

Profiting from the Connecticut Commercial PACE Financing Opportunity

February 21, 2013



Moderated by:

Brian J. McCarter

Chairman & CEO

Sustainable Real Estate Solutions, Inc. (SRS)

Sponsored by:



Speaker Biography



Anthony J. Buonicore, P.E.

ajb@bepinfo.com

(800) 238-1841

Anthony Buonicore is Managing Director of Buonicore Partners, program administrator for C-PACE in CT and publisher of the daily energy news service, *Building Energy Performance Assessment News*, and is a past president and Fellow Member of the Air & Waste Management Association. Mr. Buonicore is also a Diplomat in the American Academy of Environmental Engineers and a licensed professional engineer. He is chairman of ASTM's Building Energy Performance Assessment (BEPA) Task Group, which developed the E2797-11 BEPA standard, and is a member of the Zero Energy Commercial Buildings Consortium. Mr. Buonicore is also a member of BOMA, IFMA and the International Building Performance Simulation Association.

Panelists



- **Jessica Bailey**
 - Director of Commercial & Industrial PACE Program, CEFIA
- **Burt Hunter**
 - Chief Investment Officer, CEFIA

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CLEAN ENERGY
FINANCE AND INVESTMENT AUTHORITY

Webinar Agenda



- **Formal Presentation** (60 mins)
 - Anthony Buonicore
- **Panel Q & A Session** (20 mins)
 - Participants submit questions via the 'Question' function on GTW tool bar



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- Audio:** Contains 'Audio Mode' with two radio buttons: 'Use Telephone' (selected) and 'Use Mic & Speakers'. Below this, it lists 'Dial: +1 (484) 589-1011', 'Access Code: 441-323-911', and 'Audio PIN: 93'. A note says 'If you're already on the call, press #93# now.' and a green button says 'Connecting to Audio...'
- Questions:** A text input area with a placeholder '[Enter a question for staff]' and a 'Send' button.
- Webinar Now:** Displays 'Webinar ID: 768-362-641' and the 'GoToWebinar™' logo.

Webinar Misc Items



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- Presentation Slides - distributed to participants following the webinar



Profiting from the Connecticut Commercial PACE Financing Opportunity

“Standards, Tools & Underwriting Techniques to Ensure Success”

presented by:

Anthony J. Buonicore, P.E.

**Managing Director
Buonicore Partners, LLC
C-PACE Program Administrator**

Overview

- **CRE Market Today**
- **Connecticut PACE**
- **Power of C-PACE in Commercial Real Estate (CRE)**
- **Underwriting Energy Efficiency Financing**
 - Financial
 - Technical
- **Program Implementation**
- **Benefits to Capital Providers**
- **What Capital Providers Can Do Now**
- **Summary and Conclusions**

Commercial Real Estate Market in CT

- **CT CRE market: ~ 35,500 buildings** (excluding multifamily)
 - 95% < 50,000 SF
 - Majority multi-tenant (versus owner-occupied)
- **73% constructed prior to 1990**
 - Many still rely on original (outdated) mechanical & electrical systems that are near or at the end of their useful lives
- **EE investments typically focused on low cost/risk, quick payback retrofit projects using internal funding resources**
- **Recent recession and economic uncertainty have resulted in**
 - CapEx budgets plummeting
 - Operating budget reductions
 - Energy retrofit projects delayed

Commercial Real Estate Market in CT cont'd

- **Capital intensive, deep energy retrofits with longer paybacks often delayed**
 - Lack of internal resources
 - Desire to preserve capital in uncertain economic times
- **Despite residual uncertainty in U.S. economic climate**
 - CRE recovery is evident
 - Pent-up demand to replace/upgrade outdated energy-consuming equipment with more efficient equipment
 - Result: a major opportunity to accelerate EE market growth
- **To catalyze this growth opportunity, financing must be**
 - Easily accessible to building owners
 - Supported by a technically sound & fully-transparent underwriting process
 - Driven by a process that provides stakeholders with a high degree of confidence in the energy savings

...the PACE financing structure is one such catalyst

C-PACE: Commercially Attractive Financing

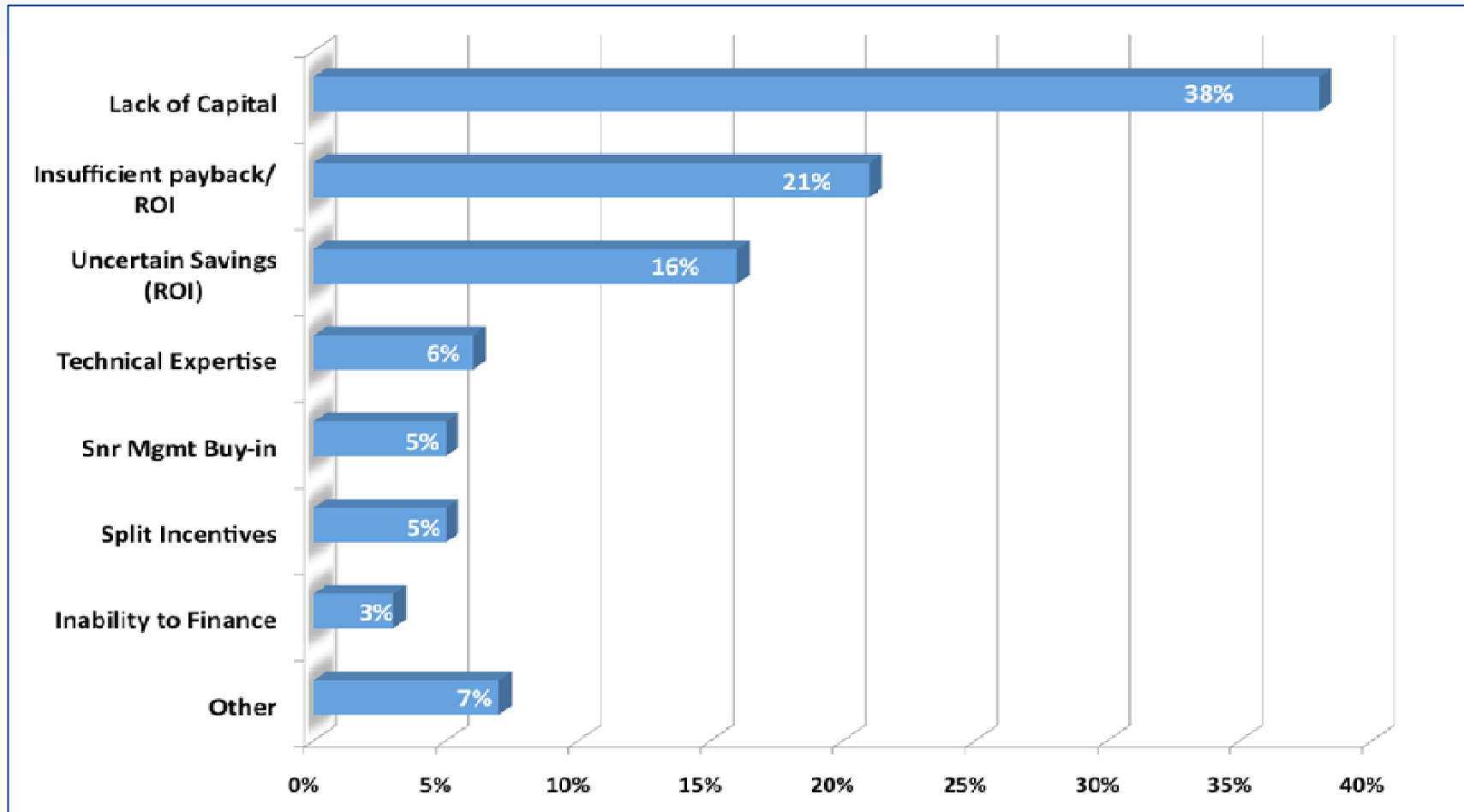
- **C-PACE** provides an *innovative financing structure* enabling commercial, industrial, & multifamily property owners to access financing for qualified energy upgrades and repay through a benefit assessment on their property tax.

Private capital provides 100% upfront, low-cost, long-term funding

Repayment through property taxes

A senior PACE lien is put on the property and stays regardless of ownership

CRE Owners Face Barriers to EE Upgrades



REFERENCES

EE Indicator – NA 2010, Johnson Controls and International Facilities Management Association (IFMA)

C-PACE Addresses Key Barriers



Lack of capital?

√

Insufficient payback / ROI?

√

Uncertain savings?

√

Lack of technical expertise?

√

Split incentives?

√

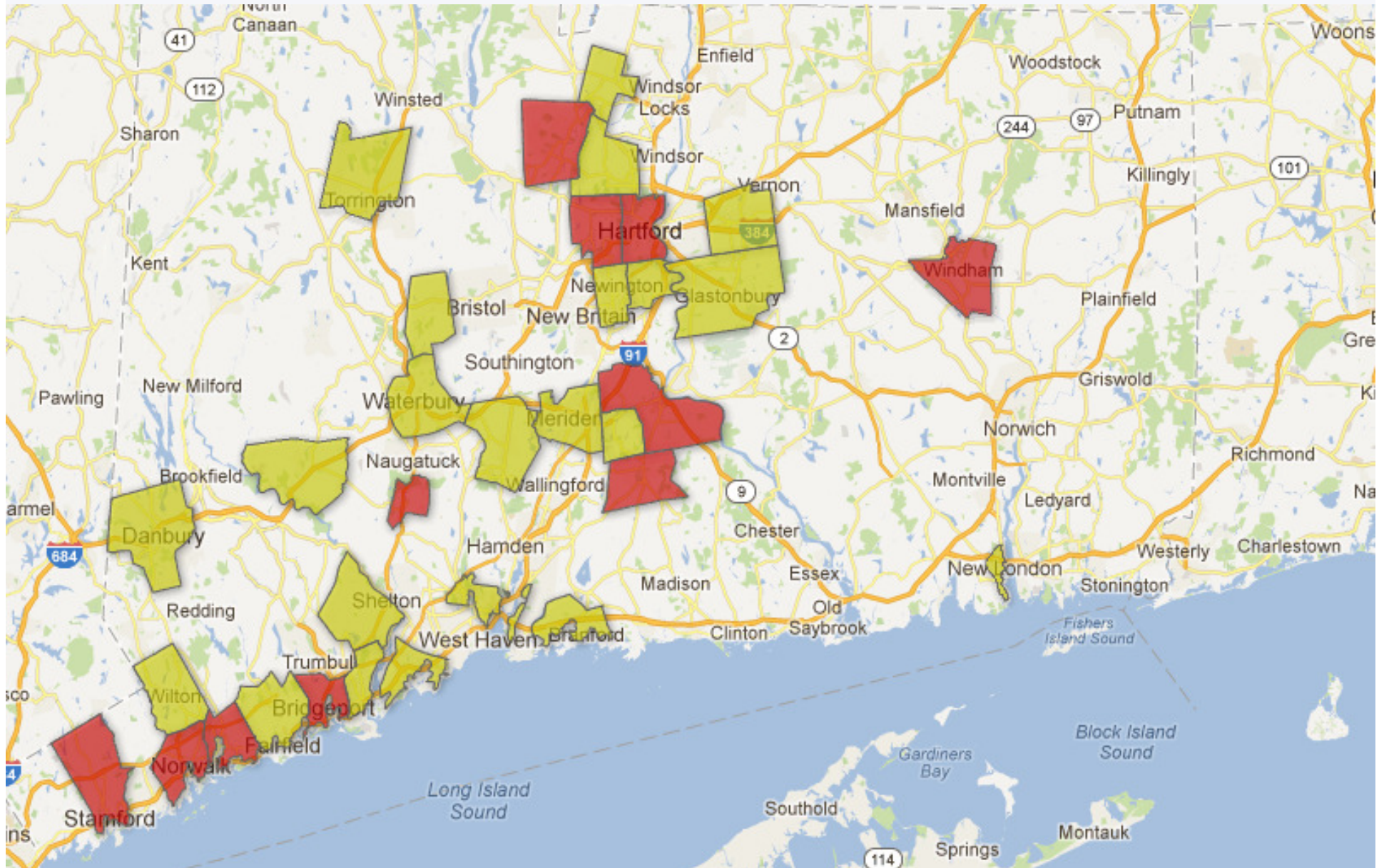
Inability to finance?

√

C-PACE Program Background

- **July 2011 – CT passed statewide enabling PACE legislation**
- **Clean Energy Finance & Investment Authority (CEFIA) directed to establish & administer the program**
- **Municipalities that “opt-in” are authorized to place a tax lien on a property whose owner has secured financing for a PACE loan.**

Municipalities Opting Into C-PACE To-date



Municipalities Opting Into C-PACE To-date

- Beacon Falls
- Bridgeport
- Durham
- Hartford
- Middletown
- Norwalk
- Old Saybrook
- Simsbury
- Stamford
- West Hartford
- Westport
- Wilton
- Windham

Coming soon: Stratford, Waterbury, East Granby, Fairfield, Manchester, Wethersfield, New Haven, Meriden, Plymouth, Cheshire, Putnam

C-PACE Program Background cont'd

- **Taxes to repay lien are collected in the normal course by the municipality**
- **Process is entirely consistent with other benefit assessments (sewers)**
- **The tax lien (assessment) has priority over existing mortgages**
- **If an existing mortgage exists, the owner must secure written consent from the lender prior to project approval and lien issuance**

C-PACE Program Background cont'd

- **The goal: attract private capital to fund EE & RE initiatives**
- **Costs covered by the project financing may include:**
 - Engineering and construction costs
 - Energy audits
 - Renewable energy feasibility studies
 - Post-construction measurement & verification of energy savings
- **Owners may recruit their own capital providers**
- **8 capital providers (to-date) have been pre-approved to fund projects**

Funding: Capital Sourcing

Qualified Capital Providers

- CEFIA qualified 8 capital providers through a RFI
- “Lending tree” model

Owner Arranged Financing

- Property owner is free to choose their capital provider from the private market
- There is no government financing required



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C-PACE Program Innovation

- **Flexibility: recognizing program will evolve as experience is gained**
- **Designed by staff with an understanding of CRE industry needs**
 - Limited available capital directed at core business activities
 - Energy efficiency is not core to CRE which has resulted in “pent-up demand” for targeted upgrades
 - Economic uncertainty caused past audit recommendations to be shelved
 - Preference for positive cash flow impact resulting from investments
 - Sale of CRE is opportunistic – not a problem under the C-PACE financing as projects have relatively long payback times, & loan is attached to the property

C-PACE Program Innovation cont'd

- **“Pre-screening” process for whole building upgrades**
 - Identify buildings where the potential for significant EE improvements exists
 - Increase likelihood for project financing
 - Time & cost effective for building owner
- **Includes a “Fast Track” review pathway**

C-PACE Program Innovation cont'd

- **Review process supports range of project types & sizes**
 - Both large and small projects
 - Targeted (single) ECM projects
 - Less technically complex projects (such as lighting)
 - Renewable energy projects only (such as solar)
 - Projects pre-approved by other CT state programs for rebates/ incentives, but still requiring some level of owner self-funding
 - Projects with prior energy audits completed, but not acted upon due to lack of financing options & owner inability to self-fund

C-PACE Program Innovation: Project “Life Cycle” Data Management Platform (CDMP)

- **Project data are entered & tracked in CDMP for use by all deal stakeholders across the entire project life cycle** (project development through M&V)
 - Powered by SRS’s cloud-based software platform
 - Facilitates consistency & transparency



The Power of C-PACE Financing: “An Offer Building Owners Will Find Difficult to Refuse”

- **Capital improvements without capital expense**
- **100% of project cost covered** (including upfront energy audit /renewable energy feasibility study and M&V costs)
- **PACE assessment is an obligation of the property, not the owner**
- **Repayment made through property tax bill**

The Power of C-PACE Financing: “An Offer Building Owners Will Find Difficult to Refuse”

- **Property tax payments may qualify as an operating expense**
- **Obligation not accelerated at the time of sale** (remains with property)
- **Tax payments may be passed through to tenants who enjoy the benefits** (for some gross leases or most triple net leases)
- **Long-term financing** (up to 20 years)
 - Energy savings will exceed investment cost
 - For most projects positive cash flow from day one
 - Increases building value
 - Enhances building’s competitive position in the marketplace

The Power of C-PACE Financing: “An Offer Building Owners Will Find Difficult to Refuse”

■ CEFIA

- Acts as a conduit for private investment
- Encourages CRE owners to arrange their own financing
- Will connect owners to capital providers (if needed)

■ CRE Owners

- Negotiate rate, terms, conditions & schedules
- Financing terms are agreed to between the owner and capital provider
- Security of the tax lien provides a financing solution for CRE owners (LLCs) who lack credit quality
- Can undertake deeper more capital intensive retrofits with greater savings potential & longer payback periods

C-PACE Underwriting

- **Financial**
- **Technical**

C-PACE Financial Underwriting

- **Tax lien holds a senior** (priority) **position** (above the mortgage)
- **Consent of property mortgage holder required**
- **Existing debt, with PACE assessment obligation, must be less than the property value***
- **Total savings over the financing term must exceed the total project investment** ($SIR > 1$)

* each property with its financials is evaluated on a case-by-case basis

C-PACE Financial Underwriting cont'd

- **Property must have clear title with no encumbrances**
 - Property taxes should be current
 - There should be no outstanding tax liens or notices of default
 - Mortgage payments must be current
 - No easements or subordination agreements that would conflict with PACE assessment
- **Project useful life must be longer than the financing term**

Mortgage Holder Consent Issue

- **Legislation requires existing mortgage lender to consent to a PACE lien**
- **Why lenders will consider and in many cases provide consent:**
 - Savings from PACE assessment assures that the cash flow of the building will be improved (higher NOI)
 - Value of collateral is improved
 - Connecticut's open market program gives the mortgage lender the opportunity to provide the energy efficiency financing to their customer (resulting in increased business)
 - In the case of a property owner default, only the past due C-PACE assessment (the portion in arrears) sits ahead of the mortgage lender (the obligation is not accelerated)

Credit-Enhancements

Default Protection

- **Non-acceleration clause in PACE program**
 - Require only the low monthly property tax payment to be paid by the foreclosing bank
 - Entire PACE loan does not become due upon default
 - Significantly reduces impact of PACE's priority lien on lender in the event of a default
- **C-PACE legislation allows establishment of a loan loss reserve funds to cover bridge payments to lenders in default situations**

Underperformance Risk Protection

- Energy Savings Insurance (ESI)
- Third party technical review
- Performance guarantees

Other

- CEFIA/Green Bank project construction financing
- CEFIA/Green Bank co-investing

Energy Savings Insurance Option

- **Can provide a backstop for energy savings performance guarantees, if needed**
- **ESI insurer agrees to pay any shortfall in energy savings below a pre-agreed baseline, less a deductible**
- **Premium paid up-front, but cost can be rolled into financing**

Technical Underwriting

Key challenge: “Will the projected energy savings be realized?”

- **Problem #1:** Energy savings can't be measured directly
- **Problem #2:** Lack of a standardized methodology to underwrite energy efficiency financing
- **Problem #3:** Without a solution to #1 & #2, EE financing cannot become a mainstream financial asset class with a high degree of standardization, predictability and scale

No longer true today!

Foundation of C-PACE Technical Underwriting

Thanks to nationally recognized technical standards defining the total process from data collection to energy savings measurement and verification...



- Energy savings can now be forecast with a high degree of confidence
- Actual energy savings performance can be measured and verified in a reliable, consistent and fully-transparent manner
- Risk of underperformance is low

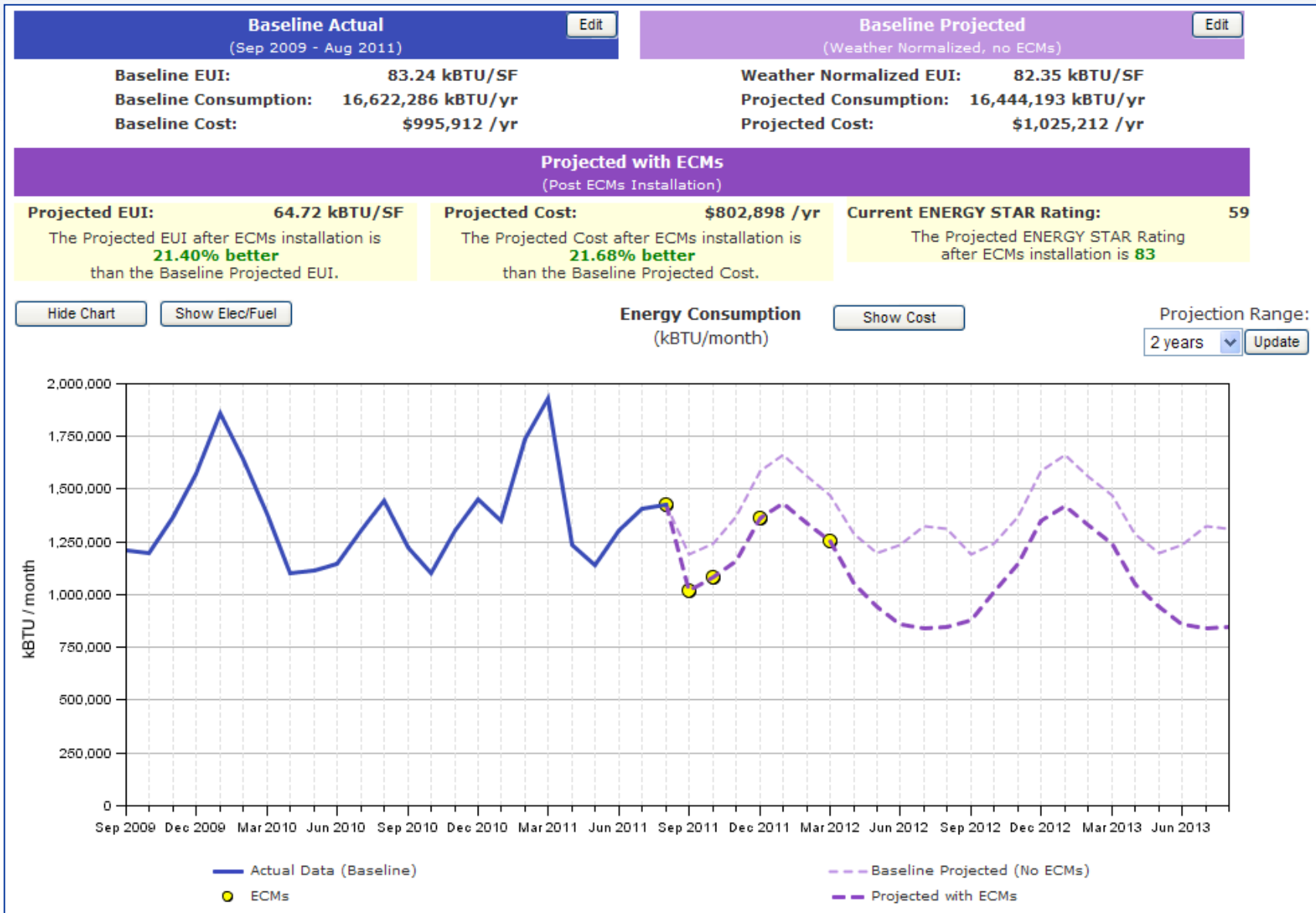
C-PACE Program Technical Standards

- **Rely on three established industry protocols:**
 - ***ASTM Building Energy Performance Assessment Standard E2797-11***
 - Methodology for collecting & analyzing baseline energy data
 - ***ASHRAE Level I, II, III Energy Audit Guidelines***
 - Methodology to identify energy conservation measures (ECMs) & project energy savings with high degree of confidence
 - ***International Performance Measurement & Verification Protocol (IPMVP)***
 - Methodology for energy savings measurement & verification
- **Underwriting methodology is technically sound, standardized, reliable & fully-transparent AND is easily available to the capital provider**

C-PACE Program Technical Standards cont'd

- **C-PACE Program project information entered into CEFIA's Data Management Platform (CDMP) to facilitate underwriting**
- **All deal stakeholders have access to CDMP**
 - CEFIA
 - Building owner
 - Capital provider
 - ESCOs
 - Contractors
 - Insurer (if ESI used)
- **CDMP follows the project post-installation thru M&V**
- **CDMP meets all reporting needs of various project stakeholders**

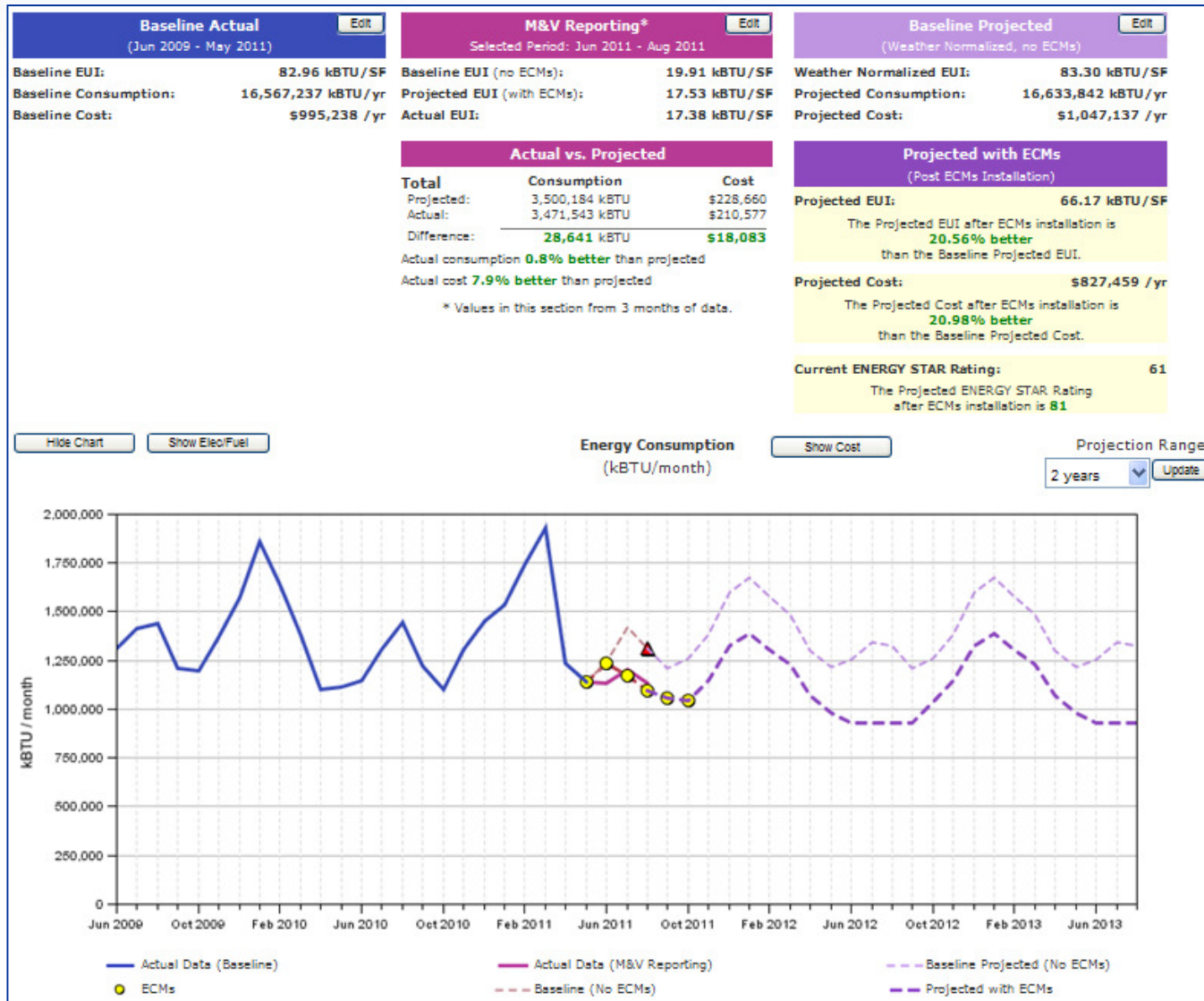
Projected Energy Savings in CDMP



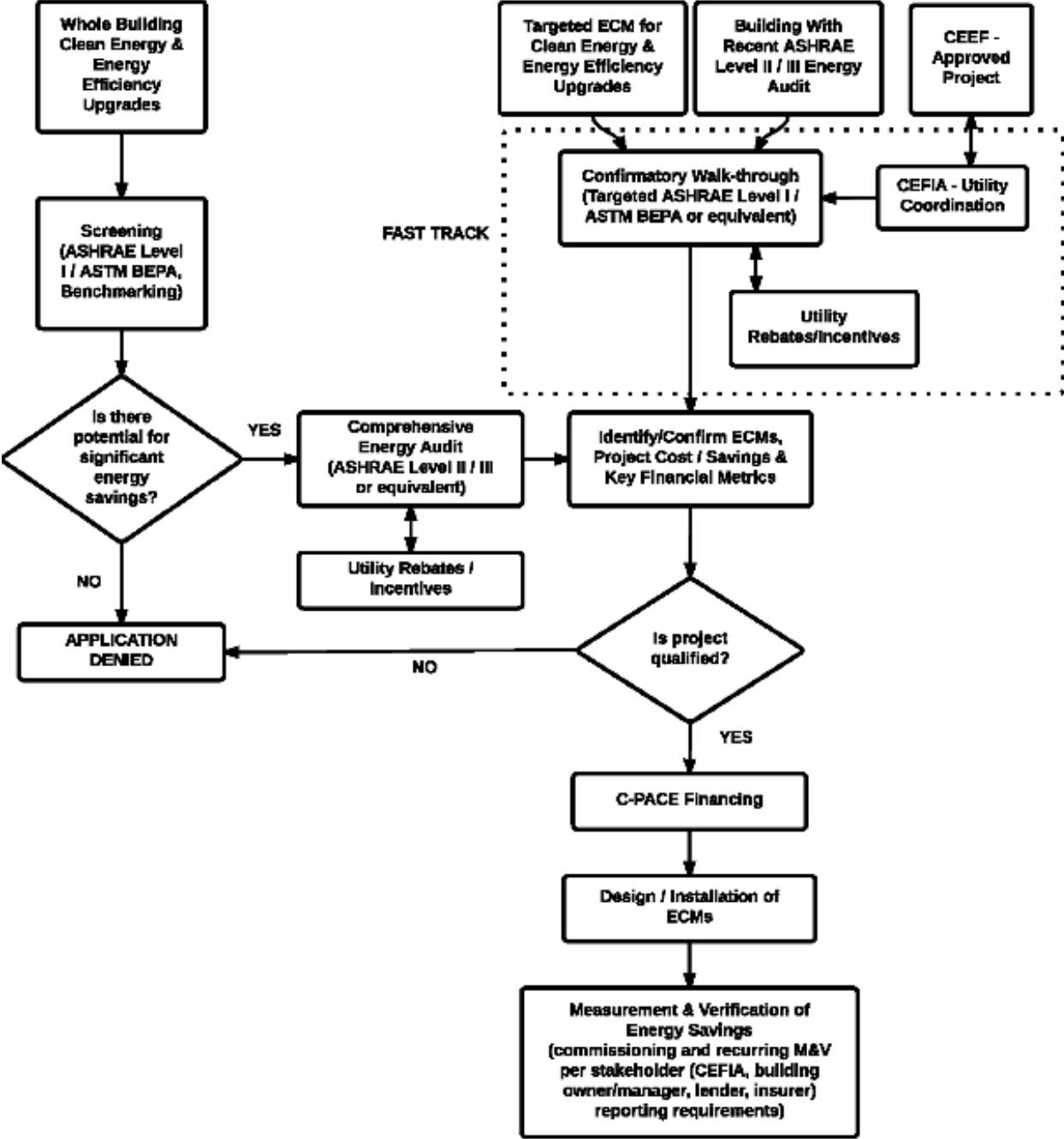
Key Financial Metrics in CDMP for Capital Providers

	Projected
Costs and Savings:	
Estimated Required Investment (unleveraged):	\$1,992,976
Estimated Annual Savings:	\$258,563
Projected: \$21,547 avg. / month	
Return on Investment (ROI):	13.0%
Simple Payback Term (years):	7.71
True Payback Term (years):	7.33
Savings to Investment Ratio (unleveraged):	3.03
Savings to Investment Ratio (leveraged):	2.06
Total Cash Flows (unleveraged):	\$2,446,034
Total Cash Flows (leveraged):	\$1,507,840
Finance Scenario:	
Estimated Required Investment (100% leveraged):	\$0
Amount Financed:	\$1,992,976
Estimated Annual Debt Service:	\$195,411
180 months at 5.5% interest	\$16,284
Estimated First Year Benefit:	\$0
Excess Annual Cash Flow (first year):	\$63,152
Financial Analytics:	
Asset Value Impact from ECMs:	
@ 6.50% CAP rate	\$3,977,899
@ 7.50% CAP rate	\$3,447,512
@ 8.50% CAP rate	\$3,041,922
Asset Value Impact less Required Investment:	
@ 6.50% CAP rate	\$1,984,923
@ 7.50% CAP rate	\$1,454,536
@ 8.50% CAP rate	\$1,048,946
Internal Rate of Return (unleveraged IRR):	11.5%
Internal Rate of Return (leveraged IRR):	N/A
Net Present Value (unleveraged NPV):	\$470,296
Net Present Value (leveraged NPV):	\$790,653
Time to Positive Cash Flow (leveraged):	Immediate

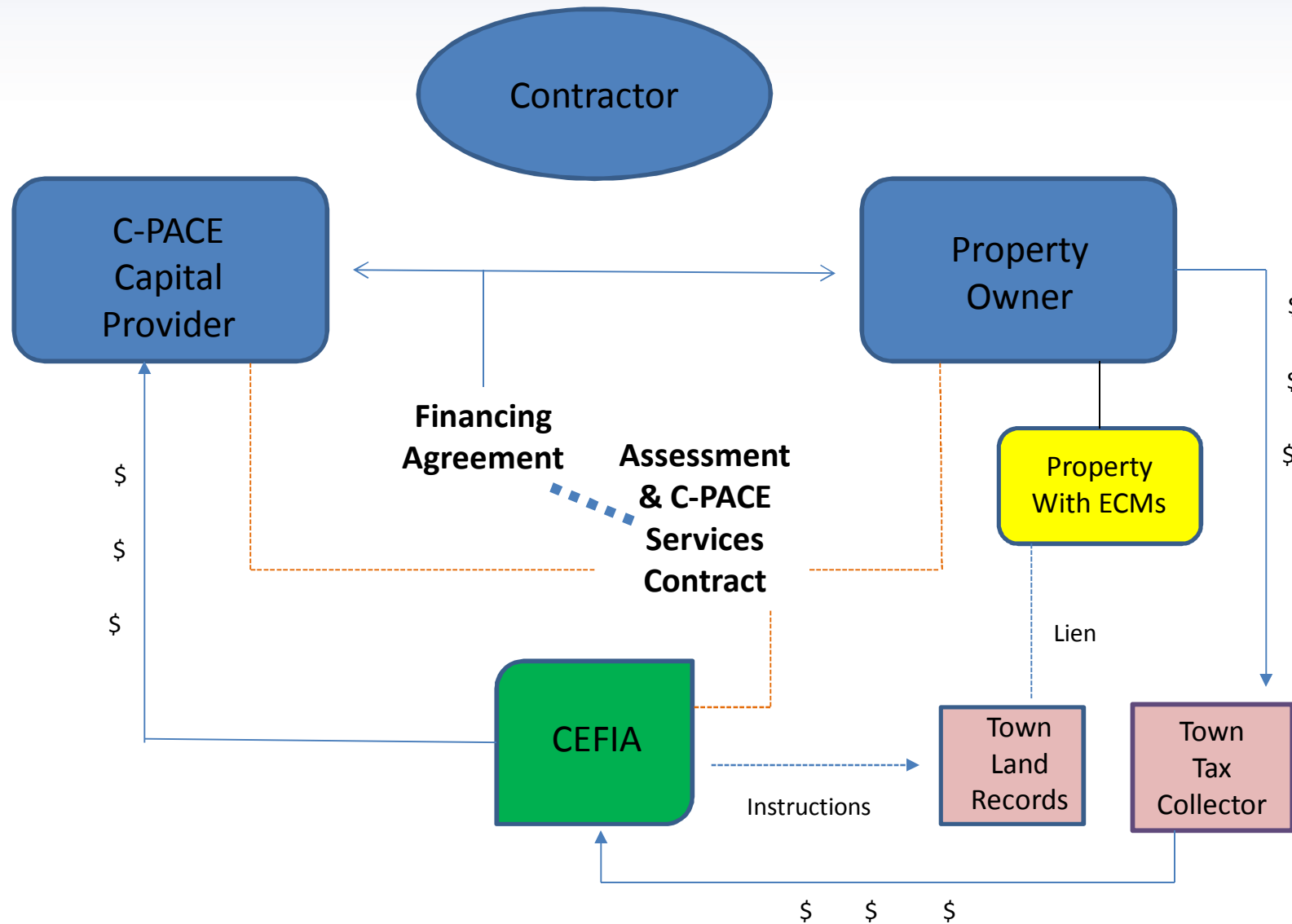
Energy Savings Tracking in CDMP (Post ECMs) for Stakeholder Reporting



C-PACE Innovative Technical Underwriting Process



CEFIA Forwards Payments to Capital Provider for Assessment Term



Key C-PACE Program Implementation Criteria

- **Energy improvements include any retrofit of qualifying commercial real estate defined as:**
 - Commercial
 - Industrial
 - Multifamily > 4 units
- **The opportunity must reduce energy consumption or include a renewable energy system that is:**
 - Permanently affixed to the qualifying commercial property
 - Achieves a savings-to-investment ratio (SIR) > 1

PACE Program Results in Benefits to Capital Providers

- **CEFIA energy efficiency technical underwriting accessible to capital providers via the CDMP**
- **Potential to increase business with existing customers & solicit new customers from institutions not participating in PACE programs**
- **Lending to existing customers where property is collateral**
 - Can protect collateral and help avoid obsolescence
 - Existing customers may have avoided replacement or upgrading of equipment due to the recession – so it may need to be done anyway
 - PACE program could make replacement a more attractive proposition
- **Potential for secondary market (securitization)**
- **Public relations**

What Can Capital Providers Do Now?

- **Learn as much as you can about the C-PACE Program**
- **Understand how EE improvements and the C-PACE financing structure can benefit your customers**
- **Develop a policy directed at EE financing**
 - Internal underwriting procedures
 - Use of CEFIA's technical underwriting
 - Response to requests to provide consent for a priority lien
 - Will you provide consent?
 - If so, under what conditions?
 - When will you prefer to provide the capital to your customer?
- **Lending officers need to be trained on C-PACE opportunity**
- **Discuss C-PACE opportunity with existing commercial customer base and determine potential for EE improvement lending thru C-PACE program (increase lending business = increased profit)**

Summary of Stakeholder Benefits: A Win-Win!

Project Capital Providers

- Provides low risk investment opportunity:
 - Senior lien
 - Association with secure payment stream (taxes)
- Legal and technical structure administered by CEFIA
- Comprehensive technical underwriting of EE improvements conducted by CEFIA

Property Owners

- Gives access to low cost, long term financing (for 100% of project cost) to improve building energy use
- No upfront capital
- Automatically transfers in the event of a sale (no debt acceleration)
- Improves attractiveness and comfort of property
- May qualify as an operating cost that potentially can be a pass-through to tenants (solving the split incentive problem)
- Can result in positive cash flow from day one

Existing Mortgage Holders

- Lowers operating costs for building and could improve NOI
- Non-accelerated obligation
- Improves value of collateral
- Creates a more attractive building for occupants and future owners
- Potential opportunity to increase business

Municipalities

- Reduces energy costs for businesses
- Attract business
- Reduce GHGs
- Create economic development opportunity, including job creation

Conclusion

- **Energy savings can now be forecast with a high degree of confidence resulting in a low risk of underperformance**
- **Actual energy savings performance can be measured and verified in a reliable, consistent and fully-transparent manner**
- **C-PACE technical underwriting represents industry best practice today**
- **C-PACE financing structure is very attractive to CRE owners and provides “an offer that is very difficult to refuse”**
- **C-PACE is enabling CRE EE financing to become a mainstream financial asset class with high degree of standardization, predictability & scale for capital providers**

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Brian J. McCarter

Chairman & CEO

Sustainable Real Estate Solutions, Inc.



Additional Resources

- **ASHRAE**
 - www.ashrae.org
- **ASTM**
 - <http://www.astm.org/Standards/E2797.htm>
- **Building Energy Performance Assessment News**
 - www.bepinfo.com
- **CT Clean Energy Finance and Investment Authority**
 - www.ctcleanenergy.com/YourBusinessorInstitution/CommercialPropertyAssessedCleanEnergyCPACE/tabid/642/Default.aspx
- **International Performance Measurement and Verification Protocol (IPMVP)**
 - www.evo-world.org
- **LinkedIn BEPA Group**
 - <http://www.linkedin.com/groups?mostPopular=&gid=2859478>