National Consumer Law Center, on behalf of its low-income clients,
and
Action, Inc. (MA); Citizens Action Coalition of Indiana; Consumer Action; Consumers Union; Community Action Partnership of Oregon; Economic Opportunity Studies, Inc.; Iowa Community Action; Low-Income Energy Affordability Network (MA); National Community Action Foundation; North Carolina Justice Center; the Pennsylvania Utility Law Project, on behalf of its low-income clients; People's Action; Public Citizen; Public Justice Center (MD), and the Public Utility Law Project of New York

August 18, 2016

Department of Energy
Office of Energy Efficiency & Renewable Energy
Forrestal Building
1000 Independence Avenue, SW
Washington, DC 20585
rpaceguidelines@ee.doe.gov

Re: Comments on *Best Practice Guidelines for Residential PACE Financing, Draft for Comment* (July 19, 2016)

To the Department of Energy:

Thank you for the opportunity to submit comments on the draft *Best Practice Guidelines for Residential PACE Financing* ("Draft Guidelines"). The undersigned organizations include the National Consumer Law Center (NCLC), on behalf of its low-income clients; Action, Inc. (MA); Citizens Action Coalition of Indiana; Consumer Action; Consumers Union; Community Action Partnership of Oregon; Economic Opportunity Studies, Inc.; Iowa Community Action; Low-Income Energy Affordability Network (MA); National Community Action Foundation; North Carolina Justice Center; the Pennsylvania Utility Law Project, on behalf of its low-income clients; People's Action; Public Citizen; Public Justice Center (MD), and the Public Utility Law Project of New York. We are nonprofit consumer and legal aid organizations that serve low-income households, including low-income homeowners and utility consumers.

Although we strongly support the goal of helping homeowners achieve greater energy efficiency, we have serious concerns about the Department of Energy's proposed best practices for implementing residential Property Assessed Clean Energy ("PACE") programs. Existing programs and the draft best practices lack vital consumer protections. The most significant protection lacking is a requirement to underwrite homeowners for their ability to repay the PACE debt.

Even if the missing consumer protections were present, however, PACE financing will still pose a serious risk to low-income homeowners.[1] Based on our experience with low-income consumers, we oppose marketing of PACE loans to low-income households.

Rather than encouraging struggling, low-income homeowners to take on additional debt, the Department and local governments should prioritize these homeowners for access to existing federal and state programs that provide free or low-cost energy efficiency upgrades.

I. PACE financing: How it works and potential problems

A. How PACE Works

From the homeowner's perspective, PACE financing works in largely the same way as a traditional home-improvement loan. The homeowner applies for a loan, gets approved, a contractor does the work, and the homeowner pays for the improvements through regular installment payments.[2] If the homeowner fails to make the payments, he or she risks losing the home to foreclosure.[3]

Behind the scenes, however, PACE financing has significant differences. PACE programs are created by state legislation authorizing local governmental units to create their own programs.[4] The local government serves as the creditor and funds qualifying improvements on a resident's home. Then the government recoups the expense, with interest, through installment payments over the term of the loan. Governments usually fund PACE programs by issuing bonds backed by the homeowner's obligation to make regular payments.[5] PACE programs do not normally require traditional underwriting for the borrower's ability to repay. And they may not require a traditional appraisal, instead relying on the tax assessment or what is commonly known as a "desktop" appraisal (an automated valuation model that does not include a visit to the property).[6]

By law PACE financing is a voluntary property tax assessment.[7] Failing to make the required payments on a PACE assessment has the same consequences as failing to pay property taxes: foreclosure.[8] The National Consumer Law Center has elsewhere documented significant abuses, and a lack of reasonable protections, for homeowners who fall behind on their property

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[1] We leave it to the states to define "low-income" to be as protective as possible, but recommend that the definition encompass Weatherization-eligible households, at a minimum.
[2] *See* 77 Fed. Reg. 36086, 36087 (June 15, 2012).
[3] *See, e.g.,* California Residential HERO Program Handbook (July 2016 – Version 2.1) at 26 ("After written notification, defaults in payment of assessments will result in the initiation of foreclosure proceedings on the December 1st following such default.").
[4] *See* 77 Fed. Reg. 36086, 36087-88 (June 15, 2012).
[5] *See* 77 Fed. Reg. 36086, 36087-88 (June 15, 2012).
[6] *See* Draft Guidelines, Establishing Property Owner Eligibility at 4. See also, 77 Fed. Reg. 36088 (June 15, 2012).
[7] *See* Prentiss Cox, Keeping Pace?: The Case Against Property Assessed Clean Energy Financing Programs 83 U. Col. L.Rev. 83, 91 (2011).
[8] *See, e.g.,* California Residential HERO Program Handbook (July 2016 – Version 2.1) at 26 ("After written notification, defaults in payment of assessments will result in the initiation of foreclosure proceedings on the December 1st following such default.")

taxes.[9] Similar problems are likely to arise for homeowners who fall behind on their PACE payments.

Because PACE financing is a property tax assessment, it automatically becomes a senior lien on the homeowner's real estate.[10] Even if the property already secures a traditional mortgage or any other debt incurred at an earlier time, the municipality will have the highest priority right to be repaid from any proceeds arising from sale of the property.

The installment payments on the assessment may be less frequent than traditional mortgage payments, coming due only when property taxes are due rather than monthly. Such payments are harder to budget for and, due to their size, pose a greater risk to the homeowner. We discuss in II.A the challenges lower-income consumers face with even a $400 emergency expense, thus increases in a property tax bill risk making that bill unaffordable. Most counties do not accept partial payment on tax bills. Instead a penalty would be applied (e.g., 10% of the bill) and interest. Thus a borrower who falls behind faces an even bigger payment obligation.

B. Potential Problems

There are a number of important issues that the Department's proposed best practices do not address. These issues are particularly relevant to low-income homeowners who are more vulnerable to financial instability and to predation by sophisticated scammers. This section describes scenarios illustrating where low-income homeowners need more protection.

1. PACE financing could lead to defaults on traditional mortgages.

The Department of Energy, the Federal Housing Administration, and the Department of Veterans Affairs have emphasized the non-acceleration of PACE assessments as a way to protect both lenders and borrowers. While we support this requirement, we believe that, in reality, it will be of limited value for most homeowners.

The typical homeowner with a PACE assessment will probably also have a traditional mortgage.[11] All mortgage loans require the homeowner to pay property taxes and assessments on a timely basis. Mortgage loan servicers routinely track the payment status of assessments to ensure that the homeowner complies with this requirement. Servicers do so because unpaid assessments pose a risk to the mortgage holder's security interest. To help borrowers make these payments, most mortgages require the borrower to make regular payments into an escrow account. The servicer will then make disbursements from the escrow account when tax payments and similar bills come due.

If the escrow account does not have sufficient funds to make a required disbursement, mortgage servicers will advance the necessary funds and then demand payment from the

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[9] *See* John Rao, *The Other Foreclosure Crisis: Property Tax Lien Sales* (July 2012). Available at http://www.nclc.org/issues/the-other-foreclosure-crisis.html.

[10] *See* 77 Fed. Reg. 36088 (June 15, 2012); Prentiss Cox, Keeping Pace?: The Case Against Property Assessed Clean Energy Financing Programs 83 U. Col. L.Rev. 83, 91 (2011).

[11] *See* Alfred M. Pollard, General Counsel, Federal Housing Finance Agency, *Keeping Up with PACE: A Joint Oversight Hearing on Residential Property Assessed Clean Energy (PACE) Programs,* Statement before the California Legislature Assembly Banking and Finance Committee and Assembly Local Government Committee (June 9, 2016) at 4.

homeowner. If the homeowner did not have an escrow account when this occurs, the servicer will usually establish one and require the homeowner to begin making regular payments that will be sufficient to cover the amount advanced plus the amount of any anticipated disbursements.

This standard industry practice raises the likelihood that borrowers will pay their PACE assessments as a component of their traditional mortgage payment—rather than making a separate payment to whoever services the PACE financing. This will be convenient for borrowers, and it substantially reduces the risk of defaults on PACE assessments. But it may, instead, cause a default on the homeowner's much larger traditional mortgage.

Failing to pay the full escrow amount due each month on a traditional mortgage constitutes default on the loan. So, if a borrower cannot meet their full mortgage payment (including the escrow that goes toward the PACE assessment), the borrower will face foreclosure on the traditional mortgage. When that occurs, the servicer will accelerate the loan, and the borrower will become liable for countless other fees associated with foreclosure. This substantially reduces the homeowner's ability to cure the default.

This is one likely consequences of the super-lien status accorded PACE financing coupled with the lack of adequate underwriting.

2. Home sellers may be forced to pay PACE assessments upon sale—if the assessment does not prevent a sale.

PACE advocates have emphasized that the assessment remains with the property and does not become a personal obligation of the property owner. That feature makes PACE financing like an assumable mortgage. But advocates and the Department overlook the reality that many buyers may not want to assume such a debt. The PACE assessment may have a higher interest rate than the prevailing market rate. And the equipment installed with the assessment may have a lower market value than the balance remaining on the debt.

A $15,000 PACE assessment at 6% annual interest with payments twice each year for 15 years will ultimately cost a total of nearly $23,000. Halfway through paying off that debt, the principal balance will still be over $9000. By that time advances in technology may have reduced the cost of more efficient products. And, regardless of advances, the installed products will have aged and will likely be less efficient. Anyone interested in buying a home with such an assessment will probably not be willing to pay more than the market value of the installed equipment, which will probably be less than the $9,000 balance due on the loan. So the home seller will probably need to reduce the sale price of the house or promise to pay off the assessment before transferring title to the property. But, if the seller needs the full appraised value of the house to pay off a traditional mortgage on the home, to cover the cost of moving, or to make a down payment on a new home, the seller may be unable to sell the property if he or she cannot find a buyer willing to assume the assessment at face value.

II. Low-Income Homeowners Should be Excluded From PACE Financing.

A. Homeownership is a critical asset for low-income consumers that should not be subject to the risk of unaffordable PACE loans.

We strongly support policies that improve the energy efficiency of low-income homes, particularly since homeownership plays a critical role in the ability of a household to "store wealth."[12] Yet, it is for this very reason that we are also extremely worried by plans that would encourage low-income households to take on unaffordable debt. On paper, the value of a particular house may appear the same regardless of who owns it. But to low-income homeowners, their house is often their only asset of any value. As a result, it plays a far greater role in the family's current and future stability than a mere appraisal can show. That means it is essential for low-income households to avoid putting their home at risk.

Low-income households have little savings to weather job loss, illness, loss of a car, and other financial shocks. According to a recent analysis by the Federal Reserve, 46 percent of all consumers said that it would be challenging to handle a $400 emergency expense, but only 34 percent of households with income under $40,000 said they could cover this surprise expense.[13] Lower-income households are also less likely to have insurance to help protect them for various risks, such as disability insurance.[14]

African American and Latino families already lag behind white families in homeownership rates (45 percent, 47 percent, and 73 percent, respectively).[15] In terms of income, the median income for a white family is $50,400 compared to $36,840 for Latino and $32,038 for African-American households.[16] Given the critical importance of homeownership to the ability of low-income families to build up wealth and transfer wealth to the next generation, the Department's guidelines for PACE loans must avoid undue risk to low-income homeowners. Low-income households are better served by a robust Weatherization program along with complementary state and utility ratepayer funded low-income energy-efficiency programs.

B. Many low-income homeowners are already at risk of foreclosure, and PACE will increase that risk.

Due to the uneven economic recovery, many homeowners are still at risk of foreclosure. For others, their finances may be so fragile that taking on additional debt could lead to default on the PACE loan or other obligations, especially if the energy savings prove to be smaller than projected, or the installed energy measures do not perform as expected, or the homeowner finds the tax bill unaffordable.

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[12] *See The Racial Wealth Gap: Why Policy Matters*, Demos and Institute on Assets and Social Policy (2015) at pp. 9-11, available at http://www.demos.org/sites/default/files/publications/RacialWealthGap_2.pdf.

[13] *See* Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2015* (May 2016) at pages 22-23. Available at http://www.federalreserve.gov/2015-report-economic-well-being-us-households-201605.pdf.

[14] *See* Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2015* (May 2016) at pages 24. Available at http://www.federalreserve.gov/2015-report-economic-well-being-us-households-201605.pdf.

[15] *See The Racial Wealth Gap: Why Policy Matters*, Demos and Institute on Assets and Social Policy (2015) at pp. 9-11, available at http://www.demos.org/sites/default/files/publications/RacialWealthGap_2.pdf.

[16] *See The Racial Wealth Gap: Why Policy Matters*, Demos and Institute on Assets and Social Policy (2015) at pp. 24-25, available at http://www.demos.org/sites/default/files/publications/RacialWealthGap_2.pdf.

Existing PACE programs focus on whether there is enough equity in the home. Loose PACE underwriting tends to look only at whether the borrower has filed for bankruptcy or is delinquent on mortgage payments or property taxes. These programs do not look at the homeowner's ability to repay a loan, even if that loan may result in lower energy operating costs for the homeowner. Unfortunately, a PACE loan could lead low-income consumers to have higher overall housing cost burdens and reduced equity in the home[17] than before the energy efficiency improvements were financed.

"The fact that homeowners save money does not mean that they will not default on their PACE assessments or mortgage loans. Homeowners could use that money for a variety of purposes, especially when confronted with job loss or other substantial financial setbacks."[18]

C. PACE loans are generally more expensive than other options.

Experience with PACE thus far indicates that less expensive financing options are available to homeowners. In its review of PACE programs, the National Renewable Energy Laboratory (NREL) found that challenges associated with PACE included high interest expense and the potential to negatively affect credit rating.[19] In the Berkeley First PACE pilot program, a large percentage of homeowners left the program. Out of 40 homeowners, 27 withdrew due to the high interest rate of the PACE program.[20] The final evaluation of the Berkeley program identified high interest rates as a barrier, and noted that "[a]t nearly twice the rate for a home equity loan, the interest rate for the pilot (including one point for financed administrative costs) steered many applicants to other sources of money but also deterred some from proceeding with installation."[21] Currently, published interest rates for the California FIRST PACE program range from 6.75% for a five year term to 8.39% for a twenty-five year term.[22] In contrast, average rates for home equity loans averaged around 4.9% for a $30,000 home equity loan.[23]

In addition to home equity loans or lines of credit, other loan products designed to encourage investments in energy efficiency and renewable energy are available in some states and at better terms than PACE financing. For instance, in Massachusetts, for moderate-income and higher income households, PACE loans make little sense because the existing Mass Save

[17] *See* Alfred M. Pollard, General Counsel, Federal Housing Finance Agency, *Keeping Up with PACE: A Joint Oversight Hearing on Residential Property Assessed Clean Energy (PACE) Programs,* Statement before the California Legislature Assembly Banking and Finance Committee and Assembly Local Government Committee (June 9, 2016) at 4.

[18] *See* Prentiss Cox, *Keeping Pace?: The Case Against Property Assessed Clean Energy Financing Programs,* 83 U. Col. L.Rev. 83, 91 (2011) at 114.

[19] *See* NREL *Energy Analysis, Property-Assessed Clean Energy (PACE) Financing of Renewables and Efficiency* (July 2010), at Table 1.

[20] *See* Prentiss Cox, *Keeping Pace?: The Case Against Property Assessed Clean Energy Financing Programs*, 83 U. Co. L. Rev. 83, 115 (2011).

[21] *See* City of Berkeley Planning and Development Department, Office of Energy and Sustainable Development, *Berkeley FIRST Final Evaluation* (Nov. 2010) at 13.

[22] *See* California FIRST Program FAQs, at https://californiafirst.org/about-californiafirst/program-faq/, visited on Aug. 10, 2016.

[23] *See* Home Equity Rates according to Bankrate.com, at http://www.bankrate.com/home-equity.aspx?ic_id=rates-funnel_home-equity_mortgages_globalnav, visited on Aug. 10, 2016.

HEAT loan program for energy efficiency improvements – which mostly relies on locally-based lending institutions – offers its loans at 0% interest.[24]

Massachusetts also offers solar loans with favorable terms for low-income and moderate-income homeowners, with up to 30% loan principal reduction for income eligible homeowners.[25] California offers innovative programs for low-income households, such as its Single Family Affordable Solar Homes program and the newer Multifamily Affordable Solar Roofs Program. In New Hampshire, the New Hampshire Electric Co-Op operates its Co-Op Energy Solutions program which subsidizes up to 50% of the cost of certain energy efficiency measures for qualified participants, and provides loans at 0% interest to assist with the remaining cost.

Federally funded weatherization[26] is available in every state and is a cost-effective means of delivering free energy-effective measures to low-income households. The major limitation with the weatherization program is the lack of stable, adequate funding, so there are waiting lists for these services in many states. However, in a number of jurisdictions, the federal weatherization funding is supplemented with utility dollars or other resources so that free or deeply subsidized energy efficiency measures are broadly available to low-income residents. For example, Massachusetts serves tens of thousands of low-income households annually through the programs funded by utility companies and the Department's weatherization program, via the Low-income Energy Affordability Network, while California offers its Energy Savings Assistance Program to large numbers of low-income residents annually.

For low-income households with access to free services, the household needs no financing from PACE or any other source. PACE therefore can only make energy efficiency much more expensive for these customers. If residential PACE is available in areas where free low-income energy efficiency services are offered, and low-income households are not somehow routinely screened out, some low-income customers will likely opt for PACE assessments by mistake, rather than enrolling to receive the same services through existing, no-cost programs.

A successful commitment to improved access to energy efficiency improvements and renewable energy for low-income homeowners should be based on public and utility financial support, not additional debt. Policy commitment to energy savings for these households must come with a financial commitment as well: to both lower energy use and keep these families secure in their homes.

III. The Department's Consumer Protections Need Strengthening

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[24] *See* http://www.masssave.com/en/residential/heating-and-cooling/offers/heat-loan-program, last visited on Aug. 10, 2016. The HEAT loan program in Massachusetts has originated $60 million in loans annually in Massachusetts between 2011 and 2014, serving 7,000 borrowers annually. HEAT has closed 50,000 loans since its inception. (Source: Eversource/EFI).

[25] *See* Massachusetts Clean Energy Center, Mass Solar Loan Program Manual, Version 2.0, Effective 06-20-2016 at 20.

[26] The federal Weatherization Assistance Program, authorized by 42 U.S.C. §§ 6861 – 6873.

While we strongly urge the Department of Energy to adopt guidance that would exclude the marketing or extension of PACE products to low-income households, to the extent that such programs already operate, stronger consumer protections are essential.

A. Essential Consumer Financing Protections

1. Consumer mortgage protections should apply to all PACE loans

The Department must ensure that its guidelines call for applying consumer credit protection laws to all PACE financing. Because PACE assessments carry the same risks as traditional home improvement financing, the Department's best practices should specify that PACE assessments be subject to the same state and federal consumer protection laws as other mortgages. Most importantly, PACE assessments should be subject to the federal Truth in Lending Act ("TILA"), the Real Estate Settlement Procedures Act ("RESPA"), and the Federal Trade Commission’s Preservation of Consumers’ Claims and Defenses rule (commonly known as the FTC "Holder Rule").

Even if a transaction is not already subject to these laws, states and localities adopting PACE legislation can mandate compliance. Compliance should be required both in the origination of the transaction and its performance. A mere reference to “applicable law” will be insufficient because it is not readily clear these laws apply to PACE assessments. Instead, all PACE legislation and contracts should specifically state that the transaction is subject to TILA, RESPA, and the Holder rule.

TILA and RESPA include a number of important consumer protections: clear disclosure of the costs several days before consummation of the transaction, the duty to underwrite for the borrower’s ability to repay the debt, the right to cancel the transaction within three business days, a ban on kickbacks, the right to dispute billing errors during servicing of the loan, and clear rules for enforcement.

In situations where a home improvement contractor or equipment vendor helps a homeowner arrange PACE financing, the Holder rule would require the contractor to arrange for the promissory note to specify that the creditor (in this case, the municipality) is subject to all claims and defenses the consumer may have against the seller, up to the amount of the assessment. This is necessary for situations where the contractor refuses to honor a warranty or causes other problems but is unable to properly compensate the homeowner. Without the FTC Holder clause, the consumer would be forced to continue paying the assessment even when the equipment malfunctioned.

One of the selling points of PACE assessments is that “they will pay for themselves”— that the energy efficiency obtained by the improvements will save the consumer enough on utility bills that the consumer will have no trouble paying for the assessment. But if the improvements are defective, the consumer will not save money and may even incur significant remediation costs. The consumer should be allowed to assert such a claim when asked to pay the assessment because the municipality will be in a better position to police contractors and should not be allowed to foreclose on someone's home because a consumer could not pay to repair a defective heat pump or poorly performing solar panels. The FTC Holder Rule has applied to traditional home improvements contracts since 1975 and has proven itself effective and reasonable.

2. PACE assessments must be properly underwritten for ability to repay.

PACE advocates promote the ease of getting PACE financing—which is based in part on the limited underwriting PACE programs require. Neither the Department's best practices nor most PACE programs require any effort to evaluate whether the borrower has enough (or any) income to repay the assessment. This may be the single biggest and most dangerous problem with PACE financing and the proposed best practices.

The failure to adequately underwrite for ability to repay was a major factor in the recent foreclosure crisis.[27] Instead of verifying the borrower's ability to repay PACE financing, PACE programs depend on the value of the borrower's home and the superiority of the PACE lien to guarantee repayment. This is known as asset-based lending. According to the Office of the Comptroller of the Currency, one "indication[] that an institution may be engaging in abusive lending practices [is] . . . loans made in reliance on the liquidation value of the borrower's home or other collateral, rather than the borrower's independent ability to repay . . . ."[28]

Asset-based lending is particularly dangerous for low-income consumers and those on fixed-incomes, such as the elderly. Such consumers are less likely to have enough discretionary income to absorb unexpected expenses. Asset-based lending and lending without regard to a borrower's ability to repay are such dangerous abuses that the Dodd-Frank Act significantly limits these practices.[29] Unfortunately, it is not clear that the Dodd-Frank Act's provisions apply to PACE assessments. For that reason, the Department should add a best practice specifying that PACE laws should expressly mandate compliance with the Dodd-Frank Act's underwriting requirements.

3. Use accurate appraisals

Given the importance that PACE financing places on the value of the collateral securing the debt, the accuracy of the appraisal takes on additional importance. Unfortunately, the proposed best practices have unacceptably low standards for appraisals. The Department recommends relying primarily on the assessed value of the property. Only if that "appears low or high" does the Department recommend looking at market data. These guidelines are inadequate.

Property assessments are not based on an individual examination of the borrower's property. There may be significant differences between neighboring properties of similar size that could affect their market value. But an assessment will not capture those differences. In addition, there is no guidance as to how to determine whether an assessment appears low or high.

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[27] *See* National Consumer Law Center, Mortgage Lending § 6.2.1 (2d ed. 2014), *updated at* www.nclc.org/library.

[28] Offc. of the Comptroller of the Currency, Advisory Letter 2000-7 (July 25, 2000), available at http://www.occ.gov/static/news-issuances/memos-advisory-letters/2000/advisory-letter-2000-7.pdf.

[29] *See* National Consumer Law Center, Mortgage Lending § 6.2.2.3.1 (2d ed. 2014), *updated at* www.nclc.org/library.

Such a weak recommendation could easily allow a program to double-check only low valuations, in an attempt to maximize the number of loans made. These problems could result in loans secured by properties with inadequate equity.

At a minimum, for homes with an existing mortgage, we recommend requiring a traditional appraisal that meets the Uniform Standards of Professional Appraisal Practice (USPAP). While a traditional appraisal is more expensive than the methods described in the DOE's best practices, reducing the risk of foreclosure and homelessness surely justifies the added cost. If a PACE program does not believe the size of the loan justifies the cost, the municipality should also consider whether it is appropriate to use a community member's home as collateral. We believe the risk of improper underwriting is far greater for the homeowner than for the municipality.

4. Require adequate disclosures

While disclosures are important, disclosures without meaningful consumer protections are wholly inadequate. Financing documents are not consumer education and consumers have a poor track record for understanding the terms of financial disclosures.[30] Considering the cost of PACE financing and the risk to the borrower, we support the Department's recommendation for property owner education. In addition to the disclosures listed in the draft best practices, the Department should specifically recommend using the Know Before You Owe disclosures recently developed by the Consumer Financial Protection Bureau. These disclosures, which include and go beyond what is required by the Truth in Lending Act, have been carefully tested and designed to be useful to potential borrowers. They could easily be adopted by PACE programs.

But we also recommend one other disclosure: one that reminds consumers to consider other ways of paying for qualifying improvements and that these alternatives have stronger consumer protections. Traditional mortgages offer greater protections than PACE financing and generally offer lower interest rates. We note that even a credit card, which is far more expensive and thus bears its own risk of unaffordable debt, is unsecured and will not put the borrower's home at risk in the event of a default.

5. Cancellation or other recourse when savings do not materialize

Protections are needed for homeowners who obtain a PACE loan based on estimates of energy savings, rebates and tax credits, but who do not realize the expected savings or are not able to qualify for expected rebates or tax credits. We recommend the following protections:

- limiting the size of the PACE loan to 80% of the projected savings. This would build in a margin for error;

- creating a reserve for homeowners (funded in whole or in part by the entities who market, audit, install and finance the PACE loans, see III.B.4) to cover shortfalls in the estimated savings or damage caused by contractors lacking adequate insurance coverage;

[30] *See* National Consumer Law Center, Mortgage Lending § 1.3.3 (2d ed. 2014), *updated at* www.nclc.org/library.

- an extended right to cancel the transaction (beyond three days), the right to collect damages, and the right to collect attorney fees (for the cost of enforcing the borrower's rights) where there are major defects in the improvements, or fraud or deceptive conduct in the transaction;

- If a Weatherization-eligible household is enrolled in a PACE program, that household should have a right to rescind the contract and have the tax lien cancelled at the expense of the party that erroneously enrolled that household.

B. Marketing and Implementation Protections

For PACE programs that currently operate, strong consumer protections are needed regarding the marketing of PACE financing and problems with the implementation of the energy efficiency measures funded through PACE financing.

1. Consult with stakeholders and experienced consumer protection agencies to develop best practices that will prevent improper sales tactics.

Homeowners need protections from high pressure sales tactics, which are intended to encourage homeowners to sign up for financing without fully understanding the transaction or the associated risks. This concern is not merely speculative, since aggressive and deceptive marketing tactics have been widely reporting in other areas of the energy sector.[31]

The FTC's Door-to-Door Sales Rule and the Truth in Lending Act both attempt to protect consumers from high pressure tactics by giving consumers a three-day right to cancel. But it is not clear that these provisions will apply to all PACE transactions, and even when they do apply, they only help consumers after the fact. They do not prevent the aggressive tactics themselves.

To address this issue, the Department should develop appropriate best practices in consultation with stakeholders, state attorneys general, and experienced federal agency partners such as the CFPB and FTC.

2. Support for Standards for Energy Auditors

We support the proposals in the DOE Best Practice Guidelines regarding Quality Assurance and Anti-Fraud Measures. An energy efficiency audit would be an initial step for a consumer who is considering energy efficiency upgrades. Therefore, DOE should include protections against unscrupulous or unqualified auditors as well as contractors.

To help ensure that energy auditors are qualified, the Department should include a requirement that auditors must be certified by Building Performance Institute (BPI) or other credentialing organization. Additionally, the Department should require that auditors must be independent of installers and lenders.

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[31] *See*, *e.g.,* "Governor Cuomo Announces New Consumer Protections for Energy Consumers to Stop Deceptive Business Practices" (Feb. 23, 2016) (referencing consumers who were "unfairly lulled by aggressive and dishonest ESCO marketing into believing they were getting savings that they did not receive."); Utility Dive, "Are rooftop solar installers fleecing customers? The industry responds" (March 18, 2015).

A likely scenario is where a qualified auditor gives the customer an erroneous estimate of expected energy savings. Estimates of energy usage reduction are difficult due to variation in household composition and behavior during the life of the loan. Further complicating estimates of savings are weather and energy rate designs that can vary over time. There need to be structural checks to avoid incentives or inclinations to overestimate savings. Having auditors contribute to the consumer reserve fund could help provide incentives to rely on reputable auditors. Consumer protections are needed for these situations where an audit was performed by qualified auditors, but where mistakes were made and expenditures outpace eventual savings. This is an instance where the reserve fund would be able to protect borrowers.

3. Support for Minimum Standards for Contractors

We support the Department's suggestions regarding Quality Assurance and Anti-Fraud Measures, which would set minimum contractor requirements, quality assurance methods, and would require dispute resolution processes. We suggest that, in addition to the DOE specifications described in the draft guidelines, the Department should develop and publish Quality Assurance Best Practices for PACE-funded improvements, much as the Department has developed similar guidelines such as "Quality Assurance Best Practices: Home Performance with Energy Star Programs."

The best practices should clearly prohibit auditors and contractors from receiving kick-backs for referrals. Any relationship between the service providers involved in a PACE transaction must also be disclosed to the borrower along with any arrangements for payments connected to the transaction.

In PACE contracts or contracts for energy efficiency and renewable energy installation, we urge that the DOE guidelines recommend a prohibition on forced or mandatory arbitration, and to preserve consumer recourse to courts or enforcement agencies if any voluntary or informal dispute resolution process does not result in a satisfactory outcome. It appears that mandatory arbitration for borrowers is already required as part of the California HERO PACE Program.[32] Mandatory arbitration serves only to conceal wrongdoing and discourage consumers from seeking relief.

4. Homeowner Guaranty Fund

We strongly recommend that municipalities which offer PACE financing be directed to create a fund of last resort to make consumers whole if they have a dispute with an auditor or contractor. The Department's draft guidance recommends a "Debt Service Reserve Fund" for investors to protect mortgage lenders. We urge the Department to include a parallel recommendation to protect homeowners.

DOE has already suggested in guidance that municipalities should maintain a registry of qualified contractors. DOE could further recommend that, as part of this registration process, licensed auditors and contractors would pay into a "Homeowner Guaranty Fund" or similar fund,

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[32] *See, e.g.,* Sample HERO Financing Program Application, California HERO Program Assessment Contract (Residential) (July 2016) available at https://www.heroprogram.com/sample-documents.

which would reimburse the aggrieved homeowner if the auditor or contractor was found to be at fault but would not or could not compensate the homeowner. A number of states require similar funds for home contractors.[33] All the parties participating in PACE from the marketers, to the auditors to the contractors to the financers should contribute to this fund and fines from bad actors should be directed back to this fund.

5. The Lack of Uniform Enforcement is a Serious Consumer Protection Shortcoming of PACE

The lack of uniform and clear enforcement is a major shortcoming of PACE and one that exposes borrowers to the substantial risk of harm. There is no comprehensive regulatory supervision over these loans. Unless there is clear regulatory supervision over these loans, there must be access to reserves for borrowers and the clear right to remove the tax lien and cancel the loan in the extreme case of fraud.

Currently, it is unclear what entity would provide oversight of PACE programs and enforcement when violations occur. This issue was raised in recent Federal Housing Finance Authority (FHFA) comments before the California legislature, noting that PACE consumer protections are narrow and that existing protections are not backed by an enforcement agency.[34]

The Department should also reach out to the state utility commissions and the state attorneys general to develop protections for PACE consumers. All states have adopted some type of Unfair and Deceptive Acts and Practices (UDAP) laws to regulate business, though these laws vary in scope.[35] The UDAP laws may provide a source of enforcement authority for state attorneys general with the PACE loans. To remove any question of this, states that wish to implement PACE could seek to amend their UDAP laws if needed, and make unfair practices by an auditor or contractor or lender a per se violation of state UDAP law.

6. Data Collection

In the draft guidelines, DOE recommends data collection and analysis, and would include sensitive borrower data such as credit scores. The risks associated with misuse or accidental disclosure of consumer data are well known. We urge DOE to include guidance that any municipality or PACE program administrator should implement stringent data privacy and security measures. Any data analysis that is to be broadly disseminated should include only aggregated information that would not be reasonably likely to allow individual consumers to be identified.

Conclusion

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[33] *See, e.g.,* Conn. Gen. Stat. § 20-432 (2015) (Connecticut Home Improvement Guaranty Fund); Md. Code Ann., Bus. Reg. §§ 8-403, 8-404 (Maryland Home Improvement Guaranty Fund); Mass. Gen. Laws c. 142A, §5 (Massachusetts Residential Homeowner Guaranty Fund).

[34] *See* Alfred M. Pollard, General Counsel, FHFA, *Statement before the California Legislature, Assembly Banking and Finance Committee and Assembly Local Government Committee; Keeping Up with PACE: A Joint Oversight Hearing on Residential Property Assessed Clean Energy (PACE) Programs* (June 9, 2016). *See also*, 77 Fed. Reg. 36088 (June 15, 2012).

[35] *See* National Consumer Law Center, Unfair and Deceptive Acts and Practices, §1.1 (8th ed. 2012).

For the reasons set forth above, the undersigned organizations respectfully request that the Department of Energy establish PACE guidelines to ensure that low-income homeowners are not saddled with unaffordable debt by excluding low-income households from PACE financing. Further, for moderate-income or higher income homeowners, the DOE should create stronger consumer protections for PACE borrowers.

Respectfully submitted,

Charles Harak, senior attorney
charak@nclc.org

Andrew Pizor, staff attorney
apizor@nclc.org

Jenifer Bosco, staff attorney
jbosco@nclc.org

Olivia Wein, staff attorney
owein@nclc.org

National Consumer Law Center, on behalf of our low-income clients
7 Winthrop Square
Boston, MA 02110-1245
(617) 542-8010

1001 Connecticut Avenue, NW, Suite 510
Washington, DC 20036-5528
(202) 452-6252

AND

Action, Inc. (MA)
Citizens Action Coalition of Indiana
Consumer Action
Consumers Union
Community Action Partnership of Oregon
Economic Opportunity Studies, Inc.
Iowa Community Action
Low-Income Energy Affordability Network (MA)
National Community Action Foundation
North Carolina Justice Center
Pennsylvania Utility Law Project, on behalf of its low-income clients
People's Action
Public Citizen
Public Justice Center (MD)
Public Utility Law Project of New York