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MEET MITCH PATEL: A HOTELIER WITH A PASSION

EXPERTS SPEAK - GREEN

YES, YOU CAN AFFORD TO GO GREEN

PACE loans show promise

By **KATHLEEN J. WU**

Hotels "going green" is no longer just buzz or chatter. Over the last decade, the hospitality industry in particular has recognized the need and social responsibility to be more energy and resource efficient. Not only is it expected, if not demanded, by hotel guests and "the right thing to do," but it can save hotels a significant amount of money each year.

According to the Environmental Protection Agency, hotel water use accounts for approximately 15 percent of total water use in commercial facilities in the U.S. Water usage represents the second highest utility cost for hotels, second only to energy. Hotels do not typically report energy usage. However, on average, hotels in the U.S. spend $2,196 per available room each year on energy. Utility costs typically represent between six and ten percent of a hotel's operating costs, depending on the size and type of hotel.

Implementing water-efficiency practices and reducing energy consumption can decrease a hotel's water use by an average of 15 percent and its energy use by approximately ten percent, decreasing the hotel's operating costs anywhere from ten to 15 percent.

Energy efficiency gives hotel owners and operators cost savings that decrease operating expenses and benefit the bottom line. It also improves the longevity of capital equipment, improves guest comfort, and shows a commitment to social responsibility.

Hotel measures for improving energy efficiency can include (to name a few):

- **Scaling back on laundry services (with placards in guest rooms making towel washing optional).**
- **Upgrading or retrofitting building systems, equipment, and appliances (including laundry equipment, lighting systems, windows, thermostats, showers and faucets, and HVAC units).**
- **Using qualified compact fluorescent lights and light-emitting diode exit signs.**

ABOUT THE AUTHOR

Kathleen Wu is a partner at the Andrews Kurth Kenyon LLP Dallas Office. Kathleen's practice is concentrated in the areas of real estate, finance, and business transactions. Her broad-based representation includes all aspects of the acquisition, management, and disposition of real estate, the origination and servicing of loans, hospitality industry matters, private-public partnerships and general business matters.

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The first major hotel project to use PACE financing was the Hilton Los Angeles/Universal City in 2014
(Image Courtesy: © 2017 Hilton Hotels & Resorts)

- **Making recycling available throughout the hotel common areas and guest rooms, including newspaper, plastic bottles and bags, and aluminum.**
- **Using sensors in the lobby that automatically adjust lighting when natural light is at its peak.**

The challenge is, of course, finding the dollars to implement changes in a hotel's systems and operations. Even though statistics show owners fully recovering money spent on sustainability measures over time, the up-front capital investment from hotel owners and investors is significant. And it can take many years before an owner will reap full recovery.

Property Assessed Clean Energy (PACE) financing was designed to help bridge the gap and has shown promise.

PACE is a financing structure allowing hotel owners (among other commercial property owners) to get low-cost, long-term funding for energy efficiency, water conservation, and renewable energy projects. The funding can cover all of a project's costs, with no out-of-pocket costs to the hotel owner, and financing terms up to 20–30 years (depending on the hotel's location and applicable PACE program). Institutional investors provide the capital for PACE financing. Those institutional investors work with municipalities and receive bonds in return, which generally pay six to seven percent interest.

Repayment of PACE loans is an assessment on the hotel's regular tax bill, so repayment is in annual (or semi-annual) installments. This stretches out amortization, making it a relatively inexpensive way to finance efficiency improvements. It allows the upgrades to be cashflow positive.

The first major hotel project to use PACE financing was the Hilton Los Angeles/ Universal City in 2014. The hotel was built in 1983 and needed renovation. Taking into account standard upgrades plus sustainability improvements, a first mortgage would not cover the scope of the renovations. Alternatively, Hilton financed the $7 million in green building improvements through the PACE program. It has been reported that after re-opening, in the first operating year Hilton Los Angeles/Universal City's NOI increased more than $300,000. ROI was 78% with a total project return estimation of $12.5 million, increasing the overall value of the hotel by $30 million.

Also in Los Angeles County, the Constance Hotel in Pasadena, California, built in 1926, was renovated with PACE financing in 2014. The renovation involved $6.8 million in PACE financing.

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The first new construction hotel project to use PACE financing was the Westin Hotel in Milwaukee. PACE financing covered $6.8 million of the project's costs. The hotel broke ground in 2016 and is anticipated to open in June 2017.

Of course, there are advantages and disadvantages for PACE financing over other options, all of which should be explored. The results of the Westin Hotel in Milwaukee remain to be seen. However, PACE projects involving upgrades seem to indicate that PACE is a viable consideration for hotel owners, investors, managers, and operators that want to go green, but cannot afford to—or do not want to—incur the upfront costs. HT