

Reviving PACE

Removing RE & EE Barriers

Imagine a government program that improves home values, reduces home ownership costs, saves energy, creates jobs, increases tax revenues without increasing taxes, requires no government subsidies, and leverages private capital for social good.

No need to imagine, that's the Property Assessed Clean Energy (PACE) program, which is now authorized by 28 states and the District of Columbia as of August 2012. PACE removes two barriers to improving energy efficiency and installing renewable energy systems in homes—high upfront costs and the fear of recovering those costs before the property's sale. Implementation of PACE for residential properties ground to a halt when the federal government, which owns most home mortgages in the country, objected to a PACE lien being in first position for payment in the case of mortgage default.

Here's how PACE works: A state or local government establishes, in statute or other policy, that the public purpose of a PACE program (clean and renewable energy, jobs, better air quality, etc.) is valid. Then a real-property secured-benefit district is formed (if it's not an entire municipality already). District property owners may participate or not; those who do not participate won't see their taxes or assessment change as a result.

To participate, an energy audit is usually required to determine the cost-effective measures to be performed by a qualified contractor. Financing is provided by the special district, typically by selling bonds that are secured solely by the payments received from participating property owners. General taxpayers are not on the hook in any way. Property owners who benefit pay off the costs for up to 20 years as part of their regular tax bills. Typically, PACE financing won't exceed 10% of the property's value; only properties with positive equity are eligible, and the program is available only to property owners who have a good tax payment record. There also must be no involuntary liens (PACE is a voluntary lien) on the property.

Because the ongoing cash savings to property owners exceed the added PACE assessment on the property, repayment is easy. The obligation transfers to the new owner if the property is sold. If the property goes into default, the bondholders are protected, since the government assessment of "taxes" is not a loan—it is first in line for repayment when the property is sold.

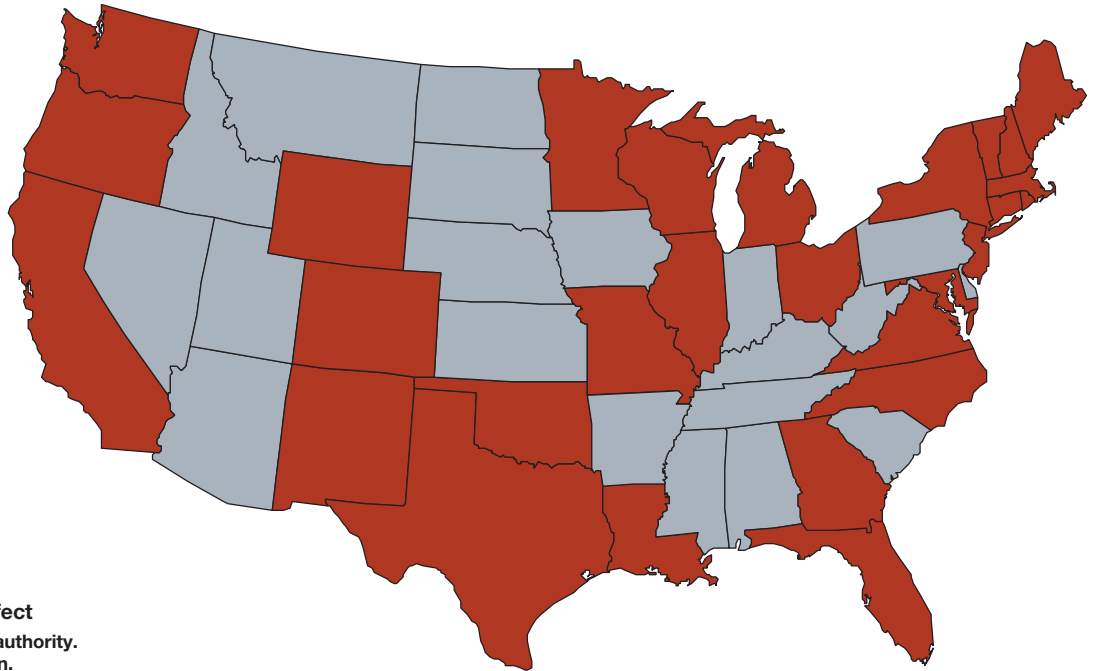
In 2008, PACE began as pilot programs in California, and was replicated in 23 states in just two years. Then, just as implementation was beginning, the residential programs came to a screeching halt in the spring of 2010 when the Federal Housing Finance Agency (FHFA) and the Office of the Comptroller of the Currency (OCC) said that PACE "presents significant safety and soundness concerns to the housing finance industry." As the housing finance industry was already significantly unsafe and unsound due to lenders making loans on homes with highly inflated values, the two federal agencies were concerned about making things worse. The FHFA regulates Fannie Mae (Federal National Mortgage Association) and Freddie Mac (Federal Home Loan Mortgage Corporation), which hold \$5 trillion in mortgages. Fannie and Freddie are "government-sponsored enterprises," Congressionally chartered corporations that the government bails out when they get into financial straits. Fannie and Freddie defaulted in 2008, so the FHFA now also serves as their conservator, as well as regulator.

"Typically, the tax liens created by assessments are senior to other obligations, like mortgages, and must be paid first in the event of foreclosure," notes the Lawrence Berkeley National Laboratory in the "Clean Energy Financing Policy" 2010 brief. "Fannie Mae, Freddie Mac, the FHFA and other financial regulators reasoned that PACE assessments were, in effect, loans—not assessments—and as such violated standard mortgage provisions requiring priority over any other loan."

But many in the renewable energy, affordable housing, real estate, environmental, local government, and venture capital sectors think that Fannie and Freddie's concerns are misplaced—PACE tends to self-select responsible and stable property owners, and the default rate on PACE properties is 0.1%, while the national average for mortgage default is more than 30 times that (3.2%). No matter, though, for PACE is still stalled out until federal regulators change their minds.

Perhaps the courts will free PACE. PACE advocates won a case in the Northern California U.S. District Court that required the FHFA to undertake a formal "rule-making" exercise. The court also required the preparation of an environmental impact statement (EIS) evaluating the consequences of the federal government's change in policy. Sometimes, the open process of an EIS results in government making a better decision.

States with PACE-Enabling Laws



- PACE Legislation in Effect
- * Hawaii has pre-existing authority.
- ** Alaska has no legislation.

The FHFA appealed the ruling to the U.S. Ninth Circuit Court of Appeals, which allowed the FHFA to postpone implementing a final rule. If the FHFA wins on appeal, the rule-making process will likely stop, unless the FHFA changes its decision or has it changed by the White House. On June 15, 2012, the FHFA issued a proposed rule that would have the effect of killing residential PACE programs.

Perhaps Congress will free PACE. The PACE Protection Act of 2011 (HR 2599, 112th Congress) has 54 cosponsors from 15 states. It would:

- Rescind the FHFA, OCC, Fannie and Freddie 2010 guidance.
- Prohibit discrimination against PACE homeowners and communities.
- Declare that PACE is an assessment, not a loan.
- Limit any risk to Fannie and Freddie by requiring national program standards, underwriting criteria, consumer protections, and qualifying improvements and contractors.

The legislation would define PACE activities to include water and energy efficiency and renewable energy retrofits of

most kinds. There have not yet been hearings on the bill in the House of Representatives, and no companion legislation has been introduced in the Senate.

Perhaps the White House will free PACE. It could tell the FHFA to reverse its course. It is a jobs program in an election year, after all.

An ECONorthwest (tinyurl.com/HPPACEstudy) study commissioned by PACENow found that for every \$1 million spent locally, \$10 million in gross economic output; \$1 million in combined federal, state, and local tax revenues; and 60 jobs result. And rather than *increasing* the risk of default, ECONorthwest found that PACE's lowering of energy operation costs and increasing of home values would *decrease* the risk of default.

While the Obama administration is supportive of PACE, the FHFA is an independent regulatory commission that is not directly answerable to the President, unlike most federal agencies. FHFA Administrator Ed DeMarco fears PACE will result in the federal taxpayers not getting as much money back for the Freddie Mac- and Fannie Mae-backed loans that are ultimately guaranteed by the federal government (aka "taxpayers"). As long as he's in office, residential PACE is likely dead. The best hope for residential PACE is either for Congress to enact a law that gives national blessing to the local programs or for the President to convince the Senate to confirm his appointee, neither of which is likely to happen until after the next election.

—Andy Kerr

on the web

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