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Recent Developments Affecting Property Assessed Clean Energy (PACE) Loans.

New Jersey Governor's Conditional Veto Restricts New Jersey PACE, Florida's Supreme Court Expands State's PACE Market, Congress Extends the Federal Investment Tax Credit and States Reduce Effectiveness of Net-Metering

In today's climate conscious world, renewable energy sources—and programs to support their use—are increasingly important. Property Assessed Clean Energy ("PACE") loans, beginning in 2008, have become a major tool for local governments, homeowners, and commercial property owners to use to install energy efficient upgrades, such as solar panels or energy efficient windows, on private property.

Previous Dechert OnPoints discussed the potential for securitization of PACE loans as well as regulatory developments regarding PACE potential.1 This Dechert OnPoint discusses some recent developments regarding PACE.

New Jersey PACE

To date, thirty-two states have approved legislation implementing some form of PACE program. The legislature in New Jersey, a potential major market for solar panel installers and other green industries, passed a bill which could have significantly expanded the Garden State's PACE program but Governor Chris Christie issued a conditional veto of that bill on November 9, 2015.

The Governor's conditional veto stipulates that (i) no municipality that is disqualified from the local budget examination exemption issued to municipalities in connection with special assistance funding from the state would be eligible for a PACE bond program, (ii) PACE assessments should not be made against properties with less than five dwelling units and (iii) existing lienholder consent must be obtained in connection with PACE assessments. Additionally, instead of rolling out the program across the state, the program would be limited to the first ten municipalities to apply and be approved by the New Jersey Division of Local Government Services.2

Advocates of the bill passed by the legislature are concerned that these conditions will stall the development of industries associated with PACE loan spending in New Jersey, and thus, limit such economic activity within the state. Proponents of the NJ PACE bill argue limiting the program to commercial properties in only ten municipalities will prevent the economies of scale needed for wide-spread development of a NJ PACE program. Advocates have also indicated that the multi-family condition proposed by the conditional veto is problematic because single-family homeowners are a major source of borrowers within PACE loan systems but Governor Christie's conditional veto bars single family homeowners from New Jersey's program.3

The conditional veto, however, appeals to mortgage companies and others who object to the super priority status of PACE assessments; Fannie Mae and Freddie Mac, for example have indicated that they will not purchase mortgage loans on homes with PACE financing if such loans have pari passu status with tax liens.45 The mortgage companies claim that such prioritization: (i) changes the risk profile of properties which are subject to PACE assessment liens relative to the credit underwriting completed in the initial closing of a mortgage loan and (ii) lessens PACE lenders incentives to maximize profits in foreclosure as compared to mortgage lenders because of the size of PACE loans (which are usually up to US$20,000) and because of the inability of PACE lenders to accelerate PACE loans for the full amount in the event of a default. Under the conditional veto scheme, PACE assessments will remain subordinate to mortgages and other lien holders unless consent is granted to change the prioritization among the liens by the applicable mortgage lenders.6

Additionally, advocates of the PACE bill have expressed concern that the Governor’s first stipulation will prohibit some large population centers, such as Newark, Camden, and Atlantic City from accessing the program because the conditional veto bars special funding recipients—which includes these cities—from participating in the program.7 These areas, however, have more potential commercial sector borrowers, given their population sizes. The ten municipality limit will also reduce the number of potential borrowers, further lessening the program’s potential success.

Florida PACE

In contrast to Governor Christie’s actions, the Florida Supreme Court recently rejected two challenges to PACE programs in Florida in a combined case.8 The court rejected a claim by the Florida Bankers Association, which objected to the super priority status of PACE loans, by holding that the group did not have standing.9 The decision sidestepped the issue of whether PACE loans may subordinate mortgage loans; even so, the solar industry seems optimistic about the potential of Florida’s PACE market.

The Florida Supreme Court also reviewed the bond validation process used to provide PACE loans, specifically whether the process complied with Florida statutes. On this point, the court validated the special assessment revenue bonds used by the Florida Development Finance Corporation (FDFC) for Florida’s PACE program.10 However, the court also held that the FDFC must remove all references within the financing agreements to judicial foreclosure as a remedy and remove all references to the FDFC’s own or delegated authority to levy the special PACE assessments in order for the program to comply with Florida statutes.11 The court held that once these changes are made, Florida’s PACE market will be in accordance with state law and the court’s decision.12

The Florida Supreme Court’s decision may help expand the growth of PACE programs in Florida, especially in the residential market. In 2014, residential PACE spending surpassed commercial PACE spending13 and Florida may be poised to take advantage of PACE market growth nationwide.

Federal Investment Tax Credit

Nationwide, the market for solar panels and the PACE loans that often finance them will be strengthened by Congress’s extension, in December 2015, of the Federal Investment Tax Credit for renewable energy. This tax credit extends the 30% federal tax credit through 2019.14 Thereafter, the credit will decline through 2022 to 10%, where it will remain.15 This tax credit has been a crucial component in the growth of renewables and this extension is predicted to lead to US$73 billion—or a 56 percent boost—in new investments according to Bloomberg New Energy Finance over the next five years.16

Commercial PACE

Commercial PACE has not taken off the same way that residential PACE has. One reason is that most statutes providing for commercial PACE require the consent of the first-mortgage lender on the related property. It appears that the consent processes within the mortgage lending institutions for allowing commercial PACE assessments to be placed on one of their borrower's properties can be lengthy. Connecticut's Green Bank appears to have done a good job explaining commercial PACE to mortgage lenders in Connecticut. It may only be a matter of time before other states follow.

Net-Metering Under Threat

Net-metering is a tool and billing mechanism that credits solar energy system owners for the electricity they add to the grid when their solar panels create more energy than their home or business uses.17 Net-metering helps consumers and businesses but some utilities dislike the policy because they believe it lowers profits.18 The public utilities commissions in both Nevada and Hawaii changed their state's rules in December and October, respectively,to lower the rates earned by selling back excess energy.19 Nevada also increased the basic service charges for solar- panel users.20 As a result, SolarCity, a major solar panel installer, announced that it will leave Nevada—firing 550 employees and closing a training center opened in November 2015 in the process of moving out.21 The moves by Nevada and Hawaii may be followed in other states; for example, a utility in Arizona is already seeking permission to enact the same changes as Nevada.22

Conclusion

Late 2015 saw many developments in the renewable energy sector including regulation that helped establish or expand PACE programs that have helped increase availability of renewable power in many states. These programs also often help create jobs, such as the 10,000 estimated jobs that Renovate America has created through its PACE lending since December 2011.23 Though New Jersey's PACE program is constrained by Governor Christie's conditional veto and questions of PACE loan prioritization remain, Florida's program appears to be poised for growth. Congress's extension of the Federal Investment Tax Credit should also help this growing field.

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USA March 1 2016