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Win-Win-Win-Win: How PACE and Patience Can Build Local Economies

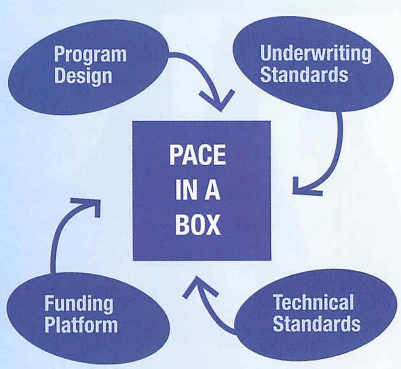
By **Calley Pace**, Way Companies; and **Brian Ratcliff**, DMI Entegral Solutions Group

Cities in Texas looking for economic development opportunities got a boost from the Texas Legislature and Governor Perry when S.B. 385—the revision to the Property Assessed Clean Energy (PACE) statute—was signed in June 2013, becoming effective immediately.

The concept of PACE is simple, yet powerful. PACE provides commercial and industrial building owners with low-interest, long-term financing for water and energy efficiency projects, as well as renewable energy installations, on existing structures.

The prospects are staggering. According to testimony given before the Texas Legislature, approximately 75 percent of commercial real estate in the country is more than 20 years old, with many buildings still relying on original, inefficient mechanical and electrical systems at or near the end of their useful lives. PACE provides an avenue to updating these buildings.

Making the positive economic impact a reality will take a lot of work and a little patience.



"If communities establish programs with consistent elements, Texas will be the national model for best PACE practices."

How PACE Works (Simplified)

1. A property owner applies for PACE financing for an energy efficient or water savings retrofit or improvement to an existing structure and agrees to pay an assessment on the property to secure the loan.
2. The savings pay for the project, as the amortization table is set so that the annual utility savings are greater than the annual assessment.
3. The owner implements the project using the affordable, long-term loan.
4. The owner repays the loan by paying the assessments, which the PACE program forwards to the lender.

Background

PACENow states that buildings account for 75 percent of all electricity usage in the United States. The electric grid is taxed, and rolling brownouts are recurring issues in many areas across Texas. Even more critical is Texas' looming water shortage, which some project will cost the Texas economy $12 billion per year because supply will not be able to keep up with demand. Yet these facts alone are not enough for commercial and industrial building owners across the state to act.

While energy and water conservation have long been the aim, in reality, the economics have been insufficient to compete with other investments. When faced with the choice, commercial and industrial building owners have opted to grow their businesses, rather than invest in capital-intensive water and energy retrofits. Often, energy and water saving projects never get past the concept stage and end up collecting dust in a binder on the bookshelf.

"Stringent return on investment standards, "no debt policies," ownership changes, high interest rates, and short-term financing are common deterrents that keep commercial and industrial owners from pulling the trigger on energy and water saving projects," explains Calley Pace, with Way Companies. "Fortunately, PACE will eliminate those barriers and provide long-term, low-interest, off-balance-sheet financing, so these projects will finally get done."

Win-Win-Win-Win

The solution is elegant, because its simplicity solves problems and removes impediments for all stakeholders. First and foremost, the building owners accomplish the projects they need in a neutral cash flow proposition without using their capital. Instead of adding to the owners' debt load, the loan is paid as a line item on tax assessments. Furthermore, the assessment stays with the property, not the owner; so short-term holders are not eliminated.

Lenders win because PACE loans are low risk (assessments are senior to all other security interests) and are also candidates for future securitization and secondary trading. Mortgage holders win because their underlying assets are being improved, values are increased, and the owners' ability to repay the mortgages is enhanced. Property with an existing mortgage will not qualify for PACE until the mortgagee provides permission in writing.

The manufacturing, engineering, and contracting communities win with new market space created.

And importantly for TML members, local governments win, because part of this economic activity creates jobs and supports green initiatives in their districts. According to a study published by PACEnow.org (ECONorthwest, 2011), every $1 million spent on energy efficiency or renewable energy results in $2.5 million in total economic output and approximately 15 new jobs nationwide.

In effect, a local government that creates a PACE program will provide a cost-effective action plan to help local businesses move forward with water and energy saving projects that benefit everyone. Since the government's PACE program overhead can be folded into the assessment, governments can reap the benefits of PACE *without cost to taxpayers.*

Challenges

This program could be a boon for the Texas economy. So what's the hesitation?

Other states with similar opportunities have yet to see PACE live up to the hype. In the five years since the inception of PACE throughout the nation, only 71 commercial PACE loans have been made. Texas was keenly aware of the difficulties other states have had. So S.B. 385 was crafted based on an "eyes wide open" approach to the challenges other states have faced with a goal of adopting the best practices, learning from mistakes, and creating a better framework for success.

According to Charlene Heydinger, executive director of Keeping PACE in Texas, the linchpin will be how we handle the next step in the process. "Our goal is to support communities interested in creating PACE programs by providing turn-key recommendations that include the best of existing programs while avoiding lessons learned in other states. Because our industrial and commercial markets are huge, the economic impact of PACE in Texas will be tremendous if we work together and get this right from the start. If communities establish programs with consistent elements, Texas will be the national model for best PACE practices."

What Now?

Cities and counties now have the legal authority to establish a PACE program within their boundaries. Owners and contractors want to get started on targeted projects. So their respective cities are under pressure to create a program quickly.

The primary elements of a PACE program are:

1. Application and approval;
2. Assessment and collection; and
3. Funding and loan repayment.

These seemingly innocuous steps quickly get overshadowed by a multitude of secondary, but critical, elements. For PACE to be (a) easy and cost effective to administer; and (b) user friendly for building owners and contractors, these secondary elements must be treated consistently from city to city. These elements include:

1. Underwriting standards;
2. Minimum project qualifications;
3. Energy audit documentation standards;
4. Energy and water savings measurement and verification;
5. Third party review of engineering; and
6. Requirements for PACE contracting/bonding.

While cities know about assessments and collections, very few have the expertise or experience, personnel and, especially, the financial resources to invest in the effort to "get it right."

"PACE programs are extremely helpful tools to expand investments in energy efficiency and renewable energy, but they can be difficult to set up because most cities don't have the expertise building programs with so many diverse components," said Laura Spanjian, director of Office of Sustainability for the City of Houston. "That's why it will be important to work collaboratively with others in the state to put together a model program all can use."

The good news is that the expertise and experience are already assembled and working on "PACE in a Box" for every city to use free of charge. The best minds from industry, city government, and the legal and financial professions have started creating a standard program toolkit so that cities don't have to—and to promote consistency in PACE programs throughout Texas.

Let's avoid what has happened in California: cities and counties acting alone or in small groups, resulting in hundreds of PACE programs across the state, all with different application processes, underwriting requirements, and technical requirements. Under a disjointed California-type program, an owner with properties in Houston, Fort Worth, and Corpus Christi could conceivably have three different engineering requirements, application processes, and loan structures. That scenario adds costs, frustrates owners, and leads to abandoned programs.

The situation is probably more damaging to the contracting community, and consequently to PACE in general, because the contractors typically generate the interest and drive PACE applications. Brian Ratcliff with Entegral Solutions noted, "When funding programs like PACE are cumbersome or the rules change from program to program, it simply adds time and overhead to projects, and ultimately takes away from the real work that needs to get done in an owner's building."

Interested? Here's What You Can You Can Do Now:

1. Get fully informed on PACE (See Resources sidebar). Also, the U.S. Department of Energy has new commercial PACE guidelines for local communities: http://pacenow.org/wp-content/uploads/2013/03/01-DOE-Clean-Energy-Finance-Guide_Chapter-12_March-2013.pdf
2. Identify local leaders who will be involved in the creation of your PACE program, spread the word, and begin preliminary discussions and education.
3. Join in the creation of "PACE in a Box." We welcome your expertise and input in making sure that the toolkit we are creating will work well for all Texas communities.
4. Take the lead on a regional discussion about whether creating a multi-jurisdictional PACE program makes sense for your area. Economies of scale, cost effectiveness, and ease of use are just a few benefits of coordinating with your neighbors. The statute provides enormous flexibility to communities interested in working together.

David Quin with Public Power Pool (P3) equates what we need to do with PACE to how he works with cities to procure power: "When local governments work together in a synergistic relationship to procure power, they are part of a joint effort that is much greater than the sum of members acting alone."

A synergistic approach to PACE offers the following benefits:

- A standardized approach makes local government officials' jobs easier;
- The legal, analytical, operational, and transaction overheads of implementing a successful program are lower if we all pull together; and
- Local governments (and constituents) will benefit from a better quality and consistent product by working together, rather than if acting individually.

Conclusion

Texas has a challenging, yet rewarding opportunity ahead. With a little patience and a valiant effort by those crafting "PACE in a Box," cities and counties in Texas can save time, headaches, and money while also multiplying their chances of a practical and efficient program. Cities win. Counties win. Constituencies win. Texas wins. ★

Resources

www.pacenow.org

www.keepingpaceintexas.org

http://texaspaceupdate.typepad.com/files/executive-summary-of-texas-pace-act.pdf

http://www.utexas.edu/law/academics/centers/energy/wp/wp-content/uploads/centers/energy/EnergyCenter.WhitePaper.PACE_.pdf

http://www.wayservice.com/2013/06/26/pace-program-gets-approval-from-texas-gov-rick-perry/

Want to learn more? Contact Brian Ratcliff at bratcliff@entegralsolutions.com; Calley Pace at cpace@wayservice.com; or Charlene Heydinger at charlene.heydinger@KeepPACE.org.