

# Property Assessed Clean Energy Equipment Financing in Pennsylvania: **Proceed With Caution**

**O**n June 12, 2018, Pennsylvania enacted legislation that authorizes counties and municipalities to finance commercial clean energy and water conservation projects and alternative energy systems using the proceeds of voluntary assessments on real property that are collected and enforced by local governments in the same manner as property taxes. The U.S. Department of Energy reports that similar commercial property assessed clean energy (C-PACE) programs are in effect in 18 other states and are in the process of implementation in 10 states, including Pennsylvania. Plans to implement C-PACE programs in Pennsylvania are currently under development or consideration in at least 16 counties.

Proponents of C-PACE programs claim the programs allow commercial property owners to obtain low-cost, long-term financing for energy efficiency improvements that can cover 100 percent of project costs and will generate energy savings greater than construction and financing costs. The programs are promoted as being beneficial to property owners who wish to make long term investments in building energy efficiency projects while passing on the costs to pass for the improvements to subsequent purchasers. C-PACE financing is also touted as beneficial to investors because the programs provide financing repaid on the property tax bill that will provide strong security

that allows lenders to offer better interest rates and longer repayment terms than are otherwise available. Before proceeding to implement or participate in C-PACE financing, however, these claims deserve careful scrutiny.

## **C-PACE Basics**

The Pennsylvania legislation (Act 30 of 2018) allows any county or a municipality with a community or economic development department to implement a PACE program by adopting an ordinance, which designates a district in which the program will operate and establishes criteria and procedures to determine the eligibility of participating property owners. Counties and other municipalities establishing PACE programs may establish whatever criteria and procedures they deem advisable, provided that each project must (1) have an energy consumption baseline, energy savings projections and a scope of work determined by a qualified contractor; (2) comply with national clean energy standards; and (3) have the completion of construction verified by a qualified inspector. In lieu of establishing their own criteria and procedures, municipalities may also select a program administrator to establish and operate a PACE program.

The law allows local governments to provide bond financing for C-PACE projects, but also allows any type of "financial institution" to also provide financing. The term "financial institution" is defined very broadly to not only include banks, savings

associations and trust companies, but also mortgage bankers and brokers, insurance companies, employee health and welfare funds, and any type of business association engaged in development or improvement of real property. The law even allows a property owner to finance its own improvements using assessments that will continue in effect after sale of the property to a new owner. In Pennsylvania, financing for C-PACE programs will most likely be provided by non-governmental capital providers.

Each C-PACE project is implemented through the execution of an agreement between the property owner and a sponsoring municipality or its program administrator. Before an assessment is imposed, notice must be given to all holders of liens on the property to be assessed, and approval must be obtained from all lien holders. Based on the recommendations of the Pennsylvania Bankers Association, the notice and consent requirements apply not just to mortgages (as is the case of many other states), but to all types of liens that secure payment obligations.

If consent is granted by property owners and lien holders, C-PACE assessments will enjoy the same first-priority status as local property tax liens and the obligations to pay assessments will be treated as taxes imposed by the sponsoring municipality or county. Assessments must also be recorded with title, and public notice must be given regarding project financing.

A prominent feature of Act 30 is that the legislation does not provide any mechanism for state regulatory

supervision or oversight of C-PACE programs. Instead, each sponsoring county or municipality is expected to supervise its own programs. Because counties and municipalities lack any commercial lending experience, these regulatory responsibilities will most likely be outsourced to private program administrators.

To overcome the lack of any state regulation over C-PACE programs, the Sustainable Energy Fund and the Keystone Energy Efficiency Alliance, working in cooperation with the Philadelphia Energy Authority and the Pittsburgh Office of Sustainability, have adopted voluntary guidelines for C-PACE programs and are promoting the use of the Sustainable Energy Fund and the Philadelphia Energy Authority as PACE program administrators. The Pennsylvania Department of Environmental Protection is also encouraging the use of the guidelines to promote consistency among PACE programs. The guidelines include procedures to determine the eligibility of property owners, approve PACE capital providers and contractors, and implement levy and lien agreements between sponsoring municipalities and property owners. It is unclear, however, whether voluntary guidelines developed and implemented by parties with financial interests in C-PACE financing can substitute for effective governmental regulatory authority.

In determining whether to participate in a C-PACE program, several factors should be carefully reviewed.

### **What are the costs of C-PACE financing?**

The U.S. Energy Department reports that C-PACE programs typically assess origination fees of between 0.2 percent to 5 percent of the amount financed; annual fees of between 0.25 percent to 3 percent of the outstanding balance;

and investment interest rates of 3 to 4 percent plus closing costs. Currently the Sustainable Energy Fund has indicated that it will charge 1.25 percent for the first \$1 million financed, 1 percent for projects between \$1 million and \$2 million, and 0.75 percent for financing projects greater than \$2 million, subject to a cap of \$50,000 per project, plus a 0.15-percent annual servicing fee and other optional charges.

Because C-PACE assessments legally are classified as local tax assessments, projects may also be subject to Pennsylvania's prevailing wage law, which generally increases project costs by approximately 20 percent.

The requirement that assessments must be collected in the same manner as local property taxes may also increase costs. This may occur because some local tax collectors are entitled to commissions that are a percentage of all taxes collected that will reduce amounts distributed to capital providers. The timing of local tax collections may also increase interest costs. Rather than providing for monthly amortization, property taxes generally must be paid either in a single lump sum amount (subject to a 2-percent discount for timely payment and a 10-percent penalty for late payment), or in three monthly installments. It is unclear whether local tax collectors may or will modify these payment schedules, discounts and penalties to accommodate monthly repayments. In the event assessments become delinquent, county tax claim bureaus or local collection agents may also impose additional interest and penalties in addition to amounts due to a project's capital provider.

### **Is the original obligor released from liability upon the sale of an assessed property?**

The imposition of an obligation that runs with title to land may or

may not be a credit enhancement that allows longer term loans and lower interest costs depending on whether or not the original property owner is released from liability upon the sale of property. Although under Pennsylvania law a prior owner is not subject to future property tax obligations upon the sale of property, nothing in Act 30 address the question of whether the agreement to levy a C-PACE assessment between a property owner and a sponsoring government or its program administrator may impose personal liability on the original property owner subsequent to the transfer of title.

If the original property owner is released from liability, a capital provider may be left with a new debtor that is less creditworthy than the original property owner. Upon the release of the original owner, a capital provider may also be left with no way to ensure compliance with the terms and conditions of a financing agreement upon the transfer of title. For example, the lender may lack any ability to prevent the removal of energy efficiency improvements from the property; enforce property maintenance requirements; require adequate insurance on financed equipment and the assessed property; or force-place insurance if the property owner fails to do so. To cover these risks, lenders may require higher interest rates than can be offered using conventional financing.

Alternatively, if an assessment agreement requires the original property owner to remain personally liable for a default subsequent to the transfer of title, C-PACE financing may not be a desirable alternative to traditional mortgage financing because most property owners may insist on full payment of all past due and future assessments prior to the transfer of title. Satisfying a PACE assessment upon a transfer of title,

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however, may expose the property owner to prepayment penalties. The ability of capital providers to waive pre-payment penalties may also be affected by requirements of the Pennsylvania law that "assessments cannot be accelerated or extinguished until fully repaid."

### **What are the risks assumed by capital providers?**

C-PACE financing is being promoted as a low-cost alternative to conventional financing that will structure loan payments "to be less than the monthly energy savings, meaning no increase in the borrower's existing operating budget." Given the volatility of energy prices, however, projections of energy costs savings are inherently unreliable. Furthermore, equipment may fail to function in the manner predicted for the full term of an assessment.

When C-PACE programs fail to live up to promotional representations, the Model Guidelines of the Sustainable Energy Fund relieve the fund and the sponsoring local government of any liability. Instead, property owners and capital providers are required to conduct due diligence to ensure that qualified and reputable contractors are chosen to perform work according to plans, specifications and requirements set forth in the Program Guidelines and are required to certify that contractors comply with program

requirements. Allegations that capital providers deceived property owners regarding the benefits of C-PACE financing may generate claims of fraudulent or negligent misrepresentation and claims for treble damages under the Pennsylvania Unfair Trade Practices and Consumer Protection Law.

### **What are the political risks associated with C-PACE financing?**

C-PACE programs depend on local tax collectors to collect assessments and on tax claim bureaus or other delinquent tax collectors to initiate foreclosure actions to satisfy delinquent assessments. These officials may not be under the jurisdiction of the county or municipality establishing a C-PACE program. During times of economic distress, and especially if energy efficiency improvements do not function as advertised or are removed, destroyed or damaged without available insurance coverage, tax collectors and local governments may also become reluctant to discharge these duties, especially with respect to subsequent purchasers that never agreed to the assessments. This may result in delays in tax collection or foreclosure efforts or in changes to the Pennsylvania C-PACE law.

Delinquent property owners may also raise constitutional challenges to the use of public officials as de-facto

debt collectors for private capital providers and the delegation authority to operate C-PACE programs to private administrators. Under Art. III, § 31 of the PA Constitution, the General Assembly may not delegate to any private corporation or association the power to levy taxes, supervise municipal improvements of the use of municipal moneys or perform any municipal function. Likewise, under Art. IX, § 9, the General Assembly may not authorize a municipality to provide money to any corporation, association, institution or individual, but it may provide standards by which municipalities may give financial assistance to commercial enterprises if necessary to the health, safety or welfare of the commonwealth or any municipality. If questions are raised regarding whether the C-PACE law makes an impermissible delegation of power or fails to provide adequate standards for providing financial assistance to commercial enterprises, how such claims will be resolved is difficult to predict.

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