

DATE: September 11, 2014

TO: City Council Sustainability Committee

FROM: Director of Utilities & Environmental Services

SUBJECT: Update on Property Assessed Clean Energy (PACE)

RECOMMENDATION

That the Committee reviews this report and recommends that the City Council approves resolutions to join the Figtree PACE Program, but restrict Figtree's authority to commercial properties only.

BACKGROUND

The California Streets and Highways Code authorizes cities and counties to form assessment districts to finance certain public improvements. Money is borrowed to pay for the improvements and the debt is paid off by the district's property owners through annual installments on their property tax bill. Property Assessed Clean Energy (PACE) programs use these types of districts to finance energy and water improvements. California AB 811 (July 21, 2008) amended the Streets and Highways Code to include the installation of renewable energy sources and energy efficiency upgrades as allowable public improvements. California AB 474 (January 1, 2010) expanded AB 811 to also make water-efficiency improvements eligible for PACE financing.

When a governmental entity authorizes a PACE district, it must create a report that includes the boundaries of the district, eligible efficiency improvements, a method for prioritizing applications, and a plan for raising capital. PACE programs may use capital available from any source, including the sale of bonds. Participation in a PACE program is voluntary and only those property owners who wish to participate pay an assessment. If a property owner participating in a PACE program sells the property, then the repayment obligation legally transfers with the property to the next owner.

The intent of the PACE legislation is to provide an additional means of financing to make energy and water improvements more affordable and accessible to property owners. PACE financing allows property owners to finance 100% of the cost of eligible improvements and spread this cost over a longer period of time, usually up to twenty years.

Some local jurisdictions in California have created their own PACE districts and programs, and others have chosen to join a joint powers authority (JPA) that has established a PACE program. On

January 5, 2010¹, the Hayward City Council voted to join the CaliforniaFIRST PACE Program, which is sponsored by the California Statewide Communities Development Authority JPA. CaliforniaFIRST launched its non-residential program in September 2012 with fourteen counties and more than 120 cities participating in California. To date, there have been eighty applications for projects totaling over \$43 million throughout California. Of these, sixteen are in Alameda County (totaling approximately \$13 million) and two (totaling approximately \$600,000) are in Hayward.

Currently, CaliforniaFIRST is the only PACE program that the City of Hayward has authorized. On January 29, 2014, the City Council Sustainability Committee considered the Figtree PACE Program² and recommended that the City Council approve the City's participation in the Program. Since that time, the residential PACE environment has evolved and staff has gained additional information about the Figtree program. The purpose of this report is to update the Committee and to provide further information about the benefits and risks associated with PACE financing, especially in the residential sector.

DISCUSSION

Expansion of PACE Financing in the Residential Sector

The primary development in PACE since January is the expansion of certain PACE programs into the residential sector, including CaliforniaFIRST. At the time of the January 29 Committee meeting, most PACE programs had put their residential activities on hold in response to opposition from the Federal Housing Finance Agency (FHFA). PACE assessments are designed to be senior to a mortgage, meaning that upon a foreclosure or forced sale, the assessment would be paid off prior to the mortgage. Because of this, the FHFA argued that PACE was too risky for lenders to support and, in July 2010, instructed Fannie Mae and Freddie Mac to stop underwriting mortgages for customers with PACE assessments. In addition, the Agency hinted at more drastic actions, such as finding PACE homeowners in default with their mortgages.

Since 2010, the State of California has made various attempts to influence the FHFA's position. The State filed a lawsuit against the FHFA, which ultimately failed in March 2013. In September 2013, Governor Brown signed Senate Bill 96 into law, creating a \$10 million loan-loss reserve to pay back lenders in case a homeowner defaulted. The reserve program was approved on March 10, 2014 by the California Office of Administrative Law and is currently accepting applications. In response, the FHFA wrote a letter to state officials on May 1, 2014 stating that the reserve fund did not sufficiently address the risks to lenders and that the Agency would not change its policy on PACE.

Despite the FHFA's firm stance, it has not taken enforcement action against participating jurisdictions or property owners. Furthermore, some residential programs have continued to operate over the past three years and have not experienced the increase in mortgage default rates that the Federal Agency feared. According to the advocacy organization PACENow, research in California found that three PACE programs with a total of around 3,000 homes had a default rate of less than one percent.

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

² See Item #4: <http://www.hayward-ca.gov/CITY-GOVERNMENT/COUNCIL-STANDING-COMMITTEES/COUNCIL-SUSTAINABILITY-COMMITTEE/2014/CSC-CCSC012914full.pdf>

These factors have encouraged residential PACE programs in California and elsewhere to restart activities. CaliforniaFIRST re-launched its residential program³ in August 2014. Because the City Council previously authorized CaliforniaFIRST to operate in Hayward, this program is now available to Hayward homeowners. Also, Figtree is planning to launch a residential program later in early 2015.

Benefits and Risks of Opening the Market of PACE Financing

There are now thirty-one states that have passed legislation supporting PACE financing, thirteen of which have active programs. Of these thirteen, only seven have more than one PACE program operating in the state. California is leading the way, with approximately ten active programs. As the number of programs grows, this has sparked a discussion about the merits of authorizing multiple PACE programs to operate in a single jurisdiction. Some advocacy groups, including PACENow, support an “open market” for PACE providers, claiming that competition helps build a stronger PACE industry landscape and provides property owners more choices.

A handful of cities have recently adopted this approach. However, the presence of multiple PACE programs operating in the same market is a relatively new occurrence and there is little data available to support claims of benefits. San Jose, which had previously approved CaliforniaFIRST, approved the HERO Financing and Figtree PACE Financing programs in December 2013. HERO (Home Energy Renovation Opportunity) launched in December 2011 for residential properties and December 2012 for commercial properties. It is sponsored by the Western Riverside Council of Governments, and has since expanded to be available throughout California. Figtree Financing is a San Diego-based clean energy financing company. The Figtree PACE program, founded in 2011, is sponsored by the California Enterprise Development Authority (CEDA). It currently only serves commercial properties. .

JPA-sponsored PACE programs like CaliforniaFIRST and Figtree generally offer little risk to local jurisdictions. The JPAs offering these programs assume the legal liability, providing legal protection to the City. Any bonds issued to finance projects are issued by the JPA, so the City has no obligation to the bonds.

However, as with most financing mechanisms, PACE programs can present risks to consumers. 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. This is especially a concern in the residential market.

A question for the Committee to consider is to what extent does the City have a responsibility to vet PACE providers and monitor them on an ongoing basis? Monitoring additional PACE programs will take additional staff time.

The PACE model differs from other types of government assessment districts, such as lighting or fire districts, because it is optional for each individual property owner. This raises a potential

³ <https://californiafirst.org/>

concern that some PACE providers will use aggressive marketing tactics to convince property owners to use their product when it may not be in the owner's best long-term interest. PACE programs claim that property owners with a PACE assessment should save money in the long-run through efficiency upgrades. However, if administered inappropriately, property owners could end up owing more than they save.

PACE financing presents further complications for homeowners with Fannie Mae and Freddie Mac mortgages. It's not illegal for these homeowners to participate in the program, but they may be required to pay off the loan first if they want to sell their home or refinance their mortgage. The Sonoma County Energy Independence Program, which has been providing PACE financing for residential properties since 2009, has found that many homeowners are able to carry their PACE lien through a refinance, but only some have been able to do so when they sell their home. It is important that these homeowners understand these implications before entering into a PACE assessment.

Figtree Financing

At its January 29 meeting, the Sustainability Committee considered the Figtree PACE Program and recommended that the City Council approve the City's participation in the Program, which would make it the second PACE Program authorized to operate in Hayward. While preparing to present the program to Council, staff reviewed Figtree's 107-page Program Report, which Council would need to adopt to join the Program. This review raised some concerns for the Committee to consider.

The primary concern related to the Figtree Program is their use of accelerated foreclosure, which gives property owners less time to remedy a default. Accelerated foreclosure is authorized by state law. It allows the program to recover delinquent assessments in a faster timeframe than the regular foreclosure process. Regular foreclosures usually take a few years, whereas accelerated foreclosures can take less than a year. Property owners receive a notice of default after their second missed payment, and the foreclosure sale can occur approximately eight months after the notice.

In contrast to Figtree, CaliforniaFIRST uses judicial foreclosure as their means of recovering delinquent assessments. Judicial foreclosure generally provides more protection for the property owner because it requires the lender to file a lawsuit and involves a judge.

Accelerated foreclosure will become a greater concern when Figtree expands its services to include residential properties. As a group, commercial property owners are considered to be generally savvier than residential owners about financing decisions because it is part of their job. Currently, the Figtree Program concentrates on commercial, industrial, retail, and multi-family properties. If Council approves the full Figtree Program at this time, then Figtree could begin serving the residential sector in the future without further Council action. Alternatively, staff could add restrictive language to the adopting resolutions, which would limit Figtree's authority to commercial and multi-family properties only.

ECONOMIC IMPACT

Both CaliforniaFIRST and Figtree have similar potential benefits to property owners, including an alternative method for owners to finance energy and water efficiency retrofits and to realize the

energy cost savings related to them. If Hayward experiences high participation from property owners, local green jobs may be created to complete these energy and water efficiency retrofits.

Figtree is currently attracting investment – in March 2014, it partnered with a New York-based financial institution for up to \$60 million in capital. If the City does not allow Figtree to operate in Hayward, this financing will not be available to Hayward property owners. However, it is unclear if there is a demand from Hayward property owners for additional financing. So far, there have only been two PACE projects in Hayward, which CaliforniaFIRST was able to finance. In March, CaliforniaFIRST raised \$20 million in venture capital and in May, it secured a \$300 million credit facility.

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. This could result in increased defaults in Hayward.

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.

PUBLIC CONTACT

Staff is aware of one Hayward property owner interested in participating in the Figtree program. A letter from the owner (Attachment I) and an email from the contractor (Attachment II) were received supporting Council's adoption of the program.

NEXT STEPS

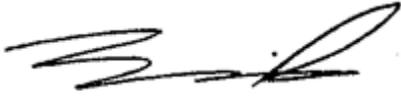
Staff will follow the recommendation of the Committee. There are three alternatives at this point. Staff is recommending the third alternative below.

- 1) Direct staff to hold off on approving additional PACE providers in Hayward until the PACE market matures and more data is available to assess the potential benefits and risks to Hayward property owners. Upon this direction, staff will continue to monitor the PACE market and report back to the Committee.
- 2) Reaffirm the Committee's January 29 recommendation that the City Council approve resolutions to join the full Figtree PACE Program and the California Enterprise Development Authority (CEDA). Upon this direction, staff will present Council with one resolution to join CEDA and a second to opt into the Alameda County Figtree PACE assessment district.
- 3) Recommend that the City Council approve resolutions to join the Figtree Program, but limit Figtree's authority to commercial and multi-family properties only. Upon this direction, staff will present Council with amended resolutions that include the restrictive language.

Prepared by: Erik Pearson, AICP, Environmental Services Manager

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

Approved by:



Fran David, City Manager

Attachments:

Attachment I	Letter from International Manufacturing
Attachment II	Email from Wipomo

INTERNATIONAL MANUFACTURING
CNC PRECISION MACHINE SHOP ISO-COMPLIANT

January 24, 2014

Hayward City Council/Hayward Sustainability Committee
& Public Works-Utilities & Environmental Services
City Hall
777 B Street
Hayward, CA 94541

Attention: Erik J Pearson, AICP/ Hayward City Council

I am the present owner of International Manufacturing, a small CNC precision machine shop in Hayward, CA. This business was built at this location over thirty years ago for Mr. Johnson Chiang and was purchased by me in 2005.

I understand that the City of Hayward will soon decide the future of the Property Assessed Clean Energy (PACE) financing. I urge the Council Sustainability Committee to recommend that the City Council adopt the Figtree PACE program.

Each year brings large increases in the cost of doing business; sometimes as much as 20%. With stiff competition, especially overseas, our company is exploring methods of reducing costs. This energy efficient retrofit proposed by Wipomo with proposed financing through PACE-Figtree is ideal.

This financing allows IMI to save or fix energy cost in the future, enjoy state and federal tax rebates, ensure greater profitability, and ultimately enjoy a tremendous increase in the value of the property. These results benefit everyone: IMI, the City of Hayward and Alameda County.

I urge you to allow this "cutting-edge" financing proposal to happen.

Sincerely,



Clement C. Johnson, III President

Erik Pearson

From: Charlie Johnson <charlie@wipomo.com>
Sent: Wednesday, January 22, 2014 9:13 AM
To: Erik Pearson
Cc: Joe Flores; cchapin@figtreefinancing.com
Subject: Figtree PACE Program | City of Hayward

Mr. Erik Pearson,

My name is Charlie Johnson, founder of Wipomo. As you are aware, Wipomo has been working closely with Figtree PACE (Property Assessed Clean Energy) Financing to bring Figtree PACE to the City of Hayward. The reason for this email today is to provide additional support to the Council Sustainability Committee as they review the Figtree PACE Program on the 29th of January.

I am urging the committee to recommend City Council adopt the Figtree PACE Program. I have a project in the City of Hayward that would immediately benefit by using Figtree PACE to finance the project. Without this funding, the energy efficiency retrofit will not be possible and the property owner will not realize the energy savings.

The County of Alameda has already adopted the Figtree PACE Program as well as numerous other cities throughout the state, including the City of San Jose, San Diego, Fresno and many others. A complete list of Participating Cities can be found at the bottom of the page on the following link:

<http://www.figtreefinancing.com/government-member-agencies/>

The Figtree PACE Program can create jobs and has already funded projects in other cities. For the news release on Figtree's latest bond issue for solar and roofing projects in Fresno, Bakersfield, and Chico, click here:

<http://info.figtreefinancing.com/e/28222/es-third-bond-just-3-months-af/wvhqm/503773218>

<http://nreionline.com/nreiwire/press-release-commercial-pace-provider-figtree-financing-issues-third-bond-just-3-months-af>

The Figtree PACE Program will allow property owners in the City of Hayward access to capital for financing energy efficiency, renewable energy, and water conservation improvements on commercial and industrial properties and pay for those costs through their annual property tax bill as a line item.

There's no financial impact to the city's General Fund, no legal liability and no upfront costs to owners who choose to make these improvements.

Upgrades to windows and doors, lighting, refrigeration, bathrooms, solar photovoltaic and water, and HVAC are some of the projects eligible for financing

During a time when many contractors are struggling to find ways to increase cash flow, the City of Hayward has an opportunity to offer this important economic development tool at no cost to the City. In addition to helping the business community, retrofitting the commercial and industrial building stock has the potential of directly assisting the local construction industry - one of the industries hardest hit by the economic downturn.

Please contact Joe Flores, Figtree's Vice President of Municipal Finance directly at (858) 771-0895 or via email: jflores@figtreefinancing.com for additional details.

You can reach me at: 760-809-3391 or via email at charlie@wipomo.com.

Thank you,
-Charlie

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Charlie Q. Johnson
Founder - CEO, Wipomo
760-809-3391
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Wipomo's "Energy Ecosystem" puts you "On the Road to Energy Independence".