# Sadie Mckeown

| | |
|---|---|
| **Duration** | 00:25:36 |
| **Speakers** | Luba Kim-Reynolds, Director, Multifamily Capital Markets, Freddie Mac Multifamily<br>Sadie McKeown, President, Community Preservation Corporation |

**Luba Kim Reynolds** [00:00:05] Welcome to the Optigo Extras podcast series where we are zooming into certain topics which relate to the latest trends in multifamily lending, capital markets and impact investing. My name is Luba Kim Reynolds and I lead our Multifamily Investor Relations in the HD Initiatives team. Today we will be focusing on decarbonization of affordable housing in New York City. We have an amazing guest, Sadie McKeown. Sadie is the President of Community Preservation Corporation. In this capacity, she leads the development implementation of CBC 's growth strategy and oversees all of the company's field offices, initiatives and its equity in impact investing platforms. Sadie has a very long list of accomplishments and sits on multiple boards like New York State Housing Finance Agency, New York State Energy Research and Development Authority, and a few others. She's a true visionary and pioneer, and I know firsthand that the topic of decarbonization of affordable housing is near dear to her heart. So, Sadie, can you tell us a bit about your background and your work on decarbonization?

**Sadie Mckeown** [00:01:15] Sure. Thank you for having me, Luba. It's a pleasure to be on and participate in this important conversation. As you mentioned, I'm the president of CPC. My history at CPC is long. I've been here for 31 years. I was a lender for 20 years, primarily doing construction loans across New York State to redevelop and revitalize multifamily housing. CPC has a focus on affordability, so we really primarily are an affordable housing lender, although we do a lot of downtown revitalization and economic redevelopment as well. And we became interested in decarbonization at CPC back in 2008 when there was a recession and the cost of energy was very high and we tried to help owners get their buildings into better condition so that they were more energy efficient because the true way to drive down the cost of energy is to make your to maximize the efficiency in your building. And so we started with energy efficiency and then over time, as our partners in the public sector changed their view of energy efficiency to include electrification and now decarbonization we followed along and have supported those initiatives and those regulations that we now have in New York City and New York State, to get buildings off of fossil fuel. Buildings are a large contributor to greenhouse gas emissions and in New York City and in New York State, they've enacted laws on the books in 2019 to require owners of properties to decarbonize and move over to electricity. At the same time, New York State and New York City are working hard to clean the energy grid so that when everyone converts over to electricity, that electricity is being powered by renewable sources and not by fossil fuel, which the large percentage of electricity is today.

**Luba Kim Reynolds** [00:03:01] Thank you, Sadie and I'm sure everyone is convinced now you know quite a bit about this topic, so really happy to have you on this podcast. And then you mentioned laws, right? So let's maybe start from the law angle in New York City. And I'm sure a lot of people recently heard or maybe not yet about local law 97. Do you want to give us a little bit background what that is and maybe even a little bit of a history of that law?

**Sadie Mckeown** [00:03:27] Sure. So as I mentioned, greenhouse gas emissions, 40% of them come from the built environment. And it is the case that 80% of the buildings that are in New York City today will be here in 100 years, or at least that's what people suggest. So if that's the case, then we need to get existing buildings off of fossil fuel if we are going to address climate change. And we really can't ignore climate change anymore. When Michael Bloomberg became the mayor of New York City, he was the first

to really focus on and look at addressing climate with laws on the books. And so it wasn't until Mayor Bill de Blasio that the city actually passed legislation under Mayor Bloomberg there was a lot of work towards getting building owners and city legislators to focus on climate and reduce our reliance on fossil fuel emissions. But in 2019, the Climate Mobilization Act was passed, and that act has a series of local laws embedded in it. And the one that's most important is local law 97. There are others around solar and other way, energy efficiency and things like that, but local law 97 essentially puts a tax on carbon. And what the Climate Mobilization Act actually does is call for decarbonization by mid-century, which is consistent with the state's climate legislation, the Climate Leadership Community Protection Act. And both laws really look at decarbonizing buildings with a focus on affordable housing and really looking at environmental justice as a core component of the legislation. So in New York City, local law 97 in 2024 is the first trigger and then in 2030 requires that buildings, larger buildings over 25,000 square feet, reduce their reliance on fossil fuel and move to decarbonization to decarbonize the properties. And in 2024, there is a set of buildings, mostly larger buildings and not affordable buildings, because regulated buildings are exempt that if they are continuing to produce the amount of carbon that they are currently producing, if it's over a certain level, they have to pay a price, have to pay, gets $268 a metric tonne of carbon over their allowable amount. So to put that in context for you, CPC has a 300 unit co-op in Queens, in our portfolio, in our construction loan portfolio, which is burning oil, and in 2024, it's highly inefficient and the boiler is really old, in 2024, it's subject to fines of about $100,000 a year. Those fines go up so that by 2030 it's almost half a million dollars a year. So unless that co-op is able to address its heating system and move to a better heating system, either electric heat pumps, ground source, heat pumps or natural gas, it will be subject to those fines. Now, having said that, it's very expensive to do that conversion to heat pumps and so there's a whole analysis that has to take place on what are the fines versus what is the cost of doing the work. In the case of this co-op, they were able to access natural gas because their system is 40 years old they're able to replace it with a natural gas system and significantly reduce the burden of the fines. They'll be exempt in 2024, but they'll be subject to fines in 2030. So any and all buildings in New York City that are over 25,000 square feet need to be paying attention to what those fines will be and then I would suggest that our interest at C.P.S. is that the lenders that have loans on those assets need to be looking at the risk that those fines create and debt service coverage. Because just like when a tax abatement ends in the middle of a loan, you have to underwrite full taxes, when that tax abatement is over, you have to underwrite these fines out into the future if the building is not undergoing a decarbonization strategy.

**Luba Kim Reynolds** [00:07:33] Thank you Sadie. This is very interesting and I did not realize, as I'm sure a lot of other people as well, that this effort has been out there for a while and it took multiple steps to get to Local Law 97. But thank you for sharing the example of the co-op as well and the word expensive really stood out to to me. Obviously a law like this will require significant capital expenditure to make the permits and I can only imagine how challenging it might be for affordable housing to comply with the law. Are there any resources out there that can help finance the improvements?

**Sadie Mckeown** [00:08:16] Absolutely. There are resources available. I'll start by saying there's not nearly enough resources to get to every single building that is low or moderate income or small building. So it's small buildings also struggle with challenge economics. So let's just say, for instance, that it costs 30 or $40,000 per unit to decarbonize a building. And you're an affordable housing building and you have rent restrictions, and you can't just increase rents to generate the income necessary to cover the cost of additional debt. To do that work, you need to look for other resources. So New York City and New York State have made resources available for affordable housing in different forms as well as the utility companies. So Con Edison and National Grid in New York all have programs that have incentives for people to get to all electric buildings. There are limited resources, but what they're trying to do with those resources is generate demand. So in addition to rebates that you can get for heat pumps through the utility companies, nice shirt out there, which is the New York State Energy Research and Development Authority has several programs. Their money comes from ratepayer dollars as regulated through the Public Service Commission. NYSERDA takes ratepayer dollars that they have and puts them into their programs for low and moderate income buildings. And there are grants available to developers who are developing all electric new construction, as well as grants and resources available through Retrofit New

York, which is a program to try to retrofit existing buildings. At the same time that on the energy side, they're trying to incent buildings to convert and also NYSERDA is also investing in companies that are driving the technologies necessary for these buildings in the future. The state and city housing agencies are also working to support and incent decarbonization. So in New York State now under their QAP, all new construction will have to be all electric. So any affordable housing deal that's developed that has access to subsidy from New York State has to be built all electric. And so what they've done is work with NYSERDA, so that NYSERDA who has a priority for decarbonization of all buildings, but specifically affordable housing, takes their ratepayer subsidy dollars and gives them to HCR, the housing agency, so that when you're awarded a 9% tax credit, you're also awarded an increment above that from NYSERDA to get that building to decarbonization because it does currently cost more. And they call it a one door solution. New York State and NYCERDA and HCR worked very closely together to create a one door solution so that an affordable housing developer that's already challenged by multiple lawyers, lots of different sources in these deals, lots of different documents could have a more streamlined process for building a decarbonized, all electric building. The next thing that HCR, the state housing agency, is doing is rolling out a Climate Friendly Homes Fund, which is a grant program for existing small buildings, buildings from 5 to 50 units that need to decarbonize and they're all grants. So you will be able to access between 25 and $35,000 a unit to convert your building from existing fossil fuel, either gas or oil, to all electric. The state and the city are putting their money where their mouth is. HPD, which is the city housing agency, also has resources available to affordable housing to help incent decarbonization because there is a recognition that the economics of adding something that costs more without a source to pay for it doesn't work. So they really are trying to do all of this at this same time to drive that demand so that eventually the cost of that construction will come down and become business as usual.

**Luba Kim Reynolds** [00:12:11] This is fascinating Sadie, I did not know that there is so many subsidies in place.I'm really glad to see how various agencies and companies in New York City are working towards the same goal. But please correct if I'm wrong though, but that sounds like a lot of those subsidies will be available for capital affordable housing. But what about the other workforce housing or naturally occurring affordable housing? Are there enough subsidies for this type of housing or  the borrowers need to look for other sources of capital?

**Sadie Mckeown** [00:12:43] It's a very good question. The New York State grants through the Climate Friendly Homes Fund is for both regulated and unregulated affordable housing. So the focus there is 80% of AMI and less. So it's workforce and it's small buildings, 5 to 50 units. The rest of the programs are primarily focused on big A affordable. But the other thing that I want to point out is that a lot of buildings, even though they're naturally occurring, maybe they have a low level of first mortgage debt. They may have the ability to access capital through the first mortgage or through a supplemental mortgage to try to get to decarbonization. So there are other opportunities, other ways for buildings to access capital. It just might not be free capital. One of the things that CPC has been very focused on is trying to find either impact investors or other first mortgage providers that are willing to discount that first mortgage an amount that is helpful towards leveraging additional debt so buildings can get to decarbonization through the first mortgage process without having to try and access an incentive or a grant because not every building will qualify. But it is challenging. It's hard to do it all at once because it's expensive. And so the other thing that we advocate at CPC is that there be a plan to get to zero over time. And one of the things about local law 97 is that even if you're exempt from the carbon fines in 2024, you are required to implement 13 different prescriptive measures over that time between now and 2024 to make your building much more energy efficient. They're not particularly expensive things. It's things like air sealing, changing your light bulbs, aerating sinks and showerheads, wrapping pipes, and really making your building much more energy efficient so that you have a head start when it comes time for you to replace your major system and move to an all electric system.

**Luba Kim Reynolds** [00:14:46] Gotcha. And it sounds like in order to make the math work, to get the necessary improvements dones, all the parts of the capital stack need to be motivated. Equity needs to be motivated from the value and the impact investing angle, subsidies need to be in place, and finally

lenders should be a part of the solution. So here at Freddie we have a green up program that subsidizes board to make efficiency improvements and a perfect program to help with the solution. And i know these type of laws are being passed in various jurisdictions now, so why do lenders need to pay attention and participate? I think we do understand the risk side, but what about from the value perspective?

**Sadie Mckeown** [00:15:39] Yes, absolutely. So we have gotten to a place in the world where we can no longer ignore climate. And I'll just very briefly give you a little statistic. So from 1980 to 1989, there were a total of 31 billion dollar a year disasters, which meant there were three events a year. In 2021, just in one year. It has incrementally increased over time, but in 2021, in one year, there were actually 20 events. So we've gone from three a year to 20 in one year, and that one year was $148 billion of cost to repair the assets that were impacted by the storms created by climate change. And so the headline is 'we all have to pay attention,' not just the first mortgage lenders, the owners, insurers, everyone, contractors, builders, we all need to start paying a lot more attention because it's it is important. The reality is, in New York City, it's an extreme case because of the fines, there is a real economic impact, but if you don't address it and the city and the state convert to clean electric, there will be less and less investment in the fossil fuel grid. And so the cost of staying on gas or oil is going to increase significantly because there will be less and less investment in that infrastructure as the investment in the electric grid increases over time. And so what you don't want is to not have decarbonized. It'll absolutely impact the value of your building, which will go down and you'll be a stranded asset in this conversion from fossil fuel based heating and cooling to all electric based heating and cooling. So it not only has an economic impact from a cash flow perspective because you have. Now pay fines that you didn't have to pay before. The cost of your fuel is going to get more and more expensive. So you want to get there. You want to do it smart. You want to do it over time so that you don't have to bear the economic impact all at once. You want to look for all those incentives. You want to reach out. And I will say that the other thing that CPC advocates for, and I really believe this about first mortgage lenders, first mortgage lenders are also in the policy business. And so we need to advocate for other tools as first mortgage lenders so that when we make a loan, it's not just born on the back of the first mortgage. And, you know, I like to think about the 1970s when cities, New York City is a great example, were on their knees from economic disinvestment with manufacturing having left jobs having left...and population leaving the city. And there was significant deterioration and abandonment of buildings. The city owned hundreds of thousands of apartments in REM that they had taken for tax foreclosure. There was a huge priority to reinvest and get people to come back to cities, but first mortgages couldn't do it alone because you could never leverage enough in a neighborhood that had vacant buildings. And so the city recognized that, and it wasn't the first mortgage lenders pushing, it was the city itself pushing, but they recognized they needed other tools. So they created a 20 year tax abatement. You could buy a building for a dollar, you could get a first mortgage from either CPC or another lender in one of their programs, and then they would back into whatever subsidy was required to take a vacant building back to full utilization, fully renovated and ready for occupancy. And that level of participation and collaboration across sectors really contributed to the solution. So when I think about climate, I think it's very similar in my mind that you need several tools. So whether that's a tax abatement, if you are already affordable housing, you probably don't pay taxes in New York City because the tax abatements are there to support affordability. But in non-regulated buildings that are paying full taxes, there could be an increment or a discount on your real estate taxes over a five or ten year period to create the space in your cash flow, in your economics, to be able to borrow the money to get to decarbonization. There could also be utility rates that are set at a lower number and fixed for a certain amount of time so that an underwriter so that a first mortgage lender can provide the capital to do the work. That's our role, is to provide the capital and feel secure, that there's not a risk because we know what the real estate taxes will be X for a certain amount of time or utility rates will be lower for a certain amount of time. There's a bunch of things that can be done in collaboration across the private and the public sector. And then for their part, you know, lenders can do things like deeper discounts and rates. Kudos to Freddie and Fannie for having their green up and green rewards programs, which are great to get to people, to efficiency, to get to decarbonization, you might have to dig a little bit further. And I would suggest that the other thing that needs to happen is to create a secondary market through the

securitization of true impact investors that are willing to buy debt at a slightly lower rate because it is so specifically indirectly supportive of climate impacts, true green impacts.

**Luba Kim Reynolds** [00:20:57] This is great and that's exactly what we've been thinking and trying to do the past few years where we created those loan programs and then we put them in our green bonds and definitely trying to get to efficient second market liquidity where a lot of investors can invest and provide this impact capital to support some of those great projects, to help to decarbonize, especially as you know, workforce housing is the bread and water, it's what we do. And it sounds like there's still a little bit of a gap and we can do a little more in that space.

**Sadie Mckeown** [00:21:35] Yeah, you know, I would say it's hard because there isn't currently regulation mandating lenders to do this. And so when I referenced the 1970s in New York City in 1976, the Community Reinvestment Act was passed and that put pressure on lenders to make those investments in those distressed cities and communities. There's a lot out there around risk and disclosure right now in the mortgage markets, but there's no specific requirement for lenders to do this. And so the onus is on the lender to step up and take that risk seriously and really evaluate that risk and say, how do I want to address that? But unless and until there's true regulation, it's hard to find that investor that stepping in and saying, okay, I have a requirement to do this. But I wanted to talk a little bit also about what you asked before around the risk, because there are two types of risk. There's the physical risk to the buildings and then there's transition risks. And when you're talking about physical risk, there's acute risk at the actual building that you're financing. So whether it's in a flood zone or it's near a place where there's wildfires, there's acute physical risk in any asset, some more than others, clearly. But then there's that chronic physical risk. As the climate continues to drive change. So flood zones, you know, have all been redrawn and there are now 100 year flood zones have changed and are much larger. And we've seen precipitous flooding over and over again in certain locations. And so there is general increased heat across the globe, obviously not just in the United States, but in communities, which absolutely impacts all of the investments that we make as lenders. And then there's that transition risk, right? And so that's where I talk about sort of the stranded assets. So policies and potentially regulation will drive us towards transitioning to get off of fossil fuel. And there's a risk will there be the technologies there, will there be the workforce there to actually do the work to transition the buildings? That's one of the things, you know, New York is at the head of the class in this, really trying to drive that innovation and trying to support companies and a workforce of people to get to that level of performance. And, you know, if you want to be able to convert your building, you need to be able to access builders and technologies that can get you there. And then there's reputational risk. At the end of the day, if you're one of the only lenders that's not supporting decarbonization, there's that potential problem, too, because the younger generations are demanding that institutions really support and address climate change. So there's all kinds of things going on within that risk category and that value proposition around real estate.

**Luba Kim Reynolds** [00:24:19] Thank you, Sadie. This is very informative as it's becoming a trend that is certainly one of the biggest fear when you're writing a long-term mortgage. We're certainly motivated to pay close attention. I really appreciate your insight and sharing your thoughts on this topic, I have learned so much and I'm sure it's going to be very useful for the audience. Sadie, really grateful for you joining this podcast.

**Sadie Mckeown** [00:24:57] Well, thank you, Luba. I really appreciate your inviting me to come and talk about it. You know, it's an institutional priority for CPC. One of our main goals is addressing the transition to a clean energy economy. But for me personally, it's also a passion to really try and do everything that I can in the work that I do to get people to pay attention because it's our future. And sometimes I get overwhelmed thinking about what would happen if we didn't address it. So thank you for having me. I've enjoyed the conversation. I'm happy to come back and talk about it any time.

**Luba Kim Reynolds** [00:25:29] Absolutely. Thank you.