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**GOOD INDUSTRY PRACTICES FOR C-PACE CAPITAL PROVIDERS IN  
DOCUMENTING COMPLIANCE WITH PROGRAM RULES AND IN  
UNDERWRITING AND CLOSING TRANSACTIONS**

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Disclaimer: Readers should not rely on this information for investment decisions.  
The C-PACE Alliance welcomes comments.

## GOOD INDUSTRY PRACTICES FOR C-PACE CAPITAL PROVIDERS IN DOCUMENTING COMPLIANCE WITH PROGRAM RULES AND IN UNDERWRITING AND CLOSING TRANSACTIONS

Commercial Property Assessed Clean Energy (C-PACE) is an alternative source of commercial real estate financing now authorized by more than 25 states and the District of Columbia. Participating states have authorized the use C-PACE financing to cover the costs of projects that improve energy efficiency or enable renewable energy generation. Some states allow C-PACE financing for water conservation projects, resiliency measures, or other publicly beneficial purposes. No public dollars or taxpayer funds are used in C-PACE financing.

C-PACE financing is based on a public-private partnership in which projects approved under criteria set by state and local lawmakers are funded by private capital providers. In this partnership, the public sector has an obligation to treat C-PACE financing in the same manner as a tax lien, while the private sector has an obligation to meet the eligibility criteria to satisfy public policy goals.

This white paper sets forth many of the good practices used by C-PACE Alliance capital providers to uphold their responsibilities in this public-private partnership. Credit rating agencies and investors look for these same practices. C-PACE Alliance encourages capital providers less-experienced with C-PACE financing to adopt these good industry practices.

A final note: Due to the variety of commercial real estate project types and sizes, this paper is not a statement of minimum performance standards nor a comprehensive list of a capital provider's responsibilities. This paper offers an overview of established practices used in most projects handled by experienced and qualified C-PACE capital providers.

### A CAPITAL PROVIDER'S RESPONSIBILITIES

Capital providers are entrusted with primary responsibility for (at least) three tasks within their control:

- documenting compliance with program rules,
- underwriting the project's financial profile and setting the financial terms of the transaction, and
- closing the transaction and disbursing funds.

In fulfilling these responsibilities, a capital provider should:

1.	<b>Follow the C-PACE authorizing statute and local ordinance or resolution, the program guidelines or handbook, and the program administrator's directions.</b> Some C-PACE programs are similar, while others vary significantly. Program administrators will determine if a transaction meets their program's eligibility rules. The capital provider must abide by those determinations and document the transaction to the program administrator's satisfaction.
2.	<b>Establish written policies and procedures.</b> Policies and procedures establish the framework to guide management and staff. Periodically reviewing these documents with staff affords an opportunity to ensure they reflect the most recent changes in program rules and in internal operations. Capital providers that wish to sell C-PACE assets should include in their policies and procedures the major factors evaluated by credit rating agencies, investors, and other capital markets experts.

3.	<b>Be accurate and complete:</b> A capital provider should confirm that the documents, calculations, and supporting materials are consistent throughout. The work product should be characterized by careful attention to detail. A capital provider’s financing package should demonstrate compliance with program rules. The use of checklists is highly recommended.
4.	<b>Communicate any areas for clarification:</b> A capital provider should discuss with the program administrator any issues in the documentation that are unclear or may require interpretation. Active communication will minimize the possibility of a misunderstanding.
5.	<b>Anticipate workflow bottlenecks and meet time commitments:</b> Plan ahead for items coming from third parties such as appraisals, mortgage holder consent, energy audits, and title searches. Preparing application materials and closing documents with ample lead times prior to deadlines will improve the quality of the work product and reduce stress at the closing.
6.	<b>Preserve C-PACE transaction files:</b> Capital providers should confirm that the appropriate documents have been recorded in the local government’s property records. Capital providers should assemble a complete transaction file soon after the closing and retain it in a secure but accessible environment.

**GOOD INDUSTRY PRACTICES IN UNDERWRITING**

A C-PACE capital provider is responsible for setting the financing terms of the transaction based on a careful and thorough underwriting process. The basic elements of good industry practices in underwriting are well-established. This list of underwriting factors is not comprehensive; however, it would be unusual for a capital provider not to consider these items in its underwriting.

1.	<p><b>Real estate valuation:</b> A capital provider’s financial analysis includes a reasoned basis for its view of property value, which may not be the highest of all possible valuations. In coming to its reasoned view, a capital provider may compare different <i>valuation methods</i> (e.g., the assessed value according to taxing authorities; desktop or automated valuations; and full appraisals by MAI-certified appraisers) and the property’s value at <i>different stages of project completion</i> (e.g., “as-is,” “as-completed,” and “as-stabilized”). In determining how much weight to accord different valuations, a capital provider considers the valuation’s reliability and how recently it was completed. The typical ratio of C-PACE financing to the as-complete valuations is 20-35 percent.</p> <p>Properties <i>without</i> current stabilized cash flow are the most challenging to value. An incomplete construction project or a property without tenants is generally worth significantly less than a project with stable cash flow.</p>
2.	<p><b>Liquidation Value or “Go Dark” Value</b> is a qualitative determination of the value of the property in a distressed situation. Even if a property owner defaults on current C-PACE installments, the assessment remains non-extinguishable, so capital providers should consider the possible re-sale scenarios. Single-use properties, restrictive zoning, partially completed</p>

	developments, and properties located in rural areas or weaker real estate markets are more difficult to re-tenant or sell.
3.	<p><b>Debt service coverage ratio (DSCR)</b> is a comparison of the property’s Earnings Before Interest, Taxes, Debt and Amortization (EBITDA) to the installment payments for a specified 12-month period. The DSCR is a measure of ability to pay the C-PACE installments as they come due. DSCR may be calculated for a historic period or projected future period.</p> <p>The DSCR may also be calculated with a denominator equal to the payments due on <i>all</i> outstanding debt. If a project includes financial incentives (for example, tax credits and TIFs), common area charges, or ground lease payments, the annual payments for these charges may be included in the denominator of DSCR as well.</p>
4.	<p><b>Strength of the project sponsor:</b> A capital provider’s due diligence should evaluate the property owner’s personnel and financial resources; its track record and experience in commercial real estate or development; its history of timely property tax and debt payments; and its likelihood of successfully operating the property as an investor or business owner-operator. For projects under development with significant completion risk, a capital provider may require the personal guarantee of a creditworthy counterparty. Capital providers may review the guarantor’s liquidity reserves and total net worth as a percentage of the total cost of development.</p>
5.	<p><b>Strength of the first mortgage holder and its construction loan administration skills:</b> The C-PACE capital provider controls the disbursement of only one source of funds. Larger projects – such as those involving new construction, gut rehabilitation, or major adaptive re-use of buildings – typically include other secured lenders that have significantly more money invested in the project than the C-PACE capital provider. In such cases, the lender with the greatest financial exposure generally controls the overall construction process. The skills and experience of the entity managing the disbursement of construction funds should be a central underwriting consideration, especially for capital providers without extensive in-house servicing experience.</p> <p>Construction loan administration calls for skills in budget monitoring; inspection management; lien waiver administration; title insurance management; legal drafting; loan servicing; and progress reporting to other funders.</p>
6.	<p><b>Special risks associated with construction projects:</b> Completing construction projects on-time and on-budget improves the likelihood of generating a durable cash flow. A partial list of factors to consider in construction projects includes: the as-is value of the asset; the strength the general contractor and its experience on projects of a similar size in a similar location; the schedule for C-PACE funds relative to total investment; whether the deal is bonded or if the contractor has adequate bonding capacity; if the contract is structured with a “guaranteed maximum price” or “not-to-exceed” price; the local market vacancy rates and the demand for development sites; and the owner’s liquid resources to cover cost overruns.</p>
7.	<p><b>Environmental condition of the property:</b> Environmental contamination can create liability for the property owner and creditors and consequently influences property value. Accurate</p>

	and recent reports on environmental conditions and the status of remediation are critical underwriting considerations.
8.	<b>Reasonable and appropriate Insurance:</b> Because C-PACE liens are non-accelerating and non-extinguishable, a capital provider should require adequate insurance coverage for various loss scenarios. The required types of insurances may include property insurance, builder’s risk insurance, and flood insurance for properties in high-risk flood zones. The capital provider typically requires to be named as loss payee and requires the right to force-place insurance coverage if insurance lapses. Capital providers may also ask for additional diligence and insurance for properties at a higher risk of loss from earthquake, wildfire, and flood damage as determined by the property’s specific location or attributes.
9.	<b>Mortgage holders’ consent:</b> Mortgage holders and capital providers share a common interest in the property’s long-term value. The consent of existing mortgage holders to the C-PACE assessment is a sign of their confidence in the property’s collateral value. Obtaining mortgage holder consent to a C-PACE financing reduces risk in the extremely unlikely event of foreclosure by clarifying the lien position of the respective parties. Obtaining mortgage holder consent increases confidence that the project is well-underwritten, a factor reflected in the project’s securitization rating. To our knowledge, no foreclosure has occurred in the history of the C-PACE industry.

The capital provider bears the risk of financial loss if an owner does not pay its C-PACE installments. Each capital provider performs its own due diligence according to its own underwriting standards. The capital provider may offer financing than the maximum leverage allowable, or a shorter repayment period than the longest term allowable to strengthen the credit quality. The ultimate financing terms of a C-PACE transaction are negotiated between the property owner and the capital provider of its choice.

**GOOD INDUSTRY PRACTICE IN CLOSING TRANSACTIONS**

Good industry practices in closing transactions and disbursing funds protect all the parties to a C-PACE financing. These closing and disbursing practices are not comprehensive; however, it would be unusual for a capital provider not to require the following:

1.	<b>Legal review:</b> Prior to closing, a capital provider’s counsel should review the title and should confirm the legal owner of the property has voluntarily agreed to the assessment. Counsel also reviews the Assessment Contract, the Bond Indenture (if any), and the underlying documents, even when the program offers template forms.
2.	<b>Legal determination of the validity of the C-PACE program:</b> The C-PACE financing depends on the program being legally enacted, so that the assessment’s lien position is clearly established with an acceptably certain method of enforcement. Capital providers use different methods to reach this conclusion.
3.	<b>Commitment of funding sources in the capital stack:</b> When a project’s capital stack includes other funding sources in addition to C-PACE, a capital provider should confirm that those sources are irrevocably committed and in place prior to releasing C-PACE

	<p>funds. This practice ensures that the project has the funds in-hand necessary to complete the project before any C-PACE funds are at risk.</p> <p>Other preconditions may include zoning approval, key man insurance, and bonding of contractors.</p>
4.	<p><b>Disbursement of funds:</b> A capital provider’s extent and intensity of oversight should be appropriate to the size and complexity of the construction project. In case a project defaults during the construction phase, the senior lender should have the ability to step in and complete the project.</p>
5.	<p><b>Post-completion evidence of public benefits:</b> The program may or may not specify certain documentation to demonstrate that C-PACE-funded improvements achieve the specified public benefits, for example, a reduction in energy consumption or the production of renewable energy. Some capital providers voluntarily maintain records such as:</p> <ul style="list-style-type: none"> <li>• documentation on the improvements being installed (contracts, cut sheets, permits, or building design drawings).</li> <li>• Determination of the expected useful life of equipment from an engineering opinion or product warranty.</li> <li>• energy audits or feasibility studies that summarize expected energy savings or resiliency benefits and the engineering credentials of the professionals producing or reviewing such documents.</li> </ul>

The C-PACE Alliance welcomes comments on this white paper and others available at <https://www.c-pacealliance.com/what-we-do/publications/>.