Travis County Sets the Pace in Texas: White Paper

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Commercial property owners in Travis County are the first in Texas to have access to a powerful new financial tool that creates value in their asset. Travis County passed enabling legislation, as authorized by State Bill 385, allowing building owners to finance 100% of the costs associated with water and energy efficient and renewable improvements for office, retail, industrial and multifamily properties. Building owners repay the loan through a special assessment levied by Travis County on the tax bill over the number of years of the average useful life of the upgrades, up to twenty years. In order to participate in this program known as Property Assessed Clean Energy or 'PACE', owners of commercial properties in Travis County must realize a positive cash flow where the savings generated from the building's operating efficiencies are greater than the PACE loan repayment.

PACE has potential to benefit a number of parties associated with commercial real estate, including property owners, financial groups, Travis County and the community. Owners of commercial real estate, who understand the value of upgrading their asset with high efficiency equipment but have been hindered by tight financial conditions, particularly after the recession, as well as the ability to provide the upfront costs, benefit utmost from PACE. As a result of the recent financial meltdown, underwriting requirements for obtaining financing for commercial real estate constricted and property owners became cautious with their assets. This "hunker-down" mentality resulted in piecemeal building repairs and upgrades, implemented only when necessary, rather than on a proactive basis. Accordingly, many commercial property owners in Travis County have assets that are underperforming and therefore demanding greater amounts of water and energy, resulting in higher operating costs.

Taking advantage of PACE becomes an obvious business decision for many commercial building owners when considering the bottom line. The United States Energy Information Administration provides that, in 2014, 41% of total U.S. energy was consumed in residential and commercial buildings. Of that, approximately 30% of the $200 billion spent annually on commercial utility bills was wasted on inefficient buildings. On average, utilities account for 29% of the operating expenses of a building which has a huge impact on the net operating income. And, history indicates that the cost of water and energy will continue to rise.

Owners of commercial real estate in the region have their own particular set of challenges that impacts energy and water use in buildings. Travis County encompasses popular Austin, Texas, where demographers state that at least 110 people move EACH DAY. That staggering number requires that local officials plan for how to supply infrastructure, water and energy to the swell of new residents on top of the existing population. Further complicating matters, Travis County continues to see wide gyrations in weather conditions. Thus far in 2015, Travis County experienced drought, historic rains, and now back towards drought, factors that governments and building owners alike should consider.

Travis County property owners may use PACE to finance efficiency improvements to their buildings to prepare for regional conditions as well as to increase value in their asset. Also positive, collecting repayment of PACE loans through a special assessment collected by Travis County provides increased security that should ease financing requirements. The ability to increase the amortization period over the term of the useful life of the upgrades up to twenty years will alleviate the obligation to repay loans in the more typical five to seven year range preferred by banks. Once the loan is paid off, the building owner enjoys the entire savings generated by the upgrades. The full benefits of PACE will be realized when owners make upgrades on a comprehensive basis which has the opportunity to create greater synergies than individual and reactive improvements. Upgrades implemented systematically further increase building performance and create the least amount of disruptions to existing tenants.

The building improvements allow the owners of the asset to take advantage of lower operating costs, higher rents and increased marketability. Additionally, since 100% of the loan may be financed with no out-of-pocket costs, property owners may put capital to other uses. And, because the loans are repaid through special assessments, the cost of repayment may arguably be passed on to tenants. Then, when building owners want to sell the property, they can demonstrate that the high performing improvements result in lower water and energy demand such that the operating costs of the building decrease and the net operating income and value of the building increase. Finally, PACE special assessments run with the land so property owners may enjoy the savings and then sell the building. The special assessment, as well as the positive cash flow, transfer to the subsequent owner of the property.

The benefits do not end with the property owner. Tenants of buildings also gain value from high performance upgrades. Businesses want to be located in buildings that conserve resources, lowering utility costs of leasing. Increasingly, companies take corporate social responsibility seriously and favor leasing from environmentally-conscious locations, particularly companies that focus on and employ on millennials, a rapidly growing demographic in Austin.

Even though most traditional financing institutions such as banks tend to make loan terms in the range of five to seven, rather than twenty years, such institutions also want to make loans on healthy assets. They will eventually see the wisdom of financing improvements that increase a building's performance and enjoy the security of recovering the loans through special assessments. Additionally, financing institutions will appreciate that the PACE loan is senior to the existing mortgage on the property, up to the amount of the costs associated with the upgrades.

By implementing PACE, Travis County exercises and provides its community with benefits of good government. The County facilitates repayment of the loans collected through special assessments issued on tax bills. There is no cost to taxpayers. Economic development is enhanced by the retrofits, where the community enjoys a healthier, higher-performing stock of buildings. And as the retrofits are implemented, jobs will be created which increases the tax base.

As with many new programs, there are a few challenges with PACE. Most notably, in order to participate in the Travis County PACE program, primary lienholders must give consent to taking a second position on the initial loan, up to the amount of the new PACE loan. Unless banks recognize that high efficiency upgrades make the asset perform better, or that the same institution holds both first and second position on the lien, more conservative banks may be reluctant to sit in the back seat.

Also menacing, PACE financing extends up to the useful life of the upgrades, potentially up to twenty years where some banks prefer shorter terms, often in the five to seven year range. While it may be tough to obtain lending from traditional banks beyond ten years, there are lending institutions that will be amenable to longer payback periods.

A few wrinkles aside, on the whole, Travis County is home to retail, office, industrial and multifamily buildings where financing improvements through PACE has great potential to decrease utility waste and operating costs, create energy, increase building performance, enhance marketability of a building and grow value in in the asset. For the owners of many buildings in Travis County, not taking advantage of PACE is leaving money on the table.

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