PACE FINANCING: A "WIN-WIN" PROPOSITION

Property **A**ssessed **C**lean **E**nergy (PACE) is an innovative program that provides low-cost, long-term financing for water and energy conservation and renewable retrofits to existing structures. **Keeping PACE in Texas** is building a business coalition supporting legislation to make commercial and industrial PACE financing available throughout Texas.

In 2009, Texas adopted a PACE statute that needs amending. Once the Texas statute is perfected, local communities can establish special PACE finance districts.

PACE is market-based financing tool. Private sector lenders provide the funding. A local government agency provides the structure to collateralize the PACE loan and collect the owner's payments on behalf of the PACE lender – all without burdening government resources (financial or otherwise). Commercial and industrial property owners, with the prior approval of their mortgagees, voluntarily enter PACE programs to obtain water and energy conservation, and renewable retrofits to existing buildings. As a result:

- Governments see job creation, healthier businesses, and increased water and energy conservation
- Property owners get water and energy-efficient properties with enhanced market value
- Contractors, engineers and equipment manufacturers enjoy increased business
- Lenders obtain a new secure loan product to better serve existing and new customers

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For more information contact:
Charlene Heydinger
Executive Director, Keeping PACE in Texas
512.469.6184, www.KeepingPaceinTexas.org

KEEPING PACE IN TEXAS

PACE BENEFITS TO COMMUNITIES

Economic Benefits

- PACE-financed engineering, construction work and equipment sales to retrofit existing commercial and industrial buildings -
  - Support local businesses
  - Create jobs
  - Increase property tax base
  - Increase sales tax revenue
  - Assists in business retention and expansion
- PACE-financed retrofits increase a building's market value through -
  - Increased occupancy rates
  - Increased rental rates
  - Reduced energy costs
  - Increased net operating income
- PACE financing helps reduce the risk of obsolescence in a community's aging building stock
- PACE financing is tax neutral for a community
- PACE programs do not burden the community's general fund or borrowing capacity
- Water and Energy-efficient buildings have reduced utility demands, resulting in -
  - Contributions to the Texas' water conservation goals
  - Reduced stress on the Texas electric grid
  - Reduced risk of brown-outs during peak periods

Air Quality Benefits

- Energy-efficient buildings have reduced carbon footprints and help communities meet clean air goals and requirements (50% of US energy is consumed by commercial and industrial buildings)
- Energy-efficient buildings provide healthier environments for their occupants and help -
  - Improve a community's "clean city" reputation
  - Attract workers and families to these communities
- PACE provides long-term financing for owners to pay the cost of code compliance, which -
  - Reduced the demand for aggressive code requirements
  - Reduces political resistance to sustainability efforts
  - Reduces dependence on costly incentives to finance sustainability projects (rebates, tax abatements, etc. which can negatively impact a local treasury

Consumer Protection

- PACE programs help consumers determine whether proposed work will deliver the projected cost savings
    - The engineering design and on-going operation of energy-efficiency improvements is reviewed, thus providing independent third-party analysis of the benefits derived from the project
- Building owners can negotiate energy savings guarantees from the contractor
- PACE programs can provide energy savings insurance (ESI) policies to cover shortfalls in projected energy savings
    - The premium may be rolled into the financing to enable payment over time
    - ESIs provide credit enhancements and may lower the cost of PACE financing
    - The insurer reviews engineering design and on-going operation of energy-efficiency improvements, thus providing independent third-party analysis of the benefits derived from the project
- Emerging cloud-based software platforms provide all parties transparent access to utility and use data on a real time basis

PACE BENEFITS TO COMMERCIAL REAL ESTATE OWNERS

Favorable Financing Terms

- PACE financing allows commercial real estate (CRE) owners to fund energy and water conservation projects without affecting the owner's capital resources, operating budgets or borrowing capacity
- PACE financing covers 100% of the project cost, including both hard and soft costs
- PACE financing is low cost and payable over an extended period (up to 20 years), allowing the annual energy savings to -
    - More than offset the annual PACE assessment
    - Decrease operating costs
    - Monetize energy savings
- PACE financing is secured by a special assessment lien on the property, with little or no impact on the owner's borrowing capacity
- On sale of the property, the PACE assessment follows title. Successive owners continue payment of the assessment while enjoying the continuing benefits of energy efficiencies.

Protect CRE Asset Value

- Water and Energy performance impact property value; reduced utility savings increase cash flow and net operating income
- Benefits of PACE-financed retrofits include:
    - Reduced operating costs / risk of obsolescence
    - Increased building value / tenant demand
    - Increased return on investment / reputation and market differentiation
    - Increased occupancy / rental rates
    - Energy-efficiency retrofits protect the asset from risks of obsolescence: exposure to utility rate increases, decreased market value, public image /reputation, building code compliance issues
- Appraisals will factor energy performance into property valuation
    - The Department of Energy and the Appraisal Foundation are working to insure that appraisal standards account for energy performance
- PACE assessments may qualify as "expense pass-throughs" to tenants under many leases
- Improved reputation

Water and Energy Independence

- Water and energy-efficient buildings have reduced exposure to costly utility rate hikes
- Buildings that have self-sustaining energy equipment will save utility costs and
    - Have access to alternative power sources when conventional power is interrupted (weather or peak use brown-outs)
    - Continue serving tenant / guest needs during power outages

Consumer Protection

- PACE programs help consumers determine whether proposed work will deliver the projected cost savings
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- Building owners can negotiate energy savings guarantees from the contractor
- PACE programs can provide energy savings insurance (ESI) policies to cover shortfalls in projected energy savings
    - The premium may be rolled into the financing to enable payment over time
    - ESIs provide credit enhancements and may lower the cost of PACE financing
    - The insurer reviews engineering design and on-going operation of energy-efficiency improvements, thus providing independent third-party analysis of the benefits derived from the project
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PACE BENEFITS TO INDUSTRIAL FACILITIES OWNERS

Favorable Financing Terms

- PACE financing allows industrial facilities owners to fund energy and water conservation projects without affecting the owner's capital resources or operating budget
- PACE financing covers 100% of the project cost, including both hard and soft costs
- PACE financing is low cost and payable over an extended period of time (up to 20 years), allowing the annual water and energy savings to -
    - More than offset the annual PACE assessment
    - Decrease operating costs
    - Monetize energy savings; increase cash flow
- PACE financing is secured by a special assessment lien on the property, with little or no impact on the owner's borrowing capacity
- On sale of the property, the PACE assessment follows title. Successive owners continue payment of the assessment while enjoying the continuing benefits of energy efficiencies

Water and Energy-Efficient Facilities Increase Competitive Edge

- Texas industries use 19% of the energy consumed by all US industries, ranking first among the states in industrial energy use
- Facility energy performance impacts property value
- Facility energy and water cost reductions increase a company's competitive edge
- Benefits of PACE-financed energy efficiency include:
    - Increased net operating income
    - Reduction in operating costs / increase in return on investment
    - Increased facility values
    - Reduced risk of obsolescence
    - Improved company reputation

Water and Energy Independence

- Facilities with water and energy conservation retrofits have reduced exposure to costly utility rate hikes
- Facilities with water conservation measures reduce exposure to limited water availability or demand for water from high-cost alternative sources
- Facilities with renewable energy retrofits will save energy costs and -
    - Have access to alternative power sources when conventional power is interrupted (weather or peak use brown-outs)
    - Continue operations when competitors are forced to shut down due to power outages

Consumer Protection

- PACE programs help consumers determine whether proposed work will deliver the projected cost savings
    - The engineering design and on-going operation of energy-efficiency improvements is reviewed, thus providing independent third-party analysis of the benefits derived from the project
- Building owners can negotiate energy savings guarantees from the contractor
- PACE programs can provide energy savings insurance (ESI) policies to cover shortfalls in projected energy savings
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PACE BENEFITS TO ENERGY SERVICES COMPANIES (ESCO's)

PACE Helps ESCOs Penetrate Private Sector Market

- ESCOs have traditionally focused on public sector energy-efficiency market and have had difficulty penetrating the private sector market because -
  - Analysis of private sector capital investments is based on short-term return on investment
  - Frequent ownership turnover of CRE discourages investment in energy-efficiency projects because project costs may not be fully recouped if payback period exceeds ownership term
  - CRE tenants often bear all increased energy costs (and would receive all the benefits of a PACE project), thus reducing owner's incentive to invest in energy-efficiency retrofits
- Private sector CRE in U.S. consists of almost 5 million buildings. Approximately 75% of CRE is over 20 years old, with many still relying on original, inefficient mechanical and electrical systems at or near the end of useful lives. PACE provides an avenue into this untapped market of buildings with delayed maintenance
- PACE programs provide third-party measurement and verification of ESCO deliverables, ESCO guarantees and insurance enhance private sector confidence in installed water and energy conservation and renewable equipment

PACE Reduces Financial Barriers to Private Sector Demand for ESCO Products and Services

- PACE financing creates private sector demand for water and energy conservation and renewable equipment and services by -
  - Enabling owners to fund project costs without affecting their capital resources, operating budgets or borrowing capacity
  - Covering 100% of project cost, including both hard and soft costs
  - Providing low-cost financing payable over an extended period of time (up to 20 years)
  - Potentially qualifying as expense "pass-throughs" to tenants under many commercial leases

PACE BENEFITS TO LENDERS

<u>New, Profitable Business Opportunities</u>

- "Open market" PACE financing model
    - Building owner arranges his own PACE financing within the private lending community
    - Enables any lender to offer competitive PACE financing products
- Energy-efficiency financing will become a mainstream business for participating lenders
- PACE financing products will enable lenders to monetize energy savings opportunities
    - Traditional lending models do not meet owner's needs for energy-efficiency financing
        - Short term and relatively expensive
        - Highly dependent on borrower's creditworthiness
        - Conventional loans are unable to fund 100% of project cost
        - Because PACE financing addresses these needs, it will dramatically accelerate growth of the energy-efficiency retrofit market
    - PACE financing creates an opportunity for lenders to increase business with existing customers
- PACE liens on the property provide very secure long-term investments
    - PACE assessments cannot accelerate; exposure is limited to past due assessments
    - If the building has tenants, and the mortgagee needs to pay the utility bills to keep the building operational, those utilities and the assessment are less expensive than the utilities would have been before the retrofits financed by the assessment
    - PACE assessments travel with the land; when the property is sold, the new owner assumes the remaining assessments, along with the water and energy utility savings (which are greater than the assessments)
- PACE financing model increases lender confidence that projected energy savings will be achieved and that actual energy savings will be reliably measured and verified
    - Insurance policies guarantee energy savings, mitigate risk of underperformance and provide a source of credit enhancement
    - Contractors guarantee savings
    - Developing software platforms provide lenders and other parties transparent access to utility and use data on a real time basis
- PACE financing products will enhance the lender's reputation

- National efforts to standardize financial and technical underwriting standards will increase confidence, and ease of use creating mainstream lending opportunities for conservation retrofits

PACE Protections for Existing Mortgagees

- Application for PACE financing will require notice to and written consent from existing mortgagees
    - Mortgagee controls decision to create PACE assessment
    - Mortgagee has opportunity to provide the PACE financing
- Energy efficiencies produced through PACE financing will increase the value of the underlying asset
- PACE financing helps protect the underlying asset from obsolescence
- Traditionally low default rates on property tax assessments
- In case of default, the PACE assessment is not accelerated
    - The mortgagee’s risk is limited to the delinquent portion of the assessment
    - PACE assessments travel with the land; when the property is sold, the new owner assumes the remaining assessments, along with the water and energy utility savings (which are greater than the assessments)