State of Alaska

Department of Revenue

Commissioner Bryan Butcher

SEAN PARNELL, GOVERNOR
333 Willoughby Avenue, 11th Floor
P.O. Box 110400
Juneau, Alaska 99811-0400
Phone: (907) 465-2300
Fax: (907) 465-2389

Alaska Department of Revenue
Municipal Energy Improvements Financing Report
January 31, 2011

Chapter 83, SLA 10, Section 43

MUNICIPAL ENERGY IMPROVEMENTS FINANCING PROGRAM RECOMMENDATION. Not later than January 31, 2011, the Department of Revenue shall submit to the legislature a report and recommendations regarding the feasibility of a municipal energy improvements financing program. The report must
(1) address financing programs for energy efficiency and renewable energy projects on residential, commercial, and industrial property through property tax assessments; and
(2) identify the costs and benefits of a municipal energy improvements financing program in the state.

Background:

The first program for municipal financing of energy improvements through the use of tax assessments was created in Berkeley, California in 2008. As of the end of 2010, twenty states: Arizona, California, Colorado, Florida, Hawaii, Illinois, Louisiana, Maryland, Missouri, Nevada, New Mexico, New York, North Carolina, Ohio, Oklahoma, Oregon, Texas, Vermont, Virginia and Wisconsin have adopted programs that allow for municipal financing of energy efficiency and renewable energy projects on privately owned property through the use of voluntary property tax assessments. The common acronym for this type of financing approach is PACE (Property Assessed Clean Energy).

In areas with PACE legislation in place, municipal governments offer bonds to investors that are backed by municipally implemented priority property tax liens on properties and then loan the money to residential or commercial property owners to pay for an energy retrofit project. The loans are repaid over the assigned term (typically 15 or 20 years) via an annual assessment on the property tax bill. PACE bonds can be issued by municipal financing districts or finance companies and the proceeds can be used to retrofit either commercial or residential properties. One of the most notable characteristics of PACE programs is that the loan is attached to the property rather than an individual. PACE enables individuals and businesses to avoid the upfront costs that are the most common barrier to installation of alternative energy projects and energy efficiency upgrades. The PACE loans are paid with property taxes over a period of years while energy costs are simultaneously lower, providing the consumer with net gains. Because this type of financing is attached to the property, and collected as part of the property tax assessment, it is not necessary to consider the individual credit of borrowers, but rather only the value of the property and the energy savings from the project.

Financing capital projects with municipal tax assessments on the property that directly benefits from the capital projects is not in any way a new concept in Alaska. It is very typical for projects such as sidewalks, water and sewer, and street improvements to be financed in this way through the establishment of a local improvement district with special tax assessments established against each of the properties that benefit. The difference between PACE financing and the typical local improvement district is that with PACE financing the individual property owner voluntarily agrees to a property tax assessment in return for money to make improvements to their property. Regardless of how the assessment is created, it gives the municipal government a priority lien on the property and payment is assured. Thus the municipal government can sell bonds or other financing instruments that are secured by the payment of the tax assessment. When the property is sold the PACE loan stays with the property and only the current portion owed must be cleared at closing.

Most PACE financing programs in the United States were put on hold in July 2010 when the Federal Housing Finance Agency issued a statement (attached to this report) that says in part:

"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. "

<u>Until and unless the Federal Housing Finance Agency changes their position on PACE financing, or national standards are adopted, financing programs for energy efficiency and renewable energy project through tax assessments will not be practical.</u>

Specific Alaska Challenges:

PACE programs are typically administered at the local government level. Alaska has a population of approximately 700,000 persons according to the 2010 census. There are 162 local governments in Alaska, however only 38 have a property tax implemented at this time. Many of these governments are simply too small to operate an energy financing program on their own. Thus, if this type of program is to operate effectively throughout Alaska, it will require statewide standards and administration and a method for pooling revenues for financing. Some parts of the state, in the unorganized borough, have no taxing authority and this type of program cannot be used in these areas.

Alaska Advantages:

Energy standards and expertise: With the funding of the weatherization and energy rebate programs over the past several years though Alaska Housing Finance Corporation, Alaska has developed a basis for understanding the energy needs of both residential and commercial consumers. Through 2010, over 30,000 ratings have been dispatched through the Home Energy Rebate program with over 9,000 rebates paid. Based on the information from this program, these 9,000 plus homeowners are saving an average of $1,580 annually on energy from the work done in this program with an average cost of $10,800 up front. Based on this, it is clear that the cost of these improvements could have been financed and amortized if a PACE type program were in place. Data is lacking on how many improvements have not been done because people lack the capital upfront. Alaska has qualified energy raters, a trained workforce and standards upon which gauge probable energy savings.

Access to capital: Nationwide, both the real estate market and the finances of local governments are weak. Alaska has not experienced a collapse in the real estate market or downgrades to municipal ratings. If a municipal financing program for energy efficiency and renewable energy projects through tax assessments again becomes practical at the national level, we would expect it to benefit from Alaska's general financial strength.

Recommendations:

- If a PACE or similar financing program is established in Alaska, qualifications should require:
    - Local governments to create PACE districts to participate.
    - Local government ongoing administration for property tax collection and lien implementation.
    - A statewide issuer of bonds to provide for local government financing need, ensuring accessibility to smaller communities and efficiency to all.
    - Uniform statewide standards, like those used by AHFC for the Home Energy Rebate program, for determining energy savings and allowable costs.

- That if creating a PACE program is a priority that consideration be given to providing a capital appropriation for a revolving loan fund, eliminating the need to borrow from third parties in the short term.

- Work with the Federal Housing Finance Agency to establish whether a PACE type program can be constructed that can conform to national mortgage underwriting standards.

FEDERAL HOUSING FINANCE AGENCY

STATEMENT

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 run 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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