

Date of Hearing: April 18, 2018

ASSEMBLY COMMITTEE ON LOCAL GOVERNMENT

Cecilia Aguiar-Curry, Chair

AB 2063 (Aguiar-Curry) – As Amended April 5, 2018

SUBJECT: California Financing Law: PACE program administrators.

SUMMARY: Establishes additional requirements for Property Assessed Clean Energy (PACE) administrators, solicitors, and consumers. Specifically, **this bill:**

- 1) Requires PACE administrators to establish a process for enrolling, promoting, and evaluating the compliance of, and for canceling the enrollment of, PACE solicitors and PACE solicitor agents that is *acceptable to the Commissioner of Business Oversight*.
- 2) Requires the PACE administrator to *timely* notify the Commissioner when a solicitor or its agent is enrolled.
- 3) Requires the Commissioner to include the administrators report on all PACE assessments in his or her annual report.
- 4) Requires that a person must not engage as a PACE solicitor unless that person is enrolled with a PACE administrator.
- 5) Requires a homeowner's ability to repay to be verified by the PACE administrator before any of the following occur:
 - a) Execution of an assessment contract;
 - b) Execution of home improvement contract; and,
 - c) Commencement of work under a home improvement contract that is financed by an assessment contract.
- 6) Specifies that a PACE administrator must not execute an assessment contract, no work can commence under a home improvement contract that is financed by that assessment contract, nor can that home improvement contract be executed until the PACE administrator has made a good faith determination that the homeowner has a reasonable ability to repay the assessment.
- 7) Requires, that if the PACE administrator is responsible to pay the difference between the amount determined and the actual amount financed, the PACE administrator must provide a written explanation as to how ability to pay was determined. This provision sunsets on January 1, 2019.
- 8) Specifies, that during the oral confirmed terms call, the PACE administrator must notify the homeowner that it is their responsibility to contact their insurance provider to determine if the improvement is covered under their plan.

9) Makes other technical and conforming changes.

EXISTING LAW:

- 1) Authorizes the PACE program through the establishment of voluntary special assessments pursuant to rules contained in the Streets and Highways Code and through the establishment of special tax districts pursuant to the rules contained in specified sections of the Government Code.
- 2) Imposes additional, specified requirements on local agencies that participate in the PACE program.
- 3) Places requirements on PACE administrators that must be met before PACE assessment contracts can be funded and recorded by a local agency.
- 4) Requires PACE administrators to be licensed under the California Financing Law (CFL).
- 5) Establishes a regulatory scheme for oversight of PACE solicitors and PACE solicitor agents.
- 6) Requires PACE administrators to make oral confirmation with property owners regarding the key terms of the assessment contract and the financed improvements.
- 7) Mandates that the PACE administrator record the oral confirmation with the property owner and retain the recording for at least five years.
- 8) Provides additional consumer protections for property owners entering into a PACE assessment contract.

FISCAL EFFECT: This bill is keyed fiscal.

COMMENTS:

- 1) **History and Statutory Authorization.** Utilizing the authority to create a financing district as a charter city, the City of Berkeley, in 2007, established a citywide voluntary program to allow residential and commercial property owners to install solar energy systems and make energy efficiency improvements to their buildings and to repay the cost over 20 years via an assessment on the property tax bill. In 2008, the Legislature granted the statutory authority to cities and counties to provide up-front financing to property owners to install renewable energy sources or energy efficiency improvements that are permanently fixed to their properties, which is repaid through the property tax bill.

Most PACE programs are implemented and administered under two statutory frameworks: AB 811 (Levine), Chapter 159, Statutes of 2008, which amended the Improvement Act of 1911, to allow for voluntary contractual assessments to finance PACE projects, and SB 555 (Hancock), Chapter 493, Statutes of 2011, which amended the Mello-Roos Community Facilities District Act to allow for Mello-Roos special taxes (parcel taxes) to finance PACE projects.

The Legislature has expanded PACE for residential and commercial property owners as an option to pay for renewable energy upgrades, energy and water efficiency retrofits, seismic improvements, and other specified improvements for their homes or buildings. Local agencies create PACE assessment districts under AB 811 or establish a Community Facilities District (CFD) under SB 555, allowing the local agency to issue bonds to finance the up-front costs of improvements. In turn, property owners enter into a voluntary contractual assessment agreement with the local agency or agree to annex their property into a CFD to re-pay the bonds via an assessment or special tax, secured by a priority lien, on their property tax bill. The intent of the program is that the assessment or parcel tax remains with the property even if it is sold or transferred, and the improvements must be permanently fixed to the property.

- 2) **PACE Models.** In California, there are several models available to local governments in administering a PACE program. Only the counties of Sonoma and Placer administer their own PACE programs. The majority of local governments contract with a private third-party or join a JPA, which contracts with a private third-party to carry out their PACE programs. The cost of third-party administration is not borne by the local agency, but is built into PACE loan financing. Some of these programs focus on residential projects, others target commercial projects, and some handle both residential and commercial portfolios.
- 3) **Evolution of PACE.** It is clear that there is an immediate need to provide additional parameters around the PACE program to ensure consumer protections. Local control of the PACE program has come at a cost. This bill seeks to provide a statewide regulatory body for PACE oversight.

At the inception of the PACE program, the presence of third party administrators and the accompanying complex financing structures were not contemplated by the Legislature. Nearly all local governments utilize the JPA and administrator model for PACE programs, and as PACE continues to evolve, the realities are very different than those imagined at the outset of legislative authorization. For example, one of the key features of the PACE program is that not only does the efficiency improvement remain with the property, but so does the obligation to repay the contractual assessment. Homeowners, mortgage and realtor industry stakeholders, PACE administrators, local governments, including tax collectors, and now consumer groups, have seen the consequences when homeowners are forced to repay the entire PACE assessment in order to sell or refinance their homes or cannot afford to make the payments on their property tax bills. The Legislature continues to grapple with laws which govern local government assessments, including lien priority, unpaid payments, foreclosure, and noticing requirements, and lending practices in determining which requirements PACE should be subject to in light of the current realities of the program.

According to a Wall Street Journal article published August 15, 2017 ("More Borrowers Are Defaulting on Their Green PACE Loans"), a Wall Street Journal analysis using tax data from 40 California counties found the number of PACE assessment delinquencies has grown by nearly 450% in the last year. Approximately 1,100 California borrowers with PACE assessments missed two consecutive payments through the tax year that ended June 30th, 2017, compared with 245 the previous year. Furthermore, because they are placed on a homeowner's property tax bill, delinquent PACE assessments accrue additional interest

rapidly, at a rate of 18% annually, making delinquencies, once incurred, that much harder for property owners to cure. PACE assessments totaling nearly \$3.7 million are past due across California through the 2016-17 tax year, up from about \$520,000 in the 2015-16 tax year.

- 4) **Bill Summary.** This bill requires that assessment contract cannot be executed, no work can commence under a home improvement contract that is financed by that assessment contract, nor can such a home improvement contract be executed until the homeowner's the ability to repay has been verified. This bill specifies that a PACE administrator must provide a written explanation as to how ability to pay was determined if there is a difference between the amount determined and the actual amount financed. Lastly, this bill states that it is the responsibility of the property owner to contact the property owner's insurance provider to determine if the improvement is covered.

Existing law requires PACE administrators to establish and maintain processes for enrolling, promoting and evaluating PACE solicitors and solicitor agents. Additionally, PACE administrators are mandated to establish and maintain a process to cancel the enrollment of PACE solicitors and solicitor agents. This bill adds to the oversight of PACE administrators by requiring that these processes are acceptable to the Commissioner of Business Oversight. This bill is sponsored by the author.

- 5) **Author's Statement.** According to the author, "Residential PACE assessments are among the fastest-growing types of property-secured financing in California, with cumulative assessments growing from at least \$350 million in 2014 to over \$2.6 billion by the end of 2016. Recent reports indicate that default rates are rising as the PACE industry continues to grow. Defaulting on a PACE assessment can lead to foreclosure or a county tax sale that causes property owners to lose their homes. While major strides have been taken to secure statewide supervision by the Department of Business Oversight and enhance consumer protections with the adoption of both SB 242 and AB 1284 last year, more work needs to be done to ensure that property owners do not enter into an assessment contract they cannot afford.

"AB 2063 will make certain that a homeowner's ability to pay the assessment is fully verified before signing an assessment or home improvement contract and before work on the improvement actually begins. The timing of the verification is crucial to decreasing the number of assessment defaults and reducing the risk of property owners losing their homes. Additionally, with the recent fires throughout California, those homeowners whose homes were destroyed and had PACE assessments for home improvements may not carry sufficient property insurance to cover the full value of the home and the subsequent improvement. These residents may be required to continue paying for an improvement that no longer exists. This bill aims to rectify that situation for Californians who may choose PACE financing in the future. Accordingly, this bill requires PACE administrators to communicate to the property owner that they should contact their insurance provider to determine whether the efficiency improvement is covered under their insurance plan.

"At the end of the day, AB 2063 promotes accountability, fervent oversight, and responsible lending while ensuring that the PACE program and its principles of energy and water efficiency can be maximized for years to come."

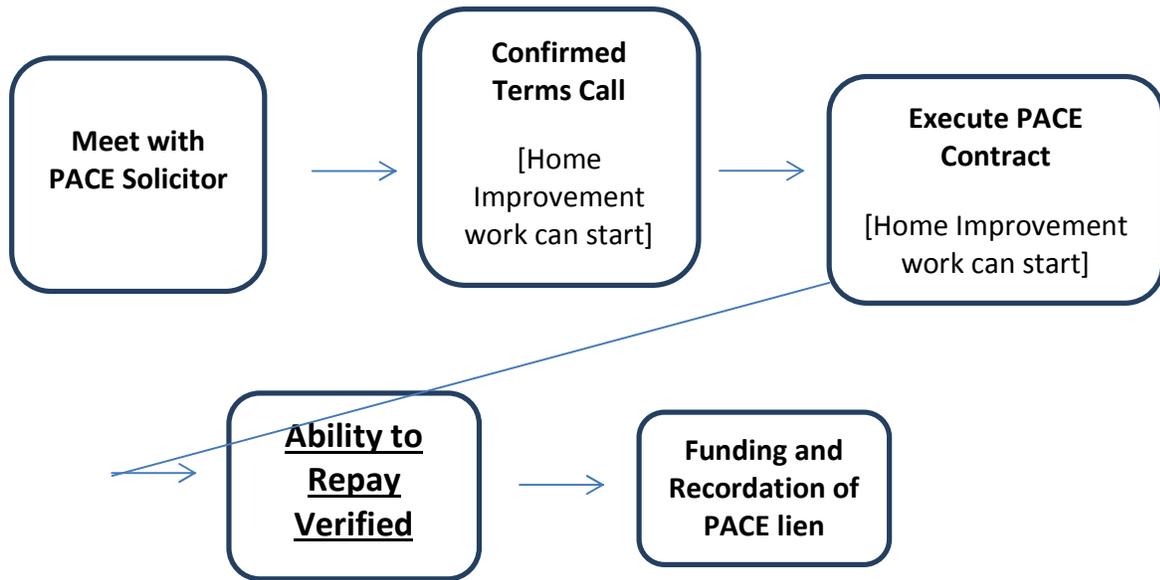
- 6) **Underwriting.** The underwriting provisions implemented by AB 1284 (Dababneh), Chapter 475, Statutes of 2017, *do not* require a PACE administrator to underwrite the property owner before that property owner obligates him or herself on a home improvement contract that will be paid for using PACE financing. Instead, existing law requires a PACE administrator to undertake an ability-to-pay determination of a property owner "prior to funding, and recordation by a public agency of the assessment contract." Funding and recordation of a PACE assessment occurs after all of the efficiency improvements are installed on a property, and the homeowner is obligated to pay for them. Essentially, a property owner can enter into an assessment or home improvement contract before ability to pay is determined, leaving the homeowner on the hook for work they potentially cannot afford.

According to conversations with interested parties who negotiated the final language of AB 1284 last year, the decision to use the "funding or recordation" language, rather than alternative language that would require underwriting much earlier in the PACE assessment process, was deliberate. In the absence of stronger language that would have required underwriting earlier in the process, consumer advocates settled for the language in Section 22687(g), which is intended to ensure that, if a property owner obligates him or herself on a home improvement contract for an amount greater than he or she is ultimately approved based on the required underwriting language, the PACE administrator is "responsible for the difference." However, AB 1284 was silent on how a program administrator is expected to comply with this requirement. AB 1284 did not require that the homeowner is provided any information as to how a program administrator, utilizing the flexibility granted to them, has determined their ability to pay. It is unclear how this section will be enforced, especially in the absence of any additional requirements that the homeowner is provided information regarding the determination of their ability to pay.

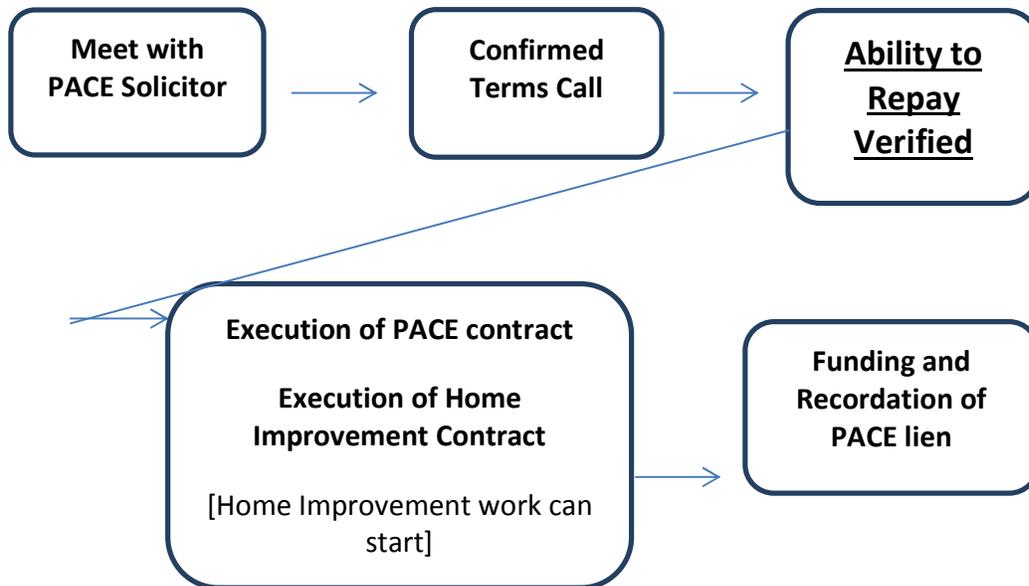
Lastly, there is no requirement that the individual property owner receiving payment from the PACE administrator has to use it to repay a portion of the assessment. Homeowners may not have a complete understanding of why they are receiving the payment, may use the payment for other purposes, and therefore still carry the risk of defaulting on the assessment.

See the next page for a graphic representation of the current underwriting process and the process AB 2063 proposes.

Process in Current Law



Process contained in AB 2063



- 7) **Prior and Related Legislation and Hearings.** AB 2693 (Dababneh), Chapter 618, Statutes of 2016, established a number of consumer notice requirements and sought to tighten financing standards for PACE assessments for residential properties. AB 2693 prohibited a local agency from allowing a homeowner to participate in PACE, unless the homeowner is provided both the right to cancel and a financing estimate and disclosure document; and, required that the financing estimate and disclosure must include specified information, including product costs, financing costs, additional information to use to compare to other financing options, and a number of statements that require the homeowner to initial. AB 2693 applied to all PACE programs, regardless of whether local agencies use a PACE administrator, for residential properties with four or fewer units.

AB 242 (Skinner), Chapter 484, Statutes of 2017, established requirements for third-party PACE administrators of PACE programs, including an oral confirmation of key terms of an assessment contract with a property owner, prohibited PACE administrators from engaging in a number of activities, required PACE administrators to biannually report to a public agency, and established requirements around home improvement contracts.

AB 1284 (Dababneh), Chapter 475, Statutes of 2017, established requirements for PACE administrators that must be met before PACE assessment contracts may be funded and recorded by a public agency, renamed the California Finance Lenders Law (CFLL) as the California Financing Law (CFL), required PACE administrators to be licensed under the CFL, and established a regulatory scheme for the oversight of PACE solicitors and PACE solicitor agents.

The Local Government Committee, jointly with the Banking and Finance Committee, held an oversight hearing, in June 2016, to provide oversight on the current administration of PACE programs and to gain a better understanding on concerns expressed over residential PACE and the impacts on the financial market.

- 8) **Arguments in Support.** Supporters argue that even though strides have been made to increase transparency, accountability, and consumer protections with AB 1284 and SB 242 of last year, further steps need to be taken in order to ensure that homeowners have the ability to pay before entering into a contract that they cannot afford. Additionally, this bill requires PACE administrators to communicate to the homeowner that they should contact their insurance provider to determine whether the efficiency improvement is covered under their insurance plan. This is a critical step to ensure, that in the case of a fire or other disaster, the homeowner is not required to continue paying for an improvement that no longer exists.
- 9) **Arguments in Opposition.** Opponents argue this bill will adversely impact the PACE program by effectively stopping the entire financing process until the ability to pay determination is completed and would impose hardships on PACE administrators and contractors. Further, in the immediate aftermath of a considered and comprehensive reform process that spanned two legislative sessions, opponents argue the bill unfairly subjects a small, emerging industry to renewed uncertainty as well as stacking unnecessary additional statutory and regulatory costs. As the newly minted regulator of PACE in California, the Department of Business Oversight is best positioned to develop and implement any new rules regarding PACE.

REGISTERED SUPPORT / OPPOSITION:

Support

California Association of County Treasurers and Tax Collectors
California Association of Realtors
California Low-Income Consumer Coalition

Opposition

California Solar and Energy Storage Association
Cleantech San Diego
Renew Financial
Renovate America (unless amended)

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