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Innovation in green real estate finance through PACE

Wow. What a wild couple of months we've seen around the globe. Social and political unrest in the Middle East tied to rapidly rising food and energy prices, unprecedented flooding in Australia disrupting that continent's valuable coal exports, and devastating earthquakes, a tsunami and nuclear fallout in Japan. These are just a few recent world events that have wreaked havoc on our increasingly interconnected financial, commodity and energy markets. Environmental considerations aside, these "black swan" events are causing well-informed building owners and managers to recognize the value in implementing aggressive energy and water management strategies in their investment properties. Currently, however, the traditional means of funding real estate capital improvements that facilitate long-term cost savings, and that mitigate risks inherent in energy price volatility and climate change, are hard to come by. It is an interesting paradox. Just as owners, managers and investors are finally embracing the concepts of green building, the affordable capital required to make smart, money-saving projects happen is locked up in frozen credit markets.

With the thousands of commercial buildings in Colorado alone, improving the energy and water efficiency of our existing building stock is a multibillion-dollar opportunity. And that's not to mention the local economic development multiplier effect that would occur should thousands of construction professionals be put back to work installing thousands of new insulation, window, HVAC, roofing, lighting and renewable energy systems every year. It has become increasingly important to create innovative strategies to finance this epic investment opportunity, while at the same time addressing the concerns of building owners. These concerns most commonly include minimizing upfront cash outlays, maintaining positive cash flow while covering debt service on energy improvements, and recovering the full "payback" of a retrofit investment before selling the property. There are several new debt and equity financing strategies emerging to address these substantial challenges, but, in this article, I will be focusing on defining and explaining the concept of PACE financing.

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What is PACE financing?

PACE is an acronym that stands for Property Assessed Clean Energy. PACE is a truly transformative financial concept whose time has come. In fact, Harvard Business Review named PACE financing one of its "10 Breakthrough Ideas for 2010." The PACE concept is relatively straightforward. The defining characteristics are:

1. Debt financing, amortized over 10 to 20 years or more, is provided from a loan pool typically funded by revenue bonds issued by a local, county or state government (think "energy financing district" or "energy district authority," for example), and is repaid through a special assessment on the property's tax bill.

2. PACE loans are secured by a "super senior" lien position, similar to other special tax liens, creating more security for lenders and lower rates and minimal upfront costs for borrowers who "opt in" to the special assessment district.

3. PACE loan repayment obligations "run with the property," addressing the challenges of property owners who may opt to not make important energy investments with longer payback periods for fear that they may sell the property before recovering their investment.

4. Due to the extended amortization period, PACE financing often helps building owners improve cash flow by realizing energy cost savings that exceed the monthly loan repayment. This improved cash flow is money that will likely find its way back into the local community, further enhancing economic development.

While Colorado has had PACE enabling legislation in place for several years, only a handful of counties have proactively designed and implemented PACE programs for commercial real estate. From what I hear, Boulder County's commercial PACE program has proven popular with both property owners and local contractors. It seems to me that we could all benefit by actively making the most of this valuable opportunity. ▲