



April 11, 2018

The Honorable Richard Roth  
California State Senate  
State Capitol, Room 4034  
Sacramento, CA 95814

RE: Senate Bill 1087

Dear Senator Roth:

The National Housing Law Project<sup>1</sup>, along with Housing and Economic Rights Advocates<sup>2</sup> and the National Consumer Law Center on behalf of its low-income clients,<sup>3</sup> write to express general support for your efforts to improve the regulation of residential PACE programs in California and to offer our support for SB 1087 as long as the bill is amended to address the concerns outlined below.

### Residential PACE

After California authorized home improvement financing through PACE loans to individual homeowners, consumer advocates around the state started receiving complaints about practices that are depressingly reminiscent of the predatory mortgage scams of the early 2000s: high pressure sales, bait-and-switch tactics, and outright fraud. As PACE residential lending expanded in recent years, the volume of complaints also grew.<sup>4</sup> These predatory practices tend

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<sup>1</sup> The **National Housing Law Project (NHLP)** is a non-profit law and advocacy center established in 1968 and based in San Francisco, California. NHLP is dedicated to advancing housing justice by using the power of the law to increase and preserve the supply of decent affordable housing, improve existing housing conditions, expand and enforce low-income tenants' and homeowners' rights, and increase opportunities for racial and ethnic minorities. Among other activities, NHLP provides free technical assistance, case consultations, litigation support, trainings and practice resources for legal services attorneys and other advocates representing homeowners in connection with residential lending, foreclosures and loss mitigation.

<sup>2</sup> **Housing and Economic Rights Advocates** ("HERA") is a California statewide, not-for-profit legal service and advocacy organization. HERA's mission is to ensure that all people are protected from discrimination and economic abuses, especially in the realm of housing. Much of HERA's work has focused on home equity preservation and preventing foreclosure.

<sup>3</sup> The **National Consumer Law Center, Inc. (NCLC)** is a non-profit Massachusetts corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of practice treatises on consumer credit laws and unfair and deceptive practices. NCLC attorneys regularly testify in Congress and provide comprehensive comments to the federal agencies on consumer regulations.

<sup>4</sup> A recent report by the National Consumer Law Center highlights the numerous stories of PACE transactions gone wrong for homeowners. See "Residential Property Assessed Clean Energy (PACE) Loans: The Perils of Easy

to target the most vulnerable homeowners: seniors, low-income households, and households with limited English proficiency. Again and again, homeowners find themselves saddled with unaffordable increases to their property tax bills for often shoddy or incomplete work. While these transactions are consummated at lightning speed, they have proven very difficult – if not impossible – for homeowners to untangle once problems come to light.

In essence, PACE deputizes largely unsupervised home improvement contractors to offer subprime home loans, with a super-priority tax lien replacing the standard deed of trust. As priority tax liens with the ability to foreclose, PACE loans are a low-risk bet for the investors who profit from the program, and yet homeowners still pay subprime interest rates (often between 8 and 11%). PACE lending is also very profitable for PACE administrators, the entities that originate PACE loans and act as intermediaries between the investors who finance the loans and the government entities that lend their names to the transactions.<sup>5</sup>

The contractors who solicit PACE loans, frequently door-to-door, have a powerful financial self-interest in seeing a PACE loan application go through. Homeowners who sign up for PACE loans usually rely on the soliciting contractor's representations about the nature and terms of the loans, yet the PACE laws do not provide clear remedies for contractor overreaching and fraud in the solicitation process or for shoddy and/or incomplete work.

Energy efficiency can be a tool for reducing energy costs and enhancing home energy security in low-income households. But PACE loans with inadequate consumer protections pose a risk to any PACE customer, as well as to communities and the broader market. They frequently impose inappropriate and unnecessary costs and risks on homeowners. For credit-worthy consumers, energy improvements can usually be installed using conventional market financing, without exposing home ownership to the risks and costs of a super-priority tax lien. Home equity loans, if judiciously used, may also provide a less expensive and less risky alternative for financing energy-efficient home improvements. For homeowners who can secure free or lower cost efficiency programs, programs such as the Weatherization Assistance Program should be the preferred method for helping these homeowners.

In just the past few months, numerous homeowners in Stockton, Fresno, Madera and elsewhere in Northern California have sought legal assistance after finding themselves saddled with unaffordable PACE assessments in connection with transactions that had several of the following features: door-to-door solicitation; misrepresentation of prices, terms and/or project scope; forged electronic signatures; failure to provide contracts in the language used during sales and marketing; failure to verify completion of project prior to releasing funds to contractor; failure to

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Money for Clean Energy Improvements” (September, 2017), available at:  
[https://www.nclc.org/images/pdf/energy\\_utility\\_telecom/pace/ib-pace-stories.pdf](https://www.nclc.org/images/pdf/energy_utility_telecom/pace/ib-pace-stories.pdf).

<sup>5</sup> Although the super priority status of PACE payments indicates a low risk of loss on PACE loans, interest rates on PACE loans run in the range of 9-10%. Interest rates on PACE Bonds collateralizing PACE programs are 2-3 points lower, in the 6-7% range. By contrast, the interest rates to the private investors who ultimately fund PACE programs run about 4%, which presumably reflect investment risks. The spread of more than double between the investor rates of return (4%) and the interest rate homeowners pay on PACE loans (9-10%) reflects the high cost of the private program administration provided by the PACE sponsors and the maintenance of reserve funds to protect investors against losses.

complete project; stonewalling and/or refusal to rescind transactions involving one or more of these abuses.

### Enactment of AB 1284

AB 1284, which went into effect on January 1, 2018, was introduced at the very end of the 2017 legislative session. The bill emerged out of closed-door discussions that left consumer advocates and other stakeholders out of the drafting process until the very last minute and did not reflect the outcome of a thoughtful, open process. The bill placed residential PACE administrators under the oversight of the Department of Business Oversight, set out a number of basic requirements for PACE administrators to follow, and authorized DBO to promulgate regulations.

While many have touted AB 1284 as some kind of gold standard of consumer protection, it was in fact a relatively weak measure that, unless strengthened, will do little to protect against the abusive practices that vulnerable homeowners regularly fall victim to when using PACE loans to finance home improvement projects. Among other things, AB 1284:

- Allows homeowners to become obligated homeowner for thousands of dollars before steps are taken to ensure the loan is affordable or meets other qualifications, with no clear method for rescinding the transaction if necessary;
- Provides vague standards for ensuring a homeowner can afford a PACE loan and that income is properly verified;
- Includes an overly broad “emergency” exception that would permit many PACE loans to be made based on unverified, stated income;
- Fails to prevent the known abuse of selling homeowners multiple PACE loans close in time, thereby undermining the already insufficient ability-to-repay safeguards;
- Enhances the risk that homeowners may owe more on their property than it is worth by combining a very high permitted maximum loan-to-value ratio with an untested regime for using automated valuations even where the results are unreliable; and
- Establishes convoluted enforcement mechanisms that do not provide clear and strong measures for accountability and concrete redress for overreaching, fraud, and shoddy and/or incomplete work by soliciting contractors; and that do not enable the DBO to promptly and effectively respond to complaints of wrongdoing by PACE administrators and contractors.

### Proposed Amendments to SB 1087

While we welcome current legislative efforts to fix some of the myriad shortcomings of AB 1284, we believe, based on the actual experiences of homeowners and their advocates, that SB 1087 falls short of what is needed to actually safeguard consumers’ interests. As outlined in the January 5, 2018, comments submitted by NCLC and NHLP to the DBO regarding the PACE regulations the DBO is developing under AB 1284, we remain very concerned about a wide range of fundamental problems with the current PACE practices. In order to truly protect the interests of homeowners, California law should provide for:

- A proper mortgage disclosure regime that includes advance notices;

- Protections against forced arbitration;
- Protections from fraudulent contractor conduct;
- Foreclosure prevention measures;
- Protections against high tax penalties on unaffordable loans;
- Foreclosure defenses for harmed homeowners;
- Protections from electronic signature abuses;
- Screening of low-income households for free or low-cost weatherization or energy-efficiency programs;
- Accountability for promised energy savings through an energy audit to quantify project costs and energy savings;
- Lien subordination to ensure that homeowners can refinance their mortgages and to give PACE lenders incentive to make affordable loans; and
- A direct private right of action for homeowners to seek damages from contractors and program administrators who violate PACE rules.
- Procedures for homeowners previously harmed by subsequently restricted PACE practices to apply for and receive relief.

It is our understanding, however, that SB 1087 is intended only as a “clean-up” bill that will not necessarily address the full range of consumer protection issues raised regarding AB 1284 and PACE. With that in mind, and while we await more information about the scope and content of the forthcoming DBO regulations as well as more clarity about amendments that may be made to AB 2063 (Aguiar-Curry), currently pending in the Assembly, at this time, we are only conditioning our support for SB 1087 on the following amendments:

*Underwriting Criteria.*

As introduced, SB 1087 proposes to replace the detailed underwriting criteria set out in Financial Code Section 22684 with a reference to regulations promulgated in connection with the PACE Loan Loss Reserve program. Our understanding is that the intent of this proposed change is to harmonize the statutory standards with related regulatory standards. However, the regulations referenced in SB 1087 are substantially weaker than the criteria set out in AB 1284. Last year, stronger regulations that more closely track the AB 1284 language were proposed by the California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA), the agency that oversees the Loan Loss Reverse fund. However, after receiving comments on the revised regulations in March 2017, CAEATFA took no further action on the matter, and there is at present no indication of when or whether CAEATFA will in fact adopt the updated standards proposed in 2017. We therefore request that SB 1087 be amended to restore the Section 22684 underwriting criteria as they appeared in AB 1284 or to strengthen those criteria further.

*Timing of Ability-to-Repay Assessment.*

The fact sheet prepared in connection with SB 1087 indicates that the bill is intended to insure that a homeowner does not become obligated on a costly home improvement contract before the PACE administrator has assessed the homeowner’s ability to repay the PACE loan. However, the bill itself only proposes to require that the ability-to-repay assessment take place before a PACE assessment contract is executed, not before the underlying home improvement contract is executed. PACE administrators should not be permitted to delay making a basic determination

about whether a homeowner can actually afford to finance a given project until after a contractor has convinced them to sign a costly home improvement contract. Such an arrangement creates unnecessary risks for the homeowner, who may be subject to aggressive debt collection by the contractor or find her title clouded with a mechanic's lien. The Finance Code should require PACE administrators to complete the ability-to-repay assessment before execution of the home improvement contract and should give the homeowner the option to rescind the transaction in its entirety in the case of a violation.<sup>6</sup>

Please note that depending on further developments, we may also seek amendments that:

- Properly limit the scope of the “emergency exception” in Section 22687(e) to protect against unwarranted delays of ability-to-repay assessments;
- Protect against over-leveraging by revisiting the loan-to-value limit in Section 22684(i) and tightening the standards for use of automated property valuations (Section 22685);
- Close loopholes in the income verification procedures; and
- Further clarify that any calculation of “basic household living expenses” for purposes of Section 22687(d)(4) must take into account the specific circumstances of the particular household.

### Conclusion

The laws and regulations California adopts regarding residential PACE programs will almost certainly become a standard that other states look to when considering whether and how to authorize residential PACE programs. It is therefore critical not only for California homeowners but for homeowners throughout the country that California establish the strongest possible consumer protections in connection with PACE lending.

National Housing Law Project  
Housing and Economic Rights Advocates  
National Consumer Law Center

cc: Eileen Newhall, Senate Banking & Financial Institutions Committee

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<sup>6</sup> Financial Code section 22687(g), the provision in AB 1284 making a PACE administrator responsible for the difference between the amount financed for a PACE project and the amount the administrator ultimately determines the homeowner can afford, is inadequate to protect homeowners' interests, particularly since it does not provide for any enforcement mechanism or even a specified process for a (likely unrepresented) homeowner to recover funds from the PACE administrator.