

**Property Assessed Clean Energy (PACE):
What is it, and can it be implemented in Arizona?**
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The essentials

- Property Assessed Clean Energy (PACE) offers a path for building owners to fund energy efficiency upgrades and renewable energy projects.
- Under the PACE framework, a local government provides the up-front capital for a building owner to install an energy efficiency project and/or a renewable energy system on their building. The building owner repays the capital over the course of 20 years through a property assessment tax.
- PACE is being successfully used in 12 states and Washington, D.C. for commercial properties. Many states also allow PACE financing for residential properties, but most residential financing programs have been shelved for now while the Federal Housing Finance Agency (FHFA) issues rules related to lien seniority for mortgaged homes.
- Developing a PACE program in Arizona would require passage of PACE-enabling legislation. PACE-enabling bills have been introduced in past legislative session, but have not been signed into law.
- During the current 2014 session, State Reps. Orr (R) and Sherwood (D) are sponsoring PACE-enabling bill HB 2206.

I. PACE basics

Property Assessed Clean Energy (PACE) financing is a voluntary, land-secured funding mechanism for energy efficiency and distributed generation renewable energy (DG) projects. A participating property owner repays the financing over a multi-year period – generally 20 years - at the same time as they pay taxes. Over the course of the repayment period, the lien stays with the property rather than the property owner. In cases of foreclosure, in most states PACE liens are collected with tax liens and are senior to mortgages and other private liens. (See Section II for more about subordination of liens and PACE).

State law must enable PACE before a local government can legally administer the program. [31 states and Washington, D.C.](#) have passed PACE-enabling statutes. At this time, Arizona does not have PACE-enabling statute, but State Reps. Orr (R) and Sherwood (D) are sponsoring a PACE-enabling bill, HB 2206 during the current legislative session. Similar bills have been submitted in past sessions.¹

¹ During the 2012 session, State Rep. Chad Campbell [sponsored HB 2298](#); during the 2013 session, State Reps. Orr and Sherwood [sponsored HB 2584](#). Read our brief on HB 2298, published in 2012, [here](#).

Once enabling legislation is in place, there are four steps to implementing a successful program:

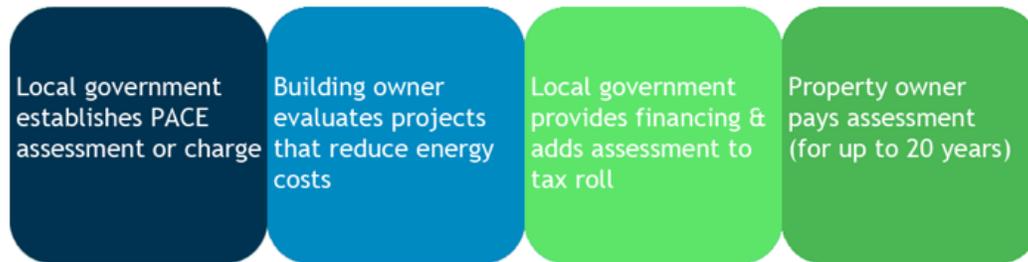


Fig. 1. Source: PACENow.org

How is PACE different from other financing programs, e.g. home equity loans?

PACE programs offer competitive interest rates with a lengthy payback period, do not encumber personal credit and are based on the value of the property, not an applicant's income or credit score. For residential properties, this means that low-income persons can participate, because in many places PACE does not require a down payment, a credit check and there is no preference for higher incomes.²

A case study on a pilot residential program in Berkeley, CA, found that 90% of participants chose PACE financing instead of other loans due to the ease of the process; 60% cited "reasonable interest rates" as a reason. Other reasons that a commercial or residential property owner might choose PACE financing:

- It eliminates high up-front investment costs;
- PACE tax assessments are transferable through property sales;
- It addresses information asymmetries between neighbors and between borrowers and lenders. Participants who talk to their neighbors about the application process, payback timing, and installation experiences can reduce uncertainty. Similarly, PACE lenders are already familiar with the benefits. This reduces the application and approval times.³

II. Taking it slow on residential PACE: lien subordination and PACE

As noted above, because PACE financing is via property tax assessments, under traditional lending practices PACE liens become senior to existing mortgages on a property. Mortgage lenders are therefore unwilling to support such financing

² For instance, see California's Figtree PACE financing comparison chart: <http://www.figtreefinancing.com/commercial-shop-compare/>

³ Kirkpatrick, Aubrey. April 2012. *Closing the "Energy-Efficiency Gap": An Empirical Analysis of Property Assessed Clean Energy*. Master's thesis, Duke University.

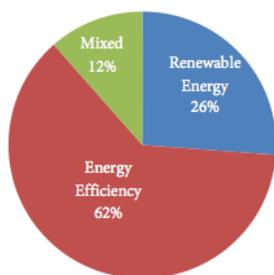
mechanisms, and in 2010 the [Federal Housing Finance Agency \(FHFA\) directed Fannie Mae and Freddie Mac](#) from buying mortgages on PACE-encumbered properties and urged states to discontinue their residential underwriting until consumer protection standards are developed. At this time, some states have addressed this issue by explicitly rejecting senior lien status for PACE programs or by requiring participants to sign an additional disclosure statement detailing the lien concerns and risks. Vermont statutorily subordinated the lien to first mortgages. To further reduce risk, Vermont has established "debt service reserve funds" (also known as loss reserve funds) to provide pools of cash for investors in case of late payments or nonpayment (24 V.S.A. §3270), [as recommended by the Department of Energy](#). California also established debt service reserve funds (California P.R.C. §2600 et. seq., the California Alternative Energy and Advanced Transportation Financing Authority Act, "CAEATFA"). Maine also subordinates PACE liens to general property taxes and primary residential mortgages, regardless of when the mortgage was recorded (35-A M.R.S. §10156). Maine's PACE program treats the transaction as a loan that runs with the property, not as a tax assessment, however. It also lends through a closed lending market and has a revolving loan fund.⁴

FHFA [issued a proposed rule](#) for residential PACE in June 2012, and has yet to issue a final rule. In March 2013, the 9th Circuit Court reversed⁵ a lower court decision that required the FHFA to go through the formal rulemaking process in the first place, citing lack of jurisdiction over FHFA's directive to Fannie Mae and Freddie Mac. It is unclear whether the FHFA will issue a final rulemaking for residential PACE in light of that decision.

III. Commercial PACE progress

12 states and Washington, D.C. operate commercial PACE programs. [According to](#)

Projects by Type of Improvement

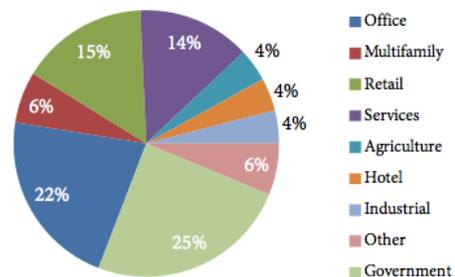


Note: Chart based on 191 projects.

Fig. 2 Source: PACENow.org

[PACENow](#), a nonprofit advocacy group for PACE, as of January 15, 2014, 200 commercial PACE projects have been completed, with \$63 million in funding. Figs. 2 and 3 break down the types of projects that commercial PACE participants are undertaking, and the types of commercial properties that are participating.

Fig. 3 Source: PACENow.org



Note: Chart based on 176 projects.

⁴ The FHFA also characterizes PACE funding as loans, rather than as tax assessments, which is at the heart of their reasoning that first mortgages should be senior to PACE liens.

⁵ [County of Sonoma v. FHFA](#), 43 ELR 20061, 12-16986 (9th Cir., March 2013)

IV. PACE-enabling legislation in Arizona: Aren't Arizona's local governments already authorized under Arizona Constitution Art. 9 § 6?

No. Arizona Constitution Art. 9 §6 Local assessments and taxes, states:

Incorporated cities, towns, and villages may be vested by law with power to make local improvements by special assessments, or by special taxation of property benefited. For all corporate purposes, all municipal corporations may be vested with authority to assess and collect taxes.

The language “may be vested” indicates that express authority must be granted to form a PACE special improvement district.⁶ See [A.R.S. Title 48](#) for all of Arizona Special Improvement District laws, including formation of districts for Antinoxious Weeds (A.R.S. §§48-301 through 48-322) and Fire Districts (A.R.S. §§48-802 through 48-854). Additionally, a city's general taxing authority requires a broad, uniform formula for calculating tax assessments, which cannot be used for PACE financing. There are further concerns that PACE financing violates the general requirement that public money be used for public purpose, because a PACE district is formed to fund private projects on private property. Many states' PACE-enabling statutes address this concern by explicitly providing that PACE serves a public purpose (e.g. Vermont, Arkansas, and Texas).

General PACE information:

- PACENow.org has maps, toolkits and other information on all state PACE programs
- A [2011 law review article](#) from the Executive Director of Pace Law School Energy and Climate Center includes a brief history of PACE programs.

Concerns about lien priority in residential PACE:

- In 2009, [Barclays Capital issued a letter](#) stressing the importance of PACE lien priority
- In 2012, the American Bankers Association and several other industry groups [submitted a comment](#) during the FHFA's proposed rulemaking commenting period, arguing that the primary lien status of PACE liens threaten stability of secondary mortgage markets.
- A [2013 law review article](#) *Keeping PACE?: The Case Against Property Assessed Clean Energy Financing Programs*, by University of Minnesota Law Professor Prentiss Cox discusses legal issues with residential PACE.

Contact information for HB 2206 Sponsors

Rep. Ethan Orr (R), District 9
Email: eorr@azleg.gov
Phone: (602) 926-3235

Rep. Sherwood (D), District 29
Email: asherwood@azleg.gov
Phone: (602) 926-3028

⁶ Personal communication with attorney Ryan Thomas, February 2013.