

PACE Lending Presents Serious Consumer and Industry Concerns

MBA believes energy efficient home improvements can be beneficial for homeowners, but significant concerns exist when these improvements are financed with Property Assessed Clean Energy (PACE) loans—a financing structure lacking vital consumer protections and presenting lien priority risks to lenders, investors and guarantors. Accordingly, MBA supported S.2155 which enacted federal legislation to provide BCFP (Bureau of Consumer Financial Protection) the authority to subject residential PACE loans to Truth in Lending Act (TILA) consumer protections. MBA also urges Congress to introduce legislation requiring PACE loan subordination in accordance with long-established lien priority standards.

OVERVIEW

- More than 20 states have enacted legislation enabling the development of residential PACE programs, and residential PACE programs are operational in California, Florida and Missouri.
- The exact structure, terms and conditions vary by program, state and municipality, but a variety of energy efficient home improvements are generally available for financing—ranging from solar panels to energy efficient appliances and windows, water conservation, etc.
- PACE programs do not follow traditional underwriting. There is no standardized review of a borrower's income, credit history, outstanding credit obligations, or expected monthly payments when a PACE loan is originated. Instead, PACE financing is often based on a borrower's equity in their property and their mortgage and property tax payment history.
- PACE loans are typically initiated by the private companies approving home improvement contractors to make these improvements with PACE financing. The PACE obligations are then purchased using proceeds raised by the issuance of municipal revenue bonds. These bonds are secured by payments on PACE loan obligations.
- The payments are added to the borrower's property tax bill as an assessment, paid through property tax installments—usually over 15 or 20 years—and the outstanding PACE loan obligation runs with the property—not the borrower—going forward.
- Because they have been added to the property tax rolls, PACE loans rest in a senior lien position to a mortgage.
- Federal guidance on PACE lending is clear:
 - In 2012, concerns spurred the Federal Housing Finance Agency (FHFA) to prohibit Fannie Mae and Freddie Mac (the GSEs) from purchasing mortgages where the residential property is encumbered by a PACE loan holding first lien position.
 - On December 7, 2017 the Department of Housing and Urban Development reversed previous Federal Housing Administration (FHA) policy by stating in the Mortgagee Letter ML2017-18 that the FHA would no longer insure mortgage that also carry PACE liens.

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- On July 1, 2018 the Department of Veterans Affairs (VA) allowed guidance (Circular 26-16-18) permitting financing for the purchase or refinance of properties encumbered by a PACE loan holding first lien position to sunset.
- State are already moving to implement consumer protections. California in 2017, for example, enacted broad ability-to-repay and pre-purchase disclosures, licensing, and examinations.

IMPACT

- **All PACE loans are not subject to appropriate, standardized consumer protections and federal regulations are needed:**
 - PACE loans are consumer loans secured by real property—with all the attributes of a mortgage product—yet they are not subject to related federal consumer protections. Unfortunately, they have been cleverly classified as a tax assessment rather than a loan.
 - Consequently, PACE lenders have not been required under federal law to consider a borrower's true ability to repay their financial debt. Moreover, consumers face aggressive marketing tactics, misleading product information and significantly higher interest rates than other financing options.
 - Borrowers often report a lack of PACE product knowledge—during, and well past, origination. For example, they are assured that their outstanding PACE loan obligation will run with the property, yet PACE loans often present property resale issues that result in the borrower paying off the PACE loan prior to closing.
 - PACE borrowers do not receive federal disclosures, remedies and other protections available for other mortgage products. The patchwork of limited or non-existent state/municipal laws provide insufficient protections.
- **PACE loans upend traditional lien priority, exposing investors and guarantors to increased loss severities:**
 - PACE loans in first lien position erode the value of the collateral supporting a first mortgage in the event of foreclosure and the eventual sale of a property.
 - However, allowing any PACE loan amount to hold senior priority undermines the lender's (and the government's) collateral position—disrupting the very nature of secured lending.

MBA'S POSITION / NEXT STEPS

- Following enactment of S.2155, the BCFP should move quickly to promulgate rules to protect consumers from the dangers posed by residential PACE loans.
- These rules must require federal TILA protections for residential PACE loans-including the BCFP's "Ability-to-Repay" and "Know Before You Owe" rules, Home Ownership and Equity Protection Act standards, etc.
- MBA also believes federal legislation is needed to require PACE loan subordination to existing government-guaranteed or -insured mortgages (per the principle of "first in time, first in right").
- MBA supports state and municipal rules that would require PACE obligations to be recorded in proper lien priority, subordinate to all prior-recorded mortgages.
- MBA advises members to educate consumers about better alternatives for financing energy efficient home improvements, including existing home equity products and recent energy efficiency products released by the GSEs.

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