

SETTING THE PACE FOR ENERGY EFFICIENCY: THE RISE, FALL, AND (POTENTIAL) RETURN OF PROPERTY ASSESSED CLEAN ENERGY

I. INTRODUCTION

This Note discusses an innovative form of legislation known as “Property Assessed Clean Energy”, or PACE. PACE allows property owners to receive funding from their municipality for the purpose of energy efficiency improvements.¹ This money is recovered by the municipality in the form of a special assessment that runs with the property, amortized over a period of ten to twenty years.² This financing mechanism has two key advantages that make it an effective tool for encouraging homeowners to make their homes more energy efficient. First, there is no dauntingly high initial net capital outlay required on the part of the property owner.³ Second, since the assessment runs with the property,⁴ property owners pay only for the benefit they derive from the energy efficiency improvements, and no more, in the event that they move before full cost recovery is made by the municipality.⁵ As these are the two most cited barriers to implementing energy efficiency improvements,⁶ PACE has the potential to spur a wave of energy efficiency retrofits throughout the country. Indeed, until recently, this scenario appeared likely as state after state enacted PACE legislation.⁷

In the summer of 2010, Fannie Mae, Freddie Mac, and the Federal Housing Finance Agency (“FHFA”)⁸ moved to quash residential PACE.⁹

1. See *infra* notes 23–24 and accompanying text.

2. See *infra* notes 25–29 and accompanying text.

3. See *infra* note 20 and accompanying text.

4. See *infra* notes 35–37 and accompanying text.

5. See *infra* notes 35–37 and accompanying text.

6. See *infra* note 20 and accompanying text.

7. The following states, as well as the District of Columbia, have passed PACE legislation at the time of this writing: California, Colorado, Connecticut, Florida, Georgia, Illinois, Louisiana, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Nevada, New Hampshire, New Mexico, New York, North Carolina, Ohio, Oklahoma, Oregon, Texas, Vermont, Virginia, Wisconsin, and Wyoming. See PACENOW, <http://pacenow.org/blog/> (last visited Mar. 23, 2012). It is notable that both Democratic and Republican-controlled states have passed PACE-enabling legislation. *Id.* Indeed, PACE has thus far enjoyed broad, bipartisan support. See discussion *infra* notes 115–19. For examples of PACE-enabling legislation, see *infra* notes 26–29.

8. Fannie Mae and Freddie Mac are the colloquial names for the Federal National Mortgage Association and the Federal Home Loan Mortgage Corporation, respectively. Fannie Mae and Freddie Mac are government sponsored enterprises (“GSEs”) that were chartered by the federal government for the purpose of providing stability to the secondary market for residential mortgages and to promote access to mortgage credit. See, e.g., Federal Home Loan Mortgage Corporation Act, 12 U.S.C. §§ 1451–1459 (2006) (establishing Freddie Mac). The GSEs are regulated by the FHFA, which was

Specifically, the FHFA believes that PACE creates unacceptable risk for lenders in general and its regulated entities in particular because most PACE legislation gives PACE assessment liens priority over pre-existing mortgages in the event of homeowner default.¹⁰ Thus, citing “safety and soundness concerns,” the FHFA directed Fannie Mae and Freddie Mac to refrain from purchasing mortgages secured by properties encumbered by PACE liens.¹¹ As Fannie Mae and Freddie Mac own or guarantee over half of all residential mortgages in the United States,¹² this action effectively killed residential PACE programs throughout the country.¹³ However, as discussed in detail below, this action arguably violated both the Administrative Procedure Act (“APA”) and the National Environmental Policy Act (“NEPA”).¹⁴

This Note will both address this recent conflict in detail and propose possible solutions. Part II of this Note will provide a detailed overview of PACE and its recent history. Part III will then examine the recent actions of Fannie Mae, Freddie Mac, and the FHFA in a critical light, arguing that these entities’ actions are ultimately counterproductive. Part IV of this Note will then discuss potential solutions to the conflict, including both legislative and judicial resolutions. Finally, Part V will discuss the future of PACE.

PACE is a promising, common-sense program that could enable homeowners to do their part to combat climate change and reduce the United States’ dependence on fossil fuels. The actions of Fannie Mae, Freddie Mac, and the FHFA in shutting down PACE exhibited rash, reactionary decision-making. This Note will make the case that PACE legislation can be structured so that lenders and loan servicers do not take on undue risk, while still providing homeowners with the means to reduce the energy consumption footprint of their homes.

created by the Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654. *See also infra* note 65.

9. *See* discussion *infra* notes 65–74 and accompanying text. The FHFA’s actions had no effect on commercial PACE financing, as Fannie Mae and Freddie Mac purchase only residential loans. Commercial PACE programs have continued apace, unaffected by the actions of the FHFA and its regulated entities. Eric Bloom, *Where Does PACE Financing Stand Today?*, MATTER NETWORK (Aug. 7, 2011), <http://www.matternetwork.com/2011/8/where-does-pace-financing-stand.cfm>.

10. *See infra* note 29 and accompanying text.

11. *See infra* note 68 and accompanying text.

12. Simon Atkinson, *US Rescues Giant Mortgage Lenders*, BBC NEWS (Sept. 8, 2008, 12:24 PM), <http://news.bbc.co.uk/2/hi/business/7505152.stm>.

13. John McChesney, *Outlook Dims for Popular Energy-Efficiency Loans*, NAT’L PUB. RADIO (July 29, 2010), <http://www.npr.org/templates/story/story.php?storyId=128700648&sc=tw>.

14. *See infra* notes 124–94 and accompanying text.

II. AN OVERVIEW OF PACE AND ITS RECENT HISTORY

Concerns about climate change and future energy shortfalls have spurred energy conservation and efficiency initiatives at a rate not seen since the 1970s oil-shortage crisis.¹⁵ Both private and state actors are moving to facilitate, encourage, and in some cases, require energy conservation measures.¹⁶ While lasting and long-term solutions to climate change and future energy shortfalls will likely entail a major overhaul of the global energy economy, simpler and more easily implemented steps can be taken in the short-term to ease this transition. Specifically, energy efficiency measures, often described as the “low-hanging fruit” of potential energy conservation efforts, can offer dramatic results in terms of reducing energy use and greenhouse gas emissions (“GHG”) through the application of commonly available technology and techniques.¹⁷

Simple home energy efficiency retrofits can help homeowners significantly reduce their utility bills while at the same time reducing GHG emissions and energy use.¹⁸ Energy efficiency initiatives can also serve to stimulate the economy through the creation of “green” jobs.¹⁹ However,

15. For example, the private clean technology (or “cleantech”) industry is expanding rapidly. The global wind, solar, and biofuels industries’ revenue, which collectively reached \$144.5 billion in 2009, is projected to grow to \$343.5 billion in the next decade. See RON PERNICK ET AL., CLEAN ENERGY TRENDS 2010: APRIL 2010 UPDATE, at 2 (2010), available at <http://www.cleaneedge.com/reports/pdf/Trends2010.pdf>.

16. For an overview of various energy conservation policy initiatives implemented by the states, see DATABASE OF STATE INCENTIVES FOR RENEWABLES & EFFICIENCY, <http://www.dsireusa.org/> (last visited Mar. 16, 2012). Perhaps the most widespread example of these policy initiatives are renewable portfolio standards, which require investor-owned utilities to generate a certain percentage of their electricity from renewable resources, as defined by statute. For an example of such a statute, see MO. STAT. ANN. § 393.1030 (West 2010 & Supp. 2011) (requiring no less than 15 percent by 2021).

17. See, e.g., Jeff Civins et al., *Environmental Due Diligence—Counting Carbon*, NAT. RESOURCES & ENV’T, Fall 2009, at 37, 40. Common energy efficiency improvements include installing adequate insulation, programmable thermostats, solar panels and solar-powered heat pumps, and replacing old appliances with new, energy efficient models. See U.S. DEP’T OF ENERGY, ENERGY SAVERS BOOKLET: TIPS ON SAVING ENERGY & MONEY AT HOME (2009), available at http://www1.eere.energy.gov/consumer/tips/pdfs/energy_savers.pdf.

18. Older homes are particularly energy inefficient. It is estimated that “if all pre-2000 homes were brought up to the same efficiency level as post-2000 homes . . . overall residential energy consumption would fall by an additional 22.5 percent.” JOINT CTR. FOR HOUS. STUDIES OF HARVARD UNIV., THE STATE OF THE NATION’S HOUSING 2010, at 31 (2010), available at <http://www.jchs.harvard.edu/research/publications/state-nations-housing-2010>.

19. One report shows that there are currently approximately 770,000 clean energy jobs in the United States, and that jobs in this sector have grown at a rate of 9.1 percent, as compared to 3.7 percent for jobs overall during the study timeframe. PEW CHARITABLE TRUSTS, THE CLEAN ENERGY ECONOMY: REPOWERING JOBS, BUSINESSES AND INVESTMENTS ACROSS AMERICA 8, 14 (2009), available at http://www.pewcenteronthestates.org/uploadedFiles/Clean_Economy_Report_Web.pdf. It has also been projected that green jobs could continue to increase at a rate of over 5.5 percent per year, with 4.2 million such jobs being generated in the United States over the next thirty years; this could

many homeowners are reluctant to take such measures due to the requisite initial net capital outlay and the relatively long period of time required to recoup this cost.²⁰ Some homeowners are unable to afford these upfront costs, while others may be unwilling to make this long-term investment if they believe they may sell the property before their energy efficiency investments result in a net gain. Policymakers in all levels of government can do much to incentivize homeowners to nevertheless take the plunge and retrofit their homes for increased energy efficiency. While a wide variety of such policies and laws have been enacted throughout the United States,²¹ this Note will focus on PACE and its implementation throughout the country.

PACE is a popular and innovative solution to obstacles preventing the widespread implementation of energy efficiency measures. Originating in California in 2007,²² PACE is a form of legislation that allows municipalities to create special assessment districts for the purpose of financing homeowners' upfront costs for energy efficiency improvements.²³ Many states already have statutes in place that allow municipalities to create assessment districts for the purpose of improving local infrastructure.²⁴ Under such a statute, for example, a city may issue

account for 10 percent of new job growth during this period. U.S. CONFERENCE OF MAYORS, U.S. METRO ECONOMIES: CURRENT AND POTENTIAL GREEN JOBS IN THE U.S. ECONOMY 17 (2008), available at <http://www.usmayors.org/pressreleases/uploads/greenjobsreport.pdf>; see also DEUTSCHE BANK CLIMATE CHANGE ADVISORS, UNITED STATES BUILDING ENERGY EFFICIENCY RETROFITS: MARKET SIZING AND FINANCING MODELS 7 (2012), available at http://www.dbcca.com/dbcca/EN/_media/Building_Retrofit_Paper.pdf (finding that energy efficiency retrofits in the United States could result in the mitigation of 600 million metric tons of CO₂, more than \$1 trillion in energy savings over ten years, and up to 3.3 million new cumulative job years).

20. Retrofits can cost anywhere from an average of \$2,500 for basic home weatherization to over \$70,000 for photovoltaic solar panel systems. Joshua G. Bassett, *Cost-Effective Renovations and Other Improvements for Creating More Energy Efficient Homes*, STUDENT PULSE (Oct. 29, 2009), <http://www.studentpulse.com/articles/23/cost-effective-renovations-and-other-improvements-for-creating-more-energy-efficient-homes>.

21. For a broad overview of the types of policies that have been implemented to incentivize energy efficiency, see *supra* note 16.

22. Cisco DeVries, *How Innovative Financing is Changing Energy in America*, GRIST (Jan. 27, 2010, 3:37 AM), <http://www.grist.org/article/2010-01-26-how-innovative-financing-is-changing-energy-in-america>.

23. Ryan North et al., *The Evolving Picture of Energy Efficiency Retrofitting for New York City Commercial Buildings*, in GREEN REAL ESTATE SUMMIT 2010: WHAT ATTORNEYS, DEVELOPERS, REGULATORS, TENANTS & LENDERS NEED TO KNOW 53–54 (2010).

24. See, e.g., CAL. GOV'T CODE §§ 53311–53368.3 (West 1997 & Supp. 2012); CAL. PUB. RES. CODE §§ 26500–26654 (West 1997) (relating to geologic hazard abatement districts); Improvement Act of 1911, CAL. STS. & HIGH. CODE §§ 5000–6794 (West 2005 & Supp. 2012); Mello-Roos Community Facilities Act of 1982, COLO. REV. STAT. ANN. §§ 30-20-601 through 30-20-628 (West 2002 & Supp. 2011); Consolidated Local Improvements Law, NEV. REV. STAT. ANN. §§ 271.010–271.850 (West 2000 & Supp. 2011); OR. REV. STAT. ANN. §§ 223.001–223.950 (West 2009 & Supp.

bonds for the purpose of financing sewer lines in a given area. The bonds are repaid through property assessments by property owners who benefit from the improvement.²⁵ PACE legislation typically expands the language of this type of statute to include energy efficiency improvements within its ambit.²⁶ The legislation also generally provides that local governments may prescribe the types of energy efficiency improvements that the municipality will be willing to finance,²⁷ as well as underwriting standards for the program.²⁸ Finally, in the vast majority of states that have enacted PACE programs, PACE legislation provides that a first priority lien will be placed on the property in the event of default or delinquency on the part of the homeowner in paying the special assessment.²⁹

In a typical PACE scenario, a municipality first sells bonds to raise starting capital for energy efficiency project financing.³⁰ Then, a homeowner seeking to finance energy efficiency improvements to her home applies to the city for the financing.³¹ Assuming the applicant shows that she will be able to pay the special assessment by meeting designated underwriting criteria, the municipality then finances approved energy efficiency projects.³² The municipality recovers this cost and pays back the bonds by placing a special assessment on the property for a period of time equal to or less than the lifetime of the energy efficiency improvements made to the property, typically no more than twenty years.³³

2011).

25. See North et al., *supra* note 23, at 53.

26. See, e.g., CAL. STS. & HIGH. CODE § 5898.12(b) (West 2005 & Supp. 2012). For an example of PACE legislation in a state that lacked the special assessment framework prior to PACE being enacted, see MO. STAT. ANN. §§ 67.2800–67.2835 (West 2007 & Supp. 2011).

27. See, e.g., CAL. STS. & HIGH. CODE § 5898.20(b) (West 2005 & Supp. 2012).

28. See, e.g., VT. STAT. ANN. tit. 24, § 3262 (West Supp. 2011).

29. See, e.g., MO. STAT. ANN. § 67.2815.5 (West 2007 & Supp. 2011). For PACE programs to be viable, the lien must be senior to pre-existing mortgages, as there would be little to no interest among bond buyers if the liens were junior, meaning municipalities would have no way to finance the upfront costs of the energy efficiency retrofits. Furthermore, subordinate PACE liens would be impractical for local government officials to administer. See Letter from Chris Moriarty, Director, Barclays Capital, and John Rhow, Senior Vice President, Barclays Capital, to Jeffrey Tannenbaum, Fir Tree Partners (Sept. 14, 2009), available at http://pacenow.org/documents/Pace%20letter%20sept%202009%20re%20liens%20_2_%20_2_%20-%20Barclays%20%209-14-09%20_3_.pdf.

30. NAT'L RES. DEF. COUNCIL ET AL., PROPERTY ASSESSED CLEAN ENERGY (“PACE”) PROGRAMS WHITE PAPER: HELPING ACHIEVE ENVIRONMENTAL SUSTAINABILITY AND ENERGY INDEPENDENCE, IMPROVING HOMEOWNER CASH FLOW AND CREDIT PROFILE, PROTECTING MORTGAGE LENDERS, AND CREATING JOBS 12 (2010) [hereinafter PACE WHITE PAPER].

31. *Id.* at 10.

32. *Id.* at 10–11.

33. *Id.* at 11; see also Berkeley FIRST: Financing Initiative for Renewable and Solar Technology, CITY OF BERKELEY, <http://www.ci.berkeley.ca.us/ContentDisplay.aspx?id=26580> (last visited Mar. 16, 2012) (detailing Berkeley’s PACE program).

PACE legislation allows property owners to reap the benefits of energy efficiency improvements while minimizing or eliminating the usual barriers to implementation.³⁴ Since the municipality provides the initial funding, there is no initial outlay of capital on the part of the homeowner.³⁵ And since the special assessment attaches to and runs with the property rather than the homeowner, a homeowner is not penalized if she moves before the energy efficiency investments result in an overall net gain; instead, the homeowner merely pays for the benefit she derives and no more.³⁶ The next owner of the property continues to enjoy the benefits of energy efficiency while paying their proportionate share of the costs, depending on how long they own the property.³⁷ Moreover, PACE programs are generally designed so that the homeowners' savings in the form of utility bill reductions will be greater than the amount the homeowners pay the city through the special assessment; that is, the Savings-to-Investment ratio is greater than one.³⁸ PACE programs therefore make energy efficiency improvements a winning proposition for both homeowners and municipalities.

Berkeley, California, was the first municipality to institute a PACE program in 2007.³⁹ In 2008 California became the first state to enable municipalities to implement PACE programs more easily by passing A.B. 811.⁴⁰ The program has enjoyed great success in California, with at least seven local governments instituting a PACE program.⁴¹ Initial feedback from these programs indicates that homeowner demand for PACE funding is high,⁴² and the programs may be helping to spur job growth.⁴³

34. See Christopher Mims, *The No-Money-Down Solar Plan*, SCIENTIFIC AM., Dec. 2009, at 50–51, available at <http://www.scientificamerican.com/article.cfm?id=world-changing-ideas>.

35. See PACE WHITE PAPER, *supra* note 30, at 12–13.

36. *Id.*

37. This ignores the inherent misalignment of interests in a landlord-tenant relationship, where the landlord has little incentive to pay for energy efficiency improvements that will primarily benefit tenants. That problem is beyond the scope of this Note. However, from an economic perspective, a landlord may be able to demand greater rent from a tenant if that tenant pays less for utilities.

38. See *infra* note 48.

39. See *supra* note 33.

40. A.B. 811, 2007–2008 Reg. Sess. (Cal. 2008).

41. These include the cities of Berkeley, Palm Desert, Yucaipa, and San Francisco, and the counties of Sonoma, San Diego, and Western Riverside. See generally PACENOW, *supra* note 7.

42. For example, the Sonoma County PACE program received over 10,000 inquiries from interested homeowners, and roughly 600 energy efficiency projects were financed by the county in the program's first nine months. HOME PERFORMANCE RES. CTR., CASE STUDY: SONOMA COUNTY ENERGY INDEPENDENCE PROGRAM 4–5 (2010) [hereinafter CASE STUDY: SONOMA COUNTY], available at http://www.hprcenter.org/sites/default/files/ec_pro/hprcenter/best_practices_case_study_sonoma.pdf. The Palm Desert program had funded some 220 projects as of March 2010. HOME PERFORMANCE RES. CTR., CASE STUDY: PALM DESERT, CALIFORNIA 2 (2010), available at <http://>

Based on this remarkable initial success in California, PACE began spreading across the nation.⁴⁴ The federal government quickly took note of the potential of the program for both encouraging energy conservation as well as stimulating the economy. In October 2009 the Vice President's Middle Class Task Force and the White House Council on Environmental Quality ("CEQ") released a report entitled "Recovery Through Retrofit" explicitly endorsing PACE legislation.⁴⁵ This report both recommended that additional funding be made available for PACE programs through the American Recovery and Reinvestment Act ("ARRA")⁴⁶ and enunciated working principles for energy efficiency programs like PACE.⁴⁷ In May 2010 the Department of Energy ("DOE") took heed of the Vice President's report; the DOE issued best practice guidelines for PACE implementation⁴⁸ and made additional grant funding available to states through ARRA. More significantly, twenty-five more states and the District of Columbia have enacted PACE legislation within the past four

www.hprcenter.org/sites/default/files/ec_pro/hprcenter/best_practices_case_study_palm_desert.pdf.

43. Sonoma County reported 8.4 percent job growth in trade labor industries during the first year of the PACE program; surrounding counties saw trade labor employment drop. CASE STUDY: SONOMA COUNTY, *supra* note 42, at 5.

44. *See supra* note 7 for a listing of states that have enacted PACE legislation.

45. "Home retrofits can potentially help people earn money, as home retrofit workers, while also helping them save money, by lowering their utility bills. By encouraging nationwide weatherization of homes, workers of all skill levels will be trained, engaged, and will participate in ramping up a national home retrofit market." MIDDLE CLASS TASK FORCE ET AL., RECOVERY THROUGH RETROFIT 1 (2009), *available at* http://www.whitehouse.gov/assets/documents/Recovery_Through_Retrofit_Final_Report.pdf.

46. American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, 123 Stat. 115. Commonly known as "the stimulus," ARRA authorized \$787 billion in federal spending in an effort to halt or at least ameliorate the effects of the economic recession. *Id.*

47. MIDDLE CLASS TAX FORCE ET AL., *supra* note 45. The report identified three barriers to widespread energy retrofitting by consumers and homeowners: lack of access to reliable information concerning energy retrofitting standards, the relative unavailability of financing for energy retrofitting projects, and insufficient skilled workers. *Id.* at 1. The report proposed a number of solutions to these potential obstacles, including developing an energy performance label for homes, developing a national home energy performance measure, establishing national workforce certifications and training standards for energy retrofitting, and supporting municipal energy financing, such as PACE. *Id.* at 2-4.

48. DEP'T OF ENERGY, GUIDELINES FOR PILOT PACE FINANCING PROGRAMS (2010) [hereinafter DOE PACE GUIDELINES], *available at* http://www1.eere.energy.gov/wip/pdfs/arra_guidelines_for_pilot_pace_programs.pdf. These guidelines were developed to "help ensure prudent financing practices during the current pilot PACE programs." *Id.* at 1. Specifically, the Department of Energy proposed that: the expected SIR should be greater than one for any proposed energy retrofit financed through PACE, the term of the assessment should not exceed the life of the energy efficiency improvements, the mortgage holder of record should receive notice when PACE liens are placed, PACE liens should not accelerate upon homeowner default, and quality assurance and anti-fraud measures should be implemented. *Id.* at 2-4.

years.⁴⁹ Federal PACE legislation was also introduced in the House of Representatives, although it failed to make it out of committee.⁵⁰

Despite these successes, PACE programs have also been subject to criticism. It has been suggested that PACE is bad public policy due to the burdens it potentially places on lenders and loan servicers such as the government sponsored enterprises (“GSEs”) of Fannie Mae and Freddie Mac.⁵¹ As noted above, PACE legislation typically provides that PACE liens are superior to pre-existing mortgages on the property.⁵² Since various subsidies exist for helping homeowners finance energy efficiency retrofits,⁵³ unscrupulous homeowners could, PACE critics argue, apply for expensive PACE financing and subsidies and walk away from the property, pocketing the subsidies as a windfall.⁵⁴ When the property then goes through foreclosure, sale proceeds would first go towards paying off the PACE assessment, reducing the amount recovered by the mortgage holder.⁵⁵ Since Fannie Mae and Freddie Mac are already undercapitalized, the argument goes, this will further damage their portfolios, putting them in greater financial jeopardy.⁵⁶

Critics also contend that the first-priority status of PACE liens creates too much risk for lenders and loan servicers even without unethical homeowners cashing in on energy efficiency subsidies before

49. For examples of other states’ PACE enabling statutes, see *supra* notes 28 and 29; *see also*, e.g., COLO. REV. STAT. ANN. §§ 40-9.7-101 through 40.9.7-123 (West Supp. 2011); 65 ILL. COMP. STAT. § 5/1-1-11 (West 2006 & Supp. 2011); OHIO REV. CODE ANN. §§ 1710.01–1710.13 (West 2009 & Supp. 2011).

50. H.R. 3836, 111th Cong. (2009). This legislation would have changed the Department of Energy indirect loan guarantee program to provide 100 percent guarantees for PACE bond programs, allowing more municipalities to successfully finance PACE programs. *Id.*

51. *See* MICHAEL SWARTZ, A WHITE PAPER ON PACE LOANS: UNCONSTITUTIONAL AND DAMAGING TO GSE’S SUCH AS FANNIE MAE AND FREDDIE MAC 5–7 (2010). This white paper also argues that PACE programs violate Article I, Section 10 of the U.S. Constitution, which provides “No State shall . . . pass any . . . Law impairing the Obligation of Contracts.” *Id.* at 2. The white paper further contends that PACE violates Article XIII D of the California Constitution, which constrains local governments’ ability to impose fees, assessments, and taxes. *Id.* at 4–5. These constitutional arguments are outside the scope of this Note. For an excellent rebuttal of these arguments, see SANJAY RANCHOD ET AL., THE CONSTITUTIONALITY OF PROPERTY ASSESSED CLEAN ENERGY (PACE) PROGRAMS UNDER FEDERAL AND CALIFORNIA LAW: A WHITE PAPER (2010); *see also* Ian M. Larson, Note, *Keeping PACE: Federal Mortgage Lenders Halt Local Clean Energy Programs*, 76 MO. L. REV. 599, 622–26 (2010).

52. *See supra* note 29.

53. *See*, e.g., *Federal Tax Credits for Consumer Energy Efficiency*, ENERGY STAR, http://www.energystar.gov/index.cfm?c=tax_credits.tx_index (last updated Jan. 3, 2012). These programs provide tax credits to homeowners who install certain prescribed energy efficiency improvements on their homes. *Id.*

54. *See* SWARTZ, *supra* note 51, at 5–6.

55. *Id.*

56. *Id.*

encumbering the property with a large PACE assessment and then defaulting.⁵⁷ These critics maintain that the first-priority status of the assessments creates too great a risk for lenders, especially in the current weak economy.⁵⁸

PACE has also been criticized on the ground that it creates a patchwork of laws that are inconsistent from state to state, and even from municipality to municipality within the same state when it comes to a PACE program's implementation.⁵⁹ Some critics say that this inconsistency in PACE programs leads to greater risk and transactional costs for lenders and loan servicers because of the lack of uniform underwriting standards for granting PACE financing to homeowners.⁶⁰ As the lending business is now national or even global in scope, and mortgages are often repackaged and resold multiple times during their lifetimes,⁶¹ it can be difficult for mortgage holders to assess the value of their portfolios.⁶² Since overvalued mortgage portfolios partially precipitated the economic crisis in 2008,⁶³ some lenders and regulators are wary of a program like PACE that has the potential to create further uncertainty in mortgage-backed assets' valuation.⁶⁴

Motivated by these concerns, and perhaps being overly cautious in the wake of the recent economic upheaval in which Fannie Mae and Freddie Mac played a key role, the FHFA took action to halt the further spread of residential PACE in the summer of 2010.⁶⁵ In May of 2010, Fannie Mae

57. *Id.* at 7.

58. *Id.* This fear is unfounded. See discussion *infra* notes 77–105 and accompanying text.

59. See, e.g., Defendants' Motion to Dismiss and Supporting Memorandum of Points and Authorities at 16, *California v. Federal Housing Finance Agency*, No. 4:10-cv-03084-CW (N.D. Cal. Dec. 2, 2010). As discussed below, this is the primary concern the FHFA has regarding PACE programs.

60. *Id.* As noted above, the DOE has proposed a set of best practice guidelines for PACE underwriting criteria that directly address this concern. DOE PACE GUIDELINES, *supra* note 48.

61. Eric Dash, *Freddie Mac Purchased and Sold Faulty Loans*, N.Y. TIMES, Apr. 14, 2005, at C3, available at <http://www.nytimes.com/2005/04/14/business/14freddie.html>.

62. Peter J. Henning, *The Mortgage-Backed Securities Mess*, DEALBOOK (Oct. 22, 2010, 10:00 AM), <http://dealbook.nytimes.com/2010/10/22/the-mortgage-backed-securities-mess/>.

63. *Id.*

64. See *supra* note 59.

65. The FHFA is an independent regulatory agency created by the Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289, 122 Stat. 2654. “[HERA] combined the staffs of the Office of Federal Housing Enterprise Oversight (OFHEO), the Federal Housing Finance Board (FHFB), and the [government sponsored enterprise] mission office at the Department of Housing and Urban Development (HUD).” *About FHFA*, FED. HOUSING FIN. AGENCY, <http://www.fhfa.gov/Default.aspx?Page=4> (last visited Mar. 16, 2012). The FHFA supervises and regulates Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. *Id.* Moreover, pursuant to HERA, in September of 2008 Fannie Mae and Freddie Mac were placed into a conservatorship run by the FHFA. *Id.* This direct control of the GSEs by the FHFA has continued to the present day. *Id.*

and Freddie Mac issued letters to lenders and loan servicers indicating that PACE financing is incompatible with the GSEs' Uniform Security Instruments.⁶⁶ For instance, the letter from Freddie Mac stated that "energy-related lien[s] may not be senior to any Mortgage delivered to Freddie Mac."⁶⁷ Shortly thereafter, the FHFA issued a Statement ("the Statement") that asserted that PACE programs "present significant safety and soundness concerns . . . [and] pose unusual and difficult risk management challenges for lenders."⁶⁸ Finally, on August 31, 2010, Fannie Mae and Freddie Mac released guidance letters confirming that they would neither purchase nor refinance mortgages with first priority PACE liens.⁶⁹ Since Fannie Mae and Freddie Mac together own or guarantee over half of the residential mortgages in the United States,⁷⁰ these actions on the part of the FHFA and the GSEs effectively killed residential PACE programs throughout the country.⁷¹ States have halted the implementation of their PACE programs,⁷² existing municipal PACE

66. See, e.g., Letter from Fannie Mae to All Fannie Mae Single-Family Sellers and Servicers (May 5, 2010), available at <https://www.efanniemae.com/sf/guides/ssg/annltrs/pdf/2010/ll1006.pdf>. Uniform Security Instruments are the notes, riders, and security instruments (deeds of trust and mortgages) used when originating residential mortgages in the United States. See *Single-Family Uniform Instruments*, FREDDIE MAC, <http://www.freddiemac.com/uniform/> (last visited Mar. 16, 2012).

67. Letter from Freddie Mac to Freddie Mac Sellers/Servicers (May 5, 2010), available at <http://www.freddiemac.com/sell/guide/bulletins/pdf/iltr050510.pdf>.

68. Press Release, Fed. Hous. Fin. Agency, FHFA Statement on Certain Energy Retrofit Loan Programs (July 6, 2010) [hereinafter FHFA Statement], available at <http://www.fhfa.gov/webfiles/15884/PACESTMT7610.pdf>. The Office of the Comptroller of the Currency ("OCC"), Federal Deposit Insurance Corporation ("FDIC"), and National Credit Union Administration ("NCUA") all issued statements that mirrored the FHFA Statement. See Bulletin OCC 2010-25, Office of the Comptroller of the Currency, Supervisory Guidance on Property Assessed Clean Energy (PACE) Programs (July 6, 2010), available at <http://www.occ.gov/news-issuances/bulletins/2010/bulletin-2010-25.html>; Financial Institution Letter 37-2010, Fed. Deposit Ins. Corp., Alert on FHFA Statement Relative to Concerns with Certain Energy Lending Programs (July 6, 2010), available at <http://www.fdic.gov/news/news/financial/2010/fil10037.html>; Regulatory Alert 10-RA-10, Nat'l Credit Union Admin., Potential Risks of Property Assessed Clean Energy Loans (July 2010), available at <http://www.ncua.gov/Legal/Pages/RA2010-10.aspx>. As these statements parrot the FHFA's concerns with PACE, this Note will only directly address the FHFA's Statement; the following analysis is equally applicable to these other agencies' statements.

69. See Announcement SEL-2010-12, Fannie Mae, Options for Borrowers with a PACE Loan (Aug. 31, 2010), available at <http://www.aba.com/NR/rdonlyres/A73585B8-6541-4A77-8184-1BEFB4AB2E60/68573/FannieMaePaceAnnouncement.pdf>; Bulletin 2010-20, Freddie Mac, Mortgages Secured by Properties with an Outstanding Property Assessed Clean Energy (PACE) Obligation (Aug. 31, 2010), available at <http://www.freddiemac.com/sell/guide/bulletins/pdf/bl1020.pdf>.

70. Atkinson, *supra* note 12.

71. See, e.g., Staci Matlock, *Feds Stall County Renewable Energy Loan Program*, SANTA FE NEW MEXICAN, July 24, 2010, at A1, available at <http://www.santafenewmexican.com/localnews/Feds-stall-county-s-renewable-energy-loan-program>.

72. *Id.*; see also Complaint for Declaratory and Equitable Relief at 3, California v. Federal Housing Finance Agency, No. 4:10-cv-03084-CW (N.D. Cal. July 14, 2010).

programs have stopped accepting new applications,⁷³ and lenders have required property owners to pay off their PACE assessments in full before allowing the property owners to refinance their mortgages.⁷⁴

III. ANALYSIS OF THE FHFA'S ACTIONS

The FHFA's actions in halting PACE were unwarranted and make little sense from a public policy perspective. Certainly the FHFA must act cautiously in directing the actions of Fannie Mae and Freddie Mac as they attempt to guide the GSEs to solvency.⁷⁵ However, in this instance the FHFA's actions bespeak a lack of proper risk analysis on the agency's part. As discussed below, PACE utilizes a form of municipal financing that has been in existence for over one hundred years, and well designed PACE programs do not create undue risk for lenders or threaten the value of mortgage-based assets.

The FHFA Statement, which effectively halted PACE programs throughout the country, reads in relevant part:

[P]rograms denominated as Property Assessed Clean Energy (PACE) seek to foster lending for retrofits of residential or commercial properties through a county or city's tax assessment regime. Under most of these programs, such loans acquire a priority lien over existing mortgages, though certain states have chosen not to adopt such priority positions for their loans.

First liens established by PACE loans are unlike routine tax assessments and pose unusual and difficult risk management challenges for lenders, servicers and mortgage securities investors. The size and duration of PACE loans exceed typical local tax programs and do not have the traditional community benefits associated with taxing initiatives.⁷⁶

This letter's conclusory language is unsupported by any analysis whatsoever. If the FHFA *had* engaged in an analysis of the effect PACE

73. Matlock, *supra* note 71.

74. J. Cullen Howe, *Federal PACE Program Threatened by Fannie Mae and Freddie Mac*, GREEN BUILDING L. UPDATE SERVICE (July 6, 2010), <http://blogs.law.columbia.edu/greenbuildinglaw/2010/07/06/federal-pace-program-threatened-by-fannie-mae-and-freddie-mac/>.

75. Indeed, the FHFA has a statutory duty to do so. HERA provides that the FHFA must "oversee the prudential operations of each regulated entity [Fannie Mae, Freddie Mac, and the Federal Home Loan Banks]" and ensure that the regulated entities operate in a "safe and sound manner." 12 U.S.C. §§ 4513(a)(1)(A)–(B)(i) (Supp. 2010).

76. FHFA Statement, *supra* note 68.

programs have upon the value of mortgages held by its regulated entities, however, the FHFA may have ultimately concluded that PACE legislation bolsters, rather than harms, the value of mortgages held by regulated entities, for several reasons.

First, data show that homeowners who obtain PACE financing for energy efficiency improvements are likely to actually *increase* the value of the property, benefitting lenders and loan servicers such as the GSEs.⁷⁷ Furthermore, well designed PACE programs will save homeowners money by reducing utility bills by a greater amount than is spent on the PACE assessment.⁷⁸ Thus, these homeowners should generally be in a better position to pay off their mortgages, reducing their risk of default. Indeed, at least one study has shown that a positive correlation exists between homes with energy efficiency improvements and lower default and delinquency rates.⁷⁹

Moreover, as noted above, PACE assessments are merely variations on land-secured financing districts upon which assessments are levied to serve some public good.⁸⁰ Such districts have long been a regular feature of many states' statutory framework.⁸¹ These traditional assessments also have priority lien status, and longstanding practice by the FHFA and the GSEs indicates that these assessments are entirely compatible with standard Uniform Security Instruments.⁸² The FHFA attempts to distinguish PACE assessments from these traditional assessments by characterizing PACE assessments as "loans" in its Statement,⁸³ and by stating that "[t]he size and duration of PACE loans exceed typical local tax programs and do not have the traditional community benefits associated with taxing initiatives."⁸⁴ The duration of a PACE assessment is immaterial; properly structured PACE legislation does not accelerate the entirety of the PACE financing secured by a homeowner in the event of default.⁸⁵ Instead, only delinquent assessment payments become due.⁸⁶

77. One study shows that property values increase from \$10 to \$25 for every \$1 saved on utility bills due to energy efficiency improvements. See Rick Nevin & Gregory Watson, *Evidence of Rational Market Valuations for Home Energy Efficiency*, APPRAISAL J., Oct. 1998, at 401.

78. See PACE WHITE PAPER, *supra* note 30, at 25–26.

79. Jonathan Hiskes, *Energy Efficiency Helps Homeowners Avoid Foreclosure*, GRIST (July 13, 2010, 1:13 AM), <http://www.grist.org/article/2010-07-12-home-energy-efficiency-cuts-mortgage-default-rates.-fannie-fredd>.

80. See *supra* note 24 and *infra* note 152.

81. See *supra* note 24.

82. See *infra* note 152.

83. FHFA Statement, *supra* note 68.

84. *Id.*

85. See PACE WHITE PAPER, *supra* note 30, at 5.

86. *Id.*

Additionally, under a well designed PACE program the amount of financing a particular homeowner will be able to secure will be commensurate with the homeowner's ability to repay the assessment, as determined by standardized underwriting criteria.⁸⁷ PACE programs should therefore pose no more risk to lenders and loan servicers than more traditional, well-accepted tax assessments that have first priority status.

The FHFA's attempt to distinguish PACE assessments by stating that they "do not have the traditional community benefits associated with taxing initiatives"⁸⁸ is unavailing for additional reasons as well. Not only does the FHFA fail to support this assertion, but it is also false on its face. States and municipalities enact and implement, respectively, PACE programs specifically for the benefits that accrue to their communities, including job growth, reduced energy consumption, lower utility bills, and reduced GHG emissions. For example, the Vermont PACE statute provides that "[t]he general assembly finds that it is in the public interest for municipalities to finance renewable energy projects and energy efficiency projects in light of the [greenhouse gas reduction and building efficiency] goals set forth [by statute]."⁸⁹ These goals fall squarely within the type of "community benefits" that traditionally derive from such tax assessment programs, such as sewer lines, sidewalks, seismic retrofitting, and fire safety.⁹⁰

The concern that a potentially unscrupulous homeowner who is "underwater" on her mortgage and may be tempted to apply for PACE financing with the intention of pocketing available energy efficiency subsidies before walking away from the property has already been addressed. As mentioned above, the Department of Energy has promulgated best practice guidelines to ensure that these scenarios do not occur.⁹¹ These guidelines also address other concerns raised by the FHFA in its Statement. Specifically, the Statement reads:

Underwriting for PACE programs results in collateral-based lending rather than lending based upon ability-to-pay, the absence of Truth-in-Lending Act and other consumer protections, and uncertainty as to whether the home improvements actually produce meaningful reductions in energy consumption. . . . However, first liens that disrupt a fragile housing finance market and long-standing lending

87. *Id.* at 6; see also DOE PACE GUIDELINES, *supra* note 48, at 5–7.

88. FHFA Statement, *supra* note 68.

89. Vermont Energy Act of 2009, H. 446, 2009–2010 Leg. Sess. § 15e (Vt. 2009).

90. See *supra* note 24.

91. DOE PACE GUIDELINES, *supra* note 48.

priorities, the absence of robust underwriting standards to protect homeowners and the lack of energy retrofit standards to assist homeowners, appraisers, inspectors and lenders determine the value of retrofit products combine to raise safety and soundness concerns.⁹²

As with the Statement's earlier assertions that found fault with PACE legislation, these concerns too lack evidentiary support and are ultimately unfounded. The DOE's best practice guidelines address all of these concerns and did so before the Statement was issued.⁹³ These guidelines include stringent underwriting criteria,⁹⁴ including ensuring that the Savings-to-Investment ratio will be greater than one,⁹⁵ that the homeowner is current on her property taxes,⁹⁶ and that the property's value exceeds the homeowner's public and private debt on the property (i.e., ensuring that the homeowner is not "underwater"),⁹⁷ among others. As noted by the DOE, these best practice guidelines are "significantly more rigorous than the underwriting standards currently applied to land-secured financing districts."⁹⁸ Given the FHFA's acceptance of the first priority status of the assessments applied pursuant to traditional land-secured financing districts,⁹⁹ the agency's refusal to countenance PACE is simply illogical.

Finally, even in a worst-case scenario under PACE, wherein a homeowner with a PACE assessment on her property goes into default, a lender's risk is extremely limited under a well designed PACE program.¹⁰⁰ For example, say a homeowner applies for and receives \$15,000 in PACE financing for energy efficiency retrofits. Assuming that the PACE financing amount does not accelerate upon default, as provided by the DOE's best practice guidelines,¹⁰¹ then only the PACE assessment payments that are delinquent before the property is foreclosed upon will be paid out of the foreclosure proceeds.¹⁰² If the foreclosure process takes one year, that would mean that \$1,000 must be paid from the foreclosure sale proceeds; the remainder of the PACE assessment would transfer with the

92. FHFA Statement, *supra* note 68.

93. See DOE PACE GUIDELINES, *supra* note 48. The FHFA issued its Statement on July 6, 2010, two months after the DOE issued its best practices guidelines on May 7, 2010.

94. *Id.* at 5–7.

95. *Id.* at 6.

96. *Id.*

97. *Id.*

98. *Id.* at 1.

99. See *infra* note 152.

100. See generally PACE WHITE PAPER, *supra* note 30, at 16–17.

101. See *supra* notes 91–98 and accompanying text.

102. See PACE WHITE PAPER, *supra* note 30, at 16–17.

property.¹⁰³ Furthermore, assuming a high default rate of 10 percent means that lenders are looking at a potential loss of \$150 per PACE-financed home—hardly a catastrophic amount for lenders.¹⁰⁴ And in at least one local jurisdiction that has implemented PACE, property tax delinquency is far *less* common among homeowners that have applied for and received PACE financing as compared to those that have not.¹⁰⁵

In sum, there is nothing intrinsic about PACE financing that makes it incompatible with prudent lending practices, even in these distressed economic times. Thus, FHFA's actions make little rational sense. However, FHFA's Statement is more than unwise; it is also unlawful.

IV. SOLUTIONS TO THE PRESENT PACE IMPASSE

There are a number of possible ways to break the current impasse concerning PACE, although some options are more feasible than others. These options range from direct negotiation with the FHFA on one end of the spectrum, to judicial action enjoining the FHFA from enforcing its unlawful Statement on the other. Ideally all interested parties would come together in a rulemaking on the FHFA's part that explicitly allows PACE financing provided that sufficiently stringent underwriting standards are utilized. The notice and comment process¹⁰⁶ would allow interested parties to make their opinions known regarding the best way to allow PACE financing to go forward while ensuring that lenders and loan servicers are not subject to unnecessary risks. Although a combination negotiation-legislative fix might be ideal, a judicial solution may very well be necessary given the FHFA's recalcitrance and the current hyper-partisan political climate.

A. *Negotiation and Executive Action*

Shortly after the Statement was issued, the DOE, which has thus far strongly backed PACE as an effective means to reduce energy consumption,¹⁰⁷ entered into negotiations with the FHFA with the hope of

103. *Id.*

104. *Id.*

105. *See supra* note 79.

106. The Administrative Procedure Act ("APA") requires federal agencies to publish proposed rules in the Federal Register and to provide the opportunity for public comment on such proposed rules. 5 U.S.C. §§ 553(b)–(c) (2006).

107. *See supra* note 48; *see also* Jonathan Hiskes, *Obama Admin Unable to Resolve Shutdown of PACE Clean-Energy Program*, GRIST (July 3, 2010, 2:08 PM), <http://www.grist.org/article/2010-07-02-obama-admin-unable-to-stop-shutdown-of-pace-clean-energy-program>.

convincing the agency that PACE programs, properly structured, present no special risk to lenders and thereby to FHFA regulated entities Fannie Mae and Freddie Mac.¹⁰⁸ However, these negotiations proved unsuccessful, with the FHFA indicating that the first priority status of PACE liens was simply unacceptable, regardless of how they were “structured, accelerated, or insured.”¹⁰⁹ As a final gambit for convincing the FHFA to change its mind, Congressman Steve Israel proposed a PACE pilot program, under which 300,000 homes would be allowed to obtain PACE financing pursuant to the DOE’s best practice guidelines.¹¹⁰ This pilot program could have allowed the FHFA to see if their predictions of the dire consequences of allowing PACE to go forward would be realized in a controlled manner. However, the FHFA refused to allow such a program to proceed.¹¹¹ At this point, therefore, it would appear that direct negotiations with the agency have broken down.

B. State or Federal Legislation

Another possible answer could come in the form of state PACE legislation that complies with the FHFA’s demands. Specifically, since the FHFA objects to the senior priority status of PACE assessments over pre-existing mortgages,¹¹² states could simply enact PACE legislation that provides that PACE assessments receive no special priority over pre-existing liens. Presumably, the FHFA would have no objection to such programs. But as was explained above, it is predicted that PACE assessments with junior lien status would not allow municipalities to find the needed purchasers for the bonds used to finance these programs.¹¹³ Nevertheless, at least one state has enacted such a statute.¹¹⁴ It remains to

108. *Id.*

109. *Id.*

110. Jonathan Hiskes, *Fate of PACE Clean-Energy Programs About to Become Clearer*, GRIST (July 21, 2010, 3:18 AM), <http://www.grist.org/article/2010-07-20-fate-of-pace-clean-energy-programs-about-to-become-clearer>. FHFA responded to the proposal with a 10,000 property pilot test program, which Congressman Israel rejected. “[That figure] does not suggest a real commitment to the program. There’s no statistician in America who would suggest you could get a valid sample with 10,000 homes,” he said.” *Id.*

111. *Id.*

112. *See supra* notes 75–87 and accompanying text.

113. *See supra* note 29.

114. ME. REV. STAT. ANN. tit. 35-A §§ 10151–10162 (West 2010 & Supp. 2011). Section 10156(3) provides that “the priority of a PACE mortgage created under subsection 2 is determined based on the date of filing of notice required under subsection 2 and applicable law. A PACE mortgage is not entitled to any special or senior priority.” ME. REV. STAT. ANN. tit. 35-A § 10156(3) (West 2010 & Supp. 2011).

be seen whether PACE will be as successful there as it has been in states that provide that PACE assessments are senior to pre-existing liens.

Federal legislation could also resolve the current impasse. Indeed, bills were introduced in both the House¹¹⁵ and the Senate¹¹⁶ shortly after the issuance of the FHFA Statement that would have (1) required the FHFA to adopt underwriting standards for PACE programs consistent with those promulgated by the DOE, (2) established that PACE financing issued pursuant to such guidelines was compatible with the Uniform Security Instruments of Fannie Mae and Freddie Mac, (3) prohibited Fannie Mae and Freddie Mac from requiring the complete repayment of any PACE assessment prior to allowing a homeowner to refinance her mortgage, (4) provided that only delinquent PACE assessment payments were due in the event of default, and (5) prohibited the FHFA, Fannie Mae, and Freddie Mac from discriminating against states and communities that have implemented PACE programs.¹¹⁷ Such legislation would have allowed PACE financing to resume its previous steady progress. However, neither the House nor the Senate bill made it out of committee.¹¹⁸ Similar legislation was proposed in 2011, but it also failed to be reported from committee.¹¹⁹ No such legislation has yet been introduced in 2012 at the time of this writing.

115. PACE Assessment Protection Act of 2010, H.R. 5766, 111th Cong (2010); *see also* Jonathan Hiskes, *House Democrats Introduce Bill to Defend PACE Clean-Energy Program*, GRIST (July 16, 2010, 7:45 AM), <http://www.grist.org/article/2010-07-15-democrats-introduce-pace-bill-to-defend-clean-energy-program>.

116. PACE Assessment Protection Act of 2010, S. 3642, 111th Cong (2010). This bill's language is identical to its House counterpart. The stated purpose of these bills was to "ensure that the underwriting standards of Fannie Mae and Freddie Mac facilitate the use of property assessed clean energy programs to finance the installation of renewable energy and energy efficiency improvements." *Id.*; *see also* Jonathan Hiskes, *Senate PACE Bill Adds to Pressure to Restore Clean-Energy Program*, GRIST (July 23, 2010, 5:39 AM), <http://www.grist.org/article/2010-07-22-senate-pace-bill-adds-to-pressure-to-restoreclean-energy-program>.

117. PACE Assessment Protection Act of 2010, H.R. 5766, 111th Cong (2010).

118. H.R. 5766 was referred to the House Committee on Financial Services on July 15, 2010, and died in committee. *Bill Summary & Status, 111th Congress (2009–2010), H.R. 5766*, THOMAS, <http://thomas.loc.gov/> (last visited Mar. 16, 2012). Likewise, the Senate version was referred to the Committee on Banking, Housing, and Urban Affairs on July 22, 2010, and also died in committee. *Bill Summary & Status, 111th Congress (2009–2010), S. 3642*, THOMAS, <http://thomas.loc.gov/> (last visited Mar. 16, 2012).

119. PACE Assessment Protection Act of 2011, H.R. 2599, 112th Cong. (2011). The bill enjoys bipartisan support, with twenty Republican cosponsors and thirty-one Democratic cosponsors at the time of this writing. However, no action has been taken on the bill since it was referred to the Subcommittee on Insurance, Housing, and Community Opportunity in August of 2011. *Bill Summary & Status, 112th Congress (2010–2011), H.R.2599*, THOMAS, <http://thomas.loc.gov/> (last visited Mar. 16, 2012).

C. Litigation

Since direct negotiation and legislative solutions have failed,¹²⁰ judicial action may be the only recourse for proponents of PACE. This approach is far from ideal, as it makes an adversary out of the agency that will continue to have a strong say in the future of PACE no matter what the outcome of such a lawsuit might be. However, such a lawsuit would appear to be the only means for restarting PACE at this juncture. In fact, numerous parties initiated lawsuits against the FHFA along these lines.¹²¹ These parties include the State of California, the Sierra Club, and the National Resources Defense Council (“NRDC”), among others.¹²² All of these parties sought to enjoin the FHFA from further blocking the enactment or implementation of PACE legislation.¹²³

120. See discussion *supra* Parts IV.A–B.

121. See Complaint for Declaratory and Equitable Relief, *supra* note 72; Complaint for Declaratory and Equitable Relief, *Sierra Club v. Federal Housing Finance Agency*, No. 4:10-cv-03084-CW (N.D. Cal. July 29, 2010); Complaint for Declaratory and Equitable Relief, *County of Sonoma v. Federal Housing Finance Agency*, No. 4:10-cv-03270-CW (N.D. Cal. July 26, 2010); Complaint for Declaratory and Injunctive Relief, *City of Palm Desert v. Federal Housing Finance Agency*, No. 4:10-cv-04482-CW (N.D. Cal. Oct. 4, 2010); First Amended Complaint for Declaratory and Injunctive Relief, *NRDC v. Federal Housing Finance Agency*, No. 1:10-cv-07647-SAS (S.D.N.Y. Oct. 8, 2010); Complaint, *Town of Babylon v. Federal Housing Finance Agency*, No. 2:10-cv-04916-LDW-ARL (E.D.N.Y. Oct. 26, 2010); Complaint for Declaratory and Injunctive Relief, *Leon County v. Federal Housing Finance Agency*, No. 4:10-cv-00436-RH-WCS (N.D. Fla. Oct. 8, 2010).

122. See *supra* note 121.

123. California seeks declaratory relief to the effect that California’s PACE program is compatible with the GSEs’ Uniform Security Instruments. Complaint for Declaratory and Equitable Relief, *supra* note 72. California also seeks to have the FHFA’s Statement overturned on the grounds that it failed to comport with the APA and NEPA. *Id.* at 13–14. Finally, California claims that the FHFA violated California state law by engaging in unfair competition. *Id.* at 12–13. NRDC, Palm Desert, and the Sierra Club likewise claim that the FHFA failed to comply with the APA and NEPA. First Amended Complaint for Declaratory and Injunctive Relief, NRDC, *supra* note 121, at 14–16; Complaint for Declaratory and Injunctive Relief, City of Palm Desert, *supra* note 121, at 4–22; Complaint for Declaratory and Equitable Relief, Sierra Club, *supra* note 121, at 11–13. Sonoma County’s complaint seeks declaratory relief that assessments administered under its Sonoma County Energy Independence Program are compatible with the GSEs’ Uniform Security Instruments, and also claims that the FHFA failed to comply with the APA and NEPA and interfered with prospective contractual relations with Fannie Mae and Freddie Mac. Complaint for Declaratory and Equitable Relief, County of Sonoma, *supra* note 121, at 11–15. Leon County alleged that the FHFA violated NEPA, the APA, the Tenth Amendment of the Constitution, and Florida’s Deceptive and Unfair Trade Practices Act. Complaint for Declaratory and Injunctive Relief, Leon County, *supra* note 121, at 22–29. Babylon claimed that the FHFA violated NEPA, the APA, and the Tenth Amendment of the Constitution, and engaged in tortious interference with a contractual relationship. Complaint, Town of Babylon, *supra* note 121, at 14–21.

1. Analysis of the FHFA's Statement's Legality Under the APA

The FHFA violated the Administrative Procedure Act¹²⁴ in two distinct ways when it issued its Statement. First, in promulgating a substantive rule that creates new prospective binding norms,¹²⁵ the FHFA should have allowed for notice and comment from the public pursuant to section 553 of the APA.¹²⁶ Second, by failing to provide analysis in support of its decision to “pause” PACE programs,¹²⁷ and by acting contrary to the evidence that is available,¹²⁸ the FHFA has acted in a manner that is arbitrary and capricious as provided in section 706(2)(A) of the APA.¹²⁹ The FHFA Statement should therefore be set aside by a reviewing court, at the very least to provide the public the opportunity to comment on the FHFA's action.

As an initial matter, the FHFA Statement meets the requirements for judicial review.¹³⁰ Courts have required that three threshold conditions be met before they have been willing to review agency actions. First, an agency action must be final.¹³¹ FHFA's Statement bears numerous marks

124. 5 U.S.C. §§ 500–596, 701–706 (2006). The APA broadly sets forth the procedures by which federal agencies must abide.

125. Specifically, the Statement reads, “FHFA is directing Fannie Mae, Freddie Mac and the Federal Home Loan Banks to undertake the following prudential actions . . .” FHFA Statement, *supra* note 68.

126. Section 553(b) of the APA requires that “[g]eneral notice of proposed rule making shall be published in the Federal Register . . .” 5 U.S.C. § 553(b). Section 553(c) of the APA provides that “[a]fter notice required by this section, the agency shall give interested persons an opportunity to participate in the rule making through submission of written data, views, or arguments . . .” 5 U.S.C. § 553(c). These provisions are collectively known as “notice and comment,” and this process is known as informal rulemaking. Formal rulemaking, which requires a public hearing and other more cumbersome procedural requirements, is initiated when an enabling statute calls for rules to be made “on the record” following the procedures outlined in sections 556 and 557 of the APA. *Id.*

127. See discussion *supra* notes 76–105 and accompanying text.

128. See *supra* note 79.

129. Section 706 of the APA provides the scope of judicial review for actions taken by federal agencies. 5 U.S.C. § 706. In particular, the provision provides that “[t]he reviewing court shall . . . hold unlawful and set aside agency action, findings, and conclusions found to be . . . arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law.” *Id.* § 706(2)(A).

130. See *id.* § 704. This provision provides that “[a]gency action made reviewable by statute and final agency action for which there is no other adequate remedy in a court are subject to judicial review.” *Id.*

131. This requirement derives from the language of section 704 of the APA, *supra* note 130. An oft-followed formula for finality holds that the agency “action must mark the ‘consummation’ of the agency’s decisionmaking process [and] not be of a merely tentative or interlocutory character”; and “the action must be one by which ‘rights or obligations have been determined,’ or from which ‘legal consequences will flow.’” *Bennett v. Spear*, 520 U.S. 154, 177–78 (1997) (internal citations omitted); see also *Oregon Nat’l Desert Ass’n v. U.S. Forest Serv.*, 465 F.3d 977, 982 (9th Cir. 2006) (holding that courts determine whether agency action is final by “look[ing] to whether the action ‘amounts to a definitive statement of the agency’s position’ or ‘has a direct and immediate effect on the day-to-day

of finality. It states that the Statement is the result of a year of “careful review” and deliberation.¹³² As a result of this “careful review,” the FHFA is directing its regulated entities to take action¹³³—this is not a tentative step but a “consummation of the agency’s decisionmaking process” in the words of *Bennett v. Spear*.¹³⁴ And while the Statement allows that the FHFA is willing to work further with interested parties in encouraging energy efficiency, there is no indication that the agency is willing to change its mind when it comes to PACE programs in their current form.¹³⁵ Thus, this Statement announces new legal obligations from which consequences will flow—the GSEs will no longer purchase mortgages encumbered by a PACE lien.¹³⁶

Second, the party that seeks judicial review of the agency action must first exhaust all administrative remedies.¹³⁷ In this case, there are no administrative remedies for potential plaintiffs to exhaust. Since the FHFA issued the Statement without giving the opportunity for notice and comment, there was no occasion for the plaintiffs to lodge their objections to the Statement with the agency.

Finally, an agency action must be “ripe” to be judicially reviewable.¹³⁸ That is, the plaintiff must not be bringing the action prematurely. The main factors used in determining whether a claim is ripe are “the fitness of the issues for judicial decision and the hardship to the parties of withholding court consideration.”¹³⁹ In this case, the issues are ripe for judicial review as they are purely legal—whether the Statement is a legislative rule under the APA and whether it constitutes a major federal action significantly affecting the environment for the purposes of NEPA. There are no factual disputes to be resolved. Moreover, withholding court consideration would impose significant hardship on those parties who seek to continue use of PACE programs to increase energy efficiency by

operations’ of the subject party, or if ‘immediate compliance [with the terms] is expected’”) (alterations in original).

132. FHFA Statement, *supra* note 68.

133. *Id.*

134. *Bennett*, 520 U.S. at 177–78; *see also* *Appalachian Power Co. v. EPA*, 208 F.3d 1015, 1023 (D.C. Cir. 2000) (holding that a guidance document was final because it contained binding, mandatory language).

135. *See* FHFA Statement, *supra* note 68.

136. *Id.*

137. *See, e.g., Myers v. Bethlehem Shipbuilding Corp.*, 303 U.S. 41 (1938) (holding that a company that was the subject of a hearing by the NLRB could not seek injunction in federal court because it had not exhausted prescribed administrative remedies).

138. *See Abbott Labs. v. Gardner*, 387 U.S. 136, 148 (1967).

139. *Id.* at 149.

preventing them from receiving the funding necessary to make such improvements.¹⁴⁰

Furthermore, the Statement is a rule,¹⁴¹ as opposed to an order,¹⁴² and thus the Statement should have been promulgated to the public to give it the opportunity to comment before the rule went into effect. The APA defines a rule as “the whole or a part of an agency statement of general or particular applicability and future effect designed to implement, interpret, or prescribe law or policy”¹⁴³ Per this definition, rules tend to look prospectively in setting legal obligations for undefined groups of persons,¹⁴⁴ whereas orders tend to look retrospectively in determining the legal consequences of past actions for defined parties.¹⁴⁵ Another distinction between rulemaking and adjudication is that rulemaking tends to rely on policy-based legislative facts, whereas adjudication rests on specific, concrete facts.¹⁴⁶ In this case, the FHFA Statement by its own terms regulates the future conduct of the GSEs—not their past actions—and the parties who might in the future feel the consequences of the Statement are undefined.¹⁴⁷ Moreover, the Statement is based not on

140. For the purpose of seeking judicial review, an ideal plaintiff would be one who has been *directly* affected by the FHFA’s Statement. Examples of such a plaintiff include a property owner who has been denied mortgage refinancing due to the presence of a PACE lien on the property, or a municipality that can no longer justify financing energy efficiency improvements in light of the FHFA’s action.

141. Informal rulemakings are governed by section 553 of the APA, which requires notice and comment. 5 U.S.C. § 553 (2006).

142. Orders are the result of adjudications, which may either be formal—meaning a hearing is required to be “on the record” by statute—and thus governed by sections 554, 556, and 557 of the APA, or informal and thus governed by section 555 of the APA 5 U.S.C. §§ 554–557. Informal adjudications provide fewer procedural protections for parties than their formal counterparts. Adjudications do not provide for notice and comment, but rather, generally provide the opportunity for a public hearing and other more quasi-judicial procedures. *Id.*

143. 5 U.S.C. § 551(4). While this definition includes the words “or particular,” this phrase is controversial in the case law, and it is “generally acknowledged that the only responsible judicial attitude toward this central APA definition is one of benign disregard.” Antonin Scalia, *Vermont Yankee: The APA, the D.C. Circuit, and the Supreme Court*, 1978 SUP. CT. REV. 345, 383.

144. *See, e.g.*, *Bi-Metallic Inv. Co. v. State Bd. of Equalization*, 239 U.S. 441 (1915) (holding that an agency action constituted a rule when it applied to an indefinite group of parties prospectively).

145. *See, e.g.*, *Londoner v. Denver*, 210 U.S. 373 (1908) (holding that a city council action was adjudicative when it pertained to a specific, defined group of persons).

146. *See* 2 KENNETH CULP DAVIS, *ADMINISTRATIVE LAW TREATISE* § 12:2, at 412 (2d ed. 1979) (“The crucial difference between [adjudication and rulemaking] is that in [adjudication] specific facts about the particular property [are] disputed, but in [rulemaking] no such specific facts [are] disputed, for the problem [is] broad and general . . .”).

147. The Statement specifically states that “[f]or any homeowner who obtained a PACE or PACE-like loan with a priority first lien prior to this date, FHFA is directing Fannie Mae and Freddie Mac to waive their Uniform Security Instrument prohibitions against such senior liens,” thus excluding those homeowners who obtained PACE financing prior to the issuance of the statement from regulation. FHFA Statement, *supra* note 68.

specific findings of fact concerning past events but rather on findings of fact that are legislative or general in nature.¹⁴⁸ These factors all cut in favor of the Statement being a rule subject to the provisions of the APA requiring notice and comment rather than an order.

Not only is the Statement a rule, but it is a substantive, legislative rule subject to the notice and comment provisions of section 553 of the APA.¹⁴⁹ Legislative rules are those rules that establish a “binding norm.”¹⁵⁰ In addition, courts tend to find a rule to be a “binding norm” and thus legislative when it contains mandatory language that indicates that the agency is not open to reexamining its position.¹⁵¹ Both of these factors show that the FHFA’s Statement is a legislative rule. The new “binding norm” in this instance is the fact that PACE assessments, contrary to how special assessment districts have been treated by the GSEs in the past, are deemed incompatible with the GSEs’ Uniform Security Instruments;¹⁵² the Statement’s mandatory language shows that the FHFA is not open to reexamining this issue.¹⁵³ Thus, the Statement is a legislative rule subject to notice and comment.¹⁵⁴ Since the FHFA did not, in fact, allow for notice and comment on the Statement before its promulgation, the rule enunciated in the Statement is invalid and should be vacated until notice and comment can take place.

148. Specifically, the Statement rests on FHFA’s assumption that senior PACE liens pose an unacceptable risk to its regulated entities. This is precisely the kind of general, policy-based “fact” envisioned by Kenneth Culp Davis. *See supra* note 146.

149. *See supra* note 126. Non-legislative rules, which include interpretive rules and policy statements, are not subject to the notice and comment provisions of the APA. 5 U.S.C. § 553(b)(A) (2006).

150. *See Prof’ls & Patients for Customized Care v. Shalala*, 56 F.3d 592, 596, 600 (5th Cir. 1995) (holding that a document promulgated by the FDA was not a legislative rule because it failed to set a “binding norm” for future conduct, meaning it was “not finally determinative of the issues or rights to which it is addressed”).

151. *See, e.g., CropLife Am. v. EPA*, 329 F.3d 876 (D.C. Cir. 2003) (holding that the unequivocal language of an EPA announcement established a “binding norm” that had the force of law, and was thus a legislative rule); *Gen. Elec. Co. v. EPA*, 290 F.3d 377 (D.C. Cir. 2002) (holding that a document promulgated by the EPA was a legislative rule and not a guidance document because it obliged parties to use predefined methods of chemical cleanup and bound the EPA to accept applications meeting predefined criteria).

152. FHFA Statement, *supra* note 68. As noted above, land-financed special assessment districts have typically been found to be compatible with Uniform Security Instruments. *See Ronald H. Rosenberg, The Changing Culture of American Land Use Regulation: Paying for Growth With Impact Fees*, 59 SMU L. REV. 177, 217 n.138 (2006) (mentioning the long history of special assessments in America); *see also German Sav. & Loan Soc’y v. Ramish*, 138 Cal. 120 (1902) (upholding priority of assessment lien for street improvements over prior mortgage).

153. In particular, the Statement reads “the FHFA is directing . . .” FHFA Statement, *supra* note 68 (emphasis added). This unqualified language suggests that the FHFA is not open to revisiting the issue.

154. *See supra* notes 126 and 149.

FHFA's Statement is also unlawful under the APA on another ground—it could be found arbitrary and capricious under section 706(2)(A) of the APA.¹⁵⁵ Under one formulation of this standard, a court will overturn agency action where it “becomes aware, especially from a combination of danger signals, that the agency has not really taken a ‘hard look’ at the salient problems, and has not genuinely engaged in reasoned decision-making.”¹⁵⁶ One factor courts look to in deciding whether an agency action is arbitrary and capricious is whether the agency is departing from agency precedent without adequate explanation.¹⁵⁷ Moreover, the Supreme Court has explained that an agency rule may be arbitrary and capricious if the agency offered an explanation for its decision that runs counter to the evidence before the agency.¹⁵⁸

Under this rubric, the FHFA's Statement may be arbitrary and capricious because it fails to provide an adequate explanation for why it views PACE assessments to be so risky that they are to be deemed incompatible with the GSEs' Uniform Security Instruments.¹⁵⁹ This is especially true in light of evidence that homeowners who receive PACE funding have been found to be *less* likely to default on their mortgages than other borrowers,¹⁶⁰ which seems to be contrary to the FHFA's position that PACE programs pose unacceptable risk to lenders and, in

155. *See supra* note 129.

156. *Greater Bos. Television Corp. v. FCC*, 444 F.2d 841, 851 (D.C. Cir. 1970) (footnote omitted); *see also* *Motor Vehicle Mfrs. Ass'n v. State Farm Mut. Auto. Ins. Co.*, 463 U.S. 29, 52 (1983) (explaining that an agency must analyze the evidence available and provide a “rational connection between the facts found and the choice made”). This standard of review has also been described as an inquiry into “whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment.” *Citizens to Pres. Overton Park, Inc. v. Volpe*, 401 U.S. 402, 416 (1971). In the rulemaking context, as here, courts have stated that judicial review of rulemaking

need be no less searching and strict [than in a case of formal adjudication], but, because it is addressed to different materials, it inevitably varies from the adjudicatory model. The paramount objective is to see whether the agency, given an essentially legislative task to perform, has carried it out in a manner calculated to negate the dangers of arbitrariness and irrationality

Auto. Parts & Accessories Ass'n v. Boyd, 407 F.2d 330, 338 (D.C. Cir. 1968).

157. *See, e.g., Atchison, Topeka & Santa Fe Ry. Co. v. Wichita Bd. of Trade*, 412 U.S. 800 (1973) (remanding the Interstate Commerce Commission's decision to impose new charges on grain inspection services so that the agency could justify its change in posture); *Shaw's Supermarkets, Inc. v. NLRB*, 884 F.2d 34 (1st Cir. 1989) (remanding a NLRB decision that found an employer was engaging in unfair labor practices so that the NLRB could explain why it was significantly departing from agency precedent).

158. *State Farm*, 463 U.S. at 43.

159. FHFA Statement, *supra* note 68.

160. *See supra* note 79 and accompanying text.

turn, Fannie Mae and Freddie Mac.¹⁶¹ Finally, one can argue that the FHFA's disparate treatment of PACE assessment districts as opposed to other special assessment districts also weighs in favor of a finding that its actions in halting PACE were arbitrary and capricious.¹⁶²

However, it is less likely that a court will rule that the FHFA's Statement is arbitrary and capricious than it is that the FHFA was required to comply with the notice and comment provisions of the APA. First, courts are, as a rule, generally quite deferential to agency decision making when they are employing the arbitrary and capricious standard.¹⁶³ Second, although the FHFA is departing from past precedent in treating PACE assessments differently than it has other special assessment districts in the past, it does provide *some* explanation.¹⁶⁴ This explanation may not hold up to intense scrutiny, but it may be enough to satisfy a court.¹⁶⁵

Therefore, a realistic outcome for a litigant challenging the FHFA's Statement under the APA would be for a court to vacate and remand the Statement to the FHFA so that the FHFA may comply with the notice and comment provisions before it puts the Statement into effect.

2. *Analysis of the FHFA's Statement's Legality Under NEPA*

Besides potentially being unlawful under various provisions of the APA, the FHFA Statement may also fail to comport with the requirements of the National Environmental Policy Act ("NEPA").¹⁶⁶ NEPA requires federal agencies to prepare a detailed statement accompanying "every recommendation or report on proposals for legislation and other major

161. FHFA Statement, *supra* note 68.

162. *See supra* note 152.

163. *See, e.g.*, FCC v. Fox Television Stations, Inc., 556 U.S. 502, 129 S. Ct. 1800, 1810 (2009) ("Under what we have called this 'narrow' standard of review . . . 'a court is not to substitute its judgment for that of the agency,' and 'should uphold a decision of less than ideal clarity if the agency's path may reasonably be discerned.'") (internal citations omitted).

164. "First liens established by PACE loans are unlike routine tax assessments and pose unusual and difficult risk management challenges for lenders, servicers and mortgage securities investors. The size and duration of PACE loans exceed typical local tax programs and do not have the traditional community benefits associated with taxing initiatives." FHFA Statement, *supra* note 68.

165. Courts often remark that they do not need great detail; the basic requirement is that the agency reveal enough of its reasoning to permit meaningful judicial review. *See, e.g.*, Ne. Md. Waste Disposal Auth. v. EPA, 358 F.3d 936 (D.C. Cir. 2004); United States v. Dierckman, 201 F.3d 915 (7th Cir. 2000); Armstrong v. CFTC, 12 F.3d 401 (3d Cir. 1993).

166. National Environmental Policy Act of 1969, 42 U.S.C. §§ 4321–4347 (2006). NEPA, which ushered in the "environmental decade" of the 1970s, in which the modern environmental regulatory framework was established in the United States, has been described as "one of the nation's most important environmental laws." Bradley C. Karkkainen, *Toward a Smarter NEPA: Monitoring and Managing Government's Environmental Performance*, 102 COLUM. L. REV. 903, 904 (2002).

Federal actions significantly affecting the quality of the human environment” that describes these environmental effects.¹⁶⁷ NEPA is procedural in nature; it requires agencies to take a “hard look” at the environmental consequences of their actions¹⁶⁸ but does not require them to refrain from actions even if the environmental consequences are likely to be dire.¹⁶⁹ The FHFA’s Statement may be challenged on the ground that it will prevent the public from improving the energy efficiency of their residential properties, thus increasing energy use and GHG emissions. The FHFA’s failure to conduct an environmental analysis of the effects of the Statement therefore violates NEPA, and the Statement should be remanded to the agency so that such an analysis may be conducted.

As noted, NEPA requires federal agencies to prepare an Environmental Impact Statement (“EIS”)¹⁷⁰ for “major Federal actions significantly affecting the quality of the human environment.”¹⁷¹ Key questions under NEPA concern what constitutes a “major Federal action” that “significantly” affects the environment. The CEQ, the entity charged with interpreting and administering NEPA,¹⁷² has defined these terms in regulations. “Major Federal action” is defined as “action[] with effects that may be major and which are potentially subject to Federal control and

167. 42 U.S.C. § 4332(C). More specifically, this provision requires a statement on the environmental effects of the proposed action that details

(i) the environmental impact of the proposed action, (ii) any adverse environmental effects which cannot be avoided should the proposal be implemented, (iii) alternatives to the proposed action, (iv) the relationship between local short-term uses of man’s environment and the maintenance and enhancement of long-term productivity, and (v) any irreversible and irretrievable commitments of resources which would be involved in the proposed action should it be implemented.

Id. Other provisions of NEPA direct federal agencies to integrate environmental concerns into their general policymaking, 42 U.S.C. § 4332(A), and create the Council on Environmental Quality, which promulgates regulations interpreting NEPA. 42 U.S.C. § 4342.

168. *Kleppe v. Sierra Club*, 427 U.S. 390, 410 n.21 (1976) (“The . . . role for a court is to insure that the agency has taken a ‘hard look’ at [the] environmental consequences [of the proposed action.]”).

169. *See Strycker’s Bay Neighborhood Council, Inc. v. Karlen*, 444 U.S. 223 (1980) (holding that NEPA does not impose a substantive requirement on federal agencies to choose the most environmentally friendly option available); *Calvert Cliffs’ Coordinating Comm., Inc. v. U.S. Atomic Energy Comm’n*, 449 F.2d 1109 (D.C. Cir. 1971) (holding that NEPA creates a judicially reviewable procedural duty on the part of federal agencies to consider environmental factors through the agency review process); *see also Karkkainen, supra* note 166, at 904 (“NEPA famously requires federal agencies to produce environmental impact statements (EISs) prior to undertaking ‘major Federal actions significantly affecting the quality of the human environment.’ It requires little else, and therein lies both its singular genius and its fatal flaw.”) (footnote omitted).

170. An EIS is defined in CEQ regulations as “a detailed written statement as required by [NEPA].” 40 C.F.R. § 1508.11 (2010).

171. 42 U.S.C. § 4332(C).

172. *See supra* note 167.

responsibility.”¹⁷³ The regulations set out four general categories into which major federal actions typically fall, including “[a]doption of official policy, such as rules, regulations, and interpretations adopted pursuant to the [APA and] formal documents establishing an agency’s policies which will result in or substantially alter agency programs.”¹⁷⁴ CEQ regulations also define “significantly,” setting forth a number of factors that bear on whether an action “significantly” affects the environment.¹⁷⁵ These factors include “[t]he degree to which the effects on the quality of the human environment are likely to be highly controversial,”¹⁷⁶ “[t]he degree to which the possible effects on the human environment are highly uncertain or involve unique or unknown risks,”¹⁷⁷ “[t]he degree to which the action may establish a precedent for future actions with significant effects or represents a decision in principle about a future consideration,”¹⁷⁸ and “[w]hether the action is related to other actions with individually insignificant but cumulatively significant impacts.”¹⁷⁹

CEQ regulations also provide for a document known as an Environmental Assessment (“EA”).¹⁸⁰ An EA is a document that may be prepared by a federal agency if the federal agency is uncertain as to whether a full EIS is required.¹⁸¹ A kind of “mini-EIS,” an EA must include a discussion of possible alternatives to the proposed actions as

173. 40 C.F.R. § 1508.18.

174. 40 C.F.R. § 1508.18(b)(1).

175. 40 C.F.R. § 1508.27.

176. 40 C.F.R. § 1508.27(b)(4).

177. 40 C.F.R. § 1508.27(b)(5).

178. 40 C.F.R. § 1508.27(b)(6).

179. 40 C.F.R. § 1508.27(b)(7). This regulation clarifies that “[s]ignificance exists if it is reasonable to anticipate a cumulatively significant impact on the environment. Significance cannot be avoided by terming an action temporary or by breaking it down into small component parts.” *Id.*

180. As defined in CEQ regulations, an Environmental Assessment

(a) Means a concise public document for which a Federal agency is responsible that serves to:

(1) Briefly provide sufficient evidence and analysis for determining whether to prepare an environmental impact statement or a finding of no significant impact. (2) Aid an agency’s compliance with the Act when no environmental impact statement is necessary. (3) Facilitate preparation of a statement when one is necessary. (b) Shall include brief discussions of the need for the proposal, of alternatives as required by section 102(2)(E), of the environmental impacts of the proposed action and alternatives, and a listing of agencies and persons consulted.

40 C.F.R. § 1508.9.

181. 40 C.F.R. § 1501.4 provides that agencies should first determine if the proposed action is one that normally requires an EIS to be prepared. If there is no clear answer, the agency should prepare an EA. 40 C.F.R. §§ 1501.4(a)–(b). NEPA itself makes no mention of EAs; this framework is a codification of the holding of *Hanly v. Kleindienst*, in which the Second Circuit held that the General Services Administration was required to prepare a preliminary report to determine if a proposed action was “significant” enough to trigger NEPA requirements. *Hanly v. Kleindienst*, 471 F.2d 823, 836 (2d Cir. 1972).

well as potential environmental impacts of the proposed actions and alternatives.¹⁸² If, after preparing an EA, a federal agency determines that the environmental impact of the proposed action will be, in fact, “significant,” the agency will go on to prepare a full EIS.¹⁸³ If, on the other hand, the agency determines that an EIS is not needed, the agency will instead issue a Finding of No Significant Impact (“FONSI”).¹⁸⁴

NEPA also expressly contemplates environmental effects that are removed in time and space from the initial federal action that serves as the catalyst. CEQ regulations provide that EIS’s shall discuss “[i]ndirect effects and their significance.”¹⁸⁵ Indirect effects are defined as those effects “which are caused by the action and are later in time or farther removed in distance, but are still reasonably foreseeable.”¹⁸⁶

Considering the FHFA Statement in light of this regulatory framework, it appears likely that the FHFA violated NEPA when it failed to prepare an EIS prior to promulgating its Statement. The environmental effects of the Statement, though not direct, are still “reasonably foreseeable” as required by CEQ regulations.¹⁸⁷ It is also well established that agency rules and regulations are “federal actions” for NEPA purposes,¹⁸⁸ and as established above, the FHFA’s Statement should properly be considered a substantive rule.¹⁸⁹ Furthermore, the Statement’s effect on the environment is likely to be highly controversial,¹⁹⁰ the degree of the effects of the Statement is

182. *See supra* note 180.

183. 40 C.F.R. § 1501.4(c).

184. 40 C.F.R. § 1501.4(e). A FONSI is defined as “a document by a Federal agency briefly presenting the reasons why an action, not otherwise excluded . . . will not have a significant effect on the human environment and for which an environmental impact statement therefore will not be prepared.” 40 C.F.R. § 1508.13.

185. 40 C.F.R. § 1502.16(b).

186. 40 C.F.R. § 1508.8(b).

187. *Id.*; *see also* *Border Power Plant Working Grp. v. Dep’t of Energy*, 260 F. Supp. 2d 997 (S.D. Cal. 2003) (holding that construction of new power plants that will have an impact on air quality was a reasonably foreseeable indirect effect of building new transmission lines).

188. *See, e.g.,* *Calvert Cliffs’ Coordinating Comm., Inc. v. U.S. Atomic Energy Comm’n*, 449 F.2d 1109 (D.C. Cir. 1971) (concerning rules for licensing new nuclear plants); *Humane Soc’y v. Johanns*, 520 F. Supp. 2d 8 (D.D.C. 2007) (holding that regulation authorizing operation of fee-for-service horse slaughter operation was a major federal action).

189. *See supra* notes 141–54 and accompanying text.

190. *See supra* note 176 and accompanying text; *see also* *Hanly v. Kleindienst*, 471 F.2d 823, 830 (2d Cir. 1972) (“[T]he term ‘controversial’ apparently refers to cases where a substantial dispute exists as to the size, nature or effect of the major federal action rather than to the existence of opposition to a use, the effect of which is relatively undisputed.”). Indeed, global warming and the extent to which it is caused by increased GHG emissions emitted by humans has been one of the most controversial topics of the last decade and a half. *See, e.g.,* Eugene R. Dunn, Letter to the Editor, *Global Warming a Hard Sell*, WASH. TIMES, Feb. 8, 2011, at B2, available at <http://www.washingtontimes.com/news/2011/feb/7/global-warming-a-hard-sell/>.

uncertain and involves unknown risks,¹⁹¹ the Statement may set a precedent that federal actions that result in increased GHG emissions need not be accompanied by an EIS,¹⁹² and the Statement is undoubtedly related to other individually insignificant but cumulatively significant actions that result in the increased emissions of GHGs.¹⁹³

If the FHFA were uncertain as to whether the environmental effects of its Statement would be significant for the purposes of NEPA, the agency should have prepared an EA as required by CEQ regulations.¹⁹⁴ A realistic outcome to a challenge to FHFA's Statement under NEPA, therefore, would be for a court to remand the Statement to the FHFA so that the agency may prepare an EA to determine if the environmental effects of the Statement will be significant.

V. THE FUTURE OF PACE

In sum, the concerns of the FHFA as reflected in its Statement, while perhaps well intentioned, are misdirected. The Statement reflects a reflexive, reactionary view of a potentially invaluable tool for combating climate change at a grassroots level. As established in this Note, well designed PACE programs do nothing to increase lenders' risk; indeed, such evidence that exists shows just the opposite. Hopefully the FHFA can be convinced of the folly of its actions. If not, a legislative solution to the current PACE impasse would be ideal, but a judicial fix may be all that is feasible in the near future.¹⁹⁵ Nevertheless, those with the power to enact

191. *See supra* note 177 and accompanying text. The types, intensity, and duration of the effects of global warming are all subjects of fierce debate within the scientific community. *See* U.S. GLOBAL CHANGE RESEARCH PROGRAM, GLOBAL CLIMATE CHANGE IMPACTS IN THE UNITED STATES (2009), available at <http://downloads.globalchange.gov/usimpacts/pdfs/climate-impacts-report.pdf>.

192. *See supra* note 178 and accompanying text.

193. *See supra* note 179 and accompanying text. Global warming is the perfect example of the sort of phenomenon that is caused by such individually insignificant but cumulatively significant actions. *See* *Ctr. for Biological Diversity v. Nat'l Highway Traffic Safety Admin.*, 538 F.3d 1172, 1216 (9th Cir. 2008) (holding an EA deficient because it failed to assess the cumulative impact of increased GHG emissions from the increased numbers of Mexican trucks that would be allowed into the United States under the proposed rule at issue).

194. *See supra* note 181 and accompanying text.

195. At the time of this writing, a motion to dismiss one of the suits against the FHFA has been denied—the court held that the plaintiffs had stated a prima facie case in regards to their claim that the promulgation of the FHFA Statement violated the APA and NEPA, and the action was not barred by HERA because the FHFA was not acting as a conservator when it issued the Statement. The court also granted a preliminary injunction requiring the FHFA to begin the notice and comment process under the APA “relating to its policy on PACE-related debts.” Order Granting in Part and Denying in Part Defendants’ Motion to Dismiss, *California v. Federal Housing Finance Agency*, No. 4:10-cv-03084-CW (N.D. Cal. Aug. 26, 2011). *But see* Order Granting Defendants’ Motion to Dismiss, *Town of Babylon v. Federal Housing Finance Agency*, No. 2:10-cv-04916-LDW-ARL (E.D.N.Y. June 23,

or implement PACE legislation should follow the best practice guidelines promulgated by the DOE even absent a legislative mandate to do so. By following these guidelines, it will be shown that PACE can be an effective tool for encouraging energy efficiency while remaining compatible with prudential lending practices. Moreover, as commercial PACE has continued unaffected by the FHFA's actions, government regulators can look to it as an example for how residential PACE might be effectively structured.

Climate change and dependence on fossil fuels represent two of the most pressing concerns our society faces today. Addressing these concerns will be a monumental task for decades to come. PACE represents innovative policymaking that attempts to address these concerns by encouraging efficient collective action. Such policymaking is precisely the kind of ingenuity that will be required in the coming years. Rather than putting roadblocks in the way of such policies, governments would be well advised to encourage such solutions by working together with other levels and agencies of government, private industry, and the public at large. It is to be hoped that the recent conflict surrounding PACE will be a mere speed bump along the road in our attempts to address and adapt to the potentially grave consequences of climate change.

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2011) (holding that the court lacked jurisdiction to hear the claims against the FHFA because HERA divests jurisdiction when the agency is acting as a conservator, and the FHFA was acting in that role when it issued its Statement); Order of Dismissal, *Leon County v. Federal Housing Finance Agency*, No. 4:10-cv-00436-RH-WCS (N.D. Fla. Sept. 30, 2011) (same); Order Granting Defendants' Motion to Dismiss, *NRDC v. Federal Housing Finance Agency*, No. 1:10-cv-07647-SAS (S.D.N.Y. June 17, 2011) (holding that the court lacked jurisdiction both because the FHFA was acting as conservator under HERA and because the NRDC lacked standing). In response to the preliminary injunction issued by the U.S. District Court for the Northern District of California, the FHFA issued an Advanced Notice of Proposed Rulemaking concerning PACE and a Notice of Intent to prepare an EIS regarding the potential environmental impacts of PACE pursuant to NEPA. *Mortgage Assets Affected by PACE Programs*, 77 Fed. Reg. 3958 (proposed Jan. 26, 2012) (to be codified at 12 C.F.R. pt. 1254). The FHFA sought comment on "whether the restrictions and conditions set forth in the July 6, 2010 Statement . . . should be maintained, changed, or eliminated, and whether other restrictions should be imposed. *Id.* The FHFA has also appealed the preliminary injunction to the Ninth Circuit, and that appeal is pending at the time of this writing. *Id.*

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