

PACE Loan Considerations for Commercial Real Estate Lenders

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Property Assessed Clean Energy (PACE) loans provide property owners with financing for "green" improvements designed to increase energy efficiency, water conservation, disaster resiliency and renewable energy solutions. PACE programs are available for both residential properties (R-PACE) as well as commercial properties (C-PACE) and allow property owners to finance the up-front cost of eligible improvements over time through a voluntary property assessment.

The first C-PACE program was instituted in Sonoma County, California in 2009. While C-PACE loans are not new, they are growing in popularity as a tool for financing energy-efficient and renewable energy improvements to real property. PACE loans will likely continue to grow in popularity, at least in the commercial context. Here are a few things commercial real estate lenders should keep in mind when analyzing a property that is encumbered by a C-PACE loan:

- **Statutorily Enacted.** C-PACE loans are authorized by state and local legislation. There is currently no federal program for C-PACE loans. At present, over 30 states have either enacted, or are considering, legislation to implement C-PACE programs. States with funded programs include New York, Texas, California, Florida, Connecticut, and Virginia. Not all C-PACE loan legislation is identical and nuances will exist among the various C-PACE loan programs.
- **Key Characteristics.** A C-PACE loan is usually for a term of 15 to 20 years, but can have a term as long as 25 to 30 years. The associated lien will run with the land. In most jurisdictions, C-PACE loans are non-recourse to the borrower/property owner and cannot be accelerated.
- **Improvement Value.** While improvements funded by C-PACE loans theoretically add to the value of an underlying property and, over time, should improve cash flow, definitive empirical evidence is scant and underwriters should scrutinize the data they receive in this regard.
- **Super-Priority Lien.** C-PACE loan assessments enjoy a lien priority akin to real estate taxes and, as such, would have priority over a recorded mortgage or deed of trust. The assessment encumbers the property. Counsel to mortgage lenders should be on the lookout for indications of a C-PACE loan when reviewing title reports and drafting loan documents.
- **Foreclosure Risk.** Although C-PACE loans have existed since 2009, there has not been a reported case relating to a foreclosure of a C-PACE loan. Nonetheless, the super-priority given to C-PACE loan assessments remains a factor that lenders should be aware of and evaluate on a deal by deal basis.
- **Mortgage Lender Protections.** Since C-PACE loans share so many similarities with real estate taxes, lenders should consider implementing procedures for evaluating them from an underwriting and deal structuring point of view. In most circumstances, mortgage loan documents already require lender consent before a borrower can obtain any financing that would encumber the mortgaged property, and these types of loan document provisions would certainly necessitate the borrower having to come to the lender for prior approval in order to enter into a C-PACE loan transaction during the term of the mortgage loan.

If a C-PACE loan is already in place at the origination of a mortgage loan financing, lenders could also require up-front and/or ongoing reserves and/or escrows for the C-PACE payments to insure proper and timely payment of the assessments in the same way many lenders reserve and/or escrow for real estate taxes and insurance premiums.

In the residential context, some people are calling for greater consumer protections on the basis that R-PACE loans should be subject to the same federal oversight as traditional residential mortgage loans. The Consumer Financial Protection Bureau, for example, is scheduled to review regulations for R-PACE loans in 2019. It remains to be seen if similar efforts will be made in the commercial context, perhaps to mitigate concerns regarding lien priority.

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