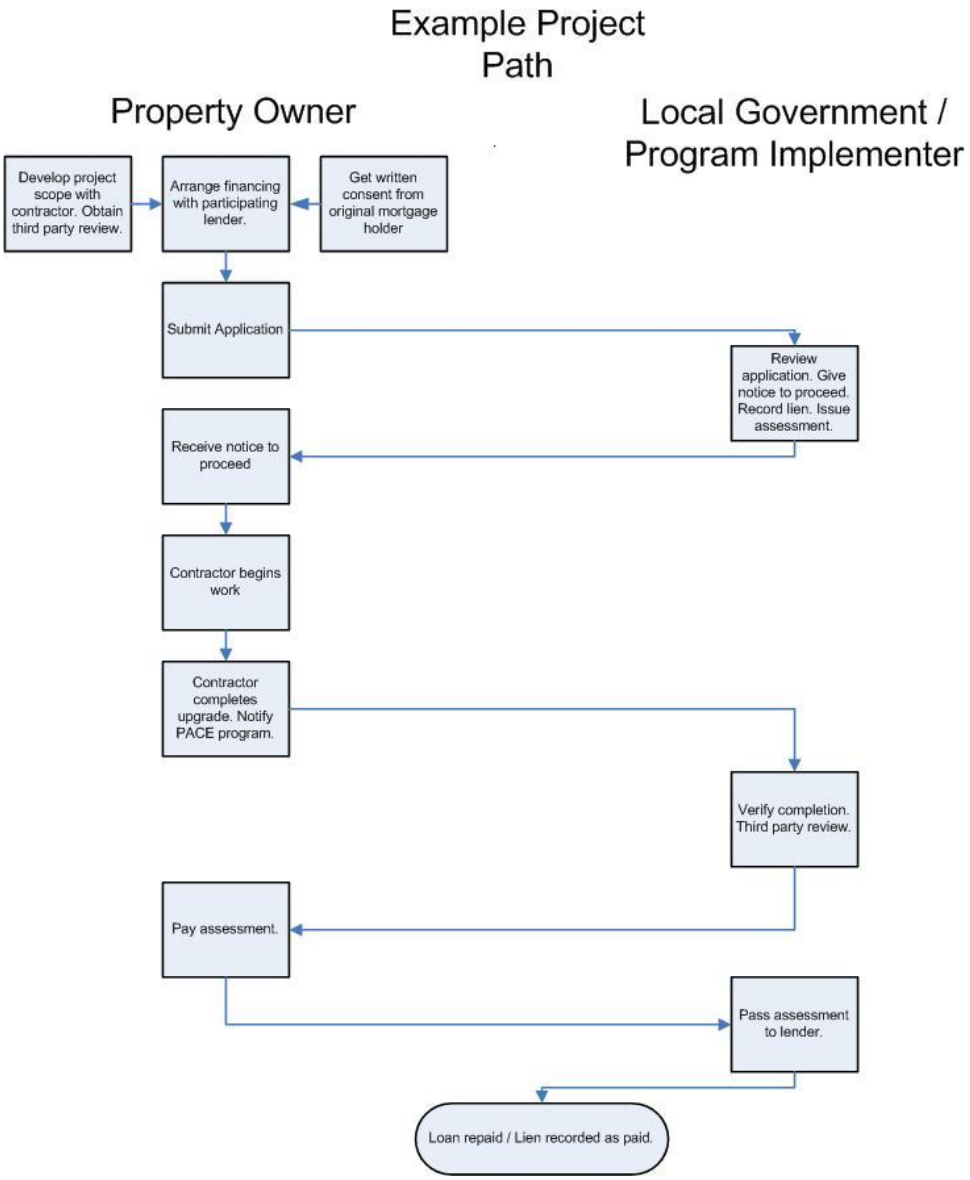
Why PACE is Attractive to Lenders

Simply put, PACE loans are attractive to lenders because they are very secure investments. Like a property tax lien, the assessment lien securing the PACE loan has priority over other liens on the property. Therefore, the risk of loss from non-payment of a PACE loan is insignificant compared to most other types of loans. PACE assessments provide lenders with an attractive new product to assist existing and new customers in addressing an almost universal pent-up demand for needed commercial and industrial property equipment modernization. In order to protect the interests of holders of existing mortgage loans on the property, the PACE Act requires their written consent to the PACE assessment as a condition to obtaining a PACE loan.

Contents

Example Project Path

The below flow chart depicts the path that typical projects will take.



The PACE Lien

A PACE lien placed on the property to secure the PACE property assessment and any interest or penalties on the assessment is a first and prior lien against the real property on which the assessment is imposed. It does not take effect until recorded in the property records. The lien:

- Exists from the date on which the notice is recorded in the appropriate county and until the assessment, interest and any penalty are paid in full;
- Has the same priority status as a lien for any other ad valorem tax;
- Runs with the land (the unpaid portion transfers to a new owner upon sale); and
- Is not eliminated by foreclosure of a property tax lien.

Delinquent installments of the assessments incur the same interest and penalties in the same manner as delinquent property taxes. A local government may recover costs and expenses, including attorney's fees, in a suit to collect a delinquent installment of an assessment in the same manner as in a suit to collect a delinquent property tax. However, only the delinquent and owed assessments may be collected in this manner; assessments not yet due stay with the land and are to be paid when they become due (the loan does not accelerate).

Lien Recording and Assessment Recording

At closing, the PACE program will promptly file written notice of each contractual assessment with the county clerk in the county in which the property is located. The senior lien on the property that secures the assessment is not imposed until the assessment is recorded.

The written notice must contain:

- The amount of the assessment;
- The legal description of the property;
- The name of each property owner; and
- A reference to the statutory assessment lien.

Underwriting Standards - Eligibility to Participate

The PACE program is an optional financing tool – a mechanism to enable owners of commercial and industrial property to gain access to funds for projects that will reduce water and energy utility costs under the most flexible and favorable terms. Although the program is designed to minimize risk by its very nature, it is still appropriate that all parties to a PACE agreement – local governments, lenders and property owners – understand where risks may arise and how they can be managed or mitigated.
The goal of establishing certain underwriting standards is to give all participants in a PACE agreement common factors to consider in evaluating proposed projects at a fundamental level before making an investment in detailed technical evaluations or engineering studies. The discussion of whether a proposed property improvement qualifies for PACE financing includes:

- Property Qualifications;
- Owner Qualifications;
- Property Improvement Qualifications;
- Lender Consent;
- Savings to Investment Ratio; and
- Costs Eligible for Inclusion in a PACE Assessment.

Eligibility requirements are incorporated in the **PACE in a Box** model documents and verified through the model application and administrative process.

Eligible Properties

The PACE Act permits a PACE assessment to be placed on privately-owned property that is:
• Commercial real property - including non-profit real property such as private schools, medical facilities, churches, etc.;
• Industrial real property - including privately owned agricultural real property; or
• Residential real property with five or more dwelling units.

Any of these properties must also:
• Be located within the jurisdiction of the PACE program;
• Have a title that is not in dispute; and
• Where there is a preexisting mortgage lien on the property:

- The mortgagee must be given written notice of the owner's intention to participate in the PACE program thirty days prior the owner entering into a contract with the PACE program; and
- The mortgagee must provide written consent to participation in the PACE program.

Properties that are statutorily *ineligible* for PACE assessments include:
• Undeveloped lots or lots undergoing development at the time of the assessment; and
• Government owned real property.

Eligible Property Owners

The PACE Act requires that PACE programs ensure that property owners demonstrate the financial ability to pay the annual PACE assessments. That demonstration must be based on particular statutory underwriting factors, including verification that any participating owner:
• Is the legal property owner;
• Is current on mortgage and tax payments;
• Is not insolvent or bankrupt;
• Holds a title to the property to be subject to a PACE assessment that is not in dispute; and
• Has consent of any preexisting mortgagee to the proposed PACE assessment through a written contract.

Because PACE assessments are secured with a senior lien having the same status as a tax lien, the financial position of the property owners is, in theory, necessary only to ensure that the owners have the ability to pay the annual PACE assessments. However, underwriting information also provides local governments and lenders the assurances they need to confirm that PACE projects are high quality and successful in every respect.
The **PACE in a Box** Checklist addresses these statutory requirements and addresses the spirit of the statute by incorporating the following verifications that the property owner:
• Has not been delinquent in the payment of its ad valorem taxes in the previous three years;
• Is in good financial standing:
- Has not been the subject of bankruptcy proceedings in the previous five years;
- Is not subject to any outstanding, unsatisfied final judgment;
- Has not had any property sold at foreclosure in the previous five years;

- Has provided a Certificate of Status from the Secretary of State of Texas; and
- Has provided a Certificate of Account Status from the Texas Comptroller of Public Accounts;

• Has provided a current credit report or, if not available, a reasonable alternative;
• Has provided a current title report and verified that the property is not subject to any liens, including mechanics liens;
• Has provided notice to any preexisting mortgagee and has provided the written consent of the mortgagee; and
• Grants consent for the PACE program administrator to pull credit information.

Eligible Projects

The PACE Act authorizes PACE funding for the installation of Qualified Improvements. Qualified improvements must:
• Be permanently fixed to the real property;
• Have a demonstrated capacity to decrease – ○ Water consumption or demand; and/or
○ Energy consumption or demand (includes renewables and distributed generation products or devices on the customer's side of the meter that use energy technology to generate electricity, provide thermal energy, or regulate temperature); and
• Have a useful life that exceeds the term of the PACE financing agreement.

Ineligible Improvements

Improvements that are not permanently fixed to real property and can be easily removed are not eligible for financing through the program. For example, screw-in fluorescent light bulbs, removable low-flow showerheads, and faucet aerators, and improvements that are not recognized as "energy efficient" according to standard engineering or scientific principles would be considered as ineligible. Once a PACE assessment has been placed on a property, the financed qualified improvements are deemed permanently fixed to the property and **PACE in a Box** documents prevent parties by contract or otherwise from removing any qualified improvement regardless of how they are defined in real estate case law or other contracts, until the assessment has been fully paid and the lien removed from the property. This **PACE in a Box** assessment standard applies whether the qualified improvement is purchased or leased. All parties must be confident in the measures selected and their projected value to, for example, existing and future tenants and property owners. PACE is not well suited for conservation measures that are design or stylistically relevant to a specific tenant or design trend if such measures are likely to go out of vogue before their life expectancy or the term of the assessment.

Length of Assessment Term

– The PACE Act requires that the assessment term must be shorter than the useful life of the improvement or, in a multi-measure project, the weighted average useful life of the improvements

Savings to Investment Ratio

PACE assessments create incentives for new investment and allow property owners to achieve energy and water savings above historical usage. The Savings to Investment Ratio (SIR) is the ratio of anticipated monetary utility savings to a participating property owner compared to the total cost invested in the property conservation improvements. The SIR is expressed as the estimated savings over the life of the assessment divided by the amount financed through the voluntary PACE assessment. As an underwriting standard, a positive SIR will provide a lender greater assurance that a participating

owner/borrower will realize a positive cash flow under the terms of the project and can service the debt at presumably no net cost or impact to normal cash flow from operations.
The responsibility for achieving the projected savings lies with the property owner. One method owners may use in evaluating improvement measures is to calculate and compare the SIR for each conservation measure. To ensure a SIR > 1 over the life of the assessment, the PACE program and project participants may:

- Use energy auditing and modeling to identify measures that will yield a SIR > 1;
- Calculate SIR based on an entire project rather than on each individual measure; and
- Incorporate normal elements of generally accepted business calculations, such as depreciation and reasonable projections of changes in utility prices.

In Texas, however, there may be other factors that justify a PACE assessment in which the SIR <1. For example, industrial retrofits may be required to insure the facility adequate power or water in spite of storms, peak demand or drought. Measures to correct non attainment findings or to address federally mandated retrofits may be essential to the business' success regardless of the SIR. If a third party lender and building owner are willing to provide a solid rationale for accepting an SIR <1, they can request a waiver of the **PACE in a Box** general rule:
General Rule - To be eligible for PACE financing, the projected savings derived from the improvement must be greater than the cost of the PACE assessment over the life of the assessment (i.e., the SIR should be greater than one, SIR>1).
Waiver - A third-party lender and a for profit-property owner may request a waiver in writing for a project with a SIR <1 so long as their requested waiver certification provides a reasonable rationale for placing a PACE assessment on the property with a SIR <1. The parties must demonstrate that they have carefully evaluated and fully understand the risks or uncertainties associated with allowing a SIR < 1, and address the interests of tenants and future property owners.

PACE Assessment Cost to Assessed Building Value Ratio

The PACE statute in Texas requires a PACE program to establish an appropriate threshold for the ratio of the amount of the PACE loan to the assessed value of the property as determined by the property appraisal district. The lower the ratio of new debt (the PACE assessment) to the value of the property, the less risk that the additional debt burden of a PACE assessment becomes a burden to the overall economic function of the property.
In some circumstances, there may be other reasons an investment greater than 20% of the assessed value would make good business sense to a property owner and private lender, particularly in the industrial sector where investment in modern, efficient equipment may turn a struggling business with water and/or energy intensive processes into a vibrant business that increases local employment. PACE assessments can enable businesses to save not just operating expenses through reduced utility use, but also to meet other challenges such as water and energy reliability in the face of storms and peak energy shortages. Similarly, the cost of any federally mandated changes in equipment that might otherwise force a stable business to close could be managed instead through PACE assessments. Finally, the new Texas Water Plan relies extensively on private sector conservation and PACE in a Box, with careful flexibility can assist businesses toward this goal. In these circumstances, the property owner and lender can seek a waiver of the **PACE in a Box** general rule:
General Rule - The amount financed using a PACE assessment cannot exceed twenty percent (20%) of the assessed value of the property.
Waver - If the PACE assessment is funded using a third-party lender, the for-profit property owner and lender may request a waiver to exceed the 20% cap. The justification for the exception must be

reasonable, clearly understood by all parties, and address the interests of tenants and future property owners.

Eligible Expenses Included in PACE Assessments

A PACE assessment may include the following statutorily authorized expenses:

• The cost of materials and labor necessary for the installation or modification of a qualified improvement;
• Permit fees;
• Inspection fees;
• Lender's fees;
• Program application and administrative fees;
• Project development and engineering fees;
• ITPR fees, including verification fees; and
• Any other fees or costs that may be incurred by the property owner incidental to the installation, modification, or improvement: ○ Legal, consulting and other fees on an actual cost basis; and
○ Changes to the existing property that are incidental to the installation of the qualified improvement on a pro-rata basis not to exceed 20% of the overall project cost.

All applicable government, utility provider or manufacturer rebates, and other upfront cost reductions should be applied as a credit against the total project cost for purposes of calculating the amount of the PACE assessment.

Any applicable funding limits are per property per financing request. The total cost must also be consistent with the PACE program's savings to investment ratio (SIR) policy and the PACE program's PACE Assessment to Assessed Building Value Ratio policy. Project lenders may impose additional minimum and maximum project funding requirements based on their own criteria and risk standards.

Energy/Water Savings Calculations by an Independent Third Party Reviewer (ITPR)

A project satisfying the underwriting requirements in **PACE in a Box** must also satisfy the Technical Standards required in the **PACE in a Box** Technical Standards manual in Section 8. Those standards establish protocols for ensuring that property owners, lenders and community leaders are able to confidently and objectively evaluate projected energy and water utility savings for proposed PACE projects. These protocols are also designed to ensure that the same technical standards are used and applied consistently throughout Texas.

The PACE Act requires an ITPR to:

• Review the baseline measurement of a property's existing water and energy consumption;
• Objectively measure the projected water and energy savings presented to a property owner; and
• Upon the completion of the project, verify that the work was completed and is operating as intended.

Project evaluation by an ITPR provides assurances to the property owner, the lender, and the local government that due diligence has been met and that a professional has validated the project using standardized engineering protocols.

Third-Party Financing Overview

The PACE Act authorizes two sources for financing PACE assessments secured by a property assessment lien – third-party financing (third-party lenders) and public financing (bonds). While early adopter PACE programs in other states relied on public financing, most of the early PACE programs began seeking ways to access additional funding sources by incorporating private lenders in PACE financing. The PACE Act allows PACE programs great flexibility in offering PACE assessments funded through private lenders and/or public financing. Although local governments have the option to issue bonds for PACE financing if they so choose, **PACE in a Box** recommends that Texas PACE programs utilize an open-market funding, third-party lender model. This model will minimize the local government's risks and burdens associated with PACE. Nonetheless, the **PACE in a Box** toolkit recommends standards for both options that promote flexibility in individual assessments while providing uniformity in process and documentation.

PACE by Contract

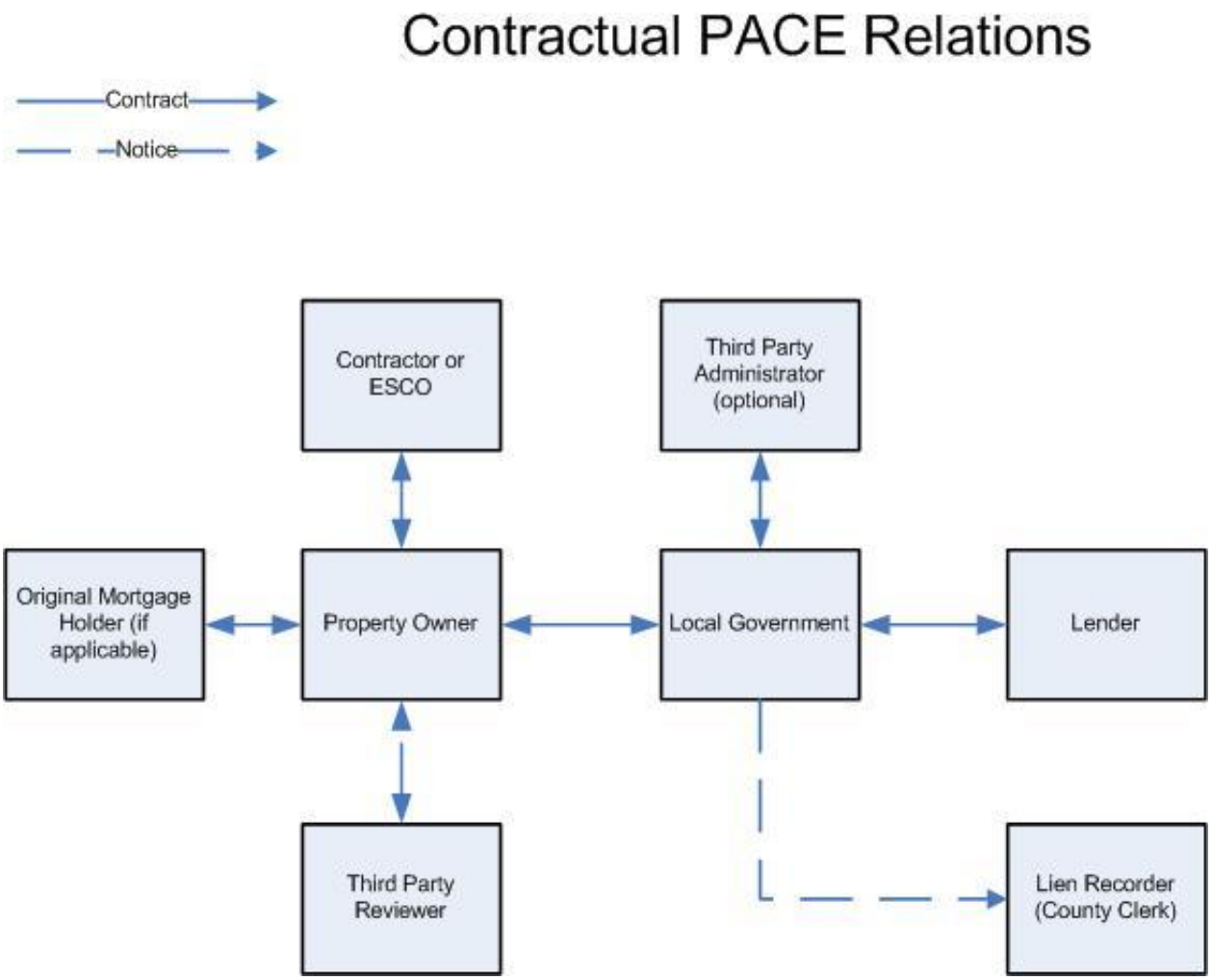
The PACE Act requires the local PACE program to use contracts to establish PACE financing and property assessment terms with the property owner and a private lender.

A written contract between the local PACE program and the property owner is required to impose a PACE assessment on a property to repay the owner's financing of a PACE project. This contract (Owner Contract) is the key document that creates the property assessment and the senior lien – the basis for the security that protects the PACE financing supplied by third-party lenders or public financing. The quality of this contract and the uniformity with which it is utilized throughout Texas will determine the speed of development and the strength of a secondary market for PACE financing in Texas. The model Owner Contract owner is included in Section 8.

If financing is provided by a third-party lender, the local PACE program must also enter into a written contract with the lender (Lender Contract) to service the debt on the PACE program through assessments. The Lender Contract is included in Section 8.

If the PACE program provides public financing (bonds), the Owner Contract must be a contract to finance the qualified project through assessments with a senior lien.

PACE financing for Qualified Improvements can be used for purchase of equipment and materials for a Qualified Improvement and for a contract, including through lease, power purchase agreement, or other service contract, for the installation or modification of a Qualified Improvement. Whether the equipment is purchased or installed and maintained by another person, all other requirements in the **PACE in a Box** model must be satisfied, including the requirement that the Qualified Improvements be permanently affixed to the property. The following flow chart lays out the flow of the contracts and communication:



Ensuring Sufficient Capital From Third-Party Lenders

The PACE Act creates an attractive, secure investment for third-party lenders and relies on the marketplace to determine whether and when PACE financing will be a useful tool for business. **PACE in a Box**'s uniform processes and documents foster lender participation by providing attractive markets with economies of scale and the standardized foundation required for the development of a secondary market. The toolkit also establishes requirements for qualified lenders and helps property owners identify qualified lenders interested in financing PACE projects.

In the **PACE in a Box** model, the property owner wishing to request a PACE assessment is responsible for identifying and selecting the lender of its choice. To help property owners identify lenders with the financial resources to meet their funding obligations, the **PACE in a Box** model establishes lender eligibility criteria and invites eligible lenders to be listed on the PACE program website so that property owners can readily identify these interested lenders.

Eligible third-party lenders may include:

• Any federally insured depository institution such as a bank, savings bank, savings and loan association and federal or state credit union;

• Any insurance company authorized to conduct business in one or more states;

• Any registered investment company, registered business development company, or a Small Business Administration small business investment company;

• Any publicly traded entity; or

• Any private entity that:
○ Has a minimum net worth of $5 million;
○ Has at least three years experience in business or industrial lending or commercial real estate lending (including multifamily lending), or has a lending officer that has at least three years experience in business or industrial lending or commercial real estate lending; and
○ Can provide independent certification as to availability of funds.

Every eligible lender can participate in the PACE program. Nothing in this section is intended to prohibit a property owner from identifying and selecting its own source of funding, whether or not from the eligible list.
To assist property owners in identifying eligible third-party lenders, a **PACE in a Box** program will provide an easily accessible list of eligible lenders that express an interest in providing PACE assessment funding. The list could be included on the PACE program website and should:
• Identify eligible PACE financing lenders;
• Provide contact information for the lenders;
• Provide additional information the local PACE program or lender may wish to include, such as: ○ Preferred project size for specific lenders;
○ Summaries of previously funded PACE projects in Texas; and
○ Links to any additional information lenders may wish to provide on their own websites.

Access to this information will enable interested property owners to contact and negotiate directly with the lender of their choice. In addition, the PACE website could include a feature that forwards to eligible lenders any property owner inquiry relating to PACE financing at the request of that property owner.
The public lists of eligible third-party lenders will not be exclusive and should include a statement that property owners are free to identify and do business with any other eligible lender, including their current lenders. Those lenders may choose to add their names to the publicly available eligible PACE lender list.
The eligible lender list will also provide for identification and listing of secondary market investors who express interest in purchasing PACE loans after the projects are completed and the PACE loan has been funded by a construction lender or mezzanine lender.
No way local PACE program should:
• Guarantee or imply that funding will automatically be provided from a third-party lender;
• Imply or create any approval, endorsement or certification of, or responsibility for, any lender; or
• Create any type of express or implied favoritism of any eligible lenders.

The Local Government's **PACE in a Box** website and any publically available list of lenders must prominently indicate these disclaimers.

Underwriting Third-Party Financing

The **PACE in a Box** model looks to third-party lenders and property owners to communicate directly and provide financial information directly among themselves. The PACE underwriting criteria sets a minimum, uniform basis for ensuring quality PACE programs that serve the community and the participating parties. Many third-party lenders will elect to perform additional underwriting to determine the credit worthiness of a property owner. The PACE Owner Contract and Lender Contract have sections available for referencing additional terms reflecting the needs of the parties involved.

Structure of Third-Party Financing

PACE in a Box third-party financing consists of:

• Model Owner Contract between the local government and property owner setting forth the assessment payment and imposing an assessment lien on the property;
• Model certificate from the local government to the third-party lender certifying that the financing is for a qualified project and the assessment is authorized under the PACE Act;
• Model Lender Contract between the local government and third-party lender; and
• Model Notice of Assessment Lien that will be filed in the real property records.

The Owner Contract

The Owner Contract creates the debt, grants the assessment lien and sets forth the terms of the assessment. Under the lender Contract, the local government assigns the assessments payable under the Owner Contract to the lender. Because the assessment lien can only be enforced by the local government, the Lender Contract makes the local government the nominal agent of the lender for collection of payments and enforcement of the assessment. These functions may be outsourced by the local government such as to the third-party administrator, a third-party servicer, or a county tax assessor-collector. Nothing in the PACE Act prohibits a lender from servicing the PACE loans it funds. Servicing is discussed in more detail at the end of this section.

Interest rate, Financing Terms, and Repayment Terms

The interest rate and repayment terms will be negotiated between the third-party lender and property owner and incorporated into the Lender Contract.

The term of the financing may be any length but may not exceed the useful life of the Qualified Improvements. In keeping with the intent of this provision of the PACE Act, PACE loans should be fully amortized by the scheduled maturity date and should not require balloon payments.

The repayment terms may provide for payment intervals agreed to by the property owner and third-party lender. Payments may be monthly, quarterly, semiannual or annual. Delinquent installments incur interest and late penalties in the same manner as delinquent property taxes.

Pre-payment of PACE assessment financing may not be prohibited. Some lenders may wish to provide for a prepayment penalty in the event a property owner wishes to prepay the PACE loan before maturity. Whether or not a PACE loan is subject to a prepayment penalty is a term to be negotiated between the third-party lender and the local government.

The Lender Contract

The Lender Contract constitutes a sale without recourse of the PACE loan by the local government to the third-party lender. Therefore, the sale does not create any obligations that would impose a debt or other burden on the local government. In most cases, the third-party lender will acquire 100% ownership of the PACE loan. But it is also possible that some PACE loans may be sold to several lenders, with each lender acquiring a percentage interest in the loan. Such an arrangement would likely require modifications to the model Lender Contract and additional inter-creditor agreements among the participating lenders.

The Lender Contract should clearly and conspicuously states that it is:

• A sale of an interest in the PACE loan and not a debt of or loan to the local government; and
• The sale is without recourse as to the local government.

The Lender Contract:

• Prohibits any modification to the PACE loan documents without the consent of the third-party lender;
• States that payments on the assessment received by the local government will be held in trust by, and segregated from the general revenues of, the local government;
• Specifies deadlines for the local government to remit payments to the third-party lender;
• Sets forth procedures for enforcement of remedies for default under the PACE program adopted by the local government;
• Includes other provisions normally incorporated in a participation agreement for commercial loans; and
• Includes a section entitled "Additional Provisions: (insert here such additional provisions upon which the third-party lender and local government may agree)."

Construction Advances

PACE loans may provide financing for construction of a qualified project or may be used to finance a qualified project upon completion of construction. Where construction financing is provided, the Owner Contract and/or the Lender Contract may include provisions relating to the timing of and requirements for construction advances. In addition to the Owner Contract, PACE loans that provide construction financing may require agreements between the property owner and the third-party lender resembling the construction loan documents used by commercial lenders.
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Existing Mortgage Lender Consent

Before a local government and a property owner execute an Owner contract, the PACE Act requires:
• Each holder of any mortgage lien on a property to be given 30 days written notice of the proposed PACE financing; and
• A written consent from the holder of each mortgage lien.

Public Financing

Capital Market Bond Issuance by Local Government

The PACE Act authorizes local governments to issue public financing for PACE projects. Local governments have access to expert bond officials and advisors. The **PACE in a Box** toolkit provides guidance regarding the specific statutory PACE public financing provisions to assist public financing experts who are already in the best position to advise local governments deciding whether to take advantage of public financing opportunities for a local PACE program.
The PACE Act prohibits a general obligation pledge of the full faith and credit of a local government. The PACE Act authorizes public financing funds from one or more of the following methods, all of which are secured with a senior lien on the property benefiting from a PACE assessment:
• Payments of contractual PACE assessments within the established PACE region;
• Reserves established by the local government from grants, bonds, or net proceeds or other lawfully available (non general revenue) funds;
• Municipal bond insurance, lines of credit, or public or private guarantees, standby bond purchase agreements, collateral assignments, mortgages, or any other available means of providing credit support or liquidity (not general revenue); or
• Any other non-general revenue funds lawfully available for these purposes.

The PACE Act requires a local government that chooses to offer public financing for its PACE program to establish:
• A maximum aggregate annual dollar amount for financing;

• A method of ranking requests in a priority order if requests appear to exceed the authorized amount; and
• A method for determining the interest rate, the term of the assessment, and the maximum amount of the assessment.

Local Jurisdiction Funding

Local governments can issue bonds either one at a time for individual projects, or on an aggregated project basis upon achievement of a certain dollar amount or timeframe. The challenge is to raise adequate upfront capital to issue bonds for smaller, individual projects so that these projects are not put on hold until there are enough to be aggregated into a total value for a bond sale.

Terms of the Property Owner PACE Loan for Local Government Funding

The financing documents between the local government and the property owner will be substantially the same Owner Contract as that adopted for the third-party lending option. The PACE Loan agreement with the property owner may provide for similar maturity, payment terms, default penalties, prepayment penalties and other provisions included or permitted for third-party lenders. Likewise, existing mortgage lenders must give consent, and the use of uniform property owner documents for both third-party financing and local government bond financing will facilitate existing mortgage lender consent.

Servicing and Enforcement

Servicing

Servicing of the PACE loan consists of billing, collecting and remitting payments to the financing source (third-party lender or bond holders). The servicer is also responsible for maintaining payment records, account balances, and otherwise interfacing between the local government, the financing provider, and the property owner.

The PACE Act authorizes a local government to contract with the governing body of another taxing unit, or other entity, including a county assessor-collector to collect PACE assessments. Some jurisdictions may choose to contract this function to the local tax assessor-collector or a regional council of governments using an interlocal government agreement. Other jurisdictions may choose to make this a function of the PACE third-party administrator who may delegate further to a servicing company. A number of companies, banks, and other financial institutions have servicing capabilities, and a local government's PACE program can issue a RFP to solicit and obtain PACE loan servicing. The PACE Act does not prohibit a local government from delegating the servicing of a PACE loan to the lender.

Servicing by the County Tax Assessor-Collector

The traditional servicing method for early adopter PACE programs has been to add the PACE assessment to the local tax bill, making the county tax assessor-collector the servicer. The chief benefit of this mechanism is the high collection rate. In Texas, however, there is no obligation for the county tax assessor-collector to perform this function absent an interlocal government agreement in which the tax assessor-collector must be reimbursed for the cost of servicing. The issues related to altering county tax software to accommodate PACE assessments may be impracticable.

Texas' Truth in Taxation statute requires that tax bills are only for taxes. While it may be possible to have assessments added to a tax bill so long as they are clearly identified as non-tax charges, some counties may resist. The PACE assessment could go in the same envelope if not included on the tax bill itself, but this will be a matter of interlocal agreement negotiations for PACE programs wishing to utilize a county tax assessor-collector for servicing of PACE loans.

Yet another challenge is that in Texas, tax bills are sent only once a year. This does not synchronize with traditional lender payments which are more likely to be once a month. Higher interest rates for property owners could result when servicing is limited to an annual collection schedule.

Servicing by a PACE Administrator or Subcontracted to a Private Servicer

The PACE Act authorizes a local government to perform the servicing function in-house or to outsource it. Local governments should set these contracts for regular review and rebidding to maintain control of costs.

There are challenges to this option that must be carefully evaluated. First, the collection rate may be an issue since property owners may not equate the senior lien status of the PACE assessment if it is not sent as part of or along with a tax bill. Second, for commercial property owners intending these payments to be passed on to tenants under typical commercial real estate leases, these assessment bills must be clearly marked as an obligation to the local government as a result of a PACE assessment directly placed on the property. If sent by any office other than the county tax assessor-collector, these direct assessment invoices must be clearly identifiable as an obligation to the local government resulting from a direct assessment on the property.

Servicing by the Third-Party Lender

Because the PACE Act relies on contracts between the PACE program and third-party lenders, it provides an avenue for delegating responsibility for servicing the contracts to the lenders themselves. This delegation could remove a cost and work-load center from the PACE administrator's responsibility. While this new opportunity in PACE administration has not been tested, it appears to present market-based opportunities for the lending community that have not yet been available in a PACE structure such as:

• Lenders and property owners would have more flexibility to negotiate the payment schedule, which could reduce the interest rates charged for annual PACE payments;

• Servicing their own loans is what lenders do now, and with that experience and expertise it is hard to see how the government can be more efficient or cost effective; and

• Lenders would get paid immediately rather than having to wait for another to collect the assessment payments and forward them to the lender.

There are challenges to this option that must be carefully evaluated. First, the collection rate may be an issue since property owners may not recognize the senior lien status of the PACE assessment if it is not sent as part of or along with a tax bill. Second, for commercial property owners intending to treat these payments as local government assessments payable by tenants under the operating expense pass-through clauses of their leases, the assessment bills should clearly reflect that the payment is an obligation owing to the local government as an assessment on the property. This is especially important if the assessment bills are sent by anyone other than the county tax assessor-collector. Finally, a potential buyer of property with an existing PACE assessment must have a way to confirm that payments on the assessment are current. Any delegation of servicing back to the lender should be accompanied by reporting requirements so that the local PACE program has current records of payment history.

Fees for Servicing

The fees for servicing will be paid by the entity providing the financing, in this case the third-party lender or the bondholders. The **PACE in a Box** toolkit includes a model servicing agreement for third-party servicing where the servicing is provided by the PACE program administrator or a third-party servicer selected through an RFP process in Section 8.

The local government must describe the procedures for collecting PACE assessments in its initial resolution to create a PACE program and in report on its proposed PACE program.

Enforcement

The enforcement and foreclosure of a PACE assessment lien must be done in the name of the local government. Foreclosure under the PACE Act is by judicial process just like a foreclosure of a property tax lien. Most local governments retain law firms that specialize in tax collections and foreclosures. PACE loans in default could be referred to these firms and foreclosure can be done in the same manner as the local government uses for its tax lien enforcement.

Model Documents and Contracts

Visit the site library **(click to be taken to the site library?)**