Montgomery County GreenBank
Your partner for clean energy ™

Montgomery County Council Bill 46-21
Environmental Sustainability –
Commercial Property Assessed Clean Energy Program
January 11, 2022

Testimony of Stephen Morel, Chief Investment Officer
Montgomery County Green Bank

At the start of 2021, the Montgomery County Green Bank (the "Green Bank") became the County's designated Program Manager of the Commercial Property Assessed Clean Energy ("C-PACE") program. As the Program Manager, the Green Bank works in conjunction with the County's Department of Environmental Protection ("DEP") and Finance Department ("FINANCE") to provide:

(i) Marketing and promotion of the C-PACE Program;
(ii) C-PACE finance application approval;
(iii) Portfolio servicing of C-PACE financing; and
(iv) C-PACE Program reporting.

As the County's green bank dedicated to catalyzing climate finance and in our role as the C-PACE Program Manager, we are enthusiastic about the opportunity for Bill 46-21 to situate C-PACE as a broader, more effective tool to support climate-related improvements and reach the County's climate goals. The Bill will delivery strong results by deepening the incentive structure to make property investments greener. Specifically, it reduces friction across key structural items that have limited the full potential a C-PACE program can offer in delivering a ***substantial climate benefit***. Bill 46-21 will lead to a great outcome for the County and further demonstrate national climate leadership.

Realizing C-PACE Program Benefits

Montgomery County was an early leader in the C-PACE market. As the County's climate priorities have developed and the C-PACE market has advanced, we believe that it has become time to advance the features of the C-PACE program. Bill 46-21 will successfully achieve that advancement and help the C-PACE program achieve its fullest potential by:

1. Supporting implementation of County climate priorities using commercial capital instead of limited public funds.

2. Offering property owners and developers a financing strategy with incentives to go green that are not available through traditional commercial lending.[1]

[1] The C-PACE assessment allows a capital provider to take a super senior position in the capital stack. Not only is it important that property owners often are more inclined to pay taxes ahead of other debts or arrears, but the super senior position also ensures repayment capacity several times over. As a result, capital providers are able to offer longer term

3. Being a critical tool for any Building Energy Performance Standards ("BEPS") that may get adopted.

4. Promoting economic development pandemic recovery as properties address resiliency and health improvements in consideration of current and future occupants.

5. Promoting sector growth including jobs and investment with energy performance contractors and related commercial real estate industries.

To recognize these benefits and better align a climate forward incentive structure into the County's commercial market, Bill 46-21 achieves key enhancements: (i) larger projects with a deeper climate impact, (ii) an improvement of the operating strength of properties, particularly in the face of emergency measures, and (iii) an aligning of C-PACE with climate resiliency.

1. Lien-To-Value. One of the key changes in Bill 46-21 is an increase in the ratio of the C-PACE financed amount to property value of 20% to up to 30%. This increase serves to grow access to C-PACE financing. If, for example, a property value is $100, the new LTV allows for $30 worth of climate investments instead of the current level of $20.

Nationally, PACE LTV ratios are within the range of 20% - 35%. Capital providers gravitate to jurisdictions with larger LTVs because it provides them more to offer customers. Capital providers are, on the other hand, reluctant to operate in jurisdictions with lower LTVs because other transaction costs limit the interest in a lesser benefit. Moving to a 30% maximum LTV moves Montgomery County in line with where jurisdictions are moving to yield a climate aligned incentive structure in a prudent manner.[2]

A greater LTV helps with two types of property activities: retrofits and new construction.

Retrofits: Building energy efficiency can be weighted downward cyclically in that poor performing buildings require larger projects and thus more financial resources to attain the same level as a building with a higher performance baseline. Over time, the financial burden becomes greater, and the disparity increases. Increasing C-PACE LTV ratios allows for an ***equitable approach*** to help certain property owners with ***larger project needs***. Looking ahead, such properties may also require such investments to

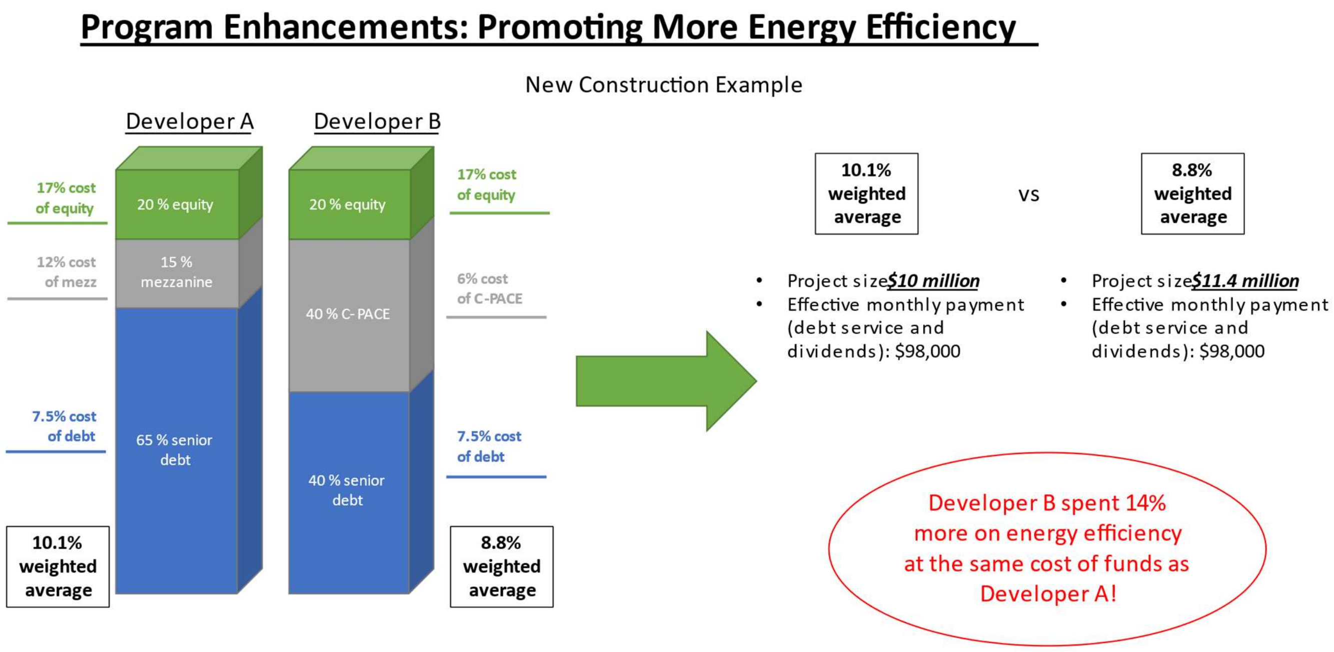
financing than they otherwise would provide (up to 20 years) and at favorable interest rates. From the Borrower's perspective, the C-PACE assessment is key to procure such favorable terms with the loan secured by the property opposed to business balance sheet. In other words, C-PACE provides a limited recourse lending window with very favorable terms.

[2] Higher debt ratios can lead to greater defaults. We believe that an increase in LTV is well measured by other controls of the C-PACE Program. From senior lender consents, loan underwriting standards from additional/sophisticated institutions, and Program Manager/County approvals of all projects, we believe there is much more incremental benefit to increasing project loan to values than incremental risk. As laid out in Bill 46-21, the LTV changes also have a sunset provision so that the Council can revisit any potential detrimental performance.

be compliant should BEPS govern their property energy standards and may require programs like C-PACE to finance the improvements.

<u>New Construction</u>: C-PACE for new construction is important for reaching the County's climate goals. A previous Council amendment set the groundwork to allow for new construction in C-PACE, but the new Bill 46-21 will provide LTV ratios that ***<u>activate the developer community</u>***.

C-PACE typically replaces mezzanine investment in new construction projects. It serves to substitute in a lower rate, and thus reduce the cost of capital for the overall project. This is financially positive for developers/building owners as it broadens repayment capacity and accelerates the project's break-even point. C-PACE can provide ***<u>a better financial situation</u>*** the more energy efficient a building becomes, even when the overall project costs are higher. To visualize this, the following shows a capital benefit from a better energy performing construction:



Another way to look at the above example is for a project that costs the same amount. If the above projects were $10 million, the use of C-PACE would bring down the entire cost of the project. Both examples are meaningful in an environment where buildings can cost tens of millions of dollars or more.

2. ***Retroactivity***. In addition to LTV changes, Bill 46-21 provides for retroactive (lookback) financing. Retroactivity offers many benefits as described below. Retroactive C-PACE is used in 12 other state programs with one-to three-year lookback periods. In Maryland, retroactive C-PACE is available in the City of Baltimore and Prince George's County. Baltimore recently approved a warehouse facility project for retroactive financing in January 2021.

Montgomery County GreenBank
Your partner for clean energy ™

Retroactivity can provide an ***economic recovery*** opportunity in response to COVID-19. Commercial and multifamily properties that have recently had qualifying energy work done may find themselves with cash preservation goals to cover working capital needs. Retroactive C-PACE allows property owners to replace more expensive debt with C-PACE's low-rate, long-term financing, improving liquidity.

Retroactive C-PACE allows the County to accommodate ***commercial entities lacking resources and time*** to access C-PACE prospectively, which presents an opportunity to address equity barriers that can exist with financing programs. If a commercial entity did not have the time/resources to investigate C-PACE at the time of an improvement, the opportunity to retroactively utilize C-PACE would provide a more efficient capital source. Commercial entities face a variety of challenges in building maintenance, ***including emergency measures***. When facing emergency maintenance/replacement issues, there is often not time to submit a C-PACE application ahead of time and wait for the standard 10-day application approval time.

A final key point about retroactive C-PACE is that it allows for a developer to utilize C-PACE at different times in a construction timeline. Senior lenders may not consent until a project is substantially complete. Retroactive C-PACE provides for a ***better relationship with senior lenders and credit risk mitigation***. For many senior lenders, C-PACE is a good term option to free up cash flows but not necessarily during construction when they are facing greater risks.

3. Climate resilience. In 2021, the Maryland C-PACE enabling legislation was amended to add climate resilience among the list of eligible measures that counties can activate in their C-PACE programs. Montgomery County has an opportunity to follow this state direction and greatly improve the resilience of county properties by enacting Bill 46-21.

Resiliency can mean different things to different people. For C-PACE, we consider specific reliance measures to include the following:

- Energy Supply
    - Renewable Energy
    - Combined Heat and Power (CHP)
    - Battery Storage
    - Backup Generation
    - Microgrid
    - Electric Vehicle Charging
- Resource Conservation
    - Efficient Lighting and HVAC
    - Water Efficiency
    - Building Envelope
- Structure Hardening
    - Seismic Retrofits
    - Wind-Resistant Roofs and Windows

- Flood Mitigation

These measures provide three key benefits: (i) energy supply resilience ensures that building systems continue operating; (ii) resource conservation measures reduce energy and water demand and increase operating time on backup; and (iii) structure hardening mitigates property damage, injury, and system outages. We believe that these benefits are important for properties to strengthen operations and property value.

Furthermore, climate resiliency is a strong ***risk mitigation tool***. Research shows that the value at stake from climate-induced hazards could, conservatively, increase from about 2 percent of global GDP to more than 4 percent of global GDP in 2050. And the risks associated with climate change are not only multiplying, but they are also disproportionately affecting poorer populations. Montgomery County is not immune to extreme weather events exacerbated by climate change, and C-PACE can be a tool to effectively finance solutions, rather than absorb the payout costs of insurance afterward.

Conclusion

On a national level, C-PACE has had a meteoric rise, with almost 40 jurisdictions now actively administering C-PACE programs, and over $2 billion in dollar volume across 2,500 projects. We are keen to see the use of C-PACE increase equivalently in Montgomery County so that the County can achieve its climate goals. The Green Bank has been proud to provide businesses with climate finance strategies and C-PACE is an important arrow in the quiver. Bill 46-21 provides the County a success in aligning the incentives of owners and developers with greener and more resilient investments.