# Residential Property Assessed Clean Energy (PACE) Loans

NATIONAL CENTER ON LAW & ELDER RIGHTS

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## National Consumer Law Center

The National Consumer Law Center uses its expertise in consumer law and energy policy to work for consumer justice and economic security for low-income and other disadvantaged people, including older adults and people of color. NCLC works with nonprofit and legal services organizations, private attorneys, policymakers, and federal and state government and courts across the nation to stop exploitive practices, help financially stressed families build and retain wealth, and advance economic fairness.

## Introduction

Property Assessed Clean Energy (PACE) programs offer loans for energy-efficient home improvements, such as solar panels, HVAC systems, and energy efficient windows. PACE loans are offered through home improvement contractors and are treated as a tax assessment against the property and are secured by a property tax lien. The PACE assessment is collected by local tax authorities and the lien takes priority over any existing mortgage. PACE programs must be authorized by state and local governments, but they are privately run.[1] The regulation of PACE lending varies widely. There is currently no federal agency that is directly regulating PACE lending. As of January 2017, California is in the process of implementing new regulations, some of which become effective in January and others later in 2018. The impact of these rules is not yet clear.

Currently, California has the most active PACE program, so this summary is largely based on consumers' experience there. However, Florida, Missouri, Vermont, and Maine also have growing PACE programs, and other states are considering them. Wall Street investors are increasingly interested in PACE loans. Many of the PACE bonds are packaged and securitized, then the new securities are snapped up by investors. Super-priority lien position and high interest rates combine to create an attractive investment.

Over the last two years there has been a sharp increase in homeowners seeking assistance from legal services and other organizations in relation to PACE loans. There is some evidence that seniors are being targeted by contractors offering PACE loans. PACE financing can be particularly risky for seniors who have a limited or fixed income. PACE lending is far less regulated than traditional mortgage financing, and the industry disputes the applicability of older consumer protection rules. Any home improvements made with a PACE loan, however, are still subject to any relevant state or federal laws. This Issue Brief will explain the background of the PACE loan program, the reports of exploitative practices associated with PACE loans, and provide practical tips to legal services attorneys assisting clients who might be vulnerable to this financial exploitation.

## Key Lessons

1. A Property Assessed Clean Energy (PACE) loan is a property tax assessment used to pay for home improvements that are intended to increase a home's energy efficiency.

2. PACE loans are becoming more widely available and are often more expensive than traditional

1 The experience in California and elsewhere has been that program administration and loan origination is handled by a third-party, non-governmental program administrators, such as Renovate America, Ygrene Works, and Renew Financial.

mortgages. However, they have weaker underwriting requirements and fewer consumer protections. There have been increasing reports of home improvement contractors targeting seniors for PACE loan projects. There have also been many other complaints regarding the work performed in PACE-financed projects.

## The Basics

PACE loans are used to pay for upgrades or repairs to a home for the purpose of making the home more energy efficient. To get a PACE loan, a homeowner must go through an authorized home improvement contractor. While consumers can select and contact a contractor on their own initiative, the more problematic PACE loans appear to originate through contractor marketing and door-to-door sales.

Any PACE transaction will involve two contracts: one for the construction work and one for the PACE assessment used to pay for the construction. The home improvement contract is subject to traditional state laws as well as the Federal Door-to-Door Sales rule.[2] The construction contract is normally consummated first, followed separately by the financing contract. Both are signed at the consumer's home. In California, the financing contract must have a three-day right to cancel, under state law. The contractor collects the minimal data needed to underwrite the loan and communicates it to the PACE administrator. Pre-consummation underwriting checks the following:

- Whether the consumer is in bankruptcy, delinquent on property taxes or late on mortgage more than once in past year;
- Confirms that the consumer owns the home;
- Confirms that the assessment plus any other loans on the property will not exceed a total loan-to-value ratio of 97%;
- Proposed improvements must not exceed 15% of the market value of the property; and
- The total of all taxes and assessments do not exceed 5% of the property value.

California requires a determination that the consumer has the ability to pay the assessment. It is not yet clear how this will work in practice. New legislation requires the two contracts to be coordinated so the construction work cannot begin until after the three-day cancelation period expires.

The program administrator pays the contractor for the work (using funds from public bond sales), a tax assessment is added to the consumer's property records, and the consumer will be billed for a portion of the total contract cost with their regular property taxes. This may be paid via a mortgage escrow account. If the consumer fails to pay, the consequences are the same as failing to make mortgage or tax payments, for example, foreclosure by the mortgage holder or the local taxation authority.[3]

## Challenges with PACE Loans

### Unaffordable loans without screening for ability to pay

Until recently, PACE loans did not require any verification of the borrower's ability to pay. Recent legislation requires verification, though there is concern that the law may not require that this occur *before* the loan is signed. There have been many reports of unaffordable loans made to seniors and low-income homeowners with

2 16 C.F.R. § 429.

3 Local governments handle property tax delinquencies in a variety of ways. The details are discussed further in chapter 17 of NCLC's *Foreclosures and Mortgage Servicing* (5th ed. 2014), *updated at* library.nclc.org.

fixed incomes and little ability to pay thousands of dollars more each year in property taxes.[4] The application and underwriting process does not include screening for eligibility for alternative state or local programs that provide free or lower cost options, such as the federal Weatherization Assistance Program.

## Problems with home-improvement contractors

PACE programs are designed to use home improvement contractors as the salespeople for the loan product. Marketing for eligible upgrades is typically done by contractors through door-to-door sales, up-selling from other repairs, advertisements, and telemarketers.[5] Some consumers have reported that the products being pitched are of questionable quality and benefit.[6] There have also been complaints of shoddy workmanship.[7] Because contractors sell the PACE loan, they have an incentive to upsell and push homeowners into purchasing unnecessary and unwanted home improvements.

Beyond upselling, some homeowners have been induced to purchase home improvements using PACE financing based on misrepresentation. For example, a common pitch to homeowners is that PACE is a government program under which energy efficient improvements can be made with little or no costs. Homeowners often do not recognize this misrepresentation immediately because of the lag time that it takes for PACE financing to appear on their tax bills or in escrowed mortgage payments.

When homeowners receive their tax bill, they often do not understand the connection to the PACE loan. For example, some homeowners may not understand that an increased tax bill is the direct result of PACE financing for home improvements that may have been done a year or year and a half earlier. In other instances, homeowners have been promised a large tax refund as a result of their energy efficient improvements. Believing in that promise, some homeowners entered into PACE transactions, and later found out they were not eligible for the nonrefundable tax credit available for certain energy efficient upgrades.[8] Low-income homeowners, in particular, who have limited or no tax liability, will not realize any significant benefit from the tax credit. That fact, however, has not stopped salespeople from using the promise of a tax refund that will purportedly pay for the work to induce homeowners to install energy efficient products.

Despite these challenges, PACE programs provide little recourse for homeowners who have been duped by home improvement contractors. Tips for helping homeowners are below.

## Predatory loans and financial exploitation

These PACE loan program practices have resulted in multiple reports of financial exploitation of older adults. Older adults living on fixed incomes and suffering from health problems are frequent targets of predatory practices.

4 NCLC has compiled examples of homeowners who have experienced problems with PACE loans. NCLC, Residential Property Assessed Clean Energy (PACE) Loans: The Perils of Easy Money for Clean Energy Improvement (Sept. 2017), available at nclc.org/issues/pace-loans.html. Links to newspaper articles about problems with PACE can be found on the same webpage.

5 Many PACE program administrators also offer co-marketing opportunities to contractors, permitting contractors to use the program's logos, advertising copy and other branding. R-PACE: Residential Property Assessed Clean Energy, A Primer for State and Local Energy Officials, p. 38 (March 2017).

6 For example, a 71-year old widow in Los Angeles was given a $23,150 PACE loan for house paint (at $50/gallon) and new windows (at about $1000/window over the retail price). See: nclc.org/images/pdf/energy_utility_telecom/pace/ib-pace-stories.pdf.

7 A woman in Santa Ana was talked into $50,000 of PACE financing for a new roof that could not be warrantied and a "cool wall," which was poorly installed and unnecessary. See: nclc.org/images/pdf/energy_utility_telecom/pace/ib-pace-stories.pdf.

8 *See* 26 U.S.C. §§ 25C, 25D (describing certain nonrefundable personal tax credits). A taxpayer claiming a nonrefundable credit can only use it to decrease or eliminate a tax liability. A taxpayer will not receive a tax refund for any amount that exceeds a taxpayer's liability for the tax year.

### Examples of Elder Exploitation from California

- A San Diego man with visible symptoms of dementia was convinced to purchase a $40,000 solar power system financed through California's HERO (PACE) program. The homeowner and his wife understood that it would cost $170 a month. But the subsequent mandatory payments were $337 a month. The contractor set up the financing on a computer and electronically signed for the husband.
- In a case of bait-and-switch, using PACE as a fraudulent inducement, an elderly man received a phone call that explained he qualified for the HERO program. He was offered a deal for new energy-efficient windows that also reduced noise. There was to be 1.5% financing and no prepayment penalty. However, the windows installed were extremely low quality, provided poor insulation, and amplified noise. Homeowner discovered that the interest rate is 26.99% and a lien has been placed on his home. Although the homeowner was induced into the transaction by the offer of HERO financing, the loan was likely not funded through PACE because of the excessively high interest rate.
- Elderly homeowners contracted to get extensive remodeling done with HERO financing. They hired a local remodeling company to do various projects, including fixing the roof. The company promised to completely tear down and rebuild the roof. However, when they finished, the homeowners found they did not actually replace the existing wood. The new roof sagged and created a hazard for the homeowners.
- A door-to-door salesman solicited an elderly, Spanish-speaking homeowner. She was induced to use a PACE loan to purchase solar panels based on representations that she would receive a $10,000 check from the IRS, her home value would increase, and her energy bills would be lowered. None of the documents were in Spanish; and the contract released the holder of all liability. All of the representations upon which the homeowner relied turned out to be false. The new tax lien has made it more difficult for potential buyers to purchase the house. And her monthly energy bill of $125 was replaced by a monthly tax bill of $450. Unable to pay the additional property tax, she has defaulted and is now facing foreclosure.

*For more details on these examples and others, see* nclc.org/images/pdf/energy_utility_telecom/pace/ib-pace-stories.pdf.

### False promises about efficiency

A common selling point promoted by the PACE industry is that energy-efficient upgrades will reduce the homeowners' utility bill in an amount sufficient to offset the cost of the improvements. As a result, homeowners who have little knowledge about the relationship between the proposed improvements and actual energy savings may be sold ineffective products. For example, in one case the windows installed with PACE financing turned out not to be Energy Star approved. PACE loans have often been used for work that is unlikely to produce significant energy savings, like expensive "cool coat" paint and similar products. Even in cases where some utility savings might be realized, it is unlikely to offset the cost of the improvements.

## Other Problems with PACE financing

### Refinancing and selling

Homeowners are told that they are not responsible for the assessment if they sell the property and that it will carry over to the new homeowner. But purchasers typically are unwilling to assume the assessments and homeowners are forced to pay them off to complete a sale. PACE loans have also caused well-documented problems with refinancing. There have also been repeated but uncertain claims that the homeowner's property value will increase—without the related disclosure that the homeowner may have difficulty selling or refinancing the home without completely paying off the PACE assessment.

## Technology meets the hard sell

A common complaint has been the use of high-pressure sales tactics used to lock homeowners into vastly overpriced improvements and high cost financing. Many senior homeowners and homeowners with limited English proficiency were pushed to enter into home improvement contacts and/or loan agreements on the spot through tablet computers and electronic signatures. These practices deny the homeowner a real opportunity to review and possibly reconsider the agreement, especially for those with no or low computer literacy. In some cases, it was unclear whether the homeowner ever received copies of agreements they purportedly signed, and in other cases, it was unclear whether the electronic signature was, in fact, the homeowner's or whether it was forged by the salesperson.

## High cost

Homeowners have also been caught by surprise by the high cost of the improvements and PACE financing. For example, one homeowner was charged $23,150 for exterior home painting, a job that should have been less than 25% of that figure. PACE loans typically carry interest rates that are high for a home-secured loan with little risk of default. Because PACE loans are considered property tax liens that take priority over any mortgages (and the servicer may be obligated to advance a delinquent tax assessment), the risk of default is much lower than traditional home financing. Yet, the cost of PACE financing is nearly double other home equity loan products. PACE loans reported to NCLC ranged from $10,800 to $56,700 (an average of just over $33,000) mostly with 10 to 20-year terms and annual percentage rates of 8 to 11%.[9] Some even have prepayment penalties, a feature that many consider predatory and that federal law now largely bans for traditional home financing. Costs to PACE borrowers are not limited to the loan contract terms, as most state property tax laws impose significant penalties and additional interest on homeowners if tax assessments are not timely paid.

## Multiple loans

Contractors have taken advantage of a loophole in the PACE loan process by making multiple loans to the same homeowner. Because of the lag time before PACE liens are recorded and registered with the local tax collector, contractors have evaded maximum loan-to-value restrictions and other requirements by placing loans with different PACE providers, knowing that PACE providers may not discover that other PACE loans are being made at approximately the same time. Several homeowners have been saddled with more than one PACE loan, often not realizing that they were entering into separate loans.

## Practice tips for attorneys

- Check for liens, get all property tax records.
- Get all documents from administrator and contractor.
- Was contractor licensed and approved?
- Was client notified of the right to cancel under the Door-to-Door Sales Rule or state law?[10] Can you exercise the right late?
- Check status of pending class actions.

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9 For more details on these examples and others, see nclc.org/images/pdf/energy_utility_telecom/pace/ib-pace-stories.pdf.

10 A California federal court has said TILA's right to cancel does not apply. *In re Hero Loan Litig.*, 2017 U.S. Dist. LEXIS 111771 (C.D. Cal. July 17, 2017). An analysis of this decision and arguments as to why it was wrongly decided can be found at National Consumer Law Center, Truth in Lending § 2.4.9.3.3 (9th ed. 2015) (online version only).

- Did originator comply with existing underwriting standards?
- Check for compliance with any state-specific PACE regulations.
- Complain to state regulatory agencies, such as California Department of Business Oversight.
- Possible claims:
  - » State law prohibiting financial abuse of an elder;
  - » Claim against local government PACE assessment agency for negligent supervision of administrator or administrator for negligent supervision of contractor;
  - » Common law and state on UDAP, home solicitation sales, other regulation of contractors; and
  - » If telemarketing was involved, look at federal Telephone Consumer Protection Act (TCPA) and the Federal Trade Commission's Telemarketing Sales Rule.[11]

## Conclusion

PACE financing is like a mortgage but is treated as a tax assessment. The law regarding which consumer protections apply is unclear. Advocates helping seniors with PACE-related problems should look to California case law and advocates because that state has the most experience with PACE. But local regulation of PACE varies widely and some jurisdictions are more restrictive than others.

## Additional Resources

- National Consumer Law Center, PACE issues: nclc.org/issues/pace-loans.html
- National Consumer Law Center, Truth in Lending § 2.4.9.3.3 (9th ed. 2015) (online only)
- National Consumer Law Center, Foreclosures and Mortgage Servicing ch. 17 and § 9.2.7 (5th ed. 2014), *updated at* library.nclc.org
- For more information, contact attorney John Rao at the National Consumer Law Center, jrao@nclc.org

**Case consultation assistance is available for attorneys and professionals seeking more information to help older adults. Contact NCLER at ConsultNCLER@acl.hhs.gov.**

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11 Telemarketing Sales Rule requires $50,000 in damages for private right of action.