STATE OF CALIFORNIA

CALIFORNIA ALTERNATIVE ENERGY AND ADVANCED TRANSPORTATION FINANCING AUTHORITY
915 Capitol Mall, Room 457
Sacramento, CA 95814
Telephone: (916) 654-5610
Fax: (916) 657-4821

March 31, 2012

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 2011 Annual Report on Senate Bill 77 (Pavley, Statutes of 2010)**

In accordance with the provisions of Public Resources Code Section 26141, 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) and Assembly Bill X1 14 (AB X1 14, Skinner, Statutes of 2011) for the calendar year ending December 31, 2011.

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 enactment of Assembly Bill 14 (AB 14, Skinner, Statutes of 2011) expanded the use of the funds and required the Authority to develop and administer the Clean Energy Upgrade Financing Program to assist in reducing the costs to property owners making energy efficiency and renewable energy upgrades to their homes.

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 PACE Bond Reserve Program and the status of those issues. The second part of the report includes a section on the status of the Clean Energy Upgrade Financing Program.

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 and Clean Energy Upgrade Financing Programs

2011 ANNUAL REPORT TO THE CALIFORNIA STATE LEGISLATURE

March 2012

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 is authorized to provide financial assistance through various programs, including:

- 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.
- Advanced Transportation and Alternative Source Manufacturing Sales and Use Tax Exclusion (STE) Program (SB 71 Program) for companies that design, manufacture, produce or assemble advanced transportation technologies or alternative source products, components or systems.
- Clean Renewable Energy Bond (CREB) Program to provide low-interest bond financing for renewable energy projects.
- 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.
- Clean Energy Upgrade Financing (CEUF) Program will provide financial assistance in the form of credit enhancements to financial institutions making loans to finance energy efficiency and renewable energy improvements on residential properties.
- Property Assessed Clean Energy (PACE) Bond Reserve Program may provide credit enhancements to local jurisdictions 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.

CAEATFA Board consists of:

Bill Lockyer, Chair
State Treasurer

John Chiang
State Controller

Ana J. Matosantos
Director of Finance

Robert B. Weisenmiller
Chairperson of the California Energy Commission

Michael R. Peevey
President of the California Public Utilities Commission

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2011 Annual Report to the California State Legislature

This report of activities for the Property Assessed Clean Energy ("PACE") Bond Reserve Program (SB 77, Pavley, Statutes of 2010) and the Clean Energy Upgrade Financing Program (AB X1 14, Skinner, Statutes of 2011) is submitted pursuant to Public Resources Code Section 26141 for the calendar year ending December 31, 2011.

EXECUTIVE SUMMARY

Under SB 77, signed into law on April 2010, the California Alternative Energy and Advanced Transportation Financing Authority ("Authority" or "CAEATFA") was mandated to develop and administer a $50 million PACE Bond Reserve Program ("SB 77 Program") to assist in reducing the overall finance costs to property owners securing a voluntary contractual assessment on their property to make energy efficiency or renewable energy improvements to their property.

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 of whether cities and counties in California would be able to leverage the credit enhancements authorized by SB 77, the Authority refocused its outreach and research efforts until the legality and vitality of residential PACE programs is further explored and clarified.

While $50 million was originally appropriated for the implementation of the SB 77 Program, other legislation enacted in 2011 reduced the amount of funds available for the program to $25 million.[1] In addition, the AB X1 14 Clean Energy Upgrade Financing Program ("AB X1 14 Program") was enacted appropriating the remaining $25 million from SB 77 to fulfill the intended purpose of the original legislation. The AB X1 14 Program will provide financial assistance in the form of credit enhancements to financial institutions making loans to finance energy efficiency and renewable energy improvements on residential and small commercial properties. Both SB 77 and AB X1 14 are authorized through January 1, 2015.

This report is divided into two sections. The first section highlights CAEATFA's activities to date to implement SB 77, including the steps taken to begin developing the SB 77 Program and an overview of the legal and legislative issues at the federal level that have slowed program development and implementation. The second part presents an update on the progress made toward developing the AB X1 14 Program, anticipated to be launched in Spring 2012.

Status of SB 77 and AB X1 14 Funds				
Cost	**FY 09/10**	**FY 10/11**	**Total Expenditures**	**Remaining Funds**
Administrative	$2,928	$26,666	$29,594	$520,406
Financial Assistance	$0	$0	$0	$24,450,000

[1] Senate Bill 679 (Pavley, Statutes of 2011), reappropriated $25 million from SB 77 to establish the Energy Conservation Assistance Account to finance energy retrofits to local governments and public institution buildings.

PACE Bond Reserve Program

Background

Legislative Summary. Legislation enacted in April 2010 (SB 77, Pavley) authorized CAEATFA to establish a Property Assessed Clean Energy ("PACE") Bond Reserve Program ("SB 77 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, will develop and administer a PACE Bond Reserve Program to reduce the overall costs of bond issuance. The SB 77 Program allows a reserve of no more than ten percent of the initial principal amount of the PACE bond. Per statute, the applicant must show how the savings will be passed on to borrowers. 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.

SB 77 Program Development

Over the past two years, CAEATFA has 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.

The Authority began the public participation process in June 2010 to develop the SB 77 Program, which included a public workshop to obtain input from municipalities, counties, PACE administrators and other stakeholders familiar with PACE financing.

As CAEATFA reported last year, the Authority slowed its program development efforts due to several issues raised at the federal level, which are addressed in the next section. However, throughout 2011, the Authority maintained communication with existing PACE programs to stay informed on program activity, expansion efforts, and their interest in a PACE bond reserve program. Table 1 provides a summary of the active PACE programs in California.

Table 1: PACE Programs in California			
Entity	**Finance Program Description**	**Funding Mechanism**	**Description of Products Offered**
Sonoma County Energy Independence Program—SCEIP	SCEIP provides PACE financing to both residential and non-residential market sectors.	County Treasury, $45M in loan volume, Sonoma County Water Agency Reserve currently $15M (up to $55M)	Financing Terms: • At 7% simple interest. • For terms of 10 or 20 years • Priority lien, property tax assessment collected through the County property tax administration system.
Placer County mPOWER PACE	mPOWER provides financing for both residential and non-residential, however, the residential program is currently suspended pending resolution with FHFA issues.	Placer County Treasury, up to $33M	Financing terms: • 6% simple interest • 5, 10, 15 & 20 year terms • Repayment on property tax bill • Min. financeable amount of $2,500, no max.
City/County of San Francisco Commercial PACE Program	San Francisco will provide financing for non-residential and residential properties five units or more through the issuance of special tax bonds payable solely from special taxes levied on such properties. The special tax bonds will be purchased by a financial institution or investor identified by the property owner on a private placement basis.	Owner arranged PACE where property owner identifies investor. Private, with limited State Energy Program credit enhancement (debt service reserve fund)	Financing terms: • Interest rates determined by project investor and property owner. • Payments tied to effective useful life of measure, could be a mix of payment terms for a comprehensive project. • Minimum financing amounts of $50K, no max.
FigTree Energy Resource Company PACE – Cities of Fresno, Palm Springs, Clovis and Exeter	FigTree issued a $725,000 PACE bond that will fund commercial projects in four different California cities. This PACE bond is the first-of-its kind in the nation since it's the first issuance of a multi-jurisdiction bond.	Private financing backed by PACE bond	Financing terms: • 8% (on total financing up to 10% of the property's assessed total value) fixed over useful life of improvements, up to 20 years. • Min financing amounts of $5K, max. amount may not exceed 10% of the assessed total value.
Ygrene Energy Fund – City of Sacramento	Privately administered PACE program for commercial properties available to voluntarily participating jurisdictions. Ygrene will develop, implement and administer Sacramento's program.	Private financing backed by PACE bond.	Financing terms not available.
Western Riverside Council of Governments (WRCOG) HERO Loan Program	The Home Energy Retrofit Opportunity Program is offered through a partnership between WRCOG and Renovate America, Inc. S100 million will be offered for residential, $25 million for large scale commercial solar projects and $200 million for small/medium commercial.	Private financing backed by PACE bond.	Financing terms: • Fixed interest rate. • Repaid through an assessment on property tax bill over 5-20 years. • Repayment based on the useful life of the improvements.

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. For example, Sonoma County, one of the oldest and still active residential and commercial PACE programs in the country, issued a draft financing feasibility analysis in January 2012 to assist Sonoma County and other government entities with developing PACE program financing options. CAEATFA is currently reviewing the feasibility analysis and will continue to work with local governments to assess the readiness of existing PACE programs in accessing the capital markets. It is believed that credit enhancements through bond structuring will be required to lower the financing costs of the assessments, or bonds, or both.

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 have 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, including many of the existing residential PACE programs in California.[2]

Legislative and legal actions were initiated at both the state and federal levels in the summer of 2010 with subsequent legislation introduced in 2011. This legislation, the PACE Assessment Protection Act of 2011 (H.R. 2599), sponsored by Representatives Nan Hayworth (R-NY), Dan Lungren (R-CA), and Mike Thompson (D-CA) will prevent the FHFA from adopting policies that contravene established state and local PACE laws and would compel it to accept the seniority of a PACE assessment. While Congress has not taken action on this PACE legislation, several advocacy efforts are underway to prepare for the 2012 session.

In addition, several local and state governments and other groups throughout the country filed lawsuits in 2010 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.

2011 Activities

In an August 2011 ruling favorable to the plaintiffs, the federal district court in the Northern District of California directed that FHFA must publish, accept and consider comments on FHFA's directive regarding mortgages with PACE obligations. More recently, in January 2012, the Northern District court ordered FHFA to initiate an official rulemaking process to allow for

[2] Since these legal concerns do not apply to the commercial sector, several PACE commercial programs were launched in California in 2011. While CAEATFA is monitoring the development and implementation of new PACE programs, the Authority has not engaged the administrators of PACE commercial programs given a statutory restriction allowing the bond reserve funds to only be used to support bonds with commercial property project costs less than $25,000, and, most commercial buildings that undergo any energy efficiency or renewable energy improvements have project costs ranging from $250,000 to $1 million.

stakeholder input in regards to the PACE energy financing programs. The FHFA is required by federal law to factor all comment into a reassessment of their current position on residential PACE programs. It is anticipated that FHFA could make a determination on its existing position on mortgages with PACE assessments in Spring 2012.

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 to PACE programs will be resolved in 2012.

Next Steps

As the future of PACE financing remains undecided at the federal level, the Authority will continue to monitor any legislative advances in Congress as well as the outcome of the FHFA's rulemaking process.

Over the next several months, the Authority will continue to engage jurisdictions with active PACE residential programs to determine whether they have enough loan volume to issue a bond that could be supported by the PACE bond reserve funds. It is anticipated that the Authority could begin a public rulemaking process in Summer 2012 to promulgate regulations for the SB 77 Program to accommodate jurisdictions that intend to issue PACE bonds.

Statutory Reporting Requirements

1. <u>The status of the account</u>.

   Of the $25 million appropriation from the Renewable Resource Trust Fund, up to five hundred fifty thousand dollars ($550,000) may be expended by the Authority for the initial administrative costs in implementing the SB 77 and AB X1 14 Programs.

   See page 1 for the status of the account.

2. <u>Summary of the PACE bonds that received assistance</u>.

   No bonds have been assisted to date since the SB 77 Program has not been developed.

3. <u>Summary of the benefits provided by the SB 77 Program, including reduced interest rates on the PACE bonds receiving assistance</u>.

   None at this time.

4. <u>The number of jobs created by the PACE programs that received assistance</u>.

   None at this time.

5. <u>Energy and water savings resulting from the PACE programs that received assistance</u>.

   None at this time.

Clean Energy Upgrade Financing Program

Background

Legislative Summary.

Since the future of PACE financing remained undecided at the federal level, the Legislature sought statutory changes to preserve the legislative intent of SB 77 through the passage of ABX1 14. This legislation, enacted in September 2011, allows the previously appropriated funds for the PACE Bond Reserve Program to be expanded to include financial incentive programs that fulfill the intended purpose of the original legislation. CAEATFA is authorized to establish the Clean Energy Upgrade Financing Program ("AB X1 14 Program) to provide financial assistance in the form of credit enhancements to financial institutions making loans to finance the installation of distributed generation renewable energy sources, electric vehicle charging infrastructure, or energy or water efficiency improvements on homes or small commercial properties. The funds are available through January 1, 2015.

Program Goal.

The purpose of the AB X1 14 Program is to reduce the overall costs to property owners of a loan by providing credit enhancement support to financial institutions making loans to finance energy efficiency and renewable energy improvements on real property. More specifically, the AB X1 14 Program has three underlying goals: 1) to promote the creation of California-based green jobs, 2) to promote the reduction of greenhouse gases, air and water pollution, or energy consumption consistent with the statute, and 3) to increase access to retrofit financing at better rates than a borrower would be able to receive without the existence of credit enhancements.

CAEATFA proposes to meet the goals of the AB X1 14 Program in two phases. In phase one, the Authority is establishing a Loan Loss Reserve Program designed to help financial institutions make loans to California homeowners for energy efficiency and renewable energy retrofits. In phase two, the Authority will issue a Request for Information ("RFI") to all interested parties – public, private, and partnerships – to obtain information and ideas on alternative financing structures that might add value to the AB X1 14 Program. CAEATFA anticipates issuing the RFI in the second quarter of 2012.

The Authority's initial financial assistance – in the form of a Loan Loss Reserve Program – will help mitigate any risks financial institutions associate with making loans in what is considered to be a new market. By providing an incentive to participating financial institutions, they may be more likely to gain confidence and express interest in making loans and offering new products to their customers who wish to make an energy efficiency or renewable energy investment. It is the intent of the AB X1 14 Program to provide a loan loss reserve so that participating financial institutions will also be more inclined to offer loans at lower rates, ideally in the five to eight percent range.

AB X1 14 Loan Loss Reserve Program Development

In developing the AB X1 14 Program, CAEATFA has undertaken a six month implementation process. The California Energy Commission ("CEC") and the California Public Utilities Commission ("CPUC") have provided significant input and subject matter expertise in the development of the quality assurance standards and contractor qualification requirements. CAEATFA gathered relevant information and conducted five stakeholder meetings and public workshops involving: State agencies, cities and counties, various interest and consumer advocacy groups, financial institutions, independent contractors and contractor associations, electric vehicle charging infrastructure manufacturers, and consulting groups representing the energy efficiency and renewable energy industries.

Through this public process, CAEATFA has gained a strong understanding of the program's mandate, California's need for energy efficiency financing incentives, and program structuring issues and concerns from interested parties. The CEC, CPUC, and stakeholders have provided input on policy matters such as what measures should be considered eligible improvements, types of certification requirements for contractors and minimum underwriting criteria for loan qualification into the AB X1 14 Program.

An initial program framework was presented at the August 30, 2011 public workshop, which was later refined and presented at the three targeted stakeholder meetings in November and December 2011. To date, 31 public comment letters have been received from stakeholders who engaged in the public rulemaking process. The proposed emergency regulations balance stakeholders' comments with the statutory, legal and program administration framework and requirements.

Proposed Program Structure

In the initial phase of the AB X1 14 Program, CAEATFA has proposed establishing a loan loss reserve whereas CAEATFA would make an initial 15 percent loan loss reserve contribution for each qualified loan made until a participating financial institution's enrolled loan volume reaches $250,000. This will allow CAEATFA to leverage private capital while mitigating some of the initial credit risk involved with making these types of new loans.

The statute allows CAEATFA to provide financial assistance for the installation of distributed generation renewable energy sources, electric vehicle charging infrastructure, and water or energy efficiency measures on homes and small commercial properties. CAEATFA has determined to initially simplify the scope of the program to include only residential projects and provide financial assistance for energy efficiency improvements and the installation of distributed generation energy sources. CAEATFA anticipates that it will be able to expand both eligible properties and eligible measures once the new program establishes a track record.

CAEATFA's proposed regulations allow distributed generation if ten percent energy savings are achieved or by demonstrating existing energy efficiency in the home. This "loading order" requirement is consistent with the state's energy policy goals of achieving energy conservation and reduction while also promoting and advancing the generation of alternative energy sources.

As required by statute, all improvements assisted through the Program must meet quality assurance standards, including contractor certifications. CAEATFA is proposing to require eligible improvements to be recommended by a pre-project energy efficiency assessment to assist in identifying appropriate and comprehensive energy efficiency retrofits and operations improvements. The eligible improvements must also be evaluated by a post-project assessment conducted by a third-party inspector to verify the improvements were installed correctly.

Next Steps

It is anticipated that the CAEATFA Board will review, consider and approve the program's regulations in the Spring 2012 at a publicly noticed meeting. Once the Office of Administrative Law approves the regulations and they become effective, CAEATFA will begin to accept applications from interested financial institutions on a rolling basis. Participating Financial Institutions will be authorized to enroll all or a part of any qualified loan into the program after the project is complete and CAEATFA receives documentation that program requirements have been met.

Staff anticipates between four and six financial institutions will initially apply to participate in the AB X1 14 Program. Over the next several months, CAEATFA will continue its program development and outreach efforts, and will engage financial institutions across the state to inform them about the AB X1 14 Program.

Statutory Reporting Requirements

1. <u>The status of the account</u>.

   See page 1 for the status of the account.

2. <u>Summary of the loans that received assistance</u>.

   The AB X1 14 Program is still under development and it is not anticipated to be launched until late Spring or early Summer 2012. For this reason, loans have not been enrolled in the AB X1 14 Program and therefore none have received any financial assistance.

3. <u>Summary of the benefits provided by the AB X1 14 Program, including reduced interest rates on the loans receiving assistance</u>.

   None at this time.

4. <u>The number of jobs created by the loans that received assistance</u>.

   None at this time.

5. <u>Energy and water savings resulting from the loans that received assistance</u>.

   None at this time.