APPROPRIATE ASSESSMENT COST TO ASSESSED VALUE RATIO

March 23, 2017

In 2013 – 2014, the Underwriting Working Group of the PACE in a Box Collaboration studied best practices elsewhere and, in an abundance of caution, set a recommended Loan to Value (LTV) ratio of 20% as the appropriate ratio for PACE projects and established the ability of for-profit organizations to request a waiver of the rule. Exhibit A includes the relevant statutory language, the relevant PACE in a Box language and the model report language.

Experience with processing PACE projects using the PACE in a Box model demonstrates that additional guidance is required for the waiver/variance requests so that the TPA evaluation is informed and based on a consistent review of relevant information. The LTV ratio addresses lender protection; the value of the property does not influence the risk of default.[1] Rather, the amount of equity in the property is the lender protection if a default occurs. A 20% LTV ratio is a conservative guidepost, or safe haven.

The purpose of these recommendations is to establish a variety of relevant factors to be considered in approving a loan above an LTV ratio of 20%. The result of establishing these variance guidelines is a holistic approach that takes all relevant factors into account, evaluates each proposed PACE project on that basis, and is open to granting reasonable variances from the 20% LTV when justified by the circumstances. The establishment of these factors also ensures that the review of the requests will be informed and based on consistently applied factors.

RECOMMENDATIONS

1. Amend the existing LTV request for variance form (Exhibit B) to include a list of factors to be addressed, including:

    a. What is the existing debt to assessed value of the property prior to closing the PACE loan?
    b. What is the estimated fair market value of the property? How was the value determined (e.g., market appraisal, desktop appraisal, insurance valuation, etc.)?
    c. What is the estimated post-renovation fair market value of the property (including addressing how this value was determined)?

2. Remove "for profit" from the waiver language so that nonprofits can apply for a waiver/variance. The abundance of caution designed to protect nonprofits is, in this analysis, potentially harmful. A 20% LTV loan on a highly leveraged for-profit property could be much riskier than a higher LTV ratio for an unleveraged non-profit property whose assessed value for tax purposes may not be close to its fair market value. In cases where a nonprofit is financially healthy and has little or no debt on its property, the restriction could actually prevent the organization from protecting its property and lowering its operating expenses.

3. Change the word "waiver" to "variance."

[1] The Savings to Investment Ratio (SIR) and the Debt Service Coverage Ratio (DSCR) speak to the consumer protection and the risk of default.

EXHIBIT 1: DOCUMENTS

1. STATUTE

The statute sec. 399.009 requires the local government in its report to provide:

(b) The method for ensuring a demonstration of financial ability under Subsection (a)(10) must be based on appropriate underwriting factors, including:

(1) providing for verification that:

(A) the property owner requesting to participate under the program:

(i) is the legal owner of the benefited property;

(ii) is current on mortgage and property tax payments; and

(iii) is not insolvent or in bankruptcy proceedings; and

(B) the title of the benefited property is not in dispute; and

(2) requiring an appropriate ratio of the amount of the assessment to the assessed value of the property.

2. PACE IN A BOX

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.

3. MODEL REPORT:

(J)

a. Financial Eligibility Requirements. The Authorized Representative will determine whether the owner, the property and the improvements are eligible for financing under the program. The Eligible Lender chosen by the owner will determine whether the owner has demonstrated the financial ability to repay the financial obligations to be collected through contractual assessments. The statutory method[2] for ensuring such a demonstration of financial ability must be based on appropriate underwriting factors, including the following:

(1) verification that the person requesting to participate in the program is the legal record owner of the benefitted property,
(2) the applicant is current on mortgage and property tax payments,
(3) the applicant is not insolvent or in bankruptcy proceedings,
(4) the title of the benefitted property is not in dispute; and
(5) there is an appropriate ratio of the amount of the assessment to the assessed value of the property.

[2] TX. Local Gov't Code §399.009(b).

Exhibit 2 AMENDED VARIANCE FORM

PROPERTY ASSESSED CLEAN ENERGY PROGRAM

OWNER AND CAPITAL PROVIDER REQUEST FOR VARIANCE OF LTV RECOMMENDATION

We, the undersigned Property Owner and Lender, hereby acknowledge the following facts with respect to the project described in the Project Application No._____(the "Project") under the_____Property Assessed Clean Energy Program:

The Variance: PACE Financing exceeds 20% of the assessed value of the property (as defined by local Appraisal District).

PACE Financing: _____

Assessed Value: _____

Loan to Value Ratio: _____

The undersigned certifies that:

I have read and clearly understand the waiver request, the information provided and the impact of this request on the property and the PACE assessment.

PACE Capital Provider Signature	Date
Title	Company/Firm
Owner Signature	Date

REASONS FOR REQUESTING VARIANCE

Please address the following for the administrator to use in determining whether to grant the variance request:

1. What is the existing debt to assessed value of the property prior to closing the PACE loan?
2. What is the estimated fair market value of the property? How was the value determined (e.g., market appraisal, desktop appraisal, insurance valuation, etc.)?
3. What is the estimated post-renovation fair market value of the property (including an explanation on how this value was determined)?

Office Use Only

Project ID _____

Received: _____