



Senate Fiscal Agency
P. O. Box 30036
Lansing, Michigan 48909-7536


 BILL ANALYSIS

Telephone: (517) 373-5383
Fax: (517) 373-1986
TDD: (517) 373-0543

Senate Bill 1502 (as enacted)
House Bill 5640 (as enacted)
Sponsor: Senator Gerald Van Woerkom (S.B. 1502)
Representative Rebekah Warren (H.B. 5640)
Senate Committee: Local, Urban and State Affairs
House Committee: Great Lakes and Environment

PUBLIC ACT 269 of 2010
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Date Completed: 4-11-11

RATIONALE

Business owners can reduce pollution and save money by implementing energy efficiency and conservation measures, including measures related to insulation, heating and cooling systems, and lighting. The upfront costs of these improvements, however, can pose a significant challenge to business owners, while the benefits are not fully realized for years after installation. In order to assist commercial property owners with energy improvements, it was suggested that local units of government should be given the opportunity to create property assessed clean energy (PACE) programs. Under such a program, a local unit may sell bonds to loan money to property owners for energy efficiency measures. In turn, recipients repay the loans through special assessments added to their property tax bills.

In a related matter, it also was suggested that all commercial and industrial electric customers, regardless of size, should be exempt from energy optimization (EO) charges under the Clean, Renewable, and Efficient Energy Act, if they participate in a PACE program. (That Act requires electric providers to establish EO programs to achieve energy savings according to a schedule. Regulated providers may recover the costs of implementing their EO plans through an itemized charge on customer bills. Customers may implement self-directed EO plans and are exempt from these charges if they meet an annual peak electricity demand threshold.)

CONTENT

House Bill 5640 created the "Property Assessed Clean Energy Act" to allow a local unit of government to establish a PACE program, under which the local unit may enter into a contract with a commercial or industrial property owner to finance energy efficiency improvements or renewable energy systems. Specifically, the bill does the following:

- Authorizes the local unit to create districts under the program.
- Provides for the repayment of the improvements' or systems' costs through assessments upon benefited property.
- Allows a local unit to issue bonds or notes to finance activities under its PACE program.
- Exempts an electric customer that participates in a PACE program from EO charges.
- Provides that an assessment imposed under a PACE program constitutes a lien against the property.

Senate Bill 1502 amended the Clean, Renewable, and Efficient Energy Act to provide that annual peak demand requirements that an electric customer must meet to be eligible to implement a self-directed EO program and be exempt from EO charges do not apply to a commercial or industrial customer that installs or modifies an electric energy efficiency improvement under a PACE program.

The bills were tie-barred to each other. They took effect on December 14, 2010.

House Bill 5640

Program Establishment

The bill allows a county, township, city, or village to establish a PACE program and, from time to time, create a district or districts under the program within the local unit's jurisdictional boundaries. Districts may be separate, overlapping, or coterminous.

To establish the program, the governing body of the local unit must take certain actions in the order prescribed in the bill. First, the governing body must adopt a resolution of intent that includes all of the following:

- A finding that the financing of energy projects is a valid public purpose.
- A statement of intent to provide funds for energy projects, which may be repaid by assessments on the property benefited, with the agreement of the record owners.
- A description of the proposed arrangements for financing the program.
- The types of energy projects that may be financed.
- Reference to a report (described below) on the proposed program and a location where the report is available.
- The time and place for a public hearing on the proposed program.

("Energy project" means the installation or modification of an energy efficiency improvement or the acquisition, installation, or improvement of a renewable energy system. The terms "energy efficiency improvement" and "renewable energy system" are defined below.)

After adopting the resolution, the governing body must hold a public hearing at which the public may comment on the proposed program, including the required report. Then, the local unit must adopt a resolution establishing the program and setting forth its terms and conditions, including a description of which aspects of the program may be amended without a new public hearing and which aspects may be amended only after a new hearing is held.

A local unit may join with any number or combination of other local units or people by contract or as otherwise permitted by law for the implementation of all or part of a PACE program. If two or more local units implement a joint program, a single public hearing held jointly by those local units is sufficient to satisfy the bill's public hearing requirements.

Report

The report on the proposed program must include all of the following:

- A form of contract between the local unit and record owner governing the terms and conditions of financing and assessment under the program.
- Identification of an official authorized to enter into a program contract on behalf of the local unit.
- A maximum aggregate annual dollar amount for all financing to be provided by the local unit under the program.
- An application process and eligibility requirements for financing energy projects.
- 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 the bill's requirements.
- A plan for raising capital to finance improvements under the program.

The plan for raising capital may include the sale of bonds or notes, subject to the Revised Municipal Finance Act, and amounts to be advanced by the local unit through funds available to it from other sources.

In addition, the report must include information regarding the following, to the extent known, or procedures to determine the following in the future:

- Any reserve funds or funds to be used as security for the bonds or notes.
- 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 as a result of the program.

The report also must include the following:

- A requirement for an appropriate ratio of the amount of the assessment to the assessed value of the property.
- A requirement that the record owner of property subject to a mortgage obtain written consent from 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.

For an energy project financed with more than \$250,000 in assessments, the report must include a requirement for ongoing measurements that establish the savings realized by the record owner from the project; and a requirement that, in the contract for the project's installation, the contractor guarantee to the owner that the project will achieve a savings-to-investment ratio greater than one and agree to pay the owner any shortfall below that level.

The local unit must make the report available for review on its website or at the office of the clerk or the official authorized to enter contracts under the program.

Assessment

A local unit may enter into a contract with the record owner of property within a district to finance or refinance one or more energy projects on the property. The contract must provide for the repayment of the cost of an energy project through assessments upon the property benefited. The financing or refinancing may include the cost of materials and labor necessary for installation, permit fees, inspection fees, application and administrative fees, bank fees, and all other fees that the property owner may incur pursuant to the installation on a specific or pro rata basis, as determined by the local unit.

Before entering into a contract with a property owner, the local unit must verify all of the following:

- That there are no delinquent taxes, special assessments, or water or sewer charges on the property.
- That there are no delinquent assessments on the property under a PACE program.

An assessment imposed under a PACE program, including any interest on the assessment and any penalty, will constitute a lien against the property until the assessment, including any interest or penalty, is paid in full. The lien will run with the property, and have the same priority and status as other property tax and assessment liens. If the payment of an assessment is delinquent, the local unit will have all rights as it does with respect to delinquent property taxes. When the assessment, including any interest and penalty, is paid, the lien must be removed from the property.

Installments of assessments due under a program must be included in each summer and winter tax bill, and 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.

Bonds & Notes

A local unit may issue bonds or notes to finance energy projects under its PACE program. Bonds or notes will not be general obligations of the local unit, but must be secured by one or more of the following as provided by the governing body in the resolution or ordinance approving them:

- Payments of assessments on benefited property within the district or districts specified.
- Reserves established by the local unit 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.
- Tax increment revenue that is lawfully available for these purposes.
- Any other amounts lawfully available for these purposes.

Bonds or notes issued under the bill are subject to the Revised Municipal Finance Act. The bonds or notes, and interest payable on them, are exempt from all taxation by the State and its political subdivisions.

Energy Optimization Charges

A commercial or industrial electric 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 the Clean, Renewable, and Efficient Energy Act, if the customer conducts a self-directed EO plan under and subject to the applicable requirements of that Act. These include the requirement that the plan provide for aggregate energy savings that each year meet or exceed the EO standards based on the electricity purchases in the previous year for the site or sites covered by the self-directed plan.

Definitions

"Energy efficiency improvement" means equipment, devices, or materials intended to decrease energy consumption, including all of the following:

- Insulation in walls, roofs, floors, foundations, or heating and cooling distribution systems.
- 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 energy use of the lighting system.
- 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 the use of water or increase the efficiency of water use.
- Any other installation or modification of equipment, devices, or materials approved as a utility cost-saving measure by the governing body of a local unit.

Energy efficiency improvements also include storm windows and doors; multi-glazed

windows and doors; heat-absorbing or heat-reflective glazed and coated window and door systems; and additional glazing, reductions in glass area, and other window and door system modifications that reduce energy consumption.

"Renewable energy system" means a fixture, product, device, or interacting group of such items installed on the customer's side of the meter that uses one or more renewable energy resources to generate electricity. The term includes a biomass stove but not an incinerator or digester.

"Renewable energy resource" means a resource that naturally replenishes over a human, not a geological, time frame; ultimately is derived from solar power, water power, or wind power; and minimizes the output of toxic material in the conversion of the energy. The term includes biomass, solar and solar thermal energy, wind energy, geothermal energy, and methane gas captured from a landfill. It does not include petroleum, nuclear, natural gas, or coal.

Senate Bill 1502

Under the Clean, Renewable, and Efficient Energy Act, an eligible electric customer is exempt from energy optimization charges it would otherwise incur if it files with its electric provider and implements a self-directed EO plan. (The eligibility requirements refer to the minimum peak demand the customer must have had in the preceding year at the sites to be covered by the plan. In 2011, 2012, or 2013, the threshold is at least one megawatt (MW) at each site or five MWs in the aggregate at all sites. In 2014 or any year after that, the threshold is at least one MW in the aggregate at all sites.)

Previously, these provisions referred to an eligible "primary or secondary" electric customer. Under the bill, an electric customer is not eligible unless it is a commercial or industrial electric customer and meets the prescribed annual peak demand thresholds.

The bill provides that the eligibility requirements do not apply to a commercial or industrial customer that installs or modifies an electric energy efficiency improvement under a PACE program.

Previously, a customer implementing a self-directed EO plan had to submit to its electric provider every two years a report documenting the energy efficiency measures taken under the plan during that two-year period. Instead, the bill requires an annual report containing that documentation for the previous year.

The bill deleted a provision requiring a customer promptly to notify the provider if the customer failed to achieve incremental energy savings as set forth in its self-directed plan for the first year that would be covered by the next biannual report. Instead, the customer report must indicate the level of incremental energy savings achieved for the year covered by the report and whether that level of savings meets the goal set forth in the customer's self-directed plan.

MCL 460.1093 (S.B. 1502)
460.931-460.949 (H.B. 5640)

ARGUMENTS

(Please note: The arguments contained in this analysis originate from sources outside the Senate Fiscal Agency. The Senate Fiscal Agency neither supports nor opposes legislation.)

Supporting Argument

Energy efficiency improvements offer various benefits for business owners and communities; financing them, however, can be difficult. The installation of energy efficiency and conservation measures leads to job creation, reduced pollution, and financial savings. In light of these benefits, it is worthwhile to provide commercial and industrial property owners with access to capital. House Bill 5640 eliminates a barrier to investment in energy improvements by spreading the capital cost over the period for paying a special assessment, which may be 10 to 20 years, while allowing business owners to begin reaping the benefits in the near term.

Response: Residential property owners also should have the opportunity to participate in PACE programs. While assistance is available for individuals who have trouble paying their utility bills, such aid does not improve residential energy efficiency. Facilitating energy conservation among homeowners would provide a more long-term solution and reduce the need for this type of funding.

Supporting Argument

Originally, under the Clean, Renewable, and Efficient Energy Act, only customers meeting the prescribed electric demand thresholds were eligible to implement self-directed EO plans and receive an exemption from their electric provider's EO charges, which meant that the exemption was available only to large consumers. Under the bills, the owner of any commercial or industrial property, regardless of the business's size, may implement a self-directed EO plan and be exempt from its provider's EO charges if the property owner participates in a PACE program and otherwise meets the Act's requirements. All businesses should have this option if it will be to their benefit.

Opposing Argument

In 2010, the Federal Housing Finance Agency (FHFA) issued a letter stating that PACE programs "present significant safety and soundness concerns...". At least one concern involves first liens established by PACE loans, and House Bill 5640 appears to give a PACE lien priority ahead of a mortgage. This senior lien status represents a significant departure from traditional lending practices, and ultimately could increase risks for lenders as well as the cost of borrowing for consumers. Although the bill requires the mortgage holder's consent for participation, the new Act could be improved in several ways. For example, a PACE lien should be made secondary to an existing mortgage, the property owner should be required to make a down payment toward the cost of the improvement, and PACE should be limited debt to 10% of a property's assessed value. Such elements would follow traditional lending standards more closely and preserve the rights of first mortgage holders.

Legislative Analyst: Julie Cassidy

FISCAL IMPACT

Senate Bill 1502

The bill will have no fiscal impact on State or local government.

House Bill 5640

The bill will increase both revenue and expense for local units by an unknown amount depending on the number of local units adopting PACE programs, the number

of taxpayers entering into agreements under the bill, and value of any improvements that occur. The bill will potentially increase revenue to the State School Aid Fund, and result in a net increase in local revenue, if the improvements result in higher taxable values.

Twenty-two states have enacted similar legislation. The largest such district is in Sonoma County, California, where approximately \$30.0 million has been disbursed for approved improvements to 1,010 homes and 22 commercial properties.

It is unclear when any fiscal impacts under the bills will occur. In addition to the uncertainties already identified, the Federal Housing Finance Agency has urged local units to place a moratorium on PACE programs. Primarily due to concerns about the priority of any program-related liens, the FHFA also has instructed Fannie Mae, Freddie Mac, and Federal Home Loan Banks to take certain actions that have apparently pre-empted the implementation of a similar Federal pilot program that was to run for 24 months in 12 states.

Fiscal Analyst: David Zin

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This analysis was prepared by nonpartisan Senate staff for use by the Senate in its deliberations and does not constitute an official statement of legislative intent.