



CONSENT CALENDAR  
June 11, 2013

To: Honorable Mayor and Members of the City Council  
From: Energy Commission  
Submitted by: Scott Murtishaw, Chairperson, Energy Commission  
Subject: HERO Property Assessed Clean Energy Program

RECOMMENDATION

Postpone a decision regarding participation in the Home Energy Renovation Opportunity (HERO) program until federal regulations on residential Property Assessed Clean Energy (PACE) loans are clarified and send a letter to the Federal Housing Finance Agency (FHFA) urging the Agency to establish federal rulemaking procedures in connection with residential PACE financing and to rescind directives to Fannie Mae and Freddie Mac that threaten the viability of residential PACE programs throughout the nation.

FISCAL IMPACTS OF RECOMMENDATION

None.

CURRENT SITUATION AND ITS EFFECTS

The Energy Commission is making the above recommendation in advance of City Council consideration of directing staff to evaluate the feasibility of the City of Berkeley participating in the HERO Program.

HERO is a Property Assessed Clean Energy (PACE) program similar to the Berkeley FIRST initiative that the City piloted in 2008. PACE programs provide financing for solar installations and energy and water upgrades and enable the homeowner to repay the cost of the financing on their property tax bill. PACE financing is an innovative and effective tool for lowering the upfront cost of energy upgrades and amortizing the cost over time. It is an important tool that can assist communities to achieve their energy and climate action goals. Unfortunately, the FHFA issued a statement (see attachment) that brought most PACE programs across the nation to a stop. The HERO program and Sonoma County's PACE program are operating in defiance of the FHFA statement. HERO is offered through a partnership between the Western Riverside Council of Governments (WRCOG) and Renovate America, Inc. The HERO program is recruiting new communities, including Berkeley.

Despite the value of PACE programs such as HERO, the Energy Commission is recommending that the City postpone a decision regarding participation in HERO until federal regulations on PACE loans are clarified. The reason for this recommendation is that the FHFA stance could result in properties with PACE loans being declared in default of their mortgages and in banks adjusting loan-to-value ratios to reflect the maximum permissible PACE amount available to borrowers in PACE jurisdictions, i.e., redlining PACE communities. Staff is not aware of any redlining actions to date, although residential properties that participate in PACE in Riverside County and Sonoma County are required to pay off their PACE assessments at sale or refinancing.

The State of California and others filed suit against the FHFA requesting that they follow established federal rulemaking procedures in connection with the prohibition of PACE. The lawsuits were initially successful in the Federal District Court, but the Ninth Circuit Court of Appeals recently reversed the decision. It is not clear whether the FHFA will continue to pursue such a rulemaking now that it is not judicially mandated. It is also unclear whether or not the FHFA will enforce the provisions of its statement or take no further action. The Energy Commission recommends that Council urge the Federal Housing Finance Agency (FHFA) to establish federal rulemaking procedures in connection with residential PACE financing and rescind directives to Fannie Mae and Freddie Mac that threaten the viability of residential PACE programs throughout the nation.

The Commission approved the recommendation on April 24, 2013 (ayes - Brown, James, Lee, Murtishaw, Schlachter; nays - none; abstentions – none; absent - Constantine).

#### BACKGROUND

The City pioneered PACE programs with the launch of BerkeleyFIRST pilot program in 2008. PACE was designed to enable owners of taxable property to access funds for clean energy and water efficiency projects and to repay the financing through a special assessment or tax on their property tax bill. Under this approach, PACE financing could pass to subsequent owners and the financing could be made available independent of a borrower's FICO score.

In December 2009, after deciding not to continue its pilot program, Berkeley joined a 14-county PACE program. Council authorized the CaliforniaFIRST program to accept PACE applications from Berkeley property owners, conduct contractual assessment proceedings, and levy contractual assessments within the territory of the City of Berkeley and authorizing related actions.

However, in July 2010, before the CaliforniaFIRST program was deployed, the FHFA issued a Statement which could cause properties with PACE liens to be in default of their mortgages and could result in banks adjusting loan-to-value ratios to reflect the maximum permissible PACE amount available to borrowers in PACE jurisdictions, i.e., redlining PACE communities. The FHFA was concerned that PACE tax and assessment

liens, which are in a superior position to mortgages (i.e., in the event of foreclosure, they are paid before the mortgages are paid), could exacerbate the mortgage crisis. The CaliforniaFIRST program, as well as similar programs across the nation, halted residential PACE financing in response to the FHFA Statement out of concern for the potential adverse impact on property owners in participating communities.

The WRCOG HERO program began operations in 2011 and now serves 17 cities and one county in Southern California. The Program has approved financing for over \$100 million of energy upgrades. Current interest rates range from 5.59% for five year loans to 8.25% for 20 year loans.

#### RATIONALE FOR RECOMMENDATION

The Energy Commission recommends postponing a decision regarding participation in HERO because of the potential financial risks to PACE participants and the broader community. However, the Energy Commission disagrees with the FHFA stance on PACE, and recommends that Council urge the FHFA to take steps to enable residential PACE to operate. PACE can be an effective tool for enabling increased energy and water efficiency and reduced global warming emissions.

#### ALTERNATIVE ACTIONS CONSIDERED

The City could proceed with residential PACE through the HERO program despite the FHFA Statement and cancel the program (with 30-days notice) if FHFA acts. This is not advised since pre-existing mortgages could be thrown into default and the community could be redlined during the 30-day notice period. And it would be a second start-and-stop of PACE financing in Berkeley.

#### CITY MANAGER

The City Manager concurs with the content and recommendations of the Commission's Report.

Consistent with the Energy Commission recommendation, staff recommends postponing a decision regarding participation in the HERO program until federal regulations on residential PACE loans are clarified and sending a letter to the FHFA urging the Agency to establish federal rulemaking procedures in connection with residential PACE financing and to rescind directives to Fannie Mae and Freddie Mac that threaten the viability of residential PACE programs throughout the nation.

Recommended language for the text of a letter to the FHFA is included in Attachment 2. The bulk of the text is based on a standard letter in circulation by PACENow, a national advocacy organization. Copies of the letter should be sent to our Congressional Delegation.

#### CONTACT PERSON

Neal De Snoo, Energy Program Manager, Planning and Development, 981-7439

Attachments:

- 1: FHFA July 6, 2010 Statement
2. Recommended Text of Letter to FHFA

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FEDERAL HOUSING FINANCE AGENCY



STATEMENT

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For Immediate Release  
July 6, 2010

**Contact:** Corinne Russell (202) 414-6921  
Stefanie Mullin (202) 414-6376

**FHFA Statement on Certain Energy  
Retrofit Loan Programs**

After careful review and over a year of working with federal and state government agencies, the Federal Housing Finance Agency (FHFA) has determined that certain energy retrofit lending programs present significant safety and soundness concerns that must be addressed by Fannie Mae, Freddie Mac and the Federal Home Loan Banks. Specifically, programs denominated as Property Assessed Clean Energy (PACE) seek to foster lending for retrofits of residential or commercial properties through a county or city's tax assessment regime. Under most of these programs, such loans acquire a priority lien over existing mortgages, though certain states have chosen not to adopt such priority positions for their loans.

First liens established by PACE loans are unlike routine tax assessments and pose unusual and difficult risk management challenges for lenders, servicers and mortgage securities investors. The size and duration of PACE loans exceed typical local tax programs and do not have the traditional community benefits associated with taxing initiatives.

FHFA urged state and local governments to reconsider these programs and continues to call for a pause in such programs so concerns can be addressed. First liens for such loans represent a key alteration of traditional mortgage lending practice. They present significant risk to lenders and secondary market entities, may alter valuations for mortgage-backed securities and are not essential for successful programs to spur energy conservation.

While the first lien position offered in most PACE programs minimizes credit risk for investors funding the programs, it alters traditional lending priorities. Underwriting for PACE programs results in collateral-based lending rather than lending based upon ability-to-pay, the absence of Truth-in-Lending Act and other consumer protections, and uncertainty as to whether the home improvements actually produce meaningful reductions in energy consumption.

Efforts are just underway to develop underwriting and consumer protection standards as well as energy retrofit standards that are critical for homeowners and lenders to understand the risks and rewards of any energy retrofit lending program. However, first liens that disrupt a fragile housing finance market and long-standing lending priorities, the absence of robust underwriting standards to protect homeowners and the lack of energy retrofit standards to assist homeowners, appraisers, inspectors and lenders determine the value of retrofit products combine to raise safety and soundness concerns.

On May 5, 2010, Fannie Mae and Freddie Mac alerted their seller-servicers to gain an understanding of whether there are existing or prospective PACE or PACE-like programs in jurisdictions where they do business, to be aware that programs with first liens contrary to the Fannie Mae-Freddie Mac Uniform Security Instrument and that the Enterprises would provide additional guidance should the programs move beyond the experimental stage. Those lender letters remain in effect.

Today, FHFA is directing Fannie Mae, Freddie Mac and the Federal Home Loan Banks to undertake the following prudential actions:

1. For any homeowner who obtained a PACE or PACE-like loan with a priority first lien prior to this date, FHFA is directing Fannie Mae and Freddie Mac to waive their Uniform Security Instrument prohibitions against such senior liens.
2. In addressing PACE programs with first liens, Fannie Mae and Freddie Mac should undertake actions that protect their safe and sound operations. These include, but are not limited to:
  - 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.

Fannie Mae and Freddie Mac should issue additional guidance as needed.

3. The Federal Home Loan Banks are directed to review their collateral policies in order to assure that pledged collateral is not adversely affected by energy retrofit programs that include first liens.

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. Further, nothing in these directions to the regulated entities affects in any way underwriting related to traditional tax programs, but is focused solely on senior lien PACE lending initiatives.

FHFA recognizes that PACE and PACE-like programs pose additional lending challenges, but also represent serious efforts to reduce energy consumption. FHFA remains committed to working with federal, state, and local government agencies to develop and implement energy retrofit lending programs with appropriate underwriting guidelines and consumer protection standards. FHFA will also continue to encourage the establishment of energy efficiency standards to support such programs.

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*The Federal Housing Finance Agency regulates Fannie Mae, Freddie Mac and the 12 Federal Home Loan Banks. These government-sponsored enterprises provide more than \$5.9 trillion in funding for the U.S. mortgage markets and financial institutions.*

Edward DeMarco, Acting Director  
Federal Housing Finance Agency  
400 7th Street, SW  
Washington, DC 20024

Dear Director DeMarco:

The Berkeley City Council urges the FHFA to develop fair rules that would allow residential PACE programs to proceed. As you are aware, the PACE concept originated in Berkeley and was quickly adopted by jurisdictions throughout the country. The program, which can stimulate investment in local economies, create jobs, reduce household energy expenses, reduce dependence on fossil fuels and related infrastructure – all while reducing our nation’s carbon emissions -- has been stymied by the lack of clear guidance from the FHFA.

The FHFA received well over 40,000 comments that support developing best-practice program guidelines, fair underwriting standards or other risk mitigation measures, such as insurance or loan loss reserves. These comments came from mayors, elected officials, major companies, and organizations around the country -- America is hungry for effective financing solutions for energy upgrades.

In addition to this overwhelming support, the merits of the issue provide a compelling reason for new engagement. The data presented in the rulemaking process effectively make the case that PACE does not materially increase risk to the Enterprises. In fact, hard analysis shows that increased energy efficiency and renewable energy generation raise home values and reduce cost of ownership. A new study from the University of North Carolina shows that owners of energy efficient houses are 32% less likely to default on mortgages.

Comments submitted during the recent rulemaking from the U.S. Conference of Mayors, National League of Cities, National Association of Counties, National Association of State Energy Officials, Alliance to Save Energy, American Council for an Energy-Efficient Economy, American Council on Renewable Energy, American Institute of Architects, BlueGreen Alliance, Boulder County, County of Los Angeles, County of Sonoma, Dow Chemical Company, ICLEI-Local Governments for Sustainability USA, Interstate Renewable Energy Council, Los Angeles Area Chamber of Commerce, Masco Corporation, Natural Resources Defense Council, Environmental Defense Fund, Efficiency Now, PACENow, Renewable Funding LLC, Sierra Club, Solar Energy Industries Association, Sungevity, U.S. Green Building Council, Vote Solar Initiative, and numerous other individual local governments, trade associations, energy companies, and nongovernmental organizations representing millions of Americans, made a compelling case for the adoption of a modified version of FHFA’s First and Third Risk Mitigation Alternatives.

In light of this overwhelming public support, and the merits of the issue, the City of Berkeley respectfully requests that you continue the rulemaking process, and work in

good faith to develop best-practice guidance and fair underwriting standards for effective residential PACE programs.