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National Association of Federally-Insured Credit Unions

May 6, 2019

Comment Intake
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 Sir or Madam:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the Bureau of Consumer Financial Protection's (Bureau or CFPB) advance notice of proposed rulemaking on residential property assessed clean energy (PACE) financing. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve over 116 million consumers with personal and small business financial service products. Although credit unions do not offer PACE financing, credit unions are impacted by the loans' superior tax lien positions as well as associated risk factors. Accordingly, NAFCU is supportive of regulations imposing ability-to-repay (ATR) underwriting requirements for PACE loans as an important consumer protection. NAFCU recommends the Bureau implement regulations that require *Truth in Lending Act* (TILA) and *Real Estate Settlement Procedures Act* (RESPA) Integrated Disclosures (TRID) to provide fair and transparent lending information to consumers. Lastly, NAFCU is supportive of regulations imposing TILA's civil liability rules against those lenders who do not adhere to the ATR underwriting requirements.

General Comments

PACE financing is intended to give consumers the ability to invest in green and energy-efficient improvements and upgrades to their home, which often involves a significant financial investment. Also, PACE financing is intended to level the playing field and allow lower income individuals seeking green and energy-efficient home improvements to obtain low-cost financing over a reasonable period of time. However, PACE financing is not being carried out as originally intended.

More recently, PACE financing programs have suffered from abuse and fraud on the part of contractors and private lenders that are carrying out government PACE financing programs. Ultimately, consumers are the ones that suffer the most. Consumers report aggressive cold call and door-to-door marketing campaigns. Aggressive marketing tactics harm certain groups of consumers more than the average consumer, such as elderly individuals or those who do not speak English as their primary language. In addition, an overwhelming amount of consumers are reporting misrepresentations made by contractors and loan servicers. Misrepresentations include, but are not limited to, energy savings that are never realized, and loans that include a government subsidy or guarantee, which, in fact, does not exist. Although some private lenders are making strides to implement a modicum of underwriting or consumer protections, such as explaining the terms to borrowers in person after they sign up for a program, there are still bad actors in this industry. PACE financing is a well-intentioned program and the proposed regulations will assist in carrying out the program as intended while protecting consumers, stimulating the economy, and providing green home improvements to combat climate change.

On May 24, 2018, the *Economic Growth, Regulatory Relief, and Consumer Protection Act* (EGRRCPA) was signed into law. Section 307 of EGRRCPA amends TILA and requires the Bureau to prescribe regulations relating to PACE financing. Specifically, the regulations must carry out the purposes of sections 129C(a) and 130 of TILA. NAFCU supported the passage of EGRRCPA and is supportive of the regulations the EGRRCPA requires governing PACE financing. Although credit unions do not offer PACE financing, we are supportive of the regulations as credit unions are indirectly impacted as mortgage lenders. Negative implications arise due to PACE loan lien priority.

Current Standards and Practices of PACE Financing by Credit Unions

Credit unions do not offer PACE financing, as any credit union lending products for home improvements do not result in a tax assessment on the real property. Although credit unions do not offer residential PACE financing, they are negatively impacted when PACE-financed improvements impose a superior lien on a property with a preexisting mortgage. NAFCU members offer loans for green and energy-efficient improvements as a substitute to PACE loans that can be secured or unsecured and do not place a lien on the member's real property. Generally, credit union members seeking mortgage loans from a credit union will uncover a PACE lien at the time a title search is conducted. NAFCU members have experienced members ultimately deciding to forgo loan origination because of the high cost of the outstanding PACE loan balance.

Additionally, PACE loans pose a safety and soundness risk to credit unions because of their senior or first lien priority over the original mortgage obligation. Credit unions assist their members by attempting to move the PACE lien to a subordinate lien position, as some counties allow for this. However, more often than not, credit unions are unable to move an outstanding PACE lien to a subordinate lien position. Due to PACE lien priority, in those states and counties with superior or first lien priority, the risk is higher for credit unions in the event of a home loan foreclosure, or if the home is destroyed by a natural disaster and an insurance claim is made. The credit union as the original mortgage holder is in the subordinate position.

Historically, the credit union industry has been weary of the risks PACE loans pose. The National Credit Union Administration (NCUA), the prudential regulator of all federal credit unions, has recognized the riskiness of PACE loans and the potential impacts on credit unions. In 2010, the NCUA issued a regulatory alert regarding the potential risks of PACE loans. The NCUA cautioned credit unions that not only could loans in a credit union's portfolio be affected, but certain PACE programs could also adversely affect earnings and liquidity based on such factors as: (1) when a

PACE loan could overtake the original mortgager’s superior lien position; (2) whether the mortgage becomes more difficult to sell to Fannie Mae and Freddie Mac, the government-sponsored enterprises (GSEs), or private investors; and (3) whether the superior lien position afforded to many PACE loans diminishes the value of certain mortgage-backed securities. The NCUA recommended that credit union management make appropriate adjustments to the credit union’s underwriting criteria considering the impacts that PACE loan payments could have on a borrower’s ATR during the mortgage underwriting process.

In addition to the credit union industry recognizing these risks, the secondary mortgage market has also recognized these risks. The Federal Housing Finance Agency (FHFA) issued a statement in 2010 cautioning lenders of potential adverse effects of an outstanding PACE loan on a lender’s security interest in collateral securing residential and commercial mortgages. Subsequently, the FHFA barred the GSEs from purchasing mortgage loans with an outstanding PACE loan, unless the terms of the loan provide for subordinate lien priority. In addition, the Federal Housing Administration (FHA) announced in 2017 that it will stop insuring mortgages on homes with PACE loans. NAFCU members are actively involved in selling mortgages to the secondary market. According to NAFCU's 2018 *Federal Reserve Meeting* survey, 22.5 percent of members sell to Fannie Mae, 9.9 percent to Freddie Mac, and 22.5 percent to both GSEs. Those credit union members with an outstanding mortgage who subsequently obtain a PACE loan impede the credit union’s ability to sell the mortgage to Fannie Mae or Freddie Mac. It is important that credit unions' ability to provide loans and services to their members is not compromised, and their access to the secondary mortgage market is not diminished.

Potential Implications of Regulating PACE Financing Under TILA

The potential implications of regulating PACE financing under TILA could include greater consumer protections and increased transparency in affordability. NAFCU is supportive of ATR underwriting requirements for PACE loans as an important consumer protection. Under section 129C(a) of TILA and Regulation Z[1], ATR requirements prohibit creditors from making a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to pay the loan according to its terms, and all applicable taxes, insurance, and assessments. In making that determination, a creditor must consider specific factors about the consumer’s finances. A minimum of eight factors are considered, including: current or expected income or assets that the consumer will rely upon to repay the loan, which does not include the property securing the loan; current employment status; monthly payment on the covered transaction; monthly payment on any simultaneous loans secured by the same property; monthly payment for mortgage-related obligations, including any payments for property taxes and insurance; current debt obligations; and credit history. Implementation of ATR requirements for PACE loans would offer beneficial consumer protections, but may also pose some unintended consequences.

[1] 12 U.S.C. § 1639c(a)) and 12 CFR 1026.43

For example, there likely would be some borrowers unable to obtain PACE financing due to an inability to meet ATR requirements; however, there are safer and cheaper alternatives to PACE financing such as the green loans offered by credit unions and home equity lines of credit. Often times, credit union members can obtain a line of credit at a lower interest rate than that of a PACE loan. Also, those borrowers unable to meet ATR requirements are better off financially as opposed to if there were no ATR requirements and they became entrapped in a loan they were unable to afford. Requiring PACE loans to be subject to the same standardized underwriting procedures applicable to other consumer loans secured by real property could also offer some efficiencies for lenders. Because lenders are already collecting ATR information, it would not be too burdensome for those lenders to attain certain minimum factors to determine a borrower's ability to pay a PACE loan. However, this additional ATR information would likely increase approval time for PACE loans. But such longer approval time may not adversely affect borrowers because obtaining financing for a PACE improvement or upgrade to a home is not necessarily a time sensitive undertaking. A borrower seeking financing for solar panels or upgrading windows to a more energy efficient model typically does not need quick financing. Although there may be some negative side effects in terms of increased underwriting costs and additional approval time for both lenders and borrowers, these are outweighed by potential improvements in foreclosures rates.

Currently, local governments are setting aside reserve accounts in case of missed PACE payments in an effort to mitigate quick foreclosure processes. Implementation of ATR requirements provides safer financing, as only those borrowers able to meet the ATR requirements will qualify, thus less reserves would be necessary and foreclosure rates would likely decline. Private lenders have touted low foreclosure rates as a success of PACE loan programs; however, some of these private lenders have resorted to paying delinquent payments in order to minimize foreclosure proceedings. Requiring ATR requirements for PACE financing would be beneficial not only to consumers, but also to governments that have programs in place and the private lenders that carry out these programs. The unintended consequences on the PACE financing industry would be minimal, would not adversely impact borrowers, and would be outweighed by the countervailing benefit to consumers.

Lastly, NAFCU supports regulations to carry out section 130 of TILA, imposing civil liability on those lenders that violate the ATR requirements. Bad actors within the industry should be held accountable for their actions. Additionally, if PACE financing is equivalent to other consumer loans secured by real property, then liability for lender non-compliance should be equivalent as well. NAFCU is supportive of regulations carrying out the ATR requirements, and civil liability for failing to comply with the ATR requirements.

The Bureau Should Adopt TRID Disclosures to Further Enhance Consumer Protections

NAFCU recommends that the Bureau adopt TRID disclosures or similar consumer friendly disclosure to enhance consumer protections. TRID disclosures were adopted to promote the informed use of consumer credit by disclosing terms and costs, to ensure that consumers are provided with greater and more timely information. In the context of PACE financing, there are no standards for disclosures, and in some cases consumers are receiving no disclosures when sold a PACE loan from a door-to-door salesman using solely electronic means to sell the product.

Consumers are not understanding key features of PACE loans, and this lack of understanding is resulting in severe consequences to the consumer, including losing their home. Consumers have reported not understanding how the payments are made, the amount of the payment they will owe, and what happens if payments are missed. Current practices are not fair and transparent. PACE loans are not subject to the same disclosure rules that similar loan products must abide by. Similar to TRID, disclosure information should be given to consumers in advance of loan consummation. TRID requires disclosures be sent to the consumer within a certain amount of time after a loan application is made. Disclosures made prior to consummation of the loan will further protect consumers from entering into a contractual loan obligation that they cannot afford which further carries out the intent of section 307 of EGRRCPA.

TRID applies to closed-end consumer credit transactions secured by real property, as well as construction loans. Although a PACE loan is not secured by the real property itself, the loan typically runs with the property which remains encumbered if the property is sold or foreclosed upon. Therefore, TRID disclosures should apply to PACE loans. Alternatively, the Bureau should apply a minimum disclosure that includes information similar to TRID's loan estimate disclosure that states the: interest rate; projected periodic payments, including taxes, insurance, and assessments; origination costs; and lender information. NAFCU members do not offer PACE financing and will not be affected by any disclosure requirements. Regardless, NAFCU recognizes that members may enter into PACE financing agreements and want to ensure members are provided with transparent and fair information about the contractual agreement they are entering into.

Conclusion

NAFCU appreciates the opportunity to provide comments on the proposed rule. NAFCU supports regulations carrying out the TILA's ATR underwriting requirements for PACE financing. Although credit unions do not offer PACE financing, credit unions are impacted by the loans' superior tax lien position as well as associated risk factors. Unintended consequences on the PACE financing industry are minimal and outweighed by benefits to consumers. NAFCU recommends that the Bureau adopt TRID disclosures to enhance consumer protections. In addition, NAFCU is supportive of regulations carrying out TILA's civil liability for lenders who violate ATR requirements. Should you have any questions or require additional information, please do not hesitate to contact me at (703) 842-2249 or kschafer@nafcu.org.

Sincerely,

Kaley Schafer
Regulatory Affairs Counsel