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CONDOMINIUMS AND COOPERATIVES

Local Law 97: Condos and Co-Ops Facing Unique Financing Challenges

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As many building owners in New York City know, Local Law 97 went into effect on Jan. 1, 2024. It is an aggressive plan to cut harmful emissions in New York City by requiring, with some rare exceptions, buildings in excess of 25,000 square feet to reduce their carbon emissions by 40% in 2030 and 80% in 2050.

While there are still many evolving nuances to the guidelines, we know the timeline for affected covered buildings to comply has begun. However, owners of certain qualified buildings may elect to undertake and complete "prescriptive energy conservation measures" by Dec. 31, 2024.

A current list of such prescriptive measures is set forth in the regulations, but some of those measures include, without limitation, new windows, replacing and repairing HVAC systems, integrating solar energy, adding proper insulation and weatherizing and air sealing buildings. All buildings (regardless of whether they must begin coming into compliance on Jan. 1, 2024, or later) *must* be in compliance with the 2030–2034 standards by 2030.

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Among those grappling with the challenge of bringing their building into compliance are condominiums and cooperatives. Aging condominiums and cooperative buildings are saddled with outdated energy systems and infrastructure. For example, most prewar buildings use boilers to supply apartments with heat through steam heat systems. To comply with Local Law 97 energy efficiency standards, building owners need to switch to electric heat pumps**.** This is a costly switch for middle and low-income condominium and co-op owners and is proving to be an extraordinary burden.

Although Local Law 97 contemplated the affordability difficulties for Housing Development Fund Cooperatives and Mitchell-Lama buildings by offering delayed compliance pathways, many other

private affordable cooperative and condominium associations do not enjoy such delayed compliance.

The effect of this is widespread. According to the 2022 Covered Buildings List published by the NYC Department of Sustainable Buildings, over 18,000 multifamily properties are affected by Local Law 97. Of those multifamily properties, about 10,000 buildings are classified as being built prior to 1940. This is significant, as older pre-war buildings face practical challenges when retrofitting energy upgrades and a steeper path to compliance due to age.

Paying for and financing Local Law 97 compliance projects will be difficult for condominiums and cooperatives, given their ownership structure. Available financing methods include allocating costs to maintenance or common charges, charging special assessments, drawing from cash reserves, and taking out loans. Unfortunately, no method is perfect, and they all have unique challenges.

If a condominium or co-op board decides to allocate the capital costs through a special assessment, there will likely be significant pushback from residents. Energy-efficient upgrades are, unsurprisingly, very costly. The special assessment to make the necessary upgrades will require a few large payments over a short period of time, placing a significant burden on unit owners and shareholders. There also remains the possibility that such large assessments would deter prospective buyers from buying into the building.

Further issues arise when unit owners or shareholders cannot afford to make such a significant monthly payment. One possible solution is for a board to identify a “preferred lender” willing to prequalify a building and offer home equity lines of credit (HELOC) to shareholders or unit owners who prefer to finance their obligations.

Alternatively, boards may seek to borrow capital to finance energy improvements. It is common for cooperatives to borrow money because a cooperative corporation owns its real property, which can be offered as collateral. Borrowing by condominium associations is far less common and may not be an option for condominiums. Because condominium associations do not own their buildings, they cannot collateralize the real property, and the only collateral for the loan is the standard monthly charges or the board’s bank accounts and reserve funds.

Section 339-jj of the New York Condominium Act permits the board of managers to borrow money, but only to the extent that the condominium’s declaration or by-laws allow for such borrowing. Many governing documents require the approval of unit owners for borrowing above a certain threshold, and acquiring the necessary majority or supermajority of unit owners is no easy feat. Unit owners may be deterred from acquiescing to a board’s loan because there is no available tax deduction for the interest payable on the loan—a cost fully incurred by unit owners.

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For new condominiums with some sponsor-controlled units, the condominium association may agree to allocate the funds from the sale of any sponsor-controlled units toward the payment of the upgrades. Alternatively, sponsors possessing any unsold units may qualify for Property Assessed Clean Energy (PACE) financing and may shift the payment structure to the property tax bill. The PACE financing program assists building owners with long-term, fixed-interest rate financing (currently around 5-6%) for capital improvements that reduce utility costs, energy consumption, and greenhouse gas emissions. While residents will still pick up the cost through their common charges, it will be less

burdensome given that PACE financing involves low-interest rates over a long period of time. Co-ops are also eligible to receive PACE funding.

The New York City Energy Efficiency Corporation (NYCEEC) also offers the Multifamily Express Green (MEG) loan, specifically for condominiums and cooperatives implementing energy upgrades. MEG loans start at a minimum of $200,000 and can finance up to 90% of the project costs. Interest rates are set at 7%, and the term is the length of the construction period plus a 10-year amortization period.

Yet, despite the availability of favorable loans for condominiums and cooperatives, there are still obstacles that must be overcome. For condominiums or cooperatives with existing loans, the terms of those loans may outright prohibit additional or secondary debt. Secondary debt may be permissible, but only through the same lender. Careful review of loans and underlying governing documents is critical to successfully planning and implementing Local Law 97 projects.

In October 2023, the NYC Department of Buildings (DOB) clarified the meaning of "Good Faith Efforts," as it is used in Local Law 97 to mitigate penalties. While not a financing solution, this clarification offers an avenue for cooperatives and condominiums to decrease their expected penalties by showing demonstrated efforts to comply with the law. To demonstrate "Good Faith Efforts," building owners can submit the annual building emissions report as required by the Law, show compliance with Local Law 84 (energy usage benchmarking), and show compliance with Local Law 88 (lighting upgrades and sub-meter installation).

Additionally, owners can demonstrate any of the following: (a) that the work necessary to achieve compliance is currently underway by having a fully approved application and permit issued for such work; (b) that electrification readiness work is underway (i.e., use of energy-efficient electric-based heating, cooling and hot water systems); (c) that the building was previously under the emissions limit for the previous year; or (d) provide a decarbonization plan by May 1, 2025, that will bring the building into compliance with its 2024 limits no later than 2026 and with its 2030 limits no later than 2040.

Looking ahead, there may still be some hope for condos and co-ops. In 2023, Councilmembers Linda Lee (D-Queens) and Vickie Paladino (R-Queens) introduced legislation to mitigate the effects of Local Law 97. Under Paladino's proposed legislation, all penalties and requirements would be delayed by seven years so enforcement would not go into effect until 2031. Lee's bill proposed that penalties for cooperatives and condominiums with an assessed value under $65,000 be lowered in gradual increments if those buildings made prior retrofits that lowered their emissions.

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It is also important to note that as Local Law 97 is currently enacted, green spaces are not used to offset a building's emissions. Lee's bill also proposes including green spaces in building emission calculations, resulting in decreased penalties for owners. Neither piece of legislation has been enacted at this point.

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