



SIMON | PROPERTY GROUP



PACE Financing for Commercial Real Estate Companies

What program managers need to communicate

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PACE FINANCING FOR CRE COMPANIES

- ✓ What CRE Companies Are Being told About PACE
- ✓ What CRE Companies Need to Know About PACE
- ✓ A Primer on CRE Leases
- ✓ Examples of The Lease Accounting Impact of PACE

WHAT CRE COMPANIES ARE BEING TOLD ABOUT PACE

- ✓ **Voluntary:** interested owners opt-in a PACE District to receive private market financing for improvements
- ✓ **Annual Tax Assessment:** property owners who use PACE to finance retrofits pay for the improvements through annual assessment payments on their property taxes
- ✓ **Senior Financing:** PACE has the same senior standing as non ad valorem taxes. As with taxes, there is no acceleration upon default
- ✓ **Transfer on Sale:** Assessments are linked to the property and transfer to a new owner upon sale

WHAT CRE COMPANIES NEED TO KNOW ABOUT PACE

1. The secure nature of PACE enables up to **20-yr funding**, which means that projects with simple paybacks as long as 12 years can be implemented on a positive cash flow basis
 - ✓ Increases EBITDA/NOI
 - ✓ Increases Property Value
2. 100% funding of hard and soft costs, including **development fees**
 - ✓ No upfront costs
3. No payoff on sale – **PACE automatically transfers to new owner**
 - ✓ Addresses the holding period bias

WHAT CRE COMPANIES NEED TO KNOW ABOUT PACE

4. The real estate tax assessment/energy cost reduction benefits can be **shared with tenants**
 - ✓ Eliminates the landlord/tenant split incentive for triple net, modified gross leases, and industrial modified gross leases
5. Provides one or more benefits under all lease types
 - ✓ Increases cost recovery
 - ✓ Increases EBITDA/NOI
 - ✓ Increases property value
 - ✓ Improves infrastructure
 - ✓ Aligns landlord and tenant interests
 - ✓ Increases sustainable development

A PRIMER ON CRE LEASES

Lease type	Type of asset
Gross	Multi unit residential Hotels
Single net	Multi tenant office
Fixed CAM	Shopping centers
Modified gross	Multi tenant office
Industrial modified gross	Multi tenant Industrial
Double net	Multi tenant office Shopping centers
Triple net	Shopping centers Multi tenant office

A PRIMER ON CRE LEASES – GROSS LEASES

Description

The Landlord is responsible for the payment of real estate taxes, building insurance, and common area repair and maintenance expenses. These costs are included in the base rent figure. The tenants are typically directly metered and responsible for utilities in their space.

Lease accounting benefits of PACE

All energy efficiency savings in the common area go directly to the landlord's bottom line. Longer payback projects generate positive cash flow by adjusting the PACE financing term to ensure that the increased real estate tax bill is offset by the decreased energy bill. This enables landlords to create value in a 5% cap rate environment without investing their own capital. Infrastructure improvements, e.g., roofs, can also be financed through PACE.

A PRIMER ON CRE LEASES – TRIPLE NET LEASES

Description

Real estate taxes, building insurance, and common area repair and maintenance expenses are "passed through" to the tenants on a pro-rata basis based on the relative size (square footage) of the area occupied by each tenant. These expense are in addition to base rent

Lease accounting benefits of PACE

All energy efficiency savings in the common area generated from investments by the landlord go directly to the tenants' bottom line. However, the energy efficiency investments are recovered from the tenants in the real estate tax bill, leaving the landlord's EBITDA neutral or positive, depending on the PACE financing term. Infrastructure improvements, e.g., roofs, can also be financed through PACE

AN EXAMPLE TO UNDERSTAND THE IMPACT OF LEASE TYPES

- ✓ Property where the CRE Company provides common area cooling and lighting
- ✓ Project involves a \$200,000 energy efficiency retrofit
- ✓ Annual energy and maintenance savings of \$26,000 (7.7 years simple payback)
- ✓ The project does not pass the CRE Company's hurdle rate for investment in energy efficiency
- ✓ PACE funding available for 20 years at 6%.

IMPACT OF PACE FOR A CRE COMPANY – GROSS LEASES

Assumptions	
Property GLA	600,000 sq. ft.
Energy Efficiency project type	LED Lighting in common area
Project size	\$200,000
Annual Energy Savings	\$26,000
Real Estate Tax Cost Recovery	NA
Administration Fee	NA
PACE Term	20 years
PACE Interest Rate	6%
Discount Rate for PV Analysis	8%

	Self-Funded	PACE 20 years
Investment by landlord	(\$200,000)	\$0
Decrease in energy costs for landlord	\$26,000	\$26,000
Real Estate Tax increase to landlord	\$0	(\$17,440)
Real Estate Tax increase recovered from tenants	\$0	\$0
EBITDA/FFO impact	\$26,000	\$8,560
Cash Flow Year 1	(\$174,000)	\$8,560
Cash Flow Year 2 thru PACE Term	\$26,000	\$8,560
Cash on cash IRR over 10 years	6.37%	NA
10-yr NPV of cash flow	(\$11,000)	\$57,400
Property value increase at 6% cap rate		\$122,000
Tenant Real Estate Tax increase (\$/sq.ft)	NA	NA
Tenant Net Cost Increase/(Decrease)	NA	NA

Funding this project though PACE increases the property value by some \$125k, without any capital investment on the part of the landlord.

IMPACT OF PACE FOR A CRE COMPANY – TRIPLE NET LEASES

Assumptions	
Property GLA	600,000 sq. ft.
Energy Efficiency project type	LED Lighting in common area
Project size	\$200,000
Annual Energy Savings	\$26,000
CAM Cost Recovery	60%
Lease-permissible CAM Capital Recovery Period	NA
Real Estate Tax Cost Recovery	90%
Administration Fee	15%
PACE Term	20 years
PACE Interest Rate	6%
Discount Rate for PV Analysis	8%

	Self-Funded	PACE 20 years
Investment by landlord	(\$200,000)	\$0
Decrease in energy costs for landlord	\$26,000	\$26,000
Energy cost decrease passed on to tenants	(\$26,000)	(\$26,000)
Real Estate Tax increase to landlord	\$0	(\$17,440)
Real Estate Tax increase recovered from tenants	\$0	\$18,050
EBITDA/FFO impact	\$0	\$610
Cash Flow Year 1	(\$200,000)	\$610
Cash Flow Year 2 thru PACE Term	\$0	\$610
Cash on cash IRR over 10 years	NA	NA
10-yr NPV of cash flow	(\$200,000)	\$4,100
Property Value Increase at 6% Cap Rate		\$10,000
Tenant Real Estate Tax increase (\$/sq.ft)	NA	\$0.03
Tenant Net Cost Increase/(Decrease)	NA	\$0.00

PACE makes this project possible, without any capital investment by the landlord, and no cost increase for the tenant.