



GUIDANCE FROM THE UNDERWRITING WORKING GROUP REGARDING *PACE IN A BOX*

September 1, 2022

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COVER NOTES:

All previous Underwriting Working Group Additional Guidance still in effect has been incorporated into this document for the purpose of incorporating all current guidance in a single document. Current Guidance will be identified in the Document Library in green font. Prior Guidance will be retired and listed in the Document Library in gray font. <https://www.keepingpaceintexas.org/library/document-library>

Context

In order to expedite the establishment of local PACE programs in Texas and to facilitate an orderly, consistent, statewide approach to PACE design and implementation, in 2013 [Keeping PACE in Texas](#) (KPT) organized a broad-based coalition of over 130 PACE stakeholders (the “Texas PACE Coalition”) to collaborate in developing a toolkit for local governments to use in creating their PACE programs. For over a year, these volunteers worked in five working groups to establish the *PACE in a Box* model program to assist local governments in establishing a program of best practices in administration, underwriting and technical standards that are uniform, user friendly, sustainable, and scalable.

The volunteers in the *PACE in a Box* Collaboration foresaw the need for a regular feedback and improvement process to prevent the documentation from becoming obsolete. Section III, INTRODUCTION TO PACE IN TEXAS, Phases of Program Development of the [PACE in a Box model program](#) states, “*PACE in a Box* programs are encouraged to work together to establish self-evaluation protocols, to keep up with developing national best practices standards, and to incorporate improvements in a regular evaluation and improvement system.”

This document is the result of the Underwriting Working Group’s 2022 review of two items highlighted by the board of KPT for review and updating as necessary in 2022:

- Considering and potentially modifying the definition of “intended” in section 399.002(3); and
- Considering and potentially modifying the interpretation of the scope of section 399.004(b)(1).

This document incorporates the 2022 updates with all other active feedback and improvement process guidance so that all current information is contained in this document. Earlier iterations that have been superseded by the information in this document are retired and retained in the KPT Document Library for historical purposes. These retired document links appear in gray font.

Earlier this year, the Technical Standards Working Group’s feedback and improvement process resulted in the release of the improved Technical Standards Manual Version 3.0 and the release of the PACE ITPR Workbook that will simplify the approval process and standardize 3rd party reviewer submissions. All updated guidance can be found on the [Keeping PACE in Texas Document Library](#).

The Keeping PACE in Texas Board gratefully appreciates the leadership of Steve Minick, chair of the Underwriting Working Group and thanks each of the 58 volunteers in 2022 for their work to update the underwriting best practices below.

ESTABLISHING INTENT TO REDUCE WATER OR ENERGY CONSUMPTION OR DEMAND AND ESTABLISHING APPROPRIATE TIME FRAMES FOR REFINANCING QUALIFIED MEASURES

Effective Date: [September 1, 2022](#)

Purpose: To clarify how statutorily required “intent” can be established when using PACE to refinance qualified measures and to clarify the appropriate dates for refinancing previously installed qualified measures

In this 2022 Guidance, the Underwriting Working Group recommends that the design of a qualified project is treated as evidence that a qualified measure is “**intended** to decrease water or energy consumption or demand, including a product, device, or interacting group of products or devices on the customer's side of the meter that uses energy technology to generate electricity, provide thermal energy, or regulate temperature” as required under Chapter 399.102(3). The required project design may be submitted as drawings, plans, or equipment specifications. The PACE qualified measures must be listed and identified with the corresponding page numbers of the design submission on which information about the qualified measures appears.

Refinancing of PACE projects can occur up to 24 months after the date on which the last qualified measure was installed, provided all other PACE in a Box underwriting and technical standards are satisfied. The Savings to Investment Ratio (SIR) is calculated from the beginning of the refinancing. The life of equipment calculation for all qualified measures should be measured from the date on which the last qualified measure was installed.

REGARDING THE SCOPE OF THE PROHIBITION ON THE USE OF A PACE ASSESSMENT ON “UNDEVELOPED LOTS OR LOTS UNDERGOING DEVELOPMENT” UNDER CHAPTER 399 OF THE LOCAL GOVERNMENT CODE

Effective date: [September 1, 2022](#)

Purpose: To clarify that when an Appraisal District determines that the property is “improved” under the property tax code, that property is developed.

This recommended additional guidance replaces the previous guidance to further clarify and simplify the scope of the prohibition of PACE assessments on undeveloped lots or lots undergoing development.

Since 2017, the Underwriting Working Group has struggled to interpret the prohibition on using PACE financing in section 399.004(b)(1), which states: "An assessment may not be imposed to repay the financing for facilities for undeveloped lots or lots undergoing development at the time of the assessment...." Guidance established in 2017 and updated in 2020 laid out a standard for ensuring property was developed to be eligible for PACE financing. The Underwriting Working Group seeks to ensure that PACE assessments are clearly within the statutory framework, so the lien is enforceable if challenged. The guidance has proved burdensome for property owners, lenders, and program administrators.

When the meaning of a previously adopted statute is unclear, statutory construction principles dictate that in the absence of more specific or current language, it is appropriate to look to related statutes for guidance. The Texas PACE Act refers to and relies upon provisions in the Tax Code.

The Underwriting Working Group identified the definition of “improvement” as real property in the Texas Tax Code Section 1.04(3)(A) and (B) to be appropriate guidance for determining whether a property is “developed” and eligible for financing under the Texas PACE Act. Under the Tax Code, the Appraisal District in each county identifies taxable real property, including any “improvement” as defined by the tax code and determines the taxable value of real property.

This guidance recommends that property on which an improvement has been recognized by the Appraisal District in accordance with Section 1.04(3) of the Tax Code be considered developed property under the PACE Act and therefore not prohibited by Chapter 399.004(b)(1). Such determination may rely on Appraisal District documentation from prior years. Property on which no improvement is or was acknowledged by an Appraisal District is an undeveloped lot or lot undergoing development on which PACE financing may not be imposed under the Texas PACE Act Chapter 399.004(b)(1). Property Owners can qualify undeveloped property as eligible for a PACE assessment by adding an improvement to the property that is or will be recognized by the Appraisal District.

Appraisal Districts update property records annually. Written recognition from an Appraisal District that a property has been improved with confirmation that it intends to update a property’s records on the next annual update serves as evidence that the property is developed and not subject to Chapter 300.004(b)(1).

APPROPRIATE LOAN TO ASSESSED VALUE RATIO (LTV)

Effective date: **September 21, 2020**

The purpose of this guidance is to authorize an increase in the appropriate PACE loan to assessed value from 20% to 25% and to establish guidelines for appraisals used in requests for variance from the use of assessed value to market value in determining the 25% LTV.

1. Set the standard LTV at no more than 25%.
2. Authorize the administrator, at its discretion and in response to a request for variance, to waive the standard LTV and approve a variance of up to 25% of the market value of the property when justified by considering the following factors:
 - a. The existing debt to assessed value of the property prior to closing the PACE loan;
 - b. A comparison of the current property tax assessed value of the property to its “as is” market value, as determined under section 3 below; and
 - c. The estimated post-renovation market value of the property, as determined under section 3 below.
3. The appraisal process must be segregated from the loan origination process. Industry specialization is highly recommended. The appraiser should have relevant experience in the subject building types/market sector.
 - a. Ideally, appraisals should not be dated older than 18 months from the date of closing. The administrator and parties must take into account case-by-case considerations, for example, the economic impact of COVID-19 or a hurricane, that could make more recent appraisals obsolete.
 - b. A variance request for a proposed PACE assessment based on a market value must be based on the “as constructed” appraisal valuation except that an “as stabilized” valuation may be used where the property is already >50% leased or occupied.
 - c. Appraisal requirements vary according to the size of the PACE project. For financing –
 - i. Above \$500,000: Appraisal from a Texas certified general appraiser licensed by the Texas Appraiser Licensing and Certification Board, <https://www.talcb.texas.gov>.
 - ii. Between \$250,000 and \$500,000: Appraisal performed by an independent third party consistent with the requirements of the Uniform Standards of Professional Appraisal Practice (USPAP) as set by the Appraisal Foundation, https://www.appraisalfoundation.org/imis/taf/standards/q_as/taf/qas.aspx; or
 - iii. Below \$250,000: Evaluation consistent with the FDIC Financial Institution Letter, FIL-16-2016, <https://www.fdic.gov/news/financial-institution-letters/2016/fil16016.pdf>.

SAVINGS TO INVESTMENT RATIO CALCULATIONS

Effective date: **December 31, 2017**

Purpose: **To provide additional underwriting guidance on calculating savings and costs (see also the Technical Standards Manual)**

Background

Consumer protection is a primary element in legislative construction. The PACE Act delegates to the local government most of the details for PACE program success and does not specifically set a Savings to Investment Ratio (SIR). Sec. 399.009(a)(8) requires that the period of the assessment must not exceed the useful life of the project. Sec. 399.009(b) requires a method of assessing the owner's financial ability to pay the assessment including requiring the local government to set "an appropriate ratio of the amount of the assessment to the assessed value of the property." Under Sec. 300.011(a), each qualified project must be given an independent third-party review of "water or energy baseline conditions and the projected water or energy savings," and under Sec. 399.011(b) the local government must require verification that the project was properly completed and operating as intended.

The Underwriting Working Group established uniform underwriting standards that would respect the statute and protect local governments. Key to this policy is the expectation that the long-term energy or water savings of a project will equal or exceed the financing cost of the improvements based on a SIR greater than 1 ($SIR > 1$). The SIR, based on best practices in other states and on the successful Texas LoanSTAR Program¹, is designed to provide confidence in PACE project success for local governments, property owners, mortgage lenders, and PACE capital providers. Relaxing the standard makes program expansion by local governments more challenging because it increases concern regarding risk of project failure. This is especially true in the early stages of TX-PACE adoption throughout the state.

Yet the Underwriting working group established the opportunity for a waiver of the SIR requirement where there are sound reasons for approving a waiver of this requirement. Any such waiver request must jointly come from both the owner and the third-party lender, provide a reasonable rationale, and address the interests of interested third parties.

PACE in a Box, section 6, Guide to Project Underwriting and Technical Standards, pp 34 – 35 states:

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 (discounted back to present value using an appropriate discount rate) 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.

¹ The Texas LoanSTAR (Saving Taxes and Resources) Revolving Loan Program provides low-interest loans to assist Texas public institutions by financing their energy-related, cost-reduction retrofit projects. Administered in the Comptroller's Office by the State Energy Conservation Office for over 20 years, this program has provided over \$500 million in financing with a zero default rate. <https://comptroller.texas.gov/programs/seco/funding/012717>.

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 ensure the facility maintains adequate power or water despite 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 $SIR < 1$ as 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.

Guidance

Purpose: The SIR serves two purposes -

1. The SIR requires a positive cash flow during the life of the assessment so that the project pays for itself. An $SIR > 1$, while an important factor in determining adequate project cash flow, it is not intended to be a substitute for a lender's underwriting criteria; and
2. The purpose of the Texas PACE Act is to help businesses overcome the barriers preventing investment in energy and water saving equipment. These benefits are important to the State of Texas because of resource limitations, population growth and drought. The use of the PACE assessment local economic development tool secured with a senior lien is appropriate for this focused purpose and in balance with the general interests and needs of the Texas business and lending communities. The SIR requirement helps ensure that the projects are indeed energy and water saving measures.

Term for SIR calculation

The current policy of measuring the SIR over the life of the assessment rather than the projected useful life of the improvements will be maintained at this time.

Waiver

- change the term “waiver” to “variance”
- Allow nonprofits to request a variance
- Provide further guidance regarding what information should be included in a request for a variance:

The program administrator is responsible for reviewing variance requests based on the following factors outlined in a Texas PACE Authority (TPA) Owner and Capital Provider Request for Variance of the SIR Requirement form.

The following factors are recommended for consideration in a PACE Administrator’s review of a variance request from a property owner and lender for approval for a project in which the SIR is less than 1:

- Are there other environmental benefits such as air or water quality or resiliency that are not captured in the SIR analysis;
- Will the proposed qualifying improvements generate environmental marketable credits that can be monetized?
- What is the SIR calculation for the project (how far below 1?)
- If the SIR is < 1 over the term of the assessment, is the SIR > 1 over the useful life of the equipment?
- What is the impact of a variance request on affected third parties?
- Other information the owner and lender wish to submit regarding the impact of the qualified improvements on the company and the community.

GUIDANCE FROM THE FINANCIAL PLATFORM WORKING GROUP and THE EDUCATION, TRAINING AND MARKETING GROUP REGARDING LENDER EDUCATION AND OUTREACH

Effective date: **December 31, 2017**

Purpose: Feedback on the conference calls for the Financial Platform Working Group and the Education, Training and Marketing Working Group mentioned the need for more education and outreach to mortgagees about TX-PACE.

Guidance

Amend the Lender Consent Model Form after the box: "Maximum Amount of Assessment Authorized" by the mortgagee to insert a new box: "Maximum Annual Installment Amount Authorized." The proposed addition would result in having both boxes appear on the form:

"Maximum Amount of Assessment Authorized_____

Maximum Annual Installment Amount Authorized_____"

Background

Section 399.101 requires written consent from the existing mortgagee as a precondition to property eligibility under the [Texas PACE Act](#). Requests were made for the insertion of additional information to clarify the impact of the PACE senior lien on the existing mortgage. Only past due assessment installments are eligible for collection in a senior lien position under Texas Local Government Code section 399.014. A PACE lender may not accelerate future installments of the PACE loan, and the property remains subject to the assessment lien for future installments until the total PACE assessment has been paid.