TO: NASEO Residential PACE Taskforce
FROM: Sandy Fazeli, Managing Director, NASEO
SUBJECT: Draft R-PACE Consumer Protection Guidelines for State Energy Offices – Input Requested

In April 2017, the "Protecting Americans from Credit Entanglements (PACE) Act of 2017" was introduced by Senators Cotton, Boozman, and Rubio in the U.S. Senate (S. 838) and by Congressmen Sherman and Royce in the U.S. House of Representatives (H.R. 1958). The primary purpose of the PACE Act of 2017 is "to amend the Truth in Lending Act (TILA) to include retrofit loans such as property assessed clean energy (PACE) loans."

Below are high-level, initial reactions collected from several State Energy Offices and statewide partners (such as green banks) on this topic. We welcome your feedback and additions to these points. In the near future, NASEO will use your input to create a more detailed analysis of R-PACE programs and what State Energy Offices should know about consumer protections. Please share your comments with Sandy Fazeli at sfazeli@naseo.org.

Well-designed and strong consumer protections are extremely important to PACE program success and the scale-up of residential energy efficiency. NASEO believes that consumer protections are paramount to the success and expansion of PACE, and to unlocking its important benefits for more consumers and communities across the country. The Truth in Lending Act (TILA) has important consumer protection elements that could be integrated into existing and future PACE programs.

Not all TILA requirements are appropriate for PACE financing. As a property assessment, PACE is closely linked to the processes local governments use to raise capital (typically, municipal bond issuances) and to bill, collect, and enforce taxes and assessments. In many states, imposing TILA requirements on PACE would run afoul of the laws and procedures that govern municipal bonding by dictating the timing and crediting of payments, foreclosure rights, and the allocation of principal and interest. TILA would also introduce new licensing and disclosure requirements for PACE programs; these requirements are catered to private lenders (such as mortgage lenders) and may not be necessary for local governments and their private administrators that they oversee.

PACE legislation and program design, including consumer protections, are highly locally-specific. This is demonstrated by the wide variety in PACE-enabling legislation across the country, which is closely linked with states' and local jurisdictions' tax codes and assessment procedures, local market conditions, and the willingness of key stakeholders (such as local governments, tax collectors, and bankers) to participate. Unlike many other tax assessments, PACE is a voluntary program that requires state legislators' approval; local government participation; and, most importantly, the **voluntary**, informed participation of property owners and homeowners. PACE providers across the country have developed processes to meet local and individual needs (some of which surpass TILA consumer protections), including following detailed disclosure procedures, holding one-on-one meetings and phone calls to walk through the financing, and providing opportunities for the borrower to cancel the contract without penalty. In California, the largest market for residential PACE in the country, strong consumer protections have emerged and been codified into law as a result of local government and state action to prevent predatory lending without overburdening or hampering PACE's growth.

PACE's success in California's home improvement market can be owed at least in part to the uniqueness of PACE as a financing mechanism. Unlike conventional consumer loans or home equity lines of credit, PACE has experienced exponential growth and success in California's home energy improvement market. Of the over $3 billion in PACE assessments made to homeowners of varying income levels and demographics, PACE repayment rates are over 98 percent, which far exceeds the performance of many credit and lending portfolios that already fall under the auspices of the TILA and Real Estate Settlement Procedures Act (RESPA). This success can be explained in part by the unique nature of PACE financing: it is a highly secure mechanism because it is tied to the property rather than the borrower; in many states, it can source capital from both public sources (through bond issuances) and private sources; and it is able to transfer from one homeowner to the next during a property sale. Many bond and securities investors view PACE as a worthwhile investment because of the security of the assessment, which lowers interest rates programs are able to offer. Additionally, bankers and lenders have grown more comfortable over time with PACE because repayment performance is high, the risk posed to the mortgage is minimal, and PACE projects tend to increase property value and promote homeownership. Substantially altering the underwriting of PACE assessments through TILA may erode investor and banker confidence in the program, resulting in higher interest rates and lowering consumer access to this low-cost, low-risk financing.

Financial consumer protections are needed in residential PACE programs; however, they alone are not sufficient to protect PACE consumers. In addition to financial consumer protections (in the form of disclosures, fair pricing, and right of rescission), many State Energy Offices engaged in home energy efficiency and renewable energy financing understand the crucial need for programmatic consumer protections. These include, depending on the type of project, energy audits and assessments; contractor training, oversight, and qualification; and/or sampling of project performance for quality assurance and quality control purposes. For residential PACE programs, these financial and programmatic elements offer a powerful suite of consumer protections by ensuring that projects result in real cost savings and by minimizing the potential for poor installation or wrong-sizing of equipment, which studies have shown can reduce manufacturers' energy efficiency expectations for equipment by as much as 30 percent. NASEO, along with the Air Conditioning Contractors of America, have engaged both State Energy Offices and PACE stakeholders across the country to emphasize the need for a holistic approach that results not only in financial repayment but also in high-quality projects.

Residential PACE financing can meet a crucial market need in many states: namely, emergency equipment replacement for families whose only alternative option is to finance using credit cards. While Weatherization programs across the country have been crucial in providing home energy improvements and comfort for eligible low-income families, there is a large portion of the U.S. market that does not have access to these services, either due to income level or to lack of sufficient program funding. Eliminating or limiting these borrowers' access to PACE programs does not amount to protecting them; in fact, it may put them in even more risk. In many cases, their only alternative to finance their new furnace, hot water heater, or air conditioning system quickly is by credit card, taking on interest rates of over 15 to 20 percent. This financing is typically more expensive, less secure, and more punitive in default situations than PACE, which typically offers interest rates between 6 and 9 percent.

Interlocal and statewide programs help improve market consistency, standards, and stakeholder buy-in in response to local market conditions and PACE borrowers' needs. In the commercial PACE market, significant progress has been made in jurisdictions where State Energy Offices, Green Banks, or other state or multijurisdictional entities have played a role in coordinating the marketplace, promoting consistent program technical and financial standards, and educating and training contractors, property owners, and financial entities in PACE. We believe that similarly, state or multijurisdictional coordination and sharing of best practices will play a key role in ensuring residential PACE programs follow consistent, sound, and cost-effective consumer protection and underwriting principles. Outside of California (where Governor Brown, the California Energy Commission, and the State Treasury have already played a key role in launching a PACE Loss Reserve, promoting consumer protections, disclosures, stakeholder discussions, and program analysis), State Energy Offices are informing governors, legislators, and key PACE stakeholders on consumer protections—many of which we expect to be even more stringent than those required by TILA.

Consider alternatives to imposing TILA requirements wholesale on residential PACE financing. Such alternatives may include:

- Modeling potential federal PACE legislation after California's 2016 PACE consumer protections law, which outlines key disclosure practices and program participation rules based on loan-to-property value ratio.
- Thoroughly investigating additional alternative forms of promoting consumer protections at the state level, including stringent contractor engagement and contractor qualification and accreditation procedures and increased oversight to ensure quality control.
- Promoting the sharing of best practices among states, and between states and local governments, in order to improve the success and consumer protection practices of PACE programs across the country.