KUTAKROCK

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MEMORANDUM

FROM: Brandon Marchiafava, Kutak Rock LLP

RE: Colorado Commercial Property Assessed Clean Energy (C-PACE) Program

I. C-PACE Program Overview

Colorado Commercial Property Assessed Clean Energy (C-PACE) Program provides owners of commercial and industrial buildings the opportunity to finance up to 100% of energy efficiency, renewable energy, and water conservation eligible improvements ("Clean Energy Upgrades"). C-PACE was created through an initiative of the New Energy Improvement District (NEID), which was authorized by the Colorado General Assembly's passage of the New Energy Jobs Creation Act of 2010, as amended by the New Energy Jobs Act of 2013 and SB-171, enacted in 2014, and further codified at C.R.S. 32-20-101 et seq. (collectively, the "C-PACE Statute"). The C-PACE Statute created the Colorado NEID (the "District"), which is governed by a Board of Directors including representatives from the Colorado Energy Office, the real estate development industry, banking, the energy efficiency and renewable energy industries and public utilities.

By implementing a competitive lending model that makes it possible for a wide variety of capital providers to participate, C-PACE financing is available at competitive rates with repayment terms up to 25 years. With no upfront costs and the benefit of positive cash flow, C-PACE affords building owners the opportunity to modernize energy related building infrastructure while lowering overall costs, increasing building comfort, and growing asset value. Harmonizing with construction loans and retro-fitting existing buildings, C-PACE offers substantial advantages, including: (i) from the borrower's vantage point, an overall reduction in costs of funds due to a fixed rate of interest that is less expensive than mezzanine financing; (ii) from the lender's perspective, it provides increased collateral value and improved debt service coverage through 100% financing of green related improvements; and (iii) from both parties points of view, C-PACE improvements enhance the value of the property and also reduces energy related costs.

Beyond the programs direct benefits to building owners, C-PACE projects promote public policy initiatives by strengthening the local job market, reducing overall greenhouse gas emissions, and increasing Colorado's deployment of renewable energy.

II. C-PACE Financing Logistics

Repayment of C-PACE financing is administered through the county's property tax assessment process. Over the course of the financing term, which may be up to 25 years, the building owner's property tax bill will have a voluntary assessment placed on it ("C-PACE

Assessment"). In most cases, the annual energy cost savings will exceed the annual C-PACE Assessment payment; thus, affording capital intensive equipment upgrades. The assessment placed on the property "runs with the property;" therefore, the assessment can be transferred to the next owner if the property is sold.

The C-PACE Assessment is collected by each Colorado county that participates in the program. The county collects the C-PACE Assessment from the property owner through the property tax collection system and then forwards those funds to the District to the be distributed to the private capital provider. The building owner will pay a servicing fee levied by the county of up to 1% of the C-PACE Assessment amount ("County Fee"). The County Fee is paid over the term of the C-PACE financing and covers the county tax assessors support services.

Though C-PACE offers outstanding benefits to building owners, there are minor fees associated with the program. In addition to the County Fee, C-PACE charges participants fees sufficient to cover the operating costs associated with program administration, including, a one-time fee equal to 2.25% of the project finance amount, which will not exceed $50,000 per project, and a minimum fee of $5,000 per project. The fee is included in the total financed amount and becomes due when project financing is successful.

III. C-PACE Issues for Mortgage Lenders to Consider.

Below are a few issues that mortgage lenders should keep in mind when analyzing a property encumbered with a C-PACE Assessment:

- **Key Characteristics**. A C-PACE loan usually has a term of 15 to 20 years, but can have a term as long as 25 to 30 years. In most jurisdictions, C-PACE loans are non-recourse to the borrower/property owner and C-PACE lenders have no acceleration rights after development – similar to property taxes, the obligation to pay the C-PACE Assessment is limited to then unpaid assessments only.

- **Confirm the Value of Clean Energy Upgrades**. While Clean Energy Upgrades could add to the value of an underlying property and, over time, could improve cash flow, definitive empirical evidence is limited on this issue. A mortgage lender should scrutinize the data it receives in this regard and may consider obtaining an independent thirty-party energy efficiency audit of the collateral property that details the expected operating cost savings due to the energy efficient improvements. A mortgage lender may also wish to obtain an as-built appraisal to identify the potential increase in the collateral property's value due to the energy efficient improvements and the corresponding effects on the loan-to-value ratio.

- **Super-Priority Lien**. C-PACE Assessments have super-priority lien status similar to real estate taxes and other governmental assessments. As such, C-PACE Assessments have priority over both existing recorded mortgages and deeds of trust and subsequent mortgage financings. C-PACE loans are secured by the real property on which the subject improvements are located and are often non-recourse to the borrower. The lien of the C-PACE loan runs with the property, even after the property is transferred to a third-party following a sale (including a foreclosure sale by a third-party mortgage holder).

- **Underwrite the Ability to Make Debt Service Payments**. A mortgage lender should compare expected cost savings with the C-PACE Assessments to determine a borrower's ability to make ongoing C-PACE Assessments and what, if any effect, assessment payments will have on a borrower's ability to timely make its debt service payments and pay the other operating expenses and carry costs of the collateral property.

- **Foreclosure Risk**. C-PACE loans cannot be accelerated, even in the event of a missed assessment payment. In the event of a C-PACE loan foreclosure, only the amount of the past due C-PACE Assessments would be due at the time of foreclosure. The future assessments remain due and payable in the future, and the property would remain encumbered by the C-PACE loan during the entire remaining term of the C-PACE loan. Foreclosing mortgage lenders and their transferees should consider the on-going C-PACE Assessments as a future financial obligation associated with owning the property.

- **Common Mortgage Lender Protections**. To protect its lien priority, as a condition to originating a mortgage loan which will encumber a property already encumbered by a C-PACE loan, or consenting to the placement of the C-PACE loan on the property already encumbered by its mortgage loan, mortgage lenders may wish to consider, among other things, an ongoing assessment reserve for the payment of future C-PACE Assessments, entering into an intercreditor agreement with the C-PACE lender, or both.

IV. Navigating C-PACE Financing Transactions

The C-PACE program offers building owners a simplified financing process to obtain up to 100% coverage of eligible energy related improvements. With C-PACE lending growing rapidly, the need for experienced legal support when conducting these transactions is crucial to navigate the requirements of the program.

The legal team at Kutak Rock LLP is well established in representing lenders and borrowers alike. Focused on efficiency, Kutak Rock LLP is a lender or borrower's one stop shop in drafting, negotiating, and executing C-PACE transactions. We have the knowledge to represent and advise on the benefits and intricacies of C-PACE loans and would be pleased to provide further information and advise you in all aspects of a C-PACE transaction.

If you have questions or would like more information, please contact Brandon Marchiafava (brandon.marchiafava@kutakrock.com; 303-382-2355).