

AUGUST 2020

N **BIZ** magazine

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What to Expect
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PACE

Houston property owners have invested over \$26 million in energy and water-saving measures with immediate positive cash flow and no out-of-pocket expenses. **You can do the same!**



PACE in the Brave New (Post-COVID-19) World

By Charlene Heydinger

Houston's Property Assessed Clean Energy (PACE) program enables businesses and nonprofits to upgrade property with energy and water-saving measures that reduce operating costs, increase resiliency and create healthier buildings.

Houston property owners have invested over \$26 million in energy and water-saving measures with immediate positive cash flow and no out-of-pocket expenses. You can do the same. Houston's Property Assessed Clean Energy (TX-PACE) program is a proven financial tool allowing property owners to upgrade facility infrastructure with little or no capital outlay.

This program enables businesses and nonprofits to lower their operating costs and rely on resulting savings to pay for eligible water conservation, energy efficiency, resiliency and distributed generation projects. Owners gain access to private, affordable, long-term financing that is not available through traditional funding avenues. Houston PACE is a market-based, bottom-line initiative included in, and supportive of, Houston's Action Climate Plan.

"PACE allows property owners/developers access to long-term, fixed-rate, non-recourse financing that is transferrable and cannot accelerate. It is best to compare the debt to a water/sewer assessment as opposed to traditional leveraged financing. The program also allows us to finance the soft costs for obtaining financing as well as capitalized interest," states Sean Ribble, business development director, Mountain West, Greenworks Lending.

Houston PACE offers an immense opportunity for investment in green, resilient, sustainable and healthy buildings that increase net operating capital, generate higher internal rates of return and significantly improve asset value without using core capital.

“PACE capital providers are focused on Texas as the state has one of the most robust and dynamic economies in the country. By providing capital for PACE, we can play an active role in reducing the state’s carbon footprint as its economy and population continue to grow. Developers find PACE attractive as it provides 100% long-term, fixed-rate, non-recourse financing for qualified energy efficiency, resiliency, water conservation and sustainability improvements incorporated in their projects. This, in turn, allows them the opportunity to further upgrade their building materials and mechanical systems, which enhances the project’s operating cost savings and sustainability,” explains Mark McClure, executive director, Counterpointe Energy Solutions, Hannon Armstrong Sustainable Real Estate.

Reimagining and Repurposing Property in a Post-COVID-19 City

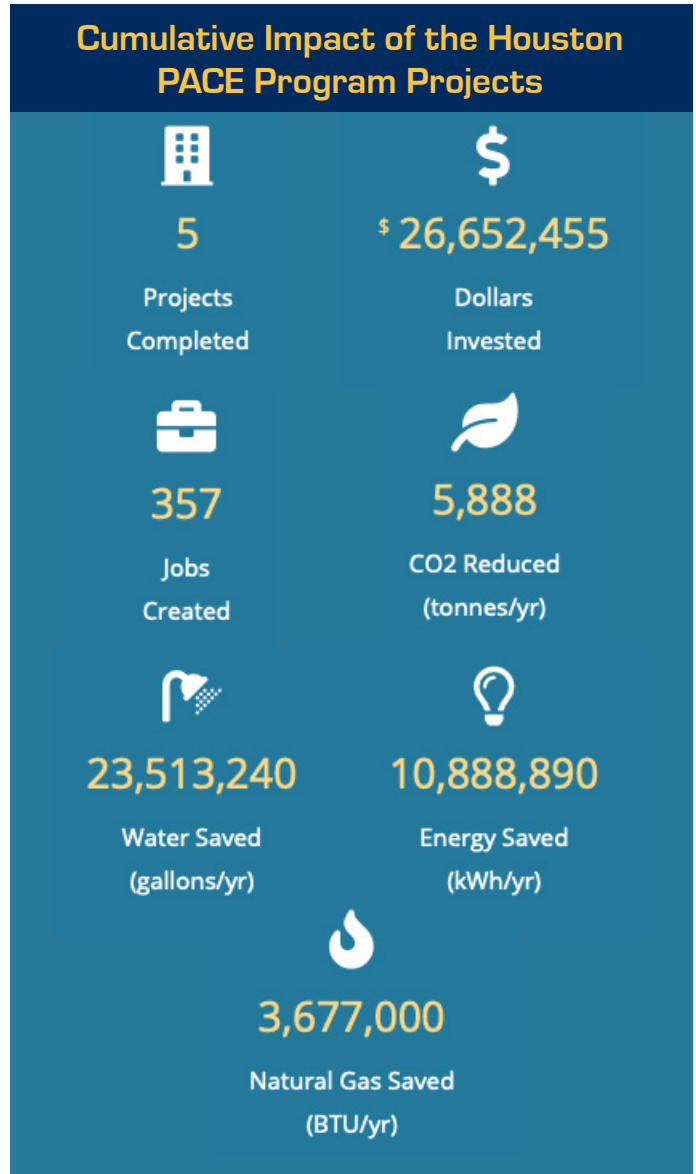
COVID-19 is causing a global rethink of the commercial real estate market that won’t return to the pre-pandemic status quo. Long-term changes are ahead as businesses and individuals plan for eventual recovery. Investors are waiting for space to become available at accessible prices. Enterprises are looking to reshape office and retail space—rethinking how much and where they need it. Society is rethinking everything—how we live, how we work, how we play—all centered around built environment. We are in a transformative period, and Houston’s PACE program opens doors to this opportunity.

Plugging the Hole in a Capital Stack vs. Shortening It

TX-PACE has financed retrofits and adaptive reuse of a wide range of facilities, including historic office buildings, a cotton gin and a mercantile warehouse with projects ranging from \$5 million to \$24 million (including a \$21 million adaptive reuse project in Houston).

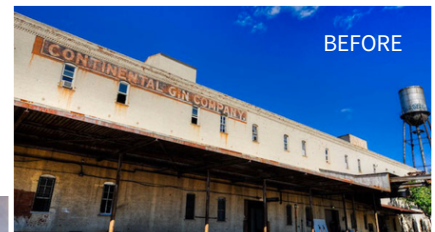
The capital stack necessary to purchase and underwrite the adaptive reuse of historic property was assembled for each of these projects. “Developers recognize the benefit that PACE offers as a lower-cost capital stack alternative in lieu of higher-cost mezzanine financing and/or preferred equity,” comments Mark McClure.

More often than not, the available capital is insufficient or too costly to justify the initial investment in high-performance energy and water-saving measures. Omitting these measures to cut costs condemns the facility to unnecessarily high operating costs, resource waste, unhealthy interior space and environmental damage over the building’s life. Combining historic tax credits and other incentives with the Houston PACE program enables investors to imagine and finance quality retrofits and adaptive reuse of vacant buildings. Without TX-PACE,



Continental Gin Building

\$5.25 M
 Deep Ellum,
 Dallas, Texas



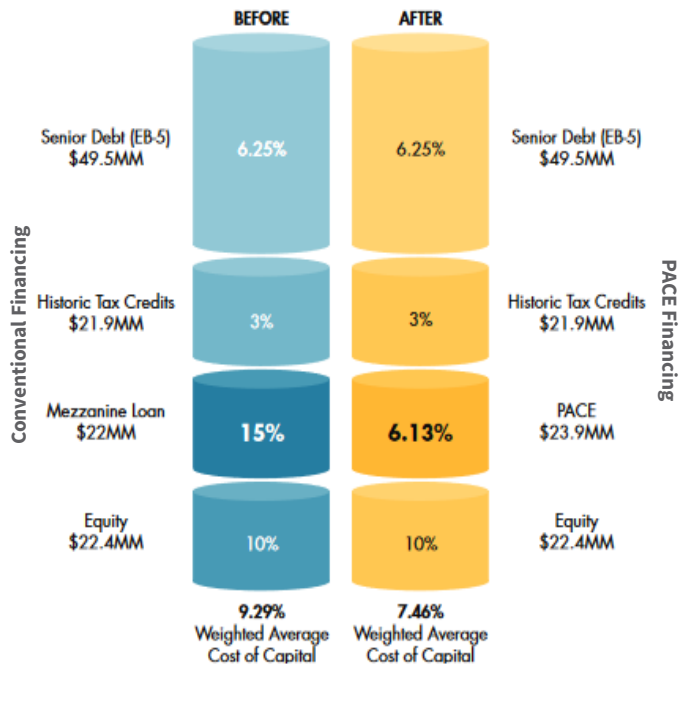
BEFORE



AFTER

The City of Dallas’s PACE program facilitated energy and water saving upgrades including roofing, glass/glazing, mechanical/HVAC, electrical/LED lighting, exterior walls, elevators and utilities. The installation of solar PV panels will enable power to be created onsite.

Butler Brothers Building Capital Stack



these projects lack justification for the expense of bringing these buildings back to life.

The 1930 Plaza Hotel, Hilton’s first high-rise, was vacant in downtown El Paso for 25 years. The utilization of El Paso County’s TX-PACE program generated \$9.2 million for energy and water-conserving infrastructure improvements, freeing up capital that is now being used to rejuvenate the historical landmark. Benefits include revitalizing downtown El Paso, creating 161 permanent jobs and saving the hotel investors 1.5 million kilowatt-hours (kWh) of electricity and 7.7 million gallons of water while avoiding more than 800 tonnes of carbon dioxide (CO₂) annually.

TFNB Your Bank For Life provided the capital for the adaptive reuse of a 100-year-old brick garage and the largest shipping container reuse project in Texas. The \$850,000 mixed-use TX-PACE project in Waco will recoup its efficiency investment through annual utility savings exceeding 271,000 kWh and 1.2 million gallons of water. Travis Kemp, senior vice-president and chief lending officer, notes, “The TX-PACE Program allowed us to provide a unique source of funding to an already creative project. The partnership between TFNB Your Bank For Life and Texas PACE Authority enabled us to leverage this valuable program with one of our local developers while also promoting energy efficiency in the first TX-PACE project in McLennan County. We look forward to more projects in the future.”

1225 North Loop—A Houston Example of Lower Operating Costs While Increasing Property Value

In 2017, the 1225 North Loop Building became the first Texas office building to use TX-PACE. The 1984 commercial office high-rise had 35-year-old chillers controlled by an antiquated system and inefficient lighting. Replacement parts were costly and difficult to find, and ongoing reliability issues were rampant. The substantial upfront outlay checked management’s exploration of replacement options.

Butler Brothers Building (pictured below) \$23.9 M — Dallas, Texas

The inclusion of \$23.9 million in energy and water-saving measures in the redevelopment capital stack of the historic Butler Brothers Building demonstrates that there is a low-cost, long-term replacement to expensive equity-partner financing.



Using the Houston PACE program to finance needed HVAC and LED lighting eliminated cash flow issues and increased the property's value. The completed project is reducing utility consumption by 38%. The lasting benefits of steadier budgets, more comfortable work environments and diminished equipment emergencies are positively impacting owners and tenants. The TX-PACE improvements avoid over 805 tonnes of CO2 emissions in Houston annually through reduced energy use.

Rachel Davis, senior vice-president of sales, Petros PACE Finance, states, "Our first transaction in Houston for the \$1.3M retrofit of 1225 North Loop, an 11-story office tower, is a perfect example of how Commercial Property Assessed Clean Energy (C-PACE) can boost sustainability and returns for building owners by funding upgrades to the property's aging mechanical and lighting systems and generating \$3.7 million in cumulative utility and operational savings."

"Our priority was the mechanical equipment upgrade," explains Property Manager Seth Eslami. "The efficiency component was just an added benefit. I am hopeful that



1225 North Loop Building

\$1.3M Retrofit – Houston, Texas

A perfect example of how Commercial Property Assessed Clean Energy (C-PACE) can boost sustainability and returns for building owners by funding upgrades to the property's aging mechanical and lighting systems and generating \$3.7 million in cumulative utility and operational savings.

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this project will help more people see that TX-PACE is not a typical 'green' program focused solely on saving the environment, but instead has a focus on improving the financial side of a business. TX-PACE can upgrade a building and can pay for itself."

Equity and the Houston PACE Program

The City is committed to ensuring that the Houston PACE program is accessible to nonprofits and underserved communities throughout the City and its Extra Territorial Jurisdiction (ETJ). Houston Business Development, Inc. (HBDi) is a nonprofit established in 1986 by the City of Houston to stimulate economic growth, support the expansion of small businesses, combat community deterioration and foster employment opportunities for low-to-moderate income citizens in the Houston metropolitan area and surrounding counties. HBDi utilized the program to



Plaza Hotel El Paso, Texas

The utilization of El Paso County's TX-PACE program generated \$9.2 million for energy and water-conserving infrastructure improvements, freeing up capital that is now being used to rejuvenate the historical landmark.

improve its facility's envelope, lighting, HVAC, water conservation and add solar energy. The resulting savings exceed the total cost of the improvements, enabling HBDi to access operational savings without cannibalizing its core mission capital. In East Austin, a \$1.6 million TX-PACE project helps repurpose an old motor court hotel into 307 energy and water-efficient studio apartments. Texas nonprofits utilize TX-PACE without having to raise charitable dollars to upgrade facilities.

PACE Resiliency

The program also facilitates resilient, efficient multi-family housing, as was recently demonstrated in Rockport, TX, where a \$2.75 million TX-PACE project enabled the construction of 435 high-energy and water-efficient apartment units. "The Pearl Point project was the first and largest multifamily housing project in the Rockport area impacted by Hurricane Harvey. The PACE program provided the final piece of financing needed to move this project forward and is a great example of how developers can use PACE to fill a hole in the capital stack and reduce their overall cost of capital," said Anne Hill, president of Stonehill PACE.

The Houston Climate Action Plan and Healthy Buildings

Houston has been on a green building trend for years and is a leader in ENERGY STAR® and LEED® facilities. COVID-19 is forcing changes that amplify the need for environmentally friendly, resilient and healthy properties. The Houston PACE program facilitates all three goals while improving property values and increasing cash flow for owners and managers and creating jobs for contractors, engineers, architects, lenders and others.

Have you done the math to see how much your property is leaving on the table? Today is the day to start working on including Houston's PACE program in your real estate investment analysis to decrease net operating expenses, increase your internal rate of return (even better) and increase your asset value (WOW)! **N**

For more information, contact Charlene Heydinger via email at charlene@texaspaceauthority.org or visit www.TexasPACEAuthority.org.

Charlene Heydinger is president of Texas PACE Authority, the nonprofit administrator of more than 50 Texas PACE programs. Ms. Heydinger also led the legislative effort for the Texas PACE Act and the collaboration to create the Texas model program of PACE best practices. Her previous experience includes serving as executive director for the Topfer Family Foundation, as vice-president and Washington counsel for Capital Cities ABC, Inc. and on Capitol Hill, where she served as staff in House leadership and on several House and Senate committees. Heydinger is a member of the Texas, Washington, DC, Michigan and U.S. Supreme Court Bar Associations.