



**Municipal Financing of Renewable Energy and Energy Efficiency  
Improvements on Private Property  
(February 1, 2009)**

***Political Interest in Energy Independence and Emission Reduction.*** In September 2006, Governor Schwarzenegger signed Assembly Bill 32, which requires California's global warming emissions to be reduced to 1990 levels by 2020. On November 7, 2006, more than 80% of the voters in the City of Berkeley voted in favor of a ballot initiative, Measure G, that established a goal of 80% reduction in greenhouse gas emissions by 2050. AB 32 and Berkeley's Measure G are two examples of growing political support for energy independence and greenhouse gas reduction. One available tool for achieving these goals is widespread adoption of grid-connected, rooftop photovoltaic systems.

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***Barriers to Adoption.*** However, there are perceived to be a number of barriers to widespread adoption of renewable energy systems on residential and commercial buildings in California. For example, in early-2008, Berkeley had the third-highest number of solar installations in Northern California, but that was only 400 installations for 50,000 parcels. One of the perceived barriers is the high up-front cost of installation. Other potential financing barriers are personal credit scores and the due-on-sale nature of traditional bank financing (where the unpaid principal balance is payable to the lender when a property is sold).

***Special Tax Financing of Renewable Energy and Energy Efficiency Improvements.*** In response, Berkeley asked whether it could provide 100%, property-based financing for photovoltaic systems in the same way that properties in Berkeley are able to finance 100% of the cost of municipal improvements such as streets, sewer and utility undergrounding.

In mid-2008, under its authority as a charter city, Berkeley adopted a special tax financing code, which is modeled on the Mello-Roos Community Facilities Act of 1982 but authorizes financing of renewable energy and energy efficiency improvements on private property (the Mello-Roos Act already authorizes special tax financing for seismic and structural work on private property). In late-2008, the City and County of San Francisco adopted an identical special tax financing code using its charter powers. Under the special tax financing model, property owners pay for authorized improvements through a special tax levy on their property tax bills. The special tax obligation is not a personal obligation of the participating property owners, but is secured by a lien recorded on each participating property. In the event a property is delinquent in the payment of special



taxes, the property will be subject to foreclosure by the county. Participation in the program is voluntary.

Berkeley is currently conducting a \$1.5 million pilot program. Property owners that choose to participate must apply for a rebate from the California Solar Initiative (CSI), and Berkeley will finance the difference (up to \$37,500 in the pilot program) between the total installation costs and the CSI rebate. Berkeley will confirm, based upon signed electrical inspection permits and final installation invoices, that authorized improvements are actually installed before releasing financing. Berkeley is only financing photovoltaic systems and mandates participation in the CSI program because it allows the City to piggyback on the CSI program with respect to qualification of improvements and installers.

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Berkeley is issuing a separate bond to finance installation costs for each property. The interest on the bonds will not be exempt from federal income taxation but will be exempt from State of California personal income taxation. The maturity date for each bond will be 20 years from its issuance. The bonds are expected to be paid from the special tax revenues received by Berkeley as a result of the levy of special taxes on all of the participating properties. Each property's special tax obligation will be equal to (i) the cost of amortizing that property's financed improvements over 20 years, with interest and (ii) special tax and bond administration costs.

On September 17, 2008, the California legislature enrolled AB 1709 (Hancock), which was modeled on Berkeley and San Francisco's special tax financing codes and would have allowed all local agencies in California to undertake Berkeley and San Francisco-style programs. On September 27, 2008, AB 1709 was vetoed by the Governor. AB 1709 is expected to be re-introduced in the 2009-10 legislative session, perhaps on an urgency basis.

***Special Benefit Assessment Financing of Renewable Energy and Energy Efficiency Improvements.*** On a parallel path, the City of Palm Desert, also a charter city, undertook a similar financing program and was instrumental in the adoption of Assembly Bill 811 in the 2007-08 legislative session. Palm Desert's program and AB 811 use special benefit assessments to achieve the same result as the special tax financings described above. Palm Desert has made more than 50 loans from its general fund using the assessment model not only for solar improvements but also for high-efficiency air conditioning systems.

***Challenges for Municipal Financing.*** Municipal financing of renewable energy and energy efficiency improvements raises a number of issues, including the following:



Existing mortgages. Most property owners finance the purchase of their property with a loan from a commercial lender, and the loan is secured by a deed of trust. Most deeds of trust limit senior liens. Liens securing special taxes and assessments are senior liens that are on a parity with the *ad valorem* property tax lien. This means that, in the event of a default, foreclosure proceeds will be used to satisfy special tax, assessment and property tax obligations before they are used to pay private loans. It is important for each property owner to confirm that it is not violating its existing deed of trust by participating in a municipal financing of renewable energy and energy efficiency improvements. Particularly in the non-residential context, deeds of trust may contain due-on-further-encumbrance provisions.

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Federal energy tax credit. Federal energy tax credits are available for qualified photovoltaic systems that are placed in service from January 1, 2006 through December 31, 2016. The tax credit is equal to 30% of the cost of the system. However, the credit is not available if the improvements were financed through a “subsidized energy financing,” which may include municipal financing programs modeled on the Berkeley and Palm Desert programs. The “subsidized energy financing” limitation may be eliminated from federal tax law as part of the economic stimulus bills in early-2009.

Federal tax exemption and tax credits. Interest on special tax and assessment bonds issued to finance renewable energy and energy efficiency improvements to private property is not exempt from federal income taxation. Efforts to change federal tax law to secure federal tax-exemption have not, so far, been successful. However, in October 2008, Congress authorized \$800 million of Qualified Energy Conservation Bonds (QECBs), which are tax credit bonds that can be issued to finance government initiatives designed to reduce greenhouse gas emissions. The \$800 million will be allocated to states, municipalities and tribal governments, and a portion of the allocation may be issued as private activity bonds. The \$800 million authorized volume may be increased as part of the economic stimulus bills in early-2009.

Program costs. Municipal financing is typically used to finance large public infrastructure projects and the financing costs are spread among a large number of taxpayers/ratepayers. It may be difficult to reduce financing costs when municipal financing is used to finance energy efficiency and renewable energy improvements for a small number of properties. For example, in a special tax financing like Berkeley’s, costs include: City staff time, bond counsel/disclosure counsel fees and expenses, financial advisor fees, underwriter costs,



initial and annual special tax administration fees and expenses, county tax levy charges (1.8% in Alameda County) and trustee fees and expenses. These costs can be prohibitively expensive unless they can be absorbed by a large number of properties.

Lender Market. Berkeley is privately placing \$1.5 million of pilot program bonds; the purchaser has the right to aggregate and remarket the bonds in \$100,000 denominations subject to certain restrictions. Palm Desert used general fund moneys to finance its initial loans. Why aren't these bonds being sold as traditional land-secured bonds in the public market? One reason is the lack of liquidity in the municipal bond market. Another reason is that special tax/assessment financings of renewable energy and energy efficiency improvements are a hybrid of property-specific commercial loans and traditional municipal infrastructure financings. Cities cannot issue bonds in anticipation of property owners signing up in the future to finance improvements because the costs of carrying the bonds would be prohibitive and because the bonds may not be marketable until the participating properties have been identified. On the other hand, cities may not wish to wait to issue bonds until they have a critical mass of participating properties for two reasons: (i) waiting would force property owners to either delay installation or finance installation themselves in anticipation of reimbursement and (ii) waiting could cause large numbers of installations to occur concurrently with or immediately following financings, which could be a competitive disadvantage for small (often local) installers with limited manpower.

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***Differences Between Special Tax and Assessment Financing.*** There are a number of differences between AB 1709 (as proposed) and AB 811:

1. AB 811 is only available to finance improvements to existing structures.
2. AB 811 is subject to Proposition 218 (California Constitution Article XIID), which introduces burdensome and unnecessary procedures into a process where all of the assessed properties have elected to participate.
3. Differences between how assessments and special taxes are levied could impact remedies available to pre-existing lenders, particular commercial lenders.
4. AB 811 may not be available to assist with financing schemes in which the improvements are owned by third parties and leased to property owners, which reduce costs by maximizing accelerated depreciation and available tax credits.

***Questions?*** Jones Hall is acting as bond counsel to Berkeley and San Francisco and other municipal entities working on solar financing programs,



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and is also working to implement regional solutions. Jones Hall wrote Berkeley's and San Francisco's special tax financing codes, and was the principal drafter of AB 1709. Please contact Chris Lynch with any questions: 415-391-5780; [clynch@joneshall.com](mailto:clynch@joneshall.com).

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