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# SCOTT ALLEN

REPRESENTATIVE • 97<sup>TH</sup> ASSEMBLY DISTRICT

## Testimony on Assembly Bill 498

### *PACE Loans*

December 12, 2019

Chairman Novak and Committee Members:

Thank you for holding this hearing on Assembly Bill 498, relating to loans and repayment assistance by a political subdivision for certain improvements to properties, and collection of the debt by special charge.

Property Assessed Clean Energy Loans (or PACE Loans) are a specific type of loan used to finance energy efficiency or renewable energy projects on real property. These projects can include a variety of improvements with an energy-saving component. For instance, upgrades to windows, water heaters, air conditioners, green appliances, or solar panels may all qualify for this type of loan. As of 2017, PACE loans were the fastest-growing type of loan in the United States. The loans are unique in that they are repaid not from the borrower to the lender directly, but through an assessment by the local unit of government.

Unfortunately, many states with PACE loan programs are facing significant practical and ethical challenges. First, contractors and plumbers who perform the work are usually the brokers of PACE loans. This creates a conflict of interest. There is little incentive to compete on price when the loan can be made to cover whatever the service costs.

Second, the contractor is not required to run a credit check, disclose a truth-in-lending statement, or otherwise determine the homeowner's ability to repay the loan. Interest rates may be higher than a typical Home Equity Line of Credit (HELOC), and without a truth-in-lending statement, borrowers may not know the true cost of borrowing. In other states, these lending structures have led to situations where homeowners find themselves unable to repay the loan, and where consumers are being taken advantage of with overpriced home improvements in the name of energy efficiency.

Finally, problems are cropping up with mortgages and sales. Because PACE loans are a government assessment, they take priority over a mortgage, even a first mortgage. If a property were to face foreclosure, it is possible that the primary mortgage holder would be unable to recoup the full value of their loan. For this reason, secondary market lenders have moved to prevent the use of PACE loans in conjunction with a typical secondary market loan like through Fannie Mae or Freddie Mac.

A sale of a home would need to satisfy the PACE loan and any mortgages to deliver clear title. A homeowner with little or no equity, or upside down on the property, would be challenged to do so. Transferring a property without satisfying the PACE lien would be nearly impossible. The buyer would need to pay cash and accept the PACE lien or have a lender make a mortgage which would not have priority.

Residential mortgage lenders are increasingly less likely to make a loan under these circumstances. In December of 2017, the U.S. Department of Housing and Urban Development said the Federal Housing Administration (FHA) would no longer insure mortgages for homes with PACE liens. The FHA was concerned with the “potential for increased losses to the Mutual Mortgage Insurance Fund due to the priority lien status given to such assessments in the case of default” and “the lack of consumer protections associated with the origination of the PACE assessment.” As mentioned earlier, the Federal Housing Finance Agency has also barred Fannie Mae and Freddie Mac from purchasing mortgages on homes with PACE loans.

Under current state law PACE loans on residential property are permissible. Heretofore we have not seen PACE loans utilized on residential properties in Wisconsin. The bill before you would continue to allow PACE loans for commercial properties, but prohibit their utilization on residential properties. In so doing we can avoid the problems and abuses experienced in other states.

Assembly Bill 498 prohibits PACE loans for residential properties with four or fewer units. Commercial properties or residential properties with five or more units (which are considered commercial) could still utilize a PACE loan.

Thank you for your careful consideration of this bill.

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*The 97<sup>th</sup> Assembly District includes portions of the City of Waukesha  
and the Towns of Waukesha, Genesee, and Mukwonago.*

December 12, 2019

Mr. Chairman and Committee Members,

I apologize I cannot attend in person today, a personal matter out of state needed my attention.

I am honored that Representative Allen asked me to speak on the PACE loan, and my opinion regarding the PACE Loan. I have been in the lending industry most of my adult life. I have been part of risk management, loss mitigation, investor relations, and most recently served as the President of the Wisconsin Mortgage Bankers Association, with 1500 registered members. My current employment is with a mortgage insurance company.

I read the information regarding the PACE Loan and will quote you from the National Mortgage Bankers Association *"The MBA believes energy efficient home improvements can be beneficial for homeowners, but significant concerns exist when these improvements are financed with Property Assessed Clean Energy. (PACE loans) – a financing structure lacking vital consumer protections and presenting lien priority risks to lenders, investors, and guarantors."* They have supported S 2155 which enacted the federal legislation to provide BCFP (Bureau of Consumer Financial Protection) the authority to subject residential PACE loans to a Truth in Lending (TILA) consumer protections. The National MBA also urges Congress to introduce legislations requiring PACE loan subordination in accordance with long established lien priority standards.

What does this mean:

1. Currently there is very little disclosure or oversight in validating the consumer can repay the debt. PACE loans do not follow traditional underwriting. There is no standardized review of a borrower's income, credit history, outstanding credit obligations, or expected monthly payments when a PACE loan is originated. Instead, PACE financing is often based on a borrower's equity in their property and their mortgage and property tax payment history.
2. The exact structure, terms and conditions vary by program, state and municipality, but a variety of energy efficient home improvements are generally available for financing. Ranging from Solar panels to energy efficient appliances, and windows, and water conservation, etc.
3. PACE Loans are typically initiated by the private companies approving home improvement contractors to make these improvements with PACE financing. The PACE obligations are then purchased using proceeds raised by the issuance of municipal revenue bonds. These bonds are secured by payments on PACE loan obligations.
4. **The payments are added to the borrower's tax bill as an assessment, paid through property tax installments – usually over 15-20 years – and the outstanding PACE loan obligation runs with the property, not the borrower, going forward.**

Because they have been added to the property tax rolls. The PACE loan rests in senior lien position.

Federal guidance on PACE lending is clear.

- a. In 2012 concerns spurred the Federal Housing Finance Agency (FHFA) to prohibit Fannie Mae and Freddie Mac (the GSEs) from purchasing mortgages where the residential property is encumbered by a PACE loan holding first lien position
- b. On December 7, 2017 the Department of Housing and Urban Development reversed previous Federal Housing Administration (FHA) policy by stating in the Mortgagee Letter ML2017-18 that the FHA would no longer insure mortgages that also carry PACE liens.

## IMPACT

All PACE loans **are not** subject to appropriate, standardized consumer protections and federal regulations are needed.

- PACE Loans are consumer loans secured by real property – with all the attributes of a mortgage product – yet they are not subject to related federal consumer protections. Unfortunately, they have been cleverly classified as a tax assessment rather than a loan.
- Consequently, PACE lenders have not been required under federal law to consider a borrower’s true ability to repay their financial debt. Moreover, consumers face aggressive marketing tactics, misleading product information and significantly higher interest rates than other financing options.
- Borrowers often report a lack of PACE product knowledge – during and well past origination. For example, they are assured that their outstanding PACE loan obligation, will run with the property, yet PACE loans often present property resale issues that result in the borrower paying off the PACE loan prior to closing.
- PACE borrowers do not receive federal disclosures, remedies, and other protections available for other mortgage products. The patchwork of limited or non-existent state/municipal laws provide for insufficient protection.

**PACE loans upend traditional lien priority, exposing investors and guarantors to increased loss severities.**

- PACE loans in first lien position erode the value of the collateral supporting a first mortgage in the event a foreclosure and the eventual sale of the property.
- However, allowing any PACE loan amount to hold senior priority undermines the lender’s (and the government’s) collateral position – disrupting the very nature of secure lending.

In summary, I believe the consumer has the need to be protected. Best results and most simplistic would be by restricting these loans on primary residential properties 1-4 family. An alternative would be to at least protect the the consumer providing them with disclosures “know-before-you-owe”, prove the ability to repay, provide information on the Home Ownership and Equity Protection Act Standards at a minimum.

The PACE loan would be required to be subordinated to an existing government – guaranteed or insured mortgages (per the principle of “first in time, first in right”. Giving the consumer protection to refinance, with a lender who sells on secondary market to the agencies.

The consumer should be **educated** about better alternatives for financing energy efficient home improvements, including existing home equity products and in recent years energy efficient products available through the GSEs. They should sign a statement that they understand the change in equity position.

Having seen how quickly the equity in a home can dissipate if the market readjusts again, there are many consumers who will be upside down and unable to refinance or sell their homes, creating the probability of loss of their homestead.

If there is something, we can do to avert this situation from occurring, it should be done. There are several structured and consumer protected loans available to still provide financing for energy efficient updates, and generally less expensive to the consumer, and allowing the lenders the right to priority lien position.

I hope this information is of value and hope there is opportunity to protect the consumer from potentially losing their home and endangering their equity position.

Respectfully submitted,

Jan Brezina

1706 Sycamore Drive  
Waukesha, WI 53189



# DUEY STROEBEL

STATE SENATOR • 20<sup>TH</sup> DISTRICT

## Testimony on Assembly Bill 498

December 12, 2019

Good Morning Chairman Novak and committee members. Thank you for scheduling this Public Hearing today and giving everyone the opportunity to discuss Property Assessed Clean Energy (“PACE”) financing.

PACE financing is a way of financing real estate improvement via a special assessment levied by a local unit of government. The special assessment is set at a rate to retire the debt and would transfer with the property were it to be sold. Under the right circumstances it can be a tool used by local governments for legitimate purposes as a creative way of financing energy efficiency or brownfield revitalization projects.

PACE financing has not been used, to my knowledge, in Wisconsin for residential properties. Elsewhere in the country, PACE financing has been utilized more extensively, including on residential properties. Since the mechanism to repay PACE financing is a special assessment, it is a superior lien to any other encumbrance. Fannie Mae and Freddie Mac will not buy a mortgage with a superior PACE lien on the title. With my testimony, I have distributed a printout from Fannie Mae’s website attesting to this fact. As the overwhelming majority of 30 year fixed rate mortgage are backed by Fannie and Freddie, homeowners would be unwittingly making their house less marketable.

AB 498 prohibits PACE lending on residential properties so Wisconsin does not preemptively go down the road some other states did. AB 498 is a consumer protection bill because one’s house is the biggest asset of most families. Buyers will not be interested in houses where they cannot get the kind of 30 year fixed financing terms that are the market standard. Moreover, since PACE loans are financed through assessments to the property, underwriting standards are quite different. Homeowners may be at greater peril for taking out an unaffordable or ill-advised loan.

When we look at consumer protection as a Legislature, we are often responding to events that have already happened and attempting to stop repetition. With AB 498 we have the opportunity to stop something before it happens. Thank you again for holding this hearing and I would be happy to address any questions members may have about this bill.

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#### B5-3.4-01, Property Assessed Clean Energy Loans (08/07/2019)

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##### Introduction

This topic contains information on Property Assessed Clean Energy (PACE) loans, including:

- [Overview](#)
- [Eligibility](#)
- [Refinancing Options for Properties with a PACE Loan](#)
- [Delivery Requirements](#)

##### Overview

Certain energy retrofit lending programs, often referred to as Property Assessed Clean Energy (PACE) programs, are made by localities to finance residential energy-related improvements and are generally repaid through the homeowner's real estate tax bill. These loans typically have automatic first lien priority over previously recorded mortgages. The terms of the Fannie Mae/Freddie Mac Uniform Security Instruments prohibit loans that have senior lien status to a mortgage.

##### Eligibility

Fannie Mae will not purchase mortgage loans secured by properties with an outstanding PACE loan unless the terms of the PACE loan program do not provide for lien priority over first mortgage liens. Lenders must monitor state and local law to determine which jurisdictions offer PACE loans that may provide for lien priority.

If the PACE loan is structured as a subordinate lien or unsecured loan, the first mortgage loan may be underwritten to Fannie Mae's standard guidelines.

However, for PACE loans originated prior to July 6, 2010, Fannie Mae waives the uniform security instrument prohibition against a PACE loan with lien priority if the corresponding mortgage loan was purchased before July 6, 2010 or is in an MBS pool with an issue date on or before July 1, 2010.

##### Refinancing Options for Properties with a PACE Loan

The following requirements apply to borrowers with loans that are owned or securitized by Fannie Mae who seek to refinance and who obtained a PACE loan prior to July 6, 2010:

- **Paying off the PACE loan:** The lender must first attempt to qualify the borrower for either a cash-out or limited cash-out refinance option, with the PACE loan being paid off as part of the refinance. To mitigate the risk posed by PACE obligations that take lien priority over the mortgage, Fannie Mae requires that borrowers with sufficient equity pay off the existing PACE obligation as a condition to obtaining a new mortgage loan. The prohibition against using the proceeds of a limited cash-out refinance to pay off a loan not used to purchase the property will not apply.

## Related Articles

[B5-3.3-01, HomeStyle Energy for Improvements on Existing Properties \(08/07/2019\)](#)

**Introduction**This topic contains the following information concerning mortgage loans on existing properties where energy-related improvements are included...

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[B5-3.2-06, HomeStyle Renovation: Renovation Contract, Renovation Loan Agreement, and Lien Waiver \(08/07/2018\)](#)

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Feedback

Loan casefiles underwritten in DU as a limited cash-out refinance may receive an Ineligible recommendation when it appears the borrower is receiving more than 2%/\$2,000 cash back due to the payoff of a PACE loan. The lender may deliver the loan with the Ineligible recommendation and retain the DU limited waiver of underwriting representations and warranties provided that the mortgage loan meets the requirements of this Guide, including (but not limited to) [A2-2.1-04, Limited Waiver and Enforcement Relief of Representations and Warranties for Mortgages Submitted to DU](#).

- **Retaining the PACE loan:** If the borrower is unable to qualify for a cash-out or limited cash-out refinance with sufficient proceeds to pay off the PACE loan, the lender may underwrite the loan as a limited cash-out refinance, with the PACE loan remaining in place. In these cases, it will not be necessary to include the PACE loan in the calculation of the CLTV ratio, though it must be included in the monthly housing expense (PITIA) and debt-to-income calculation.

#### Delivery Requirements

For those eligible limited cash-out refinances where the PACE loan remains in place, the loans must be delivered with SFC 173.

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