

Why PACE is Attractive to Property Owners

PACE enables property owners to obtain low-cost, long-term loans for up to 100% of all costs associated with the design and installation of water conservation, energy efficiency, renewable and distributed generation retrofits. These improvements can be structured to generate positive cash flow to the property owner because the cost savings derived from them exceeds the amount of the PACE assessment payment. In addition, PACE enables the property owner to amortize the cost of the improvements over their useful life. Inasmuch as PACE loans are secured by assessments on the property, they are automatically transferred to successive owners when the property is sold. Consequently, each owner of the property pays only that portion of the assessment that accrues during its period of ownership. And importantly for property owners leasing their property to tenants, PACE assessments can be passed to tenants under the typical commercial office lease.

These attributes of PACE loans enable property owners to overcome traditional barriers to making capital investments in property. Without PACE, property owners will continue tossing the problem of delayed maintenance on their property’s aging physical plant to a new owner like a hot potato. Until committing capital to modernize real property infrastructure makes sense as a value proposition, property owners will continue to waste operating expenditures on utility bills and risk exposure to utility price increases. Instead, PACE users capitalize money previously spent on utilities; the utility cost savings achieved by a retrofit pay for the retrofit itself. Property owners end up with more valuable property and access to recurring utility savings and pay only for the assessments that accrue while they own the property.

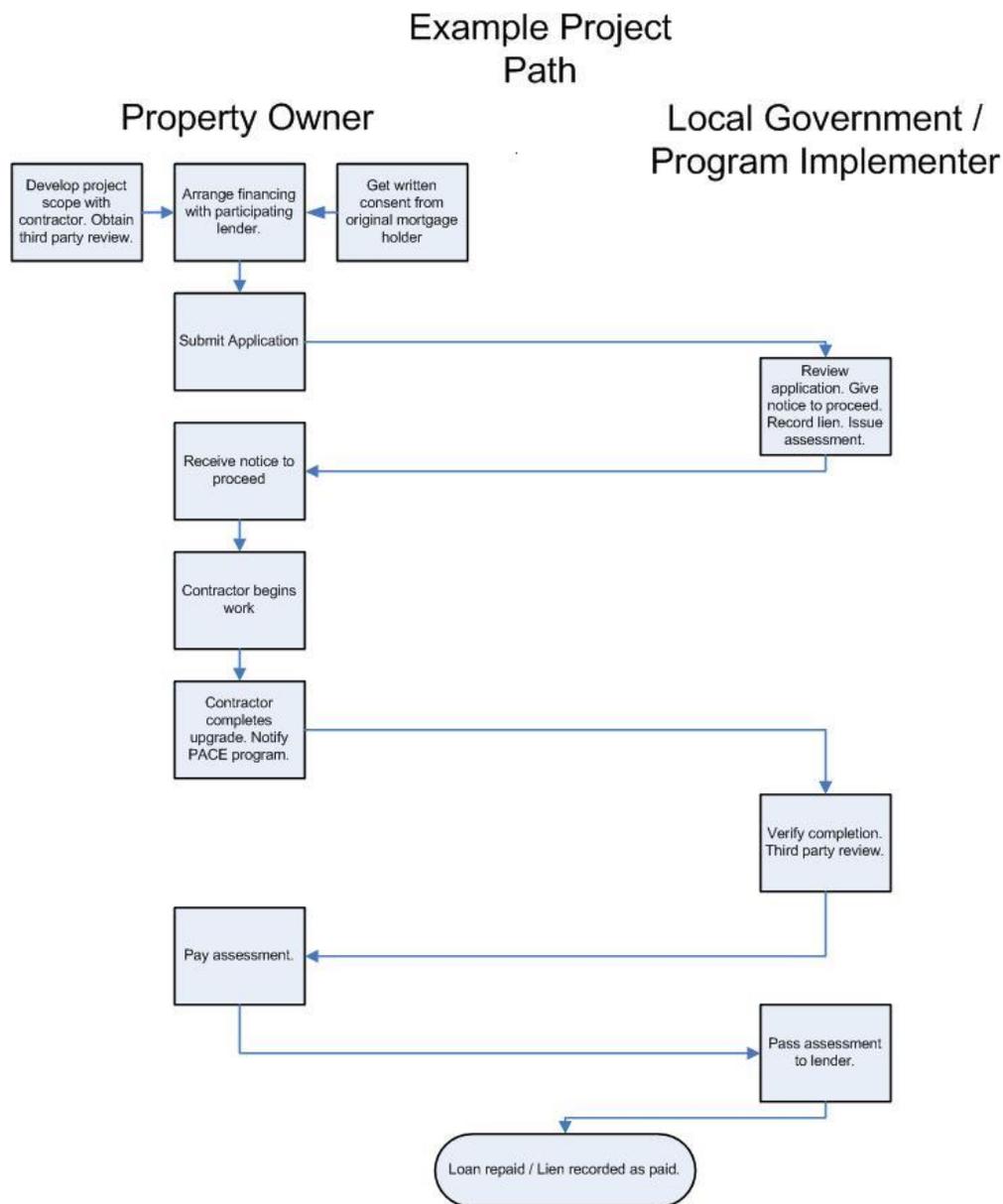
Contents

- Example Project Path 2
- Underwriting Standards - Eligibility to Participate..... 3
 - Eligible Properties 3
 - PACE in a Box checklist*..... 3
 - Eligible Property Owners 4
 - Eligible Projects 5
 - Ineligible Improvements 5
- The Application Process & Standards 5
 - Energy Analysis and Project Scoping..... 5
 - Permitting 5
 - Multiple Improvements in a Single Project; Establishing the Useful Life of a Multi-Measure Project-6
 - Length of Assessment Term..... 6
 - Savings to Investment Ratio..... 6
 - PACE Assessment Cost to Assessed Building Value Ratio..... 6
 - Eligible Expenses Included in PACE Assessments 7
 - Closing on a Project..... 7
 - Installation Verification..... 7
- The PACE Lien..... 8

Lien Recording and Assessment Recording	8
Servicing The PACE Loan	8
Ensuring Sufficient Capital From Third-Party Lenders	8
Responsibility for Authorized Improvements	9
Model Documents and Contracts	9

Example Project Path

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



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.

PACE in a Box checklist

addresses both the spirit and the explicit requirements of the statute and assists in the administration of the PACE program by including the following verifications:

- Owner's name and contact information;
- Type of ownership (e.g., corporation, limited liability company, partnership, trust, non-profit, individual, etc.);
- Address of property;
- Property tax assessor-collector ID or reference number;
- Current assessed value, assessment basis and date of assessment;
- Cost of proposed property improvements;
- Assessment lien value;
- Assessed property value to assessed lien ratio;

- PACE Financing terms;
- Description of property (acreage, type of use, improvements);
- Tenant or owner-occupied;
- Description of improvements (size, use, date of construction);
- Description of last major renovation (change in area of improvements or change in energy or water use by more than 10%);
- Description of utility service available and current use of service;
- Identification of electric distribution and energy service providers;
- Identification of water service provider or source;
- Current mortgage holder(s), if any;
- Amount of debt or current outstanding mortgage loan balance(s) for any 1st or 2nd liens;
- Most recent financial statement for the property, if applicable;
- Owner is current with all taxes or assessments on the property;
- Owner is current on all debts secured by the property;
- Owner has clear title to the property with no encumbrances;
- Property is not subject to any outstanding tax liens or notices of default;
- The useful life of the existing property or improvements is equal to or greater than the anticipated life of the financed improvements;
- Insurance company contact information and amount and type of coverage;
- Copy of a survey of the property; and
- The terms of any lease of the property are consistent with the proposed improvements and the term of the PACE financing agreement.

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.

The Application Process & Standards

Energy Analysis and Project Scoping

Once a PACE program is available in your region, the PACE program can begin considering projects for PACE financing. The process begins when a property owner and engineer or contractor study a proposed project’s scope and potential water and/or energy savings. Each proposed project must be reviewed by an independent third-party reviewer (ITPR) to review an audit that includes the property’s current water and/or energy baseline conditions and the projected water and/or energy savings expected after project implementation. ITPRs analyze the audits and conduct site visits to ensure that the projected savings identified in the audit are valid and reasonable.

An ITPR review letter is submitted directly to the PACE program. ITPRs - independent licensed Professional Engineers with the required engineering certifications - are not part of or guaranteed by the PACE program. The selection of an ITPR is the responsibility of the program participants, not the PACE program. Property Owners are encouraged to follow the guidance provided in the **PACE in a Box** Technical Standards Best Practices Manual in section 8.

Permitting

Property owners are required to obtain all necessary local building, electrical, plumbing and other permits, pass all required local inspections, and be in full compliance with applicable codes and standards. All work must be performed in accordance with all applicable federal, state, and local codes and standards. Copies of permits and other verification that plans are in compliance must be obtained and shared with the PACE administrator before construction.

Multiple Improvements in a Single Project; Establishing the Useful Life of a Multi-Measure Project-

PACE financing will enable some property owners to retrofit their property in a comprehensive manner with Qualified Improvements made up of a number of energy and/or water saving measures. This comprehensive approach is the most effective, cost-saving opportunity.

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.

Waiver - 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

- 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.

Closing on a Project

PACE financing is contingent on the signing of a contract between the PACE program and the property owner and, where third-party lending is involved, a separate contract between the PACE program and the third-party lender. A process for completing these documents must be established. Model contracts are included in Section 8 of PACE in a Box.

Installation Verification

After a PACE project is completed, an independent third-party must verify that the project was completed and is operating as intended, and report these findings to the PACE administrator. Verification can be completed by any ITPR selected by the program participants, including the ITPR that initially reviewed the water and/or energy baseline conditions and projected water and/or energy savings expected after project implementation or a different ITPR.

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 set forth in the Technical Standards Manual in Section 8.

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.

Servicing The PACE Loan

The PACE program must determine the method of servicing the debt. 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, and account balances and otherwise interfacing between the local government, the third-party lender and the property owner.

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 public lists of eligible third-party lenders will not be exclusive. 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.

Responsibility for Authorized Improvements

PACE is a financing program only. A participating local government is not recommending or warranting any particular improvements or affirming the performance or lack of performance of any measure. Neither a participating local program nor any agency assisting in coordinating any element of the program is responsible for the measures or their performance. The **PACE in a Box** coalition urges careful review of any measure that could jeopardize the ultimate success of a PACE project and by extension the PACE program. Ultimately, PACE programs look to lenders and commercial and industrial property owners who bear the ultimate responsibility to use solid business principles and common sense so as not to take undo risk to finance a questionable project.

Property owners are solely responsible for the measures installed on their property. Should there be any unsatisfactory performance or other system-related issues that arise during or after installation, the property owner must address those directly with the responsible contractor and/or vendor according to the terms of any contract between the parties.

Model Documents and Contracts

Visit the site library ([click to be taken to the site library?](#))