COUNTY OF SONOMA

575 ADMINISTRATION
DRIVE, ROOM 102A
SANTA ROSA, CA 95403

SUMMARY REPORT

Agenda Date: 7/8/2025

To: Sonoma County Board of Supervisors
Department or Agency Name(s): Auditor Controller Treasurer Tax Collector and County Administrator Office
Staff Name and Phone Number: Erick Roeser 707-565-3295, Kathy Parnell 707-565-6124, Rhianna Frank 707-565-6483, Terri Somers 707 565-6489,
Vote Requirement: Majority
Supervisorial District(s): Countywide

Title:

Sonoma County Energy Independence Program Update and Recommendations

Recommended Action:

A) Approve a wind-down of the residential component of the Sonoma County Energy Independence Program, and
B) Accept recommendation to continue the commercial-only program, effective March 1, 2026, and direct staff to return to the Board with an annual program update.

Executive Summary:

The Sonoma County Energy Independence Program ("SCEIP" or "Program") plays a pivotal role in advancing the County's climate and resiliency objectives, particularly those outlined in the Climate Action and Resiliency pillar of the Strategic Plan and the Climate Resilience Comprehensive Action Plan, which envisions a carbon-neutral, zero-waste, and climate-resilient Sonoma County. SCEIP aligns with this vision by providing Property Assessed Clean Energy (PACE) financing for energy, water, wildfire safety, and seismic strengthening improvements.

In December 2024, the Consumer Financial Protection Bureau (CFPB) adopted new federal regulations, as mandated by Congress, that will significantly impact SCEIP. Effective March 1, 2026, the Program will be required to comply with federal underwriting standards applicable to residential mortgage loans for all residential PACE applications. This includes verifying a property owner's ability to repay by evaluating income, credit history, debt obligations, and employment status, which is a significant departure from the property-based underwriting model that SCEIP has utilized since its launch in 2009.

A comprehensive review by the Program's Steering Committee (which includes representation from the Auditor-Controller-Treasurer-Tax Collector's Office, Sonoma County Administrator's Office and County Counsel) determined that implementing these new requirements would be fiscally unsustainable. Accordingly, the Steering Committee recommends phasing out the residential portion of the Program, with no new residential assessment contracts to be executed after February 28, 2026.To meet this cut-off, no new residential applications would be accepted after January 12, 2026. Existing contracts will not be impacted.

It is also recommended that the County continue to maintain and expand the commercial portion of the Program.

This would allow the County to utilize its existing infrastructure and expertise to focus on commercial PACE, which is not subject to the CFPB's new regulations. Commercial PACE is already included in the Program authorized by the Board and reflects less than 20% of the Program's total funded projects to-date and has not been heavily targeted with marketing and communication. As such, this may represent an underserved market segment, with the potential for projects that generate very large carbon reductions in support of County climate goals. The longer-term viability of continuing this commercial-only approach will be reassessed and staff will return to the Board with an update.

Additionally, the Auditor-Controller-Treasurer-Tax Collector recommends the Program maintain the existing financing interest rate for contracts executed by the end of the year to continue to be aligned with market yields for comparable Treasury investments with a similar average maturity. This would preserve the SCEIP financing interest rate at 7.99%, while the allocation for Program operations would remain at 4.00% and the Treasury Investment Pool would earn 3.99%.

Discussion:

BACKGROUND

SCEIP is a County-administered, public service program that provides financing and education services community-wide to assist in meeting the County's greenhouse gas emission reduction goals and to promote community resilience to grid power interruptions, and natural disasters such as drought, earthquakes, and wildfires. The Program provides financing to property owners, which is secured by placing an assessment on their property to fund eligible improvements. The funds are then repaid through property taxes over a period of 10 or 20 years, with a fixed interest rate. Financing is currently available to both residential and commercial property owners. A residential property owner can request up to 10% of the current market value of the property, however, the amount of the requested financing plus the amount of any existing liens cannot exceed 95% lien-to-value (LTV) ratio. A commercial property owner must obtain lender acknowledgment of the requested SCEIP assessment, and the property's market value is generally determined by the lender acknowledgment, which is also utilized to determine LTV.

Staff has developed strategies and actions as part of its education and outreach for reducing racial inequities and ensuring access for all Sonoma County residents, including underserved members of our community. The Program provides access to capital through financing that does not consider a property owner's income, credit score, or debt-to-income ratio, which increases access to non-traditional capital resources.

PROGRAM UPDATE

The Program's administrative cost is funded through a portion of the interest rate applied to the financing. Currently, the Program has a 7.99% financing interest rate, with a 4.00% increment of the interest going towards the Program's administrative costs and the remaining 3.99% portion of the interest rate going towards the Treasury's investment to its existing portfolio. The Treasury purchases the monthly bonds created by the Program, and as such, the investments must earn a reasonable rate of return for its Pool participants. As a benchmark and for comparative purposes, as of May 28, 2025, the rate on a 5-year U.S. Treasury Note is 4.06%.

Interest Rate Environment and Potential Impact on Early Payoffs

The Federal Reserve Open Market Committee (FOMC) began reducing interest rates in September 2024, with the Target Fed Funds rate reduced by a total of 100 basis points (or 1.00%) during the second half of the year. These actions lowered the Target Federal Funds rate from 5.50% to 4.50% (upper bound) by December 2024. While there have been no additional interest rate decreases since December 2024, market expectations currently suggest further rate decreases may occur in 2025 and 2026, although the timing and magnitude (and ultimately the direction) of any future rate changes remain uncertain. Based on a review of the prevailing interest rate environment, including the Treasury yield curve and forward curve, no change is recommended to the SCEIP financing interest rate at this time.

During the last period of Fed tightening, which began in March 2022, the Target Fed Funds rate was increased eleven times from 0.25% to 5.50% as of July 2023. During this period, mortgage applications nationwide declined sharply, which coincided with the higher mortgage rates, and resulted in a slow-down in the amount of mortgage refinance activity. This benefited SCEIP as observed by significantly lower early payoffs in the Program's assessments, thereby contributing to a higher bonded project balance and greater interest revenue. Staff projects that early payoffs are likely to increase in future years, not only due to possible reductions in interest rates, but also due to other factors, which could be detrimental to the Program. Home sales and purchases, which may have been on pause due to the higher mortgage interest rate environment or lower available inventory, may begin to increase if mortgage rates continue to decline, which could increase SCEIP payoffs and adversely impact the Program. Additionally, adjustable-rate mortgages that were financed during the Pandemic at historically low interest rates may begin to reset at higher rates, which could contribute to an increase in observed refinancing activity, which could also increase early payoffs.

Application Volume

The Program has received 101 financing applications to date for FY 2024-25, compared to 183 in FY 2023-24 and 264 in FY 2022-23. This fiscal year, as of May 1st, SCEIP has bonded 118 applications totaling $5,092,049 as compared to 132 in FY 2023-24 which totaled $6,340,630 and 133 applications in FY 2022-23 which totaled $5,5973,715. The Program has funded over $111 million in completed and bonded projects to date. Energy efficiency projects exceeded $27.7 million, energy generation projects, such as solar, exceeded $75 million, wildfire safety exceeded $7.8 million, and seismic and water conservation account for $273,000. The Program has bonded a total of 126 in commercial projects totaling $17,577,539 and 3,768 Residential projects totaling $94,022,461 to date.

Operating Fund Condition

The Program's operating fund has a single source of net revenue: interest paid on bonded projects net of interest expense paid on SCEIP bonds. Net revenue is influenced by the number of new projects bonded and the rate at which existing assessments are paid off. The recent growth in bonding of new projects, coupled with the decrease in early payoffs, caused an overall increase in operating revenue to the Program. Currently, early payoffs are lower than previous years; however, staff anticipates that there may be a back log of homeowners waiting for an interest rate reduction to refinance their homes. This expectation has been factored into the Program's fiscal projections.
Projections for FY 2025-26 vs. FY 2024-25 (Current Estimate):

- No growth is projected in annual bonding in FY 2025-26 - Annual bonding is projected to decrease substantially from the peak in FY 2023-24. We are currently projecting a 35% decrease in bonding this year. The outstanding bond balance is still projected to grow this year, but at a slower rate than in the previous two years.
- 7% rate is projected for payoffs in FY 2025-26 - currently trending at 5.0%
- Expenses budgeted at $1,709,257 - current estimate is $1,383,078 or 81% of projection.

Beginning in FY 2023-24, the Program was advanced $100,000 from the General Fund as a loan to the Program, which your Board approved in July 2022. The advance was necessary to address timing of cash inflows and outflows. The advance is accounted for in the projected fund balance at year end. If the advance is repaid in FY 2025-26, the ending cash balance for FY 2024-25 is projected to be $714,835.

CONSUMER FINANCIAL PROTECTION BUREAU (CFPB) AND RESIDENTIAL PACE

In May 2018, Congress passed a new law amending the federal Truth in Lending Act, which required the Consumer Financial Protection Bureau (CFPB) to adopt regulations imposing ability-to-repay requirements on property assessed clean energy (PACE) financing. After a six-year formal rulemaking process, the CFPB adopted new PACE regulations on December 17, 2024. County staff was actively engaged in the rulemaking process, including submittal of written comments at every opportunity, numerous meetings with CFPB staff, and submittal of SCEIP data for review and analysis by the CFPB. During the rulemaking process, County staff sought an exception from the pending regulations for programs like SCEIP, that are operated by local government entities for the benefit of the community without use of private administrators or other for-profit intermediaries. Despite these efforts, County staff were unable to obtain an exclusion for SCEIP from the new requirements.

Commencing March 1, 2026, the Program will be required to make an ability-to-repay determination of a property owner prior to executing a residential assessment contract, including consideration of the owner's income, credit history, debts, and employment status. Implementing these new underwriting requirements would significantly increase financing costs, and would be a sea change for the Program, which has traditionally relied on property-based underwriting criteria, like lien-to-value and loan-to-value ratios. The new regulations also impose new consumer disclosure requirements. Based on preliminary investigation by Program staff, implementing these underwriting requirements would cost between $800 and $1,200 per SCEIP application.

Under the Trump administration, new CFPB leadership has taken measures to significantly reduce staffing of the CFPB and shift the focus of its supervision and enforcement priorities. The staffing reductions are currently being challenged in federal court by the employee unions. Despite the looming uncertainty around the agency's staffing and priorities, the new PACE regulations are published, final regulations, which require no further action by the agency. Repealing the regulations, on the other hand, would require an act of Congress or initiation of a new formal rulemaking process by the CFPB. County staff have consulted with our federal lobbyist and are not aware of any formal action being initiated by Congress or the CFPB to repeal the PACE regulations.

Additionally, a PACE trade organization recently filed a complaint against CFPB in a Florida federal district court challenging the legality of the regulations. Among other claims, the complaint alleges that the regulations infringe on the sovereign taxing authority of the states. The plaintiff is seeking an injunction pending adjudication of the claims, which if granted, could delay the effective date of the regulations. The litigation is in its very early stages and County staff will be tracking its progress.

If formal action to repeal the final regulations is taken by the CFPB or Congress, or if a court issues a ruling delaying the effective date or invalidating the final regulations, staff will return to the Board to review next steps for the Program.

<u>Recommendation:</u>

Wind-Down of Residential Program and Transition to Commercial-Only

Under this scenario, the County would officially cease entering into new residential assessment contracts as of March 1, 2026, thereby marking the end of new activity under the residential portion of the Program. Following this cutoff date, County staff will shift focus toward its a commercial program. This transition provides an opportunity to explore and develop services for the commercial sector-an area that has not previously been prioritized under the current program model, while assessing how this would impact the future stability of the Program.

During FY 2025-26, Program staff will continue to manage and support existing residential assessment contracts. This includes assisting property owners with project completion, processing fund disbursement requests, and facilitating the bonding of executed contracts. The majority of staffing resources dedicated to the residential component of the program will be phased out as the Program shifts exclusively to commercial

A detailed projection of fiscal impacts and operational costs through FY 2031-32 is included in Attachment 5 of this item. Through the financing of commercial SCEIP projects, program revenues will continue to be generated, which will benefit in the long-term periods when overall operating costs are estimated to exceed program revenues.

As part of the residential program's wind-down, the County's Energy & Sustainability Division will undergo a strategic restructuring to align staffing and operational costs with the reduced program footprint. This effort aims to mitigate potential impacts to the General Fund as the program concludes.

It is important to note that this change affects only the Sonoma County Energy Independence Program (SCEIP). Other initiatives managed by Energy & Sustainability-including those funded by Bay Area Regional Energy Network (BayREN) and PG&E Local Government Partnership (LGP) funds-will remain unaffected and continue as planned.

County staff will return to the Board at a future date with a comprehensive proposal outlining the restructuring of Energy & Sustainability in response to these programmatic changes.

<u>Alternatives:</u>

1. **Compliance**: This approach involves implementing the new underwriting requirements outlined in the PACE regulations, including making an ability-to-repay determination for each Program applicant prior to execution of an assessment contract. The associated programmatic costs of compliance are detailed in Attachment 6, with overall increases ranging from $800 and $1,200 per SCEIP application. Adopting this strategy ensures that the County's program remains in full compliance with federal regulations by

the March 1, 2026, effective date. If the incremental costs attributed to new underwriting requirements were passed through to the homeowner, staff anticipates that SCEIP applications would drop considerably, making the path forward unsustainable. Based on analysis conducted by Program staff, the new costs of compliance would make the Program less competitive with private lending and eliminate some of the advantages that have made the Program attractive to some property owners. As such, bringing the Program into compliance is likely to make the Program fiscally unsustainable.

2. **Full Wind-down of SCEIP**: Under this scenario, the Program would stop accepting all new applications after January 12, 2026. This would still entail a wind-down period during the first half of 2026, as well as limited ongoing work during the tail during the term of existing contracts. Staff analysis suggest that any commercial loans issued in this window would increase the long-term fiscal stability of the programs wind-down, even if the commercial-only model does not prove viable. Additionally, the County would not be able to benefit from potential greenhouse gas reductions as the result of commercial projects. As such this option is not preferred.

Strategic Plan:
This item directly supports the County's Five-year Strategic Plan and is aligned with the following pillar, goal, and objective.

Pillar: Climate Action and Resiliency
Goal: Goal 2: Invest in the community to enhance resiliency and become carbon neutral by 2030
Objective: Objective 2: Provide $20 million in financing by 2026 that incentivizes property managers and renters to retrofit existing multi-family housing towards achieving carbon neutral buildings.

Racial Equity:

Was this item identified as an opportunity to apply the Racial Equity Toolkit?
No

Prior Board Actions:
3/18/2025 - Sonoma County Energy Independence Program Semi-Annual Bonding Authorization
9/17/2024 - Sonoma County Energy Independence Program Update and Interest Rate Determination
3/16/2024 - Sonoma County Energy Independence Program Semi-Annual Bonding Authorization
9/19/2023 - Sonoma County Energy Independence Program Semi-Annual Bonding Authorization 5/23/2023- Sonoma County Energy Independence Program Update and Interest Rate Determination
3/14/2023 - Sonoma County Energy Independence Program Semi-Annual Bonding Authorization

FISCAL SUMMARY

Narrative Explanation of Fiscal Impacts:
This item is not asking for any fiscal adjustments. Depending on the Board determination, staff will return with a future item discussing necessary staffing or other changes and associated fiscal adjustments.

STAFFING IMPACTS

Narrative Explanation of Staffing Impacts (If Required):
There is no staffing impact related to this item. Depending on the Board determination, staff will return with a future item discussing necessary staffing or other changes and associated fiscal adjustments.

Attachments:

1: SCEIP Program Report and Administrative Guidelines
2: PowerPoint Presentation
3: Current Program Budget and Fiscal Projections Summary
4: Consumer Financial Protection Bureau Final Rulemaking Summary
5: SCEIP Fiscal Projections through FY 2045-46
6: County Compliance Requirements and Associated Programmatic Costs

Related Items "On File" with the Clerk of the Board: N/A