BOARD OF SUPERVISORS AGENDA LETTER

Clerk of the Board of Supervisors
105 E. Anapamu Street, Suite 407
Santa Barbara, CA 93101
(805) 568-2240

Agenda Number:

Department Name:	Community Services Department
Department No.:	057
For Agenda Of:	May 10, 2016
Placement:	Departmental
Estimated Tme:	30 minutes
Continued Item:	No
If Yes, date from:	
Vote Required:	Majority

TO: Board of Supervisors

FROM: Department Director(s): George Chapjian, Community Services Director, (805) 568-2467
Contact Info: Angie Hacker, Division Chief, Energy and Sustainability Initiatives, (805) 568-3515

SUBJECT: **Commercial Property Assessed Clean Energy Financing**

County Counsel Concurrence
As to form: Yes

Auditor-Controller Concurrence
As to form: N/A

Other Concurrence: Risk Management
As to form: Yes

Recommended Actions:

That the Board of Supervisors:

a) Receive and file this briefing on Commercial Property Assessed Clean Energy Financing; and,

b) Determine that the recommended actions do not constitute a project subject to environmental review under the California Environmental Quality Act (CEQA) pursuant to CEQA Guidelines Section 15378(b) (4), as the actions are the creation of government funding mechanisms or other government fiscal activities which do not involve any commitment to any specific project, and direct staff to file a Notice of Exemption (NOE) (Attachment H).

Summary Text:

Property Assessed Clean Energy (PACE) financing enables property owners to finance the upfront costs of building improvements such as energy and water savings improvements and repay these costs over time through contractual assessments on local property tax bills. The Board of Supervisors last took formal action on PACE in 2010 when it halted implementation of the County-administered PACE program as a result of concerns from the Federal Housing and Finance Agency (FHFA),which regulates Fannie Mae, Freddie Mac and the Federal Home Loan Bank System (Attachment A). The U.S. Office of Comptroller of the Currency (OCC), which regulates commercial banks, also issued guidance in 2010 to alert national banks to concerns and regulatory expectations regarding PACE programs (Attachment B).

Despite the concerns expressed by FHFA and the OCC, approximately 447 municipalities in California have proceeded to adopt residential and commercial PACE programs. While the majority of PACE activity is in the residential market, over the last several years there has been increased activity in the commercial PACE market. PACENation, an association of people and organizations supporting PACE financing, estimates that 734 commercial PACE projects have been completed nationwide, totaling $230 million as of March 2016. For more details on PACE developments since 2010 see Attachment C.

However, at a recent PACE symposium, several commercial PACE administrators noted that a relatively small percentage of the commercial property owners that apply for PACE financing ultimately attain it and complete the process of having the assessment placed on the property tax roll. This low conversion rate may be indicative of factors such as the complex ownership structure of some commercial properties and the time-intensive auditing and analyses required for commercial buildings.

Additionally, the process related to bringing a commercial project to fruition and placing a PACE lien on the property and assessments on the tax roll can be time consuming and typically includes a financial application where the property is screened for eligibility using criteria such as property-based debt limit, mortgage and tax payment history, as well as an analysis of the project's financial returns. By operation of law a PACE lien is senior to any and all mortgage liens. Commercial PACE administrators typically require consent from existing mortgage lenders (lender consent), which may or may not be granted, while residential PACE administrators do not typically require lender consent.

According to input gathered from PACE advocates, commercial PACE provides potential benefits to property owners such as zero upfront investment, attractive interest rates, long term financing and the potential to transfer the PACE assessment to the new property owner with the sale of the property.

However, as highlighted by our County Auditor Controller (see Attachment D), there are also concerns related to PACE programs, such as the use of County resources to perform private loan servicer activities, questionable lending practices, lack of consumer protection and a higher risk for property owners in the case of foreclosure.

The following report provides the Board with additional details and updates regarding PACE. Staff will not move forward with commercial PACE unless directed to do so by the Board.

Background:

Authority for PACE:

Authority for PACE is provided under the Improvement Act of 1911 (Improvement Act) as amended by AB 811 (2008) and the Mello-Roos Act as amended under SB 555 (2011). The Improvement Act and Mello-Roos Act, as amended, authorize the creation of special tax districts; voluntary contractual agreements for financing between an authorized entity and the property owner; use of available funding from any source; and attachment of a lien against the property for payment of the assessment (as opposed to the individual owner).

Definition of PACE:
PACE programs allow property owners to finance the upfront cost of energy efficiency, water efficiency and renewable energy projects and repay these costs over time through an assessment on the property.

History of PACE in Santa Barbara County:
In 2010, per Board direction, the County completed all steps required by statute to implement and internally administer a PACE program for both residential and commercial property owners under the emPower program. The Board also advanced a total of $6 million in general fund dollars to start the PACE program. However, in July 2010, the FHFA issued a statement (Attachment A) relaying concerns about PACE's senior lien position over mortgages. Given potential risks to consumers and local governments, the Board adopted a resolution on July 13, 2010 directing staff not to accept residential PACE applications until FHFA's concerns had been resolved. As a result, the County's PACE program (including residential and commercial) were put on hold.

In 2011, as an alternative to residential PACE, the Board approved a redesigned, non-PACE financing option that allowed emPower to provide grant-funded credit enhancements to two local credit unions to facilitate affordable unsecured loans for residential energy improvements. emPower continues to provide a range of energy improvement services to property owners throughout the region, including Ventura and San Luis Obispo Counties.

In addition to emPower, other alternatives to residential PACE financing have emerged. For example, given the demand witnessed, these credit unions have also developed separate unsecured and secured loan products that allow homeowners to finance solar photovoltaic projects. The State of California is also working to develop new financing alternatives and has created what is known as the California Hub for Energy Efficiency Financing (CHEEF), which is developing pilot programs designed to increase the availability of lower-cost financing for energy efficiency investments for both residential and commercial customers.

Meanwhile, the Board has continued to support efforts to address FHFA's concerns regarding PACE. In fact, the County's Legislative Platform and Energy & Climate Action Plan (ECAP) includes PACE as a potential strategy in reducing Countywide greenhouse gas emissions.

Commercial PACE Activity:
Over the last several years there has been increased activity in the commercial PACE market. Recently, County staff have been approached by several third party PACE administrators as well as commercial property owners who are interested in the possibility of making commercial PACE programs available in the County.

Commercial PACE programs have been operating since 2008, when the original program was designed for implementation in Berkeley, California. While there is no agency responsible for compiling commercial PACE data, PACENation, estimates that 734 commercial PACE projects have been completed nationwide, totaling $230 million as of March 2016. In California, there are approximately 447 jurisdictions that currently allow commercial PACE to be offered using various business models described later in this document. Here locally, Ventura County is already operating a PACE program and San Luis Obispo County recently passed a resolution creating a PACE program that will launch in 2016. Both of these programs include residential and commercial options.

To provide additional information on commercial PACE, staff compiled data on the activities of several PACE administrators operating in California (Attachment E). This data includes information provided by the administrators themselves, information taken from their websites and data compiled by the Association of Bay Area Governments in its PACE Program Comparison Matrix.

While the data provided in Attachment E shows that there are a significant number of projects in the pipeline, at a California Statewide PACE Symposium held in Los Angeles on May 28, 2015, several commercial PACE administrators on a panel noted that a relatively small percentage of commercial property owners that apply for PACE financing ultimately obtain financing through PACE and complete the process. This low conversion rate may be indicative of many factors such as the complex ownership structure of some commercial properties and the time it takes to obtain lender consent, which may or may not be granted. By operation of law a PACE lien is senior to any and all mortgage liens.

Commercial PACE administrators typically require consent from existing mortgage lenders (lender consent), which may or may not be granted, while residential PACE administrators do not typically require lender consent.

The building systems (mechanical, electrical etc.,) in commercial properties are also typically more complicated than a residential property and require more detailed and time-intensive auditing and analysis to determine if the property is a good fit for PACE financing. The process related to bringing a commercial project to fruition and ultimately placing a commercial PACE lien on the property and the assessments on the tax roll is time consuming and typically includes a financial application where the property is screened for eligibility using criteria such as property-based debt limit, mortgage and tax payment history, as well as an analysis of the project's financial returns.

Eligible Commercial Properties in Santa Barbara County:

To gain an understanding of the number of commercial properties in the County that would be eligible for PACE program participation, staff compiled the information shown in the chart below with assessment roll data provided by the Santa Barbara County Clerk, Recorder, and Assessor's office.

Breakdown of Commercial Properties in Unincorporated Areas of SB County		
Type	**Description**	**# of Properties**
Agriculture	Commercial agriculture operations. May or may not have structures	4257
Ranchos	Residential improvement (home site) with commercial agriculture operations. May or may not have structures	3417
Retail	Department stores, grocery stores, banks	203
Apartments	5 units or more	224
Other	No description available/not statistically significant	212
Recreation	Parks, beaches, clubs, halls	187
Industrial	Manufacturing, warehousing, mineral processing	150
Churches	Churches, institutions, schools	94
Office	Office buildings, professional buildings	63
Auto	Service Stations, auto sales & repair, parking lots	62
Restaurants	Restaurants, bars, cocktail lounges	49
Lodging	Hotels, motels, bed and breakfast	49
Mixed Use	Commercial and residential properties combined	24
Total		**8991**

PACE vs Existing Commercial Financing Options:
There are several existing commercial financing options available such as on-bill financing available through utility providers or conventional bank loans. However, existing financing options might have limitations or terms that make commercial PACE a more attractive option to certain property owners. For example, with utility on-bill financing a property owner is only eligible to borrow $100,000 per service address with a loan period of up to 5 years. Additionally, with on-bill financing a customer must have a utility account that has been active for the past 24 months, which results in newly constructed buildings being ineligible.

PACE may also address barriers that small commercial businesses face when attempting to identify conventional financing. According to the National Institute of Building Science's report, "Financing Small Commercial Building Energy Performance Upgrades: Challenges and Opportunities," lower credit quality and limited cash or access to debt is an impediment to energy upgrades in small commercial businesses properties. The report also states that the PACE mechanism is highly accessible to small borrowers, including smaller commercial property owners.

Property owners who can easily qualify for traditional forms of financing may choose PACE financing because of some of its unique benefits. For example, PACE advocates claim that PACE provides longer, fixed financing terms (up to 25 years) that may be more likely to produce net-positive cash flow from energy savings, and the possibility of transferring the lien on the property to the next owner. PACE proponents market PACE as creating an off balance sheet lien but it is unclear whether this is the appropriate accounting method. In any case, a property owner should seek consultation from a tax advisor or certified public accountant before implementing this advice.

Market studies also suggest that existing financing options may not meet the needs of all commercial building owners. The “Energy Efficiency Indicator (EEI)” survey is conducted on a yearly basis by Johnson Controls, a leader in delivering products that increase energy efficiency in buildings. When asked about the barriers to pursuing energy efficiency in building operations, executives responsible for energy investments in their companies cited lack of funding as their top barrier every year in which the poll has been administered. Insufficient payback or return on investment was the second major barrier.

Issues for Commercial PACE Property Owners’ Consideration

There are some issues that property owners might consider before moving forward with a PACE assessment as shown below:

- *Uncertainty regarding lender consent:* Commercial PACE administrators typically require consent from existing mortgage lenders (lender consent), which may or may not be granted, while residential PACE administrators do not typically require lender consent. It might take a significant period of time to obtain lender consent, and it is not guaranteed that consent will be given. This could seriously impact the project timeline.
- *Repayment of Assessment before sale:* Property owner might be required to pay off a PACE lien prior to selling the property if potential buyers or their lenders do not want to agree to take on the assessment.
- *Risk of Foreclosure*: Jurisdictions may foreclose on properties that are delinquent on payment of their PACE assessment.

Office of the Auditor-Controller Concerns Regarding PACE

The Office of the Auditor-Controller does not advocate the placement of these assessments, which function as private loans, on the County tax bills both for residential and commercial PACE programs. The Auditor-Controller issued a report (Attachment D) in March 2016 highlighting the overarching issues and questionable practices inherent in these programs. The Auditor-Controller’s report provides arguments that highlight the risks of the program that are not included in the marketing materials provided by PACE proponents. The Auditor feels that the severity of the issues and practices surrounding the program impacts the borrower, lenders, and the County.

Commercial PACE Business Model Options:

There are several different commercial PACE Business model options that are currently being implemented (third-party administrator, public entity administrator, or hybrid public entity and third-party administrator). The possible advantages, disadvantages and costs associated with a commercial PACE program vary depending on the program model implemented. For example, a model fully administered and funded by a third party would typically be the least costly to a public entity, while a model fully administered by a public entity would internalize all operational and program costs. There are also advantages and disadvantages that cut across all business model types. For example, it may not be possible to accurately estimate internal County staff costs or to determine what unforeseen issues may arise with a particular model until the program starts operating. If the Board wants to explore commercial PACE further, staff can outline in detail the different models available for implementation and bring this information back to the Board for review.

It should be noted that despite whether a County decides to move forward with a PACE program, cities can enroll in a program on their own. In such a case, the city could request that the County add PACE assessments to the tax roll and an agreed upon fee would be charged to the program administrator for this service so that the County could recover its costs.

Next Steps:
If the County decides to pursue commercial PACE, these would be the next steps. Staff will not move forward with commercial PACE unless directed by the Board.

- Board directs staff from all relevant departments, including but not limited to Community Services (as lead), Auditor-Controller and County Counsel, to return to the Board with analysis of potential models (third-party administrator, public entity administrator, or hybrid public entity and third-party administrator)
- Staff returns to Board with analysis including cost and staffing estimates and detailed implementation steps for potential models.
- Should the County decide to proceed, select a model and determine the source of funding for commercial PACE set up and implementation.

Performance Measure:
Not applicable

Fiscal and Facilities Impacts:
Budgeted: No.

If the Board opts to pursue Commercial PACE, there will be costs associated with internal management and administration, as described above, depending on which business model is selected. These costs are not currently budgeted, but may be partially offset via the collection of program fees.

Staffing Impacts:
Not applicable

Special Instructions:
Not applicable

Attachments:
Attachment A: FHFA Statement
Attachment B: OCC Bulletin
Attachment C: PACE Developments since 2010
Attachment D: Auditor-Controller PACE Concerns
Attachment E: Commercial PACE Program Statistics
Attachment F: Timeline of PACE Directives
Attachment G: FHFA Letter in Response
Attachment H: CEQA Notice of Exemption (NOE)

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