

Client Alert

Latham & Watkins Finance Department
Environment, Land & Resources Department

California Assembly Bill 811: New Financing Opportunities for Renewable Energy and Energy Efficiency Installations

Introduction

In recent years, many factors have encouraged developers increasingly to consider incorporating renewable energy and energy efficiency features into their development projects. The State of California has established significant legislative and regulatory requirements for installing these features; consumer demand for "green" residential and commercial buildings is burgeoning; and new city and county programs on green design have brought energy-efficiency concerns to the forefront of development planning. Pending regulations to control greenhouse gas emissions under the California Global Warming Solutions Act of 2006, commonly known as Assembly Bill (AB) 32, combined with evolving requirements to mitigate greenhouse gas emissions under the California Environmental Quality Act (CEQA), heighten the need to consider incorporating renewable energy and energy efficiency features into development projects.

Incorporating renewable energy or energy efficiency features into a project may prove costly enough potentially to undercut a development project's viability. Tax incentives under US federal and state programs, such as the California Solar Initiative, however,

may now help make these features more cost-effective. AB 811, enacted in July 2008, also promises to advance the availability of these features by authorizing cities and counties to provide property owners with below-market loans for renewable energy and energy efficiency improvements.¹ AB 811 permits California cities, counties, or any city/county combination (referred to herein collectively as "cities," and individually as a "city") to establish assessment districts and finance the installation of renewable energy resources or energy efficiency improvements for willing property owners.

Since the effective date of AB 811, a few cities have established or are establishing AB 811 financing programs, including Palm Desert and Solana Beach, and more are expected to implement such programs in 2009.

Renewable Energy and Energy Efficiency Features in California

Requirements and incentives for including renewable energy and energy efficiency features in a development project in California stem from many sources, including: (i) suggestions for reducing greenhouse gas emissions

"AB 811 provides a new financing option for permanent renewable energy and energy efficiency improvements to developed property."

under AB 32;² (ii) mitigation measures under CEQA;³ (iii) voluntary green building programs, such as Leadership in Energy and Environmental Design (LEED) and the National Association of Home Builders' Green Building Program; and (iv) requirements under Senate Bill 1 (2006), which is part of the Million Dollar Roofs Initiative, for provision of solar options for certain projects with 50 or more single-family residences.⁴

Despite existing tax and other incentive programs for renewable energy and energy efficiency installations, costs of renewable energy and energy efficiency installations continue to increase, and financing such installations remains a challenge. AB 811 provides a new source of financing for some of these installations.

Legislative Summary of AB 811

Financing Through Contractual Assessments

AB 811 authorizes cities essentially to create an "assessment district" in order to finance "distributed generation renewable energy sources or energy efficiency improvements," but only those which are permanently fixed to residential, commercial, industrial or other real property, and excluding appliances.⁵ The city may obtain funds from any available source, including the issuance of bonds, and use the funds to finance the improvements directly or loan such funds directly to eligible property owners. The costs of such funds will depend on the city's source of capital. Property owners receiving AB 811 financing may (i) obtain authorization from the city to purchase the equipment and materials for installing improvements directly, and (ii) contract directly for installation of such improvements or, if established by the city, purchase such improvements from or through the city.⁶

The principal and interest of any bonds issued under AB 811 shall be paid from contractual assessments levied on and collected from property within the assessment district created under the AB 811 statute.⁷

Property owners installing eligible improvements must repay the financed amount through contractual assessments included in their property tax bills. AB 811 assessments may only be levied with the consent of the owner of each lot or parcel on which an assessment is levied at the time of assessment,⁸ and the assessments, including interest and any penalties, constitute a lien against the lots and parcels on which they are made, until they are paid off.⁹

AB 811 does not apply to property undergoing development.¹⁰ An AB 811 assessment must be levied after the property is developed.¹¹ This rule, however, does not prevent developers who still own their property after developing it from taking advantage of AB 811 financing.

Procedure for Establishing the AB 811 Financing Program

In order to establish a financing program under AB 811, a city's legislative body must first adopt a resolution that includes, among other things, a description of the boundaries of the area designated for the financing program, a list identifying the kinds of renewable energy and energy efficiency improvements that the program will finance, and an explanation of the city's plan to raise the capital amount for the work to be performed.¹² The city must subsequently hold a public hearing and present its report on the details of the proposed financing program at such hearing. All interested persons may attend the public hearing and object to or question the proposed financing program. Following such hearing and consideration of objections to or questions about the proposed financing program, the city's legislative body shall

either adopt the report as presented, direct that the report be modified and thereafter adopt the report as modified, or abandon the proceedings.¹³

The process by which property owners and/or developers opt into an approved AB 811 assessment district and financing program is not governed by statute but rather is expected to be dictated by individual financing programs and policies established by each participating city's legislative body. **It is worth noting, however that participation in such an assessment program may limit, or even eliminate, a party's eligibility to benefit from the federal energy and/or investment tax credits offered under Internal Revenue Code Sections 48 and 46, respectively.**

Existing Financing Programs Under AB 811

With the passage of AB 811, a number of cities—ranging from Napa to San Diego—are considering the creation of an AB 811 financing program for renewable energy and energy efficiency improvements.¹⁴

The City of Palm Desert's Energy Independence Program (EIP), which the Palm Desert City Council adopted in August 2008,¹⁵ is the most developed and comprehensive model of an AB 811 financing program because it encompasses the broadest range of available financing. The following overview of the EIP is based on information provided in the staff report for the City Council resolution adopting the EIP under AB 811.¹⁶

Palm Desert's Office of Energy Management administers the EIP and makes loans available to owners of developed property in Palm Desert who pay property taxes. EIP loans are available for a broad range of energy efficiency improvements, solar systems, and custom energy measures (Energy Improvements). If solicited, the Office of Energy Management offers property

owners advice about potential Energy Improvements, their estimated costs, and potential savings through the EIP.

Palm Desert property owners may request EIP loans for buying and installing Energy Improvements by submitting an application to the Office of Energy Management. Installation costs for Energy Improvements may include but are not limited to labor, drafting, engineering, permit fees and inspection charges. Either a qualified contractor or the property owner can complete installations. The Office of Energy Management reviews the submitted applications on a first-come, first-served basis to determine, among other things, that the applicant owns the property, that the proposed improvements are eligible for an EIP loan, and that the costs of the Energy Improvements are reasonable. If the Office of Energy Management approves the application, then the city and property owner can enter into a contractual assessment agreement.

Energy Improvements must be completed within 180 days after executing a contractual assessment contract. The Office of Energy Management disburses EIP loan funds to the property owner after determining that the Energy Improvements have been satisfactorily completed.

To finance the EIP loans, Palm Desert established an Energy Independence Loan Program Fund that may accept funds from any available source. Assessment installments are deposited into the Energy Loan Program Fund and may be used to reimburse Palm Desert for advances into the Energy Loan Program Fund or to make EIP loans. The aggregate dollar amount of all of the contractual assessments made for Energy Improvements is limited to \$25 million.

The Palm Desert City Council initially appropriated \$2.5 million from Palm Desert's General Fund to the Energy Loan Program Fund. At least \$1.25

million of this amount has been reserved for EIP loans to residential property owners.¹⁸

For loans made from the initial \$2.5 million, the Palm Desert City Council states that the interest rate won't exceed 7 percent.¹⁹ For subsequent EIP loans, the City Council may set the interest rate at no more than 10 percent. The term of the loans cannot exceed 20 years.

Other cities are following in the steps of Palm Desert. For example, the City of Solana Beach just recently initiated its program by issuing a Request for Proposal (RFP) from firms for design, administration, marketing and financing services for an AB 811 program.²⁰ In addition, the City of San Diego Mayor Jerry Sanders has proposed an AB 811 solar financing program, which the San Diego City Council will soon consider adopting. The County of San Diego and the Cities of Encinitas and Napa are also considering enacting AB 811 financing programs. Additional cities will likely propose AB 811 programs in the upcoming months.²¹

Opportunities to Expand the AB 811 Premise

As noted previously, AB 811 does not apply to properties still in the pre-development or development stages; it applies only to properties that are already developed. Thus, only owners of developed property who want to install renewable energy and energy efficiency improvements after initial development can take advantage of an AB 811 financing program.

Limiting the recipient pool for AB 811 financing restricts its ability to promote new energy-efficient development. One possibility for expanding the AB 811 premise is to make financing available to properties in pre-development or development stages and/or expand the list of facilities eligible to be financed

by other California financing programs to include facilities promoting energy-efficient development. For example, in 2008, the California legislature voted for Assembly Bill 1709, which, if approved, would have added renewable energy and energy efficiency improvements to the types of facilities that may be financed by a community facilities district under the Mello-Roos Community Facilities Act. Although Governor Schwarzenegger vetoed the bill, similar legislation will likely be proposed in the future.

AB 811's goal of promoting energy-efficient development could also influence the arena of redevelopment law, inspiring changes to be made in order to permit redevelopment agencies to use tenant improvement funds to finance energy-efficient improvements on private property. Such changes would permit funding of a wider array of energy-efficient projects needed to support California's population and economy without burdening individual property owners with application and direct payment obligations. Redevelopment agencies could use such funding for, among other things, renewable energy and energy efficiency upgrades to affordable housing within a redevelopment area.

Conclusion

AB 811 provides a new financing option for permanent renewable energy and energy efficiency improvements to developed property. By authorizing cities to establish programs that offer the opportunity to finance renewable resources secured by contractual property assessments to fund these improvements, AB 811 provides property owners with financing alternatives when available financing and/or costs of such improvements might otherwise be prohibitive. Other cities are likely soon to emulate Palm Desert in establishing AB 811 financing programs.

Just as the number of AB 811 financing programs will likely multiply, the scope of the AB 811 premise may also expand, allowing contractual assessment financing to become available to properties in pre-development or development stages and allowing redevelopment agencies to directly finance such improvements. Expansion of AB 811 programs would help promote and make more common renewable energy and energy efficiency improvements throughout the state, consistent with the goals of legislative and regulatory mandates such as the Million Solar Roofs Initiative and AB 32.

Endnotes

¹ Cal. Sts. & High. Code §§ 5898.12-5898.14 & 5898.20-5898.32.

² See Cal. Air Res. Bd., *Climate Change Scoping Plan* (approved Dec. 11, 2008).

³ Office of the Att’y Gen., *The California Environmental Quality Act: Addressing Global Warming Impacts at the Local Agency Level* (updated Dec. 9, 2008).

⁴ Cal. Pub. Res. Code § 25405.5.

⁵ Cal. Sts. & High. Code §§ 5898.12, 5898.20(a).

⁶ *Id.* § 5898.21.

⁷ *Id.* § 5898.28.

⁸ *Id.* § 5898.12(e).

⁹ *Id.* § 5898.30.

¹⁰ *Id.* § 5898.12(c).

¹¹ *Id.* § 5898.12(a).

¹² *Id.* § 5898.20.

¹³ *Id.* § 5898.26.

¹⁴ See Jeff Quackenbush, *Going Green: AB 811 Offers Agencies Route to Finance Energy Upgrades*, North Bay Business Journal, Oct. 6, 2008, available at <http://www.pressdemocrat.com/article/20081006/BUSINESSJOURNAL/810050245>; Mike Lee, *Solar Plan for San Diego: Sanders Promotes Financing Program*, San Diego Union Tribune, Dec. 5, 2008, available at http://www.signonsandiego.com/uniontrib/20081205/news_1n5solar.html.

¹⁵ Palm Desert Resolution 08-89, available at <http://www.cityofpalmdesert.org/Index.aspx?page=484> (last visited Feb. 10, 2009).

¹⁶ See City of Palm Desert, Staff Report, Consideration of Adoption of Resolution No. 08-89 in Connection with Establishing the City of Palm Desert Energy Independence Loan Program (Aug. 28, 2008).

¹⁷ Applications, loan contracts, and other EIP forms and materials are available on Palm Desert’s Web site. See City of Palm Desert, Energy Independence Program, available at <http://www.ci.palm-desert.ca.us/Index.aspx?page=484> (last visited Feb. 10, 2009).

¹⁸ Additional information on EIP loan restrictions and parameters are available on the Palm Desert Web site. See City of Palm Desert, Energy Independence Program, available at <http://www.ci.palm-desert.ca.us/Index.aspx?page=484> (last visited Feb. 10, 2009).

¹⁹ As stated previously, at least \$1.25 million of the initial \$2.5 million will be reserved for EIP loans to residential property owners.

²⁰ See City of Solana Beach, RFP—Solar Energy Program, Admin Support (3/13/2009), available at <http://www.ci.solana-beach.ca.us/newsdetail.asp?ID=239> (last visited Feb. 3, 2009).

²¹ In November 2007, the City of Berkeley launched a similar financing program that predated AB 811. Berkeley was able to launch this program before AB 811’s enactment due to its status as a charter, rather than general law, city. The program, entitled Berkeley Financing Initiative for Renewable and Solar Technology (Berkeley FIRST), is initially designed to fund up to forty photovoltaic solar panel installations on residential or commercial properties through city-provided loans.

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