

GreenFinanceSF Plans Commercial Pilot Program

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We are supplementing our June 2010 article on San Francisco's GreenFinanceSF PACE Program. The City temporarily suspended this program for both commercial and residential projects. This commercial pilot program suspension comes in response to concerns raised by the Office of the Comptroller of the Currency (OCC), administrator of national banks. In an OCC bulletin dated July 6, 2010, Timothy Long, Senior Deputy Comptroller for Bank Supervision Policy and Chief National Bank Examiner, expressed support for commercial property assessed clean energy (PACE) programs, such as GreenFinanceSF, but warned that these programs could increase lender exposure and jeopardize their collateral positions. Mr. Long advised lenders to analyze carefully the effect PACE programs will have on their mortgage portfolios and lending activities, and recommended that lenders secure additional collateral for commercial properties subject to PACE liens.

In response to this OCC bulletin, the City will delay rolling out the commercial GreenFinanceSF program until the OCC's position is clarified and its concerns can be addressed. In particular, the City is seeking clarification about the bulletin's recommendation that lenders secure additional collateral for commercial properties subject to PACE liens, and the impact this requirement could have on project feasibility, underwriting and financial structuring. As a result of this suspension, GreenFinanceSF officials believe that the startup of the program could be delayed until this fall or winter. The original text of our June 2010 article on the program follows.

Various federal, state and local incentives and rebates now exist to defray the cost of completing energy and water efficiency improvements to commercial buildings on a tax credit or reimbursement basis. These benefits, though useful, leave commercial building owners with the challenge of finding up-front capital to fund completion of their green retrofit projects in a tough credit environment. To address this situation, the

City of San Francisco is planning to offer project funding through a pilot program of GreenFinanceSF, the City's property-assessed clean energy (PACE) program now offered to homeowners.

GreenFinanceSF, like other PACE programs cropping up in the Bay Area, is a program that loans property owners capital, secured by a transferable lien against the property, to make qualified water and energy efficiency improvements to San Francisco buildings. The loan, together with a stated interest, is repaid over time as a special property-tax assessment. GreenFinanceSF's commercial building pilot program is in the late stages of development. Current estimates are for the City to begin accepting applications for the pilot program sometime in July 2010. Because the City has not yet finalized the details of the commercial program, the following information may change; please consult GreenFinanceSF.org for the most current information.

Commercial property owners would need to meet certain criteria to participate in the program. As currently contemplated, the program would only apply to eligible improvements to existing buildings; financing would not be available for new construction. In addition, the property currently would need to be subject to property taxes (there is an unresolved question here about if nonprofit organizations that are exempt from property tax assessments would somehow be able to participate).

The pilot program would provide funding only for specified improvements. Specifically, the program restricts funds for use on energy-efficiency, renewable-energy, and water-conservation projects. Within those categories, the building improvements would need to appear on the City's "eligible measures" list. In addition, certain types of improvements would need to meet other specified requirements. Renewable energy projects, such as solar-panel installation, would first require the completion of a "loading order," or plan to increase the building's energy efficiency by 10% or more before installing the panels. Further, all water projects and energy-efficiency and renewable-energy projects that cost more than \$50,000 would require a Water Wise evaluation. Energy-efficiency and renewable-energy projects would also require completion of energy audits, the extent of which varies by the number of improvements made and the cost of the improvements.

Other requirements pertain to the materials and contractors used and the financial condition of the applicant. Materials used for improvement measures would need to meet the most recent state and federal standards on energy and water efficiency, such as California's Title 24, regulations intended to reduce energy emissions. And the improvements would need to be completed by contractors that are qualified by the City. The applicant would also need to take advantage of any relevant rebate programs, such as California Solar Initiative for solar panels or San Francisco's Energy Watch program for energy efficiency.

Finally, in considering applications, the City may request financial information, such as how much equity the building owner has in the building and the effect the GreenFinanceSF loan will have on net operating income, and the building's occupancy rate, ownership structure, and debt coverage ratio.

Various financing terms would apply to loans issued under the program. For example, the range of loan amount would be from \$10,000 to 10 percent of the property's assessed value, and the interest rate likely would be between 7 and 10 percent. The term would be based on the useful life of the improvement, up to 20 years. Notably, the term may vary

depending on the useful life of each improvement, meaning that the loan repayment amount may decrease over time.

One critical legal issue will be that any proposed financing would require the subordination by existing lenders of their right to repayment to the priority of the special property tax assessment that would fund repayment of the loan. Although banks are becoming more familiar with the concept of PACE financing, each building owner will need to convince its lender that the value of the improvement in terms of improved economic performance or enhanced property value justifies the subordination.

Financing for GreenFinanceSF commercial loans would be sourced from municipal bonds. In the pilot program, eligible applicants would be pooled and underwritten as a single bond issuance. The entire funding process would take between three-and-a-half to five months according to current City estimates. The City is also considering the feasibility of funding large projects with individual bonds as opposed to aggregate-project-pool funds.

The GreenFinanceSF commercial building program will not be without its challenges. The program as currently envisioned will require commercial owners to invest considerable seed capital to navigate the project through the City's application process and the bond underwriting process. Applicants in pooled project funds will need to be content with an interest rate determined on the creditworthiness of the entire pool and not just their project. The relatively long lead time to closing may also be an issue for some owners. Still, GreenFinanceSF should provide a viable source of construction funding for commercial building owners willing to work within its constraints.

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