C-PACE Is Growing – What Should You Know?

lending CRE

Summary: C-PACE is a low-cost, long-term, fixed-rate financing tool funded by private capital providers. It is being used by building owners to pay as much as 100% of the costs for energy efficiency, carbon emission reduction, and resiliency projects. We explore what you need to know about C-PACE in order to be prepared today and in the future.

Did you know that a lightning bolt unleashes energy that is 5x as hot as the sun? The released energy warms up the atmosphere to nearly 30K degrees Celsius — like detonating a ton of TNT!

Knowing how powerful energy can be, it is not so strange that energy efficiency is increasing in importance in the commercial real estate (CRE) sector. Commercial property owners and communities alike are setting some big goals to improve energy efficiency, reduce carbon emissions and increase resiliency related to extreme weather events. The challenge is how to pay for those sustainable initiatives.

One solution that is surging in popularity is the commercial property-assessed clean energy (C-PACE) program. Following the introduction of residential PACE in 2007, C-PACE programs began to appear in 2009. Over the past 5Ys, the cumulative amount of capital invested through C-PACE has jumped from $335.8MM in 2016 to $2.07 billion through 2020. Rapid growth is propelling financial institutions (FIs) to understand how PACE works, and how it could potentially impact the capital stack for CRE financing.

What is C-PACE?

C-PACE is a low-cost, long-term, fixed-rate financing tool funded by private capital providers. The financing structure allows building owners to pay for 100% of the hard and soft costs of energy efficiency, renewable energy, or resiliency projects in commercial, industrial, multifamily, and nonprofit properties. Depending on the jurisdiction, C-PACE can be used in the renovation of an existing building or new ground-up construction.

C-PACE is not a loan, but rather it is assessment financing, a mechanism that has long been used to fund infrastructure, such as street improvements and school bonds. The financing drops to a line item on the building owner's property tax bill that is typically repaid over a period of 10-30Ys. In many cases, property owners are using C-PACE as a lower cost, more flexible alternative to mezzanine financing.

FIs have been slow to warm up to C-PACE because the assessment requires a lien to be placed on the property that is typically senior to other debt on the property. If the building is sold during the C-PACE repayment period, the lien securing the assessments remains on the property and becomes an obligation of the new building owner. Nonpayment of a C-PACE assessment results in the same set of repercussions as the failure to pay any other portion of a property tax bill.

What do lenders need to know?

One of the drivers behind soaring C-PACE numbers is the expansion of local legislation enabling programs to operate at the state and local levels. Legislation has been passed in 36 states and programs are now operating in 24 states plus Washington DC. A new program set to go live in New York City later this year has catapulted

C-PACE even more to the forefront for property owners and lenders. The program is expected to be a key financing tool that the city's commercial property owners will utilize to comply with the city's Climate Mobilization Act, which requires landlords to spend substantial capital on retrofitting to meet new carbon reduction standards that go into effect in 2024.

As C-PACE continues to push more into mainstream financing transactions, it may compel FIs to come to terms with the structure, in order to maintain relationships and compete for new business. According to a guide on C-PACE for mortgage lenders published by the C-PACE Alliance, some **facts that lenders should know** about the financing structure include:

- C-PACE financing does not prevent, restrict, or otherwise impact a senior lender's foreclosure rights.
- Unlike other debt, C-PACE does not require an inter-creditor agreement.
- Senior lenders may escrow the C-PACE assessments, which mitigates any risk associated with failure to pay the C-PACE assessment when due.
- The C-PACE financing typically closes concurrently with the conventional debt facility, at which time the C-PACE funds are deposited into an escrow account.
- Some local C-PACE programs allow for "look-back" financing for improvements completed within the last 1-3Ys. That can offer immediate liquidity for cash-strapped owners, which can also benefit existing lenders.
- C-PACE financing may increase the value of the senior lender's collateral. Most states require that an engineer establish the monetary savings expected to result from the C-PACE project. As such, a project has the potential to reduce a building's operating costs, while increasing its net operating income and valuation.

Since C-PACE is an area that is growing, it is important for community financial institutions to understand the essentials. The more you know, the better you can respond.

LOOKING TO GROW YOUR LOAN PORTFOLIO?

ECONOMY & RATES

Rates As Of: 06/30/2021 05:13AM (GMT-0700)

Treasury	Yields	MTD Chg	YTD Chg
3M	0.04	0.03	-0.05
6M	0.06	0.03	-0.03
1Y	0.08	0.03	-0.03
2Y	0.25	0.11	0.13
5Y	0.88	0.08	0.52
10Y	1.46	-0.13	0.54
30Y	2.07	-0.21	0.43

FF Market	FF Disc	IORB
0.10	0.25	0.15
SOFR	**Prime**	**OBFR**
0.05	3.25	0.08