County of Los Angeles
CHIEF EXECUTIVE OFFICE

Kenneth Hahn Hall of Administration
500 West Temple Street, Room 713, Los Angeles, California 90012
(213) 974-1101
http://ceo.lacounty.gov

WILLIAM T FUJIOKA
Chief Executive Officer

July 22, 2010

To: Supervisor Gloria Molina, Chair
Supervisor Mark Ridley-Thomas
Supervisor Zev Yaroslavsky
Supervisor Don Knabe
Supervisor Michael D. Antonovich

From: William T Fujioka
Chief Executive Officer

LOS ANGELES COUNTY ENERGY PROGRAM AND FEDERAL HOUSING FINANCE AUTHORITY GUIDANCE (RESPONSE TO ITEM 54-B, AGENDA OF JULY 13, 2010)

On July 13, 2010, your Board instructed the Chief Executive Officer (CEO), in cooperation with the Treasurer & Tax Collector (TTC), the Director of the Internal Services Department (ISD) and the County Office of Sustainability (COS) to:

1) Take all prudent steps to curtail, and where feasible, halt the use of Energy Efficiency and Conservation Block Grant funds on its AB 811 loan program until the uncertainties regarding federal funding for these programs has been resolved;

2) Report back to the Board of Supervisors in two weeks with initial recommendations regarding the alternative means of encouraging home and business retrofits that would achieve the original goals of the Los Angeles County Energy Program (LACEP) if the impasse in Washington cannot be promptly resolved; and to report back to the Board of Supervisors on a monthly basis thereafter until this dispute is resolved; and

3) Work with our partners in Washington D.C. to craft legislation and/or find other administrative solutions that would resolve the Federal Housing Finance Agency, Freddie MAC, and Fannie Mae's current opposition to AB 811-style loans.

Background

Through the American Recovery and Reinvestment Act (ARRA), the U.S. Department of Energy (DOE) and the Obama Administration (Administration) have invested in energy efficiency initiatives to create jobs and help homeowners save money. Innovative financing approaches are being deployed or are under development by ARRA grantees, stakeholders, and the Administration to deliver significant energy savings for homeowners without exposing lenders to undue risk. Notable among these approaches is the LACEP's, designed to help finance private residential and non-residential improvements. LACEP would utilize California Assembly Bill 811, which authorizes willing property owners to finance energy efficiency and renewable energy improvements through an assessment contract with the County. These assessments would be secured by a priority lien placed against the property and repaid through property tax assessments. This unique and promising financing program is broadly described as a Property Assessed Clean Energy, or PACE, program.

Over the past several months, financial regulators including Federal Housing Finance Authority (FHFA), Federal Depository Insurance Corporation (FDIC) and the Office of the Comptroller of the Currency (OCC) have expressed concerns about pilot PACE financing programs. Despite assurances from the DOE and the Administration that these concerns could be mitigated, on May 5, 2010 Fannie Mae (FNMA) and Freddie Mac (FMAC) sent a letter stating that their Uniform Securities Instruments prohibit loans (in this case a lien on the property) that have a senior lien priority to a mortgage, such as PACE would do.

In response to these concerns, DOE and Administration officials met repeatedly with FNMA and FMAC, and the financial regulators as well as PACE stakeholders across the country. In addition, the DOE issued updated guidance for pilot PACE financing programs on May 7, 2010.

In the course of these meetings, the DOE and Administration have offered commitments to work on new more stringent underwriting criteria, improved consumer protections, and additional measures to significantly reduce the risk and financial exposure to mortgage holders. Despite these efforts, the FHFA issued a statement codifying their concerns on July 6, 2010. In addition, the banking regulators have made clear that they will oppose any program in which PACE assessments are in the senior lien position (OCC issued a bulletin on July 6, 2010). Given this, PACE programs throughout the Country have ceased providing financing or, in the case of LACEP, halted progress towards implementation.

Response to Board's Direction

The following recaps the three parts of your Board's direction, and the response to each part.

1. **Take all prudent steps to curtail, and where feasible, halt the use of Energy Efficiency and Conservation Block Grant (EECBG) funds on its AB 811 loan program until the uncertainties regarding federal funding for these programs has been resolved.**

A breakdown of all three ARRA grants received by ISD is indicated in the table below.

General Activity Breakdown of ARRA Grants	
Formula Allocated EECBG - $12.2 MM (out of $15.4 MM total grant)	
$5.7 MM	Program Design, Implementation, Administration
$5.0 MM	Discretionary funds for interest rate buy down or participant incentives
$1.0 MM	Program management, grant administration
$0.5 MM	Consultants related to PACE Program development, other resource costs
Competitive EECBG - $14.0 MM (out of $30 MM total grant – State-wide)	
$5.0 MM	Targeted marketing, outreach and community organizing
$5.0 MM	Financial incentives
$2.0 MM	Statewide IT Database and Administrative System, Quality Assurance/Quality Control Program, Program Evaluation and Report
$1.5 MM	Project management, grant administration
$0.5 MM	Council of Governments Support/Coordination
$8.0 MM California Energy Commission Grant	
$4.5 MM	Marketing and outreach in cities that join LACEP
$2.0 MM	Contract/project management and administration
$1.5 MM	Green Job Training scholarships and incentives

The DOE has provided guidance to ARRA grantees impacted by the recent developments with pilot PACE financing programs to determine the most effective way to leverage existing or planned program infrastructure to incorporate additional financing tools. The DOE guidance, below, is consistent with your Board's directive.

> "The DOE and Administration continue to support pilot PACE financing programs. Recovery Act grantees are not expressly prohibited from using funds to support viable PACE financing programs, however the practical reality is that residential PACE financing programs with a senior lien priority face substantial implementation challenges in the current regulatory environment. In light of the clear opposition from the regulators for PACE financing programs with a senior lien priority, prudent management of the Recovery Act compels DOE and Recovery Act grantees to consider alternatives to programs in which the PACE assessment is given a senior lien priority."

As mentioned in the motion of July 13, 2010, the focus of these grants, and of LACEP, is to motivate Los Angeles County property owners to implement building retrofit programs, particularly residential retrofits. Because LACEP primarily promotes whole house retrofits, and PACE is merely an optional, attractive means to implement retrofits, the opportunity to save remaining grant funding is limited.

The California Energy Commission (CEC) and the California Public Utilities Commission (CPUC) have adopted a State-wide brand for residential retrofits to focus on the "whole house" as a building system, and not just as a conglomeration of individual equipment eligible for individual rebates. The CPUC has ordered the investor-owned utilities (IOUs) to develop a program that promotes rebates for energy efficiency measures that incorporate this "whole house" concept. These measures include: home insulation, heating and air conditioning duct work repairs, door and window sealing, pipe insulation and other measures that have a great impact on home energy efficiency but are often overlooked.

The CPUC has provided the IOUs with $140 million to implement this program pilot through 2012, to include: marketing and outreach, $1,000 to $3,500 per-home in rebates, contractor qualification criteria, and quality control/consumer protection measures. The role for LACEP in this effort includes:

- Leveraging marketing and outreach resources with the IOUs and municipal utilities;
- Developing consistent region-wide contractor training, contractor credentials, quality assurance and quality control guidelines;
- Developing a single, State-wide web portal that supports whole house retrofits, applications for rebates (including Federal HomeStar rebates), PACE financing, consumer education, and contractor selection information;
- Developing LACEP incentives for the State-wide whole house program; and

- Leveraging these activities into a regional (as model for a State-wide) program that achieves residential retrofits and is eligible for future funding from CEC, CPUC and federal government.

Areas where funding directly related to PACE would be curtailed include eliminating the option of using the $5 million in discretionary funding for a PACE interest rate buy down, and eliminating marketing and outreach funding dedicated to describing PACE financing. The grant budget for marketing and outreach dedicated to PACE financing would be limited, as most marketing and outreach dollars are intended to promote the State-wide whole house retrofit program, where PACE financing is an implementation option.

Most activities related to PACE program design, implementation and administration have already been expended in development of the PACE legal documents. The remaining expenses for judicial validation could resume after information is received regarding a proposed legislative solution or the viability of other PACE options (described later).

2. **Report back to the Board of Supervisors in two weeks with initial recommendations regarding alternative means of encouraging home and business retrofits that would achieve the original goals of the L.A. County Energy Program if the impasse in Washington cannot be promptly resolved and to report back to the Board of Supervisors on a monthly basis thereafter until this dispute is resolved;**

The DOE has provided initial guidance to ARRA grant recipients on replacing PACE financing with other financing programs for energy retrofits on private properties as described below. ISD, DOE and the LACEP consultant team will be assessing and implementing these and other alternatives if feasible.

<u>Alternative Financing</u>

Other states have developed private lending programs for property owners as unsecured loans targeted to energy efficiency and renewable energy. Such loans have stringent qualifying and credit restrictions, resulting in rates that are much better than "credit card" rates. However, they lack the PACE features of having liens tied to the property.

The Federal Department of Housing and Urban Development (HUD) is developing an FHA Title I loan based on an existing program to finance private property improvements. HUD intends to add language to specify financing for energy efficiency and renewable energy. The loans could be secured or unsecured (depending on the amount and the measures implemented), and there is some degree of federal subsidy. The financing rates are market based and today would be at 6 - 7%. HUD indicates that FHA Title I loans could be available in 3 - 6 months.

California Energy Commission Grant Reallocation

In response to the FNMA, FMAC and FHFA positions, the CEC has indicated that it is likely to reallocate approximately $35 million in State Energy Program grants which had previously been competitively awarded to PACE jurisdictions to assist with PACE financing programs. The County submitted an application for this grant but did not achieve a qualifying score. The CEC has notified the County that it is exploring how to best re-allocate these funds to assist PACE jurisdictions in implementing and promoting alternative financing programs. This time, the CEC has indicated it may spread the funds across PACE jurisdictions where they may make the most impact. The County and the CEC continue to discuss the use of these funds for LACEP.

PACE Financing with Subordinate Liens

PACE financing could be available with secondary priority status to mortgages, thus alleviating FHFA concerns over lender risk. The DOE is encouraging ARRA grantees to explore this option. In the opinion of TTC, this option is neither considered appropriate nor feasible for LACEP. The ability to market and sell AB 811 bonds in California is highly dependent upon the senior position that a PACE financing would hold relative to home mortgages. TTC cautions that many investors would be unwilling to participate in any LACEP financing that included a secondary priority status for AB 811 liens. ISD and TTC will monitor and participate in investigations into this option.

Whole House Retrofits under the Statewide Program

As mentioned earlier, the State of California has shown commitment to whole house retrofits through funding $140 million to the IOUs to implement that program. LACEP leverages this investment through the development of a single, whole house program in L.A. County to serve as the model for a State-wide program. LACEP will work with municipal utilities to encourage them develop whole house retrofit incentives.

LACEP could dedicate the $5 million in discretionary grant funding to whole house incentives or to interim financing program incentives (loan/loss reserve and/or interest rate subsidies). Absent near term information from policymakers that PACE resolution can be achieved, the discretionary funding will be used for incentives/rebates and not for financing program incentives.

Residential PACE – non FNMA/FMAC

About 10 to 15% of residential mortgages are not held by FNMA or FMAC. Theoretically, PACE liens could be processed for these property owners. However, most property owners do not know if their mortgages are held by these agencies. If their mortgages were purchased by FNMA or FMAC the liens could become due and payable prior to their stated maturity. ISD will continue to research this option and specify the market of residential mortgages that are not held by FNMA or FMAC.

Non-Residential PACE (multi-family, small commercial, medium commercial)

The FHFA guidance to FNMA and FMAC primarily impacts residential mortgages. Non-residential PACE liens could be placed without being impacted by the FHFA guidance. However, non-residential PACE financing is difficult because of the very different risk proposition to bond holders. Under residential PACE there are many smaller liens issued, and the default risk is low as it is spread across many properties. Under non-residential PACE, the liens would be larger and spread across fewer properties. This raises the risk for the bond holders. To mitigate this, the DOE is suggesting non-residential PACE liens have a somewhat lower cap of around $25,000.

Also, LACEP requires non-residential property owners obtain lender approval before obtaining PACE financing. This creates an added layer of complexity especially on smaller non-residential properties. This is not a major issue on large commercial and industrial properties where the energy projects are more sophisticated. TTC reports that putting together a viable financing program for non-residential properties may take 12 months.

PACE for Large Commercial, Industrial Properties (as a subset of non-residential PACE)

PACE financing for large commercial and industrial projects is being developed between the City of Los Angeles and the County. This program would utilize private financing for projects obtained by large commercial and industrial property owners. These projects could cost upwards of $1 million. Funding would be based solely on private placement loans – one for each property that has an energy project. The banks or other funding institutions will conduct their own credit review and analysis for each loan. The private financing would provide the funds for the placement of AB 811 bonds and the property owners would have the lien placed on the property tax bill. The lien payment would be transferred to the private lender. TTC and the City of Los Angeles are working on the details for implementing this program shortly after the validation suit is completed.

3. **Work with our partners in Washington D.C. to craft legislation and/or find other administrative solutions that would resolve the FHFA, Freddie Mac, and Fannie Mae's current opposition to AB 811-style loans.**

In response to FHFA's action, a group of national PACE stakeholders is working to appeal to Congress to resolve the issue and provide a path forward for PACE. Several senators and member of Congress have indicated interest in sponsoring such legislation. Two powerful House committee chairmen (Waxman and Frank) wrote to FHFA recently urging a resolution. Over 50 members of the House and Senate have publicly supported a favorable resolution to the PACE dilemma.

On July 16, 2010, a House bill was introduced which sought to provide a legislative recognition of the priority lien status of PACE financing. The bill was sponsored by Mike Thompson representing Sonoma County. County staff met with staff from Representative Waxman and Senator Feinstein, and will continue to meet with legislators and the national PACE stakeholder group to develop a cohesive strategy for passing federal legislation during the current session.

ISD is participating in meetings and conference calls as part of this nationwide PACE stakeholder group. The group is discussing a number of potential solutions to mitigate FHFA's position on PACE.

The County's Washington D.C. office prepared a draft resolution introduced at the National Association of Counties (NACO) meeting in Reno, Nevada on July 16-18, 2010, to indicate NACO's support of PACE legislation. On July 18, 2010, NACO adopted the resolution.

If you have any questions, or require further information on this matter, please contact me, or your staff may contact Ellen Sandt, Deputy Chief Executive Officer at (213) 974-1186, or via e-mail at esandt@ceo.lacounty.gov.

WTF:BC:EFS
TT:JJ:ef

c: Executive Office, Board of Supervisors
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