MORTGAGE BANKERS ASSOCIATION

May 3, 2019

Ms. Monica Jackson
Office of the Executive Secretary
Bureau of Consumer Financial Protection
1700 G Street NW
Washington, DC 20552

Re: **Advance Notice of Proposed Rulemaking on Residential Property Assessed Clean Energy Financing, Docket No, CFPB-2019-0011**

Dear Ms. Jackson:

The Mortgage Bankers Association (MBA) appreciates the opportunity to comment on the Consumer Financial Protection Bureau's ("CFPB" or "Bureau") above-referenced Advance Notice of Proposed Rulemaking (ANPR) on residential Property Assessed Clean Energy (PACE) financing. As a national association with members operating in California, Florida, and Missouri, the states most affected by PACE financing, we support the Bureau's efforts to implement Section 307 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA). We look forward to working with the Bureau to develop regulations that ensure consumers receive PACE financing on terms that reasonably reflect their ability to repay.

MBA recognizes and supports the important public policy objectives that are the stated rationale for PACE lending. We are confident that the housing finance industry can play an important role in promoting greater energy efficiency for individual homeowners. As the experience with PACE shows, however, policies that impact housing must be designed and executed in a way that does not sacrifice consumer protection or undermine core principles of secured lending.

It has become increasingly clear that many of the problems now apparent with PACE financing are the result of decisions that treat PACE differently than traditional mortgage financing. Unique features such as tax lien treatment, specific project eligibility guidelines, and repayment through tax bills do not change the fundamental character of PACE financing – PACE loans are mortgages. While the Bureau's rules must take into account these features, CFPB must not lose sight of the fact that PACE remains real estate secured financing. As such, the potential for consumer harm is identical to that associated with mortgage financing. Whether through a tax sale or a foreclosure, the result of homeowners' inability to repay is the same—they lose their home.

While the lack of uniformity in PACE financing makes it difficult to address many of the ANPR's questions with specificity, MBA is aware of aspects of PACE financing that commonly appear in the various single-family PACE programs. We are also aware of the impact these programs have had on both consumers and housing industry participants. Our comments reflect this perspective.

I. PACE ORIGINATION

Though the specifics of the origination process vary with each PACE program, general point-of-sale practices appear to be relatively consistent. Private contractors sell energy efficient home improvements directly to consumers, often through door-to-door sales. These contractors offer PACE-eligible "efficiency" home improvements and opportunities for PACE financing through partnerships with PACE providers (also known as PACE program administrators).[1] PACE program administrators are private, for-profit companies that have contracted with local governments to arrange PACE financing for designated energy efficient home improvements that the local government allows to be secured on its property tax rolls.[2]

Interested consumers are asked to complete PACE applications that are forwarded, either directly or through the contractor, to the PACE provider. Applications and any supporting materials are assessed for program eligibility and underwriting by the PACE provider.

The application, financing agreement, and any other documents are often displayed on tablet computers or other electronic media. Paper copies are mailed after the originals are electronically executed. The entire process, including the sales pitch, project bidding, completing the financing application, and contract signing, is completed in a matter of hours—much more quickly than the process to obtain mortgage financing and often without an adequate period for the consumer to reflect.

II. ISSUES WITH PACE ORIGINATION

Numerous reports from national media and consumer rights groups document concerns with the PACE origination process.[3] Consumers, including the elderly or those with limited English

---

[1] See California Department of Business Oversight, Frequently Asked Questions on PACE, available http://www.dbo.ca.gov/Licensees/pace/Frequently%20Asked%20Questions.asp.

[2] Andrew Khouri, *These loans were created to help homeowners, but for some they did the opposite*, Los Angeles Times (June 4, 2017). Available at http://www.latimes.com/business/la-fi-pace-loans-20170604-story.html.

[3] Kirsten Grind, *FBI SEC Look Into Business Practices of Country's Largest 'Green' Lender*, The Wall Street Journal (Sept. 26, 2017). Available at https://www.wsj.com/articles/fbi-sec-look-into-business-practices-of-countrys-largest-green-lender-1506430977; Kirsten Grind, *More Borrowers Are Defaulting On Their 'Green' PACE Loans*, The Wall Street Journal (Aug. 15, 2017). Available at https://www.wsj.com/articles/more-borrowers-are-defaulting-on-their-green-pace-loans-1502789401; Andrew Khouri, *These loans were created to help homeowners, but for some they did the opposite*, Los Angeles Times (June 4, 2017). Available at http://www.latimes.com/business/la-fi-pace-loans-20170604-story.html; Ron Hurtibise, *Federal suit says PACE home improvement loan program fails to disclose risks, costs*, South Florida Sun Sentinel (April 11, 2017). Available at https://www.sun-sentinel.com/business/fl-bz-pace-prepayment-penalty-suit-20170411-story.html.

proficiency, describe receiving PACE loans with little understanding as to the nature of the agreement.[4] These consumer accounts frequently reference misunderstandings about the cost of PACE financing and its impact on the homeowner's ability to sell or refinance the property.[5]

A. True cost of PACE financing

Confusion about the cost of PACE financing takes many forms. Some consumers report being told the PACE loan would "pay for itself" through energy savings or tax benefits associated with their PACE-financed home improvements.[6] Others were left with the belief that the PACE financing was a form of government assistance that did not require repayment.[7]

The lack of standardized disclosures appears to contribute to these misunderstandings. Consumers are shown materials that reference local taxing authorities or special PACE assessment zones. This, along with the fact that repayments are made through the property tax assessment, may lead less sophisticated consumers to believe that PACE financing is offered by the government, rather than by a private entity.

B. Impact of PACE assessment on sale or refinance

PACE financing has been promoted as debt that follows the property rather than the borrower. The idea that responsibility for repayment shifts to the new property owner is an attractive feature for many prospective PACE borrowers.

While such an arrangement is technically possible, these claims ignore the negative effect that PACE financing has on property marketability. In reality, most PACE assessments must be paid off before the property is sold. This is because FHFA prohibits Fannie Mae and Freddie Mac from purchasing PACE-encumbered mortgages, and FHA will not insure mortgages with a first-lien PACE assessment.[8] Together, these government-backed mortgage programs make up a very large percentage of the market, meaning that a prospective homebuyer would have difficulty

---

[4] Andrew Khouri, *These loans were created to help homeowners, but for some they did the opposite*, Los Angeles Times (June 4, 2017). Available at http://www.latimes.com/business/la-fi-pace-loans-20170604-story.html.

[5] Andrew Khouri, *Bakersfield votes to end controversial program that funds home solar panels*, Los Angeles Times (July 20, 2017). Available at http://www.latimes.com/business/la-fi-pace-bakersfield-20170720-story.html; Ron Hurtibise, *Federal suit says PACE home improvement loan program fails to disclose risks, costs*, South Florida Sun Sentinel (April 11, 2017). Available at https://www.sun-sentinel.com/business/fl-bz-pace-prepayment-penalty-suit-20170411-story.html.

[6] Kirsten Grind, *More Borrowers Are Defaulting On Their 'Green' PACE Loans*, The Wall Street Journal (Aug. 15, 2017). Available at https://www.wsj.com/articles/more-borrowers-are-defaulting-on-their-green-pace-loans-1502789401.

[7] Andrew Khouri, *These loans were created to help homeowners, but for some they did the opposite*, Los Angeles Times (June 4, 2017). Available at http://www.latimes.com/business/la-fi-pace-loans-20170604-story.html.

[8] Ron Hurtibise, *Federal suit says PACE home improvement loan program fails to disclose risks, costs*, South Florida Sun Sentinel (April 11, 2017). Available at https://www.sun-sentinel.com/business/fl-bz-pace-prepayment-penalty-suit-20170411-story.html.

obtaining financing to facilitate the purchase of the home unless the PACE assessment is paid in full.

Similar market considerations make refinancing a PACE-encumbered property difficult. Most PACE borrowers will need to pay-off the PACE assessment before they are able to refinance their mortgage loans. The impact of PACE assessments can be seen in the prepayment speeds for residential PACE-backed securities, which are "generally in line with CPRs for Freddie Mac- or Fannie Mae-backed residential mortgage backed securities," demonstrating their character as mortgage product rather than a tax assessment that passes from owner to owner.[9]

C. Burden of PACE repayment

Prospective PACE borrowers are often told they will not be responsible for repayment should the PACE-encumbered property be sold. As a "debt of the property," borrowers are told that responsibility for repayment would shift to the new property owner. Such statements are persuasive for homeowners worried about the long-term financial consequences of entering into a PACE financing agreement. In this way, a PACE assessment is contrasted with a mortgage, which is customarily paid off when the property is sold.

Unfortunately, these claims are also misleading. While the form of repayment may differ, the burden of repayment remains with the PACE borrower as does the possible harm for a failure to repay—loss of the house through foreclosure. As previously explained, market realities are such that most PACE assessments must be repaid by the borrower before the property can be sold. Information from the real estate brokerage industry suggests that subsequent homebuyers often do not value the PACE improvements as highly as the original owner, and often make retirement of the PACE obligation a condition of the sales contract. Even if the PACE borrower can sell a PACE-encumbered property, as may be possible with a cash buyer, the PACE borrower will be in the same financial position as they would have been had they paid off the assessment. Rational buyers with knowledge of the PACE assessment will pay less for the property because it is subject to a PACE assessment and because other similar homes may be available without the monthly PACE assessment.

D. PACE cost savings

Affordability is frequently cited as one of the principal benefits of PACE financing. According to PACE proponents, added repayment security resulting from the assessment's "super lien" status allows PACE providers to offer lower-than-market interest rates.[10] While reduced risk *should* facilitate more favorable pricing, this has not been the case for PACE financing, which is

[9] Kroll Bond Rating Agency. (June 22, 2018). The PACE Evolution. Available at (https://www.krollbondratings.com/show_report/11071).

[10] Jason R. Wiener & Christian Alexander, On-Site Renewable Energy and Public Finance: How and Why Municipal Bond Financing is the Key to Propagating Access to On-Site Renewable Energy and Energy Efficiency, 26 SANTA CLARA COMPUTER & HIGH TECH. L.J. 559, 574 (2010).

typically *more* expensive than comparable mortgage financing.[11] Except for the highest risk borrowers, traditional second mortgage or home equity line of credit financing provides a lower interest rate than PACE financing.[12]

III. PACE UNDERWRITING

PACE underwriting standards are generally established by the terms of the local PACE authorization, though additional requirements may be added by the PACE provider. Until recently, PACE programs did not consider the borrower's ability to repay. Underwriting was based exclusively on the value of the property. Other common considerations included the homeowner's equity in the property, property tax payment record, and bankruptcy history. While legislation passed in California includes ability to repay requirements for PACE loans originated on or after April 1, 2018, the law lacks implementing regulations, which makes assessing its full impact difficult. In other states with active residential PACE programs, underwriting remains collateral-based.

IV. ISSUES WITH PACE UNDERWRITING

The lack of appropriate underwriting for PACE financing has had predictable consequences. Consumers risk losing their home over a loan they cannot afford to repay. While PACE providers often dismiss affordability concerns by pointing to the low delinquency and foreclosure rates for PACE loans, these statistics paint an extremely misleading picture. PACE assessments are treated as tax liens and are therefore superior to any existing lien (i.e., the assessment has "super-lien" status), including the homeowner's first mortgage. For PACE borrowers with an existing mortgage and tax escrow, the mortgage servicer is required to advance funds to cover delinquent PACE assessments in order to protect the investor's security interest. In this way, the senior mortgage lender acts as a surety for the later PACE lender. This risk shifting effect and unearned subsidy is so reliable that it is prominently listed in ratings reports as a credit-enhancing feature of PACE backed securities.[13]

V. APPLYING TILA'S ABILITY TO REPAY

Ability to repay requirements for PACE financing should be no less robust than the requirements for mortgage financing. This conclusion is supported by the fact that the failure to repay leads to the same possible harm, the loss of the home through a foreclosure. Much like mortgage lenders,

---

[11] Prentiss Cox, Keeping PACE?: The Case Against Property Assessed Clean Energy Financing Programs, 83 U. COLO. L. REV. 83, 109 (2011).

[12] Andrew Khouri, *These loans were created to help homeowners, but for some they did the opposite*, Los Angeles Times (June 4, 2017). Available at http://www.latimes.com/business/la-fi-pace-loans-20170604-story.html.

[13] "Over 90% [of] the assets in the identified collateral pool [are] properties subject to a mortgage. In our view, if taxes are escrowed, there is a high probability that a mortgage servicer will advance for PACE Assessments together with taxes in the event of a delinquency." Standard & Poor's. (January 16, 2019). Presale: GoodGreen 2019-1. Available at https://www.spratings.com/documents/20184/0/GoodGreen+2019-1.pdf/be5c6474-205a-387d-7b07-b99567202fbe.

PACE lenders should verify borrower income and debts. If a borrower's ability to repay is positively impacted by the PACE-financed energy efficiency improvements and the PACE lender relies on this impact in underwriting the loan, a qualified and independent third party should verify the purported beneficial effect.

While it is important that the Bureau apply Congress's intent to clearly require ability to repay standards on PACE lending, the Bureau should consider giving PACE administrators the option to presumptively satisfy these requirements by restructuring their programs to subordinate the PACE assessment to existing mortgage liens. In this way, PACE subordination could function like the qualified mortgage construct in the ability to repay rules for mortgage loans.[14] Given the current "super-lien" status of PACE assessments, PACE lenders bear little credit risk and thus have little incentive to truly assess the borrower's ability to repay. Removing the protection provided by "super-lien" status and the subsidy from the senior lien holder by subordinating the assessment would encourage PACE lenders to ensure borrowers have a demonstrable ability to repay. Subordination would also allow the Bureau to create a strong construct for ATR compliance that does not directly interfere with state or local taxing authorities.

VI. APPLYING TILA & REGULATION Z

While requiring PACE lenders to ensure that prospective borrowers demonstrate an ability to repay should alleviate concerns with PACE underwriting, additional regulatory action is needed to address other concerning aspects of PACE financing. For this reason, implementing the ability to repay requirements of EGRRCPA section 307 should be treated as the first of several steps needed to bring PACE financing within the existing federal consumer protection framework. Indeed, there are ample legal and policy justifications for applying all of TILA and Regulation Z to PACE financing.

For the consumer, there is little practical difference between PACE financing and traditional mortgage financing. Both constitute binding repayment obligations secured by real estate and therefore carry significant consequences in the event of default. Consumers who fail to satisfy the terms of repayment risk losing their home through foreclosure or through a tax sale or its equivalent. This serious consequence—the potential to lose one's home—is the principal justification for many of the consumer protection laws governing mortgage lending. Given that PACE borrowers also risk losing their home, they deserve equally robust consumer protections.

Fundamental principles of market fairness also justify the full application of TILA and Regulation Z to PACE financing. Mortgage lenders offer real estate-secured financing, often at

[14] Any arguments that subordination is inconsistent with PACE financing are not born out by reality. *See* City of Sunnyvale, California's City Council resolution approving various PACE programs (i.e. HERO, Open PACE, Ygrene, FigTree) after PACE providers agree to "offer contractual subordination of the PACE assessment" to senior lien holders. Supporting documentation including Council resolution, meeting minutes, staff report, etc. available: https://sunnyvaleca.legistar.com/LegislationDetail.aspx?ID=3047212&GUID=F6FBAA69-51D6-4533-822C-4E9BD4271CD2&Options=&Search=&FullText=1.

rates lower than those offered by PACE lenders. Unlike PACE lenders, mortgage lenders must comply with all applicable consumer regulations. As demonstrated in California's experience adopting PACE ability to repay requirements, the absence of consumer protections in the PACE context provides significant operational advantages for PACE lenders. A major California PACE provider reported a 42 percent decline in PACE volume for the first half of 2018 compared to volume in the first half of 2017.[15] The decline was attributed to the additional time required to underwrite PACE loans due to the "ability to repay" requirements that went into effect in April 2018.[16,17] This indicates that the lack of consumer protections was at least partially responsible for growing PACE volumes. A result that is both unfair for non-PACE lenders and inconsistent with consumer protection.

In addition to these policy justifications, there are sound legal grounds to treat PACE financing as "credit" for purposes of TILA. It is a voluntary agreement in which a consumer accepts funds in exchange for a promise to repay principal and interest. While the Official Staff Interpretations to Regulation Z exclude tax liens and tax assessments from the definition of credit, "*third-party financing of such obligations* (for example, a bank loan obtained to pay off a tax lien) *is credit for purposes of the regulation*."[18]

PACE administrators have attempted to avoid the mortgage rules by calling the obligation a tax assessment. At the same time, however, the PACE providers have also touted the benefit that interest on PACE liens is deductible for tax purposes as mortgage interest.[19] MBA believes the CFPB should take this opportunity to definitively assert that PACE obligations are mortgages and should be covered by the full panoply of TILA, Regulation Z, and other relevant mortgage rules.

A. PACE disclosures

With adjustments based on the unique characteristics of PACE financing, the disclosure requirements of TILA and Reg. Z could protect potential PACE borrowers from the point-of-sale confusion often reported today. A PACE disclosure regime under TILA would ensure that consumers receive standardized materials to describe the important elements of the PACE financing agreement (e.g., relevant costs, effect on future property sale/refinance, the relationship between the PACE provider and the local taxing authority, etc.). It would also facilitate shopping

---

[15] https://renewfinancial.app.box.com/v/CA-PACE-Market-Update-August18
[16] Id.
[17] https://asreport.americanbanker.com/news/why-pace-has-become-a-second-look-product-in-california
[18] 12 C.F.R. § 1026, Supp. I, Sub. A, cmt. 2(a)(14)(1)(ii) (emphasis added).
[19] See, for example, the PACE industry's website PACENation: https://pacenation.us/irs-says-pace-interest-falls-mortgage-deductibility-guidelines/. Or see the recent tax guidance on the website of Renew Financial, which says: "*However, PACE payments have never been eligible for deduction as a property tax. The interest payments on a PACE assessment, however, may be eligible as a mortgage interest deduction.*"

by allowing consumers to better compare competing offers from PACE and non-PACE lenders, increasing the likelihood of the consumer receiving the most favorable financing terms.

B. PACE originator rules

Many of the concerns reported by PACE borrowers involve the aggressive and often misleading sales practices used by contractors at origination. The most egregious consumer accounts describe elder abuse and fraud. These experiences demonstrate the need for reasonable guardrails on the PACE origination process. Fortunately, TILA's Regulation Z sets out licensing, training, screening, and compensation practices for mortgage originators that, appropriately tailored, would address many of the most problematic aspects of PACE origination.

C. Right of rescission

Much like when consumers receive home equity loans (and most first mortgage refinances), homeowners who accept PACE financing encumber their home's title. Home equity and PACE financing have equally serious consequences that justify equally robust consumer protections. A cooling-off period is arguably more necessary in the PACE context given that most PACE origination is the result of direct, in-home sales conducted by the contractor who will perform the PACE-financed home improvement. TILA's 3-day right of rescission would give consumers swayed by the in-home 'hard sale' a chance to rethink any hastily-made decisions.

VII. Conclusion

MBA supports increased energy efficiency and prudent stewardship of natural resources. The achievement of these goals should be done in a thoughtful manner that takes into account the incentives created and resulting market behaviors from allowing different lending regimes to address them. The Bureau should promulgate its rules governing PACE lending to rein in the aggressive, often misleading tactics reportedly used by some PACE contractors. Such regulation requires a meaningful ability to repay standard as well as the other consumer protections found in TILA that are applied to similar real estate-secured lending.

Thank you for the opportunity to comment on this issue. Please contact me at PMills@mba.org or (202) 557-2878 with any questions you have about these comments.

Sincerely,

Pete Mills,
Senior Vice President
Residential Policy and Member Services
Mortgage Bankers Association