

Keeping it Clean

Texas Property Assessed Clean Energy Act

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Financial barriers have discouraged many commercial building owners in Texas from investing in energy efficiency and water conservation upgrades. Structures in Texas account for approximately 70 percent of electricity use and 40 percent of total energy use according to the state comptroller. The Texas Property Assessed Clean Energy (PACE) Act was designed to address those barriers by making such investments financially feasible.

Ten years have passed since the PACE Act was adopted by the Texas Legislature and signed by then-governor Rick Perry. Low interest rates and the pandemic initially hindered the program's popularity. However, today's higher interest rate environment has worked in the program's favor.

Benefits for Commercial Property Owners

The PACE program enables owners of commercial and industrial properties to obtain low-cost, long-term loans targeted at reducing energy and water consumption. Loans can be up to 100 percent of all costs associated with the design and installation of the upgrades, up to a maximum

Key Takeaways

- The Property Assessed Clean Energy Act (PACE) makes it feasible for commercial property owners to install energy efficiency and water conservation upgrades.
- Improvements must be permanently fixed to commercial property.
- Local governments can choose to offer PACE in specific geographic areas.
- Helps create more jobs in manufacturing,

of 25 percent of the property's as-complete market value. Loans can cover labor and material costs expended during the installation or modification of improvements, permit fees, inspection fees, lender's fees, program application and administrative fees, project development and engineering fees, independent third-party reviewer (ITPR) fees, and any other fees or costs incurred during the installation process.

"With the inverted yield curve, long-term interest rates are actually lower than short-term rates today," said PACE



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lender Sean Ribble, Senior Director of Originations for Nuveen Green Capital. “Our 30-year cost of capital is actually cheaper than many other traditional funding sources, and it’s common in today’s market to price at or inside of short-term loan rates.”

The program can benefit commercial property owners in a number of ways.

Retrofits or new construction upgrades financed using the PACE program are designed to generate positive cash flow to property owners. The quality and efficiency of a region’s building stock is improved while helping to create more jobs in the manufacturing, construction, and service sectors. PACE can also put underused properties back on the tax rolls.

Finally, PACE projects qualify for any additional rebates and incentives offered by governments, utility providers, or manufacturers.

How Financing Works

PACE loans are secured by annual property assessments and are automatically transferred to successive property owners in a sale.

The PACE Act authorizes two sources for financing PACE assessments that are secured by a property lien: third-party financing (private lenders) and public financing (bonds). Although local governments have the option to issue bonds for PACE financing, none in Texas have chosen to do so. Private funding minimizes local government risk associated with PACE projects.

Each property owner pays only the portion of an assessment that accumulates during their ownership. Thus far, Texas has had minimal experience with transfers. Assessments can also be passed through to tenants in commercial lease agreements.

Local government enforcement is nonrecourse and limited to past-due installments and related penalties. Any assessments in arrears are also subject to the enforcement terms in the underlying loan agreement enforceable by the lender under contract law. However, any installments that have not yet come due are not eligible for debt collection.

A PACE lien is a first lien against the property and has the same priority status as a lien for ad valorem taxes. The senior lien status of PACE assessments reduces the risk of nonpayment, making PACE loans more secure and attractive to lenders.

Lenders also benefit from PACE financing because the property is protected from income losses and valuation declines resulting from deferred maintenance.

“Deferred maintenance is the last untapped economy in Texas,” said Charlene Heydinger, president of Texas PACE Authority (TPA) and a third-party administrator. “If we can help companies deal with deferred maintenance, think of the jobs that would be created.”

“PACE loans secured by a tax assessment lien are a very safe investment. But a major hurdle to doing a PACE loan is always going to be getting the senior lender on board,” said Ribble. “Banks may be wary of PACE at first, but they also want to do business with commercial property owners. By adding a PACE loan to the capital stack, a bank can keep dry powder on the credit side by lowering their loan amount while still fostering a relationship with the property owner.”

When a pre-existing mortgage lien on a property is in place, that mortgagee must be given written notice of the owner’s intention to participate in the PACE program at least 30 days before entering into a PACE contract. Furthermore, the pre-existing mortgagee must give written consent to participation in the PACE program.

The lien takes effect when it is recorded in the property records and runs until the assessment, interest, and any penalty are paid in full. Any unpaid portion transfers to a new owner in a sale and is not eliminated by foreclosure.

Delinquent installments of the assessments incur the same interest and penalties as delinquent property taxes. A local government may recover costs and expenses, including attorney’s fees, to collect any delinquencies just like a suit to collect unpaid property taxes.

Positive cash flows to the property owner are achieved immediately because cost savings must exceed the PACE assessment to qualify. Improvement costs are amortized over their useful life. However, the term of the PACE financing agreement cannot exceed the useful life of the upgrades.

“PACE is a great program, but 25- to 30-year fixed rate loans are traditionally a better fit for the institutional sector,” said Ribble. “There is a duration risk for traditional lenders paying short-term rates to depositors that can change quickly while being tied to long-term, fixed-rate loan revenues. PACE loans are a much better match and a great source of revenue for life insurance companies and pension funds. Those groups are also being asked to show some percentage of a green component in their investment portfolios. PACE fits that requirement nicely.”

The PACE Act permits PACE assessments to be placed on privately owned commercial real property (including not-for-profit real property), privately owned industrial real property or privately owned residential real property consisting of five or more dwelling units. The act specifically



excludes “undeveloped” lots and any government-owned real property.

“If the local central appraisal district (CAD) determines that a property is improved under the property tax code, it is considered developed for purposes of the PACE Act,” said Heydinger.

The Act authorizes PACE funding for the installation of “qualified” improvements. Qualified improvements must be permanently fixed to the real property and decrease water and/or energy consumption. This includes renewables and products or devices on the customer’s side of the meter that use energy-related technology to generate electricity, provide thermal energy, or regulate temperature.

Multiple energy and/or water saving measures may be installed. The useful life of a project implementing multiple upgrades is calculated using a weighted average. As with single upgrades, the weighted average must be longer than the assessment term.

Property owners must demonstrate the financial ability to pay PACE assessments. Participants must verify that they are the legal property owner, are current on mortgage and tax payments, are not insolvent or bankrupt, and hold clean title to the property.

Using Administrators

The PACE Act gives a local government the power to hire and set compensation for a program administrator and program staff. They can be another governmental body, or services can be contracted to administer local or regional PACE programs. Third-party private administrators can provide oversight and reduce local government responsibilities in establishing and administering the program. No cost to local government or impact on public staff is incurred since they are funded by property owner user fees and grants.

“Administrators around the country try to talk once a month to share experiences,” said Heydinger. “Early on, we hoped to discover best practices being used in other states. What we actually discovered were lessons learned. For example, some states weren’t reviewing projects to verify that upgrades had been installed correctly and the utility savings were as projected.”

Heydinger believes Texas has the most flexible free-market approach for owners and lenders along with best practices in underwriting and technical standards to ensure energy- and water-saving results.

State law enables but does not require cities and counties to offer a PACE program. If a local government chooses to offer PACE, the governing body is required to designate the specific geographic area (the “region”) where PACE assessments can be placed. Regional PACE programs can make it easier for rural counties and smaller local governments to offer PACE financing.

The region may include the jurisdictional boundaries of the entire local government and must be located wholly inside the local government’s jurisdiction (including a municipality’s extraterritorial jurisdiction). Local governments can also create multiple PACE regions within their boundaries, although none have chosen to so far.

Participating properties must be inside the jurisdiction of a city or county PACE program. Property owners interested in participating can contact local county or city officials to determine whether a PACE program is in place. If not, www.keepingpaceintexas.org can provide information on the creation of one (scan QR code).



Another helpful website is Texaspaceauthority.org (scan QR code). The site lists PACE lenders, PACE contractors, a map of 94 local or county governments with a PACE program in Texas, and a list of projects completed since inception. Contractors and engineers familiar with the PACE program are listed along with the maximum and minimum amounts lenders will fund and where they are located. Capital stack examples and case studies of completed projects are also available.



Getting PACE Program Up and Running

The PACE Act requires a county or local government to take four steps in a specific order to establish a PACE program:

- publish a report on the proposed program design that is made available for public inspection,
- adopt a resolution of intent to create a PACE program,
- hold a public hearing, and
- adopt a resolution establishing the PACE program.

“What Texas did well is create state guidelines for the PACE program,” said Ribble. “You know that you’re structuring a deal similar to what other cities and counties in Texas have done in the past. That uniformity helps build trust in the program.”

Using PACE in a Box

PACE in a Box is a turnkey toolkit developed by the TPA that includes information on best practices, model documents, and contracts that assist local governments in establishing and implementing PACE programs. The kit helps develop a program that is scalable, uniform, and user-friendly. It contains all design elements, documents, and implementation steps necessary for a local government to establish an effective program. It also enables stakeholders in PACE financing transactions, including property owners, lenders, governmental agencies, energy service companies and manufacturers, to implement uniform, user-friendly standards and documents in Texas.

The PACE in a Box design focuses primarily on the use of private sector lenders. The PACE Act requires the PACE program to ensure property owners have access to third-party lenders with adequate funding for PACE projects. Once a project satisfies all underwriting requirements specified in PACE in a Box, it must then meet three technical requirements.

First, the property's current water and energy use is measured to establish a baseline for comparison. Second, each potential energy or water conserving measure is calculated to estimate the projected savings compared with the baseline. The results are compiled in an energy/water assessment report. According to PACE law, each report must be evaluated by an ITPR. PACE in a Box requires that the ITPR must be a Texas licensed engineer. This is key to ensuring quality and actual energy and water savings. Third, after the property upgrades are completed, the project must be reviewed again by an ITPR.

The ITPR validates the projected future energy or water savings by verifying that the qualified project was properly completed and is operating as intended. This assures all parties involved that actual energy and/or water savings equal or exceed the original projections. The PACE in a Box program can be found at www.keepingpaceintexas.org/library/document-library/.

Future Challenges

“The biggest challenge we face with the PACE program is visibility,” said Heydinger. “Unfortunately, few people in Texas know about it. We try to get in front of every chamber of commerce, economic development council, commercial property trade organization, and real estate council to educate them. Property owners and managers are another group. But the group TPA really needs to get in front of is commercial brokers who are helping put the capital stacks together for financing. My ultimate goal is to help make PACE boring. After everyone uses it and trusts it, PACE will hopefully become an integral part of financing for commercial properties in Texas.”

“Hopefully, the PACE program will continue to grow,” says Glenn Silva, Chief Operating Officer of Lone Star PACE and a PACE program administrator. “Texas is seeing significant in-migration from around the country, and those folks aren't bringing any extra water or energy with them.” 📌

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