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January 16, 2020

The Honorable Ikaika Anderson
Chair and Presiding Officer
and Members
Honolulu City Council
530 South King Street, Room 202
Honolulu, Hawai'i 96813

Dear Chair Anderson and Councilmembers:

SUBJECT: Response to City Council Resolution 19-133, FD1

This report serves as the Office of Climate Change, Sustainability and Resiliency's (CCSR) response to City Council Resolution 19-133, FD1 requesting CCSR to assess the feasibility of establishing a commercial property assessed clean energy (C-PACE) program in the City and County of Honolulu (the City). As recommended in the resolution, CCSR worked with internal and external partners (including several through the City's participation in the American Cities Climate Challenge) to complete this assessment. The C-PACE Alliance (CPA), including CPA members Bricker & Eckler Attorneys at Law and CleanFund Commercial PACE Capital, Inc., provided in-kind analysis and recommendations. CCSR also consulted stakeholders such as the O'ahu Resilience Strategy Climate Mitigation Working Group, Hawai'i Green Infrastructure Authority, and other nationwide PACE industry leaders to formulate the following analysis.

In summary, C-PACE is an innovative financing option usually deployed for commercial property owners which could be implemented on O'ahu following additional due diligence, passage of local legislation, and City investment in program set-up, staffing and other costs. In addition to the CCSR summary below, the attached brief authored by the C-PACE Alliance provides additional legal, market, operational, and financial considerations for potential application of C-PACE in Honolulu.

Nationwide, more than $1 billion in C-PACE financing has been approved for over 2,000 commercial and multi-family projects, helping to spur much needed advances in energy efficiency, emissions reduction, and economic development. According to PACE Nation, a national nonprofit advocating for PACE, approximately half of C-PACE funds to date have been invested in energy efficiency (49%), a quarter

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in renewable energy projects (23%), and the remaining in either a mix of the two or a growing proportion in resilience upgrades (7%) for storm, earthquake or fire preparedness.[1] The most common application of C-PACE nationwide has been among existing hospitality, office and retail buildings, with 14% helping to finance new construction projects.

According to the United States Department of Energy (DOE), some of the unique financing advantages of C-PACE include: long (10-20 year) financing terms that can cover 100% of hard and soft project costs and produce cash flow-positive projects; transfer of the assessment (and benefits) to new owners if the property is sold; and, sharing of costs and benefits between tenants and landlords under most lease structures. In contrast, disadvantages include: for properties with an existing mortgage, mortgage lender consent is required (and can be difficult or time-consuming to obtain); and, financing must be structured for *specific* properties, making it challenging for building owners to use on portfolio-wide efforts.[2]

Given the relatively widespread recognition of the positive potential of C-PACE as well as its rapid growth nationwide since 2015, many written resources are available to support industry and municipal propagation of C-PACE programs. Additional contextual background about C-PACE purpose, benefits and industry best practices can be found at the DOE, PACE Nation[3] or C-PACE Alliance[4] among other sources.

Broadly speaking regarding application in Honolulu, a well-designed C-PACE program could help advance City goals to reduce energy use and associated greenhouse gas emissions, improve affordability for island residents, build resilience to the impacts of climate change, and foster economic development. Financing tools such as C-PACE (as well as other potential incentives for businesses and property owners) could complement fundamental energy- and cost-saving public policies outlined in the Oʻahu Resilience Strategy such as immediately adopting updated energy codes and a benchmarking ordinance to foster energy disclosure and cost transparency.

As detailed in the attachment, Hawaiʻi Revised Statutes Section 46-80.1 is generally agreed to provide "enabling" state legislation that allows C-PACE to be deployed in the City and County of Honolulu. However, this language provides limited

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1 PACE Nation. (2019). PACE Market Data. Retrieved December 20, 2019, from https://pacenation.org/pace-market-data//
2 U.S. DOE. (2019). Better Buildings Financing Navigator. Retrieved December 20, 2019, from https://betterbuildingsinitiative.energy.gov/financing-navigator/option/cpace
3 PACE Nation. (2019). What is PACE Financing? Retrieved December 20, 2019, from - https://pacenation.org/what-is-pace/
4 C-PACE Alliance. (2019). CPA Publications. Retrieved August 30, 2019, from https://www.c-pacealliance.com/what-we-do/publications/

authority to utilize bond financing only (as opposed to direct financing which is increasingly the trend nationally).[5] More specific state PACE legislation was introduced in 2016 (HB1524) but deferred.

At the local governmental level, CPA identifies Chapter 34 of the Revised Ordinances of Honolulu authorizing Community Facilities Districts as the best potential vehicle to move C-PACE forward in Honolulu. However, Chapter 34 would need to be amended in consultation with the Department of Budget and Fiscal Services, other City departments, as well as other stakeholders in order to best fit O‘ahu's needs and align with unique local market requirements.

There are notable set up costs and considerations for the City prior to moving forward with a C-PACE program. Per CPA, C-PACE programs can take upwards of 30 months after launch to become financially sustainable. C-PACE programs require sufficient project volume and associated fee revenues to cover costs. Most C-PACE programs receive government appropriation or philanthropic funding for start-up costs in the intervening months and prior to launch. The lowest cost assumption is that at minimum a 0.5-1.0 FTE would need to be dedicated for several months to develop a viable program, as well as funds to hire a Program Administrator to complete further stakeholder input into program design, draft program guidelines, and bridge other internal operational gaps. Following set up, the Program Administrator would likely need to serve as the "front office" of the C-PACE program as described in the attached CPA brief.

Local leaders in the energy efficiency space and national C-PACE subject matter experts both recommend significant stakeholder input (substantially beyond that completed to date), to ensure any potential program is designed to maximize public benefit and close identified gaps in current financing tools. A broader stakeholder process would also be required to build local fluency with the program given it would be the first in Hawai‘i. While a City-based program alone faces significant operational and scale challenges, a stakeholder process could help explore potential collaborations with other agencies such as with the Hawai‘i Green Infrastructure Authority (HGIA) to maximize program efficiency and stress test how widely this financing product would be demanded by the market. The City should ensure that this is indeed a tool that developers and building owners will use, if made available, and also to learn from hard-earned lessons from the launch of similar programs such as the State's Green Energy Market Securitization (GEMS) program run by HGIA.

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5 See Leventis, G., Schwartz, L., Kramer, C. & Deason, J. (2018). *Lessons in Commercial PACE Leadership: The Path from Legislation to Launch.* Retrieved from: https://www.energy.gov/sites/prod/files/2018/05/f51/Lessons_in_Commercial_PACE_Leadership_Finalv2.pdf

In addition to stakeholder input, additional research into program design should be undertaken on O'ahu to help ensure maximum public benefits given our unique resilience and affordability challenges. A small but growing proportion of C-PACE financing nationally has been used towards resilience (e.g. seismic, hurricane, fire preparedness), types of projects that would serve key needs for our island community. While the public benefits of these kinds of projects are high their financial models are more challenging, however. Additionally, as of early 2018, only 15 of the 1000 nationwide C-PACE projects were in multi-family housing properties, so it is important to identify early on how a C-PACE program could be best designed so that buildings that house small businesses or low-income tenants can truly benefit from this type of publically-supported program.

Finally, CCSR also notes that a great deal of private financing is often available in the commercial property space. However, a *residential* PACE program could offer great promise to help individual homeowners with energy and water efficiency, storm-hardening and renewable energy upgrades. While distinct from commercial PACE programs in project scale, design, benefits and financial challenges, the City should continue to monitor developments in the residential PACE sector, including implications of an anticipated ruling by the Consumer Financial Protection Bureau, in case there comes an appropriate time to deploy residential PACE in Honolulu.

Thank you in advance for your review and consideration of this letter and the accompanying attachment. Should you have any questions, please contact me at (808) 768-2277.

Sincerely,

Joshua Stanbro
Executive Director and
Chief Resilience Officer

Attachment

APPROVED:

Roy K. Amemiya, Jr.
Managing Director

C-PACE ALLIANCE

Capital Providers

CleanFund

Counterpointe SRE

Inland Green Capital

PACE Loan Group

Petros PACE Finance

Twain Financial Partners

Law Firms

Bricker & Eckler

Chapman and Cutler

Hirschler

Norton Rose Fulbright

Stinson

Winston & Strawn

Accounting Firms

Novogradac & Company

FinTech Partner

T REX

Citadel SPV

BACKGROUND RESEARCH IN SUPPORT OF C-PACE FEASIBILITY STUDY FOR HONOLULU, HAWAII

Authors:

Caleb Bell and Christopher Jones, Bricker & Eckler
Cliff Kellogg, C-PACE Alliance
Michael Yaki, CleanFund Commercial PACE Capital

JANUARY 2, 2020

1. Introduction

In July 2019, the City Council of Honolulu, Hawaii enacted Resolution 19-133, requesting a feasibility study on the possibility of a Commercial Property Assessed Clean Energy (C-PACE) program. In August 2019, the Honolulu Office of Climate Change, Sustainability and Resiliency invited input from the C-PACE Alliance on the subject. This paper is structured as follows:

The mission of the C-PACE Alliance (CPA) is to promote and advance the public benefits of C-PACE by increasing the volume and of quality C-PACE financings. CPA's members consist of leading C-PACE capital providers and transaction experts. CPA members have invested in or professionally advised on the majority of C-PACE transaction volume nationally. CPA publishes white papers and provides technical assistance to policymakers from a practitioners' viewpoint. For more information, the CPA website is www.c-pacealliance.com.

The co-authors of this paper are: Caleb Bell and Christopher Jones (Bricker & Eckler); Cliff Kellogg (C-PACE Alliance); and Michael Yaki (CleanFund Commercial PACE Capital).

2. Overview of the Design and Implementation of C-PACE

C-PACE financing provides property owners with an alternative source of capital to pay for property improvements that improve energy efficiency, generate renewable energy, or achieve other vital public benefits. C-PACE financing can be used for improvements such as lighting, roofing, HVAC systems and automated controls, boilers and chillers, insulation, glazed windows, hot water heating systems, building envelope improvements, renewable energy systems, and much more. Some states have authorized the use of C-PACE financing for seismic retrofits, storm resiliency measures (e.g., wind and flood), fire hardening, storm water management, and water-efficiency projects. C-PACE financing is generally available to any commercial property, such as office buildings, retail, warehousing, manufacturing and multifamily properties. Generally speaking, any entity that owns a commercial property is eligible for C-PACE financing, including nonprofits for facilities such as schools, clinics, or social services.

According to PACENation (www.pacenation.us), 30 states and the District of Columbia have enacted legislation authorizing C-PACE, and of those, 21 states and the District of Columbia have active programs. Cumulatively, these programs have facilitated more than 2,000 projects exceeding $1.1 billion in C-PACE financing.

C-PACE financing offers a variety of advantages over other forms of capital because it is repaid through a voluntary special tax assessment. C-PACE transactions are typically funded entirely by private capital providers. Assessments are collected in the same manner as real property taxes. A C-PACE assessment runs with the title to the property and is designed to convey to the next owner upon a sale of the property. Under this arrangement, C-PACE capital providers can offer up to 100 percent, non-recourse financing with a repayment term equal to the weighted average useful life of the improvements (or longer in some states). Interest rates are usually fixed throughout the term of the assessment. Under the terms of many "triple net" commercial leases, a property owner may pass-through a *pro rata* share of C-PACE payment obligations to tenants.

A. Steps to Launch C-PACE

The authority to launch a C-PACE program requires state legislation. In some states, the authorizing statutory language describes a broad range of real estate financing that can be done by local governments and public sector organizations. In those states, the broad range of authorized financing includes C-PACE financing.[1] In other states, the statute is written narrowly to authorize C-PACE only.[2] (This paper discusses the relevant Hawaii statute in Section 3, *infra.*)

States implement the program in a couple of different ways. The legislation may permit municipal governments to create a local C-PACE program within certain statutory parameters. Other states name a specific entity to develop a statewide program that local governments may join.[3]

Under the first approach, local governments are usually responsible for two implementation tasks:

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[1] For example, California, Ohio, Maryland.

[2] For example, Pennsylvania, Illinois.

[3] Colorado, Connecticut, Rhode Island, and Delaware.

1. Enacting a local C-PACE ordinance or resolution. In developing such an ordinance, CPA recommends consulting with a stakeholder group that includes commercial property owners, attorneys with public finance expertise, and capital providers.

2. Assigning responsibility to supervise and manage the C-PACE program. Local governments typically assign an employee as Program Manager to oversee the program. For day-to-day operations, the local government designates a Program Administrator (PA). The structure for program administration falls into three categories: the local government itself, a third-party administrator, or capital providers may serve as PAs.

In some states, PAs were organized in order to fulfill the PA role. Other states' PAs pre-existed the C-PACE legislation and assumed the PA duties on top of their other activities. For example, in Ohio and in Minnesota, port authorities that administer other loan programs serve as the PAs. In Wisconsin, Pennsylvania, and Delaware, nonprofit organizations with expertise in energy policy and energy efficiency are PAs. In California and Florida, existing public agencies that have assessment authority and bonding capacity delegate the PA duties to capital providers.

A capable PA has the focus, resources, and staff with compliance expertise. Expertise in energy-related programs is helpful. As discussed in Section 3.B.iv, *infra*, launching a new organization as a PA requires financial support until transaction volume generates fee income to offset operating costs. A start-up PA could reasonably expect to need financial support several years. On the other hand, if the PA function is taken on board by an existing organization, cost efficiencies should reduce the level of financial break even.

B. Functions of the Program Administrator

The PA runs the C-PACE program according to the standards set by the state and local government. The Program Administrator's client is the local government that created the C-PACE program.

A stakeholder group of capital providers, contractors, and property owners can provide valuable input to the PA. Experience suggests that PAs that design and operate the program with strong stakeholder engagement will make the program more efficient and increase usage.

The critical duties of the PA are:

- to organize the process of developing program rules and the template legal documents,
- to review and approve projects applications, and
- to promote the program through advertising, education and training.

Some PAs offer extra services. For example, some PAs make visits to property owners to cultivate deal flow; review the design of the energy efficiency project; propose a structure for the financial transaction; and request and review term sheets from capital providers. These extra services can help "prime the pump" when the program first launches, but in the short-term, these services require staff time and increase operating costs. Higher program fees discourage property owners from using C-PACE. Therefore, the cost of offering these extra services should be balanced against the value to property owners. Once the C-PACE program is well-established, responsibility for promoting the program can transition to capital providers, contractors and engineers.

The PA should prepare internal organizational documents and the external-facing project documents::

- Governance systems (bylaws, IRS filings).
- Organizational chart and job descriptions.
- Financial projections for the PA, including assumptions for volume and size of projects.
- Three-year rolling workplan by quarter.
- Program guidelines and technical standards.
- Checklist for property owner to submit a complete application.
- Process flowchart for the PA's internal review and approval of a project.
- Assessment contract signed by the local government, the PA and the property owner.
- Website with program information and, if desired, online application submission.
- Financial recordkeeping systems.
- File safekeeping systems.

3. Questions & Answers

A. LEGAL - Determine potential legal barriers to implementation and recommending solutions to overcome these barriers

i. Understanding legal authority created through Hawaii's enabling legislation; limits and any areas that need additional clarification:

Hawaii Revised Statutes Section 46-80.1 provides that counties such as Honolulu may place assessments on properties for specific improvements. The authority for C-PACE, in particular, lies in the implementation of this authority at the local level, i.e., Honolulu Ord. Chapter 34, authorizing Community Facilities Districts. The existing ordinance could be amended to fit the technical requirements of C-PACE. The key items that need to be amended are discussed below and shown in Appendix.

a) Does the law clearly define assessments, their position and how they are enforced if not paid?

Yes, the law clearly defines assessments and their lien position. Under Honolulu Ord. Section 34-3.8, a lien for special tax assessments is on parity with general property taxes and other assessments. However, the ordinance is ambiguous about whether the lien for special tax assessments may accelerate or be extinguished. For the capital markets and C-PACE capital providers, the lien must not accelerate nor be extinguished in foreclosure. This ambiguity can be addressed through an amending ordinance. In addition, the fact that C-PACE financing benefits single properties rather than multiple properties will have to be clearly described in an amendment to the Honolulu ordinance. (See Appendix.)

b) Does the law specify or provide guidance on what entity is responsible for setting up the program?

Honolulu Ord. Chapter 34 indicates that special tax assessments are administered by the City and County of Honolulu. A C-PACE program would be administered by the local government responsible for approving individual C-PACE projects. The identification of departmental authority and individual officer authority to approve C-PACE projects can be addressed in an amending ordinance. (See Appendix.)

c) What guidance does the law provide on how the program should or can be structured? (i.e. state level, multi-jurisdictional, multiple local governments coming together)

HRS Section 46-80.1 permits Hawaii county governments to adopt laws to implement special assessment programs. Honolulu Ord. Chapter 34 requires administration of special tax assessments by the City and County of Honolulu. Specifically, the Director of Budget and Fiscal Services is required to collect special tax assessments. Further definition of the program design can be implemented in an amending ordinance. (See Appendix.)

d) How can funding be raised (e.g. bonding or direct capital providers, multiple providers?)

HRS Section 46-80.1 allows counties to issue revenue bonds to fund special assessment projects. The mechanism of funding C-PACE projects is used by other states. Revenue bond issues may be placed among many different capital providers, enabling an "open market" for C-PACE financing. In other states where bonding is required for C-PACE financing, each capital provider is free to establish a trust indenture and work collaboratively with local government to establish a straightforward bond placement procedure. Private capital providers fund projects on a case-by-case basis according to their own individual underwriting standards in exchange for the issuance of a revenue bond.

Under Hawaii Constitution, Article 7, Sections 12 and 13, revenue bond issues of county government that fund special assessment projects are exempt from the restrictions of Hawaii's general bond laws because they qualify as bonds secured by "receipts derived from payments by a person or persons under contract or from any security for such contract or contracts" and not from the "general credit of the issuer." The community facilities statute, HRS Section 46-80.1, implements the constitutional authorization and indicates that special assessment-secured revenue bonds are exempt from otherwise applicable county debt limitations because "the only security for such bonds is the properties benefited or improved or the assessments thereon."

Local law modifications such as an amending ordinance could streamline the authorization, documentation, and procedures for issuance of revenue bonds or provide for alternative funding mechanisms (i.e., such as assignment of special tax assessment revenue by contract). The amending ordinance may allow for the use of bonds, notes or other obligations for the purpose of financing qualifying improvements. (See Appendix.)

e) What measures are eligible for C-PACE financing (energy and water efficiency, renewable energy, resilience, seismic, storm mitigation?)?

Generally, C-PACE financing is available for a wide range of energy-related improvements, including any expenses that improve energy efficiency and energy demand management, as well as for the installation of renewable energy systems. In addition, most states allow C-PACE financing to pay the costs of water conservation measures. A newer trend is to authorize C-PACE financing for property improvements that improve or encourage building resiliency, such as storm/wind, flood, or seismic measures – depending on the jurisdiction -- all of which are intended to stabilize or increase property values.

Importantly, Honolulu Ord. 34-1.5 states that "a district may be established to finance the acquisition, planning, design, construction, installation, improvement, or rehabilitation of any real property or structure." There are no limitations on using assessments to fund privately-owned improvements under existing laws; in other words, special tax benefits may fund privately-owned improvements, including improvements on properties owned by nonprofit organizations. Nevertheless, Honolulu Ord. Section 34-1.5 should be amended to describe specifically the energy- and property-related improvements that are consistent with Honolulu public policy goals and eligible for special tax assessment financing under the CPACE program.

f) What criteria must be met to qualify for funding? (i.e. must savings be greater than cost? Is audit required? Other requirements for program administrators to follow?)

Four states and a few counties in two other states require documentation that "savings" – a term defined differently in each jurisdiction -- will exceed the project cost.[4] This calculation is called a "savings-to-investment ratio" or "SIR." New York State uses the terminology of a "cost-benefit ratio" or "CBR" for a similar concept. SIR and CBR are becoming less common because they unnecessarily limit which projects qualify for C-PACE financing and for how much. No C-PACE program has adopted an SIR or CBR requirement since 2016. CPA recommends not use SIRs or CBRs for several reasons:

- <u>The definition of "savings" does not does not capture all of the benefits from C-PACE financing.</u> Benefits to property owners include a lower cost of capital, increased tenant retention, and the increased value of the property. Benefits to the public include resiliency, productivity improvements, increased building code compliance, healthier work environments, and the societal value of pollution control. SIRs or CBRs essentially require a property owner to pay a higher price for utilizing C-PACE, reducing demand and impeding C-PACE's full potential.

- <u>SIR is not the only indication of a public benefit</u>. Many advocates assert that any property improvement that reduces energy or water usage (or is a renewable source of energy) creates a public benefit. From this perspective, no SIR test is necessary to prove a public benefit exists. Other states emphasize economic development as one of the public benefits of C-PACE programs, and this factor is not measured in SIR or CBR.

- <u>Raising capital for public purposes is a legislative and political decision, not reduceable to a mathematical calculation of SIR or CBR</u>. C-PACE financing is similar to traditional property assessments that pay for sidewalks, sewers, etc. that do not impose an SIR or CBR test.

- <u>Some C-PACE programs finance projects that promote resiliency, storm-hardening, and seismic retrofits, where SIR is not applicable</u>.

- <u>Alternative policies may be more effective in promoting energy savings.</u> In the four states and counties with SIR and CBR, they are a precondition to qualifying for C-PACE. Section 3.C.i, *infra*, discusses the ramifications of setting a mandatory level of savings, which is a similar type of precondition, as well as alternative policies that may be considered.

If political realities require an SIR or CBR analysis, the CPA recommends using a comprehensive definition of the savings generated from the project, including:

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[4] Connecticut, Michigan, New York State, Wisconsin, and certain counties in Texas and Maryland.

- Utility savings.
- Operations & maintenance savings ("net avoided spending" attributable to the property improvements).
- Financial savings where the C-PACE funds displace higher cost capital.
- Avoided fees or penalties from non-compliance with building codes.
- New revenues from renewable energy sources.
- Other monetized benefits such as tax credits, utility incentives and rebates.
- Savings on societal costs imposed by greenhouse gas emissions and particulates. An example can be found in NY State program.[5]

The capital provider is in a good position to calculate the SIR or a CBR, drawing on the program guidelines. The PA should review the completeness of the calculation by the third-party expert, but the PA should not duplicate or second-guess the expert's subject-matter knowledge.

ii. Aside from the statute quoted below,[6] could any other HI statutes provide the basis for a C-PACE program?

Existing authority contained within Hawaii Constitution, Article 7; HRS Section 46-80. 1; and Honolulu Ordinance Chapter 34 (Community Facilities Districts) is sufficient to provide the basis for a C-PACE program in Honolulu. An amending ordinance of the City and County of Honolulu should be approved that implements several specific elements of CPACE programs in line with public policy and market principles. (See Appendix.)

B. OPERATIONAL-Assessing the feasibility of collecting C-PACE assessments via property tax bills.

i. How familiar is the city with property-secured financing? Does the city have the people and tools to accomplish the necessary tasks of designing and launching a program?

The Honolulu Treasury Department is responsible for collecting and enforcing property taxes. Operational capacity, constraints and opportunities should be explored at the local level. Historically, the use of property assessments in Honolulu has been limited. According to the Honolulu Treasury

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[5] file:///C:/Users/kelloggcliff2/Downloads/Guidance-Calculating-Cost-Benefit-Ratio%20(8).pdf

[6] Haw. Rev. Stat. § 46-80 "Any county having a charter may enact an ordinance, and may amend the same from time to time, providing for the making and financing of improvement districts in the county, and such improvements may be made and financed under such ordinance. The county may issue and sell bonds to provide funds for such improvements. Bonds issued to provide funds for such improvements may be either bonds when the only security therefor is the properties benefited or improved or the assessments thereon or bonds payable from taxes or secured by the taxing power of the county. If the bonds are secured only by the properties benefited or improved or the assessments thereon, the bonds shall be issued according and subject to the provisions of the ordinance. If the bonds are payable from taxes or secured by the taxing power, the bonds shall be issued according and subject to chapter 47. Except as is otherwise provided in section 46-80.1, in assessing land for improvements a county shall assess the land within an improvement district according to the special benefits conferred upon the land by the special improvement; these methods include assessment on a frontage basis or according to the area of land within an improvement district, or any other assessment method which assesses the land according to the special benefit conferred, or any combination thereof."

Department, the property tax assessments have been used only in the Waikiki Business Improvement District. It appears that Honolulu has not issued bonds under this authority.

The program guidelines should identify the representative of the local government and the taxing authority required to bill and collect the C-PACE assessments. Alternatively, some programs allow the capital provider to bill and collect from the property owner directly. CPA recommends a short timeframe for remitting funds to capital providers, less than 10 days from the statutory tax payment due date. Long remittance periods increase the interest cost to property owners.

In general, PAs do not themselves have staff capacity for billing, collection and remittance. When those duties are assigned to a PA, the PA typically hires an institutional payment agent, increasing the cost and the number of steps involved in processing C-PACE payments.

To augment Honolulu's capacity to launch a C-PACE program, officials might consider arranging the following resources:

- Consultant pre-launch to produce all program documents and layout internal processes,
- Employee(s) to fulfill the daily operational needs of the program; whether this is a part-time or full-time employee depends on funding and scope of duties the program decides to fulfill.
- Consultant on retainer post-launch to advise on daily/weekly/monthly matters that arise.

ii. Working with other local/state governments: Benefits/costs associated with single-county approach versus a coordinated program with other HI counties and/or state program? How will Honolulu anticipate working with the State to administer this C-PACE program?

Some C-PACE statutes empower an organization to develop a standardized program statewide. Other states rely on local governments or regional NGOs to develop the program. Where to place the emphasis—on statewide leadership or on local programming—depends on whether there is support and infrastructure to put a statewide model in place or a preference for locally-driven programs led by counties or municipalities. While both options appear viable in Honolulu, a local program could be implemented more quickly than one that requires a statewide sponsor.

Given the population and commercial infrastructure on Oahu, a C-PACE program could begin in Honolulu, and then expand to other counties once the program is well-established.

Whichever approach policymakers take (statewide or local), CPA recommends encouraging standardization of rules and document templates. Standardization fosters efficiencies, reduces transaction costs and speeds up local governments' adoption of the program. However, successful C-PACE programs are mindful that a single entity with absolute authority may add unnecessary regulation and bureaucracy. An exclusive statewide PA does not *guarantee* the benefits of standardization or avoid the excesses of absolute authority.

Programs with statewide reach or with a local scope can succeed. CPA encourages policymakers to supervise their programs to prevent unnecessary bureaucracy, whether they choose a statewide model or a local government model.

iii. What HI entities (governmental or private) have the skills, knowledge and willingness to administer a C-PACE program (Hawaii Green Infrastructure Authority)?

The Green Energy Market Securitization Program (GEMS) program in Hawaii is one such statewide entity that could potentially serve a Program Sponsor or Program Administrator. GEMS is a green financing initiative designed by the Hawaii State Energy Office to make clean energy improvements more affordable and accessible for Hawaii consumers. The program provides low-cost capital to finance solar photovoltaic systems and other clean energy improvements for those who have difficulty obtaining financing for these projects. Homeowners and renters, as well as nonprofits and small businesses may qualify for project financing through GEMS.[7] The GEMS program operates clean energy financing programs in Hawaii. Even if GEMS is not directly involved in a Honolulu C-PACE program, it should be evaluated as a case study in delivering energy financing products in the state.

iv. How would start-up costs of a C-PACE program be covered?

Many C-PACE programs receive a government appropriation or secure philanthropic funding to defray start-up costs. Some programs benefit from in-kind donations of staff and office space and supplies. Colorado provided start-up funding to its statewide program. Connecticut established its C-PACE program within the state Green Bank.

The lead time on building a pipeline of transactions takes time, often several years. New programs may take 9-12 months to approve their first C-PACE project. The main challenge is funding until program volume grows.

PAs should aim to charge the lowest possible fees to encourage property owners to use C-PACE and to allow smaller projects to be successful. Property owners are sensitive to high fees, and they will compare C-PACE to other types of financing. At the same time, revenue and start-up funds must be sufficient to support long-term PA financial sustainability.

At a minimum, the PA function requires an external-facing person and an internal, project-focused operations person. If a PA is embedded in a larger organization, it benefits from shared office resources.

Revenue for the PA may come from various sources:

- up-front financial assistance (which may be structured as a grant or a contract) to cover expenses.
- one-time fees per deal or market entry fees per capital provider.
- servicing fees paid annually over the life of the C-PACE financing.
- ancillary fees to cover the cost of training stakeholders, etc. (The actual cost of these services should be borne by participants, but not as a profit center for the PA.)

C. PROGRAMMATIC - What measures should be eligible for C-PACE financing (energy and water efficiency, renewable energy, resilience, seismic, storm mitigation?)?

[7] http://gems.hawaii.gov/learn-more/

CPA recommends that policymakers consider authorizing all the listed measures unless the stakeholder group disagrees.

i. Should energy audits be required?

Yes, CPA recommends that property owners be required to obtain a documented calculation of projected energy savings from a qualified professional engineering firm. The program guidelines may set minimum qualifications for such engineering firms.

If energy audit services are offered by local firms, a competitive market will control costs. The PA can keep a list of pre-approved engineering firms to perform energy savings estimates. If the program allows a property owner to select an engineering firm that is not approved, then the PA should retain technical expertise to review the engineer's work.

ii. Should some level of savings be required?

Precisely how to use C-PACE financing to spur the greatest public benefits is ultimately a policy question. CPA believes strongly that C-PACE should create public benefits, however, CPA believes that requiring some level of savings to get access to C-PACE limits the program's potential usefulness.

- Cost and volume of C-PACE projects: Setting a level of energy savings usually drives up construction costs and increases documentation requirements. Higher costs and paperwork dampen owners' interest in using C-PACE, resulting in fewer transactions.

- Influence on owner's building design: By the time a property owner is looking for financing, she or he has a capital expense budget and a building design in mind. CPA's experience is that C-PACE financing rarely, if ever, incentivizes a property owner to redesign a project to hit a particular level of energy savings.

- Program impact: Setting a level of savings as a precondition for C-PACE financing inevitably means that fewer projects will qualify. The program's impact, in total, would likely be greater by persuading more property owners to make small improvements, even though some buildings' energy efficiency will be closer to conventional performance.

- Effect on program sustainability: Fewer C-PACE transactions equals less revenue to support the PA, making it more difficult to sustain the program.

- Alternative: upgrading local building codes: Regardless of C-PACE program rules, new construction and major renovation projects must always comply with local building codes, which already include energy efficiency standards. Every three years, states decide whether to adopt-- in whole or in part-- the latest model code from the IECC (International Energy Conservation Code). Based on web research, it appears that Hawaii adopted the 2015 IECC code with amendments.[8] Several other states have already adopted the 2018 IECC code. The IECC

[8] https://energy.hawaii.gov/hawaii-energy-building-code/2015-iecc-update

finalized its 2021 model code a few weeks ago.[9] As an alternative to setting savings requirements that limit access to C-PACE, policymakers might consider strategies to upgrade the building code and use C-PACE to help property owners meet these standards.

- Alternative: require improved energy efficiency in existing commercial buildings. In 2019, New York City and Washington, D.C. set building performance standards for commercial buildings to reduce their greenhouse gas emissions by half in the coming decade and by 80 percent by 2050.[10] This policy affects existing buildings, where building codes come into play only for new construction or major renovation projects. Here, too, policymakers might position C-PACE as a tool to help property owners meet these standards.

CPA encourages Honolulu policymakers to take these ideas under consideration as they determine which policies will achieve their desired outcomes.

D. FINANCIAL / MARKET - Assessing the feasibility of various C-PACE financing models and mechanisms

i. Scenario analysis of variable program size, interest rate, and administrative fees

To test different financial scenarios, these variables are the most significant:

Program revenue

The major sources of revenue are:

- origination fees levied at closing. Currently, typical fees range from 1.0 to 1.5 percent of the C-PACE financing amount, with a per-transaction cap of $35,000 to $75,000; and
- annual servicing fees to cover the actual costs of billing, collecting and remitting the C-PACE installment payments to the capital provider. In the current market, these fees range from zero to 25 basis points.

For purposes of estimating volume and size of C-PACE financing, it is useful to know that individual C-PACE financing typically range from approximately $300,000 to several million dollars.

Estimating the volume of transactions is difficult, but a moderate estimate would be one transaction in year 1, increasing to 5-7 transactions per year by year 3.

Fixed costs

The lowest-cost assumption is that PA staff would be an employee in an existing organization. The employee would dedicate 20+ hours per week to C-PACE program development, e.g., marketing/outreach to developers, contractors, application review/approval, etc.

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[9] In December 2019, the IECC approved the IECC 2021 model code. The article in the weblink says the new code promises to be more energy efficient than any previous version. The decision whether to adopt the IECC 2021 model code is in the hands of states and local governments. https://www.nrdc.org/experts/lauren-urbanek/better-energy-code-holiday-gift-planet.

[10] https://www.greenbiz.com/article/what-you-need-know-about-bold-new-building-laws-new-york-and-dc

Staff costs depend on local labor rates. Estimate 20 hours per week (minimum) until revenue increases to allow for additional staff time being dedicated to the program.

Office and overhead expenses will vary, so these estimates are approximations only.

- Office: in-kind donation or nominal expense (if utilizing an existing employee).
- Website development and maintenance: $3,000.
- Marketing collateral development and printing: $2,000.
- Retainer for PACE Consultants (i.e., legal, programmatic, etc.): $2,000 - $5,000/month.
- Misc. (mileage, copies, etc.): $1,000 - 3,000.
- Contractor training events: $1,000 - 3,000 (dependent on fees charged, space cost, trainer fees).

ii. Market analysis: Identifying commercial entities that may be interested in participating in a C PACE program. Is the program feasible in terms of anticipated participation?

CPA is not aware of a reliable methodology for estimating the C-PACE demand among property owners. Based on experience in other markets, contractors and capital providers will be available and responsive when property owners show interest.

iii. How will the projects be funded? Direct funding (market trend towards this) versus bonding approach? Closed (single) or open (multiple) market model for capital providers?

Private capital providers will fund projects on a case-by-case basis using their own individual underwriting standards, including due diligence requirements, borrower covenants, financing agreements, guarantees, and other protections.

In states bonds are used, each capital provider can establish a trust indenture with its own bond trustee and can work with local government to establish a bond placement procedure that concludes with the issuance of the revenue bond upon project funding.

iv. Program Risks: participation rate/annual financing volume:

PAs have needed a few years to build a pipeline of transactions to offset the program's operating costs. The volume of transactions depends on factors such as how complicated property owners perceive the program to be; how high the program fees are; the extent of marketing to property owners; and whether there are early success stories to serve as testimonials.

v. Community Impact Risk: high rate of tax delinquency = gov't obligations to initiate foreclosure proceedings to meet bond payment obligations.

Historically, property owners have made paid their assessments on-time. However, C-PACE repayment rates have not been tested under the stress of an economic downturn. Nonetheless, it seems likely that were a property owner to miss an installment payment, the senior mortgage holder would advance the amount of the unpaid assessment and add it to the outstanding loan amount in order to control the foreclosure process.

In the event that the local government does need to undertake a tax foreclosure, it may recover its expenses from the proceeds of the foreclosure sale.

vi. **Labor/contractor market impacts as property owners hold projects to wait on program.**

There should be only a brief time period, if any, between the public announcement of a C-PACE program and when the program begins to accept applications. Contractors should not promise a property owner that C-PACE is available until a formal announcement is made.

4. Open Policy Issues

A few important policy issues remain open for discussion:

1. Which department in Honolulu City or County government will be Program Manager?
2. Which entities are likely to be interested and capable to be a PA candidate?
3. Should the Honolulu Council be asked to approve C-PACE assessments on each individual property, or would the Council delegate its authority to a third party within certain pre-negotiated parameters?
4. Would the program allow projects with traditional (non-C-PACE) funding to refinance with C-PACE financing?
5. What is the appropriate way to clarify that C-PACE projects are not "public works" covered by Hawaii prevailing wage law?

These issues can be handled by amending the Honolulu ordinance or by addressing the issue in the program guidelines.

5. Honolulu Market Data

Estimating the Honolulu C-PACE market size remains a challenge because even the most established programs are just ten years old. As the industry gained experience over the last decade, program rules and best practices evolved (will continue to evolve), making it difficult to use prior performance as the basis for estimating how new markets will develop.

A few reference points are available:

- According to PACENation (www.pacenation.us), the five states with highest cumulative C-PACE volume are: California ($293 million); Ohio ($241 million); Connecticut ($144 million); Texas ($102 million); and Minnesota ($89 million).

- The C-PACE program with a population comparable in size to Honolulu is Washington, DC (710,000 residents in DC compared to 934,000 in Oahu). Like Honolulu, Washington, DC has a robust hospitality industry (22 million tourists visit DC annually, compared to almost 10 million tourists in Oahu annually). Since completing its first project in 2013, the DC C-PACE program has financed 29 projects for $41 million. C-PACE projects include office buildings, a YMCA facility, multifamily housing, charter schools, churches, breweries and a soccer stadium.

- According to CoStar, a private company that collects data on commercial real estate markets, Honolulu has 1,222 commercial buildings of 50,000 square feet and up. It appears that Honolulu has ample prospects for a C-PACE program.

Honolulu, HI MSA - Property Summary Table

	Total # Properties	Average SF	# Buildings Over 50k	Built pre-1960	Built 1960-1979	Built 1980-1999	Built 2000 or later	
Flex	32	52,569	5	1	0	3	1	
Health Care	40	96,565	20	1	5	2	8	
Hospitality	115	344,070	91	6	50	4	13	
Industrial	1,052	34,705	180	25	74	40	25	
Multi-Family	1,424	91,342	553	9	208	96	66	
Office	421	67,095	147	15	57	53	12	
Retail	710	47,238	166	17	55	36	46	
Specialty	193	49,543	55	3	4	4	23	
Sports & Entertainment	24	66,450	5	0	0	1	1	
Grand Total	**4,011**	**183,675**	**1,222**	**77**	**453**	**239**	**195**	964

Decade Total	964	
Grand Total	1,222	
Difference	258	# buildingsfor which CoStar does not have a date

Finally, it should be noted that Honolulu is different than all other US markets due to its highest-in-the nation price for electricity. According to the Energy Information Administration, Hawaii's average price per KwH is 34 percent higher than any other state and almost 2½ times higher than the U.S. national average (refer to the chart on the following page).

The Honolulu market appears to have the ingredients to attract property owners to use C-PACE as a financing tool that creates public benefits and achieves high usage.

Annual Average Price per Kilowatthour by State

Rank	State	Average Electricity Rate for All Sectors (Cents per Kilowatthour)	
49	Hawaii	26.07	247%
48	Alaska	19.52	
47	Connecticut	17.62	
46	Rhode Island	16.44	
45	New Hampshire	16.16	
44	Massachusetts	16.14	
44	California	16.14	
43	New York	14.78	
42	Vermont	14.57	
41	New Jersey	13.38	
40	Maine	12.94	
39	Maryland	12	
38	District of Columbia	11.81	
37	Michigan	11.39	
36	Wisconsin	11.05	
35	Delaware	10.99	
34	Arizona	10.71	
33	Florida	10.65	
32	Kansas	10.58	
	National Average	**10.54**	
31	Minnesota	10.53	
30	Pennsylvania	10.16	
29	South Dakota	9.98	
28	Colorado	9.94	
27	Alabama	9.89	
26	Missouri	9.83	
26	South Carolina	9.83	
25	Georgia	9.75	
24	Ohio	9.71	
23	New Mexico	9.64	
22	Indiana	9.61	
21	Tennessee	9.54	
20	Illinois	9.33	
19	Virginia	9.28	
18	North Dakota	9.26	
17	Mississippi	9.19	
16	**Nebraska**	**9.16**	
15	North Carolina	9.15	
14	Montana	9.02	
13	West Virginia	9	
12	Oregon	8.98	
11	Iowa	8.92	
10	Nevada	8.76	
9	Utah	8.66	
8	Texas	8.55	
7	Kentucky	8.44	
6	Idaho	8.3	
5	Wyoming	8.29	
4	Arkansas	8.18	
3	Oklahoma	8.12	
2	Washington	7.94	
1	Louisiana	7.75	

Source: *Electric Data Browser* (http://www.eia.gov/electricity/data/browser/) Energy Information Administration, Washington, DC. Nebraska Energy Office, Lincoln, NE.

C-PACE ALLIANCE

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