

PACE Financing: Consumer Financial Protections and Tax Considerations



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Claudia Callaway leads the firm's newly formed Platform Lending Initiative. In this role, she focuses her practice on defending clients against state and federal class actions regarding consumer protection and consumer finance laws, representing clients before the Consumer Financial Protection Board (CFPB), the Federal Trade Commission (FTC) and state banking agencies, and assisting clients in adhering to the dynamic landscape of platform and peer-to-peer (P2P) lending.

CFPB

Having represented clients before the CFPB since it was established, Claudia understands the varying perspectives of key stakeholders involved, and helps clients navigate the hurdles, pitfalls and opportunities available to the numerous parties involved under the CFPB's jurisdiction. Working with banks, credit unions, platform lenders and other financial services clients, Claudia provides pragmatic advice on numerous state and federal banking and consumer protection matters, including privacy, collections, credit reporting and usury issues. She also assists clients with the enforcement of arbitration provisions and class action waivers.

REGULATORY DILIGENCE EXPERIENCE

In Claudia's regulatory practice she represents a bevy of financial services clients, including installment lenders, collection agencies, money transmitters, state and federally chartered banks, mortgage servicers, credit card issuers, and credit reporting agencies in a broad range of regulatory issues before federal and state agencies and self-regulatory organizations (SROs) nationwide..

PLATFORM AND P2P LENDING

Claudia is also recognized as a veteran in the platform lending space, which enables her to provide her clients with real-time updates and developments in this ever-changing landscape. She has spoken numerous times on issues related to merchant cash advance, crowdfunding, business-to-business and P2P consumer finance, and brings a holistic understanding of the technical, regulatory and financial complexities within the platform lending arena..

LITIGATION EXPERIENCE

Claudia represents consumer lenders, third-party debt collectors and other consumer financial services clients in class action suits and litigation around the country, in many cases to prevent class action suits before they happen. She frequently handles cases involving the Dodd-Frank Act, the Truth in Lending Act (TILA), the Equal Credit Opportunity Act (ECOA), the Fair Debt Collection Practices Act (FDCPA), the Fair Credit Reporting Act (FCRA), the Gramm-Leach-Bliley Act and the Federal Trade Commission Act. She advises on state unfair and deceptive trade practices laws, and removal of class actions to federal court under the Class Action Fairness Act (CAFA).

In addition to her client responsibilities, Claudia has also served as an adjunct professor at Georgetown University Law Center and American University Washington College of Law, taught in Georgetown's Criminal Justice Clinic and acted as faculty advisor to the national champion Georgetown Patent & Copyright Moot Court Team. Claudia serves on the board of directors for the Washington Lawyers' Committee for Civil Rights and Urban Affairs, and on the board of directors for the Bridges Public Charter School in Washington, DC.



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Christina J. Grigorian works with clients in all matters related to banks, bank holding companies, and state-licensed consumer and commercial lenders. She counsels the firm's financial institution clients concerning structural and operational issues, including legislative developments impacting such operations, and has worked with companies and individuals in the establishment of de novo entities, such as national banks, federal savings banks and state-chartered institutions, as well as state-licensed lenders.

Christina guides clients with respect to state licensing regulations and applications. She is experienced in electronic payment networks, network processing and network participation agreements, and innovative uses of electronic funds transfers in areas such as state-funded childcare provider reimbursements. Christina also advises numerous clients in the area of credit card operations, including private-label card agreements and consumer documentation, and has extensive experience with issues related to Internet commerce, addressing Internet lending and sales. In addition, Christina audits third-party consumer and commercial lenders on behalf of capital sources, providing counsel as to the regulatory posture of the target.

Christina counsels clients on issues related to compliance with the USA Patriot Act, the Bank Secrecy Act and the regulations set forth by the US Office of Foreign Assets Control. She has advised clients with respect to regulatory review of financial institutions and has counseled numerous financial entities on compliance issues raised during and after supervisory agency review.

In addition, Christina also works with lead generators (marketers), installers, and solar companies in connection with the compliant offering of solar products directly to consumers. Related to this, Christina has reviewed contractual agreements between commercial entities related to the provision of such products and services as well as lease and purchase agreements provided directly to consumers.

Christina works extensively within the clean energy space, advising providers as well as capital sources on the regulatory framework by which such products are offered to consumer and commercial customers

While attending law school, Christina served as the editor in chief of *The Business Lawyer*, a joint publication of the University of Maryland School of Law and the American Bar Association Section of Business Law.



Brandon Hadley

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Brandon Hadley concentrates his tax practice in debt instruments, financial products, securitization, cross-border investments and tax credit investments. His principal areas of experience include debt capital markets transactions, asset-backed securitization, the structuring of derivatives and hybrid securities, and tax credit investments including tax equity investments in solar projects. Brandon has substantial experience in: (i) complying with the Foreign Account Tax Compliance Act (FATCA) and related withholding tax issues; (ii) structuring cross-border investments into the United States; and (iii) negotiating tax-related issues with syndicated loans, warehouse lines and credit agreements (including tax indemnification, withholding tax, registration, controlled foreign corporation (CFC) and section 956-related issues with guarantees and collateral, and applicable high-yield debt obligation (AHYDO)-related issues).

Brandon counsels US and offshore issuers and underwriters in public offerings and private placements of securities. He has provided tax advice for private equity investments in US real estate, performing and non-performing debt instruments, and equity securities.

Brandon is a member of the Solar Access to Public Capital (SAPC) working group formed by the Department of Energy's National Renewable Energy Laboratory (NREL) to increase access to public capital for solar projects. He focuses on the transaction structures that allow securitization of solar assets to co-exist with the investment by tax credit investors. Brandon also is a member of the truSolar® Working Group's Legal Committee which is developing uniform standards for solar project screening, rating and underwriting.

An advisor to many tax-exempt organizations with respect to US federal tax matters, Brandon provides pro bono services to, and serves on the board of, the Amara Legal Center.



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Genus Heidary is an experienced litigator and regulatory attorney, helping energy, technology and consumer finance industry clients, among others, resolve their most pressing issues.

Devoting much of her time to environmental and white collar law, Genus frequently navigates internal investigations and civil and criminal enforcement matters, including those implicating fraud and abuse, consumer finance, the Clean Air Act, clean technologies and the Occupational Safety and Health Act.

As a member of Katten's Consumer Finance practice, Genus also concentrates on class action and multidistrict litigation. She focuses her practice on defending clients against state and federal class actions, with particular emphasis on consumer protection and consumer finance laws.

With significant life sciences experience, Genus works with Katten's Food Outbreak and Product Recall team. Prior to entering the field of law, Genus worked in the public health policy arena in numerous capacities at both the local and federal levels, including serving under the San Mateo County Director of Health Services and as a Congressional Fellow in the Office of Congresswoman Hilda L. Solis.

At the University of California, Los Angeles, Genus was the Ann G. Quealy Memorial Fellowship recipient for "Outstanding Graduate." While in law school, she externed for the Honorable Consuelo M. Callahan, US Court of Appeals for the Ninth Circuit, and for the Honorable Otis D. Wright II, US District Court, Central District of California. During this time, she also was a law clerk at the Los Angeles County Public Defender's Office, an editor of the *Pepperdine Dispute Resolution Law Journal* and a member of the Moot Court team, for which she finished as a finalist in both domestic and international competitions.

An Overview – Not Legal Advice

The issues set forth below are intended to provide a practical overview regarding Property Assessed Clean Energy financing. This presentation is not intended to constitute “legal advice.”

THE STATUS OF PACE ASSESSMENTS

What is a PACE “Transaction”?

- A Property Assessed Clean Energy (PACE) transaction is a special assessment, *i.e.*, a “debt of property”, against real property.
 - **Not classified as a loan**
 - Assessments are recorded in the public record
 - Debt is tied to the property rather than the property owner
 - Interest can trigger a foreclosure of the underlying property
- PACE financing allows property owners to fund energy efficiency or renewable energy improvements. Eligible property owners living within a local government area that has adopted PACE can finance up to 100% of project.
 - Property owners pay back PACE funding over time as a voluntary property tax assessment through existing property tax bill
 - Energy savings usually exceed the payment – so typically “cash flow positive” for the assessed party

How is a PACE transaction different from a traditional loan?

- PACE is a special assessment, commonly referred to as a “PACE assessment”, which is tied to a property.
- Unlike a loan, where a transfer of ownership of the property takes place, the PACE assessment obligation stays with the property – not the property owner.
- Generally, PACE assessments can be repaid over longer terms than some banks may allow for traditional loans.

How are PACE assessments used?

PACE assessments typically finance one or more of the following:

- Energy efficiency projects
- Renewable energy improvements
- Roof repairs
- Radon mitigation
- Asbestos removal
- Seismic retrofitting
- Wind hardening, etc.

Eligibility Project Lists (EPLs)

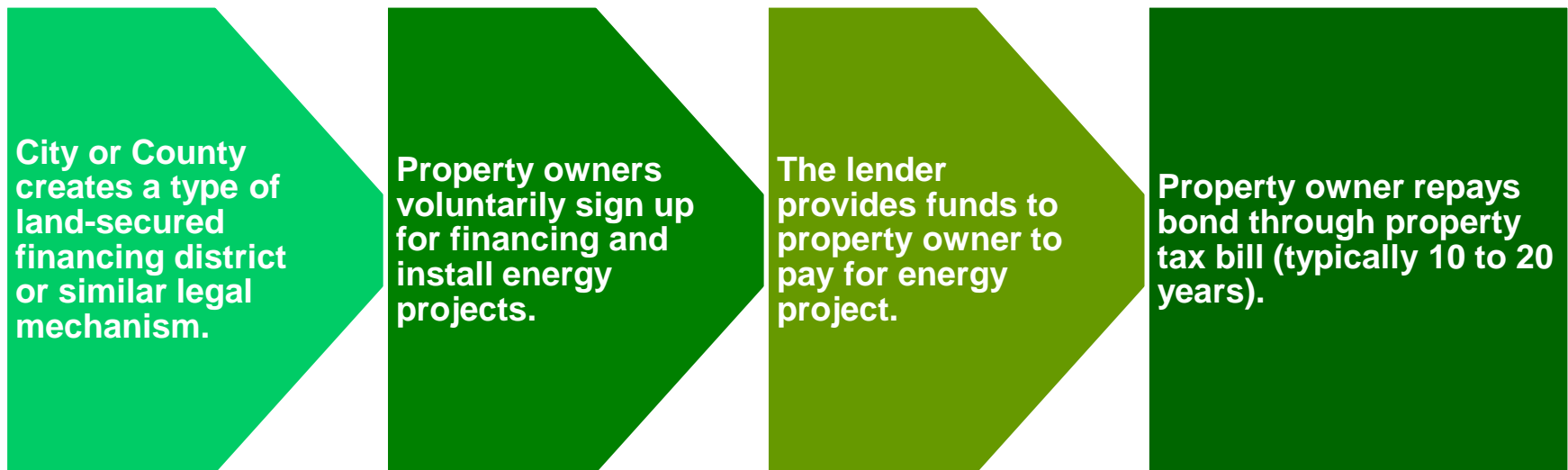
- Differ by local government areas that have adopted PACE
- Detail eligible products list
- Cannot finance portable appliances
- Ensure improvements are industry recognized
 - Examples
 - EnergyStar: must meet pre-established criteria
 - EPA Water Sense: project must be 20% or more water efficient

Where does money for PACE financing come from?

- PACE programs allow local governments, state governments, or other inter-jurisdictional authorities, authorized by state law, to fund up-front cost of PACE funded energy improvements.
- Land-Secured Financing District: PACE financing is generally based on an existing structure known as a “land-secured financing district” (also referred to as an “assessment district”, or a “local improvement district”) for which the local government has historically issued bonds to fund projects with a public purpose e.g., streetlights, sewer systems, or underground utilities.

How Does PACE Financing Work?

The Pace Process



** Depending upon the program structure, the lender may be a private capital provider or local jurisdiction.*

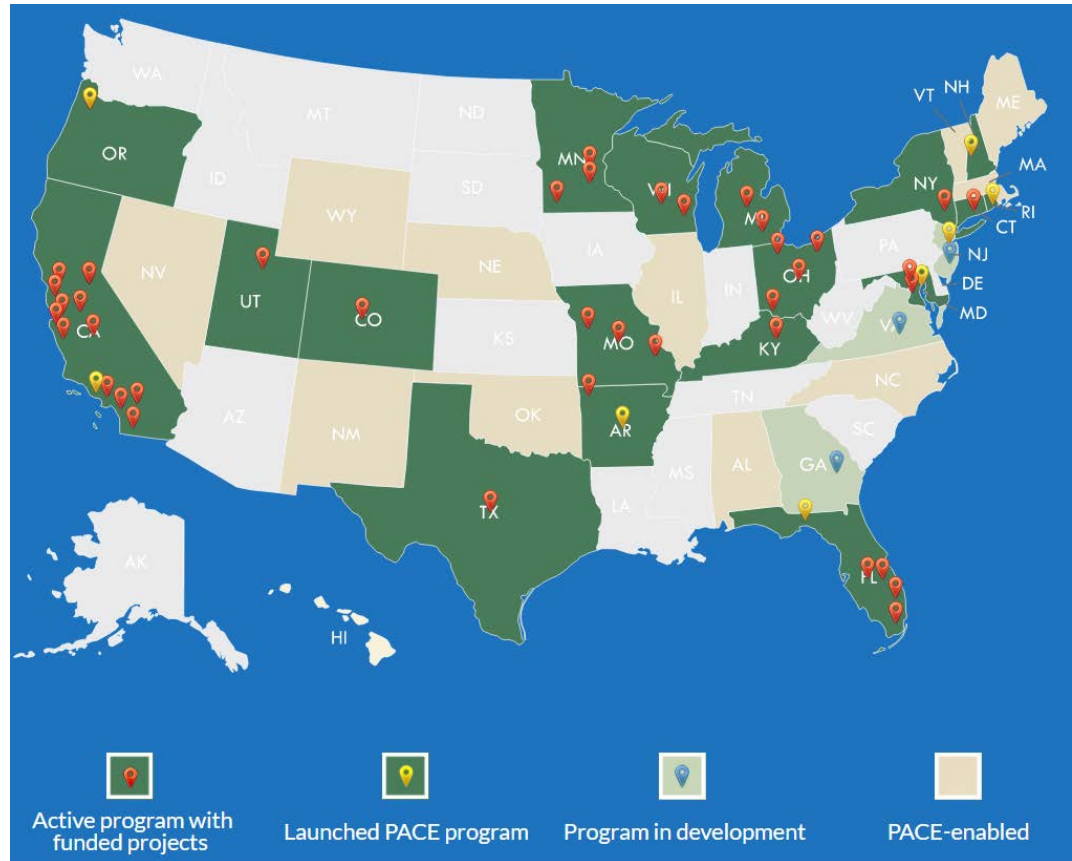
Source: U.S. Dept. of Energy (DOE), Property-Assessed Clean Energy Programs (May 2017)

Characteristics of a PACE Transaction

- PACE transactions can be:
 - Consumer
 - Commercial
 - Nonprofit
 - Agricultural
- Usually have a defined repayment period between 10-20 years
- Secured by real property and paid as an addition on the property owner's tax bill
- Rate is typically between 8-12%

Where Are PACE Programs Active?

- At least 31 states have PACE-enabling laws.
- At least 16 states with active PACE programs.
- Approximately \$ 4 billion in transactions to date.
 - Of that, approximately \$2 billion are consumer transactions.
 - California is the biggest market.



Source: PACE Nation (May 2017)

PACE Market Program Participants

- Program participants include the following:
 - PACE administrator
 - Financing source
 - Home improvement contractors
 - Property owners
 - Lenders with mortgage on the property that has a PACE assessment

PACE ASSESSMENT & TRANSFERABILITY

A PACE assessment is a “debt of property”, meaning the debt is tied to the property as opposed to property owners. So, the repayment obligation may transfer with property ownership if:

- The buyer agrees to assume the PACE obligation as evidenced by purchase of property; and
- The new first lien holder allows PACE obligation to remain on property.

PACE Program Guidelines

- Typical programs address the following components:
 - Consumer protection
 - Contractor management
 - Property owner interest in property (equity)
 - Minimum = typically 10%
 - Fannie Mae = 15% of completed value
 - Review of applicant's credit characteristics
 - Must determine financial eligibility of property owner
- Other Program Considerations
 - Marketing policies and guidelines
 - Contractor guidelines (including warning and suspension policies and procedures)
 - Pricing reviews

Customer Education Components

Some PACE programs include the following components of customer education:

- Fees, interest rates and charges
- Total cost of assessment
- Estimated annual payment
- How PACE assessment is billed and repaid
- Relationship to mortgage payment
- Tax deductible issues
- Energy savings/energy production
- Transferability
- Effect on ability to sell property

Source: DOE, Best Practice Guidelines for Residential PACE Financing Programs (Nov. 18, 2016), <https://energy.gov/sites/prod/files/2016/11/f34/best-practice-guidelines-RPACE.pdf>

Foreclosure Issues

PACE assessments are typically treated as a “super priority” lien

- Federal Housing Administration (FHA) and the Department of Veteran Affairs (VA) require that unpaid PACE assessments must NOT be accelerated and non-accelerated balance shall transfer and not extinguish at time of sale or refinance

Assessing Effectiveness of PACE Programs

To assess effectiveness, certain data points are reviewed:

- PACE assessment amount
- PACE assessment defaults and delinquencies
- Mortgage default and foreclosure for homes with PACE assessments
- Expected energy and cost savings
- Borrower data
- Number of projects funded
- Annual energy and water savings
- Number of jobs created

PACE TRANSACTIONS : IMPORTANT SHIFTS AND CASE STUDIES

PACE Transactions: Federal Action

- May 2010: DOE releases “Guidelines for Pilot PACE Finance Programs”, which highlights best practice guidelines for residential market.
- July 2010: Federal Housing and Finance Administration (FHFA) releases “Statement on Certain Energy Retrofit Loan Programs” expressing opposition to senior-lien PACE status, explaining that senior-lien PACE is contrary to Fannie Mae-Freddie Mac Uniform Security Instrument, and directing government sponsored entities to tighten origination and underwriting process.
- Nov. 2010: FHFA issues letters to *Efficiency Maine* expressing support for the subordinate-lien status of loans made by Main PACE program.
- Mar. 2014: Largely in response to FHFA concerns, California Alternative Energy and Advance Transportation Authority launches the [PACE Loss Reserve Program](#), which covers first mortgage lender losses incurred due to the existence of a PACE lien on a property during foreclosure or sale.
- July 2016: VA announces [PACE Loan Processing \(Circular 26-16-18\)](#), which addresses origination and loan processing requirements for VA-guaranteed loans when a property is subject to a PACE obligation.

PACE Transactions: Federal Action

- July 2016: FHA announces [Property Assessed Clean Energy guidance \(Mortgagee Letter 2016-11\)](#), which indicates that a home with an existing residential PACE obligation is eligible for FHA insured mortgage financing provided that the mortgage lender determines certain requirements have been met.
- July 2016: White House announces “Clean Energy Savings for All” initiative, citing to FHA and VA guidance, on the ability of homes with PACE assessments to use their mortgage products.
- Nov. 2016: DOE releases Best Practices Guidelines for Residential PACE Financing Programs
- Apr. 2017: Twin legislative proposals introduced in U.S. House and Senate entitled “Protecting Americans from Credit Exploitation Act” (PACE Act), which seeks to amend Truth in Lending Act (TILA) to include PACE assessments.

Consumer Advocate Position

Consumer advocates and some Congressional leaders have criticized current programs based on the following:

- Lack of consumer protections
- Few checks to ensure energy savings are real and cost effective
- Inappropriate for low income or elderly consumers
- No Ability to Repay requirements
- Technology may be obsolete quickly

Potential Mortgage Lender Position: Example

In 2012, several trade organizations representing bankers, in response to proposed FHFA PACE based rule-making, likened PACE obligations to mortgages, and proposed the following threshold inquiries for PACE financing:

- Consumer's ability to pay assessment
- The use of borrower's credit profile vs. a home's collateral value to determine PACE financing
- Obligation that requires PACE funders to bear some risk of loss upon PACE assessment default
- Consumer financial protections to (1) prevent abuse, especially posed by home improvement contractors, and (2) limit borrower default on mortgage obligations

Federal Housing Administration (FHA) Treatment

July 2016: HUD states that it will insure mortgages on properties that have a PACE assessment

- Full obligation cannot have priority
- Lenders must escrow PACE payments like property taxes
 - FHA should never be at risk of losing collateral in a tax sale
 - Appraisals must take into account PACE assessments and value of the improvements

Department of Veteran Affairs (VA)

Treatment

July 2016: Similar to FHA, VA states that homes with an existing PACE obligation are eligible for VA-guaranteed financing provided certain requirements are met, including the following:

- Full obligation cannot have priority
- Lenders must escrow PACE payments like property taxes
 - Appraisals must take into account PACE assessments and value of the improvements

Congressional Bills: 2017 “Protecting Americans from Credit Exploitation Act”

- April 2017: Twin bills introduced in U.S. House and Senate entitled “Protecting Americans from Credit Exploitation Act” (PACE Act).
 - Introduced by Sens. Tom Cotton (R-Ark), Marco Rubio (R-Fl) and John Boozman (R-Ark)
 - Introduced by House Reps. Brad Sherman (D-CA) and Ed Royce (R-CA)
- “A Bill to amend the Truth in Lending Act to include retrofit loans such as property assessed clean energy loans, and for other purposes.” Senate Bill 838 (introduced April 5, 2017).
- Congressional proposals would, among other things, call for TILA disclosures for PACE Loans, which would require loan level disclosures including the following:
 - Cost of the loan
 - Annual percentage rate (APR)
 - A “Real Property Retrofit Loan Disclosure” that would serve as a statement “explaining that the real property retrofit loan will result in a lien on the real property securing the loan.”

Congressional Bills: 2017 “Protecting Americans from Credit Exploitation Act”

FOR

- Some Banking Community Members *i.e.*, Mortgage Bankers Association, American Bankers Association
 - These are “consumer mortgage loans”
 - Do savings offset payments?
- California Association of Realtors (CAR)
 - In 2016, CAR successfully sponsored AB 2693, which requires Truth in Lending Integrated Disclosure be provided to a property owner participating in a PACE program; a 3-day right of rescission, and a notice to the property owner that he/she may not be able to refinance or sell w/o paying off PACE Loan

AGAINST

- PACE Administrators and trade organizations, *e.g.*, PACE Nation
 - “The right answer is to find solutions that strengthen consumer protections, while keeping this important option for homeowners and communities alive.”
 - PACE Nation
- National Resources Defense Council
 - Although Council agrees that consumer protections should be examined

March 2017: Class Action (TILA and HOEPA)

In March 2017, two pending class actions filed against a major PACE administrator and local county in federal district court in Los Angeles, California, were consolidated for pretrial purposes and appointment of interim class counsel. Among other things, the plaintiffs allege the following:

- Alleged violation of TILA
- Alleged violation of the Home Ownership Equity Protection Act (HOEPA)
- Alleged conspiracy to violate TILA and HOEPA
- Alleged violation of the California Business and Professional Code governing unlawful, unfair and/or deceptive activities

March 2017: Class Action (Unfair, Fraudulent and Deceptive Practices)

In March 2017, California and Florida based plaintiffs filed a class action against another major PACE administrator in federal district court in San Francisco, California. Among other things, the plaintiffs allege the following:

- Alleged violation of the California Business and Professional Code governing unfair or fraudulent activities
- Alleged violation of the Consumer Legal Remedies Act
- Alleged violation of the Florida Deceptive and Unfair Trade Practices Act
- Alleged Fraudulent Inducement
- Alleged Negligent Misrepresentation
- Alleged Unjust Enrichment
- Alleged Negligence

PACE TAX CONSIDERATIONS

Special Tax Assessment & Lien

- Super Senior Lien
- Paid with Property Taxes (Semi-Annually)
 - Assessment Administrator & Tax Collector
 - Allocation of payments
 - Not tax deductible
- Collection of Overdue Tax Assessments
 - Overdue tax assessments may be collected
 - Tax sale does not accelerate future tax assessments
 - Judicial foreclosure or tax certificate sale

Tax Credits May Be Available

- 30% Federal Investment Tax Credit (ITC)
 - Homeowner
 - Tax equity investor
 - Five-year recapture period
- State tax credits
- Tax credits can complicate financings & securitizations

POLICY AND PRACTICAL IMPLICATIONS

POLICY AND PRACTICAL IMPLICATIONS

- PACE assessment classification as a “lien” is open to challenge
- Federal Preemption issues
- Awareness of Plaintiff’s bar
 - Initial effects now being felt

DISCUSSION

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