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Ladies and Gentlemen:

Our organizations represent virtually all federally insured financial institutions in Texas, including commercial banks, savings banks, credit unions, and mortgage bankers. We have followed the evolution of Property Assessed Clean Energy (PACE) loan programs since the enactment of Local Government Code Chapter 399, been involved in discussions and development of PACE underwriting standards, and our members also represent a large potential base for PACE loan lenders.

We are very concerned about recent trends in PACE programs, and we write today to voice those concerns. Frankly, our recent observations cause us to question whether the intended public purposes of PACE – energy efficient retrofits – are being fulfilled. However, if PACE is to be continued, then it is our hope that your organizations may reach consensus on best practices for the administration of PACE programs by local government.

Our primary concerns in summary are as follows. A more complete explanation of each follows.

Structure of PACE Loans

The original purpose of providing financing for energy improvements to commercial properties that would otherwise not be commercially feasible is being supplanted by attempts to obtain essentially mezzanine financing at favorable terms by leveraging priority lien treatment.

Existing lienholders must consent to the PACE transaction for it to be implemented.

Standards for achievement of energy efficiencies should be set and results monitored to assure that the program is in indeed being used for its articulated purpose.

PACE loans should not be used for new construction as the underlying justification of lack of long-term financing is not present.

Administration

A single third-party administrator should be used by a local governmental unit. Selection of multiple administrators facilitates borrowers in extracting looser terms in a race to the bottom for quality.

Administrators should not be paid based on funded projects as that provides a perverse incentive to approve such without regard to quality.

Administrators should be subject to performance audits and conflicts rules.

ANALYSIS AND REASONING

PACE programs involve the government stepping in to assist a private development when traditional market financing is not available.

Energy Efficiency Rehab. The Texas PACE statute (Local Government Code Chapter 399) was promoted as providing a public benefit in increased energy efficiency and water conservation in the renovation and upgrading of older commercial, industrial, and multifamily buildings. As we recall, the Keeping PACE in Texas spokespersons represented that viable financing in the traditional free market lending arena would not be available for these upgrades due in substantial part to the shorter loan amortizations and maturities for renovation loans typically imposed in traditional markets. PACE loans secured by a governmental assessment on the property were promoted as a means of providing longer payouts than the free market provided.

Funding is being used in place of mezzanine financing. Recent anecdotal evidence suggests to us that PACE is now being promoted not so much as to ensure energy efficiency upgrades for which private market financing may not be available, but as a cheaper source of additional financing to reduce the amount of “skin in the game” or equity from the owner or project developer. If local government chooses to use third party administrators for PACE, then it is imperative that the local government require the administrator to adopt rigorous technical standards, require that PACE projects demonstrate a significant energy or water conservation savings investment ratio, follow strict conflict of interest standards, and be subject to regular performance audits.

PACE Loans should not be used for new construction or residential projects. The proponents of Local Government Code Chapter 399 have sold PACE as a program meant for rehabilitation and retrofitting of older existing facilities with inefficient energy systems. The pitch was that financing for energy enhancements could not be financed in the traditional free market because lenders would only provide short-term financing and not the longer-term financing needed. PACE lenders are now pressing to expand PACE to new construction. There can be no credible argument made for PACE for new construction. New construction is typically financed over a 20- to 30-year period. Thus, any new construction project would have the long-term financing provided by the private market that PACE proponents say is needed without the need for governmental intervention.

There is already a vibrant market for loans to provide solar products and other energy efficient remodeling for residential properties at traditional residential rates. There is no public policy

justification for expanding PACE to residential projects. There are multiple reports of consumer abuse in states where residential PACE is a reality. The existence of a PACE lien on residential properties creates problems for those homeowners wishing to sell or refinance their properties. Full and appropriate consumer protections are simply not possible, nor are appropriate cost/benefit analyses. Finally, the imposition of a priority lien on an existing mortgage loan is potentially problematic for both the borrower and the lender. **The undersigned parties are unalterably opposed to expanding PACE to residential properties in Texas.**

Good Government Requires Accountability: Why Local Government Should Have A Single Third-Party Administrator.

Local Government would never hire two outside health inspectors and then let a restaurant choose which health inspector examined the restaurant. A local government would not hire two outside building inspectors and then allow a developer or contractor to choose who inspected the project. For financial institutions, a borrower does not get to pick which appraiser he or she uses to appraise the bank's collateral. So why should local government hire multiple administrators to run Property Assessed Clean Energy (PACE) loan programs?

PACE loans use a governmental lien assessment to finance a private project. PACE program administrators are charged with making sure a PACE project has a sufficient public benefit to justify receiving a governmental benefit. PACE administrators are responsible for making sure that PACE financed improvements meet the technical standards and achieve the energy or water conservation goals that justify the intervention of government in a private project. Having multiple administrators for a specific PACE program where program lenders and participants get to choose the administrator inevitably will lead in a race to the bottom. Lenders and owners will gravitate to the administrator that has the weakest standards or technical reviews.

Selection of a single administrator is and should be competitive. Some say that having a single administrator is anti-competitive. This is not true. As with any governmental function that is outsourced to a private party, competition is provided through the RFP and selection process. Qualified parties will compete to become the selected administrator just as parties compete now to receive any governmental contract in an open forum. Ideally, the administrative contract would be subject to cancellation if program standards are not met and should have a limited term. A competitive RFP process should be required before any third-party administrative contract is renewed.

The administrator should be subject to rigorous oversight by the local government.

PACE loans should be made only for those projects where the energy system and water system improvements will provide energy savings or water conservation achieved through upgrading systems. This can only be measured by rigorous technical standards set by an independent body, such as the Texas State Energy Conservation Office. If energy efficiency improvement and water conservation is the goal, then there must also be a means to establish a baseline of current use in order to determine if the proposed upgrades provide a savings to investment ratio. In our opinion, the government should only intervene with PACE where the savings to investment ratio is 1:1 or higher. If a PACE project cannot meet this standard, then some waiver could be granted to the extent the project also substantially reduced carbon, ozone or other emissions or contributed to improve the quality of wastewater discharge.

PACE administrators should not be paid based on funded projects. Because the PACE administrator is to be paid from fees, local government should exercise caution where the collection of a fee is dependent on funding of a PACE loan. However the fees are determined, the fees should be paid upfront before a PACE loan is approved. This will help ensure that the PACE administrator properly underwrites the project and that the technical review is not compromised just to close a deal and collect a fee.

PACE Administrators should be subject to regular performance audits and subject to conflicts of interest rules and public information laws. If Texas is to permit PACE programs, PACE must be administered by administrators whose first responsibility is to see that program standards are met. PACE administrators should be subject to strict conflict of interest standards and should be subject to oversight and audits to see that program standards are in fact being met. PACE administrators should also be subject to our public information laws to provide transparency.

PACE loans should be subject to prior consent by existing lienholders, as is currently the law. If appropriate oversight is in place to assure that there are truly energy savings or water conservation, then existing lienholders will be incentivized to approve such projects. If such standards are not met, then there is no public policy justification for permitting such private projects to be given a priority lien, ahead of pre-existing commercial lienholders. This provision was key to our ultimate support of the existing PACE statute and remains a key tenet of the process.

We are hopeful that the Texas Legislature will carefully evaluate any proposals to weaken the negotiated standards of the PACE statutes. Any weakening will do little to further energy conservation and efficiencies, and instead unjustly enhance the financial standing of a handful of those wishing to profit from a well-intentioned provision in Texas law.

We appreciate your consideration of our very significant concerns and are obviously happy to discuss further.

Sincerely,

Cornerstone Credit Union League
Credit Union Coalition of Texas
Independent Bankers Association of Texas
Texas Bankers Association
Texas Mortgage Bankers Association