

**CALIFORNIA ALTERNATIVE ENERGY AND  
ADVANCED TRANSPORTATION FINANCING AUTHORITY**  
**Meeting Date: February 18, 2014**

***Request to Consider and Approve Emergency Regulations for the Property Assessed Clean  
Energy (PACE) Loss Reserve Program***

Prepared By: *Noah Proser*

**Issue.** In 2013, Senate Bill 96 (Committee on Budget and Fiscal Review) authorized the California Alternative Energy and Advanced Transportation Financing Authority (Authority or CAEATFA) to create a risk mitigation program for Property Assessed Clean Energy (PACE) loans using \$10 million allocated in the Budget Act of 2013. Pursuant to this authority, CAEATFA staff (Staff) are proposing emergency regulations to create a residential PACE Loss Reserve Program (Program). The proposed regulations are included in Attachment A.

**Background.** PACE is an innovative financing method that uses community facility districts or improvement districts to finance the installation of distributed generation renewable energy sources, electric vehicle charging infrastructure, or energy or water efficiency improvements. PACE improvements can be funded by bonds or other sources of capital that are repaid through the property owner's property tax bill. PACE allows homeowners to finance retrofits over up to 20 years with no money down. Additionally, PACE obligations have lien-priority over other voluntary obligations. The security provided by this priority allows PACE programs to offer favorable interest rates.

In 2010, the Federal Housing Finance Agency (FHFA) raised concerns that Property Assessed Clean Energy (PACE) financing created safety and soundness concerns for federal mortgage enterprises due to its priority lien status over mortgages. FHFA directed federal mortgage enterprises to adjust their lending criteria in areas with residential PACE programs and require homeowners to seek approval from their mortgage lenders before taking on a PACE obligation. Following this decision, many PACE administrators halted their residential PACE programs to avoid placing homeowners in conflict with the terms of their mortgages. The State of California and several other parties sued FHFA for making this decision without a formal rulemaking; however, in March 2013, the 9<sup>th</sup> Circuit Court of Appeals ruled in FHFA's favor.

The proposed Program seeks to address FHFA's concerns regarding the senior lien priority of PACE obligations by reimbursing first mortgage lenders for specified losses resulting from the existence of a PACE lien on a property during a foreclosure or forced sale for unpaid property taxes. Covering those losses should mitigate any additional risk to first mortgage lenders created by PACE liens and allow residential PACE programs in California to move forward.

**PACE Loss Reserve Program Goals & Development.**

**1. Program Goals.**

The Program is intended to remove any additional risk to the first mortgage lender resulting from the existence of a PACE loan on a property in a foreclosure or forced sale for unpaid taxes. By addressing the concerns raised by FHFA, the Program should provide additional safeguard for both existing and new residential PACE programs to expand in California. If FHFA and the federal mortgage enterprises are satisfied, they may allow mortgages to be purchased without requiring the PACE loan to be extinguished. Lifting this requirement would restore one of the principal advantages of PACE financing: transferability of the loan upon the sale of a home.

Additionally, by tracking the performance of PACE portfolios over the next several years, the Program should provide more detailed information on the actual credit risk associated with PACE financing than is currently available. This information will be useful for potential investors in PACE bonds and securities and may allow them to accept lower returns on these investments.

**2. Program Development.**

Staff has been working with stakeholders on program goals and potential structures since July 2013 and has determined that a loss reserve model would accomplish the Program’s goals efficiently and at a reasonable cost to participants and the State.

Staff provided the proposed regulations to the public for review and comment on January 16, 2014 and held a workshop on January 24, 2014. Forty-three stakeholders participated in the workshop, and seven comment letters were submitted to the Authority. After considering the comments received, Staff provided revisions to the proposed regulations on February 4, 2014 and received four additional comment letters to date.

Staff has analyzed and considered all comments and incorporated changes to the emergency regulations when appropriate. The proposed final emergency regulations balance stakeholders’ comments with the statutory, legal and Program administration framework.

**Program Structure.**

**1. Application – §10081**

To apply for the Program, PACE program administrators will submit:

- the formation documents required by the PACE program’s authorizing statute;
- documents showing the PACE program meets the Authority’s underwriting criteria;
- a description of transactional activities including fees;
- a description of quality assurance and consumer protection protocols; and,
- information on the size of their existing loan portfolios.

Additionally, applicants will agree to permit CAEATFA to audit their records as requested by the Executive Director. CAEATFA will have 10 calendar days to review and approve complete applications.

**Key Policy Issues and Decisions:**

The Authority’s statute specifies underwriting criteria that PACE programs receiving assistance must meet. The underwriting criteria listed in the proposed regulations are largely drawn from these statutory criteria. Stakeholders have commented that some of these criteria are too restrictive and do not match their current practices.

**Loan Value Limitation**

CAEATFA’s statute limits the value of loans receiving assistance to less than 10% of the home value.<sup>1</sup> Several stakeholders have commented that this limitation will preclude homeowners in less affluent areas from performing whole-house energy efficiency retrofits or installing rooftop solar. While stakeholders have suggested several alternative underwriting criteria that could provide similar or greater levels of protection, these alternatives would require a statutory change.

**Requirement to Meet Underwriting Criteria in Full**

Some stakeholders also suggested that PACE programs would appreciate the ability to partially enroll in the Program, covering only those loans that met the criteria. Doing so would provide those PACE programs using different underwriting criteria than the Program with the flexibility to enroll without altering their current operations; however, Staff determined that partial enrollment would weaken the impact of the Program. Allowing partial enrollment would also create an administrative burden for mortgage lenders, PACE programs, and the Authority to establish the eligibility and coverage status of each loan.

In the application to the Program, PACE programs will demonstrate that these criteria are met going forward, but their existing portfolios will not need to meet the criteria to be covered as described below. It is unclear whether requiring full enrollment will deter participation from PACE programs with less restrictive underwriting criteria. Some stakeholders have indicated that they may temporarily alter their programs to meet the underwriting criteria, but will seek legislative changes to the 10% limitation in the long term.

**2. Function of the Reserve - §10083**

The Program will cover two, specific types of losses for first mortgage lenders:

- a. If a first mortgage lender forecloses on a property with a PACE loan, the Program will cover the amount of property tax attributable to the PACE lien that is paid by the first mortgage lender while in possession of the property. The Program will also cover penalties and interest if accrued through no fault of the first mortgage lender.

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<sup>1</sup> Public Resources Code §26063(a)(4)

- b. If a county conducts a forced sale on a property for unpaid taxes, the Program will cover any losses to the first mortgage lender up to the amount of overdue PACE payments.

PACE programs will submit claims for eligible losses to CAEATFA and either accept payment from the loss reserve as a reimbursement or as a pass-through to the first mortgage lender.

Staff analyzed several potential liability scenarios and determined that the \$10 million authorized for the Program should last beyond 10 years in most cases. Even in the most conservative scenario, the reserve is projected to last through year eight. While this scenario is unlikely, it would still provide sufficient time to better understand the performance of PACE portfolios and seek additional funds if necessary.

In reality, Staff expect the reserve funds to last beyond 10 years since losses are limited in several ways. Unlike traditional property taxes, PACE loans are screened by PACE programs' underwriting criteria to select homeowners that are likely to repay their obligations. Where homeowners do fail to pay their obligations (either the PACE assessment or the mortgage), claims to the reserve are limited to those cases where the first mortgage lender takes possession of the home or where the property is sold by the county for less than the combined value of the taxes and the first mortgage. Since regular property tax payments will resume upon the property's sale, the reserve will not be liable for the full PACE loan amount, only those payment amounts described above.

**Key Policy Issues and Decisions:**

**Eligibility of Losses to Private Mortgage Lenders**

The proposed Program would cover losses to any first mortgage lender as described above. Some stakeholders have commented that reserve funds should solely be used to compensate federal mortgage enterprises to address FHFA's specific concerns and increase the lifespan of the \$10 million currently allocated. Staff has determined that discriminating between federal mortgage enterprises and other first mortgage lenders would result in confusion and uncertainty in the market. Since mortgages are resold regularly and private mortgage lenders may have similar concerns as FHFA, Staff is proposing to cover all first mortgage lenders for eligible losses.

**Limitation of Losses to First Mortgage Lenders**

Additionally, Staff had not originally specified that losses could only apply to first mortgage lenders. Stakeholders commented that only first mortgage lenders should be eligible to receive payments from the reserve, as second mortgages have a lesser lien priority. It is unlikely that a second mortgage lender would incur the eligible losses described; however, Staff has updated the proposed regulations to limit losses to first mortgage lenders to address this possibility.

**3. Coverage of PACE Portfolios – §10082**

The Program will cover PACE loans for the length of their terms for the losses allowed under the Program as specified. All loans issued by enrolled programs and included on reports submitted to the Authority will be covered by the reserve. In addition, the Program will accommodate existing loan portfolios of existing programs that apply up to 90 days after the regulations take effect, and any loans issued by a newly created PACE Program up to 30 days before its enrollment in the Program.

**Key Policy Issues and Decisions:**

**Accommodating Existing PACE Programs' Loan Portfolios**

Staff has proposed to incorporate the existing portfolios of PACE programs to minimize risk and uncertainty in the market and maximize the Program's impact. For existing PACE Programs that apply within 90 days of the effective date of the regulations, the Program will cover any loans issued through the enrollment date. These loans will be covered at no charge since the PACE Programs have no means of collecting additional fees from loans that have already been issued, and the Authority already has a budget allocation for administrative expenses in the current year. Additionally, for new PACE Programs, Staff has proposed a 30 day coverage window before enrollment to allow those programs to begin lending during the Authority's review of their applications. Loans issued within that 30 day period would also be covered at no charge. As discussed above, the preexisting loans would not need to meet the Program's underwriting criteria to be covered by the reserve.

**4. PACE Program Reporting and Administrative Fee - §10086**

Enrolled PACE programs will report to CAEATFA on March 1<sup>st</sup> and October 1<sup>st</sup> of each year. The March 1<sup>st</sup> report will include information on loans issued between July 1 and December 31 of the previous year. The October 1<sup>st</sup> report will include information on loans issued between January 1 and June 30 of that year, and cumulative information on the loan portfolio and energy and water savings resulting from the PACE loans.

Each of these reports will be submitted with an administrative fee of 0.25% (25 basis points) of the principal value of new loans issued during the reporting period. This fee will not be assessed on the existing portfolio of loans described above.

**Key Policy Issues and Decisions:**

**Administrative Fee**

The administrative fee is designed to cover the Authority's reasonable costs of administering the Program over twenty or more years. Since many PACE loans have 20-year terms, Staff expects to administer the Program for up to 20 years after the last loan is issued. Fee revenue will depend on enrollment and loan activity, and may need to be adjusted once a track record for the Program is established. Some stakeholders requested a formal timeline for review of the fee amount. Staff is proposing to review the fee after two years and annually thereafter or upon determination by the Board.

**5. Reports to the Legislature**

As required by the Program’s authorizing statute, the Authority will report the status of the loss reserve account, a summary of the loans that received assistance, the amount of energy savings resulting from and number of jobs created by those loans, and a summary of the benefits provided by the Program to the Legislature on an annual basis. Due to the standard timeframes for the preparation of annual tax levies, the reported data will be based on the fiscal year.

**Regulatory Process.**

Upon Board approval of the proposed final emergency regulations, the formal emergency rulemaking process will begin. Staff will post the notice of emergency rulemaking, a finding of emergency and the text of emergency regulations to the CAEATFA website. Staff will also provide these documents to all interested parties through the e-mail listserv. Upon submittal of the regulation package to the Office of Administrative Law (“OAL”), emergency regulations will be subject to a five day public comment period. CAEATFA will have until day eight to respond to any public comments that are submitted; and OAL must make a final decision on the tenth day following submission. If on the tenth day OAL approves the emergency regulations, they will be filed with the Secretary of State and become effective upon this filing date. The emergency regulations will be valid for six months (180 days), during which time CAEATFA will begin the regular rulemaking process.

**Tentative Timeline.**

All of the dates below are tentative and subject to change at any time.

February 18 <sup>th</sup>	CAEATFA Board reviews and approves emergency regulations and proposed Program forms
February 25 <sup>th</sup>	Emergency regulations are submitted to OAL five business days after approval by the Board and notice by the Authority
March 7 <sup>th</sup>	OAL decision deadline, emergency regulations in effect for 180 days
June 5 <sup>th</sup>	Last day for existing PACE programs to apply to accommodate existing portfolios
September 3 <sup>rd</sup>	End of 180 Days for emergency regulations

**Recommendation.** Staff recommends adoption of a resolution to approve the proposed emergency regulations establishing the PACE Loss Reserve Program and authorize Staff to undertake emergency and regular rulemaking proceedings and other actions related to promulgation of the regulations.

Attachments:

- Attachment A – Proposed Text of Emergency Regulations

**Resolution of the California Alternative Energy and Advanced Transportation Financing Authority Approving Regulations and Authorizing Emergency and Regular Rulemaking Proceedings and Other Actions Related Thereto, Including the Public Notice and Comment Procedures to Implement The PACE Loss Reserve Program**

WHEREAS, the California Alternative Energy and Advanced Transportation Financing Authority ("Authority") is authorized by California Public Resources Code Section 26009 to adopt regulations to implement and make specific the statutory provisions governing the Authority; and

WHEREAS, the Authority has determined that amendments to the Authority's regulations relating to its implementation of the PACE Loss Reserve Program (the Program), as authorized in Section 26060 of the Public Resources Code, are necessary to be adopted at this time to implement the Program.

NOW, THEREFORE, BE IT RESOLVED by the California Alternative Energy and Advanced Transportation Financing Authority as follows:

Section 1. The proposed form of Regulations, on file with the Authority, is hereby approved. The Chair, Executive Director and Deputy Executive Director are hereby authorized to file the Regulations, with the supporting documentation required by law, with the Office of Administrative Law as emergency regulations in the form currently on file with the Authority.

Section 2. The Chair, Executive Director and Deputy Executive Director are hereby authorized to proceed with the public notice and comment procedures required by California Rulemaking Law prior to submitting emergency and regular regulations to the Office of Administrative Law.

Section 3. The Chair, Executive Director and Deputy Executive Director of the Authority are hereby authorized to take necessary actions, including making any necessary changes to the Regulations to secure approval by the Office of Administrative Law, and to execute and deliver any and all documents necessary or advisable in order to effectuate the purposes of this resolution.

Section 4. This resolution shall take effect immediately upon its approval.



Attachment A

**PROPOSED TEXT OF REGULATIONS**

**CALIFORNIA CODE OF REGULATIONS**

**Title 4. Business Regulations**

**Division 13. California Alternative Energy and Advanced Transportation Financing Authority**

**CALIFORNIA ALTERNATIVE ENERGY AND ADVANCED TRANSPORTATION FINANCING AUTHORITY REGULATIONS IMPLEMENTING THE PACE LOSS RESERVE PROGRAM**

**Article 4. PACE Loss Reserve Program**

**§10080. Definitions.**

(a) “Authority” means the California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA) established pursuant to Division 16 (commencing with Section 26000) of the Public Resources Code.

(b) “Executive Director” means the Executive Director of the Authority or his or her designee.

(c) “Loan” means a loan issued by, or a contractual assessment or special tax levied by a PACE program.

(d) “PACE Program” means a residential property assessed clean energy program financing the installation of distributed generation renewable energy sources, electric vehicle charging infrastructure, or energy or water efficiency improvements and established pursuant to:

- (1) Chapter 29 (commencing with Section 5898.10) of Part 3 of Division 7 of the Streets and Highways Code; or,
- (2) Chapter 2.5 (commencing with Section 53311) of Part 1 of Division 2 of Title 5 of the Government Code.
- (3) A charter city’s constitutional authority under Section 5 of Article XI of the California Constitution.

(e) “Program” means the PACE Loss Reserve Program established pursuant to Chapter 4 (commencing with Section 26050) of Division 16 of the Public Resources Code.

**§10081. Application by PACE Program to the PACE Loss Reserve.** A PACE Program seeking to participate in the PACE Loss Reserve Program shall complete an application that shall include the following information:

(a) The formation documents required pursuant to:

**Agenda Item – 4.A.**

- (1) Streets and Highways Code Sections 5898.12, 5898.14, and 5898.20 – 5898.22;  
or,
  - (2) Chapter 2.5 (commencing with Section 53311) of Part 1 of Division 2 of Title 5 of the Government Code; or,
  - (3) In the case of a charter city, a copy of a resolution or other document adopted by the city's governing board evidencing approval of the PACE Program.
- (b) If not included in the documentation required in subdivision (a) above, documents showing that the PACE Program requires that property owners can show all of the following as part of the financing underwriting process:
- (1) All property taxes for the assessed property are current for the previous three years or since the current owner acquired the property, whichever period is shorter.
  - (2) The property is not subject to any involuntary lien in excess of \$1,000.
  - (3) The property is not subject to any notices of default.
  - (4) The property owner is not in bankruptcy proceedings.
  - (5) The property owner is current on all mortgage debt.
  - (6) The party seeking financing is the holder of record on the property.
  - (7) The property is within the geographical boundaries of the PACE Program.
  - (8) The Loan is for a residential property of three units or fewer.
  - (9) The Loan is for less than ten percent (10%) of the value of the property.
- (c) If not included in the documentation required in subdivision (a) above, a detailed description of:
- (1) The transactional activities associated with the Loan issuance, including all transactional costs; and,
  - (2) Requirements for quality assurance and consumer protection, as related to achieving efficiency and clean energy production.
- (d) A summary of the PACE Program's existing residential financing portfolio certified pursuant to Section 10087 as of the date of application. The summary shall include the following information:
- (1) The total number of Loans in the portfolio.
  - (2) The total value of the portfolio.
- (e) The PACE Program's agreement to permit an audit of any of its records relating to enrolled Loans, during normal business hours on its premises, by the Authority or its agents, and to supply such other information concerning enrolled Loans as shall be requested by the Executive Director.

- (f) Upon receipt of a completed application, the Executive Director will within ten business days review and determine whether additional information is required, or whether the application is sufficient to enroll the PACE Program. The Executive Director's decision whether an application is sufficient shall be final.

**§10082. Coverage of PACE Loan Portfolios.**

- (a) For PACE Programs created before the effective date of these regulations and making application pursuant to Section 10081 not more than 90 calendar days after the effective date of these regulations, all PACE Loans outstanding at the time of enrollment shall be covered by the loss reserve pool for the length of their term. In addition PACE Loans originated after enrollment and included in reports as provided in Section 10085 shall be covered by the loss reserve pool for the length of their term.
- (b) For PACE Programs created after the effective date of these regulations, all PACE Loans originated not more than 30 calendar days before the date of the PACE Program enrollment pursuant to Section 10081 shall be covered by the loss reserve pool for the length of their term. In addition PACE Loans originated after enrollment and included in reports as provided in Section 10085 shall be covered by the loss reserve pool for the length of their term.

**§10083. Claims Against the Loss Reserve Pool.** Any PACE Program may make claim for payment from the loss reserve pool for the following losses incurred by first mortgage lenders and limited to losses on the Loans described in Section 10082 directly attributable to the existence of a PACE Program lien on a specified property. Losses include:

- (a) Losses resulting from the first mortgage lender's payment of any PACE assessment paid while in possession of the property subject to the PACE assessment. Losses may also include penalties and interest where they have accrued through no fault of the first mortgage lender.
- (b) In any forced sale for unpaid taxes or special assessments, losses incurred by the first mortgage lender resulting from PACE assessments being paid before the outstanding balance.

In no instance shall the loss exceed the amount of the PACE assessment, or in the case of forced sale for unpaid taxes or special assessments, the amount of the delinquent PACE assessments.

**§10084. Claims Procedure.**

- (a) Any PACE Program seeking to make a claim against the loss reserve pool for losses as described in Section 10083 shall submit satisfactory evidence of the eligible loss,

including but not limited to the assessor's parcel number, the loss amount, the origination date, the first mortgage lender, the date of the loss or losses, and the certification described in Section 10087. The Authority shall make payments to PACE Programs within 20 calendar days of receipt of a completed claim.

- (b) In the event of an eligible claim on a Loan where the PACE Program has been terminated pursuant to Section 10086, the Authority may seek additional evidence of the eligible loss from the first mortgage lender.

**§10085. PACE Program Reporting and Administrative Fee.**

- (a) Each enrolled PACE Program shall report to the Authority twice each calendar year. These reports shall be certified pursuant to Section 10087.
  - (1) On March 1<sup>st</sup> of each year, each enrolled PACE Program shall submit the following for the period from July 1 through December 31:
    - i. The assessor's parcel number, principal amount, annual assessment amount and term of each new Loan originated in the reporting period.
    - ii. The total number and value of new Loans originated in the reporting period.
    - iii. Payment of the administrative fee set forth in paragraph (b) of this section.
  - (2) On October 1<sup>st</sup> of each year, each enrolled PACE program shall submit the following for the period from January 1 through June 30:
    - i. The information and payment outlined in subdivision (a)(1) above.
    - ii. The total number of outstanding Loans.
    - iii. The total value of the Loan portfolio.
    - iv. Information on energy and water savings resulting from the projects funded by the covered portfolio of Loans.
- (b) The Authority shall assess an administrative fee of 0.0025 (0.25%) of the principal value of each Loan issued by a Participating PACE Program during the period covered by the report, except those outstanding at the time of enrollment as described in Section 10082. Two years after the effective date of these regulations and every year thereafter, the Authority shall review the fee. In addition, the Authority may review the fee at any time upon a vote of a majority of the Authority.
- (c) In the event that a report and payment is not received within 60 calendar days of the due date as set forth in this section, the Authority may terminate the PACE Program's enrollment, pursuant to Section 10086(b).

**§10086. Termination and Withdrawal from the Program.**

- (a) Each enrolled PACE Program may withdraw from the Program after giving written notice to the Authority. The notice shall specify either:
  - (1) That the enrolled PACE Program waives any further interest in the loss reserve pool (including for the reason that all Loans covered by the loss reserve pool have been repaid); or,
  - (2) That the enrolled PACE Program will not enroll any further financings under the Program but shall continue to count on the loss reserve pool to secure all Loans reported prior to the notice.
  
- (b) The Executive Director may terminate participation of an enrolled PACE Program in the Program, by notice in writing, upon the occurrence of any of the following:
  - (1) Entry of a cease and desist order, regulatory sanction, or any other action against the PACE Program that may impair its ability to participate in the Program; or
  - (2) Failure of the enrolled PACE Program to abide by any applicable law, including these regulations; or
  - (3) Failure of the enrolled PACE Program to report any Loans under the Program for a period of one year; or
  - (4) Provision of false or misleading information regarding the enrolled PACE Program to the Authority, or failure to provide the Authority with notice of material changes in submitted information regarding the enrolled PACE Program.

In the event of termination, the enrolled PACE Program shall not be authorized to have any further Loans covered by the loss reserve pool, but all previously enrolled Loans shall continue to be covered by the loss reserve pool until they are paid, claims are filed, or the enrolled PACE Program withdraws from the Program pursuant to this section.

**§10087. Certification of Reports and Claims.**

- (a) All applications, reports and claims submitted by a PACE Program must be signed by the PACE Program administrator certifying that they are accurate and true.
  
- (b) If an application, report or claim is submitted by a third-party program administrator on behalf of a PACE Program, an appropriate public official must provide the Authority with a signed letter certifying that the PACE Program has the ability to audit the records of the third-party administrator, including all information included in the applications, reports and claims submitted to the Authority.

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