MORTGAGE BANKERS ASSOCIATION

August 19, 2016

U.S. Department of Energy
Office of Energy Efficiency & Renewable Energy
Forrestal Building
1000 Independence Avenue, S.W.
Washington, D.C. 20585

RE: Residential Property Assessed Clean Energy (PACE) Financing Programs

To Whom It May Concern:

From the inception of the Property Assessed Clean Energy (PACE) program, the Mortgage Bankers Association (MBA)[1] has had significant concerns regarding the lack of consumer protections and the impact of the program on duly recorded first lien mortgages. While we appreciate the work the Department of Energy (DOE) has undertaken in the revision of its "Best Practice Guidelines for Residential PACE Financing Programs" (Guidelines) to upgrade standards for program design, compatibility with energy efficiency programs, and services and evaluation of program outcomes, much more fundamental reforms are needed.

MBA thanks DOE for the opportunity to comment on the draft Guidelines in the development of clear and concise standards for jurisdictions across the country with established PACE programs or those seeking to create a program. MBA believes it is particularly important to create a framework that will provide consumers with accurate, clear information on PACE financing due to the long-term ramifications that are not often immediately apparent when a consumer enters into an agreement to obtain PACE financing.

Background

In substance, PACE loans are mortgage financing products utilized for home improvements that improve a property's energy efficiency or conserve water-use—including solar panels, energy efficient appliances and windows, etc. States pass enabling legislation to trigger PACE program implementation, which causes existing PACE program specifics to vary by state/municipality. Private companies initiate these loans and approve contractors to make these energy improvements. Often, improvements are funded from proceeds raised by the issuance of municipal bonds.

Unlike a traditional mortgage, however, the PACE obligation runs with the property, not the borrower. PACE loan, payments are added to a borrower's property tax bill and paid through property tax installments. Like a mortgage, loan terms are typically for a period of 15 or 20 years,

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[1] The Mortgage Bankers Association (MBA) is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; to expand homeownership and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage-lending field. For additional information, visit MBA's Web site: www.mba.org.

but offer interest rates significantly higher than traditional mortgage rates. Because the PACE loan then runs with the property, not the borrower, it creates a monthly payment encumbrance for the subsequent purchaser upon resale. Nevertheless, this difference does not alter the fact that a PACE obligation is a mortgage product, and it is this form-over-substance structure that is at the root of the PACE program's problems.

MBA supports efforts to facilitate the ability of homeowners to finance energy improvements, however, there are several fundamental concerns surrounding the PACE loan structure that present risks for borrowers, first lienholders, and mortgage guarantors that warrant further attention and review. These concerns include:

- **Consumer Protections**: PACE loans do not utilize the same financial assessments or offer the disclosures typically associated with real estate financing. As a result, homeowners may not fully understand the consequences of assuming an increased financial obligation on their tax bill. Additionally, PACE qualifying criteria may allow borrowers to assume an obligation even if they are not financially equipped to make the payments. Finally, although borrowers are often advised in PACE marketing materials that future buyers will assume their payments on resale, the practical reality has been that subsequent purchasers do not value the energy improvements in the same manner and often insist that the PACE obligation be extinguished or the sale price reduced.

- **Lien Priority:** Given the repayment of PACE loans through the tax structure, delinquent PACE amounts may become senior in lien priority to prior recorded mortgages. This issue has raised particular concern for many in our membership as the PACE obligation requires servicers to advance delinquent PACE assessments, and undermines their duly recorded first lien position in a foreclosure. This concern and others spurred the Federal Housing Finance Agency (FHFA) to establish policy prohibiting Fannie Mae and Freddie Mac (GSEs) from purchasing mortgages where the property has a PACE loan attached.[2]

Recommendations

MBA supports DOE's efforts to provide additional safeguards to make PACE programs safer for borrowers and more viable for lenders in the future. However, rather than having a separate set of standards from DOE, MBA believes the best way to address PACE program consumer protections is through a formal regulatory framework that ensures PACE loans have the same protections as other home improvement financing options secured by a mortgage.

MBA strongly recommends that PACE obligations be classified as consumer credit transactions secured by a dwelling, ensuring that borrowers are covered by federal consumer protection laws, as are the entities that originate PACE loans. This would also ensure that competing products are covered by the same protections and allow consumers to shop safely and compare similar products. Key protections that should be explicitly extended to PACE lending include:

- **Ability-to-Repay Requirements** – requires documentation of the lenders' assessment of the borrower's ability to afford the obligation;

[2] See Enterprise Underwriting Standards, 77 Fed. Reg. 36,086, (June 15, 2012) (proposed rule); Federal Housing Finance Agency, Statement of the Federal Housing Finance Agency on Certain Super-Priority Liens, Dec. 23, 2014, available at: http://www.fhfa.gov/Media/PublicAffairs/Pages/Statement-of-the-Federal-Housing-Finance-Agency-on-Certain-Super-Priority-Liens.aspx

- **Truth in Lending Act Requirements (TILA) (including Homeownership Opportunity and Equity Protection Act (HOEPA) and High Cost Mortgage Protections)** – requires important disclosures like Annual Percentage Rate (APR), and enhanced protections for certain loans with higher interest rates;

- **Know Before You Owe Disclosures**– provides consumers with a Loan Estimate to compare different loan options, and a Closing Disclosure to ensure those estimates were accurate;

- **Secure and Fair Enforcement for Mortgage Licensing (SAFE) Act Requirements**– requires individuals engaged in mortgage loan origination activities to be licensed by completing education requirements, passing a test, and passing a background check.

A. *Provide Clear Consumer Protections*

Without clear and definitive measures and the development of standardized disclosures to educate potential participants on how PACE financing works, property owners will not be able to accurately weigh the potential risks of utilizing PACE to finance energy improvements to their property.

1. "Ability-to-Repay"

PACE financing is generally based on the tax capacity of the property, rather than on the borrower's ability to repay (income, other credit obligations, etc.). Therefore, PACE qualifying criteria may allow borrowers to assume an obligation that significantly increases their property tax payments even if they are not financially equipped to pay, increasing their risk of default on their mortgage. While the Guidelines suggest PACE Program administrators determine the financial eligibility of the property by ensuring the estimated property value is "in excess of property owner's public and private debt on the property, including mortgages, home equity lines of credit (HELOC), and the addition of the PACE assessment," this suggested consideration is not sufficient to replace an "Ability-to-Repay" determination. MBA recommends that PACE programs be subject to the Consumer Financial Protection Bureau's (CFPB) "Ability-to-Repay" requirements to best determine the borrower's ability to repay through a comprehensive assessment of a borrower's income, credit history, and expected monthly payments.[3]

2. TILA, including HOEPA and High Cost Mortgage Protections

PACE financing is not technically classified as a "loan," but as a voluntary assessment. However, a PACE loan is still a financial obligation secured by a dwelling that can negatively affect the mortgage repayment ability of consumers and impact their ability to sustain homeownership. Moreover, these loans also typically carry interest rates far higher than conventional mortgage loans—often ranging between six and eight percent—in a time when mortgage rates have reached the lowest levels in decades. Consequently, PACE obligations should be covered by the disclosure requirements and consumer protections under TILA and HOEPA.

[3] See 12 C.F.R. § 1026.43.

In contrast, to PACE, conventional financing options such as HELOCs or second mortgages are fully covered by TILA and HOEPA. To ensure that consumers have the best opportunity to effectively compare the cost of a PACE loan to conventional financing alternatives, MBA recommends that PACE programs be subject to TILA requirements, including HOEPA and high cost mortgage protections, due to the high interest rates PACE programs offer. Unless the Guidelines include information that explicitly delineates the same disclosures and protections as TILA, PACE programs will likely employ different methods of disclosure and content will vary significantly across programs.

3. "Know Before You Owe"

In addition to avoiding coverage under TILA, PACE loans are not accompanied by the CFPB's new "Know Before You Owe" (KBYO) disclosures. Therefore, homeowners may not fully understand the consequences of assuming an increased financial obligation on their tax bill. To remedy this, MBA recommends that PACE obligations be classified as consumer credit transactions secured by a dwelling, and thereby subject to the CFPB's "Know Before You Owe" requirements. Coverage under KBYO will ensure that consumers understand their loan options, are able to shop for the best product for their unique needs, and are not surprised by unexpected costs. Though the Guidelines address a list of disclosures that should be provided to consumers to educate potential participants, the Guidelines only suggest broad categories of necessary consumer disclosures for PACE financing. PACE programs should be held to the same standard as similar competing products to ensure that borrowers have the knowledge needed to choose the best product for their needs.

4. SAFE Act

Because PACE obligations are, in form, mortgages, individuals engaged in PACE loan origination activities should be subject to SAFE Act licensing. By requiring, those who originate PACE loans to also complete education requirements, pass a comprehensive exam, and pass a background check, consumers will benefit from a standardized process that will increase accountability. At the same time, state regulators will be able to track and monitor those involved in PACE lending, thereby reducing the likelihood that bad actors will be engaged in the PACE financing business. PACE loan originators should abide by the same established standards as their competitors offering traditional home equity financing.

B. *Enhance PACE-specific Disclosures Regarding Lien Priority, Tax Assessments and Implications for Resale*

Currently, many PACE loan repayment structures are built into the property tax collection process. This allows delinquent PACE amounts to become senior in lien priority to prior recorded mortgages. As a result, FHFA has prohibited the GSEs from purchasing a mortgage where the property has a first-lien PACE loan attached to it to "ensure protection of the core financing for the home."[4]

In addition to undermining the first lien, the remaining PACE obligations also may affect the salability of the property, creating significant obstacles for PACE borrowers. With the outstanding

[4] See Enterprise Underwriting Standards, 77 Fed. Reg. 36,086, (June 15, 2012) (proposed rule); Federal Housing Finance Agency, Statement of the Federal Housing Finance Agency on Certain Super-Priority Liens, Dec. 23, 2014, available at: http://www.fhfa.gov/Media/PublicAffairs/Pages/Statement-of-the-Federal-Housing-Finance-Agency-on-Certain-Super-Priority-Liens.aspx

PACE loan obligation running with the property, borrowers who later sell to buyers seeking conventional financing may find themselves having to pay off the outstanding PACE loan, or agreeing to a lower sales price. In some cases, borrowers may find themselves underwater, precipitating default. The Guidelines discuss PACE assessments and their potential impact on mortgage financing, noting that "some mortgage lenders may be unwilling or unable to modify or refinance a property subject to a PACE assessment due to the type and position of the assessment," but do not specifically state that PACE financing should not displace a mortgage to a second lien position.

PACE program eligibility guidelines recently released by the Federal Housing Administration (FHA) and the Department of Veterans Affairs (VA) have not removed lien priority concerns by simply indicating that a PACE loan is a tax assessment. Due to this categorization, PACE obligations will still have priority over previously recorded liens, and more specifically, FHA guidance will still allow a property to become subject to a lien superior to the FHA-insured mortgage for delinquent PACE loan amounts. This framework sets a dangerous precedent for mechanisms that support private entities, rather than public improvements, using public tax assessments. As part of FHA's program, as servicers advance PACE loan payments, in the event a borrower becomes delinquent, or the property enters foreclosure, the Mutual Mortgage Insurance (MMI) Fund will ultimately serve as a "backstop" for privately originated home improvement loans.

Finally, PACE marketing materials often promote the notion that future buyers will assume their payments on resale. However, the practical reality has often been that subsequent purchasers do not value the energy improvements in the same manner and often insist that the PACE obligation be extinguished or the sale price reduced. These risks should be fully explained to borrowers in a separate PACE disclosure.

Due to these concerns, MBA recommends that the Guidelines incorporate specific disclosures and best practices that directly address the potential impact PACE assessments may have on lien priority and subsequent resale of the home. This addition will provide the necessary consumer protections for PACE program participants as well as the appropriate safeguards for mortgage lenders to mitigate the potential risks of PACE loan obligations.

C. *Other Concerns*

MBA also cites the following additional concerns regarding PACE program execution and real estate transactions.

1. Property Appraisal Standards

There is little empirical information to support appraisers in valuing energy related home improvements. The absence of clear standards for appraisers poses a risk that improvements or cost savings may be overvalued, as benefits are often difficult to quantify. This poses challenges for lenders in terms of collateral support for lending decisions, and for consumers in evaluating the benefits of a project. MBA believes there is much more work to be done before consumers are able to assume PACE obligations with confidence. MBA recommends that DOE lead the efforts in developing a valuation methodology for energy efficient improvements by working with the appraisal industry and energy efficiency experts.

2. Lack of PACE Program Standardization

Since the initial issuance of DOE guidelines on PACE financing programs in 2010, 31 states have passed PACE-enabling legislation, and the number of states with active PACE programs including both commercial and residential PACE has grown significantly. However, these programs may vary significantly from one another. This poses significant challenges specifically for lenders seeking to determine whether a PACE program is compliant with FHA's and DOE's guidelines. PACE program eligibility under FHA's program is structured as a lender warranty, circumscribed by general requirements and standards that PACE programs must meet to be eligible for FHA financing. This framework exposes lenders to both indemnification and False Claims Act risk due to the lack of standardization that exists among jurisdictional PACE programs. In order to address this lack of consistency, MBA recommends that PACE obligations be regulated by federal consumer protection laws as a first step towards ensuring the standardization of PACE program execution around the country.

Conclusion

MBA greatly appreciates the efforts DOE has put into enhancing consumer protections for borrowers looking to achieve homeownership. Toward this end, MBA urges DOE to review the aforementioned aspects of PACE lending.

MBA has asked the CFPB to intervene on PACE's significant consumer protection issues and continues to urge FHA to slow implementation and engage with industry and consumer groups to address many of the problematic aspects of its PACE guidance. MBA ultimately recommends that PACE obligations, be classified as consumer credit transactions secured by a dwelling, to ensure that federal consumer protection laws are expanded to protect borrowers who choose PACE financing. Without the standardization and regulation of individual PACE programs, borrowers will lack the necessary knowledge to make appropriate product decisions and will experience inconsistent processes and outcomes.

We welcome the opportunity to discuss this issue further with you or your staff. Should you have questions or wish to discuss our concerns, please contact Tamara King, Vice President of Residential Policy and Member Engagement, at (202) 557-2758 or TKing@mba.org, or Katherine Tung, Policy Advisor of Residential Policy, at (202) 557-2870 or KTung@mba.org.

Sincerely,

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