

WILL CHANGES TO ALLOW FINANCING FOR NEW CONSTRUCTION AND GROUND LEASES RESTART C-PACE FINANCING IN NEW YORK?



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On August 19, 2024, New York City released the long-awaited updated program guidelines (the Amended Program Guidelines) for New York City's¹ commercial property assessed clean energy financing (PACE Financing) program (NYC PACE Program) to allow PACE Financing on new construction, major renovations, and certain leasehold interests and to exempt new construction, major renovations, and certain qualified improvements from any "savings-to-investment" ratio (SIR) requirement.

PACE Financing is an innovative public/private partnership that provides for cost-effective, revenue-neutral² 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.

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 program to provide PACE Financing to property owners for the installation

of eligible renewable energy systems or energy efficiency improvements.³ As of February 7, 2025, 78 municipalities in New York State (not including New York City) have developed PACE Financing programs, administered by the Energy Improvement Corporation (the EIC).⁴

While other New York State municipalities were developing PACE programs, PACE Financing didn't make its entry into New York City until 10 years later when, on May 19, 2019, the New York City Council passed the Climate Mobilization Act (CMA), a package of bills intended to, among other goals, cause large- and medium-sized buildings to reduce their greenhouse gas emissions by 40 percent by 2030 and 80 percent by 2050. Some emissions limits under the CMA have commenced as early as this year.

As part of the CMA, the New York City Council laid the municipal groundwork for the NYC PACE Program by creating the New York City Sustainable Energy Loan Program, enacted by Local Law Number 96 (as subsequently amended, NYC SELP)⁵ in order to help building owners pay for the potentially significant costs of compliance with the CMA. An analysis commissioned by the City of New York in September of 2023 found that 15,000 buildings will need an aggregate investment of \$12 billion to \$15 billion to comply with 2030 CMA emissions limits at current costs and with current technology.⁶ Of that, only \$5 billion to \$6 billion would pay for itself through energy savings.⁷ While the enactment of the NYC SELP was the critical first step to enabling a PACE Financing program in New York City, the NYC SELP required the New York City Department of Finance (NYC DOF), which was appointed as the administering agency, to promulgate certain administrative rules (Administrative Rules) in order to implement New York City's PACE program.

The NYC SELP and the Administrative Rules require a program administrator (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 NYC PACE Program. Unlike other PACE programs in

New York State, which are administered by the EIC, the Program Administrator for the NYC PACE Program is the New York City Energy Efficiency Corporation (NYCEEC). Among other duties, the Program Administrator is responsible for establishing certain "Program Guidelines," including templates for PACE Financing legal documents, and additional requirements for PACE lenders and borrowers under the NYC PACE Program. The Amended Program Guidelines, Core Program Documents, list of approved PACE Lenders, and other useful information can be found at the below link.⁸

Under the Program Guidelines certain capital providers (PACE Lenders), including private financing organizations, not-for-profit corporations, community development financial institutions, and public agencies, are pre-approved by the Program Administrator to provide PACE Financing to certain eligible property owners (PACE Borrowers) for financing certain projects at "Eligible Sites" located within the five boroughs of New York City. One important program requirement is that the property benefiting from the PACE Financing must not owe any delinquent unpaid civil penalties, taxes, or other debt to New York City. 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 Borrowers may only obtain PACE Financing under the NYC PACE Program for commercial or multi-family buildings (one- or two-unit residential buildings are specifically excluded from the NYC PACE program). However, co-operative apartment buildings can use PACE Financing for Eligible Improvements (described below) which need not be limited to be just common area improvements.⁹ On the other hand, existing condominium apartment buildings generally cannot use PACE Financing, though exceptions may be possible in situations where the existing condominium sponsor continues to maintain several units of the building under common ownership. New construction condominium projects can use PACE Financing for development financing under the NYC PACE Program; however, that PACE Financing needs to be repaid when the individual units are sold.¹⁰

The Program Guidelines, consistent with the NYS PACE Statute and the NYC SELP, make PACE Financing available to fund “Eligible Improvements” consisting of:

- “Energy Efficiency Improvement[s]” to “real property, whether as a component of the new construction of a building or the renovation or retrofitting of an existing building to reduce energy consumption, (such as window and door replacement, lighting, caulking, weatherstripping, air sealing, insulation, and heating and cooling system upgrades, and similar improvements); and
- 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.” In addition to funding the cost of installing such improvements and systems, funds from PACE Financing 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.¹¹

Previously the Program Guidelines only permitted PACE Financing in connection with the renovation or retrofit of existing improvements on property that the PACE Borrower owned in fee; however, the Amended Program Guidelines have now expanded PACE Financing to “New Construction,” “Major Renovations,” and certain “Leasehold Interests.” These are welcome and long-anticipated changes to the Program Guidelines to conform to amendments to the NYS PACE Statute, which was signed into law by the governor on September 21, 2020,¹² and subsequent amendments to the NYC SELP and the Administrative Rules.

When using PACE Financing for “New Construction” (defined as work that requires a new building permit pursuant to item 1 of Section 28-105.2 of the New York City NYC SELP) or “Major Renovations” (defined as eligible construction that increases the surface area of a building by more than 110 percent), the

project being financed must entail the design, development, and construction of a “Low Carbon Building.” A Low Carbon Building is defined as a building that is designed, constructed, operated, and maintained so that any device, machinery, equipment, component, system, or element installed or used in such building that causes or otherwise results in the combustion within or upon such building of any substance emits no more than 25 kilograms of carbon dioxide per million British Thermal Unit of energy. Some exceptions are made for certain manufacturing and commercial uses and for usage related to providing emergency power. In addition, any device installed or used in such building that: (i) has no connection to the gas supply line or fuel oil piping system of such building; (ii) is used on an intermittent basis; and (iii) is not used to supply such building, or any portion of such building, with heat or hot water is also exempt. Borrowers can use PACE Financing to finance not only the design, development, and construction of Low Carbon Buildings, but also the installation of efficient energy systems in such buildings.

Under the Program Guidelines, all projects financed under the NYC PACE Program must have a SIR of 1.0 or greater. The SIR is the ratio between: (i) the present value of the total estimated cost benefits over its lifetime (including cost savings from energy savings and other project-related benefits (e.g., the cost of penalties avoided under the CMA as a direct result of the Eligible Improvements financed by the PACE Financing)); and (ii) the total eligible construction and other costs financed by the PACE Financing. The Amended Program Guidelines exempt both Major Renovation and New Construction from the SIR requirement.

In addition, “Pre-Qualified Projects” and projects that consist entirely of “Pre-Qualified Energy Efficiency Improvements” are also exempt. Pre-Qualified Projects are retrofit projects that are designed so that the building is completely electrified according to local code and regulations. In the case of such a Pre-Qualified Project, the entire project, including non-electrification measures that would otherwise be eligible (for example, upgrading to energy

efficient windows), are exempt from the SIR requirement. “Pre-Qualified Electric Energy Efficiency Improvements” are defined to include certain electric HVAC, electric domestic hot water, and electric energy recovery systems that meet or exceed certain performance standards.

When using PACE Financing for “Leasehold Interests,” some of the requirements include: (i) the fee owner has consented in writing to the PACE Financing; (ii) the remaining term of the lease is no less than the term of the PACE Financing; and (iii) the Leasehold Interest has been recorded or is eligible to be recorded in the Office of the City Register, except for properties in Staten Island, in which it must be eligible to be recorded in the Richmond County Clerk’s Office (as applicable, the Real Property Records).

PACE Financing may also be obtained to repay equity or more expensive construction financing for completed work, provided that the applicable project complies with NYC SELP, Administrative Rules and Program Guidelines. This is an important feature of the NYC PACE Program, which was not changed by the Amended Program Guidelines, as it allows PACE Financing to, among other things, 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. For example, we have seen this technique become popular in other jurisdictions in connection with the work out of distressed assets and have seen this used as additional capital to plug an equity deficit in connection with an out-of-balance demand from a construction lender on a substantially completed construction project.

The Mechanics of a PACE Transaction in New York City

As noted above, PACE Financings are repaid through periodic assessments levied on the subject property and collected at the same time as municipal taxes as a separate item on the tax bill (the Program Charge). Such Program Charges 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 New York City 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 (City) and the Program Administrator, which provides that the City will collect the Program Charge from the PACE 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.

Upon execution of the Program Financing Agreement and Collection Agreement, a written notice is recorded in the Real Property Records establishing as part of the public record that the property is subject to the PACE Financing.

Under Section 11-3005 of the NYC SELP, the PACE Financing constitutes a lien upon the real property benefited by such PACE Financing 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.

Advantages of PACE Financing for Borrowers

Building owners seeking to finance Eligible 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 and the Amended Program Guidelines will make many more projects eligible under the NYC PACE Program.

While PACE programs vary by jurisdiction, advantages of PACE Financing (whether under the NYC PACE Program or PACE Financing programs in other jurisdictions) when compared to conventional debt generally include the following:

- Borrowers may obtain financing in the amount of up to 100 percent 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 very competitive and, because of the structure of the PACE program, are fixed for the life of the PACE Financing.
- PACE Financing is generally not subject to mortgage recording tax, which can result in significant cost savings in mortgage recording tax jurisdictions.
- The term of the PACE Financing (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).
- Since PACE Financing is based on the value of an asset and not the credit of the building owner, personal guaranties are typically not required once the improvements have been completed (although most PACE Lenders require completion guaranties during the construction phase of a project incorporating Eligible Improvements financed by a PACE Financing).
- With respect to PACE Financings that require a SIR (or an equivalent requirement), the applicable PACE programs typically require a SIR (or equivalent) ratio of 1.0 or under, 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.¹³
- Since Program Charges (or their equivalent) 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.

- The PACE Financing and the associated future Program Charges automatically transfer with the property to a new owner upon its sale.

PACE Financing and Existing Mortgage Lenders

Given that a PACE Financing 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. 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:

- Unlike conventional debt financing, PACE Financing is non-accelerating upon a payment default. The only amount which becomes due (and on which the PACE Lender may foreclose) is the amount of the unpaid Program Charge plus interest and penalties. This limits the amount of debt that could become due ahead of the mortgage lender in the event of a payment default under the PACE Financing.
- The initial Program Charges, 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 Financing at origination (so that no Program Charge would be due during the initial construction phase of a construction project).
- 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. In fact, unlike underwriting an escrow for taxes and insurance, the Program Charges under the PACE Financing are fixed for the life of the PACE Financing and (absent a default) will never increase from what is initially scheduled at the closing of the PACE Financing.

- Mortgage lenders can sometimes negotiate for notices of defaults under the PACE Financing and the opportunity to cure such defaults prior to such time that the PACE Lender would be able to institute foreclosure proceedings on account of delinquent Program Charges.
- A PACE Financing does not restrict a mortgage lender's ability to foreclose, and the lien of the PACE Financing survives a foreclosure by the mortgage lender. This means that the mortgage lender does not need to pay off the PACE Financing upon a foreclosure and automatically will assume the remaining obligations under the PACE Financing after taking the REO property.
- PACE Financing can lower operating expenses and ultimately increase property values.

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 Financing is not treated as a mortgage, mortgagee title insurance is not currently offered to the PACE Lender in New York State. Also, there is a dearth of case law dealing with PACE Financings in the bankruptcy context, so the rise of PACE Financing may raise novel issues if and when commercial PACE Borrowers file for bankruptcy which may need to be further considered.

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 now been passed in 40 states, plus Washington, DC, and PACE programs are active and operating in 32 states plus Washington, DC.¹⁴ PACE Financing has exploded over the past five years, an explosion that may have been assisted by a lack of available conventional financing during the COVID pandemic for capital infusions into existing eligible projects as PACE Lenders began to fill a capital void for such needs. In 2020, there was \$2.282 billion in PACE Financing in the United States

(up from \$1.578 billion in 2019), increasing to \$3.612 billion in 2021, further increasing to \$5.169 billion in 2022, and finally to \$7.178 billion in 2023.¹⁵ Thus in 2023, the year in which the World Health Organization (WHO) ended the global emergency status for COVID-19,¹⁶ the dollar volume of PACE Financing increased by a staggering 355 percent over the total volume in 2019, the last calendar year before the WHO declared the COVID-19 outbreak a Public Health Emergency of International Concern.¹⁷

Many observers are anticipating that the Amended Program Guidelines will breathe new life into the NYC PACE Program, which had stalled and only produced three PACE Financings in New York City since its inception in 2019. We anticipate that the NYC PACE Program will continue to evolve and further updates will follow as the landscape develops. 📌

Notes

- 1 N.Y.C. Mayor's Off. of Climate and Env'tl. Justice and N.Y.C. Energy Efficiency Corp., NYC Accelerator PACE Guidelines [hereinafter Amended Program Guidelines], (rev. Aug. 19, 2024) available at https://accelerator.nyc/sites/default/files/2024-08/PACE%20Program%20Guidelines_v3.0_FINAL.pdf.
- 2 As discussed below, generally, 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.
- 3 See New York State General Municipal Law Article 5L Municipal Sustainable Energy Loan Program, N.Y. Gen. Mun. Law § 119-gg, available at <https://www.nysenate.gov/legislation/laws/GMU/A5-L>.
- 4 EIC NY, Municipalities in New York State with an OPEN C-PACE Program (Feb. 7, 2025), available at https://www.eicpace.org/_files/ugd/1b6741_21e0a22d77b843d5b2b65217ff21f810.pdf?index=true.
- 5 See N.Y.C. Sustainable Energy Program, Local Laws of the City of New York For the Year 2019, No. 96 available at https://www.nyc.gov/assets/sustainability/downloads/pdf/local_law_96.pdf.
- 6 See N.Y.C. Mayor's Off. of Climate and Env'tl. Justice and N.Y.C. Energy Efficiency Corp., Getting 97 Done: A Plan to Mobilize New York City's Large Buildings to Fight Climate Change (Sept. 2023), available at https://climate.cityofnewyork.us/wp-content/uploads/2023/09/Getting_LL97Done.pdf.
- 7 Id.
- 8 N.Y.C. PACE Accelerator Financing, available at <https://accelerator.nyc/resources/finance/PACE>.
- 9 Based on correspondence with Financing Specialists at NYC Accelerator on October 7, 2024 (on file with author).
- 10 Id.
- 11 Amended Program Guidelines, *supra* note 1, at 5.
- 12 N.Y. Gen. Mun. Law § 119-gg. See <https://www.nysenate.gov/legislation/bills/2019/s6523>.
- 13 See U.S. Dep't of Energy, Off. of Energy Efficiency & Renewable Energy, Lessons in Commercial PACE Leadership: The Path from Legislation to Launch (Feb. 2018), available at https://www.energy.gov/sites/prod/files/2018/03/f49/Lessons_in_Commercial_PACE_Leadership_Final.pdf.
- 14 PACE Programs, PACENation, available at <https://pacenation.org/pace-programs>.
- 15 Id.
- 16 Jennifer Rigby and Bhanvi Satija, WHO declares end to COVID global health emergency, Reuters, May 8, 2023, available at <https://www.reuters.com/business/healthcare-pharmaceuticals/covid-is-no-longer-global-health-emergency-who-2023-05-05/>.
- 17 World Health Organization, [WHO] Statement on the second meeting of the International Health Regulations (2005) Emergency Committee regarding the outbreak of novel coronavirus (2019-nCoV) (Jan. 20, 2020), available at [https://www.who.int/news-room/detail/30-01-2020-statement-on-the-second-meeting-of-the-international-health-regulations-\(2005\)-emergency-committee-regarding-the-outbreak-of-novel-coronavirus-\(2019-ncov\)](https://www.who.int/news-room/detail/30-01-2020-statement-on-the-second-meeting-of-the-international-health-regulations-(2005)-emergency-committee-regarding-the-outbreak-of-novel-coronavirus-(2019-ncov)).