



CITY COUNCIL AGENDA REPORT

MEETING DATE: APRIL 1, 2014

ITEM NUMBER: _____

SUBJECT: ADOPT RESOLUTION 201_-_____ CONSENTING TO THE INCLUSION OF PROPERTIES WITHIN THE CITY OF COSTA MESA IN THE CALIFORNIA HERO PROGRAM TO FINANCE DISTRIBUTED GENERATION RENEWABLE ENERGY SOURCES, ENERGY AND WATER EFFICIENCY IMPROVEMENTS AND ELECTRIC VEHICLE CHARGING INFRASTRUCTURE AND APPROVING AN AMENDMENT TO A CERTAIN JOINT POWERS AGREEMENT RELATED THERETO.

DATE: MARCH 21, 2014

FROM: OFFICE OF THE CHIEF EXECUTIVE OFFICER

PRESENTATION BY: DANIEL K. BAKER, MANAGEMENT ANALYST

FOR FURTHER INFORMATION CONTACT: DAN BAKER (714) 754-5156

RECOMMENDATION:

It is requested that the City Council consider and Adopt Resolution 201_-_____ consenting to the inclusion of properties within the City's Jurisdiction in the California HERO Program to Finance Distributed Generation Renewable Energy Sources, Energy and Water Efficiency Improvements and Electric Vehicle Charging Infrastructure and approving an amendment to a certain joint powers agreement related thereto.

BACKGROUND:

Assembly Bill (AB) 811 was signed into law on July 21, 2008, and AB 474, effective January 1, 2010, amended Chapter 29 of Part 3 of Division 7 of the Streets & Highways Code of the State of California ("Chapter 29") and authorizes a legislative body to designate an area within which authorized public officials and free and willing property owners may enter into voluntary contractual assessments to finance the installation of distributed generation renewable energy sources, energy efficiency, and/or water conservation improvements that are permanently fixed to real property, as specified. The financing for these improvements has come to be known as PACE, which stands for Property Assessed Clean Energy.

The HERO Program (for PACE financing) has been very successful in Western Riverside County, since its launch in late 2011; the Program has approved over \$400 million in applications and has funded over \$100 million in projects. Because of its success, the California HERO Program is now being offered to provide additional California cities and counties with a turnkey program that saves significant time, cost and local resources that would otherwise be needed to develop a new local program. Currently the following Cities in Orange County have adopted the program: Anaheim Brea, Buena Park, Garden Grove, La Palma, Newport Beach, Placentia, Santa Ana Stanton, Tustin, and Westminster. Jurisdictions only need to adopt the form of

resolution accompanying this staff report and approve an amendment to the joint exercise of powers agreement, related to the California HERO Program, as provided as an attachment to the resolution.

ANALYSIS:

The California HERO Program is being offered to allow property owners in participating cities and counties to finance renewable energy, energy and water efficiency improvements, and electric vehicle charging infrastructure on their property. If a property owner chooses to participate, the installed improvements will be financed by the issuance of bonds by a joint powers authority, Western Riverside Council of Governments ("WRCOG"). The bonds are secured by a voluntary contractual assessment levied on such owner's property, with no recourse to the local government or other participating jurisdictions. Participation in the program is 100% voluntary. Property owners who wish to participate in the program agree to repay the amount borrowed through the voluntary contractual assessment collected together with their property taxes. This financing is available for eligible improvements on both residential and non-residential properties.

The benefits to the property owner include:

- Eligibility: In today's economic environment, alternatives for property owners to finance renewable energy/energy efficiency/water efficiency improvements or electric vehicle charging infrastructure may not be available. As such many property owners do not have financing options available that would provide funding for improvements that lower their utility bills.
- Savings: Energy prices continue to rise and selecting in energy efficient, water efficient and renewable energy improvements reduces utility bills.
- 100% voluntary: Property owners can choose to participate in the program at their discretion. Improvements and properties must meet eligibility criteria in order to qualify for financing.
- Payment obligation stays with the property: Under Chapter 29, a voluntary contractual assessment stays with the property upon transfer of ownership. Certain residential conforming mortgage providers will, however, require the assessment be paid off at the time the property is refinanced or sold.
- Prepayment option: The property owner can choose to pay off the assessments at any time, subject to applicable prepayment penalties.
- Customer oriented program: Part of the success of the program is the prompt customer service. Committed funding partners provide funding promptly upon project completion resulting in both property owner and contactor satisfaction.

The benefits to the City include:

- Increase local jobs.
- An increase in property values (energy efficient homes and buildings are worth more money).
- An increase in sales, payroll and property tax revenue.
- As in conventional assessment financing, the City is not obligated to repay the bonds or to pay any delinquent assessments levied on the participating properties.

- All California HERO Program and assessment administration, bond issuance and bond administration functions are handled by California HERO. Little, if any, City staff time is needed to participate in the California HERO Program.
- By leveraging the already successful HERO Program, the City can offer financing to property owners more quickly, easily and much less inexpensively than establishment of a new local Program.

The proposed resolution enables the California HERO Program to be available to owners of property within our City to finance renewable energy, energy efficiency and water efficiency improvements and electric vehicle charging infrastructure. The resolution approves an Amendment to the WRCOG Joint Powers Agreement to add the City as an Associate Member in order to enable the California HERO Program to be offered to the owners of property located within the City who wish to participate in the California HERO Program

Federal Housing Finance Agency (FHFA), Fannie Mae and Freddie Mac

PACE enabling legislation was adopted by the State of California to encourage the adoption of energy efficiency, renewable energy and water efficiency measures on homes and businesses. When the legislation was enacted, many people believed PACE was an attractive financing option due to its ability to automatically transfer payments to a new owner if the property sold.

In response to the Directive issued by the FHFA on July 6, 2010 and implemented, in part, by Fannie and Freddie (Government Sponsored Entities, GSEs) on August 31, 2010, mortgage originators were informed that the GSEs would not be purchasing any mortgages with PACE liens.

In response to this, the State of California and other entities filed lawsuits against FHFA. The original intent of the lawsuit was to amend or dismiss the Directive by requiring that FHFA follow the rulemaking procedures as set forth under the Administrative Procedure Act. On October 16, 2010, the District Court issued a judgment which required FHFA to go through the rule making procedures. However, the trial court ruled that the FHFA's Directive would continue in effect. FHFA filed an appeal with the Ninth Circuit Court of Appeal, seeking to overturn the judgment requiring the FHFA to go through the rule making procedures. On March 19, 2013, the Ninth Circuit Court of Appeals ruled that the FHFA did not have to follow the rule making procedures in order to issue the Directive and dismissed the case. Thus, the FHFA does not need to go through the rule making procedures.

In the July 6, 2010 statement issuing the Directive, FHFA supported PACE programs whose assessments are junior/subordinate to Fannie/Freddie's mortgage interests. The statement also directed Fannie/Freddie to implement the following additional actions:

- Adjusting loan-to-value ratios to reflect the maximum permissible PACE loan amount available to borrowers in PACE jurisdictions;
- Ensuring that loan covenants require approval/consent for any PACE loan;
- Tightening borrower debt-to-income ratios to account for additional obligations associated with possible future PACE loans;
- Ensuring that mortgages on properties in a jurisdiction offering PACE-like programs satisfy all applicable federal and state lending regulations and guidance.

FHFA stated that “Nothing in this Statement affects the normal underwriting programs of the regulated entities or their dealings with PACE programs that do not have a senior lien priority.” To date neither Fannie nor Freddie have taken action to implement any of the additional actions contained in the Directive.

The PACE enabling legislation in California provides that PACE assessments, like traditional assessments levied by public agencies in California, are equal in priority as general property taxes and as such are senior to private debt on the property and thus have first liens/senior liens priority. However under federal law, the Ninth Circuit Court of Appeal, which includes California, in *Rust v. Johnson* (9th Circuit (1979) 597 F.2d 174) ruled that local government cannot collect payment of assessments if they impair loans insured or owned by Freddie/Fannie (“Conforming Loans”). The court ruled that if a federal government entity has a mortgage interest on a parcel subject to assessments or special taxes, the property cannot be sold at a foreclosure sale unless it can be sold for an amount sufficient to preserve the federal government mortgage interest. Thus under federal law as set forth in the opinion under *Rust v. Johnson*, assessments, including PACE assessments, placed on the property are not “first liens” or “senior liens” with respect to Conforming Loans. Disclosure of *Rust v. Johnson* has been provided for in Official Statements of Municipal Bond issuances for traditional assessment district and community facilities district bond issues since 1979, in a form similar to the following:

Portions of the property within the Assessment District may now or in the future secure loans. Any such loan is subordinate to the lien of the Assessments. However, (a) in the event that any of the financial institutions making the loan that is secured by real property within the Assessment District is taken by the Federal Deposit Insurance Corporation (“FDIC”), (B) the FDIC or another federal entity acquires a parcel subject to the Assessment lien, (C) the Federal National Mortgage Association, the Federal Home Loan Mortgage Corporation or similar federal agency or instrumentality has a mortgage interest in a loan on property subject to the Assessment lien, and, prior thereto or thereafter, the loan or loans go into default, the ability of the City to collect the interest and penalties specified by state law and to foreclose the lien of a delinquent unpaid assessment may be limited.

Additionally, under federal law, subordinate liens to mortgages are permitted and cannot be blocked (See U.S. Code Title 12 Banks and Banking, Section 1701j-3). Thus, the impact of a PACE assessment being subordinate in effect to the interests of Fannie/Freddie by virtue of the ruling in *Rust v. Johnson* and the inability to prevent a person from putting a subordinate lien on their property may make it difficult for FHFA/Fannie/Freddie to impose additional Directives adversely affecting the property owner’s mortgage.

FISCAL AND STAFF IMPACTS:

There is no negative fiscal impact to the City’s general fund by consenting to the inclusion of properties within the City limits in the California HERO Program. All California HERO Program administrative costs are covered through an initial administrative fee included in the property owner’s voluntary contractual assessment and an annual administrative fee which is also collected on the property owner’s tax bill.

RECOMMENDED ACTION:

Adopt the attached Resolution approving an Amendment to the WRCOG Joint Powers Agreement to add the City as an Associate Member in order to authorize the City's participation in the California HERO Program, which will enable property owners to finance permanently fixed renewable energy, energy and water efficiency improvements and electric vehicle charging infrastructure on their properties.

DANIEL K. BAKER
Management Analyst

Attachment: [Proposed Resolution](#)