

THE SPLIT INCENTIVE

The Problem – Background

In a majority of multi-family rental properties, utility expenses are not covered as part of rent (72-83% nationwide). In these instances renters bear the monthly cost of natural gas, electricity and water, which eliminates a financial incentive for building owners to replace poorly performing, low efficiency equipment or upgrade the building envelopes. This so-called split incentive is a major barrier to making energy efficiency improvements in multi-family housing.

Policy-Based, State-Wide Solutions for Michigan

The ideal policy for overcoming the split incentive would be a transparent program that includes both landlord and tenant incentives, creates durable energy and cost savings, and addresses program costs primarily through savings. Solutions identified through the course of this initiative include:

1. **Labeling:** Supplying expected energy costs to potential renters at the time of rental. In markets where housing supply exceeds demand, the true cost of renting can drive efficiency upgrades as renters choose low cost housing. In Michigan's affordable housing market demand outpaces supply, which limits the impact of this policy.
2. **Building Codes:** Updating building codes to mandate high efficiency improvements for new building stock. Building codes can improve building performance considerably, however the upfront cost of efficiency improvements could be unpopular and increase rents thereby pricing out low-income tenants.
3. **Utility Rebates:** Expanding utility-based energy efficiency rebate programs to tenants in addition to property owners. Rebate programs exist in many forms, but are typically accessible to building owners or managers only. The major drawback to an expanded rebate program is the complexity of managing unit-by-unit upgrades.
4. **"Bill Neutral" Financing:** Using a third party "market maker" or on-bill financing. This type of financing can be an especially attractive option as it allows for longer pay back periods than building owners typically are willing to accommodate. Additionally, on-bill financing can allow for "bill neutral" efficiency upgrades that do not cost tenants in the short term but allow for savings in the long term. Drawbacks to on-bill financing include tenant education when transferring "debt" to new tenants and securing regulatory approval in the case of a tariff-based program.
5. **Communicating Owner Benefits:** Appealing to owners' long-term interests. The benefits of energy efficiency upgrades include increased property values including an ability to borrow against the increased value, reduced tenant turnover, and improved non-energy benefits such as pest control. A policy that makes property owners aware of the long-term benefits and helps them access these benefits could also help overcome the split incentive issue

Other Considerations

In addition to these policy recommendations, we also identified a need to clarify and segment marketing efforts to address the specific interests and needs of building owners, investors, and property managers independently.

Project Background

These policy options were developed by an independent team of experts in the field of housing and energy efficiency. They were brought together as part of a network of individuals and organizations working to improve energy efficiency in multifamily housing in Michigan. Partners include: Community Economic Development Association of Michigan (CEDAM), Ecology Center, EcoWorks, Energy Foundation, Michigan Energy Options, Michigan Environmental Council, Elevate Energy, National Housing Trust, and Natural Resources Defense Council.

References

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