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Property Assessed Clean Energy (PACE)
Concerns about this program

Background

The law allows public agencies within the State of California to place contractual assessments on private property which allows for a revenue stream that supports loans to property owners, both commercial and residential, to finance energy improvements.

California Assembly Bill 811 (AB 811) signed into law July 21, 2008 provides a mechanism to finance energy saving assets that are attached to residential and commercial properties, generally financed through issuance of bonds that are then repaid by levying assessments against owners of the properties via the property tax billing process. PACE is a real estate finance tool that creates risks for real estate property owners, in addition to other concerns.

The Santa Barbara County Board of Supervisors adopted Resolution No. 10-201 on July 13, 2010 that stated as long as the July 6, 2010 Statement by the Federal Housing Financing Agency (FHFA) is in effect, the County will not accept applications for PACE assessment financing for residential properties. In that statement, FHFA determined that certain energy retrofit programs present significant safety and soundness concerns for both residential and commercial properties.

Purpose of this Paper

This paper highlights some of the significant complexities and issues surrounding the PACE program. These items are presented as a compilation of facts, practical observations from property tax experts, published deficiencies, and thoughtful analyses given the program as a whole. In the end, it is concluded that this program is not a well thought out program as pointed out by the FHFA, leaves participating property owners in a financially precarious situation, and simply doesn't belong as part of the property tax collection process.

Why should the County continue to be concerned with PACE assessment financing?

1. The Federal Housing Finance Agency urges putting these programs on pause

- As late as May 1, 2014 the Federal Housing Finance Agency stated "that it 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. This follows a significant July 6, 2010 Statement that included "first liens established by PACE loans are unlike routine tax assessments and pose unusual and difficult risk management challenges for lenders, servicers and mortgage security investors." FHFA urged state and local governments to reconsider these programs and put them on pause.
- Underwriters of PACE financing continue to mislead the FHFA position in their PACE financing programs and continue to solicit services to local governments to administer a PACE program. Despite unsuccessful lawsuits and legislative solutions FHFA has not changed its position.

2. The program uses County resources to perform private services acting as a loan servicer

- The County becomes bill collector for commercial and residential private activity bonds and loans.
- The assessment firms underwriting the program are not part of the local government entity nor a part of the community.
- The essence of property tax assessment and collection is to finance government, hence the age old concept of granting of the tax lien superior to all other liens. These superpowers are granted to governments by our Constitution and respected by private financing to ensure we all pay our taxes. The expansion of these collection powers for selected private financing as pointed out by the FHFA pose many challenges.
- The assessment contract obligates the property owner to pay the PACE property assessment over a period up to 20 years. This implies a long-term liability but the property tax assessment process only recognizes the annual payment.
- The PACE assessment is identified on the property tax bill solely as an assessment. There is not a breakout of principal and interest nor is there any disclosure of the total amount of the assessment and the principal or future interest amount outstanding.

3. Higher risk for property owners in the case of foreclosures and other property transactions, which may not be entirely understood by all parties

- Investors in PACE bonds look solely to the value of the property as their source of repayment and not to the ability of the property owner to clear defaults.
- Property owners are allowed to borrow under some programs up to 105% of the equity of the property.
- Transfer of property to a new owner – unlike a mortgage there is no approval of the buyer of the property. The PACE bond holder again looks solely to the value of the property and not to the credit of the property owner on a transfer.

- Future property tax assessments related to a financing are not disclosed on the title report of the property as a lien against the property. This could result in lack of disclosure to a potential buyer of the property as to the amount of loans outstanding.
- This lack of disclosure may lead a property tax payer to assume the County is the responsible party for a PACE financing non-disclosure.

4. Unrecorded liabilities…

- Liability is only established for each year's assessment. Significant liabilities for the total assessment are not recorded as liens or trust deeds.
- Foreclosure liabilities are only recorded for each assessment unlike mortgage debt that would be recognized for the whole amount of the entire debt. This could affect the ability of the PACE bondholder to accelerate the entire debt on default.
- There is little Generally Accepted Accounting Principle Guidance (GAAP) for these loans. Without GAAP, there are no clear rules on who owns the liability and how to record or disclose the liabilities.

5. The program uses questionable lending practices seen during the recent housing finance collapse

- Traditional property tax and assessment delinquencies have significant penalties of 10% and annual 18% interest applied to delinquent taxes and assessments. If the county does not exercise do care in stripping PACE delinquencies from the tax roll, the issuing agency could have access to the same penalties and interest. This would provide them with benefits to cover their risk of making loans to less qualified borrowers.
- There has been a novelty to PACE financing that has occurred after the 2008 mortgage crisis. The same unlimited and unregulated loan structures are being used. High interest rates, significant fees and lax underwriting standards are in place.
- Some of the same mortgage brokers who worked for now defunct mortgage companies are selling PACE financing.
- Commercial PACE is being marketed as off book financing. The assessment is not being considered long-term debt and being left off balance sheets of borrowers.

6. It complicates the County property tax bill process with no upside benefit

- The security for the bonds and their source of repayment is the property being financed and the cash flow generated by the property tax assessment
- Unless the County wants to Teeter funds (use County General Funds) to cover potential delinquent assessments there is no financial advantage to the County since it can only cover its cost. Currently $1.00 per assessment. However, if the County chose to use the Teeter program it would shift the risk of collecting on a foreclosure from the lender to the County
- The PACE assessment does not require the prepayment of the assessment upon change of ownership. However, a new lender on the sold property may not underwrite a traditional mortgage without liquidation of the PACE financing.
- Disclosures to buyers may be poorly written especially with regards to the tax assessment process and the significant penalties and interest that could be charged by the County for the benefit of the underwriter.
- Although the County is strictly the billing and payment collection service provider via the property tax billing and collection process, this is an easier said than done situation

because of the complexity of property tax mechanics overall. Taxpayers are already confused about the current items placed on their tax bill, PACE assessments add even more complexity.

7. The lack of consumer protection ---

It is quite interesting to see one side of government push so hard to erode/avoid/ignore the consumer protections hard fought by other areas of government.

- It appears borrower's (taxpayers) may not understand how much they are borrowing and how much it is costing them in both hard dollars and in possible problems selling their homes.
- To some extent this program could easily become predatory in nature: catering to a base that is unsophisticated, and primarily to those who are unable to afford these energy upgrades using traditional (and less costly) financing.
- A lot of money is flowing through fees and other add on costs which is a bit questionable and typically a sign of hard money lenders. It is hard to understand how these transactions avoid the typical mortgage loan disclosures required in California and a host of other banking laws. Some of which were expanded post great recession to further inform consumers of what they are actually getting themselves into.
- These assessments become a "super" lien and go against the long established history of lien financing. It may be considered a violation of the mortgage covenants per the federal housing authority and will require these to be repaid upon most sales after up front financing costs have been incurred for PACE financing (as most mortgage lenders follow the federal underwriting standards, whether or not they intend to portfolio or sell in the secondary market).

Conclusions

Given the novelty of PACE financing and the mechanics of placing the PACE assessment on a tax bill collected once or twice per year and a lack of understanding by County taxpayers on how the process works, I would strongly urge the County not support the placement of PACE assessments on the County tax bills both for residential and commercial PACE programs.

There are a variety of other more cost effective financial opportunities for County residents to finance energy improvements.

Submitted By:

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