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VIA ELECTRONIC MAIL

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Department of Business Oversight
1515 K Street, Suite 200
Sacramento, CA 95814

The Honorable Jan Lynn Owen, Commissioner
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RE: PRO 02/17 (PACE)

Dear Commissioner Owen, et al.:

Thank you for the opportunity to comment on the Department of Business Oversight's proposed rulemaking implementing Assembly Bill 1284 ("AB 1284") and Senate Bill 242 ("SB 242"). We appreciate that the DBO has engaged in a thoughtful approach to implementing AB 1284, has been willing to engage in a constructive dialogue regarding the implementation of AB 1284, and has incorporated into the regulations comments from PACE Administrators. In that spirit, we submit these comments to the Department's draft rules implementing AB 1284.

We strongly support AB 1284's goals of bringing uniformity and certainty to the market for Property Assessed Clean Energy ("PACE") financing across California. To that end, AB 1284 furthers the public policy objectives underlying California's PACE program – making energy- and water-efficiency improvements accessible to and affordable for all Californians, including moderate- to low-income homeowners, by providing an innovative financing mechanism for those improvements.

The crux of this correspondence is this: PACE has fundamentally changed since the implementation of AB 1284 and SB 242. Property owners now have important protections enacted into law. At the same time, these changes have resulted in a dramatic, 50% reduction in the number of PACE applicants applying for and willing to complete the financing qualification process; a noticeable reduction in the number of contractors willing to participate in PACE; and an accompanying reduction in revenues to program administrators. As drafted, DBO's regulations will exacerbate these impacts and threaten the viability of PACE and its role in combating climate change in California. We urge you to recognize the progress that has already been made in protecting consumers, and to adopt a more moderate approach to regulation.

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The Public Purpose of PACE: Addressing Climate Change

Since the California Legislature passed the nation's first PACE law (AB 811-Levine) in 2008, and continuing through last session, it has consistently affirmed the urgent policy goal of PACE: to address climate change by making energy and water efficient, and renewable energy improvements accessible to more Californians by removing the upfront cost-hurdle posed by these improvements and providing for financing terms that make payments more affordable. Because combating climate change was deemed to be a top policy priority for the State, PACE was designed to allow local governments to use their taxing authority to make PACE available to homeowners as an alternative means of financing.

PACE began in California as city or county operated programs using public treasury funds for program administration and project financing (in Sonoma and Placer counties, for example), with limited success and limited opportunity to scale in terms of utilization rates by homeowners. When private program administrators brought private capital and built out a business channel with licensed home improvement contractors, PACE adoption grew rapidly. More than 200,000 California homeowners have used PACE to finance more than $4 billion in energy- and water-saving improvements – achieving the scale necessary to have a meaningful impact on climate change.

Program design that evolved the contractor channel helped transform PACE from a government-sponsored program to a point-of-sale product where the concept of efficiency improvements could be introduced to a homeowner at the critical point when their attention was already focused on making a decision on a home improvement. PACE's rapid growth under this public-private business model has led to unprecedented success in achieving the Legislature's climate change goals, with the improvements PACE has financed estimated to generate:

- 5.5 million tons of greenhouse gas emission reductions – the equivalent of taking 1.2 million cars off the road for a year
- More than 10 billion gallons of water savings

This success has been recognized by California Energy Commissioner David Hochschild, who said "one of the most important policies helping California build a clean energy future is Property Assessed Clean Energy (PACE)." Additionally, the Lawrence Berkeley National Laboratory found that "residential Property Assessed Clean Energy (R-PACE) programs increased deployment of residential solar photovoltaic (PV) systems in California, raising it by about 7-12% in cities that adopt these programs."

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AB 1284 and SB 242 Changed the Nature of the PACE Sales Process and Product

SB 242 and AB 1284 were the Legislature's response to two important issues that had become evident in the PACE marketplace: 1) some consumers did not fully understand what they were getting themselves into when they agreed to have a PACE assessment placed on their property; and 2) some consumers were making PACE-financed improvements to their homes without the means to repay the PACE obligation.

SB 242 put into place safeguards against contractor misrepresentations through the statutory requirement – unprecedented in any form of financing – that the PACE program administrator must call each property owner applicant to orally confirm the improvements they sought, along with confirmation of the key terms and key aspects of the PACE assessment, including many of the disclosures already required on written financing documents required by statute (2016's AB 2693). SB 242 also put into place stronger cancellation provisions for home improvement contracts by rendering the home improvement contract unenforceable until after the homeowner had reviewed the assessment contract, financing disclosures, and received their confirm terms call AND after the 3-day right to cancel has expired.

The phone call to confirm PACE financing terms is not just a strong consumer protection against contractor misrepresentation. It has fundamentally shifted the locus of the sale of PACE, away from the contractor sales representative in the home to the direct telephone interaction between the PACE administrator's customer service representative and the homeowner. In short, the contractor's role has shifted from PACE solicitor to PACE introducer, if you will. This shift has significant implications for DBO's approach to rulemaking: the dramatically reduced role of the contractor sales representative in the sale of PACE financing allows DBO to focus its regulatory attention on its licensees – PACE administrators – rather than on contractors, which are already regulated by the Contractors State License Board (CSLB).

AB 1284 changed the nature of the PACE product from a traditional property tax assessment – for which there is no individual property owner underwriting – to a hybrid product, with a detailed and explicit ability-to-pay standard, similar to that in other forms of financing, to ensure that consumers have the means to make their increased annual property tax payment. The specific underwriting standards, contained in sections 22684 and 22687, are unusual in the level of prescription provided in the statute. The Legislature typically leaves the articulation of such details to the discretion of the regulator. In the case of PACE, however, the Legislature was intentionally specific in enumerating the ability-to-pay underwriting requirements because of the unique hybrid nature of PACE. As a hybrid form of financing – reflecting the features of both traditional, tax assessment-secured financing as well as the point-of-sale characteristics of unsecured credit – the Legislature sought to craft robust consumer protections that preserved the ability of PACE to continue to be marketed competitively.

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The Purpose and Effect of the Draft Regulations

It is in this context that it is important to review DBO's draft regulations with regard to the path forward for PACE in California. Because the plain language and intent of the key provisions of AB 1284 and SB 242 work together to prevent the consequences of fraud, misrepresentation, and overburdening of debt, it is important that DBO not craft regulations that place additional requirements or burdens on these provisions that, however well-intentioned, undermine the intent of the Legislature.

The continued viability of PACE is dependent on maintaining viability of the relationship between program administrators and their contractor channel, and keeping PACE as a competitive point-of-sale financing alternative that is attractive to homeowners. It is against this backdrop that we offer these general observations on the DBO draft.

The Draft DBO Regulations Will Deter Contractor Participation in PACE

Contractors and their home improvement salespersons are the part of the engine that is in large part responsible for enabling the success of PACE in California. DBO's proposed regulations constitute an existential threat to the relationship between PACE program administrators and contractors, giving even more contractors good reasons to stop introducing PACE altogether to their clients.

It is important to recognize that issues regarding the home improvement contract, contractors and home improvement salespersons – indeed, the home improvement industry -- are already under the jurisdiction of and regulated by the Contractors State License Board and the Business and Professions Code. The proposed DBO regulations that address issues related to the enforcement of the home improvement contract, such as contractor workmanship and building permits as opposed to financing are outside the scope of DBO's statutory authority, and add requirements that are duplicative and, in some instances, that are also foreign to the compliance practices required by the CSLB.

We have already witnessed the decline of contractor participation because of the reforms enacted in AB 1284. It is no exaggeration to say that the additional costs and requirements in the draft regulations will drive remaining contractors away from PACE. To cite a few such costly and overly burdensome requirements:

- Restraining advertising and marketing that are not only contrary to how efficiency improvements are advertised on governmental websites and programs, but would in practice require small businesses to either double their advertising budget, or refrain from advertising PACE altogether. (1620.05)
- Restraining contractor and salesperson behavior during the PACE transaction that no contractor is forced to follow for any other form of financing (1620.03; 1620.11)

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- Requiring an onerous and detailed process for complaints if the contractor offers PACE, a process that is not currently required by the CSLB of any home improvement contractor regardless of whether the contractor offers any form of financing. (1620.11)
- Regulating workmanship, including warranty performance and permitting compliance, is already within the purview of the CSLB and local governments; this secondary regulatory regime does not exist for a contractor unless it were to offer PACE. (1620.08; 1620.09; 1620.11)
- Conditioning payment of contractors on factors outside of their control – ie, approvals by local building departments and, in the case of solar, utilities – that is not present for any other form of financing or as a condition of a home improvement contract(1620.09)
- Demanding price data on every transaction which is not currently required by the CSLB of any home improvement contractor to conduct business and would place new administrative burdens on any contractor offering PACE. (1620.04; 1620.10)
- For solar contractors, creating confusion where the Legislature last year mandated a complaint system through CSLB and standards on energy savings representations (which also conflict with the aforementioned restrictions on representations in advertising and marketing) through the CSLB and the CPUC. (AB 1070)

In sum, for contractors, the proposed DBO regulations impose new and substantial costs if they wish to continue offering PACE on behalf of program administrators. This "PACE Penalty" will deter contractors from participating in PACE and effectively terminate its efficacy as an agent of climate change for California.

The Draft DBO Regulations Will Deter Homeowner Participation in PACE

The willingness of homeowners to utilize PACE is directly correlated with the friction or ease associated with the PACE transaction. Program administrators are already seeing that highly qualified property owners are exiting the PACE marketplace because they are equally qualified for unsecured loans that do not require the same financing qualification documentation as PACE since the implementation of AB 1284. Not only do unsecured loans or credit cards lack the same documentation requirements, they do not require that the improvement be energy efficient nor do they provide the same level of statutorily-required consumer protections as PACE.

Further increasing the transaction friction as will be required by the proposed regulations – what behavioral social scientists call the "hassle factor" – will increase the flight of homeowners from PACE. Examples of how the "hassle factor" will increase in the proposed regulations include:

- Requiring a property owner to document 2 years' worth of income through tax returns – a level of documentation not even required for mortgage lending (1620.22)
- Requiring a property owner to document child care, health care, and caregiving expenses that goes beyond the statutory requirements of a "reasonable estimate." (1620.24)

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- Requiring documentation of an improvement's actual energy savings, which will require property owner consent, utility company cooperation, documents, and possibly an energy audit. (1620.03; 1620.07)
- Limiting the emergency or immediate necessity option to "seasonality" and to certain parts of the state. Given the swings of temperature and climate throughout the state due to climate change, this is an onerous and unrealistic burden, not to mention a possible health risk for those homeowners accommodating ongoing health reasons that require temperature or air quality control inside the home. (1620.25)

Decreasing the willingness of homeowners to participate in PACE thwarts the adoption of efficiency improvements and, therefore, will not achieve the climate change goals of the Legislature.

The Draft DBO Regulations Will Impose Impossibly High Costs on Program Administrators

PACE began to gain widespread adoption by local governments and homeowners in 2014, after the Legislature created the CAEATFA Loss Reserve and provided a capital-based answer to objections raised by the Federal Housing Financing Agency. As such, it is still a relatively new industry. In just over four years, approximately $4 billion in PACE financing has been approved and funded. By comparison, the mortgage lending industry alone in California routinely funds over $200 billion a year in financing.

PACE Program administrators are already experiencing the costs associated with implementing the ability-to-pay provisions and the confirmation of terms calls required by AB 1284 and SB 242. Many of the requirements sought in the draft regulations would exponentially increase the costs to an industry which is already experiencing a substantial decline in volume – and thus revenue – since the implementation of both bills. This "expense shock" from implementation of both AB 1284 and SB 242 will be increased dramatically through the additional duties that would be imposed by the proposed regulations.

Many of these duties include data and compliance requirements associated with issues mentioned above:

- Collecting 2 years' worth of documentation for income verification. (1620.22)
- Collecting actual child care, health care, and caregiving expense. (1620.24)
- Collecting documentation of actual energy savings. (1620.03; 1620.07)
- Collecting data on home improvement contract pricing from an industry that is not required by the CSLB to provide such data to a homeowner or even the CSLB. (1620.04; 1620.10)
- "Regulating" the workmanship and performance issues of contractors, which is currently under the jurisdiction of the CSLB (1620.08; 1620.11)
- Physical documentation and linguistic assistance requirements that go beyond what current California law requires of any other business. (1620.03; 1620.08)

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- Preparing and publishing a mandatory brochure that is both repetitive and conflicts with the terms of the statutorily required confirm terms call and Financing Estimate and Disclosure (1620.06)

In addition, there are some proposed regulations that are impractical or impossible for a program administrator to be reasonably expected to abide by, including:

- Preparing or approving all advertisements, marketing materials, and other information about the PACE program that is provided to property owners (1620.11)
- Ensuring a property owner receives a confirmation of key terms call prior to proceeding with work under a home improvement contract (given that in some cases, a project will have already begun prior to the homeowner deciding to use PACE financing) (1620.11)
- Obtaining a copy of each home improvement contract from a PACE solicitor (the contract is a private contract between the homeowner and contractor, and the homeowner may wish to maintain that privacy)

If all these proposed regulations were to go into effect, the sum total of the burden and cost to program administrators would be staggering. Until the market normalizes and program administrators can project the impact of just implementing AB 1284 and SB 242 as is, we urge DBO to be judicious in determining how to further regulate the industry.

Sincerely,

Cliff Staton
Executive Vice President
Renew Financial