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Should Tax Collectors Be Loan Collectors?

Investors love a federal green-energy program for property owners. But if there's a backlash, localities could be caught in the middle.

As proof that no good deed goes unpunished, a well-intentioned federal green-energy program has put local governments into a new alliance with finance companies, sparking a small frenzy on the bond market and turning county tax collectors into de facto home-loan servicers in 34 states and the District of Columbia.

Property Assessed Clean Energy (PACE) is an Obama-era Department of Energy program designed to help residential and commercial property owners finance renewable-energy systems and energy-efficiency improvements. PACE, according to The Wall Street Journal, has become the nation's fastest-growing loan category. Along the way, the property-tax assessment and payment system has morphed into a home equity loan repayment process, posing new perils for property owners and localities alike.

PACE works like this: Contractors offer special home-equity loans to homeowners to go green. Once the green upgrades are completed and the loan documents are signed, the loans are packaged with thousands of similar loans and sold to investors in the form of bonds. Any observer of the last great boom-and-bust cycle — along with any fan of the 2015 film "The Big Short" — will recognize the process.

But here's the rub: PACE loans aren't repaid like a car loan or a mortgage. Instead, localities serve as the middlemen by collecting payments once or twice a year as an assessment in the property owner's tax bill. Localities earn a fee and then forward the proceeds to finance companies.

The premise is a good one, at least in theory. It incentivizes property owners to make environmental upgrades, requiring no cash up front. The *Harvard Business Review* named the concept as one of 10 "Breakthrough Ideas for 2010," and *Scientific American* profiled the concept's creator.

Institutional investors are devouring the bonds because of their high credit ratings and green status. The first PACE program bond, structured by Deutsche Bank and issued in 2014, was awarded an AA credit rating by the Kroll Bond Rating Agency. The interest rate — the "coupon" in bond-speak — was 4.75 percent.

Recently the largest ever PACE bond was issued. It contained 13,432 assessments on homes in 31 California counties. The assessments had an average balance of about $24,400, an average interest rate of 7.96 percent and an average term of 14.95 years. This suggests an additional annual tax-bill payment averaging about $3,200 per property owner.

Critics in the banking industry argue that the PACE model gives these assessments priority lien status over mortgages. To placate lenders in California, which has been a laboratory for the concept and where PACE loans are known as HERO loans, a $10 million mortgage-loss reserve was established in 2014. Still, the banks don't like it.

Other critics contend that the program has been developed as fodder for the bond market and that environmental aims are secondary. PACE financing has been used to purchase everything from furnaces to pool covers to artificial turf. The National Consumer Law Center has reported abuses with the program, including some in which elderly homeowners were victimized.

From a public-policy standpoint, proponents see little difference between PACE and a locality paving a street and then assessing homeowners for the cost. PACENation, an industry group, argues that the increased investment has created stable work for local contractors — often family-owned businesses that have served their communities' needs for heating, air-conditioning, plumbing, roofing and landscaping for decades.

In the middle of all of this are participating localities, which sometimes deal with reports of abuse by contractors selling the loans with scant oversight, and homeowners, some of whom are shocked when their tax bills double or triple.

Even worse, localities fear that, if the home market goes bust again, they may be forced into wide-scale foreclosure proceedings, possibly leaving taxpayers on the hook to cover resulting loan-repayment shortfalls. And if and when a backlash comes from taxpayers or investors, it's likely to be local governments, the middlemen in all of this, that will have to deal with it.

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