

Does Your Lease Keep Pace? Retail Lease Considerations Associated with Property Assessed Clean Energy

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Simon Property Group, Inc. recently needed a new roof on its mall in Sonoma, California. Simon elected to install a new roof to reflect sunlight and heat away from the building that would improve energy efficiency. Rather than making payments directly to its lender to finance the project, a special assessment will appear on the mall's property tax bills for the ten year term of the loan. This unique payment structure results from Simon participating in one of the growing number of Property Assessed Clean Energy ("PACE") programs across the country.

This *Update* considers areas of retail leases where the use of PACE financing by a property owner could trigger unintended consequences for the landlord or tenant.

What is a PACE program?

A PACE program offers property owners a financing arrangement for energy efficiency and renewable energy projects. PACE loans are unique because of the following characteristics:

- *Payments Through Property Tax Charge or Assessment*—Rather than the owner paying the lender directly, the government sponsor of the PACE program places the payment obligations on the property owner's property tax bill as a special charge or assessment.
- *Charges Continue after the Sale of the Property with a PACE Project*—Obligations related to a PACE loan run with the property. Any subsequent owner of a property that includes a PACE loan will continue to have the applicable special assessment on its tax bill for the term of the loan.
- *Term Linked to Useful Life of the Improvements*—The term of a PACE loan tends to be longer because it is based on the expected useful life of the improvements. Such an approach makes the project cash flow positive more quickly.

These unique features address financial barriers to the adaptation of energy efficient improvements for many property owners, such as providing a 100% financing solution and a longer than normal payback schedule that may make projects immediately cash flow positive. To date, 13 states have active PACE programs. (In 2010, only California and Colorado had active PACE Programs).¹

How does a PACE loan impact your retail lease?

Participation in a PACE program may require some lease upgrades to maintain balance between the landlord's and tenant's rights and obligations. Here are a few considerations when PACE financing is involved:

- *Responsibility for the Special Charge*—It is anticipated that the special charge will flow through to tenants on a pro rata basis. A lease that provides that each tenant will pay its portion of the property tax bill, but excludes any special assessments or fees, may prevent a landlord from passing the special charge to its tenants as planned. Assuming the tenant is responsible for utilities, a lease amendment may be desirable to balance the benefit of the energy efficiency with payment obligations.
- *Obligation to Maintain Targeted Systems*—Improvements financed using a PACE loan, such as energy efficient heating and air conditioning systems, can be dealt with a variety of ways in a lease. However, only property owners are generally eligible for participation in PACE programs, and not tenants. Accommodations may need to be made to existing lease terms if they provide that the tenant has the obligation to install and maintain the systems that could be upgraded to generate energy efficiency.
- *Adequacy of Roof Access and Space*—Depending on the nature of the project, lease terms may provide existing tenants too much space on the roof to permit certain projects. As part of evaluating the project, a landlord would need to ensure it has the ability to adequately control rooftop access and space with existing (or amended) lease terms.
- *Sufficiency of Power Representations*—A lease may include representations associated with the supply of electricity. Updates related to such representations may be needed to address issues that may arise with new technology.

Jurisdictions across the country continue to establish PACE programs. Building owners across the country continue to seek to make energy efficiency and renewable energy improvements. As more projects utilize this new financing option, the need for leases that accommodate the unique features of PACE financing will become more imperative.

¹ For more details on PACE programs, read von Briesen's article, "Unique Opportunities in Property Assessed Clean Energy (PACE) Financing" or visit www.pacenow.org.

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