Feasibility Study for Virginia PACE Program Administrator

Executive Summary

Virginia Community Capital (VCC) recommends that the Virginia Energy Efficiency Council (VAEEC) take the lead in advancing PACE in Virginia. As a respected non-profit, the VAEEC would have the clout to influence key stakeholders such as government and quasi-governmental agencies, environmental advocacy organizations, industry organizations, financial institutions, and business/real estate organizations. Support of and advocacy for programs that promote energy efficiency in Virginia, such as the Property Assessed Clean Energy financing system, aligns well with the VAEEC's mission to advance energy efficiency in Virginia.

While a statewide program administrator would be the ideal solution to rapid advancement of PACE in Virginia, there is no known immediate funding to support the creation of statewide program administrator. As we discuss in the body of the report, a statewide PACE program would cost between $500,000 to $1 million to operate in the first two years.

However, funding may be available in 2017 from a US Department of Energy grant to help seed and develop PACE efforts in Virginia. The Virginia Department of Mines, Mineral and Energy in partnership with District of Columbia and the Maryland Clean Energy Center have applied for a grant from the US Department of Energy to:

1) Develop standardized, and low-cost program design and administrative structures throughout the region;
2) Increase market awareness of PACE through coordinated outreach to and education of key stakeholder groups whose participation in PACE will accelerate its adoption and growth in the region.

The grant is not to fund the implementation of a regional PACE program administrator but to create the foundational infrastructure to streamline the creation and operational functions for PACE program administrators. If awarded, the DOE grant will promote region-wide awareness of PACE, address administrative structure, owner eligibility, financial underwriting guidelines, energy audit and measurement & verification requirements, contractor training and support, capital provider support, and marketing messages and strategy. The VAEEC would receive some funding from this DOE/DMME grant to implement some of the work in the grant.

VCC recommends the VAEEC develop a comprehensive local government and energy contractor PACE education and outreach effort and offer local governments interested in PACE technical assistance. As discussed later in the report, there is a great need to educate local governments about PACE. An additional recommended task is to build grass roots efforts to compel localities to create PACE programs. The VAEEC is well positioned to build a grass roots campaign of energy service companies, clean energy advocates and property owners in local jurisdictions.

Arlington County issued a RFP to select and engage a third party PACE program administrator in February 2016. The creation of a PACE program in Arlington with a third party administrator creates another path forward to advance PACE in Virginia. Other localities can replicate the Arlington model, which calls for a third party to run their program and be paid from origination fees. For example, in late March 2016, the Richmond City Council passed a resolution calling for the Chief Administrative Officer to submit a proposal to City Council by January 31, 2017 with recommendations for creating a PACE program. The city is now forming a PACE stakeholder group and will study the Arlington model as part of its work plan to develop recommendations for implementing a PACE program.

In summary, the most impactful next step is for the VAEEC to launch a local government and energy service company education and outreach campaign to compel local governments to start PACE programs and point them to Arlington as a model to replicate. As interest and support grows for PACE among local governments, it may become feasible for the VAEEC to take a larger role in helping form and seek resources for a statewide program administrator.

Background

With the funding received from an anonymous foundation, Virginia Community Capital (VCC) launched an investigation into the feasibility of a statewide program administrator for implementing Property Assessed Clean Energy (PACE) financing programs in Virginia. In order to look at this holistically, the analysis included: 1) analysis of PACE program administration models in selected states in the US and 2) representative interviews with Virginia local government officials and staff to gauge interest level and knowledge of PACE financing.

Interviews with Local Governments

VCC chose Neal Barber of Community Futures, with over 40 years of executive experience in the state, to contact various jurisdictions in Virginia. From July through October 2015, Mr. Barber contacted elected officials and general staff of ten planning district commissions, four towns, ten counties, and twelve cities. These localities ranged from multi-jurisdictional planning districts such as the Northern Virginia Regional Commission (NVRC) and the Hampton Roads Planning District Commission (HRPDC), to small towns such as Tappahannock on the Northern Neck. These localities were also chosen to provide geographic diversity, with Blacksburg in the southwest to Hampton Roads cities in the southeast and Arlington County in the north.

In addition to determining the level of interest in and knowledge of PACE, Mr. Barber also examined the potential barriers to local adoption and administration as well as the characteristics that would make a PACE program easier for locality implementation. In order to assess these criteria, Mr. Barber spoke with elected officials, planning district commission staff, local administrators or deputies, sustainability officials, and economic and community development officials in these selected jurisdictions.

Mr. Barber made two principal conclusions about these localities and their stance on PACE financing. Firstly, the majority of elected officials and general staff are largely unaware of PACE, with knowledge greatest in localities with dedicated sustainability officers and where significant resources and manpower had been dedicated to implementing energy efficiency and renewable energy. For example, Arlington County and the City of Charlottesville were not only aware of PACE but were taking concrete steps towards adoption and implementation. Many elected officials recognized the many potential benefits that PACE could have for their locality if implemented, but were unsure of what the potential utilization rate would be among their constituents.

The second main conclusion is that jurisdictions do not want to be the first adopters of PACE in the state, and prefer instead that other localities lead the way. Officials also largely favor a statewide or regional administrator to cut down on administrative costs and manpower allocation. The interviewees indicated no specific preference that the entity be public or private, or statewide or regional. Most localities also strongly prefer the availability to use preexisting ordinances, program design manual, administrative procedures, and other relevant documents. Many interviewees also pointed to the benefit of a local "champion" in promoting and implementing PACE. Having a local champion to demonstrate the benefits of the program would facilitate outreach to building owners, contractors, and other stakeholders. In summary, among those jurisdictions that were largely unaware of PACE, most were enthusiastic about the possible benefits of the program but wanted adoption to be as streamlined and inexpensive as possible. It is clear from the interviews that the most important next steps for PACE implementation in Virginia would be additional education, introduction of a "plug-and-play" administration, and significant levels of education and outreach**.**

Key findings from select PACE programs in the US

The second prong of Virginia Community Capital's exploration of the opportunity for PACE implementation was to engage a nationally known PACE consultant, Abby Johnson of Abacus Property Solutions, to analyze best practices around the country and develop an initial set of recommendations for Virginia. Ms. Johnson has nearly three years of experience working on PACE projects and programs in numerous states, and has been an integral part of the PACE process in Virginia since late 2013.

Ms. Johnson's analysis of PACE programs in other states resulted in several key conclusions on what makes a PACE program successful. In order for a program to be viable, there needs to be a minimum annual volume in the range of $10-$20 million, which assumes that upfront ongoing administrative fees are the primary source of funding for the PACE administrator. If this kind of volume is not attainable and maintainable, the PACE program will not be self-sustaining. From numerous interviews, Ms. Johnson calculated that the typical cost to develop and implement a PACE program for a full service administrator runs between $500,000 and one million dollars, which included allocating

PACE Program	Budget
Staff- in-house and outsourced	$235,000
Marketing/training/website	$100,000
Travel	$20,000
Rent and utilities	$25,000
Insurance	$20,000
Legal	$60,000
G&A	$10,000
Total	$470,000

Figure 1 Sample Set-up Budget

funds for program management, marketing management, and financial management. Approximately 50% of costs are for program setup in the first 12 months, 25% for implementation in 12-18/24 months, and 25% for ongoing maintenance.

Similar to Mr. Barber's findings, Ms. Johnson identified education as a major factor in successful programs in other states. She advised that providing education and outreach to the various stakeholders would be a significant portion of the budget for any future Virginia program.

Access to financial support both for developing and maintaining a program is key to have the resources to run the program and develop a deep, viable pipeline. To date, the most successful PACE programs largely had internal funding or financing structures, most prominently the Green Bank in Connecticut. Internal financing mechanisms streamline deal flow, removing the need for significant amounts of the administrative work required when using external financing sources. Internal funding serves to educate building owners, localities and contractors on PACE as well as fund underwriting and servicing functions related to PACE transactions.

Connecticut – similarly to California – had external factors that drive demand for energy efficiency and renewable energy projects including high utility rates, robust incentive structures, and/or high-energy usage in the target state or locality. Interest in developing projects leads logically to search for favorable financing options such as PACE.

Another finding that supports development of a central program is related to the transactional costs associated with funding PACE projects in particular smaller projects (under $300-$400k), which to date have represented a large percentage of PACE transactions throughout the country. Thus, the ability to streamline underwriting and assessment terms, and standardize documentation into one "small assessment" program would increase deal flow and approval rates and lower the PACE program loan fees charged on a project.

The ability to develop uniform documentation is critical for three main stakeholders: 1) property owner and/or their representative looking for a consistent, straightforward path to financing a project 2) program administrator wanting to keep costs down to attract property owners and remain profitable and 3) capital providers who need a consistent product to meet the criteria of PACE investors in PACE notes and bonds on the back end. Currently, the majority of PACE investors are building a pool of notes/bonds with the goal of securitization as an exit strategy. Providing uniform underwriting procedures and documentation would attract investors to Virginia, increasing competition among capital providers, and simplifying the application process for the most important stakeholder – the property owner. This function is best completed at the state level with an eye for collaborating with Washington DC and Maryland, given the significant level of investment across state lines.

Recommendations and Next Steps

Ms. Johnson developed a number of reasonable next-steps for PACE implementation in Virginia. As mentioned at the beginning of this report, Ms. Johnson believes that - barring a more detailed involvement by the state government - the Virginia Energy Efficiency Council would be best suited to take the lead in this process.

While some jurisdictions such as Arlington County are taking a proactive role in developing a PACE program, most are waiting for evidence of success from other localities. Taking advantage of trailblazers such as Arlington and using them as educational examples of how to start a PACE program is a logical first step in raising awareness. The findings both from other states and in Virginia indicate that continued outreach and education on the benefits of PACE are essential to generating ground level demand for programs at the local level. As more localities observe the successes of PACE financing in Virginia, they will begin to envision the benefits to their citizens. VAEEC can take a guiding role in providing continued education to all localities in Virginia.

Framing PACE as an economic development tool has been identified as a successful way of marketing the program especially towards geographically “challenged” areas. After early adopters are given time to establish successful PACE programs, efforts will need to be directed at developing these underserved markets. These small and rural localities simply do not have the resources or manpower to undertake most or any of the PACE implementation process. Many localities do not have the resources to put out the request for proposals (RFPs) for administrators or even handle the in-house administration necessary for interacting with an outside third party administrator.

The use of a centralized PACE program administrator would create consistency and simplicity in the four main areas of marketing and outreach, program and project criteria, financing and servicing and enforcement of assessments. This centralized administrator could also use its statewide status to identify additional opportunities from the statute that could drive demand such as developing a program targeting new construction or land-based projects. A centralized administrator would also have the ability to lead from the top through program development and from the bottom through regional and local partnerships.

It is VCC’s belief that the VAEEC, with funding, could take the lead in creating the entity that would either administer the PACE program directly or outsource to a vetted third party – a common practice throughout the country. VAEEC or its designated administrator would partner with both the private sector (contractors, lenders, etc.) and local and regional public and non-profit entities. This entity would then create a program manual that would be vetted for Virginia application and which would require the expertise of third party advisors. The entity would also adapt existing documentation from other programs where applicable with the caveat that Virginia’s documents would have some variation based on state code and procedures. Goals for streamlining implementation and adoption fall under the previously mentioned categories of marketing/outreach, program/project criteria, financing, and servicing. Below is a snapshot into some of the tasks and documents required to design and implement a PACE program in Virginia:

1. **Marketing/outreach plan** - to develop and sustain dealflow that will lead to sustaining program after initial setup period:
   - Develop initial qualified contractor/channel partner list, which entails outreach to contractor community including presentations, calls and meetings. Focus will be on general contractors and specialty groups such as NECA that have proven track record in PACE in other states
   - Develop/Adapt contractor training/vendor materials for one day course on PACE basics, Deal sizing, Selling PACE, etc.
   - Develop marketing agreements/MOI and strategic plan for different kinds of entities such as:
     - Government or quasi-governmental agencies such as EDAs, planning districts, VML VACO, DHCD, YesVirginia, VaSaves, county attorney groups
     - Environmental/efficiency/ AEC organizations: VA League of Conservation Voters, AIA, AEE, RREA, LEAP, Solar Foundation, Local chapters USGBC
     - Industry specific organizations - Virginia Housing Coalition, VHDA, VMA, VA Solar and wind trade associations, etc.
     - Financial management- VA treasurer and commissioner of revenue groups
     - Business friendly/Real estate organizations – VACRE, ULI, NAIOP, AOBA/BOMA, IREM, Chambers of Commerce, Hotel and Motel Association, VA manufacturers, VA Contractor Association
   - Reduce marketing costs by leveraging these local and regional partners through co-sponsored/hosted events, website information exchange, conferences, etc. Examples include using the extension programs of state schools, local real estate events, presentations to these different types of organizations (e.g. AOBA, VACRE, IFMA, ULI, CREW and ULI), write articles in local papers, etc.
   - Create and maintain web and social media presence

2. **Program/Project Criteria development** – Commercial PACE assessment contracts similar to commercial real estate loans vary much more than residential loans. Although it is impossible to standardize completely, development of detailed underwriting criteria and protocols based on tenancy type (owner occupied, multi-tenant), occupancy, market characteristics, borrower payment history, etc. would assist in qualifying more projects, more accurately:
   - <u>Program/project criteria</u>:
     - Basics: program fees, range of interest rates, terms, prepayment policies, project size, etc.
     - Develop underwriting criteria and model that incorporates DMME financial guidelines while leaving room for customization; envisioned as Excel based model initially. Work with Arlington County as they develop their program
     - Analyze feasibility and value to market development of developing interactive, semi-automated, web-based platform that allows front end deal sizing and back end underwriting, document upload, approval capabilities, and tracking of assessment post-lien
     - Determine energy analysis requirements – by type, loan size, etc.
     - Develop detail list of eligible measures and how non energy/water related measures can be included if related to the PACE upgrade (e.g. reinforcement of roof for solar PV panels
     - Develop procedures to process other incentives (which reduces net PACE assessment)
     - Develop a model ordinance which will incorporate best practices from program manual

- Stakeholder qualification:
    - Contractors:
        - Qualifications and eligibility criteria
        - License and insurance requirements
        - Contractor application and participation agreement
    - Building owner:
        - Service agreement between contractor and owner
        - Owner qualification
        - Owner application (initial and full applications to reduce due diligence on every potential project and borrower
        - Owner checklist of required items
    - Capital Providers:
        - Qualification criteria
        - Application
        - Participation agreement

3. **Financing** – Several approaches should be explored in order to determine how a central administrator should be involved in the qualification and identification of capital providers. There is an inherent conundrum in the PACE market currently where the desire for greater competition in an open market model is pitted against the perceived need for on-demand capital (this conundrum is addressed in Arlington's RFP). How VAEEC engages in this process should be explored to maximize deal flow:
    - Work with qualified capital providers to standardize loan documents
    - Develop set of financing related documents such as:
        - Description of total financing costs
        - Financing agreement between locality & property owner
        - Advance request
        - Lender disclosure agreement
        - Lien assignment to PACE capital provider
        - Lender subordination agreement (sources tell us that development of subordination agreement is more complicated than the standard one or two page "lender consent" document typical in other programs)
        - Assessment contract

4. **Servicing** – Develop the process and identify out-sourcing partners to minimize local government involvement in mechanics of calculating, recording, collection, remitting and reporting assessments.
    - Calculate payment schedule, assessment amount, adding line item to tax bill on software (Which vary amongst Commissioners of the Revenue and Treasurers), sending out the bill, notification of delinquencies, notice of default among other tasks are part of servicing the PACE "loan" post funding. These can be outsourced to third parties; however, the central entity should examine how much they want to assist localities in this process which could range from vetting third party providers (similar to vetting capital providers to handling the servicing process at the state level up until when the locality actually bills the owner
    - Itemized total assessment document
    - Loan payment calculation widget

- Identification of procedures used for ten largest localities including those prioritized (discussed in following paragraphs) including entity that bills assessment, entity that calculates assessment, software used, staff procedure for adding line item
- Potential for Measurement and verification of project post-construction that verifies some level of savings or improvement over the baseline established pre PACE assessment

A detailed budget for setup and implementation as well as financial projections should be developed in conjunction with development of the program manual or effectively the Virginia PACE business plan.

The entity should also prioritize partnering with localities that would be able to rapidly adopt and implement PACE programs within the few years, most notably Arlington County which released their RFP for a program administrator in late February 2016. Among other tasks, the Arlington County administrator will be responsible for developing all technical, marketing and legal program documents for the County and develop a marketing strategy that results in a consistent metro DC area PACE program. Given the timeframe for completion of these tasks (3Q 2016), it is imperative that VAEEC have the resources to engage with stakeholders throughout Virginia – starting with neighboring northern Virginia jurisdictions - to ensure consistency of the program and strategy with Arlington's. This would include significant interaction with the metro Washington Council of Governments (MWCOG), Northern Virginia Regional Commission (NRVC) and the individual jurisdictions of Fairfax, Loudoun, and Prince William counties, and the cities/towns of Alexandria, Fairfax, Falls Church and Culpeper.

In addition, VAEEC will need to get the input of prominent Virginia localities – most in the "Crescent" area - that have expressed interest in developing a PACE program. These include: the cities of Richmond, Charlottesville, and Blacksburg, and localities within Hampton Roads such as Chesapeake, Norfolk, and Virginia Beach. In addition, to ensure that the PACE value proposition for rural (agricultural and mountainous) Virginia is captured, VAEEC will need financial resources to develop marketing and outreach strategies tailor made for these areas. Most prominently, the economic development potential of PACE should be extolled through area specific training for local contractors and engineers, identification of obsolescent properties in need of revitalization, and inclusion of innovative energy/water/renewable measures for agricultural adaptation (e.g. waste to energy) into the list of eligible measures.

In order to have a successful program in Virginia that can avoid the false and slow starts of many other states, VAEEC will need significant assistance – strategic, technical and legal - to create a viable Virginia PACE strategy. Similar to Texas, VAEEC will require financial resources to engage and coordinate multiple stakeholder groups and meetings to develop a "PACE in a Box" structure which will develop required documents and protocols to start, run and maintain a PACE program. In addition to receiving some assistance from volunteers in additional stakeholder meetings, VAEEC will need to formally engage consultants who can develop the technical and financial aspects of PACE projects; attorneys to create required legal agreements, notes and contracts; and marketing professionals who will create a marketing roadmap to tackle outreach from state and regional groups while at the same time engaging local officials in the process to create a truly "Virginia made" program. By involving local and regional partners, greater excitement and credibility of the value to all PACE stakeholders (owner, contractor, lender, government) would be created. Finally, VAEEC and its consultants should identify additional funding sources that will target job creation and training grants that will further ensure that PACE in Virginia has a sustainable and profitable future.