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PROPERTY ASSESSED CLEAN ENERGY (PACE): VICTIM OF LOAN GIANTS OR WAY OF THE FUTURE?

Michael A. Wrapp*

Introduction

In recent years, Property Assessed Clean Energy (PACE) programs provided the citizens of many states and localities with an affordable means of making energy improvements to their property. Essentially, PACE programs create a long-term payment mechanism for property owners so that they may pay for energy improvements gradually as long as they continue to own their property and reap benefits from them, rather than having to pay daunting upfront costs for cleaner, more efficient energy. Shortly after the first PACE program was implemented in Berkeley, California, similar programs and policies rapidly proliferated throughout the United States. But despite their rapid proliferation and beneficial effects, PACE programs are not without detractors. In fact, the Federal Housing Finance Agency (FHFA), the Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac) have taken a firm stance against such programs, provoking legal responses from a number of interested parties. Thus far, a few key decisions are indicative of the disagreement among federal courts with respect to the viability of PACE programs.

This Note will first examine the spread of energy efficiency programs in general, as well as the mechanics of PACE programs in particular. It will proceed to briefly outline the history and development of PACE programs, from their inception in California to their rapid proliferation throughout the United States. Next, it will discuss the objections made against these programs by the FHFA, Fannie Mae, and Freddie Mac, as well as the legal response of PACE supporters. Then, it will analyze the most significant aspects of the various federal court decisions that have

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occurred in recent months. Finally, it will attempt to chart the potential future of PACE programs while providing suggestions about possible means of improving them and ensuring their success.

I. Spread of Energy Efficiency Programs Generally

Energy efficiency and conservation measures have garnered increased attention from both private and public actors in recent years.[1] Incentives have become especially prevalent with respect to solar energy. More specifically, more and more financial institutions are using incentives to pave the way for the installation of solar photovoltaic systems.[2] In the years to come, it is likely that alternative financing methods for the installation of solar energy capacity will only continue to multiply.[3] States and the federal government have offered financial incentives for the purchase and installation of renewable energy systems for decades, but these incentives have remained relatively unpopular due to a variety of factors, including an overwhelming number of choices, a significant amount of required paperwork, and the cost of a typical system, which is usually around $10,000 or more.[4] In order to be effective, state and federal incentive programs must accomplish two key priorities: they must streamline the purchase experience and they must cut upfront costs to the extent that consumers will not be deterred by them.[5]

As of 2011, nineteen states offered some kind of tax incentive to reduce consumers' cost of purchasing and installing technology that enables greater energy efficiency.[6] At the local and state levels of government, property tax incentives are the most

1. John C. Dernbach, Robert B. McKinstry, Jr. & Darin Lowder, *Energy Efficiency and Conservation: New Legal Tools and Opportunities*, 25 Nat. Resources & Env't 7, 7 (2011) ("Energy efficiency and conservation measures are low-hanging fruit in the U.S. effort to reduce greenhouse gas emissions and wean ourselves from imported fossil energy.").

2. Jason R. Wiener & Christian Alexander, *On-Site Renewable Energy and Public Finance: How and Why Municipal Bond Financing is the Key to Propagating Access to On-Site Renewable Energy and Energy Efficiency*, 26 Santa Clara Computer & High Tech. L.J. 559, 565 (2010) ("More and more financial institutions are providing funding sources for solar PV systems in response to consumers' increasing interest in the installation of such systems.").

3. *Id.* at 566.

4. Joel B. Eisen, *Can Urban Solar Become a "Disruptive" Technology?: The Case for Solar Utilities*, 24 Notre Dame J.L. Ethics & Pub. Pol'y 53, 77–78 (2010).

5. *Id.* at 76–77.

6. Roberta F. Mann, *Federal, State, and Local Tax Policies for Climate Change: Coordination or Cross-Purpose?*, 15 Lewis & Clark L. Rev. 369, 383 (2011).

commonly available form of renewable energy incentive.[7] For instance, with respect to residential property, homeowners may receive tax credits for building new homes that meet certain energy standards, improving the energy efficiency of their homes, or installing the capacity to generate renewable energy.[8] In particular, many states and the federal government offer incentives for the residential installation of solar capacity.[9] Property tax abatements, unlike credits or exemptions, are wholly ineffective unless the energy improvement in question causes an increase in the value of the property, consequently excluding the property owner from an otherwise required increase in property tax.[10]

Ultimately, high upfront costs to consumers remain perhaps the largest barrier to the purchase and installation of improved energy efficiency and renewable energy capacity.[11] Municipal financing is one method of reining in the high upfront costs of residential energy improvements.[12] In order to rein in upfront costs of such improvements, municipalities may create special assessment districts (SADs):

> A SAD is a political subdivision created to construct a proposed improvement, with no powers or liabilities except for those expressly or implicitly conferred by state statute. SADs are designated geographical or political areas in which special levies are assessed upon properties in order to finance local improvements that directly benefit those properties that have been assessed.[13]
>
> SADs are by no means a recent development. In fact, they have been used to finance local improvements since colonial times.[14]

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7. *Id.* at 384 ("Property tax incentives are exemptions, exclusions, abatements, and credits that exclude the added value of the upgrade or renewable energy system from the valuation of the property for taxation purposes.").

8. *Id.* at 380.

9. *Id.* at 387.

10. *Id.* at 385–86.

11. Ethan Elkind, *Fannie and Freddie Stop the PACE of Clean Energy*, LEGAL PLANET: THE ENVTL. LAW & POLICY BLOG (June 18, 2010), http://legalplanet.wordpress.com/2010/06/18/fannie-and-freddie-stop-the-pace-of-clean-energy/ ("One of the biggest barriers to getting homeowners to retrofit their homes to make them more energy efficient and install renewables like solar panels is the high upfront costs.").

12. Wiener & Alexander, *supra* note 2, at 569.

13. *Id.* at 569–70.

14. *Id.* at 571; Justin Gillis, *Tax Plan to Turn Old Buildings 'Green' Finds Favor*, N.Y. TIMES, Sept. 20, 2011, at B1 ("For decades, cities and counties have created special taxing districts to finance improvements that benefit private property, such as street lights or sewers. Bonds are issued to pay for the

II. Mechanics of PACE Programs

PACE programs, on the other hand, are relatively new, and have been described as particularly dynamic and controversial.[15] PACE programs use a particular type of SAD known as an energy financing district (EFD).[16] Through EFDs, municipal governments can offer property owners lower-than-market interest rates on loans toward energy improvements, which are in turn paid back through property tax.[17] While EFDs are useful for a number of reasons, perhaps their most beneficial features are longer repayment periods and lower interest rates as compared to conventional loans.[18] A municipality must fulfill several legal requirements in order to set up and implement an EFD. As an initial matter, local governments must obtain permission, typically from the state legislature in the form of an enabling statute, to make special assessments.[19] As is the case with SADs generally, local governments must often turn to bonds as a means of obtaining the capital necessary to back PACE liens.[20]

Within the EFD framework used by PACE programs, the cost of energy efficiency and renewable energy improvements is added to property owners' yearly property tax, obliging them to pay back the cost by way of a lien on the property.[21] Thus, the obligation to pay for the improvements runs with the property, not the property owner.[22] As a result, PACE programs include

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projects, then repaid with surcharges on tax bills. If an owner sells, the surcharge stays with the property.").

15. Ian M. Larson, Note, *Keeping PACE: Federal Mortgage Lenders Halt Local Clean Energy Programs*, 76 Mo. L. Rev. 599, 599 (2011).

16. Wiener & Alexander, *supra* note 2, at 574.

17. *Id.*

18. *Id.*

19. *Id.* at 575–76 (For instance, "[i]n California, the City of Berkeley used its existing power under the Mello-Roos Community Facilities Act of 1982, which established authority for charter cities to form custom SADs, to create its FIRST program, which finances residential solar installations. Subsequently, statewide legislation has made this power available to all California cities and counties."); Larson, *supra* note 15, at 604; Jonathan B. Wilson, Maura A. Marcheski & Elias B. Hinckley, *The Great PACE Controversy: Renewable Energy Financing Program Hits a Snag*, 25 Prob. & Prop. 38, 39 (2011) ("To implement a PACE program, local governments must have statutory authority to both issue bonds and use the bond proceeds to finance renewable energy projects. Typically, local governments create statutorily authorized special assessment districts, similar to those used for other public projects.").

20. Larson, *supra* note 15, at 601.

21. *Id.* at 600.

22. *Id.* at 602. For example, beginning on March 1, 2010, in San Francisco, PACE program participants were eligible for loans of up to $50,000 for energy improvements. The loans were to be attached to the property, rather than the owner, and paid back over no more than twenty years. Gerry Shih, *San*

sufficient front-end funding to help property owners avoid upfront costs and defray their financial concerns about measures that might otherwise be prohibitively expensive.[23] In addition, the fact that the relevant property tax assessment runs with the property means that PACE programs effectively address property owners' concerns about recovering costs from energy improvements if they sell their property.[24] In the event of foreclosure or failure to pay property taxes, a PACE lien takes priority over the property owner's mortgage, and payments that are due must first be made to the municipality rather than the mortgage lending company.[25] While controversial, first lien priority upon foreclosure or default is crucial for the success of municipal special assessments such as those used in PACE programs because it provides an irreplaceable incentive for investors, who can be relatively certain that their investments are secure.[26]

Francisco Joins the Club of Green Financiers, N.Y. TIMES BAY AREA BLOG (Feb. 8, 2010, 8:12 PM), http://bayarea.blogs.nytimes.com/2010/02/08/san-francisco-joins-the-club-of-green-financiers/.

23. Wilson et al., *supra* note 19, at 38–39; Erin Elizabeth Burg Hupp, *Refining Green Building Regulations and Funding Green Buildings in Order to Achieve Greenhouse Gas Reductions*, 42 URB. LAW. 639, 645–46 (2010) ("Importantly, PACE bonds include front-end funding for the *installation* of energy-saving devices, provide municipalities flexibility in implementing such funding, and allow owners to contract directly with contractors. PACE bonds, therefore, are one avenue for local governments in the financial battle against the high upfront cost of certain green building retrofits.").

24. Wilson et al., *supra* note 19, at 39 ("Because PACE financing runs with the property, the buyer acquires not only the benefit of the energy improvements but the remaining payment obligation as well. In this way, PACE financing is intended to encourage renewable energy and energy efficiency investments even when the current owner may not retain ownership long enough to completely recoup the investment.").

25. Larson, *supra* note 15, at 602. "According to PACE supporters, the government's inherent power to assess taxes not only gave municipalities the capacity to establish PACE boards but also gave board-approved bonds seniority over any outstanding land-secured debts. The seniority of municipal assessments effectively means that the lender's private mortgage loans are instantly subordinated to the municipality." *Id.* at 605.

26. *Id.* at 606 ("Municipal bonds backed by property taxes traditionally have experienced low default rates, and the assurance of being repaid first even when default occurs provides a prime incentive for investors."). "'[T]here is currently almost no demand in the secondary market for conventional junior mortgage instruments.'" *Id.* "Because first lien status is critical to the success of PACE programs, eliminating the priority lien status would make PACE programs effectively impossible to finance through the capital markets." Natural Res. Def. Council, Inc. v. Fed. Hous. Fin. Agency, 815 F. Supp. 2d 630, 633 (S.D.N.Y. 2011).

III. A Brief History of PACE Programs: Origins and Proliferation

Given the relative historical success of the state with respect to energy efficiency and renewable energy, perhaps it is not surprising that PACE programs were first developed and implemented in California.[27] The state paved the way for the innovative PACE approach to energy improvement financing with the implementation of its 2008 Assembly Bill 811 (AB 811), which enabled all California cities and counties to create SADs.[28] AB 811 authorized cities and counties to provide special property tax assessments to owners of already-developed residential, commercial and industrial property for the installation or purchase of renewable energy capacity.[29] The City of Berkeley established the first PACE program, known as the Financing Initiative for Renewable and Solar Technology (FIRST) program, in November 2008.[30] The program was an immediate success, and other California cities soon began to implement their own PACE programs.[31] Eventually, PACE financing went statewide in California.[32] As PACE programs became more popular nationally, many states, including Colorado, Florida, Hawaii, Illinois, Louisiana, Maryland, Nevada, New Mexico, New York, North Carolina, Ohio, Oklahoma, Oregon, Vermont, Virginia, and Wisconsin, passed legislation to implement programs similar to those in Cal-

27. *On Its Own Sunny Path*, Economist, Oct. 29, 2011, http://www.economist.com/node/21534802 (discussing California's progressive legislation related to greenhouse gas emissions and renewable energy).

28. Hupp, *supra* note 23, at 646. "AB 811 requires that the city: (i) designate the boundary of the area where these loans are available; (ii) draft a specific contract specifying the terms and conditions of the loan; (iii) create a method for prioritizing property owners' requests; and (iv) create a plan for raising capital through bond funds." *Id.*

29. *Id.* "AB 811 requires that the property be already developed in order to ensure that the funds are used for the retrofitting of existing buildings rather than the construction of new buildings." *Id.*

30. Larson, *supra* note 15, at 602; PACE Program Financing, One Block Off The Grid, http://solarfinancing.1bog.org/pace-program-solar-financing/ (last visited Jan. 7, 2013); Wiener & Alexander, *supra* note 2, at 577 ("Berkeley's FIRST program was launched in November 2008. In November 2007, Berkeley's city council approved of the concept for a Sustainable Energy Financing District ('SEFD'). The city amended the Berkeley Municipal Code to create the Special Tax Financing Law ('STFL') under its charter authority. The STFL, which incorporated by reference provisions of the Mello-Roos Act, authorized the creation of a SEFD.").

31. Larson, *supra* note 15, at 602–04; Wiener & Alexander, *supra* note 2, at 577.

32. Larson, *supra* note 15, at 603.

ifornia.[33] By the spring of 2011, at least twenty-three states and the District of Columbia had passed legislation specifically providing for PACE programs.[34] Although the many PACE programs that rapidly appeared throughout the country were fundamentally similar, there were some variations, even among the very first programs that were established.[35]

IV. Advantages of PACE Programs

There are a number of very good reasons that PACE programs spread throughout the country so rapidly. They provide many intriguing advantages for property owners, investors, local governments, and the nation as a whole. Broadly speaking, the SAD features of PACE programs are beneficial in ways that distinguish them from equity-based financing options.[36] First of all, PACE programs make financial assistance for energy improvements available to property owners who might not otherwise qualify for equity or debt financing.[37] Although most PACE programs have minimal requirements that must be met by participants, they typically do not require participants to have a particular credit rating.[38] In addition, the superiority of EFD liens over any mortgage obligations on the property provides local governments and investors with increased security and enhances their expectations of payment in the event of default.[39] Furthermore, PACE programs have beneficial tax consequences for property owners, local governments, and investors.[40] Finally,

33. Wilson et al., *supra* note 19, at 39.

34. Dernbach et al., *supra* note 1, at 11. In fact, PACE programs were established all across the continental United States. Shih, *supra* note 22 ("Since Berkeley and Palm Desert in Southern California kick-started their pilot programs in consecutive weeks two years ago, the concept has quickly gained traction from coast to coast, with cities and counties in 12 states, including Sonoma County; Boulder, Colo.; and Montgomery County, Md., in the suburbs of Washington, D.C., rolling out similar concepts."); Gillis, *supra* note 14, at B4 ("The idea took off, and 25 states and the District of Columbia soon passed PACE legislation. One of the most successful programs to date has been in Sonoma County, Calif., where retrofit projects exceeding $50 million have been financed.").

35. See Wiener & Alexander, *supra* note 2, at 577–80, for a survey of early PACE programs in cities and counties including Berkeley, Palm Desert, and Sonoma County, California; Boulder, Colorado; and Babylon, New York.

36. Wiener & Alexander, *supra* note 2, at 581.

37. *Id.*

38. *Id.*

39. *Id.*

40. *Id.* at 582 ("The tax-free status of municipal and county bonds allows these governments to obtain lower interest rates in many cases, which they can

the EFDs used in PACE programs are a means of financing that is relatively familiar to local governments.[41]

Most significantly, PACE programs allow property owners to make energy-related improvements to their property without being deterred by daunting upfront costs.[42] In fact, the increased property tax assessments required to repay PACE liens are offset by PACE participants' reduced energy costs.[43] Perhaps the second most important feature of PACE programs is that they address property owners' concerns about recovering costs in the event that they decide to sell their property.[44] As mentioned previously, the EFD assessment obligations of the programs run with the property rather than the property owner, so program participants will only have to worry about the tax consequences of special assessments as long as they continue to own the property in question.[45] Essentially, PACE financing is more attractive to property owners than tax credits or rebates because it caters to their tendency to downplay obligations that span far into the future.[46]

PACE programs are also highly beneficial on a much larger scale. On a communal level, PACE programs can create jobs and promote sustainability while only placing financial burdens on

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potentially pass on to participating property owners. In addition, the interest portion of the repayments is tax-deductible, similar to mortgages.").

41. *Id.* at 575 ("Since SADs are already commonly used to finance a number of local improvements, municipal and county officials are more likely to be familiar with operating them.").

42. Wilson et al., *supra* note 19, at 38–39; Eisen, *supra* note 4, at 85 ("Property tax financing seems to eliminate the solar system's upfront cost, as a homeowner pays nothing up front and the city or county offers 100 percent financing.").

43. Wilson et al., *supra* note 19, at 39. In fact, "[e]xperts point out that, with modern techniques and equipment, a retrofit can typically cut a building's energy use so much that the project pays for itself in as little as five years. The most famous recent example was the refurbishment of the Empire State Building, which cut energy use by nearly 40 percent, turning it into one of New York's greenest buildings." Gillis, *supra* note 14, at B4.

44. Wilson et al., *supra* note 19, at 39.

45. Wiener & Alexander, *supra* note 2, at 581; Eisen, *supra* note 4, at 85 ("Because the debt is repaid through the property tax, if the homeowner moves before the system's payoff period, the debt simply continues to be repaid by the next owner. The obligation is meant to attach to the land, not the borrower, and to run with the land until paid off.").

46. Eisen, *supra* note 4, at 85 ("The PACE obligation is comparable to taking on a second mortgage, and because Americans move so often, homeowners might discount an obligation that spans decades into the future. This is what PACE proponents effectively hope for when they assert the obligation will run to subsequent homeowners.").

those taxpayers that choose to participate in them.[47] Moreover, the renewable energy and energy efficiency improvements brought about by PACE programs typically benefit not only program participants, but entire communities, by increasing property values.[48] PACE programs are also beneficial on a national level because they help compensate for gaps and shortcomings in federal energy policy. As a result of their local funding, they promote energy improvements and sustainability at a minimal cost to the federal government and do not necessitate federal regulation or an increase in federal energy taxes.[49]

V. Disadvantages of PACE Programs

Unfortunately, the PACE approach to financing energy improvements is not entirely free of disadvantages. While they provide a number of financial incentives and benefits, PACE programs are unavailable to many people, perhaps especially those in lower-income communities, because only property owners, not renters, may participate in them.[50] In addition, the administrative costs related to determining property owners' suitability for participation can often make them prohibitively expensive for local governments to implement and manage.[51] Similarly, local government debt constraints can deter communities from implementing PACE programs.[52] From the perspective of consumers,

47. Wilson et al., *supra* note 19, at 39.

48. *Id.* at 39; Wiener & Alexander, *supra* note 2, at 583 ("PACE programs offer a relatively low risk source of financing that has tangible benefits for property value, the environment, and energy distribution. . . . Similarly, PACE financing may arguably enhance the tax base of a community through higher property values.").

49. Wilson et al., *supra* note 19, at 39.

50. Wiener & Alexander, *supra* note 2, at 582. Nevertheless, "[c]ities and counties may be able to address this potentially serious limitation by tailoring their programs specifically to landlords." *Id.*

51. *Id.*; Eisen, *supra* note 4, at 87 ("PACE is far too complex for the average locality to administer. . . . A city would be required to make decisions on an ongoing basis about individual homeowners' suitability for participation in the program. This is a responsibility that not all cities will be willing to undertake, and it is therefore no surprise that cities like Berkeley with active environmental departments have been the first ones to adopt PACE.").

52. Wilson et al., *supra* note 19, at 39 ("Virginia was one of the many states to authorize PACE. But Arlington County, perhaps the most progressive community in the state, is on record as having no plans to create a local program because of debt concerns. . . . Increasing a community's total debt obligation, which a PACE bond issuance would do, can result in a lower credit rating for the community, which in turn increases capital costs for all community programs."); Eisen, *supra* note 4, at 87 ("Many localities are fighting for their economic lives, and schools, libraries and other public facilities will be much higher priorities than PACE.").

though the programs certainly reduce otherwise daunting upfront costs, they do not fully encompass and streamline the transaction costs of energy improvements.[53] Furthermore, some property owners may be reluctant to participate in PACE programs if they are required to disclose their higher property tax obligations in the event that they choose to sell their property.[54] After all, while PACE programs spread rapidly and were authorized in more than 22 states, only a few thousand people took advantage of them, although this may be due simply to the limited amount of time they were authorized prior to the rise of the controversy that currently surrounds them.[55] Perhaps most importantly, PACE programs have created a number of controversial issues with respect to the relative priority of PACE liens and mortgage obligations in the event of foreclosure.[56] Although one of the advantages of PACE programs is their minimal underwriting requirements, the fact that they offer loans typically not available from private lenders puts additional strain on an already tense relationship between local governments, property owners, and mortgage lenders.[57] Finally, yet another potential disadvantage of PACE financing is the possibility that the technology used for energy improvements will become obsolete and lose significant value during the life of a PACE lien.[58]

Some argue that the most critical issue with PACE programs is that they fail to account for the practical realities of the real estate market.[59] A prominent example of this issue is that in many instances PACE programs fail to anticipate that, while property encumbered with a PACE lien may be sold at any time without any lingering PACE obligations for the prior owner, a

53. Eisen, *supra* note 4, at 88 ("Cities with programs in place have no municipal installers. So while the city provides the funding to the homeowner, she is still required to handle legal and technical responsibilities.").

54. *Id.* at 86.

55. Todd Woody, *Energy Savers, Loan Losers: Efficiency Program is Jeopardized by Policy on Mortgages*, N.Y. TIMES, July 1, 2010, at B1.

56. Hupp, *supra* note 23, at 647.

57. Prentiss Cox, *Keeping PACE?: The Case Against Property Assessed Clean Energy Financing Programs*, 83 U. COLO. L. REV. 83, 113 (2011).

58. *Id.* at 115 ("Alternative energy investments, in particular, occur in an environment of rapid technological change that means costs of a solar PV system may be in long-term decline. A solar PV system that costs $12,000 today may, in ten years or less, cost $3,000, be a quarter of the size, and produce three times the electricity. Today's economically beneficial investment may look like a MS-DOS computer on the roof in 2019.").

59. *Id.* at 85–86. "When properly characterized and understood as a home financing technique, PACE loses much of its appeal as a means of resolving long-standing homeowner concerns about investments in residential energy improvements." *Id.* at 86–87.

mortgage that is encumbered with a PACE lien may be very difficult to sell on the secondary mortgage market.[60] Moreover, real estate transactions do not take place in a vacuum, and potential buyers are likely to consider all encumbrances on real property, including PACE liens, when negotiating purchases.[61] As a result, some argue that the perceived benefits of PACE financing are often negated upon resale of property.[62] Essentially, PACE financing offers the same advantages and disadvantages as any transferable, fixed-rate financing mechanism.[63] An emphasis on the public benefits of PACE financing does not change its fundamental essence from the perspective of property owners or lenders, who simply view it as another lien on the property when anticipating possible circumstances in the case of default.[64]

VI. Challenges by the FHFA, Fannie Mae, and Freddie Mac

Meanwhile, it is the issues regarding mortgage and lien priority that are at the heart of the recent controversy surrounding PACE programs. As mentioned previously, PACE liens take priority over mortgages in the event of foreclosure, which makes them more appealing to both local governments and investors and is crucial to their success.[65] However, this feature of PACE liens also raises grave concerns for mortgage underwriters because it makes PACE-encumbered mortgages much more difficult to sell even before foreclosure.[66] More specifically, Fannie

60. *Id.* at 86 ("The failure of existing PACE programs to adequately anticipate the adverse secondary mortgage market reaction is a prominent example of this problem.").

61. *Id.* at 96–97 ("A property tax special assessment that is the subject of negotiation between the seller (the 'PACE homeowner' who obtained the financing) and the home buyer has two foreseeable outcomes: (1) the PACE homeowner pays off the remaining balance of the PACE financing at the time of sale, or (2) the buyer assumes responsibility for future special assessments.").

62. *Id.* at 96 ("The arguments for homeowner advantages with PACE are predicated on the idea that tying repayment to property tax assessments radically changes the characteristics of financing for homeowners. Unfortunately, the dynamics and constraints of the real estate finance market shape the realities of PACE financing. As a result, the claimed benefits for PACE programs disappear upon closer examination.").

63. *Id.* at 101.

64. *Id.* at 106. "As with the sale of the property by a PACE homeowner, the impact on lenders does not disappear simply because the PACE obligation exists in the form of a liability for future tax payments rather than a current lien on the property." *Id.* at 107.

65. *See supra* notes 25 and 26.

66. Wilson et al., *supra* note 19, at 39 ("Standard government tax assessments—ones that are used to fund public projects—typically have senior lien priority over mortgages. Mortgage underwriters feared that the loans secured

Mae, Freddie Mac, and the FHFA have voiced numerous concerns about the impact of innovative PACE financing on taxpayers.[67] The depth of the controversy over PACE programs became fully apparent when, with the supervision of the FHFA, Fannie Mae and Freddie Mac flatly refused to purchase any mortgages burdened by a PACE lien.[68]

Essentially, Fannie Mae and Freddie Mac elected to block PACE programs, rendering their present effects uncertain and placing their future in jeopardy.[69] On May 5, 2010, Freddie Mac issued an industry-wide memorandum instructing all of its lenders that PACE liens were not to be considered senior to any mortgages.[70] On July 6, 2010, the FHFA issued a statement echoing the concerns of Fannie Mae and Freddie Mac with respect to PACE liens.[71] It also directed the two agencies, as well as the Federal Home Loan Banks, to take three actions regarding their local PACE programs: to waive prohibitions against senior municipal liens in existing PACE-encumbered mortgages; to take specific steps to protect themselves in PACE jurisdictions; and to ensure that any pledged collateral was free of PACE liens.[72] On the same day, the United States Comptroller of the Currency issued a memorandum cautioning national banks and lenders about the possible impact of PACE programs.[73] Then, on July 14, 2010, the FHFA issued another statement expressing support for Fannie Mae and Freddie Mac's actions against PACE programs, citing its obligation to police mortgage proceedings for

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by mortgages would become subordinate to PACE liens and as a result would not be readily sellable on the secondary mortgage market.").

67. Woody, *supra* note 55, at B2 ("Fannie Mae and Freddie Mac, the government entities that guarantee more than half of the residential mortgages in the United States, have different priorities. They are worried that taxpayers will end up as losers if a homeowner defaults on a mortgage on a home that uses such creative financing. Typically, property taxes must be paid first from any proceeds on a foreclosed home.").

68. Larson, *supra* note 15, at 600.

69. Todd Woody, *Loan Giants Opt to Block Energy Programs*, N.Y. TIMES, July 4, 2010, at 12; Woody, *supra* note 55, at B2 ("The uncertainty has had ripple effects beyond homeowners. For example, after San Francisco suspended its program, Recurve, a local retrofitting company, was forced to temporarily lay off workers.").

70. Larson, *supra* note 15, at 610; Woody, *supra* note 55, at B2.

71. Larson, *supra* note 15, at 610; *Regulators Warn on Energy Retrofit Loan Programs*, 29 BANKING & FIN. SERVICES POL'Y REP. 34, 34–35 (2010) [hereinafter *Regulators*].

72. Larson, *supra* note 15, at 610–11.

73. *Id.* at 611–12; *Regulators*, *supra* note 71, at 34–35.

safety and soundness.[74] Among its many criticisms of PACE liens, the FHFA has argued that they are fundamentally different from other special assessments that are commonly accepted and routinely used by local governments.[75]

The restrictions imposed by the FHFA, Fannie Mae, and Freddie Mac have had a devastating impact on PACE programs, particularly in California, where the programs first developed and became popular.[76] In fact, the restrictions have not only negatively impacted properties with PACE liens, but all residential properties in jurisdictions with PACE programs.[77] Many cities and local governments were outraged.[78] Advocacy group PACE-Now argued that the restrictions effectively halted any active or potential programs throughout the country.[79] On July 29, 2010, the Sierra Club filed the first of many legal complaints against the FHFA seeking declaratory and equitable relief and asking for an injunction to prevent further interference with PACE financ-

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74. "In keeping with our safety and soundness obligations, the Federal Housing Finance Agency will defend vigorously its actions that aim to protect taxpayers, lenders, Fannie Mae and Freddie Mac. Homeowners should not be placed at risk by programs that alter lien priorities and fail to operate with sound underwriting guidelines and consumer protections. Mortgage holders should not be forced to absorb new credit risks after they have already purchased or guaranteed a mortgage." Statement on PACE Programs, Edward J. DeMarco, Acting Director, Fed. Hous. Fin. Agency (July 14, 2010) (on file).

75. According to the agency, they "'present significant risk to lenders and secondary market entities, may alter valuations for mortgage-backed securities and are not essential for successful programs to spur energy conservation.'" Todd Woody, *A Blow to Home Retrofits*, N.Y. TIMES GREEN BLOG (July 6, 2010, 4:21 PM), http://green.blogs.nytimes.com/2010/07/06/a-blow-to-home-energy-retrofits/.

76. Woody, *supra* note 55, at B2. "[I]t is not a stretch to assume that lenders in the home financing market are guided in their decisions by Fannie Mae and Freddie Mac requirements. They are likely to give important consideration to [Government Sponsored Enterprise] lending guidelines, and will be less likely to offer mortgages that do not conform thereto." Town of Babylon v. Fed. Hous. Fin. Agency, 790 F. Supp. 2d 47, 50 (E.D.N.Y. 2011).

77. Cox, *supra* note 57, at 104 ("Because the FHFA statement linked its underwriting restrictions to all mortgages in a jurisdiction with PACE rather than just properties with a PACE loan, the existence of a PACE program would impact all residential home finance in a given community.").

78. Woody, *supra* note 69, at 12.

79. Larson, *supra* note 15, at 612. "Stated concisely, PACENow made three key responses: (1) in ignoring state assessment rights, FHFA mischaracterized PACE programs as granting loans; (2) because only the portions of PACE liens in arrears are accelerated into senior positions, PACE lien seniority does not significantly harm creditors; and (3) collateral-based programs, the type of borrowing PACE relies upon, do not pose significantly higher risks than ability-to-pay lending." *Id.* at 612–13.

ing.[80] Critics of the FHFA, Fannie Mae, and Freddie Mac have argued that their concerns are out of proportion and undermine the basic authority of local governments to use assessments for public improvements.[81]

In addition to localities and advocacy groups, many significant federal government actors have reacted strongly in support of PACE financing. The White House in particular has been very supportive of PACE since its inception. In fact, PACE supporters have relied heavily on a set of White House policy guidelines issued in a report by Vice President Joe Biden in 2009 when arguing for PACE's inherent safety to lenders.[82] Shortly after the release of Vice President Biden's report, the White House allocated $80 billion of American Recovery and Reinvestment Act (ARRA) funds in support of local government PACE programs.[83] The Obama Administration provided strong financial backing for PACE programs,[84] and, along with other federal, state, and local government entities, has continued to voice public support for them in the midst of the current controversy.[85] On May 7, 2010, merely two days after Freddie Mac issued its initial industry-wide memorandum to lenders, effectively undermining the seniority of PACE liens, the Department of Energy (DOE) issued a set of best practice guidelines, including much more rigorous underwriting standards, designed to help implement the policy framework announced by Vice President Biden in 2009 and ensure prudent financing practices with respect to PACE pro-

80. *Id.* at 614.

81. Elkind, *supra* note 11.

82. "The White House Policy Framework included three guidelines intended to protect individual homeowners and eight guidelines intended to protect lenders; it is these guidelines that supporters would come to rely on as proof of PACE's inherent safety to lenders." Larson, *supra* note 15, at 607–08 (citing POLICY FRAMEWORK FOR PACE FINANCING PROGRAMS (Oct. 18, 2009), http://www.whitehouse.gov/assets/documents/PACE_Principles.pdf.).

83. Larson, *supra* note 15, at 607; Dernbach et al., *supra* note 1, at 11 (stating that ARRA programs encouraged the development of PACE programs).

84. Woody, *supra* note 55, at B1 (stating that the Obama Administration devoted $150 million in stimulus money to PACE programs).

85. Wilson et al., *supra* note 19, at 40 ("Despite the position of FHFA and OCC, other federal agencies and the White House continued publicly to support PACE programs as a tool for job creation and clean energy growth. In response to the recent FHFA statement, additional state and federal officials have come forward to support continuing PACE programs. California, a state with strong PACE support, has taken specific action against the FHFA's statement.").

grams.[86] Congress also reacted quickly to the mortgage industry's blockade of PACE programs, introducing promising yet ultimately unsuccessful legislation called the PACE Assessment Protection Act of 2010[87] as part of an effort to compel the mortgage lending agencies to facilitate PACE programs.[88] In the fall of 2010, further attempts at reaching a legislative compromise between the priorities of PACE supporters and the real estate finance industry were derailed when Republicans assumed control of the House of Representatives after the November 2010 elections.[89] In the summer of 2011, Congress produced yet another unsuccessful legislative attempt to resolve the PACE controversy, known as the PACE Assessment Protection Act of 2011, which would have required Fannie Mae and Freddie Mac to respect all PACE assessments in compliance with the aforementioned DOE guidelines, including much more rigorous underwriting standards, but never made it out of committee.[90]

VII. Key Federal Court Decisions

Amid unsuccessful legislative efforts, pressure to resolve the PACE controversy has mounted against the federal govern-

86. These DOE guidelines, issued two days after Freddie Mac's May 5, 2010 statement and prior to the FHFA's statements condemning PACE programs, set forth recommended best practices for PACE programs and assessments. These best practices are meant to provide additional protection to both PACE program participants and mortgage lenders. *See generally* Dep't of Energy, Guidelines for Pilot PACE Financing Programs (May 7, 2010), http://www1.eere.energy.gov/wip/pdfs/arra_guidelines_for_pilot_pace_programs.pdf.

87. H.R. 5766, 111th Cong. (2010); S. 3642, 111th Cong. (2010).

88. Larson, *supra* note 15, at 613. "According to the resolution, Fannie Mae and Freddie Mac would be barred from making special requirements for properties affected by PACE liens." *Id.* "Congressman Mike Thompson (D-Cal.) introduced the bill, H.R. 5766, with 29 cosponsors in the House of Representatives. Identical companion legislation [S. 3642] was introduced in the Senate by Barbara Boxer (D-Cal.), Jeff Merkley (D-Ore.), Kirsten Gillibrand (D-N.Y.), and Mark Begich (D-Alaska)." Wilson et al., *supra* note 19, at 41.

89. Wilson et al., *supra* note 19, at 42. Efforts to arrive at a compromise were led by Representative Steve Israel (D-N.Y.) and Representative Mike Thompson (D-Cal.). *Id.*; Woody, *supra* note 75 ("Representative Steve Israel, Democrat of New York, said the Department of Energy was willing to insure the Federal Housing Finance Agency against any PACE-related mortgage losses[, but the FHFA rejected the Department's offer].").

90. H.R. 2599, 112th Cong. (2011); "A bill introduced in Congress known as 'The PACE Assessment Protection Act' would resolve the conflict between PACE programs by requiring that the underwriting standards used by [Fannie Mae and Freddie Mac] acquiesce in all respects to PACE program assessments that comply with the guidelines issued by the Department of Energy (DOE)." Cox, *supra* note 57, at 107.

ment,[91] and a number of lawsuits have been filed against the FHFA, Fannie Mae, and Freddie Mac.[92] In very general terms, these lawsuits contend that PACE liens should not be treated differently than any other property tax assessments that are normally given priority over preexisting mortgage liens.[93] More specifically, they allege that the FHFA has violated the Administrative Procedure Act (APA) by effectively conducting rulemaking without fulfilling notice and comment requirements.[94] Furthermore, they allege violations of the National Environmental Policy Act (NEPA).[95] They often seek declaratory relief in the form of an official ruling that PACE liens are assessments rather than loans.[96] Perhaps most significantly, however, they typically seek an injunction against the underwriting restrictions imposed on PACE liens by the FHFA, Fannie Mae, and Freddie Mac.[97] A few key decisions are indicative of the disagreement among federal courts with respect to the legal status of PACE programs and the restrictions imposed against them.

A. Town of Babylon v. Fed. Hous. Fin. Agency*, 790 F. Supp. 2d 47 (E.D.N.Y. 2011).*

The first of these decisions involved claims initially filed in the Eastern District of New York against the FHFA, Fannie Mae, Freddie Mac, and the Office of the Comptroller of the Currency (OCC) by the Town of Babylon, New York in an effort to protect its PACE program, known as the Long Island Green Homes Program.[98] The town alleged, among other grievances, that the defendants had promulgated rules in violation of the APA and violated NEPA by failing to conduct a required environmental impact analysis with respect to those rules.[99] In granting the

91. Woody, *supra* note 75 (stating that efforts to pass legislation permitting PACE programs to go forward without FHFA restrictions will likely intensify).

92. *See* Wilson et al., *supra* note 19, at 41–42 (discussing lawsuits filed by California Attorney General Jerry Brown and Sonoma County, as well as the reactions of Governor Arnold Schwarzenegger and other public officials).

93. Cox, *supra* note 57, at 85.

94. *Id.* at 104.

95. *See, e.g.*, Town of Babylon v. Fed. Hous. Fin. Agency, 790 F. Supp. 2d 47, 48–49 (E.D.N.Y. 2011).

96. Cox, *supra* note 57, at 105.

97. *Id.* at 104–105.

98. *Town of Babylon*, 790 F. Supp. 2d at 51. According to the Town of Babylon, "the typical cost of a PACE improvement is less [than] $9,000, and . . . reduced energy costs typically exceed the homeowners' monthly repayment obligations, which average less than $92. Babylon further asserts that there has never been a single default on a PACE financed repayment obligation." *Id.*

99. *Id.* at 48–49.

defendants' motions to dismiss, the court first noted the FHFA's role as conservator of Fannie Mae and Freddie Mac, commonly known as the Government Sponsored Enterprises (GSEs), which it assumed in September 2008 in accord with the Housing and Economic Recovery Act of 2008 (HERA).[100] As conservator, the FHFA is granted broad authority to "'take any action authorized by [the federal banking statute], which [it] determines is in the best interests of the [GSE's] or the FHFA.'"[101] The court reasoned that the FHFA's actions with respect to PACE programs were clearly undertaken within the scope of its role as conservator, and were thus beyond the court's jurisdiction.[102] With respect to the OCC's motion to dismiss, the court held that the town could not satisfy the element of redressability that is required to establish standing for its claim.[103] Essentially, the court arrived at the somewhat precarious conclusion that, even if it "were to grant the requested relief with respect to OCC, such action would not require banks to authorize mortgages subject to first lien priority PACE programs."[104] Thus, the court dismissed the town's claims with respect to the FHFA, Fannie Mae, Freddie

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100. *Id.* at 50.

101. *Id.* (quoting 12 U.S.C. § 4617(b)(2)(J)(ii)).

102. *Id.* at 54 ("FHFA's argument that HERA divests this court of jurisdiction is dispositive. . . . HERA clearly and specifically limits the power of courts to review the actions of the FHFA when acting as a conservator. Thus, 12 U.S.C. § 4617(f) provides that 'no court may take any action to restrain or affect the exercise of powers or functions of the Agency as a conservator or a receiver.'") (quoting 12 U.S.C. § 4617(f)).

103. The required elements to establish standing are injury in fact, a causal connection between the injury alleged and the conduct complained of, and a likelihood that the injury will be redressed by a favorable decision. *Id.* at 55.

104. *Id.* This reasoning has been criticized by Ethan Elkind, among others. In an entry of his blog, Elkind counters that

> [t]he court's decision places an excessive evidentiary burden on the plaintiffs. PACE was humming along fine with national bank support and was only stopped cold in its tracks by the single event of FHFA's new PACE policy. The banks clearly stopped lending because the federal government would no longer underwrite those loans. Why assume there was any other reason, given the obvious timing of events? And why also assume that somehow those same national banks may have learned something new in the past year, when most of the programs were on hold, and now won't be willing to lend to PACE properties even if FHFA changes course?

Ethan Elkind, *A Judicial Setback for PACE Energy Efficiency and Renewables Financing*, LEGAL PLANET: THE ENVTL. LAW & POLICY BLOG (July 7, 2011), http://legalplanet.wordpress.com/2011/07/07/a-judicial-setback-for-pace-energy-efficiency-and-renewables-financing/.

Mac, and the OCC. On appeal, the Second Circuit affirmed the district court's decision.[105]

B. Natural Res. Def. Council, Inc. v. Fed. Hous. Fin. Agency, *815 F. Supp. 2d 630 (S.D.N.Y. 2011).*

Another district court exhibited similar reasoning when the Natural Resources Defense Council (NRDC) brought suit against the FHFA and the OCC in the Southern District of New York.[106] The NRDC brought similar claims against the defendants, alleging violations of the APA and NEPA.[107] Once again, the FHFA and the OCC moved to dismiss the claims.[108] Like the court in *Town of Babylon*, this court justified its dismissal of the claims against the FHFA by emphasizing the FHFA's role as conservator of Fannie Mae and Freddie Mac.[109] In addition, the court agreed with the OCC's argument that the NRDC could not satisfy the redressability element of standing because redressability would depend on the national banks' willingness to resume their support for PACE programs.[110] The NRDC sought to counter this argument by referring to numerous municipal officials' assurances that they would resume their activities with respect to PACE programs if regulators' actions were vacated.[111] Nevertheless, the court maintained that these municipal officials, regardless of their own sentiments toward PACE programs, would be unable to resume developing and implementing them without the support of national banks.[112] Furthermore, despite the fact

105. Town of Babylon v. Fed. Hous. Fin. Agency, 699 F.3d 221, 230 (2d Cir. 2012) ("[E]ven if the OCC Bulletin were vacated, Fannie Mae's and Freddie Mac's refusal to purchase mortgages of properties subject to first-lien PACE programs would remain in force. Any contention that national banks would continue to lend on the same terms as before the issuance of the OCC Bulletin must simply ignore the impact of Fannie Mae's and Freddie Mac's changes in policy. Therefore, we conclude that appellants have failed to show that it is likely, as opposed to merely speculative, that their claims against the OCC would be redressed by vacatur of the Bulletin, and the claims against the OCC were properly dismissed for lack of standing."). The Natural Resources Defense Council, appealing from a similar decision in *Natural Resources Defense Council, Inc. v. Federal Housing Finance Agency*, 815 F. Supp. 2d 630 (S.D.N.Y. 2011), was also a party to this appeal.

106. *Natural Res. Def. Council, Inc.*, 815 F. Supp. 2d at 630.

107. *Id.* at 632.

108. *Id.*

109. *Id.* at 634–35, 642 ("Because the FHFA was acting within its authority under HERA when it issued the Letter, section 4617(f) applies and bars adjudication of this suit.").

110. *Id.* at 637.

111. *Id.* at 639.

112. *Id.*

that national banks supported PACE programs prior to the actions of the FHFA and OCC, the NRDC was unable to provide sufficient evidence to establish that banks would likely resume their support of the programs if these actions were vacated.[113] Consequently, the court ruled that the NRDC failed to demonstrate redressability of its alleged injuries, dismissing the NRDC's claims against the OCC, as well as the FHFA.[114] On appeal, the Second Circuit affirmed the district court's decision.[115]

C. People ex rel. Harris v. Fed. Hous. Fin. Agency*, No. C 10-03084 CW, 2012 WL 3277229 (N.D. Cal. Aug. 9, 2012), vacated sub nom.* Cnty. of Sonoma v. Fed. Hous. Fin. Agency*, No. C 12-16986, 2013 WL 1130925 (9th Cir. Mar. 19, 2013).*

Meanwhile, plaintiffs challenging restrictions on PACE programs have been somewhat more successful, at least temporarily, in the Northern District of California. California, Sonoma and Placer Counties, the City of Palm Desert, and the Sierra Club brought suit against the FHFA, Fannie Mae, and Freddie Mac.[116] While these plaintiffs brought claims[117] similar to those brought in New York, the California court reasoned very differently with

113. *Id.* For instance,

> Rodney Dole, an official in Sonoma County, California, has declared that in his "opinion" and "experience," the national banks and other lenders would once again grant mortgages on properties encumbered by PACE liens if the Bulletin were vacated. This unsubstantiated assertion is insufficient to meet the NRDC's burden. . . . Even if this Court vacated the Bulletin, the national banks would still be subject to OCC regulations and would still be required to consider safety and soundness in making their lending decisions. The national banks would still be free to refuse to grant mortgages on properties encumbered by PACE liens. Therefore, the NRDC has failed to sufficiently allege that its requested relief is "likely" to redress its injuries.

Id. at 639–40.

114. *Id.* at 642. For criticism of this conclusion see Elkind, *supra* note 104.

115. *See supra* note 105.

116. People *ex rel.* Harris v. Fed. Hous. Fin. Agency, No. C 10-03084 CW, 2011 WL 3794942, at *1 (N.D. Cal. Aug. 26, 2011). The court primarily addressed the procedural issue of standing in this 2011 opinion, then proceeded to address the more substantive issues of the case in its 2012 opinion, *People* ex rel. *Harris v. Federal Housing Finance Agency*, No. C 10-03084 CW, 2012 WL 3277229 (N.D. Cal. Aug. 9, 2012), vacated sub nom. *Cnty. of Sonoma v. Fed. Hous. Fin. Agency*, No. C 12-16986, 2013 WL 1130925 (9th Cir. Mar. 19, 2013).

117. *Id.* at *1 ("Plaintiffs allege . . . that (1) Defendants disregarded statutorily imposed procedural requirements in adopting policies about the PACE debt obligations, (2) Defendants' determinations were substantively unlawful because they were arbitrary and capricious, and (3) Defendants mischaracter-

regard to the legal status of the claims. As in the New York cases, the defendants argued that it was mere speculation that redressability could stem from a change in FHFA policy alone.[118] However, unlike the federal district courts in New York, the *Harris* court distinguished the current dispute from cases relied upon by the defendants, holding that the plaintiffs had sufficiently alleged that changes in FHFA policy, especially those informed by the notice and comment process, would redress their grievances.[119] As a result, the court held that the plaintiffs, with the exception of the Sierra Club, successfully established standing for their claims.[120]

As an initial matter, the court recognized that there is a longstanding "presumption in favor of judicial review of administrative actions."[121] Unlike the New York courts, the California court held that the FHFA was not immune from judicial review in this instance, reasoning that substantive rulemaking is not within the scope of the FHFA's powers as conservator of Fannie Mae and Freddie Mac.[122] In addition to resembling substantive rulemaking, the FHFA's action with respect to PACE programs was deemed to be subject to judicial review under the APA

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ized the legal nature of the obligations, contrary to state law, deeming them loans rather than traditional public assessments.").

118. *Id.* at *3.

119. *Id.* at *5 ("The present actions differ because further action by a federal agency would not be required to achieve Plaintiffs' goals. Plaintiffs have alleged that PACE encumbrances were treated like tax assessments until the FHFA took the actions it did. Plaintiffs adequately allege that a change in the FHFA's policy would lead to a return [to] previous marketplace practices.").

120. *Id.* at *7; Lawrence Hurley, *Recent Court Ruling Favors White House-Backed Home Energy Efficiency Program*, N.Y. TIMES (Sept. 6, 2011), http://www.nytimes.com/gwire/2011/09/06/06greenwire-recent-court-ruling-favors-white-house-backed-31917.html ("One of the key elements of Wilken's ruling was that she concluded the plaintiffs had standing to sue, something the judges in New York had not found, in part because there was no guarantee that banks would recommence lending even if FHFA reversed its position.").

121. *Harris*, 2011 WL 3794942, at *5 (citing Love v. Thomas, 858 F.2d 1347, 1356 (9th Cir. 1988)).

122. *Id.* at *7–8. The court notes that the FHFA's action "appears to fall under the authority of section 4624(a), which provides that the FHFA Director 'shall, by regulation, establish criteria governing the portfolio holdings of the enterprises. . . [.]' This would seem to support Plaintiffs' argument that the FHFA's action amounted to substantive rule-making." *Id.* at *8. In addition, "[t]he FHFA's policy does not refer to a specific homeowner seeking a mortgage, or to a group of PACE participants. It is a prospective, generally applicable directive. Accordingly, it would be inappropriate to apply the adjudication exemption from the APA's notice and comment requirements to the actions of which Plaintiffs complain." *Id.* at *11.

because it may be characterized as a final agency action.[123] Furthermore, the court determined that the plaintiffs satisfied the requirements for stating cognizable claims of NEPA violations.[124] Thus, the court held that the plaintiffs, with the exception of the Sierra Club, had standing with respect to their claims of APA violations and also satisfied the requirements necessary to pursue claims for violations of the NEPA.[125] Consequently, the court granted Sonoma County's motion for a preliminary injunction requiring the FHFA to proceed with the notice and comment process with regard to its restrictive policy on PACE-encumbered mortgages,[126] despite allowing the policy to remain in place for the time being.[127] Eventually, the plaintiffs jointly moved for summary judgment on all of their claims.[128] In a victory for PACE proponents, the court granted the plaintiffs' motion for summary judgment with respect to their notice and comment claim under the APA, denying the defendants' cross-motion for summary judgment.[129] Accordingly, the court ordered that "the FHFA shall complete the notice and comment process and publish a final rule to consummate that process."[130] On appeal, however, the Ninth Circuit vacated the district court's order, holding that the FHFA did in fact act within its powers as conservator and

123. *Id.* at *10 ("The July 2010 statement indicated the FHFA's final stance on PACE obligations, and the February 2011 letter reiterated that policy, thus demonstrating a final agency action by the FHFA subject to review under the APA."); Hurley, *supra* note 120 ("Furthermore, by finding that FHFA is required to seek notice and comment, Wilken agreed with one of the primary claims made by the plaintiffs, which is that the 2010 statement was a final agency action reviewable by a court under the Administrative Procedure Act.").

124. *Harris*, 2011 WL 3794942, at *15.

125. *Id.* at *17.

126. In another entry of his blog, Ethan Elkind stated that "[u]nlike her federal counterparts in the east, Judge Wilken acknowledged that FHFA's decision 'decimated' residential PACE programs around the country" and that she recognized the possible benefits that could be gleaned from the notice and comment process. He also speculates that Judge Wilken's favorable language may indicate that she will "eventually order FHFA leaders to prepare a full-blown environmental impact statement (EIS) to analyze the impacts of their policy." Ethan Elkind, *A Judicial Win for PACE Clean Energy Financing*, LEGAL PLANET: THE ENVTL. LAW & POLICY BLOG (Aug. 29, 2011), http://legalplanet.wordpress.com/2011/08/29/a-judicial-win-for-pace-clean-energy-financing/.

127. *Harris*, 2011 WL 3794942, at *17–*18; Elkind, *supra* note 126; Hurley, *supra* note 120.

128. People *ex rel.* Harris v. Fed. Hous. Fin. Agency, No. C 10-03084 CW, 2012 WL 3277229, at *1 (N.D. Cal. Aug. 9, 2012), *vacated sub nom.* Cnty. of Sonoma v. Fed. Hous. Fin. Agency, No. C 12-16986, 2013 WL 1130925 (9th Cir. Mar. 19, 2013).

129. *Id.* at *17.

130. *Id.*

that its actions were not subject to judicial review or the rulemaking requirements of the APA.[131]

D. Leon Cnty., Fla. v. Fed. Hous. Fin. Agency, *816 F. Supp. 2d 1205 (N.D. Fla. 2011).*

Although it acknowledged the rulings that the California district court had already made in *Harris* in 2011, the court in yet another recent case in the Northern District of Florida chose to follow the reasoning of the New York district courts. The case was brought by Leon County, Florida against the FHFA, Fannie Mae, and Freddie Mac.[132] Leon County had created the Leon County Energy Improvement District to manage a PACE program known as the Leon County Energy Assistance Program (LEAP), and sued the defendants seeking injunctive and declaratory relief for claims under the APA, among other claims.[133] In its discussion of the FHFA's role as conservator, the court reasoned that the scope of the agency's powers was sufficiently broad to include "restricting an entity-in-conservatorship's purchase of PACE-encumbered mortgages."[134] Thus, the court held that Leon County's claims must be dismissed, essentially opting to take the side of the New York district courts in the current PACE controversy.[135] On appeal, the Eleventh Circuit affirmed the district court's decision.[136]

VIII. The Future of PACE Programs: Possible Solutions

In the wake of these legal challenges by PACE supporters, the FHFA proceeded with the rulemaking process in order to codify its policies against PACE programs. At the time of the court's August 2012 decision in *Harris*, the FHFA had received 33,000 comments in response to its January 2012 Advance Notice

131. Cnty. of Sonoma v. Fed. Hous. Fin. Agency, No. C 12-16986, 2013 WL 1130925, at *7 (9th Cir. Mar. 19, 2013).

132. Leon Cnty., Fla. v. Fed. Hous. Fin. Agency, 816 F. Supp. 2d 1205, 1205 (N.D. Fla. 2011).

133. *Id.* at 1206.

134. *Id.* at 1207.

135. *Id.* at 1209 ("There is a contrary decision . . . but the New York decisions have the better of it.").

136. Leon Cnty., Fla. v. Fed. Hous. Fin. Agency, 700 F.3d 1273, 1279 (11th Cir. 2012) ("For all of these reasons, we agree with the district court that, under the specific facts in this case, the FHFA's directive not to purchase PACE-encumbered mortgages was within the FHFA's broad powers as conservator. Accordingly, because § 4617(f) provides that 'no court may take any action to restrain or affect the exercise of powers or functions of the [FHFA] as a conservator or receiver,' *see* 12 U.S.C. § 4617(b), the district court correctly held that § 4617(f) bars Leon County's claims.").

of Proposed Rulemaking seeking comment on whether its restrictions on PACE programs should be maintained.[137] On June 15, 2012, the FHFA issued a Notice of Proposed Rulemaking and Proposed Rule concerning underwriting standards for Fannie Mae and Freddie Mac with regard to PACE programs.[138] Essentially, if finalized, the proposed rule would codify restrictions on Fannie Mae and Freddie Mac to prevent them from purchasing most mortgages encumbered by PACE liens, and from consenting to the imposition of a first lien PACE obligation on any mortgage.[139] As the *Harris* court noted, the FHFA was originally required to issue a final rule within a reasonable time after the end of the ninety-nine day comment period, which came to a close on September 13, 2012.[140] Given that the Ninth Circuit recently vacated the *Harris* court's order, it is no longer entirely clear how the FHFA will proceed, but it is reasonable to presume that the agency will issue a final rule rather than abandoning rulemaking altogether at this late stage in the process.

A number of states have already reacted in various ways to recent developments in the PACE controversy. Once again, California has taken the lead with respect to PACE programs. The state has already amended its PACE statutes in order to codify stricter underwriting requirements for PACE liens, and some of the state's local governments have continued to champion PACE programs.[141] In addition, the FHFA has already voiced its

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137. *Harris*, 2012 WL 3277229, at *16. More specifically, the Advance Notice of Proposed Rulemaking, issued on January 26, 2012, seeks comment with regard to the restrictions set forth in the FHFA's July 2010 statement and February 2011 letter. *Id.*

138. *Id. See* Enterprise Underwriting Standards, 77 Fed. Reg. 36,086 (proposed June 15, 2012) (to be codified at 12 C.F.R. pt. 1254).

139. Paula Melton, *Feds Say Popular PACE Retrofit Program Is Still Too Risky*, BUILDINGGREEN.COM (July 17, 2012), http://www.buildinggreen.com/auth/article.cfm/2012/7/17/Feds-Say-Popular-PACE-Retrofit-Program-Is-Still-Too-Risky/?&printable=yes; Enterprise Underwriting Standards, 77 Fed. Reg. 36,086, 36,107 (proposed June 15, 2012) (to be codified at 12 C.F.R. pt. 1254).

140. *See Harris*, 2012 WL 3277229, at *17. David Gabrielson, executive director of advocacy group PACENow, estimates that a final rule could come from the FHFA by May 2013. Jim Witkin, *For Sacramento, Energy Upgrades With No Upfront Costs*, N.Y. TIMES GREEN BLOG (January 31, 2013, 3:02 PM), http://green.blogs.nytimes.com/2013/01/31/for-sacramento-energy-upgrades-with-no-upfront-costs/.

141. Larson, *supra* note 15, at 627. For instance, Sacramento recently announced an especially large, ambitious new program called Clean Energy Sacramento. Jim Witkin, *For Sacramento, Energy Upgrades With No Upfront Costs*, N.Y. TIMES GREEN BLOG (January 31, 2013, 3:02 PM), http://green.blogs.nytimes.com/2013/01/31/for-sacramento-energy-upgrades-with-no-upfront-costs/. In addition, Riverside County recently announced that its highly successful Home Energy Renovation Opportunity (HERO) Financing PACE pro-

approval of Vermont's program, which actually "makes all PACE liens junior to a mortgage."[142] Maine, New Hampshire, and Oklahoma "have also rewritten their laws to address FHFA's concerns" about priority in case of foreclosure.[143] Florida, whose PACE assessments are primarily commercial rather than residential, essentially did just the opposite in 2010 when it adopted a state law to the effect that PACE assessments are loans equivalent in priority to base mortgage obligations.[144]

While the current controversy, highlighted by federal court decisions and the rulemaking process, leaves the future of PACE programs far from certain, it does represent an opportunity to step back and examine more comprehensive means of overcoming the challenges they accentuate and perpetuating their beneficial effects. In a very basic sense, the challenge of coordinating legislation related to alternative energy and climate change, including PACE legislation, is an issue of federalism.[145] Indeed, complex networks of federal and state programs and policies meant to address the same area of concern often result in problematic outcomes because of the conflicting purposes of various actors.[146] Often, state and local governments act to fill gaps and address areas of weakness in federal legislation.[147] "For at least a decade, states have exercised de facto national leadership on cli-

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gram is now available to communities throughout California. *Wildly Successful Residential PACE Program in Riverside County Now Available to Communities throughout California*, PR NEWSWIRE (Jan. 30, 2013), http://www.prnewswire.com/news-releases/wildly-successful-residential-pace-program-in-riverside-county-now-available-to-communities-throughout-california-188983991.html.

142. Melton, *supra* note 139.

143. *Id.*

144. *Id.* (stating a belief that the FHFA's rule, if finalized, will not cause problems for the predominantly commercial Florida property owners interested in PACE because the FHFA deals almost exclusively with residential mortgages).

145. Mann, *supra* note 6, at 391.

146. *Id.* at 388 ("Property tax incentives for renewable energy are popular, but some property-tax-related programs are facing failure because of policy set at the federal level. . . . California Attorney General Jerry Brown sued Fannie Mae and Freddie Mac, asking the court to declare that the program known as [PACE], available in about half of California's counties, does not violate the federal lending standards. The Department of Energy invested $150 million in PACE projects, and a 2009 study showed that energy efficient homes had default and delinquency rates 11% lower than for typical homes. This is a clear example of cross-purpose between federal programs and between federal and state policies.").

147. *Id.* at 372; John C. Dernbach et al., *Making the States Full Partners in a National Climate Change Effort: A Necessary Element for Sustainable Economic Development*, 40 ENVTL. L. REP. NEWS & ANALYSIS 10,597, 10,599 (2010) ("The high level of state action on climate change over more than a decade is commonly

mate change policy development."[148] There are a number of reasons why some degree of state and local autonomy with respect to climate change legislation is vitally important, regardless of the strength of federal climate change efforts.[149] Among these reasons is the fact that when states and localities are granted sufficient autonomy to develop and refine innovative policies, they can reduce the costs of pursuing regulatory alternative energy goals through frameworks such as those set up by PACE programs.[150] "States are best positioned to identify the programs that can remove disincentives to implement the most cost-effective measures to reduce emissions, and develop the financing and institutional mechanisms that can assist in the development of those programs."[151] Furthermore, given the issues of federalism at stake, preserving some degree of state autonomy with respect to climate change and alternative energy could make comprehensive federal legislation more palatable to members of the public and Congress that are concerned about states' rights.[152] Nevertheless, it is clear that coordination between federal, state, and local governments is preferable to ad hoc policymaking for purposes of guarding against conflicts and inefficiencies.[153] Therefore, in order for PACE programs and similar measures to have a broad and lasting impact, political leaders must strike an effective balance between state and local autonomy and coordination between various levels of government.

An open, collaborative dialogue is necessary in order to arrive at a viable solution to the PACE controversy that strikes an effective balance not only with respect to the various levels of government, but also with respect to the needs of all parties involved.[154] The FHFA, Fannie Mae, and Freddie Mac believe that the first lien priority of PACE programs severely undermines traditional mortgage lending practices, likely opening the door

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explained as a response to the weak federal effort—a necessary effort to fill a vacuum.").

148. Dernbach et al., *supra* note 147, at 10,597.

149. See *id.* at 10,601–04 for a list of seven reasons that states must play a continued and growing role on climate change.

150. *Id.* at 10,602–03.

151. *Id.* at 10,606.

152. *Id.* at 10,604.

153. Mann, *supra* note 6, at 372 ("When national, state, and local governments all attempt to influence energy use through tax legislation without coordination, inefficiencies and conflicts are bound to arise.").

154. Wilson et al., *supra* note 19, at 42 ("A solution will require understanding on both sides of the goals and limitations of the other, and a willingness to work toward a manageable solution for all involved.").

to dangerous repercussions.[155] Consequently, these entities firmly hold that significant changes and restrictions are necessary in order to ensure that PACE programs conform to traditional mortgage lending practices.[156] PACE supporters, on the other hand, believe that these entities' concerns are irrational and that their attempts to stifle the innovation and public benefits represented by PACE are without justification.[157] Obviously, the needs of all parties involved must be adequately reconciled if an effective compromise is to be reached.[158]

A number of the issues at stake in the current controversy may appear nearly intractable at first glance.[159] Perhaps of foremost importance is the matter of whether PACE financing is properly characterized as a lien or a loan.[160] This distinction is critical because much of PACE financing's popularity derives from its priority over preexisting mortgages, which is in turn dependent on characterization as a government lien rather than a loan.[161] Notably, the DOE has emphasized that PACE liens "should not exceed ten percent of any given property's value, with a minimum threshold cost of $2500."[162] As long as state and local governments that implement PACE programs follow this guideline, the financing they provide will likely remain within the scope of their historically accepted assessment authority, avoiding classification as a loan.[163] Secondly, there is the matter of whether PACE financing substantially harms lenders when property owners default on their mortgages, as claimed by the FHFA, Fannie Mae, and Freddie Mac.[164] In response to this con-

155. *Id.* at 39–40.

156. *Id.*

157. *See, e.g.*, Elkind, *supra* note 11 ("Fannie and Freddie's concerns are overblown, and they should issue an immediate clarification and retraction. Federal guidelines for PACE programs already contain numerous safeguards to prevent losses, and in the event of a foreclosure, the government only gets paid back on the delinquent PACE payments, not the whole thing. And in any event, local governments have been using assessments for years for all sorts of public improvements, and Fannie and Freddie are calling into question that basic authority. When it comes to public improvements, you can't get any bigger than fighting climate change.").

158. Wilson et al., *supra* note 19, at 42.

159. Larson, *supra* note 15, at 615.

160. *Id.*

161. *Id.* at 615–16.

162. *Id.* at 617.

163. *Id.* at 618 ("[A] PACE assessment of twenty years at ten percent of a property's value falls well within the boundaries of a state's historically recognized assessment authority and thus should not be mischaracterized as a 'loan' simply by virtue of its size and scope.").

164. *Id.* at 610–11.

cern, PACE supporters have pointed to low default rates on property tax payments, noting that default rates with respect to property encumbered with PACE liens are often even lower than their normal counterparts.[165] Consequently, they argue that PACE programs are not likely to have a significant adverse impact upon mortgage lenders, provided that federally approved underwriting standards are followed.[166]

Most proposed solutions to the current controversy involve measures to bolster underwriting standards for PACE financing. Some have suggested that in order to secure mortgage lenders' positions, state and local governments should amend PACE legislation to explicitly codify the underwriting standards that have been recommended by the DOE.[167] Meanwhile, others suggest that the FHFA, Fannie Mae, and Freddie Mac could resolve the current controversy by simply agreeing to accept PACE-encumbered mortgages, but only those that comply with certain underwriting standards.[168] As mentioned previously, California has already amended its PACE statutes in order to codify stricter underwriting requirements for PACE liens.[169] Thus, while it seems that the federal lending entities' concerns about PACE programs were intensified by an overwhelming number of distinct state and local laws,[170] California's goal-oriented, innovative approach further underscores the importance of striking a balance between federal influence and state autonomy with regard to PACE financing.

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165. *Id.* at 621 ("There is no reason to suspect that the ratio of assessments to defaults will increase substantially from the current level of less than two percent. For example, in Sonoma County, California, the site of the country's largest PACE program, there has not been a single default on a PACE-encumbered home during its two-year existence; during that same period, however, the default rate for Sonoma County mortgages was seven percent.").

166. *Id.* ("In fact, none of the literature or argumentation by PACE critics has articulated an actualized harm to the industry: the entirety of the criticism has been based on what *could* occur, assuming that PACE boards fail to adopt or adhere to any of the recommended underwriting requirements. For this reason, PACE programs are unlikely to significantly impact lenders as long as federally approved underwriting standards are employed.").

167. *Id.* at 626.

168. *Id.* ("Such a limit on approved PACE loans would sufficiently protect lenders while allowing PACE lending to go forward.").

169. *Id.* at 627.

170. *Id.* at 628 ("Hyper-individualization may account for some part of the lending authority's overreaction: as PACE legislation swept the nation, federal lending agencies faced conflicting state-law issues of priority, registration, and constitutional law, but lacked an effective mechanism for resolving these issues.").

The ideal solution to the PACE controversy would involve measures that "meet[ ] the needs of mortgage underwriters, the secondary mortgage markets, and the communities that would issue supporting bonds yet still promote a simple, accessible financing platform for individuals and businesses to make clean energy and energy efficiency investments."[171] Nevertheless, if efforts directed toward a large-scale compromise ultimately fail, perhaps leaders should examine possible means of building upon the most successful aspects of PACE financing, rather than merely trying to preserve programs that may have already run their course. While PACE programs are not without their flaws, they have certainly attracted property owners to invest in alternative energy and helped to organize the market for energy improvement investments.[172] One potential method of improving PACE programs would be for local governments to obtain administrative funding by conditioning participation in the programs on the payment of more transparent direct fees, rather than including the costs of program administration in PACE liens.[173] Presumably, greater transparency regarding costs and funding would make PACE programs even more appealing to potential participants.[174] In addition, PACE programs would be more appealing if local governments could develop innovative ways to address not merely the upfront monetary costs of energy improvements, but the transaction costs, such as the costs related to finding and selecting an installer,[175] that program participants face when they must determine precisely how to spend the PACE funding that they receive. Expanding and regionalizing various existing PACE programs so as to combine lower-income communities with higher-income communities might be one way to address concerns about adequate funding and the level of participation within lower-income communities.[176] Finally, given that

171. Wilson et al., *supra* note 19, at 42.

172. Cox, *supra* note 57, at 116 ("Homeowners showed an increased willingness to make energy improvements when the local government solicited them to participate in an arranged and publicly sanctioned program. This market organization benefit may exist independent of the PACE financing model.").

173. *Id.* at 117 ("Transparency in costs and funding, along with accurate disclosure and promotion of the consequences of a PACE lien, should be a principle for developing sustainable residential energy investment programs.").

174. *Id.*

175. Eisen, *supra* note 4, at 88 ("Cities with programs in place have no municipal installers. So while the city provides the funding to the homeowner, she is still required to handle legal and technical responsibilities. . . . The real innovation would be to find a different institutional structure that avoids piecemeal policies and addresses the transaction costs for [homeowners].").

176. *See* Wiener & Alexander, *supra* note 2, at 586–90.

commercial PACE programs tend to raise fewer concerns from mortgage lenders, some local governments have simply opted to shift their focus to encouraging energy improvements on commercial rather than residential property.[177]

On the other hand, implementing PACE programs in a similar fashion yet on a more modest scale might be another alternative to instituting any kind of broad, fundamental changes. More modest PACE programs might not be as ambitious or transformative as their predecessors, but they could provide lawmakers with an opportunity to further analyze the advantages and disadvantages of the PACE financing model in a less problematic context.[178] More specifically, PACE programs with smaller financing[179] limits and shorter lien terms would probably be much more acceptable to federal mortgage lenders, who might be willing to concede traditional tax lien priority to state and local governments under these conditions.[180] Moreover, in light of the current controversy, modest, incremental goals may be more realistic and effective than grand regulatory aspirations.[181] The PACE financing model may open the door for similar innovative alternative energy and sustainability programs, but only if lawmakers are able to resolve the current controversy or devise effective methods of avoiding the issues that are at its roots.[182]

IX. Conclusion

The current controversy has left the future of PACE programs mired in doubt and uncertainty. Though its ultimate outcome remains far from certain, it represents an important opportunity to step back and critically examine the numerous advantages and disadvantages of PACE programs. A critical examination reveals that while state and local governments are best positioned to develop innovative programs like PACE, some degree of federal influence and authority is necessary to guard against potential conflicts and inefficiencies. In order for PACE

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177. Cox, *supra* note 57, at 117.

178. *Id.* at 121.

179. *Id.* at 120. "The value of the lien priority in permitting broader loan availability through reduced underwriting might also make more sense in the context of small loans. Smaller loans reduce the repayment burden on the homeowner and thus may be less likely to trigger tax forfeiture. Smaller risk assumption by mortgage lenders with reduced sized PACE financing would limit the impact on overall mortgage lending criteria or costs charged to borrowers." *Id.*

180. *Id.* at 118 (suggesting that a financing limit of $4,000 and a lien term of ten years or less might be reasonable solutions).

181. *Id.* at 121.

182. Wilson et al., *supra* note 19, at 42.

programs to be truly successful, lawmakers must strike an effective balance between state and local autonomy and coordination between the various levels of government. Similarly, lawmakers must arrive at a compromise that adequately meets the needs of all parties involved. As many have suggested, it is possible that the codification of stricter federal underwriting standards would go a long way toward resolving many of the issues at the root of the current controversy.

Regardless of their ultimate fate, PACE programs have already had a significant impact on legislation and regulation with respect to alternative energy and sustainability throughout the United States. Even if a large-scale compromise is not readily attainable, perhaps more modest measures will be sufficient to perpetuate and build on PACE financing's most beneficial aspects. Indeed, it is possible that PACE programs instituted on a more modest scale with regard to the amount of funding and the duration of liens could achieve their intended purpose while largely avoiding the controversial implications of their predecessors. In any case, PACE programs represent an important step in the march toward a future of increased alternative energy use and sustainability. At the very least, they will continue to engender fruitful dialogue and encourage innovative thinking and policymaking with respect to energy issues. In fact, perhaps the promotion of a political climate characterized by open dialogue and innovation is more important than any particular policy development in isolation. After all, given that there is no panacea with regard to alternative energy, each and every instance of progress is valuable and contributes to the larger goal of a more sustainable future.