# Building Green Can Make Dollars and Sense

## C-PACE is an affordable, attractive financing option that can help fill lending gaps

By Brian McCarter

Pick up pretty much any publication that covers the commercial real estate industry today, and you'll notice a common theme. Your clients who are looking for bank construction loans are in for a difficult time.

That's because lenders, increasingly reluctant to take on new-construction risk, are raising their rates and fees, and getting more stringent with their underwriting requirements. That includes requiring more owner equity in the capital stack.

While this challenge is all too familiar to mortgage brokers, a relatively new financing tool called Commercial Property Assessed Clean Energy, or C-PACE, may help solve it. This financing option represents an opportunity that should be of interest to clients who are pursuing new-construction loans. It also can provide you, as a commercial mortgage broker, with a competitive advantage.

### Program benefits

C-PACE is an innovative, voluntary financing program for energy-efficiency, water-efficiency and renewable-energy projects. If you're familiar with C-PACE — and you may be, since more than 30 states have PACE-enabling legislation on the books — you probably think of it as way to fund energy-equipment replacement projects. This isn't surprising, given most C-PACE projects that have closed to date have done exactly that.

What many people don't know is that a growing number of programs now allow commercial real estate developers to tap into C-PACE financing for new construction. C-PACE financing for new construction is attractive to developers for two primary reasons:

It provides affordable, long-term, nonrecourse financing that can reduce the owner-equity contribution or the need for other types of high-cost capital; and

It enables commercial property developers to achieve superior building performance by financing improvements that are often value-engineered out of a project.

Most developers know that designing energy-efficient buildings is a smart move. Such buildings reduce operating costs, help attract and retain tenants, and maximize lease rates. They also have better environmental performance and are more sustainable than their less-efficient peers — not to mention they go a long way toward enhancing the comfort and health of occupants.

These benefits, touted in a development's marketing plan, are very compelling to many of today's prospective tenants. What's more, efficient buildings typically qualify for utility incentives. Your lenders may welcome C-PACE, too. A 2017 study of commercial properties by Lawrence Berkeley National Laboratory showed that owners of energy-efficient buildings are less prone to defaulting on their mortgages, compared with owners of buildings lacking energy-efficient features.

### New construction

C-PACE can provide developers with financing for up to 20 percent of a project's total eligible construction cost, excluding land-acquisition costs, legal fees, off-site infrastructure costs and other costs not associated with the building itself. To access the financing, the building must be constructed in a county, city or district that has a C-PACE program for new construction — or your client must lobby to get one put in place.

Next, the developer must design the building so that its energy-efficiency performance exceeds the current requirements of the local energy code by a stated percentage, typically in the range of 15 percent to 20 percent. In some programs, the greater the increase above code, the greater the amount that can be financed.

In Rhode Island, for example, if the "as-designed" energy-performance model for the building exceeds the code-compliant baseline by at least 15 percent, the developer can access C-PACE financing for up to 15 percent of the total eligible construction cost. Exceeding code by 30 percent can boost the eligible C-PACE financing amount to 20 percent.

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C-PACE financing, which is nonrecourse and provided by private-capital sources, is repaid through an assessment recorded on the property, similar to a sewer assessment. Terms can extend up to 25 years — and your client can transfer the assessment to a new owner if he or she sells the property. What's more, the most active C-PACE programs use an open-market model for financing, so you can help your clients choose the most competitive rates and terms from among a group of capital providers that submit financing proposals for a given project.

## The financing process

Because it's a relatively new source of financing with its own criteria, C-PACE for new construction may have a few extra steps that you're unfamiliar with. For this reason, many programs offer a great deal of help along the way.

To get started, the developer — or an agent of the developer — is required to submit an application that identifies the property and project specifics, including the construction costs by trade component. The program administrator will then review the application to make sure the project meets all C-PACE program eligibility requirements.

The program administrator also may consult with local utilities, the project developer, the property owner, the engineering/construction company and the energy-modeling company. The purpose of this collaboration is to understand the project, review C-PACE requirements (particularly with respect to building-energy simulation modeling) and ensure consistency with potential utility incentives.

The results of the modeling are then reviewed by the C-PACE program administrator to evaluate whether it complies with or exceeds the applicable building-energy code. This information is then used to determine the C-PACE financing amount as a percentage of the total eligible construction cost.

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The bottom line: For your clients who are commercial real estate developers, C-PACE provides a compelling incentive to design sustainable buildings, which are not only more valuable than their inefficient competitors, but also perform better and cost less to operate.

Today, thanks to the C-PACE program, there's no longer any reason to value-engineer energy-efficiency and renewable-energy measures out of a project. Your clients will likely welcome the potential to add this innovative nonrecourse financing to the capital stack, which can help to reduce the equity contribution required for the project while also making it possible to build a sustainable, high-performing building right from the start. ■