Summary

A $1.8 million PACE bond financed energy efficiency upgrades at 644 Broadway on the edge of San Francisco’s historic Chinatown as part of a complete redevelopment of a four story mixed-use building owned by Bay Area based Cypress Properties Group. A range of energy and water efficiency upgrades has made 644 Broadway highly desirable for its tenants. PACE financing was a substitute for a higher equity contribution to the building’s “capital stack,” a feature that made PACE very attractive to Cypress Properties. The financing was managed and arranged by Clean Fund, a specialized PACE finance company based in Sausalito. Clean Fund worked closely with the San Francisco’s PACE program, GreenFinanceSF, established in 2011 to help property owners make their buildings more efficient through PACE financing.

Project Highlights

PACE project size: $1.8 million
Projected energy savings: 24% greater than modeled baseline
Term: 20 years
Building size: 45,000-square-foot
About the Site and Project

The mixed-use, four-story building at 644 Broadway is located at the cross roads of North Beach, Chinatown and the Broadway District. In June 2013, the 100% vacant building was acquired by Cypress Properties Group, a Bay Area based real estate developer. It was originally built as an office building and had previously housed several corporate tenants, a subterranean movie theater, and a three-level Dim Sum restaurant which had operated in the building for nearly 30 years. Cypress Properties had big plans for the building and saw an opportunity to create a space and tenant mix that would add a significant benefit to the surrounding neighborhoods. Jeff Lee, one of the Principals at Cypress Properties, noted: "We wanted to lease the building to unique companies that share the vision of creating a world-class destination for locals, tourists and the creative community and draw inspiration from the past, when this area was the focal point of the 'Beat Generation' with the likes of Dylan, Kerouac, Ginsberg and Kenneth Rexroth hanging out nearby at City Light's Book Store and Tosca in North Beach.” In fact, the building owners have already succeeded in this effort, having attracted several dynamic anchor tenants including China Live and the San Francisco Film Society. Other tenants include Telling Pictures, Disher Music and Sound, FilmHouseX and Boxcar theater.

PACE Financing

PACE, Property Assessed Clean Energy financing, is a simple and effective way for commercial property owners to access long-term, fixed-rate capital to pay for energy efficiency, renewable energy, and water conservation measures in virtually any property type. Examples of eligible measures include efficient heating and cooling systems, lighting improvements, solar panels, insulation, cool roofs, and smart building controls.

PACE offers unique benefits for financing energy-saving projects including long-term, fixed-rate, low-cost, 100% funding for project hard and soft costs, secured by the value of the property (and not the owner's credit). The financing transfers to a new owner upon sale. These attributes can make PACE more cost effective than using traditional forms of debt or equity. When tenants benefit from energy cost savings but do not share in the cost of implementing them, this “split incentive” can be a barrier to upgrading a building. As a municipal assessment, PACE repayment costs can typically be passed along to tenants. Commercial debt financing generally does not extend past 10 years, which makes it challenging to structure cash-flow positive projects involving long-term payback measures. With PACE, commercial clients can implement sustainability projects with payback periods of up to 30 years and achieve positive cash flow, which increases the property’s NOI (net operating income) and corresponding property value.

Property Owner

Founded by Bay Area commercial real estate veterans Chris Wight and Jeff Lee, Cypress Properties Group invests in real estate projects that demand creative vision and collaborative partnerships to enhance the value of acquisition targets while concurrently improving the neighborhoods in which the assets are located and the lives of the people that ultimately occupy the space.

Building Details

Address: 644 Broadway, San Francisco
Type: Mixed-use
Size: 45,000-square-foot
Floors: 4, plus an underground theater
Year of Construction: 1984
Architect/Design: Tanner Hecht Architecture
Contractor: CCI

Project Financing

PACE Project Size: $1,800,000
Term: 20 years
Type: Privately placed bond
PACE Financing, continued.

PACE is currently available in more than 1,000 municipalities across the country and growing, as more states adopt PACE enabling legislation and municipalities make PACE funding a resource to their communities.

For Cypress Properties Group, PACE financing was especially attractive because it substituted for what would have been a much more expensive equity commitment and allowed the building owner to undertake a larger scope of work. This project is a great example of a value added real estate investor recognizing the power of PACE.

Since 644 Broadway is a multi-tenant property, PACE helped the building owners solve their “split incentive” problem by sharing the costs and benefits of their investment in energy and water efficiency with tenants. Since PACE is an assessment and can be treated as an operating expense, it can be passed through to tenants who will benefit from lower energy costs. As Noah Cowan of San Francisco Film Society, one of the building tenants, noted, “We are excited about ideas of sustainability, creativity and community. The writers, directors, and producers thrive in this environment, where they feel as though they are in a very contemporary and sustainable building that will be a hub of creativity in the city. Plus, an energy and water efficient space results in lower energy costs which benefits as as a non-profit.”

Additionally, it was important to the property owner that PACE financing is a form of a public-private partnership. The City of San Francisco worked with a private investor, Clean Fund, to make this project possible. Such partnerships are typical throughout the US, as local governments recognize the PACE financing structure can unlock the private capital markets and help cities and counties achieve their environmental and economic goals. Both partners at Cypress Properties have been sustainability advocates and were already pursuing LEED Gold certification for the building. Taking this into account, PACE fit well within their economic and environmental goals. “Through San Francisco's PACE program, we absolutely realized the power of PACE — the building has become more valuable not only from a financial point of view but from a people's standpoint.”

Project Development Process

The PACE process can generally be broken down into similar steps across different programs throughout the nation. First, an owner develops and submits a preliminary application to the applicable PACE program for initial program underwriting. Concurrently, the building owner works with a contractor to finalize a list of proposed improvements with an eye towards understanding the projected cash flows and submits a final PACE application.

Financing Partner

Clean Fund is a leader in providing commercial PACE financing and services to building owners for energy efficiency, water efficiency and renewable energy projects. Clean Fund, one of the innovators in the PACE market, works across all property types and targets projects between $500K-$15MM on a national basis.

Commercial PACE Program

San Francisco is well established as one of the world's leading markets for green and energy efficient commercial properties. The city established GreenFinanceSF to offer PACE financing for a wide range of energy efficiency, renewable energy, and water conservation improvements.

Project Developer

ReNewAll develops programs and projects for the benefit of building owners, schools, municipalities, contractors and the trades. ReNewAll provides sustainable, integrated community and economic development solutions, which successfully incorporates the triple bottom line. At the time of the transaction they were under contract with San Francisco to assist with contractor recruitment, and project development and origination.
Project Development Process, continued.

The PACE program processes the application, qualifying improvements, helping to arrange financing (if needed) and the repayment mechanism by securing the assessment or charge to the property. San Francisco’s GreenFinanceSF PACE program, building on its experience completing large PACE projects, has simple and clear guidelines in place.

The 644 Broadway project was sourced by Clean Fund, which managed the process for Cypress Properties Group from the beginning. One key to the project’s success was collaboration among all the partners. The project began with an all-hands meeting at the site that helped set the expectations and assign clear roles. Cypress Properties Group applied for PACE financing in July 2014. Work on the building was already in progress and the building owner was incurring project expenses which presented a somewhat unique challenge for the PACE program: how to retroactively determine which improvements were eligible for PACE financing. Clean Fund then worked with ReNewAll, a California-based project developer contracted by GreenFinanceSF to help underwrite commercial projects, to help review the plans, specifications, contracts, invoices, and installed improvements to determine the fundable PACE scope. As a result, PACE reimbursed $1.4 million of incurred expenses, and set aside just over $400,000 for work still to be performed.

Since the PACE assessment is senior to existing mortgages, project partners, following an industry best practice, sought the mortgage lender’s consent. This process was spearheaded by Clean Fund and supported by Cypress Properties Group. The lender quickly realized that the scope of work would increase the building’s value, which minimized any risk of loss. PACE assessments do not accelerate in the event of a default, which minimized any risk of loss.

Retroactive and Take Out PACE Financing

Since 2008, the application as well as programmatic approach to PACE financing have evolved. The application has broadened to include water efficiency, hurricane resilience, and, in some places, seismic hardening measures. Today, programs vary in their approaches to extend PACE funds for projects already in the works.

In Los Angeles, if interim construction financing is being used, the PACE financing may close after construction is complete. In fact, one of the recent projects in the Los Angeles County, Constance Pasadena hotel renovation, was already in the works when a PACE application was filed. In CT, the C-PACE program does not retroactively finance completed projects, however, if a PACE application is in process and demonstrates intent to finance the measures via C-PACE, then PACE financing can be disbursed at the end of the construction period. Such financing arrangement is called ‘take out’ financing. Responding in a manner similar to CT’s approach, San Francisco’s program demonstrated flexibility to accommodate this project by approving measures already installed on the property, which was backed by an initial application that had demonstrated the owner’s intent to use PACE.

List of Improvements

- HVAC Replacement
- LED lighting
- Building controls
- Cool roof
- Envelope improvements
- Low flow water fixtures

Anchor Tenants

China Live: Founded by restaurateurs George Chen and his wife Cindy Wong-Chen, and managing partner Richard Miyashiro, China Live will be a 20,000-square-foot culinary destination. China Live will fully move into the three floors of 644 Broadway in June 2015. While the ground floors will offer a food and beverage marketplace, the top second floor will include an upscale restaurant, Eight Tables, in addition to bar, lounge, and banquet space.

The San Francisco Film Society: the San Francisco Film Society is a national leader in exhibition, education and filmmaker services. The Film Society has joined the project as anchor tenant in the fall of 2014 and leased a portion of the 4th floor at 644 Broadway to house its innovative and popular FilmHouse residency program, which provides free office space to up to 25 filmmakers.
Retroactive and Take Out PACE Financing, continued.

It is estimated that some 60% of US commercial building stock were constructed before 1980, and could well benefit from an energy efficiency upgrade. PACE was initially conceived as a financing tool that could incentivize owners of these existing buildings to make them more energy efficient. Since PACE solves one of the major barriers to energy efficiency investment – availability of up-front funds – PACE could motivate the owner to upgrade their building. Today, a new trend of applying PACE financing to a project already in development is emerging in the market. In part, it reflects the way such projects are sourced. Arguably, it is more effective to “sell” PACE financing to a building owner who is planning a major renovation of a property that includes energy efficiency and/or renewable energy upgrades. PACE may incentivize “value-add investors” to do larger scale efficiency projects than they might have otherwise.

It could be argued that in situations where PACE is applied retroactively or as take out financing, the risk to PACE funder is minimized since it is easy to verify the improvements that have been put in place.

Contractors and Improvements

PACE financing paid for both energy efficiency and water efficiency components of the renovation, including cool roof, HVAC upgrade, lighting, building controls, and bathroom fixtures. As a result of the project, the building will cut more than 20% of its energy use, if compared to the model baseline.

CGI, a medium sized energy service company, was the general contractor for this project. Urban Fabric was involved on the LEED and design side.

Conclusion and Implications for the PACE Market

This project was a successful collaboration between the property owner, Clean Fund, and GreenFinanceSF. As a result, a resource-efficient building attracted long-term anchor tenants, such as China Live and the San Francisco Film Society. The tenants recognized the value of a sustainable space and lower utility bills. Since the building is located on the border between Chinatown and North Beach, this redevelopment will add to the revitalization both neighborhoods and create 500 new jobs.

“When we looked at this building we just saw this huge opportunity to do something creative with the space and re-energize the neighborhood. We could not be more pleased to have China Live, the San Francisco Film Society and our other creative tenants as occupiers and partners in fulfilling our vision for the property,” said Chris Wight, principal at Cypress properties Group.

This project has implications beyond San Francisco and even California, because it shows how PACE can be used by a value-add investor. Cypress Properties Partners leveraged the power of PACE to augment their project capital strategy and ensure high performance building improvements. Program designers and administrators should consider accommodating a takeout financing option, as it meets the timing and process needs of certain building renovations, allowing for similar projects to be undertaken across the country.

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