

A photograph of modern skyscrapers with glass facades, reflecting the sky and each other, under a bright, hazy sky. The buildings are viewed from a low angle, looking up.

# POSITION PAPER

## PROPERTY ASSESSED CLEAN ENERGY

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#### BOMA'S POSITION

BOMA Florida is committed to the reduction of energy consumption and the concomitant energy cost reduction, and environmental benefits of energy efficient retrofits throughout Florida. Likewise, BOMA supports the potential for property preservation and insurance reduction with installation of wind storm hardening improvements. BOMA Florida continues to support PACE as a job creation tool, energy efficiency initiative, and viable green retrofit financing option for property owners.

#### BACKGROUND

##### *PACE Legislation*

Property Assessed Clean Energy (PACE) refers to enabling legislation passed by Florida in 2010 that provides innovative financing for residential and commercial property improvements in the areas of energy efficiency, water conservation, renewable energy, and wind resistance (hurricane hardening). Section 163.08, Florida Statutes. The State of California passed the first PACE program in 2008, and now over half the states plus the District of Columbia have authorized a PACE financing program.

PACE has, since its inception, been touted as a significant job creation tool, promising a boost to green construction trades.

The program accentuates the movement toward energy independence and reduction of Florida's carbon footprint, while offering the property owner a lower cost option to finance 100% of improvements which will provide long-term reduction in energy bills and a positive return on investment. Commercial and industrial property often has the best cost/benefit realization for investments in conservation improvements.



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### BACKGROUND CONTINUED

What makes PACE unique is that the financing is provided by a local governmental authority for private property improvements, and the loan is repaid via the annual property tax bill as a non-ad valorem special assessment. 100% of the costs of running the program can be passed thru to the participants in the program so there is no cost to the government. The security of the debt repayment mechanism will, presumably, provide access to lower cost financing. The PACE assessment is of equal dignity to other county taxes and assessments and is therefore first in line. These programs overcome barriers to traditional financing of such improvements by financing 100% of the qualifying improvements with a repayment term of up to 20 years. These assessments stay with the property upon sale.

The Florida law specifically states the consent of the lender is not required if the improvement does not exceed 20% of the just value of the property. However, the mortgage holder must be provided advance notice of property owner's intent to enter into a PACE agreement on mortgaged property. Acceleration of payment provisions in a mortgage are not enforceable by a lender solely because the property owner entered into a PACE agreement. Any subsequent buyers of property encumbered by a PACE agreement must be provided notice of the agreement in the contract for sale.

### ISSUES

As a voluntary opt-in based on low cost financing, PACE is a viable option for property owners hoping to reduce energy consumption and improve wind storm resistance and save money in the long term through investment in energy efficiency. It allows for the costs of the improvements, since they are repaid as a special assessment on the property, to be passed through to tenants. Although the law only requires lender notice, there are two models in use in Florida: lender notification (e.g., Ygrene and Alliance NRG programs) and lender

consent (e.g., Renew PACE, f/k/a Florida Green Energy Works). In the lender consent model, the first mortgage holder, if any, must sign a consent and estoppel as part of the approval process.

The major concern with the lender notification model is that resale of the property could be difficult unless the PACE assessment was satisfied prior to closing. The Federal Housing Finance Agency for Fannie Mae and Freddie Mac has objected to PACE loans unless the loan does not have priority over first mortgage liens. Fannie Mae as recently as May 31, 2016, published a guide which states that they will not purchase mortgage loans secured by properties with an outstanding PACE loan if that loan has priority over the first mortgage. Application of such a policy in resales in the non-residential lending market is not known, but is a concern, even if the lender consents at the time of the property owner's enrollment in the program.

Implementation of PACE in Florida was slowed by a number of lawsuits challenging bond validations for several programs. The Florida Bankers Association had attempted to appeal a PACE program bond validation on a theory that the program allowed an unconstitutional impairment of contract. They were found not to have standing and their appeal was dismissed by the Florida Supreme Court in October, 2015 without addressing the issue. No other challenge has been made to PACE as an unconstitutional impairment of contract. Several other challenges to bond validations from programs have resulted in nothing more than required clarification of documents.

### ACTION REQUESTED

BOMA Florida encourages its members to work with local municipalities in establishing PACE programs, educating local municipalities on the program, consolidating municipal involvement per regional geographic area, as well as running for local boards.



# POSITION PAPER

## PROPERTY ASSESSED CLEAN ENERGY



### QUESTIONS & ANSWERS ON PACE LEGISLATION PRESENTED BY BOMA FLORIDA GOVERNMENT AFFAIRS AND ENERGY AND SUSTAINABILITY COMMITTEES

1. Q: How has typical enabling legislation established the criteria needed to achieve "energy efficiency;" will the criteria be under the jurisdiction of each municipality or granting board? What will be the suggested basis for the criteria--what measures will the criteria be based on? For example, if the basis will be the uniform building codes what will occur in the future with the changing codes--will the criteria change in tandem or via index to the changing codes? Will projects being submitted during a future change of criteria basis be able to grandfather into the existing code for financing purposes (for example, if the criteria basis is being updated from 2010 to 2015)?

A: *All construction work in Florida must adhere to the current code. The PACE statute does not require that the energy, efficiency improvement achieve some predefined metric beyond prevailing code compliance. No energy audit is required by statute unless the property is mortgaged, the total amount of the assessment exceeds 20% of the just value of a property and the property owner seeks to avoid lender consent. Many of the local programs have established some metric of improvement over a base line energy audit for conservation improvements and/or limits on the project's percentage of value of the property which property owners are cautioned to review early on in the consideration of participation in such a program.*

2. Q: How will tax write-offs be incorporated into this financing option?

A: *The Florida Courts have affirmed that PACE assessments are of equal dignity to property taxes. The specific tax treatment of PACE assessments should be determined by the property owner's tax counsel. Contributing to that determination are the following facts:*

- PACE assessments are of equal dignity to property taxes and like all non-ad valorem assessments, are included in the property tax bill
- The components of the tax bill cannot be selectively paid
- Property taxes are not reported on the balance sheet

- Non-ad valorem assessments may be deducted from taxes as a business expense
- The PACE obligation is assumable
- The remedy for the Investor to the non-paying property owner is the uniform method of collection – the same as with property taxes. Court cases have affirmed that this is the sole method of collection and judicial foreclosure is not an option
- Default on payment of a PACE assessment does not result in acceleration of the obligation and the obligation is not callable upon default
- The amount and interest rate are not based upon personal credit but property value.

3. Q: What happens if a property owner commits to a major improvement and the market takes a downturn and the property owner is unable to cover the non-ad valorem assessment costs? Will the taxpayer base bear responsibility, or will the bond-holders, or both?

A: *The remedy for the Investor backing a local government PACE program is the same remedy as if the property owner does not pay their property taxes. A property owner cannot pay a selected portion of their tax bill, i.e. they can't pay their property taxes but not the non-ad valorem assessment associated with an improvement. If the property owner defaults on their tax bill, the uniform method of collecting unpaid taxes is used. Ultimately, a tax certificate is sold by the County. A redeemer pays the taxes and the property owner now owes the redeemer the amount of property taxes plus a fee. The uniform method of collection is a protracted but predictably successful process, but in the end, the risk is ultimately the Investor's risk, not the taxpayer base of the jurisdiction.*

4. Q: How has a PACE financed property fared in the market in other geographic areas? Have subsequent purchasers encountered challenges in obtaining mortgage financing or stricter financing terms due to the seniority of the PACE tax lien? Will lease terms disallowing non-ad valorem pass-throughs in Real Estate Tax

reimbursements decrease in value through decreasing NOI-is it therefore advantageous for Landlords to ensure non ad valorem pass-through's are allowable in leases?

A: Part a. – There is not sufficient experience with the program to fully assess whether there will be challenges in financing as a result of the PACE assessment. In most programs, the PACE assessment may be paid off at any time in full with no penalty. It is also assumable. As a result, the PACE assessment simply becomes a negotiable term of sale.

Part b. – The particular accounting/tax treatment for a PACE assessment will vary based on individual property goals. The PACE assessment may be capitalized, depreciated and interest paid would be tax deductible. Or, the PACE assessment may be treated as property taxes, reducing tax basis, and deductible as a business expense. The Landlord's NOI will decrease as a result of a PACE assessment. Landlord's will generally have two options; since the PACE improvement will increase a tenant's cash flow through lower operating costs a rent increase by inclusion of the cost in CAM or more rarely base rent depending on the lease terms, may be warranted leaving the overall cost neutral. New lease agreements may include higher rents or allowable pass-throughs.

**5. Q: Will PACE financing in any way affect the assessed value of the property?**

A: PACE financing is used most often to finance prescriptive replacements of existing systems, and should not affect the assessed or taxable, value of the property other than general increase due to year over year property values. Article VII, Section 4 of the Florida Constitution was amended in 2008 to allow the Legislature to adopt law preventing an increase in assessed value for installation of renewable energy devices and wind storm protection on residential property.

**5. A: (continued)** This was implemented in section 193.624, F.S. As a result of legislation, a further expansion of the constitutional protection will be on the ballot August 30, 2016 that expands the assessment increase protection for installation of solar or other renewable energy devices to non-residential property and adds a tangible personal property exemption.

**6. Q: The authorizing legislation refers to "affixed" improvements; will the common law definition of fixture serve here? With the changing technologies associated with energy efficiency, will this**

**definition suffice?**

A: §163.08(10) states "A qualifying improvement shall be affixed to a building or facility that is part of the property and shall constitute an improvement to the building or facility or a fixture attached to the building or facility." The improvement must become a permanent part of the property. For example, PACE financing is available for solar panels, but not available for EnergyStar appliances. Most local programs are also adding an agreement provision which prohibits removal of a PACE funded improvement without full payment of the obligation.

**7. Q: §163.08(2)(b)(2) limits renewable energy improvements to the listed items; with the promise of every-changing energy technology, will other methods be able to be included? BOMA Florida suggests the legislation include the language "including but not limited to."**

A: Actually, §163.08(2)(b) should be sufficiently broad to accommodate new technologies as it states, "Qualifying improvement includes any" and subpart (2) follows. "Renewable energy improvement, which is the installation of any system in which the electrical, mechanical, or thermal energy is produced from a method that uses one or more of the following fuels or energy sources; hydrogen, solar energy, geothermal energy, bioenergy and wind energy. The definition of allowable energy conservation measures is likewise sufficiently broad.

**8. Q: §163.08(9) refers to a 3 year period of prior ownership that the current owner cannot have been delinquent on property obligations; could this deter new ownership?**

A: §163.08(9) states, "Before entering into a financing agreement, the local government shall reasonably determine that all property taxes and any other assessments levied on the same bill as property taxes are paid and have not been delinquent for the preceding 3 years or the property owner's period of ownership whichever is less; that there are no involuntary liens, including, but not limited to, construction liens on the property that no notices of default or other evidence of property-based debt delinquency have been recorded during the preceding 8 years, or the property owner's period of ownership, whichever is less; and that the property owner is current on all mortgage debt on the property." The statute accommodates PACE financing for new property owners and property owners readying properties for sale.

**9. Q:** §163.08(12)(a) refers to a not to exceed 20% of just value figure to avoid mortgage holder consent of PACE financing; Is this percentage reasonable for commercial as well as residential properties, as it may deter securing financing? BOMA Florida assumes that “just value” is defined as assessed value.

**9. A:** §163.08 (112)(a) states, “Without the consent of the holders or loan servicers of any mortgage encumbering or otherwise secured by the property the total amount of any non-ad valorem assessment for a property under this section may not exceed 20 percent of the just value of the property as determined by the county property appraiser.”

*If the property owner has the mortgage lender’s consent, they can exceed the 20 percent limitation. Additionally, the statute allows a property owner to obtain an energy audit and if that audit demonstrates that the annual energy savings equals or exceeds the annual repayment amount of the PACE assessment, the limit to 20% of just value does not apply. In the case of a property without a mortgage or other property-based debt, by statute, the property owner may exceed the 20 percent limitation. PACE financing that may by statute exceed 20 percent of the property’s just value is still subject to the terms of any PACE program Investor approval. “Just Value” is the term used in the Constitution to define the property appraiser’s duty to establish the present cash value of property.*

**10. Q:** §163.08(13) renders unenforceable mortgage agreements accelerating payment in the event the property owner obtains PACE financing; is this meant to be retroactive to existing agreements? Will this provision harm property owners’ chances of obtaining financing?

*A: The answer to this question comes in two parts, first, the law is meant to address all agreements. It is not clear how unenforceable acceleration would affect the property owner’s chances of obtaining financing. Is this the existing property owner attempting to obtain more financing on the existing property, or a prospective buyer trying to obtain financing on a property on which a PACE assessment rests? Assuming that the question is really relating to a prospective buyer obtaining financing for the purchase of a property on which a PACE assessment rests, the answer is simply that the PACE assessment then becomes a*

*negotiable term of sale. Either the current property owner increases the sale price of the property to accommodate the additional values of the PACE improvement and uses the additional value to pay off the PACE-related balance out of sale proceeds or the prospective buyer, working with the Lender, assumes the remaining PACE-related balance, resuming scheduled payments.*

**11. Q:** Will the interest rates associated with PACE financing be comparable to market loans? Will the interest from PACE financing be available for a write-off?

*A: The answer to these questions comes in parts. First the interest rates are competitive in the secondary lending market. (Rates and terms vary among PACE providers). The PACE financing may be handled two ways, depending on your Tax Counsel. One way would be to view the PACE improvement as an asset and capitalize it, taking depreciation and deducting the interest. The other way is to treat the PACE improvement as an off-balance sheet property tax expense and deduct the entire property tax bill as a business expense.*

**12. Q:** Will PACE financing apply to new construction?

*A: Per proposed §163.08(10), properties without substantial completion or certificate of occupancy will not be qualified to participate in PACE financing for wind-resistance improvements.*

