

WHITE PAPER

**C-PACE FINANCING:
AN UNCOMMON SOLUTION TO
PROJECT FINANCING**

WRITTEN BY:

JAMES C. SEIFFERT
JAMESON M. SEIFFERT
NICK MAGLASANG

**STITES &
HARBISON**

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[James C. Seiffert](#)
Stites & Harbison, PLLC
jseiffert@stites.com



[Jameson M. Seiffert](#)
Stites & Harbison, PLLC
jmseiffert@stites.com



[Nick Maglasang](#)
Twain Financial Partners
nick.maglasang@twainfinancial.com

Commercial Property Assessed Clean Energy (“C-PACE”) is an overlooked and underutilized solution to funding energy efficient capital improvements which commercial developers and building owners should consider when putting together their project’s capital stack.¹ Often referred to as “assessment financing,” C-PACE allows a property owner to repay all hard and soft costs of energy and water improvements by way of a special, voluntary assessment levied against the qualified property. Commercial projects² which incorporate renewable energy or alternative energy technologies or install energy efficiency measures are all viable candidates for this low risk financing.³ Funding is available for new construction and renovation and can be obtained retroactively if a project has already started or is completed.⁴ While C-PACE program standards differ from state to state, and jurisdiction to jurisdiction, one thing is clear – a project need not rely on costly state-of-the-art technologies to qualify, but rather can secure funding by merely installing energy savings improvements that are more efficient than the building’s current energy use or meets or exceeds local building specifications. Typically, items eligible for C-PACE financing include, but are not limited to HVAC systems, LED lighting, roofing, low-flow plumbing, building envelope improvements, automated controls and insulation.

C-PACE programs are enacted by individual states and adopted by local governments.⁵ In 2015, Kentucky passed its C-PACE program, the Energy Project Assessment District (“EPAD”) Act (the “Act”) which authorizes counties and municipalities to establish energy project assessment districts which, in partnership with the private sector, provide capital for sustainable energy improvements to commercial property through a special, long-term, voluntary property assessment.⁶

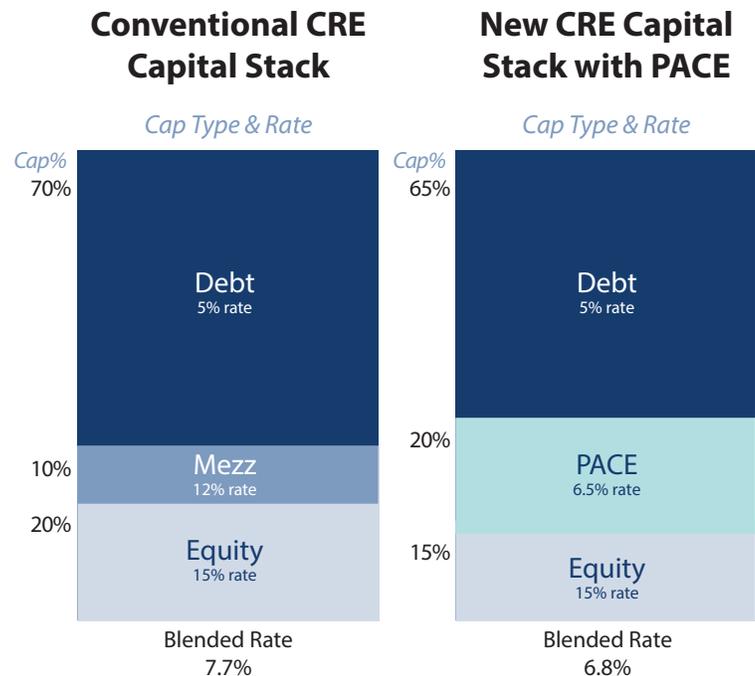
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This is not a government sponsored loan or subsidy program and no taxpayer funds are expended by local governments. Rather, the government’s role, both at the state and local levels, is that of facilitating and administering the program while allowing the private sector, be it a financial institution or a private specialty lender, to structure and finance qualified projects.

C-PACE financing is viewed as a “gap filler” which compliments, rather than replaces, traditional commercial financing. Depending the size of the C-PACE loan and underlying asset, interest rates on C-PACE financing currently range between 5.0% to 6.0%. Therefore, C-PACE lenders are not really competing with senior debt. Rather, projects are utilizing C-PACE to replace more expensive mezzanine debt or preferred equity, ultimately lowering the blended cost of capital for the project. When considering a project’s capital stack, C-PACE financing works well with federal and state incentive programs, such as tax credits, tax incremental financing, bond financing, EB-5 and utility rebates.⁷

Moreover, with the assessment attached to the property, there is an opportunity for the property owner, in certain situations, to pass the assessment along with some of the savings through to commercial tenants by way of the commercial lease or hotel guests as an additional charge on their hotel bills.

When compared to traditional commercial financing, C-PACE differs markedly both in its terms and its repayment. The terms of a C-PACE assessment customarily include: (i) 100% upfront financing with no required down payment, (ii) competitive fixed market rate interest, (iii) self-amortizing principal and interest payments, (iv) long-term maturity based on the useful life of the improvements, often lasting



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between 20 and 30 years (often including prepayment provisions) and (v) nonrecourse obligation with no personal guarantees. As for repayment, C-PACE proceeds are repaid by a special assessment, paid annually, bi-annually or quarterly, depending on the jurisdiction, which attaches to the property thereby eliminating any personal liability to the property owner. With the aid of C-PACE financing, a project can often generate cost savings which exceed the annual assessment amount resulting in a more energy efficient, sustainable property, increased property values and immediate positive cash flow.⁸

In exploring the use of C-PACE in Kentucky, we spoke to a number of state and local lenders, many of whom said, anecdotally, lenders, in general, are skeptical of this type of financing since the assessment is viewed as a superior lien having priority over a mortgage. A closer examination of the C-PACE assessment, however, may ease their apprehension. First, the property owner must obtain written consent from all existing mortgage holders before a C-PACE assessment can be added to the property's tax bill. Consequently, the lien will not attach to the mortgage property without the existing lender(s) having the opportunity to evaluate the relative risk of the assessment.⁹ Second, the energy improvements covered by C-PACE financing increase the overall value of the mortgage property, thus increasing, rather than decreasing, the property's collateral value. Third, upon a mortgage default or tax foreclosure, only the annual C-PACE assessment (including penalties, interest and fees) that is in arrears becomes due and payable. Consequently, there is no acceleration of the outstanding principal as there is with a commercial mortgage.¹⁰ As a result, C-PACE capital providers do not require an inter-creditor agreement and cannot prevent, restrict or otherwise impact the senior lender's foreclosure remedies. In the event of a default on the senior debt, the senior lender can foreclose on its mortgage in the same manner as if it were the sole lienholder on the property. Fourth, a mortgage lender will often require, as an additional security, property owners to escrow the C-PACE assessment along with property taxes and insurance and require the establishment of a reserve to collect the payments through the construction period. Also, in an effort to appease mortgage lenders' concerns, capital providers often agree to capitalize the first 24 months of assessment payments. Finally, upon a sale or disposition of the property, the outstanding C-PACE obligation transfers with the property and becomes the responsibility of the new property owner.¹¹

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For Kentucky projects, the EPAD Act allows the local governing body to dictate the terms of the application process.¹² Consequently, applying for C-PACE financing will differ from district to district. For projects in Metro Louisville, a two-step application process exists. Initially a property owner¹³ will submit a short Initial Eligibility Form (the “IEF”) to the Metro Louisville Office of Advanced Planning and Sustainability, the program’s administrator.¹⁴ The content of the IEF confirms the property owner’s interest in the program and verifies the property’s qualification and the project’s eligibility.¹⁵ While it is not a prerequisite, it is recommended that the property owner consider conducting an energy audit and submitting their results with the IEF.¹⁶ The EPAD Act does not impose a statutory requirement that the energy improvement(s) generate more energy savings than the repayment amount; however, it is advised that projects demonstrate a savings to investment ratio of greater than 1.0.¹⁷ Often times, a project’s plans, specifications and budget do not need to be altered in order to qualify for C-PACE financing. Upon approval of the IEF by the program administrator, the property owner next submits the Formal Project Application (the “FPA”) along with required supporting documentation, which identifies: (i) the particular qualifying improvements and an estimate of the energy savings and (ii) the essential financials about the property and its operating status.¹⁸

During this process, the property owner will look to acquire financing by aligning with a capital provider.¹⁹ The EPAD employs what is known as an “open source” funding model, in which private capital providers compete to provide competitively priced capital, or a turnkey program, in which a single private financing source is pre-selected to simplify the funding process and reduce complexity for the building owner.²⁰ The property owner and the capital provider will negotiate the terms of the financing and although each C-PACE capital provider has its own underwriting guidelines, most of them will rely on the existing equity in the property and finance a percentage of the property’s market value depending on renovation of an existing building or new construction.²¹ For example, Twain Financial Partners’ target C-PACE lien-to-value ratio is 25% of “as complete” value for existing or new construction. An EPAD lender can prove to be a valuable resource throughout the process, from developing the scope of the energy project, to assisting in the selection of an energy contractor, to assisting in the preparation of the Formal Program Application as well as the EPAD Assessment Schedule. Upon reaching an agreement on the lending terms, a EPAD Program Financing Agreement (the “EPFA”) is entered into

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among the property owner, the capital provider and the program administrator. One of the more important documents required to close the transaction is the written consent of each lender holding a mortgage lien on the property evidencing its acceptance of the special assessment. It is also recommended that the property owner make sure the C-PACE financing in no way violates the terms of any other loan or credit facility.²² At closing, 100% of the C-PACE proceeds will be funded into an escrow account to be used for the PACE eligible expenses and will be disbursed as the energy costs are incurred. It is also at this time that the special assessment is added to the property's tax bill and the governmental entity levying the property taxes will assign its rights to the C-PACE payments to the capital provider. There are certain fees associated with this financing which include the cost of an energy audit, a one-time program administrator fee, and legal and closing costs. It is possible to roll these costs into the financed amount which saves the project from having to pay out of pocket for these expenses at closing. The time needed to close a C-PACE financing depends upon jurisdiction and project, but generally requires 30-60 days, start to finish.²³

C-PACE financing is not available to all projects nor will it make sense for all qualified projects to use it. It is worth noting that there are some drawbacks. For example, it has limited application since not all states have enacted the program, it is not inexpensive since interest rates often exceed traditional mortgage rates, it can be a challenge persuading a mortgage lender to grant consent, and it can prove difficult in convincing a buyer to acquire the property with the assessment. And equally important, developers and property owners understand the economics of energy improvements – high upfront costs often take considerable time to recoup the full economic benefits. However, C-PACE financing, often overlooked and underutilized, is an innovative solution that allows property owners to install these upgrades at no out of pocket costs and no personal liability, improve their property values, while repaying the debt over the life of the improvements.

¹ The commercial property assessed clean energy (C-PACE) program addresses commercial energy installations and upgrades. C-PACE applies to income-generating properties (commercial properties which includes multifamily (5+ residential units)). See [“Good Industry Practices For C-Pace Capital Providers In Documenting Compliance With Program Rules And In Underwriting And Closing Transactions.”](#) C-PACE Alliance, January 19, 2021.

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² Qualified projects include retail, industrial, office, hospitality, agricultural, multifamily residential units (consisting of five units or more units) and qualified property owners include both for-profit and nonprofit businesses. For example, see Section 3.B., page 4-5, Energy Project Assessment District (EPAD) Program Manual for Louisville, KY, Version 1.0, revised March 2020.

³ Examples of energy or alternative energy technologies include solar systems, wind power and storage systems such energy products such as HVAC, windows, doors, building envelope, green or cool roofs, meters, elevators, pools and control systems. Soft cost include the cost of the product, installation and other approved ancillary costs. cost of and fees for energy, water and similar audits, appraisals, labor, designs, drawings, engineering services, building permit fees, surveys, inspections, materials required in connection with the installation of the eligible products and technical reviews. For example, see Section 3.C.1, p. 5-6, Energy Project Assessment District (EPAD) Program Manual for Louisville, KY, Version 1.0, revised March 2020.

⁴ [The PACE Financing Guide](#), Twain Financial Partners.

⁵ As of February 2021, 39 states have enabled C-PACE financing and at least 22 states are operational. See <https://www.pace-equity.com/how-pace-financing-works> for all states enacting PACE programs.

⁶ Kentucky Revised Statutes Sections 65.206-65.209. There are currently 13 active EPADs in Kentucky: Boone County, Campbell County, City of Covington, Fayette County, Franklin County, City of Hillview, Jefferson County, Kenton County, Morgan County, Nelson County and Pendleton County.

⁷ Section 5.H, Energy Project Assessment District (EPAD) Program Manual for Louisville, KY, Version 1.0, revised March 2020 for the specific Mortgage Lien Holder Consent to Special Assessment form.

⁸ [PACE financing-A primer for real estate investment management professionals](#), Robert Johnson, Jr. PACE Equity, October, 2016, p. 47.

⁹ For example, see Section 4.B.(1), Energy Project Assessment District (EPAD) Program Manual for Louisville, KY, Version 1.0, revised March 2020 for the specific Mortgage Lien Holder Consent to Special Assessment form.

¹⁰ See "[Mortgage Lender's Guide to C-PACE: Lender Consent](#)," C-PACE Alliance, October 22, 2019.

¹¹ [PACE financing-A primer for real estate investment management professionals](#), Robert Johnson, Jr. PACE Equity, October, 2016, p. 50.

¹² For purposes of outlining the EPAD application process, we have relied on the rules applicable to projects in Metro Louisville. See Energy Project Assessment District (EPAD) Program Manual for Louisville, KY, Version 1.0, revised March 2020.

¹³ See Section 3.D7, Energy Project Assessment District (EPAD) Program Manual for Louisville, KY, Version 1.0, revised March 2020 for the specific criteria that must be satisfied to be a qualified property owner.

¹⁴ The Jefferson County EPAD program is administrated by the Metro Louisville Office of Advanced Planning and Sustainability, which in conjunction with the Jefferson County Sheriff's office and the Louisville Metro Office of Management & Budget. Section 3.A., p. 4, Energy Project Assessment District (EPAD) Program Manual for Louisville, KY, Version 1.0, revised March 2020. The other remaining 12 districts in the Commonwealth are administered by ENERGIZE KENTUCKY, a Kentucky for-profit limited liability company.

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¹⁵ See Section 4.A., p. 8, Energy Project Assessment District (EPAD) Program Manual for Louisville, KY, Version 1.0, revised March 2020 to see the specific criteria that must be satisfied for an eligible project.

¹⁶ See Section 3.C., p. 5, Energy Project Assessment District (EPAD) Program Manual for Louisville, KY, Version 1.0, revised March 2020 to see the specific criteria that must be satisfied for an eligible project.

¹⁷ *Id.*

¹⁸ Section 6., p. 14, Energy Project Assessment District (EPAD) Program Manual for Louisville, KY, Version 1.0, revised March 2020. Documentation includes, description of the property, energy project summary, list of contractors, written project estimate, project budget, property appraisal, title search, and pictures of project.

¹⁹ Section 4.B., p. 8-9, Energy Project Assessment District (EPAD) Program Manual for Louisville, KY, Version 1.0, revised March 2020.

²⁰ See "[Learn More About the Pace Equity Market Leader Program](#)," PACE Equity.

²¹ Section 4.D., p. 13, Energy Project Assessment District (EPAD) Program Manual for Louisville, KY, Version 1.0, revised March 2020. Underwriting requirements are provided by each EPAD capital provider. LMG will make no representations or warranties about financing. An example of an underwriting standard used by national capital providers require total related property debt, including mortgage debt, EPAD financing and other obligations secured by the property should not exceed 90% of the property's value based on its assessed value or a recent appraisal. *Id.*

²² Section 4.B. 1), p. 9, Energy Project Assessment District (EPAD) Program Manual for Louisville, KY, Version 1.0, revised March 2020. As required by the EPAD Act and LMCO Chapter 165, each lender holding a mortgage of record must execute a Mortgage Lien Holder Consent to Special Assessment.

²³ [The PACE Financing Guide](#), Twain Financial Partners.