

To: Member of the Rochester Hills City Council
From: Lee Zendel
Subject: The PACE program

Dear Council Members,

Remember the City is putting its stamp of approval on both this program and if Lean&Green Michigan-Levin Energy Partners (L&GM-LEP) will be given a monopoly in Rochester Hills to offer it. As such I believe there are a lot of questions that need answering, some that should require written answers, **before** proceeding further.

First, I will bring up my questions and/or concerns about the PACE program report that Council approved on May 20, 2013 as the required first step in the Program's adoption.

1.(From PACE program report #15)

“a baseline energy audit must be conducted for the property that is approved by LEP”.

I see no mention of the qualifications, experience, certification, etc of who is to do that audit and what criteria LEP will require to approve that audit.

2. (From Pace program report #15)

“LEP shall conduct an independent technical and financial review, of the audit at the property owners expense”

This is apparently different that the energy audit in my #1 above and the same question is I see no mention of the qualifications, experience, certification, etc of LEP is to do this audit and what criteria LEP will require to approve that audit or what fee(s)will be charged. Fees should not be whatever LEP wants to charge today but rather should be a published schedule.

3.(from the PACE program report #15)

“As set forth in the PACE Special Assessment Agreement attached as Appendix A, a baseline energy audit conducted by a third party.....must be conducted before an energy project is undertaken. Each contract will require and provide for adequate funding for monitoring and verification of energy savings THROUGHOUT [emphasis added, l.z.] the life of the special assessment.”

a. I was unable to find where in Appendix A it requires said prior baseline energy audit?

b. I was unable to find where in Appendix A it requires funding for monitoring and verification of energy savings THROUGHOUT the life of the special assessment for all projects, not just those over \$250,000.

If neither of these items are in Appendix A, it would be a sloppiness reflection on LEP. If they are in Appendix A, then I apologize.

4.(from the PACE program report #16)

“For projects financed with more than \$250,000 in assessments a performance guarantee must be provided by the contractor.....the performance guarantee must meet the standards set by LEP”

Just what is required for such a guarantee- an insurance policy or a formal bond? What are those standards? Do they currently exist in writing?

5.(from PACE program report #16

“ For projects financed with more than \$250,000 in assessments, an agreement to conduct **annual** energy and financial audits demonstrating energy savings must be established with committed financial and logistical arrangements for ongoing verification and measurement of energy savings that meet standards set by LEP”

- a. Who is this agreement between?
- b. What are the standards? Has LEP committed those standards to writing?
- c. Who is to pay for this dual annual audit? Penalty for non-compliance?
- d. What about energy improvements that do not immediately show up as savings?
- e. How does this requirement affect subsequent owners of the property or of the contractor?
- f. What difficulties are there in measuring dollar energy savings?
- g. “ committed financial and logistical arrangements” explain and by who?

.(PACE Program report #9)

“Application, administrative and program fees for record owners shall be those of LAGM. Administration and program fees will be determined on a project specific basis”

The least that R.H. property owners should expect before joining this program is a written estimate of the amount or range of fees, and how they are determined since they would be liable for them as part of their property taxes for the next 10,15, or 20 years as well as the apparently on-going annual fees. Fee schedules should be available

Those fees, the annual audit fee for the larger projects and any increase in property taxes because of the improvements could change the economic viability of a project to just marginal.

For example, the spreadsheet shown to Council at the May 20th meeting had the owner spending \$750,000 on energy improvements. Assume the tax assessor believes the improvements added 1/2 of that amount to the market value of the property which means the taxable value goes up \$187,500. At the R.H. millage rate for commercial property that would add over \$9,000 annually in taxes.

Adding in the unknown cost of the annual monitoring and that \$14,052 gain in cash flow shrinks to less than \$5,000 per year, Tax credits might improve that \$5,000 but changes in tax laws can occur.

Beyond that if the tax assessor is correct in not assigning 100% of the improvements costs to the market value of the property, the first-lien position of the PACE assessment does reduce the collateral value of the property to the existing mortgagee. I'm sure every Council member has at one time or another has read an article giving an estimate of how much on average a homeowner would recover from a remodeling project upon sale of the home. According to one article, on average, the recovery for a home project is about 60%. No type project returned as much as 90%. I'm confident that it is not different for commercial property.

Unanswered Question. Assume a property owner with a PACE special assessment in place is trying to sell the property and feels the special assessment is hurting sale prospects. Can he prepay the remaining years of assessment?

Council would be remiss in its due diligence if it did not inquire into who are the personnel that is Levin Energy Partners, and to their qualifications regarding their ability to conduct the technical and financial reviews called for in the PACE program report. In my opinion, therefore the qualification(s) of Levin Energy Partners personnel is critical.

In 2008, The Federal Home Finance Agency (FHFA) became the conservator of both Fannie Mae and Freddie Mac. The function of both of them was to purchase RESIDENTIAL mortgages from mortgage banks and mortgage brokers. In 2010, the conservator issued an advisory that expressly directed the Enterprises (Fannie & Freddie) not to purchase mortgages affected by first-lien PACE obligations.

Naturally, it ended up in various courts. One Federal court ruled that the FHFA had to go through a formal rule making (NPR). FHFA did so while appealing the lower courts decision. The appeals court this past March 2013 ruled in favor of FHFA so in essence the original advisory stands. Fannie and Freddie will not buy any residential mortgages where there is a first lien PACE obligation except with the permission of the mortgage holder. Since the two of them own about \$5-6 trillion of home mortgages, the answer for most homeowners with a mortgage in most cases probably will be no.

The question is if banks will be guided by the conservator's action when it comes to commercial PACE loans. Beyond that will the Dodd-Frank law and its regulations have something within them yet unknown that will affect PACE loans. About two-thirds of the package's rule-making deadlines have been missed as the third anniversary of its passage nears. Dodd-Frank, another 2500 page bill, appears to be one that "we have to pass it to learn what's in it."

As Freddie Mac stated in its comment submission to the FHFA NPR "We are not aware of reliable evidence supporting a conclusion that energy efficiency improvements increase property values in an amount equal to the cost of the improvement. Rather, our experience with other home improvements suggests that any increase in property value is likely to be substantially less than such cost, meaning that homeowners who take on PACE loans are likely to increase their ratio of indebtedness relative to the value of their properties." It is very likely in my opinion, that the same will hold true for commercial properties.

The Environmental Defense Fund, in its comment letter to the NPR, "indicated that analytic standards are absent for PACE programs and suggested that FHFA's analysis "may be hamstrung as a consequence of the lack of analytic standards for projecting, ensuring, and measuring/verifying the anticipated and realized energy savings in residential PACE programs nationwide." The comment continued, "Our experience has led us to identify the lack of uniform, accepted methods as a crucial barrier to such financing by banks in several other sectors, including large commercial buildings and multifamily residential buildings."

To possibly set up national standards the legislature passed H.R. 2559. For example, H.R. 2599 includes dozens of sections and subsections purporting to create standards for acceptable PACE projects, many of which involve complex calculations based on unstated assumptions and unspecified methodologies. One of the principal standards that H.R. 2599 would impose is that "The total energy and water cost savings realized by the property owner and the property owner's successors during the useful lives of the improvements, as determined by [a mandatory] audit or feasibility study, * * * are expected to exceed the total cost to the property owner and the property owner's successors of the PACE assessment." **But no methodology for actually computing the costs and savings is provided.**

As such FHFA concluded: "Without a reasonable, reliable, and consistent methodology for making the calculations that purport to determine whether proposed projects are financially sound (including a reasonable and reliable method for determining the applicable metrics and discount rate), a standard based on the purported financial soundness of PACE- funded projects would not, in FHFA's judgment, adequately protect the Enterprises (Fannie & Freddie) from financial risk."

Then there is the question of granting a monopoly to L&GM-LEP for PACE in Rochester Hills. "Municipal governments rarely insert themselves into the process of determining which private companies are allowed to offer services within their communities. An open PACE marketplace ensure that PACE program benefits and service will be robust and lasting. Competition is good for business. It improves the product, program and experience for property owners by encouraging companies to provide the best possible product.

Many cities and counties in California are recognizing that they don't have to make an exclusive choice because they can, in fact, offer as many PACE programs as they'd like. They are still taking the time to ensure programs are properly vetted.”

At least 20 California cities and 6 counties offer open PACE marketplaces. What is Rochester Hill's rush to give a monopoly to L&GM-LEP, especially in my judgment they have not been properly vetted.

At the least, Council should invite Ann Arbor's Clean Energy Coalition which has successfully completed a PACE program funding of five commercial properties in Ann Arbor. Council could learn from them about fees, audits etc., and even if they would like to join in an open PACE marketplace in Rochester Hills-competition is good.

Too many questions and concerns remain and should be answered, in some cases in writing, before Council takes further action. There is no rush.