May 31, 2022

Opponent Testimony H.B. 646

Chair Hillyer, Vice Chair Grendell, Ranking Member Galonski, and members of the House Civil Justice Committee,

Thank you for the opportunity to testify about Property Assessed Clean Energy (PACE) and H.B. 646. My name is Crystal Crawford, Vice President of Program Development for Ygrene Energy Fund. I'm joined today by Jim Malle, Ygrene's Director of Government Affairs in Missouri.

If H.B. 646 were to pass, residential PACE would be killed before it even has a chance to get off the ground as a result of the troubling provisions in this bill, including the status of the tax lien and the lender consent requirements. If the committee determines that PACE liens should be subordinate to first mortgages and allows lenders to have veto power over how property owners decide to improve their homes, there is no need to enact consumer protections because residential PACE will be prevented from operating in Ohio. As a proponent mentioned in regard to priority, H.B. 646 ensures the banks will get repaid. So, to be clear, this legislation is not a consumer protection bill – it is a bank protection bill.

Rather than repeat our previous testimony submitted when this language was originally considered as an amendment to S.B. 61, we instead take this opportunity to correct the record from the previous hearing where several myths, fallacies, and misstatements were made about residential PACE and to respond directly to the arguments put forward by the proponents of the legislation.

<u>PACE is not a federal program.</u>

During the May 24 hearing, PACE was referred to as a federal program. This is false. There is no federal enabling legislation for PACE.

Instead, PACE is enabled through statewide legislation and then authorized and implemented at the local level. Ohio enacted PACE enabling legislation in 2009. Representative Seitz helped craft the language.

Under Ohio's PACE statute, local governments decide whether to allow residential PACE in their community. Just as easily, local governments, if dissatisfied with PACE providers or the program, can de-authorize PACE programs.

PACE is not a loan.

PACE is not a loan, and it is incorrect to refer to PACE as a loan. PACE is a form of non-ad valorem special tax assessment financing authorized by local governments for a specific public purpose. Funding from PACE programs can be used only for very specific property improvements that reduce energy consumption, produce renewable energy, and provide a public benefit, which is why local governments enable these programs.

In fact, an important consumer protection built into the program's design is that a contractor is only paid for their work after the property owner has signed off that the improvement was installed properly and is functioning as intended. In residential home repairs and installations, we have all heard the horror stories of a property owner paying a contractor (usually with a HELOC or other traditional loan) half of the agreed upon price and then never hearing from the contractor again. That cannot happen with PACE.

Fundamentally, by referring to PACE as a loan, H.B. 646's language is flawed from the start and demonstrates its unsuitability as a regulatory framework.

There is no proof residential PACE will cause more foreclosures.

At the May 24 hearing, it was stated unequivocally that residential PACE will cause more foreclosures. That claim was not substantiated in any way. Out of the more than 300,000 residential PACE assessments funded across the nation, there have been fewer than 10 known PACE-related tax foreclosures. That represents less than 1/100th of one percent of all PACE assessments.

Furthermore, the DBRS analysis, which was shared previously with this committee, shows the opposite. According to the DBRS Commentary on Residential PACE Delinquency Trends (February 2018), homeowners with PACE assessments were less likely to default on their tax payments.

A specific claim about the Missouri market was categorically false. Proponents claimed that more than 100 homes were facing public auction as a result of failure to pay their PACE assessment, which is unsubstantiated. Property owners can face foreclosure for many reasons outside of their control like loss of job or an illness, but to claim, without proof, homes are facing public auction because of PACE is misleading. The fact is, Ygrene has never foreclosed on a property owner for failure to pay his or her PACE assessment.

Homeowners can use PACE only for specific improvements.

One witness at the May 24 hearing referenced a PACE project for a bathroom remodel as an example of a PACE project gone wrong. Every state PACE-enabling statute

dictates the improvements that are eligible for PACE. Ohio's PACE statute allows for energy efficiency, renewable energy, and lakeshore improvements.

A property owner cannot remodel a bathroom using PACE. Perhaps a savvy property owner, who has secured additional financing or loans, could update lighting and HVAC systems with PACE as part of a remodel and use the other financing for other components of a bathroom remodel. But PACE financing can be used only for authorized improvements. Further, PACE programs have policies and procedures that function as checks to prevent the funding of ineligible measures.

Claiming PACE is used for any home improvement other than what is authorized by state statute is categorically false.

Consumer Protections

Let's now discuss residential PACE consumer protections in detail.

PACE is regulated.

Proponents claimed that PACE is completely unregulated. This is categorically false.

Residential PACE programs are regulated by the hundreds of local governments that authorize PACE within their jurisdiction and retain the authority to terminate a PACE program at any time for the failure to abide by program guidelines. In Ohio, the PACE program will be governed by the Toledo Lucas County Port Authority's (TLCPA) consumer protection policy (previously shared with this committee) and by the ordinances and residential program plans adopted by participating local governments. Because of PACE's unique structure, where the program can operate only where specifically authorized by a local government, leaving enforcement to local governments is arguably the most efficient use of government resources. More importantly, because the local government decides whether PACE is right for its own community, local governments hold the most important tool – the ability to allow or deny the operation of residential PACE programs.

We have explained many facets of the consumer protections previously. To reiterate, PACE providers use strict underwriting to determine the property owner's ability to pay, terms are clearly explained in writing and through recorded phone calls, property owners have a three day right to cancel (seniors receive a five day right to cancel), the term of financing cannot exceed the useful life of the product, and there is no prepayment penalty. PACE program administrators participating in the TLCPA program must determine that a property owner has the ability to pay the annual assessment by ensuring that the annual assessment payment does not exceed ten percent (10%) of the property owner's annual household income. This protection exists in addition to the many other underwriting

requirements established by the TLCPA's consumer protection policy as well as national consumer protection policies adhered to by all residential PACE program administrators.

States with residential PACE programs are not pulling back their programs.

Proponents incorrectly claimed that states with residential PACE are significantly pulling back their program. California, Florida, and Missouri have not limited or pulled back their programs through state legislative activity. All three markets are growing steadily with dozens of cities, counties, and local communities authorizing PACE within the last year.

As in Ohio, local communities can decide if PACE is appropriate for them. A proponent mentioned Summit County's Port Authority decision to withdraw from participating in the Ohio residential PACE program. That only goes to prove our point - that the program is effectively regulated at the local level. Nearly three dozen Ohio communities are ready and waiting to participate in the TLCPA residential PACE program.

PACE is not sold exclusively door to door.

A proponent claimed PACE affiliated contractors walk door to door targeting vulnerable homeowners. Again, this is yet another unsubstantiated claim. Property owners hear about PACE through many different channels and often reach out directly to PACE programs for information or to apply for financing prior to deciding on specific, qualifying improvements. Other property owners learn about PACE when they are seeking an efficient furnace replacement in the dead of winter or an efficient HVAC system in the heat of summer to make their homes safer and more efficient.

If an affiliated PACE contractor does make an in-home sale, that contractor must abide by all in-home sales laws, and Ygrene provides another level of consumer protection in this scenario to ensure that consumer protections are enforced.

Contractors are not explaining financing.

We agree with the proponents. We also do not want roofers explaining how PACE financing works. That is why contractors are trained not to explain PACE financing terms to property owners; rather, if a property owner is interested in PACE, the property owner is connected with Ygrene's trained staff who explain the terms and conditions and limitations of the program. That is the first of multiple calls and disclosures provided to all property owners. And the requirement that PACE program administrators provide all financial disclosures to homeowners both in writing and on live recorded phone calls is a unique consumer protection that does not exist in other financing options - making PACE one of the safest forms of financing in the home improvement market.

Residential PACE uses a form of the "know before you owe" disclosure.

PACE is not legally required to use the official "know before you owe" forms required by the Consumer Finance Protection Bureau. However, Ygrene uses a similar form. That form is attached to this testimony and, as mentioned above, property owners have a right to cancel.

Energy audits are unnecessary and would only increase costs for property owners.

Energy audits are unnecessary for residential PACE. Certainly, if a property owner requests an energy audit that is their right and can even be an eligible cost under the PACE program, but mandating audits for all property owners creates unnecessary delays and cost increases.

Proponents argue that the improvements cannot be guaranteed to increase efficiency. Again, that statement ignores reality. There is no question that a new HVAC system will be more efficient than the older HVAC system being replaced. This is true even if the HVAC system is not the most efficient model available on the market. This is true with other improvements as well. Insulation, new windows, LED lighting, and other qualifying improvements all provide energy efficient benefits with their addition to a property.

Ygrene and other residential PACE providers do not guarantee greater efficiency because a PACE provider cannot guarantee a property owner's behavior. PACE providers cannot account for a homeowner who leaves the windows open while running the furnace. Requiring energy audits and requiring guarantees in statute needlessly creates liability for PACE providers and raises costs for property owners.

Lender sign-off is anti-consumer.

Requiring lender sign-off is anti-consumer and violates a property owner's rights to improve their property as they see fit. Lenders should not have veto power over how a property owner chooses to pay for home improvements. Financial institutions are not consulted when a property owner uses a credit card or pays in cash. This is an encroachment on the rights of everyday Ohioans. Banks should not stand in the way of property owners wishing to make their homes safer and more efficient. Further, giving banks the right to prohibit a property owner from utilizing PACE allows them to strong-arm homeowners into using the bank's financing, which violates the very foundation of free market competition to the detriment of the consumer. Property owners benefit from competition; allowing a lender the ability to veto a property owner's choice to use a particular financial product is anti-free market.

Tax Lien Status

Finally, let's discuss tax liens and their priority status. First, it is important to note that placing a PACE tax lien in subordination to a first mortgage would represent the only instance in the Ohio Revised Code where a tax lien is subordinate to a mortgage. Not only is this dangerous precedent setting, but it would also upend over 100 years of Ohio tax law.

PACE assessments are functionally similar to other liens and assessments.

In response to a question, proponents argued that PACE assessments are not the same as a new community charge or a sewer assessment. Certainly, there are differences between the different liens specifically what those mechanisms can be used for and their terms. However, for banks and other lenders, a tax lien is a tax lien, whether it is for PACE or another program. If, as the proponent's claim, financial institutions are having difficulty on the secondary market with PACE liens because they are tax liens, then the same should be true for all tax liens.

Logically, a 60-year tax lien for a sewer assessment, which will also likely be for a far higher amount than a 15-year residential PACE assessment, should be more problematic on the secondary market.

As one committee member pointed out, the market has evolved in California, Missouri, and Florida as residential PACE expanded in those states. No state with a subordinate PACE provision has ever launched a PACE program. Subordinating the PACE assessment would kill the PACE program before it could ever get off the ground in Ohio.

Fannie Mae, Freddie Mac, and other federal programs work with PACE.

A recurring point expressed by proponents is that federal mortgage enterprises, such as the Federal Housing Administration, Fannie Mae, Freddie Mac, and the Veterans Administration, will not back mortgages on properties with PACE financing. This is inaccurate. Fannie Mae and Freddie Mac will not purchase new loans unless the PACE assessment has been paid off, which is the case with nearly every form of financing that is recorded on the property.

With conventional mortgages, all tax liens (PACE or otherwise) must be extinguished at the point of origination. That is not unique to PACE and to state otherwise is incorrect. In practice, whether it is a sale or a refinance, lenders require all tax liens (generally as well as second mortgages, third mortgages, or any other encumbrance of the property) to be extinguished for conventional mortgages at time of origination. A PACE lien is not unique in this regard and to insist otherwise is to misstate how transactions occur.

Importantly, the FHFA's request for input in 2020, as referenced in the proponent's testimony, does not constitute an official position on PACE liens. After receiving commentary from many stakeholders – including many banks and mortgage lenders and organizations that commented that the FHFA should not pursue any changes in underwriting practices in states with PACE programs – the FHFA has taken no action since the 2020 request for input.

How do we know these programs can work with PACE liens? Because it is still occurring. Residential PACE programs are being authorized in new jurisdictions regularly, programs are being considered in new states each year, and PACE is growing in the markets where it operates.

Residential PACE does not work without lien priority.

As mentioned above, placing a PACE tax lien subordinate to a mortgage would be a radical change to how property taxes are assessed in Ohio. H.B. 646 proposes creating the only instance in the Revised Code where a tax assessment is subordinate to private financing. The Ohio General Assembly has for many years recognized the public policy goal of access to capital for energy efficiency projects as a public purpose in furtherance of the goals listed in Article VIII of the Ohio Constitution. The bill proposed would water down the State's ability to enforce its property tax liens.

More importantly, we know from other states that PACE does not function if the tax lien is made subordinate. In states that have enacted policies that place PACE liens subordinate to first mortgages or that require lender consent (Colorado, Vermont, and Oklahoma as examples), residential PACE has never been able to get off the ground. No state with a subordinate PACE lien has ever funded a PACE project.

Again, as stated in our prior testimony, we understand the financial institutions' objection to a residential PACE lien's priority status over a first mortgage; however, reality demonstrates that their concern is overstated. There is no acceleration on a PACE assessment. So, in the unfortunate scenario of a mortgage foreclosure, only the taxes owed can be collected ahead of the mortgage. For example, Ygrene's average residential PACE project size is ~$23,000 with a median annual payment amount of ~$2,000 or the equivalent of $167 per month (similar in size to a family cell phone plan). On a property worth $400,000 with an outstanding mortgage of $300,000, the amount that could prime the mortgage is only the annual payment amount due and any amount in arrears, which may amount to a few thousand dollars. In this scenario, the annual PACE assessment amount that would prime the mortgage is de minimis.

Further, research from the Journal of Structured Finance (Winter 2016) showed that PACE projects increase the value of the property by between $199 and $8,882. Thus, in many cases, the PACE project is improving the equity position of the lender even when the seniority of the annual PACE assessment payment is taken into account.

As a member of the committee pointed out, the annual PACE payment relative to the mortgage is literally pennies on the dollar.

Conclusion

In conclusion, Ygrene takes consumer protection seriously, and our partners at TLCPA are equally committed to providing Ohioans with a robust and tested residential PACE program. We would be happy to engage with this committee on creating an appropriate regulatory framework that protects consumers.

We know residential PACE can work in Ohio. A small pilot program administered through the Lucas County Land Bank's Heritage Homes project has operated for years and performed dozens of assessments. There are no reported issues with that program.

As noted, the critical issues for this legislation are the status of the tax lien and the lender consent requirements. H.B. 646 will unequivocally kill residential PACE before it ever gets off the ground. If it is the committee's intention to allow banks to make decisions for Ohioans instead of allowing them to choose from a free market, then proceed. If, however, the intention is to add best in class consumer protections, then H.B. 646 is not the right vehicle.