STATE OF CALIFORNIA

CALIFORNIA ALTERNATIVE ENERGY AND ADVANCED TRANSPORTATION FINANCING AUTHORITY
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March 31, 2011

Mr. Gregory Schmidt
Secretary of the Senate
State Capitol, Room 400
Sacramento, CA 95814

Mr. E. Dotson Wilson
Chief Clerk of the Assembly
State Capitol, Room 3196
Sacramento, CA 95814

Re: **California Alternative Energy & Advanced Transportation Financing Authority 2010 Annual Report on Senate Bill 77 (Pavley, Statutes of 2010)**

In accordance with the provisions of Section 26141 of the Public Resources Code, the California Alternative Energy & Advanced Transportation Financing Authority ("Authority" or "CAEATFA") respectfully submits its Annual Report on Senate Bill 77 (SB 77, Pavley, Statutes of 2010) for the calendar year ending December 31, 2010. SB 77 appropriated $50 million from the Renewable Resource Trust Fund to the Authority for the purpose of creating a Property Assessed Clean Energy ("PACE") Bond Reserve Program, which would assist local jurisdictions in financing the installation of energy efficiency and renewable energy upgrades for residential and commercial properties. While the Authority began the initial administration and outreach in 2010 to develop the PACE Bond Reserve Program, most residential PACE programs have been stalled as a result of legal and legislative challenges at the federal level.

The information presented in this report includes an overview of the Authority's activities to date, including a summary of the issues that prevented the Authority from further developing the Program, the status of those issues as well as a brief overview of statutory changes the Authority is exploring to fulfill the intended purpose of the legislation – to promote energy efficiency and job creation in new clean industries that will stimulate the economy.

Should you have any questions or need additional information, please feel free to contact me at (916) 653-3303.

Sincerely,

Christine Solich
Executive Director

Attachments
Cc: Bill Lockyer, Chair of the Authority
Board Members of the Authority
Diane F. Boyer-Vine, Legislative Counsel Bureau
Mac Taylor, Legislative Analyst

California Alternative Energy and Advanced Transportation Financing Authority

PACE Bond Reserve Program

2010 ANNUAL REPORT TO THE CALIFORNIA STATE LEGISLATURE

March 2011

About CAEATFA:

The California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA) provides financing for facilities needed to develop and commercialize advanced transportation technologies and alternative energy that conserve energy, reduce air pollution, and promote economic development and jobs. Over the last few years, CAEATFA has provided financial assistance through various programs, including:

- SB 71 Advanced Transportation and Alternative Source Manufacturing Sales and Use Tax Exclusion Program for companies that design, manufacture, produce or assemble advanced transportation technologies or alternative source products, components or systems.
- Qualified Energy Conservation Bonds (QECBs) to provide low-interest financing to promote the use of alternative energy and energy efficiency in state, local and tribal government facilities.
- Clean Renewable Energy Bond (CREB) Program to provide low-interest bond financing to state and local governments, cooperative electric companies, clean renewable energy bond lenders and tribal governments for certain renewable energy and clean coal facilities.
- Zero Emission Vehicle Program (ZEV) provides advanced transportation projects financial assistance in the form of a sales and use tax exclusion for the purchase of manufacturing equipment.
- California Ethanol Producers Incentive Program (CEPIP), on behalf of the California Energy Commission, may provide operators of existing ethanol production plants in California with temporary financial assistance during difficult economic conditions.
- Energy Upgrade California (EUC) Program, on behalf of the California Energy Commission, may establish a financial clearinghouse of affordable financing options to help residential and commercial property owners pay for the upfront cost of energy efficiency and renewable energy improvements to their property.

PACE Bond Reserve Program

This report of activities for the Property Assessed Clean Energy ("PACE") Bond Reserve Program is submitted pursuant to Public Resources Code Section 26141 for the calendar year ending December 31, 2010.

EXECUTIVE SUMMARY

Under Senate Bill 77 (SB 77, Pavley, Statutes of 2010), the California Alternative Energy and Advanced Transportation Financing Authority ("Authority" or "CAEATFA") is mandated to develop and administer a $50 million PACE Bond Reserve Program to assist in reducing the overall financing costs to property owners securing a voluntary contractual assessment on their property to make energy efficiency or renewable energy improvements to their property.

Soon after the passage of the legislation, CAEATFA began conducting research on existing PACE programs in the State of California and engaged key stakeholders to receive feedback on best practices and sound underwriting criteria in an effort to develop regulations for the Program. The Authority held one public workshop in Van Nuys, California in June 2010 to obtain input from local jurisdictions and other stakeholders familiar with PACE financing.

In July 2010, several legal issues raised by the Federal Housing Financing Agency ("FHFA") caused many local jurisdictions throughout the country, including jurisdictions in California, to put a hold on developing, launching and administering their PACE residential programs. Due to the uncertainty on whether cities and counties in California would be able to leverage the credit enhancements authorized by Senate Bill 77, the Authority refocused its outreach and research efforts until the legality and vitality of residential PACE programs is further clarified and explored. The Authority continues to engage active and new PACE commercial programs in California to learn about the need for a PACE Bond Reserve.

The Authority is exploring legislative expansion of Senate Bill 77 in the 2011 legislative cycle to expand the intended purpose of the original legislation – to promote energy efficiency and job creation in new clean industries that will stimulate the economy.

This report highlights CAEATFA's activities to date to implement Senate Bill 77, including the steps taken to begin developing the PACE Bond Reserve Program and an overview of the legal and legislative issues at the federal level that hinder Program development and implementation.

Background

Legislative Summary. Legislation enacted in April 2010 (SB 77, Pavley) authorized the California Alternative Energy and Advanced Transportation Financing Authority ("CAEATFA") to establish a Property Assessed Clean Energy ("PACE") Bond Reserve Program to assist local jurisdictions in financing the installation of distributed generation renewable energy sources or energy or water efficiency improvements that are permanently affixed on residential and commercial property through the use of a voluntary contractual assessment. Tax liens created by assessments are typically senior to other obligations, including mortgages, and must be paid first. In response to the legislation, CAEATFA began conducting research to develop minimum loan structure and credit underwriting criteria.

Program Goal. The purpose of the PACE Bond Reserve is to provide credit enhancement support to local jurisdictions with existing PACE programs to reduce the interest rate on issued bonds. In essence, local jurisdictions establish a financing district and issue bonds to make voluntary assessments available to residential and commercial property owners who wish to make energy efficiency or renewable energy improvements to their property. CAEATFA, in turn, would develop and administer a PACE Bond Reserve Program to reduce the overall costs of bond issuance. The Program would provide a reserve of no more than ten percent of the initial principal amount of the PACE bond. As a result, it is anticipated that these savings would be passed on to the consumer. By providing a credit enhancement, the PACE financing would continue to create jobs, lower energy demand and spur new clean industries that could grow the California economy.

Program Development

CAEATFA conducted extensive research on California's existing residential and commercial PACE programs to understand the program structure and bond underwriting criteria being employed by municipalities and counties.[1] In addition to conducting research on programs across the State, CAEATFA also endeavored to become familiar with other successful energy efficiency financing programs across the country and to learn from their best practices, including programs such as Pennsylvania's Keystone HELP, Oregon's Clean Energy Works and Maine's Home Energy Savings Loan. CAEATFA also reviewed and analyzed independent reports and best practices identified by the Department of Energy and other research groups including the Lawrence Berkeley National Laboratory.

CAEATFA began the public participation process to develop the Program, which included conversations and input from local jurisdictions, consultants and private companies assisting with the development and administration of PACE programs. In addition, CAEATFA held a public workshop in Van Nuys, California on June 30, 2010, to obtain input from municipalities, counties, PACE administrators and other stakeholders familiar with PACE financing. CAEATFA engaged lenders and trustee banks to receive input on credit underwriting criteria the Authority should consider as it started developing the Bond Reserve Program structure.
The collaborative process resulted in a broad overview and understanding of PACE programs in the State of California.

[1] CAEATFA's research on PACE programs in California include, but is not limited to, Berkeley's Financing Initiative for Renewable and Solar Technology (FIRST) program, City and County of San Francisco's GreenFinanceSF program, Sonoma County's Energy Independence program, California Statewide Communities Development Authority's California FIRST program, County of Los Angeles, Placer County's mPOWER program, Pacific Housing and Finance Agency's Energy and Water Efficiency program, North Coast Energy Independence program, Santa Barbara County's mPowerSBC program, Alameda County's Green Packages program, Santa Cruz's Energy Independence and Economic Stimulus Initiative, the Western Riverside Council of Governments' program and programs for the cities of San Diego, Santa Monica, Solana Beach, Yucaipa and Palm Desert.

The Authority slowed its outreach and research efforts due to several issues raised at the federal level, which are addressed in the next section. However, the Authority has maintained periodic communication with existing PACE programs to stay informed on program activity, expansion efforts, and their interest in the SB 77 Program. CAEATFA continues to explore the need for the reserve funds among jurisdictions that are moving forward with PACE programs in either the residential or commercial sectors. Some local jurisdictions have expressed a desire to access the PACE Bond Reserve funds once they have reached a critical mass in underwriting assessments to support the issuance of a PACE bond.

Legislative and Legal Challenges with PACE Programs

On July 6, 2010, the Federal Housing Finance Agency ("FHFA") issued a pronouncement concluding that PACE programs "present significant safety and soundness concerns" and violated standard mortgage provisions since PACE tax liens required priority over any other loan or mortgage.

The concerns expressed by FHFA caused the majority of the PACE residential programs throughout the country to be placed on hold. However, since these concerns do not apply to the commercial sector, several PACE commercial programs in California are under development, including Placer County's mPOWER, County of Santa Barbara, City of San Francisco, County of Los Angeles, City of San Diego and City of Fresno's Programs. In addition, the City of Palm Desert's and Sonoma County's Energy Independence Programs were launched in 2009 and have continued to administer their PACE programs for both the residential and commercial sectors.

Legislative and legal actions have been initiated at both the state and federal level. California Congressman Mike Thompson and Senator Barbara Boxer introduced legislation in the summer of 2010 in Congress that would overrule the FHFA and would compel it to accept the seniority of a PACE assessment. While Congress has not taken action on this PACE legislation, work is continuing to prepare for the 2011 session.

Besides the legislation introduced by Congressman Thompson and Senator Boxer, several local and state governments and other groups throughout the country filed lawsuits to try to restart stalled PACE programs, including Sonoma County, the California Attorney General's Office, the Sierra Club and the Natural Resources Defense Council. Also filing suit was the City of Palm Desert, one of the first to initiate tax-assessed financing for energy projects in 2008. The first court orders regarding elements of the PACE lawsuits were issued on December 2010 and cover Sonoma County's request for a preliminary injunction and the court's desire for the U.S. Department of Justice to weigh in.

There is also an active and cooperative mobilization effort being led by non-profit organizations, municipalities, counties and states. There is optimism that the legal and legislative challenges will be resolved in 2011. Several local jurisdictions in California, Ohio and New York have, or indicated that they are, determined to move forward with their programs.

Statutory Reporting Requirements

1. The status of the account.

   Of the $50 million appropriation from the Renewable Resource Trust Fund, up to three hundred thousand dollars ($300,000) may be expended by the Authority for the initial administrative costs in implementing the PACE Bond Reserve Program.

   The Authority spent $16,924.79 for administrative purposes in 2010 to conduct research and engage stakeholders on eligibility and evaluation criteria in the development of program regulations. CAEATFA continues to monitor the status of PACE programs and continues to engage stakeholders who are interested in the SB 77 program.

2. Summary of the PACE bonds that received assistance.

   While Authority staff conducted initial research to implement this legislation, the program has not yet been developed due to legal and legislative challenges that must be overcome at the federal level. As a result, the development of the PACE Bond Reserve Program has been slowed and no PACE bonds have sought or received assistance.

3. Summary of the benefits provided by this Program, including reduced interest rates on the PACE bonds receiving assistance.

   No benefits have been achieved to date since the program has not been developed or implemented.

4. The number of jobs created by the PACE programs that received assistance.

   No benefits have been achieved to date since the program has not been developed or implemented.

5. Information on energy and water savings resulting from the PACE programs that received assistance.

   No benefits have been achieved to date since the program has not been developed or implemented.

Next Steps

As the future of PACE financing remains undecided at the federal level, the Authority will be seeking an author for statutory changes to preserve the legislative intent of SB 77. The contemplated revision will allow the previously appropriated funds for the PACE Bond Reserve Program to be expanded to include financial incentive programs in addition to a PACE Bond Reserve that fulfill the intended purpose of the original legislation – to promote energy efficiency and job creation in new clean industries that will stimulate the California economy.

Recently, the Authority has been engaged by the California Energy Commission to identify financing options that promote statewide consumer energy efficiency and job stimulation. The Energy Commission has begun to design the Energy Upgrade California Program – including a statewide web portal – which is funded through American Recovery and Reinvestment Act ("ARRA") funds. When complete, the web portal is intended to serve as a one-stop clearinghouse for consumers interested in energy efficiency financing through a network of lenders and contractors. The clearinghouse is anticipated to include financial incentives such as a loan loss reserve for certain borrowers or other types of credit enhancements.

Over the next several months, the Authority will continue to engage financial institutions to gauge their interest in alternative energy financing options beyond PACE. Through a statewide public process, the Authority will seek to obtain lender feedback during the development of the underwriting criteria and credit enhancement structure of the Energy Upgrade California financial clearinghouse. The Authority will also continue to work with local governments that propose to create their own financial product or who have an existing PACE program. The Authority has made a concerted effort to stay informed of the status, loan volume and program structure of local jurisdictions with energy efficiency financing programs as lenders in these existing programs may eventually choose to participate in the statewide financial clearinghouse.

It is anticipated that through this engagement with the California Energy Commission, the Authority will continue its work to identify and develop potential options to move forward energy efficiency financing for consumers within the State and continue to report on the status of these activities as they progress.