Regulatory Aspects of Utility Cost Recovery in Apartments

Recovering utility costs from residents for the utilities they use in apartment buildings dramatically lowers both consumption by residents and operating expenses for apartment owners and managers (operators). Whether through the utilization of sub-meters, which measure actual use, or ratio utility billing systems (RUBS), which allocate utility expenses to residents based on pre-defined criteria such as square-footage or apartment type, having residents pay for what they use positively affects conservation and operator costs.

This white paper seeks to provide an overview of the regulatory landscape as it applies to apartment operators recouping utility costs from residents, while highlighting industry best practices to ensure both maximum compliance and cost recovery, as well as promoting conservation among residents.

INCREASED CONSERVATION, DECREASED EXPENSES

According to the National Apartment Association's (NAA) 2014 Survey of Operating Income & Expenses in Rental Apartment Communities, per unit utility costs were $995 for master-metered buildings where owners paid for the primary utility. By the same measure, in sub-metered buildings, or those with other cost recovery measures in place, such as the RUBS method, those costs were just $346, a savings of more than 65%.

In an earlier joint study by the NAA and National Multi Housing Council that's referenced widely throughout the industry, residents in sub-metered buildings consumed as much as 39% less water when compared to master-meter buildings. Buildings using a RUBS system consumed as much as 27% less.

In a wide-ranging case study of results at 198,533 units nationally, Greystar Real Estate Partners, the largest apartment management company in the United States, was able to reduce its utility costs by 43% compared to the national average of apartment operator utility costs through sub-metering and partnering with NWP for utility billing.

In another case, Lindy Property Management, which owns and manages 6,400 units at 34 properties in Pennsylvania and Florida, was able to significantly improve conservation and reduce costs across its portfolio after implementing sub-metering. The firm reduced its overall cost for its natural gas utility from an average of $1,000 per unit per year to just $300 today, a 70% savings. Its 200-unit Garden Groves community in Sarasota, Florida, Lindy lowered water and sewer expenses from $17,000 to $12,000 monthly.

REGULATORY CHALLENGES

Yet, while the increased conservation and decreased expense benefits of utility cost recovery are well documented, hurdles for operators to actually recover utility dollars have

remained persistent in the apartment industry. From a regulatory standpoint, a myriad—of often murky—regulations at the state, county and municipal levels have resulted in uncertainty and confusion among apartment operators. In some cases, sub-metering may be prohibited. In others, RUBS may not be allowed. In still others, cost recovery practices may be condoned and encouraged at one jurisdictional level, but prohibited at another.

The regulatory landscape requires that owners that recover utility expenses from residents act with extreme caution. There is no uniform federal guidance for recovering utility expenses, and the rules vary widely at the state and local levels. Apartment operators are often left wondering what their best options are. Should they try to navigate the regulatory landscape on their own and recoup their costs at the risk of incurring penalties, fines and litigation if they make a misstep? Or should they just include utilities as a flat fee in the rent, creating a disincentive for residents to conserve and putting themselves at a competitive disadvantage to "lower" priced apartments in their market that don't include utilities in the rent? Neither option seems desirable.

Not only are apartment operators often unsure about which utilities they can seek reimbursement for, but they're often perplexed as to the methods they're allowed to employ in doing so, as well as the required bill format, the information they need to include on the bill and the required resident disclosures for each jurisdiction.

Legal expertise in this specialized area is not something in-house lawyers at apartment operators are generally familiar with and only a very few law firms in the country are well versed in this area of law. However, when you partner with a utility billing company, especially one with a large, national footprint, they should be taking care of all that for you. They should spend a considerable amount of time and money making sure what you're doing is permitted in your area, that the submeter is installed in compliance with all state and local requirements, and that the billing statements to the residents are legally prepared.

FEDERAL CONSIDERATIONS

Federal regulations do exist for utility cost recovery for some very specific tenants, including Housing and Urban Development's Section 8 & 32 voucher programs, as well as the Low Income Housing Tax Credit. In order to remain eligible for those voucher and tax-benefit programs, operators must follow rules proscribed by the IRS when it comes to sub-metering and cost recovery. Also, in some cases for water, operators using a RUBS methodology must comply with certain provisions of the Clean Drinking Water Act. For the majority of market-rate multifamily operators, however, federal guidelines don't explicitly address this area.

STATE & MUNICIPAL REGULATIONS

At the state level, there are a myriad of entities, codes and regulations hidden in many different areas that can affect the legality of resident utility billing programs. As just an example, at a state level there can be regulation by state public utility or public service commission regulations, consumer protection regulations, health and safety codes, environmental agency regulations, department of weights and measures regulations, rent control laws, sanitation codes, and landlord tenant codes to name just some.

How various state entities regulate apartment operators recovering utility expenses from residents varies widely and can become further complicated by local and municipal codes and regulations.

The following examples illustrate the range and scope of regulations in different states.

In Texas, sub-metering for both electricity and water is required for all new construction and Texas has very specific laws and requirements that apartment operators must follow when billing residents for some utilities. The penalties for non-compliance are stiff. The penalties for violating a rule of the commission regarding utility billing for each violation (and each bill which is non-compliant can be considered a separate violation) are three times the amount of any overcharge, plus a civil penalty equal to one month's rent, plus reasonable attorney's fees, and court costs, unless the apartment operator can prove that the violation was a good faith, unintentional mistake. However, failure to have competent knowledge of the law and a billing system capable of complying with the law is not likely to be viewed as a good faith unintentional mistake.

In California, while there is no statute on water and sewer billing they are generally permitted at the state level, while gas and electric billing are generally prohibited by public utility regulations and utility billing is not allowed in many rent-controlled municipalities. Yet there may be additional regulation at a local level, for example, some municipal utilities like the Los Angeles DWP may permit water and sewer billing, but prohibit billing residents certain fees.

In Florida, sub-metering and cost recovery of utilities is generally permitted, as long as it isn't done for profit, i.e. apartment operators don't charge residents more for the commodity than they themselves are charged by the utility, however, there are various Florida municipal jurisdictions, such as West Palm Beach and Miami-Dade County among others, which have additional restrictions and the penalties for violations can be substantive. For example, Miami Dade Water and Sewer Department regulations can impose penalties of ten thousand dollars ($10,000) for each violation of any of the provisions of the water and sewer billing laws. Each bill containing a violation and each violation on a bill (i.e., one resident bill can have multiple violations) and each day during any portion of which such violation occurs or continues to occur constitute separate violations.

When it comes to recovering utility costs, as with real estate, knowing the unique laws and regulations affecting your state and local sub-markets and the hierarchy of the various laws affecting utility billing programs is a must.

FEES FOR UTILITY BILLING SERVICES

In addition to whether utility billing to residents is permitted or not, many states have rules for whether fees incurred from a utility billing program can be charged to residents. "In Massachusetts, you can't add anything," says Michael Foote, senior regulatory counsel at NWP Services Corporation. "Some states put a volumetric limit on it. It varies from city to city, county to county, and state to state." In Indiana, it's $4. In the City of Seattle, it's $2 per commodity and $5 total, but in Texas you can charge a billing fee of up to 9% of your submetered water and sewer costs but no billing fees for allocated water and sewer, while billing fees for other commodities such as trash are generally unregulated.

In general, where sub-metering and cost recovery is allowed for regulated utilities, many public utility and public service commissions expressly prohibit apartment operators from doing so at a profit. In other words, operators can't mark up the price of utilities charged to residents. Doing so is almost a guaranteed path to fines, fees and penalties, or worse, class action litigation by plaintiff's lawyers.

It should be noted in this regard that while the algebra of multifamily has in recent years resulted in increasingly profitable multiples for multifamily operators, the opposite can be true in terms of consequences for improper utility cost recovery practices. Mischarging a number of tenants over several months or years is the exact scenario plaintiffs' lawyers look for when compiling potential class action litigation.

PUBLIC UTILITY COMMISSION REGULATIONS INADVERTENTLY BECOMING A PUBLIC REGULATED UTILITY

Utility providers, whether of natural gas, electric, water or sewer, typically operate as government-sanctioned monopolies. As such, they are heavily regulated. Their rates are usually determined by public utility commissions at the state level.

In situations where apartment units are directly metered and billed by the utility, as is often the case for gas and electric today, the issue of apartment owners recouping costs becomes moot. But in instances where apartment operators pay for utilities in the apartment units based on master-meters at a community, and then bill residents, either through a sub-metering or a ratio allocation formula (RUBS) program, legal issues can quickly arise. Whereas owners may simply be trying to recover their costs from residents, their efforts could be interpreted—generally when these owners markup the fees or utility amounts above their costs—as "reselling" the commodity, thus triggering the specter of public utility regulatory oversight and consequences. When owners act as utilities by "marking up" rates to residents or recovering more than their utility expense, the line between operating multi-family housing and "selling" commodities becomes blurred and the owner could inadvertently become a public utility subject to all relevant public utility regulations.

MUNICIPAL RULES

There can be any number of different municipal requirements for recovering utility costs depending on where an apartment operator is located. For example, while there is general regulatory guidance for Florida sub-metering for multifamily buildings, DeKalb County has different regulations under an ordinance that has been in place since 2008.

And while there currently are no state statutes on billing in California, certain municipalities like the Los Angeles DWP prohibit certain fees. When it comes to recovering utility costs, as with real estate, knowing the unique legal characteristics of your local sub-markets and the hierarchy of the various laws affecting utility billing programs is a must.

Some cities, such as Cleveland, OH, prohibit using specific methodologies, while other local jurisdictions, like Montgomery County, MD, may permit submetering and RUBS methodologies. These methodologies, however, have very detailed regulations covering the calculation, method, bill content and fee restrictions.

CONCLUSION

Given the complexities of national, state and municipal regulations governing the recouping of utility expenses from residents by apartment operators, a measured, thought-out approach to this area is a must. Careful consideration and due diligence should be carried out to determine the exact regulatory aspects that apply to an apartment community in a given jurisdiction.

Seeking good legal counsel and partnering with utility billing companies with licensed attorneys with specialized expertise in this area, can get apartment operators started on a path to prudent utility cost recovery.

For almost two decades, NWP Services Corporation has worked exclusively with multifamily owners and managers to provide a legally compliant, full life cycle of utility expense recovery through resident billing, invoice processing automation, utility spend management, analytics, and energy management. To learn more and to speak with a representative, please contact NWP at 800.323.3178 or multifamily@nwpsc.com. ●

For More Information

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