Climate Change and Clean Technology Blog

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California Fighting Back to Save PACE Program

By Lindsay Young

On July 14, 2010, California Attorney General Jerry Brown filed a lawsuit against Fannie Mae and Freddie Mac (*California v. Federal Housing Finance Agency, N.D. Cal., No. 10-3084*), claiming that the government-sponsored enterprises are thwarting the State's PACE (Property Assessed Clean Energy) programs, which encourage homeowners to make their homes more energy and water efficient. Under PACE programs, local governments lend money to homeowners who then use the funds to install solar panels, better insulation and other energy efficiency improvements. The homeowners pay for the improvements through special property tax assessments over a period of 10 years or more. The PACE programs, which have already created thousands of jobs, have additionally attracted over $150 million in stimulus money for the State of California.

Fannie Mae and Freddie Mac contend that PACE funding constitutes a loan or senior lien that has priority over existing mortgages, which is not permitted under Fannie Mae and Freddie Mac's standardized mortgage documents. On May 5, 2010, both Fannie Mae and Freddie Mac issued advice letters to all lending institutions stating that PACE "loans" that have senior lien status to a mortgage are not permitted. On July 6, 2010, the Federal Housing Finance Agency (FHFA), the federal agency that serves as the conservator for Fannie Mae and Freddie Mac, upheld this interpretation. Therefore, Fannie Mae and Freddie Mac will not buy or guarantee mortgage loans that participate in these programs, and, as lenders will not issue mortgage loans that do not satisfy Fannie Mae and Freddie Mac's requirements, several California counties have suspended their PACE programs.

California, on the other hand, argues that Fannie Mae and Freddie Mac are incorrectly characterizing the programs as loans. Under California law, PACE funding is classified as a tax assessment. Tax assessments can be used to finance improvements that serve a public purpose, and in some instances, privately-owned improvements can also serve a valid public

purpose. California argues that PACE's energy efficient private home improvements do in fact serve a public purpose, which is supported by California's legislative record, thus making the characterization of PACE funding as a tax assessment proper. Furthermore, Fannie Mae and Freddie Mac have for decades accepted and agreed that tax assessments constitute priority liens, which do not in themselves violate Fannie Mae and Freddie Mac's mortgage requirements. If the courts agree with California's characterization of PACE funding as an assessment rather than a loan, the PACE programs would then be compatible with Fannie Mae and Freddie Mac's mortgage requirements.

Most counties in California have developed or plan to develop a PACE program, 22 other states have passed laws permitting PACE programs, and legislation is pending in most other states. As Fannie Mae and Freddie Mac either own or guarantee 30 million homes, constituting over half of the countries' residential mortgage loans, FHFA's decision to uphold Fannie Mae and Freddie Mac's interpretation will effectively thwart PACE programs across the country. Several cleantech companies that rely on PACE funding, thousands of jobs and millions of dollars of capital now hinge on whether the courts will reverse FHFA's decision.

For more information, please contact Lindsay Young. Ms. Young is an associate in the Corporate/Securities Group in the firm's Orange County office.