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**VIA EMAIL TO REGULATIONS@DBO.CA.GOV**

The Honorable Jan Lynn Owen
Commissioner of Business Oversight
Department of Business Oversight
1515 K. Street, Suite 200
Sacramento, CA 95814-4052

January 5, 2018

Re: Invitation for Comments on Proposed Rulemaking Implementation of AB 1284
PRO 02/17 (PACE)

Dear Commissioner Owen:

First, thank you for the opportunity to comment on AB 1284 and SB 242 and the regulations that the Department of Business Oversight will adopt pursuant to the new PACE statutes. We respectfully suggest that two overriding principles guide the regulations for AB 1284 and SB 242:

First, there must be a clear and consistent application of the statutes and regulations for consumers seeking PACE from any PACE program administrators to ensure that the consumer protections established are available and in force. It is essential that the consumer protections contained in AB 1284 and SB 242 be equally applied by all PACE program administrators in the marketplace.

Second, to ensure this, DBO must create a regime that not only allows, but requires, simultaneous launching by all program administrators of these changes in law under a consistent regime, or a cessation of acceptance of any applications from homeowners by any program administrator that is not in compliance with the changes in law until that program administrator has come into compliance. Consumers should not be placed in a position of being disadvantaged simply by choosing a program administrator that is not ready or unable to implement the requirements of AB 1284 or SB 242 – especially the Ability to Pay (ATP) provisions that go into effect on April 1, 2018.

Because AB 1284 and the ATP provisions were heavily discussed before the Legislature, and the provisions are quite comprehensive in nature, there is little that is left to the discretion of program administrators except for the following, for which we seek guidance from DBO:

- The definition, usage, and calculation of assets in section 22687(b)(1)(e) and its application in the determination under 22687(d);
- The definition and standards/measures used to calculate the Residual Income requirement in 22687(d)(4)

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**The Legislature Was Deliberate in its Policy Choices on Ability to Pay**
It is important that DBO recognize that the provisions of Ability to Pay (ATP) are tied together as a whole, and to focus on individual elements, as some stakeholders might, misses the regulatory forest for the trees.

**Recognition of the unique nature of PACE**
PACE is not traditional financing. It was conceived to be an alternative means of financing higher-priced energy and water efficiency and renewable energy upgrades to encourage homeowners to retrofit their homes to conserve energy and combat climate change. Its structure of using state bond laws and securing repayment through the property tax was to encourage longer repayment terms that yield lower monthly or annual payments. As such, while similar, PACE is not the same as other secured lending.

**PACE is important California Public Policy**
The importance of PACE as a state public policy cannot be understated. PACE was envisioned as a means to increase energy efficiency and spur the growth of residential renewable energy as a means of combatting climate change. PACE is a tool to improve and retrofit older homes in California and bring them into the energy-efficient age. Beginning in 2008, the Legislature has made several amendments to current law to expand PACE (to water conservation, seismic improvements, and electric charging infrastructure) and increased the maximum assessment on the property (from a flat 10% of market value to the current formula of 15% up to $700,000 in property value and 10% on the amount above), and to allow the use of municipal bonding to finance PACE assessments.

The laws enacted in the past two legislative sessions create and enhance protections for consumers utilizing PACE, while not undermining the efficacy of PACE as a climate change mitigation tool.

**PACE is an attractive option for homeowners**
PACE comes with better terms, better rates, and significantly higher and additional consumer protections relative to other financing options, unsecured lending in particular. As was stated throughout the discussion on AB 1284 and SB 242, PACE as a form of financing is meant to compete with unsecured home improvement financing at the point of sale. In a common situation, an event occurs to a homeowner – an HVAC system ends its operational life, a roof begins to leak, or a property owner reviews their utility bill – and the homeowner calls a contractor. PACE was created to intervene at that point-of-sale decision and offer a means of financing higher cost green improvements. Conventional unsecured financing – with shorter terms, higher payments, and higher interest rates – had tilted the field towards the least costly – and less efficient – home improvement options. The decision to even offer PACE, therefore, is one where a contractor has found that the convenience of it as a financing tool – even with its property-secured features – is comparable to the unsecured financing that has long been available to the contractor.

Throughout the debate and discussion on AB 1284, therefore, keeping the usage of PACE attractive to the contractor channel was critical. If PACE becomes another, cumbersome, mortgage-like underwriting financing tool, it will lose acceptance and usage by contractors, making PACE a financing tool that no one will use. (Surveys show that mortgage-like products are less preferred by consumers, who at

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present prefer to pay with credit cards or other unsecured financing by a wide margin over home equity loans). The decision by a contractor to offer PACE as a financing option to a homeowner, and homeowner decisions to accept that offer is what now leads homeowners – through PACE - to choose the more environmentally friendly home improvement options.[1]

**The Ability to Pay determination in 1284 is predicated on PACE as a point-of-sale competitor**
In AB 1284, the ability to pay determination is deliberately placed at a different point in time than other secured lending. This particular point was discussed at length in the public discussion on both SB 242 and AB 1284 because contractors would be less likely to offer PACE to homeowners if its approval period was substantially lengthier than other unsecured financing products because of the verification process.

In other words, stakeholders who look to the statutory language as merely an outside marker where DBO can place the ATP anywhere inside that marker, are not recognizing the intent of the Legislature. In fact, because the ATP was placed towards the end of the transaction, the Legislature added 22687(g) to provide a remedy for homeowners where the ability to pay did not match the initial financing provided for the PACE improvement.

Notwithstanding the different placement of the determination of ATP, the requirement that the ATP be determined prior to funding and recordation has the same legal effect as the time of consummation in a mortgage loan. Unless and until the PACE loan is funded – which does not occur until the issuance of a certificate of completion, and does not become an official obligation (and thus not secured) until recordation, the financing does not obligate the homeowner to the financing. In other words, the PACE obligation – much like the responsibility to repay a mortgage – is not triggered until funding and recordation.

We believe that clarification is necessary in those instances where the statute is unclear, while adhering to the policy intent of the Legislature. Broadly speaking, that intent is to achieve the twin public policy goals of protecting consumers and allowing for the continued market acceptance of PACE as a financing tool to combat climate change.

With that, we offer our comments on those sections that we believe require clarification or interpretation by the Legislature.

**Ability to Pay Provisions**
Timing of the January 1, 2018 effective date: We want to confirm that this date does not apply to any assessment contract executed prior to January 1, 2018, even if funding or recordation may occur after January 1, 2018. As DBO may be aware, there is often a significant delay between the time that an assessment contract is offered to a homeowner and the time it is signed by the homeowner. There may also be a significant delay between the time the assessment contract is signed by the homeowner and the time that the project is completed, and the funding and recordation occurs. Therefore, we want to confirm that DBO interprets the law to mean that beginning January 1, 2018, all new contracts that are

[1] See http://newsroom.suntrust.com/2017-02-27-LightStream-Homeowners-Plan-to-Increase-Spending-on-Renovations-in-2017

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offered, and executed must meet the requirements of Sections 22684-22687 – but that assessment contracts signed prior to January 1, but not yet funded or recorded, do not have to meet the requirements of Sections 22684-22687.

Definition of "commercially reasonable and available (22684 (l))

"Commercially reasonable and available" should be interpreted in the context of a PACE transaction, which must be competitive with unsecured financing or lose the contractor channel that provides PACE as an alternative means of financing. Therefore, what may be commercially reasonable and available for a mortgage transaction which takes 3-5 weeks to close is not commercially reasonable for PACE.

Definition of Ability to Pay Determination (22687(a))

No regulations should be issued that would set a specific point in time prior to funding and recordation for the ATP determination.

Consideration of Debt Obligations using Reasonably Reliable Third-Party Records (22687(c))

DBO should confirm that the specification and use of the credit reports required should suffice as reasonably reliable third-party records for all the obligations listed.

Response to Bet Tzedek proposal (22687(c)(4))

Bet Tzedek is urging DBO to require that monthly housing expense calculations must include whether the property owner's escrow account requires two months' cushion in reserve. We suggest that DBO not require a specific amount in reserve, but require the PACE administrator take all of the homeowner's relevant financial information into account in determining housing expenses.

Verification of assets (22687(b)(1) and (b)(1)(e))

22687(b)(1) refers to "the current or reasonably expected income or assets of the property owner" that is relied upon in the ability to pay determination. It is our position that if a Program Administrator is not relying on assets to determine ATP then there be no requirement to verify such assets. We recognize that Section 22687(d) requires that income – not assets – is the required source for qualifying a homeowner's ATP.

Definition of Residual Income (section 22687(d)(4))

We look forward to working with DBO and all stakeholders to define residual income and the data sources to be used to arrive at a determination of residual income. Our overall position is that there needs to be a common standard used by all program administrators to avoid a potential race-to-the-bottom in how different program administrators calculate residual income. We request that DBO authorize a program administrator to use a debt-to-income ratio approach as a reasonable "estimation of basic living expenses" in determining residual income. The DTI approach is a common underwriting practice in secured lending, such as with home equity lending (which is perhaps the most comparable product to PACE).

Emergency HVAC Exception (22687(f))

We support ensuring that only energy efficient air conditioning, HVAC, and boilers – heating and cooling systems -- are eligible for the emergency exception; however, we would oppose any regulation limiting installation costs which, depending on the age and other aspects of a property, may and will vary.

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**Conclusion re: ATP Provisions**

While we have raised other issues in the ATP section, we believe that the only barriers to full implementation of the ATP on the April 1, 2018 date that fully protects consumers are 1) clarification of the definition and verification of assets in the ATP determination and 2) the appropriate standard to be used to measure Residual Income.

**Non-ATP Provisions**

PACE Solicitor & Solicitor Agent Enrollment and Monitoring (22680)

Broadly speaking, it is important for DBO to create clear definitions or guidelines on the meaning of:

- "readily and publicly available information" of a PACE solicitor (22680(a)(1))
- "clear pattern of consumer complaints" (22680(d)(1))
- "high likelihood" that the PACE solicitor will not engage in lawful behavior (22680(d)(2))
- "a risk-based commercially reasonable procedure to monitor and test compliance" of PACE solicitors with the new law (22680(e)(1))
- "a procedure to regularly monitor" the activities of PACE solicitors (22680(e)(2))
- "the prescribed manner" by which the commissioner will require reporting of enrolled, canceled, and withdrawn solicitors and solicitor agents, and how program administrators may learn of canceled enrollments.

PACE Training (section 22681)

While the program specifies that program administrators shall establish and maintain a training program that is acceptable to the Commissioner, it does not specify that the program administrators create the training program. And while the section requires that the 6 hours of training be completed within three months of enrollment, it is silent on whether a PACE solicitor agent who has completed training with one PACE program administrator has to repeat the training if the solicitor agent begins to work with a different PACE program administrator.

We would request that DBO allow the option for third parties – not program administrators – to offer training for PACE solicitor agents. If program administrators cooperate in establishing and maintaining a third-party program that has a curriculum acceptable to DBO, it will create a standard of uniform training for the industry.

It follows, therefore, that if there is a standardized curriculum acceptable to DBO, DBO should find that training for one program should be credited and transferable to another. This will promote flexibility in the industry for both contractors and program administrators.

PACE Registry (section 22693)

We believe that DBO should prioritize the creation of a PACE registry. The provisions in section 2284(k) requiring either finding evidence of a recorded assessment or asking the property owner to disclose a PACE assessment are important, but ultimately not as dispositive as a real-time registry. We agree with the comments of Bet Tzedek that entries into the registry should occur at the date of funding (i.e. when

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the program administrator disburses funds to the Contractor), not recordation, to offer the greatest protection to the property owner.

There are examples of registries with regard to other financing products. For example, the state of Illinois mandated a real-time registry for certain types of loans, which had restrictions on the number and amount of paydays loans by any one individual. The regulatory authority contracted with a third-party to have a registry in place before a year had passed, at a relatively modest cost.

We encourage DBO to open up a rulemaking on the registry as soon as possible to solicit comments on the requirements for registering a PACE assessment, amount of information required to be provided, and cost-sharing of a new system.

**SB 242 Provisions**

Definition of Contractors and other Third Parties (sections 5902, 5922, 5923)

These sections go into effect on January 1, 2018. On January 1, 2019, the provisions regarding PACE solicitors and PACE solicitor agents go into effect.

In the legislative history of AB 1284, PACE solicitors can be (but are not all) contractors, who are required to qualify and register with the CSLB; PACE solicitor agents can be defined (but not all are) as home improvement salespersons, who are required to qualify and register with the CSLB. It is not clear what "other third parties" refers to, but the obvious interpretation would be PACE solicitor agents (who are not contractors but clearly part of the PACE solicitation process. The remaining question is whether there are other "third parties" who should be subject to these provisions.

Definition of "Thing of Material Value" (section 5923)

We believe that "thing of material value" should exclude leads generated by a program administrator, because a lead generated by a program administrator may or may not turn into a financed assessment contract, its value is speculative at best. In practice, if a program administrator has an application filed on its own website or web portal, a strict interpretation might exclude a program administrator from referring the application to an appropriate (HVAC, solar, etc.) contractor. It is clearly not the intent of the Legislature to prohibit this benign practice.

Thank you for your consideration of these comments. We look forward to working with DBO and stakeholders to bring an improved PACE program to California's homeowners.

Please feel free to contact the undersigned if you have any questions regarding the foregoing comments.

Sincerely,

Jonathan Kevles
Vice President

cc: Coleen Monahan, **via email to colleen.monahan@dbo.ca.gov**