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Sustainability Commission Meeting: May 19, 2016

Subject
Memo on Property Assessed Clean Energy (PACE) for discussion

Description
According to the City's 2010 GHG inventory, energy consumption is the largest contributor to greenhouse gas emissions at 55%. Through the implementation of the Climate Action Plan, the City seeks to conserve energy communitywide to reach local, state and regional GHG emissions targets. To help reach these emissions reduction goals the climate action plan identifies a community-wide goal of retrofitting existing buildings:

- 1,200 single family homes
- 475 multi-family units
- 875,000 square feet of commercial spaces

Access to financing capital for property owners to complete energy upgrades is a critical component of Cupertino's Climate Action Plan (CAP) and reaching these ambitious energy retrofit goals. CAP measure C-E-2 Retrofit Financing, specifically identifies Property Assessed Clean Energy (PACE) as a way of reducing GHG and achieving our retrofit goals.

As was reported in the 2015 CAP progress report, retrofits completed to date:
Single family homes: 50 homes (BayREN (15) & PG&E Upgrade (35))
Multi-family: 311 units (BayREN Multifamily Building Enhancement)
Commercial: 36 projects (Silicon Valley Energy Watch)

Background: PACE programs allow property owners to finance energy efficiency, water efficiency upgrades, and renewable energy projects on existing buildings through a special assessment placed on their annual property tax bill and the debt is paid off in annual installments. The intent of PACE is to provide an affordable and accessible means of financing energy upgrades to existing homes and businesses, ultimately making our existing building stock more sustainable and lowering greenhouse gas emissions. This allows the property owner to benefit from the energy and water savings for these improvements without having to make a large investment up front, and they can pay for the improvements overtime with 5-20 year terms.

In January 2010, Council approved the PACE provider, California First to service residents of Cupertino as a part of a pilot program. Since 2010, communities all across California have allowed PACE financial providers to service their residents, and now there are about 5-6 service providers statewide. Each provider offers various interest rates, payback periods and terms, but all provide a similar service of lending capital for energy and water upgrades to existing buildings. Eligible products that can be financed with PACE may vary between individual PACE providers and administrators. In general, most products that can be permanently affixed to a property and reduce on-site electric, gas, or water consumption will be considered eligibleincluding attic insulation, HVAC (heating, ventilation and air conditioning) replacements, solar photovoltaic systems, thermal systems, low-flow toilets, and seismic upgrades depending on the provider. See Exhibit A for comparison matrix of PACE providers.

PACE financing can be set up and administered under one of two different pieces of legislation, SB 555 or AB 811. Most operational PACE programs in the state were formed under the AB 811 amendment to the Improvement Act.

California AB 811 (July 21, 2008) amended the Improvement Act of 1911, part of the Streets and Highways Code, to include renewable energy sources and energy efficiency upgrades in the list of public improvements that can be financed through an assessment district. California AB 474 (January 1, 2010) and California SB 1340 (September 30, 2010) expanded AB 811 to include water efficiency improvements and the installation of charging stations for electric vehicles.

California SB 555 (October 5, 2011) amended the Mello-Roos Community Facilities Act of 1982 to include renewable energy sources, energy efficiency upgrades, and water efficiency upgrades in the list of public improvements that can be financed through a Mello-Roos Community Facility District.

The primary difference between the two statuses is that SB 555 allows for publically owned buildings to be included, although these properties would need to be assigned Assessor Parcel Numbers in order for public properties to be included. In practice, however, AB 811 programs also include non-profit and publically owned buildings if they can receive a property tax bill. Both the AB 811 and SB 555 type of PACE programs, are voluntary contractual agreements for financing between an authorized entity and the property owner, they use available funding from any source including existing bond issuing statutes and attach the assessment for payment of the assessment to the property.

Analysis:

The City has received many inquiries from local PACE providers wanting to expand offerings in Cupertino. Most PACE programs operate under Joint Power Agreements (JPA) on the assessment district mode AB811. Services are made available at no cost to City, JPA, or member agencies; admin costs are rolled into assessments that are paid for by participating property owners. Prior to processing loan agreements under a PACE program, the JPA or governmental agency sponsoring the program obtains court validation of the program to be implemented in a region. Before opting in, the City can make sure that each administrator of the PACE program has indicated its willingness to enter into an agreement with the City under which it would indemnify and hold the City harmless from the operation of their respective programs. Additionally, the City should ask each PACE administrator to add the City as an additional insured under its insurance policies for commercial liability, professional errors and omissions, and automobile liability. At the time of this memo, all PACE providers participate in California's PACE Loss Reserve Program, which is beneficial as an added risk mitigation (more about Loan Loss Reserve Program this towards end of memo).

To help with the process of evaluating all the different PACE providers and JPA models, the Association of Bay Area Governments (ABAG)has created a Regional Collaborative Services Agreement which is modeled after successful agreements in Sonoma and Marin Counties and is intended to ensure consistent application of key programmatic elements ("best practices") considered to be critically important for local government partners. These elements include consumer protections and disclosures, local government risk mitigation and indemnification, co-marketing complementary energy efficiency programs, contractor and project quality assurance, and performance tracking, data, and reporting.

This will help the City of Cupertino ensure consistency among all PACE providers that serve the city, mitigate risk, and provide for a unified voice among all Bay Area regional cities in negotiating key programmatic elements at one time. To date,   ABAG has signed agreements with five active PACE administrators which include; Pace Funding Now, HERO, FigTree, Alliance NRG and Ygrene. See Exhibit B for the Regional Service Agreement signed by WRCOG Hero program as a sample)

What are the options if the City wants to establish its own PACE program? The City could consider establishing its own PACE program under AB811 or SB555. Some other jurisdictions including Sonoma County, City and County SF, LA County, operate their own PACE programs.

Formation and operation would be an administrative burden and a labor intensive process that would involve many departments including the City Manager's Office, Sustainability, Finance, Public Works, and City Attorney. Existing PACE programs have the institutional capacity to manage the relatively complex financing mechanisms, program design, and requisite government functions such as coordination with the recorder's office and treasurer/tax collector, etc. Jurisdictions with concerns about capacity and internal coordination find opting into an existing program more appealing. If the City wanted to explore this route, we would need to talk to other communities to determine the amount of staff, hours, funding etc. needed to develop and administer a City run PACE program. The City would also need consultation with the City Attorney, and possibly outside council from someone with a background in securities law as the City would have greater exposure and liability than it would have if it joins an existing JPA run PACE program.

Another alternative is to issue an RFP and allow a third party to administer and fund a PACE program specific to the City. City of Sacramento is the only city to date in California that operates a PACE program using third party administer to operate and fund a city specific program. This would also require staff resources beyond current capacity and is not recommended.

What about the 2010 FHFA directive that placed restrictions on properties subject or eligible for mortgages backed by Fannie Mae or Freddie Mac?
After PACE programs started gaining traction in California in 2009, residential programs soon encountered a significant hurdle. The Federal Housing Finance Agency (FHFA) was concerned that residential PACE assessments had a lien status superior to that of existing mortgages underwritten by Fannie Mae and Freddie Mac. This meant that, in the event of a default, any outstanding PACE assessments would be paid off before other liens such as first deeds of trust.

In 2010, Fannie Mae and Freddie Mac stated that they would no longer purchase mortgage loans secured by properties with outstanding PACE loans. This effectively stopped residential PACE programs, with the exception of a few pilot programs.

In 2013, Senate Bill 96 directed the California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA) to develop the PACE Loss Reserve Program to mitigate the potential risk to mortgage lenders associated with residential PACE financing. The $10 million Loss Reserve will make first mortgage lenders whole for any losses in a foreclosure or a forced sale that are attributable to a PACE lien covered under the Program. The goal of the Program is to put first mortgage lenders in the same position they would be in without a PACE lien. **To date, CAEATFA has not received any claims on the loss reserve from any of the existing PACE programs enrolled.** During program development, CAEATFA staff initially estimated that the loss reserve would last between eight to twelve years. Now that the fund has been active, CAEATFA is currently working with financial advisors to help determine the Program's potential long-term liability and longevity based on Program activity to date. To date: all PACE providers that have signed ABAG's Collaborative Services Agreement are enrolled in the State's Loan Loss Reserve Program. More information on CAETFA can be found here: http://www.treasurer.ca.gov/caeatfa/pace/summary.asp

Staff has identified the following benefits in allowing more than one PACE provider to serve residents:

- 100% voluntary program, residents utilize this source of financing if they want to.
- Creates competition in the marketplace and allows residents and business owners to have a choice in their PACE provider.
- Each provider has different interest rate and terms allowing owners to choose what works for them and their specific energy efficiency/solar project and financial circumstances.
- Each provider covers a different range of energy, water and seismic upgrades- so more options means more types of projects can be eligible.

- Little, if any staff, time is needed to participate, all program assessment and administration is handled by the third party PACE service provider.
- Saving money: energy and water prices continue to rise, and allowing energy and water upgrades to existing buildings now saves money in the future.
- No down payment or credit checks needed- property owners pay for upgrades overtime when they pay their property tax bill and the interest can be tax deductible.

City Fiscal Impact:

Participation in PACE programs does not impact the General Fund or any City funds. PACE programs use private sector capital to provide property owners with funding. Joining any of the existing PACE programs will not expose the City to financial liability and we can include language in the agreements so that the PACE providers hold the city harmless.