Comments of the

National Consumer Law Center
(on behalf of its low-income clients)

and the

National Housing Law Project

to the

Department of Business Oversight

Regarding Draft Rules Implementing AB 1284

June 8, 2018

Thank you for the opportunity to comment on the Department's draft rules implementing AB 1284 for PACE loans. The National Consumer Law Center[1] submits these comments on behalf of its low-income clients and with the National Housing Law Project.[2]

For clarity, we have structured our comments to track the headings used in the draft rules. However, the majority of our comments focus on a few main areas of concern: (1) ensuring that the rules implementing the underwriting and ability-to-pay requirements actually protect property owners from entering into unaffordable or otherwise unsustainable assessment

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[1] The **National Consumer Law Center, Inc. (NCLC)** is a non-profit Massachusetts corporation, founded in 1969, specializing in low-income consumer issues, with an emphasis on consumer credit. On a daily basis, NCLC provides legal and technical consulting and assistance on consumer law issues to legal services, government, and private attorneys representing low-income consumers across the country. NCLC publishes a series of practice treatises on consumer credit laws and unfair and deceptive practices. NCLC attorneys regularly testify in Congress and provide comprehensive comments to the federal agencies on consumer regulations. Questions for NCLC can be directed to John Rao (jrao@nclc.org).
[2] The **National Housing Law Project (NHLP)** is a non-profit law and advocacy center established in 1968 and based in San Francisco, California. NHLP is dedicated to advancing housing justice by using the power of the law to increase and preserve the supply of decent affordable housing, improve existing housing conditions, expand and enforce low-income tenants' and homeowners' rights, and increase opportunities for racial and ethnic minorities. Among other activities, NHLP provides free technical assistance, case consultations, litigation support, trainings and practice resources for legal services attorneys and other advocates representing homeowners in connection with residential lending, foreclosures and loss mitigation. Questions for NHLP can be directed to Lisa Sitkin (lsitkin@nhlp.org).

contracts; (2) ensuring that record retention and reporting requirements are sufficiently comprehensive and robust to allow both DBO and consumers to monitor PACE program activity effectively and hold non-compliant parties accountable when necessary; and (3) ensuring that the procedures for receiving and handling property owner complaints are accessible, transparent and effective at delivering meaningful assistance to consumers.

A. Definitions (10 C.C.R. § 1620.02)

- DBO defines "Authorized by a program administrator" to mean "enrolled with a program administrator" but then adds that a solicitor or solicitor agent "is also authorized by a program administrator if the program administrator funds a home improvement contract of the PACE solicitor."[3] While we recognize that this definition might be intended to ensure that program administrators retain responsibility in connection with any home improvement contract they fund, regardless of the solicitor's enrollment status, the proposed definition implies that a program administrator is permitted to fund a home improvement contract involving a non-enrolled solicitor or solicitor agent. In order to avoid any confusion on this point, we recommend removing the second sentence of the definition and adding language, either here or elsewhere in the rules, clarifying that an assessment contract involving a non-enrolled solicitor or solicitor agent shall be void and unenforceable.

- DBO defines "To solicit a property owner" as excluding an individual who includes a PACE assessment in a list of two or more financing options given to a property owner, if no information on the options is provided and no particular option is recommended. We recommend that this exception should not apply if the list of financing options is limited to programs available through the same program administrator. For example, if the list of financing options provided to the property owner contains both the HERO and Benji loan programs, the exception should not apply and the individual should be a PACE solicitor or solicitor agent.

- DBO defines "Extinguishment of a PACE assessment" to mean "the property owner has satisfied all obligations under an assessment contract and no further amount related to the PACE assessment will appear on the property owner's taxes."[4] This definition is too narrow. There may be cases in which a PACE assessment is extinguished and the property owner's obligations are satisfied even when the property owner has not been the party to satisfy those obligations. For example, in some cases, a program administrator or a solicitor or solicitor agent may pay some or all of a property owner's PACE assessment obligations in connection with errors or violations. In other cases, the PACE assessment may be cancelled as part of the resolution of a property owner complaint. In order to be comprehensive, this definition should be revised to read:

[3] § 1620.02(b).
[4] § 1620.02(k).

"Extinguishment of a PACE assessment" means the property owner's obligations under an assessment contract have been satisfied or cancelled and no further amount related to the PACE assessment will appear on the property owner's property tax bill.

B. Obligations of Program Administrator (10 C.C.R. § 1620.03)

- Throughout this section and elsewhere in the draft rules, DBO uses the phrase "intended to ensure" with regard to various policies and procedures program administrators are required to maintain. The use of the word "intended" in this context implies that a program administrator's procedures and policies are sufficient if the program administrator merely intended them to accomplish something. We believe that the emphasis is more properly placed on a program administrator's obligation "to ensure" that something is accomplished. We therefore recommend that DBO change "intended to ensure" to "to ensure" in the following subsections: 1620.03(b), (c), (d) and (f); 1620.05(a) and (b); 1620.08(b)(3) and (l)[5]; and 1620.10(b).

- Section 1620.03(c) requires provision of a physical copy of the assessment contract in one of five specified languages "before the property owner signs the contract" if the contract was negotiated in one of those languages. We are concerned that the lack of a specific time frame in this subsection could invite pro forma compliance, i.e., provision of translated versions of the contract just moments before it is signed. In order to ensure that affected property owners have sufficient time to thoroughly review and consider the translated contract, we recommend adding a requirement that the translated document be provided at least 48 hours before the contract is signed.

- Section 1620.03(f) requires program administrators to implement relatively permissive procedures regarding solicitor or solicitor agent representations about potential energy savings. In view of the dangers inherent in door-to-door sales and solicitations and the documented cases of misrepresentations made to property owners by solicitors and solicitor agents, we recommend that this requirement be revised to prohibit solicitors and solicitor agents from making representations regarding energy savings except to the extent such representations (1) repeat exactly what is contained in the mandatory PACE brochure (addressed below in Section D); and (2) notify the property owner that any potential energy savings are not guaranteed. If our recommendation is not adopted, the final rule should specify that the "evidence supporting the energy savings" must include an energy audit that is performed before the assessment contract is signed to quantify the project costs and estimated energy savings of the proposed energy improvements. The energy audit should be done by an accredited third-party provider of energy audits and should include information regarding the energy savings, stated in (1) kilowatt hours or therms, as applicable and (2) annual dollar savings amount, comparing the property owner's current bills to expected bills based on energy-savings or renewable energy measures that the owner is considering financing with PACE borrowing.

[5] Change "the process shall be designed with the intent of ensuring" to "the process shall be designed to ensure."

C. PACE Pricing (10 C.C.R. § 1620.04)

- The requirement that program administrators track pricing for PACE improvements should be worded as a clear obligation to do the tracking. As written, the draft rule merely requires program administrators to "implement a process to track price data"; it should instead explicitly direct that program administrators "shall track price data".

- In view of the amount of time before the initial licensure deadline of January 2019 that program administrators already have to establish a process for tracking price data, there is no need for a further 6-month delay after initial licensure for this requirement to go into effect. The price tracking requirement should be effective as of the date of a program administrator's initial licensure.

- In order to protect consumers from overcharges or price gouging in the PACE program, the price tracking requirement should not be limited to undefined "common" PACE improvements but should instead apply to any item included on a program administrator's list of eligible improvements.

- The draft rule does not indicate how often program administrators will be required to track price data for PACE improvements. We recommend that the tracking occur at least annually to capture price changes in a fast-changing market.

- The draft rule does not specify the type or scope of the data set program administrators should use in their tracking of price data for PACE improvements. Since this requirement is intended to protect consumers from overcharges or price gouging by providers of PACE-financed improvements, the draft rule should be revised to specify that tracked prices must include prices charged for non-PACE-financed improvements and that the data must be reported in a manner that allows for easy comparison of prices charged for PACE-financed improvements to those charged for non-PACE-financed improvements.

- Program administrators should be required to provide the price data to the Commissioner as part of their annual reporting rather than just "upon request" so the Commissioner is able to monitor PACE pricing issues on a regular and comprehensive basis. The price data should also be publicly available.

D. Mandatory Brochure (10 C.C.R. § 1620.06)

- Allowing each program administrator to develop its own separate, differently worded consumer brochure[6] would undermine the goal of ensuring that all potential PACE borrowers receive the same basic information and disclosures regarding the mechanics and the risks of PACE financing. In addition, a system that requires the Commissioner to review each individual program administrator's brochure strikes us as an unnecessary waste of resources. DBO should create a single mandatory brochure in consultation with the relevant stakeholders and should require its use by

[6] *See* § 1602.06(a)(2).

all PACE program administrators rather than giving them the option of creating their own versions of the brochure.

- The draft rule only requires delivery of the mandatory brochure to a property owner "prior to entering into an assessment contract."[7] We are concerned that the lack of a specific time frame in this subsection could invite pro forma compliance, *i.e.*, provision of the brochure just moments before the borrower is asked to sign an assessment contract. In order to ensure that affected property owners have sufficient time to thoroughly review and consider the contents of the brochure, we recommend adding a requirement that the brochure be provided at least 48 hours before the contract is signed.

- Contents of the brochure:

    - The warning about a potential tax sale should focus on the potential loss of the home in a tax sale or to foreclosure (if the borrower defaults on a mortgage that includes increased escrow impound payments).[8] We recommend the following language in the list of items that the brochure must include:

        The risk of losing the home in a tax sale for failing to pay the assessment contract, including the timing of the sale and the minimum amount for which the property may be sold; or in a foreclosure for defaulting on a mortgage that includes an increased escrow impound for property taxes.

    - The brochure should not refer to "tax benefits" since that phrase implies that any tax impacts would be beneficial for the property owner. The brochure should instead employ the more neutral phrase "tax impacts".[9]

    - It is unclear what the reference in section 1620.06(c)(8) to "minimum eligibility standards" means exactly. If it is intended to refer to the underwriting criteria set forth in Financial Code section 22684, it would be clearer to include the statutory reference in the rule.

    - The required explanation regarding potential impact on a mortgage impound account needs to include more detail and also needs to include the possibility that a borrower's non-payment of an increased property tax bill could result in imposition of new impound for taxes by the mortgage lender. We recommend the following language:

        An explanation of the potential impact of the PACE assessment on the borrower's monthly payment obligation to her mortgage lender, including an explanation that (i) an increased property tax bill will result in

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[7] § 1602.06(a).
[8] § 1620.06(c)(6)
[9] § 1620.06(c)(7). *See also* Streets and Highways Code § 5913(a)(B)(2)(L) (using the term "tax impacts" in connection with the program administrator's oral confirmation call to the property owner).

increases to any required escrow payment to the mortgage lender; (ii) for borrowers who currently pay their property tax bills directly, failure to pay the assessment contract as part of the property tax bill could result in the mortgage lender requiring the borrower to make monthly escrow payments for property taxes going forward; and (iii) for borrowers with reverse mortgages, failure to pay the assessment contract as part of the property tax bill would constitute a default on the reverse mortgage that could result in loss of the home to foreclosure.

- The brochure should inform property owners of the right to submit a complaint to the program administrator or the PACE solicitor. It should also include a description of the complaint procedures required by the final regulations.

E. Books and Records (10 C.C.R. § 1620.07)

The draft rule requiring retention of specified records regarding solicitors and solicitor agents ties the retention period to the date of a solicitor or solicitor agent's disenrollment from a PACE program. The date of disenrollment will generally be unrelated to the term of any assessment contract used to finance work with which a particular solicitor or solicitor agent was involved. In order to preserve documents that might be relevant to a property owner's claims, DBO should revise this rule to require retention of the specified records for four years after the extinguishment of the latest assessment contract used to finance work with which a particular solicitor or solicitor agent was involved.

F. Complaint Processes and Procedures

PACE regulations should promote accountability and make it possible for homeowners to obtain redress for problems quickly and easily. To date, when homeowners have problems with PACE-financed improvements and/or PACE assessment contracts, they frequently have trouble finding someone to complain to and getting that party to take action to address the problem(s). We are concerned that DBO's draft PACE rules do not adequately delineate the scope of program administrators' responsibilities, particularly as they relate to the actions of solicitors and solicitor agents, and do not provide a sufficiently clear and enforceable set of procedures for how complaints should be handled. In addition, we are concerned about the absence of any independent oversight of the complaint process and about the lack of clear and consistent deadlines for resolving complaints. We recommend that DBO revise the draft rules regarding complaint procedures as described in the comments on the PACE draft rules submitted by Bet Tzedek.

G. Completion of Work (10 C.C.R. §1620.09)

- The draft rule implies that a PACE administrator is permitted to make payments other than the "final payment" to the contractor prior to verifying that the contractor has obtained any necessary permits or permissions.[10] DBO should revise the rule to change "final payment" to "any payment" to ensure that no PACE funds are

[10] § 1602.09(b) and (c).

disbursed to a contractor for a project that is still contingent on third-party permits or permissions.

- The draft rule only requires verification that the property owner "is able to obtain" necessary permissions for certain improvements.[11] DBO should revise the rule to require verification that the necessary permission has actually been obtained.

H. Unfair Business Practices (10 C.C.R. § 1620.10)

- The list of unfair business practices should include providing any payment to the PACE solicitor before verifying that any necessary permits or permissions have been obtained.

- The draft rule implies that there are circumstances under which a program administrator's policies could permit a PACE solicitor or solicitor agent to charge prices for PACE-financed improvements higher than prices for such improvements in the regional market.[12] DBO should delete the clause "without economic justification".

- The draft rule indicates that PACE solicitors and solicitor agents will be permitted to "obtain financing offers from more than one program administrator on behalf of a property owner".[13] This language conflicts with the prohibition on a program administrator's "disclosing to a PACE solicitor or PACE solicitor agent the amount of PACE financing available to a property owner."[14] DBO should delete the final clause starting with "This paragraph does not prevent…" or, at a minimum, clarify the meaning of "obtaining [a] financing offer[] … on behalf of a property owner" to remove any implication that a solicitor or solicitor agent may be informed of the amount of PACE financing available to a property owner.

I. PACE Solicitor Enrollment Standards or Processes (10 C.C.R. § 1620.11)

The draft rule regarding the contents of a program administrator's agreement with a PACE solicitor only requires the solicitor to "maintain all advertising for 24 months."[15] The wording in this rule is imprecise, and the retention period proposed is too short. We recommend revising this subsection as follows:

> *A PACE solicitor shall retain all advertisements, marketing materials, and other information about the PACE program that is provided to property owners, including all documentation related to a PACE assessment contract, for a period of four years after the extinguishment of the assessment under such PACE assessment contract.*

[11] § 1602.09(c).
[12] § 1602.10(b)(18).
[13] § 1602.10(b)(19).
[14] § 1602.10(a)(1).
[15] § 1620.11(b)(3)(K).

J. Solicitor Agent Enrollment Standards or Processes (10 C.C.R. § 1620.12)

The draft rule creates an undefined category of "conditional enrollment" for solicitor agents. Given the importance of all of the applicable enrollment criteria, a person should not be able to engage in any PACE-related activities limited to enrolled persons without first meeting all of those criteria.[16] DBO should delete this provision.

K. Enrollment Denial (10 C.C.R. § 1620.13)

The standard for establishing a "clear pattern" of consumer complaints about dishonest business practices set forth in the draft rule is too narrow.[17] As written, the draft rule confines a "clear pattern" to "more than one complaint in the same geographical area".[18] Given that many PACE solicitors and program administrators work in multiple regions of the state, there is no good reason for disregarding multiple complaints merely because they occurred in different geographical areas. Moreover, the term "same geographical area" is not defined and could be interpreted extremely narrowly by a program administrator to mean a specific city or even neighborhood. DBO should delete the clause "in the same geographical area" where it appears in this subsection as well as in subsections 1620.15(a)(4) and (a)(5).

L. Annual Report Data (10 C.C.R. § 1620.19)

- The draft rule requires program administrators to make an annual report "by March 15 of each year" but does not specify when this reporting obligation starts in relation to a program administrator's initial licensure.[19] In order to ensure that this important data is provided as early as possible, the DBO should clarify that the reporting obligation will go into effect once a program administrator is licensed by revising this subsection as follows:

  A program administrator shall by the first March 15 following the date of its initial licensure as a PACE program administrator and then by March 15 of each following year report the following information for activity from the prior calendar year:

- The draft rule only requires reporting of "[t]he number of foreclosure actions on PACE property reported to the program administrator during the prior calendar year."[20] This reporting requirement is inadequate to meaningfully track the potential adverse effects of PACE financing on homeownership and borrower finances. While foreclosure by a mortgage lender is one of the most dangerous risks a PACE borrower may face, the failure to maintain payments on a PACE assessment contract can also result in serious mortgage delinquencies involving thousands of dollars in delinquency-related fees and charges even if a foreclosure does not occur.

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[16] § 1602.12(e).
[17] § 1602.13(a)(1).
[18] § 1602.13(a)(1)(A) and (C).
[19] § 1620.19(a).
[20] § 1602.19(a)(3)(A).

For example: a property owner has an annual pre-PACE property tax bill of $3,600 and pays her property taxes through an escrow account with her mortgage servicer. Before PACE, her monthly escrow payment is $350.[21] She takes out a PACE loan with an annual PACE assessment of $4,800. After the next escrow account analysis, her monthly escrow payment will increase by at least[22] $467 to $817. If the property owner cannot to afford to pay the increased escrow payment as part of her monthly mortgage obligation, she will go into default on the mortgage, incurring late fees, property inspection fees and, if the delinquency lasts for several months, fees related to the preparation, mailing and recording of default notices (Notice of Default, Notice of Trustee's Sale). Even if she is able to reinstate or modify her mortgage account at a later date, she will still end up paying most, if not all, of the additional delinquency-related charges.

In addition, the draft rule fails to capture all of the relevant foreclosures and serious delinquencies that may occur. By limiting the required data on this issue to foreclosures "reported to the program administrator during the prior calendar year",[23] the draft rule excludes any foreclosure or serious delinquency that is not reported to a program administrator. It is unclear who would be reporting this information to program administrators and in what manner, but it is highly unlikely that all – or even most – foreclosures on relevant properties would be subject to reports received by program administrators from property owners, mortgagees or other third parties. Program administrators can easily track foreclosure and delinquency activity on properties subject to PACE assessment contracts by simply checking on free[24] or commercially available[25] online databases, so it is reasonable to require them to collect this information as part of their annual reporting obligation.

The draft rule also contains a number of undefined and/or imprecise terms and phrases, such as "PACE property" and "amount recovered through foreclosure".

For these reasons, we recommend that DBO revise subsection 1602.19(a)(3)(A) as follows:

The number of Notices of Default, Notices of Trustee's Sale and Trustee's Deeds upon Sale, respectively, recorded on properties subject to PACE assessment contracts

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[21] Because mortgage servicers are permitted to include a two-month reserve in a borrower's escrow account, the monthly escrow payment will generally exceed 1/12th of the annual property tax bill. In this case, the annual taxes plus the two-month reserve would be $3,600 + $600 = $4,200, so the monthly payment would be at least $350. The exact amount will depend upon the timing of when the escrow disbursements are due.

[22] Depending on when the escrow account analysis occurs in relation to when the property tax payments are due, the new monthly escrow payment may also include a portion of any anticipated shortage in the escrow account during the coming year.

[23] § 1620.19(a)(3)(A).

[24] The majority of counties in California offer free online access to records of recorded notices. *See, e.g.*, http://www.criis.com/index.html (providing access to recorded documents for 12 counties); https://arcc-acclaim.sdcounty.ca.gov/ (San Diego County); *and* http://acrparis.sbcounty.gov/ (San Bernardino County).

[25] *See, e.g.*, https://www.ndcdata.com/ (covering all counties in California).

administered by the program administrator during the prior calendar year. For each recorded Notice of Default and Notice of Trustee's Sale, include the year of the assessment contract, the original amount of the assessment contract, the zip code of the property, the date the Notice was recorded and the reinstatement amount reflected in the Notice. For each Trustee's Deed upon Sale, include the year of the assessment contract, the original amount of the assessment contract, the zip code of the property, the amount of the unpaid date at the time of the trustee's sale, and the amount paid by the buyer (grantee) in the trustee's sale.

M. Underwriting General Standards (10 C.C.R. § 1620.20)

- Section 1620.20(a) provides that program administrators shall use "forms and documents written in plain English (or the property owner's primary language) and in a font size and typeface that promote readability." We support this requirement but urge DBO to specify that the reference to "forms and documents" includes the property owner's application, consistent with section 1620.20(b).

- Section 1620.20(b) requires a program administrator to provide a property owner with a "copy of the property owner's application and all forms and documents related to the transaction." Section 1620.03(c) requires that the property owner be provided a "physical copy" of the assessment contract. In referring to a "physical copy," we believe DBO intends that an electronic copy does not satisfy the requirement. We recommend that section 1620.30(b) should also require a "physical copy," and that it should be provided at or before the assessment contract is signed.

- To fulfill its supervisory authority over program administrators, DBO should require transparency by program administrators of their general underwriting standards. Nothing in section 1620.20 or any other provision of the draft rule requires a program administrator to disclose its substantive underwriting standards or method for making an ability-to-repay determination. Without such disclosure it will be impossible for DBO to determine for purposes of supervision and enforcement whether a program administrator has made a proper determination based on its underwriting guidelines. For example, if a program administrator considers the consumer's monthly debt-to-income ratio but fails to disclose the specific ratio it applies, DBO would not be able to verify whether the underwriting standard is being applied consistently and accurately. Similarly, if a program administrator uses a table of estimated basic living expenses to determine residual income, the table with dollar amounts based on household size should be provided to DBO so that DBO may verify that program administrators are accurately determining whether property owners have sufficient residual income to meet basic household living expenses.

- We are concerned that nothing in section 1620.20 or any other provision of the draft rule addresses verification of the household's debt obligations. Subdivision (c) of Financial Code section 22687 requires program administrators to "consider the monthly debt obligations of the property owner to determine a property owner's ability to pay the annual payment PACE assessment obligations using reasonably reliable third-party records, including one or more consumer credit reports ….” The final rule should state explicitly that a credit report does not serve as a reasonably reliable third-party record for purposes of verifying items that do not appear on the credit report. Some recurring debt obligations of the property owner may not be shown on credit reports, such as certain housing expenses and obligations for alimony or child support. For example, if the owner has a reverse mortgage or does not have a mortgage with an escrow account, the owner's credit report will not have information about obligations for property taxes and assessments, hazard and flood insurance, private mortgage insurance, cooperative, condominium, or homeowners association fees (including any special assessments if paid on a recurring basis), and ground rent or lease payments. Thus, program administrators will need to obtain records or billing statements for these obligations issued by third-parties, such as local taxing authorities, insurance companies, or condominium associations. DBO should also provide guidance in the final rule on the types of debt obligations that are not customarily found on credit reports and will likely require third-party records other than credit reports.

- We are also concerned that nothing in section 1620.20 or any other provision of the draft rule requires program administrators to consider as part of the ability-to-pay review the unique aspect of PACE tax assessments that they are not repaid in monthly installments. If the homeowner has a reverse mortgage or does not have a mortgage with an escrow account, the program administrator should be required to determine whether the homeowner has the ability to pay the annual assessment in two lump-sum installments rather than as a monthly payment amount. A program administrator's ability-to-repay determination would not be reasonable and in good faith if factors affecting the homeowner's ability to budget for lump-sum assessment payments are ignored. For example, if a property owner has both a full-time job and a part-time job, and the part-time job is only seasonal for two months of the year, it may not be reasonable to determine the owner's repayment ability based on the income from both jobs since the part-time income may not be available to the homeowner when the assessment payment comes due.

- Program administrators should also be required to consider the timing of when the first assessment payment is due in relation to when the assessment contract was signed, as the property owner may not have had sufficient time to budget for the lump-sum payment or may not have adequate savings to draw upon. This can also be an issue for homeowners with a mortgage escrow account, as the servicer will account for the large increase in tax disbursements by adjusting the monthly escrow payment, and the timing of the escrow analysis in relation to when the first assessment payment is due may cause the escrow account to have a shortage. Recovery of this shortage together with the payments required to fund the escrow account going forward (including the typical two-month cushion) can produce a sharp increase in the monthly escrow payment amount that significantly exceeds the monthly cost of the PACE assessment. Program administrators should consider the effect of this payment shock on the homeowner's ability to repay.

N. Property Owner Protections (10 C.C.R. §1620.21)

- Section 1620.21(a) requires that that the program administrator disclose to a property owner the market value determination at the time financing disclosures are given. We recommend that this provision specify that the disclosure be given in a written form that the owner may keep. The disclosure should also include all pertinent documentation related to the valuation.

- Section 1620.21(b) requires that that the program administrator maintain a "firewall" between the persons making the good faith ability-to-repay (ATR) determination and others participating in the transaction, including PACE solicitors and solicitor agents. We are pleased that this provision, similar to what we recommended in our initial comments, is included in the draft rules and urge DBO to retain it in the final rule.

- Section 1620.21(c) requires that that the program administrator shall not compensate persons making the ATR determination or involved in approving the funding "based on the outcome of any ability to pay or funding decision." We urge that this provision additionally provide that any compensation for these individuals may not be based on the terms of the assessment contract, such as the interest rate charged to the owner. The final rule should provide that program administrators shall not pay to individuals involved in underwriting, directly or indirectly, compensation (including salaries, bonuses, commissions, and any financial or similar incentive) in an amount that is based on a term of the PACE transaction, the terms of multiple transactions by such individuals, or the number (or quotas) of PACE assessment contracts that are approved for funding and recordation.

O. Property Owner Income (10 C.C.R. §1620.22)

- Section 1620.22(a) is intended to implement subdivision (a)(5) of Financial Code section 22687 related to confirmation calls about the owner's income. This provision should additionally prohibit program administrators from asking during confirmation calls whether the homeowner believes he or she has an ability to pay the annual PACE assessment.

- We support section 1620.22(b) and urge DBO to retain this provision in the final rule.

- The principles for determining a property owner's current or reasonably expected income contained in section 1620.22(c) are generally helpful and should be retained in the final rule. However, we believe that several of the provisions should include more specific guidance, as discussed below.

- Section 1620.22(c)(1) provides that the examples of the records that a program administrator may use to verify a property owner's income or assets in subdivision (b)(1) of Financial Code section 22687 are not exhaustive. We support this principle. However, the final rule should also specify that reliance upon several of the listed examples in isolation could lead to an unreasonable determination of repayment ability. For example, if the program administrator relies on income from the owner's employment in determining repayment ability, the owner's current employment status must be considered and verified. Reliance solely upon an IRS tax transcript or a W-2 wage and tax statement, which provide only a retrospective look at the homeowner’s past income, is not sufficient to establish whether the homeowner is currently employed or has a reasonable expectation of continued employment. This potential concern is not lessened by section 1620.22(c)(3), which generally requires records that reflect two years of income, as two years of past income derived from IRS tax transcripts or W-2 wage and tax statements would not verify current income.

- To verify wage income, the final rule should require program administrators to obtain a pay stub from the most recent pay period or seek verification of employment status from the homeowner’s employer. If a program administrator obtains third-party records directly from the consumer, such as a pay stub, the program administrator must ensure that the records are reasonably reliable and specific to the individual consumer. Any income records obtained from a third-party service provider, such as a party the homeowner's employer uses to respond to income verification requests, must also be subject to appropriate due diligence by the program administrator to ensure they are reasonably reliable and specific to the individual consumer. If a program administrator verifies a homeowner's employment status orally by calling the employer, the program administrator should be required to prepare a record of the information obtained orally that will be retained in the loan file.

- We are concerned that section 1620.22(c)(7) does not fully implement the requirement in section 22687(b)(1) of Financial Code. Section 22687(b)(1) permits the use of automated income verification, but only if the source of the verification is “specific to the income of the property owner and not based on predictive or estimation methodologies, and has been determined sufficient for such verification purposes by a federal mortgage lending authority or regulator.” In contrast, section 1620.22(c)(7) simply provides that a program administrator shall not determine income “based on records or data that is not specific to the property owner.” We are concerned that without express guidance as to what is “specific” to a property owner, some program administrators may attempt to use automated income verification systems or other forms of verification that are not consistent with the minimum statutory requirements. The rule should provide examples of what is not acceptable. For example, the final rule should state that records and data regarding average incomes in the homeowner's geographic location or average wages paid by the homeowner's employer are not sufficient for income verification.

- The final rule should require that program administrators obtain approval from DBO before using any automated verification system to validate homeowner income, employment, and asset data, after providing proof that the system is not based on predictive or estimation methodologies, and that it has been approved by a federal mortgage lending authority or regulator. DBO should also require an annual certification by program administrators that such automated system remains compliant.

- The automated income verification systems that currently exist operate to verify only salary and wage income, by accessing third-party payroll service records or IRS tax transcripts. DBO should prohibit the use of automated systems for other purposes until they become reasonably reliable. The final rule should provide that until such time as a program administrator can demonstrate to the satisfaction of DBO that an income verification system is reasonably reliable, program administrators shall not use automated systems for verification of self-employment income, military or reserve duty income, bonus pay, tips, commissions, interest payments, dividends, retirement benefits or entitlements, rental income, royalty payments, trust income, public assistance payments, and alimony, child support, and separate maintenance payments.

- Subdivision (b)(2) of Financial Code section 22687 states that "[i]ncome may not be derived from temporary sources of income, illiquid assets, or proceeds derived from the equity from the subject property." While section 1620.22(c)(2), (3) and (4) properly implement this requirement as to temporary sources of income, we believe that section 1620.22 should expressly provide that illiquid assets and proceeds derived from the subject property's equity must not be considered in determining repayment ability.

P. Other Assets (10 C.C.R. §1620.23)

- Section 1620.23 permits a program administrator to rely on a property owner's assets for the payment of certain "nonroutine, nonrecurring, or atypical" obligations. One such obligation listed in the draft rule is the "first payment obligation" or a one-time increase in the owner's impound account payment (presumably to cover the first assessment payment). We are concerned that this practice could lead to an unreasonable determination of repayment ability by a program administrator. We echo the comments from Bet Tzedek on this provision. In addition, we are concerned that reliance on assets for the payment of any PACE-related expenses could result in approval of an owner who lacks sufficient current income but anticipates increased future income. Reliance on income increases that have not yet occurred would undermine affordability reviews in most instances. We urge DBO to delete this provision. If it is retained, the final rule should provide that any reliance by a program administrator on the expectation that income will be available for repayment of the assessment after the first payment obligation must be reasonable and verified with third-party records that provide reasonably reliable evidence of the homeowner's expected income.

- Section 1620.23 should be limited to consideration of an owner's liquid assets that are readily available to the owner, such as cash in a savings account. Funds in an owner's retirement account should not be considered.

Q. Basic Household Living Expenses (10 C.C.R. §1620.24)

- Section 1620.24 provides that if a program administrator uses a recognized standard formula for estimating the owner's living expenses, the program administrator must add to the formula amount the owner's actual expenses for child care payments, medical expenses, and caregiving expenses. We strongly support inclusion of this provision in the final rule, and urge DBO to require program administrators to collect and document this expense information from property owners on the application form. However, we believe that the final rule must do more to fully implement the residual income provision in subdivision (d)(4) of Financial Code section 22687.

- Section 22687(d)(4) defines basic household living expenses as "expected expenses which may be variable based on circumstances and consumption patterns of the household." A program administrator must therefore consider the unique circumstances of the household and may not rely solely upon a chart or table containing minimum residual income figures, such as the VA's Table of Residual Incomes by Region. In addition to the owner's actual expenses for child care payments, medical expenses, and caregiving expenses, the final rule should instruct program administrators to consider the individualized expenses of the property owner's household based on its "circumstances and consumption patterns." For example, if a property owner has extraordinary food expenses due to special dietary requirements related to a medical condition, the program administrator should be required to make an appropriate adjustment to any pre-determined food expense amount on a residual income chart or table.

- Section 22687(d)(4) permits a program administrator to make a reasonable estimation of basic living expenses "based on the number of persons in the household." Importantly, this requires consideration of the entire household's expenses, not simply those of the property owner. DBO should require that any chart or table of estimated expenses reflecting minimum residual income consider household size, and that program administrators must include in determining household size all members of the household without regard to the nature of their relationship.

- As discussed above, DBO should require program administrators to submit to DBO for approval any chart or table they intend to use for estimating basic living expenses. The submission should include information on how the chart or table was developed, the process by which it is updated, and evidence that it provides reasonable estimation of living expenses based on household size. As we stated in our initial comments, we are concerned that residual income charts or tables, such as the VA's Table of Residual Incomes by Region (which was not intended to be used in isolation), do not provide sufficient granularity to provide a realistic estimate of living expenses in the various California communities. For example, the VA Table indicates that a family of four in the West region (which includes California) should have residual monthly income of $967.[26] This amount is intended to cover the household's expenses for food, health care, clothing, transportation, telecommunications and miscellaneous expenses.[27] The UC Berkeley Labor Center Living Wage and Self-Sufficiency chart suggests that the VA figures significantly underestimate the expenses of a California family.[28] For example, UC Berkeley estimates the following monthly expenses in the residual income expense categories for a household with two working parents and two children in San Diego: $773 for food, $491 for health care, $510 for transportation, and $787 for miscellaneous expenses, for a total of $2,561. Thus, the VA Table underestimates the San Diego household's needed residual income by $1,594 per month.

R. Emergency (10 C.C.R. §1620.25)

- Section 1620.25 is intended to implement the emergency exception to the ability-to-pay review found in section 22687(e) of the Financial Code. The draft rule requires that the improvement to be financed must be for a system whose primary function is "temperature regulation." We are concerned that without specific guidance from DBO, some contractors and program administrators may take advantage of the emergency exception for certain work that is only marginally related to temperature regulation, such as window replacement or "cool coat" paint. DBO should define "temperature regulation" and provide specific examples of what is and is not included in this category.

- Similarly, the final rule should define or describe what constitutes an emergency. Window replacement and other similar improvements should not be eligible for the emergency exception. In general, the replacement of an HVAC system may be an emergency or immediate necessity only if the property owner's current system in inoperable or if its continued use would cause an immediate threat to the health and safety of the property owner.

- We support section 1620.25(d), which requires that the waiver of the right to cancel shall be in the same language as the confirmation call under Streets and Highway Code section 5913. However, the final rule should require that the waiver be handwritten and personally signed by the owner. Docusign and e-sign should be prohibited for the waiver.

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[26] 38 C.F.R. § 36.4340(d) (for loan amounts of $79,999 and below). The numbers in the VA Table are based on data supplied in the Consumer Expenditures Survey (CES) published by the Department of Labor's Bureau of Labor Statistics.

[27] Under the VA residual income standard, utilities and home maintenance, and child care and support payments, are deducted from income before comparison to the minimum residual income figures.

[28] UC Berkeley Labor Center, Making Ends Meet: How Much Does It Cost to Support a Family in California?, interactive chart available at: http://calbudgetcenter.org/resources/making-ends-meet-much-cost-support-family-california/.

S. Responsible for the Difference (10 C.C.R. §1620.26)

DBO's draft rule regarding the "responsible for that difference" requirement in section 22687(g) of the Financial Code would not provide a meaningful remedy for homeowners saddled with unaffordable PACE obligations. Section 22687(g) provides that "[i]f there is a difference between the determination of the property owner's ability to pay the annual PACE obligations and the actual amount financed for the property owner, and the property owner is obligated on the underlying home improvement contract, the program administrator shall be responsible for that difference." This provision is intended to put the property owner in the position she would have been in if the actual amount financed had not exceeded the amount it was determined she would be able to pay on the annual PACE obligation. For a program administrator to be "responsible for that difference," therefore, the program administrator must take steps to ensure that the property owner is not required to make payments that exceed her ability to pay. This means that the compensation provided by a program administrator that has financed an amount that exceeds the amount the property owner is able to pay must cover all interest, administrative and financing charges attributable to the unaffordable portion of the actual amount financed.

As currently written, the draft rule proposed to implement the "responsible for the difference" requirement would not achieve the purpose of Section 22687(g). Section 1620.26 sets forth two options for satisfying the requirement: (a) prepayment of the assessment contract for the amount of the difference; or (b) payment of the amount of the difference directly to the homeowner. Neither of these options would put the property owner in the position she would have been in if the actual amount financed that is reflected in the assessment contract had not exceeded her ability to pay. In addition, the draft rule does not address the scenario in which the program administrator approves financing in a higher amount but later adjusts the amount in the recorded assessment contract to reflect the owner's repayment ability, thereby leaving the owner potentially responsible for payment to the contractor of any remaining amounts owed on the improvement contract.

We address first the situation in which the amount financed reflected in the recorded assessment contract exceed ability-to-pay determination. The draft rule does not provide a definition for "the difference" and thereby leaves it to the discretion of the program administrators to make this calculation without any regulatory guidance. As a result, a program administrator might simply subtract the amount of the ability to pay determination from the actual amount financed and treat that as the whole "difference," leaving the property owner responsible for all interest and other administrative and financing charges resulting from the excessive principal financed. Such an outcome would not satisfy the "responsible for the difference" requirement.

The proposed prepayment method for addressing the financing of an unaffordable loan presents an additional problem: even if the unpaid balance of the assessment is reduced by the amount of the program administrator's prepayment, unless the assessment contract is modified, the reduction would only shorten the repayment period on the assessment contract; the annual PACE obligation will remain at the same unaffordable level. If a property owner cannot afford the annual payments, she could lose her home long before the shortened contract term ends.[29]

[29] It is not entirely clear from the text of the draft rule whether DBO intended for the prepayment option in

The proposal to allow a program administrator to satisfy the “responsible for the difference” requirement by making a lump-sum payment directly to the property owner is similarly flawed. Even if the amount paid to the property owner is properly calculated to include all interest and other administrative and financing charges resulting from the excessive principal financed, expecting a property owner who will likely be living with multiple financial pressures to manage and allocate a large lump-sum payment over the course of a decade or more is simply unrealistic. As a result, the property owner’s annual PACE obligation would likely remain unaffordable going forward.

Under either of the proposed options, the property owner would receive property tax bills including an unaffordable PACE assessment amount, and any delinquent or defaulted payments to the County tax collector would result in significant late fees and interest charges based on the excessive annual obligation amount.

As explained in our initial comments submitted in January 2018, the more appropriate method for addressing this situation would be to modify the terms of the existing PACE assessment contract to make the annual assessment payment amount reflect the homeowner’s ability to pay. Consistent with the statutory language, the homeowner must not be responsible for paying the difference between what the homeowner paid or is obligated to pay on the home improvement contract and the qualifying loan amount determined under the ability-to-pay analysis.

We recognize that there might be administrative and legal issues under California law (and securitization or bond requirements) in modifying an assessment contract that has been funded and recorded. If that is true, DBO should require that program administrators take action that is equivalent to a loan modification. The preferred method for accomplishing this result is to require that the program administrator conduct a refinancing transaction that pays off the existing assessment contract that was made without the ability-to-pay review. As part of the refinancing, the homeowner will be provided a new assessment contract in an amount established by the ability-to-pay review, with the proceeds being used to pay off a portion of the balance owed on the existing assessment contract. The program administrator must be required to pay any remaining balance owed on the existing assessment contract, including any outstanding interest, prepayment fees or other fees related to the payoff of the existing assessment contract, as well as any origination and recording fees related to the new assessment contract.

For example, assume that the homeowner signed a PACE loan in the amount of $30,000 with a 10 year term. Assume also that after the loan was funded and the assessment contract was signed, the program administrator determined that the homeowner had an ability to repay only a $10,000 loan. A new PACE loan and assessment contract in the amount of $10,000 should be provided to the homeowner. If the payoff amount on the existing assessment contract is $31,400

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§ 1620.06(a) to function like a loan modification or a refinance transaction that would in fact reduce the annual payment obligation. If so, DBO should revise the language to clarify that intention. The draft rule does reference potential recording fees for the “transaction” and contemplates a “revised Financing Estimate and Disclosure,” but as currently written, it would allow the program administrator to prepay only the amount of the “difference”, which would not result in a change in the amount of the periodic payment obligation without an explicit directive to modify the payment terms.

at the time of the refinancing, and the net proceeds from the new $10,000 loan is $8,971 after prepaid interest and program costs are subtracted, the program administrator should pay the amount of $22,429 to pay off the existing assessment contract.

We next address the situation in which the program administrator approves financing in a higher amount but later adjusts the amount in the recorded assessment contract to reflect the owner's repayment ability. This could result in the program administrator making a final payment to the contractor that will not be sufficient to pay the outstanding balance owed on the improvement contract. The draft rule fails to adequately address this situation. Rather than require the program administrator to pay the amount of the difference directly to the homeowner as proposed in the draft rule, we urge DBO to require that the program administrator take all steps necessary to ensure that the homeowner is held harmless from any liability to the contractor. Thus, the program administrator should be required to pay the difference to the contractor and obtain a written release from the contractor acknowledging that the improvement contract has been paid in full and that the property owner has no further liability under the improvement contract. The program administrator should also be required to ensure that any mechanic's lien or other encumbrance against the property related to the improvement contract is released or discharged by the contractor.

T. Automated Valuation Model (10 C.C.R. § 1620.27)

- Financial Code section 22684 provides that a property owner's total loan-to-value ratio for all mortgage related debt including all PACE assessments shall not exceed 97 percent of the market value of the property. By allowing such a high loan-to-value ratio, even modest errors in valuation could result in a property owner owing more on the loans than the home is worth. The only substantive provision in the draft rule that deals with the use of automated valuation models (AVM) is section 1620.27(b). We believe that this provision by itself fails to address the significant consumer protection concerns in the use of AVMs.

  Section 1620.27(b) provides that the "selection of a property value with the lowest standard deviation shall meet the standard of determining the property value with the highest confidence score." We believe that this provision may be in conflict with subdivision (a)(1)(D) of Financial Code section 22685. Subdivision (a)(1)(D) provides that a program administrator shall utilize the estimated value with the highest confidence score for a property, but if a model that otherwise meets the criteria set out in the section does not obtain a confidence score for a subject property, the PACE program should use the average of all estimated values from at least three different AVM models, even where those values do not have confidence scores. DBO should clarify that section 1620.27(b) is not intended to override Financial Code section 22685(a)(1)(D).

- As we discussed in our initial comments, we believe that DBO should require a full appraisal if a program administrator cannot obtain three estimated values for the subject property, each of which has an adequate confidence score. Research has shown that there is wide variation in AVM accuracy. The properties for which no confidence score is obtained are the ones most likely to result in an inaccurate valuation. AVMs generally are used in combination with other analytics, data reviews, property inspections or appraisals. AVMs are most often used to support bulk decisions such as portfolio valuations or for appraisal reviews.[30] Their accuracy is weaker when used for valuation for any individual property. For example, in one study of 666 U.S. counties, on average the percentage of automated valuations across all counties falling within +/- 10 % of the sales price was only 70%, with variation between 20% and 92%, depending on the county. Thus, 30% of valuations on average were more than 10% different from sales price (which is itself different from appraised value). On average, almost half of all valuations across all of the counties were within +/- 5% of the sales price. About half were in excess of +/- 5%. However, in one county only 9% of the valuations were within the 5% bracket. The highest recorded individual county accuracy figure was 76%.[31] On an individual level, such widespread potential for error undermines the lending process and a homeowner’s security.

- Another problem with section 1620.27(b) is that not all AVMs link confidence scores to a standard deviation or other statistical measurements. In addition, confidence scores among AVM models are not all based on the same factors. Some AVM's derive confidence scores from less reliable factors such as the number of local properties used in the estimate, neighborhood range of values, or other indicators that do not adequately evaluate an AVM's performance against the sale price. Thus, the final rule should include other safeguards to ensure that property owners are protected from unreliable AVM models. For example, DBO should establish minimum criteria for determining confidence scores and require that program administrators use an AVM models that meet or exceed these criteria.

- An assumption made by all AVM models is that the property is in a marketable condition and is not in need of any significant repairs. The final rule should require that if a PACE solicitor or solicitor has knowledge that these assumptions are not correct with respect to the property that would be subject to a PACE assessment, that information must be communicated to the program administrator. The program administrator should then be required to obtain a full appraisal (or a BPO that meets designated rigorous standards).

U. Commercially Reasonable (10 C.C.R. § 1620.29)

- Section 1620.29 lists the circumstances in which verification by a program administrator of information or criteria related to “submitting, presenting, or

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[30] Automated Valuation Models: Increased Use Leaves Plenty of Work for Appraisers (Feb. 16, 2017), available at https://www.mckissock.com/blog/appraisal/automated-valuation-models-increased-use-leaves-plenty-of-work-for-appraisers/.

[31] George Andrew Matysiak, The Accuracy of Automated Valuation Models (AVMs), Report for The European Group of Valuers’ Associations (TEGoVA) (May 2017), *available at* http://www.tegova.org/data/bin/a591190c05b2c3_Geoge_Matysiak_Valuation_Report.pdf.

otherwise approving for recordation" an assessment contract is "commercially reasonable and available." We generally support this provision but have concerns about section 1620.29(e), which provides that: "Where information was not reasonably available through an independent source, the verification relied on the representation of the property owner." Based on the "Industry Response" that was submitted to DBO on March 12, 2018, we urge DBO to clarify what is meant by "reasonably available."

- In the joint "Industry Response" submitted by the three major program administrators on March 12, 2018, they gave several examples of the types of information that they believe would not be reasonably available. One example relates to the underwriting requirement that the borrower has not had more than one late payment of property taxes on the property for the previous three years. The program administrators seem to be asserting that property tax payment information is not commercially reasonable and available. Based on that premise, they take the position that "program administrators should be able to rely upon attestations of property owners with respect to th[is] underwriting criteria."[32] We strongly disagree.

  First, for most, if not all, California counties, property tax payments histories are readily searchable online at no cost by simply entering an assessor's parcel number or property address.[33] More importantly, PACE is intended to be a partnership between local government entities, including local tax collectors, and the private program administrators. Certainly program administrators and local tax collectors can, if free online search tools are insufficient, develop a system that would allow program administrators to review a property owner's recent property tax payment history. We urge DBO to clarify in the final rule that property tax payment histories are "commercially reasonable and available" and that program administrators may not rely upon attestations of property owners with regard to this underwriting criterion.

- Two other examples that were discussed in the "Industry Response" indicate that program administrators believe that it is not commercially reasonable to require program administrators to independently verify that 1) the property owner has not sought, authorized, or obtained other PACE assessments, or 2) the measures financed by an assessment contract are eligible. As to both examples, we do not believe that program administrators should rely solely upon attestations of property owners. Until such time as a registry for PACE assessments is in operation, program administrators should be required to obtain information about other assessment contracts from the PACE solicitor on the project, who would be in a position to have knowledge about whether other energy-related improvements are planned or have been done on the property. Program administrators should be required to obtain attestations from PACE solicitors that that they have no knowledge the property owner has sought, authorized, or obtained other PACE assessments on the property. If the PACE

[32] Industry response letter dated March 12, 2018, page 5.
[33] *See, e.g.*, https://iwr.sdtreastax.com/SanDiegoTTCPaymentApplication/Search.aspx (San Diego County); https://www.acgov.org/ptax_pub_app/RealSearchInit.do?rsShowSeachParmsWithHistory=true (Alameda County); https://www.mytaxcollector.com/trSearch.aspx (San Bernardino County).

solicitor has knowledge of other improvements, this should trigger an inquiry by the program administrator to other PACE programs and tax collection offices, and a search of land records on the property. A similar process should occur on whether the assessment contract is financing eligible measures. Rather than rely solely upon attestations of property owners, program administrators should be required to obtain attestations from PACE solicitors that that they have no knowledge that there the measures being done on the property are ineligible.

Thank you again for considering our comments.