



**Keeping PACE in Texas  
PACE in a Box Underwriting Working Group  
Chaired by Steve Minick**

**Topic: TX-PACE Refinancing/Lookback**

**Next Steps** The Chair encourages all stakeholders to review the notes, ask questions, and/or provide additional comments on any part of the discussion regarding establishing intent and establishing an appropriate look back period for TX-PACE projects. Comments should be **submitted by August 17, 2020** to [Charlene.Heydinger@keeppace.org](mailto:Charlene.Heydinger@keeppace.org).

**1. Meeting Notes: Virtual Meeting No. 3, July 30, 2020**

**Attendees:**

Steve Minick, chair  
Marina Badoian-Kriticos, TPA  
Tommy Deavenport, Petros  
Ethan Elser, PACE Equity  
Marcus Glomset, PFS  
Charlene Heydinger, KPT  
Abby Johnson, VPA  
Lee McCormick, LSP  
Ally Neary, Stonehill PACE  
Tracy Philips, CO PACE  
Sarah Silberman, KPT  
Josh Smith, Petros  
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**Review of the “intent” language in the Texas PACE Act**

Steve Minick, Chair – presented the purpose of the virtual call, which was to discuss issue of refinancing/lookback PACE in a Box recommendations [set in 2014](#) and revisited by the Underwriting Working Group on [December 31, 2017](#). The statute requires intent and has been interpreted to require that intent be established before any measures can be included in PACE financing (work done before intent is established can’t be included in a PACE project). Should this be changed to intent must be established before a certificate of occupancy (OC) is received?

Primary topics:

- How does one establish intent?
- When can intent be established?
- What is the practical limitation for how far back in time a TX-PACE project refinancing should be permitted?

The Chair reminded participants that the scope of the call is on the guidance that can be achieved without statutory changes.

History: In 2017, the Underwriting Working Group was asked to provide guidance on establishing intent for projects nearing completion or at completion before TX-PACE financing in place. Refinancing was not an issue at the time. The 12/31/2017 guidance was to fill out preliminary application and send TPA an email letting TPA know the intent is to save energy/water prior to construction. Because the preliminary application is not available unless a PACE program is in place, the guidance was not helpful to property owners desiring to establish intent in areas where PACE programs were not yet established.

Discussion participants: Ethen Elser, Charlene Heydinger, Abby Johnson, Steve Minick, Tracy Philips, Josh Smith

Discussion:

### **Requirements for Establishing Intent to decrease energy or water consumption or demand**

The use of intent in the statute was discussed as the intent of the improvement itself or that of the property owner. The importance of a clear standard for the program administrator was highlighted.

There are multiple benefits to installing qualified measures, such as reducing consumption or demand, achieving savings, improving the environment, pleasing tenants, etc. Can the act of installing qualified measures establish intent to reduce energy or water consumption?

Discussion points:

- To date, establishing intent prior to expenses on qualified measures being eligible for PACE is required. Communications with service providers, applications for utility incentives, etc. can help establish intent.
- Intent is implied when the result is a reduction in energy or water use (use actual result as demonstrating intent as an alternative to a list of objective factors to evidence intent); When people make long-term investments, they anticipate future energy/water savings
- Could select from a range of options to establish a choice to save energy/water?
- Establish an outcome/results driven analysis
- Imply intent when construction is above code
- Imply intent in qualified demand reduction measures (distributed generation)
- In retrofits to code, there is a good baseline to compare to and have more tools to demonstrate improvements are significant over base stock, and the modeling required should be used to demonstrate intent. The delta between the baseline and building to code

demonstrates intent. If no baseline – building above code demonstrates intent. There is a decision made to retrofit building and there is no legal requirement to retrofit. An owner retrofitting property intends to install a better system. This creates a nexus of intent that the Independent Third-Party Reviewer (ITPR) could review to make conclusion on admin behalf. This is in the ITPR wheelhouse.

Summary of suggestions for change:

- New construction – building above code is evidence of intent to reduce energy or water consumption
- Retrofits – Decision to retrofit building with qualified measures is evidence of intent to reduce energy or water consumption
- Distributed generation – is evidence of intent to reduce demand

### **Requirement for when intent is established**

If intent is implied per the discussion above, then there would be no need to establish intent prior to demonstrating intent prior to eligibility. It's possible to imagine projects where there is no documentation, but intent was to save energy/water, because owners cannot always show demonstrable intent. Perhaps having a contractor cosign an intent letter with a property owner could be an option.

### **Establishing an appropriate limit to how far back refinancing should be allowed**

States have taken a bit of a different interpretation on the length of time in which PACE financing can be used to refinance previously installed qualified measures. The Texas PACE Act does not spell out how far back in time PACE refinancing is appropriate. The average in other states is 1 to 3 years, but there is not a lot of legal authority; the limits have been discretionary. It is challenging to gather the required documents beyond a 36-month timeframe.

Factors to be considered:

- Need for PACE refinancing to produce cash flow in light of the financial impact from COVID-19
- 12 months ends up being short because of real estate development lead times.
- Refinancing a construction loan to a permanent loan requires flexibility to include PACE in the capital stack. In refinancing projects, borrowers are looking to realize economic savings that will allow them to improve operating revenue and improve financial footing during this time.

Local governments and the public benefit from the ancillary benefits of PACE refinancing, including putting non-performing buildings back on the market, economic benefits, etc. and these benefits are ongoing savings in out years. Refinanced projects can result in benchmarking data for local governments and through case studies and other outreach, PACE refinancing can be examples for capital provider and other owners to deploy additional projects and spur additional PACE projects in the region.

In spite of the uncertainties of the real estate market due to COVID-19 it is not necessary to roll out the term of the lookback in phases (12 months to 26 months) because the lender consent

requirement provides a quality control. Mortgage lenders will scrutinize how funds are being used

In a PACE refinancing situation, the baseline for establishing the life of the equipment (the maximum term of the PACE assessment) is established from the time the asset has been in service. The Savings to Investment Ratio (SIR) is set from the time the refinancing takes place through the term (not to exceed the useful life of the qualified measures). As a result, the SIR will be slightly higher for refinance PACE project because savings date back to beginning of items in service, but the investment will be artificially shorter so the PACE principle and interest will be applied to the balance of term.

CH – All agree that SIR start when retrofit happens, not when financing happens.

## 2. Notes from Technical Standards Working Group meeting, 6/19/220

Chaired by Steve Minick

Notes taken by Sarah Silberman

Steve Minick, Chair, welcomed the participants to the meeting and introduced the purpose of the meeting – to revisit some of the guidance re: underwriting of PACE in Texas created in 2014 and updated in 2017. <https://www.keepingpaceintexas.org/library/document-library/>

**TOPIC #1: LOAN TO ASSESSED VALUE RATIO**, currently set at 20%. What considerations and rationale to changing the current ratio and what would that mean to the current PACE in a Box model program?

- Josh Smith, Petros PACE Finance: This seems like both a numerical question and a structural one. When PIAB guidelines were established, 20% was standard across the board for PACE companies (same at CleanFund). In the last 4 years, as investors and senior mortgage lenders that number has increased. Not uncommon to see loans at 25% or higher. **Challenging to talk about this in a vacuum, because PACE is only one component of a capital stack. Depending on how the capital stack is designed, the lean could justify it going higher.** Don't know to what extent the TPA working group is doing to talk about lean to value. Thinking about ways in which we can offload the burdens and obligations in better ways to ensure that the lenders are doing a reasonable and commercially good job so that they're doing a good job at that level than strictly a transaction by transaction level
- Minick: Many things on the surface can be seen as arbitrary, much of that was to convince governments that there is uniformity and etc. to get the program established. The program was designed to assure local governments who were nervous about programs that were based on local tax mechanisms. Many things have changed and now we need to decide if there is enough experience to determine whether another ratio is appropriate.
- Ethan Elser, PACE Equity: Echo Josh. **Assessed value in these projects is not a great way to determine what an appropriate loan to value is, especially if it's going through a great amount of development it's adding value.** In the program where there's limits it's coming from an appraisal. I would further state that if there is a concern about consumer protection, these transactions to a local government you can state that there's a lot of lawyers involved so you have a lot of different people looking at these. **These transactions are so high that they have a lot of eyes on them and they're good investments and wouldn't be approved otherwise.**
- John Fleming, TMBA: We were involved in the original discussions on this issue. 20% was not exactly arbitrary but after new considerations to perceptions from local governments. One of the strengths of the existing guidelines is that the 20% when you look at it, but there were provisions in the underwriting guidelines that permit a waiver, but it requires an analysis to be made. My question would be given the waiver process under the original guidelines what have the PACE community experience with the existing standards being problematic and can we fix it with the waiver process and not the 20% and maybe 20% maybe even isn't the right number it could be 10%. The bigger issue is: "can the total indebtedness be covered by the cash flow of the project?". **Maybe the assessed value is maybe not the right value because it may not be the same as market value. We need to make sure that we do not want PACE financing to be focused on an asset-based lending situation that we get to a place where we increase the likelihood of payment defaults in a capital stack.** Don't want a repeat of the 80s, the financial crisis of 2008. Have to be careful in the underwriting to maintain skin in the game. Need to look at these measures but it's important that the standards provide flexibility with sound underwriting principles that minimize the change of default with good cash flow so that we don't have to use the collateral. Would be bad for PACE and the local govt.

- Karen Neely, IBAT: Intrigued by our timing issue. **Right now regulators are more concerned with the potential of facing a gigantic real estate mortgage crisis that will make the 2008 one look like a walk in the park.** Can their return on their assets is down from 1.5 to 0.3 and one thing we learned from 2008 is that the ability to repay is the most important. ATR analysis. We must be mindful of our context and keep that at the front of our minds regardless of what we do.
  - Charlene Heydinger, KPT: Loan to assessed value is in the statute. In 2013 and 2014 this Underwriting Working Group was thoughtful about how to address the inequities in the central appraisal districts' assessed value (CAD). The Working Group established a waiver process. In 2017 one of the capital providers asked for guidance to request a waiver. In March 2017 the Underwriting Working Group established guidance listing the factors for consideration of a waiver and almost every project requests a waiver. This is the system that is used so far and feedback from the capital providers indicates that 20% of the market value is not appropriate.
  - Minick: Do you have any feeling as to what 25% base would do to the number of waivers?
  - TX is one of two states that uses assessed value that uses a loan to value ratio. **Almost every other state that has a hard or a soft cap; uses some of appraised value or market value and then allow the capital provider to create a market appraisal**
  - Abby Johnson, VPA: Are lenders more or less likely to consent with what we currently use? Do we have feedback from the first mortgage lenders on this?
  - Heydinger: We are still trying to educate our senior lenders on the benefits of PACE. Local governments and their issues of risk need to be addressed individually. We skew more on the conservative side as a result.
  - Elser: Our experience nationally is this is very much a project by project consideration, relying on an appraisal rather than an assessed value.
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- Fleming: That is consistent with how I would expect senior mortgage lenders to react. It will be project to project and based on appraised market value made by the lender. Then I'll be looking at the total indebtedness. If the total indebtedness is 50% with a PACE lending at 25% then it'll look much different than total indebtedness of 75%. Would like to ask Josh to what extent has the current guideline been a practical impediment that could not be addressed through the waiver process ?
  - Smith: To a point that was raised earlier, **if you are granting a waiver on almost all projects you are doing then you have to wonder if that is an efficient system. If almost every project needs a waiver than likely no.** In Texas there is a concern that being overly aggressive in terms of sharing appraisals could trigger an assessment of underlying properties. I have had to undergo some challenging processes where we're meeting in offices to share appraisals in ways that are administratively difficult. Not to say that this is stopping us from doing these, but it's making the process more complicated and slower and frankly firms like mine have the resources to do that, but the extra stress goes on TPA and they are where the burden lies. **If every deal is an exception and there are actual costs to granting those exceptions then it's something to examine.**
  - Fleming: Be careful. As someone who regularly mediates CADs, you've got project developers saying I'll tell you what the assessment is for the purpose of tax and not purpose of money. **If there is a reluctance to share appraisals with local government officials then that's a problem**
  - Smith: We're given many documents under NDA and then when people ask us for portions of that, navigating the NDA process is administratively challenging
  - Fleming: That sets up a whole lot of other issues. **It sounds like asking a government agency to grant a governmental benefit but then not give them all the information and all of the requirements for that loan.** This is a governmental lien that private entities are taking

advantage of for private desires. We should be careful about messaging that round the capitol. This is the government's lien we're just doing our business on it.

- Smith: In general, we are dealing with transactions where developers are looking to acquire land and do so at fair value and so I think the idea is that there are other forms of **public private partnership that this is similar to like TIFF. Frankly in those projects there are not those same restrictions and limitations that PACE has despite those using public funds. We should look at aligning PACE with similar programs and the extent to which those other programs do or do not have restrictions and bring everything in line.**
- Fleming: Given the fact that Charlene has reminded us of the constraint, what would your recommendation be.
- Smith: Only requires a reference to assessed value. One could set a limit of 200% assessed value if it's set artificially low. We don't have to use assessed value and appraised value. In our transactions we see 25% of appraised value as being a baseline. Some circumstances in which other exceptions can be made. The idea is to reduce the waiver process so that the number of waivers given are manageable and reasonable.
- Minick: Memorialize what's happening in the real world in our guidance?
- Smith: **PIAB has been successful in Texas for many years without any major failures, I think historical practice is probably a good indicator that what we're doing is working. If we dial the needle that way, then great and if it goes wrong then we can just go back to the way that was before. There are a number of parties with more financial skin in the game and so far, the momentum in the market has indicated that they are willing to go higher than 20% so we should listen to that.**

**Summary of comments regarding increasing LTAV ratio:**

**Pros: 1) Would decrease the number of waivers completed, making the system more efficient. 2) A higher ratio is accepted in other peer programs. 3) These transactions have many sets of eyes on them, it is unlikely they would be approved if the project were likely to default big.**

**Cons: Timing may not be right considering the financial crisis**

## **TOPIC #2: REFINANCING AND LOOK BACK PERIOD**

Because of COVID there is a nationwide interest in using PACE to refinance. There's nothing in the Texas statute that would prohibit that. For the discussion today:

1. How do we go back and establish intent as required by the statute?
2. How far back should you be able to go?

Discussion:

- Elser: From the PACE Equity side, most of the time except in very new legislations there is not a reference to retroactive or refinancing but it is allowable. **Our stance would be that most programs do allow it in some way, overwhelmingly allow it for that 1-3 year mark after**

**completion.** Our conversation on the previous point is very relevant, in those projects you still need to have the same dynamics that make it viable. Right now, we have mortgage lenders reaching out to us to give some more breathing room to the property because of COVID and all that jazz. Not sure that the intent has to be documented pre-construction.

- Fleming: **PACE was sold to the legislature as provided a means to see that sustainable additions could be made to a project because it could not otherwise be financed. The things are now built, they are there, then what is the purpose of energy conservation if you've already achieved it before even asking for PACE financing? Energy enhancements are already in the project**
- Elser: We have projects all the time that would have done more if they knew that they could. Partly this is about "Oh not for right now, but for the next time" so there are those considerations. This is not always the case, but there are other public benefits and our funds can be used for further improving the property or stabilizing it. There will always be the quality control issues though.
- Smith: There's two separate issues to be addressed here. Under the text of the statute, what is permitted? The intent element goes to whether you intended the qualified improvements for energy and water conservation, not to the mechanisms through which they're financed. This is more of a policy question, though. Public benefits section should be something we're talking about. There is more public benefit than what we're currently talking about. Will refinancing stimulate the economy, unlock reserves to be used if properties are underperforming, creating jobs, etc.? There are limitations certainly but there is a growing recognition of an interest in using PACE to unlock additional capital across the country.
- Johnson: If it were determined to allow it in some form, there could be some teeth to put in to ensure that it meets the current standards or that there would be some limitations to the term of its useful life. Is this something we could develop some good criteria about?
- Heydinger: Still have to meet every existing requirement, so the burden wouldn't be on an administrator. Looking at the statute allowing local bonds, so what Josh was referencing was issuing local bonds so the point is well taken, but the focus is on energy and water with private financing and we could get there through the SIR requirement. In Texas it needs to be focused on energy and water, just in the way that we are built and getting local governments involved. Any thoughts on how far back we should look back?
- Victor Sauers, TKO Energy Capital: Weather can change, like look backs. We don't expect our writers to be expert weathermen/women who can account for changes in the weather, so lookback is reasonable. Whatever policy we change, do we create unintended backlash? When you rely on intent, you rely on engineers -- More than yes or no it's also what that criteria of the length of time includes, we need clear guidelines of what that looks like
- Minick: This goes back to the whole project by project thing we heard earlier
- Sauers: If I wanted to be as aggressive as lending is right now, I could probably look back and deny every time. But I could also go back and say value was added each time, so we need that criteria and standard guidance. Essentially, we just need to find that good balance

#### **Summary of lookback and refinancing discussion:**

**Pros: 1) Most other programs do it with a limit of 1 to 3 years; 2) Would allow people to complete projects that may not have been possible before**



**-Cons: 1) PACE was sold to the legislature as a means to complete energy/water efficiency projects, if the projects are already complete then what is the point of PACE financing them?**

### **TOPIC #3: UNDEVELOPED LOTS AND LOTS UNDERGOING DEVELOPMENT**

In 2017 when the Underwriting Working Group reviewed the “undeveloped lots and lots undergoing development” language in the statute, pro-bono attorneys met several times and determined that the statute allowed the use of PACE on previously developed. Multiple projects have been proposed where new construction would be built on land formerly developed as residential. The question before the Underwriting Working Group is “should the guidance include property that was previously developed as residential?”

#### Discussion

- **Fleming: It's my impression that PACE has never been presented to the legislature to be used for new construction. The statute definitions are what they are, but this is not the way the program was presented to the legislature or the public. We need to be consistent with what we presented.** But there are policy and programmatic decisions that need to be made along that line. Not everything that is lawful should be permissible. We have to give some real consideration as to whether the program we presented is different than the program which we have right now. The more you move away the more you jeopardize PACE as a program. There are some members of the legislature that indicated that if there is not a sufficient public purpose that they would consider a repeal of the PACE statute. PACE is still under scrutiny at the legislative level and caution should be exercised when we make these decisions
- **Minick: I would go even further. There are also members of the legislature that have concerns about this program for completely inaccurate reasons, but the reality is that those concerns are out there, and we don't want them to repeal PACE because they misunderstand and then doing new construction lets their foot in the door.** Some people in the legislature misunderstand what PACE is and think that this is not what they supported, and those people have not been reeducated.
- **Elsner: A review of the statute is that it is for previously developed lots just other previously developed lots besides commercial, but anyway we would be supportive of this. A parking lot or a mobile home is a stretch, but expanding the definition of previously developed is something we view as a positive change**

#### **Summary of undeveloped lots discussion:**

**Pros: 1) May be good to expand the definition of developed to increase number of projects (but not to the extent of a parking lot or a mobile home)**

**Cons: 1) Not representative of what PACE was sold as to the legislature; 2) Some members of the legislature already don't like PACE, may use this as an excuse to write it out in January**