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If you Build It, Will They Come?

Presentation at ACEEE's Energy Efficiency Finance Forum

May 23, 2017

PACENation
Building the clean energy economy

Our mission is to promote Property Assessed Clean Energy financing by providing leadership, support, problem solving, data and networking opportunities for a growing universe of PACE market participants.

- Monthly Newsletters
- Quarterly Market Data
- Case Studies
- Industry White Papers
- Downloadable Guided PowerPoint Presentations
- *PACE Talks* Interviews
- Library of PACE Laws and Market Data
- Legislative Best Practices
- YouTube Tutorials
- Regular Blog

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PACE Financing for the CRE Market

- ✓ The CRE Market and its characteristics
- ✓ Why is EE a tough sell in the CRE market?
- ✓ What Makes PACE so Compelling?
- ✓ Example of the Financial Impact of PACE

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How do CRE companies make money?

- **Buy it or build it right** – CRE companies build and purchase the correct property in the correct location
- **Lease it right** – CRE companies lease space to the right mix of tenants to maximize the value of the property
- **Finance it right** – CRE companies utilize the appropriate amount of debt and equity to reduce their overall cost of capital and maximize their return on investment given a conservative level of risk.

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The Basic Objective of CRE Companies

Maximize cash flow available for distribution

Priorities of CRE Companies

"… the two most important things in the future are top-line growth and **minimizing cap ex outflows**."

- *Real Estate Forum July/August 2015*

Despite Ben Franklin's maxim that "A penny saved is a penny earned", asset management and expense minimization a distant 4th on the list of CRE priorities

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Why do CRE Companies Minimize CAPEX?

Capital expenditures are deducted directly from cash flow

- ✓ *Less cash available for distribution*
- ✓ *Less cash for new acquisitions/core projects*

NOI	$1,000,000
Less CAPEX	($100,000)
Cash Available for Distribution	$900,000

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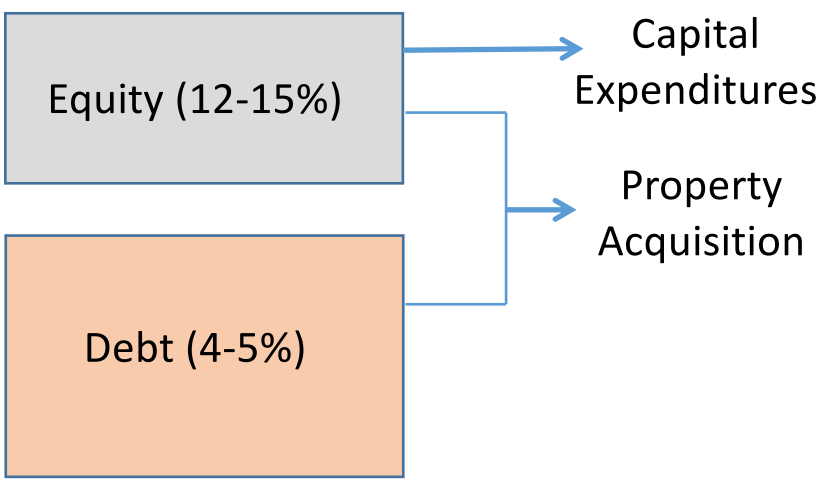
Why are Hurdle Rates for CAPEX so High?



Capital expenditures are deemed to come from “the equity pocket”, and investments not related to the core business are further subjected to allocation of capital, and are burdened with risk allocation premiums

Other Reasons CRE avoid Energy Project CAPEX

- ✓ **Time Pressure:** People are overworked and have little time or inclination to focus on anything new
- ✓ **Poor Credit:** CRE properties are often owned by special purpose entities with no assets beyond the property and parent companies are reluctant to provide parental guarantees.
- ✓ **Holding Period Bias**: CRE companies are not inclined to invest in a property if they don't know how much longer they will own it
- ✓ **Perceived Risk:** CRE executives don't trust savings forecasts and add substantial risk premiums to hurdle rates.
- ✓ **Split Incentive:** Many lease forms provide dis-incentives for landlord to invest in energy projects

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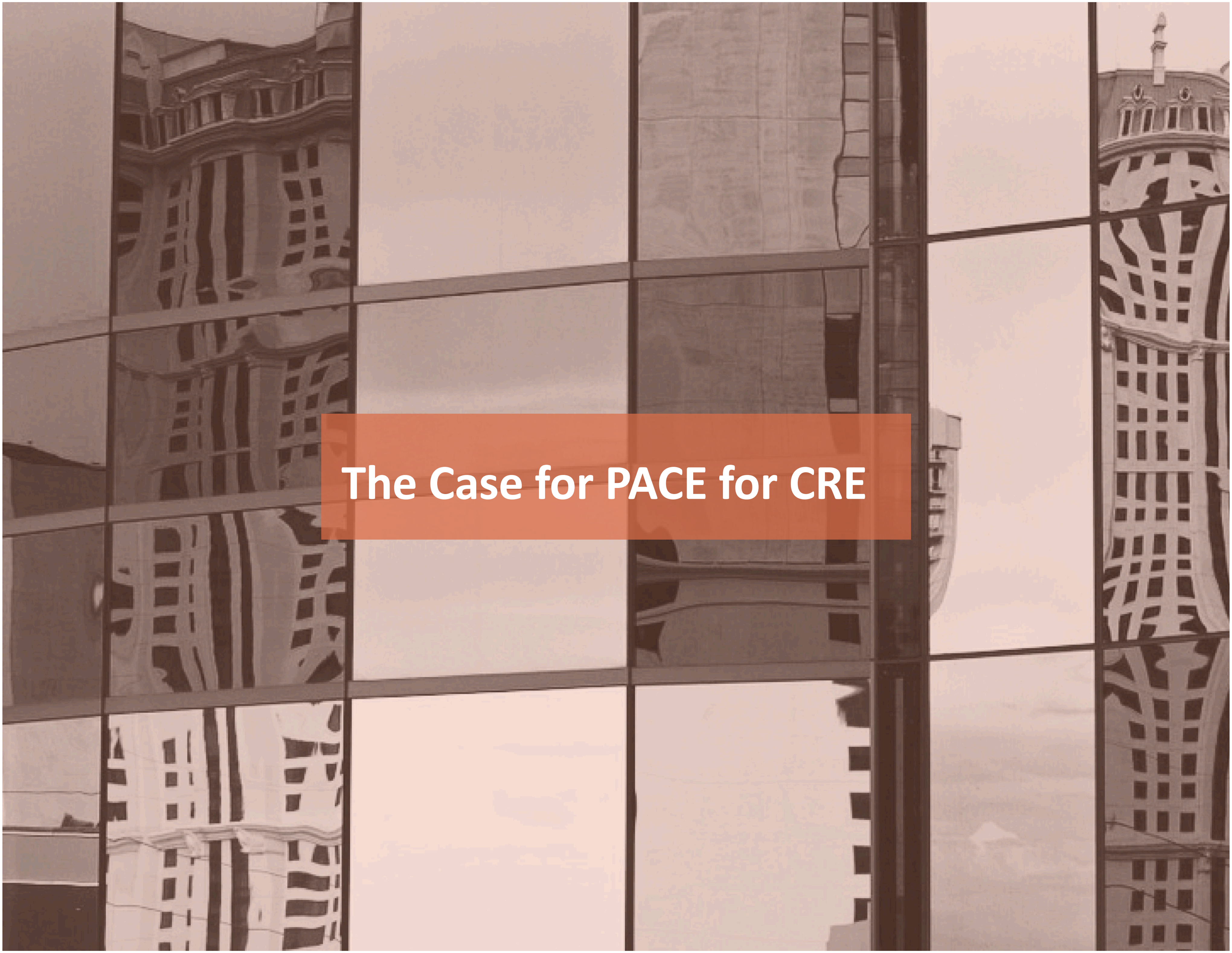
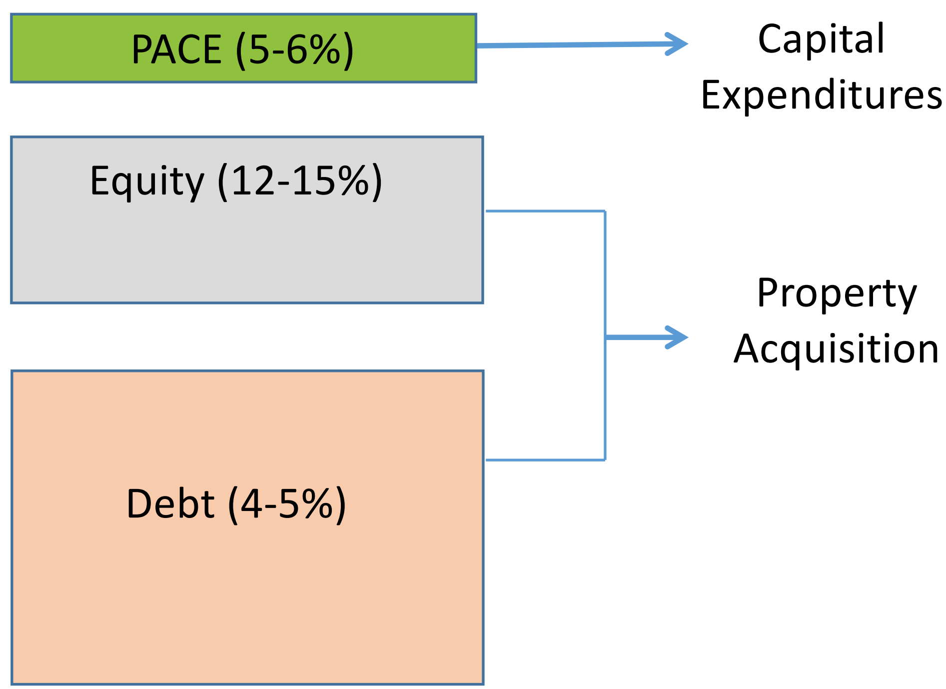
The Case for PACE for CRE



The Case for PACE



What Makes PACE so Compelling?

✓ **Cash Flow vs CAPEX**

- PACE funds 100% of hard and soft costs and eliminates deductions from cash flow for CAPEX.
- PACE is a cheaper form of financing for CAPEX

What Makes PACE so Compelling?

✓**Poor Credit**

- PACE is strictly property-based financing
- Good real estate tax payment history, not credit strength, is key to financing.
- Reasonable loan to value requirements
- Non recourse to building owner

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What Makes PACE so Compelling?

✓**Holding Period Bias**

- Automatic transfer to the new owner upon the sale of the property
- Non-accelerating

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What Makes PACE so Compelling?

✓**Perceived Risks**

- 20-yr funding available based on the average useful life of ECMs reduces risk by making it possible to generate more positive cash flow
- Well accepted by mortgagees
- Favorable balance sheet treatment

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What Makes PACE so Compelling?

✓ **Split Incentive**

- Depending on the lease structure, the annual PACE tax assessment burden may be shared with tenants, along with the benefits of an energy efficiency or renewable energy project.
- The tenants' cash flow savings from reduced energy costs from the improvements are partially off-set by the increase in property tax pass through, resulting in a net savings for tenants
- This eliminates the split incentive imbedded in many lease forms.

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Saving Energy & Creating Jobs

GeorgeC@PACENation.org