Pace Alberta Co-op Ltd.
#200, 12120 – 106 Ave. 780.482.5467
Edmonton, AB contact@paceAB.green
T5N 0Z2 www.paceAB.green

PACE for Commercial Building Owners

March 30, 2018

Property Assessed Clean Energy, better known as PACE, is a financing innovation that is revolutionizing the way property owners upgrade their homes and businesses in the USA, with over 5 billion dollars invested in PACE financed upgrades since 2008. (http://pacenation.us/pace market data/) The team behind PACE Alberta Co-op has been advocating for the creation of a made in Alberta PACE program since March 2016, and while it is not yet available in Alberta, significant progress has been made and it is expected that a PACE program will available sometime in 2018.

As such, the following description of PACE is based on characteristics which PACE Alberta is advocating be adopted.

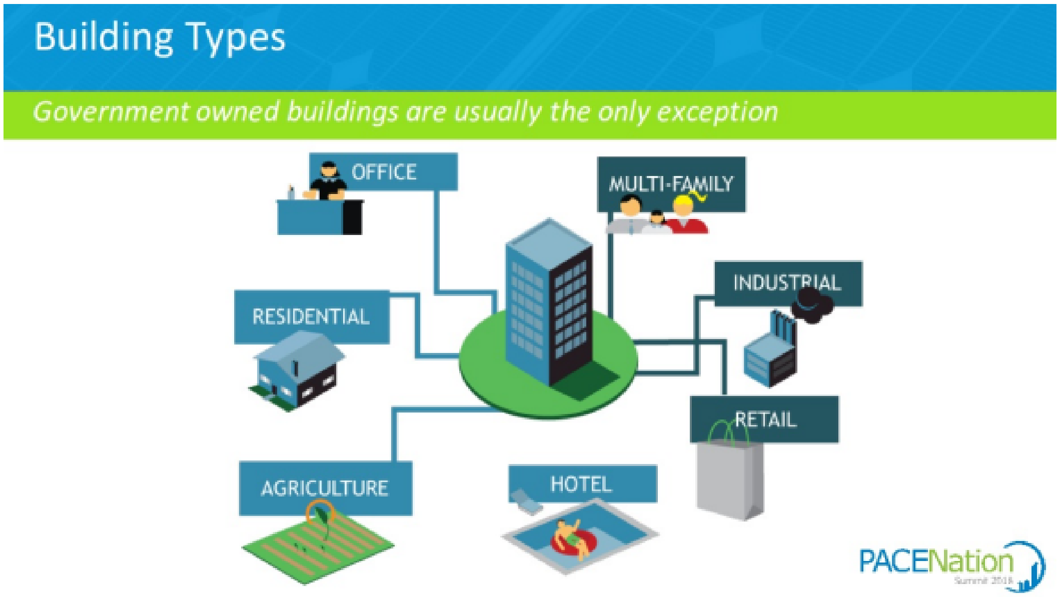
In a nutshell, PACE financing programs allow building owners to fund 100% of the upfront cost of energy and resource improvements to their businesses and repay the financing over time through their taxes. Commercial PACE upgrades create savings which are often greater than the servicing costs thus generating an immediate positive cashflow benefit upon completion. While the majority of PACE financing has historically been used to retrofit buildings, PACE financing is now being used in the USA to upgrade the performance of new construction developments and it is anticipated that PACE financing in Alberta will be available for new builds as well, including developer/builders of single family homes. While the remainder of this article references commercial buildings, it should be understood that the same PACE financing program should be available for all owners of commercial, industrial, agricultural, multifamily, and nonprofit properties to obtain low cost, long term financing for energy efficiency, water conservation, renewable energy projects, and more.

PACE financing's popularity has a few key characteristics, but the most fundamental one is the fact that the financing is secured by a tax lien on the property and is repaid over the expected life of the upgrade/system through the property tax, thus permitting long term and secure financing (up to 30 years based on expected life of the upgrades/systems) which stays with the building in spite of sales or even foreclosures.

PACEAlberta
Building the clean energy economy

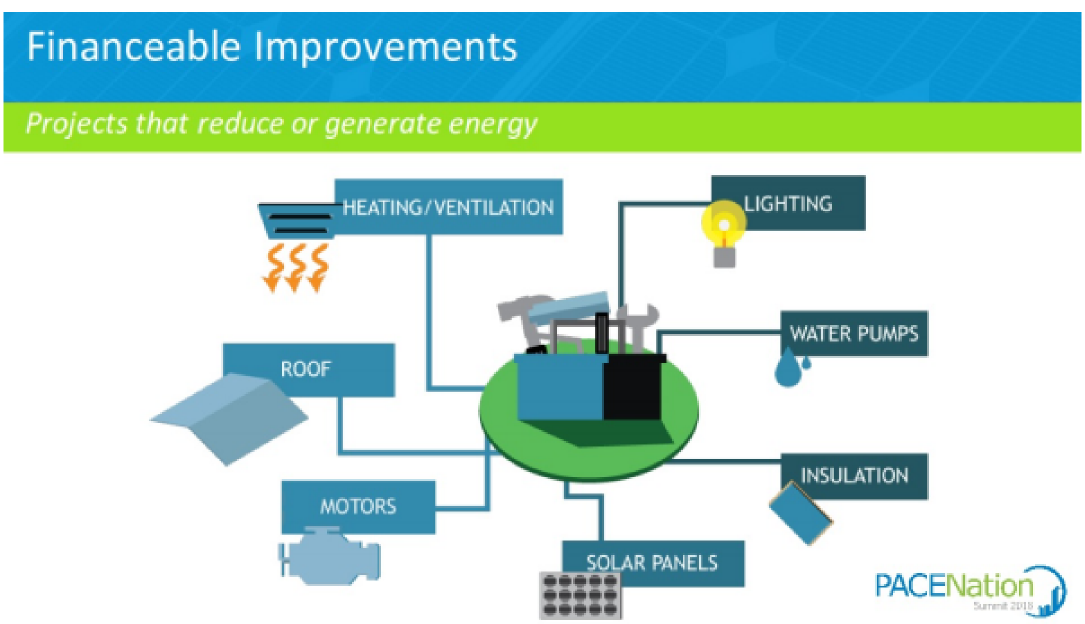
Eligibility

PACE financing is available for almost every form of business or operation; so long as the applicant owns the property and pays property taxes.



Eligible PACE Upgrades

The public facilitation of PACE financing is founded on the principle that the result will be a "public good". As such, PACE is not only being used in the USA to upgrade the performance of buildings and operations (both existing and new) but in addition, has been used to finance safety upgrades such as earthquake performance, tornado proofing, and asbestos remediation.



The following section excerpted from the 2013 report published by the Institute for Building Efficiency titled “Setting the PACE: Financing Commercial Retrofits” summarizes the value of PACE.

Advantages of PACE Financing

Here is a summary of ways in which PACE financing should help building owners overcome financing barriers to energy efficiency, according to program administrators and market leaders.

1. **Zero up front investment:** PACE provides up to 100 percent financing for building efficiency projects, providing external capital and freeing up internal budget resources. This feature addresses the number one barrier to pursuing energy efficiency as identified in the EEI survey – lack of internal funding.

2. **Immediate positive cash flow:** PACE projects are designed to ensure that the energy savings minus the PACE payment results in a positive cash flow each month based on a forecast of savings: Implementing PACE projects actually lowers monthly operating expenses. Some owners also consider in their cash flow calculations other avoided costs, including repairs and maintenance, equipment replacements, regulatory compliance costs, and tax deductions. Including these additional benefits could provide an additional incentive for owners to act. It may be possible for owners to combine PACE with other financing to support broader renovation projects.

3. **Long term financing:** Financing for commercial property almost never exceeds 10 years. Terms from five to seven years are the most common for general real estate lending, and one to three–year terms are most common for construction project lending. Funding of energy efficiency projects over their useful lives (up to 20 years*) makes many more projects cost effective. The EEI survey showed that building owners on average prefer a 3.4 year payback time on energy efficiency investments, but this is when they are investing their own capital and expect to be cash flow negative until the payback date. By providing 100 percent financing with a 20 year amortization*, PACE should help overcome the number two barrier to pursuing energy efficiency – insufficient payback/ROI. [*NOTE: PACE financing is now being often being extended up to 30 years and matched to the expected life of the upgrade, which will suite envelope and HVAC systems upgrades and solar PV and geo-exchange heat pump systems]

4. **A PACE assessment stays with the property upon sale:** In the commercial buildings market where properties are often owned for short periods of time, PACE financing enables building owners to make deep energy efficiency improvements with financing that does not need to be paid off upon sale, but instead transfers to the new owner.

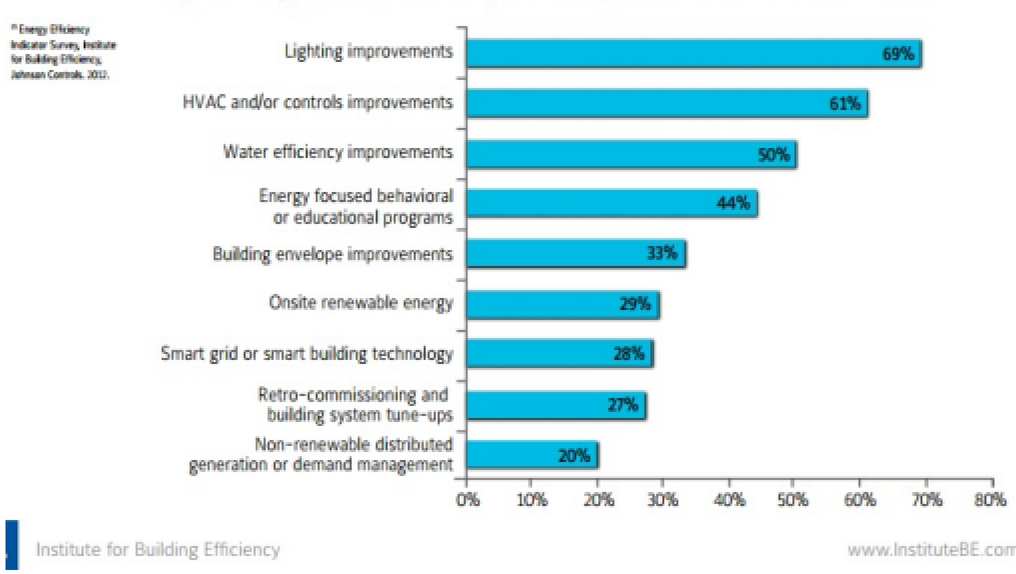
5. **Ability to pass payments through to tenants:** PACE projects are financed using a property tax assessment that can be passed through to tenants easily under many common lease structures. In most leases where tenants pay for their share of utilities, they also pay their share of property taxes. In contrast, capital expenses sometimes cannot be passed along to tenants, or when they can be passed along, the repayment amount is usually small, since it is based on the useful life of the equipment or a standard depreciation schedule. Under PACE, tenants, who generally pay the energy bills and will see the energy cost savings from a building efficiency project, also share in repayment of the energy efficiency investment. In this way, PACE structures overcome the landlord/tenant split incentives barrier to building efficiency projects. The building owner incurs no current costs and acquires permanent property improvements.

6. **Low interest rates:** Interest rates vary with lending type. PACE offers an opportunity to acquire a bond tax lien financing rate for projects with typical construction risks. Interest rates under PACE programs tend to be in the 6 to 7 percent range (see note), and sometimes lower if a city or state provides incentives, such as by subsidizing the interest rate directly or providing a loan loss reserve or other credit enhancement. While these rates may not match the 3 percent range available to high credit quality borrowers, they can be competitive with rates accessible to most commercial properties. Interest rates in the 6 to 7 percent range can be attractive to a CFO because they can sometimes be locked in for up to 30 years. The longer borrowing term has a greater effect on improving cash flow than the interest rate. Rates at this level may also be attractive to building owners who are already above their leverage threshold and are unable to finance capital expenditures through self funding or borrowing. In addition, ...PACE financing provides access to the institutional grade debt market and to longer term financing than [small business] owners could secure on their own. An increase in PACE project flow is likely to encourage more efficient borrowing mechanisms that drive PACE borrowing rates down relative to current levels. (Note: PACE financing rates currently range as low as 4.99%)

7. **Higher rents and greater long term property value:** Research is emerging that validates the assumption of market advocates that efficient (green) buildings can command higher rents and increased property values. PACE can enable more building owners to capture these potential financial benefits. Building owners note that since PACE adds a line item to the property taxes, it can help facilitate the discussion of the value of solar and energy efficiency projects when a property is sold or rented. Also, building owners noted that being the first in their community to do a PACE financed project can enhance the public image of and add value to the improved building.

8. **Off balance sheet:** The accounting treatment is still an open question for building efficiency projects financed with PACE. The current year's assessment would always be on the balance sheet, but the entire investment may not be entered as a long term liability because assessments are only a one year obligation. [Depending on the accounting treatment] If the full investment can be treated as off–balance sheet, that helps building owners significantly with the first barrier cited in the EEI survey – the lack of funding – because a single year's assessment is less likely to affect a building owner's ability to take on additional debt for other projects.

Figure 6. Energy Efficiency Measures Implemented by Decision Makers in the Last 12 Months[21]



PACENation, the American organization responsible for advocating for PACE in the USA and around the world has a number of valuable resources for commercial building owners, including:

1. PACE Alberta detailed Commercial PACE article: (http://paceab.ca/resources/4._PACE_for_Commercial_Buildings.pdf)
2. PACENation web page dedicated to PACE for Commercial: (http://pacenation.us/commercial pace/)
3. Youtube video titled “Why Should Property Owners Use PACE?” (https://youtu.be/BLe_2cBT8pk)
4. Youtube video titled “Money is Often Misunderstood” which is designed to “remove confusion about how the cost of PACE financing compares with the cost of internal capital allocated by companies to energy efficiency and renewable energy projects.” (https://youtu.be/e_Lnp9KBC4)

Conclusion: PACE for Commercial is win-win

While it remains to be determined what the Province determines will qualify as PACE building upgrades, over what time frame, and how the program will be delivered, the foregoing information provides an overview of how a PACE program in Alberta will benefit commercial building owners.

It is no wonder that PACE was named “top 20 world changing ideas” in 2009 by Scientific American; **it is a win-win scenario all around: creating jobs, enhancing property values and ROI, and doing so with not one tax dollar required.**