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### FINANCING

# PACE Goes Live in New York: Watch Out for the Pot Holes



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New York City made history when it passed legislation enabling the PACE (Property Assessed Clean Energy) loan program in 2019. Enabling PACE in New York City brought a brand new source of financing to New York City owners for energy-efficient capital improvements. The authors first introduced how PACE loans work in an article, *How New York City Is Picking Up the 'PACE'*, published in the Law Journal on Nov. 5, 2019.

Before the PACE program could “go live” and become fully activated in New York City, the public awaited the publication and adoption of proposed PACE program rules, guidelines and loan documents, which were all delayed due to the

pandemic. The good news is that the rules were adopted earlier this year, and the guidelines and draft loan documents were released shortly thereafter, leading up to New York City’s first PACE loan closing in June at 111 Wall Street. The \$89 million PACE loan closing at 111 Wall Street effectively marked the “grand opening” of the New York City PACE loan program. Recently, another PACE loan closed at 730 Third Avenue.

### Cascade of Benefits

The opening of the PACE program in New York City is expected to cause a cascade effect of benefits to the local and national PACE markets. First, New York City owners will now have access to an additional source of financing that has not been available to them until now, which will allow such owners to make carbon-reducing/energy-efficient capital improvements that will benefit not only the building

and its tenants but also the environment. The expanding list of PACE providers interested in servicing the New York City market will benefit borrowers as increased PACE providers compete for business. Increasing usage of PACE loans in the borrower’s capital stack will also drive a competitive wedge between senior lenders who are willing to consent to PACE loans and those who are not. Historically, senior lenders often had the upper hand in refusing to consent to PACE loans. However, lenders who refuse to consent to PACE will likely lose their competitive advantage in New York City to those willing to consent to PACE. Finally, now that the largest city in the country (by population) has followed the growing trend in enabling PACE loans, other jurisdictions around the country will likely follow suit, which is a win-win for property owners and local governments, not to mention the environment.

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## Room for Improvement

While we applaud the New York City Council, Mayor's Office of Climate and Sustainability, and many other parties for their efforts towards launching the PACE program (especially in the middle of a pandemic), there is already room for improvement. There are a few pressing issues noted here that we encourage City leaders to improve or clarify quickly.

To start, the New York City PACE guidelines require all potential PACE providers to submit a Request for Qualification (RFQ), or, in other words, an application for approval to provide PACE loans in New York City. The RFQ process is robust and asks many probing questions. For example, the RFQ requires applicants to disclose detailed underwriting policies and procedures, expected financing terms, capital availability, and financial statements. Many potential PACE providers will balk at the extent of required disclosures. Although there is a mutual confidentiality agreement that the applicant may request as part of its RFQ, any applicable Freedom of Information Laws (FOIL) will supersede the confidentiality agreement. This means that information submitted in the RFQ may be accessible to the public via a FOIL request even with a valid mutual confidentiality agreement

in place. Thus, applicants must be mindful of applicable FOIL laws, and the City may want to consider loosening its disclosure requirements so as not to deter PACE providers from entering the New York City market.

Perhaps a greater concern is that Local Law 96 of 2019, the local statute that enabled PACE in New York City, does not clearly address the

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applicability of mortgage recording tax (MRT). In fact, the statute is silent on it. Instead, a Frequently Asked Questions (FAQ) publication released on May 17, 2020 by NYCEEC, the New York City PACE administrator, is the only reference made to MRT. The NYCEEC PACE FAQ states, "there is no lien recordation associated with the NYC PACE financing process, therefore no mortgage recording taxes will be collected by New York City or the State of New York." Although the clarification on the MRT exemption in the FAQ is worth noting, the FAQ does not carry any legal weight or

authority since it is neither a statute nor a rule authorized via the official rulemaking process. Therefore, we caution PACE borrowers and providers to take notice that, although NYCEEC's current position is that MRT does not apply to a PACE loan in New York City, their position is not codified in the law.

Moreover, upon the closing of New York City's first PACE loan at 111 Wall Street referenced above, the requisite notice relating to the loan was recorded with the City Register and included a statement that "This notice, by its own terms and by the delivery and the recording hereof, is not intended, and should not be construed, to create a lien on the Property." The notice for the PACE loan at 730 Third Avenue included a similar statement that "This notice, by its own terms and by the delivery and the recording hereof, is not intended, and should not be construed, to create a lien on the Property." We understand that these sentences may have been included in an effort to clarify that PACE loans made in New York City are not subject to New York City MRT (NYC MRT). Unfortunately, these provisions in the notices may have only muddied the waters further. For purposes of the NYC MRT, the term "mortgage," as defined under N.Y. Tax Law §250(2)(a), includes "every mortgage or deed of trust which imposes a lien on or

affects title to real property” (emphasis added). Furthermore, New York City has issued a memorandum of general Q&As on the NYC MRT, which broadens the definition of a mortgage to include any *instrument in writing* that affects title to real property. A notice of PACE loan obligations for each PACE loan will be recorded in the land records for the respective property to document that the property is participating in the PACE program. As a result, the PACE loan notice can be considered a mortgage under N.Y. Tax Law §250(2)(a) regardless of whether or not this notice is considered a lien. If the legislative intent was to exempt PACE loans in New York City from the NYC MRT, additional clarification is needed. Without additional guidance, as the law stands today, it is not certain that PACE loans in New York City will be exempt from NYC MRT.

Another significant concern regarding the NYC PACE law relates to the enforcement of the PACE loan. Typically, and as is the case in most states where PACE has been enacted, the lien on the property put into place via the PACE loan is treated similarly to a special assessment lien or as a real estate tax lien. In the event of non-payment, the PACE lien is ultimately enforced through a tax sale. The tax sale enables the PACE lien to prime any mortgages or other liens on the property (other than

tax liens). In NYC, the PACE loan is only enforced through a tax sale if the property owner also failed to pay the property’s real estate taxes. If the real estate taxes are current, §58-07(e) of Chapter 58 of Title 19 of the Rules of the City of New York (the PACE Rules) authorizes the PACE provider to enforce the PACE loan through a foreclosure pursuant to Article 13 of the Real Property Actions and Proceedings Law (Article 13), which governs mortgage foreclosures. The enforcement of a PACE loan through an Article 13 foreclosure proceeding may give rise to challenges regarding the priority of the PACE loan, particularly with respect to mechanic’s liens.

Section 58-07(d) of the PACE Rules provides that an unpaid PACE lien “shall have priority over all other liens and encumbrances on the subject property except for the lien of City Charges.” However, a party enforcing a mortgage lien under Article 13 only primes mechanic’s liens if that lender complied with the numerous requirements of the New York State Lien Law (the Lien Law), such as the filing of a building loan agreement in the City Register. It is unclear, in the circumstance of a PACE provider foreclosing a PACE loan under Article 13, whether the PACE assessment will always prime mechanic’s liens if the PACE provider did not to comply with the Lien Law. We can certainly foresee a

good faith challenge by parties holding mechanic’s liens as to whether the priority of the PACE lien in such a circumstance actually has the aforementioned priority language of §58-07(d) superseding the Lien Law. Additionally, the provisions in the recorded PACE notices discussed above affirming that such notices do not “create a lien” may also support challenges to the priority of PACE loans.

As with any rollout of a brand new program, we expect new issues to arise as the PACE program picks up steam in New York City. The issues pinpointed here are those that we see to have an immediate impact on New York City borrowers and PACE providers and need to be addressed sooner than later for a successful New York City PACE program.