

Date of Hearing: April 27, 2016

ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT

Susan Talamantes Eggman, Chair

AB 2618 (Nazarian) – As Amended March 17, 2016

**SUBJECT:** Community facilities districts: powers.

**SUMMARY:** Expands the authority granted to a Mello-Roos community facilities district (CFD) formed to finance and refinance energy efficiency, water conservation, and renewable energy improvements to privately or publically owned property. Specifically, **this bill:**

- 1) Authorizes a CFD, formed pursuant to the Mello-Roos Community Facilities Act, to use power purchase agreements for the purposes of financing and refinancing energy efficiency, water conservation, and renewable energy improvements to privately or publically owned property pursuant to existing law.
- 2) Authorizes a CFD, formed pursuant to an alternate procedure in existing law, which authorizes private property owners to pay Mello-Roos special taxes to finance specified energy improvements, to also finance seismic safety improvements necessary for compliance with seismic safety standards or regulations.

**FISCAL EFFECT:** None

**COMMENTS:**

- 1) **Property Assessed Clean Energy (PACE) Programs.** Utilizing the legal authority to create a financing district as a charter city, the City of Berkeley, in 2007, established a citywide voluntary program to allow residential and commercial property owners to install solar systems and make energy efficiency improvements to their buildings and to repay the cost over 20 years via an assessment on the property tax bill. Since the inception of PACE as a financing tool in Berkeley, the Legislature has granted the authority to local governments to provide up-front financing to property owners to install renewable energy sources or energy efficiency improvements that are permanently fixed to their properties, which is repaid through the property tax system. Most PACE programs are implemented and administered under two statutory frameworks: AB 811 (Levine), Chapter 159, Statutes of 2008, amended the Improvement Act of 1911 to allow for voluntary contractual assessments to finance PACE projects, and SB 555 (Hancock), Chapter 493, Statutes of 2011, amended the Mello-Roos Community Facilities District Act to allow for Mello-Roos special taxes (parcel taxes) to finance PACE projects.

The Legislature has expanded PACE for residential and commercial property owners to pay for renewable energy upgrades, energy or water efficiency retrofits, seismic improvements, and other specified improvements for their homes or buildings. Local agencies create PACE assessment districts under AB 811 or establish a CFD under SB 555, allowing the local agency to issue bonds to finance the up-front costs of improvements. In turn, property owners enter into a voluntary contractual assessment agreement with the local agency or agree to annex their property into a CFD to re-pay the bonds via an assessment or special tax (parcel tax), secured by a priority lien, on their property tax bill. The intent of the program is

that the assessment or parcel tax remains with the property even if it is sold or transferred, and the improvements must be permanently fixed to the property.

In California, there are several models available to local governments in administering a PACE program. Only Sonoma and Placer County administer their own PACE program. The majority of local governments contract with a private third-party or join a Joint Powers Authority (JPA) which contracts with a private third-party to carry out their PACE programs. The cost of third-party administration is not borne by the local agency, but is built into PACE loan financing. Some of these programs focus on residential projects, others target commercial projects, and some handle both residential and commercial portfolios.

Only a few local governments have begun to use voluntary contractual assessments for seismic improvements. For example, the City of Berkeley and the City and County of San Francisco began to offer financing for improvements to soft, weak and open front (SWOF) buildings and additional voluntary seismic retrofits by a voluntary contractual assessment program administered by Alliance NRG.

- 2) **PACE and Mello Roos.** The Mello-Roos Community Facilities Act authorizes local governments to form a CFD and levy special taxes (parcel taxes) to finance a wide variety of facilities and services. Current law establishes the process for the formation of a CFD, and requires two-thirds voter approval for the Mello-Roos special tax. A CFD issues bonds secured by these special taxes to finance the facilities and services. SB 555 authorized the use of Mello-Roos taxes to help finance renewable energy, water conservation, and energy efficiency improvements on private property. The improvements financed by a CFD must be affixed to or on real property and may only be installed with the prior written consent of the owner or owners of the building or real property. SB 555 also prohibited a CFD from financing renewable energy, water conservation, and energy efficiency improvements on privately owned property in connection with the initial construction of a residential building, unless the initial construction is undertaken by the intended owner or occupant.

Additionally, SB 555 authorized an alternate procedure for establishing a CFD that initially contains no parcels of land, but consists only of territory from which parcels may subsequently be annexed to the CFD with the unanimous approval of parcel owners. This process allows a property owner to opt into the PACE program by voting to annex their property into the CFD, which authorizes the levy of the special tax and special tax lien on their property.

- 3) **Bill Summary.** Existing law authorizes CFDs to finance seismic safety work on buildings or real property, privately or publicly owned, that must be done to comply with seismic safety standards or regulations. The alternate procedure established by SB 555 is the statutory authority used by third party providers, like the sponsor of this bill, to administer PACE programs. CFDs, formed pursuant to this alternate procedure established by SB 555, are limited in the types of facilities they can finance or refinance: energy efficiency, water conservation, and renewable energy improvements. This bill would add seismic safety improvements necessary for compliance with seismic safety standards or regulations to the list of improvements to facilities that can be financed by a CFD formed for the more specific purposes of allowing voluntary participation by property owners to annex their property into the CFD to utilize PACE financing to make these types of improvements.

This bill also expands the authority granted by SB 555 by allowing a CFD to use a power purchase agreement for the purposes of financing and refinancing renewable energy, water conservation, and energy efficiency improvements on privately or publicly owned property. This bill is sponsored by Ygrene.

- 4) **Author's Statement.** According to the author, "According to the United States Geological Survey, there is a 99.7% chance that a major earthquake of 6.7 in scale will strike California in the next 30 years. A major earthquake occurring is only a matter of when – not if. Unfortunately, the number of residential and commercial buildings lacking appropriate, seismically safe features is far too high when considering the level of seismicity in California. In Los Angeles alone, nearly 1,500 older concrete buildings have been identified as at-risk and the potential, statewide damage from the next big earthquake could far exceed economic loss of past California earthquakes.

"As more local jurisdictions begin to follow suit of San Francisco and Los Angeles when considering mandating retrofitting, innovative ways to accelerate compliance for property owners are needed. Along with energy efficiency, water conservation, and renewable energy projects, contractual assessment districts and some types of community facilities districts already allow for seismic safety improvements to be financed through PACE programs. This bill clarifies that all community facilities districts under the Mello-Roos Act may finance seismic safety improvements. By creating financing mechanisms for commercial and residential property owners, this bill provides property owners with another tool to make the necessary investment to improve the safety of their home or business before the inevitable "big one" strikes."

- 5) **Federal Housing Finance Agency.** In 2010, Federal Housing Finance Agency (FHFA), which oversees the nation's largest mortgage finance companies, Fannie Mae and Freddie Mac, raised concerns that residential PACE financing could pose a risk for federal mortgage enterprises (Fannie Mae and Freddie Mac), because PACE loans are a first-priority lien in the case of foreclosure and lenders would have to pay outstanding PACE assessments before paying mortgage costs. In August of 2010, Fannie Mae and Freddie Mac announced they would not purchase mortgages for homes with first lien priority PACE obligations. The FHFA's action triggered many local governments to suspend their residential PACE programs.

SB 96 (Committee on Budget and Fiscal Review), Chapter 356, Statutes of 2013, addressed this concern. This budget trailer bill tasks the California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA) with administering a PACE loss reserve program of \$10 million to keep mortgage interests whole during a foreclosure or a forced sale. CAEATFA recently filed its regulations for the program, and is now accepting applications from PACE administrators.

The PACE Loss Reserve Program will compensate first mortgage lenders for losses resulting from the existence of a PACE lien in a foreclosure or forced sale. The program will cover PACE payments made during foreclosure, if a mortgage lender forecloses on a home that has a PACE lien, and any losses to a first mortgage lender up to the amount of outstanding PACE payment, if a county conducts a forced sale on a home for unpaid taxes. The intent of the Program is to put the first mortgage lender in the same position it would be in without a PACE lien.

The FHFA issued clarity to their position following the creation of the PACE Loss Reserve Program, in a letter to the Governor dated May 1, 2014, which reads, "I am writing to inform you that FHFA is not prepared to change its position on California's first-lien PACE program and will continue to prohibit the Enterprises from purchasing or refinancing mortgages that are encumbered with first-lien PACE loans...In making this determination, FHFA has carefully reviewed the Reserve Fund created by the State of California and, while I appreciate that it is intended to mitigate these increased losses, it fails to offer full loss protection to the Enterprises. The Reserve Fund is not an adequate substitute for Enterprise mortgages maintaining a first lien position and FHFA also has concerns about the Reserve Fund's ongoing sustainability. "

- 6) **Federal Housing Administration.** In August 2015, the Federal Housing Administration (FHA) announced the development of Single Family FHA PACE guidance. "The Single Family FHA guidance will address the impact of PACE assessment on purchases, refinances and loan modification options available to borrowers experiencing distress and will require the subordination of PACE financing to the first lien FHA mortgage. The guidance will address the eligible methods of subordination of existing PACE liens."

The FHFA has not issued anything further following the announcement from FHA regarding the development of guidelines.

- 7) **CAEATFA.** As part of the 2015-16 Budget, the Legislature tasked CAEATFA, in consultation with the California Public Utilities Commission, to create a working group with stakeholders to develop criteria for the comparative assessment of energy efficiency financing programs in California, including PACE financing. CAEATFA has created a public process to ensure stakeholder participation and draft criteria for the comparative assessment of energy efficiency financing programs for public comment. The draft criteria, includes energy saving attributable to program financing, cost-effectiveness, and customer experience, which includes customer satisfaction and customer protections.
- 8) **Related Legislation.** AB 2693 (Dababneh), currently pending in the Assembly Banking and Finance Committee, is double referred to this Committee. AB 2693 seeks to address a number of issues raised since the creation of PACE regarding consumer protection and disclosures, and the lien status.
- 9) **Committee Amendments.** The Committee may wish to ask the author to remove Section 1 from the bill regarding power purchase agreements in consideration of the following:

The Committee may wish to consider the value of authorizing a CFD to use power purchase agreements to finance energy improvements. The concept of a power purchase agreement is to offer consumers another option, if they cannot afford up-front costs to purchase and install energy saving improvements like solar panels. Under the authority granted by this bill, property owners would make payments with special taxes on a property tax bill, instead of on a utility bill, which provides more security because of the lien priority of special taxes. The Committee may wish to consider what benefits a PACE power purchase agreement would offer consumers that is not already available under existing law.

AB 44 (Blakeslee), Chapter 564, Statutes of 2010, expanded the use of voluntary contractual assessments to include financing electricity purchase agreements. AB 44 also required an electricity purchase agreement to contain specified qualifications, conditions, and protections for property owners. The Committee may wish to note that this bill does not include any of those same requirements.

Given the current discussions regarding data collection and performance of PACE financing at CAEATFA, the outstanding issues regarding lien priority, and concerns expressed over the lack of disclosure provided by third party PACE providers the Committee may wish to consider the timeliness of expanding any PACE programs at this time. Additionally, the Committee may wish to consider beyond the scope of this individual bill, if it is time to take a closer look at PACE programs and the involvement of local governments in both the implementation and oversight of programs at the local level.

10) **Arguments in Support.** Ygrene argues, "There are currently at least 10 statewide and regional PACE programs in the State, most of which have been formed based on the AB 811 statute. There are also two known programs based on the SB 555 statute. On behalf of the Golden State Finance Authority, Ygrene operates a SB 555 based program in approximately 200 counties and incorporated cities, including Los Angeles, San Jose, Oakland and other jurisdictions where there are mandates and strong demand for seismic retrofits to 'soft-story' multi-family residential, commercial and other properties. Given these facts it is imperative that as much private capital and program choice as possible – this bill would result in an increase to the available capital and choices for property owners."

11) **Arguments in Opposition.** None on file.

#### **REGISTERED SUPPORT / OPPOSITION:**

##### **Support**

Ygrene Energy Fund [SPONSOR]

##### **Opposition**

None on file.

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