

NASEO Financing Committee Call

Monday, March 7, 2016

Topic: Residential Property Assessed Clean Energy (PACE) Financing

Attendees

- Ben Bolton, Tennessee
- Al Christopher, Virginia
- Kenley Farmer, District of Columbia
- Sandy Fazeli, NASEO
- Elizabeth Grimes, Alabama
- Robert Jackson, Michigan
- Danielle Jensen, Nebraska
- John Joshi, New York
- Jeff King, Colorado
- Suzanne Linfante, Nevada
- Kristy Manning, Missouri
- Paul Miller, Louisiana
- Tony Morgan, Florida
- Jack Osterman, Nebraska
- Eleni Pelican, DOE
- Jeff Pitkin, New York
- Eric Rehm, Minnesota
- Alexa Voytek, Tennessee

Summary and Action Items

The discussion began with round-robin introductions, then focused on states' experiences in enabling and launching PACE financing programs in the residential single family and commercial markets. Key themes and issues raised during the call are listed below. Action items for NASEO and/or Financing Committee members are **highlighted in yellow**.

PACE-enabling legislation:

- Some states experiencing setbacks in enacting PACE-enabling legislation at the state level, and in driving demand for PACE projects. Resistance from some key stakeholders, including local jurisdictions, banking associations, and lenders.
- Some PACE statutes include features that can ease stakeholder concerns, such as energy audit requirements, savings-to-investment thresholds, cost-effectiveness, underwriting guidance, lender consent, and consumer protections.
 - Several states expressed the need to engage bankers' associations and lenders on PACE early on in PACE statute development and program design. PACENation has a useful lender support study that describes how lenders perceive PACE, available at <http://pacenation.us/wp-content/uploads/2014/03/Lender-Support-Update-20143.pdf>.
 - Virginia's Department of Mines, Minerals, and Energy used an extensive stakeholder process to develop voluntary underwriting guidelines for commercial PACE, available at <https://www.virginia.gov/Connect/Commonwealth-Calendar/Events/Lists/Public-Hearing/2015/09/15/CommercialPACStakeholderGroup>.
 - Some states and jurisdictions are adopting a multi-jurisdiction or regional approach (i.e., New York and Connecticut Green Banks; DC-Maryland-Virginia coordination on PACE) to promote coordination among localities and, ideally, appeal to property owners whose buildings might extend into different states and jurisdictions. Example: Metropolitan Washington COG PACE Workgroup: <https://www.mwcog.org/uploads/committee-documents/YV1WV11X20150520153826.pdf>
- Stakeholder engagement can also increase buy-in: working with contractors, financial institutions, and building owners early in the legislative process to understand how best to frame PACE to appeal to these groups.
 - A Texas business coalition, "Keeping PACE in Texas," was a strong driver of PACE-enabling legislation in Texas, and has since also developed voluntary program standards,

financial guidelines, and technical criteria for PACE programs, which have been adopted or considered by several counties and cities. Their website, <http://www.keepingpaceintexas.org/>, describes the coalition's work and stakeholder engagement strategies.

- States need to make sure statutes provide guidance for marketing but avoid placing overly rigid requirements and standards

Action item: NASEO has begun, in conjunction with PACENation, a scan of select PACE-enabling statutes that may help states understand the common features of PACE-enabling legislation across the states. We will share this as soon as it is available.

Residential PACE setbacks at the federal level and interaction with HUD and/or FHFA:

- In several states, efforts to pursue residential PACE were stalled following the 2010 Federal Housing Finance Agency (FHFA) announcement prohibiting Fannie Mae and Freddie Mac from purchasing home mortgages with first-lien PACE attached to them (and as a result, many states and cities have focused their recent efforts on establishing commercial PACE)
- Renewed focus on residential PACE at the federal level since the August 2015 announcement by the Federal Housing Administration (FHA), housed within HUD: <http://portal.hud.gov/hudportal/documents/huddoc?id=FTDO.pdf>
- FHA has already shared its stance on the seniority of PACE liens: "the Single Family FHA guidance will address the impact of PACE assessments on purchases, refinances, and loan modifications available to borrowers experiencing distress and **will require the subordination** of PACE financing to the first lien FHA mortgage. The guidance will address the eligible methods of subordination of existing PACE liens."
- Process of "contractual subordination" has been used by select California PACE administrators (led by Renovate America) and is being explored by other states. Renovate allows homeowners who request subordination (typically at time of refi or sale) to subordinate their PACE assessments through a contract. An alternative option is legislative subordination, whereby the PACE statute gives a junior position to the PACE deal. There is concern among some in the PACE community that if subordinating PACE liens becomes prevalent, it could hurt the credit quality of PACE securities and raise borrowing costs
- As FHA guidelines are not yet available, we are uncertain what type of subordination approach will fully satisfy FHA's requirement.
- FHA is different from FHFA; but there is a sense in the PACE community that guidelines adopted by FHA may be similar to eventual guidelines adopted FHFA (if adopted at all)

Action item: NASEO submitted a comment letter in response to HUD's August 2015 announcement, and received a response back from HUD on February 24, 2016. This correspondence is now available at NASEO's PACE Resources webpage, <http://naseo.org/financing-resources-pace>. If other states are willing to share their comment letter to HUD and HUD's response, email those documents to sfazeli@naseo.org and we can have them posted on our website.

Commercial versus Residential PACE programs:

Key differences between commercial and residential PACE mean that program design and administration choices may vary between sectors. For instance:

- Market need: some states have robust residential or commercial EE financing programs either through the SEO, their utilities, banks and credit unions, or national programs like WHEEL,

limiting the market need and demand for PACE financing. PACE should be examined in the context of existing supply and demand for EE/RE financing in the market.

- Consumer protections: Borrower risk profiles and the need for safeguards vary between the commercial and residential markets. In residential PACE, especially to protect low-income or vulnerable homeowners, PACE program administrators have explored safeguards such as underwriting criteria (including homeowner ability to pay, debt-to-income ratio, and savings-to-investment ratios), quality assurance processes, and loan loss reserves (such as [California's statewide PACE Loss Reserve](#)).