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Keeping PACE with Energy Efficiency Demand in California

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Property Assessed Clean Energy Financing (PACE) programs, for residential and commercial properties, were in development throughout the United States when the Federal Housing Finance Agency (FHFA) sought to impose limits on such residential PACE assessments. The FHFA directed Fannie Mae and Freddie Mac not to acquire mortgages on properties with PACE liens and to suggest additional measures negative to residential PACE programs.

Western Riverside Council of Government's (WRCOG) HERO Program, however, continues to thrive, for residential property financing, thanks to the determination of WRCOG to provide this valuable program to its constituents. A commercial program was recently launched, and WRCOG is also expanding both its residential and commercial program statewide, offering many benefits to other jurisdictions thinking of offering a PACE program.

WRCOG's HERO Program allows home and business owners to finance energy efficiency and water conservation improvements through low, fixed rate financing that is repaid over time through annual assessments collected on the homeowner's property tax bill. California law allows for local jurisdictions to enter into contractual assessments with property owners for such improvements.

After the establishment of the FHFA, in response to the mortgage crisis of 2008, the agency warned that PACE programs, which established priority liens over existing mortgages, presented significant safety and soundness concerns. The FHFA directed Fannie Mae and Freddie Mac to discontinue the purchase of mortgage loans secured by properties with an outstanding PACE obligation unless the terms of the PACE program do not permit establishment of liens with priority over the first mortgage liens. With those two organizations purchasing the vast majority of mortgage loans, many developing PACE programs that supported residential improvements with senior or priority liens elected to pause their implementation efforts.

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WRCOG held a different view. By making disclosures to the property owners regarding the possible consequences of participation in the HERO Program resulting from the FHFA directive, the homeowner is allowed to make an informed decision when electing to participate in the HERO Program. A program of the County of Sonoma held a similar view and also continues to operate. Because the FHFA directive was announced prior to the launch of the WRCOG program in late 2011, specific disclosure language was incorporated into the WRCOG HERO applications and contracts from the onset.

Despite the disclosure of the potential need to prepay the assessment, the popularity of the program has been extensive. Since its launch, the WRCOG HERO program has attracted applications from 5,000 homeowners who have been approved for more than $140 million in eligible renewable energy and water efficiency projects. Completed and funded projects exceed $30 million, with an average project cost of $18,000. Energy efficient heaters and air-conditioners, energy efficient windows and solar photovoltaic systems are the most popular improvements. More than 800 contractors are registered with the program and the HERO Program has garnered many awards and much recognition.

Realizing that other jurisdictions throughout the state have a need for and could benefit from PACE programs, WRCOG is now expanding by offering the newly formed California HERO Program to cities and counties throughout the state. The benefits are great, as the WRCOG program has many unique features.

There is no cost to a city or county for participation in the California HERO Program. Compensation to WRCOG, for their conduit bond issuance function, is paid through bond fees. With no exclusivity agreement, participating jurisdictions can work with other programs in addition to California HERO. The program also offers flexibility to be branded locally.

The HERO Program is proven to create jobs. Contractors are appreciative of the funding tool that has provided new business and opportunities to deploy and expand their local workforce. Based on contractor feedback, the program has generated and supported more than 2,000 jobs in the current program region.

Most importantly, a jurisdiction doesn't need to invest time and expense into starting up a program. By leveraging the existing implementation model , other jurisdictions have the benefit of the HERO team's lessons learned and can get their own program up and running quickly and easily.

Also unique to the WRCOG HERO Programs are the funding methods. Originally, WRCOG envisioned a more traditional assessment district bond model where assessments for participating property owners would be accumulated until the aggregate principal amount of such contracts would support the issuance of a conventionally sized bond issue but realized that couldn't be successfully marketed property owners or contractors. Such a model could cause extensive delays to both the property owners and the contractors while waiting for a critical mass to be reached before funding loans. Instead, under the HERO Program, the property owner enters into an assessment contract with WRCOG, as conduit bond issuer, in order to assign the ongoing assessment payments to repayment of bonds issued to fund the improvements. This dramatically streamlines the process for the improvements being made since bonds are issued weekly and the payment is received by the contractor within two weeks from the completion of the improvements. This funding is made possible by warehouse financing provided by the program's funding partners – Renovate America, Inc. for the residential program and Samas Capital, LLC for the commercial program – that enable the financing to be provided on an expedited basis.

In the early days of the WRCOG program, a separate bond, commonly referred to as a micro-bond, was issued for each property. With the immediate success of the program, as many as 70 bonds were being issued on a weekly basis which tested the administrative resources of the program team members who essentially had to close 70 bond issues each week. Adjustments were made so that now the contracts are aggregated by terms of the contract (5, 10, 15 or 20 years, depending upon the useful life of the product being used) into one bond for each such term. Now only four bonds are issued weekly. The California HERO team continues to make the program administrative enhancements to make the operations even more streamlined.

Also unique is the plan of the program's funding partners to aggregate the bonds and sell them into the asset-backed securities (ABS) market, a strategy never before utilized for municipal bonds. The process has resulted in increased scrutiny during the rating process, but the end result is expected to be broad market acceptance and increased investor participation. The benefit of this structure to the property owner is prompt funding at a fixed interest rate that is set at the time of assessment origination and remains the same for the entire repayment term. For the participating jurisdiction, this provides immediate funding to enhance consumer participation and job growth without subjecting the agency to remarketing risk for the aggregated bonds. All risk is borne by the funding partners. Furthermore, because of the first-to-market platforms utilized in the California HERO Program, property owners borrowing amounts are not increased as dramatically as would be required in a municipal structure to fund a reserve account.

The availability of financing provides great rewards to property owners looking to improve energy efficiencies and increase value. The HERO Program serves as a tremendous role model for job creation and streamlined funding of energy and water efficiency improvements. Other local jurisdictions can easily join this successful program to offer this valuable tool to property owners though a simple resolution approval.

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Note: This article originally appeared on the now-defunct BBKnowledge blog, where Best Best & Krieger authors shared their knowledge on emerging issues in public agency law.