

Just in Time For Earth Day, New York City's PACE Financing Program Is (Almost) Here!

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On April 21, 2021, the much-anticipated final administrative rules (the "[Administrative Rules](#)")¹ adopted by the New York City Department of Finance (the "[NYC DOF](#)") to implement New York City's Property Assessed Clean Energy ("[PACE](#)") loan program became effective.²

PACE financing is an innovative public/private partnership that provides for cost-effective, revenue neutral³ financing for energy efficient improvements and renewable energy systems, which are repaid through assessments on the property, similar to property tax assessments. PACE financing is authorized by state-level enabling legislation which is then adopted at the local and municipal level.

I. PACE in New York

PACE was first introduced into New York State in 2009, when the New York State Legislature enacted General Municipal Law Article 5-L (the "[NYS PACE Statute](#)") which authorized municipalities in New York State to create a PACE loan program to provide financing to property owners for the installation of eligible renewable energy systems or energy efficiency improvements repaid through an assessment (similar to real property taxes) on the real property.⁴ As of March 30, 2021, 62 municipalities in New York State (not including New York City) have developed PACE loan programs, administered by the Energy Improvement Corporation (the "[EIC](#)").⁵

While other New York municipalities were developing PACE programs, PACE financing didn't make its entry into New York City until ten years later when on May 19, 2019, the New York City Council passed the Climate Mobilization Act, or the "[CMA](#)," a package of bills intended to, among other goals, cause large and medium-sized buildings to reduce their greenhouse gas emissions by 40% by 2030 and 80% by 2050 with some emissions limits commencing as early as 2024. As part of the CMA, the New York City Council passed Local Law 96 of 2019, which laid the municipal groundwork for New York City's PACE program by creating the New York City Sustainable

¹ <https://rules.cityofnewyork.us/wp-content/uploads/2020/10/Notice-of-Adoption-of-Final-Rule-2020-RG-082-Establishment-of-Sustainable-Energy-Loan-Program-final-3.12-Legal-11589588.pdf>.

² <https://rules.cityofnewyork.us/rule/establishment-of-sustainable-energy-loan-program/>

³ As discussed below, the cost savings of the energy efficient improvements being financed are intended to equal or exceed the assessments paying for such improvements, thus resulting in revenue neutral financing.

⁴ See New York State General Municipal Law Article 5L Municipal Sustainable Energy Loan Program – Commercial Property Assessed Clean Energy (PACE) Guidance Document, prepared by New York State Energy Research and Development Authority (NYSERDA), September 22, 2020, available at <https://www.nysERDA.ny.gov/all-programs/programs/commercial-property-assessed-clean-energy> .

⁵ See <https://www.eicpace.org/whereisopencepace>.

Energy Loan Program⁶ (the “NYC SELP”) in order to help building owners pay for the potentially significant costs of compliance with the CMA. An analysis published by Urban Green Council in June 2019 found that compliance with the CMA could potentially result in building retrofit costs as high as \$24.3 billion in New York City through 2030.⁷ While NYC SELP was the critical first step to enabling a PACE financing program in New York City, NYC SELP required the NYC DOF, which was appointed as the administering agency, to promulgate the Administrative Rules in order to implement New York City’s PACE program.⁸

NYC SELP and the Administrative Rules require a program administrator (the “Program Administrator”) to be engaged by New York City pursuant to an “Administration Agreement” to manage and assist in the implementation and administration of the New York City PACE program. Among other duties, the Program Administrator is responsible for establishing certain “Program Guidelines,” including templates for PACE loan legal documents, and additional requirements for PACE lenders and borrowers under the NYC PACE Program. Under the Program Guidelines certain capital providers (“PACE Lenders”), including private financing organizations, not-for-profit corporations, community development financial institutions and public agencies, will be pre-approved to provide PACE financing to certain eligible property owners (“PACE Borrowers”). One important program requirement for potential PACE Borrowers to keep in mind is that the property benefiting from the PACE loan must not have any unpaid civil penalties or taxes or other debt owed to New York City that is delinquent.

Unlike other PACE programs in New York State which are administered by the EIC, the Program Administrator for the New York City PACE program is the New York City Energy Efficiency Corporation (“NYCEEC”). As of the date of this writing, the Program Guidelines and list of approved PACE Lenders has not been made publicly available, but the authors have been advised by the NYCEEC that such publication is imminent and is expected to be available soon at the below link.⁹

Although the NYS PACE Statute and the NYC SELP are arguably broad enough to permit a residential PACE program, the Administrative Rules make it clear that PACE loans may only be obtained by owners of commercial or multi-family buildings (owners of “private dwellings”¹⁰ are specifically excluded from the NYC PACE program). The Administrative Rules, consistent with the NYS PACE Statute and the NYC SELP, make PACE loans available to fund (i) “energy efficiency improvements” which “consist of innovations or retrofits to a building that reduce energy consumption, such as window and door replacement, lighting, caulking, insulation, and heating and cooling system upgrades, and similar improvements” and (ii) “qualified renewable energy systems” which “consist of systems for the generation of electrical or thermal energy, by means of a solar thermal, wind, geothermal, or other approved renewable energy technology.” It is notable that the Administrative Rules only permit PACE loans in connection with the renovation or retrofit of existing construction; however recent amendments to the NYS PACE

⁶ See Chapter 30 of Title 11 of the New York City Administrative Code, available at <https://codelibrary.amlegal.com/codes/newyorkcity/latest/NYAdmin/0-0-0-111848>.

⁷ https://www.urbangreencouncil.org/sites/default/files/urban_green_retrofit_market_analysis.pdf

⁸ New York City Administrative Code, Chapter 30, § 11-3007

⁹ See <https://www1.nyc.gov/site/nycaccelerator/resources/pace.page> for information on pre-qualified PACE lenders (and for organizations seeking to become pre-qualified PACE lenders) as well as templates for PACE closing documentation.

¹⁰ As defined in Subdivision 6, Section 4 of the New York State Multiple Dwelling Law.

Statute (signed into law by the Governor on September 21, 2020)¹¹ and NYC SELP (enacted by the New York City Council on April 18, 2021) have expanded PACE financing to new construction, so it would be expected that the Administrative Rules will similarly be expanded to permit PACE loans to be made for new construction as well. In addition to funding the cost of installing such improvements and systems, funds from PACE loans may be utilized for related soft costs, including those incurred in connection with energy audits and feasibility studies, and the costs of verifying the installation of such systems and improvements. PACE loans may also be obtained to repay equity or more expensive construction financing for completed work, provided that the applicable project complies with NYC SELP and other requirements set forth by NYCEEC.¹² This is an important feature of the NYC PACE program as it allows PACE Loans to potentially be used as “rescue capital” to pay down a distressed mortgage loan in situations in which there are completed improvements that would qualify for PACE financing. We have most recently seen this technique used in other jurisdictions in connection with the work out of distressed hotel assets, where, as discussed below, hotel owners are able to “pass through” certain of the assessments to guests as taxes and fees.

II. The Mechanics of a PACE Transaction in NYC

As noted above, PACE loans are repaid through assessments levied on the subject property and collected at the same time as municipal taxes (as a separate item on the tax bill). Such assessments constitute a lien on the property that is subordinated (pursuant to agreement with the PACE Lender) to municipal taxes and assessments, sewer rents, sewer surcharges, water rents, and certain other city charges, but senior to all other liens (including mortgage liens). In order to accomplish this, the principal transaction documents that a PACE Lender will enter into in a NYC financing are (i) a “Program Financing Agreement,” effectively a loan agreement, governing conditions to disbursement, with the PACE Borrower. (ii) a “Collection Agreement” with the City of New York (the “City”) and the Program Administrator, which provides that the City will collect the periodic assessment established under the Program Financing Agreement (the “Program Charge”) from the Borrower, and remit such Program Charge to the Program Administrator, which will in turn remit such Program Charge to the PACE Lender, and (iii) a “Master Transfer and Remittance Agreement” between the City, the Administrator and a trust, of which the City is the sole beneficiary, created to acquire and collect on liens securing delinquent unpaid real estate taxes and similar charges, payable to the City, which Master Transfer and Remittance Agreement establishes the mechanism for collection of delinquent Program Charges.

Once a PACE Lender has entered into a PACE loan with a PACE Borrower, the Program Administrator must send the NYC DOF written notice that a Program Financing Agreement has been entered into within the earlier of 30 days of the date of the origination of such PACE loan and 15 days prior to the date the tax bill for the property which is subject to the PACE loan is issued by the NY DOF. Such notice (a “Payment Report”) must identify the property that is subject to the PACE Loan, the date of the Program Financing Agreement, the original principal amount of the PACE Loan, the total principal balance and accrued interest outstanding on the PACE loan on the date of such notice and the Payment Charge due to the PACE Lender on the next applicable collection date. Upon receipt, the NY DOF must list the Program Charge as a clearly identified line item on the next tax bill for the subject

¹¹ See <https://www.nysenate.gov/legislation/bills/2019/s6523/amendment/a> .

¹² See *Local Law 96: PACE Financing Frequently Asked Questions*, issued by the NYC Mayor’s Office of Sustainability and the New York City Energy Efficiency Corporation, <https://be-exchange.org/climate-mobilization-act-series-pace-financing/> (last visited January 24, 2021).

property. Thereafter, the Program Administrator must provide an updated Payment Report no later than 15 days before the NY DOF issues the next tax bill for the property.

Upon execution of the Program Financing Agreement and Collection Agreement, a written notice is recorded in the Office of the City Register (except for properties in Staten Island, in which such notice is recorded in the Richmond County Clerk's Office) establishing as part of the public record that the property is subject to the PACE loan.

Under Section 11-3005 of the New York City Administrative Code, the PACE loan constitutes a lien upon the real property benefited by such PACE Loan and the Administrative Rules provide that the PACE Lender, or any subsequent holder of such lien may enforce such lien pursuant to all applicable provisions of law, including Article 13 of the New York State Real Property Actions and Proceedings Law.

III. Advantages of PACE Financing

Building owners seeking to finance qualifying improvements, whether to comply with the requirements of the CMA or otherwise capture the savings associated with energy-efficient improvements, may find various aspects of PACE financing compelling. While PACE programs vary by jurisdiction, advantages of PACE financing when compared to conventional debt generally include the following:¹³

- Borrowers may obtain financing in the amount of up to 100% of the cost of the applicable improvements or renovations, with no out-of-pocket costs.
- Given its relative lien priority compared to conventional mortgage financing, interest rates on PACE financings are anticipated to be extremely competitive and, given the structure of the PACE program, are fixed for the life of the PACE loan.
- Based on conversations with those involved with the implementation of the program, PACE loans are not subject to mortgage recording tax, which results in significant cost savings.
- The term of the PACE loan (and the amortized payments) may extend as long as the weighted average useful life of the installed energy improvements (and therefore range up to between 20 and 30 years versus the more traditional three- to five-year terms of conventional mortgage debt).
- Since PACE financing is based on the value of an asset and not the credit of the building owner, personal guaranties are generally not required.¹⁴
- PACE loans typically require a minimum savings-to-investment (SIR) ratio, which means that projected annual cost savings are greater than repayment installments. This can increase the net operating income of the building, which is a positive factor for both building owners and existing mortgage holders.¹⁵

¹³ See *id.*

¹⁴ See Lessons in Commercial PACE Leadership: The Path From Legislation to Launch, February 2018, available at https://www.energy.gov/sites/prod/files/2018/03/f49/Lessons_in_Commercial_PACE_Leadership_Final.pdf.

¹⁵ See *id.*

- As PACE arrangements are special assessments paid on the property tax bill, property owners may not have to directly account for them as added debt on their books.¹⁶
- When applicable, a PACE charge may be passed through to tenants under many commercial leases and to hotel guests as occupancy taxes in many jurisdictions.
- Unlike most conventional mortgages, PACE debt is non-accelerating in the event of a payment default, and future payment obligations automatically transfer with the property to a new owner upon its sale.

IV. PACE Financing and Existing Mortgage Lenders

Given that a PACE loan will prime any mortgage debt encumbering the same property and therefore will be prohibited under any properly drafted mortgage loan documents, before a building owner may obtain PACE financing, any existing mortgage lenders must consent to the subordination of their applicable liens. Moreover, enabling legislation in certain other states, such as Texas, expressly condition any PACE loan on obtaining the consent of any mortgage lender. Initially, mortgage lenders were reluctant to agree to such subordination, which, in turn, hindered the adoption of PACE financing nationally. However, mortgage lenders have grown more comfortable with PACE financing and are increasingly consenting based on the following reasons:

- PACE financing can lower operating expenses and ultimately increase property values.
- The initial assessments, for up to a two year period (or in certain instances, even longer) may be able to be capitalized into the initial principal balance of the PACE loan at origination and/or mortgage lenders can require their borrower to escrow for any amounts not so capitalized, thus reducing the risk of default on the more senior PACE obligations.
- Mortgage lenders can negotiate for notice of defaults under the PACE loan and the opportunity to cure such defaults prior to such time that the PACE Lender would be able to institute assessment foreclosure proceedings.
- Since the PACE loan is non-accelerating, this limits the amount of debt that could become due ahead of the mortgage lender in the event of a default under the PACE loan.
- Since the PACE loan runs with the land (and is not personal to the borrower), the lien of the PACE loan survives a foreclosure by the mortgage lender and, conversely, a PACE loan does not restrict a mortgage lender's ability to foreclose.

Further, as legislation like the CMA becomes more widespread and PACE financing becomes more widely acceptable to mortgage lenders, mortgage lenders that reject PACE financing may find themselves at a competitive disadvantage when compared to the growing number of mortgage lenders that integrate the PACE model.

V. Unique Issues Related to PACE Financing

As PACE financing is relatively new, several unique issues may arise in connection with such loans, of which practitioners, lenders, and borrowers should be aware. First, since the lien of the PACE loan is not treated as a

¹⁶ See *id.*

mortgage, mortgagee title insurance is not currently offered to the PACE Lender in New York State; however several title insurers are investigating what title coverage could be provided. Also, there is a dearth of case law dealing with PACE loans in the bankruptcy context, so the rise of PACE loans may raise novel issues if and when commercial PACE loan borrowers file for bankruptcy which may need to be further considered.

VI. The Growth of PACE Financing

The PACE financing model has played, and will continue to play, an increasingly important role in funding sustainable building improvements. PACE-enabling legislation has been passed in 36 states, plus Washington D.C.,¹⁷ and the PACE model was used to finance \$660 million of sustainable improvements from 2016 through 2018, after only being used to fund \$208 million of such improvements in the prior six years, and \$1.5 billion in 2019, representing a 150% growth over 2018.¹⁸ Hence, it should come as no surprise that NYC has passed NYC SELP in connection with the CMA, and that its commercial and multi-family building owners will be able to take advantage of PACE financing in the near future.

The enactment of the NYC SELP and promulgation of the Administrative Rules is the culmination of a long process but is just the beginning of a new era of PACE financing in New York City. Further updates will follow as the landscape develops. In the meantime, please contact any of the below members of the PACE financing team at Haynes and Boone.

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¹⁷ *PACE Programs*, PACENation, <https://pacenation.org/pace-programs/#> (last visited April 20, 2021).

¹⁸ Joe Gose, *To Meet Demand for Green Buildings, Developers Get a Leg Up*, The New York Times (last updated Aug. 28, 2019), <https://www.nytimes.com/2019/08/27/business/green-buildings-pace-loans.html>.