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Via Electronic and Overnight Mail

Federal Housing Finance Agency
c/o Alfred M. Pollard, General Counsel
Eighth Floor, 400 Seventh Street, S.W.
Washington, D.C. 20024
(Comments/RIN 2590-AA53)

RE: **Comments of the California Attorney General on the Federal Housing Finance Agency's Notice of Proposed Rulemaking re Property Assessed Clean Energy (RIN 2590-AA53)**

This letter constitutes the comments of the California Attorney General's Office on the Notice of Proposed Rulemaking addressing whether and under what conditions the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac") (collectively, the "Enterprises") will purchase mortgages for properties participating in Property Assessed Clean Energy (PACE) programs.[1] 77 Fed. Reg. 36086 (June 15, 2012). State PACE laws in California[2] and across the nation allow local governments to use their long-standing powers of assessment to finance renewable energy systems and energy and water efficiency retrofits for their residents. Since Fannie Mae and Freddie Mac own or guarantee approximately half of all residential mortgages in the U.S., the direction that the Agency gives the Enterprises by this rule will largely determine the fate of residential PACE programs nationally.

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[1] The Attorney General submits these comments pursuant to her independent authority under the State Constitution, common law, and statutes to represent the public interest. These comments are made on behalf of the Attorney General and not on behalf of any other agency or office.

[2] See, e.g., A.B. 811, 2007-08 Leg. Sess. (Ca. 2008), available at http://www.leginfo.ca.gov/cgi-bin/postquery?bill_number=ab_811&sess=0708&house=B&author=levine and attached as Exhibit A.

In the Notice, the Agency sets out its Proposed Rule, which is simply to prohibit the Enterprises from "purchas[ing] *any* mortgage that is subject to a first-lien PACE obligation." 77 Fed. Reg. at 36107 (emphasis added).[3] The Notice also states that the Agency will consider certain alternatives that would accommodate PACE under specifically prescribed circumstances. As we did at the Advance Notice stage of this rulemaking,[4] we urge the Agency to follow the requirements of the Administrative Procedure Act (APA) and its own statute, the Safety and Soundness Act (12 U.S.C. § 4501 *et seq.*), in devising its PACE rule. These requirements obligate the Agency to base its decision-making on data and analysis, and not bare assumptions that PACE poses risks to the Enterprises; to give full and fair consideration to alternatives to a flat ban on PACE; and to consider not only potential risk to the Enterprises, but also the larger public interest that PACE programs serve.

As set out below, the evidence, including the scholarly literature, establishes that efficiency and renewable energy improvements of the type financed by PACE programs *increase* home value and *increase* homeowner cash flow, thus reducing risk to the Enterprises. Expert analysis of the data from Sonoma County's successful PACE program further establishes that participating in PACE does not increase the probability of mortgage default. The Agency must consider this evidence in formulating a final rule and cannot rely on unsupported, contrary assumptions. The Agency must give full and fair consideration to alternatives that would adequately protect the Enterprises while still allowing PACE to proceed, especially in light of the important public interests served by accommodation. Accordingly, the Agency must judge the alternatives against a reasonable, achievable standard rather than the "no risk" standard it proposes in the Notice. Of the alternatives proffered that would accommodate PACE, only Alternative 3 is both practical and can be implemented in the near term. This alternative would adopt a set of set of uniform, nationwide standards for PACE programs. While we question whether the additional limits and restrictions in Alternative 3 are necessary, we note that local governments and other PACE supporters are willing to institute these program changes in order to ensure that this important program may continue.[5]

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[3] In California and in most states with PACE laws, PACE assessments have lien priority, meaning that they are paid before any private mortgage, in the same manner as all other taxes and assessments.

[4] Our previous comment letter is available on the FHFA's website at http://www.fhfa.gov/webfiles/23503/95_Kamala_D_Harris_AttnyGnrl_California.pdf.

[5] We understand that a number of local governments, including Sonoma County, Placer County, and the City of Palm Desert have submitted or will submit comments supporting Alternative 3. *See also* suggested form letter on the PACENow website at http://salsa3.salsalabs.com/o/50696/p/dia/action/public/?action_KEY=8250.

COMMENTS

I. <u>The Agency Must Take Into Account the Evidence and the Public Interest in Issuing Its Final Rule.</u>

Section 706(2)(A) of the APA prohibits agency "action, findings, and conclusions" that are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2). In order to satisfy the APA, an "agency must explain the evidence which is available, and must offer a 'rational connection between the facts found and the choice made.'" *Motor Vehicle Mfrs. Ass'n of U.S., Inc. v. State Farm Mut. Auto. Ins. Co*. ("*State Farm*"), 463 U.S. 29, 43 (1983) (*quoting Burlington Truck Lines v. United States*, 371 U.S. 156, 168 (1962)). Under this standard, the Agency cannot, as it has to date, simply rely on unsupported assumptions and conclusory assertions that PACE poses financial risks to the Enterprises. Rather, the Agency has an obligation to seek out evidence about PACE's potential financial risks, and the magnitude of those risks, and PACE's potential financial benefits, and to consider the evidence placed into the record on these issues during this rulemaking.

In addition, the APA requires the Agency to consider alternatives to flatly prohibiting Fannie Mae and Freddie Mac from purchasing any mortgages for properties participating in PACE. While an agency has considerable discretion to exercise its expert judgment, an agency does not have discretion to ignore apparently reasonable courses of action without offering an explanation and engaging in analysis. *See State Farm,* 463 U.S. at 46, 48 (holding that before National Highway Transportation Safety Administration could rescind passive restraint standards because of problems with automatic seatbelts, agency was required to give consideration to less drastic option of modifying standard to require airbag technology); *see also Muckleshoot Indian Tribe v. U.S. Forest Service,* 177 F.3d 800, 813-14 (9th Cir. 1999) (holding that agency's failure to consider adequate range of alternatives in environmental impact statement violated the National Environmental Policy Act (NEPA)).[6]

Under the rule of *State Farm*, 463 U.S. at 37-38, if the Agency determines that PACE poses risks to the safety and soundness of the Enterprises, it must evaluate whether those risks could be addressed by actions short of a complete prohibition on Fannie Mae and Freddie Mac purchasing mortgages for properties participating in PACE. The Agency itself, in its July 6, 2010 Directive, indicated that asserted risk could be reduced by imposition of "robust underwriting standards to protect homeowners" and "energy retrofit standards to assist

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[6] In its Advance Notice, the Agency stated that it would prepare an Environmental Impact Statement (EIS) in compliance with NEPA. 77 Fed. Reg. 3958 (Jan. 26, 2012). To date, the Agency has not released any environmental documents related to the PACE rulemaking. We note that if the Agency issues a rule flatly prohibiting the Enterprises from purchasing mortgages for properties participating in PACE, such action would constitute a major federal action significantly affecting the quality of the human environment and thus would require an EIS. If the Agency issues a rule that would accommodate PACE, depending on the scope and effect of that rule, a Finding of No Significant Impact might well suffice.

homeowners, appraisers, inspectors and lenders determine the value of retrofit products."[7] (We note that this is the intent and purpose of Alternative 3, discussed in Section IV.D., below.)

In addition to the APA, the Safety and Soundness Act imposes additional requirements on this rulemaking. The Agency's supervisory and regulatory responsibilities under the Safety and Soundness Act are not limited to ensuring a return for Fannie Mae and Freddie Mac and their shareholders and executives. As stated in 12 U.S.C. section 4513(a)(1)(B)(v), one of the "principal duties of the Director" is to "ensure that . . . the activities of each regulated entity and the manner in which such regulated entity is operated are *consistent with the public interest*." (Emphasis added). In the case of PACE, the Agency must consider the public interest, which includes not only benefits to homeowners and the environment, but also the interest in working with the states to accommodate their PACE laws and respecting the long-standing power of local governments to tax and assess.

II. The Evidence Does Not Bear Out the Agency's Unsupported Assertions that PACE Poses Serious Risks to the Enterprises.

In the Notice, the Agency asserts that PACE presents three types of "risk" to Fannie Mae and Freddie Mac as mortgage holders: (1) in the event of foreclosure, the mortgage holder must pay any past-due PACE assessments; (2) in the event of foreclosure, the mortgage holder bears the risk of any diminution in home value resulting from the outstanding PACE lien or the PACE project itself, "which may or may not be attractive to potential purchasers"; and (3) the homeowner's obligation to pay PACE assessments "may itself increase the risk that the homeowner will become delinquent or default on other financial obligations, including any mortgage obligations." 77 Fed. Reg. 36088. The Agency restates these purported risks throughout the Notice, but does not support them with any specific evidence. As set forth below, the evidence establishes that PACE programs in fact present at most minimal and wholly manageable risk to the Enterprises. Accordingly, general assertions of risk cannot support a rule that would completely block PACE.

A. Escrow accounts can remove risks associated with past-due assessments.

When put into perspective, the Agency's first asserted risk – that the Enterprises must pay any past-due assessments at the time of any foreclosure – is not sufficiently substantial to justify shutting down PACE. The amount of the annual assessment would of course vary with the amount financed and the financing term, but, for example, a $15,000 PACE project financed over 20 years would yield an annual PACE assessment of approximately $1,400 in a

[7] Available at www.fhfa.gov/webfiles/15884/PACESTMT7610.pdf.

representative program.[8] It is that single overdue assessment, and not the entire amount financed, that would be due at foreclosure.[9]

Moreover, the obligation to pay outstanding taxes and assessments in the event of foreclosure is not particular to PACE, but is true of any past-due taxes and assessments (e.g., for parks, sidewalks, roadway paving, or the undergrounding of utilities). The Enterprises have developed a very strong, reliable mechanism to ensure that there are funds available to pay taxes and assessments. Taking the Fannie Mae/Freddie Mac California Deed of Trust as an example, this model document provides that the lender may establish an escrow account to ensure that taxes and assessments are paid. (Cal. Deed of Trust at p. 4, ¶ 3.)[10] If this asserted issue truly is a concern, establishing an escrow account for PACE assessments would ensure that the Enterprises would not be required to pay for any missed PACE assessments at the time of any foreclosure.

B. The data establish that renewable energy and efficiency improvements *increase* home values.

The Agency at various points quotes, and apparently adopts, the unsupported assertion that the existence of a PACE obligation at the time of foreclosure will likely *reduce* what the buyer is willing to pay for the property. *See, e.g.*, 77 Fed. Reg. at 36093, 36100, 36105.[11] At the same time, the Agency fails to acknowledge data and studies cited by commenters on the Advance Notice, including the California Energy Commission (CEC), establishing that energy efficiency and renewable energy projects reliably *increase* property values.[12] To summarize some of the most recent and well supported studies:

- As set out in an April 2011 report by Lawrence Berkeley National Laboratory, investigators examined the residential selling prices across the State of California of approximately 2,000 homes with existing photovoltaic (PV) systems against a comparable set of approximately 70,000 non-PV homes. They found that California homes with PV systems have sold for a premium over comparable homes without PV systems of approximately $3.9 to $6.4 per installed watt of PV, with most coalescing

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[8] *See* Sonoma County's annual payment calculator, available at http://www.sonomacountyenergy.org/lower.php?url=annual-payment-calculator.

[9] *See* letter from California Attorney General to Acting Agency Director Edward DeMarco, dated June 22, 2010, attached as Exhibit B.

[10] Available at http://www.freddiemac.com/uniform/doc/3005-CaliforniaDeedofTrust.doc and https://www.efanniemae.com/sf/formsdocs/documents/secinstruments/doc/3005w.doc.

[11] As the California Energy Commission stated in its comments on the Advance Notice, the Agency's position is at odds with the practices of Fannie Mae and Freddie Mac in allowing for Energy Efficient Mortgages (EEMs). *See* comment letter of California Energy Commission, dated March 28, 2012, at p. 3. EEMs are grounded in the assumption that energy efficiency improvements add value to the home.

[12] *See* comment letter of the CEC, dated March 26, 2012, at pp. 2-3.

near $5.5/watt. This corresponds to a home sales price premium of approximately $17,000 for a relatively new 3,100 watt PV system (the average size of PV systems in the study). The authors concluded that the sales price premiums appear to be comparable to the investment that homeowners have made to install PV systems in California, which from 2001 through 2009 averaged approximately $5/watt.[13]

- Case studies across the U.S. (e.g., in Colorado, Oregon, Washington and North Carolina) spanning 2009 to 2011 confirm that ENERGY STAR and other green-labeled homes routinely sell for a percentage-of-sales-price and per-square-foot premium.[14]

- After the date of the publication of the Advance Notice, Nils Kok, Maastricht University, Netherlands and University of California, Berkeley, and Matthew E. Kahn, University of California, Los Angeles, published the results of their analysis of 1.6 million homes sold in California between 2007 and 2012, controlling for other variables known to influence home prices in order to isolate the added value of green home labels. They found that California homes labeled ENERGY STAR, LEED for Homes and GreenPoint Rated sold for 9 percent more (±4%) than comparable, non-labeled homes. Given that the average sales price of a non-labeled home in California is $400,000, the price premium for a certified green home translates into some $34,800 more than the value of a comparable, non-labeled home.[15]

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[13] Ben Hoen, Ryan Wiser, Peter Cappers and Mark Thayer, Lawrence Berkeley National Laboratory, Environmental Energy Technologies Division, *An Analysis of the Effects of Residential Photovoltaic Energy Systems on Home Sales Prices in California* (Apr. 2011), available at http://eetd.lbl.gov/ea/emp/reports/lbnl-4476e.pdf. The authors note that, in addition, homeowners with PV benefit from electricity cost savings after PV system installation and prior to home sale.

[14] Bryan Bloom, Mary Ellen C. Nobe, and Michael D. Nobe, *Valuing Green Home Designs: A Study of ENERGY STAR© Homes*, 3 The Journal of Sustainable Real Estate (Apr. 2011), available at http://www.costar.com/uploadedFiles/JOSRE/JournalPdfs/06.109_126.pdf; Ann Griffin, Earth Advantage Institute, with Ben Kaufman, GreenWorks Realty and Sterling Hamilton, Hamilton Investments, LLC, *Certified Home Performance: Assessing the Market Impacts of Third Party Certification on Residential Properties* (May 2009), available at http://www.earthadvantage.org/assets/uploads/Final_report_from_web_from_greenresourcecouncil.org_site.pdf; The Earth Advantage Institute (EAI), *Certified Homes Outperform Non-Certified Homes for Fourth Year* (June 8, 2011), available at http://www.earthadvantage.org/resources/library/research/certified-homes-outperform-non-certified-homes-for-fourth-year/; North Carolina Energy Efficiency Alliance, *Market Impacts of ENERGY STAR® Qualification for New Homes* (2011), available at http://ncenergystar.org/sites/ncenergystar.org/files/NCEEA_ENERGY_STAR_Market_Impact_Study.pdf.

[15] Nils Kok, Maastricht University, Netherlands / University of California, Berkeley, and Matthew E. Kahn, University of California, Los Angeles, *The Value of Green Labels in the*

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In light of the evidence that efficiency and renewable energy improvements increase home values, the Agency cannot, consistent with its obligation under the APA, proceed from the assumption that these improvements have a neutral or negative value.

C. PACE improvements, unlike virtually any other assessed improvement, can improve a homeowner's monthly cash flow, and therefore should *decrease* risk.

In a well designed PACE program, total energy savings to the homeowner that will be realized by the suite of PACE improvements exceed the total cost of the PACE assessments. Nonetheless, the Agency makes various unsupported assertions to reach the counter-intuitive conclusion that the impact of PACE improvements may not in practice improve the monthly cash flow of the participating homeowner. None bear scrutiny.

For example, the Agency states that future value depends on energy prices; in the Agency's view, "[e]nergy prices are variable and unpredictable, and therefore any forward-looking estimate of utility-cost savings is inherently speculative." 77 Fed. Reg. 36100, *see also id.* at 36092. Contrary to FHFA's assertion, other federal agencies, such as the U.S. Department of Energy (DOE), routinely make informed predictions about future residential energy costs to support their rulemaking efforts.[16] FHFA should be able to do the same, perhaps with assistance from DOE. Moreover, the fact that the Agency may need to rely on energy price models does not make such an endeavor speculative.[17]

The Agency also asserts summarily that "some homeowners may choose to consume rather than monetize energy efficiency gains, as by adjusting their thermostat to realize efficiency gains as comfort rather than as monetary savings." 77 Fed. Reg. 36101. The potential

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California Housing Market / An Economic Analysis of the Impact of Green Labeling on the Sales Price of a Home (July 2012), available at http://www.corporate-engagement.com/files/publication/KK_Green_Homes_071912.pdf.

[16] Under the Energy Policy and Conservation Act, DOE must establish efficiency standards for certain types of residential products to "achieve the maximum improvement in energy efficiency . . . which the Secretary determines is technologically feasible and economically justified." 42 U.S.C. § 6295(o)(2)(A). This analysis requires DOE to consider, among other things, "the savings in operating costs throughout the estimated average life of the covered product . . . ." 42 U.S.C. § 6295(o)(2)(B)(i)(II).

[17] *See Sierra Club v. Costle*, 657 F.3d 298, 333-34 (D.C. Cir. 1981) (agency entitled to rely on model as substantial evidence supporting its decision); *see also Am. Pub. Gas Ass'n v. Fed. Power Comm'n*, 567 F.2d 1016, 1036-37 (D.C. Cir. 1977) ("Reasoned decisionmaking can use an economic model to provide useful information about economic realities, provided there is a conscientious effort to take into account what is known as to past experience and what is reasonably predictable about the future.")

for such "rebound" does not mean that efficiency projects are not worthy of investment.[18] Rather, this phenomenon is simply a caution that one cannot assume in every instance that all possible efficiency gains will be realized in practice.

In any event, the rebound effect is irrelevant to the Agency's PACE rulemaking. Where an agency is charged with quantifying reduced energy use, as DOE is under the Energy Policy and Conservation Act, the rebound effect may require the agency to consider reducing projected energy savings by some percentage.[19] Here, however, the Agency's asserted concern is about risks to Fannie Mae and Freddie Mac tied to a homeowner's ability to make timely mortgage payments. The fact that a homeowner may choose to spend some small percentage of energy bill savings resulting from PACE improvements on purchasing more energy is not relevant to this concern. What *is* relevant is that a portion of the homeowner's household budget that previously was dedicated to paying an energy bill is now freed-up to spend in the way that the homeowner sees fit. This new elasticity in the household budget may lead to spending on comforts (including additional heating or cooling) when the household financial situation is strong, and on necessities (such as mortgage payments) should the household financial situation come under stress. In sum, the increase in household discretionary funds resulting from PACE improvements can only *increase* the likelihood that a PACE participant will stay current on his or her mortgage. There is no reasonable basis for the Agency to conclude otherwise.

III. <u>Expert Analysis of Sonoma County's Operating PACE Program Establishes that Participation in PACE Does Not Increase the Risk of Default.</u>

In response to the Agency's request for empirical data and analysis related to financial risk (77 Fed. Reg. 36104), the California Attorney General's office retained an expert economist, Dr. Joseph Janczyk of Empire Economics, to evaluate Sonoma County's Energy Independence Program, one of the longest running and largest PACE programs in the nation.[20] The expert

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[18] "Rebound is a change in energy-using behavior that increases the level of service that results from an energy efficiency action. The most common form is 'take back,' which can occur if consumers increase energy use as a result of a new device's improved efficiency." Steven R. Schiller, Schiller Consulting, Inc., *Model Energy Efficiency Program Impact Evaluation Guide* (Nov. 2007), prepared for U.S. EPA, at p. 5-2, available at http://www.epa.gov/cleanenergy/documents/suca/evaluation_guide.pdf.

[19] *See, e.g.*, 77 Fed. Reg. 32308, 32339 (May 31, 2012) (electing not to use a rebound effect in establishing final rule for residential clothes washers); 76 Fed. Reg. 70548, 70583 (Nov. 14, 2011) (electing to use a residential rebound effect of 8.5% in establishing final rule for fluorescent lamp ballasts); 76 Fed. Reg. 37408, 37468-69 (June 27, 2011) (electing to use a rebound effect of 20% in establishing final rule for residential furnaces and residential central air conditioners and heat pumps).

[20] Since Sonoma County established its PACE program in March of 2009, the program has provided over $57 million in financing to support a total of 1,673 residential and 55 commercial projects. Sonoma County reports that 86% of the PACE projects were installed by local

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produced two reports – one on the default rate among PACE participants as compared to the County as a whole, and one examining the causes of default – which we have submitted to the Agency under separate cover.[21] We summarize the results of the expert's analyses below.

PACE Default Rate: We asked the expert to examine the mortgage default rate in the Sonoma County PACE program. For purposes of the expert's research, "default" exists where (1) the borrower has missed one or more mortgage payments, and (2) the lender has filed a Notice of Default with the County Recorder. Default includes properties that are in foreclosure or bank-owned at the time the expert gathered the data. In Sonoma County, only 13 residential properties participating in PACE were in default, out of a pool of 1,536 residential properties with mortgages participating in PACE, for a default rate of 0.85%. The default rate for properties participating in PACE is *less than half* the 2.19% default rate for the County's non-PACE residential properties with mortgages. (Default Rate Report at p. 5.) The expert determined that the substantially lower default rate for PACE participants is statistically significant, meaning it is not the result of chance. (Default Rate Report at pp. 6-7.)

Causes of Default: The expert also conducted a more focused case study of residential properties with mortgages in five of the County's 80+ Zip Codes. The expert chose these areas for further study because each had a substantial number of residential properties participating in PACE, thus providing sufficient data points about PACE properties to draw statistically significant conclusions. Selecting five Zip Codes also ensured a substantial total pool for analysis; the five selected Zip Codes collectively contain more than 19,000 residential properties. (Default Factors Report at pp. 1, 3, 7.)

The expert first conducted a qualitative comparative economic analysis, meaning that he examined whether and how certain relevant characteristics of residential properties participating in PACE were similar to, or differed from, those of non-participating properties. The residential properties in the five Zip Codes were divided into four groups: Non-PACE Timely (not in default); Non-PACE Default; PACE Timely; and PACE Default. Because the PACE Default group contained only six properties, the expert could not conduct any further comparative analysis for this group. (Default Factors Report at pp. 7, 9.)

The analysis showed that for the Non-PACE Timely and Non-PACE Default groups, tax burdens were the same; the latter group was in default even though it did not have a higher

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contractors and that the program has created 700 jobs. *See* http://www.sonomacountyenergy.org/.

[21] Empire Economics, *Economic Analysis of Mortgage Loan Default Rates, Sonoma County Energy Independence Program (SCEIP)* (June 28, 2012) ("Default Rate Report"); Empire Economics, *Comprehensive Economic Analysis of the Factors Underlying Default, Sonoma County Energy Independence Program (SCEIP)* (August 24, 2012) ("Default Factors Report").

average tax burden than the former group. [22] In addition, the tax burden for the PACE Timely group was higher than for both Non-PACE groups; the higher tax burden (which took into account PACE assessments) did not cause this set of properties to go into default.[23] This indicates that something other than taxes and assessments led to default in these groups. (Default Factors Report at pp. 11.) The results of the expert's comparative analysis are set out in detail in the report. (Id. at pp. 9-14.)

The expert next conducted a quantitative analysis to answer FHFA's request for a cross comparison that would allow for examination of factors that might affect default. *See* 77 Fed. Reg. 36104. The analysis revealed that there was a highly statistically significant, positive relationship between default and the following characteristics that are not related to PACE but rather are related to general mortgage lending practices and the housing market: initial loan-to-value (LTV) ratios[24] (the higher the LTV, the higher the likelihood of default); conventional loans (i.e., not FHA or VA loans); and sale during the peak of the housing market price bubble. Thus, these characteristics were strong predictors of mortgage default in the Zip Codes studied. (Default Factors Report at pp. 16-19.)

If FHFA's theory that PACE assessments increase the risk of default by placing an extra annual payment burden on the mortgage holder is correct, one would expect to see increases in default in any situation where taxes and assessments are relatively high, whatever the reason for the tax or assessment. The regression analysis established, however, that higher tax burdens (burdens which include PACE assessments) had *no statistically significant impact* on the probability of mortgage default. (Default Factors Report at pp. 16.)

The expert's analyses of the data from one of the nation's largest and longest-running PACE programs thus confirm that participation in PACE does not increase risk of default. Accordingly, the Agency must give serious consideration to an alternative that would accommodate, rather than obstruct, the program.

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[22] "Tax burden" is defined as the sum of all taxes and assessments levied annually (including PACE assessments) divided by the property's assessed value as reflected in the official property records. For the group of 18,348 Non-PACE Timely properties and for the group of 394 Non-PACE Default properties, the average tax burden was approximately 1.16%.

[23] For the 390 PACE Timely properties, the average tax burden was 1.69%.

[24] The LTV ratio is defined as the total of all loans at the time of sale (e.g. first and second mortgages) divided by the home sale price, expressed as a percentage. Assessments, which are not loans, are not included in the LTV calculation. As noted, assessments were accounted for in the tax burden calculation.

IV. <u>The Agency Must Give Serious Consideration to an Alternative That Would Manage Any Risk to the Enterprises and Serve the Public Interest in Accommodating PACE.</u>

The Agency's Proposed Rule – to block PACE – thwarts the public interests that flow from accommodating PACE. FHFA presents three alternatives to its Proposed Rule that would in theory accommodate PACE and further these public interests. The Agency refers to these as (1) the "Guarantee/Insurance" Alternative; (2) the "Protective Standards" Alternative; and (3) the "Underwriting Standards" Alternative. As set forth below, only Alternative 3 is practical and capable of implementation in the near term. Where the record establishes that this alternative would protect the Enterprises from risk, and, at the same time, serve the larger public interest in accommodating PACE, selecting the Proposed Rule over this alternative would be arbitrary and in violation of the Safety and Soundness Act.

A. <u>The Agency must judge the alternatives against a reasonable, achievable standard that both protects against risk to the Enterprises and acknowledges the public interest.</u>

As noted above and in the Attorney General's comments on the Advance Notice, the APA requires that FHFA consider reasonable alternatives to a flat prohibition on the purchase of mortgages for properties participating in PACE. *See State Farm*, 463 U.S. at 46, 48; *see also Muckleshoot Indian Tribe*, 177 F.3d at 813-14. While the Notice of Proposed Rulemaking sets out three alternatives, it also implies that any viable alternative "must provide mortgage holders with equivalent protection from financial risk to that of the Proposed Rule [to ban PACE], and could be implemented as readily and enforced as reliably as" a flat ban. 77 Fed. Reg. 36107. This is not a proper standard against which to judge the alternatives, because no alternative that would accommodate PACE, no matter how well designed, could guarantee absolutely no risk. Application of this standard will virtually guarantee that the Agency will *not* give serious consideration to the alternatives it has devised, in violation of the APA.

Failure to consider alternatives that would accommodate PACE would, in addition, violate the Agency's governing statute, the Safety and Soundness Act, 12 U.S.C. sections 4501-4642. As we stated in our comments on the Advance Notice, one of the "principal duties of the Director" is to "ensure that . . . the activities of each regulated entity and the manner in which such regulated entity is operated are consistent with the *public interest*." (Emphasis added). In the case of PACE, the public interest favors working with the states to accommodate their PACE laws and respecting the long-standing power of local governments to tax and assess. In addition, the public interest is advanced by allowing PACE programs to proceed in order to obtain the benefits of energy efficiency, consumer savings, pollution reduction, and green jobs and industries. The Agency must consider these benefits in determining whether the accommodation of PACE by Fannie Mae and Freddie Mac, with or without additional restrictions or conditions, is in the public interest.

B. The First Risk-Mitigation Alternative – Guarantee/Insurance – does not appear to be market-ready.

The Agency's first alternative to a flat ban on PACE, the "Guarantee/Insurance" alternative, would require either insurance or a PACE program-sponsored reserve fund that benefits mortgage holders and protects them against risk of loss in the event of foreclosure. This alternative is, however, currently impracticable. Governments, and in particular local governments, are not in a position to create reserve funds that run to the benefit of mortgage holders. In addition, to our knowledge, no insurance product similar to that described in the Notice of Proposed Rulemaking exists. We believe that as PACE programs gain a track history, and as their low risk becomes even more evident based on real-world experience, viable insurance products may well emerge in the market place. For this reason, FHFA should leave open the possibility that future insurance products may satisfy the Agency's concerns about PACE, but the Agency should focus this rulemaking on alternatives that are currently viable.

C. The Second Risk-Mitigation Alternative – Protective Standards – is inconsistent with the assessment financing mechanism and will unnecessarily and substantially curtail participation in PACE.

The Agency's second alternative is referred to as the "Protective Standards" alternative. The primary focus of this alternative is "the imposition of a substantial equity cushion." 77 Fed. Reg. 36108. In this alternative, the Agency ignores that PACE operates through a lien on the property and special assessments and continues to characterize the PACE obligation as a loan. Under this alternative, in the Agency's words: "[c]urrent combined loan-to-value ratio (reflecting all obligations secured by the underlying property, including the putative PACE obligation, and based on a current qualified appraisal would be no greater than 65%[.]" *Id.* (footnote omitted).

This provision alone makes the alternative unworkable. Equity is commonly defined as the difference between the fair market value of a home and the amount the homeowner owes on the mortgage or mortgages. Alternative 2 would require more than 35% equity for a homeowner to participate in PACE. Where obligations such as special assessments, including PACE assessments, total 10% of the value of the home, as they do under many operating PACE programs, the effective required equity rises to 45%.[25] Applying this requirement to the Sonoma County program, which, as discussed, has a very low rate of default, shows its drastic results. Sonoma County reported to us that as of August 1, 2012, there were 1,684 residential properties participating in Sonoma County's PACE program. A 35% equity requirement would decrease participation by 64% (to 603); a 45% equity requirement would decrease participation by 73% (to 461).

Alternative 2 seems designed only to substantially and unnecessarily restrict participation in PACE. We therefore urge the Agency to reject this alternative.

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[25] Where L = amount owned on all mortgages and V = home value, Alternative 2 would require that $L + 0.1(V) = .65(V)$, which means that $L \div V = .55$, yielding a required effective equity of .45 or 45%.

D. The Third Risk-Mitigation Alternative – H.R. 2599 Underwriting Standards – protects the Enterprises and advances the public interest.

The Agency's third alternative, entitled "H.R. 2599 Underwriting Standards," is the only alternative that addresses the Agency's concerns about risk and is, at the same time, practical and capable of implementation in the near term. Alternative 3 imposes a set of uniform requirements on all PACE programs nationwide addressing such things as: lien recording; exclusion of participants who are in arrears on mortgage payments or have declared bankruptcy; required energy audits; minimum savings-to-cost ratio for the improvements; and caps on the amount financed as measured against the estimated value of the property.

As set out below, Alternative 3 places additional requirements on even the most stringent and successful programs and thus can only further reduce risk in what are already low-risk programs.[26] We acknowledge there are some details concerning Alternative 3 that remain to be worked out concerning costs, savings, and the useful life of improvements. These details are not a sufficient basis for the Agency to reject Alternative 3, however; expert agencies and entities already have created tools to address these areas, and they stand ready to assist the FHFA in areas that may be beyond its current expertise.

1. Alternative 3 will further reduce risk in what are already low-risk programs.

Alternative 3, the "Underwriting Standards" alternative, proposes to require for all PACE programs the standards set out in H.R. 2599, a bill introduced by Representative Nan Hayworth (R-NY) on July 20, 2011, with 54 bipartisan co-sponsors[27] (the "Underwriting Standards" Alternative). As the bill states,

> It is the purpose of this Act to ensure that those PACE programs which incorporate prudent programmatic safeguards to protect the interest of mortgage holders and property owners remain viable as a potential avenue for States and local governments to achieve the many public benefits associated with energy efficiency, water efficiency, and renewable energy retrofits. In addition, it is essential that the power and authority of State and local governments to exercise their longstanding and traditional powers to levy taxes for public purposes not be impeded.

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[26] We are not aware of any evidence to suggest that foreclosures are common in operating California PACE programs or that default rates for properties in such programs are higher than for non-participating properties. As set out in Section III, the expert's Sonoma County case study established that in that program, default rates are lower for PACE participants, and defaults are caused by factors unrelated to PACE.

[27] *See* http://www.gpo.gov/fdsys/pkg/BILLS-112hr2599ih/pdf/BILLS-112hr2599ih.pdf. H.R. 2599 remains in committee.

H.R. 2599, 112th Cong. § 2 (2011).

The "prudent programmatic safeguards" in this alternative include certain standards that many operating PACE programs already require, in whole or in part. Some examples follow. In California, a PACE lien, like other liens for special assessments, is "recorded in the relevant jurisdiction's public land-title records" and the "PACE obligation is embodied in a written agreement expressing all material terms[.]" 77 Fed. Reg. 36108. Both Sonoma County's and Palm Desert's PACE programs exclude participants who have a Notice of Default showing on title, though they do not currently look back for a three-year period as this alternative would require. (*Id.*) Sonoma County already excludes participants who have filed for bankruptcy in the previous three years, and Palm Desert excludes those who are involved in a bankruptcy at the time of application; Alternative 3 would extend the bankruptcy look-back period to seven years. *Id.* Both Sonoma County and Palm Desert require that PACE improvements be installed by qualified contractors. (*Id.* at 36109.)[28]

The standards that local governments have included in their PACE programs have been sufficiently stringent that they have not resulted in any documented risk to Fannie Mae, Freddie Mac, or other mortgage holders. Still, local governments across California and the nation have stated their support for Alternative 3, which goes well beyond even the most stringent and rigorous of the operating PACE programs. Again taking the Sonoma County and Palm Desert PACE programs as examples, Alternative 3 will not only strengthen some existing provisions (such as lengthening the period for disqualifying default or bankruptcy), but will also add new, substantive provisions. For example, Alternative 3 requires these programs to perform audits to ensure that the savings resulting from improvements will exceed costs, and to conduct appraisals to ensure that PACE assessments do not exceed 10 percent of the property value. 77 Fed. Reg. 36109. Altogether, the standards in Alternative 3 will set a high, uniform bar for all existing and new PACE programs.

While PACE program experience to date suggests that these new standards are not necessary to address risk, nonetheless, local governments believe that PACE is sufficiently important that they are willing to invest substantial time and resources to include these additional standards to address FHFA's concerns.[29]

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[28] Sonoma County's PACE program, for example, maintains a list of approved contractors. *See* http://www.sonomacountyenergy.org/lower.php?url=find-a-contractor. Contractors must sign a "Standards of Conduct" document. The document provides that the County "reserves the right to deny funding for any project to be performed by a Contractor that has not agreed to these terms and conditions, or who has failed to abide by these standards." A contractor may also be "banned from participation in [PACE] funded projects" for non-compliance. *See* http://drivecms.com/uploads/sonomacountyenergy.org/Contractor_Standards.pdf. Thus, FHFA's assertion that the Advance Notice's "comments confirm the current absence of adequate consumer protection" (77 Fed. Reg. 36103) is not consistent with the evidence.

[29] Alternative 3 requires the "consent of the mortgage holder" for first-lien PACE obligations. 77 Fed. Reg. 36018. In a final rule adopting Alternative 3's approach, FHFA should clarify how

(continued…)

2. Documenting Alternative 3's process would help to ensure that PACE improvements are reflected in home values.

As discussed in Section II, where the market is aware of efficiency and renewable energy improvements, for example, through green-labeling, home values reliably increase. To maximize opportunities for increasing PACE home values, it is essential that the market is aware of PACE improvements and that appraisals accurately reflect these improvements at the time of sale. *See* Victoria Doyle, Building Industry Research Alliance, *The Role of Appraisals in Energy Efficiency Financing* (May 2012) (prepared for Office of Energy Efficiency and Renewable Energy, DOE).[30]

Accordingly, we propose an additional documentation requirement that could easily be incorporated into Alternative 3. As a part of the PACE process, the required "certificate of completion" for the project, and the "total energy and water cost savings" and the "total cost to the property owner" reflected in the required "audit or feasibility study" (*see* 77 Fed. Reg. 36109) should be packaged into a document that could be referred to as a "PACE Certification." The certificate of completion for the project should contain the type of information and level of detail that would assist appraisers in valuing the improvements. The Appraisal Institute Residential Green and Energy Efficient Addendum provides a general template for the certificate, which could be filled out by the contractor on project completion.[31] The property owner would be required to complete a simple form provided by the local government that would require as attachments the certificate of completion and, in addition, the cost/savings portion of the audit or feasibility study.

The local government would note the existence of a "PACE Certification" in the recorded lien and would make the PACE Certification available in the property records or in a publicly accessible database searchable by Assessor's Parcel Number. PACE programs could inform participants that their properties may be referred as "PACE Certified" (thereby creating a type of green label) until the PACE lien is extinguished. This label could be used, for example, in marketing the home in Multiple Listing Services. Appraisers, real estate agents, and prospective buyers would all have access to the PACE Certification document.

(…continued)
consent will be obtained so that it does not create an unnecessary barrier to PACE, e.g., by providing that mortgage holders are deemed to consent if a PACE program complies with FHFA's requirements.

[30] Available at www.nrel.gov/docs/fy12osti/54329.pdf. The author notes, among other things, that there is a need to improve and increase communication between "stakeholders," including homeowners, financing entities, and appraisers, concerning energy efficiency measures, and to provide evidence of the measures to the appropriate point of contact. *Id*. at pp. 14-15.

[31] See http://www.appraisalinstitute.org/education/green_energy_addendum.aspx. A copy of the current version of the Green Addendum is attached as Exhibit C.

This additional documentation step would further protect the Enterprises in the rare event of foreclosure on a property participating in PACE by ensuring that detailed information relevant to the value the PACE improvements is available in the marketplace.

3. Expert agencies, entities, and resources are available to assist FHFA in filling in any remaining program details.

The Agency states that it has "reservations" about Alternative 3 that relate to program details, specifically, the methodology to be used in computing costs and savings for the required audit or feasibility study and how the "useful life" of the improvement would be determined for purposes of setting the assessment term. 77 Fed. Reg. 36109. In fact, a quick internet search reveals that there are a number of tools currently and readily available that can be used to calculate cost, savings, and useful life. These include, but are not limited to, the Solar Advantage Value Estimator created by the CEC as part of its "Go Solar" program;[32] the PV Value™ Photovoltaic Energy Valuation Model recently developed by Sandia National Laboratory[33] (in consultation with Solar Power Electric Power and the Appraisal Institute);[34] the National Renewable Energy Laboratory's PVWatts™ calculator;[35] various location-specific solar value calculators;[36] DOE's solar water heater calculator;[37] DOE's suite of Energy and Cost Savings Calculators for Energy-Efficient Products;[38] and the Database for Energy Efficient Resources, developed by the CEC and the California Public Utilities Commission, which contains well-documented estimates of energy and peak demand savings values, measure costs, and effective useful life in one data source.[39] These are merely a sampling of the many diverse resources available.

Moreover, we note that DOE and the CEC have extensive expertise in complex program design and regulation related to efficiency and renewable energy, expertise that extends to efficiency and renewable energy cost, savings, and useful life. DOE, the CEC, and other expert agencies and entities, have indicated in their comments at the Advance Notice and Proposed

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[32] Available at http://www.gosolarcalifornia.org/tools/save.php.

[33] Available at http://energy.sandia.gov/?page_id=8047. The website notes that "[f]or appraisers, the inputs specific to PV in the Residential Green and Energy Efficient Addendum can be used as inputs . . . ."

[34] *See* http://spefl.com/pvvalue.

[35] Available at http://www.nrel.gov/rredc/pvwatts/.

[36] *See, e.g.*, the New Orleans Solar Calculator, available at http://www4.eere.energy.gov/solar/sunshot/resource_center/resources/new_orleans_solar_calculator.

[37] Available at http://energy.gov/energysaver/articles/estimating-cost-and-energy-efficiency-solar-water-heater.

[38] Available at http://www1.eere.energy.gov/femp/technologies/eep_eccalculators.html.

[39] Available at http://www.deeresources.com/.

Rule stages of this rulemaking their willingness to assist FHFA in filling in program details.[40] While adopting Alternative 3 would be more challenging than simply saying “no” to PACE, the record establishes that every standard articulated in Alternative 3 can be formulated based on data, analysis, and reasonable and supported assumptions.

As its final “reservation,” FHFA states that “a clear method for enforcing standards would be beneficial.” 77 Fed. Reg. 36109. The method for enforcing the standards is plain: local government commitment. Those local governments with operating residential PACE programs have successfully undertaken such diverse tasks as creating experienced contractor lists and contractor criteria, checking participant eligibility, ensuring consumer protection, verifying project completion, recording necessary documents, and controlling risks to the program and to mortgage holders. Local governments have as great an interest – if not a greater interest – than does FHFA in making sure that PACE succeeds for all interested parties.

In sum, none of the Agency’s stated concerns about Alternative 3 is a sufficient reason to reject this reasonable and considered alternative.

CONCLUSION

We appreciate the opportunity to comment on the Notice of Proposed Rulemaking and trust that the Agency will give serious consideration to Alternative 3, which would accommodate PACE and serve the public interest.

Sincerely,

/s/
JANILL RICHARDS
Supervising Deputy Attorney General
JASON MALINSKY
Deputy Attorney General

For KAMALA D. HARRIS
Attorney General

Attachments [Note: additional materials cited have been submitted under separate cover]

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[40] *See, e.g.,* comments of DOE (Mar. 28, 2012) (stating that “DOE has an interest in working with FHFA on developing solutions for investments in residential energy efficiency that are compatible with a stable and strong housing market in America” and “strongly urg[ing] FHFA to partner with relevant stakeholders, including DOE . . . .”); comments of CEC (Mar. 28, 2012) (stating that the CEC “look[s] forward to working with FHFA to facilitate access by homeowners to PACE financing . . . .”)

EXHIBIT A

Assembly Bill No. 811

CHAPTER 159

An act to amend Sections 5898.12, 5898.20, 5898.22, and 5898.30 of, and to add Sections 5898.14 and 5898.21 to, the Streets and Highways Code, relating to contractual assessments, and declaring the urgency thereof, to take effect immediately.

[Approved by Governor July 21, 2008. Filed with Secretary of State July 21, 2008.]

LEGISLATIVE COUNSEL'S DIGEST

AB 811, Levine. Contractual assessments: energy efficiency improvements.

Existing law authorizes the legislative body of any city, as defined, to determine that it would be convenient and advantageous to designate an area within which authorized city officials and free and willing property owners may enter into contractual assessments and make arrangements to finance public improvements to specified lots or parcels under certain circumstances. Existing law requires the legislative body to make these determinations by adopting a resolution indicating its intention to do so and requires the resolution to include certain information, including, but not limited to, identification of the kinds of public works that may be financed, a description of the boundaries of the area within which contractual assessments may be entered into, and a description of the proposed arrangements for financing the program. Existing law also directs an appropriate city official to prepare a report to include, among other things, the terms and conditions that would be agreed to by a property owner within the contractual assessment area and the city and identification of the types of facilities that may be financed through the use of contractual assessments.

This bill would additionally authorize a legislative body of any city, as defined, to determine that it would be in the public interest to designate an area within which authorized city officials and free and willing property owners may enter into contractual assessments to finance the installation of distributed generation renewable energy sources or energy efficiency improvements that are permanently fixed to real property, as specified. The bill would require the resolution of intention to include, among other things, the kinds of distributed generation renewable energy sources or energy efficiency improvements that may be financed as well as a statement specifying that it is in the public interest to finance those distributed generation renewable energy sources or energy efficiency improvements. The bill would further require the report to include, among other things, the types of distributed generation renewable energy sources or energy efficiency improvements that may be financed through the use of contractual assessments. The bill would authorize a property owner, upon written consent of an authorized city official, to purchase directly the related equipment and materials for the installation of distributed generation renewable energy sources or energy efficiency improvements and to contract directly for the installation of those sources or improvements. The bill would make findings and a declaration in this regard.

This bill would declare that it is to take effect immediately as an urgency statute.

The people of the State of California do enact as follows:

SECTION 1. Section 5898.12 of the Streets and Highways Code is amended to read:

5898.12. (a) It is the intent of the Legislature that this chapter should be used to finance public improvements to lots or parcels which are developed and where the costs and time delays involved in creating an assessment district pursuant to other provisions of this division or any other law would be prohibitively large relative to the cost of the public improvements to be financed.

(b) It is also the intent of the Legislature that this chapter should be used to finance the installation of distributed generation renewable energy sources or energy efficiency improvements that are permanently fixed to residential, commercial, industrial, or other real property.

(c) This chapter shall not be used to finance facilities for parcels which are undergoing development.

(d) This chapter shall not be used to finance the purchase or installation of appliances that are not permanently fixed to residential, commercial, industrial, or other real property.

(e) Assessments may be levied pursuant to this chapter only with the free and willing consent of the owner of each lot or parcel on which an assessment is levied at the time the assessment is levied.

SEC. 2. Section 5898.14 is added to the Streets and Highways Code, to read:

5898.14. (a) The Legislature finds all of the following:

(1) Energy conservation efforts, including the promotion of energy efficiency improvements to residential, commercial, industrial, or other real property are necessary to address the issue of global climate change.

(2) The upfront cost of making residential, commercial, industrial, or other real property more energy efficient prevents many property owners from making those improvements. To make those improvements more affordable and to promote the installation of those improvements, it is necessary to authorize an alternative procedure for authorizing assessments to finance the cost of energy efficiency improvements.

(b) The Legislature declares that a public purpose will be served by a contractual assessment program that provides the legislative body of any city with the authority to finance the installation of distributed generation renewable energy sources and energy efficiency improvements that are permanently fixed to residential, commercial, industrial, or other real property.

SEC. 3. Section 5898.20 of the Streets and Highways Code is amended to read:

5898.20. (a) (1) The legislative body of any city may determine that it would be convenient and advantageous to designate an area within the city, which may encompass the entire city or a lesser portion, within which authorized city officials and property owners may enter into contractual assessments for public improvements and to make financing arrangements pursuant to this chapter.

(2) The legislative body of any city may also determine that it would be convenient, advantageous, and in the public interest to designate an area within the city, which may encompass the entire city or a lesser portion, within which authorized city officials and property owners may enter into contractual assessments to finance the installation of distributed generation renewable energy sources or energy efficiency improvements that are permanently fixed to real property pursuant to this chapter.

(b) The legislative body shall make these determinations by adopting a resolution indicating its intention to do so. The resolution of intention shall include a statement that the city proposes to make contractual assessment financing available to property owners, shall identify the kinds of public works, distributed generation renewable energy sources, or energy efficiency improvements that may be financed, shall describe the boundaries of the area within which contractual assessments may be entered into, and shall briefly describe the proposed arrangements for financing the program. The resolution of intention shall state that it is in the public interest to finance the installation of distributed generation renewable energy sources or energy efficiency improvements, or both, pursuant to paragraph (2) of subdivision (a), if applicable. The resolution shall state that a public hearing should be held at which interested persons may object to or inquire about the proposed program or any of its particulars, and shall state the time and place of the hearing. The resolution shall direct an appropriate city official to prepare a report pursuant to Section 5898.22 and to enter into consultations with the county auditor's office or county controller's office in order to reach agreement on what additional fees, if any, will be charged to the city or county for incorporating the proposed contractual assessments into the assessments of the general taxes of the city or county on real property.

(c) As used in this chapter, each of the following terms has the following meaning:

(1) Notwithstanding Section 5005, "city" means a city, county, or city and county.

(2) "Legislative body" has the same meaning as defined in Section 5006.

SEC. 4. Section 5898.21 is added to the Streets and Highways Code, to read:

5898.21. Notwithstanding any other provision of this chapter, upon the written consent of an authorized city official, the proposed arrangements for financing the program pertaining to the installation of distributed generation renewable energy sources or energy efficiency improvements that are permanently fixed to real property may authorize the property owner to purchase directly the related equipment and materials for the installation of distributed generation renewable energy sources or energy efficiency improvements and to contract directly for the installation of distributed generation renewable energy sources or energy efficiency improvements that are permanently fixed to the property owner's residential, commercial, industrial, or other real property.

SEC. 5. Section 5898.22 of the Streets and Highways Code is amended to read:

5898.22. The report shall contain all of the following:

(a) A map showing the boundaries of the territory within which contractual assessments are proposed to be offered.

(b) A draft contract specifying the terms and conditions that would be agreed to by a property owner within the contractual assessment area and the city.

(c) A statement of city policies concerning contractual assessments including all of the following:

(1) Identification of types of facilities, distributed generation renewable energy sources, or energy efficiency improvements that may be financed through the use of contractual assessments.

(2) Identification of a city official authorized to enter into contractual assessments on behalf of the city.

(3) A maximum aggregate dollar amount of contractual assessments.

(4) A method for setting requests from property owners for financing through contractual assessments in priority order in the event that requests appear likely to exceed the authorization amount.

(d) A plan for raising a capital amount required to pay for work performed pursuant to contractual assessments. The plan may include amounts to be advanced by the city through funds available to it from any source. The plan may include the sale of a bond or bonds or other financing relationship pursuant to Section 5898.28. The plan shall include a statement of or method for determining the interest rate and time period during which contracting property owners would pay any assessment. The plan shall provide for any reserve fund or funds. The plan shall provide for the apportionment of all or any portion of the costs incidental to financing, administration, and collection of the contractual assessment program among the consenting property owners and the city.

(e) A report on the results of the consultations with the county auditor's office or county controller's office concerning the additional fees, if any, that will be charged to the city or county for incorporating the proposed contractual assessments into the assessments of the general taxes of the city or county on real property, and a plan for financing the payment of those fees.

SEC. 6. Section 5898.30 of the Streets and Highways Code is amended to read:

5898.30. Assessments levied pursuant to this chapter, and the interest and any penalties thereon shall constitute a lien against the lots and parcels of land on which they are made, until they are paid. Division 10 (commencing with Section 8500) applies to the levy and collection of assessments levied pursuant to this chapter, insofar as those provisions are not in conflict with the provisions of this chapter, including, but not limited to, the collection of assessments in the same manner and at the same time as the general taxes of the city on real property are payable and any penalties and remedies and lien priorities in the event of delinquency and default.

SEC. 7. This act is an urgency statute necessary for the immediate preservation of the public peace, health, or safety within the meaning of Article IV of the Constitution and shall go into immediate effect. The facts constituting the necessity are:

In order for legislative bodies of cities and free and willing property owners to enter into contractual assessments to finance the installation of distributed generation renewable energy sources or energy efficiency improvements and for the state to begin to experience the effects of these contractual assessments, such as saving millions of kilowatthours, as early as this summer when usage is the highest, it is necessary that this act take effect immediately.

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EXHIBIT B

EXHIBIT B

EDMUND G. BROWN JR.
Attorney General

State of California
DEPARTMENT OF JUSTICE

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June 22, 2010

Edward DeMarco, Acting Director
Federal Housing Finance Agency
1700 G. Street, N.W.
Washington, D.C. 20552-0003 FAX: (202) 414 3823

RE: Energy Efficiency and Renewable Energy Assessments (PACE) and Lien Priority

Dear Acting Director DeMarco:

On May 17, 2010, we sent you a letter expressing concern about lender and industry advice letters issued by Fannie Mae and Freddie Mac on May 5, 2010. These advice letters equated financing under Property Assessed Clean Energy (PACE) programs with "loans," and strongly suggested that such "loans," because they have lien priority, would preclude sale of mortgages to Fannie and Freddie. As we have repeatedly made clear to FHFA General Counsel, Alfred Pollard, under California law, PACE financing is achieved through special assessments, not loans. The distinction is key. Like other special assessments, such as those used by California's local governments since the beginning of the last century to finance road paving and sidewalk improvements, unpaid PACE assessments take priority over mortgages. Fannie Mae's and Freddie Mac's own standardized documents recognize the priority of assessment liens.

While the advice letters are ambiguous, the effect they have had in this state is not. The letters have had a devastating impact on PACE programs in California, placing at risk hundreds of millions of dollars of federal stimulus funding, hundreds of millions of dollars of state, local and private funding, and impacting California's efforts to promote green jobs and greenhouse gas emission reductions. Despite requests from the California Attorney General, the Governor, the Vice President, Members of Congress, the Department of Energy, the private lending community, and the Council on Environmental Quality, your agency has taken no action to resolve the situation or even identify a process by which the matter will be resolved.

The FHFA has raised a potentially serious issue – that PACE programs may increase the risk of default by increasing homeowner debt. As the attached hypothetical establishes, however, the practical effect on Fannie Mae's and Freddie Mac's portfolios is minimal, given the relatively small liens that may result from missed PACE assessments and the default rate that reasonably can be expected in PACE communities. Nonetheless, California and the local governments that are attempting to move forward with PACE programs are prepared – immediately – to discuss with you how those risks have already been addressed and minimized through detailed program requirements and "best practices." Depending on what further concerns the FHFA may have, we commit to working with you to identify and implement further actions as needed. We cannot, however, afford your agency's continued silence. The time to act on this matter is at hand.

There is a great deal at stake here for California and for the nation's economy. We take seriously the FHFA's concerns about mortgage security and are prepared to address those concerns. We ask you to take seriously the need to move forward immediately with California's PACE programs, with energy efficiency and renewable energy retrofit efforts, with federal stimulus funding, and with California's determined efforts to create jobs and economic momentum.

We would like to set up a meeting as soon as possible in order to resolve this matter. We believe that the meeting would benefit from the participation of the Vice President's Office, the Governor's Office, and other officials who have been working extensively on this matter. Please contact me at your earliest convenience by the end of this month so that we can move forward in the most constructive manner possible.

Thank you for your immediate attention.

Sincerely,

Ken Alex

KEN ALEX
Senior Assistant Attorney General

For EDMUND G. BROWN JR.
Attorney General

Attachments

cc: Joseph R. Biden Jr., Vice President
Dianne Feinstein, U.S. Senator
Barbara Boxer, U.S. Senator
Steven Chu, Secretary, U.S. Department of Energy
Shaun Donovan, Secretary, U.S. Department of Housing and Urban Development
Timothy Geithner, Secretary, U.S. Department of the Treasury
Carol Browner, Director, White House Office of Energy and Climate Change
Nancy Sutley, Chair, Council on Environmental Quality
Michael J. Williams, President and Chief Executive Officer, Fannie Mae
Charles E. Haldeman, Jr., Chief Executive Officer, Freddie Mac
Arnold Schwarzenegger, Governor, State of California
Bill Lockyer, State Treasurer and Chair, CAEATFA
Karen Douglas, Chair, California Energy Commission

Hypothetical Exploring Risk Associated with PACE Liens
Averaged Over a Portfolio of Mortgages

The impact of the PACE financing on the risk borne by mortgage lenders is minimal. The following mortgage foreclosure scenario shows why:

> A homeowner of a house valued at $300,000 with a $250,000 mortgage seeks $15,000 in PACE financing, reflecting the costs of a renewable energy system and energy efficiency upgrades, less all available rebates and incentives. (Some large solar projects may cost more; efficiency-only upgrades will be substantially less.)
>
> With a 7% interest rate (which is on the high side) and a 20-year payback period, the estimated annual PACE assessment would be $1,470.[1]
>
> The homeowner stops paying the mortgage and property taxes, including assessments. Delinquency on the mortgage occurs when the home owner is less than three monthly payments behind in the mortgage, and default when the homeowner is three or more monthly payments behind; default triggers foreclosure.[2]
>
> At the time of foreclosure for failing to pay the mortgage, it is likely that at most, one PACE assessment of **~$1,500** would have achieved priority lien status. (This is because under California law, there is no acceleration of the entire amount financed for failure to pay an assessment, including a PACE assessment; rather, the new owner assumes the continuing obligation to pay the assessments as they become due.)

If we run the same hypothetical with PACE financing of $20,000, the PACE lien consisting of one missed annual assessment would be $1,960.

This exercise suggests that with a "portfolio" of Fannie/Freddie mortgages that have PACE liens, assuming a high foreclosure rate of 10%, PACE seniority would average $150 per home (10% x $1,500). Using a more reasonable foreclosure rate of 5%, average PACE seniority per home would be a mere $75.

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[1] Results obtained by using Sonoma County's annual payment calculator, available at http://sonomacountyenergy.org/lower.php?url=calculator.

[2] See California Urban Strategies Council, *California Foreclosure Timeline*, available at http://www.urbanstrategies.org/foreclosure/Timeline/ForeclosureProcessTimelineandInterventions_7_11_07.pdf.

EXHIBIT C

AI Reports® Form 820.03*	Client File #:		Appraisal File #:	

Residential Green and Energy Efficient Addendum

Client:		
Subject Property:		
City:	State:	Zip:

Additional resources to aid in the valuation of green properties and the completion of this form can be found at
http://www.appraisalinstitute.org/education/green_energy_addendum.aspx

ENERGY EFFICIENT ITEMS

The following items are considered within the appraised value of the subject property:

Insulation	☐ Fiberglass Blown-In ☐ Foam Insulation ☐ Cellulose ☐ Fiberglass Batt Insulation ☐ Other (Describe): ☐ Basement Insulation (Describe): ☐ Floor Insulation (Describe):	R-Value: ☐ Walls ☐ Ceiling ☐ Floor
Water Efficiency	☐ Reclaimed Water System (Explain): ☐ Rain Barrels - #:	☐ Cistern - Size: Gallons ☐ Rain Barrels Provide Irrigation Location:
Windows	☐ ENERGY STAR® ☐ Low E ☐ High Impact ☐ Storm ☐ Double Pane ☐ Triple Pane ☐ Tinted	☐ Solar Shades
Day Lighting	☐ Skylights – #: ☐ Solar Tubes - #: ☐ ENERGY STAR Light Fixtures	☐ Other (Explain):
Appliances	ENERGY STAR Appliances: ☐ Range/Top ☐ Dishwasher ☐ Refrigerator ☐ Other: Water Heater: ☐ Solar ☐ Tankless (On Demand) Size: Gal.	Appliance Energy Source: ☐ Propane ☐ Electric ☐ Natural Gas ☐ Other (Describe):
HVAC (Describe In Comments Area)	☐ High Efficiency HVAC – SEER: ☐ Heat Pump ☐ Programmable Thermostat ☐ Wind	☐ Thermostat/Controllers ☐ Passive Solar ☐ Radiant Floor Heat ☐ Geothermal
Energy Rating	☐ ENERGY STAR Home ☐ HPwES (Home Performance with ENERGY STAR) ☐ Other (Describe):	☐ Indoor Air PLUS Package ☐ Energy Recovery Ventilator Unit ☐ Certification Attached
HERS Information	Rating: Date Rated:	Monthly Energy Savings on Rating: $
Utility Costs	Average Utility Cost: $ per month based on:	☐ Dashboards - #:
Energy Audit	Has an energy audit/rating been performed on the subject property? ☐ Yes ☐ No ☐ Unknown If yes, comment on work completed as result of audit.	
Comments		

*NOTICE: The Appraisal Institute publishes this form for use by appraisers where the appraiser deems use of the form appropriate. Depending on the assignment, the appraiser may need to provide additional data, analysis and work product not called for in this form. The Appraisal Institute plays no role in completing the form and disclaims any responsibility for the data, analysis or any other work product provided by the individual appraiser(s).

Client:		Client File #:	
Subject Property:		Appraisal File #:	

Solar Panels

The following items are considered within the appraised value of the subject property:

Description	Array #1 ☐ Leased ☐ Owned	Array #2 ☐ Leased ☐ Owned	Array #3 ☐ Leased ☐ Owned	Array #4 ☐ Leased ☐ Owned
KW				
Age of Panels				
Energy Production Kwh per Array				
Source for Production				
Location (Roof, Ground, Etc.)				
If Roof/Slope for Array				
Azimuth per Array				
Age of Inverter(s)				
Name of Utility Company:		Cost per Kwh charged by Company: $ /Kwh		
Comments (Discuss incentives available for new panels, condition of current panels, and any maintenance issues)				

Green Features

The following items are considered within the appraised value of the subject property:

Certification	Year Certified:	Certifying Organization:	☐ Reviewed on site	☐ Certification attached to this report
Rating	Score:	☐ LEED® Certified: ☐ Silver ☐ Gold ☐ Platinum ☐ Other:		
		☐ ICC-700 *National Green Building Standard* Certified: ☐ Bronze ☐ Silver ☐ Gold ☐ Emerald		
		Certifying Organizations Green Score Range - High Score: Low Score:		
Additions	Explain any additions or changes made to the structure since it was certified:			
	Do changes require recertification to verify rating is still applicable? ☐ Yes ☐ No			
Comments				

*NOTICE: The Appraisal Institute publishes this form for use by appraisers where the appraiser deems use of the form appropriate. Depending on the assignment, the appraiser may need to provide additional data, analysis and work product not called for in this form. The Appraisal Institute plays no role in completing the form and disclaims any responsibility for the data, analysis or any other work product provided by the individual appraiser(s).

Client:		Client File #:	
Subject Property:		Appraisal File #:	

Location - Site

The following items are considered within the appraised value of the subject property:

Walk Score	Score:	Source:	
Public Transportation	☐ Bus – Distance: Blocks	☐ Train – Distance: Blocks	☐ Subway – Distance: Blocks
Site	Orientation - front faces: ☐ East/West ☐ North/South	Landscaping: ☐ Xeriscaped ☐ Zero Impact ☐ Natural	
Comments			

Incentives – Amount of Incentive and Terms

The following items are considered within the appraised value of the subject property:

Federal	
State	
Local	
Source	
Comments	

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