

Focus on Environmental Matters



PACE programs, growth of green building due diligence take spotlight

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As green buildings become more common in the real estate sector and climate-change related regulation develops, two issues are arising in real estate transactions: new financing mechanisms and the need for green building due diligence.

In a matter of a little more than 18 months, Property Assessed Clean Energy (PACE) programs have spread across the U.S. as a mechanism to finance renewable energy and energy efficiency upgrades for residential and commercial property owners.

PACE is a new model of land-secured financing that has been adopted by states as a tool to achieve their renewable energy and energy efficiency goals. In 2008, California started the trend by passing enabling legislation, and 18 other states have followed suit, including Arizona, Florida, Illinois, New York and Texas. Michigan is considering similar legislation, HB 5640, introduced by Rep. Rebekah Warren, D-Ann Arbor.

PACE programs expand the use of traditional land-secured financing historically used for financing public-interest projects such as sidewalks, street paving, water works, street lighting and parks.

Traditional land-secured financing initiatives typically create "special assessment districts" encompassing properties that are specifically benefited by the improvement. Property owners within the district pay back a pro-rata share of the improvement costs over a number of years. Assessments generally are included on the property tax bill. All properties

within a special assessment district are subject to the assessment and the assessment runs with the land.

Currently, there are thousands of land-secured financing districts in the United States. They are a familiar financing mechanism to units of government, the lending industry and the real estate sector.

The PACE model enables energy improvements to be financed in much the same way. Under the PACE model, properties that voluntarily consent to participate in the program are subject to a special assessment.

States that have adopted legislation enabling PACE programs generally find that reducing energy consumption and adopting renewable energy is in the public interest and serves a valid public purpose, and local government actions creating a PACE special assessment are based upon the same finding.

The legal mechanisms of PACE programs vary based on jurisdictional differences, but contain similar features. The programs authorize local units of government to sell bonds secured in the first instance by the pledge of special assessment payments, and secondarily by certain reserve funds.

The capital raised from the bond sale is made available to consenting residential and commercial property owners within the PACE special assessment district to install renewable energy systems or make energy efficiency upgrades to their home or business.

The costs of the improvements are repaid over a period of years on the property tax bill as a special assessment. Because the assessment runs with the land, it is transferred with the property and as-

sumed by the subsequent owner in the event of a sale.

Local governments are obliged to follow procedural guidelines when setting up a program within their jurisdiction. Programs allow for different types of renewable energy and energy efficiency upgrades. Generally, the payback periods, loan amounts and financing mechanisms vary by state and local unit of government.

Due diligence

Another major development in real estate transactions is the growth of green building due diligence. There are a number of market drivers fueling this trend including mandatory transactional energy disclosure and labeling regulations that require disclosure of energy consumption prior to a building sale or lease.

California, New York, Washington and several major cities across the country have adopted laws to require such disclosures. In addition, the funds dispersed from American Recovery and Reinvestment Act (ARRA) came with "green strings" attached requiring that states accepting such funds agree to upgrade their building codes by adopting green building and energy efficiency requirements.

Finally, various green building rating systems have emerged in the marketplace. LEED, Energy Star and the Green Value Score are different industry standards used to describe the energy efficiency and green qualities of a real estate asset.

With the growth in regulatory requirements related to energy use, changes in building codes requiring the adoption of green building practices, and industry rating systems for energy usage and building techniques, a need to standardize the in-

formation in transactional settings is rapidly emerging.

The American Society of Testing and Materials (ASTM) has stepped in to fill this void with the anticipated passage by midyear of its new *Guide for Building Energy Performance Disclosure*. This will be an enhancement to the Phase One Environmental Site Assessment and Property Condition Assessment (PCA) procedures routinely used in real estate transactions today.

The ASTM Standard is expected to address:

- Property and building characteristics (property type, building age, last major renovation, number of floors, square footage, occupancy, heating system, air conditioning system, etc.);
- Electrical consumption and cost (minimum prior 12 months);
- Oil, natural gas and steam consumption and cost (minimum prior 12 months);
- Benchmarking against peer buildings

as determined by green building certification and rating systems;

- Water consumption and cost (minimum prior 12 months);
- Carbon dioxide emissions, carbon footprint, carbon neutral potential;
- Energy audit history;
- Green building certification/rating;
- Applicable energy efficiency ordinances/codes (local/federal); and
- Applicable economic incentives, credits and grants for energy efficiency improvements (federal, state, local, utility).

These new green building due diligence procedures will reveal the need for energy efficiency investments that can be financed in part by PACE-type programs in combination with traditional debt and equity sources.

Real estate owners, lending institutions, local units of government and professionals involved in real estate transactions should stay apprised of the development of

PACE programs and the emergence of green building due diligence in the U.S., given their likely impacts in the near-term.



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