# 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:**

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|---|---|
| **Department Name:** | Community Services |
| **Department No.:** | 057 |
| **For Agenda Of:** | October 18, 2016 |
| **Placement:** | Departmental |
| **Estimated Tme:** | 30 minutes |
| **Continued Item:** | Yes |
| **If Yes, date from:** | May 10, 2016 |
| **Vote Required:** | Majority |

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| **TO:** | Board of Supervisors | |
| **FROM:** | Department Director(s) | George Chapjian, Community Services Director<br>(805) 568-2467 |
| | Contact Info: | Angie Hacker, Division Chief, Energy and Sustainability Initiatives<br>(805) 568-3515 |

**SUBJECT:** **Commercial Property Assessed Clean Energy (PACE) Financing**

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**County Counsel Concurrence**
As to form: Yes

**Auditor-Controller Concurrence**
As to form: No

Other Concurrence:
As to form: Yes

**Recommended Actions:**

That the Board of Supervisors:

a. Receive and file this briefing on Commercial Property Assessed Clean Energy (PACE) Financing;

b. Direct staff to either:

   i. Not pursue Commercial PACE further at this time; OR

   ii. Pursue implementation of a third-party administration model for Commercial PACE and return to the Board at a later date with a budget revision request for funds needed to implement the third-party administration model (which will require a 4/5 vote); and

c. Determine that the above recommended actions is not the approval of a project that is subject to environmental review under the California Environmental Quality Act (CEQA) pursuant to CEQA Guidelines Section 15378(b)(4), finding that the actions are the creation of a governmental funding mechanism or other government fiscal activity, which does not involve any commitment to any specific project which may result in a potentially significant physical impact on the environment, and direct staff to file a Notice of Exemption (NOE) (Attachment 1).

## Summary Text:

The Board of Supervisors last received a report regarding commercial PACE on May 10, 2016. At that time, staff provided the Board with updates regarding commercial PACE, including possible benefits, issues for consideration, program uptake, and summary information on commercial PACE business model options. The Board directed staff to return with a more detailed report on commercial PACE to include: 1) An analysis of the business model options and an estimate of possible costs to the County; 2) Information on potential disadvantages to the County associated with establishing a commercial PACE program; and, 3) Input from other local governments about their experiences with commercial PACE.

This agenda item provides the Board with the option to pursue establishment of a Commercial PACE program or not to pursue a Commercial PACE program and continue to refer commercial property owners to other available financing options such as utility on-bill financing and conventional bank loans.

## 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 community facilities districts to levy special taxes; 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.

Commercial PACE Business Model Options

There are several business model options currently used to operate PACE programs. Summaries of these options are described below. More detailed descriptions can be found in Attachment 2.

### Third-party Administrator Model

*Estimated time to implement: 2-6 months*
*# of Counties utilizing this model: Approximately 33(Examples: Ventura, San Luis Obispo, San Diego)*

In this model a public entity typically joins an existing Joint Powers Authority (JPA) to expand an already established financing district and make commercial PACE available to property owners in the JPA's newly expanded jurisdiction. The JPA contracts with a third-party administrator to design and develop the program and operate it for the JPA members. HERO, Figtree, Ygrene and AllianceNRG are all examples of third-party administrators. Another example of a third-party program is the California Statewide Communities Development Authority's (CSCDA) Open PACE program, which prequalifies several PACE program administrators to be included in its Open PACE program. The third-party administrator is typically responsible for operations, project tracking, technical support, contractor recruitment, customer service, quality control and marketing. The third-party administrator may contract with a financing organization or bank that serves as the capital provider, but some programs also allow property owners to source their own capital. The majority of public entities in California are utilizing this model.

*Possible Advantages to the County:*

- Lower investment costs associated with joining a “turnkey” model that is already operating.
- County does not pay the third-party administrator to operate the program; instead the third-party administrator retains proceeds from administering the program and providing commercial PACE financing.
- The third-party administrator will pay the County’s costs associated with placing liens on the tax roll as set by a fee agreement.
- Lower financial risk given that public entities opting into the JPA would not be responsible for financing, administration or providing capital.
- Program applications and agreements are typically between the property owner and the third-party administrator, which might reduce risks for public entities.
- Agreements between the third-party administrator and the JPA typically provide indemnification language protecting cities and counties, further lowering potential liability.

*Possible Disadvantages to the County:*

- County is not able to set or control program fees, borrowing costs, or interest rates.
- County might have limited ability to conduct consumer protection activities, such as monitoring or controlling program practices and ensuring proper disclosures to consumers.
- Ongoing costs to monitor third-party administrators.

*Possible Costs:*
Setup costs could include staff time and expenses required to develop and conduct a request for proposal to identify a third party administrator(s), prepare Board reports and other documents, negotiate fee agreements, and set up processes for adding assessments to property tax bills. Annualized ongoing costs not recovered by fees could include staff time and expenses required to address unforeseen issues, conduct customer service activities, communication with and oversight of commercial PACE program administrators and review of monthly status reports.

| **3rd Party Model** | | |
|---|---|---|
| **Expenses** | **Total One-Time Set Up Cost** | **Annualized Ongoing Cost** |
| Staff Time | $21,121.55 | $13,566.00 |
| Lending Capital | $0.00 | $0.00 |
| **Total** | **$21,121.55** | **$13,566.00** |

**Public Entity Administration Model**
*Estimated time to implement: 18-24 months*
*# of Counties utilizing this model: Approximately 4 (Examples: Placer, Sonoma, San Francisco, Los Angeles Commercial PACE program)*

In this model, a public entity would independently design and develop its own commercial PACE program. The public entity, rather than a third-party administrator, would be wholly responsible for program implementation and the public entity, rather than an outside financing organization typically provides the needed capital. However, some programs allow for owner-arranged financing. This option may involve creating or joining a JPA to form a financing district if the public entity wanted to make the commercial PACE program available to other jurisdictions (i.e, neighboring counties, cities). This is the model that Santa Barbara County used when it developed its PACE program in 2009-2010. However this model was only found to be feasible when it included the residential market and requires a high capital investment.

*Possible Advantages to the County:*

- County can control the fees and program costs associated with the commercial PACE program.
- County can collect program fees to offset some costs and possibly recoup investment if program participation rates are high enough.
- County would have more control over program disclosures and consumer protections.

*Possible Disadvantages to the County:*

- Significant costs related to start up and annual operating expenses including the need to hire one new staff position.
- Inability to ensure that commercial program participation rates will be high enough to fully fund program administration costs and recoup startup costs.

*Possible Costs:*
Set up costs could include staff time and expenses required to conduct a feasibility study, seek judicial validation if necessary, identify the best financing option(s), contract with bond counsel, set up program processes, develop an application process and create program documents, write Board reports and other documents, and set up processes for adding assessments to property tax bills. Ongoing costs could include staff time and expenses required to conduct marketing and customer service activities, recruit contractors, administer title checks, review applications, conduct quality assurance, review monthly status reports and compile performance data. Costs also include providing the capital needed to finance the building improvements for individual projects.

| Public Entity Model | | |
|---|---|---|
| **Expenses** | **Total One-Time Set Up Cost** | **Annualized Ongoing Cost** |
| Staff Time | $287,280.17 | $157,280.17 |
| Lending Capital* | $10,000,000.00 | |
| **Total** | **$10,287,280.17** | **$157,280.17** |

*Lending capital may not be required if utilizing owner arranged financing option

### Hybrid Public Entity and Third-party Administrator Model

*Estimated time to implement: 12-18 months*
*# of Counties utilizing this model: Approximately 2 (Examples: Riverside County, Los Angeles County Residential PACE program)*

In this model, a public entity designs and develops the program and contracts with a third party for elements of program administration such as project tracking, technical support, marketing, contractor recruitment and customer support. A public entity may choose to provide the financing capital or allow property owners to source their own capital provider. Alternatively, the public entity may choose to require the third-party administrator to provide the financing capital and facilitate the financing with the property owner. The main differences between this model and the third-party administrator model are that in the hybrid model, the public entity designs the program, sets fees, and defines disclosures and underwriting criteria. It does not appear that a public entity typically has as much input on these issues in the third-party administrator model. In addition, this model allows a public entity the flexibility to choose which program administration activities it would like to outsource to the third-party administrator.

*Possible Advantages to the County:*

- County does not pay the third-party administrator. The third-party administrator retains proceeds from administering the program and providing commercial PACE financing, a portion of which may be provided to the County to offset its own program operations costs as negotiated through an agreement with the third-party administrator.
- County has more control of mitigating potential risks to consumers by managing disclosures and underwriting criteria.

*Possible Disadvantages to the County:*

- Significant costs related to start up and annual operating expenses including the need to hire one new staff position.
- Inability to ensure that program participation rates will be high enough to fully fund program administration costs, recoup startup costs and become self-supporting.

*Possible Costs:*
Costs could include staff time and expenses required to design and develop the program, develop and conduct a request for proposal to identify an administrator(s), negotiate fee agreements, write Board reports and other documents, work with administrator(s) to develop program processes, and set up processes for adding assessments to property tax bills. Ongoing costs could include staff time and expenses required to conduct marketing and customer service activities, communicate with commercial PACE program administrators, review monthly status reports and compile performance data.

| **Hybrid Public Entity & Third Party Model** | | |
|---|---|---|
| **Expenses** | **Total One-Time Set Up Cost** | **Annualized Ongoing Cost** |
| Staff Time | $187,280.17 | $71,720.11 |
| Lending Capital* | $0.00 | $0.00 |
| **Total** | **$187,280.17** | **$71,720.11** |

*Would likely allow owner-arranged financing or require third-party to provide financing

<u>Summary of Local Government Commercial PACE Survey:</u>
Staff conducted a survey to obtain information from other counties about their experience with commercial PACE. Of the 32 counties that responded, 22 indicated that they have established a commercial PACE financing program in their unincorporated area. Respondents were asked what made

their county feel comfortable with making commercial PACE available in their jurisdiction. To avoid acceleration of current mortgages, most commercial PACE program administrators require a property owner to obtain existing mortgage lender consent prior to obtaining PACE financing. The majority of respondents indicated that this made them feel comfortable with moving forward.

10 of the counties that responded stated that they have not established a commercial PACE program in their unincorporated area. When asked why their county had not established a commercial PACE program, respondents stated that they were either unsure why, they felt there were unclear administration questions that needed to be answered, or that commercial PACE had gotten caught up with the issues surrounding residential PACE. A more detailed analysis of the survey can be found in Attachment 3.

Office of the Auditor-Controller Recommendations Regarding Commercial PACE

The Office of the Auditor-Controller has provided their input regarding pursuit of a Commercial PACE program for the unincorporated area of Santa Barbara County in Attachment 4.

Next Steps:

Should the Board decide to pursue commercial PACE, staff would recommend the third-party administration model option given the advantages outlined above. The next steps would be as follows:

1. Staff to return to Board with a Budget Revision Request which would require a 4/5 vote to appropriate funds for program set up (one time) and administration.

2. Staff to conduct a Request for Proposal to determine program administrator(s).

3. Staff to return to the Board to authorize execution of all establishing documents with selected third-party administrator.

If the Board decides not to pursue commercial PACE, staff will continue to refer commercial property owners to other available financing options such as utility on-bill financing and conventional bank loans.

## Fiscal and Facilities Impacts:

Budgeted: No

## Fiscal Analysis:

All of the commercial PACE administration models would require an allocation of General Fund dollars. If the Board proceeds, staff will return with a budget revision request per the following estimates.

| 3rd Party Model | | | Public Entity Model | | | Hybrid Public Entity & Third Party Model | | |
|---|---|---|---|---|---|---|---|---|
| Expenses | Total One-Time Set Up Cost | Annualized Ongoing Cost | Expenses | Total One-Time Set Up Cost | Annualized Ongoing Cost | Expenses | Total One-Time Set Up Cost | Annualized Ongoing Cost |
| Staff Time | $21,121.55 | $13,566.00 | Staff Time | $287,280.17 | $157,280.17 | Staff Time | $187,280.17 | $71,720.11 |
| Lending Capital | $0.00 | $0.00 | Lending Capital* | $10,000,000.00 | | Lending Capital** | $0.00 | $0.00 |
| **Total** | **$21,121.55** | **$13,566.00** | **Total** | **$10,287,280.17** | **$157,280.17** | **Total** | **$187,280.17** | **$71,720.11** |

*Lending capital may not be required if utilizing owner-arranged financing option
**Would likely allow owner-arranged financing or require third-party to provide financing

**Staffing Impacts:**

Required staff time could be covered by existing staff for the third-party model, but an additional full time staff position would be needed for the public entity model or the hybrid public entity and third party model.

**Attachments:**

Attachment 1: CEQA Notice of Exemption (NOE)
Attachment 2: PACE Administration Model Options
Attachment 3: Local Government PACE Survey Summary Analysis
Attachment 4: Auditor Controller Recommendations

**Authored by:**

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