



Affordable Housing Developers Facing Increased Development Challenges

Developers face rising construction costs and operating expenses, volatile interest rates and more.

Page 4

Unprecedented Challenge, Extraordinary Response

How state housing finance agencies are filling affordable housing construction cost gaps.

Page 14

Fannie Mae, Freddie Mac Make Great Sources of Gap Financing for OZ Projects While Preferred Equity Comes at a Cost

Opportunity zones developers find creative gap financing solutions amid rising financing costs.

Page 11

Bridging Grants as a Source of a Leverage Loan in NMTC Transactions

Structuring challenges and solutions for NMTC bridging grants.

Page 52

C-PACE and Historic Tax Credits—A Natural Pair for the Preservation and Renewal of Historic Real Estate

SAL TARSIA, CASTLEGREEN FINANCE

The federal government has offered historic tax incentives for the preservation and renewal of our country's real estate history for nearly a half-century. Since inception of the federal historic tax credit (HTC) incentive, 38 states joined the effort by offering their own HTCs. More recently, Commercial Property Assessed Clean Energy (C-PACE) programs were introduced through statutes in 35 states for the purpose of encouraging energy efficiency, water conservation and property resiliency.

C-PACE is another program focused on property renewal, but with a concentration on different components of the improvement plans. It is a long-term, fixed-rate financing instrument that converts into and is repaid through a non-ad valorem real estate tax assessment and paid as part of the real estate taxes each year. As it becomes part of the real estate tax framework, it does not interfere with the financing structures typically implemented by tax credit investors and lenders.

HTCs and C-PACE are two popular programs that are complementary in accomplishing the public objectives of preservation of historic buildings while also modernizing their systems and efficiency. The marriage of the two public-private partnerships yields a variety of benefits.

Case Study: Recent \$122 Million Refinance for Fairmont Breakers Hotel in Long Beach, California

The Breakers Hotel, built in 1925 and opened in 1926, was once the hotel to the Hollywood stars in the Roaring '20s. Conrad Hilton purchased it in 1938, the eighth hotel in the Hilton chain. World War II accelerated the downfall of the historic Breakers as it was converted to a Navy outpost with gun mountings on its rooftop that remained until 1991, when it was converted to a senior living facility. It endured years of neglect and deferred maintenance before its purchase by Pacific6 Enterprises at the end of 2017 with the ambitious plan of restoring the property to its grandeur.

Headwinds including local approvals for the extensive plan, halted construction efforts during COVID-19, and the inflationary and interest rate pressures that followed

put the project's completion in jeopardy. However, the strong support of the ownership group, combined with a 20% federal HTC approval that yielded nearly \$30 million of HTCs, \$57.8 million of C-PACE proceeds, a \$48.5 million traditional construction mortgage, and \$16 million of HTC bridge financing put the project back on track to be opened this year under a premier Fairmont flag.

The revitalized Breakers Fairmont will include the restoration of its iconic exterior, well known as a landmark in the area, and the reopening of the famous Sky Room combined with modern amenities. In addition, the new Breakers includes nearly \$11.7 million of seismic reinforcement, energy savings equipment designed to save over 600,000 kWh/year and more than 6.2 million gallons of water, yielding more than \$2.5 million of lifetime operational savings. In addition, carbon emissions are expected to be reduced by 247.2 metric tons of carbon dioxide annually, an impact equivalent to eliminating more than 622,500 miles driven by passenger cars or more than 300 acres of U.S. forestry each year.

The Power of HTCs and C-PACE Together

In combining the two government incentives—HTCs and C-PACE—new life was breathed back into an iconic real estate property. Below are some of the natural alignments between HTCs and C-PACE that help support their combined execution for historic renovations.

Preservation of historic architecture: The HTC incentives have long helped offset the additional cost of property renewal while maintaining the historic character of some of the most architecturally beautiful buildings in the country. When combined with C-PACE, the projects can be renovated using the additional economic incentives that encourage sustainable property infrastructure, energy efficient systems and

controls, and water conservation measures. This not only maintains historic integrity, but also ensures the sustainability of these property sites.

Enhanced Energy Efficiency: C-PACE can be used to fund such eligible improvements as HVAC upgrades, lighting, insulating improvements, water conservation measures and system controls. These improvements are generally related to new systems and modern technologies that generate significant economic savings on utility bills and operational maintenance. The savings created provide an additional offset to the costs associated with historic preservation initiatives. Furthermore, the eligible improvements in compliance with the PACE program do not disrupt the HTC compliance because it focuses on mechanical equipment and other property enhancements that are commonly within the structure's walls and otherwise outside the visual field of the property.

Environmental and Sustainable Benefits: Resiliency measures are another important part of C-PACE financing and may also be used for improvements such as seismic strengthening, as well as wind and flood mitigation. These property upgrades serve to extend the useful life of the newly preserved historic properties. In addition, the improvements consistent with C-PACE promote reductions in the significant carbon emissions associated with older buildings, in turn reducing and sometimes even eliminating their carbon footprint.

Marketability: While historic properties have an allure among both investors and tenants, the economic bottom line and cultural initiatives among investors and tenants still dominate decision making. The addition of C-PACE into a historic property capital stack allows for investors and tenants alike to have their cake and eat it too. That is, they can enjoy the nostalgic appeal

of owning or residing in a historic property while also supporting cultural and environmental goals, and benefit financially by saving energy, all at a lower cost of capital. The combined benefits of historic appeal and energy efficiency and sustainability result in multiple enhancements to property values.

Access to Capital: HTCs attract investment capital for eligible property improvements which may then be recovered for a five-year period after completion. Conversely, C-PACE provides capital at the time it is needed for eligible improvements which then may be repaid for up to 30 years. The addition of C-PACE to the capital stacks of these historic renovations offers additional upfront capital, providing an additional option as investors anticipate the tax credits flowing in after construction completion. Therefore, when combining the two programs, the building and valuable investment capital may be preserved and/or used to further enhance the property.

By intertwining these public-private financial instruments, property owners can embark on comprehensive revitalization projects that not only maintain the unique character and charm of historic properties but also implement energy-efficient upgrades that reduce operational costs and environmental impact. Implementing this strategic dual approach of combining C-PACE and HTCs, property owners can achieve the delicate balance of honoring the past by safeguarding tangible pieces of history while embracing the future and using modern technologies, ultimately creating sustainable, resilient and economically vibrant spaces for generations to come. ❖

Sal Tarsia is managing partner of CastleGreen Finance. He is a leading industry expert in Commercial Property Assessed Clean Energy (C-PACE) financing. In 2021, he co-founded CastleGreen Finance, a private capital source that specializes in C-PACE financing. He has nearly three decades of experience in commercial real estate financing, which, in addition to C-PACE, includes structured lending and CMBS originations and underwriting.

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