Statement on the intersection of C-PACE assessments, HTC equity and the use of SNDAs

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This Statement explains how commercial PACE ("C-PACE") assessments and Historic Tax Credit ("HTC") equity complement one another without requiring the legal subordination of C-PACE that HTC investors expect from other project lenders.

Developers seeking to finance the retrofit or new construction of commercial properties increasingly look for alternative sources of capital such as C-PACE assessments. When projects involve the rehabilitation of historic properties, another potential capital source is available in the form of HTCs. HTCs are a complementary product to C-PACE assessments, and the use of both in the same transaction is becoming popular, raising questions about how to correctly document the two forms of capital.

The federal HTC program encourages private investment in the rehabilitation of historic buildings by permitting investors in eligible projects to claim 20 percent of certain rehabilitation expenses as a credit against their federal tax liability. HTC transactions are generally structured in one of two ways: a single tier structure or a master lease structure. In a single tier structure, the entity that owns the property admits a tax credit investor (the "HTC Investor") for a majority ownership interest, and the project sponsor retains a minority interest. When HTCs are earned upon the property being placed in service, the HTC Investor receives its allocated HTCs in proportion to its share of the profits of the entity. In a master lease structure, the property-owning entity (i) leases the property to an entity (the "Master Tenant") that will operate the property and pay all property operating expenses and (ii) elects to pass through all of the HTCs to the Master Tenant. The Master Tenant entity admits the HTC Investor for a majority interest in the entity, and the HTC Investor receives an allocation of the HTCs proportionate to its share of profits of the Master Tenant.

In both structures, the HTC Investor's ability to claim the tax credits is subject to no "recapture event" occurring during the five-year period after the project is certified as complete. In a single tier HTC transaction, recapture events include certain changes in ownership and a transfer of the ownership of the underlying property. In a master lease HTC transaction, recapture events include a termination of the master lease. A foreclosure on the property could trigger these types of recapture events and therefore put the investor's HTCs at risk.

Therefore, the HTC Investor seeks to avoid foreclosure during the five-year recapture period, because this could cause the HTC Investor to lose up to 100 percent of its investment. For this reason, HTC Investors often seek a subordination, non-disturbance and attornment ("SNDA") or foreclosure rights agreement ("FRA") from project lenders. SNDAs and FRAs are appropriate in the context of a mortgage lender or other property-secured financing, but are inappropriate for C-PACE assessments for several reasons.

1. C-PACE assessments are a type of property assessment, substantially similar to utility, hospital and school special assessment taxes. The C-PACE capital provider's security is limited to the assessment. An HTC Investor would not seek an SNDA or FRA from the utility, school or hospital system. The C-PACE capital provider should be treated the same way, as its rights and remedies are similarly situated.

2. C-PACE documents do not typically provide for acceleration of C-PACE payments that come due in future tax periods. Generally, a C-PACE capital provider's only recourse is for the taxing authority to collect the unpaid property taxes that have already come due, including the C-PACE portion, which nonpayment may eventually lead the taxing authority to institute foreclosure proceedings.

3. The municipality or other assessing authority controls the enforcement process for unpaid C-PACE assessments. As such, an SNDA or FRA from the C-PACE capital provider would not provide the HTC investor any benefit. Note that it would also be inappropriate for the assessing authority to enter into an SNDA or FRA in favor of the HTC Investor for C-PACE assessments since it would not typically do so for taxes and other assessments payable to a governmental authority. Additionally, the capital markets would not finance on the best available terms an arrangement where the assessing authority had entered into such an SNDA or FRA.

4. The C-PACE capital provider typically has no direct recourse to the property. Rather, in the event of a default on a C-PACE assessment, the municipality enforces the unpaid C-PACE assessment in the same manner as it handles enforcement of delinquent *ad valorem* real property taxes.

5. The C-PACE lien status is specified in state statute and likely cannot be modified or subordinated by private agreement. The municipality, as a beneficiary of the C-PACE assessment, acts pursuant to this statutory authority by foreclosing in the same manner as *ad valorem* real property taxes.

6. C-PACE assessments are secured with a super-senior payment right, and a waiver of that right through an SNDA or FRA would impair the ability to securitize C-PACE in the capital markets on economically efficient terms.

While an SNDA or FRA is inappropriate in connection with a C-PACE assessment, there are alternatives that may help provide comfort to an HTC investor. For example, to avoid a potential foreclosure or recapture event, the parties could establish a reserve account, ensuring that funds will be available to cover any deficiencies in C-PACE assessment payments during the recapture period.

Given that C-PACE assessments are a relatively new capital tool, many HTC Investors are seeing C-PACE in the capital stack of commercial real estate transactions for the first time. HTC Investors should consider the distinctions between C-PACE assessments and traditional loans when structuring an HTC transaction.

For the above reasons C-PACE capital providers have concluded that it is not appropriate or beneficial for a C-PACE capital provider to execute SNDAs or FRAs in connection with HTC transactions.