

# PACENOW

## **PACENow Commercial Working Group:** ABS Strategy Meeting

December 10, 2009

## Pace Commercial Working Group: ABS Strategy Meeting - Transcript

**Jeff Tannenbaum:** *Founder of PACENow and Fir Tree Philanthropies*

Introduces himself and discusses background of PACE:

- Wants to create a new asset class that in five to ten years will retrofit our nation
  - GHG reductions,
  - Job creation
- Need commercial and multi-family markets to lead the way
- Runs through timeline of PACE
- Combination of right idea and right time → idea to policy extremely quickly

**Introductions:** Members of today's meeting include members from the following sectors: real estate, banks, think tanks, and rating agencies.

**Stephen Compagni Portis:** *Chairman and CEO of renewable Funding, LLC*

Elaborates on Property Assessed Clean Energy (PACE) bonds:

- PACE is a financing mechanism, which utilizes a bond issued by a municipality and is secured by a tax lien on the property being improved.
- The lien is senior to existing mortgages and can be funded if there is enabling legislation in the jurisdiction that's wishes to implement the program
- PACE covers all projects that are deemed "clean energy" projects:
  - Generating clean energy (ex: Solar, PV) or
  - Reduce energy demand (ex: EE).
- Benefits include:
  - Due to the nature of the transaction, the lien on the property is tied to the property regardless of sale - no consent is required
  - Facilitates a long-term, fixed rate, flexible financing mechanism
  - Creates a mechanism that allows for comparable metrics
    - Loan-value
    - Collateral coverage
  - Skeletal system is in place: embraced by 17 states through enabling legislation, and federal government has endorsed program
- There is a huge opportunity to reduce our energy use in existing building stock
- Recent Federal estimates suggest that to retrofit existing building stock (residential, commercial, industrial), will result in savings of **\$2-4 trillion per year**

**George Caraghiaur:** *VP – Energy Services at Simon Property Group*

**Bill Hammer:** *VP – Development at Simon Property Group*

- Question posed by **Jeff Tannenbaum:** Can you elaborate on the project you financed in Sonoma, how you financed it, and comment on the legality of PACE?
  - Sonoma County was one of the first counties to take advantage of enabling legislation in CA.
  - Through Sonoma County, Simon Property Group was able to retrofit the roof at Santa Rosa Mall (500k of roof retrofit, paid over the course of 10 years through a tax that will be assessed on the mall)
  - The process was fairly easy, and the interest rate was competitive at 7%

- Did not worry about lien on the property as they have no mortgage
- Simon Property Group estimates that if PACE were implemented they would have about \$300-400M on their portfolio in which could be financed
  - Malls: replacing roof malls with EE roof, hv sheet equipments – cooling equipment, improvements in any projects, ROI EE based projects
  - The typical mall would have about \$3 million worth of retrofits x 100 malls = \$300M
- If renewable energy was added to the program, than for every 1MW of solar produced, they could generate \$5M. This is an additional \$500M generated

**Jeff Tannenbaum:** How can PACE become attractive to Citi and Barclays?

- Competition is typically a bad thing, but the more retrofits, the better because then you get to scale and EE will become cheaper
- Suggests creating a backlog of PACE ready projects

**Question:** Can Simon hold off a year or are they mission critical to get retrofits now?

**George Caraghiaur:** emergency projects need to be done immediately but programs implemented solely on their ROI can be done at any time. If an investment were to pay them back in less than three years, they would need to capture the economic benefit today

**Bill Hammer:** Many projects, (i.e. roof replacements) are planned in advance. They could wait for a program.

**Jeff Tannenbaum:**

- **Question:** By creating a backlog of applicable projects, where could PACE benefit real estate companies, and how big could it be for business?

**Drew Torbin:** *Director of ProLogis*

ProLogis owns roughly 500M sq ft of rooftop

- Projected that PACE could be used for 100MW of production
- Other EE projects that could be significant (ex: cool roofs, lighting)
- PACE would also open up additional markets they haven't looked at due to the way they are financed
  - Sell power back to utilities and monetize the roof through PV, Solar
- Question: due to the way REITs are structured – does owner of building have to be the owner of equipment?

**Iain Campbell:** *VP & GM... for Johnson Controls*

In the performance contracting space, there is roughly \$5-6 billion of private, short-term (2-3 years), investment

- If private sector was scaled, then there would be a \$12-14 billion market a year just for EE retrofits within commercial and industrial sector
- 17 states with legislation (will make about \$2.3 billion a year for 10 years)

**Colony Capital:**

New to PACE and unsure of specifics of program

- How do you trump an existing mortgage?
  - Existing loan documents have no prohibition against an assessment
  - In NY there are BIDs
  - Some loan documents would require lender to get approval and consent

**Stephen Compagni Portis:**

Land secured municipal financing has been in existence for 100 years

- In CA, legislation AB811 is from 1911
- Land secured municipal financing has been done generally with consent of neighborhood
- Mortgage lenders have accepted program as part of real property finance
- PACE is 100% voluntarily on a property by property basis and thus doesn't impact those who don't opt-in

**Iain Campbell:**

Johnson Controls guarantees energy savings up to 20 years - acts as a backstop. Someone with investment grade credit will write out a check

**Stephen Compagni Portis:**

The increase in tax is less than the savings, thus improving the borrowers credit. To this extent improvements enhance the net operating cash flows, making the property more valuable.

*Starwood:*

- Property tax is not capitalized on the balance sheet, it is written as a normal expense

**Greg Hale:** *Senior Financial Policy Specialist at NRDC*

- For existing lenders, in case of foreclosure → it is just a back tax lien that is paid ahead of mortgage (depends on state)

**Phone:** Has there been an example where a lender has been involved in PACE?

- **Jeff Tannenbaum:** Commercial is brand new – Simon Property Group was one of the first large PACE commercial projects
- **Stephen Compagni Portis:** 4 in CA: Palm Desert, Palm Springs (commercial and residential), Boulder County (residential and will launch commercial in 2 months), and Sonoma County (commercial and residential) – approved a \$3 million project and a \$7 million project
- Difference between commercial and residential programs:
  - Residential: follows fannie and freedie form (doesn't preclude a voluntary choice),
  - Commercial (every mortgage is different and someone needs to make an assessment → may see an improvement or not)

**Peter Morrow:** *Senior VP – Global Tax at Starwood Hotels and Resorts*

- Owners have deferred maintenance capital over the past few years

- They want to take a more aggressive stance on clean energy and sustainability
  - Maintenance capital is over 100M a year on their balance sheet

**Dan Probst:** *Chairman – Energy and Sustainability Services at Jones Lang LaSalle*

- Management company – they don't own anything but manage on behalf of clients
  - Corporate owner occupiers and investor side – owners have done assessments and identified opportunities but the obstacle moving ahead has been financing
- Operating expense savings > incremental tax bill than PACE is a no brainer

**David Pogue:** *National Director of Sustainability at CB Richard Ellis*

- Agrees with comments of Starwood and Jones Lang
- 23 building audits were conducted. Results: would cost \$15 million with 3 year payback but owner opted not to do it – wanted a 1 year payback
- Capital constraint has been a real problem the last 18 months

**Jeff Tannenbaum:**

- Who else do we need to get to the table in order to develop a list of projects?
- \$500 million that can be pushed into ABS facility

ESCOs (Honeywell), Irvine Company, Westbuild, Arden Realty, Walmart, Safeway Stores, McDonalds (franchise holders – have no debt), Multifamily REITs (Avalon Bay)

- (*Real Estate Round Table*) People like PACE but don't know where to begin – need outreach program...building audit
- (*Real Estate Round Table*) Can bond proceeds be used for initial, phase 1 audit where they would get biggest bang for buck?

**Stephen Compagni Portis:**

- No specific parameters in legislation
- Programs will finance up to 100% of all out of pocket expenses associated with audits, equipment
- Process of auditing is a new field (certified, qualified, can you trust them?)

**Iain Campbell:**

- ESCO model: audit is conducted for free. If there is a feasible project than you move forward with that project.

**Stephen Compagni Portis:**

- Technology agnostic opened up a lot of doors in solar (may not want to be lent against for 5-10 years until technology is proven)

**George Caraghiaur:**

- Approach NESCO – EE audits over 20+ years

### Financing

- **Jeff Tannenbaum** - How can we make this happen – how can we create the market?

### *Barclays*

- Need to understand that financing is done in a "small box"
- An assessment district, will have a program administrator and sometimes will be internally financed
- Municipalities need to get on board, who are ready to issue bonds and decide how they are going to finance them (public underwriting or private placement)

### *Citi*

- Demand needs to translate into whether it is feasible for a LL to do a program if districts are established
- End users want to do this type of financing but need to create demand

### **Jeff Tannenbaum**

- Start with low hanging fruit (SF, SD < LA – counties in CA going live)
- Create a by-zip code project list
- Go to live jurisdictions and say these are the towns and lets create a database within these towns
- Nuance is that you are pulling projects out of municipal projects that they might do

### *Market already exists:*

- Storm recovery bonds in ABS where ratepayers will be added to bill. Securitized asset (charged additional price). Rating agencies like it. Modest amount of enhancement. \$30-40 billion sold
  - Libor +50
  - Securitization of tax liens (NY, Puerto Rico) (problem of critical mass)
- Viability of the project (roof on shopping center) – mall closes, then roof is obsolete

### Warehouse Line Financing

- How realistic is it for Barclays or Citi to provide an interim facility prior to takeout of ABS facility
  - On the municipality level, there needs to be education in giving out bonds
  - To get best rates need to get municipalities online that like ABS

### ABS vs. Muni's

- Is it obvious that one route will be cheaper in terms of developing markets (from Muni's standpoint)

### *Barclays*

- ABS market will sell but you are selling against the instinct of the municipality (pooling and aggregating)
  - Ex: pooling tobacco – homogenous credit, during the mid 1990's leases securitized from vendors

### ***STEPPED OUTSIDE TO FIX MUSIC ON LINE***

#### **Craig Brundage:** *Former S&P Ratings Executive*

- PACE is a brand new idea and it will take rating agencies a long time to feel comfortable with it
  - The fact PACE loan is senior to existing mortgage (less than 5% loan to value) is very favorable
  - Structure is going to be key getting agencies to make sure that payment streams are reliable and steady

#### **Jeff Tannenbaum:**

- Generally when you go into delinquency on real estate, you no longer pay taxes, it accrues: IRR goes up for property tax lender
- How do you respond to that as a rating agency? We are super senior but some projects will not go well, but eventually you will get paid 100% on the dollar

#### **Craig Brundage:**

- Need someone servicing the bond, but the rating agency will be ok
- Limited by state legislation on this: can pay bond trustee earlier
- In CA – there is a long lag between collection and taxes
- Municipal rating at A (have been small assessment districts)
- Can get investment grade rating (agencies will scale up with greater diversification and scale)
- Shouldn't have a problem traunching investment grade bonds depending on how large and the diversification of bonds
- Can get there with existing Special Assessment Criteria

#### **Citi**

- There could be political risk
  - In bond documents, need to make sure timing issues are assessed
  - If you opt-out political risk, you can get AAA ratings

#### **Susan Leeds:** *Senior Financial Fellow at NRDC*

- With regard to interim financing, many cities have resources. If warehouse lines and execution are clear there shouldn't be a problem.
- What is the best way to secure warehouse financing and bring in the federal government to provide limited assistance in backstopping this until it's proven?

**Stephen Compagni Portis:**

- Pending legislation can be helpful but don't count on it. What's most critical is to raise the pool of commercial warehouse financing to bring a diversified pool to the ABS market
- Need to find a syndicate of banks (\$500 million) in warehouse financing

**Jeff Tannenbaum:**

- How tough is it to do warehouse lines of \$200 million?

*Problem:*

- No track record of previous deals
- Would need to sell securities one by one to get out of securitization market
- Rating criteria is still undetermined

*Citi*

- Find 5 open minded investors to pool \$20 million each and hammer out a contract

*Barclays*

- There are bonds out there that assessment districts are being financed by

Someone needs to jump off the deep end

- Private market place makes a lot of sense, but it is missing the secondary market that is needed to drive down costs over time

*NRDC and EDF*

- Some interesting ideas with working with Real Estate companies (database)

How is this any different than the current ESCO problem with existing lenders? They fear having any additional lien on the property – need a set of standards to alleviate this fear.

- Current mortgage may prohibit some from participating

**Jeff Tannenbaum:** how do existing lenders get confidence that savings will be there?

Without a rigorous program, people will write in language to prohibit legitimacy of PACE in order to avoid what we are seeing in the ESCO market.

**George Caraghiaur:** There is 100% confidence that savings will be there because ESCOs back up guarantees

**Iain Campbell:**

- Discusses shortcoming of ESCO model
- Plans to move into multifamily residential sector

*Next Steps*

- *Banking:* the residential side is further ahead than financing side
- Underwriting criteria needs to be crafted on commercial side (like residential side)

- String existing programs together to better scale national program
- Help utilities come together to do aggregation

**Jeff Tannenbaum:**

- Create a database of existing programs and backlog projects that could be retrofit
- Need to develop rating criteria
  - From this, everything else will follow
  - Bankers can see rated cash flows
  - Will lead to a securitization vehicle
- Short term answer: unrated private placement players to pool money