Law & Accounting

Building blocks of C-PACE projects: A document checklist

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An increasing number of Colorado property owners are taking advantage of the Colorado Commercial Property Assessed Clean Energy program. Once the C-PACE financing documents are finalized with a capital provider, what happens next? Owners should take the following steps to operate their C-PACE projects effectively:

1. Update the construction contract. The first step, of course, is to construct the C-PACE improvements. The owner will need to hire a contractor who is registered with the Colorado C-PACE program. The owner and the contractor will enter into a direct construction contract, which will incorporate the various obligations under the applicable construction funding and disbursement agreement. Similar to a traditional construction loan, C-PACE funds are disbursed in installments during the construction process. The capital provider may elect to pay the contractor directly or reimburse the owner for paid construction costs. In either case, the owner should include contract language that requires the contractor to satisfy the disbursement conditions before receiving any payments. In addition, if there is a senior loan encumbering the property, the senior lender may require C-PACE funds to be held in a separate escrow account. In such circumstances, the construction contract should incorporate the additional escrow-related requirements. The capital provider and senior lender (if applicable) also will need to approve any changes to the construction contract, plans and budget during the construction process.

2. Update the leases. Most C-PACE projects will have tenants that benefit from the new improvements. Generally, C-PACE assessments are passed through to the tenants under the leases. Although C-PACE improvements constitute capital expenditures (which generally are not considered reimbursable operating costs), the C-PACE-related costs should be included in operating costs because the improvements provide continued energy savings and reduce the overall operating costs for the project. The owner should update any triple-net or base-year leases so that amortized C-PACE costs (including finance closing costs, the program administration fee and interest) are part of operating costs. For projects with base-year leases, the leases also should clearly state that C-PACE costs are included in the base-year operating costs. Alternatively, C-PACE payments can be passed through to tenants as a real estate tax. C-PACE assessments are included as a special assessment on an owner's tax bill and payable with other real estate taxes. The owner should confirm that the real estate tax provision contemplates special assessments and that the spirit of the operating cost provision does not conflict with the owner's ability to pass through capital expenditures funded through special assessments. After completing the C-PACE process, owners may be inclined to implement additional sustainability practices into their newly improved, greener projects. Such owners should incorporate any desired sustainability-related tenant requirements into the leases.

3. Update the loan documents. C-PACE financing is frequently combined with other forms of traditional financing, and the other lender will need to approve the C-PACE loan. For existing loans, the owner will obtain the senior lender's consent during the C-PACE approval process. For future financing, the new lender will need to be comfortable with the existence of the C-PACE assessment lien. Some lenders may be nervous about a senior priority lien on their collateral. However, if it is characterized as a nonaccelerating assessment, similar to a sewer assessment, the lender may be more comfortable with the idea. It may be helpful to point out that C-PACE payments cannot be accelerated and a capital provider cannot foreclose on the project. If another lender forecloses, the successor owner will be obligated to pay the C-PACE assessment like any other standard county assessment.

4. Update the purchase and sale agreement. An owner may not sell its project during the construction of the C-PACE improvements. Once the improvements are complete, however, the owner may be interested in selling the project, thanks to its enhanced value. The purchase and sale agreement should disclose the C-PACE assessment on the project so that the buyer and its prospective lender are aware of its existence. Upon the sale, the future owner will be responsible for subsequent C-PACE payments. Prepayments of the C-PACE loan are permitted with a prepayment penalty, but C-PACE liens are designed to run with the land and be binding on future owners of the project. A selling owner may need to explain to a buyer that the C-PACE assessment remains on the project because the related improvements continue to provide cost savings to the project and appeal to new tenants seeking sustainable space. With the growing number of C-PACE projects across Colorado, more buyers will understand and appreciate the advantages of owning and operating a C-PACE project. ▲