

Legislative Analysis



PROPERTY ASSESSED CLEAN ENERGY ACT; PACE-FINANCED SELF-DIRECTED EO PLANS

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**Senate Bill 1502 as enrolled
Public Act 269 of 2010
Sponsor: Sen. Gerald Van Woerkom**

**House Bill 5640 as enrolled
Public Act 270 of 2010
Sponsor: Rep. Rebekah Warren**

**House Committee: Great Lakes and Environment
Senate Committee: Local, Urban and State Affairs**

First Analysis (2-10-11)

BRIEF SUMMARY: House Bill 5640 (Public Act 270 of 2010) creates a new act called the "Property Assessed Clean Energy Act" (PACE Act) enabling local units of governments (defined as counties, townships, cities, villages) to provide financing to the record owners of privately-owned commercial or industrial properties for specified energy and water conservation projects. PACE loans are to be repaid through a voluntary assessment and lien on the benefited property under a contract between the local unit of government and the property owner. Installment payments on the assessment are to be collected in the manner of either general property taxes or special assessments. A PACE program may also allow commercial loans to be secured by a voluntary assessment and lien on the benefited commercial or industrial property. If a property is subject to a mortgage, the owner must have the mortgage holder's written consent to participate in a PACE program.

Local units of government may issue bonds to obtain funds for a PACE program, secured by assessments on benefited properties and other funds.

MCL 460.931-949 (new act).

HB 5650 was tie-barred to Senate Bill 1502 (Public Act 269 of 2010).

SB 1502 allows any commercial or industrial electric customer—without regard to annual peak electric demand—to implement a self-directed energy optimization (EO) plan under the Clean, Renewable, and Efficient Energy Act, if a customer finances an electric energy efficiency improvement under a PACE program. Customers with self-directed EO plans are exempt from otherwise applicable EO surcharges on their electric bills. The bill also modifies the reporting obligations of customers with self-directed EO plans.

MCL 460.1093

FISCAL IMPACT: A precise fiscal impact of the bill cannot be determined since it is not known how many local units will choose to participate, how many projects will be undertaken, and the extent to which these projects increase taxable values. To the extent that taxable values increase, both local property tax collections and School Aid Fund revenues would also increase. However, local unit expenses would also increase by an unknown amount due to administrative costs.

THE APPARENT PROBLEM:

As originally conceived, the bill was intended to help private property owners, especially residential homeowners, finance energy efficiency improvements and renewable energy projects that they might otherwise not be able to afford or might be reluctant to undertake. The basic idea of a typical property-assessed clean energy or "PACE" program is that the local unit of government loans money to private property owners, generally homeowners, who use the funds to make energy efficiency or renewable energy retrofits on their property. The local unit of government obtains money for the loans by issuing bonds or using some other source of funds. The property owner agrees to a voluntary assessment and lien on the property to ensure that the local unit of government is repaid, and theoretically the assessment will run with the land if the property is sold. The assessment is repaid by means of installment payments added to the homeowner's property tax bill. The installment payments are generally stretched out over a long time period—as long as 20 years—if the improvement that was financed has a similarly-long expected useful life.

PACE financing enables homeowners who have no upfront capital or who might not be deemed creditworthy by traditional lenders to secure financing for energy efficiency or renewable energy retrofit projects. In addition, homeowners may be more willing to invest in renewable energy or energy efficiency projects if they don't have to worry about repaying the entire loan if they sell the house before the assessment has been repaid and the hoped-for savings from the project have been realized. The idea is that the assessment would run with the land, be paid off through installment payments tacked on to property tax bills or special assessments, and, if the PACE assessment were not paid off in full when the property changed hands, the assessment and lien, and the installment payments resulting from the assessment and lien, would simply transfer to the property's new owner.

Proponents suggested that local units of government would be protected from losses related to defaults and foreclosures because the repayment mechanism—placing an assessment on property that is then repaid in the manner of property taxes or special assessments—reduces the risk of defaults or losses. Also, the utility savings realized by the homeowners would help homeowners make their installment payments. (Depending on how it was structured, however, a PACE program could place funds of the local unit of government at risk. For example, if the local unit chose to set aside a reserve fund to cover defaults, the entire reserve fund could be at risk.)

Proponents say that PACE programs provide a multitude of benefits including a reduction in energy use and greenhouse gas emissions and the creation of local jobs.

PACE programs emerged in 2008 with early programs in California and Colorado that quickly caught the attention of the federal government and communities around the nation. In just two years, at least 15 states enacted enabling legislation to allow PACE programs to go forward. The federal Department of Energy encouraged the development of these programs.

Yet because most PACE programs give PACE liens priority over existing mortgage liens, many mortgage lenders have strenuously objected to PACE programs. In fact, many PACE programs were put on hold or discontinued in the summer of 2010 after the Federal Housing Finance Agency (the agency that regulates Fannie Mae, Freddie Mac, and Federal Home Loan Banks) issued a statement calling for a moratorium on PACE programs until concerns relating to PACE lien priority, underwriting standards, and consumer protection could be resolved.¹

After that statement was issued, HB 5650 was revised to cover only commercial and industrial properties, and to require property owners to have the written permission of their mortgage lender to participate. The bill was also expanded to cover water conservation projects in addition to projects relating to energy efficiency and renewable energy. Moreover, as enacted, the bill also allows *commercial loans*, not just PACE loans, to be repaid through a voluntary lien and assessment on commercial or industrial property.

HB 5640 was tie-barred to a Senate Bill 1502, a bill that expands the eligibility of commercial and industrial electric customers to implement self-directed energy optimization plans (and thereby avoid certain charges imposed by their electric provider). SB 1502 makes any commercial or industrial electricity customer that finances an electric energy efficiency improvement through a PACE program eligible to implement a self-directed EO plan. Customers using other types of financing must meet existing peak-demand-based eligibility requirements to implement a self-directed EO plan.

THE CONTENT OF THE BILLS:

Senate Bill 1502

**Senate Bill 1502 amends the Clean, Renewable, and Efficient Energy Act to make *any* commercial or industrial customer that installs or modifies an electric energy efficiency improvement under a PACE program eligible to file and implement a self-directed energy optimization (EO) plan as provided in Section 93 of the act, without regard to the otherwise applicable eligibility requirements based on annual peak electric demand. The act currently requires a customer implementing a self-directed EO plan to submit a brief report to the customer's electric provider every two years. The bill requires such a

¹ See FHFA Statement of Certain Energy Retrofit Loan Programs, July 6, 2010, available at <http://www.fhfa.gov/webfiles/15884/PACESTMT7610.pdf>.

customer to submit an *annual* report indicating the level of incremental energy savings achieved that year and whether that level met the goal in the customer's self-directed EO Plan.

House Bill 5640

Title. The act is called the "Property Assessed Clean Energy Act."

Program description. Following prescribed procedures, a local unit of government (county, township, city, or village) may establish a property assessed clean energy (PACE) program, and create one or more districts from time to time under the program. Within a district, a local unit of government may enter into a contract with the record owner (meaning the fee title holder or land contract vendee of record) of privately-owned commercial or industrial property to finance or refinance one or more energy projects on the property. "Energy projects," as defined in the act, relate to "energy efficiency improvements" and "renewable energy systems." Both of those terms are also defined in the act. "Energy efficiency improvements" include water conservation improvements. (See Definitions below.)

The contract may provide for the repayment of an energy project's cost through assessments on the benefited property. The financing or refinancing may include the cost of materials and labor necessary for the installation; permit fees; inspection fees; application and administrative fees; bank fees; and all other fees that may be incurred by the property owner under the installation on a specific or pro rata basis, as determined by the local unit of government.

Steps to establish program. To establish a PACE program, the local governmental unit's governing body must take the following actions in the following order:

- Adopt a resolution of intent that includes: (1) a finding that the financing of energy projects is a valid public purpose; (2) a statement of intent to provide funds for energy projects to be repaid by assessments on the property benefited, with the agreement of the record owners; (3) a description of the proposed arrangements for financing the program; (4) the types of energy projects that may be financed; (5) a reference to a report on the proposed program and where the report is available; and (6) the time and place for a public hearing on the proposed program.
- Hold a public hearing for public comment on the proposed program, including the required program report.
- Adopt a resolution establishing the program and setting forth its terms and conditions. The resolution must (1) include the matters required to be contained in the report—the report itself, or an amended version of it, may be incorporated by reference to satisfy this requirement; and (2) specify which aspects of the program are amendable only after a new public hearing.

Program amendment. A PACE program may be amended by resolution of the governing body. The governing body must hold a hearing before amending the program only if this is required under the terms of the resolution establishing the program.

Required report; availability for review. The report on a proposed PACE program must be made available for review on the local unit of government's website or at the office of the clerk or other official authorized to enter into program contracts. The report must include all of the following information:

- A form of contract between the local unit of government and the record owner governing the terms and conditions of financing and assessment under the program.
- The official authorized to enter into program contacts on behalf of the local unit of government.
- The maximum aggregate annual dollar amount for all financing to be provided by the local unit of government under the program.
- An application process and eligibility requirements for financing energy projects under the program.
- A method for determining interest rates on assessment installments, repayment periods, and the maximum amount of an assessment.
- An explanation of how assessments will be made and collected consistent with Section 13(2) of the act (e.g., on summer and winter property tax bills or, alternatively, in the manner of a special assessment).
- A plan for raising capital to finance improvements under the program. The plan may include: (1) the sale of bonds, subject to the Revised Municipal Finance Act (MCL 141.2101 to 141.2821); (2) amounts to be advanced by the local unit of government through funds available to it from any other source; and (3) owner-arranged financing from a commercial lender. Under owner-arranged financing, the local unit of government may impose an assessment and forward payments to the commercial lender or the record owner may pay the commercial lender directly.
- Information regarding all of the following, to the extent known, or procedures to determine the following in the future: (1) any reserve fund or funds to be used as security for bonds or notes; (2) any application, administration, or other program fees to be charged to participating property owners that will be used to finance costs incurred by the local unit of government as a result of the program.
- A requirement that the term of an assessment not exceed the useful life of the energy project paid for by the assessment.
- A requirement for an appropriate ratio of the amount of the assessment to the property's assessed value.
- A requirement that the record owner of property subject to a mortgage obtain the written consent of the mortgage holder before participating in the program.
- Provisions for marketing and participant education.
- Provisions for adequate debt service reserve fund.
- Quality assurance and antifraud measures.

- A requirement that a baseline energy audit be conducted before an energy project is undertaken, to establish future energy savings. After the energy project is completed, the local unit of government must obtain verification that the renewable energy system or energy efficiency improvement was properly installed and is operating as intended.
- For an energy project financed with more than \$250,000 in assessments, both of the following are required: (1) a requirement for ongoing measurements that establish the savings realized by the record owner from the energy project; and (2) a requirement that, in the contract for installation of the energy project, the contractor guarantee to the record owner that the project will achieve a savings-to-investment ratio greater than one and agree to pay the record owner, on an annual basis, any shortfall in savings below this level.

Assessments. A local unit of government may impose a PACE program assessment only under a written contract with the record owner of the property to be assessed.

Verification. Before entering into a contract with a property owner, the local unit of government must verify that there are no delinquent taxes, special assessments, water or sewer charges, or PACE program assessments on the property.

Lien. A PACE program assessment, including any interest or penalty, constitute a lien against the property until paid in full. The lien runs with the property and has the same priority and status as other property tax and assessment liens. The local unit of government has the same rights in the case of PACE assessment delinquency as it does with respect to delinquent property taxes. When the PACE assessment, including any interest and penalty, is paid, the lien must be removed from the property.

Method of collecting installment payments. Installments of assessments due under a program must be included in each summer and winter tax bill issued under the General Property Tax Act, and must be collected at the same time and in the same manner as property taxes. Alternatively, installments may be billed and collected as provided in a special assessment ordinance of general applicability adopted by the local unit of government under state law or local charter.

Bonds or notes. A local unit of government may issue bonds or notes to finance energy projects under a PACE program. The bonds or notes are not general obligations of the local unit of government but must be secured by one or more of the following, as provided by the resolution or ordinance approving the bonds or notes:

- Payment of assessments on benefited property within the specified district or districts.
- Reserves established by the local unit of government from grants, bond or note proceeds, or other lawfully available funds.
- Municipal bond insurance, lines or letters of credit, public or private guaranties, standby bond purchase agreements, collateral assignments, mortgages, and any other available means of providing credit support or liquidity, including but not

limited to, arrangements described in Section 315 of the Revised Municipal Finance Act, MCL 141.2315. (Among other things, Section 315 of that act authorizes the principal and interest on bonds to be payable from taxes or other revenues of the municipality.)

- Tax increment revenues if lawfully available for such purposes.
- Any other amounts lawfully available for such purposes.

Statutory lien. A pledge of assessments, funds, or contractual rights made by a governing body in connection with the issuance of bonds or notes by a local unit of government under this act constitutes a statutory lien on the assessments, funds, or contractual rights so pledged in favor of the person or persons to whom the pledge was given, without further action by the governing body. The statutory lien is valid and binding against all other persons, with or without notice.

Parity of series of bonds or notes. Bonds or notes of one series issued under the act could be secured on par with bonds or notes of another series issued by the local unit of government under the terms of a master indenture or master resolution entered into or adopted by the local governmental unit's governing body.

Revised Municipal Finance Act. Bonds or notes issued under the act are subject to the Revised Municipal Finance Act, MCL 141.2101 to 141.2821.

Tax exemption. Bonds and notes issued under the act, and the interest payable on them, are exempt from all taxation by the State of Michigan and its political subdivisions.

**Public and governmental purpose. The act declares that bonds or notes issued under the PACE Act "further essential public and governmental purposes, including, but not limited to, reduced energy costs, reduced greenhouse gas emissions, economic stimulation and development, improved property valuation, and increased employment." [As previously noted, resolution of intent establishing the program must also include a finding that "the financing of energy projects is a valid public purpose."]

Self-directed energy optimization plans. A commercial or industrial electricity customer that installs or modifies an electric energy efficiency improvement under a PACE program is exempt from the energy optimization charges the customer would otherwise incur under Section 89 or 91 of the Clean, Renewable, and Efficient Energy Act, MCL 460.1089 and 460.1091, provided that the customer conducts a self-directed energy optimization plan according to the requirements of Section 93 of that act, MCL 460.1093. (Any customer who conducts a self-directed energy optimization plan according to those acts requirements is exempt from the specified charges, whether or not they finance the project through a PACE program.) Those requirements include, but are not limited to, a requirement that the annual aggregate energy savings from the self-directed plan meet or exceed the energy optimization standards, based on the previous year's electricity purchases for sites covered by the self-directed plan.

Joint programs. A local unit of government may join with any other local unit of government, or with any person, or with any number or combination of units and persons, by contract or otherwise as may be permitted by law, for the implementation of a PACE program, in whole or part. If a PACE program is implemented jointly by two or more local units of government, a single joint public hearing is sufficient to satisfy the requirement that the local unit of government hold a public hearing before adopting a resolution establishing the program.

Definitions. [§3] Terms defined in the bill include:

"District" means a district created under a PACE program by a local unit of government within the local unit of government's jurisdictional boundaries. A local governmental unit may create more than one district, and districts may be separate, overlapping, or coterminous.

"Energy efficiency improvement" means equipment, devices, or materials intended to decrease energy consumption, including, but not limited to, all of the following:

- Insulation in walls, roofs, floors, foundations, or heating and cooling distribution systems.
- Storm windows and doors; multi-glazed windows and doors; heat-absorbing or heat-reflecting glazed and coated window and door systems; and additional glazing, reductions in glass area, and other window and door system modifications to reduce energy consumption.
- Automated energy control systems.
- Heating, ventilating, or air-conditioning and distribution system modifications or replacements.
- Caulking, weather-stripping, and air sealing.
- Replacement or modification of lighting fixtures to reduce the lighting system's energy use.
- Energy recovery systems.
- Day lighting systems.
- Installation or upgrade of electrical wiring or outlets to charge a motor vehicle that is fully or partially powered by electricity.
- Measures to reduce water usage or to increase the efficiency of water usage.
- Any other installation or modification of equipment, devices, or materials approved as a utility cost-savings measure by the governing body.

"Energy project" means "the installation or modification of an energy efficiency improvement or the acquisition, installation, or improvement of a renewable energy system."

"Governing body" means a county board of commissioners, a township board, or the council or other elected legislative body of a city or village.

"Local unit of government" means a county, township, city, or village.

"Person" means "an individual, firm, partnership, association, corporation, unincorporated joint venture, or trust, organized, permitted, or existing under the laws of this state or any other state, including a federal corporation, or a combination thereof. However, person does not include a local unit of government."

"Property" means "privately owned commercial or industrial real property located within the local unit of government."

"Record owner" means "the person or persons possessed of the most recent fee title or land contract vendee's interest in property as shown by the records of the county register of deeds."

"Renewable energy resource" means "a resource that naturally replenishes over a human, not a geological, time frame that is ultimately derived from solar power, water power, or wind power. Renewable energy resource does not include petroleum, nuclear, natural gas, or coal. A renewable energy resource comes from the sun or from thermal inertia of the earth and minimizes the output of toxic material in the conversion of the energy and includes, but is not limited to, all of the following":

- Biomass.
- Solar and solar thermal energy.
- Wind energy.
- Geothermal energy.
- Methane gas captured from a landfill.

"Renewable energy system" means "a fixture, product, device, or interacting group of fixtures, products, or devices installed on the customer's side of the meter that use [one] or more renewable energy resources to generate electricity. Renewable energy system includes a biomass stove but does not include an incinerator or digester."

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■ This analysis was prepared by nonpartisan House staff for use by House members in their deliberations, and does not constitute an official statement of legislative intent.