Why C-PACE is a Game Changer in Funding Sustainability Projects

By Larry Derrett

C-PACE's growth continues and has now been used to fund over 2,000 sustainability projects throughout the US. The program provides *private* capital allowing owners and developers of commercial properties to obtain low-cost, 100% financing for 20+ years for energy efficiency, sustainability and renewable energy infrastructure deployed in new or existing buildings.

Why have building owners said YES to using C-PACE to close over 2,000 projects? Read further below for a summary of the financial and operational benefits of the program.

The Basics of C-PACE

PACE is a source of private capital which stands for Property Assessed Clean Energy - the "C" denotes the commercial program. C-PACE programs across the country have combined to fund 2,000 energy efficiency, renewables and resiliency projects. See the addendum at the end of this article for a few of the types of businesses that can access the program as well as an example of eligible projects that can be funded.

Currently active in 22 states, C-PACE is a unique form of funding repaid through a beneficial assessment which becomes an attachment to the building and added to the owner's property tax bill. The program is established at the state level by statute and is adopted by legislation sponsored by the local taxing authority.

A Totally Different Approach to Credit

A C-PACE lender's approach to credit is quite different from that of a traditional debt provider. The assessment is an attachment to the building which survives changes in ownership. Therefore, the C-PACE lender is most concerned with whether ***any*** owner would value the usefulness and location of the building. This is in stark contrast to the traditional approach of senior and mezzanine debt providers who rely on a number of protections which often tie the hands of building owners.

C-PACE offers low cost funding which places no financial or operational constraints on building owners.

The rest of this article explains how that is the case.

Financial Benefits

Funding for 100% of Efficiency Retrofit Project Costs Over 20+ Years

C-PACE allows building owners to spread payments over 20+ years which is quite beneficial for new development and redevelopment projects. For pure retrofits the low annual payments are of great benefit as described below.

Increase Net Cash Flow from Efficiency Retrofits

Since funding is repaid over 20+ years, annual payments are very low, especially when compared to a traditional 7-year loan. As a result, energy and avoided maintenance/repair savings will exceed the annual C-PACE assessment for virtually any pure efficiency retrofit.

If C-PACE is used to fund virtually any pure equipment retrofit, net cash flow will increase!

This is illustrated below for a project with the following assumptions:

Project Illustration	
Efficiency project cost	$500,000
Annual energy and maintenance savings	$70,000
Simple payback	$500,000/$70,000=7.14

Typical 7-year debt financing: the chart below shows how the project has negative net cash flow each year with a cumulative deficit in Year-7 of ($123,578).

Year	1	2	3	4	5	6	7
Energy savings	50,000	50,000	50,000	50,000	50,000	50,000	50,000
Maintenance savings	20,000	20,000	20,000	20,000	20,000	20,000	20,000
Total savings	70,000	70,000	70,000	70,000	70,000	70,000	70,000
Debt payments	87,654	87,654	87,654	87,654	87,654	87,654	87,654
Net savings	-17,654	-17,654	-17,654	-17,654	-17,654	-17,654	-17,654
Cum. net savings	-17,654	-35,308	-52,962	-70,616	-88,270	-105,924	-123,578

20+ year C-PACE funding: the chart below shows how the project results in an immediate positive net cash flow due to the low annual C-PACE assessment.

Year	1	2	3	4	5	6	7
Energy savings	50,000	50,000	50,000	50,000	50,000	50,000	50,000
Maintenance savings	20,000	20,000	20,000	20,000	20,000	20,000	20,000
Total savings	70,000	70,000	70,000	70,000	70,000	70,000	70,000
Debt payments	42,984	42,984	42,984	42,984	42,984	42,984	42,984
Net savings	27,016	27,016	27,016	27,016	27,016	27,016	27,016
Cum. net savings	27,016	54,032	81,048	108,064	135,080	162,096	189,112

The reduction in operating expenses makes the building more attractive to tenants and potential buyers. Furthermore, the assessment becomes an obligation of the buyer and does not require consent of the C-PACE lender.

C-PACE has become an important tool for some developers as part of a strategy to buy, enhance value and then sell properties.

No Guarantees Required from Ownership

This is a huge benefit to independent small business owners and developers- no personal guarantees.

Large organizations can benefit if the parent wishes to minimize guarantees of funding provided at the subsidiary level.

No Acceleration of the Assessment

The C-PACE lender *does not have the right to accelerate the full unpaid balance*, even if a scheduled payment is past due. Only the unpaid amount that has been billed but not paid, is recoverable. This provides great flexibility to owners in case they need to restructure their debt – there is one less traditional lender involved.

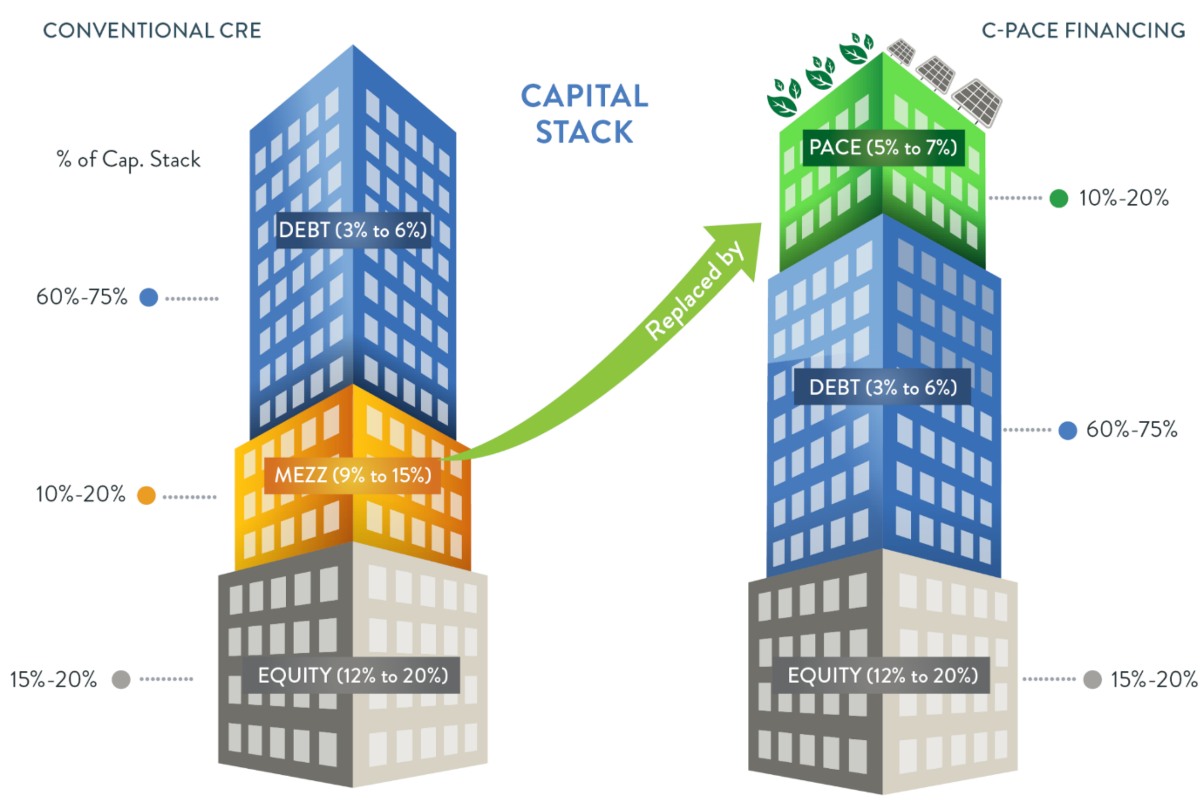
Absence of Constraints Required in Traditional Debt

The C-PACE structure does not impose traditional lender protections such as cross default, restrictions on distributions, maintenance of debt covenants or quarterly reporting requirements.

Cheaper Capital for New Development and Redevelopment of Properties

C-PACE provides an excellent addition to the capital stack for development/redevelopment projects. The concept is simple – to the extent lower cost C-PACE funding can be used in lieu of mezzanine debt or common/preferred equity, it lowers the owner's weighted average cost of capital (WACC).

New construction funding using C-PACE is offered in many, but not all of the states in which the program has been established. Check with us to find out if new construction funding is offered in the state where your new project is located.



When compared to Mezzanine, not only is C-PACE cheaper, it also allows owners to avoid the lengthy negotiation of a complex inter-creditor agreement. In addition, it allows owners to operate with much more financial flexibility as shown below.

	Mezzanine Debt	C-PACE
Full acceleration rights	yes	no
Financial covenants needed	yes	no
Cross default	yes	no
Quarterly financial statement reporting	yes	no
Restrictions on distributions & building sale	yes	no

C-PACE is "patient financing." The building owner's only concern is to pay the assessment with their property tax bill.

Operational Benefits

Freedom to Sell the Building – Assessment Assumed by Buyer

The C-PACE lender does not have the right to block a sale. As mentioned previously, the assessment is an attachment to the building and becomes an obligation of the buyer. This is a great benefit for owners who actively manage their investment portfolio, particularly for CRE private equity firms and developers.

Unique Benefits for Efficiency Projects for Owners Using Triple Net Leases

Under many triple net lease structures, building owners and tenants have misaligned interests regarding the costs and benefits of retrofits. With traditional financing, building owners absorb the risk of financing while tenants enjoy the benefits of reduced energy and maintenance/repair costs.

Since the C-PACE assessment is added to the property tax charge, it can often be passed to tenants contractually in triple net leases. However, to truly align interests, owners will want to justify that tenant comfort will improve, yet *their net out-of-pocket costs will decline*. This is possible because in most retrofits, energy and maintenance/repair cost savings will exceed the low 20+ year C-PACE payments.

This is a win-win!

Tenants are happy because they are saving money and are in a more comfortable environment. The owner has a more valuable building with lower operating costs and upgraded equipment.

Is there a downside to using C-PACE?

The C-PACE assessment creates a first lien on the building which generally requires a consent from the lender who has a mortgage on the building. In the developmental stages of C-PACE a few years ago, this sometimes presented a challenge. This is much less of an issue today because C-PACE lenders and program administrators have become more proficient in explaining the following:

- the reduction in operating expenses enhances the value of the lender's collateral (the building); and
- though the C-PACE lender has a first lien related to the amount of the total assessment, the enforceable remedy runs only to ***the amount that has been billed, but not paid***. This is a quite minimal amount when considering the overall value of the building.

As of October 2018, 167 financial institutions had granted consent to C-PACE liens including some of the largest banks in the world: JP Morgan, Chase, Bank of America, Wells Fargo, Bank of New York, Mellon (as Trustee), and many large foreign banks.

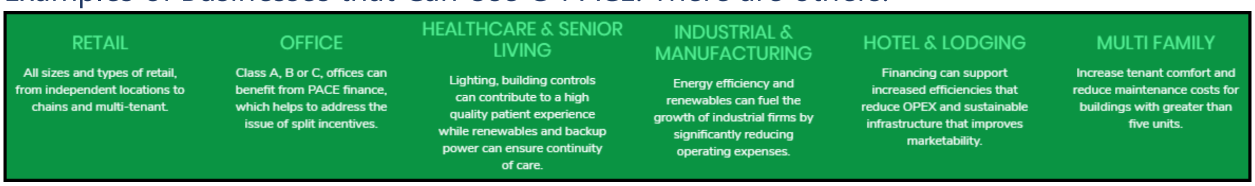
Conclusion

- C-PACE programs provide 100% funding for sustainability projects with repayment terms of 20+ years.
- C-PACE is being embraced all over the US with over 2,000 projects closed to date.
- For virtually any pure retrofit, net cash flow increases by using C-PACE to fund the project.
- For new construction and major renovation projects, C-PACE can be used in lieu of mezzanine debt or common/preferred equity to lower the weighted average cost of capital for building owners. With respect to mezzanine debt, owners can avoid the lengthy and complex negotiations associated with an inter-creditor agreement.
- Owners can realize a number of financial benefits because C-PACE does not require restrictions on distributions, rights to accelerate debt, guarantees from ownership, compliance with financial covenants, cross default provisions, or quarterly reporting requirements.

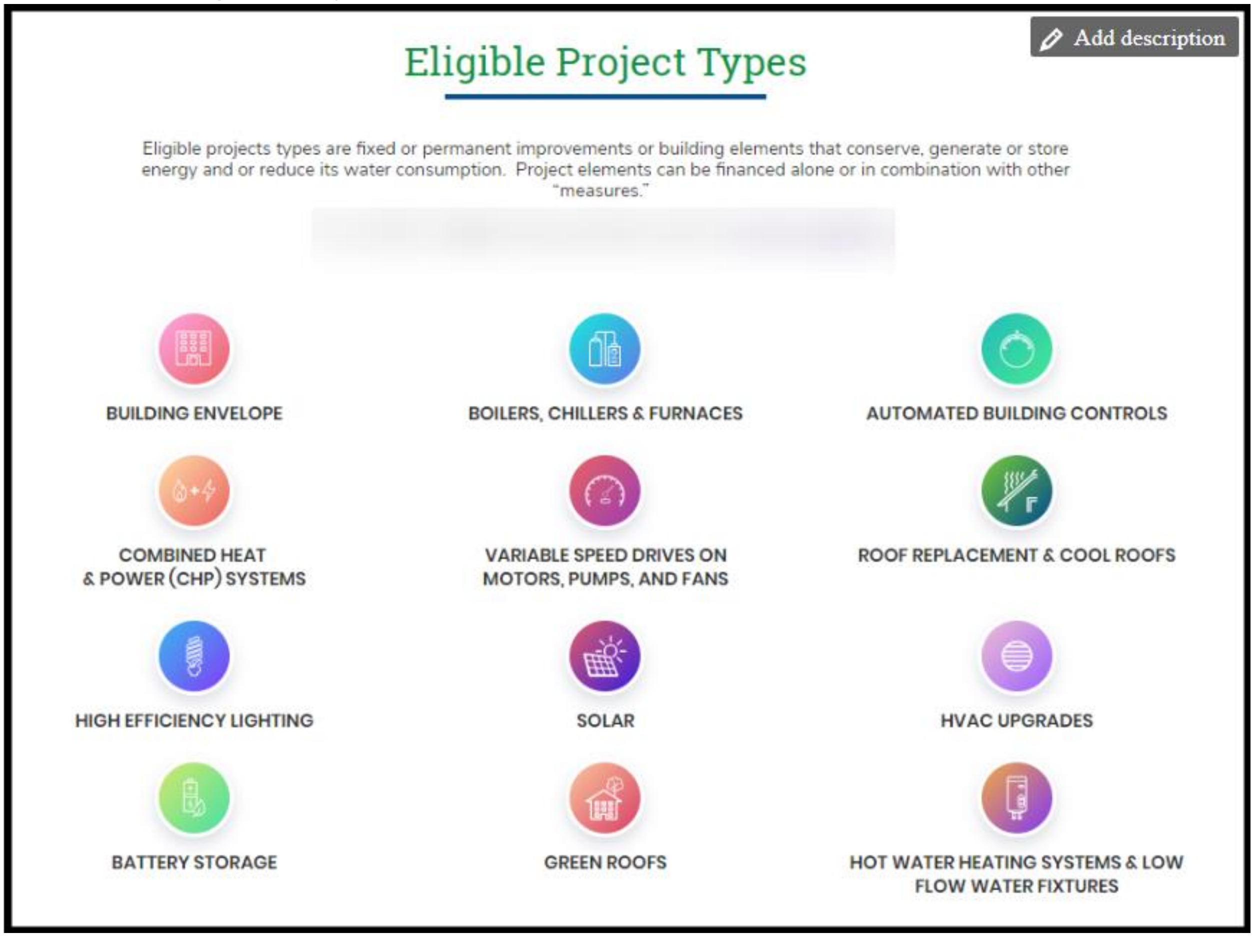
- Owners can realize operational benefits including the flexibility to sell the building and pass the C-PACE assessment to the buyer. In addition, C-PACE provides a valuable tool to solve the misalignment between building owners and tenants as to the risks and rewards of efficiency retrofits.
- C-PACE transactions require lender consent from the holder of the mortgage on the building. However, 167 financial institutions had agreed to grant C-PACE consents including some of the largest financial institutions in the world.

Questions? Feel free to reach out to Larry Derrett, founder and CEO of EnFlux Building Solutions at 713.714.0575, lderrett@enfluxbuildingsolutions.com, or https://www.linkedin.com/in/derrett/

Examples of Businesses that Can Use C-PACE. There are others.



Examples of Eligible Projects. There are others.



EnFlux Building Solutions has partnered with Counterpointe Sustainable Real Estate, LLC to introduce C-PACE financing to its business partners and potential clients around the US. EnFlux provides a range of capital solutions including C-PACE and a separate program for small retrofits anywhere in the US, including those areas where C-PACE is not active.

Counterpointe Sustainable Real Estate, LLC is a private capital provider that specializes in Property Assessed Clean Energy (PACE) financing. The firm's management team has over 100 years of combined real estate and financial experience focused on making the economics of sustainable real estate work.