Date of Hearing: April 19, 2017

ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT
Cecilia Aguiar-Curry, Chair
AB 271 (Caballero) – As Amended April 4, 2017

SUBJECT: Property Assessed Clean Energy program.

SUMMARY: Makes changes to the statutes which govern unpaid Property Assessed Clean Energy (PACE) assessments. Specifically, **this bill**:

1) Authorizes a county tax collector to direct the county auditor to remove a delinquent installment from the county's secured tax roll. Provides that this bill only applies to a delinquent installment based on a voluntary contractual assessment, voluntary tax, or special tax that arises from a contract entered into on or after January 1, 2018, pursuant to existing law which governs contractual voluntary assessments and Mello-Roos special taxes which provide the authorization for Property Assessed Clean Energy (PACE) programs.

2) Requires the county tax collector, immediately upon the removal pursuant to 1), above, to provide notice on the secured tax roll that the delinquent installment has been removed.

3) Requires the notice to be displayed on the secured tax roll in the manner that conveys that the removal has occurred and may include the name and telephone number of the person or entity to be contacted to receive further information.

4) Defines "PACE assessment" to mean a voluntary contractual assessment or voluntary special tax that arises from a contract entered into on or after January 1, 2018, pursuant to statutes in existing law which govern contractual voluntary assessments and Mello-Roos special taxes which provide the financing authorization for PACE programs.

5) Requires for a property subject to a PACE assessment that accrues a penalty or cost pursuant to existing law which governs unpaid property taxes that become delinquent and defaulted and are subject to specified penalties, that accrued penalty or cost applicable to the PACE assessment, whether collected on the secured roll or in a sale or foreclosure, to be deposited in a restricted county fund created pursuant to 9), below.

6) Requires the holder of the lien based on the PACE assessment to remit the penalty or cost, if collected pursuant to a sale or foreclosure, to the county tax collector within 30 days of the sale or foreclosure.

7) Prohibits a property subject to a PACE assessment, except as provided in 8), below, from being subject to an agreement wherein the authority to collect a defaulted lien based on a PACE assessment is transferred to, subject to, or contingent upon, third-party approval or another arrangement or agreement by the lienholder, unless that lien has been removed from the county's secured tax roll and the right to collect the PACE assessment and any defaulted lien amount is returned to the administrator of the PACE program.

8) Provides that the prohibition in 7), above, does not apply to a PACE assessment made subject to, on or before January 1, 2018, a contractual waiver of the right to foreclose, or other arrangement or agreement between a lienholder and a lender, or a lienholder and another

third party, wherein the agreement requires approval by the other party prior to the lienholder's exercise of foreclosure.

9) Requires the county to create a restricted fund to receive moneys described in 5) and 6), above, and requires counties to appropriate moneys from the fund only for the purpose of offsetting general fund property tax revenues of local taxing agencies that are lost when a property subject to a PACE assessment is sold at a tax-defaulted land sale for less than the minimum price described in existing law.

10) Prohibits a PACE assessment removed from a county's secured tax roll, pursuant to this bill, from being subject to penalties and interest in existing law for delinquent assessments.

11) Provides that, if the Commission on State Mandates determines that this bill contains costs mandated by the state, reimbursement to local agencies and school districts for those costs shall be made, pursuant to current laws governing state mandated local costs.

FISCAL EFFECT: This bill is keyed fiscal and contains a state mandated local program.

COMMENTS:

1) **History and Statutory Authorization.** Utilizing the 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 energy 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. In 2008, the Legislature granted the statutory authority to cities and counties 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 bill.

   Most PACE programs are implemented and administered under two statutory frameworks: AB 811 (Levine), Chapter 159, Statutes of 2008, which 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, which 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 as an option to pay for renewable energy upgrades, energy and 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 Community Facilities District (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, 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.

2) **PACE Models.** In California, there are several models available to local governments in administering a PACE program. Only the counties of Sonoma and Placer administer their

own PACE programs. 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.

3) **Messages from the Federal Government.** In 2010, the 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 outstanding PACE assessments would be paid before mortgage costs. FHFA specifically pointed to the underwriting for PACE programs, which result in collateral-based lending, rather than lending based upon ability to pay. FHFA statements also reference the absence of Truth in Lending Act and other consumer protections. 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.

   The State of California and several other parties sued FHFA for not conducting a formal rulemaking before its decision; however, the 9th Circuit Court of Appeals ruled in FHFA's favor in March of 2013. (County of Sonoma, et al. v. Federal Housing Finance Agency, 710 F.3d 987 (2013)).

   SB 96 (Committee on Budget and Fiscal Review), Chapter 356, Statutes of 2013, sought to address FHFA's decision, and tasked 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 established regulations, and the majority of PACE administrators participate in the program. The loss reserve currently supports 81,707 PACE financings with an outstanding value of over $1.8 billion from 14 PACE programs. The PACE Loss Reserve Program is designed to compensate first mortgage lenders for losses resulting from the existence of a PACE lien in a foreclosure or forced sale. The program covers 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 Governor Brown 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."

In July 2016, the Clean Energy Savings for All Americans initiative, included guidelines from the U.S Department of Housing and Urban Development and the Department of Veterans Affairs as to how properties with residential PACE assessments can be purchased and refinanced with Federal Housing Administration (FHA) mortgage insurance and VA insured mortgages. Key requirements include: (1) the PACE obligation is collected and secured by the creditor in the same manner as a special assessment against the property, pursuant to state law; (2) only the delinquent PACE assessment payments take a first lien position ahead of the mortgage; and, (3) the assessment transfers from one property owner to the next, including through a foreclosure sale.

To date, FHFA has maintained its position against first-priority PACE liens.

4) **Liens.** PACE financing provides creditors security that they would be repaid because property tax liens are super priority liens that are senior to mortgage debt. If a house is sold in a foreclosure or tax sale, the PACE lien holder will be paid before other lienholders, like mortgage lenders. In response to FHFA's decision not to purchase mortgages with PACE liens, some third party PACE providers have started offering an option to homeowners who are unable to refinance or sell their homes called "Limited Subordination" or "Contractual Subordination." These contractual lien subordinations are an agreement between the PACE lien holder and a mortgage lender, where the PACE lien holder "subordinates" their right to foreclose on a home for non-payment of PACE assessments, and to the proceeds from foreclosure, until the mortgage lender has been paid in full for amounts due under its mortgage.

This practice is not utilized by all PACE providers in the industry, and not addressed in state statute. According to Renovate America, a third party PACE administrator, they have completed over 2,000 subordination contracts. The consequences of contractual subordination agreements are untested when it comes to the issues presented to a county tax collector to comply with existing law which governs defaulted assessments, interest penalties, and tax defaulted property sales.

In November 2016, the Department of Energy released the "Best Practice Guidelines for Residential PACE Financing Programs". These guidelines state, "PACE Assessment Non-Acceleration upon Property Owner Default: In the event of a sale of a property with an outstanding PACE Assessment, including a foreclosure sale, the obligation remains with the property and the new homeowner will be responsible for paying the remaining PACE financing balance. A PACE assessment should survive the foreclosure process (i.e., the full PACE obligation amount does not become due and payable in the event of foreclosure of the property). After a foreclosure, the subsequent owners are responsible for future assessment payments, and could be responsible for any delinquent amounts that remain if foreclosure proceeds were insufficient to pay-off the delinquent amount."

A PACE assessment does not accelerate upon default, meaning only the amount that is owned is due (not the entire amount of the PACE assessment). Default of PACE assessment triggers a local agency's right (as the PACE lien holder) to request that the defaulted PACE assessment be stripped from the tax roll. This right to strip an assessment from the tax roll and pursue the judicial foreclosure process to recover the defaulted PACE assessment remains with the PACE lien holder.

As a result of contractual subordination agreements, some PACE lien holders defer their right to strip a defaulted PACE assessment from the tax roll to the holder of the first mortgage. In other PACE models that do not use or offer any contractual lien subordination, the PACE lien holder identifies if any properties with a PACE assessment are delinquent and maintains the sole discretion to pursue or defer foreclosure proceedings.

5) **Bill Summary.** This bill applies to PACE assessments and delinquent installments based on PACE assessments that arise from a contract entered into on or after January 1, 2018.

   a) **Delinquent Installment.** This bill authorizes a county tax collector to direct the county auditor to remove a delinquent installment based on a PACE assessment from the property tax roll. Under existing law, only the governing body of the local agency (PACE lien holder) may direct the removal of a defaulted installment based on a PACE assessment from the secured property tax roll.

   b) **Limited Subordination Agreements.** This bill prohibits a property with a PACE assessment from being subject to an agreement where the authority to collect a defaulted lien based on a PACE assessment is transferred to, subject to, or contingent upon third party approval, unless the priority lien has been removed from the county's secured tax roll and the right to collect the PACE assessment and any defaulted lien amount is returned to the administrator of the PACE program.

   c) **County Reserve Fund.** Under existing law, unpaid property taxes that become delinquent and defaulted are subject to specified penalties, including defaulted PACE assessments. This bill requires a PACE assessment lien holder to remit any penalties and costs applicable to the defaulted PACE assessment collected, pursuant to a tax defaulted land sale or a foreclosure be deposited into the restricted fund. This bill requires counties to create a restricted fund and to only appropriate moneys from the fund to offset any losses in property tax revenue to local governments as a result of properties with PACE assessments being sold at tax defaulted property sales for less than the minimum prices established by existing law.

6) **Author's Statement.** According to the author, "The PACE program has proven an effective way to finance energy efficiency and renewable energy upgrades for consumers. Yet as PACE continues to grow, so do opportunities for unscrupulous behavior and the potential for consumers to be taken advantage of by a program otherwise designed to help them. We must ensure that consumer protections are in place, and this bill does that. AB 271 protects counties, schools, and taxpayers, and also protects PACE so it can remain a viable alternative for energy efficiency and renewable energy generation."

7) **Property Tax.** Existing law establishes January 1st of each year as the “lien date,” or the date upon which the assessor values property, and property taxes are imposed on its owner in the form of a lien against the property. For property on the secured roll, which generally includes real property such as land and buildings, tax collectors must send bills to taxpayers by November 1st. Taxpayers must pay their bills in two installments: the first on November 1st, which becomes delinquent December 10th, and the second on February 1st, with delinquency occurring on April 10th. Taxpayers can pay in full at the first installment.

Many other locally-imposed charges, fees, taxes, and assessments, such as Mello-Roos taxes, benefit assessments, and parcel taxes, are also collected as part of the property tax bill, and subject to the same restrictions and penalties.

When taxes become delinquent, state law imposes a 10% penalty on each amount, and counties can also apply administrative charges. The property becomes tax defaulted if taxes remain unpaid as of June 30th, triggering redemption penalties of 1.5% a month (18% per year) until the full amount is paid. After five years, the tax collector with approval by the board of supervisors can sell a tax defaulted residential property to satisfy back taxes, penalties, costs, and other liens; for commercial property, the tax collector can do so after three years. After the sale, proceeds first pay for the costs of newspaper publishing, and recording fees. Funds are then distributed to taxing agencies with valid claims, and to the tax collector to pay for notices and contacting taxpayers. After that, proceeds satisfy liens held by parties in interest. Any amounts left over, known as “excess proceeds,” are then divided up between each taxing entity according to their appropriate share of the property tax, after the county deducts specified costs.

8) **Pending Issues**. Last session, AB 2693 (Dababneh), Chapter 618, Statutes of 2016, established a number of consumer notice requirements and sought to tighten financing standards for PACE assessments for residential properties. This Committee, jointly with the Banking and Finance Committee, held an oversight hearing, to provide oversight on the current administration of PACE programs and to gain a better understanding on concerns expressed over residential PACE and the impacts on the financial market. Following a series of news articles in the Wall Street Journal, the filing of two class action lawsuits, and the introduction of legislation at the Federal level, the topic of residential PACE and expression of concerns over the lack of oversight and protections for consumers continue. PACE administrators and supporters of PACE programs continue to point to energy savings and the fact that the industry is still relatively new and experiencing growing pains.

   SB 242 (Skinner), pending in the Senate Governance and Finance Committee, contains several provisions which seek to address a number of these issues that have been raised about PACE programs administered by third party providers.

9) **Policy Considerations.** The Committee may wish to encourage the author to continue to work with the Committee to address several issues moving forward:

   a) **Level of Notification**. Ensure adequate notification that a defaulted PACE assessment has been removed from the secured property tax roll.

   b) **County Reserve Fund**. Clarify what happens with any excess proceeds in a county's restricted fund.

   c) **Terminology**. Clarify the use of the term "delinquent" instead of "defaulted" installments, and "PACE administrator" instead of "PACE lien holder".

10) **Arguments in Support.** The California Association of County Treasurers and Tax Collectors argue, "The proposed changes will protect tax payers and those who rely on local government services by removing defaulted PACE liens from the property tax bill. The proposed changes will reduce the chances counties, schools, other local government entities and the State will lose revenue as a result of properties with PACE assessments being sold at

tax defaulted land sale at prices below the original minimum bid amount. It will also ensure that the property tax bill is not being used to inappropriately enrich private parties at the expense of consumers who may not realize that tax code related penalties and interest will apply to their delinquent PACE assessments."

11) **Arguments in Opposition.** Renovate America states, "Removing delinquent installments from the secured tax rolls changes PACE from a secured financing instrument, increases consumer costs, and reduces the availability of PACE financing. Removing delinquent installments from the secured tax rolls will increase foreclosures of property owners. The legislation would prohibit contractual subordination, limiting homeowner options at time of sale or refinance."

12) **Double Referral.** This bill is double-referred to the Revenue and Taxation Committee.

REGISTERED SUPPORT / OPPOSITION:

Support

California Association of County Treasurers and Tax Collectors [SPONSOR]
California Credit Union League

Opposition

Renovate America
Ygrene

Analysis Prepared by: Misa Lennox / L. GOV. / (916) 319-3958