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July 26, 2023

Comment Intake—PACE
c/o Legal Division, Docket Manager
Consumer Financial Protection Bureau
1700 G Street NW
Washington, DC 20052

Re: Residential Property Assessed Clean Energy Financing (Regulation Z) Forbearances (Docket No. CFPB–2023–0029/RIN 3170–AA84)

Dear Sir or Madam:

The Credit Union National Association (CUNA) represents America's credit unions and their more than 135 million members. On behalf of our members, we are writing regarding the recent proposed rule entitled Residential Property Assessed Clean Energy (PACE) Financing (Regulation Z) (hereinafter "PACE Proposal).[1] CUNA applauds the rule proposed by the Consumer Financial Protection Bureau (CFPB or Bureau) for the protections it will provide to consumers, including ensuring that consumers are informed about and able to afford the PACE financed improvement loans they may enter into. However, without direct and immediate notification of the origination of PACE loans to first-position mortgages that operate escrow accounts, the consumer protections put into place by the Bureau may not have practical or timely effect.

Background

In general, PACE financing permits a property owner to finance the purchase of energy-related retrofitting or improvements and pay for those improvements through a special assessment on the property. PACE programs are authorized through the passage of state level legislation and implemented on a local level. These state-approved programs typically allow the creation of special districts where a local municipality assesses levies on a property on which the owner has agreed to a PACE financing arrangement.

As PACE financing programs have grown in number over the past decade, these unconventional loan programs have remained a serious concern for credit unions, consumer groups, and other entities participating in the housing market. As stated by the Bureau, PACE financing is enabled in several states, however, PACE financing programs are primarily active in California, Florida, and Missouri.[2] It is therefore notable that PACE reform laws have now been passed in California[3]

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[1] Residential Property Assessed Clean Energy Financing (Regulation Z) (PACE Proposal), 88 Fed. Reg. 30388 (July 26, 2023).
[2] PACE Proposal at 30389.
[3] See Cal. St. & Hwy. Code, §5898.16.

and Missouri,[4] and proposed in Florida,[5] to address consumer harm related to this financing. While the general goal of increasing access to energy efficient housing modifications is admirable, the absence of conventional consumer protections and adequate safeguards have left homeowners vulnerable.

Congress addressed these concerns in the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA)[6] enacted May 24, 2018. Among other things, EGRRCPA amended the Truth in Lending Act to require the Bureau to implement underwriting requirements for PACE financing that account for its unique nature.[7]

General Comments

CUNA vigorously applauds the PACE Proposal. Because PACE liens can pose significant danger and complication for borrowers that have existing mortgage loans, it is critical that PACE financing companies have an obligation to ensure that borrowers fully understand the loan and are able to repay the loan. Further, it is critical that borrowers be entitled to the same rights and protections they would expect when encumbering the title to their home under any other circumstances.

Liens based on municipal levies typically take "super priority" over other liens, including first-position, purchase money mortgage liens, retroactively reducing the availability and reliability of the equity in the collateral. Further, in many states, a foreclosure related to unpaid municipal levies may involve a faster process than a civil mortgage foreclosure process in the same jurisdiction. In combination, these characteristics can pose significant risk to borrowers and their mortgagees.

In a first-position mortgage transaction, it is standard to include contractual language requiring the mortgagor to maintain the first-position lien of the mortgagee.[8] Failure to satisfy, contest, or subordinate a lien that takes priority over the mortgage is likely a default under the mortgage agreement or deed of trust.[9] For this reason, both the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC) have instructed their mortgage sellers/servicers that if a mortgage loan was sold as a first lien position, it must remain so for the remainder of the life of the loan.[10] If a PACE lien is originated and takes priority over a FNMA- or FHLMC-owned mortgage, the borrower must pay off the PACE obligation immediately with proceeds from a no-cash out refinance.[11] If a mortgage servicer is unable to comply with this requirement, they would be obligated to purchase the loan back from FNMA or

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[4] See Mo. Rev. Stat. §67.2818 (2023),

[5] See, e.g., Florida HB 1151, available at https://www.flsenate.gov/Session/Bill/2023/1151/BillText/c2/PDF, and Florida HB 669, *available at* https://www.flsenate.gov/Session/Bill/2023/669/BillText/c2/PDF.

[6] Pub. L. 115-174, §307.

[7] 15 U.S.C. §1639c(b)(3).

[8] See, e.g., FNMA Legal Documents, Standard Instruments by State, California (3005) Standard Form, ¶4, Florida (3010) Standard Form, ¶4, Missouri (3026) Standard Form, ¶4, *available at* https://singlefamily.fanniemae.com/fannie-mae-legal-documents.

[9] *Id.*

[10] *See* FNMA, Selling Guidance, B5-3.4-01, Property Assessed Clean Energy Loans (Dec. 15, 2020) and FHLMC, Bulletin 2016-16 (Aug. 24, 2016).

[11] *Id.*

FHLMC and hold the loan on the mortgage lender's own books. If the mortgage lender is unable to do so, their options would include to sell the loan at a discount or foreclose on the property.

Borrowers who originate PACE loans do not always understand that in doing so, they may be forced to refinance the debt at current interest rates. They rarely understand that they may be technically defaulting on their mortgage agreement or deed of trust. These risks are substantial. PACE financing companies should be obligated to undertake licensing, training, disclosure, and underwriting obligations that befit the danger posed to borrowers by these loans—the loss of their homes. For this reason, CUNA strongly supports the Bureau's proposal. However, there is one critical piece missing to give effect to the necessary and appropriate protections established by the rule: notice to the mortgage servicer.

The Need for Direct Notice to Mortgage Servicers

In its proposal, the Bureau states it "considered requiring all PACE creditors to notify the servicer at consummation that the borrower has entered into a PACE transaction."[12] In support of doing so, it correctly states:

> "This requirement would eliminate one source of delay leading to payment shocks—the time between origination and the mortgage servicer learning of the PACE transaction. Such a requirement could reduce the likelihood that a payment spike would be significant enough to result in a consumer being unable to meet the payment obligations of the PACE transaction."[13]

Ultimately though, the Bureau concluded that it is "preferrable" to address the risks associated with non-notification through the ability to repay requirements which require the borrower be able to repay their PACE loan.[14] The Bureau provides no discussion as to why this is preferrable.

Relying on the ability to repay requirements to avoid the payment spike is a mistake, as none of the requirements even imply that the mortgage servicer might become aware of the loan. Under the requirements of proposed section 1026.43(c) and its proposed commentary, it appears a PACE financing company could meet the requirements by obtaining a recent mortgage statement with the monthly escrow payment and reverse engineering the math to establish the ability-to-repay.[15] There is no guidance in the commentary about how the PACE financing company should guestimate the timing for when the servicer "is expected to learn" of the transaction. Therefore, there is nothing preventing a PACE financing company from simply asking the borrower to notify their mortgage servicer themselves within a specific timeframe. If a borrower forgets, falls ill, or otherwise fails to do so, they may be able to afford the payment shock several months down the line, or their circumstances may have changed, and they may not. Even if they can afford the shock, it may be extremely difficult and put the borrower's financial well-being at risk. It is not reasonable to accept this potential harm when weighing it against the burden of notifying the mortgage servicer. This is especially true when subsequent communications from the mortgage

[12] PACE Proposal at 30412.
[13] *Id.*
[14] *Id.*
[15] PACE Proposal at 30431.

servicer to the borrower are so critical to the borrower fully understanding the implications of the loan they have originated.

CUNA strongly supports the Bureau decision to treat PACE credit as credit under Regulation Z, which would include the right of rescission. However, the right of rescission as set out in section 1026.23 contemplates that the borrower has received *actual information* about their monthly payment amount and an understanding of the implications of the lien. In comparison, the PACE disclosures proposed by the Bureau merely state "If you have a mortgage with an escrow account, contact your mortgage servicer for what you will owe and when."[16] A borrower originating a PACE lien is far less likely to have full information regarding their payment or the title complications they are signing on for. To give full effect to consumer's right of rescission, immediate notification to the mortgage servicer is necessary.

Upon notice of the existence of these PACE loans, credit union mortgage servicers immediately issue a short-year escrow statement identifying the borrower's new monthly payment. This protects both the borrower and the credit union. Further, if the loan is owned by FNMA or FHMLC, the existence of a super-lien on the property may require that the credit union refinance the PACE loan immediately at market rates. In a rising rate environment, the borrower may wish they had not taken out the loan at all. Truly understanding the actual payment and the consequences of the loan is only achieved once the mortgage servicer has been notified. Without requiring immediate notification to the mortgage servicer, consumers' right of rescission is essentially meaningless.

The ability to repay requirements cannot avoid the shock of a payment spike, only ensure that borrowers are, on paper, able to survive it. By declining to require one simply, direct notice to the mortgage servicer, the Bureau signs consumers up for a payment spike that will stress their financial health and only delay their full understanding of the payment amount and legal consequences of the loans.

Other Comments

CUNA would further suggest that PACE loan companies have some obligation to provide a statement during the life of the loan, particularly for consumers who are not paying via an escrow account through a mortgage servicer. It does seem appropriate to exempt PACE financing companies from a periodic statement requirement tied to billing cycles, as the requirement would be overly burdensome. However, the requirements of Regulation Z could be simplified and streamlined to provide useful reminders for consumers without overburdening PACE financing companies.

The Bureau should consider the addition of subparagraph 1026.41(h) that requires a simple periodic statement for PACE loans. Rather than tying the requirement to billing cycles, the statement should be an annual statement for loans with 5-year terms or, for longer term loans, a statement tied to benchmarks in the loan term (*e.g*., a statement is due at every 20 percent interval of the loan term). The content of the statement should confirm the amount of principal which has been paid up to that point, the remaining balance and term, an estimated pay-off date, and contact

[16] PACE Proposal at 30402.

information for PACE financing company. By providing a statement every few years, borrowers will have reasonable opportunities to easily review their mortgage servicing payment histories online to identify, resolve, or escalate any discrepancies or confusion.

Finally, the Bureau should reconsider its recommended language regarding the risk of foreclosure/tax sale. Regarding late payment, the Loan Estimate and Closing Disclosure merely state "If your property tax payment is late, you may be subject to penalties and late fees established by your property tax collector."[17] It makes no mention of foreclosure or the risk of losing the home. In comparison, below are the disclosures required by California and Missouri state law, respectively, on the topic:

> Statutory Penalties: If your property tax payment is late, the amount due will be subject to a 10% penalty, late fees, and 1.5% per month interest penalty as established by state law, **and your property may be subject to foreclosure**. (Emphasis added.)[18]
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> That failure to timely pay the annual assessment and taxes will result in a tax lien and penalties and fees being assessed and added to the annual assessment and taxes, and that if the delinquency is not paid, **the property could be sold at a tax sale resulting in issuance of a tax certificate or collector's deed to a purchaser that could result in the property owner losing his or her home**; […] (Emphasis added.)[19]

The Bureau estimates that 70.1 percent of borrowers have a first-position mortgage on their home when they originate a PACE loan, significantly reducing the likelihood of a tax sale/foreclosure directly related to the assessment. However, the risk is not eliminated. Further the remaining 29.9 percent who pay their assessments directly are still exposed to a legal risk of significant import. It appears the Bureau has concluded that tax foreclosures related to PACE liens are so insignificant that the risk is not worth discussion.[20] However, it is also important to note that the PACE Report the Bureau relies on includes data from July 2014 through June 2020.[21] This period would capture the tail-end of recovery from the foreclosure crisis and otherwise include a generally improving and favorable conditions with regard to delinquency. The Bureau should draft disclosures that are applicable for all market conditions. It is appropriate to disclose the legal risk of tax sale and foreclosure to all PACE loan borrowers.

Further, as previously discussed, late payments and tax foreclosure are not the only foreclosure risk that borrowers face regarding PACE loans. A borrower who obtains a PACE loan may be in default on the contractual terms of their mortgage without ever being in delinquency. Because of the prevalence of the requirement to remove priority liens in mortgage and deed of trust agreements and the FNMA and FHLMC policies that require refinancing, most borrowers may be

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[17] PACE Proposal at 30434 and 30438.

[18] Cal. St. & Hwy. Code, §5898.17(b)(1).

[19] Mo. Rev. Stat. §67.2818.4(13) (2023).

[20] See, e.g., PACE Proposal at 30420.

[21] CFPB, Property Assessed Clean Energy (PACE) Financing and Consumer Financial Outcomes (PACE Report), p.8.

compelled to refinance to avoid foreclosure related to this contractual default. The Bureau should also require disclosure of these risks.

Currently, the Loan Estimate and Closing Disclosure state "If you sell the property, the buyer or their mortgage lender may require you to pay off the PACE loan as a condition of the sale."[22] These seems to indicate that a requirement to pay off the loan may happen at sale of the property. For a borrower with no intention to move, they may assume there would be no need to refinance or pay off the loan early. An additional disclosure regarding this risk is appropriate and warranted.

CUNA suggests that on the Loan Estimate, the Servicing disclosure should be rewritten as follows:

> You will pay your PACE loans as part of your property tax payment. If you have a mortgage escrow account that includes your property tax payments, contact your mortgage servicer to understand what you will owe and when, and any legal or contractual implications that could arise from this loan. Otherwise, you will pay your taxing authority directly.

Regarding the Closing Disclosure, the below line should be appended to the Security Interest disclosure:

> This security interest may have legal or contractual implications regarding any preexisting mortgage on the property. Contact your mortgage servicer to understand any legal or contractual implications that could arise from this loan.

These disclosures would ensure that borrowers have some degree of notice that the loan could have potential legal or contractual implications and directs them to contact their mortgage servicer to identify any potential consequences based on the precise language in the borrower's mortgage agreement or deed of trust. It is appropriate for these conversations to happen prior to the origination of the PACE loan and the conclusion of the rescission period, not afterwards.

Conclusion

CUNA applauds the Bureau's PACE Proposal and thanks it for establishing strong consumer protections around these loans. Thank you for the opportunity to respond to the Bureau's PACE Proposal and to provide some additional considerations to give the rule its fullest effect. CUNA is happy to provide additional information or resources if needed. If you have questions or require additional information related to our feedback, please do not hesitate to contact me at (202) 503-7184 or esullivan@cuna.coop.

Sincerely,

Senior Director of Advocacy & Counsel
Credit Union National Association

[22] PACE Proposal at 30434 and 30438.