FURTHER GUIDANCE REGARDING PACE IN A BOX FROM THE UNDERWRITING, TECHNICAL, FINANCIAL PLATFORM AND LENDING WORKING GROUPS December 31, 2017; *REVISED AND REPLACED IN PART ON JANUARY 22, 2021*[1]

GUIDANCE REGARDING PACE IN A BOX SECTION 6, GUIDE TO PACE PROJECT UNDERWRITING AND TECHNICAL STANDARDS

I. FURTHER UNDERWRITING WORKING GROUP GUIDANCE REGARDING THE SCOPE OF THE STATUTORY PROHIBITION OF THE USE OF PACE ASSESSMENTS FOR UNDEVELOPED LOTS AND LOTS UNDERGOING DEVELOPMENT

Background

The Texas PACE statute, Chapter 399 of the Local Government Code allows the use of PACE financing on real property. Section 399.002(5) states:

> *"Real property" means privately owned commercial or industrial real property or residential real property with five or more dwelling units."* Section 399.004(b) states in part, *"An assessment under this chapter may not be imposed to repay the financing of: (1) facilities for undeveloped lots or lots undergoing development at the time of the assessment;…"*

The PACE in a Box model document restates the Texas PACE Act prohibition regarding the type of real property on which a qualifying improvement is eligible for a PACE assessment.[2]

Stakeholders asked for clarification of this statutory language. The following proposed guidance regarding the use of TX-PACE financing is designed to promote the highest use of the program respecting both the statutory intent and desire for risk avoidance in the establishment of this new local-adoption model program in Texas.

Proposed Guidance

A developed lot eligible for PACE financing includes commercial, industrial or multifamily real property –

1) On which –
   a) Exists a facility intended to be affected by:
      i) a retrofit that includes qualified improvements;
      ii) an addition to/expansion of the facility with qualified improvements; or
      iii) the construction of an additional facility on the same developed lot with qualified improvements; or

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[1] Guidance that has been revised or replaced is noted in italicized red font. Updated guidance can be found in the Further Guidance dated January 22, 2021, which is available through a dedicated link on the document library webpage

[2] https://www.keepingpaceintexas.org/docs/library/piab_tlkt.pdf, Section 6, p33

b) A previous ~~commercial, industrial or multifamily~~[3] structure has been demolished to make way for a new commercial industrial or multifamily structure intended to include qualified improvements; and

2) Categorized as improved property by in the County Appraisal District (CAD) records.

II. FURTHER TECHNICAL STANDARDS WORKING GROUP GUIDANCE FOR MEASURING SAVINGS FOR NEW CONSTRUCTION ON DEVELOPED LOTS

Background

All PACE projects require a cost/benefit analysis, where costs and benefits are calculated as the difference in the baseline scenario and the scenario as proposed to be constructed. A new scenario has arisen for developed lots undergoing redevelopment. In this scenario, the existing structures are removed from the developed lot and new structure(s) is/are constructed on the same lot.

Stakeholders asked for guidance establishing a baseline, calculating projected savings, and calculating the SIR for developed lots undergoing redevelopment. The following proposed guidance is designed to address those requests. The guidance below will also apply to new additions to existing property and construction of a new facility on a lot already containing a structure.

Proposed Guidance

Because most of Texas currently uses 2015 IECC Energy Codes for new construction, establishing a baseline for a redevelopment (tear down/ rebuild) is based on the Texas state energy code – the2015 IECC/ASHRAE 90.1-2013. The following paragraphs provide guidance on establishing a baseline, calculating projected savings, and calculating the SIR for developed lots undergoing redevelopment.

Calculate a whole building number measured in energy use for both –
(1) IECC 2015 minimum equipment (baseline scenario) and;
(2) Energy use of the proposed "above-code" equipment (scenario as proposed to be constructed).
This information will be used to determine avoided annual electricity costs and annual demand charge reduction in the savings calculations.

Calculate SIR using current technical guidance (i.e. sum of savings over the life of assessment versus sum of investment over the life of assessment). An SIR of 1 or greater is expected, or the project will need to request a waiver (discussed below). Additionally, an owner may choose to "buy down" (contribute cash) towards the project to increase the SIR. A SIR "buy down" (contribution of cash) should not exceed 50% of the total investment. At least 50% of the calculated savings should be energy or water related.

For more information on what constitutes "Savings" and "Investment", see the Texas PACE Authority User Guide (Page 15):
https://www.texaspaceauthority.org/Documents/Program%20Guide%20Version%202.0.pdf?dl=0

Other Considerations

[3] This language is deleted by the Underwriting Working Group Further Guidance issued on 1/21/2021.

Efficiency Floor: The new building must achieve at least a 5% energy performance above baseline, measured in energy use per square foot.

Secondary Analysis

The analysis should also include an incremental cost versus incremental savings analysis, i.e.

(1) What are the incremental costs of the project to go from code compliant equipment to the proposed equipment?

(2) What are the incremental savings of the project due to the more efficient equipment compared to code?

III. FURTHER UNDERWRITING WORKING GROUP GUIDANCE REGARDING THE SAVINGS TO INVESTMENT RATIO CALCULATIONS

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 Program[4], 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

[4] 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.

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.
>
> 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:
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> - 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 in spite of 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.

IV. UNDERWRITING WORKING GROUP GUIDANCE REGARDING THE PACE IN A BOX "LOOK BACK" POLICY NOTE: SECTION IV IS RETIRED AND REPLACE BY UNDERWRITING WORKING GROUP GUIDANCE ISSUED ON 1/22/2021.

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

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. TPA is developing a webinar for Texas mortgage holders and has submitted an article for publication in the early 2018 issue of the Texas Independent Banker. In addition, TPA was asked to provide more information in the Lender Consent model document.

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.

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____________________________________"