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STATE BOARD OF EQUALIZATION
STAFF LEGISLATIVE ANALYSIS

Date:	**03/19/13**	Bill No:	**Assembly Bill 122**
Tax:	**Nonresidential Building Energy Retrofit Financing Program**	Author:	**Rendon**
Sponsor:	**State Controller**	Code Sections:	**PRC 25987.1, et al**
Related Bills:		Effective Date:	**01/01/14**

This analysis addresses provisions that impact the BOE.

BILL SUMMARY

This bill requires the Board of Equalization (BOE) to collect loan payments from participants in the Nonresidential Building Energy Retrofit Financing Program, created by this measure.

ANALYSIS

CURRENT LAW

The BOE administers 34 separate tax and fee programs, the largest being the California Sales and Use Tax Law. These taxes and fees provide revenue for state government, counties, cities, and special districts.

PROPOSED LAW

This bill creates the **Nonresidential Building Energy Retrofit Financing Program** (Program) by adding Chapter 13 (commencing with Section 25987.1) to Division 15 of the Public Resources Code. Under the Program, the State Energy Resources Conservation and Development Commission (California Energy Commission or CEC) approves applications for a building owner's project. Program participants receive monies to upgrade buildings with alternative energy sources or improvements to energy or water efficiency. To be eligible, the projected energy and water cost savings generally must exceed the project's total costs.

The bill requires the BOE to collect "energy remittance repayments" from Program participants. The California Alternative Energy and Advanced Transportation Financing Authority (Authority), on behalf of the CEC, will sell revenue bonds backed by the Energy Remittance Repayment Agreements (ERRAs) discussed below.

Third-Party Administrator - RFP. By July 1, 2014, the CEC will develop a Request for Proposal (RFP) for a third-party to develop and administer the Program. The third-party administrator:

- establishes underwriting guidelines (*§ 25987.10);*
- manages project applications (*§ 25987.4(w));*
- evaluates Program compliance and makes recommendations to the CEC *(§ 25987.15);* and
- establishes an annualized repayment schedule required by the Agreement to cover the interest, administrative cost fee, and loan loss fee (*§ 25987.16).*

Application Approval. Prior to approving an application, the CEC will hold a public meeting, notifying lienholders on the building to be retrofitted in writing, as specified. *§ 25987.18*

At a later business meeting, the CEC will approve applications and authorize the recording of an ERRA. Within 30 days of approval, the CEC then forwards the ERRA to the BOE for recording. *§ 25987.20, § 25987.22*

Energy Remittance Repayment Agreement. An ERRA is defined as a "contractual agreement between an eligible building owner and the [CEC], secured by a lien …recorded in the county where the property is situated and on an eligible building specially benefited by a new energy improvement for which the [CEC] will make reimbursement or a direct payment to the party financing the energy improvements, and 'contractual energy remittance' means that reimbursement or direct payment." *§ 25987.4 (i)*

Record ERRA and File Lien. A recorded lien secures an ERRA. The CEC forwards the ERRA to the BOE for recording. The BOE then issues the lien and records both the ERRA and lien between the CEC and the building owner in the county where the building is located. Finally, the BOE notifies the CEC when the ERRA and the lien are recorded. *§§ 25987.8, 25987.12, 25987.16, 25987.20, and 25987.22*

The lien:

- is in the amount specified in the ERRA. *§ 25987.12*
- has the force, effect, and priority of a judgment lien. *§ 25987.21(a)*
- is subordinate to any and all secured mortgage liens recorded against the deed of the eligible building at the time of the recording. *§ 25987.21(a)*
- is superior in priority to all subsequent liens recorded except where the first mortgage is refinanced. In that instance, the ERRA remains secondary to the primary mortgage. *§ 25987.21(b)*
- is not extinguished if the property is foreclosed on. *§ 25987.21(e)*
- is released upon full repayment. *§ 25987.16(g)*

Collection Function and Loan Servicing. The bill requires the BOE to collect repayment installments (loan payments) required pursuant to the ERRA. Participants either pay via an electronic funds transfer or pay a 10% penalty. The participating building owner and the third party administrator agree to the installment payment amount according to an "annualized schedule." The CEC adopts a resolution that sets the schedule. *§§ 25987.14(b), 25987.16, 25987.17, and 25987.20*

Late Payments. If a participant misses a payment, the BOE is to assess a 10% penalty on the unpaid installment amount. Within 60 days from the date the installment payment was due, the BOE will issue a demand letter to the participant, with notice to the CEC, payable within 30 days. If the participant doesn't cure the default within the 30 days allotted, the BOE may declare the entire outstanding balance under the ERRA immediately due and owing and *may* begin foreclosure proceedings on the building using either judicial or non-judicial foreclosure proceedings. In accordance with lien priority laws, revenue generated from the building's sale is distributed to satisfy the liens on the building. *§§ 256987.16* and *25987.17*

Funds. The BOE deposits remittances into the Nonresidential Building Energy Retrofit Debt Servicing Fund the bill establishes. *§§ 25987.38-.40*

Subsequent Sale of Property Subject to ERRA. If the real property is sold, the repayment obligation under an ERRA is assigned to, and assumed by, the buyer upon taking title. *§ 25987.25(a)(9) and 25987.27(b)(2)*

Regulations and MOUs. Related to the administration of the Program, this bill:

- Requires the CEC to provide general direction and oversight to the BOE related to the BOE's duties. *§ 25987.7(a)*
- Authorizes the BOE to prescribe, adopt, and enforce guidelines relating to the collection of the installment repayment. The guidelines are exempt from Administrative Procedure Act requirements. *§ 25987.17(d)*
- Authorizes the BOE, CEC and Authority to promulgate necessary regulations to implement and administer this chapter. *§ 25987.42*
- Authorizes the BOE, CEC, and Authority to enter into a memorandum of understanding providing for the transfer of energy remittance payments between the three agencies in furtherance of this chapter. *§25987.31(g)*
- Requires the BOE to continue to collect the energy remittance payments and service the loans (accept payments, release liens, etc.) even if the Authority is unable to sell the revenue bonds. *§ 25987.31(h)*

Start-up Cost Loan. The General Fund shall loan the BOE up to $1 million and the CEC up to $7 million for implementation. By January 1, 2024, the BOE and CEC must repay the loan with interest. If program administration cost fees are insufficient to pay back the loan, the Director of Finance and the agencies shall discuss alternative repayment provisions. *§ 25987.41*

COMMENTS

1. **Sponsor and purpose.** The Controller is sponsoring this bill to make energy efficiency upgrades cost effective for nonresidential building owners while simultaneously stimulating California's construction labor workforce.
2. **Loan servicing.** Currently, the BOE does not service loans or collect installment payments from private property owners for property improvements. The mission of the BOE is to serve the public through fair, effective, and efficient tax administration. This bill represents a departure from BOE's traditional "tax collection" functions.
3. **If a property owner is delinquent, foreclosure is the only collection tool.** To effectively and efficiently collect the repayments, the BOE should be allowed to seek collection of delinquent monies before proceeding to foreclosure. To provide these collection tools, it is recommended that the bill be amended to authorize the BOE to use the Fee Collection Procedures Law (FCPL).[1] These statutes generally provide for the BOE's administration of fee programs. For example, these provisions allow the BOE to levy rents from any tenants if payment is not forthcoming from the loan recipient in lieu of eviction and foreclosure. Among other things, the FCPL provides for collection, reporting and return filing, refund, and appeals procedures, as well as the BOE's authority to adopt regulations related to the FCPL's administration and enforcement.

[1] Part 30 (commencing with Section 55001) of Division 2 of the Revenue and Taxation Code.

While the BOE does have authority to seize and sell property to collect delinquent taxes and fees, it is not a common or routine BOE practice. If the BOE forecloses, who maintains the property? How would maintenance costs be covered? The bill implies that the BOE would commence foreclosure if a property owner did not cure a deficiency "within the allotted time," which could be as soon as 90 days after a single late payment. We suggest this phrase be deleted since it conflicts with the language making foreclosure optional. An interpretation of the above-mentioned phrase that a foreclosure proceedings must commence after this time period as elapsed, could require the BOE to foreclose when the building owner is otherwise current on mortgage and property taxes and may not be prudent. Further, it could cause foreclosure without regard to whether there would be sufficient funds from the sale to repay the remittance repayment agreement since it is subordinate to superior liens *(§ 25987.21)*. The bill's text states the BOE would "foreclose on the energy remittance agreement." This is not accurate. Rather the BOE would enforce the lien filed to secure the ERRA by foreclosing on the property. We suggest clarifying the language to address these issues as shown on page 7, Amendment 1.

4. **Record ERRA and file a lien to secure payment.** The bill requires the BOE to record two documents. The first is the ERRA and the second is a lien on the property as security for the ERRA. The documents are recorded at the same time with the county recorder. The bill's text does not always distinguish between the two types of documents and erroneously refers to the ERRA when it intends a reference to the lien for the ERRA. In one location, the bill's text erroneously refers to the commission recording a document. Occasionally, the bill's text refers to filing a lien "on the deed." Liens are filed on property rather than "on the deed." We suggest clarifying the language to address these issues as shown on page 7, Amendment 2.

5. **Monthly payments are intended, but the bill is silent as to the payment frequency.** The repayment period is for 20 years or the improvement's useful life, whichever is shorter. The third party administrator establishes an "annualized" schedule for the repayment required by the ERRA (*§ 25987.16)*. Additionally, the CEC provides the BOE with the resolution specifying the amount required to be paid to the BOE, the payment schedule, and the interest rate imposed (*§ 25987.20)*. The sponsor indicates the payment is intended to be monthly. Since the bill is silent on this issue, the repayment could be on an annual, quarterly, monthly, or some other basis. We suggest an amendment specifying monthly payments with a specific due date or payment date as shown on page 7, Amendment 3.

6. **Subsequent buyers assume liability for the payments.** This bill appears to contemplate transfers of title without payoff of the lien. Additionally, it appears buyers would assume the loan without CEC or Authority approval as to their qualifications for the Program and without the recordation of a new ERRA and lien. The seller is required to provide the buyer with a disclosure statement that informs the subsequent buyer that the buyer is responsible for making all subsequent installment payments. But there is no express language that makes a subsequent buyer liable for the prior owner's loan. Nor is there express authority for the BOE to pursue collection from the new owner. The BOE should have clear authority to pursue collection from persons other than the initial program participant. Additionally, the bill lacks a requirement to notify the BOE concerning the payee change as a result of a sale. The suggested amendments to address these concerns are shown on page 8, Amendment 4.

7. **Refund provisions lacking.** The bill needs an amendment to authorize refunds for energy remittance repayment overpayments from the accounts into which the overpaid amounts were deposited. We suggest allowing the BOE to make any necessary refund as shown on page 8, Amendment 5.

8. **Administration Account Deposits.** The bill states that the Authority will deposit the program administration cost fee portion of the installment payment and penalties into the Administration Account. *(§§ 25987.23(b), 25987.40)* Since the BOE is collecting the payment, it seems more efficient for the BOE to make the deposit directly into this account. If so, the suggested amendment is shown on page 8, Amendment 6.

9. **Roles and responsibilities.** Given the number of governmental agencies assigned various functions under the Program, plus a third-party administrator, clear roles and responsibilities are vital.

   - **Early Payoffs**. For example, the bill lacks details on early payoffs of the funds. Would the third-party administrator or the BOE determine payoff amounts?

   - **Income Tax Information.** If the interest paid by a property owner is tax deductible, does the property owner need annual notification of the interest paid? If so, who prepares the forms?

   - **Foreclosure by other parties.** Remittance payments are not due while the property is in foreclosure and owned by a financial institution, such as when the mortgage holder commences the foreclosure process. After taking title, the first nonfinancial-institution owner must make the back payments within 60 days. The bill does not state who monitors this situation. Special accounting procedures are necessary while the payments are held in abeyance. Who is responsible for revising the payment schedule for the suspended payments? Moreover, who notifies the BOE of the new owner?

10. **This bill might result in the BOE seeking to collect from participants that hold only a leasehold interest in the underlying real property.** In approving participants, the bill requires the CEC to "consider," but does not appear to require that the applicants be the legal owners of the underlying land. Accordingly, under the bill, it appears, for example, that a participant could also include a tenant that holds only a leasehold interest in a commercial building pursuant to a ground lease. As a result, BOE's contemplated foreclosure duties could extend to the foreclosure of a commercial tenant's leasehold interest (which may also be subject to complex commercial lease and leasehold financing terms and conditions).

11. **The BOE's collection duties would commence in the future at an unknown date.** By July 1, 2014, the CEC will issue the RFP for Program development. The CEC will need time to select the third-party administrator. Presumably, the selected third-party needs time to develop the loan criteria and lending process to be used for the Program. Further, property owners need to apply and be approved for the Program by the CEC. Thus, the BOE does not immediately begin collection.

12. **Will repayment schedules and due dates vary by participant?** The more the terms of the ERRAs vary, the greater the collection costs.

13. **BOE's start-up costs.** To implement the proposed collection program, the BOE expects to develop computer programs and hire appropriate staff. The bill loans the BOE up to $1 million from the General Fund for administrative start-up costs.

However, the Program's volume of participants is unknown. It is unclear if the BOE can repay the General Fund loan from the energy remittance repayment collections. At this time, the BOE's costs are unknown. It is preferred that General Fund loan for BOE's costs be made to the CEC instead, since the BOE is only the collection agency for the other entity's program consistent with other programs.

14. **BOE's ongoing costs.** A "program administration cost fee" levied on the participants is intended to cover the Program administrative costs incurred by the CEC, the Authority, and the BOE. The Authority is to deposit fees and penalties (collected by the BOE) into the "Administration Account," which would be continuously appropriated to the Authority, CEC, and BOE for the Act's implementation costs. The bill is silent as to how this fee will be determined, though it does appear that it is the BOE that is authorized to charge the fee. Additionally, since demand for the Program is unknown, would the fees levied on participants be sufficient to continuously cover the costs of administering the program? *§§ 25987.9, 25987.11, 25987.16, 25987.23(b), and 25987.40*

15. **Prior legislation**. Last year's Senate Bill 1130 (De Leon) contained identical provisions. It was held in Senate Appropriations Committee.

COST ESTIMATE

The BOE would incur non-absorbable costs to adequately develop and administer this new collection and loan servicing function. These costs include developing computer programs, processing remittance payments, creating payee accounts based on information provided by the third party administrator and the CEC, recording liens and ERRAs, pursuing collection, foreclosing on a variety of real property interests, training staff, and answering participant inquiries. The bill currently provides up to a $1 million loan for BOE's costs. However, the BOEs costs are unknown at this time. A detailed cost estimate is pending to evaluate whether this amount would be sufficient.

REVENUE ESTIMATE

The fees associated with this measure are reimbursement administrative cost fees and loan loss fees which do not impact state revenues once the General Fund loan is repaid.

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This staff analysis is provided to address various administrative, cost, revenue and policy issues; it is not to be construed to reflect or suggest the BOE's formal position.

STATE BOARD OF EQUALIZATION

PROPOSED AMENDMENTS TO AB 122

As amended March 19, 2013

Amendment 1

On page 13, Line 30 add "The board shall administer and collect the repayment installments imposed by this chapter pursuant to the Fee Collection Procedures Law (Part 30 (commencing with Section 55001) of Division 2 of the Revenue and Taxation Code). For purposes of this part, the references in the Fee Collection Procedures Law to "fee" shall include the repayment installment imposed by this chapter and references to "feepayer" shall include a participant required to pay the repayment installment imposed by this chapter." after "payable."

On page 14, Lines 7-8, delete "within the time allotted"

Amendment 2

On page 11 make the following changes:

Line 21, substitute "have" for "record"

Line 22, add "recorded and secured by a lien recorded in the amount of the agreement" after "agreement"
Lines 22 and 30, delete "the deed of"
Line 36, substitute "recorded on" for "secured by"
Line 36, add "to secure the agreement" after "property"

On page 14 make the following changes:
Lines 11-12, substitute "enforce the lien" for "foreclose on the energy remittance repayment agreement"
Line 21, add "lien for the" after "release of the"

On page 16 make the following changes:
Line 14, substitute "and lien on" for "on the deed of"
Lines 23-24, substitute "on" for "against the deed of"
Lines 25, 26, 29, and 33 add "lien for the" before "energy"
Line 28, delete "the deed of"

On page 17 make the following changes:
Line 4, add "lien for the" before "energy"
Line 14, substitute "and file a lien on" for "on the deed of"

Amendment 3

On page 13, line 26, add "with monthly installments due on the xx of the month" after "schedule"

Amendment 4

On page 13, Line 30, add “A participant includes a buyer of property subject to a lien for an energy remittance repayment agreement that assumed the repayment obligation upon taking title to the property.”

On page 21, Lines 3 and 4, add new paragraph “(3) The notice shall provide that the buyer of the real property shall notify the board upon taking title that the buyer will assume the obligation for the repayment installments of the energy remittance repayment agreement and provide the information the board requires to collect subsequent installment payments from the new buyer.”

Amendment 5

On page 17, Line 27, add “The funds in the account may be used to pay refunds of installment payments for overpayments.” after “chapter”.

Amendment 6

On page 27, line 36 substitute “board” for “authority” after “The”