Energy Efficiency Financing Primer

How to put together a PACE Capital Stack for Commercial Projects

Energy efficiency, clean energy, and distributed generation projects are great ways to improve the value of a property and reduce energy costs. A major barrier to getting energy efficiency projects done is often the upfront costs, so how are they paid for? Many organizations either don't have the money to self-finance the upgrades or prefer to invest elsewhere if an internal payback threshold is not met. There are a variety of different ways to pay for your projects using someone else's money and paying it back over time. While each is structured differently, the end goal is for your investment in energy efficiency to pay off.



Butler Brothers Building, Source: Texas PACE Authority

Texas Commercial Property Assessed Clean Energy (PACE) is a financing mechanism that enables property owners to cover a shortfall in a capital stack or increase long-term returns for a project when investing in qualifying property improvements. This proven financial tool incentivizes owners of eligible commercial, industrial, and multifamily properties to lower operating costs and use the savings to upgrade facility infrastructure with little or no capital outlay. The costs are paid back over time through a voluntary assessment. By incorporating PACE, owners can leverage more capital in energy efficiency, water conservation, or distributed generation projects and reduce risk by decreasing the amount of equity needed, resulting in more money on to the bottom line.

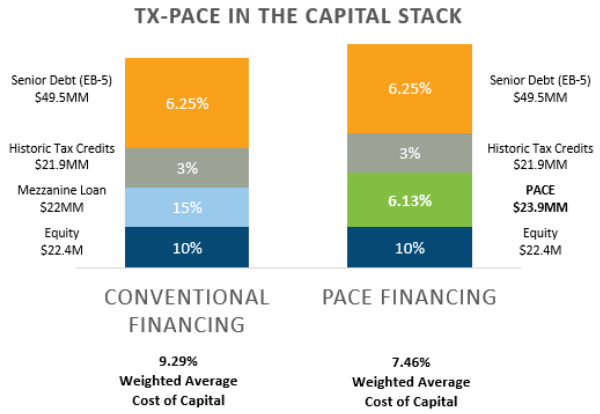
Whether part of a larger capital stack or on its own, Texas PACE financing is structured to

- fill a financing gap;
- replace or reduce expensive mezzanine debt or equity;
- cash-flow positive;
- require no out of pocket costs by the owner;
- include hard and soft costs related to the installation of a qualified improvement (limited to 20% of the total assessment);
- require that project savings are greater than the investment; be non-recourse;
- have senior lien status that is paid off over time as a voluntary land-secured assessment;
- easily combine with rebates and incentives;
- be competitively priced capital; and
- allow other financial tools to be layered on, e.g. Energy Services Performance Contracts (ESPS), Energy Service Agreements (ESA), etc.

Using Texas PACE to Optimize a Capital Stack

Texas PACE can be a competitively priced complement to traditional financing, helping owners diversify and fill gaps in a capital stack. By combining multiple sources of financing and incentives as alternatives to mezzanine and equity debt, owners can lower cost and leverage better returns. Many capital providers also offer turnkey services and can help search for incentives, rebates, and tax credits to further lower the cost or fill gaps in the project.

In the example below, a mixed-use retrofit in the City of Dallas leveraged $23.9 million in PACE financing as replacement for more expensive mezzanine financing in a complicated capital stack. PACE decreased the debt service requirements for the project and resulted in lower utility costs with the installation of energy efficiency and water conservation measures.



Comparison of Conventional and PACE financing in an energy efficiency capital stack, Source: Texas PACE Authority

The PACE Advantage

Texas PACE offers a range of benefits not available via traditional financing options. It can integrate with other financing sources and help overcome insufficient traditional capital. PACE helps fill gaps in the capital stack with low-cost, long-term, fixed market rate, non-recourse capital. The lower repayment terms can help a project remain profitable when the cost of equity, mezzanine and other capital options are too high. With terms longer than traditional bank loans, owners don't need to go into their own pockets to finance capex projects. PACE is a valuable tool as financed improvements cash flow positive, often immediately.

Summary of Results			
	Self-Funded	Conventional Loan	PACE
Out-of-Pocket Investment	($1,100,000)	($220,000)	$0
Average Annual Savings	$125,000	$125,000	$125,000
Annual Payment	$0	($197,672)	($95,903)
Cash Flow Impact Year 1	($975,000)	($342,090)	$29,097
Net Project Cash Flow Year 2	($850,000)	($464,180)	$58,194
Years to Positive Project Cashflow	8.8	11.64	IMMEDIATE
Debt Service Over Finance Term	$0	($988,359)	($1,918,060)
10-Year Project NPV	($134,783)	($324,553)	$224,679
20-Year NPV	$457,776	$268,007	$362,613

Source: Texas PACE Authority

The project summary example above contrasts the financial impact of using internal capital or conventional loans versus PACE. A project with a simple payback of 8.8 years if self-funded cash flows positive day one when financed with PACE because there is no out-of-pocket investment.

Learn more about how the Texas PACE program works
https://www.texaspaceauthority.org/resources/case-studies-marketing

HARC SECO State Energy Conservation Office TEXAS PACE AUTHORITY