How C-PACE Solves the Sustainability Funding Dilemma for Nonprofits

By Larry Derrett

The nonprofit segment can benefit substantially from using C-PACE private capital to fund sustainability projects. Nonprofits who own their buildings are often plagued by unusually high energy and repair costs due to old inefficient equipment that cools, heats or lights their facilities.

Replacing this equipment requires capital which must be obtained through increased donations or debt. In many cases, neither are an option.

Now there is a solution with C-PACE.

By answering each of the questions below, this paper reveals how C-PACE uniquely solves the sustainability funding challenges faced by nonprofits. After reading this article, hopefully you'll agree the case for C-PACE is quite compelling.

1) Why can C-PACE provide private capital when traditional lenders say no?

2) How can nonprofits increase their NET cash flow by using C-PACE for efficiency projects?

3) Does C-PACE require financial covenants, restrictions on operations or reporting requirements often found in traditional debt facilities?

For those who are pressed for time and can't read the entire article, skip to the Summary at the end.

If you are unfamiliar with the C-PACE program, it has been used to provide capital to fund over 2,000 projects related to energy efficiency projects, retrofits, renewables, and the "green elements" of new construction projects. See the bottom of this article to learn more about the C-PACE program, where it is offered in the US and the types of projects which can be financed.

The scope of this article has been simplified by focusing solely on energy efficiency projects.

Nonprofits such as private schools, churches, assisted living centers, and hospitals occupy or own a large number of facilities in the US. They range in size with varying abilities to access funding through donations or the traditional debt markets.

The Repair vs Replace Dilemma for HVAC Equipment

Nonprofits who own facilities often face a dilemma when old HVAC equipment breaks down. Do they *repair* it for another year or two knowing it's a short-term band-aid with the continuation of unusually high operating costs? Or, do they replace it and reap the benefits of a comfortable environment and a large reduction in operating costs?

***Note**: this dilemma is faced by all building owners, not just nonprofits.*

A Typical Scenario

A nonprofit operating in Texas relies on an old, inefficient HVAC system to cool their building. Energy bills have increased substantially over the past few years and expensive repairs have become the norm. It's mid-July and 80 degrees inside the building. Employees are understandably complaining. Struggling to keep up with the higher cooling demand, the old system breaks down and needs repair.

The nonprofit's mechanical contractor who has serviced the building for years, is called out and quotes a very high price to repair the equipment. After having performed costly repairs over the past two years, the contractor again suggests the equipment be replaced. Once again, the nonprofit faces the *repair vs replace dilemma.*

The Funding Problem

In raising funds for basic operations, the nonprofit has tapped into existing and new donors. Furthermore, it sought funding from local banks previously to replace the HVAC system, but

was turned down. That's because the banks applied their traditional approach to credit, and the nonprofit didn't fit in the box (which I appreciate having been a banker for years).

Realizing the banks will say no again, there is no option other than the expensive repair and enduring another year of extremely high operating costs. This begs the question: what will the nonprofit do the next time the equipment breaks down?

This is where C-PACE comes into play.

1) Why can C-PACE provide private capital when traditional lenders say no?

This is an obvious question and the answer reveals why C-PACE is truly unique.

C-PACE can often be used to fund projects that are unacceptable to traditional lenders. That's because the C-PACE approach to credit is totally different.

How can the C-PACE lender use a different approach while still managing credit risk? One has to understand the basic financial/legal underpinnings of the program as summarized below.

C-PACE funding is repaid through a property assessment quite similar to a property tax levied on a building. As such, the assessment is *attached to the building* which survives changes in ownership. If the nonprofit goes out of business, the next owner of the building will become responsible for the C-PACE assessment.

Therefore, the C-PACE lender is most concerned with whether ***any*** owner would value the usefulness and location of the building. For example, an office building in a heavily populated area is generally a good candidate for C-PACE. By contrast, a specially designed amusement park in the suburbs is often not a good fit.

There are other items C-PACE lenders consider such as whether the ownership has endured a recent bankruptcy, are mortgage payments current, and are there any mechanics liens, etc....attached to the building. However, one can see there should many cases where a nonprofit can obtain C-PACE funding which is otherwise not available.

This alone is a great benefit, but there's much more.

2) How can nonprofits increase their *NET* cash flow by using C-PACE for efficiency projects?

Achieving the above almost seems too good to be true - but it is. That's because C-PACE can be repaid over 20+ years, resulting in very low annual debt payments. As such, the debt payments are more than covered by the increase in energy savings and avoided equipment repair costs.

For virtually any pure efficiency retrofit, the nonprofit's NET cash flow will increase when using C-PACE. The incremental cash flow can now be used for ongoing operations or to fund other investments.

This is best explained below. A picture is worth a thousand words. Let's assume a $500,000 project which achieves savings that pay back the cost in slightly over 7 years.

Project Illustration	
Efficiency project cost	$500,000
Annual energy and maintenance savings	$70,000
Simple payback	$500,000/$70,000=7.14

As shown below, the annual Total Savings of $70,000 exceed the annual C-PACE assessment of $42,984. This creates incremental *NET* cash flow of $27,016 which can be used to subsidize operations or fund other investments. Note how in Year 7 the Cumulative Net Savings are $189,112!

Year	1	2	3	4	5	6	7
Energy savings	50,000	50,000	50,000	50,000	50,000	50,000	50,000
Maintenance savings	20,000	20,000	20,000	20,000	20,000	20,000	20,000
Total savings	70,000	70,000	70,000	70,000	70,000	70,000	70,000
Debt payments	42,984	42,984	42,984	42,984	42,984	42,984	42,984
Net savings	27,016	27,016	27,016	27,016	27,016	27,016	27,016
Cum. net savings	27,016	54,032	81,048	108,064	135,080	162,096	189,112

Let's consider another scenario assuming the bank agreed to fund the project, but requires repayment over 7 years (instead of 20).

Year	1	2	3	4	5	6	7
Energy savings	50,000	50,000	50,000	50,000	50,000	50,000	50,000
Maintenance savings	20,000	20,000	20,000	20,000	20,000	20,000	20,000
Total savings	70,000	70,000	70,000	70,000	70,000	70,000	70,000
Debt payments	87,654	87,654	87,654	87,654	87,654	87,654	87,654
Net savings	-17,654	-17,654	-17,654	-17,654	-17,654	-17,654	-17,654
Cum. net savings	-17,654	-35,308	-52,962	-70,616	-88,270	-105,924	-123,578

As you can see, Total Savings of $70,000 per year do not cover the $87,654 debt payment. This results in an annual *NET cash flow deficit* of ($17,654) which places even more pressure on the nonprofit to raise additional funds to cover shortfalls. In a more likely case, the debt would have to be repaid over 5 years resulting in an even greater annual deficit than shown above.

3) Does C-PACE require financial covenants, restrictions on operations, or reporting requirements found in traditional debt?

In short, the answer is no. In my many years of working in the finance business as a banker and CFO, I've never seen a debt structure offering this type of flexibility. Examples are below.

- If the owner chooses to sell the building, the ongoing C-PACE assessment becomes the obligation of the buyer. This is automatic and cannot be blocked by the C-PACE lender.
- The C-PACE lender cannot accelerate the unpaid outstanding, even if a payment is missed. They are entitled only to the annual assessment that has been billed, but not paid.
- The building owner is not burdened with ongoing requirements of financial statements, financial covenants or prohibitions against asset sales, ongoing investments, etc..
- C-PACE is non-recourse - the owners of the building will not be asked to provide debt repayment guarantees.

It's hard for me to imagine any other debt type arrangement with the *friendly capital* provided by C-PACE.

Summary

- Due to the way in which creditworthiness is determined, C-PACE can provide private capital for efficiency retrofits even when traditional lenders cannot.
- Since C-PACE is repaid over 20+ years, pure efficiency projects will generate incremental *NET* cash flow to fund operations or other badly needed investments.
- The nonprofit can freely sell the building and the C-PACE assessment is automatically transferred to the buyer.
- C-PACE total outstanding debt cannot be accelerated, nor does the nonprofit have to operate under onerous reporting requirements and other restrictive financial or operating covenants.

My next article will focus on why C-PACE has not made greater penetration in the nonprofit market. **A preview**: many of the mechanical contracting companies who are well equipped to pitch the economic benefit of replacing HVAC equipment, *choose to ignore nonprofits* in

their marketing efforts. That's because, as I've heard time and again, nonprofits never have any money! C-PACE changes that and *EnFlux* is focused on working with the mechanical contracting community to spread the word - *you can close more large projects by introducing C-PACE to your customers.*

Questions? Feel free to reach out to Larry Derrett, founder and CEO of *EnFlux* Building Solutions.

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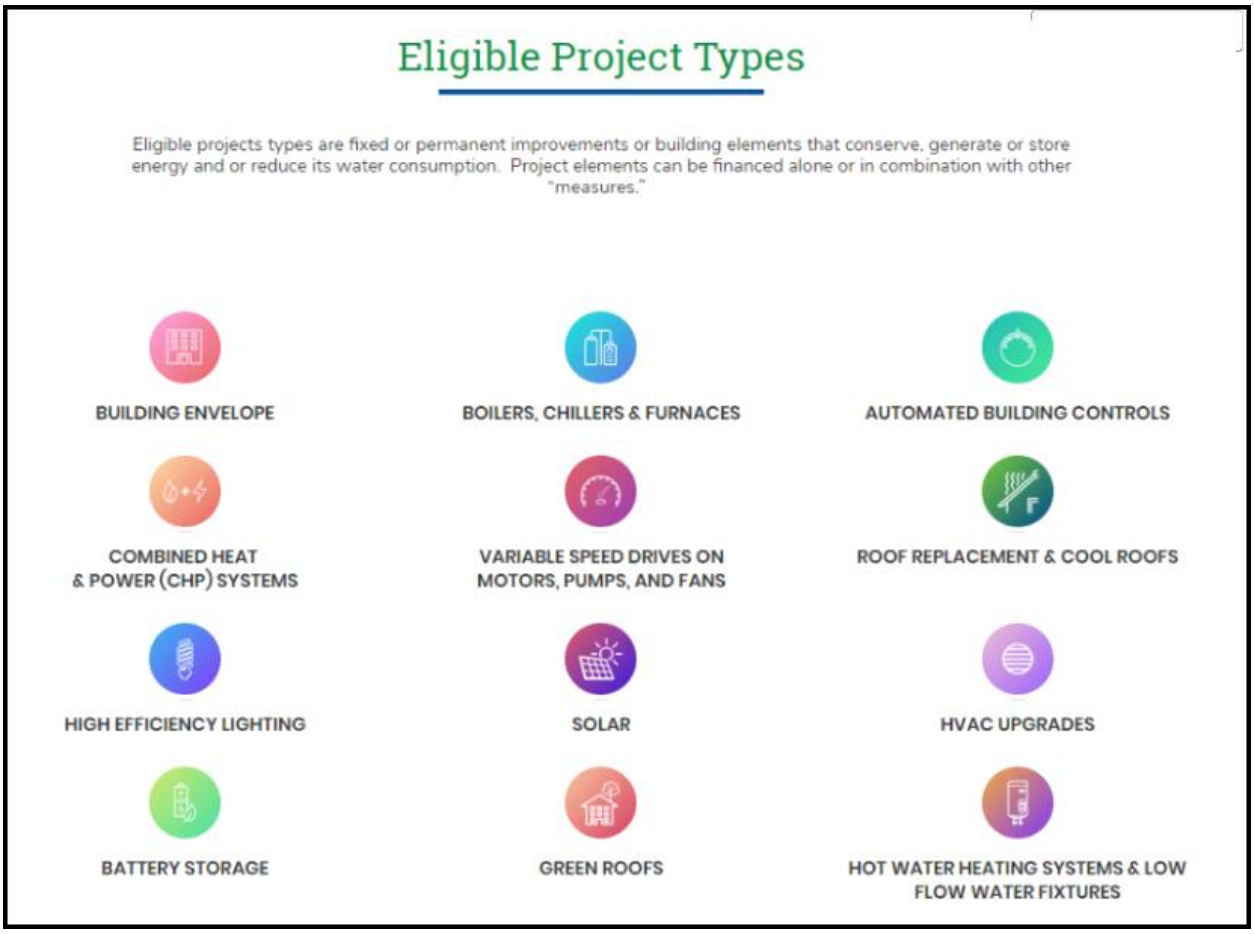
To learn more about C-PACE and where the program is offered click here. See below for examples of projects which can be funded. Most C-PACE lenders prefer projects of no less than $250,000 or $500,000.



About the author: Larry Derrett is the founder and CEO of *EnFlux* Building Solutions, which provides financing and energy solutions to building owners directly or through contractors who provide them services. For three years, he led the financial structuring group at Enron Energy Services working solely on the origination side of the business helping clients understand the importance of allocating capital to energy efficiency projects. Upon the demise of Enron, he formed HVAC Capital Corp whose clients included large mechanical contractors with a national footprint. HVAC Capital provided a finance program that contractors could use to offer financing to their customers for replacement projects. During this time, Larry trained hundreds of sales reps on the finer points of incorporating financial selling into their sales process. Having sat on both sides of the desk as a banker and CFO, he brings a unique perspective to why businesses often fail to invest in energy efficiency projects.