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CONNECTICUT GREEN BANK

Statement of the Connecticut Green Bank
Concerning Raised House Bill 5563
AN ACT CONCERNING RESIDENTIAL PROPERTY ASSESSED CLEAN ENERGY

The Connecticut Green Bank is the nation's first green bank. We're creating a thriving marketplace to accelerate green energy adoption in Connecticut by making clean energy financing accessible and affordable for homeowners, businesses and institutions. Our mission is to accelerate private investment in clean energy deployment within Connecticut, and to achieve economic prosperity, job creation and energy security throughout the state.

To achieve its mission, the Connecticut Green Bank has established the following three goals:

1. To attract and deploy capital to finance the clean energy[1] goals for Connecticut, including:

    a. Helping Connecticut in becoming the most energy efficient state in the nation;
    b. Scaling-up the deployment of renewable energy in Connecticut; and
    c. Providing support for the infrastructure needed to lead the clean energy economy.

2. To develop and implement strategies that bring down the cost of clean energy in order to make it more accessible and affordable to consumers.

3. To reduce reliance on grants, rebates, and other subsidies and move towards innovative low-cost financing of clean energy deployment.

Connecticut's Comprehensive Energy Strategy ("CES") calls for energy conservation to reduce energy consumption and utility bills for homes throughout the state while creating thousands of new jobs. Importantly, the CES highlights the importance of delivering deeper efficiency gains in heating, air conditioning, ventilation, insulation, windows, furnaces and boilers; it also highlights the importance of solar photovoltaic and other renewable technologies as well as converting to natural gas as two means to promote cleaner energy sources. The CES also cites the importance of leveraging private capital through innovative financing mechanisms such as Property Assessed Clean Energy ("PACE"), which not

[1] Public Act 11-80 defines "clean energy" broadly and includes familiar renewable energy sources such as solar photovoltaic, solar thermal, geothermal, wind and low-impact hydroelectric energy, but also includes fuel cells, energy derived from anaerobic digestion, CHP systems, infrastructure for alternative fuels for transportation and financing energy efficiency projects.

only provides capital almost exclusively from private investor resources but also enables financing of these improvements over tenors that more closely match the energy improvement's useful life.

Both residential and commercial PACE policies currently exist in the Connecticut General Statutes, but only the statute for commercial PACE has been updated since the passage of Public Act 11-80 to operationalize it into a functioning program.[2] Through this the Green Bank administers its nationally-acclaimed Commercial Property Assessed Clean Energy (C-PACE) program, which uses a municipality's traditional assessment power to finance renewable energy and energy efficiency improvements on retail, office, industrial, non-profit, and multifamily properties. House Bill 5563 revisits the residential statute so that the Green Bank can also operationalize these powers for the 1-4 family residential market and create a counterpart Residential PACE program (R-PACE). **The Green Bank strongly supports House Bill 5563 and considers it a priority proposal for the 2016 Regular Legislative Session.**

Background on the Green Bank's existing Commercial PACE program

The C-PACE program is the Green Bank's flagship financing product for the commercial and industrial market. C-PACE allows building owners to finance up to 100% of qualifying energy efficiency and clean energy improvements through a voluntary assessment on their property tax bill. Property owners pay for the improvements over time through this additional charge on their property tax bill, and the repayment obligation transfers automatically to the next owner if the property is sold. Capital provided under the C-PACE program is secured by a lien on the property, so capital can be raised from the private sector at lower rates of interest and for longer terms than would be available without the security of the PACE assessment.[3]

In 2014, the Green Bank structured the nation's first PACE-backed securitization of commercial energy efficiency financings. A portfolio of $20 million comprised of 30 energy improvement projects across 22 municipalities was sold in two tranches to investor Clean Fund. The Green Bank is now beginning to co-fund its C-PACE financing with a capital facility provided by Hannon Armstrong, a financing and investment firm providing debt and equity financing to the energy efficiency and renewable energy markets. This facility will provide access to up to $100 million in private financing for C-PACE, and will streamline the process building owners currently undergo to source competitive financing for comprehensive energy projects.

Also in late 2015, the Green Bank, in its statewide program administrator role, facilitated the largest C-PACE project in the country. Using 100% private capital from CleanFund, State House Square in Hartford is financing $8.5 million in comprehensive energy upgrades. By contrast, the smallest C-PACE financing has been for $30,550, demonstrating that C-PACE finances clean energy improvements across a diverse range of properties. Altogether, the total volume of C-PACE financings is now over $75 million.

[2] First articulated in Public Act 11-80, Sec. 100. Public Act 12-2 operationalized this policy for properties other than 1-4 family residential, designating the Green Bank as the program administrator for the C-PACE program.
[3] Current interest rates for participating borrowers range from 4.50% to 6.25%.

How PACE Works

PACE uses a municipal benefit assessment mechanism, similar to how a local sewer or water improvement might assess a group of benefitted properties in that area. With PACE, only a single benefitted property carries the liability for payment even though distributed behind-the-meter clean energy carries spillover benefits for others.[4] When a property owner finances an improvement with PACE instead of a traditional loan, a benefit assessment is placed on the property by the municipality and it is recorded as a lien. The property owner pays off the benefit assessment the same way they pay their mortgage or associated municipal assessments – if for example a homeowner typically makes regular payments through a property escrow, then the PACE payment would be drawn down at the same interval as municipal tax payments. The municipality then remits those PACE payments to the PACE program administrator [Figure 1].

Figure 1: Flow of Payments.

Improved property → Municipality → Program Administrator

The Green Bank sees PACE as an effective way for homeowners to finance clean energy. PACE financing has advantages that combine to differentiate it from traditional financing products:

- Broad applicability. Financing can be used for renewable energy and energy efficiency projects, health and safety measures, resiliency and water conservation upgrades, and related activities such as energy audits and feasibility studies.

- Transferability. The obligation runs with the property, not with the borrower. This allows the property owner to pursue deeper energy upgrades that might not pay back during the current owner's occupancy, but that have financing terms that better match the useful life of the improvement. This also means interest rates are based on the underlying collateral and not by the FICO score of the person – this has the potential to democratize interest rates across the pool of borrowers. And it fills a gap with the potential of broadening participation in traditionally underserved markets.

- Immediacy. The Land of Steady Habits has an aging housing stock that is steadily subject to deferred maintenance. PACE overcomes this in several ways: 1) it requires no down payment; 2) it allows energy upgrades to be addressed along with other remedial items needed in Connecticut homes such as lead, asbestos, mold, knob and tube wiring, flood mitigation, and water conservation; and 3) it overcomes the consumer's hesitation with investing in a property they might not occupy forever, due to the lien's transferability to subsequent property owners. As a result, PACE can pull deferred property upgrades closer to the present, creating bill savings

[4] e.g., reduced greenhouse gas emissions, reduced need for power generation and reserve capacity, and deferred capacity upgrades to the transmission and distribution system.

earlier in time for the homeowner. And a homeowner just purchasing a benefitted property inherits the improvements and the associated energy savings, too.

- Market-based Approach. The use of financing enables more energy upgrades by letting homeowners pursue deeper improvements. PACE attains favorable interest rates through market mechanisms rather than publicly subsidized interest rate buy-downs. The Green Bank will administer R-PACE using private capital, and without the need for new ratepayer-supported commitments. The Green Bank envisions a continuum of product offerings through its public-private partnerships. Our Smart-E Loan[5] program – using partnerships with local credit unions and community banks – is optimal for improvements with 5-10 year payback terms. R-PACE would be suitable for improvements with payback tenors up to 20 or 25 years, with the help of its transferability feature that enables longer payback projects.

- Additive to Home Value. A study[6] of 773 home sales in California having undergone PACE-financed improvements showed improved resale values. Regardless of the methodology used, the extra value on PACE-improved homes ranged from $199 to $8,882 after taking into account financing costs.

The Municipal Role

Prior to opting into R-PACE, a municipality's legislative body or chief executive officer must authorize a written agreement with the Green Bank enabling the municipality to assess, collect, remit, and assign tax assessments against the properties of R-PACE borrowers.[7] After a PACE transaction, the property owner begins seeing the PACE lien as a line item on their property tax bill. Through program design, the Green Bank will work with the various R-PACE capital providers to compensate the municipalities for their costs incurred as a result of the program, similar to C-PACE. The Green Bank indemnifies municipalities involved in C-PACE transactions through its Municipal Agreement, and will offer the same indemnification under R-PACE transactions.

The Green Bank's Role

The Green Bank will act as the statewide program administrator for the R-PACE program; it may also recruit program partners to assume responsibilities. The Green Bank may also establish loss reserves or other credit enhancement tools as may be necessary to attract private capital investment and encourage low to moderate income segment investments, while actually deploying very few public dollars (as opposed to handing out grants or incentives that cannot later be recovered and redeployed).

[5] http://www.energizect.com/smarte

[6] "PACE Loans: Does Sale Value Reflect Improvements?" by Laurie S. Goodman and Jun Zhu. The Journal of Structured Finance. Winter 2016, volume 21, number 4.

[7] For comparison's sake: since Commercial PACE's introduction in 2012, 111 municipalities representing 90% of Connecticut's commercial and industrial buildings have passed similar such resolutions for C-PACE enablement.

As the statewide administrator, it will be the responsibility of the Green Bank to ensure the program is held to robust consumer protection standards covering:

- Financing terms requiring a fixed rate, no negative or interest-only amortizations allowed, a term not longer than the useful life of improvements being installed, maximum limits on loan-to-value and lien-to-value ratios, limitations on late property tax and mortgage payments and bankruptcy filings;
- Disclosures and documentation, including relevant Truth in Lending Act provisions;
- Eligible measures that comply with program efficiency standards and goals and maximum financing amounts for product types;
- Marketing and communications, operations and post-funding homeowner support;
- Protected classes, such as senior citizens;
- Data security and privacy;
- Requirements for program participants such as capital providers and contractors; and
- Misconduct protocols.

Federal Guidance

The Federal Housing Finance Agency ("FHFA") oversees and serves as conservator of Fannie Mae and Freddie Mac, which purchase, guarantee, and securitize home mortgages from banks and small lenders. In 2010 FHFA issued a directive declaring that PACE assessments present significant risk to secondary mortgage markets. The directive stymied the growth of R-PACE and created confusion at the state level as to how this policy could be implemented. Thirty-four states have passed PACE-enabling legislation; 12 of them enacted statutes that could apply to the residential market. The first such laws began passing in 2008.[8]

Because of this uncertainty in the residential PACE market, the Green Bank focused solely on the commercial market. In Connecticut, C-PACE transactions require the consent of the commercial property's underlying mortgage holder for each instance a lien is placed. This is typically granted because businesses make the case that their cash flow improves as a result of the deal, which bolsters their ability to make ongoing mortgage or lease payments. This works for the commercial market because of the one-off nature of transactions and the more intimate relationship between commercial property owners and the banks (i.e., the mortgage holder) that service them. The residential market works quite differently – transaction volume is greater; mortgages are frequently packaged and sold which, for practical purposes, bars access to the mortgage holder; and federal government-sponsored enterprises like Fannie Mae and Freddie Mac are not participants in the mortgage.

Recently, there has been momentum in the efforts of federal housing programs to provide certainty around the permissible use of R-PACE on mortgages that are insured or guaranteed by the federal government. In August 2015, the US Department of Housing and Urban Development (HUD) announced its endorsement of R-PACE on single family mortgages insured by the Federal Housing Administration

[8] http://www.pacenation.us/resources/pace-enabling-legislation/

(FHA) so long as the assessment is subordinate to the FHA-insured mortgage.[9] FHA has announced they anticipate publishing more detailed guidelines in early 2016. The announcement indicated that HUD and FHA are working with other government agencies—including FHFA – in developing the guidance which will include structural requirements that residential PACE financing be subordinate[10] to the government-insured mortgage, as well as other "best practices" for PACE programs, including strong consumer protection standards. Governor Malloy, with the support of the Green Bank, Department of Banking, DEEP and DECD, issued a letter to Secretary Castro in November clarifying the key criteria that should be considered as part of FHA's pending guidelines.

Capital providers and originators operating in the R-PACE framework are sharpening their pencils to accommodate the anticipated federal guidance while still providing attractive interest rates. The Green Bank wants Connecticut to host this growing industry because its presence can provide deeper penetration into the total addressable market of energy improvement customers, and do so in a way that will reach more households with the opportunity for energy savings.

Lessons From Other States

California's residential PACE programs - originally launched in 2008 - are seen as PACE program models that, over the years, have demonstrated the most impressive results and greatest volume. Fear of federal pushback did not stop California jurisdictions from continuing to develop the concept, with county-level platform providers pulling together the financing and project contractor elements of a transaction. California's leading R-PACE program is Home Energy Renovation Opportunity, or HERO, operated by Renovate America, Inc. for several municipalities, including Western Riverside Council of Governments and San Bernardino and Los Angeles counties. The HERO program, which has grown to 80% of the residential PACE financing market nationwide, has led to investment of over $1.3 billion in PACE improvements for more than 63,000 homes while creating over 11,000 jobs.

Lien Priority Relative to R-PACE

All liens filed before an R-PACE lien have superior payment priority to an R-PACE lien in the event of default. Figure 2 depicts the priority order of lien payments filed after an R-PACE field is recorded.

Figure 2: Payment Priority for Liens (as proposed)

1. Residential real property tax
2. 1st mortgage
3. R-PACE
4. 2nd mortgage (unless filed prior to R-PACE)
5. All other liens (unless filed prior to R-PACE)

[9] http://portal.hud.gov/hudportal/documents/huddoc?id=FTDO.pdf
[10] Whether statutory or contractual

This hierarchy of seniority represents a major compromise from previous proposals, and a departure from how workable PACE programs have been designed. Up to now, a major feature common to the PACE mechanism is that it subordinates liens beneath it. Although this has been successful for the commercial market, the Green Bank has shifted its thinking around whether lien supremacy is a necessary part of residential PACE – in an effort to calibrate with federal guidance and the concerns of the banking industry. We now see transferability of the debt to subsequent property owners, the fact that the obligation runs with the property – not the borrower, and credit risk based more on the underlying collateral in the property as the core feature distinguishing PACE. If House Bill 5563 passes then Connecticut will be pioneering a new policy design that uses a subordinated lien position and bolstered by robust consumer protection standards. We want to make this work, and in the process open the competitive market to energy improvement businesses making use of PACE to drive consumer activity.

Thank you for the opportunity to testify in support of House Bill 5563.