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Transferring PACE Assessments Upon Home Sale

By Jason Coughlin*, Merrian Fuller**, and Mark Zimring**

A significant barrier to investing in renewable energy and comprehensive energy efficiency improvements to homes across the country is the initial capital cost. Property Assessed Clean Energy (PACE) financing is one of several new financial models broadening access to clean energy by addressing this upfront cost issue.

Recently, the White House cited PACE programs as an important element of its "Recovery through Retrofit" plan.[1] The residential PACE model[2] involves the creation of a special clean energy financing district that homeowners elect to opt into. Once opted in, the local government (usually at the city or county level) finances the upfront investment of the renewable energy installation and/or energy efficiency improvements. A special lien is attached to the property and the assessment is paid back as a line item on the property tax bill.[3] As of April 2010, 17 states have passed legislation to allow their local governments to create PACE programs, two already have the authority to set up PACE programs, and over 10 additional states are actively developing enabling legislation.

This policy brief analyzes one of the advantages of PACE, which is the transferability of the special assessment from one homeowner to the next when the home is sold. This analysis focuses on the potential for the outstanding lien to impact the sales negotiation process, rather than the legal nature of the lien transfer itself.

Potential Benefits of the Transfer of the PACE Assessment upon Sale

PACE programs address the short-term time horizons that prevent many homeowners from making renewable energy and energy efficiency improvements. Although these improvements can frequently

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*National Renewable Energy Laboratory (NREL) **Lawrence Berkeley National Laboratory (LBNL)
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[1] The October 2009 report "Recovery Through Retrofit" produced by Vice President Joe Biden's Middle Class Task Force is available here: http://www.whitehouse.gov/assets/documents/Recovery_Through_Retrofit_Final_Report.pdf
[2] In many cases, PACE assessments can be placed on both residential and commercial properties. In this memo, we focus on residential properties because that is where there is the most experience to date.
[3] For more detailed information on PACE financing programs, please visit: http://www.eecbg.energy.gov/solutioncenter/financialproducts/PACE.html

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yield cost savings for more than 20 years, it is often difficult for homeowners to break even on their investments if they plan to occupy the home for a shorter time period.

PACE programs have the potential to eliminate this investment hurdle by allowing the special assessment to transfer with ownership (similar to other property assessments). By allowing for a longer repayment period, the goal is for the savings generated by the individual renewable energy and energy efficiency project to exceed the cost of the special assessment payments. The useful life of the investment should also exceed the repayment term of the special assessment so that the homeowner continues to benefit even after repaying the lien. When a home is sold, the outstanding assessment transfers with ownership, and the subsequent owner accrues both the savings associated with the original investment as well as the cost of the remaining special assessment payments.

A photovoltaic (PV) system or a house with high-efficiency features also may be a strong selling point and may increase the value of the property. Indeed, these features may distinguish one home from others in a tough real estate market because electricity bills will be lower than comparable houses. Finally, there may be other less tangible benefits associated with the cache of owning a "green" home.

Some anecdotal evidence supports greater demand for energy efficient homes as buyers are increasingly aware of the true operating costs of homes with varying levels of efficiency improvements or a renewable energy system.[4] However, the actual dollar value that a PV system or energy efficiency improvements add to the selling price of a home remains an outstanding issue that requires additional research. As more homeowners install renewable energy systems and make energy efficiency investments (whether using PACE financing or some other mechanism), a greater number of homes will eventually be sold that have these features. This information will then provide the necessary data to make more definitive statements about the incremental value of such improvements.

Potential Issues with Transfer of the PACE Assessment

Special assessments attached to properties as liens have been a common method of financing improvements to local infrastructure for quite some time.[5] Common uses of the special assessment financing include paving roads, burying power lines, extending public services into neighborhoods, and seismic retrofits. The annual cost of traditional special assessments varies tremendously. For example, according to the San Diego County Assessor's office, in 2006, Mello-Roos district [6] annual assessments per property in the county ranged from $174 to $3,000, with an average of $1,488.[7]

[4] "Certified Home Performance: Assessing the Market Impacts of Third Party Certification on Residential Properties." May 2009. Griffin, Ann. Earth Advantage Institute. http://www.earthadvantage.org/uploads/GBVI_Report.pdf

[5] A lien is a legal claim against property that secures the repayment of debt or some other obligation. There is a variety of liens, both voluntary (e.g., a mortgage lien) and involuntary (e.g., a property tax lien).

[6] Mello-Roos districts are established by local governments in California to finance specific public facilities and services such as schools, roads, and libraries. Mello-Roos districts were authorized by state law in 1982, which allows any public agency to establish a Mello-Roos district for the purpose of issuing the necessary tax-exempt bonds and imposing fees to pay off these bonds. Mello-Roos definition and tax information were accessed from the San Diego County Assessor's Office Web site: http://arcc.co.san-diego.ca.us/arcc/taxbills.aspx.

[7] This average is assumed to include commercial assessments, so the average annual assessment for residential homes is likely to be less.

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PACE special assessments are unique in that property owners have the ability to opt-in individually to a special district and the eligible uses of the funds, which can include energy efficiency, renewable energy improvements, and water conservation measures to private property.[8] Although other special assessments appear as line items on a homeowner's property bill, they are unlikely to be as directly identifiable to a particular investment as a PACE lien.

As a result, the possibility that this outstanding lien becomes part of the sales negotiation process should be considered. This is likely to be more of a concern with higher-cost PACE-financed investments such as PV systems, although a PACE-financed project that involves a comprehensive energy efficiency retrofit project, including high-cost energy efficiency improvements (e.g., new windows), also may result in a relatively large PACE special assessment. If the purchase price of the home is reduced to compensate for the outstanding lien that remains with the house, the seller will likely experience a lower return on investment than expected, depending on the terms of the sale.

A second possibility is that the lien is repaid by the seller as a condition of closing. In other words, even though the original capital cost barrier was addressed when the project was installed, the reduction in the proceeds from the sale of the home to compensate for the lien creates an exit cost for the seller. This cost could be substantial depending on how the prospective homebuyer views the project and the associated assessment, as well as who holds the stronger bargaining position given the condition of the local real estate market.

PACE programs have not been in existence long enough to make any definitive statements about the impact of the special assessment on the final selling price of a given home. It is possible that the majority of liens will transfer to the new homeowner without any material changes or adjustments to the purchase price; this is especially true if the original PACE assessment was modest or if the original lien has been materially reduced over time as repayments are made. For those with no intention of moving during the term of the PACE financing, it is a nonissue. Nor is it likely to be a major issue in a robust real estate market with many interested buyers. However, in a depressed real estate market, buyers may be scarce. In these cases, the outstanding lien may become part of the sales price negotiation process.

In the PACE program of Boulder County, Colorado, one home with a PACE lien has sold to date. This assessment included a PV system. In this instance, the lien was paid off by the seller as a condition of the sale.[9] The original homeowner received the full benefit of the residential investment tax credit for the PV system, which was apparently a factor in the negotiation process.[10] While one example is not representative of what will occur across a broader collection of PACE programs, it does indicate that program administrators should be cognizant of this issue as they conduct their outreach efforts.

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[8] While the investments themselves are made to private property, the public benefits of PACE programs could include (depending on location) improved air quality, a reduction in greenhouse gas emissions, reduced energy dependence, and local economic development, including job creation.

[9] February 2010 e-mail communications with Boulder County PACE program administrators.

[10] In the ClimateSmart program, the lien is not reduced by a participant's ability to benefit from the 30% Income Tax Credit (ITC).

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Conclusion

The goal of this paper is to consider what implications a PACE lien may have on the home sales negotiation process so that it can be addressed upfront rather than risk a future backlash to PACE programs. If PACE programs do expand at a rapid rate, the chances are high that there will be other cases where prospective buyers uses PACE liens to negotiate lower home prices or require repayment of the lien as a condition of sale. As a result, PACE programs should highlight this issue as a potential risk factor for the sake of full disclosure. A good example of this is in Boulder County where the following statement is included in the ClimateSmart PACE program materials:

> ***Please Note:*** *There is no legal requirement that the loan be paid off when you refinance or sell your home. However, this may be an item subject to negotiation with a future buyer and may also be a matter of negotiation with the mortgage lender.*[11]

Such candid disclosure for what might be a low risk event can be debated. However, a selling point of PACE programs is the transferability of the lien to the new homeowner. To the degree this benefit is questioned, PACE programs may end up looking more like home equity loan financing, with the associated debt repaid at closing, rather than property-based financing that remains with the improved home. While it is possible that upfront disclosure might negatively impact participation rates in PACE programs, it also will protect the integrity of a PACE program in later years if such situations come to pass. Ideally, this will become less of an issue over time as more homebuyers understand the positive economic and societal benefits of owning a home with clean energy features.

[11] ClimateSmart Loan Program's FAQs: http://www.bouldercounty.org/bocc/cslp/FAQ/About.htm