Renew Missouri

Advancing Efficiency and Renewable Energy

Implementing PACE in Missouri:

Commercial/Industrial/Agricultural PACE Program Best Practices

February 2011

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Acknowledgements

This document represents the collective effort of several groups, all of whom share a common belief that good policy will lead to good results and when implemented correctly, property assessment clean energy financing has the capability to be a "game changer" in Missouri in terms of creating quality jobs and fostering energy independence. The following groups deserve a special recognition for their efforts to develop the best practices contained in this document:

GILMORE BELL
GILMORE & BELL, PC
www.gilmorebell.com

Microgrid Energy
www.microgrid-energy.com

Armstrong Teasdale
www.armstrongteasdale.com

STIFEL NICOLAUS
www.stifel.com

Country Club Bank
www.countryclubbank.com

ENERGY EQUITY FUNDING, LLC
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Missouri Association of Accredited Energy Professionals
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1.0 Introduction

The Property Assessment Clean Energy Act, Sections 67.2800 to 67.2835 of the Revised Statutes of Missouri, as amended (the "PACE Act"), allows municipalities to create Clean Energy Development Boards (CEDBs) to implement property assessment clean energy (PACE) programs. The purpose of PACE is to eliminate the upfront cost of installing energy efficiency and renewable energy improvements. By reducing this barrier to energy efficient and renewable energy improvements, PACE programs hope to promote energy security by reducing energy consumption from fossil fuel sources and create jobs by stoking the demand for energy efficiency and renewable energy improvements.

A copy of Missouri's PACE Act is attached hereto as ***Appendix A***. The concept of PACE is relatively simple. Essentially, it allows property owners to finance the costs of installing energy efficiency or renewable energy improvements on their property through an additional special assessment paid as part of their real property taxes. Initial funding for these improvements is raised through the issuance of bonds or other obligations, which are then repaid over time from the special assessments paid by participating property owners. These bonds or other obligations can be publicly sold or placed with a private investor. Ideally, the value of the energy savings resulting from the installation of energy efficiency or renewable energy improvements will be equal to or greater than the cost of the assessment, thereby making participation in the PACE program cashflow positive. A more detailed summary of Missouri's PACE Act is attached hereto as ***Appendix B*** in the form of a memorandum prepared by the law firm of Gilmore & Bell, P.C.

The application of PACE to commercial, industrial and agricultural properties is a fairly new concept. Accordingly, following the passage of the PACE Act, Renew Missouri formed a committee made up of persons with legal, financial, governmental and energy expertise to study other existing PACE programs, draw upon their own expertise and develop conceptual best practices to guide the implementation of PACE for commercial, industrial and agricultural properties in Missouri. The committee adopted the viewpoint that all best practices had to (1) help make a PACE program sustainable and functional and (2) help make the PACE program a cost-effective alternative to finance energy efficiency and renewable energy improvements. This document contains the recommended best practices from the committee.

Please note that in preparing this document, the committee thoroughly reviewed Chapter 13, Commercial Property-Assessed Clean Energy (PACE) Financing, of the Department of Energy's Clean Energy Finance Guide, Third Edition (the "Clean Energy Finance Guide").[1] The committee believes that this document should be read as a supplement to the Clean Energy Finance Guide. The committee also drew heavily from the Guidelines for Pilot PACE Financing Programs[2] published by the Department of Energy in May 2010 (the "Department of Energy Guidelines"). The committee viewed these guidelines as a starting point that could be expatiated and revised where necessary to specifically fit the needs of commercial and industrial PACE application.

[1] Available at http://www2.eere.energy.gov/wip/solutioncenter/pdfs/revFinal_V3Ch13CommercialPACEDec9.pdf.
[2] Available at http://www1.eere.energy.gov/wip/pdfs/arra_guidelines_for_pilot_pace_programs.pdf.

Although the PACE Act authorizes residential PACE programs, recent positions taken by Fannie Mae, Freddie Mac and the Federal Housing Finance Agency (FHFA) concerning the impact of PACE on Fannie Mae and Freddie Mac purchased mortgages make it impossible, from a practical standpoint, to pursue a residential PACE program[3]. However, large multi-family residential properties, which do not receive financing from Fannie Mae or Freddie Mac, may be eligible to participate in a commercial PACE program. Communities interested in residential PACE should monitor pending efforts in the U.S. Senate and House of Representative to legislatively overrule the positions taken by Fannie Mae, Freddie Mac and the FHFA. Interested communities may also wish to research alternatives to residential PACE programs, including junior lien or unsecured loan programs[4].

As PACE programs in Missouri and across the country mature, it is likely that market forces and/or governmental regulations will dictate additional or alternative best practices. Municipalities will be best served by discussing PACE program implementation with their financial and legal advisors to ensure that they are satisfying the current market and governmental requirements. In addition, interested municipalities may wish to periodically visit www.MissouriPACE.com for updates concerning PACE implementation activities throughout the state.

[3] Please see http://pacenow.org/blog/wp-content/uploads/12.01.10-PACE-Overview-and-Regulatory-Response2.pdf for more information.

[4] For example, the U.S. Department of Housing and Urban Development recently announced a PowerSaver Pilot Loan Program (preliminary information is available at http://edocket.access.gpo.gov/2010/pdf/2010-28015.pdf) that would partially guarantee junior lien and unsecured loans made to property owners for the purpose of installing energy efficiency upgrades. Bond-funded junior lien and unsecured loan programs can also be structured.

2.0 Identifying Appropriate PACE Projects

PACE financing may only be used for "energy efficiency improvements" and "renewable energy improvements," as each is defined in the PACE Act (See ***Appendix B***). Determining the types of projects that fall within these definitions is relatively simple[5]; however, further analysis is necessary to determine if such projects are appropriate for PACE financing.

2.1 Expected Savings-to-Investment Ratio (SIR) Greater Than One

Section 67.2815.1 of the PACE Act requires CEDBs to make a finding that "the estimated economic benefit expected from the project during the financing period is equal to or greater than the cost of the project." There are several methods one might develop to measure "estimated economic benefit," however for most projects, the simplest method will be to measure the value of expected energy savings versus the cost of the project. The Department of Energy Guidelines suggest that SIR should be calculated using the following formula:

SIR = (aggregate estimated energy savings during the financing period, discounted to a present value using a reasonable discount rate) / PACE-financed project costs

This formula has generally been used in the past to compare "energy savings returns" on various improvements where an entity has the resources to complete such improvements without additional financing. Because PACE programs involve the payment of annual assessments throughout the financing period rather than simply paying the cost of an improvement upfront, some other PACE programs have instead sought to calculate SIR by simply comparing the value of the projected energy savings to the PACE assessments. Using this approach (and assuming level payments of PACE assessments throughout the financing period), SIR can be calculated using this alternate formula:

SIR = (value of annual energy savings upon project completion) / annual PACE assessment[6]

Under either approach, a SIR above 1.0 will mean that the economic benefit of the project exceeds the cost of the project. The more that a SIR exceeds 1.0, the greater the benefit relative to the cost. The advantage of using the SIR approach is that so long as the expected energy savings are achieved, the property owner's participation in PACE will be cashflow-positive – e.g., they will save more money in energy costs than they will pay in PACE assessments.

The ability of PACE to put a property owner in a cashflow-positive position depends on (1) the accuracy of the estimated energy savings[7] and (2) the actual value of the SIR. Inaccurate

[5] On mixed-use projects, it will be important that any use of PACE not interfere with the marketability of the residential portion of the property (e.g., by creating a lien on a residential condominium that would prevent Fannie Mae or Freddie Mac from purchasing a mortgage on that condominium).

[6] This formula could be also be performed on an aggregate basis by dividing the projected cumulative value of the energy savings or renewable energy generated during the financing period by the total amount of PACE assessments expected to be paid.

[7] On larger projects, CEDBs may wish to require that an applicant for PACE financing obtain a performance guarantee.

projections of energy savings could negatively impact a property owner's ability to pay future assessments. The amount that the SIR exceeds 1.0 provides a coverage "cushion" if energy savings projections are not realized. For example, if a SIR for a project was calculated at 1.25, the project would remain cashflow positive even if realized energy savings were significantly lower than estimated energy savings.

The appropriate amount of a coverage "cushion" is likely to vary based on different projects, integration of new technologies and underwriting preferences. Unfortunately, it is not possible at this time to recommend one standard coverage "cushion" for every type of project. Nonetheless, it is important that projects be undertaken pursuant to the guidelines below to ensure that estimated energy savings are accurately predicted:

- Projects should be identified as part of an energy audit (preferably ASHRAE Level II or higher[8]) or assessment performed by a (1) certified energy auditor, (2) a professional engineer or certified energy manager with relevant experience in energy efficiency or renewable energy projects or (3) an Industrial Assessment Center (IAC)[9].

- The CEDB should require the energy auditor, professional engineer, certified energy manager or IAC to provide a written report to the CEDB detailing the estimated energy savings and SIR.

- The CEDB should require that energy modeling be completed using an industry standard process or software package. Any modeling software used should be consistent with the software used by statewide energy programs, such as the Missouri Department of Natural Resources' (MDNR) Energize Missouri Industries program[10], or approved by the U.S. Department of Energy for calculating energy-efficiency commercial building tax deductions[11].

2.2 The Term of the Assessment Should Not Exceed the Useful Life of the Improvements

PACE should not be used to finance projects for terms longer than the project's useful life. There are two separate ways to ensure that the financing period does not extend beyond the useful life of the improvements. First, the aggregate project's useful life could be calculated using an average of all improvements included in the project, weighted by each improvement's cost. Second, individual improvements within an aggregate project could be assigned a specific portion of the overall assessment. For example, if an applicant proposed a project consisting of "Improvement A" that has a useful life of 8 years and "Improvement B" that has a useful life of 20 years, the applicant's annual assessments in years 1-8 would include portions attributable to Improvement A and Improvement B, and beginning in year 9, the annual assessment would only be attributable to the cost of Improvement B.

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[8] More information on the differences between levels of ASHRAE audits can be found at http://microgrid-energy.com/the-difference-between-ashrae-level-1-2-3-energy-audits/.
[9] More information on Industrial Assessment Centers can be found at http://www1.eere.energy.gov/industry/bestpractices/iacs.html.
[10] http://www.dnr.mo.gov/transform/energizemissouriindustry.htm.
[11] http://www1.eere.energy.gov/buildings/qualified_software.html.

It is recommended that CEDBs require auditors, professional engineers, certified energy managers or IACs working on a project to provide the CEDB with a schedule showing the useful life and cost of each improvement included in the project.

2.3 The PACE Financing Should Be Appropriately Sized

The Department of Energy Guidelines suggest that the value of any PACE-financed project be limited to 10% of the value of the property. This 10% ratio was developed looking mostly at residential projects in high property value areas. Developers in Missouri have suggested that, given the property values in Missouri and the likely size of commercial and industrial projects, that 15% of the value of the property is more reasonable. Preliminary input from potential underwriters of PACE financings indicate that this is an acceptable ratio. Insufficient data exists to determine what an appropriate ratio for agricultural projects might be.

Property valuations for the purpose of determining the appropriate maximum size of a PACE financing can be accomplished using several acceptable means. The most preferred means would be a full appraisal performed by licensed appraiser (the appraisal should be no more than 12 months old at the time the PACE financing is approved). In some instances, particularly, when it is not believed that the size of the PACE financing will approach the 15% maximum, a "desktop appraisal"[12] or even data from the county assessor's office[13] may suffice.

The transactional costs associated with a PACE financing will likely dissuade applicants from seeking PACE financing for very small projects, however, CEDBs may wish to establish minimum project sizes nonetheless.

2.4 PACE Lien Non-Acceleration

Under Section 67.2815.5 of the PACE Act, the aggregate outstanding amount of the PACE special assessments is not accelerated in the event of a default. Rather, only the annual payments then outstanding are due upon a default.

While non-acceleration is likely to be viewed as an advantage for most projects, it may be a disadvantage for certain projects that are likely to only be beneficial to the current user of the property. For example, if PACE were used to finance a project that more efficiently heats mass quantities of water for a property owner that used a lot of hot water, the PACE special assessment would become an immense burden if the successor property owner does not use as much hot water and therefore does not realize the same level of energy savings. In this example, the PACE financing could arguably hinder the ability to sell (or at least reduce the selling price of) the property. While this is ultimately a market risk to be borne by the participating property owner, CEDBs should carefully consider whether or not projects with little opportunity for re-

[12] A desktop appraisal involves a licensed appraiser estimating the value of the property without conducting a physical examination of the property.

[13] The method and manner of assessing commercial property may differ between counties throughout the state. CEDBs and their financial consultants should familiarize themselves with the local assessor's methods before determining whether or not it may be appropriate to rely on the assessor's data.

use by successor property owners are good candidates for PACE financing. Assessment Contracts should also be drafted as to allow pre-payment of the PACE lien, without penalty, so that property owners are free to pay off liens early.

2.5 Rebates and Tax Credits

The total amount of PACE financing should be net of any expected incentives, such as tax credit programs. CEDBs should require full disclosure of all sources of funds (e.g. grants, tax credits, private capital and financing, PACE assessments, etc.) for the PACE eligible improvements by the applicant as a component of the application process. The CEDB can then utilize sources and uses accounting to identify the portion of the project investment to be funded by PACE assessments, net of the incentives.[14]

2.6 Obtain Consent from Lenders and Tenants

Loan agreements between a commercial or industrial property owner and a private lender will likely require that the property owner not take any action that affects the priority of the lender's lien on property without the lender's consent. Failure to obtain consent could trigger a default, which could make the full amount of the loan become due and payable. Accordingly, consent from a lender should be required. The Clean Energy Finance Guide includes a more thorough discussion of this issue.

Many leases will also have requirements that tenants be notified before a property owner takes any action to implement an additional assessment on the property. Accordingly, participating property owners should certify to the CEDB that they have given all required tenant notices.

CEDBs should also require that participating property owners indemnify the CEDB against any and all claims that might be brought against the CEDB because of the failure of property owner to obtain any consent or give any notice.

[14] Please note that Section 67.2815.1 of the PACE Act requires the CEDB to make a finding that there are sufficient resources to complete the project. Sources and uses accounting will assist the CEDB in making this finding.

3.0 Properly Administering a PACE Program

PACE programs must be administered in an efficient manner in order to provide a cost-effective source of funds to finance energy efficiency and renewable energy improvements. PACE programs must also be administered in a responsible manner to ensure that liens are properly placed on properties and financed projects are completed as intended.

To meet this challenge, some municipalities with PACE programs have looked to private, for-profit "PACE administration" firms. In addition to administering a PACE program, some of these firms also have access to financing sources.[15] However, such financing sources are not likely to be appropriate or cost-effective for all types of commercial, industrial and agricultural projects, particularly large projects undertaken by credit-worthy property owners (who might be able to access less expensive financing by arranging for financing themselves or participating in a pooled or stand-alone PACE bond issuance).

3.1 Education and Outreach

Effective implementation of a PACE program requires outreach and education for municipalities, property owners and lenders. While all parties must clearly understand how the PACE program works and be familiar with its requirements, there are additional aspects that municipalities, property owners and lenders should focus on.

Municipalities considering establishing CEDBs must be made aware of the economies of scale that may be available through regional cooperation and the administrative responsibilities associated with keeping a CEDB in good standing. To understand these issues, municipalities should consult with their legal and financial advisors. Once the CEDB is created, there is also the need that the municipality and the CEDB understand the basis for energy savings projections (including the discussion in **Section 2.1** of this document). Education is this area is desired because it will allow for better analysis of the PACE program's performance and will also likely have an impact on the likelihood that the special assessments for a project will be paid (i.e., it is hypothesized that property owners will be more likely to default on their obligation to pay special assessments if the projected energy savings do not materialize).

Property owners and lenders must fully understand the risks associated with PACE, namely that failure to pay special assessments could lead to foreclosure in the same manner that the failure to pay regular real property taxes will lead to foreclosure. Because lender consent is likely to be a requirement (see the discussion in **Section 2.6**), part of the initial implementation of a PACE program should also include outreach to prominent and reputable local lenders to make sure they understand not only this risk, but also the benefits of PACE.

[15] See the discussion of the "warehousing" approach to PACE financing contained in Chapter 13 of the Clean Energy Finance Guide, Third Edition (http://www2.eere.energy.gov/wip/solutioncenter/pdfs/revFinal_V3Ch13CommercialPACEDec9.pdf).

3.2 Quality Assurance & Anti-Fraud Measures

The effectiveness of PACE financed improvements is dependent on the quality of the work performed. The stability of PACE programs requires that a high level of quality be achieved on a consistent basis and that programs be administered in a manner that reduces the potential for fraud. Quality assurance and fraud prevention is best achieved by requiring:

- The CEDB should require the use of licensed and certified contractors. CEDBs may wish to develop lists of pre-approved local contractors. Additionally, the MDNR maintains a list of energy auditors that are qualified for its Energize Missouri Industries program at http://dnr.mo.gov/transform/em-iee-auditors.pdf. CEDBs may wish to rely on this list when reviewing qualifications of energy auditors.[16]

- Contractors should be paid directly from the CEDB, trustee or escrow agent. Bond proceeds should not be given directly to a property owner (except if necessary to reimburse the property owner for costs associated with the project).

- CEDBs should require the submittal of a certificate of substantial completion signed by an engineer, architect, construction manager or energy auditor that participated in the project prior to the payment of all project costs.

CEDBs may also consider implementing a program for an independent post-completion project inspection. The cost of such inspections will not warrant that they be required for all projects (particularly, those projects completed for sophisticated property owners by reputable contractors). However, a random inspection of 2% to 3% of projects will likely have a beneficial impact on the consistency of quality installation techniques and assist in indentifying troublesome contractors.

3.3 Data Collection

Due to the role of public entities in the formation of CEDBs and the relative youth of the PACE concept, it is important that adequate data be collected about projects to ensure that public resources are being appropriately rationed and that the public policies behind PACE are sound. However, data collection requirements cannot be so intrusive as to deter property owners from participating. To address these competing interests, the PACE Act includes a requirement for an annual report to be submitted by each CEDB to its sponsoring municipality or municipalities and the MDNR. This annual report must include:

- A brief description of each project financed by the CEDB during the preceding calendar year, including the physical address of the property, the name or names of the property owner, an itemized list of the costs of the project, and the name of any contractors used to complete the project;

[16] Please note that this list was completed as part of a program with a limited timeframe. MDNR anticipates that this list will likely cease to exist in 12 – 18 months.

- The amount of assessments due and the amount collected during the preceding calendar year;

- The amount of CEDB administrative costs incurred during the preceding calendar year;

- The estimated cumulative energy savings resulting from all energy efficiency improvements financed during the preceding calendar year; and

- The estimated cumulative energy produced by all renewable energy improvements financed during the preceding calendar year.

If actual operational data is not available from property owners, the estimated energy savings and energy production should be calculated using the annual estimates contained in the energy audit or assessment performed as part of the project identification stage (see **Section 2.1**). These projections can then be carried forward each year during the estimated useful life of the project.

4.0 Underwriting Factors to Consider

As noted above, the success of a PACE program will depend on its ability to be a cost-effective source of financing. As a generalization, lower interest rates are directly related to lower risk. Investors will only purchase PACE bonds at low interest rates if they perceive that their risk is low. Risk associated with PACE bonds, compared to other types of revenue bonds, is generally low because the bonds are secured by a senior tax lien on the property. Final underwriting criteria will likely vary between the type of project or projects financed and the source of the financing. For example, a publicly-offered PACE bond issue that finances several projects might have different underwriting criteria than a PACE sold to a local bank to finance a single project. Regardless of these variables, there are several general underwriting criteria that can be used to ensure that risks of default remain low.

4.1 Debt Service Reserve Fund & Other Credit Enhancements

Market pressures may require that a debt service reserve fund be established as part of a PACE bond issue or that other credit enhancements, such as a letter of credit be obtained. CEDBs should consult with their financial and legal consultants to determine the best method for credit enhancement.

Several of the parties involved in drafting this document envision the establishment of a statewide fund that could be used as a reserve fund for PACE bonds issued throughout the state. It is currently theorized that a $5 million reserve fund could provide adequate credit support for approximately $50 million of PACE bonds.

4.2 Property Ownership

Applicants for PACE financing will need to provide proof of title. The preferred method for proof of title is to provide a title report or title commitment issued by a title company. For larger projects, it may also be necessary to obtain title insurance to further protect bondholders. Commercial properties often have complicated ownership structures so it is important that the any application for PACE financing and subsequent transaction documents be authorized by all entities with an ownership interest.

Applicants that do not yet own the property, but have it “under contract” will need to submit a copy of a purchase agreement for the property and close on the transaction prior to or simultaneously with the PACE financing.

CEDBs should take care to review the title report and title commitments for deed restrictions and easements that might impair the value of the property. CEDBs should also require that an affirmation that the person signing the Assessment Contract and other documents on behalf of the property is authorized to do so. Certain entities, including corporations, limited liability companies and partnership may need to provide copies of bylaws, operating agreements and other corporate documents to prove such authority.

4.3 Property-Based Debt & Lender Verification

In conjunction with the consent required by **Section 2.6** above, it is recommended that CEDBs require all mortgage holders on a property to certify the outstanding principal amount of the mortgage and that the mortgage is not in default. The lender should also acknowledge that the special assessment lien created by participation in the PACE financing will be senior to the mortgage. A title report should be used to verify that all mortgages are accounted for and that there are no other impairments to the property's title that would interfere with the PACE financing[17].

Total property-based debt, including mortgages, equity credit lines and the total PACE assessment, should not exceed the value of the property (as calculated in **Section 2.3** above). The value of these debts compared to the property value will yield a "debt-to-value" ratio. It is likely that different projects and different PACE-bond financing options will require different debt-to-value ratios. For example, an underwriter or purchasers of PACE bonds for a project located in an area where property values have recently decreased may require a lower debt-to-value ratio.

4.4 Property Owner Ability to Pay

Like other forms of special assessment financing, PACE programs attach the obligation to repay the cost of project to the property rather than to the property owner. Generally, the standard underwriting criteria for other types of special assessment financing are limited to calculations involving the size of the financing, the amount of the special assessment and the projected default rate. However, given the current economic difficulties, particularly with respect to the commercial real estate market, these additional criteria are suggested to further decrease the likelihood of defaults:

- As noted in **Section 2.1**, a SIR greater than one, calculated using industry standard approaches, should help the property owner maintain or improve its debt-to-income ratio with respect to the continued operation of the property and accordingly, decrease the likelihood of defaults caused by negative cashflow.

- The property owner should be current on all taxes with an established record of paying property taxes in a timely manner.

- The property owner, or its parent entity, has not declared bankruptcy or had a property foreclosed upon for at least seven years.

* * *

[17] The CEDB should review title reports closely to determine if there are any impairments to the title of the property that would interfere with the PACE financing. For example, the CEDB should require that all mechanic and materialman liens be released or that lien waivers be obtained prior to participation in a PACE financing.

APPENDIX A

PROPERTY ASSESSMENT CLEAN ENERGY ACT
SECTIONS 67.2800 – 67.2835, RSMO.

67.2800. 1. Sections 67.2800 to 67.2835 shall be known and may be cited as the "Property Assessment Clean Energy Act".

2. As used in sections 67.2800 to 67.2835, the following words and terms shall mean:

(1) "Assessment contract", a contract entered into between a clean energy development board and a property owner under which the property owner agrees to pay an annual assessment for a period of up to twenty years in exchange for financing of an energy efficiency improvement or a renewable energy improvement;

(2) "Authority", the state environmental improvement and energy resources authority established under section 260.010;

(3) "Bond", any bond, note, or similar instrument issued by or on behalf of a clean energy development board;

(4) "Clean energy conduit financing", the financing of energy efficiency improvements or renewable energy improvements for a single parcel of property or a unified development consisting of multiple adjoining parcels of property under section 67.2825;

(5) "Clean energy development board", a board formed by one or more municipalities under section 67.2810;

(6) "Energy efficiency improvement", any acquisition, installation, or modification on or of publicly or privately owned property designed to reduce the energy consumption of such property, including but not limited to:

(a) Insulation in walls, roofs, attics, floors, foundations, and heating and cooling distribution systems;

(b) Storm windows and doors, multiglazed windows and doors, heat-absorbing or heat-reflective windows and doors, and other window and door improvements designed to reduce energy consumption;

(c) Automatic energy control systems;

(d) Heating, ventilating, or air conditioning distribution system modifications and replacements;

(e) Caulking and weatherstripping;

(f) Replacement or modification of lighting fixtures to increase energy efficiency of the lighting system without increasing the overall illumination of the building unless the increase in illumination is necessary to conform to applicable state or local building codes;

(g) Energy recovery systems; and

(h) Daylighting systems;

(7) “Municipality”, any county, city, or incorporated town or village of this state;

(8) “Project”, any energy efficiency improvement or renewable energy improvement;

(9) “Property assessed clean energy local finance fund”, a fund that may be established by the authority for the purpose of making loans to clean energy development boards to establish and maintain property assessed clean energy programs;

(10) “Property assessed clean energy program”, a program established by a clean energy development board to finance energy efficiency improvements or renewable energy improvements under section 67.2820;

(11) “Renewable energy improvement”, any acquisition and installation of a fixture, product, system, device, or combination thereof on publicly or privately owned property that produces energy from renewable resources, including, but not limited to photovoltaic systems, solar thermal systems, wind systems, biomass systems, or geothermal systems.

3. All projects undertaken under sections 67.2800 to 67.2835 are subject to the applicable municipality's ordinances and regulations, including, but not limited to those ordinances and regulations concerning zoning, subdivision, building, fire safety, and historic or architectural review.

67.2805. 1. The authority may, as needed, promulgate administrative rules and regulations relating to the following:

(1) Guidelines and specifications for administering the property assessed clean energy local finance fund; and

(2) Any clarification to the definitions of energy efficiency improvement and renewable energy improvement as the authority may determine is necessary or advisable.

2. Any rule or portion of a rule, as that term is defined in section 536.010, that is created under the authority delegated in this section shall become effective only if it complies with and is subject to all of the provisions of chapter 536 and, if applicable, section 536.028. This section and chapter 536 are nonseverable and if any of the powers vested with the general assembly under chapter 536 to review, to delay the effective date, or to disapprove and annul a rule are subsequently held unconstitutional, then the grant of rulemaking authority and any rule proposed or adopted after August 28, 2010, shall be invalid and void.

67.2810. 1. One or more municipalities may form clean energy development boards for the purpose of exercising the powers described in sections 67.2800 to 67.2835. Each clean energy development board shall consist of not less than three members, as set forth in the ordinance or order establishing the clean energy development board. Members shall serve terms as set forth in the ordinance or order establishing the clean energy development board and shall be appointed:

(1) If only one municipality is participating in the clean energy development board, by the chief elected officer of the municipality with the consent of the governing body of the municipality; or

(2) If more than one municipality is participating, in a manner agreed to by all participating municipalities.

2. A clean energy development board shall be a political subdivision of the state and shall have all powers necessary and convenient to carry out and effectuate the provisions of sections 67.2800 to 67.2835, including, but not limited to the following:

(1) To adopt, amend, and repeal bylaws, which are not inconsistent with sections 67.2800 to 67.2835;

(2) To adopt an official seal;

(3) To sue and be sued;

(4) To make and enter into contracts and other instruments with public and private entities;

(5) To accept grants, guarantees, and donations of property, labor, services, and other things of value from any public or private source;

(6) To employ or contract for such managerial, legal, technical, clerical, accounting, or other assistance it deems advisable;

(7) To levy and collect special assessments under an assessment contract with a property owner and to record such special assessments as a lien on the property;

(8) To borrow money from any public or private source and issue bonds and provide security for the repayment of the same;

(9) To finance a project under an assessment contract;

(10) To collect reasonable fees and charges in connection with making and servicing assessment contracts and in connection with any technical, consultative, or project assistance services offered;

(11) To invest any funds not required for immediate disbursement in obligations of the state of Missouri or of the United States or any agency or instrumentality thereof, or in bank certificates of deposit; provided, however, the limitations on investments provided in this subdivision shall not apply to proceeds acquired from the sale of bonds which are held by a corporate trustee; and

(12) To take whatever actions necessary to participate in and administer a clean energy conduit financing or a property assessed clean energy program.

3. No later than July first of each year, the clean energy development board shall file with each municipality that participated in the formation of the clean energy development board and with the director of the department of natural resources, an annual report for the preceding calendar year that includes:

(1) A brief description of each project financed by the clean energy development board during the preceding calendar year, which shall include the physical address of the property, the name or names of the property owner, an itemized list of the costs of the project, and the name of any contractors used to complete the project;

(2) The amount of assessments due and the amount collected during the preceding calendar year;

(3) The amount of clean energy development board administrative costs incurred during the preceding calendar year;

(4) The estimated cumulative energy savings resulting from all energy efficiency improvements financed during the preceding calendar year; and

(5) The estimated cumulative energy produced by all renewable energy improvements financed during the preceding calendar year.

4. No lawsuit to set aside the formation of a clean energy development board or to otherwise question the proceedings related thereto shall be brought after the expiration of sixty days from the effective date of the ordinance or order creating the clean energy development board. No lawsuit to set aside the approval of a project, an assessment contract, or a special assessment levied by a clean energy development board, or to otherwise question the proceedings related thereto shall be brought after the expiration of sixty days from the date that the assessment contract is executed.

67.2815. 1. A clean energy development board shall not enter into an assessment contract or levy or collect a special assessment for a project without making a finding that there are sufficient resources to complete the project and that the estimated economic benefit expected from the project during the financing period is equal to or greater than the cost of the project.

2. An assessment contract shall be executed by the clean energy development board and the benefitted property owner or property owners and shall provide:

(1) A description of the project, including the estimated cost of the project and details on how the project will either reduce energy consumption or create energy from renewable sources;

(2) A mechanism for:

(a) Verifying the final costs of the project upon its completion; and

(b) Ensuring that any amounts advanced or otherwise paid by the clean energy development board toward costs of the project will not exceed the final cost of the project;

(3) An acknowledgment by the property owner that the property owner has received or will receive a special benefit by financing a project through the clean energy development board that equals or exceeds the total assessments due under the assessment contract;

(4) An agreement by the property owner to pay annual special assessments for a period not to exceed twenty years, as specified in the assessment contract;

(5) A statement that the obligations set forth in the assessment contract, including the obligation to pay annual special assessments, are a covenant that shall run with the land and be obligations upon future owners of such property; and

(6) An acknowledgment that no subdivision of property subject to the assessment contract shall be valid unless the assessment contract or an amendment thereof divides the total annual special assessment due between the newly subdivided parcels pro rata to the special benefit realized by each subdivided parcel.

3. The total special assessments levied against a property under an assessment contract shall not exceed the sum of the cost of the project, including any required energy audits and inspections, or portion thereof financed through the participation in a property assessed clean energy program or clean energy conduit financing, including the costs of any audits or inspections required by the clean energy development board, plus such administration fees, interest, and other financing costs reasonably required by the clean energy development board.

4. The clean energy development board shall provide a copy of each signed assessment contract to the local county assessor and county collector and shall cause a copy of such assessment contract to be recorded in the real estate records of the county recorder of deeds.

5. Special assessments agreed to under an assessment contract shall be a lien on the property against which it is assessed on behalf of the applicable clean energy development board from the date that each annual assessment under the assessment contract becomes due. Such special assessments shall be collected by the county collector in the same manner and with the same priority as ad valorem real property taxes. Once collected, the county collector shall pay over such special assessment revenues to the clean energy development board in the same manner in which revenues from ad valorem real property taxes are paid to other taxing districts. Such special assessments shall be collected as provided in this subsection from all subsequent property owners, including the state and all political subdivisions thereof, for the term of the assessment contract.

6. Any clean energy development board that contracts for outside administrative services to provide financing origination for a project shall offer the right of first refusal to enter into such a contract to a federally insured depository institution with a physical presence in Missouri upon the same terms and conditions as would otherwise be approved by the clean energy development board. Such right of first refusal shall not be applicable to the origination of any transaction that involves the issuance of bonds by the clean energy development board.

67.2820. 1. Any clean energy development board may establish a property assessed clean energy program to finance energy efficiency improvements or renewable energy improvements. A property assessed clean energy program shall consist of a program whereby a property owner may apply to a clean energy development board to finance the costs of a project through annual special assessments levied under an assessment contract.

2. A clean energy development board may establish application requirements and criteria for project financing approval as it deems necessary to effectively administer such program and ration available funding among projects, including but not limited to requiring projects to meet certain energy efficiency standards.

3. Clean energy development boards shall ensure that any property owner approved by the board to participate in a property assessed clean energy program or clean energy conduit financing under

sections 67.2800 to 67.2835 shall have good credit worthiness or shall otherwise be considered a low risk for failure to meet the obligations of the program or conduit financing.

4. A clean energy development board may require an initial energy audit conducted by a qualified home energy auditor as defined in subdivision (4) of subsection 1 of section 640.153 as a prerequisite to project financing through a property assessed clean energy program as well as inspections to verify project completion.

67.2825. 1. In lieu of financing a project through a property assessed clean energy program, a clean energy development board may seek to finance any number of projects to be installed within a single parcel of property or within a unified development consisting of multiple adjoining parcels of property by participating in a clean energy conduit financing.

2. A clean energy conduit financing shall consist of the issuance of bonds under section 67.2830 payable from the special assessment revenues collected under an assessment contract with the property owner participating in the clean energy conduit financing and any other revenues pledged thereto.

67.2830. 1. A clean energy development board may issue bonds payable from special assessment revenues generated by assessment contracts and any other revenues pledged thereto. The bonds shall be authorized by resolution of the clean energy development board, shall bear such date or dates, and shall mature at such time or times as the resolution shall specify, provided that the term of any bonds issued for a clean energy conduit financing shall not exceed twenty years. The bonds shall be in such denomination, bear interest at such rate, be in such form, be issued in such manner, be payable in such place or places, and be subject to redemption as such resolution may provide. Notwithstanding any provision to the contrary under this section, issuance of the bonds shall conform to the requirements of subsection 1 of section 108.170.

2. Any bonds issued under this section shall not constitute an indebtedness of the state or any municipality. Neither the state nor any municipality shall be liable on such bonds, and the form of such bonds shall contain a statement to such effect.

67.2835. The director of the department of economic development is authorized to allocate the state's residual share, or any portion thereof, of the national qualified energy conservation bond limitation under Section 54D of the Internal Revenue Code of 1986, as amended, for any purposes described therein to the authority, any clean energy development board, the state, any political subdivision, instrumentality, or other body corporate and politic.

APPENDIX B

SUMMARY OF PACE ACT

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Property Assessment Clean Energy Act (PACE) Sections 67.2800 to 67.2835, RSMo.

September 2010

Introduction

When the General Assembly passed House Bill 1692 during its 2010 legislative session, Missouri joined a growing number of states that have enacted property assessment clean energy (PACE) legislation. The PACE concept is relatively simple. Essentially, it allows property owners to finance the costs of installing energy efficiency or renewable energy improvements on their property through an additional special assessment paid as part of their real property taxes. Initial funding for these improvements is raised through the issuance of bonds or other obligations, which are then repaid over time from the special assessments paid by participating property owners. Because the special assessments have a "senior tax lien" status (i.e., in the event of foreclosure, the special assessments along with property taxes get paid before a mortgage holder), bonds secured by the special assessments may be able to attract favorable interest rates.

Benefits to PACE

There are several benefits to this financing structure. Property owners who wish to participate do not need to pay cash or provide other upfront funding. By accessing capital through the issuance of bonds, PACE programs should be able to generate favorable net borrowing costs for participating property owners. Because the special assessments necessary to pay the cost of the energy efficiency or renewable energy improvements can be spread out over up to twenty years, it is possible for a property owner to realize immediate positive cashflow so long as the annual energy cost savings resulting from improvements exceeds the annual special assessment. Additionally, if property ownership changes during the financing term, the new owner assumes the obligation to pay the special assessments (and also inherits the energy savings resulting from the financed project).

Eligible Property

The Missouri legislation allows for PACE to be applied to all types of property, including residential, commercial and industrial. Publicly-owned property is also eligible and in some instances, PACE financing for publicly-owned property may be a favorable alternative structure to energy performance contracts.

Recently, Fannie Mae and Freddie Mac have indicated that they believe PACE financing for residential projects interferes with the covenants contained in the mortgages that they back. Legislation is pending in Congress that would resolve this issue and the Attorney General of the State of California has filed a lawsuit on this issue; however, most residential PACE programs throughout the country are now suspended until a resolution is reached. *Missouri municipalities should not create residential PACE programs until a resolution is reached.* PACE programs for commercial, industrial and public properties are not affected by Fannie Mae's and Freddie Mac's actions and may be currently implemented.

Eligible Projects

The Missouri PACE legislation allows PACE to be used for energy efficiency improvements and renewable energy improvements. Energy efficiency improvements include any acquisition, installation or modification on or of publicly- or privately-owned property designed to reduce the energy consumption of such property, including, but not limited to:

- Insulation in walls, roofs, attics, floors, foundations, and heating and cooling distribution systems;
- Storm windows and doors, multiglazed windows and doors, heat-absorbing or heat-reflective windows and doors, and other window and door improvements designed to reduce energy consumption;
- Automatic energy control systems;
- Heating, ventilating, or air conditioning distribution system modifications and replacements;
- Caulking and weatherstripping;
- Replacement or modification of lighting fixtures to increase energy efficiency of the lighting system without increasing the overall illumination of the building unless the increase in illumination is necessary to conform to applicable state or local building codes;
- Energy recovery systems; and
- Daylighting systems.

Renewable energy improvements include any acquisition and installation of a fixture, product, system, device, or combination thereof on publicly- or privately-owned property that produces energy from renewable resources, including, but not limited to photovoltaic systems, solar thermal systems, wind systems, biomass systems, or geothermal systems.

Implementing PACE

Creation of a Clean Energy Development Board

Cities, towns, villages, and counties that want to implement PACE programs must form a Clean Energy Development Board (CEDB). A municipality-specific CEDB may be formed by ordinance or order of an individual municipality; joint or regional CEDBs may be formed by ordinance or order of all participating municipalities. CEDBs are separate political subdivisions from their sponsoring municipalities and are governed by a Board of Directors made up of at least three persons. The Board of Directors of a municipality-specific CEDB will be appointed by the chief elected officer of the municipality with the consent of the municipality's governing body. The Board of Directors of a joint or regional CEDB will be appointed in a manner agreed to by all participating municipalities.

Best Practices

CEDBs will be responsible for implementing PACE programs, including the approval of eligible projects. The Missouri PACE legislation grants a significant amount of flexibility to CEDBs to approve projects. CEDBs must find that the estimated economic benefit of a project outweighs its costs, but are otherwise free to approve any other project meeting the definitions of energy efficiency improvement or renewable energy improvement. Accordingly, CEDBs may wish to establish guidelines to ensure that only feasible projects for credit-worthy applicants are approved. The U.S. Department of Energy has published certain PACE best practices that CEDBs may want to consider. These best practice guidelines are available on the internet at http://www1.eere.energy.gov/wip/pdfs/arra_guidelines_for_pilot_pace_programs.pdf. Gilmore & Bell is also currently working with other interested parties to develop best practices specifically tailored to fit the Missouri PACE legislation.

Additionally, as PACE programs mature, it is likely that bond underwriters will develop criteria to ensure PACE bonds are marketable. Accordingly, CEDBs may wish to consult bond underwriters or other financial advisers when developing guidelines for project approval.

Administration

When a CEDB approves a project for PACE financing, it must enter into an "assessment contract" with the property owner. The assessment contract must include, at a minimum, (1) a description of the project, (2) procedures for verifying the actual construction of the project, (3) an agreement by the property owner to pay annual special assessments until the total amount of the financing is paid off, (4) a covenant that the requirement to pay annual special assessments will run with the land and (5) an acknowledgement that subdivision of the property will not be allowed unless the assessment contract is amended to divide the annual assessments due between the subdivided parcels pro rata to the benefit received by each parcel from the financed project.

Depending on the scope of a PACE program and the number of participating property owners, administration of such a program may become burdensome. Several private companies have been created in the last few years that offer PACE administration services. Municipalities may also want to check with their regional planning commission to see if any PACE program administration activities are being coordinated on a regional level.

Annual Reporting

The Missouri PACE legislation requires each CEDB to file an annual report with the CEDB's sponsoring municipality and the Department of Natural Resources, which includes:

- A brief description of each project financed by the CEDB during the preceding calendar year, including the physical address of the property, the name of the property owner, an itemized list of the project costs, and the name of any contractors used to complete the project;
- The amount of assessments due and the amount collected during the preceding calendar year;
- The amount of clean energy development board administrative costs incurred during the preceding calendar year;
- The estimated cumulative energy savings resulting from all energy efficiency improvements financed during the preceding calendar year; and
- The estimated cumulative energy produced by all renewable energy improvements financed during the preceding calendar year.

Bond Issuance

CEDBs can issue bonds to finance PACE programs. Bonds may be issued for individual projects or to finance or refinance several projects together. CEDBs can also cooperate with other CEDBs (or other qualified bond issuers, such as a municipality) pursuant to joint financing agreements to combine their financing needs into a more economical bond issue (certain economies of scale can be achieved with larger bond issues and larger bond issues may attract more investors). Gilmore & Bell and several other interested parties are currently trying to develop a structure that will allow individual CEDBs to aggregate their financing needs with other CEDBs throughout the state. We believe such a structure may be an efficient way to provide cost-effective PACE financing, particularly to CEDBs established outside of metropolitan areas.

Using Other Incentives to Maximize the Benefit of PACE

PACE, by itself, provides an incentive to complete energy efficiency and renewable improvements because it eliminates the up-front costs of completing a project, thereby allowing property owners to realize positive cash flow from reduced utility bills almost immediately. PACE can also be used with tax abatement and other incentives, particularly for large commercial and industrial projects, to provide both more effective development incentives and to encourage larger energy efficiency or renewable energy project components. For example, if PACE financing were used in concert with real property tax abatement, energy efficiency and renewable energy improvements could be financed without increasing the aggregate amount of annual property taxes and PACE assessments due above the amount of annual property taxes that would have been due without tax abatement.

Additionally, municipalities may want to coordinate with local utility companies and the Department of Natural Resources to determine if there are any programs to assist in funding financing costs, energy audits or CEDB administration costs.

Over the last two years, several members of Congress have proposed various methods for reducing PACE financing costs, ranging from preferred tax treatment to direct subsidies. None of these proposals has yet received Congressional approval.

PACE Alternatives

Due to Fannie Mae's and Freddie Mac's position on residential PACE programs, municipalities that want to create a program for financing residential energy efficiency and renewable energy improvements in the near future will need to do so on a subordinate lien basis – i.e., the lien created by the financing will be junior to the Fannie Mae or Freddie Mac backed mortgage. This structure, because it provides less security than the senior tax lien offered by PACE, makes it very challenging to develop a program that is financially workable. However, by using available Energy Efficiency and Conservation Block Grant funds or other municipal funds to offset a portion of the financing costs and structuring the program so that it is eligible for Qualified Energy Conservation Bond issuance (a type of bond that provides a federal subsidy of up to 70% of the interest costs), some municipalities may be able to develop workable programs.

Contact Information

For more information on PACE financing in Missouri, please contact Mark Spykerman (mspykerman@gilmorebell.com) or Mark Grimm (mgrimm@gilmorebell.com) at (314) 436-1000.

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