An innovative form of financing specific energy and weather-related improvements in homes, known as residential PACE, has taken off, growing to $2 billion in investments in 2016 alone. While these voluntary programs provide homeowners with additional options for financing renewable energy, energy and water efficiency, and retrofits to make homes more resilient against seismic activity and storms, policymakers and consumer advocates are seeking to ensure that such programs sufficiently protect consumers.

Residential Property Assessed Clean Energy (R-PACE) programs provide financing for projects that homeowners pay back through property tax bills. PACE financing was developed to overcome the high up-front capital investment for solar installations, more efficient air conditioners, hurricane-resistant windows and the like. Customers with sufficient equity in their homes who need an emergency appliance replacement and can’t access desirable financing—or who want competitive financing rates—can find PACE to be an attractive alternative. A 2016 study of California’s residential PACE programs found the average assessment was approximately $20,000.
Successful residential PACE programs use a public-private partnership model, in which local governments “opt-in” to offer PACE and collect and disburse payments, while the private sector finances and administers the program. When a customer signs a PACE contract with an administrator for an improvement, an assessment (or lien) on the property for the amount of the project is filed with the local government. Once the project is complete, the PACE administrator (often a third party) remits payment to the contractor. The customer repays the administrator for the improvement, typically over five to 20 years, through an addition to their property taxes. This form of tax assessment has historically been used for investments in the public right of way, such as sidewalks.

Since a PACE assessment is structured like other municipal assessments, in a foreclosure, any overdue portion of PACE assessment or property taxes is senior (first priority for payment) to the first mortgage. Once the overdue amount is paid off, the remaining balance is transferred to the new owner (termed “non-acceleration”). For lenders who remain concerned about PACE’s seniority status, many PACE program administrators offer a “limited subordination,” where mortgages will be paid first in foreclosures. The Kroll Bond Rating Agency reported in February 2017 that delinquency rates were less than 2 percent for homes with R-PACE liens. Recent research found that homes with PACE assessments increased or did not affect the value of properties, addressing concerns about their marketability. By comparison, a fixed-rate, fixed-term home equity loan must always be paid off in full when a home is sold.

State consumer protection concerns include risk of deceptive sales practices and that liens may not be covered by the Truth In Lending Act or Real Estate Settlement Procedures Act. There is also concern that there is no duty to inform a homeowner if they are eligible for free energy efficiency improvements through the federal Weatherization Assistance Program.

An emerging area of concern is a homeowner’s ability to repay, such as considering a homeowner’s debt to income ratio. As a result, some states have placed statutory limits on the PACE lien amount. For example, a PACE lien in Florida cannot exceed 20 percent of a home’s value.

State legislation can include lists of eligible improvements, require projects to meet a certain definition of cost-effectiveness, and address mortgage-holder notification. California requires that the total of all annual property tax payments (a PACE lien and all other line items on the property tax bill) cannot exceed 5 percent of the property’s value. Missouri legislation states that project costs cannot exceed the amount listed in the contract and that final costs be verified. Additionally, the residential PACE industry has released voluntary consumer protection standards.

Federal Action

The Federal Housing Finance Authority (FHFA), Housing and Urban Development’s Federal Housing Administration (FHA) and the Veterans Administration (VA) all have PACE policies. The FHA and the VA released guidance last year stating they accept mortgages into their portfolios with PACE assessments. The FHFA has advised mortgage lenders that it will not purchase or guarantee mortgages on properties with existing PACE liens, resulting in a de facto requirement that any PACE assessment is paid off in full during a sale.

The Department of Energy released comprehensive best practice guidelines for residential PACE programs last year with recommendations in a number of areas. They include: homeowner education, a multi-day right to cancel, minimum equity requirements, maximum assessment amounts, disclosure on PACE’s relationship to mortgages, mortgage-holder notification, low-income customer considerations, non-acceleration of assessments in a default, transferability of assessments in a sale, and consideration of forbearance or deferral.

State Action

At least 22 states have enabling legislation for residential PACE, but only California, Florida and Missouri have active programs. While this is the result of multiple factors, state legislation is highly influential in creating a desirable market for private capital, sufficient oversight for state and local government, attractive and simple processes for contractors, and appropriate consumer protections.

California—which represents the largest share of the residential PACE market—enabled R-PACE in 2008. Last year, legislation mandated a new statewide R-PACE disclosure requirement modeled after federal Know Before You Owe mortgages practices. The bill also included a three-day right-to-cancel for contracts, and limits contractors and program administrators from claiming a specific increase in property value that a PACE-financed project will create. Pending legislation includes ability-to-repay underwriting criteria, among other protections.

Additional Resources

Property Assessed Clean Energy Financing

Here Comes the Sun: A State Policy Handbook for Distributed Solar Energy

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