



## **PACE (Property Assessed Clean Energy) Financing**

*A Policy to Help Property Owners Access Financing for Renewable Energy and Energy Efficiency Improvements*

### **FREQUENTLY ASKED QUESTIONS: Bonding and Tax Questions**

#### **How will the interest rate on the bonds be calculated?**

This will depend upon the terms provided to the City by its financial partner and is based upon conditions in the municipal bond market, program specifics, and other factors.

#### **Who will buy the bonds?**

Bonds of this type will be purchased by banks or other investors in the same way other municipal bonds issued by cities are purchased. Interest on the bonds will be taxable to the investor at the federal level, but exempt from state income taxes.

#### **Who collects the assessment?**

Assessment payments are collected on the property tax bill by the County and will be due on the same dates as ad valorem property taxes.

#### **What if the property owner does not pay the assessment?**

Assessments, like other property taxes, will be secured by a lien on the subject property, which ranks senior to the first mortgage. As a general matter, if a property owner fails to pay ad valorem property taxes for five years, the county will foreclose on the property to collect delinquent taxes.

#### **Is a participant obligated to continue repaying if the energy improvement stops working?**

The assessment obligation will continue for the entire 20-year period whether or not the energy improvement continues to work.

#### **Aren't there concerns from the mortgage lending community about the seniority lien status of PACE?**

The Federal Housing Finance Agency (FHFA) expressed concern in June 2009 about PACE assessments having superior lien status to existing first mortgages. The FHFA argued that PACE liens could create risk for homeowners and impair the value of first mortgages to creditors and any subsequent holder of the first mortgages. However, according to analysis from the White House and leading banking institutions, these concerns do not represent real legal challenges.

First, PACE liens should be treated as any other lien originating from a special tax distinct assessment. The right to secure a senior tax lien is a fundamental local governmental power. Local governments exercise their taxing power to promote infrastructure deemed a public purpose. In fact, a super senior special tax or assessment lien is an exceptionally common practice throughout the U.S.

Second, the risk to private lenders is extremely limited. As noted in Bloomberg Law Reports: "Although PACE assessments are senior to private debt, only delinquent amounts are subject to foreclosure. Like all land-secured property taxes, the remainder of the assessment remains as a lien on the property to be paid over time by subsequent property owners. If the delinquent assessments are secured by a senior lien, a subordinate private lender may protect its lien by paying the delinquent assessment amount (which will typically be a nominal amount compared to the outstanding balance of the private mortgage) and adding the amount of any such protective advance to the amount of its loan."

Source: [http://votesolar.org/wp-content/uploads/2010/02/PACE\\_BloombergLawArticle.pdf](http://votesolar.org/wp-content/uploads/2010/02/PACE_BloombergLawArticle.pdf)

Finally, the seniority of the PACE lien to that of first mortgage debt is critical to the development of a PACE bond market. The result of a subordinate lien would create problems with buyers, rating agencies and material bond administration. Barclays Capital reports that: "[T]here would be little to no meaningful bond buyer interest in pari passu or subordinated PACE liens and therefore the PACE bond market would be highly unlikely to develop..."

Source: [http://votesolar.org/wp-content/uploads/2010/02/PACE\\_Barclays\\_9-14-09.pdf](http://votesolar.org/wp-content/uploads/2010/02/PACE_Barclays_9-14-09.pdf)

Fannie Mae issued a letter on 9/18/2009, which said: "Servicers should treat Energy Loan Tax Assessment Programs (ELTAPs) as any tax or assessment that may take priority over Fannie Mae's lien."

Source: <https://www.efanniemae.com/sf/guides/ssg/annltrs/pdf/2009/110709.pdf>

### **How has the bond market been working in states where programs are up and running?**

As of January 2010 there are only four PACE programs in operation. This is a very nascent finance mechanism, and the bond market implications are hard to determine at this point. Berkeley and Boulder are the only examples of municipalities that issued bonds. Palm Desert applied general funds and Sonoma has chosen to use county treasury funds.

- **Volume?** Boulder decided to solicit applications for the program and then release a bond. Results: \$9.55 Million in first round of funding, with 519 properties signed up (\$3.6 million in PV, \$500K in solar thermal projects, and the remainder in energy efficiency). Berkeley does on-demand bonding.
- **Interest Rates?** Keep in mind that until recently the entire municipal bond market had not been functioning well. After September of 2009, the interest rates in the municipal bond market increased to rates ranging between 9%-10%. As of January 2010, rates have returned to the more typical range of 7%- 8%. Boulder sold its bond at 5.68% interest and then added 1% to cover its costs, to offer a total of 6.68% to end customers.
- **Credit Quality?** Generally municipal bonds have a triple B or an A rating (Boulder has an AA rating). The credit quality of each jurisdiction will vary depending on municipal rating and underwriting criteria in the program. A good question for any interested county is what is your current revenue bond rating? For smaller locations it might make more sense to pool resources with other municipalities to obtain a higher credit rating, through structures such as a joint powers authority. Note that Boulder has a "moral obligation" clause whereby the city backs every loan in case of property owner default.

### **What can cities do to minimize risk of property owners defaulting on the assessment payments?**

Cities can and should design eligibility criteria that prevent homeowners that are particularly high risk of default from participating. For example, the underwriting criteria for many programs in CA looks at property tax payment history for the last three years, foreclosure in the last five years, involuntary liens on the property, bankruptcy, equity in the property, and restrictions on the amount of financing available as compared to the value of the property and the other public debt (i.e. other tax assessment or special tax liens).

Boulder, CO performs a similar qualification and provides additional security to lenders by creating a "debt service reserve" set aside to cover lien payments in the unlikely event that a property owner defaults on the senior lien. The reserve is funded by a combination of city funds and a pass-through charge to participating property owners.

### **How will PACE programs interact with federal tax credits and other state incentives?**

PACE programs are new and the interaction with federal tax credits and incentives will vary state to state. CaliforniaFIRST programs allow property owners to finance the portion of their solar PV system that is eligible for the federal investment tax credit (ITC) after deducting local and state rebates.

A concern has been raised that because property owners may receive the tax credit as part of their income tax refund the next year, they should not be allowed to finance that portion of the costs. However, individual tax circumstances vary and a substantial portion of property owners will not be eligible to claim some or all of their tax credit, at least in the first year. In California, property owners are informed of the circumstances surrounding the use of the ITC and provided appropriate information to enable them to make an informed decision as to whether to include the ITC in their financed amount.

### **Can participants deduct the solar financing costs on their income taxes as they do for other property taxes?**

Participants will be permitted to deduct the interest component of their solar financing assessment, similar to a home equity line or a home mortgage.

### **How is the Special Tax calculated for each Property Owner?**

The annual special tax amount for each property owner is calculated based upon (a) the cost of the energy project installed in that property owner's residential or commercial property, (b) the interest rate paid by the City on Special Tax Bonds or other monies used to fund the cost of that property owner's energy project, and (c) an upfront and annual administrative charge levied by the City and financing partner.



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