McGUIREWOODS

Pointers for PACE Programs

PURPOSE OF PACE (Property-Assessed Clean Energy) PROGRAMS

They enable property owners to finance energy efficiency upgrades, renewable energy improvements, resource recovery equipment and similar capital improvements through loans that are repaid through assessments on the real property benefiting from those upgrades.

ADVANTAGES OF PACE FINANCING

- **Lowers Initial Investment Costs.** It minimizes the need for large upfront investments that otherwise typically accompany capital improvements and renovations, and enables property owners to save cash.
- **Longer Amortization Periods.** Property owners may be able to extend the term of the financing for a period that is more commensurate with the useful life of the improvements being financed (typically up to 20 years), resulting in lower aggregate periodic payments and enhanced return on investment.
- **Cash Flow Improvement.** A reduction in operating expenses may be derived from energy and other utility savings resulting from PACE improvements.
- **Enhanced Transferability of Property Ownership.** The special assessment on the real property generally travels with the ownership of the real property in the same manner as an ordinary real property tax assessment, thus permitting property owners to do PACE improvements without having to repay the debt incurred to finance the improvements if the improved property is later sold.

LEGAL CONSIDERATIONS FOR PACE FINANCING – STATE AND LOCAL

- Typically, a lien attaches to the underlying property with the same priority as a tax lien. Seniority to existing or first mortgage liens may vary.
- Potential remedies for failure to pay the assessment include sale of the property at a tax sale and significant late fees and penalties. Although PACE loans generally are not accelerable or prepayable, they also are generally not eliminated as a result of a foreclosure of an ordinary property tax lien.
- The assessment and lien status should remain unaffected by transfers of the real property to new owners. Many PACE statutes require existing lien holders to consent to the PACE financing and potential attachment of a superior lien

COMMON UNDERWRITING AND DUE DILIGENCE REQUIREMENTS

Underwriting standards are substantially similar to those required for conventional mortgage loans, although specific underwriting standards and requirements vary.

PROPERTY ELIGIBILITY

The following criteria commonly are used to determine if a property qualifies for PACE financing:

- **Location.** The property generally must be within the jurisdiction of the governmental entity authorizing the program.
- **Nature of Use.** Eligible properties may include residences, schools, medical facilities, industrial facilities, churches, warehouses, office buildings, retail space, shopping malls, hotels and athletic facilities.
- **State of Title.** A program may require that the locality or administrator of the program receive evidence that the title to the property will not be in dispute.
- **Default History.** A program may require that the locality or program administrator receive evidence that the payment of all taxes, assessments and charges relating to the property is not delinquent; that there is no recent history of any such delinquency; and that there has been no recent default under any mortgage liens encumbering the property.

- **Bankruptcy.** A program may require evidence that the property has not been involved in any recent bankruptcy proceedings.
- **Existing Liens.** If any existing liens encumber the property, most programs require that the holders of those liens expressly consent to the imposition of the special assessment or surcharge on the property for the repayment of the loan.
- **Historical and Projected Financial and Operating Data.** Many PACE programs also require review and approval of financial and operating data similar to a conventional credit underwriting, including financial statements, tax returns, planned capital expenditures, vacancy rates for the property, leases, tenants, appraisals of the property, financing and operating data, insurance, and incentives, tax credits and abatements for the property.
- **Historical and Projected Performance Metrics.** Programs may require that the property meet certain financial metrics, commonly including minimum loan-to-value ratios (sometimes including PACE assessment or loan payments) and debt service coverage ratios.

PROPERTY OWNER ELIGIBILITY

The following criteria typically are used to determine whether property owners qualify for PACE financing, depending on the type of program:

- **Legal Fee Owner.** Fee simple title to the property typically must be vested solely in the person or entity applying for PACE financing for that property.
- **Bankruptcy.** PACE programs may require evidence that the property owner is not insolvent or bankrupt, or involved in insolvency or bankruptcy proceedings.
- **Credit and Good Standing.** Certain PACE programs require the delivery of a credit report or certificate of good standing on the property owner.

PROJECT ELIGIBILITY

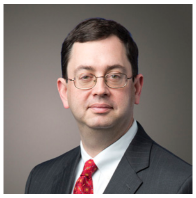
The following criteria are standard for determining whether improvements themselves are eligible for PACE financing:

- **Energy Efficiency or Resource Conservation.** Upgrades and other improvements to be financed with the proceeds of a PACE loan generally must have a demonstrated capacity to decrease the consumption of, or demand for, water or energy.
- **Useful Life.** Many PACE programs require that the improvements to be financed have a useful life that equals or exceeds the term of the PACE loan.
- **Fixtures.** Certain PACE programs require that the improvements to be financed be permanently fixed to the real property or the buildings located on the real property, and not easily removed.
- **Energy Audits.** Most PACE programs require an energy audit of the existing facilities on the property by an independent or PACE program-approved third-party engineer to determine the opportunities for the installation of beneficial energy efficiency upgrades and improvements, and the amount by which the energy savings is projected to exceed the PACE assessments or loan payments over time. For some PACE programs, a quality assurance verification program is also required to monitor energy savings over PACE property assessments over time.
- **Feasibility.** The property owner may be required to provide a feasibility study for the project.
- **Savings to Investment Ratio.** PACE programs typically require evidence, often in the form of an energy audit, that the projected savings realized from the improvements will exceed the payments to be made under the PACE loan.
- **Construction Financing.** For PACE construction projects, PACE programs may require terms, conditions and deliverables similar to those commonly found in conventional construction financings:
  - Construction, architectural and engineeringg contracts and assignments thereof
  - Plans and specifications
  - Project budgets
  - Lists of major subcontractors
  - Financial statements for contractors
  - Environmental reports

- Payment and performance bonds
- Evidence of contractor's liability and builders' risk insurance
- Plan and cost reviews
- Site plans
- Evidence of utility availability

- **Expenses.** Certain costs, fees and expenses incurred in connection with the project and the PACE loan may be financed with proceeds of the PACE loan and repaid over time by the property owner via the property assessments or loan payments. Such expenses commonly include the following, typically subject to an aggregate cap:
  - Lender fees
  - Permit fees
  - Inspection fees
  - Energy audit fees
  - Engineering, architectural and other development fees
  - PACE program application and administrative fees
  - Legal fees

CONTACTS



Mark A. Kromkowski
Partner
312.849.8170
mkromkowski@mcguirewoods.com

Douglas E. Lamb
Partner
804.775.1107
dlamb@mcguirewoods.com

David S. Reidy
Partner
415.844.1969
dreidy@mcguirewoods.com

Jennifer J. Stearman
Partner
410.659.4408
jstearman@mcguirewoods.com