

PACE: A TOOL FOR FINANCING GREEN ENERGY IMPROVEMENTS



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PACE is a financing tool which has a green halo around it. Its purpose is to promote energy efficiency and the use of renewable energy. PACE, an acronym for Property Assessed Clean Energy, was passed by the Nebraska Unicameral in 2016. By comparison, it has existed in California since 2007. There are currently 36 states with some form of PACE legislation.

Owners and property developers of course are already able to finance these types of improvements, but this gives them a tool so that the loan term is longer (as much as 20 or 25 years), since the loan is repaid through a voluntary assessment on the improved property that runs with the land. This super-priority of the lien allows for a lower interest rate. This allows borrowers to finance improvements that ordinarily would not be economical. To date, over \$60 million has been lent pursuant to PACE loans in Omaha. Nationwide, over \$1.5 billion of commercial PACE loans have been made to date.

The definition of improvements that are allowed under a PACE loan is very broadly written. They would include any acquisition, installation or modification benefiting public or private property that is designed to reduce the utility demand or consumption in existing buildings or new construction, and to promote the efficient and effective management of natural resources. This would include the management of stormwater, which does not fit the usual rubric of “clean energy.”

This broadening of the meaning of clean energy occurs in other states. The PACE program in Washington state allows for earthquake resiliency retrofitting and the program in Florida allows for hurricane retrofitting.

A PACE loan can finance the costs of materials and labor, and can also finance the costs for permit fees, inspection fees, application and administrative fees, bank fees and other fees incurred by the owner/borrower for the installation of the project.

PACE Act, local ordinance

PACE loans are made in Nebraska pursuant to the Property Assessed Clean Energy Act (the “Act”). To be functional, the act contemplates that first a city must enact its own PACE ordinance. To do this, the city must enact an ordinance and create a clean energy assessment district, which

can cover the city itself and the city’s extra-territorial zoning jurisdiction. PACE ordinances have been passed in Omaha, Lincoln, Beatrice, Bellevue, Columbus, Fremont, Grand Island, Hastings, La Vista, Norfolk, North Platte and Waverly. In Omaha, this is referred to as the City of Omaha Property Assessed Clean Energy (PACE) ordinance (the “Omaha ordinance”).

As previously mentioned, the act requires each city to set up an organization, or “District”, that will coordinate PACE loans. In Omaha, the district is known as the Eastern Nebraska Clean Energy Assessment District (“ENCEAD”).

Pursuant to the act and the Omaha ordinance, the owner will complete a financing application, including eligibility requirements, as set forth in a program manual (the “Program Manual”) created for the city of Omaha by the city planning director (in the parlance of the Omaha ordinance, the city planning director is referred to as the “district administrator”). Once the application is filed, the district administrator reviews the application. A project will not be eligible if the property owner is delinquent in the payment of real estate and personal property taxes and special assessments.

If the application is approved by the district administrator, then the district administrator is authorized to proceed with an “assessment contract.” The assessment contract will then be entered into by the owner/borrower, the lender and the city itself. The assessment contract is essentially a loan agreement and governs the terms and conditions of the financing and assessments that are paid by the owner/borrower. A “suggested” form of an assessment contract is attached to the Omaha ordinance. It is “suggested” in the sense that it must be substantially in the form that is attached to the Omaha ordinance or contain the terms of the form that is attached to the Omaha ordinance.

The assessment contract sets forth the payments due under the loan. Since the owner/borrower is actually paying special assessments, these payments due to the lender are paid twice per year (usually), rather than a typical monthly payment. In at least one case in Omaha, payments are to be made once per year. The county treasurer sends the assessment amount to the city, and the city sends this payment to the lender in accordance with the payment schedule. The terms of the payment schedule will be attached to the assessment contract and will be completed for each loan.

On non single-family residential property, the act allows the lender to collect the assessments directly from the owner like an ordinary loan, rather

than routing those payments through the county treasurer and the city. But if the lender collects these assessments directly from the owner/borrower, the lender is obligated to notify the city, within three business days, if an assessment becomes delinquent. Conversely, on single-family residential property loans, the lender cannot collect these payments directly from the borrower, which is irrelevant in any event since the Omaha ordinance does not allow residential loans. Agricultural loans are not allowed either under the Omaha ordinance. The same holds true for all other participating Nebraska cities.

Weighted average useful life

The term of the annual assessments for repaying the loan may not exceed the “weighted average useful life” of the energy project. The calculation of the weighted average useful life would follow this simple example: Say there are two separate energy reduction projects being installed, each with different useful lives. This includes a chiller with a 30-year useful life and LED lighting with a 20-year useful life. Assume that both the chiller and the lights cost the same. Then the “weighted average useful life,” or the term of the loan, would be the average useful life of the two separate projects. That is: (30+20) divided by two, which equals 25 years.

It gets more complicated when both the useful lives of the installations and the costs are different.

Before an assessment contract can be entered into, the city must verify that the energy project creates an “estimated economic benefit” over the term of the assessment equal to or greater than the cost of the energy project.

In Omaha, this is referred to as a Savings to Investment Ratio (the “SIR”). The SIR, or ratio, must be 1.0 or greater. This means the cost of the actual energy saving improvements, not the cost of the entire construction project. This “estimated economic benefit” may be derived from federal, state or third-party engineer certifications or from standards of energy or water savings associated with the energy-efficiency improvement. The city can waive this requirement upon the request of the owner/borrower, and if such a request is denied, the owner/borrower may appeal the denial as provided in the Omaha ordinance.

If the owner/borrower sells the property, the payments on the loan stay with the property, rather than following the borrower. However, if an owner/borrower is going to sell the property, then prior to entering into a purchase agreement to sell the property, the owner/borrower must

provide notice to the buyer that the buyer is going to assume responsibility for these payments. Before the assessment contract can even be entered into, the owner/borrower must obtain a subordination agreement from all of the existing mortgage/deed of trust holders (if any) stating that those mortgages/deeds of trust are subordinated to the incoming PACE lien.

Candidates for PACE

What kind of owners would be likely candidates for a PACE loan? For PACE loans that have already been made in Omaha, it is very heavily weighted in favor of hotels. PACE loans work well for hotels because the hotel can “pass through” all or a portion of the PACE special assessment to a guest on top of the actual hotel bill. When making a hotel reservation, the PACE special assessment (as well as sales tax) is not included in the suggested rate. But when it comes time to check out, the customer gets that bill.

Two other types of borrowers seem really ripe for this type of loan. The first is a landlord that wants to do this type of energy savings work. The payments on the loan are in effect payment of special assessments or real estate taxes that can be “passed through” to the tenant. The tenant then pays all taxes, or in this case special assessments, levied against the leased property.

The second is a non-profit entity, like a church, which is having difficulty finding typical real estate financing. Commercial construction loans typically have a three- to five-year maturity period, making the repayment terms difficult when it comes to energy savings projects. PACE changes all of this by allowing the nonprofit to finance energy-efficiency projects through a special assessment levied by the local government.

Since the loan has a super-priority and the county will enforce this assessment just like any other delinquent tax obligation, lenders feel secure in providing fixed interest loans with terms of up to 20 years (or more). This results in a positive cash flow for the nonprofit since the monthly savings generated by the energy project are greater than the loan repayment obligation. However, no Omaha PACE loans have been made to date for churches or other non-profits.

PACE is a new and growing tool to help finance green-friendly improvements. But more growth is available in this industry. Very few businesses in Nebraska, other than hotels, have exploited this mechanism, and only PACE-specialty lenders have made loans with this financing tool. To date, no traditional commercial banks have made PACE loans in Omaha.