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Monitoring and analyzing the utility use of multifamily housing

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Reducing a development's utility consumption obviously improves the available cash flow, but what are the bigger implications for its market value?

Our company, WegoWise, is an online tool for monitoring and analyzing the utility use of multifamily housing. An example is a five building, 50-unit property in the northeast. The development has a gross rent roll of \$1.2 million per year. After operating costs other than utilities, the operating income is \$876,000 per year.

Using information tracked in WegoWise, we know that an average development of this size spends about \$78,000 on utility expenses. An efficient one only spends \$37,000 per year. A poor performing one, though, spends \$150,000 per year! Compared to high efficiency buildings, a typical development spends more than twice as much. A poorly performing development spends over four times this amount.

While cash flow improvement provides substantial incentive for undertaking efficiency improvements, an even more compelling argument can be made when looking at how the improved operating income translates to higher property values. A standard approach to real estate value calculation is the use of capitalization rates ($\text{Property Value} = \text{Net Operating Income} / \text{Cap rate}$). The Cap Rate helps to gauge investor demand for a particular set of cash flows. Assuming a modest cap rate of 8%, a development's value can shift dramatically as a function of its utilities expenses.

Remembering that the operating income is \$876,000 before utility expenses, a property with \$78,000 of utility costs will have a net operating income of \$798,000. Applying the 8% cap rate yields a property value of \$9.975 million. A poor performing development with utility costs of \$150,000 will have a value of \$9.075 million. The efficient one with \$37,000 in utility expenses has a value of \$10,487,500! This is a spread of \$1.4 million between the efficient and poor properties based purely on utility costs.

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