

FINANCIAL ALLY IMPLEMENTATION MODEL

COMMERCIAL PACE FINANCING AT PIER 1 IN SAN FRANCISCO



LOCATION

San Francisco, CA

CHALLENGE

Energy Efficiency and Renewable Energy Retrofit in a Multi-Tenant Historic Facility

FINANCING SOLUTION

Commercial PACE

FUNDS COMMITTED

\$1.4 million

FINANCING COMPLETION DATE

October 15, 2012

CONSTRUCTION COMPLETION DATE

Spring 2013

PROJECT PARTNERS

Prologis, Clean Fund, Renewable Funding, Johnson Controls, GreenFinanceSF (City and County of San Francisco)

Overview and Background

On October 15, 2012, Prologis, Inc. closed \$1.4 million in PACE (Property Assessed Clean Energy) financing for energy efficiency and renewable energy upgrades to its headquarters at the historic Pier 1 building in San Francisco. The project represents the largest PACE-funded commercial retrofit in the country to-date and the first completed project in the GreenFinanceSF program. Built in 1918 and long used for maritime purposes, Pier 1 was converted to commercial office use in 2001 by Prologis, which continues to manage the property and sublets space to five office and retail tenants. Prologis was able to pass both the energy and cost savings, along with the property-assessed project costs, on to all building tenants.

The Pier 1 Commercial PACE Playbook



Policies

PACE accesses low-cost, long-term capital to finance improvements to private property that meet a public purpose. PACE funds can finance energy efficiency and renewable energy upgrades to buildings. Interested property owners and master tenants evaluate measures that achieve energy savings and receive 100 percent financing, repaid as a property tax assessment for up to 20 years. By eliminating upfront costs, providing low-cost long-term financing and making it easy for building owners to transfer repayment obligations to a new owner upon sale, PACE overcomes two of the biggest hurdles to widespread adoption of renewable energy and energy efficiency—the high upfront cost and property owners’ uncertainty about when they might sell their property.

PACE is currently available in 28 states, with commercial PACE programs active in Connecticut, South Florida, Minnesota and California. San Francisco is one of the first U.S. cities to launch a PACE program, called GreenFinanceSF, making \$100 million in bonding capacity available to the City’s commercial property owners.

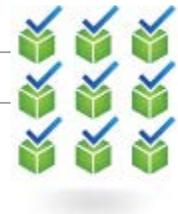
When GreenFinanceSF launched its Commercial PACE program in November 2011, it began outreach and education to a number of San Francisco building property owners, master tenants, PACE capital providers and large building contractors. The GreenFinanceSF program had a number of key program characteristics, including:

- An “open-market” financing model in which any qualified financing entity can provide funding for PACE projects, as opposed to a “single entity” model in which one firm is the designated financial partner for all projects.
- A “lender acknowledgement” model in which building owners notify the financial institution that holds the property’s mortgage that they are considering pursuing PACE financing, and receive affirmative acknowledgement from the institution before proceeding.
- Active involvement from City of San Francisco staff to assist all parties involved in the transaction, and to explore other additional financing options to complement the PACE transaction.

When Prologis engaged Johnson Controls Inc. in early 2012 to provide turnkey design and implementation of energy efficiency and solar upgrades for its corporate headquarters at Pier 1 in San Francisco, they were guided by three priorities:

- Reduce energy costs and consumption at Pier 1.
- Update systems, reduce maintenance costs, and improve occupant experience.
- Explore energy efficiency financing options for the project, including Commercial PACE.

GreenFinanceSF staff worked to help guide Prologis through the financing process, connect them with financial partners, and uncover additional financing options.



Process



Source: PACENow.com

The Pier 1 project followed the four key steps of any Commercial PACE project shown above, with a few unique additions.

- **Step 1: Local Government Establishes PACE Program** – In 2011, the City and County of San Francisco Department of the Environment established a Commercial PACE program to allow local property owners to use a property-based assessment mechanism to fund energy efficiency projects. This mechanism has long been used by municipalities to fund improvements to real property that meet a public purpose such as lighting districts, parks, and water and wastewater systems. As with most PACE financings, the value of the building serves as collateral and secures payment of the assessment. The tax lien structure of PACE provides capital providers with extremely strong collateral, thereby enabling long-term, affordable financing. Establishing GreenFinanceSF has given San Francisco another instrument to meet the City's ambitious energy and greenhouse gas reduction goals.
- **Step 2: Building Owner or Master Tenant Chooses Retrofit Project** – Prologis hired Johnson Controls to serve as their contractor for their Pier 1 energy efficiency retrofit, in part due to Johnson Controls' experience with an array of energy efficiency financing options. Johnson Controls performed an energy assessment of Pier 1 and developed multiple Scopes of Work for Prologis to review. These Scopes of Work included proposed energy efficiency measures and their projected savings and costs, and cost estimates for renewable projects weighed similarly against projected energy savings. Johnson Controls worked with Clean Fund to develop preliminary PACE financing terms, which were used for PACE project economics scenarios.

In parallel, Clean Fund worked with the GreenFinanceSF program to verify that PACE finance could be used for the Pier 1 property. Pier 1 is owned by the Port of San Francisco, and under many other programs, PACE finance cannot be used for publicly-owned properties. However, GreenFinanceSF's underlying legislation allowed Prologis' long-term leasehold interest to serve as the collateral to support the PACE tax lien mechanism. The leasehold interest value was determined by County Assessor data and Prologis pays possessory interest taxes based on that value.

Normally a PACE capital provider manages the PACE finance aspects of a project from start to finish. In the case of Pier 1, the complicated property situation—with the Port owning the underlying property as well as being Prologis' major tenant in the Pier 1 building—required the GreenFinanceSF program staff to take the lead role in coordinating the PACE process across multiple City departments.

- **Step 3: Building Owner or Master Tenant Chooses Financing Partner** – Often this step occurs simultaneously with Step 2 above, for the simple reason that in most situations project scope is determined by financing terms. The choice of financing partner occurred later in the process with the Pier 1 project due to the lead role GreenFinanceSF played in coordinating both the PACE financing and its associated Qualified Energy Conservation Bond (see below). After getting the project over its many hurdles, GreenFinanceSF introduced Prologis to financial institutions that had agreed to participate in the PACE program. Because GreenFinanceSF is an “open-market” model, Prologis was able to work with any qualified financial institution to provide financing. Prologis requested proposals from two institutions. After reviewing the potential interest rate, term, and other bond terms, Prologis chose Clean Fund as their financial partner.

Properties with a mortgage must obtain “lender affirmative acknowledgement” in order to participate in the GreenFinanceSF program. This ensures that all parties involved understand the terms of the PACE financing and the building’s primary mortgage financing is protected. Because Prologis owns the Pier 1 leasehold interest outright, there was no lender involved. Upon receiving approval from the Port of San Francisco to proceed, GreenFinanceSF implemented the PACE financing according to the terms negotiated between Prologis and Clean Fund. Clean Fund purchased the PACE project bond, and the City provided the proceeds to Prologis to pay for project costs. For the 20 year term of the financing, Prologis will have the PACE principal and interest included in its property tax bill, which will be collected by the City and remitted to Clean Fund.

- **Step 4: Building Owner or Master Tenant Pays Assessment over Agreed-Upon Term** – As the Pier 1 master tenant, Prologis reached agreement with the Port of San Francisco and all building subtenants to pass through the pro-rata share of the additional property tax assessments, along with all energy and costs savings associated with the retrofit. Thus, the tenants will receive their proportional share of both the benefits and costs of the project over the 20-year term.

A relatively unique aspect of the project was its use of Qualified Energy Conservation Bonds (QECBs). QECBs are a form of tax credit bond that can be issued to finance government initiatives designed to reduce greenhouse gas emissions. Proceeds can be direct tax credit payments in lieu of interest to bondholders, or as cash payments to issuers. In California, QECBs are allocated quarterly by the California Debt Limit Allocation Committee (CDLAC). \$22.3 million in QECB volume cap was up for allocation while the Prologis project was under development. The GreenFinanceSF program applied for \$1,400,000 in May and was awarded allocation for the Pier 1 project on July 18, 2012.

The use of QECBs had two primary benefits for the Pier 1 project:

- The QECBs provided an interest rate buy-down of 3.07%.
- The strict schedule requirements of QECB awards helped to ensure that the Pier 1 project progressed to completion quickly.

QECBs are often not used in commercial building projects because they trigger prevailing wage requirements. Because the Pier 1 project was on Port of San Francisco land, these prevailing wage requirements were already in place, automatically satisfying that requirement for this particular project.

All parties agree that the Pier 1 PACE financing would have been completed in the absence of QECBs, but this additional financing did improve the financial terms for Prologis, thus helping to

increase the scope of their energy efficiency retrofit, while also helping to speed up the completion of the project.

■ **Tools:**

- [PACENow Lender Consent Guide](#)



Building Description

Located along San Francisco's waterfront and adjacent to the iconic Ferry Building, Pier 1 was formerly a sugar warehouse and is now owned by the Port of San Francisco and leased on a long-term basis to Prologis. Dating from 1932, Pier 1 is in the National Register of Historic Places.

In 2001, Prologis (formerly AMB Property Corporation) renovated Pier 1 and converted it into Class A office space. Prologis received recognition for the sustainable features of its 2001 renovation, but decided in 2011 that it was time to enhance the sustainability of Pier 1, and set goals to improve the building's energy efficiency, reduce utility bills, and improve building comfort. The company also sought to install a solar array to further reduce grid energy purchases and showcase renewable energy at its global headquarters.



Project Partners

Prologis is the leading owner, operator and developer of industrial logistics real estate across the Americas, Europe and Asia. Prologis has committed to implementing energy efficiency and renewable energy projects across its portfolio of 554 million square feet of industrial and commercial properties in 21 countries.

Clean Fund LLC, a PACE finance firm based in San Rafael, California, funded the project by purchasing the \$1.4 million PACE bond from the San Francisco's GreenFinanceSF program. For the Prologis project, Clean Fund completed upfront project qualification and analysis that allowed Johnson Controls to include PACE finance in their initial project proposal. Clean Fund then worked extensively with the City to ensure that a leasehold interest could support a PACE bond that would be attractive to investors, and finally Clean Fund negotiated the bond terms with Prologis after being selected as capital provider following an open, competitive process.

Renewable Funding is a private energy finance company and program implementer that works with nearly 150 local governments in the United States and Australia to design and administer PACE programs for commercial properties. Renewable Funding helped San Francisco to design the GreenFinanceSF program, and currently administers the CaliforniaFIRST commercial PACE program, which serves two-thirds of the population of California and also uses the open market model.

Johnson Controls is a global energy services company and is leading the retrofit work being completed on Pier 1. The company delivers products, services and solutions that increase energy efficiency and lower operating costs in buildings. Its solutions have reduced carbon dioxide emissions by 19 million metric tons and generated savings of \$7.5 billion since 2000.

GreenFinanceSF is the City and County of San Francisco's Commercial PACE program and is administered by the Department of the Environment and the Controller's Office of Public Finance.

Technologies Applied



This project included the following improvements at the Pier 1 facility:

- A 200 kW rooftop solar array
- Upgrade of 1,500 lighting fixtures to more efficient technology, including:
 - Upgrade existing T5/T8 fluorescent bulbs with high efficiency bulbs in existing fixtures
 - Replace existing ballasts with low power ballasts
 - Replace PAR floodlights with LED bulbs
 - Replace CFL fixtures with LEDs
 - Projected to reduce lighting energy demand by more than 50 kW
- Daylight harvesting and occupancy sensors to turn off lights when not needed
- Re-commissioning of the building's heating, ventilation and air conditioning systems to provide better comfort and use less energy

Financing Terms and Sources



Ninety percent of the Prologis project was financed with a \$1.4-million, 20-year, low-interest bond purchased by Clean Fund from the City of San Francisco.

PACE bond features	
Out-of-pocket PACE costs	\$0
Repayment term	20 yrs
PACE bond market interest rate	6.93%
QECB rate subsidy	3.07%
Net interest rate	3.86%

PACE financing costs were allocated pro rata to all subtenants including Port of San Francisco based on building square footage per existing leases.

Energy and Cost Savings



The improvements are projected to reduce the building's purchased electricity by 32 percent, thus cutting its utility bills by \$98,000 annually.

The avoided cost of the project increases as grid energy prices rise, projected at 3.5% per year, leading to a Net Present Value of energy savings of approximately \$350,000.

Prologis will be entering all actual utility data into Portfolio Manager, and information in this space will be updated as data arrives.