Local Law 96 – PACE Financing

Executive Summary

Local Law 96 of 2019 (the "Law") authorizes a sustainable energy loan program utilizing **Property Assessed Clean Energy (PACE)** financing[1]. The program is subject to criteria set forth in both the Law and New York State General Municipal Law Article 5-L, as well as guidance issued by NYSERDA and "Program Guidelines" issued by the City of New York.

- New York City Local Law 96 of 2019 ("Local Law 96")
- New York State General Municipal Law Article 5-L ("Article 5-L")
- NYSERDA PACE guidance documents
- The NYC Program Guidelines are not yet available (this document will be updated accordingly)

PACE loans are voluntary third-party loans repaid through a charge on a building's property tax bill. This mechanism provides for the following unique characteristics:

- PACE loans transfer to the new owner upon sale of the property.
- PACE loans are non-accelerating and do not require immediate repayment of the outstanding principal balance after a payment default.
- PACE repayments can be passed through to commercial tenants on many commercial leases, helping landlords to recover their investment in improved tenant spaces.

Financing benefits

- Up to 100% financing with no out-of-pocket costs to the property owner
- Immediate cash flow benefits
- Loan terms of up to 20 to 30 years
- Competitive interest rates (typically 6-7% based on recent transactions)

Eligibility

- All projects must consist of energy efficiency measures and/or renewable energy systems that are supported by a certified energy audit or feasibility study.
- All projects must demonstrate a savings-to-investment ratio (SIR) of 1.0 or greater.

New York City-specific characteristics

- PACE liens are subordinate to all other City liens.
- Delinquent PACE liens may be enforced through the City's tax lien securitization program.
- Up to 20% of project costs can be ancillary measures not directly responsible for energy efficiency or renewable energy (e.g., asbestos remediation).

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[1] As used in this document, PACE refers to *commercial* Property Assessed Clean Energy, sometimes called C-PACE. PACE for single-family homes (*residential* PACE or R-PACE) is not authorized in New York State.

Key issues for bankers

Senior/mortgage lender consent

- Existing mortgage holders will be required to consent to a new PACE financing.
- Due and unpaid PACE payments are senior to the mortgage loan.
- Many PACE loans are cash flow positive due to energy savings offsetting debt service expense, increasing the building's value.

Treatment of PACE charges

PACE charges are line items on buildings' tax bills, unlike traditional debt service payments. Banks should treat these charges accordingly. Strategies include:

- Escrowing monthly as part of mortgage payments
- Establishing reserves to cover payments in case of an operating deficit
- Failure to pay PACE payments or escrow are a default under the loan agreement
- Exercising retained foreclosure rights
- Confirming that the measures financed with PACE will improve the building's NOI
  - PACE loans require a projected SIR of 1.0 or greater
  - PACE loans will help avoid fines under Local Law 97 (annual building emissions limits)

PACE and CMBS

Current CMBS documentation likely prohibits PACE financing without Servicer consent. In 2014, Moody's published guidance to classify PACE loans as an "unpermitted encumbrance" in loan documents.

- Nationally, very few PACE loans have been originated to CMBS borrowers.
- CMBS Servicer review is cost prohibitive ($5,000-$7,500) and consent is not guaranteed.
- To enable widespread availability of PACE financing to CMBS borrowers, standard CMBS loan documents require modification.
- Nationally, approximately 34% of mortgages on commercial buildings are CMBS loans.

Affordable housing barriers

- Multiple approvals often required (mortgage lender, HUD, LIHTC investors, etc.)
- Hard for LMI financings to accommodate PACE because of tight LTV and DSCR requirements

New construction

Article 5-L now allows PACE financing in new construction projects as well as on buildings subject to ground leases. A similar amendment is expected to the Local Law 96 in 2021 Standards for new construction financing can be found in the NYSERDA guidance.

Further considerations for banks

- Develop standard criteria and steps for providing PACE consent within the bank
- Record PACE consents provided by the bank and make records accessible
- Consider the transaction volume that might be required for the bank to originate PACE loans.