

CALIFORNIA ENERGY COMMISSION

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Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
400 Seventh Street S.W., Eighth Floor
Washington, D.C. 20024
RegComments@fhfa.gov

Re: **Comments on the Federal Housing Finance Agency's Advance Notice of Proposed Rulemaking Concerning Mortgage Assets Affected by Property-Assessed Clean Energy Programs – RIN 2590-AA53**

Dear Mr. Pollard:

We write this letter in response to the request of the Federal Housing and Finance Agency (FHFA) for comments on its Advanced Notice of Proposed Rulemaking (ANPR) concerning mortgage assets affected by Property-Assessed Clean Energy (PACE) programs. The California Energy Commission (Energy Commission) asks FHFA to recognize that PACE programs are uniquely suited to facilitate real and lasting energy efficiency upgrades to existing buildings; that PACE programs do not pose substantial risks to property owners, property purchasers, or mortgage holders of properties with PACE assessments; and that the public interest in achieving the energy and environmental benefits of PACE programs outweighs the risks posed by such assessments.

BUILDING EFFICIENCY IS CRITICAL TO ACHIEVING CALIFORNIA'S ENERGY AND ENVIRONMENTAL POLICY GOALS

California has led the nation in energy efficiency since the 1970's. Important policies such as minimum energy efficiency standards in building construction and appliances, and the decoupling of investor-owned utility profits, have enabled California to maintain a steady rate of per capita energy consumption over a 20-year period.¹

The benefits of these policies have been significant. The Energy Commission reports that:

The Energy Commission staff estimates that [California's building and appliance efficiency] standards have also saved customers \$66 billion in

¹ The Energy Commission was founded in 1974, with a mandate to employ a range of measures to reduce wasteful, uneconomical, and unnecessary uses of energy and to promote all feasible means of energy conservation. Cal. Pub. Res. Code §§ 25007 and 25008.

electricity and natural gas costs (in 2010 dollars) since 1975. President Obama, noting in his 2012 State of the Union address that more efficient use of energy saves money, asked Congress to send him a bill to “help manufacturers eliminate energy waste in their factories and give businesses incentives to upgrade their buildings. Their energy bills will be \$100 billion lower over the next decade, and Americans will have less pollution, more manufacturing, and more jobs for construction workers who need them.”²

Building efficiency improvements offer immediate and attractive benefits to consumers, the economy, and the state. McKinsey Global Institute identifies building improvements as the most cost-effective of all potential carbon mitigation strategies analyzed in their research.³

ENERGY EFFICIENCY UPGRADES INCREASE PROPERTY VALUES

Energy improvements have been shown to increase property values. The Appraisal Institute of America recently released a “Residential Green and Energy Efficient” addendum, helping appraisers understand how to incorporate the enhanced value provided by these upgrades into the appraisal process.⁴ A new report released by Lawrence Berkeley National Laboratory shows that California homes with photovoltaic solar electric systems installed achieve on average a \$17,000 premium at the time of sale.⁵ And finally, the Journal for Sustainable Real Estate recently released a report showing that homes with the EnergyStar label capture \$9 per square foot more than buildings without this rating.⁶ Cost-effective energy savings improvements offer homeowners the opportunity to save money, thereby enhancing the ability of homeowners to cover other expenditures, including a mortgage payment. Installing energy improvements also protects consumers from rising energy costs over time.

Fannie Mae and Freddie Mac, which FHFA regulates, have acknowledged the increased financial security provided by energy improvements through their policies on Energy Efficient Mortgages (EEMs). An EEM, offered through the U.S. Department of Housing and Urban

² California Energy Commission. 2011 Integrated Energy Policy Report, p. 8. Available online at: <http://www.energy.ca.gov/2011publications/CEC-100-2011-001/CEC-100-2011-001-CMF.pdf>.

³ Beinhooker, Eric; Oppenheim, Jeremy; Irons, Ben; Lahti, Makreeta; Farrell, Diana; Nyquist, Scott; Remes, Jaana; Naucner, Tomas; Enkvist, Per-Anders. 2008. The Carbon Productivity Challenge: Curbing Climate Change and Sustaining Economic Growth. McKinsey Global Institute. Available online at: http://www.mckinsey.com/~media/McKinsey/dotcom/Insights%20and%20pubs/MGI/Research/Resource%20Markets/The%20carbon%20productivity%20challenge/MGI_carbon_productivity_challenge_report.aspx (March 20, 2012).

⁴ Appraisal Institute. “Residential Green and Energy Efficient Addendum.” Form 820.03. Available online at: http://www.appraisalinstitute.org/education/green_energy_addendum.aspx (March 19, 2012).

⁵ Hoen, Ben, Wiser, Ryan, Cappers, Peter, and Thayer, Mark. “An Analysis on the Effects of Residential Photovoltaic Energy Systems on Home Sales Prices in California.” Environmental Energy Technologies Division, Lawrence Berkeley National Lab. April 2011. Available online at: <http://eetd.lbl.gov/ea/emp/reports/lbnl-4476e.pdf> (March 19, 2012).

⁶ Bloom, Bryan; Nobe, Maryellen C.; Nobe, Michael D. “Valuing Green home Designs: A Study of EnergyStar® Homes.” April, 2011. Journal of Sustainable Real Estate, volume 3, no. 1-2011.

Development and financed by Fannie Mae, offers borrowers an extended lending capacity beyond their existing debt-to-income ratio on the presumption that energy savings will offset the cost of financing.⁷ If FHFA seeks data to support the claim that energy savings improvements can increase a homeowner's income stability and support successful mortgage payments, it has no further to look than the Fannie Mae EEM database.

FHFA expresses concern that its securities will be negatively affected by PACE assessments collected on foreclosure in advance of the mortgage. However, PACE policies in California allow for only a year of delinquencies – as opposed to the entire value of the assessment – being collected upon foreclosure of the home. As Freddie Mac and Fannie Mae control 98 percent of the secondary market for mortgages, this amounts to an insignificant impact on the portfolio. Assuming an aggressive foreclosure rate of 10 percent, this would translate into a per home loss of less than \$150. Adjusting the assumptions to reflect a much more realistic foreclosure rate of 5 percent, the impact to the Fannie and Freddie portfolio would be closer to \$75 per home.⁸

The evidence to date shows that FHFA's concerns regarding the risk of PACE programs are unsupported. Data from the longest-operating residential PACE program in the country, in Sonoma County, California, indicates that of all tax delinquencies, those properties with PACE assessments reveal a *lower* rate of delinquency than other properties.⁹ Such data show that the delinquency rate for mortgage payments among homes with a PACE assessment was 1.1 percent, compared to an average delinquency rate among all Sonoma County homes of 8 to 10 percent. The above real-world data show that PACE assessments actually enhance the financial standing of recipients, improving the ability of property owners to manage their cash flow.

Any perceived risk is further mitigated by California law, which prohibits a property owner's participation in PACE programs if such participation would result in the total amount of any annual property taxes and assessments exceeding 5 percent of the property's market value, as determined at the time the owner's contractual assessment was approved.¹⁰

PACE IS AN IDEAL FINANCING MECHANISM FOR ENERGY EFFICIENCY UPGRADES TO EXISTING BUILDINGS

In identifying key components of financing programs to support energy improvements to existing buildings, the California Air Resources Board states "funding mechanisms need to be

⁷ EnergyStar. "Energy Efficient Mortgages." Online at: http://www.energystar.gov/index.cfm?c=mortgages.energy_efficient_mortgages (March 20, 2012).

⁸ See June 22, 2010 letter from Ken Alex, Senior Assistant Attorney General, California Department of Justice, to Edward DeMarco, Acting Director, FHFA. Available online (pages 30 – 32) at:

[http://ag.ca.gov/cms_attachments/press/pdfs/n1951_final_pace_complaint_&_exhibits_\(stamped\).pdf](http://ag.ca.gov/cms_attachments/press/pdfs/n1951_final_pace_complaint_&_exhibits_(stamped).pdf). These calculations assume annual payments of \$1,500. Most residential PACE assessments will vary from \$5,000 to \$30,000, resulting in annual payments of approximately \$540 to \$ 3,200 (at 7 percent and 20 years).

⁹ See pages 7 – 8 of the comments of the County of Sonoma (March 23, 2012). Available online at:

http://www.fhfa.gov/webfiles/23639/216_Sonoma_County_Board_of_Supervisors.pdf.

¹⁰ Cal. Streets and Hwys. Code § 5898.15, subd. (a) (Cal. Sen. Bill 1340, Stats. 2010, ch. 649).

established that will provide investment capital to upgrade these buildings in ways that account for and monetize extended lifecycle benefits, and that are not hampered by building sale or occupancy turn over."¹¹ PACE programs are uniquely suited to meet this need. Because of the security of the lien instrument, PACE programs have the potential to provide consumers access to low-interest capital and terms that match the expected life of improvements. By offering access to low-cost capital, a homeowner can spread the cost of cost-effective efficiency improvements over a longer period of years or decades, and alleviate the need to supply the necessary \$10,000 to \$50,000 cash up front.

Another unique aspect of PACE is that it can be administered by public agencies. This enables local governments to coordinate PACE programs with other environmental goals and programs. Public agencies may also be able to offer financing at a lower cost than private institutions. PACE assessments are unique in that the improvements financed have the potential to improve both the material condition of the property as well as the income stability of the occupants.

While other financial products do exist, none are as effective as PACE. Because a PACE assessment is secured through priority lien on the property, financing can be secured at much more attractive interest rates. Additionally, by tying the improvement to the property, home and business owners have the incentive to invest in permanent improvements lasting up to 30 years, even though they may not intend to occupy the property for that long.

PACE PROGRAMS HAVE BEEN SUCCESSFULLY IMPLEMENTED

PACE financing has been recognized throughout the nation as a potential mechanism to assist and enable energy efficiency retrofits of existing buildings. In 2008 the Legislative and Executive Branches of the State of California enacted laws and implemented policies authorizing the use of PACE financing to facilitate the retrofitting of California's stock of existing buildings.¹² Various state and federal agencies – including the U.S. Department of Energy and the California Energy Commission – have embraced PACE as an important tool to promote energy efficiency.

The announcement by FHFA of its policy to disallow PACE liens in loans purchased by Freddie Mac and Fannie Mae forced the Energy Commission to cancel programs developed under the American Recovery and Reinvestment Act utilizing PACE financing. The Energy Commission was able, however, to support four small pilot programs utilizing PACE, including three commercial programs located in the City and County of Los Angeles, the City and County of San Francisco, and the County of Placer, and one residential PACE program in Sonoma County.

¹¹ California Air Resources Board. 2009. Scoping Plan, Appendix C, C-147. Available online at: <http://www.arb.ca.gov/cc/scopingplan/document/scopingplandocument.htm> (March 20, 2012).

¹² Cal. Streets and Hwys. Code § 5898.15, subd. (a) (Cal. Asm. Bill 811, Stats. 2008, ch. 159; Cal. Asm. Bill 474, Stats. 2009, ch. 444).

These programs incorporate best practices recommended by the U.S. Department of Energy on May 7, 2010. Such best practices include limits on the allowable lien size based on the equity of the home, the use of assessments to evaluate appropriate and cost-effective improvements, and required lender notification (or lender consent in the case of commercial properties). They also make use of the strong quality assurance and quality control infrastructure that exists in California, helping to protect both homeowners and investors from poor quality workmanship. The Energy Commission urges the FHFA to look to these pilot efforts for evidence that PACE programs not only motivate consumer action to install home energy improvements, but do so in a safe and secure way.

FHFA'S PROPOSED ACTION WILL NEGATIVELY IMPACT THE ABILITY OF LOCAL GOVERNMENTS TO ADOPT ASSESSMENTS FOR THE PUBLIC BENEFIT

As noted in the joint comment letter of the National Association of Counties, National League of Cities, and the U.S. Conference of Mayors, traditional mechanisms for local financing and revenue – for example, sales and property taxes and bond financing – are difficult to assess. This has led local governments to develop PACE and other innovative financing programs to assist neighborhoods in achieving community and economic goals, despite periods of fiscal challenge. FHFA's anti-PACE directives serve to dissuade local governments from implementing original solutions to local financing, and foreclose an important mechanism for financing improvements that deliver immediate and future financial and environmental benefits.¹³

CONCLUSION

For the reasons stated above, the Energy Commission asks FHFA to issue a Notice of Proposed Rulemaking that facilitates the responsible implementation of PACE. We thank FHFA for its consideration of these comments, and look forward to working with FHFA to facilitate access by homeowners to PACE financing.

Sincerely,



Robert P. Oglesby
Executive Director

¹³ See pages 1 – 2 of the comments of the National Association of Counties, National League of Cities, and the U.S. Conference of Mayor (March 2, 2012). Available online at:
http://www.fhfa.gov/webfiles/23425/62_Ntl_Assn_of_Cities_Counties_and_US_Conf_of_Mayors.pdf