sector;
- provide opportunities for local manufacturers and suppliers of clean technologies;
- improve the quality and amenity of buildings; and
- reduce the impact of rising energy and water costs on businesses.

### **Benefits for Building Owners:**

- Obtain finance for up to 100% of the total project costs
- Can access up to 80% of the capital value of the land
- Longer term financing that enhances cash flow – operationalising what might have been a capital expenditure and enabling business owners to bring forward planned asset upgrades
- Requires no additional security or guarantees
- Overcomes split incentives and provides ability to pass through costs to tenants
- Provides a simple solution to building upgrades – no need to update leases
- Contributions can be requested from tenants to help service the loan, improving return on investment and payback periods
- Potential to access longer loan term (10-20 years) fixed rates that are more attractive than traditional commercial financing (2-5 years)
- Debt tied to the property not the owner (so doesn't affect existing loan to valuation ratios)
- If desired, the debt can be transferred to the new owner if the property is sold
- Energy savings can effectively pay back the capital outlay

### **Benefits for Local Government:**

- Ability to attract investments and stimulate economic activity with private sector funding
- Prevent capital leakage from communities
- Contribute to emissions reductions for regions
- Create affordable opportunity for business to address rising energy costs
- Facilitating sustainable finance for sustainability initiatives

For a guide on BUF for Local Government, see link:  
<http://www.lga.sa.gov.au/page.aspx?u=6640&c=78806>

### **Benefits for Tenants**

- Improves amenity with zero upfront capital outlay
- Any financial contributions a tenant makes are equal to or less than the energy bill savings resulting from the upgrades
- The tenant can never be financially worse off

### **Broader Benefits**

- Creates economic opportunities – activating underutilised premises
- Rejuvenates business precincts
- Expands rates base (upgrades may increase building values)
- Provides an additional council service on a cost recovery basis for commercial building owners
- Makes heritage buildings more attractive for commercial purposes
- Increases building and disability code compliance
- Delivers environmental benefits

## **What is required for BUF to be enacted in WA?**

### **Legislative Change**

Legislative change is required in Western Australia for local government to participate in BUAs, declare the charge, levy and collect payments. Currently this is a barrier to entry for Western Australia.

An amendment to the *Local Government Act* describing minimum Local Government involvement, existing mortgagee considerations and tenant pass-through criteria is the first step to creating and enabling an environment for BUF in WA. Lessons from other states show that keeping the wording of the legislation simple and encouraging standardisation of the program is most effective.

For the first time in more than 20 years, the WA Local Government Act 1995 is being reviewed to modernise the outdated laws and reduce red tape. The review is being conducted over two phases and the Property Council and the City of Perth lodged individual submissions in response to the first phase which focused on accountability and transparency of Local Government.

Phase two is anticipated to be open for public comment in August 2018. The Property Council and the City of Perth will lodge a joint submission advocating for the legislative changes that would allow for Building Upgrade Finance to become a reality.

After submissions on the *Local Government Act Review* are considered by the Department, drafting of the Bill will be progressed by the Parliamentary Counsel's Office. Any submissions raising issues that won't be able to be addressed through

legislation will be forwarded to the relevant agency to respond to. Once the legislation is enacted by Parliament, the formulation of associated policy and regulatory instruments required for the implementation of Building Upgrade Finance shall be considered.

### **Establishment of a simple, collaborative implementation process**

Lessons from other states have shown that taking a 'launch and wait' approach is not ideal, and that a well-designed implementation process, coupled with advocacy and early adopter / critical stakeholder engagement is more likely to see successful uptake. Working with engaged stakeholders across the multiple stakeholder groups including building owners, lenders, contractors, tenants and local governments is optimal.

Early consideration of fundamental issues such as: set-up and administration costs; administrative framework; funding partners; program guidelines; strategic partnerships; market demand; eligibility and approval process; risk management and mitigation and communications and marketing will also smooth the way to a seamless roll-out.

## **Why are the City of Perth and the PCA (WA) advocating for Building Upgrade Finance?**

Perth is experiencing a transition from the construction phase of the resources boom to the production phase. Perth, and Western Australia more broadly, is experiencing challenging economic conditions that have resulted in downward pressure on the Perth commercial buildings market.

At the height of the boom, average rents in the Perth CBD peaked at almost \$900 per square metre. Since then the economic conditions have softened, many long-term leases have ended and the commercial buildings market has experienced 25-year high record vacancy rates. For tenants, this presents an opportunity to negotiate new leases, new terms and new options.

For Local Government, planning tools influence the design and performance of new buildings, however our ability to apply incentives to or influence building upgrades to existing buildings is limited. The challenge for Perth is how to address its existing non-premium building stock.

It's worth noting however that vacancy rates have fallen significantly in Perth's Premium Grade office sector, from 11.7 to 6.3 percent. The lower vacancies in premium and A grade office stock suggests a flight to quality in Perth's commercial buildings market, demonstrating that Perth tenants want higher-performing buildings.

For B and C Grade building stock the opposite is true. These buildings, with out-of-date finishes, services and utilities, represent approximately 62 percent of the CBD's office space. It is also these buildings that have been hit hardest by Perth's high vacancy rates, experiencing an average vacancy rate of around 25 percent.

Higher performing buildings deliver better returns for owners and for tenants. Conversely, poor performing buildings have broader impacts than the obvious high cost implications. The City's greenhouse gas emissions profile reveals that buildings are responsible for 65 percent of emissions across the Perth local government area. Commercial buildings alone make up 51 percent of city-wide emissions.

### **Upsides and economic incentives**

Aside from the obvious environmental benefits, studies have shown buildings with better environmental performance experience what's called a 'green premium in value'. Buildings with higher NABERS energy ratings can achieve higher investment returns, lower operating costs, higher asset values and lower vacancy rates. The *Building Better Returns* report (2011), published by the Australian Property Institute and Property Funds Association, found that Green Star-rated buildings are delivering a 12% 'green premium' in value and a 5% premium in rent, when compared to non-rated buildings. Combined with better indoor environment quality, higher performing buildings provide healthier, more comfortable and more productive working space.

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.

### **Call to Action**

The Property Council and City of Perth plan to prepare a submission during phase two of the Local Government Act 1995 Review.

You can join us by providing input into our submission and/or prepare your own via this link: <https://www.dlgc.wa.gov.au/LegislationCompliance/Pages/LGARReview.aspx>

## For Further Information

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