



BUILDING UPGRADE FINANCE CONSULTATION

Explanatory paper of consultation materials

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Government of South Australia
Department of Environment,
Water and Natural Resources

About

This paper provides an overview of the package of materials that the Government of South Australia is seeking feedback on as part of the *Building Upgrade Finance* consultation. This includes:

- draft *Local Government (Building Upgrade Agreements) Regulations 2016*
- draft 'no worse off' methodology for estimating tenant cost savings arising from upgrade works under a building upgrade agreement (draft approved methodology), and
- draft Building Upgrade Agreement template.

Feedback from the local government, property and finance sectors, tenants of commercial buildings and other interested stakeholders is sought with regard to the content and provisions of, and requirements set out in these draft materials.

Note: In this document 'Regulations', 'approved methodology' and a 'Building Upgrade Agreement template' are taken to mean draft Regulations, draft approved methodology and a draft Building Upgrade Agreement template issued for public consultation.

Note: The draft Building Upgrade Agreement template is intended for consultation and feedback only. It is a working draft document designed for stakeholder feedback and does not represent the final considered position of the Government in relation to any of the matters it deals with. The document is not intended for use in any arrangement, noting that the statutory and regulatory scheme under which the draft template is proposed to be used is not yet complete. The document does not contain legal advice about the operation of the provisions of the building upgrade scheme under the Local Government Act 1999, yet to come into effect.

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1. Introduction

The South Australian Government is establishing a Building Upgrade Finance mechanism in South Australia to help overcome barriers to investment in improving the energy, water or environmental performance of existing commercial buildings.

Following the completion of a business case and a series of consultation processes, with support from the local government, property and finance sectors, in February 2015 the South Australian Government introduced legislation which enables the introduction of the mechanism in South Australia. The *Local Government (Building Upgrade Agreements) Amendment Act 2015* (the Act) passed South Australia's Parliament and was assented to by His Excellency the Governor in December 2015.

The Act provides for making of regulations to further define the parameters of the mechanism and its application. The Act also requires that a 'no worse off' methodology for estimating tenant cost savings (an approved methodology) be developed and published in the Government Gazette. In addition, when introducing the draft legislation into Parliament, Minister for Climate Change, Hon. Ian Hunter MLC, stated the Government's intention to develop a Building Upgrade Agreement template to assist local councils, financiers and property owners with entering into the tripartite agreement.

The South Australian Government is now seeking feedback from the local government, property and finance sectors, tenants of commercial buildings and other interested stakeholders on the draft Regulations, the draft approved methodology and the draft Building Upgrade Agreement template. Once these elements have been finalised, the Act will be proclaimed and will come into operation.

2. Background

What is Building Upgrade Finance?

The mechanism will allow building owners to access commercial loans to improve the energy, water or environmental performance of existing commercial buildings. Similar mechanisms have been established in Victoria and New South Wales.

Under the Building Upgrade Finance mechanism, a local council, a commercial building owner and a financier can voluntarily enter into a building upgrade agreement. Under this agreement, the building owner agrees to undertake upgrade works in respect of their building, the financier agrees to advance money to the building owner for the purpose of funding the upgrade works, and the council agrees to declare a building upgrade charge 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 repayment on to the financier once received from the building owner. As a result of the arrangement, the loan is effectively tied to the property rather than the property owner. In the event of the transfer of ownership of the property, the charge can remain with the property if the purchaser so agrees.

The building upgrade charge effectively secures the loan, as it is ranked in priority to mortgages and liabilities to the Crown should the council exercise its statutory power of sale in respect of the charge. This provides heightened security to financiers, allowing them to offer finance to building owners on more attractive terms.

Under many commercial leases, tenants pay local government charges. Provided certain tenant-protection conditions are met¹, this allows a building owner to recover a contribution towards the building upgrade charge from their tenant, thereby sharing the building upgrade costs and resulting utility savings with the tenant.

These features of the mechanism will help owners of existing commercial buildings in South Australia to access loans to undertake capital upgrades and address the split incentive between landlords and tenants in leased buildings. The mechanism is thereby designed to help unlock investment in building retrofits and realise the associated economic and environmental benefits.

Local Government (Building Upgrade Agreements) Amendment Act 2015

The [Local Government \(Building Upgrade Agreements\) Amendment Act 2015](#), which provides for the establishment of the mechanism in South Australia, passed through South Australia's Parliament in December 2015. The development of legislation was informed by the feedback from prior consultation.

¹ As specified in the Act and the draft Regulations.

For more information about the development of the enabling legislation, prior consultation processes and feedback visit www.environment.sa.gov.au/climatechange-buf.

3. Draft Regulations

Draft *Local Government (Building Upgrade Agreements) Regulations 2016* further define the parameters of the Building Upgrade Finance mechanism and its application in South Australia. Key aspects of the draft Regulations are summarised below. Where relevant, additional information relating to content of the draft Building Upgrade Agreement template is also provided.

Eligible buildings

Consistent with the intent of the mechanism, the draft Regulations limit the eligibility of the mechanism to buildings which are wholly or primarily used for commercial, industrial or other non-residential purposes. This comprises a broad range of commercial and industrial buildings, including office buildings, shopping centres, hotels and factories, warehouses, wineries and chicken sheds, etc. Residential buildings are not eligible to access the mechanism.

Extending eligibility to heritage works

In an Australian first, heritage works to or within heritage buildings will be eligible to access the mechanism. These are defined to encompass a broad range of works in relation to a heritage building, including works associated with Building Code and disability access compliance and works that facilitate the heritage building's ongoing occupation.

Examples of envisaged eligible 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.

To be eligible for finance under the Building Upgrade Finance mechanism, a heritage building must also be a predominantly non-residential building.

Rate of penalty interest

The Act provides for regulations to determine penalty interest on money advanced by the financier to the building owner under the Building Upgrade Finance mechanism. To ensure a consistent approach to the mechanism's operation across the State and compatibility with local councils' existing processes, the draft

Regulations specify that the penalty interest is to be determined using a formula similar to that applied to overdue instalments of council rates.

Draft Regulation 6 determines the calculation of penalty interest on money advanced by the financier. The formula featured in draft Regulation 6 includes the cash advance debenture rate (CADR). CADR for a particular financial year means the cash advance debenture rate used by the Local Government Finance Authority of South Australia at the commencement of that financial year².

Regulation 6 does not extend to the calculation of penalties on overdue council service fees or late payment fees included in the building upgrade charge notice. The Act requires that the amount of any service fee or a late payment fee or a method for calculating such fees be specified in a building upgrade agreement. The draft Building Upgrade Agreement template complies with this requirement (Schedule 4).

Contents of the building upgrade agreement – as required under the Act and the draft Regulations

The Act lists the content that must be specified in a building upgrade agreement, which includes the description of works, the amount of funding and the building upgrade charge, the schedule of payment, and local council service and late payment fees. The Act also provides for the inclusion of other mandatory matters.

The draft Regulations specify such further mandatory content, which includes:

- building owner reporting requirements, and
- information use and disclosure provisions.

Reporting requirements

The draft Regulations require the building owner to report to the other parties to the building upgrade agreement the date when the works were completed ('completion report'). The draft Building Upgrade Agreement template specifies that this must occur within 45 calendar days from the completion date and defines the meaning of 'practical completion'. The draft agreement template also clarifies that if works consist of a number of components, for the purpose of reporting, the works are considered to be complete when the full scope of works (as specified in the agreement) is complete. That is, a notice of completion of individual components is not required to be submitted.

If the subject of the building upgrade agreement is environmental upgrade works, the draft Regulations require the building owner to also report on the environmental performance of the building and associated cost savings in the first twelve months after the completion of works, compared with the performance before the works. The draft Building Upgrade Agreement template specifies that this report must be submitted to the other parties within 15 months from the completion date of the upgrade. The draft Regulations specify the information required to be included in this 'first year performance' report. The draft Building Upgrade Agreement template

² *Local Government Act 1999*

clarifies that an ‘environmental performance rating given by an accredited body designated by the Minister’ is taken to mean an accredited rating by the National Australian Built Environment Rating System (NABERS).

The draft Regulations require a one-off performance report only to minimise the administrative complexity of the mechanism whilst enabling the assessment of its effectiveness. The ‘first year performance’ reporting requirement does not extend to heritage upgrades of heritage buildings as defined in the draft Regulations (unless they deliver environmental savings).

Use and disclosure of information

The Act requires the councils to keep a public register of building upgrade agreements (described further below).

The Act also entitles the Minister to require a council to report on building upgrade agreements entered into by the council. The draft Regulations specify building owner reporting requirements as discussed above.

The draft Building Upgrade Agreement template specifies that the building owner agrees that the information contained in a building upgrade agreement as well as in the ‘completion’ and ‘first year performance’ reports can be reported by the council to the Minister. It is envisaged that the Minister may use this information for the purpose of the assessment of the mechanism’s operation and effectiveness, and for public reporting.

The draft agreement template also outlines how the information can be used by the council.

Sale of land for non-payment of a building upgrade charge

The Act specifies that if an amount in respect of a building upgrade charge remains unpaid for more than three years, the council may sell the land for non-payment³.

The draft Regulations specify further provisions relating to the sale of land process. These are consistent with the sale of land for non-payment of rates process specified in the *Local Government Act 1999*.

Recovery of tenant contribution under the ‘no worse off’ pathway

The Act provides for the following two pathways to the recovery of a tenant contribution towards the building upgrade charge:

- a ‘consent’ approach – where the tenant consents to the payment of a contribution towards the building upgrade charge; and
- a ‘no worse off’ approach – where the building owner can require the tenant to pay a contribution, but only when the contribution does not exceed the estimate of cost savings resulting from the upgrade that may be made by the tenant during the period to which the contribution relates. Under this pathway, the cost savings must be estimated in accordance with an approved methodology which must be published in the Government Gazette.

³ The Act does not extend the power of sale to Crown land.

In accordance with the provisions of the Act, the draft Regulations define further requirements relating to the recovery of a tenant contribution under the 'no worse off' pathway. The draft Regulations require the building owner to:

- report annually to the contributing tenant on the cost savings made by the tenant, using the approved methodology (to allow the building owner to collect the information required to produce the report, the draft Regulations specify that the report must be produced within three months from the end of the reporting period), and
- if the reported tenant savings were less than the tenant contributions paid within the reporting period, credit or refund the contributing tenant with any exceeded amount and reduce the future tenant contributions to this lesser amount.

The draft Regulations provide for the building owner and the tenant to agree that the above requirements do not apply or are modified.

The draft Regulations also clarify that if the reported tenant cost savings exceed the tenant contributions paid within the reporting period, the building owner is not entitled to recover the difference from the tenant for that period. The legislation and draft Regulations, however, do not preclude the building owner from reviewing the estimate of future savings using the approved methodology and data available from the reporting year, and issuing the tenant with a revised notice for future contributions.

The draft Regulations require the building owner to inform the contributing tenant of the cessation of the building upgrade charge. This requirement applies to both pathways to the recovery of a tenant contribution.

Register of building upgrade agreements

The Act requires participating councils to maintain a register of building upgrade agreements executed in their respective municipal area. The register must be accessible to the public at no charge. The draft Regulations prescribe information required to be maintained in the register. As the building upgrade charge is a statutory charge and does not appear on the Certificate of Title of the relevant land, these provisions aim to ensure that relevant information is readily available to interested parties.

The Regulations require councils to keep the register up to date and prescribe that the register be updated within five days following the execution of the agreement, or the full payment of the charge, or the termination of the agreement.

Other provisions

The draft Regulations also specify further provisions relating to buildings which are subject to strata or community scheme.

The Act provides for making regulations in respect to the following matters:

- exclusions in the definition of 'upgrade works' (Schedule 1B, Clause 1)

- additional requirements that must be met before a council can enter into a building upgrade agreement (Schedule 1B, Clause 2(5)(b))
- additional content of a written notice to the existing mortgagee from the building owner (Schedule 1B, Clause 2(6)(a)(iii))
- additional content of and requirements to a written notice of the building upgrade charge issued by the council to the building owner (Schedule 1B, Clauses 6 (2) & (3)).

The draft Regulations do not currently specify any further requirements with regard to the matters above.

4. Draft approved methodology

The State Government engaged external experts to develop a ‘no worse off’ methodology to estimating tenant cost savings. Consistent with the requirement under the Act and the draft Regulations, the draft methodology is to be used:

- to estimate cost savings that may be made by the tenant if a tenant contribution is recovered via the ‘no worse off’ pathway, i.e. estimating savings over a forecast period based on annual predicted savings (Schedule 1B, Clause 12(2)(b)(ii)(C)), and
- also under the ‘no worse off’ pathway, to report annually to the contributing tenant on the savings made within the reporting period (draft Regulation 10(1)(a)), unless otherwise agreed (draft Regulation 10(2)).

The draft methodology has been developed to ensure that it provides for a robust pathway to estimating tenant cost savings whilst minimising the costs associated with its application.

The draft methodology utilises a number of sub-methods to suit a wide range of environmental upgrades which give rise to gas, electricity and water utility savings. Other upgrades (e.g. works that enable the recovery of materials, implementation of end-of-trip facilities, heritage upgrades of heritage buildings etc.), are deemed to result in zero cost savings to the tenant.

For more information about the draft methodology, refer to the Methodology Guide.

5. Draft Building Upgrade Agreement template

A draft Building Upgrade Agreement template has been developed to assist the local government, property and finance sectors with using the mechanism and to reduce associated costs to the parties.

The content of the draft Building Upgrade Agreement template is in line with the requirements of the Act and the draft Regulations. It has been drafted with a view of achieving, as much as possible in the context of the South Australian legislative scheme, consistency with agreements that are used in New South Wales and Victoria with regard to similar mechanisms, as well as simplicity. As such, a deliberate effort

has been made to minimise unnecessary duplication with provisions of the Act and the draft Regulations.

While the draft Building Upgrade Agreement template should be read together with the Act and draft Regulations, it has been drafted in a way that, on its own, it is a helpful document to the parties to the Agreement.

A number of suggestions have been made about timeframes and other matters outside of the strict provisions of the Act and draft Regulations. There are also a number of specific clauses which the Government is seeking feedback on, and those are marked accordingly in the document.

While the document could be modified and adapted to suit needs of particular parties within the intent of the Act and the draft Regulations, mandatory clauses are specified in the template. Once the agreement template is finalised following the consultation process, these sections may not be amended. As mentioned earlier in this paper, the Act lists such mandatory content and the draft Regulations specify two additional matters, i.e. building owner reporting requirements and use and disclosure of information provisions.

Whilst the Act and the draft Regulations extend the eligibility to commercial buildings that are subject to a strata scheme, the feedback received to date indicates that due to issues associated with ownership structure, Building Upgrade Finance may not be best suited to such buildings and, as a result, there could be limited demand from this sector. Consequently, the draft Building Upgrade Agreement does not accommodate an arrangement in relation to upgrade works to commercial strata buildings. However, this does not preclude an appropriate building upgrade agreement being developed by buildings owners, a strata corporation, a financier and a relevant local council, should there be demand.

The draft template agreement is intended for consultation and feedback only. It is a working draft document designed for stakeholder feedback and does not represent the final considered position of the Government in relation to any of the matters it deals with. The document is not intended for use in any arrangement, noting that the statutory and regulatory scheme under which the draft template is proposed to be used is not yet complete. The document does not contain legal advice about the operation of the provisions of the building upgrade scheme under the *Local Government Act 1999*, yet to come into effect.