

# AB 811: The Promise and Challenge of Public Agency Financing for Private Renewable Energy and Energy Efficiency Improvements

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## I. INTRODUCTION

The Legislature enacted AB 811 as an urgency measure in July 2008 to authorize public agencies to establish programs to finance renewable energy and energy efficiency improvements on private property.<sup>1</sup> Under this law, once a public agency establishes such a program, a property owner can obtain public agency financing for renewable energy or energy efficiency improvements on the property in exchange for consent to the levy of an assessment on the improved property for the cost of the improvements. The assessment is paid in annual installments concurrently with property taxes pursuant to a contract between the public agency and the property owner.<sup>2</sup>

The City of Palm Desert worked with the Legislature to draft AB 811 as a tool for meeting carbon emission reduction goals.<sup>3</sup> Soon after the statute's adoption, Palm Desert and the County of Sonoma launched AB 811 programs and began financing renewable energy and energy efficiency improvements on private property throughout their respective jurisdictions. In both locales, property owners have been eager to take advantage of the programs.<sup>4</sup>

This "green" public financing tool has broad political appeal that crosses party lines. In the Assembly, Sonoma County is represented by Democrats and Palm Desert is represented by a Republican. As described

in a Palm Desert publication, from a local government's perspective, the AB 811 program "helps your residents and businesses cut their energy costs, helps you meet environmental objectives and reduce your carbon footprint, helps your local utility meet its energy savings and renewable energy goals and pays for itself and costs you nothing."<sup>5</sup>

Why, then, are there few AB 811 programs operating in the state? Although the Palm Desert and Sonoma County programs have tremendous public support, the economic climate and legal uncertainties arising from the novelty of this new public financing tool are limiting implementation in many other jurisdictions.

## II. AB 811 OVERVIEW

AB 811 is fairly straightforward. It amended Chapter 29 of Part 3 of Division 7 of the Streets and Highways Code (commencing with Section 5898.10), which already allowed for contractual assessment financing for public improvements where the costs and time delays in creating an assessment district pursuant to other authority would be prohibitively large relative to the cost of the public improvements to be financed.<sup>6</sup> AB 811 expanded Chapter 29 to promote financing of the installation of distributed generation renewable energy sources and energy efficiency improvements that are permanently fixed to residential, commercial, industrial or other real property.<sup>7</sup>

To establish an AB 811 program, a public agency must adopt a resolution of intention that directs the preparation of a report on the program and establishes a public hearing date. The process does not involve an election or majority protest hearing because the assessments are imposed pursuant to an agreement with the property owner. Instead, the process requires a public hearing that provides the community with an opportunity to be heard on the program. The report must establish guidelines for administration of the program and include: a map of the territory within which the contractual assessments are proposed; a plan for raising capital to finance the improvements; and a form of the assessment agreement to be executed by the public agency and the property owner.<sup>8</sup> Once the program has been adopted, the agency can begin executing assessment agreements and financing improvements.

As amended by AB 811, Chapter 29 authorizes public agencies to finance distributed generation renewable energy sources such as solar energy systems, as well as energy efficiency improvements such as installation of an efficient heating, ventilating and air conditioning system or a tankless water heater.<sup>9</sup> The only prerequisite for the latter is that the improvements be permanently fixed to real property. This leaves wide discretion for public agencies to define the type of improvements to be financed.

### III. WHY WAS AB 811 NEEDED?

Prior to the adoption of AB 811, charter cities, such as Palm Desert, likely could finance energy efficient improvements to an owner's property.<sup>10</sup> However, it was less certain whether such cities had the authority to be repaid with property taxes and to secure the repayment obligation with a lien that is superior to pre-existing private liens.<sup>11</sup> Thus, the Legislature adopted AB 811 to expressly authorize public agencies to secure the property owner's obligation to repay such financing with a superior priority lien against the improved property.<sup>12</sup>

As recognized by the Legislature, energy conservation efforts, including the promotion of energy efficiency improvements to real property, are necessary to address the issue of global climate change. However, the upfront cost of making real property more energy efficient prevents many property owners from making those improvements. As a result, the Legislature adopted AB 811 to make energy efficiency and renewable energy improvements "more affordable and to promote the installation of those improvements."<sup>13</sup>

Financing programs offered by public agencies under Chapter 29 provide benefits to property owners that generally are not found in conventional financing. For example, under Chapter 29, agencies have discretion to establish a repayment schedule that is generally longer than conventional financing.<sup>14</sup> Both Palm Desert and Sonoma County offer repayment terms of up to 20 years as compared to the 5 to 7 year conventional financing term.<sup>15</sup> In addition, unlike conventional financing that must be repaid upon sale of the property, the contractual assessment remains with the property.<sup>16</sup> A public agency assumes a relatively small amount of risk in providing the financing because contractual assessments are paid concurrently with property taxes and have the same lien priority, penalties and remedies as property taxes in the event of delinquency and default.<sup>17</sup>

### IV. WHY DO SO FEW AB 811 PROGRAMS EXIST?

As a new public financing tool, AB 811 financing raises economic and legal issues that still need to be sorted out. This sorting out process places significant demands on a public agency's resources and requires a commitment from the agency's legislative body and administrative officials.<sup>18</sup>

#### A. ECONOMIC ISSUES

To begin with, a public agency needs a source of capital to provide property owners with funds for their improvements and to pay

for administrative costs of the AB 811 program. These resources are difficult to come by in an economic climate that has many public agencies making significant budget cuts to deal with declining tax revenues.<sup>19</sup> Moreover, the current trend of declining property values has resulted in a financial market reluctant to provide land-secured financing to public agencies.<sup>20</sup> Therefore, it appears that few public agencies currently have the financial resources to implement AB 811 programs.

#### B. LEGAL ISSUES

In addition to the economic limitations, AB 811 financing raises legal questions. Contractual assessments do not look like traditional benefit assessment financing. The payment of a traditional benefit assessment is compulsory in the absence of a majority protest by the property owners within the proposed assessment district. Also, with very few exceptions, benefit assessments finance public improvements that specially benefit certain properties.<sup>21</sup> In contrast, an AB 811 contractual assessment financing arrangement requires the property owner to request financing for an improvement on that owner's property, and the property owner must agree to the levy of an assessment on the improved property.<sup>22</sup> These differences raise constitutional questions as to the validity of a statute that affords voluntary contractual assessments the same superior lien priority as compulsory assessments. Specifically, the Legislature's authority to adopt AB 811 is subject to constitutional limitations including: (i) the legislation must be a valid exercise of the State's police power; (ii) the legislation cannot authorize a gift of public funds or lending of public credit; and (iii) the legislation cannot substantially impair contractual obligations.

The police power is the power under which the Legislature can adopt laws to promote health, safety, morals or general welfare.<sup>23</sup> To be a valid exercise of the police power, a statute must be reasonably necessary to accomplish these objectives.<sup>24</sup> When enacting AB 811, the Legislature determined that "a public purpose will be served by a voluntary contractual assessment program that provides the legislative body of any public agency with the authority to finance the installation of distributed generation renewable energy sources and energy or water efficiency improvements that are permanently fixed to residential, commercial, industrial, agricultural, or other real property."<sup>25</sup> Significantly, in *County of Sonoma v. State Board of Equalization*,<sup>26</sup> the California Court of Appeal held that energy conservation is a proper subject of the State's police power, and that legislation granting retroactive tax relief to an alternative energy company was reasonably related to promoting energy conservation.

Secondly, the California Constitution prohibits giving or lending of public credit of the State or of any public agency. However, this prohibition does not preclude expenditures, disbursements and loans for public purposes, even if a private person incidentally benefits.<sup>27</sup> The determination of what constitutes a public purpose is primarily a matter for legislative discretion, and the courts will not override such a determination so long as the legislative body has a reasonable basis for its action.<sup>28</sup> As discussed above, the court in *County of Sonoma* held that legislation that promotes energy conservation serves a legitimate public purpose. Moreover, the Legislature has determined that global warming poses a threat to California's economic well-being, public health, natural resources and environment due to the deterioration of air quality, the reduction in the quality and supply of water, and the damage to marine ecosystems and the natural environment resulting from the present level of energy consumption in California.<sup>29</sup> In adopting AB 811, the Legislature found that "energy and water conservation efforts, including the promotion of energy efficiency improvements to residential, commercial, industrial, agricultural, or other real property are necessary to address the issue of global climate change."<sup>30</sup> These are good arguments in support of finding that AB 811 financing does not violate the constitutional ban on gifts of public funds or lending of public credit.

Thirdly, the contracts clauses of the Federal and California Constitutions impose another limit on the power of the Legislature. The Federal Constitution provides that "No state shall...pass any...law impairing the obligation of contracts."<sup>31</sup> The California Constitution similarly provides that a "law impairing the obligation of contracts may not be passed."<sup>32</sup> The California Supreme Court has applied federal case law when interpreting this provision.<sup>33</sup>

"The threshold inquiry [under the Contracts Clause] is whether the state law has, in fact, operated as a substantial impairment of a contractual relationship."<sup>34</sup> Although the government cannot substantially impair contractual obligations, it may modify the remedies available under a contract without offending the Constitution.<sup>35</sup> Contractual assessments seemingly do not abrogate any of the terms of a pre-existing secured loan. Further, the superior lien priority provided to the contractual assessment lien by AB 811 arguably does not modify the nature of the pre-existing lender's security interest or the manner of its enforcement. The pre-existing lender still may foreclose upon the property in the event of a default under its loan agreement, and also may protect its security interest in

