

Dear _____ :

This letter is in reply to your letter dated March 31, 2022, and supplemental correspondence, in which Company requests a ruling that certain Commercial Property Assessed Clean Energy (“CPACE”) Assets (as described below) are “obligations...secured by an interest in real property” under section 860G(a)(3) of the Internal Revenue Code.

FACTS

The facts are represented as follows:

Series LLC is a limited liability company formed under the laws of State A on Date 1. Series LLC has issued several limited liability company interests, one of which is Company. Company is a registered series of Series LLC within the meaning of the State A Limited Liability Company Act. Company holds CPACE Assets and intends to make one or more real estate mortgage investment conduit (“REMIC”) elections.

CPACE Assets arise from CPACE programs administered by local property taxing jurisdictions. CPACE programs provide funding for a property owner to finance the cost of eligible improvements on commercial property. The property owner then repays the cost plus interest over time through a voluntary property tax assessment. These eligible improvements include the installation of improvements related to renewable energy, energy efficiency, climate resiliency, water conservation, seismic retrofitting, and similar clean energy pursuits.

Typically, a property owner that wants to participate in a CPACE program enters into a contract with a governmentally established entity for the CPACE program (the “Local Authority”) whereby the property owner agrees to a special property tax assessment being imposed on the owner’s commercial property (the “CPACE Assessment”). The processing of a property owner’s request for a CPACE Assessment is similar to that of the underwriting for a traditional property loan. This includes a review of the real property, proposed improvements, other debt secured by the property, and certain limited credit criteria on the property owner at the time of the application. For the property owner incurring the obligation to pay the CPACE Assessment, an advance of cash is made from a third party CPACE program participant to the property owner secured by the owner’s real property and recovered through installment payments required to be made by the property owner pursuant to the CPACE Assessment. Similar to a mortgage, a CPACE Assessment is recorded in the relevant land title records pursuant to the laws of the applicable local jurisdiction. Company holds the secured right to receive repayment of the cash advance through the Local Authority’s collection of the CPACE Assessment (“CPACE Asset”). Company acquires

a CPACE Asset by either participating in the CPACE program as the third party who advances cash to the property owner or by acquiring the right from an affiliate who participates and advances the cash.

A CPACE Assessment represents a lien on the entire property and not just on the specific improvement that is funded and installed pursuant to the contract. Company represents that a CPACE Asset is secured by the real property upon which the improvement was made and failure of the property owner to pay an installment of the CPACE Assessment will result in the ability to seize the entire property to satisfy the amount due.

Company was formed for the purpose of holding CPACE Assets that will be either directly originated by Company or acquired through an affiliate. The CPACE Assets that the Company intends to hold arise from the following CPACE programs: State A Program, State B Program, State C Program, State D Program, Municipality Program, and State E Programs.

CPACE Asset payments are made by the property owner as an additional amount due alongside the property owner's regular property taxes and are paid in installments. The obligation to make CPACE Asset payments remains with the property, regardless of any intervening sales, until it is fully paid. State A Program and Municipality Program CPACE Assessments are *pari passu* with *ad valorem* real property taxes and other special assessments and senior to all other encumbrances. Additionally, State B Program, State C Program, State D Program, and State E Program's CPACE Assessments are junior to *ad valorem* real property taxes and special assessments and senior to all other encumbrances. Thus, in all jurisdictions in which Company is participating, the CPACE Assessment, and, thus, the secured right of CPACE Assets, are senior to mortgages.

In the event that a property owner fails to make an installment payment on a CPACE Asset, only the amount of the missed payment is due. Enforcement of the CPACE Assessment can be undertaken following the missed payment, but only for the missed installment. Because each CPACE program is a product of local law the mechanism for enforcement of the CPACE Assessment may differ, but generally if a property owner does not make a payment on a CPACE Asset, the property owner can lose the property, which in turn will be used to satisfy the missed payment. Future installment payments on the CPACE Asset remain due and the property will continue to be encumbered by the CPACE Assessment during the remainder of its term. Since a CPACE Asset retains a security interest in the property, any subsequent property owner will be subject to future installment payments and the remedies for missing said payment.

LAW AND ANALYSIS

Section 860D(a) defines REMIC to mean any entity that meets several requirements including that as of the close of the 3rd month beginning after the startup day and at all times thereafter, substantially all of the assets of the entity consist of qualified mortgages and permitted investments.

Section 860G(a)(3)(A) defines “qualified mortgage” to include any obligation (including any participation or certificate of beneficial ownership therein) which is principally secured by an interest in real property and which (i) is transferred to the REMIC on the startup day in exchange for regular or residual interests in the REMIC, (ii) is purchased by the REMIC within the 3-month period beginning on the startup day if, except as provided in regulations, such purchase is pursuant to a fixed price contract in effect on the startup day, or (iii) represents an increase in the principal amount under the original terms of an obligation described in clause (i) or (ii) if such increase (I) is attributable to an advance made to the obligor pursuant to the original terms of a reverse mortgage loan or other obligation, (II) occurs after the startup day, and (III) is purchased by the REMIC pursuant to a fixed price contract in effect on the startup day.

For purposes of section 860G(a)(3), section 1.860G-2(a)(4) of the Income Tax Regulations defines “interests in real property” by reference to section 1.856-3(c) and “real property” by reference to section 1.856-3(d). Section 1.856-3(c) defines “interests in real property” to include, in part, fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements thereon, and options to acquire leaseholds of land or improvements thereon. Section 1.856-3(d) defines real property by reference to section 1.856-10. Section 1.856-10(b) defines “real property” to mean land and improvements to land. Section 1.856-10(d) defines “improvements to land” as inherently permanent structures, which includes buildings, and their structural components.

Section 1.860G-2(a)(1) provides that, for purposes of section 860G(a)(3)(A), an obligation is principally secured by an interest in real property only if it satisfies the test of either section 1.860G-2(a)(1)(i) or (ii). Section 1.860G-2(a)(1)(i) provides that an obligation is principally secured by an interest in real property if the fair market value of the interest in real property securing the obligation (A) was at least 80 percent of the adjusted issue price of the obligation at the time the obligation was originated, or (B) is at least equal to 80 percent of the adjusted issue price of the obligation at the time the sponsor contributes the obligation to the REMIC. Section 1.860G-2(a)(1)(ii) provides that an obligation is principally secured by an interest in real property if substantially all of the proceeds of the obligation were used to acquire or to improve or protect an interest in real property that, at the origination date, is the only security for the obligation.

Section 1.860G-2(a)(5) provides that obligations secured by interests in real property include the following: mortgages, deeds of trust, and installment land contracts; mortgage pass-thru certificates guaranteed by GNMA, FNMA, FHLMC, or CMHC (Canada Mortgage and Housing Corporation); other investment trust interests that represent undivided beneficial ownership in a pool of obligations principally secured by interests in real property and related assets that would be considered to be permitted investments if the investment trust were a REMIC, and provided the investment trust is classified as trust under section 301.7701-4(c) of the Procedure and Administration Regulations; obligations secured by manufactured housing treated as single family residences under section 25(e)(10) (without regard to the treatment of the obligations or the properties under state law).

Section 1.860G-2(a)(7) provides that for purposes of section 860G(a)(3) and (4), the term "obligation" includes any instrument that provides for total noncontingent principal payments that at least equal the instrument's issue price even if that instrument also provides for contingent payments.

Under the CPACE programs at issue in this ruling, the property owner is obligated to repay the entire amount of funds borrowed to make an eligible improvement on their property plus interest through the CPACE Assessment. Additionally, Company represents that each CPACE Asset is secured by a lien on the entirety of the real property on which the improvements are installed. The security interest in the property runs with the land, encumbering the property until all payments are made under the CPACE Asset. Company also represents that each lien is of superior priority to all other obligations other than property taxes and special assessments.

CONCLUSION

Based on the facts represented, we rule that CPACE Assets held by Company constitute obligations secured by an interest in real property for purposes of section 860G(a)(3) of the Code.

CAVEATS

This ruling's application is limited to the facts, representations, Code sections, and regulations cited herein. Except as specifically ruled upon above, no opinion is expressed concerning any federal income tax consequences related to the facts herein under any other provisions of the Code. In particular, no opinion is expressed or implied regarding whether CPACE Assets are principally secured by an interest in real property. Additionally, no opinion is expressed or implied regarding if Company otherwise qualifies as a REMIC under part IV of subchapter M of Chapter 1 of the Code.

This ruling is directed only to the taxpayer that requested it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

The ruling contained in this letter is based upon information and representations submitted by Company and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Andrea M. Hoffenson
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Financial Institutions & Products)

cc: