

**DATE:** June 18, 2014

**TO:** City Council Sustainability Committee

**FROM:** Director of Utilities & Environmental Services

**SUBJECT:** Property Assessed Clean Energy (PACE) – Consideration of New Programs

## **RECOMMENDATION**

That the Committee reviews this report and recommends that the City Council approves resolutions to join the Home Energy Renovation Opportunity (HERO), Ygrene and Open PACE Programs.

## **SUMMARY**

Access to financing for property owners to complete energy upgrades is a critical component of Hayward's Climate Action Plan. The City Council has previously authorized two PACE programs to operate in Hayward – CaliforniaFIRST in 2010 and Figtree Commercial PACE in 2014. Staff has been monitoring the PACE market as it has grown over the past year. The purpose of this report is to present three additional PACE programs for the Committee to consider for authorization: HERO PACE, Ygrene PACE, and Open PACE.

This report discusses the following developments in the PACE market:

1. Recent State legislation and programs are paving the way for PACE expansion.
2. PACE is increasingly being used to finance water efficiency improvements in light of the drought.
3. Cities like San Francisco and Berkeley are partnering with PACE providers to provide financing for their seismic retrofit programs.
4. The PACE Loss Reserve has taken the role of setting consumer protection standards for PACE programs statewide.
5. PACE programs continue to experience low default rates. In addition, HERO, Ygrene, and Open PACE have not initiated a single foreclosure since they began operations.

In light of the developments above, staff feels that it is in the City's interest to approve these three PACE programs. The City can provide additional consumer protection to Hayward property owners by including information on its website and offering PACE financing workshops.

## BACKGROUND

*General Plan Policies* – Hayward’s General Plan/Climate Action Plan, adopted on July 1, 2014, includes the following policies and implementation programs that support PACE financing:

**Natural Resources Element, Program 9: Financing Program for Residential Energy Efficiency Retrofits** – The City shall work with regional agencies and organizations to develop a residential energy efficiency retrofit financing program for single-family and multi-family homes.

**Natural Resources Element, Program 10: Financing Program for Commercial Energy Efficiency Retrofits** – The City shall work with regional agencies and organizations to develop a commercial energy efficiency retrofit financing program for commercial and industrial properties.

Property Assessed Clean Energy (PACE) programs allow property owners to finance energy and water efficiency improvements and pay off the debt through annual installments on their property tax bill. The intent of PACE programs is to provide an additional means of financing to make environmentally sustainable property improvements more affordable and accessible to property owners. In recent years, some PACE programs have also included seismic upgrades as an eligible improvement. The potential benefits of PACE financing over other financing options include 100% financing for eligible improvements, a longer repayment period of up to twenty years, and the reliability of pre-approved contractors.

PACE financing is a relatively new model. There are two pieces of legislation that enable PACE programs in California and several additional laws that clarify and expand this legislation.

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. Proponents feel that SB 555 is a better law in concept, in part because it explicitly includes publicly owned properties. However in practice, SB 555 serves the same purpose as AB 811.

On September 26, 2013, Governor Brown signed SB 96, which created a \$10 million PACE Loss Reserve to keep mortgage lenders whole during a foreclosure or a forced sale of a property with a PACE assessment. This reserve fund was established in response to Federal Housing Finance Agency (FHFA) concerns that residential PACE financing could pose a risk for Fannie Mae and Freddie Mac because PACE assessments are first-priority liens and are paid first in the case of foreclosure. In August 2010, Fannie Mae and Freddie Mac announced they would not purchase mortgages for homes with first lien priority PACE obligations. As a result, homeowners may need

to pay off their PACE assessment before they can sell their homes. This announcement put a significant halt on the expansion of the PACE market for several years. The FHFA has not changed its position to date, but the California PACE market has regained its momentum over the past two years, partially due to the PACE Loss Reserve.

On September 26, 2014, the State passed AB 1883 and AB 2597. These two bills pave the way for further expansion of the PACE financing model in California. AB 1883 allows governments to issue bonds for up to three years' worth of PACE deals, rather than for each individual project. This will reduce the administrative fees incurred and passed onto consumers. In addition, AB 1883 makes it easier to finance pre-paid solar leases with PACE and amends the Improvement Act of 1911 to make it more consistent with the Mello-Roos Act. AB 2597 modifies the PACE Loss Reserve legislation to increase the maximum allowed amount of a PACE assessment from 10% to 15% of the value of the property.

The City Council has authorized two PACE programs to operate in Hayward. The first program was CaliforniaFIRST, which the City Council approved on January 5, 2010<sup>1</sup>. CaliforniaFIRST is sponsored by the California Statewide Communities Development Authority JPA. It launched its non-residential program in September 2012. It re-launched its residential program<sup>2</sup> in August 2014, which had been on hold due to concerns from the Federal Housing Finance Agency. Because the City Council previously authorized CaliforniaFIRST to operate in Hayward, the residential program is now available to Hayward homeowners.

The City Council voted to join the Figtree PACE program on October 28, 2014<sup>3</sup>. Figtree Financing is sponsored by the California Enterprise Development Authority JPA. Figtree is a San Diego-based clean energy financing company that was founded in 2011. It currently only serves commercial properties. As recommended by the Council Sustainability Committee<sup>4</sup>, the City Council limited Figtree's operating authority to commercial properties since Figtree has not yet set the terms for a potential residential program and there were concerns about consumer risks.

## DISCUSSION

### *The Growing Trend towards an Open Market for PACE*

As the market for PACE has grown and the fears of increased defaults have not been realized, more cities are being drawn to the benefits of offering multiple PACE programs to their property owners. These benefits include increased access to financing and expertise in different types of properties and improvements.

When the country's first PACE program launched in Berkeley in 2008, it was a new and untested financing mechanism. At that time, a handful of municipalities launched self-funded PACE programs. For example, Sonoma County created and continues to administer the Sonoma County Energy Independence Program (SCEIP).

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<sup>1</sup> <http://www.hayward-ca.gov/CITY-GOVERNMENT/CITY-COUNCIL-MEETINGS/rp/2010/rp010510-07.pdf>

<sup>2</sup> <https://californiafirst.org/>

<sup>3</sup> <http://www.hayward-ca.gov/CITY-GOVERNMENT/CITY-COUNCIL-MEETINGS/2014/CCA14PDF/cca102814full.pdf>

<sup>4</sup> <http://www.hayward-ca.gov/CITY-GOVERNMENT/COUNCIL-STANDING-COMMITTEES/COUNCIL-SUSTAINABILITY-COMMITTEE/2014/CSC-CCSC091114full.pdf>

Since then, over 30 states have passed PACE-enabling legislation and private financing companies have entered the market by partnering with joint powers authorities (JPA) to establish and finance PACE programs. Most jurisdictions in California, including Hayward, have chosen to join such JPAs instead of administering their own programs. JPA sponsored PACE programs offer little risk to local jurisdictions because the JPA assumes the legal liability. Any bonds issued to finance projects are issued by the JPA, so the City has no obligation to the bonds.

When these JPA partnerships with private financing companies first became available several years ago, local jurisdictions were rightfully cautious and careful to vet each program to make sure it met their needs and did not create excessive risk for their property owners. Some jurisdictions felt it was safest and easiest to authorize only one PACE program to operate in their boundaries.

Since then, the idea of an “open market” for PACE providers has become widely accepted as the route forward. Advocacy groups like PACENow have supported an open PACE market for years, claiming that having multiple programs operating in the same jurisdiction helps build a stronger industry landscape and provides property owners more choices. Following suit, most PACE providers now allow or actively encourage jurisdictions to authorize multiple programs.

For example, as mentioned above, Sonoma County chose to create its own PACE program, SCEIP, in 2009. Several months ago, Sonoma County authorized CaliforniaFIRST and HERO to operate alongside SCEIP under an initiative it is calling the PACE Financing Marketplace. In addition, cities throughout Sonoma County have authorized Figtree and Ygrene. A primary benefit of having multiple PACE programs is the increased access to financing for property owners. SCEIP has financed more than \$60 million in projects, but it only has \$17 million available for future improvements. The County has estimated it needs \$2 billion in home improvements to meet its greenhouse gas reduction target<sup>5</sup>.

#### *Different Programs, Different Expertise*

Each PACE program has developed specific expertise and enhanced customer support. Giving property owners the option of all programs allows the property owner to use the program that best meets their needs.

For example, Ygrene is the first and only PACE program to have completed multifamily housing projects. Earlier this year, California Governor Jerry Brown established a multifamily PACE pilot in partnership with the MacArthur Foundation and the U.S. Department of Housing and Urban Development. The Pilot will enable PACE financing for certain affordable multifamily properties that have received funding from HUD and the California Housing Finance Agency. Because Ygrene has experience with financing multifamily projects, it is well poised to provide financing for this pilot program.

In addition to helping meet greenhouse gas reduction goals, there is a growing interest in how PACE programs can help Californians respond to the drought. HERO has launched a marketing and

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<sup>5</sup> <http://www.pressdemocrat.com/business/3939909-181/homeowners-face-dizzying-new-choices>

outreach program specifically targeting water efficiency improvements to homeowners. Approximately 4% of HERO's projects are now water-related, including outdoor landscaping options, weather based irrigation systems, rainwater catchment systems, and high-efficiency devices.

There is also growing interest in how PACE programs can help California prepare for an earthquake. Open PACE includes the provider Alliance NRG, which has expertise in using PACE for seismic upgrades and is the only PACE program to set aside funding specifically for this purpose. San Francisco and Berkeley recently partnered with Alliance NRG to be the finance provider for their Mandatory Retrofit Programs. Ygrene will also finance seismic retrofits.

Hayward's Development Services Department is in the preliminary stages of establishing a voluntary seismic retrofit program for single-family homes. The program will use a pre-approved set of seismic retrofitting plans that were created by the Association of Bay Area Government's Resilience Program<sup>6</sup>. The plan set saves the homeowner the cost of hiring an engineer and can be used for older homes that meet certain criteria. There are 16,000 homes in Hayward that were built before 1973 and would be potential candidates for such a retrofit. The cost of this type of retrofit is between two and ten thousand dollars. Access to 100% financing options like PACE will likely increase the uptake of this voluntary program.

#### *Balancing the Benefits of an Open PACE Market with Consumer Protection*

As with most financing mechanisms, PACE programs can present risks to consumers. As the governing body responsible for authorizing PACE programs, the City of Hayward must weigh these potential risks against the benefits of greater consumer choice and increased access to financing. Because of this, staff has reviewed the program terms for HERO, YGreene and Open PACE. A summary of each program is provided below and a comparison table is provided in Attachment I.

With enough information, savvy property owners should be able to assess if PACE financing is a wise long-term investment for their particular circumstance. However, as we saw with the 2008 mortgage crisis, property owners don't always have the knowledge needed to make well-informed financing decisions and can fall prey to aggressive marketing tactics. Therefore, it is important that PACE programs include consumer protections and operate ethically.

PACE financing presents further complications for homeowners that have Fannie Mae or Freddie Mac mortgages or may want to sell in the future to a buyer that has a Fannie or Freddie mortgage. It's not prohibited for these homeowners to participate in the program, but they may be required to pay off the assessment first if they want to sell their home or refinance their mortgage. It is important that PACE programs fully inform homeowners of this potential risk before they enter into a PACE assessment.

Staff has been following the PACE market and has identified several trends that staff feels should mitigate consumer risk. First is the fact that the State of California and the Governor's Office are actively supporting the expansion of the PACE market as a tool to meet the State's climate goals. Governor Brown has tried on several occasions to convince the FHFA to change its position. While

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<sup>6</sup> <http://resilience.abag.ca.gov/residents/planset/>

he has not succeeded, the FHFA has also chosen not to take enforcement action against participating jurisdictions or property owners as originally feared.

As mentioned above, the Governor signed legislation in 2013 to establish a PACE Loss Reserve to provide assurance to mortgage lenders. CaliforniaFIRST, Ygrene, Figtree and HERO are all participating in the Loss Reserve. PACE programs assert that the rate of foreclosure for their properties is lower than the national average. After a year of operation, the Loss Reserve has not yet received any claims, which supports this assertion.

The PACE Loss Reserve has also served the purpose of setting consumer protection standards for PACE programs statewide. In order to receive the benefits of the PACE Loss Reserve, PACE programs must first apply with the State and meet certain requirements. These requirements are included as Attachment II.

PACE Programs have learned from their experience over the past five years and have further refined their consumer protection mechanisms. For example, HERO now proactively identifies when one of their properties is going up for sale and offers training to the real estate agent on the assessment and the PACE improvements so potential buyers will be aware.

In light of these developments, staff feels that there are measures in place to mitigate consumer risks in the PACE market and that it is in the City's interest to pursue an open market model for PACE programs in Hayward. The City can further mitigate risks by providing consumer information on its website and offering financing workshops to interested property owners.

#### Home Energy Renovation Opportunity (HERO)

HERO launched in December 2011 for residential properties and December 2012 for commercial properties. Approximately 220 jurisdictions, covering 44% of the total households in California, have authorized HERO. It is sponsored by the Western Riverside Council of Governments. HERO has funded more than \$617 million in projects and has a list of 1 million eligible products for its contractors to offer.

#### Ygrene Energy Fund

Ygrene launched in 2010 for residential, commercial, industrial, and agricultural properties. It operates under SB 555. Approximately 50 jurisdictions have authorized the program, which is sponsored by the Golden State Finance Authority (GSFA). Ygrene was launched by SCEIP cofounder Dennis Hunter, who realized the need for a more efficient administrative and financial PACE model. Ygrene claims that its financing is 100% tax deductible because it operates under SB 555 rather than AB 811. However, there is potential consumer liability involved with this deduction because there is no IRS code pertaining to PACE financing under SB 555.

#### Open PACE

Open PACE launched in 2015 and operates under AB 811. Approximately 20 jurisdictions have authorized the program since its recent launch. It is sponsored by the California Statewide Communities Development Authority (CSCDA). CSCDA founded Open PACE with the goal of creating a platform to vet and pre-qualify PACE providers so that local governments only need to

pass a single resolution to authorize multiple programs. Currently, Open PACE has only pre-qualified two PACE programs – California FIRST and AllianceNRG.

### *In Case of Default*

PACE assessments are collected in the same manner as general property taxes and are subject to the same penalties and remedies in the event of delinquency and default. These remedies include fines and fees as well as judicial foreclosure. Judicial foreclosure is included as a remedy in the Improvement Act of 1911 and the Mello-Roos Community Facilities Act of 1982 to provide security for bondholders.

Judicial foreclosures generally provide more protection for the property owner than non-judicial foreclosures because they require the lender to file a lawsuit and they involve a judge. Most foreclosures in California are non-judicial, also called trustee sales. The process of a trustee sale takes approximately four months<sup>7</sup>. Judicial foreclosures are rare in California. They are typically used when no power of sale is present in the contract, in which case the court declares a foreclosure and the home is auctioned off to pay back the financier. The homeowner has the “right of redemption” under judicial foreclosure, which allows him or her to buy the home back for one year after the sale. Timelines for judicial foreclosures vary because they involve the court system. A judicial foreclosure with redemption may take approximately two and a half years<sup>8</sup>.

Although PACE programs have the authority to institute judicial foreclosure proceedings under PACE legislation, some programs have the internal policy not to use this remedy when others are available. For example, Alliance NRG defers to the relevant County’s tax delinquency policies, which tend to provide more opportunities for tax redemption. HERO, Ygrene and Open PACE programs listed above have not initiated a single foreclosure since they began operations.

## **ECONOMIC IMPACT**

The HERO, YGrene, and Open PACE programs have similar potential benefits to property owners as CaliforniaFIRST and Figtree PACE. They provide an alternative method for owners to finance improvements and to realize the energy and water cost savings related to them. If Hayward experiences high participation in PACE programs, local green jobs may be created to complete these energy, water, and seismic improvements.

The primary benefit of allowing an open PACE market in Hayward is to increase the total amount of financing available to Hayward property owners for improvements. However, it is unclear how much demand there is from Hayward property owners for additional financing. So far, there have only been two PACE projects in Hayward. Both were commercial projects financed by CaliforniaFIRST.

As mentioned above, there are also potential economic risks to property owners when they take on PACE financing. In the worst case, cost savings may not materialize as predicted and the owners could end up owing more than they can afford, which could result in increased foreclosures.

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<sup>7</sup> <http://www.car.org/legal/foreclosure-short-sale-folder/foreclosure-timeline-pdf-1/>

<sup>8</sup> [http://real-estate-law.freeadvice.com/real-estate-law/mortgage\\_matters/mortgage-foreclosure-process.htm](http://real-estate-law.freeadvice.com/real-estate-law/mortgage_matters/mortgage-foreclosure-process.htm)

However, this has not been the experience of PACE programs up to this point and staff feels that the risk is low. On the contrary, most PACE programs claim that the default rates of their property owners are lower than nationwide averages.

## **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.

## **NEXT STEPS**

Staff is recommending the below actions.

- That the Committee recommends that the City Council approve resolutions to join HERO, Ygrene, and OPEN Pace. Upon this direction, staff will present Council with resolutions to join the Western Riverside Council of Governments and the Golden State Finance Authority, and resolutions to include Hayward properties in the HERO Program, Community Facilities District No. 2014-1 (Ygrene), and the CSCDA Open PACE Program.
- That staff will devote time in the coming year to providing further information on the City's website about the terms of each PACE program and to hosting a financing workshop for property owners interested in PACE financing.

*Prepared by:* Mary Thomas, Administrative Analyst

*Recommended by:* Alex Ameri, Director of Utilities & Environmental Services

*Approved by:*



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Fran David, City Manager

**Attachments:**

Attachment I	PACE Program Comparison Table
Attachment II	Requirements to Participate in the PACE Loss Reserve Program

Program	JPA	Administered by	Funding	Total Financing Available in CA	Nearby Jurisdictions	Total CA Jurisdictions	seismic retrofitting	Contractors	Eligible Costs
HERO Residential	Western Riverside Council of Governments (WRCOG)	Renovate America	Municipal Bonds	Unlimited	Albany, Berkeley, Concord, Walnut Creek, Redwood City, San Jose, San Francisco	219 84 coming soon	No	Mandatory certification	Audits, labor, design, drafting, engineering, permit fees, inspection charges
HERO Commercial		Samas Capital							
Ygrene Residential	California Home Finance Authority	Ygrene Energy Fund	Private Capital from Local Banks	Unlimited	Davis, Woodland, Sacramento	47 (5 commercial only) 5 coming soon	Yes	Mandatory certification and training	Audits, labor, design, drafting, engineering, permit fees, inspection charges
Ygrene Commercial									
CaliforniaFIRST Residential	California Statwide Communities Development Authority (CSCDA)	Renewable Funding	Venture Capital		Alameda, Berkeley, Dublin, Fremont, Newark, Oakland, San Leandro	300 plus	No	Mandatory certification	Audits, labor, design, drafting, engineering, permit fees, inspection charges
CaliforniaFIRST Commercial									
Alliance NRG (OpenPACE Residential)	California Statwide Communities Development Authority (CSCDA)	Deutsche Bank, Leidos Engineering and Counterpointe Energy Solutions			Berkeley, San Francisco, Campbell, Burlingame	20	Yes	Mandatory certification	Audits, labor, design, drafting, engineering, permit fees, inspection charges
Alliance NRG (OpenPACE Commercial)									
Figtree Commercial	California Enterprise Development Authority (CEDA)	Figtree Company, Inc.	Bonds/REITs	Unlimited	Dublin, San Jose, Burlingame, Redwood City, Walnut Creek	117	Yes	Mandatory approval	Audits, labor, design, drafting, engineering, permit fees, inspection charges

  

Program	Eligible Properties/Property Owners				Costs			Disclosure to property owner of FHFA stance on PACE	
	Minimum financing	Current on property taxes	Total debt on property must not exceed	Total annual property tax and assessments	Declaration of bankruptcy	Interest Rate Terms	Interest Rate		Program Fees
HERO Residential	\$5,000	no more than one late payment in past three years	10% of property's value	Not to exceed 5% of property's market value	Depending on city, not within 2 to 7 years	Fixed at time financing docs are issued	6.75% - 8.45%	\$130 + 4.99% Closing	Application
HERO Commercial			20% or property's value		Not within 7 years		5.75% - 6.5%	\$1,025	
Ygrene Residential	\$2,500	Currently	15% of property value	Not to exceed 5% of property's market value	Not currently	At the time the property owner enters into a UAA	5.99% - 7.75%	\$700	Multiple Disclosures (Financing Docs & Lender Notification process)
Ygrene Commercial							5.99% - 7.75%	Starts at \$700	
CaliforniaFIRST Residential	\$5,000	no more than one late payment in past three years	10% of property value	Not to exceed 5% of property's market value	Not within 2 years	set at the time that Financing Documents are issued	6.75% - 8.39%	6.5% + 6.5% Closing	
CaliforniaFIRST Commercial							6.5% - 6.75%		
Alliance NRG (OpenPACE Residential)	\$5,000	No additional liens on property for past three years	10% of property value	Not to exceed 5% of property's market value	Not within 7 years	fixed at time of completed application			
Alliance NRG (OpenPACE Commercial)									
Figtree Commercial	\$2,500	no late payment in past three years	10% of property value	Not to exceed 5% of property's market value	Not within 5 years		4.63%-6.5%	\$695	Application/Lender Consent for commercial projects

## Requirements to Participate in the PACE Loss Reserve Program

### California Code of Regulations

- Title 4. Business Regulations
  - Division 13. California Alternative Energy Source Financing Authority
    - Article 4. Pace Loss Reserve Program
      - § 10081. Application by Pace Program to the Pace Loss Reserve.

A PACE Program seeking to participate in the PACE Loss Reserve Program shall complete an application that shall include the following information:

(a) The formation documents required pursuant to:

- (1) Streets and Highways Code Sections 5898.20-5898.22, and 5898.24; or,
- (2) Chapter 2.5 (commencing with Section 53311) of Part 1 of Division 2 of Title 5 of the Government Code; or,
- (3) In the case of a charter city, a copy of a resolution or other document adopted by the city's governing board evidencing approval of the PACE Program.

(b) If not included in the documentation required in subdivision (a) above, documents showing that the PACE Program requires that property owners can show all of the following as part of the financing underwriting process:

- (1) All property taxes for the assessed property are current for the previous three years or since the current owner acquired the property, whichever period is shorter.
- (2) The property is not subject to any involuntary lien in excess of \$1,000.
- (3) The property is not subject to any notices of default.
- (4) The property owner is not in bankruptcy proceedings.
- (5) The property owner is current on all mortgage debt.
- (6) The party seeking financing is the holder of record on the property.
- (7) The property is within the geographical boundaries of the PACE Program.
- (8) The Financing is for a residential property of three units or fewer.
- (9) The Financing is for less than fifteen percent (15%) of the value of the property, up to the first seven hundred thousand dollars (\$700,000) of the value of the property, and is for less than ten percent (10%) of the remaining value of the property above seven hundred thousand dollars (\$700,000).
- (10) The total mortgage-related debt and PACE Financing on the underlying property does not exceed the value of the property.

(c) If not included in the documentation required in subdivision (a) above, a detailed description of:

- (1) The transactional activities associated with the Financing issuance, including all transactional costs; and,
- (2) Requirements for quality assurance and consumer protection, as related to achieving efficiency and clean energy production; and,
- (3) Any credit enhancement or insurance associated with the PACE Program.

(d) A summary of the PACE Program's existing residential Financing portfolio certified pursuant to Section 10087 as of the date of application. The summary shall include the following information:

- (1) The total number of Financings in the portfolio.
- (2) The total value of the portfolio.

(e) The PACE Program's agreement to permit an audit of any of its records relating to enrolled Loans, during normal business hours on its premises, by the Authority or its agents, and to supply such other information concerning enrolled Loans as shall be requested by the Executive Director [of the California Alternative Energy and Advanced Transportation Financing Authority].

(f) Upon receipt of a completed application, the Executive Director will within ten business days review and determine whether the application is complete, or whether additional information is required to enroll the PACE Program. The Executive Director's decision whether an application is complete shall be final.