PACE Program Group

July 30, 2009

Mr. James B. Lockhart III
Director
Federal Housing Finance Agency
1700 G Street, NW
Washington, DC 20552-0003

RE: Property Assessed Clean Energy Programs/ Energy Loan Tax Assessment Programs

Dear Mr. Lockhart:

We are in receipt of your June 18, 2009 letter regarding "Energy Loan Tax Assessment Programs." Because we have all prioritized the creation of a Property Assessed Clean Energy (PACE) program in our communities, we would like to jointly address the issues raised in the letter. We sincerely appreciate your interest and welcome the opportunity to continue the discussion of these programs and the issues raised by your letter in more detail with representatives of Federal Housing Finance Agency, other federal government stakeholders, the organizations referenced in your letter, and other appropriate lender groups.

First and foremost, we share your opinion that energy efficiency improvements to homes can improve the country's use of resources, reduce overall energy use, and provide cost savings to homeowners. We are also in agreement that great care must be taken in program design and operation to avoid unintended consequences to property owners or lenders.

However, we do not share your opinion that the PACE programs necessarily put homeowners or lenders at risk. Existing PACE programs have been designed with great care and in coordination with multiple stakeholders, including representatives from the financial community as described in the attached document.

More broadly, it is important to note that this type of financing is not new or particularly risky. Land-secured financing districts have been used on existing properties in built communities to finance improvements for more than a century. Most of the concerns raised in your June 18th letter could similarly be raised with any type of land-secured financing district or assessment lien. We are concerned that PACE programs are being held to a new standard because the financed improvements are privately owned, yet the financed improvements advance a menu of crucial public purposes.

In fact, many existing assessment or special tax districts create liens that are in excess of those created by PACE programs, are placed on properties regardless of an owner's ability to pay, and do not produce an offsetting cash flow such as is created through the financing of energy efficiency improvements.

From this perspective, the PACE programs discussed in your letter are likely to provide far greater protection to property owners, lenders, and the secondary mortgage market than a standard special tax or assessment district. What's more, as the attached response details, these PACE programs have multiple mechanisms to protect property owners and lenders beyond those mentioned in your letter.

The community of cities, counties, organizations, and entities engaged in PACE programs is more than willing to engage in detailed discussions about the issues raised in your letter with representatives of the FHFA, other federal government stakeholders, the organizations referenced in your letter and other appropriate lender representatives. We also continue to work individually and collaboratively to standardize a sustainable model for PACE programs. We will keep FHFA informed about the evolution of PACE program design and welcome your feedback and ongoing engagement.

Please contact any of us if you have any questions. Cisco DeVries of Renewable Funding can also help facilitate contact with all of the undersigned parties. You can reach Cisco DeVries directly at cisco@renewfund.com or (510) 451-7902.

Sincerely,

Gavin Newsom
Mayor
City of San Francisco, CA

Chuck Reed

Chuck Reed
Mayor
City of San Jose, CA

Rodney A. Dole
Auditor-Controller-Treasurer-Tax Collector
Sonoma County, CA

Alice Lai-Bitker
President
Alameda County Board of Supervisors

Tom Bates
Mayor
City of Berkeley, CA

Tom Plant
Director, Governor's Energy Office
State of Colorado

Henry Gardner
Executive Director
Association of Bay Area Governments

Ann Livingston
Sustainability Coordinator
Boulder County, CO Commissioners Office

Patrick Conlon
Director, Office of Energy Management
City of Palm Desert, CA

cc: Neil Milner, Conference of State Bank Supervisors
David Saunders, American Association of Residential Mortgage Regulators
William Pound, National Conference of State Legislatures
Mary Martha Fortney, National Association of Credit Union Supervisors
Raymond Scheppach, PhD, National Governor's Association
Tom Cochran, U.S. Conference of Mayors
Larry Naake, National Association of Counties

Detailed Response to Federal Housing Finance Agency
Property Assessed Clean Energy Programs
July 2009

Background

The immediate threat posed by climate change, rising energy costs and energy dependence have spurred over one thousand cities and dozens of states to set greenhouse gas or energy reduction goals and implement policies to reduce the use of fossil fuels. President Obama has made this issue a cornerstone of his agenda, saying that "unless we free ourselves from a dependence on these fossil fuels and chart a new course on energy in this country, we are condemning future generations to global catastrophe."

Considerable recent research has found that the country can achieve major reductions in greenhouse gas emissions and reduce energy use if owners of existing buildings make energy efficiency improvements. However, there are a number of challenges to achieving widespread adoption of energy efficiency improvements in existing buildings, including: (i) significant upfront costs, (ii) common ownership patterns (the average homeowner moves every 5-7 years, which is not long enough to recoup the upfront cost of energy efficiency investment through energy savings)[1] and (iii) problems with traditional sources of financing (most notably, traditional home improvement loan/equity lines of credit are due-on-sale and, in the current economic environment, are not widely available).

Policy makers have looked at many options to help property owners pay for energy improvements in a manner that would eliminate burdensome upfront costs and allow the financing to transfer with the property. As noted in your letter, one program that is rapidly gaining interest is the so-called "Property Assessed Clean Energy" (PACE) program.

For the most part, PACE programs are simply additions to existing state laws that already authorize the creation of "land-secured" financing districts to pay for improvements in the public interest, whether publicly- or privately-owned.

Land-secured financing districts – which are creatures of state law and are variously referred to as assessment districts, public improvement districts and community facilities districts, among other terms – are a building block of municipal finance and have been utilized for more than a century. They are used to finance projects including street paving, parks, open space, water and sewer systems and street lighting, among others.

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[1] The letter states that homeowners "may never realize the energy cost savings during their occupancy of the property". If, as is the case with traditional bank products, a homeowner were obligated to repay financing during the term of his/her occupancy of the property, that might be the case. However, PACE programs offer transferability to subsequent homeowners so that energy efficiency improvements can be financed over their useful life, which will allow properties (as opposed to particular owners) to achieve energy cost savings over the life of the improvement.

All the districts operate by placing a senior tax/assessment lien on properties that receive a benefit from the financed improvement. The lien secures a tax/assessment payment that is levied on properties through the property tax bill. Tens of thousands of these districts already exist in this country and are a standard part of the property appraisal, underwriting and disclosure process.

PACE Programs

PACE programs are not the first to use land-secured financing districts to finance privately owned improvements with a public purpose. For example, New Jersey authorizes the voluntary financing of private sidewalk and curb repairs by homeowners. California allows the financing of seismic improvements, geologic hazard abatement and toxic remediation to private property. Massachusetts provides septic tank replacement programs and secures repayment with assessment liens. Neighborhoods regularly pay for the full costs of voluntarily undergrounding utilities using the same mechanism.

Many of the issues raised in your June 18th letter could similarly be raised with any of these districts, some of which create liens in excess of those generally created by PACE programs and none of which produce an offsetting cash flow such as is created through the financing of energy efficiency improvements.

State and local governments have embraced PACE programs because they offer a solution to many of the challenges to widespread adoption of energy efficiency and renewable energy in the existing building stock. Not only do PACE programs reduce the upfront cost, but the programs also allow for the repayment obligation to transfer to subsequent property owners when the improved property transfers.

State laws enabling PACE programs have now been passed in a number of states, including: California, Colorado, New Mexico, Oregon, Nevada, Maryland, Virginia, Illinois, Vermont, Illinois, and Texas. Legislation is pending in a number of others.

The federal government has also become very involved in supporting the growth of these financing programs. Congress and the President supported PACE financing programs by amending federal tax law and by authorizing tax credit subsidies for PACE bonds in The American Recovery and Reinvestment Act of 2009. The U.S. Department of Energy, U.S. Environmental Protection Agency, and the U.S. Department of Housing and Urban Development have hosted workshops and trainings for cities interested in setting up PACE financing programs.

The Department of Energy already guarantees loans for clean energy projects, and the current version of the American Clean Energy and Security Act (H.R. 2454) would allow the extension of those guarantees and other support to PACE programs.

Response to Specific Issues

We believe PACE programs are an important public initiative, but we also recognize the need to balance the public purposes with private interests, including those of existing lenders.[2] In anticipation of further discussions, we would like to address a number of the issues you raised in your letter.

Homeowner Protections

First, we do not agree that PACE programs will necessarily "create risks for homeowners," as is suggested in the letter of June 18th. The underlying premise of land-secured financing is that the financed improvements add value to the properties assessed to pay for the improvements. The economic nexus between energy efficiency improvements and taxes/assessments levied to pay for the improvements is uniquely direct; PACE programs not only improve the assessed property but also offer immediate energy savings that more traditional public improvements do not.

The majority of energy improvements made as part of the program will have a positive net present value; in many cases, the energy savings are immediately in excess of PACE tax/assessment payments. And, of course, there are a host of indirect costs – many of which are externalized – that may be avoided through widespread adoption of energy efficiency improvements. However, although PACE-related savings realized by the property owner mitigate the potential risks associated with an increased tax burden, it is important to recognize that cost savings are not the goal of PACE programs; rather, PACE programs are a tool to help reduce greenhouse gas emissions and reduced energy consumption.

Second, although PACE financing does not involve traditional loan products, PACE programs do not "ignore prudent underwriting standards," as is suggested in the letter:

- Every program currently in operation screens both the property and the project to ensure that both meet carefully defined program terms and conditions. All of the programs cap the total amount of financing available. For example, in the City of Berkeley, California's PACE program: (i) properties are screened to ensure that property taxes and all other property-based debt is current and has been current for the last three years, (ii) solar systems and installers are required to meet the strict standards set by the State of California for rebate eligibility and (iii) financing is capped at $37,500 per property.

- Most programs require that the average useful life of the financed project must be equal to or greater than the financing term. For example, solar systems have a useful life of 25-30 years and are generally provided a 20-year warranty for the panels. All programs finance solar systems at 15- or 20-year durations.

[2] Moreover, we recognize that the interests of the lender community are aligned with important public policies, as your letter notes by reference to federal loan modification and foreclosure prevention programs.

- With respect to homeowner disclosure, all PACE programs provide detailed information on all program costs prior to financing commitment. For example, in Boulder County all prospective participants were required to attend a mandatory workshop prior to application and then to meet individually with program staff to review their application, program, and financing costs. It is possible that your research into this issue did not take into account the information provided to property owners directly as opposed to on general websites.

- In addition, all PACE programs provide clear information to property owners regarding the terms of their participation and the consequences of failing to make PACE tax/assessment payments. For example, the Berkeley program terms state:

  > *"The property owner must repay the tax obligation regardless of personal financial circumstances, the condition of the property, or the performance of the system. Do not apply for financing if you are not certain you can pay the additional property tax. Just as with any property based debt such as a mortgage, the failure to pay your property tax – in full or in part – will result in financial repercussions, including the eventual foreclosure of your property by the County Tax Collector."*

- PACE financing cannot be originated by "unregulated parties such as home remodeling firms" as you state in your letter. PACE financing is originated by local government.

- PACE is a voluntary program and is not the best financing choice for every property owner. However, the rates are comparable to similar financing available through private sources. For example, home equity loans with fixed interest rates in the United States averaged 8.47% as of July 8, 2009. PACE programs generally provide interest rates between 7-9%.

- All programs take specific steps to eliminate fraud. Payment is issued to the property owner or contractor only when approved by the property owner and when all terms and conditions for the program are met.

- Most of the programs were created in consultation with banks and other lenders. For example, the County of Sonoma worked closely with a group of banks and lending institutions active in their area.

Existing Lender Protections

First, and most importantly, we do not agree that the effect of PACE programs is to "impair the value of first mortgages to creditors and any subsequent holder of first mortgages…." As explained above, the underlying premise of land-secured financing is that the financed improvements will improve the value of the property, and that is particularly true with PACE because it reduces the cost of operating the assessed properties.

Second, special tax and assessment liens are already part of the standard underwriting criteria in this country: they exist on millions of properties throughout the country and are regularly placed on properties when private mortgages are already in place.

Third, the letter indicates concern about the impact on existing lenders of foreclosure of senior PACE tax/assessment liens. It is important to recognize that unlike a mortgage, which may be accelerated in the event of default, PACE taxes/assessments in most jurisdictions are not accelerated in the event of delinquency. Therefore, the minimum price at a foreclosure sale is equal to the amount of delinquent tax/assessment installments, not the entire cost of the financed improvements.