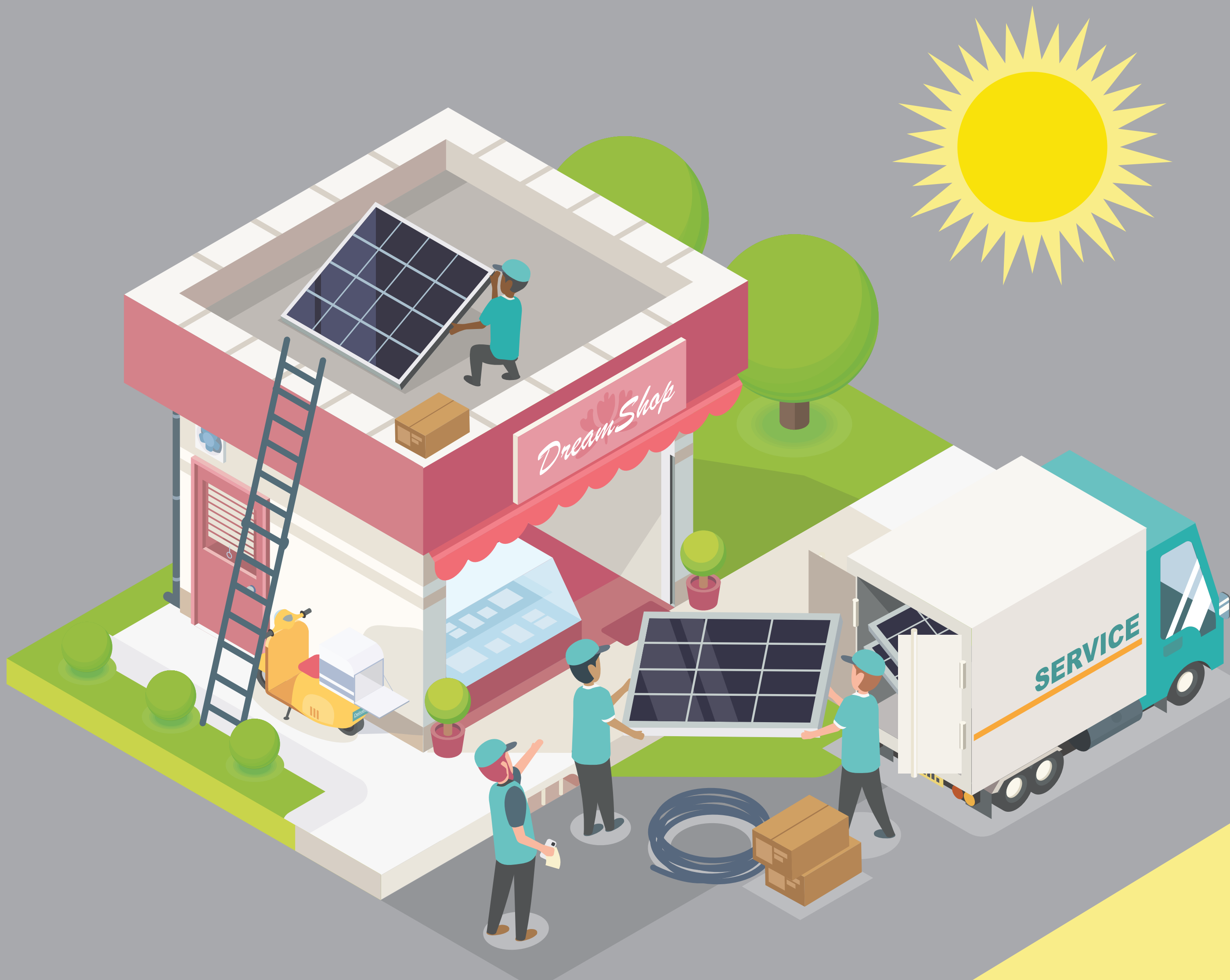
IMPROVING ACCESS TO C-PACE FOR SMALLER BUSINESSES

Case Studies from Three States



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Introduction

Smaller-sized building energy retrofit projects, typically undertaken by small businesses,[1] face increased challenges when accessing Commercial Property Assessed Clean Energy (C-PACE) financing. These businesses can benefit from additional support from both State Energy Officials and C-PACE administrators to ensure that C-PACE financing is available to projects of all sizes. This brief provides examples of actions that C-PACE administrators in three states are taking to help ensure that C-PACE financing is available for small-to-medium sized businesses within their jurisdictions. The strategies detailed in these case studies provide potential solutions to increase small business access to C-PACE financing and help realize the many benefits of clean energy projects, such as job retention and creation and reduced operating costs. State Energy Officials can work with C-PACE administrators to implement some or all of these strategies to ensure that the benefits of C-PACE are accessible to businesses of all sizes.

Over the past decade, investors are trending toward using C-PACE financing for larger projects (totaling $500,000 or more). C-PACE investors and administrators are understandably drawn to larger-scale projects because they tend to provide greater returns and have lower transaction costs as a portion of their total project costs. This tendency toward using C-PACE for larger projects is accelerating as C-PACE programs nationwide finance new construction projects for larger commercial companies. As a result, smaller businesses, which may be interested in financing smaller retrofit projects rather than paying for them upfront due to credit, budget, or facility constraints, may find it more difficult or costly to borrow capital through C-PACE programs relative to larger projects. Accordingly, smaller businesses may need to find other sources of capital, which can be more difficult and time consuming. As a result, the broad public purpose underlying the establishment of C-PACE programs may not effectively reach all segments of the economy.

Common barriers impeding the ability of small businesses to utilize C-PACE financing include a relative lack of financial expertise about how the C-PACE financing process works and high programmatic fees for the project compared to the size of the project being financed. Smaller businesses located in rural areas

Spotlight: C-PACE and Current Economic Conditions

The recent economic shock from the COVID-19 pandemic resulted in severe economic and jobs impacts, presenting additional barriers to smaller business access to C-PACE financing. However, in addition to direct stimulus and low-interest loans, C-PACE can be part of a longer-term, broader solution set that provides additional resources and options for heavily-stricken businesses and employees. The use of C-PACE for retroactivity, where C-PACE can refinance eligible energy projects that have already been completed, is another option that may assist with small business financial solvency. The use of C-PACE for retroactivity is currently allowed in a dozen states.

[1] Many of the challenges described in the report are applicable to smaller-sized and lower-costed projects. Because small businesses are more likely to face credit and cash challenges, they often opt for smaller projects. For this resource, while small projects are not unique to small businesses, "small projects" are meant to address the unique challenges faced by small businesses in clean energy financing, including C-PACE. For the purposes of this paper, small projects are projects that fall under $500,000 in total financing.

may find it even more challenging to access C-PACE financing if their state or local governments have not yet enabled C-PACE for their jurisdictions, their mortgage holders are unaware of C-PACE, their local contractors are unfamiliar with C-PACE, or if the property's value is insufficient to support the underwriting criteria. Combined, these barriers significantly limit uptake of C-PACE by smaller businesses that could otherwise greatly benefit from having access to this source of capital to make needed improvements.

Roles of State Energy Offices

The barriers to accessing C-PACE for small businesses present an opportunity for both State Energy Offices and C-PACE administrators to work together to develop new ideas and programs that can help smaller businesses access C-PACE financing and make energy improvements to their properties. Making C-PACE more accessible to smaller businesses not only helps speed the adoption of C-PACE as a financing mechanism, but also further ensures that C-PACE is fulfilling the public purpose role that many states envisioned when enabling it through legislation. By increasing the accessibility of C-PACE financing to small businesses, State Energy Offices can increase economic development and job creation as well as help achieve gubernatorial or legislatively-mandated state energy efficiency or renewable energy goals, particularly in rural areas where many smaller businesses are located.

State Energy Offices can perform a number of functions to support small business access to C-PACE financing. Some State Energy Offices retain slots on the Advisory Boards that develop C-PACE programs and/or oversee the third-party administrators that directly manage those programs, such as in Alaska, Colorado, and Connecticut. They can act as additional marketing arms for a statewide C-PACE program, providing education and outreach to communities throughout the state to familiarize potential customers and local lenders with the C-PACE program. State Energy Offices serve as conveners, bringing together key stakeholders to discuss new ideas or best practices for C-PACE programs to consider for improvement. Finally, State Energy Offices, may choose to directly administer a statewide C-PACE program. All of these roles require varying amounts of staff resources and commitment but provide a gradient of options that State Energy Offices can consider utilizing to ensure that smaller businesses have equitable access to C-PACE financing across a state.

In order to help educate State Energy Officials on how C-PACE programs are working to increase small business access to C-PACE financing, NASEO interviewed C-PACE administrators in three states. The case studies below describe the efforts that C-PACE administrators in Colorado, Michigan, and Minnesota are taking to ensure that smaller businesses can access and utilize C-PACE financing to make energy improvements. This report provides an overview of the success of each C-PACE program and details the strategies each program is using to promote the use of C-PACE financing by smaller businesses. Ideally, State Energy Offices can use this information to collaborate with C-PACE administrators and increase small business access to C-PACE financing.

Table 1: C-PACE Program Strategies for Reaching Smaller Businesses by State

C-PACE Program	Strategies Used for Making C-PACE More Accessible	Smaller Projects Financed (< $500,000, as of December 2020)
CO C-PACE	- Develop local lender network - Engage lenders in rural counties - Work with branches of banks that close on C-PACE loans to reach out to branches that do not yet finance C-PACE	- 29 projects (44 percent of total, ~$6.3 million in total investment)
Lean and Green Michigan	- Reduce level of audit needed for smaller projects - Do not require savings guarantees or Savings to Investment Ratios (SIRs) - Aggressively market program to property owners	- 8 projects (33 percent of total, ~$1.9 million in total investment)
MINN Pace (Saint Paul Port Authority)	- Utilize dedicated source of public capital to finance small business C-PACE projects - Sell-off loans to private sector to replenish funds and continue lending	- 215 projects (86 percent of total projects, ~$27 million in total investment)

Colorado: Development of a Rural Lender Network Increased Success in Financing Rural Small Business C-PACE Projects

The Colorado C-PACE (CO C-PACE) program has successfully deployed C-PACE financing throughout the state. Since its inception in 2016, the program has funded 66 projects, representing over $65.9 million of C-PACE financing.[2] Smaller projects under $500,000 in C-PACE financing represent approximately 44 percent of the program's total portfolio. The program also funded C-PACE projects in rural areas that are as small as $60,000 in their total financing amount.

Program Name	Program Administrator	Program Structure	Total Smaller Projects Funded (as of December 2020) (percent of Total Projects)
CO C-PACE	Third Party (SRS)	Statewide Program	29 (44 percent)

Recognizing that small businesses need additional assistance, CO C-PACE developed a network of local lenders to increase access to C-PACE financing in Colorado communities. This involved outreach to lenders in both rural areas and cities to increase awareness of the C-PACE financing process, then using those lenders to educate other branches of the same lending family to rapidly disseminate information on C-PACE around the state.

Program Strategies for Reaching Smaller Businesses

As part of its mission to deliver the benefits of C-PACE across the state, CO C-PACE developed a streamlined process for engaging community lenders in local communities throughout Colorado. The process involved several steps. First, as soon as a county opted into the statewide C-PACE District, CO C-PACE reached out to the local capital providers and began to educate them on the underlying principles of C-PACE. This outreach increased provider exposure to C-PACE and heightened their understanding of its usefulness as a financing mechanism. This education also laid the groundwork to increase the comfort levels of partner capital providers with the mortgage holder consent process that is critical to the success of C-PACE as a financing mechanism. Second, CO C-PACE then worked to get capital providers in each participating county to join the program's existing lender network. Once CO C-PACE received word of a retrofit project under development, the program reached out to capital providers in the county and discussed the project with them, or conversely, reached out to the building owner of the project about local lenders who may be interested in financing their improvements. Engaging in this process resulted in increased business development opportunities for partner lenders.

[2] Market Data. CO PACE, 2020. https://copace.com/market-data/.

CO C-PACE also conducted additional outreach with capital providers in smaller and rural counties, whom the administrator determined are more likely to respond positively to the C-PACE message if they understood that the financing option can help them better serve their communities. The administrator found the long-term benefits of building trust and rapport through in-person conversations with local communities paid off in the form of increased interest and opportunities for project finance using C-PACE in those communities. Additionally, the program identified that once it is able to engage a bank in a rural area, it can then set up a webinar for all the branches of the bank. The program will invite the bank's representative to present their perspective on C-PACE, so other branches are hearing the story from someone in their own organization. This use of organizational ties built trust among local capital providers and resulted in increased interest and uptake of C-PACE from other branches, further spreading C-PACE demand to other counties.

Spotlight: Lenders as Both Consenters and C-PACE Capital Providers

One approach CO C-PACE uses to get local capital providers interested in C-PACE financing is to find a way for the local lender to finance both the mortgage on the property as well as the C-PACE lien. For example, if a building owner comes to the C-PACE program with a potential project with an existing mortgage that is currently held by a bank in the county, CO C-PACE will reach out to the bank that owns the mortgage and tell them that they can finance the C-PACE assessment so that they own both the mortgage and the lien. By working with lenders so they finance both the C-PACE lien and the mortgage to reduce risk, CO C-PACE has successfully introduced C-PACE to many smaller lenders throughout the state.

CO C-PACE's efforts to engage with and develop a network of local lenders (17 local lenders are currently participating in the program) was critical to making C-PACE work for smaller businesses. Local lenders understand their community needs and the financing landscape and typically have many more contacts with potential C-PACE customers than the program administrator. Their presence in the community gives local lenders a base level of trust with smaller businesses; this trust is critical to get smaller businesses to consider C-PACE as a financing option. Local lenders provide additional leverage that enables the statewide C-PACE program to reach much farther into communities and impact more business owners than if the administrator attempted to reach all of those business owners by itself.

In Colorado, smaller projects (less than $500k) are now almost 44 percent of the total number of C-PACE financed projects in the state and will continue to grow as the program increases its efforts to reach rural communities. Yet CO C-PACE does not plan to slow down its efforts in the small business market. The CO C-PACE program administrator recently developed and released a cloud-based application to help contractors originate projects for small businesses and for small business building owners to estimate the savings and financial impacts from potential upgrades to their properties. The application, the Energy Performance Improvement Calculator (EPIC™),[3] uses existing data from projects

[3] Energy Performance Improvement Calculator. Sustainable Real Estate Solutions, Inc., 2020. https://srsworx.com/.

completed by CO C-PACE's third-party administrator, SRS,[4] and combines these data with analytics to help building owners and contractors quickly develop and underwrite projects. Streamlined project development and underwriting can boost small business uptake of C-PACE in Colorado.

[4] Sustainable Real Estate Solutions (SRS) is a Market Partner in the U.S. Department of Energy's Commercial PACE Working Group. Learn more online at: https://www.energy.gov/eere/slsc/commercial-pace-working-group.

Michigan: Streamlining C-PACE Fee Structures Leads to Increased Uptake by Smaller Businesses

The C-PACE administrator in Michigan, Lean & Green Michigan, financed 24 C-PACE projects worth over $37 million since its inception in 2011, resulting in over 207,000 tons of CO2 reductions, $65 million in cumulative energy savings, and the creation of over 540 jobs.[5] Of the 24 financed C-PACE projects, eight are for smaller projects under $500,000. Lean & Green Michigan is a Market Partner in the U.S. Department of Energy's Commercial PACE Working Group.[6]

Program Name	Program Administrator	Program Structure	Total Smaller Projects Funded (as of December 2020) (percent of Total Projects)
Lean and Green Michigan	Third Party	State/Local Opt-in	8 (33 percent)

Lean & Green Michigan developed a set of streamlined requirements for smaller C-PACE projects at or under $250,000. These requirements lowered the incidental costs associated with C-PACE financing, including the fees associated with the audit process and verification of energy savings, making C-PACE more attractive and easily accessed for financing by small business owners in the state.

Program Strategies for Reaching Smaller Businesses

Michigan's enabling legislation authorizing C-PACE provided the initial impetus for Lean & Green Michigan to develop a streamlined set of C-PACE fees and requirements. The Michigan legislation established some additional requirements for projects requiring financing of over $250,000, including regular measurement and verification (M&V) of savings, a guarantee that the energy savings produced by the improvements outweighed the increase in property taxes,[7] and a performance guarantee for energy savings.[8] Because smaller projects under $250,000 did not have to comply with these requirements, Lean & Green Michigan saw an opportunity to streamline fees and requirements so smaller projects could benefit from C-PACE financing. Thus, Lean & Green Michigan developed a program called "PACE Express," for smaller businesses in the state.

[5] Market Data. Lean & Green Michigan, 2020. https://leanandgreenmi.com/market.
[6] Learn more about U.S. DOE's C-PACE Working Group online at: https://www.energy.gov/eere/slsc/commercial-pace-working-group.
[7] This principle is also referred to as a Savings-to-Investment Ratio of greater than one (SIR>1). This report will use this terminology for the rest of the study.
[8] 2010 HB 5640, "Property Assessed Clean Energy Act," http://www.legislature.mi.gov/documents/2009-2010/publicact/pdf/2010-PA-0270.pdf.

PACE Express streamlines the C-PACE process for projects at or under $250,000 so that smaller businesses have more of an incentive to choose C-PACE financing to make energy retrofits. Small businesses participating in PACE Express have the following benefits:

- Contractors are only required to perform an ASHRAE Level 1 audit, instead of an ASHRAE Level 2 audit;
- There is no requirement for project savings to exceed project costs; and
- There is no guarantee of energy savings needed for a project.

These combined changes to Lean & Green Michigan's C-PACE process for smaller projects allowed smaller business owners more flexibility with project design and reduced the fees to third parties (e.g., for the audit, for M&V) for completing smaller projects as part of the deal. Additionally, Lean & Green's closing fees are lower for PACE Express projects than for standard C-PACE products, resulting in further savings to smaller business owners. The PACE Express model made C-PACE more attractive to small business owners, who positively responded to the tailored offerings, and spurred small business owner interest in using C-PACE as a financing mechanism. The removal of the guaranteed SIR>1 requirement was especially important to the success of this program, because the calculation and guarantee of the SIR can be complicated and expensive. These expenses can cause small business owners to use non-C-PACE financing.[9]

The biggest challenge Lean & Green Michigan currently faces is ensuring smaller businesses are aware of PACE Express. While Lean & Green Michigan has a dedicated email listserv to highlight updates to its program, many of the subscribers are currently contractors and local government officials, not small business owners. The organization is considering other methods to get the word out to property owners, but recognizes that reaching small businesses across the state takes time.

Finally, as business owners increase their interest in using PACE Express to help finance their projects, Lean & Green Michigan may work with the legislature to amend the state's enabling legislation to allow for larger projects to qualify for PACE Express. They note that some owners have expressed interest in larger projects but instead have reduced their projects to $250,000 so they qualified for the more streamlined program, resulting in missed opportunities for deeper and more impactful retrofits. Modifications to the C-PACE enabling legislation can enable more small businesses to complete deeper, higher-cost retrofits under the PACE Express model.

Many business owners consider C-PACE to be complicated and tough to understand. With PACE Express, Lean & Green Michigan is making C-PACE "cheaper, faster, and easier," helping to stimulate demand for C-PACE financing in a harder-to-reach segment of Michigan's economy.

[9] Kumar, Bali, interview by Sam Cramer. 2020.

Minnesota: Dedicated Capital Funding Source for Smaller C-PACE Projects Leads to Increased Use of C-PACE by Small Businesses

The St. Paul Port Authority (SPPA) in Minnesota, which administers the state's statewide C-PACE program (MinnPACE), finances a strong pipeline of small business projects using C-PACE. As of December 2020 the program has financed over 250 projects comprising $100 million in total investment since 2010.[10] These projects resulted in over $6 million in annual energy savings, created over 800 construction jobs, and retained over 200 jobs in related sectors. Out of these 250 projects, 215 are smaller projects; MinnPACE financed over $24.5 million in energy retrofits through these smaller projects.[11]

Program Name	Program Administrator	Program Structure	Total Smaller Projects Funded (as of December 2020) (percent of Total Projects)
MinnPACE	Quasi-governmental entity	State/Local Opt-in	215 (86 percent of projects, 27 percent of $ value)

SPPA utilizes a dedicated tranche of funding through its revolving loan fund (RLF) to lend to smaller businesses interested in leveraging C-PACE financing for retrofits. This separate funding stream ensures there is capital available for smaller projects at reasonable rates while allowing the private sector to purchase the loans and associated revenue streams on the secondary market, freeing up capital for additional lending. This allows small businesses to acquire capital quickly and at lower rates, making C-PACE a more attractive financing option for those businesses.

Program Strategies for Reaching Smaller Businesses

When Minnesota enabled C-PACE, the state legislature asked SPPA to develop and manage a statewide C-PACE program. After performing an analysis of the state's economy, SPPA decided to target their efforts in C-PACE toward high-potential markets, including solar projects, multi-tenant buildings, and small businesses. SPPA originally used funding from the American Recovery and Reinvestment Act (ARRA) to establish a RLF to deliver low-cost loans to business owners for efficiency retrofits. SPPA began to consider repurposing that RLF to act as a source of capital to finance C-PACE projects in these sectors. However, SPPA also needed to approach the private sector about the possibility of purchasing C-PACE loans made by the RLF, in order to ensure the fund is continually replenished. After securing interest from

[10] Klein, Peter, interview by Sam Cramer. 2020. *MINNPace Small Business Capital Fund* (February 23).

[11] *Ibid.*

both larger C-PACE capital providers and small community banks toward purchasing the loans, SPPA began to almost entirely reorient its loan fund towards providing capital for C-PACE loans (as opposed to conventional unsecured loans under an RLF).

Today, SPPA funds small C-PACE projects upfront using capital from its RLF. Once the C-PACE assessment is in place on the property at the end of the year, the private sector steps in to purchase the loan. SPPA typically sells the C-PACE lien to the secondary market within one year of financing a project. Revenue from the sale of C-PACE loans replenishes SPPA's RLF. The interest rate on these loans is set by the market. Those rates have ranged from 4.5 to 5 percent depending on the year (and are at 4.25 percent for 2020). SPPA keeps 25 basis points (.25 percent) from the interest rate to pay for its costs, while the entity buying the loan keeps the remainder.

Noting the success of SPPA in reaching smaller businesses and in developing C-PACE using its funding, in 2012 the Minnesota Legislature passed a bill that provided an additional $10 million in funding to SPPA to continue to provide additional C-PACE financing. SPPA used this capital to increase its outreach and lending capability to smaller businesses. SPPA has now closed on over 215 loans for C-PACE projects under $300,000, resulting in over $24 million of energy upgrades for small businesses since the program's inception.

SPPA believes their strategy to reach smaller businesses is replicable and scalable for other states and encourages other states to develop dedicated tranches of funding to reach small businesses in their jurisdictions as well.[12]

Conclusion

In many states it is challenging for smaller businesses to access C-PACE financing because there are significant barriers to entry and high fixed transaction costs that make smaller projects less attractive for property owners, capital providers, and program administrators. However, depending on the applicable state statute, C-PACE programs may have a lot of flexibility when it comes to developing strategies to make sure C-PACE is accessible to smaller businesses. For example, the three case studies above showcase the importance of lender networks (Colorado), tiered program parameters amenable to small and large projects (Michigan), and a quasi-public capital provider willing to take on the first risks associated with project origination (Minnesota). State Energy Offices can work with C-PACE administrators in their states to help develop similar strategies to the ones outlined in this paper in order to increase small business access to C-PACE financing. Through the increased use of C-PACE financing, State Energy Officials can better achieve state clean energy goals and spur increased economic development in their jurisdictions.

[12] In November 2019, Peter Klein from SPPA spoke on a U.S. Department of Energy webinar for the Commercial PACE Working Group. Webinar slides are available online – *Commercial PACE for Underserved Market Segments: Small and Medium Commercial Businesses*.

Related Resources

The resources below provide additional information on the successful development and deployment of C-PACE throughout the nation in order to educate State Energy Officials wishing to better understand the latest in C-PACE financing.

- Accelerating the Commercial PACE Market: Statewide Programs and State Energy Office Participation in PACE Financing: This brief, authored by NASEO in 2016, provides an overview of the different types of program structures that C-PACE programs can utilize, explores the State Energy Office role in developing C-PACE programs, and makes the case for greater coordination between C-PACE programs, both within a state and between states.
- Lessons in Commercial PACE Leadership: The Path from Legislation to Launch: This 2018 report by the U.S. Department of Energy and Lawrence Berkeley National Laboratory discusses lessons learned from government officials and C-PACE administrators through each step of the C-PACE program development process. It also analyzes the different decision points needed to set up a C-PACE program and the trade-offs between each potential decision.
- Commercial PACE Financing and the Special Assessment Process: Understanding Roles and Managing Risks for Local Governments: This issue brief authored by U.S. Department of Energy and Lawrence Berkeley in 2019 seeks to inform local governments about the risks they may incur by placing C-PACE liens on commercial properties and the staff and resource commitments they may need to take on when enabling C-PACE in their jurisdictions. The brief talks about trends in the relationship between third-party administrators and local governments as well as the latest statistics on lien delinquency and default rates for C-PACE.