CONSUMER FINANCIAL PROTECTION BUREAU

12 CFR Part 1026

[Docket No. CFPB–2023–0029]

RIN 3170–AA84

Residential Property Assessed Clean Energy Financing (Regulation Z)

AGENCY: Consumer Financial Protection Bureau.

ACTION: Proposed rule; request for public comment.

SUMMARY: Section 307 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) directs the Consumer Financial Protection Bureau (CFPB or Bureau) to prescribe ability-to-repay rules for Property Assessed Clean Energy (PACE) financing and to apply the civil liability provisions of the Truth in Lending Act (TILA) for violations. PACE financing is financing to cover the costs of home improvements that results in a tax assessment on the real property of the consumer. In this notice of proposed rulemaking, the Bureau proposes to implement EGRRCPA section 307 and to amend Regulation Z to address how TILA applies to PACE transactions to account for the unique nature of PACE.

DATES: Comments must be received on or before July 26, 2023.

ADDRESSES: You may submit comments, identified by Docket No. CFPB–2023–0029 or RIN 3170–AA84, by any of the following methods:

- *Federal eRulemaking Portal: https://www.regulations.gov.* Follow the instructions for submitting comments.
- *Email: 2023-NPRM-PACE@cfpb.gov.* Include Docket No. CFPB–2023–0029 or RIN 3170–AA84 in the subject line of the message.
- *Mail/Hand Delivery/Courier:* Comment Intake—PACE, c/o Legal Division Docket Manager, Consumer Financial Protection Bureau, 1700 G Street NW, Washington, DC 20552.

Instructions: The CFPB encourages the early submission of comments. All submissions should include the agency name and docket number or Regulatory Information Number (RIN) for this rulemaking. Because paper mail in the Washington, DC area and at the CFPB is subject to delay, commenters are encouraged to submit comments electronically. In general, all comments received will be posted without change to *https://www.regulations.gov.*

All submissions, including attachments and other supporting materials, will become part of the public record and subject to public disclosure. Proprietary information or sensitive personal information, such as account numbers or Social Security numbers, or names of other individuals, should not be included. Submissions will not be edited to remove any identifying or contact information.

FOR FURTHER INFORMATION CONTACT: Luke Diamond, Daniel Tingley, Counsels; Kristin McPartland, Amanda Quester, Alexa Reimelt, or Joel Singerman, Senior Counsels, Office of Regulations, at 202–435–7700. If you require this document in an alternative electronic format, please contact *CFPB_Accessibility@cfpb.gov.*

SUPPLEMENTARY INFORMATION:

I. Summary of the Proposed Rule

Section 307 of the Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) directs the Bureau to prescribe ability-to-repay (ATR) rules for Property Assessed Clean Energy (PACE) financing and to apply the civil liability provisions of the Truth in Lending Act (TILA) for violations.[1] In this notice of proposed rulemaking, the Bureau proposes to implement EGRRCPA section 307 and to amend Regulation Z to address the application of TILA to ''PACE transactions'' as defined in proposed § 1026.43(b)(15).

The proposed rule would:

- Clarify an existing exclusion to Regulation Z's definition of credit that relates to tax liens and tax assessments. Specifically, the CFPB is proposing to clarify that the commentary's exclusion to ''credit,'' as defined in § 1026.2(a)(14), for tax liens and tax assessments applies only to involuntary tax liens and involuntary tax assessments.
- Make a number of adjustments to the requirements for Loan Estimates and Closing Disclosures under §§ 1026.37 and 1026.38 that would apply when those disclosures are provided for PACE transactions, including:
  - Eliminating certain fields relating to escrow account information;
  - Requiring the PACE transaction and other property tax payment obligations to be identified as separate components of estimated taxes, insurance, and assessments;
  - Clarifying certain implications of the PACE transaction on the property taxes;
  - Requiring disclosure of identifying information for the PACE company;
  - Requiring various qualitative disclosures for PACE transactions that would replace disclosures on the current forms, including disclosures relating to assumption, late payment, servicing, partial payment policy, and the consumer's liability after foreclosure; and
  - Clarifying how unit-periods would be disclosed for PACE transactions.
- Provide new model forms under H–24(H) and H–25(K) of appendix H for the Loan Estimate and Closing Disclosure, respectively, specifically designed for PACE transactions.
- Exempt PACE transactions from the requirement to establish escrow accounts for certain higher-priced mortgage loans, under proposed § 1026.35(b)(2)(i)(E).
- Exempt PACE transactions from the requirement to provide periodic statements, under proposed § 1026.41(e)(7).
- Apply Regulation Z's ATR requirements in § 1026.43 to PACE transactions with a number of specific adjustments to account for the unique nature of PACE financing, including requiring PACE creditors to consider certain monthly payments that they know or have reason to know the consumer will have to pay into the consumer's escrow account as an additional factor when making a repayment ability determination for PACE transactions extended to consumers who pay their property taxes through an escrow account.
- Provide that a PACE transaction is not a qualified mortgage (QM) as defined in § 1026.43.
- Extend the ATR requirements and the liability provisions of TILA section 130 to any ''PACE company,'' as defined in proposed § 1026.43(b)(14), that is substantially involved in making the credit decision for a PACE transaction.
- Provide clarification regarding how PACE and non-PACE mortgage creditors should consider pre-existing PACE transactions when originating new mortgage loans.

The Bureau proposes that the final rule, if adopted, would take effect at least one year after publication of the final rule in the **Federal Register**, but no earlier than the October 1 which follows by at least six months **Federal Register** publication. The Bureau requests comment on all aspects of the proposed rule and on whether there are any other provisions of TILA or Regulation Z that the Bureau should address with respect to PACE transactions.

II. Background

A. PACE Market Overview

1. How does PACE financing work?

PACE financing is a mechanism that enables property owners to finance certain upgrades to real property

[1] 15 U.S.C. 1639c(b)(3)(C).

through an assessment on their real property.[2] Eligible upgrade types vary by locality but often include upgrades to promote energy efficiency or to help prepare for natural disasters. The voluntary financing agreements (PACE loans) are made between the consumer and the consumer's local government or a government entity operating with the authority of several local governments,[3] and they leverage the property tax system for administration of payments. PACE financing is repaid through the property tax system along with the consumer's other property tax payment obligations. The assessments are typically collected through the same process as real property taxes.[4] Local governments typically fund PACE transactions through bond issuance, with these bonds in turn collateralized and sold as securitized obligations.

PACE assessments are secured by a lien on the consumer's real property. The liens securing PACE loans typically have priority under State law similar to that of other real property tax liens, which are superior to other mortgage liens on the property, including those that predated the PACE lien.[5] In a foreclosure sale, this superior lien position means that any amount due on the PACE loan is paid with the foreclosure sale proceeds before any proceeds will flow to other liens. The PACE assessment is tied to the property, not the property owner. As such, the repayment obligation remains with the property when property ownership transfers unless paid off at the time of sale.

Although some local governments operate PACE financing programs directly, most contract with private PACE companies to operate the programs. These private companies generally handle the day-to-day operations, including tasks such as marketing PACE financing to consumers, training home improvement contractors to sell PACE to consumers, overseeing originations, performing underwriting, and making decisions about whether to extend the loan. The PACE companies may also contract with third-party companies to administer different aspects of the loans after origination. Typically, PACE companies purchase PACE bonds that are issued by local governments to fund the programs, which generate revenue for the PACE companies from interest on consumer payments. PACE companies are also sometimes involved in securitizing the bond obligations for sale as asset-backed securities. Additionally, PACE companies often earn various fees related to the transactions.[6]

PACE companies often rely heavily upon home improvement contractors both to sell PACE loans to consumers and to facilitate the origination of those loans. Home improvement contractors frequently market PACE financing directly to consumers in the course of selling their home improvement contracts, often door-to-door. They often serve as the primary point of contact with consumers during the origination process, typically collecting any application information that the PACE companies use to make underwriting and eligibility determinations. The contractors may also deliver disclosures relating to the PACE transaction and obtain the consumer's signature on the financing agreement.

2. Origin and Growth of PACE Programs

In 2008, California passed Assembly Bill no. 811 to enable the first PACE programs. The Bureau is aware of 19 States plus the District of Columbia that currently have enabling legislation for residential PACE financing programs, but only a small number of states have had active programs, primarily California, Florida, and Missouri.[7]

During the early years of PACE financing, lending activity appears to have been relatively limited, with cumulative obligations of around $200 million through 2013.[8] In 2014, PACE financing activity accelerated, reaching peak production in 2016 with over $1.7 billion in investment.[9] This level of activity was maintained in 2017, but it declined between 2018 and 2021, with an average investment of $769 million per year during those years.[10] Overall, as of December 31, 2021, the PACE financing industry had financed 323,000 home upgrades, totaling over $7.7 billion.[11]

3. Common Financing Terms

According to data analyzed in a report that the Bureau is releasing concurrently with this proposal (''PACE Report''), the term of PACE loans that were originated between July 2014 and June 2020 was most often 20 years, but ranged between five and 30 years.[12] The Report also finds that the interest rates for those loans clustered around 7 to 8 percent with annual percentage rates (APRs) averaging approximately a percentage point higher.[13] Fees vary by program, but the CFPB has reviewed agreements that include fees for application, origination, tax administration, lien recordation, title, escrow, bond counsel, processing, title, underwriting, and fund disbursement. The Bureau is not aware of any PACE obligations that are open-end or have a negative-amortization feature.

4. Consumer Protection Concerns

Consumer advocates have expressed concerns that the PACE market lacks adequate consumer protections. They have indicated that the highly secure super-priority lien associated with PACE transactions creates incentives for PACE companies and home improvement contractors to originate loans quickly, often on the spot, without regard to affordability or consumer understanding. They have reported allegations of deceptive sales tactics, aggressive sales practices, and fraud.

Consumer advocates have criticized other aspects of PACE financing as well,

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[2] Some States authorize PACE financing for residential and commercial property. In this proposal, the term PACE financing refers only to residential PACE financing unless otherwise indicated.

[3] Although PACE financing programs may be sponsored by individual local governments, many are sponsored by intergovernmental organizations whose membership consists of multiple local governments.

[4] *See, e.g.,* Cal. Sts. & Hwys. Code sec. 5898.30; Fla. Stat. 163.08; Fla. Stat. 197.3632(8)(a); Mo. Stat. 67.2815(5).

[5] *See, e.g.,* Cal. Sts. & Hwys. Code sec. 5898.30 (providing for ''the collection of assessments in the same manner and at the same time as the general taxes of the city or county on real property, unless another procedure has been authorized by the legislative body or by statute . . . .''); Fla. Stat. 163.08(8) (''The recorded agreement shall provide constructive notice that the assessment to be levied on the property constitutes a lien of equal dignity to county taxes and assessments from the date of recordation.''). However, authorizing statutes in some PACE States provide for subordinated-lien status for PACE financing. *See, e.g.,* Minn. Stat. 216C.437(4); Me. Stat. tit. 35A 10156(3), (4); 24 V.S.A. 3255(b).

[6] *See, e.g.,* Energy Programs Consortium, *R–PACE, Residential Property Assessed Clean Energy, A Primer for State and Local Energy Officials* (Mar. 2017), *http://www.energyprograms.org/wp-content/uploads/2017/03/R-PACE-Primer-March-2017.pdf.*

[7] *See infra* note 329. There has been pilot program activity for residential PACE financing in some states. *See, e.g.,* DevelopOhio, *Lucas County PACE program benefits homeowners* (Aug. 16, 2019), *https://www.developohio.com/post/detail/lucas-county-pace-program-benefits-homeowners-234705.* Some States that previously authorized residential PACE financing programs have amended their statutes such that PACE financing is no longer authorized for single-family residential properties. *See, e.g.,* 2021 Wis. Act 175 (codified at Wis. Stat. sec. 66.0627).

[8] *See* PACENation, *Market Data, https://www.pacenation.org/pace-market-data/* (last visited Mar. 30, 2023).

[9] *See id.*

[10] *See id.* The latest data available on the PACE financing industry trade association's website is for 2021.

[11] *See id.*

[12] *See* CFPB, *PACE Financing and Consumer Financial Outcomes* at Table 2 (May 2023), *https://files.consumerfinance.gov/f/documents/cfpb_pace-rulemaking-report_2023-04.pdf* (PACE Report). The PACE Report is discussed in more detail in part IV.

[13] *Id.*

such as the high cost of funding compared to other mortgage debt, excessive capitalized fees, and inadequate disclosures. They have argued that these aspects of PACE financing can result in unexpected and unaffordable tax payment spikes that can lead to delinquency, late fees, tax defaults, and foreclosure actions.[14] Some local officials have echoed many of these concerns in discussions with CFPB staff.

Additionally, consumer advocates have expressed concern that some home improvement contractors involved in the origination of PACE transactions provide consumers with misleading information about potential energy savings or promote the most expensive energy improvements, regardless of their actual energy conservation benefits.[15] They have noted that such practices could result in homeowners receiving a smaller reduction in their utility bills than anticipated, making PACE financing payments more difficult to afford.

Additionally, consumer advocates have alleged that PACE financing is disproportionately targeted at older Americans, consumers with limited English proficiency or lower incomes, and consumers in predominantly Black or Hispanic neighborhoods. They have also highlighted that, although a PACE assessment technically remains with the property at sale, most home buyers are unwilling to take on the remaining payment obligation for a PACE lien, or their mortgage lender prohibits them from doing so.[16] Consumer advocates have reported that PACE consumers are often unaware of these issues when agreeing to the financing, which causes an unanticipated financial burden when consumers are required to pay off the PACE assessment to complete a home sale.

Mortgage industry stakeholders have also asserted that PACE financing introduces risk to the mortgage market, as PACE liens take priority over pre-existing mortgage liens.[17]

Since 2015, the CFPB has received over 50 complaints related to PACE financing, primarily from consumers in California and Florida. Many of the complaints allege fraud, deceptive practices, overly high costs, or trouble with refinancing the consumer's home. Six of the complaints involve older Americans, and five of the complaints involve consumers with limited English proficiency. Consumer advocates have suggested that consumers may not be aware of their ability to submit PACE complaints to the CFPB database or may have had difficulty categorizing them, which may have resulted in a lower number of complaints reported. Consumers in California are also able to submit complaints to their State PACE regulator and submitted 385 complaints between 2019 and 2021.[18]

In August 2019, Renovate America, Inc. (Renovate), a major PACE company at the time, reached a $4 million settlement with six counties and one city in California.[19] The complaint, filed in State court, alleged that Renovate America misrepresented the PACE program or failed to make adequate disclosures about key aspects of the program, including its government affiliation, tax deductibility, transferability of assessments to subsequent property owners, financing costs, and Renovate's contractor verification policy.[20] Subsequently, in June 2021, the California State PACE regulator moved to revoke Renovate's Administrator license, required to operate a PACE company in the State, after finding that one of its solicitors repeatedly defrauded homeowners in San Diego County.[21] Renovate ultimately consented to the revocation.[22]

In October 2022, Ygrene Energy Fund Inc. (Ygrene), a major PACE company, reached a $22 million settlement with the Federal Trade Commission (FTC) and the State of California over allegations regarding its conduct in the PACE marketplace.[23] In a joint complaint, the FTC and California alleged that Ygrene deceived consumers about the potential financial impact of its financing and unfairly recorded liens on consumers' homes without their consent.[24] The complaint further alleged that Ygrene and its contractors falsely told consumers that PACE financing would not interfere with the sale or refinancing of their homes and used high-pressure sales tactics and even forgery to enroll consumers into PACE programs.[25]

5. State Laws and Regulations in States With Active PACE Programs California

California authorized PACE programs in 2008 to finance projects related to renewable energy and energy efficiency, and later expanded the scope to include water efficiency, certain disaster hardening, and electric vehicle charging

[14] *See, e.g.,* Nat'l Consumer Law Ctr., *Residential (PACE) Loans: The Perils of Easy Money for Clean Energy Improvements* (Sept. 2017), *https://www.nclc.org/images/pdf/energy_utility_telecom/pace/ib-pace-stories.pdf; see also* Off. of the Dist. Att'y, Cnty. of Riverside, *News Release, District Attorneys Announce $4 Million Consumer Protection Settlement* (Aug. 9, 2019), *https://rivcoda.org/community-info/news-media-archives/district-attorneys-announce-4-million-consumer-protection-settlement;* Kirsten Grind, *America's Fastest-Growing Loan Category Has Eerie Echoes of Subprime Crisis,* Wall Street Journal (Jan. 10, 2017), *https://www.wsj.com/articles/americas-fastest-growing-loan-category-has-eerie-echoes-of-subprime-crisis-1484060984.*

[15] *See* Claudia Polsky, Claire Christensen, Kristen Ho, Melanie Ho & Christina Ismailos, *The Darkside of the Sun: How PACE Financing Has Under-Delivered Green Benefits and Harmed Low Income Homeowners,* Berkeley L., Env't L. Clinic, at 8–13, *https://www.law.berkeley.edu/wp-content/uploads/2021/02/ELC_PACE_DARK_SIDE_RPT_2_2021.pdf.*

[16] *See* Freddie Mac, *Purchase and "no cash-out" refinance Mortgage requirements* (Mar. 31, 2022), *https://guide.freddiemac.com/app/guide/section/4606.4.* As of February 2023, guidelines from both Fannie Mae and Freddie Mac generally prohibit purchase of mortgages on properties with outstanding first-lien PACE obligations. Similarly, the Federal Housing Administration (FHA) updated its handbook requirements in 2017 to prohibit insurance of mortgage on properties with outstanding first-lien PACE obligations, *see* U.S. Dept. of Hous. & Urban Dev., *Property Assessed Clean Energy (PACE)* (Dec. 7, 2017), *https://www.hud.gov/sites/dfiles/OCHCO/documents/17-18ml.pdf.*

[17] *See, e.g.,* Fed. Hous. Fin. Agency (FHFA), *FHFA Statement on Certain Energy Retrofit Loan Programs* (July 6, 2010), *https://www.fhfa.gov/Media/PublicAffairs/Pages/FHFA-Statement-on-Certain-Energy-Retrofit-Loan-Programs.aspx; FHFA Notice and Request for Input on PACE Financing,* 85 FR 2736 (Jan. 16, 2020); *Joint Letter from Mortgage Trade Assocs. to FHFA Director Mark Calabria* (Mar. 16, 2020), *https://www.housingpolicycouncil.org/_files/ugd/d315af_6cb569a5427f4e26ab4ef4d55038b3f6.pdf.*

[18] Cal. Dep't of Fin. Prot. & Innovation, *Annual Report of Operation of Finance Lenders, Brokers, and PACE Administrators Licensed Under the California Financing Law*, at 41 (Aug. 2022) *https://dfpi.ca.gov/wp-content/uploads/sites/337/2022/08/2021-CFL-Aggregated-Annual-Report.pdf.*

[19] *See* Riverside Cnty. Dist. Att'y, *District Attorneys Announce $4 Million Consumer Protection Settlement With "PACE" Program Administrator Renovate America, Inc.* (Aug. 9, 2019), *https://rivcoda.org/community-info/news-media-archives/district-attorneys-announce-4-million-consumer-protection-settlement; see also State of California* v. *Renovate America,* Case No. RIC1904068 (Super. Ct. Riverside Cnty. 2019).

[20] *Id.*

[21] *See* Cal. Dep't of Fin. Prot. & Innovation, *DFPI Moves to Revoke PACE Administrator's License After Finding Its Solicitor Defrauded Homeowners* (June 4, 2021), *https://dfpi.ca.gov/2021/06/04/dfpi-moves-to-revoke-pace-administrators-license-after-finding-its-solicitor-defrauded-homeowners/.*

[22] Cal. Dep't of Fin. Prot. & Innovation, *Settlement Agreement* (Sept. 8, 2021), *https://dfpi.ca.gov/wp-content/uploads/sites/337/2021/09/Admin.-Action-Renovate-America-Inc.-Settlement-Agreement.pdf?emrc=090ca0.*

[23] *See* Fed. Trade Comm'n, *FTC, California Act to Stop Ygrene Energy Fund from Deceiving Consumers about PACE Financing, Placing Liens on Homes Without Consumers' Consent* (Oct. 28, 2022), *https://www.ftc.gov/news-events/news/press-releases/2022/10/ftc-california-act-stop-ygrene-energy-fund-deceiving-consumers-about-pace-financing-placing-liens; see also* Complaint for Permanent Injunction, Monetary Relief, Civil Penalties, and Other Relief, *Fed. Trade Comm'n et al* v. *Ygrene Energy Fund Inc.,* No. 2:22–cv–07864 (C.D. Cal. 2022), *https://www.ftc.gov/system/files/ftc_gov/pdf/Complaint%20-%20Dkt.%201%20-%2022-cv-07864.pdf.*

[24] *Id.*

[25] *Id.*

infrastructure measures.[26] Since 2008, California has passed several laws to add and adjust consumer protections for PACE programs, with major additions in a series of amendments that took effect around 2018 (collectively, 2018 California PACE Reforms). Current California law requires that, before executing a PACE contract, PACE administrators must make a determination that the consumer has a reasonable ability to pay the annual payment obligations based on the consumer's income, assets, and current debt obligations.[27] Additionally, California law requires, among other protections, financial disclosures prior to consummation; [28] a three-day right to cancel, which is extended to five days for older adults; [29] mandatory confirmation-of-terms calls; [30] and restrictions on contractor compensation.[31] California law also imposes certain financial requirements for consumers to be eligible for PACE financing, including that consumers must be current on their property taxes and mortgage and generally not have been party to a bankruptcy proceeding within the previous four years.[32] There is also a maximum permissible loan-to-value ratio for PACE financing under California law.[33] California law exempts government agencies from some of these requirements.[34]

As part of the 2018 California PACE Reforms, California significantly increased the role of what is now called California's Department of Financial Protection and Innovation (DFPI).[35] In 2019, the DFPI began licensing PACE administrators and subsequently promulgated rules implementing some of California's statutory PACE provisions, which became effective in 2021.[36] DFPI also has certain examination, investigation, and enforcement authorities over PACE administrators, solicitors, and solicitor agents.[37]

PACE administrators must be licensed by the DFPI under the California Financing Law. They must also establish and maintain processes for the enrollment of PACE solicitors and solicitor agents, including training and background checks.[38] PACE administrators are required to annually share certain operational data with DFPI.[39] DFPI compiles the data in annual reports on PACE lending in California, which provide aggregated information on PACE loans, PACE administrators and solicitors, and consumer complaints.[40]

Florida

Florida authorized PACE programs in 2010 to finance projects related to energy conservation and efficiency improvements, renewable energy improvements, and wind resistance improvements.[41] The authorizing legislation imposes certain financial requirements to be eligible for PACE financing, including that consumers must be current on their property taxes and all mortgage debts on the property.[42] It also includes a maximum loan-to-value ratio and requires a short general disclosure about PACE assessments.[43] Additionally, Florida law requires that the property owner provide holders or servicers of any existing mortgages secured by the property with notice of their intent to enter into a PACE financing agreement together with the maximum principal amount to be financed and the maximum annual assessment necessary to repay that amount.[44]

Missouri

Missouri authorized PACE programs in 2010 to finance projects involving energy efficiency improvements and renewable energy improvements.[45] In 2021, Missouri enacted new legislation imposing certain consumer protection requirements for PACE transactions. The law currently requires clean energy development boards (the government entities offering PACE programs) to provide a disclosure form to homeowners that shows the financing terms of the assessment contract, including the total amount funded and borrowed, the fixed rate of interest charged, the APR, and a statement that, if the property owner sells or refinances the property, the owner may be required by a mortgage lender or a purchaser to pay off the assessment.[46] It also requires verbal confirmation of certain provisions of the assessment contract, imposes specific financial requirements to execute an assessment requirement, and provides for a three-day right to cancel.[47] The 2021 legislation also limited the term, amount of financing, and total indebtedness secured by the property and required the clean energy development board to review and approve assessment contracts.[48] The new requirements became effective January 1, 2022.[49]

6. Self-Regulatory Efforts

In addition to consumer protections mandated by State governments, in November 2021, the national trade association that advocates for the PACE financing industry announced voluntary consumer protection policy principles for PACE programs nationwide.[50] According to the trade association, the 22 principles are designed to establish a national framework for enhanced accountability and transparency within PACE programs and to offer greater protections for all consumers, as well as additional protections for low-income homeowners, based on stated income, and those over the age of 75.[51] They include provisions relating to ability-to-pay, financing disclosures, a right to cancel, and foreclosure-avoidance protections, among others.

B. EGRRCPA

The Economic Growth, Regulatory Relief, and Consumer Protection Act of

[26] *See, e.g.,* Cal. Sts. & Hwys. Code secs. 5898.12, 5899, 5899.3.

[27] Cal. Fin. Code sec. 22686–87.

[28] Cal. Sts. & High. Code sec. 5898.17.

[29] Cal. Sts. & High. Code sec. 5898.16–17.

[30] Cal. Sts. & High. Code sec. 5913.

[31] Cal. Sts. & High. Code sec. 5923.

[32] Cal. Fin. Code sec. 22684(a), (d)–(e).

[33] Cal. Fin. Code sec. 22684(h).

[34] Cal. Fin. Code sec. 22018(a) (exempting public agencies from the definition of ''program administrator'' that is subject to the ability-to-pay requirements set forth under Cal. Fin. Code sec. 22687).

[35] Cal. AB 1284 (2017–2018), Cal. SB 1087 (2017–2018).

[36] 10 Cal. Code Regs. sec. 1620.01 *et seq.* California law uses the term ''program administrator'' to refer to companies that are referred to here as PACE companies. *See* Cal. Fin. Code sec. 22018.

[37] Cal. Fin. Code sec. 22690. California law uses the term ''PACE solicitor'' and ''PACE solicitor agent'' to refer to persons authorized by program administrators to solicit property owners to enter into PACE assessment contracts, often home improvement contractors. *See* Cal. Fin. sec. 22017(a)–(b).

[38] Cal. Fin. Code secs. 22680–82.

[39] Cal. Fin. Code sec. 22692.

[40] *See, e.g.,* Cal. Dep't of Fin. Prot. & Innovation, *Annual Report of Operation of Finance Lenders, Brokers, and PACE Administrators Licensed Under the California Financing Law* (Aug. 2022), *https://dfpi.ca.gov/wp-content/uploads/sites/337/2022/08/2021-CFL-Aggregated-Annual-Report.pdf.*

[41] *See* Fla. HB 7179 (2010), *codified at Fla. Stat. 163.08 et seq.*

[42] Fla. Stat. sec. 163.08(9).

[43] Fla. Stat. sec. 163.08(12), (14).

[44] Fla. Stat. sec. 163.08(13).

[45] Mo. HB 1692 (2010), codified at Mo. Rev. Stat. 67.2800(8) (defining projects eligible for financing).

[46] Mo. HB 697, codified at Mo. Rev. Stat. 67.2818(4).

[47] Mo. HB 697, codified at Mo. Rev. Stat. 67.2817(2) (financial requirements to execute an assessment contract); 67.2817(4) (right to cancel); 67.2817(6) (verbal confirmation).

[48] Mo. HB 697, codified at Mo. Rev. Stat. 67.2817(2), 67.2818(2)–(3).

[49] Mo. HB 697, codified at Mo. Rev. Stat. 67.2840.

[50] *See* PACENation, *PACENation Unveils 22 New Consumer Protection Policies for Residential PACE Programs Nationwide* (Nov. 5, 2021), *https://www.pacenation.org/pacenation-unveils-22-consumer-protection-policies-for-residential-pace-programs-nationwide/.*

[51] *Id.*

2018 (EGRRCPA) was signed into law on May 24, 2018.[52] EGRRCPA section 307 amended TILA to mandate that the CFPB take regulatory action on PACE financing, which it defines as ''financing to cover the costs of home improvements that results in a tax assessment on the real property of the consumer.'' Specifically, it provides in relevant part that the CFPB must prescribe regulations that (1) carry out the purposes of TILA section 129C(a), and (2) apply TILA section 130 with respect to violations under TILA section 129C(a) with respect to PACE financing, and requires that the regulations account for the unique nature of PACE financing.[53] TILA section 129C(a) contains TILA's ATR provisions for residential mortgage loans and TILA section 130 contains TILA's civil liability provisions. Thus, section 307 requires the Bureau to apply TILA's ATR provisions to PACE financing, and to apply TILA's civil liability provisions for violations of those ATR provisions, all in a way that accounts for the unique nature of PACE financing. This proposal discusses the proposed implementation of the ATR and civil liability requirements further in the section-by-section analysis of proposed § 1026.43.

III. Advance Notice of Proposed Rulemaking

On March 4, 2019, the CFPB issued an Advance Notice of Proposed Rulemaking (ANPR) to solicit information relating to residential PACE financing.[54] The purpose of the ANPR was to gather information to better understand the PACE financing market and other information to inform a proposed rulemaking under EGRRCPA section 307.

The ANPR sought five categories of information related to PACE financing: (1) written materials associated with PACE transactions; (2) descriptions of current standards and practices in the PACE financing origination process; (3) information relating to civil liability under TILA for violations of the ATR requirements in connection with PACE financing, as well as rescission and borrower delinquency and default; (4) information about what features of PACE financing make it unique and how the CFPB should address those unique features in this rulemaking; and (5) views concerning the potential implications of regulating PACE financing under TILA.

In response to the ANPR, the CFPB received over 115 comments, which were submitted by a diverse group of entities, including individual consumers, consumer groups, private PACE industry participants, mortgage stakeholders, energy and environmental groups, and government entities, among others. A summary of some of the legal and policy positions reflected in the ANPR comments is included below, and additional information from the ANPR comments is referenced throughout this proposal.

Regarding the need for PACE regulation, consumer groups and mortgage industry stakeholders generally agreed that PACE transactions require Federal regulation, advocating for strong ATR rules, in particular. Some also supported further application of TILA to PACE financing, including disclosure requirements, rescission rights, loan originator compensation requirements, and protections for high-cost PACE transactions. These commenters indicated that PACE financing is consumer credit, and should be regulated similar to a traditional mortgage because it is voluntary financing that is secured by the consumer's home and because delinquency can lead to penalties, additional interest, and foreclosure. Some argued for more stringent regulations than currently apply to traditional mortgages due to what they asserted was the dangerous nature of PACE financing, citing problematic lending incentives, alleged abuses by home improvement contractors, and alleged targeting of PACE to vulnerable populations.

On the other hand, PACE industry participants generally opposed the imposition of additional or stringent regulations. Many argued that PACE financing is safe for consumers, citing the involvement of State and local governments, the relatively small size of the debt obligation, existing State and local requirements, low delinquency rates, and other features of PACE financing. Some expressed concern that overly broad rules could infringe on the fundamental taxing authority of State and local governments, undermine PACE's public purpose of reducing barriers to green energy financing, decrease access to private capital, and potentially lead to the termination of PACE programs. Some were also worried that regulations would erode PACE's point-of-sale nature, causing consumers and contractors to turn to more dangerous unsecured credit products and decrease new applications. Many argued that PACE financing is not consumer credit subject to TILA, and that the CFPB lacks authority to impose TILA's requirements beyond its ATR rules.

In regard to application of TILA's ATR requirements to PACE financing, there were again differing opinions among commenters. Consumer groups and mortgage industry stakeholders generally agreed that TILA's existing ATR requirements should be applied, but some suggested adjusting them to account for factors such as the cadence of property tax payments, which tend to be due on an annual or semi-annual basis, and the potential for payment shocks related to PACE financing's impact on the consumer's existing mortgage escrow account. Some called for verification of consumers' financial information, and for the ATR rules to account for pre-existing and simultaneous PACE financing to prevent loan stacking or loan splitting. In contrast, some PACE industry participants opposed application of TILA's existing ATR requirements, stating that it would be unnecessary and too burdensome, and would lead to decreased consumer participation in PACE programs. Some also argued that mandatory income verification for all consumers would interfere with the point-of-sale nature of PACE financing, and that a modeled income requirement would be sufficient. Some recommended an emergency exception to any ATR requirement. Still others recommended that the CFPB structure any ATR rules to avoid conflict with existing California regulations.

A few commenters provided their opinions on whether certain PACE transactions should be entitled to a presumption of compliance with the CFPB's ATR requirements similar to QM status. One PACE company suggested that a reasonable safe harbor is necessary to ensure that private capital continues to invest in PACE financing. However, some consumer groups opposed offering a presumption of compliance, stating that PACE is structurally unsafe and a source of abuse for some populations. A mortgage trade association recommended that, if the CFPB decides to permit such a presumption, subordination of the PACE lien should be required.

Regarding the application of TILA section 130 to PACE financing, some consumer groups suggested that PACE companies should be held liable under TILA section 130 because they are responsible for operating the PACE

[52] Public Law 115–174, 132 Stat. 1296 (2018).

[53] EGRRCPA section 307, amending TILA section 129C(b)(3)(C)(ii), 15 U.S.C. 1639c(b)(3)(C)(ii). EGRRCPA section 307 also includes amendments authorizing the Bureau to ''collect such information and data that the Bureau determines is necessary'' in prescribing the regulations and requiring the Bureau to ''consult with State and local governments and bond-issuing authorities.''

[54] *Advance Notice of Proposed Rulemaking on Residential Property Assessed Clean Energy Financing,* 84 FR 8479 (Mar. 8, 2019).

programs. Some PACE industry participants expressed concern that, if government entities become subject to civil liability, they might stop operating PACE programs. Finally, one PACE company recommended capping civil liability at the amount of the assessment, to prevent TILA's statutory damages from exceeding the principal amount of the average PACE transaction.

IV. Data Collection

EGRRCPA section 307 authorizes the CFPB to ''collect such information and data that the Bureau determines is necessary'' to support the PACE rulemaking required by the section.[55] In October 2020, the CFPB requested PACE financing data from all companies providing PACE financing at that time. The request was voluntary and was intended to gather information on PACE transaction applications and originations between July 2014 and June 2020, including basic underwriting information used for applications, application outcomes, and loan terms. The CFPB also contracted with one of the three nationwide consumer reporting agencies to obtain credit record data for the PACE consumers in the PACE transaction data.

In August 2022, the CFPB received from its contractor de-identified PACE data from the four PACE companies that were active in the PACE market at the time of submission and matching de-identified credit record data for the consumers involved in the PACE transactions.[56] The PACE company data encompassed about 370,000 PACE transaction applications submitted in California and Florida from 2014 to 2020 and about 128,000 resulting PACE transaction originations. The CFPB's contractor was able to provide matching credit data for about 208,000 individual PACE consumers, which included periodic credit snapshots for each consumer between June 2014 and June 2022. In total, the matched consumers submitted about 286,000 PACE applications and entered into approximately 100,000 PACE transactions.[57]

The CFPB utilized the acquired data to develop a report that analyzes the impact of PACE transactions on consumer outcomes, with a particular focus on mortgage delinquency. In addition to other analyses, the report examines consumers who obtained originated PACE transactions and compares them to those who applied for PACE transactions and were approved but did not proceed. The report, entitled ''PACE Financing and Consumer Financial Outcomes'' (PACE Report) is being published concurrently with this NPRM.[58]

Among other findings, the PACE transactions analyzed in the PACE Report led to an increase in negative credit outcomes, particularly 60-day mortgage delinquency, with an increase of 2.5 percentage points over a two-year span following PACE transaction origination. Additionally, the PACE borrowers discussed in the PACE Report resided in census tracts with higher percentages of Black and Hispanic residents than the average for their States.[59] However, the effect of PACE transactions on non-PACE mortgage delinquency was statistically similar for PACE borrowers in majority-white census tracts compared to those in majority-non-white census tracts.[60] The PACE Report also assesses the impact of the 2018 California PACE Reforms, discussed in part II.A.5. The analysis finds that these laws improved consumer outcomes while substantially reducing the volume of PACE lending.[61]

V. Outreach

To learn about the industry and the unique nature of PACE financing, the Bureau has engaged with a wide variety of stakeholders since 2015, including consumer advocates, a range of public and private participants in the PACE financing industry, mortgage industry stakeholders, and representatives from energy and environmental groups. The engagement has included listening sessions, roundtable discussions, question-and-answer sessions, consultation calls soliciting stakeholder input, briefings on the ANPR, panel appearances by CFPB staff, and written correspondence.

The CFPB's outreach relating to PACE financing is summarized at a high level below.[62] The outreach has supplemented information on PACE financing that the CFPB has gleaned from independent research; the detailed comments responding to the ANPR, discussed in part III; the data collection described in part IV; and information from publicly available sources such as news reports, research and analysis, and litigation documents.

A. Consumer Advocates

The CFPB began corresponding with consumer advocates regarding PACE financing in 2016. These stakeholders have shared their concerns about consumer risks in the PACE financing market and stories of PACE financing resulting in financial harm to consumers.

The CFPB has continued the engagement since EGRRCPA section 307 was passed, meeting on numerous occasions with individual consumer advocates and consumer advocacy groups to discuss a range of topics related to PACE financing. For example, these stakeholders have shared their understanding of how the PACE financing industry functions, including the structure of the financial obligation, the different roles of government units and private parties, industry trends, and the effects of State legislation on PACE financing. Similar to the perspectives they shared in ANPR comments, discussed in part III, they have also voiced consumer protection concerns and shared legal and policy analysis regarding the implementation of EGRRCPA section 307 and the application of TILA to PACE transactions.

B. Private PACE Industry Stakeholders

Since 2015, the CFPB has engaged on dozens of occasions with various private PACE industry stakeholders, including private PACE companies, a national trade organization, private companies that help administer the assessments (assessment administrators), and at least one bond counsel. These stakeholders have provided the CFPB a great deal of information about PACE transactions, industry business practices, market trends, and the roles of different industry participants.

Additionally, the PACE financing providers, assessment administrators, and a national trade organization have shared industry trends and their views on how the industry has been developing in different jurisdictions. They have also shared their views on some of the challenges and progress the industry has experienced as the programs have developed, including, for example, the causes of fluctuations in loan volumes, industry efforts to improve the consumer experience, benefits of PACE financing, and the effects of consumer protection

[55] 15 U.S.C. 1639c(b)(3)(C)(iii)(I).

[56] The Bureau received data from FortiFi Financial, Home Run Financing, Renew Financial, and Ygrene Energy Fund.

[57] Matched consumers resided in census tracts with smaller Hispanic populations, higher median income, and lower average education compared to consumers who were not matched. The PACE Report verifies that weighting the sample to be more like the full population of PACE consumers has no meaningful effect on the main results of the Report. PACE Report, *supra* note 12, at 11.

[58] *See* PACE Report, *supra* note 12.

[59] *Id.* at 4.

[60] *Id.* at 38–39, Figure 11.

[61] *Id.* at 4–5.

[62] The CFPB also engaged in extensive outreach with numerous stakeholders to design and complete the Bureau data collection on PACE financing that is discussed in part IV.

requirements in particular States. Some of these stakeholders have also shared their perspectives on EGRRCPA section 307 and considerations the CFPB should bear in mind in this rulemaking.

C. State and Local Governments and Bond-Issuing Authorities

As part of the CFPB's PACE rulemaking, EGRRCPA section 307 requires that the CFPB ''consult with State and local governments and bond-issuing authorities.'' [63] Consistent with this requirement, the CFPB has conferred on numerous occasions with State and local governments and bond-issuing authorities involved in PACE financing to gather information about PACE for the rulemaking. Entities with which the CFPB has consulted over the years include government sponsors of PACE financing programs, agencies involved in different aspects of the programs, local property tax collectors, public PACE financing providers, and county and city officials. The CFPB engagements with bond-issuing authorities occurred on a number of occasions, including discussions over the phone and in-person, and through written correspondence. The CFPB also conferred on a number of occasions with membership organizations representing municipalities.

In the course of developing the NPRM, CFPB staff also conducted a series of consultation calls to promote awareness about the CFPB rulemaking and gather input on topics that the CFPB was considering addressing in this proposal, including, for example, whether the CFPB should use the same ATR framework for PACE financing that currently applies to mortgage credit or a different framework, what changes should be made to account for the unique nature of PACE financing, whether to apply any existing QM definitions to PACE financing, how to apply TILA's general civil liability provisions to violations of the ATR requirements for PACE financing, and the implications of this rulemaking for PACE financing bonds. Each call was targeted to specific stakeholder groups, including: (1) State agencies in the three States that currently offer PACE, (2) California local government officials, (3) Missouri local government officials, (4) Florida local government officials, and (5) State and local officials from states that do not currently offer PACE. In addition to feedback provided during the calls, some participants provided input after the calls.

Public entities involved in the operation of PACE financing and third parties operating on their behalf have expressed divergent views on PACE financing. For example, some individuals from local tax collectors' offices and other government units have expressed concern about the risks or challenges that PACE financing can create for consumers or local taxing authorities. In part because of these concerns, some government representatives have shared consumer protection recommendations and background information about how the PACE financing industry operates in particular jurisdictions. Several localities with active PACE financing programs have expressed consumer protection concerns and informed the CFPB that they would welcome application of TILA's ATR provisions to PACE, or that they have implemented certain consumer protection standards themselves. A nonprofit organization that administered a PACE financing program on behalf of a local government informed the CFPB that the locality ended its PACE financing program, largely due to consumer protection concerns.

Other local governments (and third parties they work with) have shared views that reflect more positive assessments of the industry. For example, representatives from one government sponsor of PACE financing (that later ceased sponsoring new PACE financing originations [64]) told the CFPB that the program carries important consumer benefits, including that it provides a financing option for home improvement projects that have energy and environmental benefits, and creating jobs. Local government representatives in certain jurisdictions have expressed enthusiasm about aspects of PACE financing such as increased solar panel installations, and have indicated that they think PACE financing programs generally function well. Some government sponsors indicated that their PACE financing programs had instituted a number of practices that were consumer-protective, such as repayment analysis, low fees, contractor screening, or monitoring and oversight of private entities involved in the originations. Some government sponsors expressed concern that Federal regulation could negatively impact PACE programs, and that the CFPB should not apply TILA's ATR provisions or other consumer protections to PACE financing. Several State and local entities also informed the CFPB that consumer complaints had declined significantly in recent years.

D. Other Stakeholders

The CFPB outreach has also included other stakeholders with an interest in PACE financing. For example, several times since 2016, the CFPB has discussed PACE financing with national and State-level mortgage industry trade organizations. These stakeholders have provided updates on, for example, State-level developments in the PACE financing industry and analysis of Federal policy involving PACE financing. Some have also shared concerns about the potential impact of PACE financing on mortgage industry participants, noting, for example, the priority position of liens securing PACE transactions relative to non-PACE mortgage liens, the challenges non-PACE mortgage industry stakeholders have in obtaining information about PACE transactions and attendant risks, and that non-PACE mortgage servicers may need to collect PACE transactions through an escrow account, which may include advancing their own funds if the consumer is unable to afford the PACE financing payment. Some mortgage industry stakeholders have also raised consumer protection concerns, sharing anecdotal reports of consumer harm and asserting that, in practice, consumers have often had to repay the full PACE financing balance before they have been able to sell properties encumbered with a PACE financing lien. Some suggested that the CFPB should treat PACE like a standard mortgage or apply TILA more generally to PACE.

The CFPB has also met with representatives from environmental and energy groups. These representatives shared general views on, for example, the role of PACE financing in the marketplace, industry trends, and potential risks to consumers.

As discussed in part IX, the CFPB has also consulted with Federal government entities.

VI. Legal Authority

The Bureau is proposing to amend Regulation Z pursuant to its authority under the Consumer Financial Protection Act of 2010 (CFPA) and other provisions of the Dodd-Frank Wall Street Reform and Consumer Protection

[63] 15 U.S.C. 1639c(b)(3)(C)(iii)(II).

[64] The Bureau understands that a number of government sponsors, some of which participated in the Bureau's outreach, have stopped participating in new originations. *See, e.g.,* Jeff Horseman, *Riverside-based agency to end controversial PACE loans for energy improvements,* The Press-Enterprise (Dec. 12, 2022); Andrew Khouri, *L.A. County ends controversial PACE home improvement loan program,* L.A. Times (May 21, 2020), *https://www.latimes.com/homeless-housing/story/2020-05-21/la-fi-pace-home-improvement-loans-la-county#:~:text=Los%20Angeles%20County%20has%20ended,risk%20of%20losing%20their%20homes.*

Act (Dodd-Frank Act),[65] EGRRCPA section 307, TILA, and Real Estate Settlement Procedures Act of 1974 (RESPA).[66]

A. Dodd-Frank Act

CFPA section 1022(b)(1). Section 1022(b)(1) of the CFPA authorizes the Bureau to prescribe rules ''as may be necessary or appropriate to enable the Bureau to administer and carry out the purposes and objectives of the Federal consumer financial laws, and to prevent evasions thereof.'' [67] Among other statutes, TILA, RESPA, and the CFPA are Federal consumer financial laws.[68] Accordingly, the Bureau proposes exercising its authority under CFPA section 1022(b) to prescribe rules that carry out the purposes and objectives of TILA, RESPA, and the CFPA and prevent evasion of those laws.

Dodd-Frank Act section 1405(b). Section 1405(b) of the Dodd-Frank Act provides that, notwithstanding any other provision of title XIV of the Dodd-Frank Act, in order to improve consumer awareness and understanding of transactions involving residential mortgage loans through the use of disclosures, the Bureau may exempt from or modify disclosure requirements, in whole or in part, for any class of residential mortgage loans if the Bureau determines that such exemption or modification is in the interest of consumers and in the public interest.[69] Section 1401 of the Dodd-Frank Act, which amends TILA section 103(cc)(5), generally defines a residential mortgage loan as any consumer credit transaction that is secured by a mortgage on a dwelling or on residential real property that includes a dwelling, other than an open-end credit plan or an extension of credit secured by a consumer's interest in a timeshare plan.[70] Notably, the authority granted by section 1405(b) applies to disclosure requirements generally and is not limited to a specific statute or statutes. Accordingly, Dodd-Frank Act section 1405(b) is a broad source of authority to exempt from or modify the disclosure requirements of TILA and RESPA. In developing this proposed rule, the Bureau has considered the purposes of improving consumer awareness and understanding of transactions involving residential mortgage loans through the use of disclosures and the interests of consumers and the public. The Bureau proposes these amendments pursuant to its authority under Dodd-Frank Act section 1405(b). For the reasons discussed below and in the 2013 TILA–RESPA Rule, the Bureau believes the proposal is in the interest of consumers and in the public interest, consistent with Dodd-Frank Act section 1405(b).

B. TILA

TILA section 105(a). TILA section 105(a) directs the Bureau to prescribe regulations to carry out the purposes of TILA and provides that such regulations may contain additional requirements, classifications, differentiations, or other provisions and may further provide for such adjustments and exceptions for all or any class of transactions that the Bureau judges are necessary or proper to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or to facilitate compliance therewith.[71] A purpose of TILA is to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various available credit terms and avoid the uninformed use of credit.[72] Additionally, a purpose of TILA sections 129B and 129C is to assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive, or abusive.[73]

TILA section 105(b). TILA section 105(b), amended by the CFPA, requires publication of an integrated disclosure for mortgage loan transactions covering the disclosures required by TILA and the disclosures required by sections 4 and 5 of RESPA.[74] The purpose of the integrated disclosure is to facilitate compliance with the disclosure requirements of TILA and RESPA and to improve borrower understanding of the transaction. The Bureau provided additional discussion of this integrated disclosure mandate in the 2013 TILA–RESPA Rule.[75]

TILA section 105(f). Section 105(f) of TILA, 15 U.S.C. 1604(f), authorizes the Bureau to exempt from all or part of TILA any class of transactions if the Bureau determines after the consideration of certain factors that TILA coverage does not provide a meaningful benefit to consumers in the form of useful information or protection.

TILA section 129C(b)(3)(A), (B)(i). TILA section 129C(b)(3)(A) directs the Bureau to prescribe regulations to carry out the purposes of the subsection.[76] In addition, TILA section 129C(b)(3)(B)(i) authorizes the Bureau to prescribe regulations that revise, add to, or subtract from the criteria that define a QM upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of TILA section 129C; or are necessary and appropriate to effectuate the purposes of TILA sections 129B and 129C, to prevent circumvention or evasion thereof, or to facilitate compliance with such sections.[77]

TILA section 129C(b)(3)(C)(ii). In section 307 of the EGRRCPA, codified in TILA section 129C(b)(3)(C), Congress directed the Bureau to conduct a rulemaking to ''prescribe regulations that carry out the purposes of [TILA's ATR requirements] and apply section 130 [of TILA] with respect to violations [of the ATR requirements] with respect to [PACE] financing, which shall account for the unique nature of [PACE] financing.'' [78]

C. RESPA

RESPA section 4(a). RESPA section 4(a), amended by the CFPA, requires publication of an integrated disclosure for mortgage loan transactions covering the disclosures required by TILA and the disclosures required by sections 4 and 5 of RESPA.[79] The purpose of the integrated disclosure is to facilitate compliance with the disclosure requirements of TILA and RESPA and to improve borrower understanding of the transaction. The Bureau provided additional discussion of this integrated disclosure mandate in the 2013 TILA–RESPA Rule.[80]

RESPA section 19(a). Section 19(a) of RESPA authorizes the Bureau to prescribe such rules and regulations and to make such interpretations and grant such reasonable exemptions for classes of transactions as may be necessary to achieve the purposes of RESPA.[81] One purpose of RESPA is to effect certain changes in the settlement process for residential real estate that will result in more effective advance disclosure to

[65] Public Law 111–203, 124 Stat. 1376 (2010).

[66] 12 U.S.C. 2601 *et seq.*

[67] 12 U.S.C. 5512(b)(1).

[68] CFPA section 1002(14), 12 U.S.C. 5481(14) (defining ''Federal consumer financial law'' to include the ''enumerated consumer laws'' and the provisions of CFPA); CFPA section 1002(12), 12 U.S.C. 5481(12) (defining ''enumerated consumer laws'' to include TILA and RESPA).

[69] Public Law 111–203, 124 Stat. 1376, 2142 (2010) (codified at 15 U.S.C. 1601 note).

[70] Public Law 111–203, 124 Stat. 1376, 2138 (2010) (codified at 15 U.S.C. 1602(cc)(5)).

[71] 15 U.S.C. 1604(a).

[72] 15 U.S.C. 1601(a).

[73] 15 U.S.C. 1639b(a)(2).

[74] Public Law 111–203, 124 Stat. 1376, 2108 (2010) (codified at 15 U.S.C. 1604(b)).

[75] 78 FR 79730, 79753–54 (Dec. 31, 2013).

[76] 15 U.S.C. 1639c(b)(3)(A).

[77] 15 U.S.C. 1639c(b)(3)(B)(i).

[78] 15 U.S.C. 1639c(b)(3)(C)(ii).

[79] Public Law 111–203, 124 Stat. 1376, 2103 (2010) (codified at 12 U.S.C. 2603(a)).

[80] 78 FR 79730, 79753–54 (Dec. 31, 2013).

[81] 12 U.S.C. 2617(a).

home buyers and sellers of settlement costs.[82] In addition, in enacting RESPA, Congress found that consumers are entitled to greater and more timely information on the nature and costs of the settlement process and to be protected from unnecessarily high settlement charges caused by certain abusive practices in some areas of the country.[83] In developing proposed rules under RESPA section 19(a), the Bureau has considered the purposes of RESPA, including to effect certain changes in the settlement process that will result in more effective advance disclosure of settlement costs.

VII. Section-by-Section Analysis

1026.2 Definitions and Rules of Construction.

1026.2(a) Definitions

1026.2(a)(14) Credit

Section 1026.2(a)(14) defines ''credit'' to mean ''the right to defer payment of debt or to incur debt and defer its payment.'' Currently, comment 2(a)(14)–1.ii states, in part, that ''tax liens'' and ''tax assessments'' are not considered credit for purposes of the regulation. The Bureau proposes to amend comment 2(a)(14)–1.ii to add the word ''involuntary'' to clarify which tax liens and tax assessments are not considered credit. Amended as proposed, comment 2(a)(14)–1.ii would provide that ''involuntary tax liens, involuntary tax assessments, court judgments, and court approvals of reaffirmation of debts in bankruptcy'' are not considered credit for purposes of the regulation.[84] The proposed amendment would resolve ambiguity in the existing comment and bring the exclusion in line with the definition of credit in TILA and congressional intent with respect to TILA coverage.

For a number of years, stakeholders have expressed disagreement in litigation, ANPR comments, and other communications about whether comment 2(a)(14)–1.ii excludes PACE transactions from TILA coverage. The ambiguity derives largely from the text of the comment in light of the structure of PACE transactions. The comment excludes tax assessments and tax liens, and PACE transactions have attributes of both involuntary special property tax assessments that are not subject to TILA and voluntary mortgage transactions that are. As described in part II.A, PACE transactions have been treated as assessments under State law, are collected through local property tax systems, and are secured by liens treated similarly to property tax liens; but PACE transactions arise through voluntary contractual agreement, similar to other credit transactions that are subject to TILA.

In general, PACE industry stakeholders have argued that PACE transactions are not TILA credit, in part because the text of the comment states that tax liens and tax assessments are not credit without explicitly distinguishing between voluntary and involuntary obligations; and consumer advocates and mortgage industry stakeholders have argued that PACE transactions *are* TILA credit because, unlike other tax liens and assessments, PACE transactions are voluntary for consumers. One Federal district court has directly addressed the question, ruling that PACE financing is not credit for purposes of TILA in part due to the text of comment 2(a)(14)–1.ii.[85]

The Bureau proposes to amend the commentary to clarify that PACE transactions are credit under TILA and Regulation Z. Amended as proposed, comment 2(a)(14)–1.ii would state that ''involuntary tax liens, involuntary tax assessments, court judgments, and court approvals of reaffirmation of debts in bankruptcy'' are not considered credit for purposes of the regulation. By adding the word ''involuntary'' to comment 2(a)(14)–1.ii, the Bureau would clarify that the comment does not exclude tax liens and tax assessments that arise from voluntary contractual agreements, such as PACE transactions. Thus, under the proposed amendments, tax liens and tax assessments that are voluntary would be credit if they meet the definition of credit under TILA and Regulation Z and are not otherwise excluded.[86]

The proposed amendment would bring the exclusion in comment 2(a)(14)–1.ii in line with the definition of credit in TILA and Regulation Z. TILA defines ''credit'' to mean the ''right granted by creditor to a debtor to defer payment of debt or to incur debt and defer its payment,'' and Regulation Z defines ''credit'' as ''the right to defer payment of debt or to incur debt and defer its payment.'' [87] In general, PACE transactions appear to easily fit these definitions—the agreements provide for consumers to receive funding for home improvement projects and repay those funds over time in installments.[88]

The proposed amendments to comment 2(a)(14)–1.ii would also be in line with congressional intent. Congress enacted TILA in part to enable consumers ''to compare more readily the various credit terms available'' to them, and to ''avoid the uninformed use of credit.'' [89] To that end, relevant legislative history indicates that TILA was intended to require ''all creditors to disclose credit information in a uniform manner'' so that ''the American

[82] 12 U.S.C. 2601(b).

[83] 12 U.S.C. 2601(a). In the past, RESPA section 19(a) has served as a broad source of authority to prescribe disclosures and substantive requirements to carry out the purposes of RESPA.

[84] The proposed rule would also make a conforming change later in the comment, inserting the word ''involuntary'' before ''tax lien'' in an illustrative example of third-party financing that is credit for purposes of the regulation notwithstanding the exclusion.

[85] *See In re HERO Loan Litig.*, 017 WL 3038250 (C.D. Cal. 2017); *see also Burke* v. *Renew Fin. Grp., Inc.,* 2021 WL 5177776 (C.D. Cal. 2021) (ruling that PACE transactions are not consumer credit under TILA). The *In re HERO* and *Burke* courts suggested that PACE assessments are not ''consumer credit transactions'' for purposes of TILA. 2017 WL 3038250, at *2–*3; 2021 WL 5177776, at *3. TILA defines ''consumer credit transactions'' to mean that a credit transaction is ''one in which the party to whom credit is offered or extended is a natural person, and the money, property, or services which are the subject of the transaction are primarily for personal, family, or household purposes.'' 15 U.S.C. 1602(i). Consistent with this, Regulation Z defines ''consumer credit'' to mean ''credit offered or extended to a consumer primarily for personal, family, or household purposes.'' 12 CFR 1026.2(a)(12). Residential PACE transactions satisfy these definitions. Notwithstanding the rulings in *Burke* and *In re HERO,* such Residential PACE transactions satisfy these definitions. Notwithstanding the rulings in *Burke* and *In re HERO,* such transactions are ''offered or extended'' to consumers, who as natural persons are the targets of marketing and sales efforts, are offered the loans and decide whether to sign up, and are signatories to the financing agreements, which are for money to fund home improvement services that are primarily for personal, family, or household purposes.

[86] Under the proposed amendments, tax liens and tax assessments that are not voluntary for the consumer would continue to be excluded.

[87] 15 U.S.C. 1602(f); 12 CFR 1026.2(a)(14). Regulation Z further defines creditor generally as ''a person who regularly extends consumer credit that is subject to a finance charge or is payable by written agreement in more than four installments (not including a down payment), and to whom the obligation is initially payable, either on the face of the note or contract, or by agreement when there is no note or contract.'' 12 CFR 1026.2(a)(17).

[88] Treating PACE transactions as TILA credit is consistent with the FTC's assertion of claims against a PACE company under the Bureau's Regulation N, 12 CFR part 1014, which the parties settled pursuant to a proposed court order. *See Stipulation as to Entry of Order for Permanent Injunction, Monetary Judgement, and Other Relief* (Oct. 28, 2022), *https://www.ftc.gov/system/files/ftc_gov/pdf/Stipulation%20-%20Dkt.%202%20-%2022-cv-07864.pdf; see also* part II.A.4 (describing the settlement). Regulation N, also known as the Mortgage Acts and Practices—Advertising Rule, implements section 626 of the Omnibus Appropriations Act, 2009, as amended. 12 U.S.C. 5538. Regulation N applies to the advertising, marketing, and sale of a ''mortgage credit product,'' defined as ''any form of credit that is secured by real property or a dwelling and that is offered or extended to a consumer primarily for personal, family, or household purposes.'' 12 CFR 1014.2. Regulation N defines ''credit'' identically to Regulation Z but does not include any commentary analogous to comment 2(a)(14)–1.ii to Regulation Z.

[89] TILA section 102(a), 15 U.S.C. 1601(a).

consumer will be given the information he needs to compare the cost of credit and to make the best informed decision on the use of credit.'' [90] Clarifying that voluntary tax liens and tax assessments can be credit, such that PACE transactions are subject to TILA's uniform disclosure requirements, would squarely align with these goals. Consumers have a number of financing options for home improvement projects, such as home equity lines of credit, personal loans, and credit cards. Just like these other financing options, PACE transactions carry certain costs, terms, and conditions that consumers must be aware of in order to make informed credit decisions. Requiring TILA disclosures for PACE transactions allows consumers to shop among different options and across creditors.

Notably, it appears that the current text of comment 2(a)(14)–1.ii was not intended to exclude voluntary transactions such as PACE. The Board of Governors of the Federal Reserve System (Board) first issued the comment in 1981 as part of a broader rulemaking issuing commentary to Regulation Z.[91] In preamble preceding that issuance and in several public information letters that were forerunners to the 1981 rule, it is clear that the Board was addressing whether certain types of involuntary tax and assessment obligations were credit under TILA and Regulation Z. In one letter, the Board stated that the definition of ''credit'' ''necessarily assumes the right to avoid incurring debt. That is, the debt must arise from a contractual relationship, voluntarily entered into, between the debtor and creditor.'' [92] Because ''such a relationship [did] not exist in the delinquent tax arrangement case,'' the Board found that TILA and Regulation Z ''would not govern the transaction.'' [93] Other letters contained similar analysis,[94] and the Board reiterated this reasoning in preamble predating the commentary in which it explained its rationale for the comment, again focusing on the involuntary nature of the obligations as the reason they were not credit.[95] The Board explained:

> Certain transactions do not involve the voluntary incurring of debt; others do not involve the right to defer a debt. Tax liens, tax assessments and court judgments (including reaffirmations of a debt discharged in bankruptcy, if approved by a court) fall into this category and are therefore not covered by the regulation.[96]

Moreover, in this preamble and in the commentary to Regulation Z that it adopted later that year, the Board specifically juxtaposed the excluded obligations with voluntary ones, stating that, while the obligations it was excluding are not credit, ''third-party financing of such obligations (for example, obtaining a bank loan to pay off a tax lien) would constitute credit for Truth in Lending purposes.'' [97] There is no indication that, in issuing the comment excluding tax liens and tax assessments, the Board had considered any tax lien or tax assessment that had originally arisen from a voluntary contractual agreement.

PACE industry stakeholders have asserted a number of additional reasons PACE transactions should not be treated as TILA credit, including that PACE financing serves important public policy purposes as mandated by State law, and that PACE transactions are special assessments that are repaid through the property tax system and are secured by liens enforced similar to property tax liens under State law. The Bureau is not aware of any indication that Congress intended for TILA to exclude voluntary transactions like PACE financing on account of their being processed through property tax systems or because they are intended to further certain public policy purposes.

The Bureau recognizes that clarifying the exclusion in comment 2(a)(14)–1.ii as limited to involuntary tax assessments and involuntary tax liens would ensure that TILA applies generally to PACE transactions. As a result, it would ensure that certain participants in PACE transactions would be subject to TILA requirements. For example, various disclosure and other requirements would apply to the entity that is the ''creditor'' as defined in § 1026.2(a)(17), which the Bureau understands is typically the government sponsor in a PACE transaction.[98] Other requirements would apply to any entity that operates as a ''loan originator'' for a PACE transaction, which could include a PACE company or home improvement contractor depending on the roles those entities play in a particular transaction.[99] In the Bureau's view, PACE transactions share relevant characteristics with other credit transactions, as described above. If they were not subject to TILA and Regulation Z, consumers would be at risk, and it would run counter to the purposes for enacting TILA expressed by Congress. The Bureau understands, however, that certain existing requirements in Regulation Z might warrant adjustment to better accommodate the unique structure of PACE transactions. The Bureau is proposing amendments to that end, as described in the relevant section-by-section analyses in this proposal.

The Bureau seeks comment on the proposed amendments to comment 2(a)(14)–1.ii. The Bureau also seeks comment on whether any TILA provisions not addressed in this proposal warrant amendment for PACE transactions.

1026.32 Requirements for High-Cost Mortgages and 1026.34 Prohibited Acts or Practices in Connection With High-Cost Mortgages

The Home Ownership and Equity Protection Act (HOEPA) was enacted in 1994 as an amendment to TILA to address abusive practices in refinancing and home-equity mortgage loans with high interest rates or high fees.[100] Loans that meet HOEPA's high-cost coverage tests are subject to special disclosure requirements and restrictions on loan terms, and borrowers in high-cost

[90] H.R. Rep. No. 1040, 90th Cong. (1967).

[91] *See* 46 FR 50288, 50292 (Oct. 9, 1981).

[92] Fed. Rsrv. Bd., *Public Information Letter No. 166* (1969).

[93] *Id.*

[94] *See* Fed. Rsrv. Bd., *Public Information Letter No. 153* (1969) (similar with regard to sewer assessment installment payments); Fed. Rsrv. Bd., *Public Information Letter No. 40* (1969) (''[T]he term 'credit', for the purposes of Truth-in-Lending, assumes a contractual relationship, voluntarily entered, between creditor and debtor. Since such a relationship [did] not exist in the case of tax assessments by the Sewer District (and, similarly in the case of ad valorem taxes imposed by a city), . . . such assessments (and city taxes) would not fall within the coverage of [TILA] or Regulation Z.'').

[95] 46 FR 20848, 20851 (Apr. 7, 1981).

[96] *Id.*

[97] *Id.; see also* 46 FR 50288, 50292 (Oct. 9, 1981) (adopting the relevant comment with the same language). In 2011, the authority to interpret TILA and implement Regulation Z transferred to the Bureau, which republished the 1981 Board interpretation as an official Bureau interpretation in comment 2(a)(14)–1.ii with no substantive changes.

[98] Implementing TILA section 103(g), § 1026.2(a)(17) defines ''creditor'' generally as a person who regularly extends consumer credit that is subject to a finance charge or is payable by written agreement in more than four installments, and to whom the obligation is initially payable. The Bureau's understanding, consistent with ANPR comments and other research, is that these characteristics apply to government sponsors of PACE transactions in the PACE programs that have been active.

[99] Section 1026.36(a)(1) generally defines a ''loan originator'' as a person who, in expectation of direct or indirect compensation or other monetary gain or for direct or indirect compensation or other monetary gain, performs any of the following activities: takes an application, offers, arranges, assists a consumer in obtaining or applying to obtain, negotiates, or otherwise obtains or makes an extension of consumer credit for another person; or through advertising or other means of communication represents to the public that such person can or will perform any of these activities. See the section-by-section analysis of proposed § 1026.41 for discussion of servicing provisions in Regulation Z.

[100] Public Law 103–325, 108 Stat. 2160.

mortgages have enhanced remedies for violations of the law.[101] The provisions of HOEPA are implemented in Regulation Z in §§ 1026.32 and 1026.34.[102]

The Bureau is not proposing any changes to § 1026.32 or § 1026.34 in this proposed rule. Thus, if the proposed rule is finalized as proposed, the high-cost loan requirements implemented in §§ 1026.32 and 1026.34 would apply to PACE transactions that meet the definition of high-cost mortgage in § 1026.32(a)(1) in the same way that they apply to other high-cost mortgages.[103] The Bureau requests comment on whether any clarification is required through rulemaking or otherwise with respect to how HOEPA's provisions as implemented in Regulation Z apply to PACE transactions that may qualify as high-cost mortgages. In particular, the Bureau requests comment on the interest rates and late fees that consumers may have to pay in connection with their PACE transactions both before and after default, and whether, for example, late fees that apply to all property taxes should be treated differently from contractually-imposed late fees for purposes of HOEPA's limitations on late fees[104] as implemented in § 1026.34(a)(8).

1026.35 Requirements for Higher-Priced Mortgage Loans

35(b) Escrow Accounts

35(b)(2) Exemptions

35(b)(2)(i)

35(b)(2)(i)(E)

TILA section 129D generally requires creditors to establish escrow accounts for certain higher-priced mortgage loans (HPMLs).[105] Regulation Z implements this requirement in § 1026.35(a) and (b), defining an HPML as a closed-end consumer credit transaction secured by the consumer's principal dwelling with an APR exceeding the average prime offer rate (APOR)[106] for a comparable transaction by a certain number of percentage points.[107] With certain exemptions, Regulation Z § 1026.35(b) prohibits creditors from extending HPMLs secured by first liens on consumers' principal dwellings unless an escrow account is established before consummation for payment of property taxes, among other charges (HPML escrow requirement). The Bureau is unaware of any PACE transactions that require consumers to escrow property tax payments or other charges, whether or not the PACE transaction could be characterized as an HPML. The Bureau believes that requiring escrow accounts for PACE transactions that would be subject to the HPML escrow requirement would provide little or no benefit to consumers while imposing substantial burden on industry. The Bureau proposes to add § 1026.35(b)(2)(i)(E) to exempt PACE transactions from the HPML escrow requirement.

The Bureau believes that a mandatory escrow requirement would provide little or no benefit to PACE borrowers. According to the Bureau's PACE data, nearly three-fourths of PACE borrowers had a mortgage at the time their PACE transactions were funded.[108] As a result, a large proportion of PACE borrowers already may have escrow accounts through their pre-existing mortgage loan.[109] For PACE borrowers for whom this is true, PACE payments are already incorporated into the mortgage escrow accounts as part of the property tax payment. Those borrowers who do not have a pre-existing escrow account are already paying their property taxes and any other traditionally escrowed charges on their own and likely do not need or perhaps even want an escrow account. Because the PACE charges are billed with the property taxes, the Bureau believes that it is unlikely that such borrowers will mistakenly neglect to pay them.

Additionally, escrow accounts for PACE transactions would be governed by rules in Regulation X.[110] The rules include a variety of detailed requirements governing, for example, escrow account analyses, escrow account statements, and the treatment of surpluses, shortages, and deficiencies in escrow accounts.[111] The Bureau believes the additional cost and burden to comply with these requirements in this context would not be warranted given the lack of consumer benefit.[112]

Further, Federal law requires certain escrow account disclosures, including escrow account statements required under Regulation X[113] and escrow-related elements of the TILA–RESPA integrated disclosure forms required under Regulation Z,[114] that could be confusing in the context of PACE transactions. A defining feature of PACE is that the loans are paid back through the property tax system. The escrow account disclosures were developed to address more traditional escrow accounts; they would not effectively communicate that an escrow account for a PACE transaction would collect the principal and interest payments as part of the property tax payment. These disclosures would not be required if the Bureau finalizes this proposal—Regulation X does not require escrow account statements if there will be no escrow account,[115] and the TILA–RESPA integrated disclosure forms would not be required to disclose escrow-related information for PACE transactions.[116] Additionally, the escrow account disclosures may create uncertainty about whether the PACE transaction affects the consumer's pre-existing mortgage escrow account when applicable.

The Bureau notes that some of the consumer protection concerns that

[101] *See* 15 U.S.C. 1602(bb), 1639.

[102] 12 CFR part 1026.

[103] A mortgage is generally a high-cost mortgage if (1) the spread between the APR and the average prime offer rate (APOR) is greater than 6.5 percentage points for a first-lien transaction or 8.5 percentage points for a subordinate-lien transaction, (2) points and fees exceed 5 percent of the total loan amount (for loans under $20,000) or the lesser of 8 percent or $1,000 (for loans over $20,000), or (3) the creditor can charge prepayment penalties more than 36 months after consummation or in an amount exceeding 2 percent of the amount prepaid. 12 CFR 1026.32(a)(1). As discussed in the PACE Report, the Bureau estimates that a small percentage of PACE transactions would exceed the APR–APOR spread trigger, while over one-third of existing PACE transactions have points and fees that would exceed the HOEPA points and fees coverage trigger. PACE Report, *supra* note 12, at 15.

[104] 15 U.S.C. 1639(k).

[105] 15 U.S.C. 1639d.

[106] Section 1026.35(a)(2) defines APOR as an APR that is derived from average interest rates, points, and other loan pricing terms currently offered to consumers by a representative sample of creditors for mortgage transactions that have low-risk pricing characteristics. The Bureau publishes APORs for a broad range of types of transactions in a table updated at least weekly as well as the methodology the Bureau uses to derive these rates.

[107] Section 1026.35(a)(1) defines HPML to mean "a closed-end consumer credit transaction secured by the consumer's principal dwelling with an APR that exceeds the APOR for a comparable transaction as of the date the interest rate is set" by at least 1.5, 2.5, or 3.5 percentage points depending on the lien priority and the size of the loan relative to the maximum principal obligation eligible for purchase by Freddie Mac.

[108] *See* PACE Report, *supra* note 12, at 12.

[109] *See* Adam H. Langley, Lincoln Inst. Of Land Pol'y, *Improving the Property Tax by Expanding Options for Monthly Payments,* at 2 (Jan. 2018), *https://www.lincolninst.edu/sites/default/files/pubfiles/langley-wp18al1_0.pdf* (stating that, in 2015, 44 percent of U.S. homeowners paid their property taxes as a part of their monthly mortgage payment).

[110] *See generally* Regulation X, 12 CFR 1024.17.

[111] *Id.*

[112] Commenters to the 2008 HPML escrow rule estimated that the cost could range between one million and $16 million for a large creditor. *See* 73 FR 44521, 44558 (July 30, 2008).

[113] *See* 12 CFR 1024.17(g)–(j).

[114] *See* 12 CFR 1026.37, .38.

[115] *See generally* 12 CFR 1024.17.

[116] As discussed in the section-by-section analyses of §§ 1026.37(p) and 1026.38(u) below, the Bureau is proposing to eliminate certain escrow-related fields from the TILA–RESPA integrated disclosure forms, and the remaining escrow-related fields can generally be left blank on the TILA–RESPA integrated disclosure forms if there is no escrow account associated with the transaction.

prompted the Board to adopt the initial HPML escrows rule do not apply in the same way to the PACE market. The Board first implemented the HPML escrow requirement in Regulation Z in 2008, before the requirement was codified in TILA, relying on its authority to prohibit deceptive or unfair acts or practices.[117] The Board's HPML rule was originally intended to protect consumers who receive relatively high interest rates. The Board was concerned that market pressures discouraged creditors from offering escrow accounts to borrowers getting subprime loans, increasing the risk that these consumers would base borrowing decisions on an unrealistically low assessment of their mortgage-related obligations. In contrast, PACE borrowers for whom the HPML escrow requirement would apply will already be paying property taxes as a function of homeownership, and the Bureau understands that PACE transactions do not generally require any mortgage-related insurance. To the extent consumers do lack information about their overall payment obligations, and to the extent this could lead to them receiving unaffordable PACE loans, the Bureau believes such concerns are better addressed through other TILA provisions, including the TILA–RESPA integrated disclosures and ATR requirements that are tailored to PACE as discussed in the section-by-section analyses below.[118]

One ANPR comment letter from consumer groups advocated for applying the HPML escrow requirement for PACE consumers without an existing mortgage escrow, to help spread out payments. The Bureau recognizes that having the option to break up property tax payments into smaller amounts could be helpful to taxpayers generally and particularly to taxpayers with PACE accounts who do not already have a pre-existing mortgage with an escrow account.[119] The Bureau believes it would be beneficial if local taxing authorities facilitated the spreading-out of payments for PACE borrowers[120] but does not believe that requiring an escrow account for PACE HPMLs would be the best way to accomplish this.

The Bureau is proposing this exemption pursuant to TILA sections 105(a) and 105(f). For the reasons discussed in this section-by-section analysis, the Bureau believes that exempting PACE transactions from the requirements of TILA section 125D is proper to carry out the purposes of TILA. As described above, the Bureau believes that the requirements of TILA section 125D would significantly complicate, hinder, and make more expensive the credit process for PACE transactions. The Bureau thus has preliminarily determined that the goal of consumer protection would not be undermined by this exemption.

TILA–RESPA Integrated Disclosure Requirements Implemented Under Sections 1026.37 and 1026.38

The CFPA directed the Bureau to integrate the mortgage loan disclosures required under TILA and RESPA sections 4 and 5, and to publish model disclosure forms to facilitate compliance.[121] The Bureau issued regulatory requirements and model forms to satisfy these statutory obligations in 2013 (2013 TILA–RESPA Rule).[122] The requirements and forms generally apply to closed-end consumer credit transactions secured by real property or a cooperative unit, other than a reverse mortgage subject to § 1026.33.[123]

The integrated disclosures consist of two forms: a Loan Estimate and a Closing Disclosure. The Loan Estimate provides the consumer with good faith estimates of credit costs and transaction terms. It is designed to provide disclosures that are helpful to consumers in understanding the key features, costs, and risks of the mortgage for which they are applying.[124] In general, the Loan Estimate must be provided to consumers within three business days after they submit a loan application[125] and not later than the seventh business day before consummation.[126] The Closing Disclosure is a final disclosure reflecting the actual terms of the transaction. In general, the Closing Disclosure must be provided to the consumer three business days before consummation of the transaction.[127]

As the Bureau explained in the 2013 TILA–RESPA Rule, the TILA–RESPA integrated disclosure forms use clear language and design to make it easier for consumers to locate key information, such as interest rate, periodic payments, and loan costs.[128] The forms also provide information to help consumers decide whether they can afford the loan and to compare the cost of different loan offers, including the cost of the loans over time.[129] These benefits are important for PACE borrowers just as they are for other mortgage borrowers.

The Bureau believes that certain elements of the current TILA–RESPA integrated disclosures may benefit from adaptation so that the forms more effectively disclose information about PACE transactions in view of their unique nature. The Bureau proposes the modifications to the Loan Estimate and Closing Disclosure described below. Where this proposal would not provide a PACE-specific version of a particular provision, the existing requirements in §§ 1026.37 and 1026.38 would apply. As with other mortgage transactions, elements of the forms that are not applicable for PACE transactions may generally be left blank.[130] The Bureau requests comment on the proposed amendments and on any further amendments that may improve consumer understanding for PACE transactions. The Bureau is proposing model forms in appendix H–24(H) (Loan Estimate) and appendix H–25(K) (Closing Disclosure) reflecting the proposed PACE-specific implementation of the TILA–RESPA integrated disclosure requirements.

The Bureau is not proposing amendments to the timing requirements for the Loan Estimate and Closing Disclosure for PACE transactions. The Bureau explained in the 2013 TILA–RESPA Rule that the seven-business-day waiting period between provision of the Loan Estimate and consummation is intended to effectuate the purposes of both TILA and RESPA by enabling the informed use of credit and ensuring effective advance disclosure of settlement charges.[131] The Bureau

[117] 73 FR 44521 (July 30, 2008). The requirement was later codified in TILA section 129D, 15 U.S.C. 1639d.

[118] *See* section-by-section analyses of proposed §§ 1026.37, 1026.38, 1026.43, *infra.*

[119] Langley, *Improving the Property Tax by Expanding Options for Monthly Payments, supra* note 109, at 7.

[120] *See generally id.* (encouraging local governments to expand options for consumers to pay property taxes on a monthly basis).

[121] CFPA sections 1098 & 1100A, codified at 12 U.S.C. 2603(a) & 15 U.S.C. 1604(b), respectively.

[122] *See* 78 FR 80225 (Dec. 31, 2013); 80 FR 43911 (July 24, 2015). The TILA–RESPA integrated disclosure requirements have been amended several times. *See https://www.consumerfinance.gov/rules-policy/final-rules/2013-integrated-mortgage-disclosure-rule-under-real-estate-settlement-procedures-act-regulation-x-and-truth-lending-act-regulation-z/.*

[123] *See* § 1026.19(e)(1) and (f)(1).

[124] *See* 78 FR 79730, 80225 (Dec. 31, 2013).

[125] *See* § 1026.2(a)(3)(ii) (defining ''application'' for these purposes as one that ''consists of the submission of the consumer's name, the consumer's income, the consumer's social security number to obtain a credit report, the property address, an estimate of the value of the property, and the mortgage loan amount sought'').

[126] Section 1026.19(e)(1)(iii)(A)–(B).

[127] Section 1026.19(f)(1)(ii)(A).

[128] 78 FR 79730, 80225 (Dec. 31, 2013).

[129] *Id.*

[130] *See* comments 37–1 and 38–1.

[131] 78 FR 79730, 79802–03 (Dec. 31, 2013); *see also id.* at 79806–07 (reasoning in context of considering amendments to bona fide personal financial emergencies that, at least with respect to

Continued

explained that the three-business-day-period following provision of the Closing Disclosure greatly enhances consumer awareness and understanding of the costs associated with the mortgage transaction.[132] As with the substantive disclosures, the timing requirements are important to PACE borrowers, particularly given concerns that the origination process for some PACE borrowers may not provide enough time to understand the obligation and shop for other financing options.[133]

The Bureau is proposing the implementation of the disclosure requirements described in the section-by-section analyses of proposed §§ 1026.37(p) and 1026.38(u) pursuant to its authority under TILA section 105(a) and 105(f), and RESPA section 19(a). For the reasons discussed in the respective section-by-section analyses, the Bureau believes, in its initial analysis, that the proposed implementation would be necessary and proper to carry out the purposes of TILA and RESPA. The proposed provisions that would implement the disclosure requirements under TILA section 105(a), including adjustments or exceptions discussed in the applicable section-by-section analyses, are intended to assure a meaningful disclosure of credit terms, avoid the uninformed use of credit, or facilitate compliance with TILA. In general, the proposed changes are intended to make the Loan Estimate and Closing Disclosure more effective and understandable for PACE borrowers, and to facilitate compliance given the unique nature of PACE transactions. The Bureau believes that the proposed provisions that would implement the disclosure requirements under RESPA section 19(a), including interpretations discussed in the applicable section-by-section analysis, would further the purposes of RESPA and be consistent with the Bureau's authority under RESPA section 19(a).

For the reasons discussed in the respective section-by-section analyses, the Bureau is proposing various exemptions in §§ 1026.37(p) and 1026.38(u) pursuant to its authority under TILA section 105(a) and 105(f). With respect to TILA section 105(a), the Bureau believes, in its initial analysis, that the proposed exemptions would be necessary and proper to carry out TILA's purposes, including by assuring the meaningful disclosure of credit terms and avoiding the uninformed use of credit. Additionally, with respect to TILA section 105(f), the Bureau's preliminary determination, after considering the factors in TILA section 105(f)(2), is that the disclosures proposed to be exempted would not provide meaningful benefit to consumers in the form of useful information or protection. In the Bureau's preliminary analysis, the exempted disclosure requirements would significantly complicate, hinder, or make more expensive credit for PACE transactions, and the exemptions would not undermine the goal of consumer protection. Where the Bureau believes that doing so would help assure the meaningful disclosure of credit terms and avoid the uninformed use of credit, the proposal would replace the exempted disclosures with disclosures that serve similar purposes to the existing disclosures, but that would better fit the context of PACE transactions.

Section 1026.37 Content of Disclosures for Certain Mortgage Transactions (Loan Estimate)

37(p) PACE Transactions

Section 1026.37 implements the TILA–RESPA integrated disclosure requirements by setting forth the requirements for the Loan Estimate. Proposed § 1026.37(p)(1)–(7) would set forth modifications to the Loan Estimate requirements for ''PACE transactions,'' as defined under proposed § 1026.43(b)(15), to account for the unique nature of PACE.

37(p)(1) Itemization

TILA section 128(a)(6), (a)(16), (b)(2)(C), and (b)(4) are currently implemented in part by § 1026.37(c)(1) through (5), which generally requires creditors to disclose a table itemizing each separate periodic payment or range of payments, among other information, under the heading ''Projected Payments.'' As part of the projected payments table, the creditor is required to state the total periodic payment under § 1026.37(c)(2)(iv), as well as the constituent parts of the total periodic payment under § 1026.37(c)(2)(i) through (iii). Relevant here, § 1026.37(c)(2)(iii) generally requires a field for the disclosure of the amount payable into an escrow account to pay for some or all mortgage-related obligations, as applicable, labeled ''Escrow,'' together with a statement that the amount disclosed can increase over time. Proposed § 1026.37(p)(1) would exempt PACE transactions from the escrow account payment disclosure requirements implemented under § 1026.37(c)(2)(iii).

As discussed in the section-by-section analysis of proposed § 1026.35(b)(2)(i)(E), the Bureau is unaware of any PACE transactions that carry their own escrow accounts. Thus, the escrow account payment field under § 1026.37(c)(2)(iii) would generally be left blank if it were included on the Loan Estimate associated with any PACE transaction.[134] This blank entry could cause confusion for PACE borrowers who pay their property taxes into pre-existing escrow accounts associated with non-PACE mortgage loans, since PACE transactions are typically part of the property tax payment. It also could create doubt for the consumer about whether the PACE transaction will be repaid through the existing escrow account. The Bureau believes the proposed exemption would mitigate this risk.

37(p)(2) Taxes, Insurance, and Assessments

TILA sections 128(a)(16) and 128(b)(4)(A) are currently implemented in part by § 1026.37(c)(4)(ii). Section 1026.37(c)(4) requires creditors to include in the projected payments table[135] information about taxes, insurance, and assessments, with the label ''Taxes, Insurance & Assessments.'' Section 1026.37(c)(4)(ii) generally requires disclosure of the sum of mortgage-related obligations, including property taxes, insurance premiums, and other charges.[136] Section 1026.37(c)(4)(iii) through (vi) requires various statements about this disclosure. Under proposed § 1026.37(p)(2)(i) and

relatively large mortgage loans, the seven-business-day-waiting-period would provide consumers a meaningful opportunity to shop for a loan, compare available financing options, and negotiate favorable terms, and that the seven-business-day-waiting period ''is the minimum amount of time'' in which consumers could meaningfully do so).

[132] 78 FR 79730, 79847 (Dec. 31, 2013).

[133] *See* part II.A.4, *supra.*

[134] See existing comment 37–1, which provides that a portion of the Loan Estimate that is inapplicable may generally be left blank. (Existing comment 38–1 provides similarly for the Closing Disclosure.)

[135] As noted in the section-by-section analysis of proposed § 1026.37(p)(1), § 1026.37(c) generally requires creditors to disclose a table itemizing each separate periodic payment or range of payments, among other information, under the heading ''Projected Payments.''

[136] Section 1026.37(c)(4)(ii) requires disclosure of ''[t]he sum of the charges identified in § 1026.43(b)(8), other than amounts identified in § 1026.4(b)(5), expressed as a monthly amount, even if no escrow account for the payment of some or any of such charges will be established.'' Section 1026.43(b)(8) defines mortgage-related obligations as ''property taxes; premiums and similar charges identified in § 1026.4(b)(5), (7), (8), and (10) that are required by the creditor; fees and special assessments imposed by a condominium, cooperative, or homeowners association; ground rent; and leasehold payments.'' See also the section-by-section analysis of proposed § 1026.37(p)(8)(i) for discussion of the applicable unit-period for PACE transactions.

(ii), the Bureau would retain most of these requirements for PACE transactions, with changes to the disclosures currently required under § 1026.37(c)(4)(iv), (v), and (vi) for PACE transactions.

Currently, § 1026.37(c)(4)(iv) requires a statement of whether the sum of mortgage-related obligations disclosed pursuant to § 1026.37(c)(4)(ii) includes payments for property taxes, certain insurance premiums, or other charges.[137] Section 1026.37(c)(4)(iv) currently does not require a more specific statement regarding the PACE payment, separate from other property tax obligations. The Bureau is proposing § 1026.37(p)(2)(i) to provide such specificity. Proposed § 1026.37(p)(2)(i) would require a statement of whether the amount disclosed pursuant to § 1026.37(c)(4)(ii) includes payments for the PACE transaction and, separately, whether it includes payments for the non-PACE portions of the property tax payment. The statement about the PACE loan payment would be labeled ''PACE Payment,'' and the statement about the other property taxes would be labeled ''Property Taxes (not including PACE loan).'' Besides having a more specific statement regarding the PACE payment separate from the other property taxes, the other components regarding certain insurance premiums or other charges would continue to be disclosed under proposed § 1026.37(p)(2)(i) similar to how they are disclosed under current § 1026.37(c)(4)(iv). The Bureau believes these proposed changes would help consumers understand the unique nature of PACE and reinforce that the PACE transaction will increase the consumer's property tax payment.

Section 1026.37(c)(4)(iv) also currently requires creditors to state whether the constituent parts of the taxes, insurance, or assessments will be paid by the creditor using escrow account funds. Proposed § 1026.37(p)(2)(i) would eliminate this requirement for PACE transactions. Omitting this information would avoid potential consumer confusion for similar reasons as explained in the section-by-section analysis of proposed § 1026.37(p)(1).

The Bureau is also proposing amendments to the requirements in § 1026.37(c)(4)(v) and (vi). Currently, § 1026.37(c)(4)(v) requires a statement that the consumer must pay separately any amounts described in § 1026.37(c)(4)(ii) that are not paid by the creditor using escrow account funds; and § 1026.37(c)(4)(vi) requires a reference to escrow account information, required under § 1026.37(g)(3), located elsewhere on the Loan Estimate. Proposed § 1026.37(p)(2)(ii) would replace these disclosures with the following for PACE transactions: (1) a statement that the PACE transaction, described in plain language as a ''PACE loan,'' will be part of the property tax payment; and (2) a statement directing the consumer, if the consumer has a pre-existing mortgage with an escrow account, to contact the consumer's mortgage servicer for what the consumer will owe and when. The Bureau believes the proposed disclosures would promote consumer understanding of PACE transactions and their effect on any pre-existing mortgage loans, and that omitting the two existing disclosures would not impair consumer understanding of the transaction.

37(p)(3) Contact Information

TILA section 128(a)(1) is currently implemented in part by § 1026.37(k), which requires disclosure of certain contact information, under the heading ''Additional Information About this Loan.''[138] In general, a creditor must disclose: (1) the name and NMLSR ID,[139] license number, or other unique identifier issued by the applicable jurisdiction or regulating body for the creditor, labeled ''Lender,'' and mortgage broker, labeled ''Mortgage Broker,'' if any; (2) similar information for the individual loan officer, labeled ''Loan Officer,'' of the creditor and the mortgage broker, if any, who is the primary contact for the consumer; and (3) the email address and telephone number of the loan officer. Section 1026.37(k)(1) through (3) further provides that, in the event the creditor, mortgage broker, or loan officer has not been assigned an NMLSR ID, the license number or other unique identifier issued by the applicable jurisdiction or regulating body with which the creditor or mortgage broker is licensed and/or registered shall be disclosed, with the abbreviation for the State of the applicable jurisdiction or regulating body.

Proposed § 1026.37(p)(3) would additionally require similar disclosures for PACE companies if such information is not disclosed under the requirements described above. Specifically, proposed § 1026.37(p)(3) would require disclosure of the PACE company's name, NMLSR ID (labeled ''NMLS ID/License ID''), email address, and telephone number of the PACE company (labeled ''PACE Company''). Similar to § 1026.37(k)(1) through (3)'s existing requirements with respect to creditors, mortgage brokers, and loan officers, proposed § 1026.37(p)(3) would provide that, in the event that the PACE company has not been assigned an NMLSR ID, the creditor must disclose on the Loan Estimate the license number or other unique identifier issued by the applicable jurisdiction or regulating body with which the PACE company is licensed and/or registered, along with the abbreviation for the State of the applicable jurisdiction or regulatory body stated before the word ''License'' in the label, if any. These disclosures would not be required if the PACE company's contact information is otherwise disclosed pursuant to § 1026.37(k)(1) through (3). Proposed comment 37(p)(3)–1 would clarify that, for example, if the PACE company is a mortgage broker as defined in § 1026.36(a)(2), then the PACE company is disclosed as a mortgage broker and the field for PACE company may be left blank.

As explained in the 2013 TILA–RESPA Rule, disclosing the name and NMLSR ID number, if any, for the creditor, mortgage broker, and loan officers employed by such entities provides consumers with the information they need to conduct the due diligence necessary to ensure that these parties are appropriately licensed.[140] Having this information may also help consumers assess the risks associated with services and service providers associated with the

[137] Section 1026.37(c)(4)(iv) refers to ''payments for property taxes, amounts identified in § 1026.4(b)(8), and other amounts described in'' § 1026.37(c)(4)(ii). Section 1026.4(b)(8), in turn, refers to ''[p]remiums or other charges for insurance against loss of or damage to property, or against liability arising out of ownership or use of property, written in connection with a credit transaction.'' Additionally, the Bureau notes that a creditor issuing a simultaneous loan that is a PACE transaction would generally be required to include the simultaneous PACE loan in calculating the sum of taxes, assessments, and insurance described in § 1026.37(c)(4)(ii), since the simultaneous PACE loan would increase the consumer's property tax payment. This is consistent with existing comment 19(e)(1)(i)–1, which cross-references existing § 1026.17(c)(2)(i) and generally provides that creditors must make TILA–RESPA integrated disclosures based on the best information reasonably available to the creditor at the time the disclosure is provided to the consumer. As discussed in the section-by-section analysis of § 1026.43(c)(2)(iv), the Bureau is also proposing to clarify that a creditor originating a PACE transaction knows or has reason to know of simultaneous loans that are PACE transactions if the transactions are included in any existing database or registry of PACE transactions that includes the geographic area in which the property is located and to which the creditor has access.

[138] Section 1026.37(k) also integrates the disclosure of certain information required under appendix C to Regulation X.

[139] Under § 1026.37(k)(1), the NMLS ID refers to the Nationwide Mortgage Licensing System and Registry identification number.

[140] 78 FR 79730, 79975–76 (Dec. 31, 2013).

transaction, which in turn serves the purposes of TILA, RESPA, and the CFPA and Dodd-Frank Act.[141] The Bureau believes that similar considerations apply to the disclosure of the PACE company.

Proposed § 1026.37(p)(3) would reference proposed § 1026.43(b)(14) for the definition of ''PACE company.'' As explained in the section-by-section analysis of proposed § 1026.43(b)(14), ''PACE company'' means a person, other than a natural person or a government unit, that administers the program through which a consumer applies for or obtains PACE financing.

The Bureau seeks comment on proposed § 1026.37(p)(3) generally, and on whether to require the contact information for the PACE company under the ''PACE Company'' heading in all cases, instead of under the ''Mortgage Broker'' heading when applicable.

37(p)(4) Assumption

TILA section 128(a)(13) is currently implemented in part by § 1026.37(m)(2), which requires the creditor to disclose a statement of whether a subsequent purchaser of the property may be permitted to assume the remaining loan obligation on its original terms, labeled ''Assumption.'' This existing disclosure requirement could be misleading for PACE transactions. In general, PACE payment obligations can transfer with the sale of the property, such that the subsequent property owner would be required to pay the remaining obligation as a function of property ownership. However, the new homeowners generally do not technically assume the loans.

Proposed § 1026.37(p)(4) would instead require a statement reflecting a PACE-specific risk that stakeholders have indicated sometimes occurs when consumers try to transfer the PACE obligation by selling the property. The proposed statement would state that, if the consumer sells the property, the buyer or the buyer's mortgage lender may require the consumer to pay off the PACE transaction as a condition of the sale. For clarity, proposed § 1026.37(p)(4) requires the creditor to label this disclosure ''Selling the Property'' and use of the term ''PACE loan'' in the disclosure. The Bureau believes the proposed disclosure would further the purposes of TILA by providing useful information about key risks of PACE loans, thus avoiding the uninformed use of credit.

[141] *See id.*

37(p)(5) Late Payment

TILA section 128(a)(10) is currently implemented in part by § 1026.37(m)(4), which requires the creditor to disclose a statement detailing any charge that may be imposed for a late payment, stated as a dollar amount or percentage charge of the late payment amount, and the number of days that a payment must be late to trigger the late payment fee, labeled ''Late Payment.'' Unlike non-PACE mortgage loans, however, late payment charges for PACE transactions are typically determined by taxing authorities as part of the overall property tax payment. It may be challenging to disclose all late charges that may be associated with a property tax delinquency succinctly and effectively on the Loan Estimate, either under existing § 1026.37(m)(4) or otherwise. The Bureau understands that some States impose several types of late charges, some of which can change as the delinquency persists or depend on factors that are unknown at the time of the disclosure.

To avoid potential confusion for consumers and ensure the Loan Estimate includes useful information about the charges a PACE borrower might accrue in delinquency, the Bureau proposes to implement TILA section 128(a)(10) for PACE transactions by requiring the disclosure in proposed § 1026.37(p)(5) rather than the existing disclosure in § 1026.37(m)(4). Proposed § 1026.37(p)(5) would require creditors, to include one or more statements relating to late charges, as applicable. First, proposed § 1026.37(p)(5)(i) would require a statement detailing any charge specific to the PACE transaction that may be imposed for a late payment, stated as a dollar amount or percentage charge of the late payment amount, and the number of days that a payment must be late to trigger the late payment fee, labeled ''Late Payment.'' Proposed comment 37(p)(5)–1 would clarify that a charge is specific to the PACE transaction if the property tax collector does not impose the same charges for general property tax delinquencies. Although the Bureau is not aware of PACE transactions that impose such PACE-specific late charges, if any PACE transactions do provide for it, disclosure of late payment information would be incomplete without it. If a PACE transaction does not provide for it, the disclosure would not be required.

Second, proposed § 1026.37(p)(5)(ii) would require, for any charge that is not specific to the transaction, either (1) a statement notifying the consumer that, if the consumer's property tax payment is late, they may be subject to penalties and late fees established by their property tax collector, as well as a statement directing the consumer to contact the tax collector for more information; or (2) a statement describing any charges that may result from property tax delinquency that are not specific to the PACE transaction, which may include dollar amounts or percentage charges and the number of days a payment must be late to trigger the fee. Proposed § 1026.37(p)(5)(ii) would provide flexibility for the creditor while ensuring that the Loan Estimate contains useful information about charges that may result from a property tax delinquency.

The Bureau solicits comment on whether it should require creditors to disclose specific late-payment information and, if so, what information to require.

37(p)(6) Servicing

RESPA section 6(a) is currently implemented by § 1026.37(m)(6), which requires the creditor to disclose a statement of whether the creditor intends to service the loan or transfer the loan to another servicer, using the label ''Servicing.'' PACE transactions are not subject to transfer of servicing rights as far as the Bureau is aware. Thus, the Bureau is proposing to implement RESPA section 6(a) for PACE transactions by requiring a servicing-related disclosure that would be more valuable for PACE borrowers.

Proposed § 1026.37(p)(6) would require the PACE creditor to provide a statement that the consumer will pay the PACE transaction, using the term ''PACE loan,'' as part of the consumer's property tax payment. Proposed § 1026.37(p)(6) would also require a statement directing the consumer, if the consumer has a mortgage escrow account that includes the consumer's property tax payment, to contact the consumer's mortgage servicer for what the consumer will owe and when. Proposed § 1026.37(p)(6) would preserve the label ''Servicing'' for the disclosure. The Bureau believes that proposed § 1026.37(p)(6) would promote the informed use of credit.

37(p)(7) Exceptions

37(p)(7)(i) Unit-Period

Because PACE transaction payments are repaid with the property taxes once or twice a year, the applicable unit-period would typically be annual or semi-annual. The proposed model form for PACE under proposed appendix H–24(H) would use ''annual'' in the tables disclosing loan terms and projected payments. Proposed § 1026.37(p)(7)(i) would provide that, wherever the proposed form uses ''annual'' to describe the frequency of any payments or the applicable unit-period, the creditor shall use the appropriate term to reflect the transaction's terms, such as semi-annual payments. Proposed § 1026.37(p)(7)(i) would be similar to existing § 1026.37(o)(5), which permits unit-period changes wherever the Loan Estimate or § 1026.37 uses ''monthly'' to describe the frequency of any payments or uses ''month'' to describe the applicable unit-period.[142]

37(p)(7)(ii) PACE Nomenclature

The Bureau understands that PACE companies may market PACE loans to consumers using brand names that do not include the term ''Property Assessed Clean Energy'' or the acronym ''PACE.'' To improve the Loan Estimate's utility and understandability, proposed § 1026.37(p)(7)(ii) would clarify that, wherever § 1026.37 requires disclosure of the term ''PACE'' or the proposed model form in appendix H–24(H) uses the term ''PACE,'' the creditor may substitute the name of a specific PACE financing program that will be recognizable to the consumer. Proposed comment 37(p)(7)(ii)–1 would provide an example of how a creditor may substitute the name of a specific PACE financing program that is recognizable to the consumer as PACE on the form.

Section 1026.38 Content of Disclosures for Certain Mortgage Transactions (Closing Disclosure)

38(u) PACE Transactions

Section 1026.38 implements the TILA–RESPA integrated disclosure requirements by setting forth the requirements for the Closing Disclosure. Proposed § 1026.38(u)(1)–(9) would set forth modifications to the Closing Disclosure requirements under § 1026.38 for ''PACE transactions,'' as defined under proposed § 1026.43(b)(15), to account for the unique nature of PACE.

38(u)(1) Transaction Information

TILA section 128(a)(1) is currently implemented in part by § 1026.38(a)(4), which requires disclosure of identifying information for the borrower, the seller, where applicable, and the lender,[143] under the heading ''Transaction Information.''[144] Proposed § 1026.38(u)(1) would additionally require the Closing Disclosure for a PACE transaction to include the name of any PACE company involved in the transaction, labeled ''PACE Company.'' It would refer to proposed § 1026.43(b)(14) for the definition of ''PACE company'' for these purposes: a person, other than a natural person or a government unit, that administers the program through which a consumer applies for or obtains PACE financing.

As the Bureau explained in the 2013 TILA–RESPA Rule, disclosing the identifying information for the borrower, seller, and lender is intended to effectuate statutory purposes by promoting the informed use of credit.[145] The Bureau believes disclosing the PACE company's identifying information would do the same.[146]

38(u)(2) Projected Payments

TILA section 128(a)(6), (a)(16), (b)(2)(C), and (b)(4) is currently implemented in part by § 1026.38(c). Under § 1026.38(c)(1), the Closing Disclosure must disclose the information in the projected payments table required on the Loan Estimate under § 1026.37(c)(1)–(4),[147] with certain exceptions. These disclosures generally include the total periodic payment, as well as an itemization of the periodic payment's constituent parts. Additionally, § 1026.38(c)(2) requires the projected payments table on the Closing Disclosure to include a statement referring the consumer to a detailed disclosure of escrow account information located elsewhere on the form.

Proposed § 1026.38(u)(2) would retain the existing structure of the projected payments table but would (1) eliminate the field for escrow account information that is part of the periodic payment disclosure currently required under § 1026.37(c)(2)(iii); (2) require the creditor to disclose whether the amount disclosed for estimated taxes, insurance, and assessments includes payments for the PACE transaction and, separately, whether it includes the non-PACE portions of the property tax payment, with corresponding labels for both; and (3) require a statement that the PACE transaction will be part of the property tax payment and a statement directing the consumer, if they have a mortgage with an escrow account, to contact their mortgage servicer for what they will owe and when. Additionally, proposed § 1026.38(u)(2) would require the creditor to omit the existing reference to detailed escrow account information located elsewhere on the form. With these proposed amendments, the projected payments table for the Closing Disclosure in a PACE transaction would mirror that on the Loan Estimate as amended under proposed § 1026.37(p)(1) and (2). The Bureau is proposing these changes for the same reasons as set forth in the section-by-section analyses of proposed § 1026.37(p)(1) and (2) above.

38(u)(3) Assumption

TILA section 128(a)(13) is currently implemented in part by § 1026.38(l)(1), which requires the information described in § 1026.37(m)(2) to be provided on the Closing Disclosure under the subheading ''Assumption.'' Section 1026.37(m)(2) requires the creditor to disclose a statement of whether a subsequent purchaser of the property may be permitted to assume the remaining loan obligation on its original terms. As discussed in the section-by-section analysis of proposed § 1026.37(p)(4), the Bureau understands that this disclosure would not be as relevant for PACE transactions, since subsequent property owners typically would not assume PACE obligations. For the reasons discussed in the section-by-section analysis of proposed § 1026.37(p)(4), proposed § 1026.38(u)(3) would thus implement TILA section 128(a)(13) for PACE transactions by requiring the creditor to use the subheading ''Selling the Property'' and to disclose the information required by § 1026.37(p)(4) in place of the information required under § 1026.38(l)(1).

38(u)(4) Late Payment

TILA section 128(a)(10) is currently implemented in part by § 1026.38(l)(3), which requires the creditor to disclose on the Closing Disclosure the information described in § 1026.37(m)(4) under the subheading ''Late Payment.'' It requires a statement detailing any charge that may be

[142] Comment 37(o)(5)–4 explains that, for purposes of § 1026.37, the term ''unit-period'' has the same meaning as in appendix J to Regulation Z.

[143] For purposes of § 1026.38(a)(4)(iii), the lender is defined as ''the name of the creditor making the disclosure.'' In relevant part, the ''creditor'' is a ''person who regularly extends consumer credit that is subject to a finance charge or is payable by written agreement in more than four installments (not including a down payment), and to whom the obligation is initially payable.'' *See* § 1026.2(a)(17). As noted in the section-by-section analysis of proposed § 1026.2(a)(14), government sponsors are typically the creditors for PACE transactions.

[144] Section 1026.38(a)(4) also integrates the disclosure of certain information required under appendix A to Regulation X.

[145] 78 FR 79730, 80002–03 (Dec. 31, 2013).

[146] See part II.A.1 for discussion of the central role PACE companies often play in PACE transactions.

[147] Section 1026.37(c)(1)–(3) requires information about the initial periodic payment or range of payments; and § 1026.37(c)(4) requires information about estimated taxes, insurance, and assessments. The Bureau is proposing changes to these disclosure requirements for PACE transactions as described in the section-by-section analysis of proposed § 1026.37(p)(1) and (2).

imposed for a late payment, stated as a dollar amount or percentage charge of the late payment amount, and the number of days that a payment must be late to trigger the late payment fee, labeled ''Late Payment.'' Proposed § 1026.38(u)(4) would make changes relating to the disclosure of late payment charges on the Closing Disclosure for PACE transactions to parallel the changes that would be made in proposed § 1026.37(p)(5) with respect to the Loan Estimate. The Bureau proposes these changes for the same reasons discussed in the section-by-section analysis of proposed § 1026.37(p)(5).

38(u)(5) Partial Payment Policy

TILA section 129C(h) is currently implemented by § 1026.38(l)(5), which requires certain disclosures regarding the lender's acceptance of partial payments under the subheading ''Partial Payments.'' Section 1026.38(l)(5)(i) through (iii) generally requires disclosure of whether the creditor accepts partial payments and, if so, whether the creditor may apply the partial payments or hold them in a separate account. Section 1026.38(l)(5)(iv) requires a statement that, if the loan is sold, the new lender may have a different policy.

For PACE transactions, however, the current partial-payment disclosure may not accurately and effectively reflect partial-payment options for PACE transactions. In general, partial payment policies for PACE transactions are typically set by the taxing authority and not by the creditor. The tax collector may offer payment options not described accurately in the disclosure required under § 1026.38(l)(5), and any payment options would likely apply to the full property tax payment, not only to the PACE payment specifically. Further, if a PACE borrower pays their property taxes into an escrow account on a pre-existing mortgage loan, their PACE loans may be subject to a partial payment policy associated with the pre-existing mortgage loan, which the disclosure of partial-payment policies associated with the creditor for the PACE transaction would not necessarily reflect.

Proposed § 1026.38(u)(5) would avoid potential inaccuracies that might arise under existing requirements and is intended to provide the consumer with useful information as it relates to a PACE transaction. It would require that, in lieu of the information required by § 1026.38(l)(5), the creditor shall disclose a statement directing the consumer to contact the mortgage servicer about the partial payment policy for the account if the consumer has a mortgage escrow account for property taxes, and to contact the tax collector about the tax collector's partial payment policy if the consumer pays property taxes directly to the tax authority.

38(u)(6) Escrow Account

TILA section 129D(h) and 129D(j) is currently implemented in part by § 1026.38(l)(7), which requires a statement of whether an escrow account will be established for the transaction, as well as detailed information about the effects of having or not having an escrow account, under the subheading ''Escrow Account.'' For similar reasons as discussed in the section-by-section analysis for proposed § 1026.37(p)(1) with respect to exempting escrow-related information from the projected payments table on the Loan Estimate for PACE transactions, and because certain elements of the disclosure under § 1026.38(l)(7) could be inaccurate for some PACE borrowers, proposed § 1026.38(u)(6) would exempt creditors in PACE transactions from the requirement to disclose on the Closing Disclosure the information otherwise required under § 1026.38(l)(7).

38(u)(7) Liability After Foreclosure

TILA section 129C(g)(2) and 129C(g)(3) is currently implemented in part by § 1026.38(p)(3), which requires the creditor to disclose certain information about the consumer's potential liability after foreclosure. It requires, under the subheading ''Liability after Foreclosure,'' a brief statement of whether, and the conditions under which, the consumer may remain responsible for any deficiency after foreclosure under applicable State law, a brief statement that certain protections may be lost if the consumer refinances or incurs additional debt on the property, and a statement that the consumer should consult an attorney for additional information.

In general, this disclosure provides useful information for consumers who may have State-law protections against deficiency. However, it may not be applicable in the same way, or at all, with respect to PACE transactions due to their unique nature. Thus, proposed § 1026.38(u)(7) would provide that the creditor shall not disclose the liability-after-foreclosure disclosure described in § 1026.38(p)(3).[148] It would provide that, if the consumer may be responsible for any deficiency after foreclosure or tax sale under applicable State law, the creditor shall instead disclose a brief statement that the consumer may have such responsibility, a description of any applicable protections provided under State anti-deficiency laws, and a statement that the consumer should consult an attorney for additional information. This information would be under the subheading ''Liability after Foreclosure or Tax Sale.'' The Bureau believes this information would be more useful for PACE borrowers than the existing disclosure required under § 1026.38(p)(3), thus helping to avoid the uninformed use of credit.

38(u)(8) Contact Information

TILA section 128(a)(1) is currently implemented in part by § 1026.38(r), which generally requires certain information disclosed in a separate table, under the heading ''Contact Information.''[149] For transactions without a seller, § 1026.38(r) requires specified contact and licensing information for each creditor, mortgage broker, and settlement agent participating in the transaction. Proposed § 1026.38(u)(8) would require the same contact and licensing information for the PACE company if not otherwise disclosed pursuant to § 1026.38(r). As discussed in the section-by-section analysis of proposed § 1026.37(p)(3) and proposed comment 37(p)(3)–1,[150] the PACE company may be a mortgage broker, in which case its information would be required under the existing requirements in § 1026.38(r); proposed § 1026.38(u)(8) would not require the disclosure of the PACE company a second time. As explained in the section-by-section analysis of proposed § 1026.43(b)(14), given the important role that PACE companies play in PACE transactions, the Bureau believes that disclosing their contact information could be useful to consumers and would facilitate the informed use of credit.

38(u)(9) Exceptions

38(u)(9)(i) Unit-Period

To permit creditors the flexibility to disclose the correct unit-period for each PACE transaction, proposed

[148] As described in § 1026.37(m)(7), if the purpose of the credit transaction is to refinance an extension of credit as described in § 1026.37(a)(9)(ii), the Loan Estimate would be required to disclose information about the consumer's liability after foreclosure. The Bureau believes that this disclosure is unlikely to be required on a Loan Estimate for a PACE loan. Therefore the proposal does not currently address such language on the Loan Estimate.

[149] Section 1026.38(r) also integrates the disclosure of certain information required under appendix A and appendix C to Regulation X.

[150] Proposed comment 37(p)(3)–1 explains that a PACE company may be a mortgage broker as defined in § 1026.36(a)(2).

§ 1026.38(u)(9)(i) would provide that, wherever proposed form H–25(K) of appendix H uses ''annual'' to describe the frequency of any payments or the applicable unit-period, the creditor shall use the appropriate term to reflect the transaction's terms, such semi-annual payments. The Closing Disclosure changes in proposed § 1026.38(u)(9)(i) parallel the Loan Estimate changes in proposed § 1026.37(p)(7)(i), and the Bureau is proposing proposed § 1026.38(u)(9)(i) for the same reasons stated in the section-by-section analysis of proposed § 1026.37(p)(7)(i). Proposed § 1026.38(u)(9)(i) is also similar to existing § 1026.38(t)(5)(i), which permits changes wherever the Closing Disclosure or § 1026.38 uses ''monthly'' to describe the frequency of any payments or uses ''month'' to describe the applicable unit-period.'' [151]

38(u)(9)(ii) PACE Nomenclature

The Bureau understands that PACE companies may market to consumers using brand names that do not include the term ''Property Assessed Clean Energy'' or the acronym ''PACE.'' To ensure that consumers understand Closing Disclosures provided for PACE transactions, proposed § 1026.38(u)(9)(ii) would clarify that, wherever § 1026.38 requires disclosure of the term ''PACE'' or the proposed model form in appendix H–25(K) uses the term ''PACE,'' the creditor may substitute the name of a specific PACE financing program that will be recognizable to the consumer. Proposed comment 38(u)(9)(ii)–1 would provide an example of how a creditor may substitute the name of a specific PACE financing program that is recognizable to the consumer as PACE on the form.

1026.41 Periodic Statement

41(e) Exemptions

41(e)(7) PACE Transactions

TILA section 128(f) generally requires periodic statements for residential mortgage loans.[152] Section 1026.41 implements this requirement by requiring creditors, servicers, or assignees, as applicable, to provide a statement for each billing cycle that contains information such as the amount due, payment breakdown, transaction activity, contact information, and delinquency information.[153] Proposed § 1026.41(e)(7) would exempt PACE transactions, as defined in proposed § 1026.43(b)(15), from the periodic statement requirement to reduce consumer confusion while avoiding undue burden for PACE creditors.

Several unique characteristics of PACE financing support this proposed exemption. First, PACE payments and delinquency charges are typically integrated with broader property tax payments and delinquency charges. Consumers may be confused about whether fields in the periodic statement include details of the PACE financing, property taxes, or both, or why the figures do not align with those in their property tax statements. Second, the annual or semi-annual payment schedule for PACE financing means that information on the periodic statement about the next expected payment would come many months before the payment was due, given timing requirements for periodic statements under Regulation Z, which may limit its utility for consumers.[154] Finally, requiring a periodic statement could impose a significant burden on the party providing the statement given that local taxing authorities would hold needed information such as whether and when payments were made or delinquency charges applied.

Even with the proposed exemption, consumers would still receive information regarding payments and delinquency from their property tax collector and, if they have a mortgage with an escrow, from their mortgage servicer. Consumers could also obtain information about the PACE loan by requesting a payoff statement pursuant to § 1026.36(c)(3).

The Bureau seeks comment on proposed § 1026.41(e)(7) and whether a periodic statement requirement would benefit PACE consumers. Specifically, the Bureau seeks comment on the types of disclosures related to PACE financing that consumers currently receive from PACE creditors, property tax collectors, and others. The Bureau also seeks comment on whether an annual or semi-annual disclosure like the periodic statement would be useful for PACE consumers and, if so, what information it should contain.

The Bureau also requests comment on whether there are any other mortgage servicing requirements in Regulation Z or X beyond the periodic statement requirement that the Bureau should address in the final rule. Some servicing requirements, such as the requirements to provide periodic statements and to provide payoff statements, apply not just to servicers but also to creditors and assignees.[155] Both Regulation Z and Regulation X also impose certain servicing requirements that apply only to ''servicers'' as defined in Regulation X, 12 CFR 1024.2(b).[156] Regulation X generally defines servicer as ''a *person* responsible for the servicing of a federally related mortgage loan'' and servicing as receiving any scheduled periodic payments from a borrower pursuant to the loan's terms and making certain payments to the loan's owner or other third parties.[157] The definition of ''person'' in RESPA [158] has been interpreted not to apply to government entities.[159] This proposed rule does not address any servicing requirements that apply only to ''servicers'' as defined in Regulation X because there does not appear to be a ''servicer'' in typical PACE transactions. Pursuant to the terms of PACE transactions that the Bureau has reviewed, the consumer's local government taxing authority typically receives the borrower's regular PACE payments as part of the consumer's larger property tax payment.

The Bureau proposes to use its authority under TILA sections 105(a) and (f) and Dodd-Frank Act section 1405(b) to exempt PACE financing from the periodic statement requirement. The Bureau preliminarily concludes that this exemption is necessary and proper under TILA section 105(a). Furthermore, the Bureau preliminarily concludes, for the reasons stated above, that disclosure of the information specified in TILA section 128(f)(1) would not provide a meaningful benefit to PACE consumers, considering the factors in TILA section 105(f). The Bureau preliminarily believes that this conclusion would be true regardless of the loan amount, borrower status (including related

[151] Comment 38(t)(5)–3 explains that, for purposes of § 1026.38, the term ''unit-period'' has the same meaning as in appendix J to Regulation Z.

[152] 15 U.S.C. 1638(f).

[153] For purposes of § 1026.41, the term ''servicer'' includes the creditor, assignee, or servicer of the loan, as applicable. § 1026.41(a)(2).

[154] *See* 12 CFR 1026.41(b).

[155] *See* §§ 1026.41(a)(2); 1026.36(c)(3).

[156] *See, e.g.,* 12 CFR 1024.41 (loss mitigation); 1026.36(c)(1) and (2) (payment processing and pyramiding of late fees).

[157] 12 CFR 1024.2(b) (emphasis added); *see also* 12 U.S.C. 2605(i)(2).

[158] *See* 12 U.S.C. 2602(5).

[159] *See, e.g., New Jersey Title Ins. Co.* v. *Cecere,* 2020 WL 7137873, at *10 (D.N.J. 2020); *United States* v. *Davis,* 2018 WL 6694826, at *4 (C.D. Ill. 2018); *Rodriguez* v. *Bank of Am.,* 2017 WL 3086369, at *5 (D.N.J. 2017). Other entities involved in PACE transactions, such as the PACE company and home improvement contractor, would fall within RESPA's definition of ''person'' but do not appear to meet the Regulation X definition of ''servicer'' in typical PACE transactions. For federally related mortgage loans, defined in RESPA section 3(1), 12 U.S.C. 2602(1), and Regulation X § 1024.2(b), RESPA covered persons are generally subject to RESPA's provisions including the anti-kickback provisions in 12 U.S.C. 2607.

financial arrangements, financial sophistication, and the importance to the borrower of the loan), or whether the loan is secured by the consumer's principal residence. Consequently, the proposed exemption appears to further the consumer protection objectives of the statute, and helps to avoid complicating, hindering, or making more expensive the credit process. The Bureau also believes that the proposed modification of the requirements in TILA section 128(f) to exempt PACE financing would improve consumer awareness and understanding and is in the interest of consumers and in the public interest, consistent with Dodd-Frank Act section 1405(b).

1026.43 Minimum Standards for Transactions Secured by a Dwelling

Section 1026.43 implements the requirement in TILA section 129C(a) that creditors must make a reasonable, good faith determination of a consumer's ability to repay a residential mortgage loan and defines the loans eligible to be ''qualified mortgages,'' which obtain certain presumptions of compliance pursuant to TILA section 129C(b). The Bureau is proposing a number of amendments to § 1026.43 and its commentary to account for the unique nature of PACE. Specifically, this proposal would (1) define ''PACE company'' and ''PACE transaction'' for purposes of § 1026.43; (2) provide an additional factor a creditor must consider when making a repayment ability determination for PACE transactions extended to consumers who pay their property taxes through an escrow account; (3) provide that a PACE transaction is not a QM as defined in § 1026.43; and (4) extend the requirements of § 1026.43 and the liability provisions of section 130 of TILA [160] to any PACE company that is substantially involved in making the credit decision. This proposal would also amend the commentary to this section to explain that a creditor originating a PACE transaction knows or has reason to know of any simultaneous loans that are PACE transactions if the transactions are included in a relevant database or registry of PACE transactions. The Bureau further proposes to amend the commentary to make clear that pre-existing PACE transactions are considered a property tax for purposes of considering mortgage-related obligations under § 1026.43(b)(8) and to clarify the verification requirements for existing PACE transactions. The CFPB seeks comment on these proposed amendments.

Background on the Existing Ability-to-Repay Requirements for Mortgages

The Dodd-Frank Act amended TILA to establish, among other things, ATR requirements in connection with the origination of most residential mortgage loans.[161] As amended, TILA prohibits a creditor from making a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that, at the time the loan is consummated, the consumer has a reasonable ability to repay the loan according to its terms, and all applicable taxes, insurance (including mortgage guarantee insurance), and assessments.[162]

TILA identifies the factors a creditor must consider in making a reasonable and good faith assessment of a consumer's ability to repay. These factors are the consumer's credit history, current and expected income, current obligations, debt-to-income (DTI) ratio or residual income after paying non-mortgage debt and mortgage-related obligations, employment status, and other financial resources other than equity in the dwelling or real property that secures repayment of the loan.[163]

In January 2013, the Bureau issued a final rule amending Regulation Z to implement TILA's ATR requirements (January 2013 Final Rule).[164] This proposal refers to the January 2013 Final Rule and later amendments to it collectively as the ATR/QM Rule. The ATR/QM Rule implements the statutory criteria listed above in the eight underwriting factors a creditor must consider in making a repayment ability determination set out in § 1026.43(c)(2).[165] These factors are (1) the consumer's current or reasonably expected income or assets (other than the value of the dwelling and attached real property that secures the loan) that the consumer will rely on to repay the loan; (2) the consumer's current employment status (if a creditor relies on employment income when assessing the consumer's ability to repay); (3) the monthly mortgage payment for the loan that the creditor is underwriting; (4) the monthly payment on any simultaneous loans secured by the same dwelling; (5) monthly mortgage-related obligations; (6) the consumer's current debts, alimony, and child-support obligations; (7) the consumer's monthly DTI ratio or residual income; and (8) the consumer's credit history.[166]

The ATR/QM Rule generally requires a creditor to verify the information it relies on when determining a consumer's repayment ability using reasonably reliable third-party records.[167] For example, to verify the consumer's income and assets, a creditor may use a tax-return transcript issued by the Internal Revenue Service or a variety of other records, such as filed tax returns, IRS Form W–2s, payroll statements, financial institution records, or other third-party documents.[168]

The ATR/QM Rule also defines categories of loans, called QMs, that are presumed to comply with the ATR requirement.[169] Under the ATR/QM Rule, a creditor that makes a QM loan is deemed to have complied with ATR requirements presumptively or conclusively, which generally depends on whether the loan is ''higher priced.'' [170] The ATR/QM Rule defines several categories of QM loans. As

[160] 15 U.S.C. 1640.

[161] Dodd-Frank Act sections 1411–12, 1414, 124 Stat. 2142–48, 2149; 15 U.S.C. 1639c.

[162] 15 U.S.C. 1639c(a)(1). TILA section 103 defines ''residential mortgage loan'' to mean, with some exceptions including open-end credit plans, ''any consumer credit transaction that is secured by a mortgage, deed of trust, or other equivalent consensual security interest on a dwelling or on residential real property that includes a dwelling.'' 15 U.S.C. 1602(dd)(5). TILA section 129C also exempts certain residential mortgage loans from the ATR requirements. *See, e.g.,* 15 U.S.C. 1639c(a)(8) (exempting reverse mortgages and temporary or bridge loans with a term of 12 months or less).

[163] 15 U.S.C. 1639c(a)(3).

[164] 78 FR 6408 (Jan. 30, 2013).

[165] *See id.* at 6463.

[166] 12 CFR 1026.43(c)(2).

[167] 12 CFR 1026.43(c)(3)–(4).

[168] 12 CFR 1026.43(c)(4). TILA section 129C(a)(4) provides that, in order to safeguard against fraudulent reporting, any consideration of a consumer's income history must include the verification of income using either (1) IRS transcripts of tax returns; or (2) an alternative method that quickly and effectively verifies income documentation by a third-party, subject to rules prescribed by the Bureau. In the January 2013 Final Rule, the Bureau implemented TILA section 129C(a)(4)(B) by adjusting the requirement to (1) require the creditor to use reasonably reliable third-party records, consistent with TILA section 129C(a)(4), rather than the ''quickly and effectively'' standard of TILA section 129C(a)(4)(B); and (2) provide examples of reasonably reliable records that a creditor can use to efficiently verify income, as well as assets. *See* 78 FR 6408, 6474 (Jan. 30, 2013).

[169] 15 U.S.C. 1639c(b)(1).

[170] The ATR/QM Rule generally defines a ''higher-priced'' loan to mean a first-lien mortgage with an APR that exceeded APOR for a comparable transaction as of the date the interest rate was set by 1.5 or more percentage points; or a subordinate-lien mortgage with an APR that exceeded APOR for a comparable transaction as of the date the interest rate was set by 3.5 or more percentage points. 12 CFR 1026.43(b)(4). A creditor that makes a QM loan that is not ''higher priced'' is entitled to a conclusive presumption that it has complied with the ATR/QM Rule—*i.e.,* the creditor receives a safe harbor from liability. 12 CFR 1026.43(e)(1)(i). A creditor that makes a loan that meets the standards for a QM loan but is ''higher priced'' is entitled to a rebuttable presumption that it has complied with the ATR/QM Rule. 12 CFR 1026.43(e)(1)(ii).

relevant here, those categories include General QM, Small Creditor QM, Seasoned QM, and Balloon-Payment QM loans.[171]

QM Definitions

One category of QM loans defined by the ATR/QM Rule consists of ''General QM loans.'' [172] The January 2013 Final Rule provided that a loan was a General QM loan if:

• The loan did not have negative-amortization, interest-only, or balloon-payment features, a term that exceeds 30 years, or points and fees that exceed specified limits; [173]

• The creditor underwrote the loan based on a fully amortizing schedule using the maximum rate permitted during the first five years; [174]

• The creditor considered and verified the consumer's income and debt obligations in accordance with appendix Q; [175] and

• The consumer's DTI ratio was no more than 43 percent, determined in accordance with appendix Q.[176]

The Bureau amended the General QM definition on December 10, 2020 (General QM Final Rule).[177] The General QM Final Rule amended Regulation Z to remove the General QM loan definition's DTI limit (and appendix Q) and replace it with limits based on the loan's pricing. For non-PACE mortgages, loan pricing in general is strongly correlated with early delinquency rates, which the General QM Final Rule used as a proxy for repayment ability.[178] The Bureau concluded that a comparison of a loan's APR to the APOR for a comparable transaction is a more holistic and flexible indicator of a consumer's ability to repay than DTI alone.[179] The Bureau further concluded that the bright-line pricing thresholds established in the General QM Final Rule strike an appropriate balance between ensuring consumers' ability to repay and ensuring access to responsible, affordable mortgage credit.[180] Under the amended rule, a loan meets the General QM loan definition only if the APR exceeds the APOR for a comparable transaction by less than 2.25 percentage points, with higher thresholds for loans with smaller loan amounts, for certain manufactured housing loans, and for subordinate-lien transactions.[181]

In May 2013, the Bureau amended the ATR/QM Rule to add, among other things, a new QM category for covered transactions that are originated by creditors that meet certain size criteria and that satisfy certain other requirements (the Small Creditor QM).[182] Those requirements include many that apply to General QMs, with some exceptions. Specifically, Small Creditor QMs are not subject to the pricing threshold for QM status, and the threshold for determining whether Small Creditor QMs are higher-priced covered transactions, and thus qualify for the QM safe harbor or rebuttable presumption, is higher than the threshold for General QMs.[183] In addition, Small Creditor QMs must be held in portfolio for three years (a requirement that does not apply to General QMs).[184]

In December 2020, the Bureau created a new category of QMs (Seasoned QMs) for first-lien, fixed-rate covered transactions that have met certain performance requirements, are held in portfolio by the originating creditor or first purchaser for a 36-month period, comply with general restrictions on product features and points and fees, and meet certain underwriting requirements.[185] To qualify, a transaction generally must have no more than two delinquencies of 30 or more days and no delinquencies of 60 or more days at the end of the seasoning period of 36 months beginning on the date on which the first periodic payment is due.[186] The Bureau found that if combined with certain other factors, successful loan performance over a number of years indicates sufficient certainty to presume that loans were originated in compliance with the ATR/QM Rule.[187]

TILA section 129C(b)(2)(E)(iv)(I) granted the Bureau the discretion to create a special provision allowing origination of balloon-payment QMs, which it implemented in the January 2013 Final Rule.[188] As directed by Congress, the Bureau considered the issues facing small creditors in rural and underserved areas and determined that it was appropriate to exercise its discretion under TILA to reduce burdens on certain small creditors that operate predominantly in rural or underserved areas. Accordingly, the Bureau established a special provision allowing these creditors to originate balloon-payment QMs, even though balloon-payment mortgages are otherwise precluded from being considered QMs.[189]

43(b) Definitions

Section 1026.43(b) sets forth certain definitions for purposes § 1026.43. The Bureau is proposing to amend the commentary to § 1026.43(b)(8), regarding the existing definition of mortgage-related obligations, to clarify the treatment of payments for pre-existing PACE transactions. The Bureau is also proposing two new definitions in § 1026.43(b)(14) and (b)(15). Under the proposal, § 1026.43(b)(14) would define

[171] 12 CFR 1026.43(c), (e), (f). TILA section 129C(b)(3)(B)(ii) directs HUD, the Department of Veterans Affairs (VA), the Department of Agriculture (USDA), and the Rural Housing Service (RHS) to prescribe rules defining the types of loans they insure, guarantee, or administer, as the case may be, that are QMs. Section 1026.43(e)(4) provides that, notwithstanding paragraph § 1026.43.43(e)(2), a QM is a covered transaction that is defined as a QM by HUD under 24 CFR 201.7 and 24 CFR 203.19, VA under 38 CFR 36.4300 and 38 CFR 36.4500, or USDA under 7 CFR 3555.109. In addition, section 101 of the EGRRCPA amended TILA to provide protection from liability for insured depository institutions and insured credit unions with assets below $10 billion with respect to certain ATR requirements regarding residential mortgage loans. The Bureau is not aware of any PACE creditors that would qualify for protection under these provisions, and these provisions are not addressed in this proposed rule.

[172] Another temporary category of QMs defined by the ATR/QM Rule, Temporary GSE QMs, expired on October 1, 2022.

[173] 12 CFR 1026.43(e)(2)(i)–(iii).

[174] 12 CFR 1026.43(e)(2)(iv).

[175] 12 CFR 1026.43(e)(2)(v).

[176] 12 CFR 1026.43(e)(2)(vi). Appendix Q contained standards for calculating and verifying debt and income for purposes of determining whether a mortgage satisfied the 43 percent DTI limit for General QM loans. The standards in appendix Q were adapted from guidelines maintained by the Federal Housing Administration (FHA) of HUD when the January 2013 Final Rule was issued. 78 FR 6408, 6527–28 (Jan. 30, 2013) (noting that appendix Q incorporates, with certain modifications, the definitions and standards in HUD Handbook 4155.1, Mortgage Credit Analysis for Mortgage Insurance on One-to-Four-Unit Mortgage Loans).

[177] 85 FR 86308 (Dec. 29, 2020).

[178] See part IX.A for a discussion of why these dynamics differ for PACE transactions.

[179] 85 FR 86308, 86317 (Dec. 29, 2020).

[180] *Id.*

[181] *Id.* at 86367.

[182] 78 FR 35430 (June 12, 2013). The Bureau made several amendments to the Small Creditor QM provisions in 2015. 80 FR 59944 (Oct. 2, 2015).

[183] QMs are generally considered to be higher priced if they have an APR that exceeds the applicable APOR by at least 1.5 percentage points for first-lien loans and at least 3.5 percentage points for subordinate-lien loans. In contrast, Small Creditor QMs are only considered higher priced if the APR exceeds APOR by at least 3.5 percentage points for either a first- or subordinate-lien loan. 12 CFR 1026.43(b)(4). The same is true for another QM definition that permits certain creditors operating in rural or underserved areas to originate QMs with a balloon payment provided that the loans meet certain other criteria (Balloon Payment QM loans). QMs that are higher priced enjoy only a rebuttable presumption of compliance with the ATR requirements, whereas QMs that are not higher priced enjoy a safe harbor.

[184] 12 CFR 1026.43(e)(5)(ii).

[185] 85 FR 86402 (Dec. 29, 2020).

[186] 12 CFR 1026.43(e)(7)(ii).

[187] 85 FR 86402, 86415 (Dec. 29, 2020).

[188] 78 FR 6408, 6538 (Jan. 30, 2013).

[189] *Id.* The Bureau further amended the Regulation Z requirements for balloon-payment QMs in response to the HELP Rural Communities Act in October 2015. 81 FR 16074 (Mar. 25, 2016); *see* Public Law 114–94, 129 Stat. 1312 (2015).

PACE company, and § 1026.43(b)(15) would define PACE transaction.[190]

43(b)(8) Mortgage-Related Obligations

Section 1026.43(b)(8) defines ''mortgage-related obligations'' to include property taxes, among other things. In turn, § 1026.43(c)(2)(v) requires a creditor to consider the consumer's monthly payment for mortgage-related obligations in making the repayment ability determination required under § 1026.43(c)(1). The Bureau proposes to amend comment 43(b)(8)–2 to explicitly state that payments for pre-existing PACE transactions are considered property taxes for purposes of § 1026.43(b)(8). The intent of this proposed amendment is to ensure that it is clear that a creditor must consider payments for pre-existing PACE transactions as mortgage-related obligations.

The proposed amendment to comment 43(b)(8)–2 is consistent with the existing rule but adds an explicit reference to PACE transactions for clarity. Comment 43(b)(8)–2 already provides that all obligations that are related to the ownership or use of real property and paid to a taxing authority, whether on a monthly, quarterly, annual, or other basis, are property taxes for purposes of § 1026.43(b)(8). PACE transactions are related to the ownership or use of real property and are paid to a taxing authority. In addition, the existing comment provides as an example that taxes, assessments, and surcharges imposed by independent districts established or allowed by the government with the authority to impose levies on properties within the district to fund a special purpose qualify as property taxes for purposes of § 1026.43(b)(8). The Bureau seeks comment on this proposed amendment.

43(b)(14) PACE Company

To provide clarity and for ease of reference, the Bureau proposes to add a definition of ''PACE company'' in § 1026.43(b)(14).

As discussed in part II.A above, most local governments that engage in PACE financing rely on private companies to administer PACE programs. PACE companies are generally responsible for operating the applicable programs, including marketing PACE financing to consumers, administering originations, making decisions about whether to extend the loan, and enlisting home improvement contractors that will implement the projects to facilitate the originations. PACE companies thus play an extensive role in PACE transactions, and as discussed in the section-by-section analysis of § 1026.43(i) below, the Bureau proposes to apply the requirements of § 1026.43 to any PACE company that is substantially involved in making the credit decision.[191]

Proposed § 1026.43(b)(14) would provide that PACE company means a person, other than a natural person or a government unit, that administers the program through which a consumer applies for or obtains a PACE transaction. Proposed comment 43(b)(14)–1 would provide indicia of whether a person is administering a PACE financing program. The Bureau intends this proposed provision and associated commentary to target the private companies involved in running the PACE programs as described above—the Bureau understands that it would not apply to home improvement contractors, who may be natural persons and who generally do not administer the PACE program. The CFPB seeks comment on this proposed definition and, in particular, on whether it accurately identifies the intended entities and whether the use of this term accounts for the unique nature of PACE financing.

43(b)(15) PACE Transaction

Section 307 of the EGRRCPA amended TILA to define the term ''Property Assessed Clean Energy financing'' for purposes of TILA section 129C(b)(3)(C) as financing to cover the costs of home improvements that results in a tax assessment on the real property of the consumer.[192] The Bureau proposes to add a definition for the term ''PACE transaction'' to Regulation Z that is based on the EGRRCPA section 307 definition. Specifically, proposed § 1026.43(b)(15) would provide that a PACE transaction means financing to cover the costs of home improvements that results in a tax assessment on the real property of the consumer. The Bureau seeks comment on this proposed definition.

43(c) Repayment Ability

Section 307 of the EGRRCPA directed the Bureau to prescribe regulations that carry out the purposes of TILA's ATR provisions for residential mortgage loans with respect to PACE transactions. The Bureau has preliminarily concluded that the existing ATR framework set out in § 1026.43(c) effectively carries out the purposes of TILA's ATR provisions and is generally appropriate for PACE transactions, with adjustments to the commentary to § 1026.43(c) and the addition of the provisions set out in § 1026.43(i) described below.

As described above, the existing ATR requirement in § 1026.43(c)(1) requires a creditor to make a reasonable and good faith determination of a consumer's ability to repay at or before consummation of a covered mortgage loan. Section 1026.43(c)(2) provides eight factors that a creditor must consider in making the repayment ability determination, while § 1026.43(c)(3) and (c)(4) generally requires a creditor to verify the information that the creditor relies on in determining a consumer's repayment ability using reasonably reliable third-party records. These verification requirements are important to carrying out the purpose of TILA's ATR provisions.[193] TILA section 129C(a)(4) is intended to safeguard against fraudulent reporting and inaccurate underwriting, as the statute specifically notes that a creditor must verify a consumer's income history ''[i]n order to safeguard against fraudulent reporting.'' These concerns appear to be heightened in the PACE market given the consumer protection issues observed by advocates and others, such that weakening the verification requirement in this context would be inappropriate. The Bureau believes the current ATR provisions, which provide minimum requirements for creditors making ability-to-repay determinations but do not dictate particular underwriting models, are similarly appropriate for PACE transactions, subject to certain proposed adjustments specific to PACE transactions discussed below.

Applying existing § 1026.43(c) to PACE transactions will allow PACE creditors to account for the particular features of the PACE transactions that they originate when assessing a consumer's ability to repay. The Bureau's ATR framework is designed to be flexible, to allow creditors to develop

[190] If the Bureau finalizes the new definitions in proposed § 1026.43(b)(14) and (b)(15), the final rule would add the new definitions into § 1026.43(b) where they belong alphabetically in that paragraph and would renumber existing definitions as needed and make conforming technical adjustments to cross-references to those definitions to reflect the renumbering changes.

[191] The Bureau also proposes to apply section 130 of TILA, 15 U.S.C. 1640, to covered PACE companies that fail to comply with § 1026.43. *See* section-by-section analysis of proposed § 1026.43(i)(3).

[192] *See* 15 U.S.C. 1639C(b)(3)(C)(i).

[193] *See* 78 FR 6408, 6475 (Jan 30. 2013) (''One of the purposes of TILA section 129C is to assure that consumers are offered and receive covered transactions on terms that reasonably reflect their ability to repay the loan. *See* TILA section 129B(a)(2). The Bureau believes that a creditor consulting reasonably reliable records is an effective means of verifying a consumer's income and helps ensure that consumers are offered and receive loans on terms that reasonably reflect their repayment ability.'').

and apply their own underwriting standards, and to permit creditors to consider the facts and circumstances of each individual extension of credit. The ATR provisions of Regulation Z also do not provide comprehensive underwriting standards to which creditors must adhere.[194] For example, the rule and commentary do not specify how much income is needed to support a particular level of debt or how credit history should be weighed against other factors. So long as creditors consider the factors set forth in § 1026.43(c)(2) according to the requirements of § 1026.43(c), creditors are permitted to develop their own underwriting standards and make changes to those standards over time in response to empirical information and changing economic and other conditions.[195] As such, the Bureau preliminarily believes that the existing ATR framework provides PACE creditors sufficient operational flexibility while still requiring compliance with the general requirement to make a reasonable and good faith determination at or before consummation that the consumer will have a reasonable ability to repay the loan according to its terms.

For these reasons, the Bureau proposes to apply existing § 1026.43(c) to PACE transactions, with adjustments to the commentary to § 1026.43(c) and the addition of the provisions set out in § 1026.43(i) described below. The Bureau seeks comment on these proposed changes. In particular, the Bureau seeks comment on whether § 1026.43(c) should be amended to permit or require a creditor to consider the effect of potential savings resulting from the home improvement project financed in the PACE transaction (such as lowered utility payments).

43(c)(2) Basis for Determination

43(c)(2)(iv)

Section 1026.43(c)(2) sets forth factors creditors must consider when making the ATR determination required under § 1026.43(c)(1), and the accompanying commentary provides guidance regarding these factors. Section 1026.43(c)(2)(iv) provides that one factor a creditor must consider is the consumer's payment obligation on any simultaneous loan that the creditor knows or has reason to know will be made at or before consummation of the covered transaction. The Bureau proposes to add new comment 43(c)(2)(iv)–4 to provide additional guidance to creditors originating PACE transactions. Proposed comment 43(c)(2)(iv)–4 would provide that a creditor originating a PACE transaction knows or has reason to know of any simultaneous loans that are PACE transactions if the transactions are included in any existing database or registry of PACE transactions that includes the geographic area in which the property is located and to which the creditor has access.

Proposed comment 43(c)(2)(iv)–4 is intended to help address concerns about the prevalence of ''loan splitting'' and ''loan stacking'' in the PACE industry that were raised in ANPR comments from consumer groups and other stakeholders. As described in the comments, loan splitting refers to the practice of a contractor dividing a loan for one consumer into more than one transaction to make each transaction appear more affordable, while loan stacking refers to contractors returning to a PACE borrower to offer additional PACE financing (often through different creditors). The Bureau's statistical analysis indicates that a little more than 13 percent of PACE borrowers between 2014 and 2020 received multiple PACE transactions, with many of these transactions originated simultaneously or within a few months of each other, which could be indicative of loan splitting or stacking.[196] About one-fourth of PACE borrowers with multiple PACE transactions consummated multiple transactions in the same month, and about three-quarters of PACE borrowers with multiple PACE loans consummated more than one transaction within the same 6-month period.[197] In some cases, the creditor originating the second or successive PACE transaction might not be aware of previous transactions, due to delays in recording.

Given these concerns and the increased possibility of a PACE borrower having previously entered a PACE transaction, the Bureau preliminarily concludes that it is practical and appropriate for a PACE creditor to search any existing database or registry of PACE transactions that includes the geographic area in which the property is located and to which the creditor has access. A PACE industry association has recommended that market participants create a PACE-related lien registry for PACE companies to review when underwriting consumers for PACE transactions.[198] In addition, the Bureau understands that at least one active PACE State has contemplated establishing a real-time registry or database system for tracking PACE assessments.[199] The Bureau believes that if a database of PACE transactions that covers the geographic area in which the property is located exists, proposed comment 43(c)(2)(iv)–4 would lead PACE creditors to discover more simultaneous loans, which could reduce the extent of loan splitting and loan stacking. The Bureau is not proposing to apply this provision to creditors originating non-PACE mortgages, because the origination of a PACE loan and a non-PACE mortgage in short succession does not appear to raise the same concerns regarding loan splitting or loan stacking. Additionally, it is relatively rare for a new mortgage borrower to have a pre-existing PACE transaction on the same property, since PACE transactions are less common than non-PACE mortgages and a property sale is unlikely to be completed unless any existing PACE loan has already been paid off. The Bureau seeks comment on this proposal.

43(c)(3) Verification Using Third-Party Records

In general, a creditor must verify the information that the creditor relies on in determining a consumer's repayment ability under § 1026.43(c)(2) using reasonably reliable third-party records. The Bureau proposes to amend comment 43(c)(3)–5 to clarify how this requirement applies to consumers with existing PACE transactions.[200] Current comment 43(c)(3)–5 provides that, ''[w]ith respect to the verification of mortgage-related obligations that are property taxes required to be considered under § 1026.43(c)(2)(v), a record is reasonably reliable if the information in the record was provided by a governmental organization, such as a taxing authority or local government.'' Additionally, the comment provides that the creditor complies with § 1026.43(c)(2)(v) by relying on property taxes referenced in the title report if the source of the property tax information was a local taxing authority.

The Bureau proposes to amend comment 43(c)(3)–5 to clarify that a

[194] *See* comment 43(c)(1)–1.

[195] *See id.; see also* comment 43(c)(2)–1.

[196] *See* PACE Report, *supra* note 12, at 12, 24.

[197] *See id.* at 24.

[198] PACENation, *Residential Property Assessed Clean Energy (R–PACE) State and Local Consumer Protection Policy Principles,* at 3 (Oct. 21, 2021), *https://www.pacenation.org/wp-content/uploads/2021/11/PACENation-R-PACE-Consumer-Protection-Policy-Principles-ADOPTED-October-21.2021.pdf.*

[199] *See* Cal. Fin. Code sec. 22693.

[200] As discussed above, the Bureau is proposing to clarify that payments for pre-existing PACE transactions are considered a property tax and therefore mortgage-related obligations under § 1026.43(b)(8). *See* discussion of comment 43(b)(8)–2 in section-by-section analysis of proposed § 1026.43(b)(8) *supra.*

creditor that knows or has reason to know that a consumer has an existing PACE transaction does not comply with § 1026.43(c)(2)(v) by relying on information provided by a governmental organization, either directly or indirectly, if the information provided does not reflect the PACE transaction. A PACE creditor might know or have reason to know of a PACE transaction that is about to be originated and that, therefore, will not appear in property tax records or property tax information in a title report. For example, a PACE creditor might learn of the existing PACE transaction by searching a relevant database of PACE transactions, or a consumer might inform the creditor of the PACE transaction in application materials. In those circumstances, the proposed amendment provides that a creditor would not comply with the requirement to verify mortgage-related obligations using reasonably reliable third-party records by verifying the consumer's property taxes solely using property tax records or property tax information in a title report that do not include the existing PACE transaction. The CFPB seeks comment on this proposed amendment.

43(i) PACE Transactions

43(i)(1)

Many consumers who obtain PACE transactions have pre-existing mortgages that require the payment of property taxes through an escrow account. Consumers with such pre-existing mortgages will typically also make their PACE transaction payments through their existing escrow account. Under certain circumstances, the addition of payments for a PACE transaction can result in a sharp increase in the consumer's escrow payments. This increase is relevant to the consumer's ability to repay the PACE transaction. The CFPB preliminarily concludes that, for consumers who pay their property taxes through an escrow account, a creditor's reasonable and good faith determination of a consumer's ability to repay a PACE transaction according to its terms must include the creditor's consideration of the effect of incorporating a PACE transaction into a consumer's escrow payments. For the reasons discussed below, the Bureau proposes to add new § 1026.43(i)(1) to require that a creditor making the repayment ability determination under § 1026.43(c)(1) and (2) also consider any monthly payments the consumer will have to pay into the consumer's escrow account as a result of the PACE transaction that are in excess of the monthly payment amount considered under § 1026.43(c)(2)(iii).

One unique aspect of PACE transactions is that, unlike traditional mortgages, consumers may pay them through an escrow account on another mortgage loan. PACE transactions are also distinct from non-PACE mortgage loans in several other respects, including with regard to the timing of when the first PACE payment is due and their annual or semi-annual repayment schedule. These distinct features of PACE transactions can result in significant payment spikes for consumers. Consumers who are required to make their PACE payments through their existing escrow account have faced particularly long delays before payments have come due on their PACE transaction.[201] These consumers only begin repaying their PACE transaction once their mortgage servicer conducts an escrow account analysis and adjusts their monthly payment to reflect the addition of the PACE transaction to their property tax bill. A servicer must conduct an escrow account analysis every 12 months but may, and in some cases must, do so more frequently. The Bureau understands that the timing of this analysis—and whether the servicer knows of the PACE transaction at the time of the first analysis following consummation—can have a significant impact on the amount of the consumer's initial escrow payments once adjusted to incorporate the PACE transaction.[202]

For example, assume a PACE transaction was consummated in June 2021, and the first PACE payment was due November 1, 2021. If the servicer had not learned of the PACE transaction before receiving a tax bill for the November 1, 2021 payment, the PACE transaction would not have been promptly incorporated into the consumer's escrow account. Assuming no funds were set aside to pre-pay the consumer's escrow account, in this example the servicer's next escrow account analysis might newly account for (1) the initial payment due November 1, 2021 for which no escrow funds were previously collected, (2) the upcoming PACE payment that would be due November 1, 2022, and (3) any potential adjustments to the escrow account cushion attributable to the PACE transaction.[203] In this example, a consumer could experience a sharp and unexpected increase in their initial escrow payments beyond the amount that would have been owed had the PACE transaction been incorporated into escrow promptly. This payment spike would undercut a central benefit of escrow accounts to consumers in spreading out large obligations into more manageable, regular payments.

Consumer group commenters to the ANPR stated that the delay in this adjustment of the escrow account means that the first year or two of a consumer's increased escrow payments to account for the PACE transaction will likely be higher than in subsequent years due to significant shortages in the escrow account. These commenters expressed that if, for example, the servicer analyzes the escrow account just before property tax bills are issued, the servicer will advance the full property tax amount, including the amount owed on the PACE transaction, but the escrow account will then carry a deficiency (or negative balance due to the prior year's PACE payment) going forward. They stated further that, at the next escrow account analysis, the servicer will calculate the new escrow payment by adding to the base payment an amount sufficient to repay the deficiency, an amount to cover the upcoming year's PACE payment that was not accounted for in the prior year's escrow analysis (an escrow shortage), and a reserve cushion of no greater than one-sixth (1⁄6) of the estimated total annual payments from the account.[204] A State trade association indicated that in general, it is not uncommon for a PACE transaction to double a consumer's monthly escrow payment because the PACE transaction amount could be as much or more than the existing property tax. This commenter stated that the escrow adjustment to bring the escrow account current after one year, provide for the next PACE payment, and fund a cushion can potentially triple the consumer's monthly escrow payment amount for a 12-month period.

The CFPB understands that at least some PACE consumers have had difficulty repaying their PACE transaction because of this substantial and unanticipated spike in their escrow

[201] Regulation X provides that an escrow account is any account established or controlled by a servicer on behalf of a borrower to pay taxes, insurance premiums, or other charges with respect to a federally related mortgage loan, including those charges that the servicer and borrower agreed to have the servicer collect and pay. 12 CFR 1024.17(b).

[202] *See generally* 12 CFR 1024.17(c)(3) (discussing annual escrow account analyses).

[203] Under 12 CFR 1024.17(c)(1), servicer may charge a cushion of no greater than one-sixth (1⁄6) of the estimated total annual payments from the account.

[204] A deficiency is the amount of a negative balance in an escrow account, while a shortage is an amount by which a current escrow account balance falls short of the target balance at the time of escrow analysis. 12 CFR 1024.17(b).

payments. Some consumer group commenters to the ANPR asserted that the addition of a PACE transaction to the property tax bill has frequently driven PACE consumers' escrow payments to unaffordable levels that result in many PACE consumers being unable to make their full mortgage payments and going into default and even foreclosure. These commenters cited as examples a homeowner in Stockton, California, who saw his escrow payment increase by almost $500 a month, and an older adult homeowner in Oakland, California, whose monthly fixed income was only about $1,000 and faced an increase in her escrow payment of over $900.

The Bureau preliminarily concludes that a creditor can only make a reasonable and good faith determination of the consumer's ability to repay the PACE transaction by considering the potential spike in the consumer's escrow payments it may cause. As described above, commenters to the ANPR expressed that the payment spike that can result when a PACE transaction is added to a consumer's property tax bill frequently increases their escrow payments to unaffordable levels, which could result in the consumer's default and even tax sale or foreclosure. The CFPB thus preliminarily concludes that it is consistent with the purposes of the ATR requirements to require a PACE creditor to consider whether a consumer who will pay their PACE payments through an escrow account will be able to make their monthly escrow payment once the escrow payment amount is adjusted to account for any potential deficiency or shortage and an escrow cushion attributable to the PACE transaction. Although the initial increase in the escrow payment would not last for the entire remaining duration of the PACE transaction, it could last for a year or longer and thus have a direct bearing on the consumer's ability to afford their PACE transaction during the timeframe in which this higher amount is owed. This short-term payment spike is also foreseeable by PACE creditors at consummation.

The CFPB also preliminarily concludes that the heightened consumer uncertainty that may arise for PACE transactions paid through escrow accounts as compared to other types of covered transactions supports this proposal. The Bureau has heard anecdotally and from commenters to the ANPR that PACE consumers are often surprised by and unprepared for the large payment spike. A few consumer group commenters to the ANPR asserted that the information provided by PACE programs regarding the relationship between PACE financing and escrow accounts is insufficient to prepare consumers for the payment shock—or equip them to prevent it—when there is a delay between consummation and when the servicer learns of the PACE transaction and adjusts the escrow payment.[205] The Bureau is concerned that the consumer uncertainty that can arise from the lack of information regarding how escrow accounts work in the context of PACE transactions could be further compounded by the lack of notice to consumers regarding when the escrow payments incorporating the PACE transactions will begin. The uncertainty that PACE consumers with escrow accounts experience regarding how much their escrow payments will increase because of their PACE transaction and when those increases will occur may persist even with the proposed disclosures and other protections that would be afforded under the proposal. Accordingly, the CFPB expects that the uniquely unpredictable and complex nature of the initial PACE payment obligations could make it challenging for these consumers to accurately track the amount owed as a result of their PACE transaction and set aside an amount sufficient to cover the higher initial payments once the escrow account is adjusted.

For these reasons, the Bureau proposes to add new § 1026.43(i)(1). Section 1026.43(i)(1) would require that, for PACE transactions extended to consumers who pay their property taxes through an escrow account, in making the repayment ability determination required under § 1026.43(c)(1) and (c)(2), a creditor must consider the factors identified in § 1026.43(c)(2)(i) through (viii) and also must consider any monthly payments that the creditor knows or has reason to know the consumer will have to pay into any escrow account as a result of the PACE transaction that are in excess of the monthly payment amount considered under § 1026.43(c)(2)(iii). The CFPB preliminarily concludes that proposed § 1026.43(i)(1) would provide an appropriately calibrated means to address concerns about a consumer's repayment ability when incorporation of the PACE transaction into the escrow payments could result in a sharp payment increase. As described above, the Bureau preliminarily concludes that it would not be reasonable for a creditor to make an ATR determination while ignoring a potentially significant and unexpected spike in the consumer's escrow payments once adjusted to account for the PACE transaction. At the same time, this potential payment spike would not last for the duration of the PACE transaction. Creditors would be required to consider any monthly payments that are in excess of the monthly payment amount considered under § 1026.43(c)(2)(iii), but they would not need to assume these higher payments would be owed for the entire duration of the loan. Creditors would also not be required to calculate this amount as part of the consumer's monthly payment amount for purposes of § 1026.43(c)(5) or to include the amount considered under proposed § 1026.43(i)(1) in their DTI or residual income calculations required under § 1026.43(c)(2)(vii) but could do so at their option as one possible means of complying with proposed § 1026.43(i)(1). The Bureau expects the proposal would provide an appropriate means for creditors to consider this limited duration, but potentially significant PACE-related obligation, faced by consumers who pay through an escrow account.

Proposed § 1026.43(i)(1)(i) and (ii) would provide additional detail on what factors creditors must take into account when considering any monthly payments that the creditor knows or has reason to know the consumer will have to pay into the consumer's escrow account as a result of the PACE transaction that are in excess of the monthly payment amount considered under § 1026.43(c)(2)(iii). Under the escrow requirements in Regulation X, servicers are permitted to charge an additional amount to maintain a cushion of no greater than one-sixth (1/6) of the estimated total annual payments from the escrow account,[206] and the Bureau understands that servicers frequently charge the full allowable amount of this cushion. Accordingly, proposed § 1026.43(i)(1)(i) would provide that, in making the consideration required by § 1026.43(i)(1), creditors must take into account the cushion of one-sixth (1/6) of the estimated total annual payments attributable to the PACE transaction from the escrow account that the servicer may charge under 12 CFR 1024.17(c)(1), unless the creditor reasonably expects that no such cushion will be required or unless the creditor reasonably expects that a different

[205] As an example, these commenters stated that California's financing estimate and disclosure includes the following advice: ''If you pay your taxes through an impound account you should notify your mortgage lender, so that your monthly mortgage payment can be adjusted by your mortgage lender to cover your increased property tax bill.'' Cal. Sts. & Hwys. Code sec. 5898.17.

[206] 12 CFR 1024.17(c)(1).

cushion amount will be required, in which case the creditor must use that amount. The Bureau preliminarily concludes that it is appropriate to require consideration of this cushion for PACE transactions given the unique potential for consumer uncertainty regarding the timing and amount of the new, higher escrow payments once adjusted to include the PACE transaction.

Proposed § 1026.43(i)(1)(ii) would address specifically the payment spike that can result from a delay in incorporating the PACE transaction into the consumer's escrow payments. It would require that in considering the amount specified by § 1026.43(i)(1), if the timing for when the servicer is expected to learn of the PACE transaction is likely to result in a shortage or deficiency in the consumer's escrow account, the creditor must take into account the expected effect of any such shortage or deficiency on the monthly payment that the consumer will be required to pay into the consumer's escrow account. There may be a significant time lag between when a PACE transaction is consummated and when the first escrow payment reflecting the PACE transaction comes due. As commenters to the ANPR noted, this delay could result in consumers incurring an escrow deficiency and shortage that would lead to significantly higher escrow payments than otherwise would have been required had the PACE transaction been incorporated promptly into the consumer's escrow payments. The Bureau understands that the timing of when the servicer is expected to learn of the PACE transaction can affect the existence and amount of such a deficiency or shortage. This, in turn, would affect the monthly payment that the consumer is required to pay into their escrow account and the amount that would be considered under proposed § 1026.43(i)(1).

As described above, when the servicer is expected to learn of the PACE transaction will depend, in part, on whether the servicer is informed of the covered PACE transaction at or prior to consummation. For example, assume a PACE transaction is consummated in June, the first payment is due November 1 of the same year, and the consumer has an escrow account. The creditor does not notify the servicer of the PACE transaction at consummation and no funds are allocated to pre-pay the consumer's escrow account for any payments related to the PACE transaction. If the creditor considers the consumer's monthly payment on the PACE transaction under § 1026.43(c)(2)(iii) but fails to consider that the consumer will be unable to pay the higher amount required for the initial escrow payments due to the one-sixth (1⁄6) cushion and escrow shortage or deficiency, the creditor does not comply with § 1026.43(i)(1). On the other hand, if under the same circumstances the creditor notifies the servicer of the PACE transaction at consummation to ensure the transaction will be incorporated into the escrow account promptly and determines that, given the timing of the notification, there will not be an escrow shortage or deficiency, and also confirms the consumer will be able to make initial escrow payments even with the additional one-sixth (1⁄6) cushion, the creditor complies with § 1026.43(i)(1). For the purposes of proposed § 1026.43(i)(1)(ii), where a creditor provides prompt notification to the servicer of the PACE transaction, it appears that it would be reasonable for the creditor to assume that the time at which the servicer learns of the PACE transaction will likely not result in a shortage or deficiency in the consumer's escrow account. The Bureau seeks comment on proposed new § 1026.43(i)(1) and specifically on whether it would provide additional clarity to include the above examples in commentary to § 1026.43(i)(1).

Although the proposed rule would not require creditors to notify servicers of PACE transactions, the Bureau strongly encourages prompt notice to servicers of the PACE transaction and rapid adjustment of the escrow payments by servicers to minimize payment spikes for PACE consumers. As an alternative approach to addressing the potential delay in incorporating PACE payments into a consumer's escrow account, the Bureau considered requiring all PACE creditors to notify the servicer at consummation that the consumer has entered into a PACE transaction. This requirement would eliminate one source of delay leading to payment shocks—the time between origination and the mortgage servicer learning of the PACE transaction. Such a requirement could reduce the likelihood that a payment spike would be significant enough to result in a consumer being unable to meet the payment obligations of the PACE transaction.

The Bureau considered imposing this requirement pursuant to its authority under TILA section 129B(e)(1).[207] This section authorizes the Bureau to prohibit or condition terms, acts, or practices relating to residential mortgage loans that the Bureau finds to be abusive, unfair, deceptive, predatory, necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of TILA sections 129B and 129C, necessary or proper to effectuate the purposes of TILA sections 129B and 129C, to prevent circumvention or evasion thereof, or to facilitate compliance with such sections, or are not in the interest of the borrower. The Bureau believes the act or practice of originating a PACE transaction for a consumer who has a pre-existing non-PACE mortgage and pays property taxes through an escrow account without notifying the servicer of the non-PACE mortgage may not be in the interest of the borrower because it could lead to a payment shock when the PACE transaction is incorporated into the borrower's escrow account, as described above. The Bureau preliminarily concludes, however, that it is preferrable to address the payment shock risk associated with non-notification under proposed § 1026.43(i)(1)(ii), which would grant PACE creditors greater flexibility to determine on a case-by-case basis how best to ensure that consumers have the ability to repay their PACE loans in light of escrow delays. The Bureau nevertheless seeks comment on this alternative approach and any advantages or disadvantages it has in comparison to proposed § 1026.43(i)(1)(ii).[208]

43(i)(2)

EGRRCPA section 307 requires the Bureau to prescribe regulations that carry out the purposes of TILA section 129C(a) with respect to PACE transactions. For the reasons described below, the CFPB is proposing to apply the Regulation Z ATR framework to PACE transactions without providing for a QM presumption of compliance for PACE transactions. Specifically, proposed § 1026.43(i)(2) would provide that, notwithstanding § 1026.43(e)(2), (e)(5), (e)(7), or (f), a PACE transaction

[207] 15 U.S.C. 1639b(e)(1).

[208] Some commenters to the ANPR recommended requiring creditors to consider a consumer's ability to repay the full annual or semi-annual PACE payment (rather than the monthly payment amount, as otherwise required by § 1026.43(c)(2)(iii)) based on a single month's income. The Bureau declines to propose such amendments. The ATR requirements anticipate that covered transactions (and other obligations that must be considered) may feature non-monthly payments and require that these non-monthly payments be converted into monthly payment amounts. Comment 43(c)(5)(i); *see, e.g.,* comment 43(c)(2)(v)–4. The Bureau thus does not believe that the non-monthly payment aspect of PACE transactions is unique and seeks to take an approach here that is consistent with how it has handled other non-monthly payments under the ATR rules.

is not a QM as defined in § 1026.43. If finalized, this provision would exclude PACE transactions from eligibility for each of these QM categories in § 1026.43.[209] For the reasons explained herein, the CFPB preliminarily concludes that it would be inappropriate to provide PACE transactions eligibility for a presumption of compliance with the ATR requirements, particularly given the inherent consumer risks presented by these transactions and the unique lack of creditor incentives to consider repayment ability in this new and evolving market.

The purposes of the QM provisions of Regulation Z include ensuring that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of TILA section 129C. The purpose of TILA section 129C is to assure that consumers are offered and receive residential mortgage loans on terms that reasonably reflect their ability to repay the loans and that are understandable and not unfair, deceptive, or abusive. QMs thus are intended only to be those mortgages for which it is reasonable to presume that the creditor made a reasonable determination of consumer repayment ability. The unique nature of PACE transactions, however, raises serious risks that undermine the Bureau's confidence in the reasonableness of presuming creditor compliance with the ATR requirements.

First, as described above, certain aspects of PACE financing create unique risks for consumers and can result in unaffordable payment spikes that can lead to delinquency, late fees, tax defaults, and foreclosure actions. PACE consumers who make their payments through an existing escrow account may face large and unpredictable payment spikes that make it difficult for them to repay their PACE obligation. For consumers who do not have an existing escrow account, the annual or semi-annual payment cadence with payments due simultaneously with large property tax payments may render loans unaffordable. The super-priority lien status of PACE transactions also heightens the risk of negative outcomes for consumers. These characteristics suggest that it may be inappropriate to provide a presumption of compliance to PACE financing. TILA specifically excludes from the QM definition loans with certain risky features and lending practices well known to present significant risks to consumers, including loans with negative amortization or interest-only features and (for the most part) balloon loans.[210] The CFPB preliminarily concludes that certain aspects of PACE financing can result in unaffordable payments that present similar risks to consumers and therefore should not be granted QM status.

Available data that show the broader effect that PACE transactions have on consumers' finances further highlight affordability risks inherent in PACE financing. The Bureau's PACE Report estimated the causal effect of a PACE transaction on consumer financial outcomes and found clear evidence that PACE transactions increase non-PACE mortgage delinquency rates.[211] For consumers with a pre-existing non-PACE mortgage, getting a PACE transaction increased the probability of a 60-day delinquency on their non-PACE mortgage by 2.5 percentage points over a two-year period.[212] For comparison, the average two-year non-PACE mortgage delinquency rate in the Bureau's data was about 7.1 percent.[213] The PACE Report finds that consumers in lower credit score tiers are most negatively affected by their PACE transaction, with consumers with sub-prime credit scores experiencing an increase in non-PACE mortgage delinquency almost two-and-a-half times the average effect, and more than 20 times the effect on consumers with super-prime credit scores.[214] In addition, the PACE Report finds that a PACE loan increases the probability of both foreclosure and bankruptcy by about 0.5 percentage points over a two-year period.[215] The CFPB also noted in its PACE Report that PACE transactions may impact other credit outcomes if consumers adjust their borrowing and spending behavior to prioritize their payments for mortgage and property taxes.[216] The PACE Report finds that, for the 29 percent of PACE consumers without a pre-existing non-PACE mortgage, their average monthly credit card balance increased by over $800 over a two-year period following origination of the PACE transaction.[217] The PACE Report concludes that consumers without a pre-existing non-PACE mortgage appear to respond to the cost of PACE transactions by increasingly relying on credit cards. Although not tied directly to the consumer's performance on the PACE transaction, these results suggest that at least some consumers without a pre-existing non-PACE mortgage have obtained PACE transactions that were unaffordable at the time of consummation. The CFPB preliminarily concludes that, even with the ATR requirements applied to PACE, affordability risks could remain due to PACE transactions' inherent features that shield creditors from losses, as discussed below.

In addition, the Bureau is concerned that creditors originating PACE transactions may possess a uniquely strong disincentive to adequately consider a consumer's income or assets, debt obligations, alimony, child support, and monthly debt-to-income ratio or residual income, as required under the Bureau's existing QM definitions, and under the Regulation Z

[209] The Bureau also appreciates that, as a consequence of this proposal, PACE transactions would not be permitted to include prepayment penalties. 15 U.S.C. 1639c(c); 12 CFR 1026.43(g). The Bureau understands that in general PACE transactions currently do not include these penalties.

[210] In the January 2013 Final Rule, the Bureau observed that the clear intent of Congress was to ensure that loans with QM status have safer features and terms than other loans. *See, e.g.,* 78 FR 6407, 6426 (Jan. 30, 2013) (discussing ''Congress's clear intent to ensure that qualified mortgages are products with limited fees and more safe features''); *id.* at 6524 (discussing ''Congress' apparent intent to provide incentives to creditors to make qualified mortgages, since they have less risky features and terms'').

[211] A large majority of PACE borrowers have a primary mortgage at the time of the PACE origination. For consumers with a mortgage, difficulty in paying the cost of a PACE loan will generally manifest in the data as a mortgage delinquency. Payments on PACE transactions are made with property tax payments, and many consumers pay their property taxes through their monthly mortgage payment. *See* PACE Report, *supra* note 12, at 3.

[212] *Id.* at 26–27. As in the Bureau's analysis of the General QM Final Rule, the PACE Report uses delinquencies of at least 60 days as the outcome of interest, to focus on sustained periods of delinquency that may indicate financial distress, rather than isolated incidents or late payments.

[213] *Id.* at 27.

[214] *Id.* at 37.

[215] *Id.* at 33.

[216] The Bureau stated in the PACE Report that it expected that credit card outcomes may be particularly relevant for PACE consumers without non-PACE mortgage loans. The PACE Report finds essentially no impact on credit card balances or delinquency rates for consumers with a pre-existing non-PACE mortgage in the two-year period following consummation of their PACE transaction. *Id.* at 41–42. In general, accumulating revolving debt following a new financial obligation may be probative of difficulty repaying the new obligation. Typically, the Bureau has not evaluated these outcomes in its rulemakings related to the QM categories due to both the availability of more direct measures of ability to repay in the non-PACE mortgage space and the greater data requirements for reliably attributing changes in revolving balances to the effect of a new financial obligation. The data would need to link non-mortgage outcomes to a mortgage application, follow such outcomes over time, and ideally have a similarly situated comparison group that does not receive the new mortgage loan, to capture how non-mortgage outcomes would have evolved absent the new loan. Although the data used in the PACE Report had all of these characteristics, the datasets used in the January 2013 Final Rule and General QM Final Rule and the Bureau's 2018 ATR/QM Assessment, such as the HMDA data, generally lacked one or more of these necessary characteristics.

[217] *Id.* at 41.

ATR framework, because these creditors bear minimal risk of loss related to the transaction. As noted, under most PACE-enabling statutes, the liens securing PACE transactions take the priority of a property tax lien, which is superior to other liens on the property, such as mortgages, even if the other liens predated the PACE lien.[218] In the event of foreclosure, any amount owed on the PACE transaction is paid by the foreclosure sale proceeds before any proceeds will flow to other debt. This, combined with relatively low average loan amounts, appears to significantly limit the economic risk faced by creditors originating PACE transactions. Further, as described in the PACE Report and in part IX.A below, mortgage servicers will often pay a property tax delinquency on behalf of a consumer regardless of whether the consumer had a pre-existing escrow account. This means for the more than seventy percent of PACE consumers with a pre-existing non-PACE mortgage, it is unlikely that the PACE transaction would ever cause a loss to the PACE creditor.[219] In addition, the PACE transaction repayment obligation generally remains with the property when ownership transfers through foreclosure or otherwise. Thus, any balance that remains on the PACE transaction following a foreclosure sale will generally remain as a lien on the property for future homeowners to repay, further reducing the risk of loss to the creditor. These factors limit creditors' economic incentives to determine repayment ability and raise risks of consumer harm that undermine the Bureau's confidence in the reasonableness of presuming creditor compliance with the ATR requirements.

Further, the PACE market is still relatively new and evolving. As discussed in part II.A, PACE has only existed for 15 years, and State PACE authorizing statues have been amended in a number of ways since the product originally emerged. Additionally, some major PACE companies have recently exited the industry. These factors, coupled with the other factors discussed above, make it particularly difficult to draw any inferences that would support providing PACE transactions a presumption of compliance with the ATR requirements.

In addition to these concerns about PACE transactions receiving a QM presumption of compliance, the Bureau also preliminarily concludes that the criteria used to determine QM status under the existing QM definitions in § 1026.43 would not be suitable for PACE transactions. In particular, the Bureau preliminarily concludes that the unique pricing model and risk structure associated with PACE transactions may make any price-based criterion—including the pricing thresholds set forth for the General QM category in § 1026.43(e)(2)(vi) and any PACE-specific thresholds the Bureau might develop—an inappropriate measure of a consumer's repayment ability at consummation.

In the General QM Final Rule, the Bureau noted that loan pricing for non-PACE mortgages reflects credit risk based on many factors, including DTI ratios and other factors that may also be relevant to determining ability to repay, such as credit scores, cash reserves, or residual income, and may be a more holistic indicator of ability to repay than DTI ratios alone.[220] However, the pricing for PACE transactions has some notable differences from the non-PACE mortgage market.[221] The available data on PACE financing demonstrates that the pricing for such transactions is tightly bunched, with about half of PACE transactions analyzed by the Bureau having APRs between 8.3 and 9 percent.[222] The Bureau's available data indicate that pricing is primarily correlated with State and property type, causing the Bureau to doubt that any pricing threshold could serve as an appropriate indicator of a consumer's ability to repay.[223] The PACE Report confirms that PACE transactions are not generally priced based on traditional measures of credit risk; it notes that APRs for PACE transactions are uncorrelated or very weakly correlated with traditional measures of risk such as loan balance, loan-to-value (LTV) ratio, or credit score.[224] Rather, as discussed in part IX.A, the data on PACE pricing shows that it is consistent with the unique and substantial protection from loss enjoyed by parties involved with PACE transactions that is not common in the non-PACE mortgage market.

Further, while the Bureau's research indicates some differences in delinquency rates on non-PACE mortgages correlated to PACE rate spreads, it is not clear that the pricing thresholds for the General QM category would be predictive of early delinquency and could be used as a proxy for measuring whether a consumer had a reasonable ability to repay at the time the PACE transaction was consummated.[225] According to the Bureau's research, PACE transactions with rate spreads above 3.5 percent and between 2.25 and 3.49 percent increase delinquency rates on a consumer's non-PACE mortgage by an estimated 2.8 percent and an estimated 1.4 percentage points, respectively, and that PACE transactions with rate spreads below 2.25 percent have almost zero effect on non-PACE mortgage delinquency.[226] The CFPB preliminarily concludes that this data would not be sufficient to provide a basis for applying the current General QM pricing thresholds to PACE transactions even if a QM were not otherwise inappropriate for the reasons discussed above. As discussed in part IX.A below, the economic logic that normally supports pricing being based on risk is absent in the market for PACE transactions. As a result, even though the PACE Report finds that PACE transactions with low rate spreads had relatively better delinquency outcomes, it does not appear reasonable to presume that a creditor that offers a PACE transaction with a low APR has made a reasonable and good faith determination of a consumer's ability to repay.[227]

The Bureau also preliminarily concludes that the QM categories in § 1026.43(e)(5), (e)(7), and (f) would not

[218] *See, e.g.,* Cal. Sts. & Hwys. Code sec. 5898.30; Fla. Stat. Ann. Sec. 163.08(8).

[219] PACE Report, *supra* note 12, at 18.

[220] 85 FR 86308, 86325, 86361 (Dec. 29, 2020).

[221] *See generally* part II.A.

[222] PACE Report, *supra* note 12, at 22.

[223] For example, projects involving solar panels (comprising over a third of projects in California but less than 7 percent of projects in Florida) are the least expensive among project types, and projects in Florida had substantially lower APRs than projects in California. *Id.* at 22–23.

[224] *Id.*

[225] Pursuant to the General QM Final Rule, a loan generally meets the General QM loan definition in § 1026.43(e)(2) only if the APR exceeds the APOR for a comparable transaction by less than 2.25, 3.5, or 6.5 percentage points, respectively, depending upon the loan amount, whether the loan is a first or subordinate lien, and whether the loan is secured by a manufactured home. Most PACE transactions would qualify for the highest pricing threshold for General QMs, 6.5 percent, which generally applies to transactions with loan amounts of less than $66,156 (indexed for inflation). 12 CFR 1026.43(e)(2)(vi)(A)–(F).

[226] PACE Report, *supra* note 12, at 40.

[227] The Bureau is also skeptical that defining a category of QMs for PACE transactions based on a specific DTI threshold would be suitable for PACE, given the risk factors described above. Moreover, the CFPB's available evidence does not demonstrate a correlation between a PACE consumer's DTI and non-PACE mortgage outcomes. The Bureau estimates that the effect of a PACE transaction on a consumer's non-PACE mortgage is essentially the same for consumers with DTI ratios above and below 43 percent, a threshold commonly used in the mortgage market and, prior to the General QM Final Rule, a criterion for the General QM category. *Id.* at 48–49. In any event, even assuming that the data revealed a DTI threshold that was sufficiently predictive of early delinquency to serve as a proxy for whether a consumer had a reasonable ability to repay at the time of consummation, the Bureau doubts that a presumption of compliance would be appropriate given the unique characteristics of PACE transactions discussed above.

be appropriate for PACE transactions for additional reasons beyond the inherent risk of these transactions. As discussed above, the Small Creditor QM category in § 1026.43(e)(5) extends QM status to covered transactions that are originated by creditors that meet certain size criteria and that satisfy certain other requirements. The Bureau created the Small Creditor QM category based on its determination that the characteristics of a small creditor—its small size, community-based focus, and commitment to relationship lending—and the incentives associated with portfolio lending together justify extending QM status to loans that meet the criteria in § 1026.43(e)(5), including that the creditor consider and verify the consumers DTI or residual income.[228]

The CFPB preliminarily concludes that this reasoning does not apply in the context of PACE transactions. PACE financing is primarily administered by several large PACE companies that administer programs on behalf of government creditors in each State where residential PACE is active. The PACE companies' role in the transaction eliminates the community-based focus or relationship-lending features that in part justified treating certain small creditors differently for purposes of the Small Creditor QM. The Bureau thus has reason to question whether PACE companies have a more comprehensive understanding of the financial circumstances of their customers or of the economic and other circumstances of a community when they administer a program.[229] Moreover, as discussed above, the incentives for creditors are different for PACE financing than they are for other loans, limiting the effect that holding loans in portfolio has on underwriting practices. Even if a loan is held in portfolio, creditors and PACE companies bear little risk associated with PACE financing, making it more likely these entities will be repaid even in the event of foreclosure or other borrower distress.

Similarly, the reasoning for the Seasoned QM loan category set out in § 1026.43(e)(7) would not apply to PACE transactions. In 2020, the Bureau created the Seasoned QM category for loans that meet certain performance requirements, are held in portfolio by the originating creditor or first purchaser for a 36-month period, comply with general restrictions on product features and points and fees, and meet certain underwriting requirements. As discussed above, the effect that holding loans in portfolio has on underwriting practices is limited for PACE transactions, so the portfolio lending requirement would provide only a limited incentive to make affordable loans. Additionally, mortgage servicers will often pay a property tax delinquency on behalf of a consumer who has both a PACE mortgage and a non-PACE mortgage regardless of whether the borrower had a pre-existing escrow account. For these borrowers, the payment of their property taxes may have no connection to their actual ability to repay their PACE transaction, let alone to creditor compliance with the ATR requirements at consummation. Given this, it does not seem appropriate to draw any inference from a borrower's successful payment history on a PACE transaction regarding the creditor's ability-to-repay determination at consummation.

Moreover, in the context of PACE financing, successful loan performance over a seasoning period of 36 months would not give sufficient certainty to presume that loans were originated in compliance with the ATR requirements at consummation. While a non-PACE mortgage would typically have 36 payments due in the seasoning period, thus demonstrating that the loan payments were affordable to the consumer on an ongoing basis, a PACE transaction would have no more than three or six payments because PACE transactions are paid annually or semi-annually. Evidence of successful performance over only three or six payments would not be sufficiently probative of the creditor's compliance with the ATR requirements at consummation for PACE transactions to create a presumption of compliance.

Similar concerns apply to the Balloon-Payment QM category in § 1026.43(f). The ATR/QM Rule permits balloon-payment loans originated by small creditors that operate in rural or underserved areas to qualify for QM status, even though balloon-payment loans are generally not eligible for General QM status. In addition to the general reasons discussed above for not having a QM definition for PACE, the same specific concerns noted above with respect to the Small Creditor QM—namely, that the involvement of nationwide PACE companies limits the applicability of any special features of small creditors—are equally applicable to the Balloon-Payment QM criteria. Moreover, the Bureau is not currently aware of PACE financing with balloon payments.

The CFPB recognizes that applying the ATR requirements without providing QM status for any PACE transactions may affect the number of PACE loans made. As discussed in more detail in part IX.D, however, the Bureau expects that many affected consumers will retain access to other forms of mortgage and non-mortgage credit that could serve the purposes of PACE-authorizing statutes, such as energy efficiency improvements. Moreover, the CFPB believes any credit access impacts must be justified against the consumer protection risks of extending QM status to PACE transactions. As discussed, the many distinct features of the PACE market and PACE financing significantly undermine the case that it would be appropriate to afford PACE creditors and companies protection from civil liability under TILA section 130 for claims that they failed to comply with the proposed ATR requirements.

For these reasons, the Bureau is proposing to apply the Regulation Z ATR framework to PACE transactions without providing for a QM presumption of compliance. The CFPB is issuing this proposal consistent with EGRRCPA section 307 and pursuant to its authority under TILA sections 129C(b)(3)(C)(ii), 129C(b)(3)(B)(i), and 105(a). EGRRCPA section 307 makes no mention of PACE loans qualifying for a presumption of compliance with the ATR requirements it directed the Bureau adopt for PACE financing. Rather, it provides in relevant part that the CFPB must prescribe regulations that (1) ''carry out the purposes of subsection (a)''—*i.e.,* that no creditor shall make a residential mortgage loan unless the creditor makes a reasonable and good faith determination based on verified and documented information that the consumer has a reasonable ability to repay the loan—and (2) apply TILA section 130 with respect to ''violations under subsection (a)'' to such financing. Nowhere does EGRRCPA section 307 mention TILA section 129C(b) (the provisions governing QMs) or otherwise indicate that the Bureau's adoption of ATR requirements specific to PACE loans should make further allowance for any presumption of compliance with those requirements. Instead, by requiring that the Bureau ''account for the unique nature'' of PACE financing, the Bureau preliminarily concludes that Congress understood that elements of the existing ATR regime for residential mortgage loans—including the QM provisions—may not be appropriate in the case of PACE financing.

In any event, TILA 129C(b)(3)(A) directs the Bureau to prescribe

[228] 78 FR 35430, 35485 (June 12, 2013) (''The Bureau believes that § 1026.43(e)(5) will preserve consumers' access to credit and, because of the characteristics of small creditors and portfolio lending described above, the credit provided generally will be responsible and affordable.'').

[229] *See* 80 FR 59947 (Oct. 2, 2015).

regulations to carry out the purposes of section 129C and TILA section 129C(b)(3)(B)(i) in turn authorizes the Bureau to prescribe regulations that revise, add to, or subtract from the criteria that define a QM upon a finding that such regulations are necessary or proper to ensure that responsible, affordable mortgage credit remains available to consumers in a manner consistent with the purposes of this section, necessary and appropriate to effectuate the purposes of this section and section 129B, to prevent circumvention or evasion thereof, or to facilitate compliance with such sections. TILA section 105(a) likewise provides that regulations implementing TILA may contain such additional requirements, classifications, differentiations, or other provisions, and may provide for such adjustments and exceptions for all or any class of transactions, as in the judgment of the Bureau are necessary or proper to effectuate the purposes of TILA, to prevent circumvention or evasion thereof, or to facilitate compliance therewith. Consistent with those authorities, after taking into account the purposes of the ATR and QM provisions and the unique nature of PACE financing, the Bureau preliminary concludes there is ample reason not to extend a presumption of compliance with the ATR requirements to PACE transactions. The Bureau seeks comment on its preliminary conclusion not to extend QM to PACE financing.

43(i)(3)

EGRRCPA section 307 requires the Bureau to ''prescribe regulations that carry out the purposes of [TILA's ATR requirements] and apply [TILA] section 130 with respect to violations [of TILA's ATR requirements] with respect to [PACE] financing, which shall account for the unique nature of [PACE] financing.'' Section 1026.43 currently applies to the creditor of any transaction that is subject to § 1026.43's ATR requirement. Proposed § 1026.43(i)(3) would also apply the requirements of § 1026.43 to any PACE company that is substantially involved in making the credit decision for a PACE transaction. A PACE company would be ''substantially involved'' in making the credit decision if it makes the credit decision, makes a recommendation as to whether to extend credit, or applies criteria used in making the credit decision. A PACE company would not be substantially involved in making the credit decision for purposes of proposed § 1026.43(i)(3) if it merely solicits applications, collects application information, or performs administrative tasks. Proposed § 1026.43(i)(3) would also apply section 130 of TILA [230] to covered PACE companies that fail to comply with § 1026.43. These proposed amendments would implement EGRRCPA section 307 and would account for the unique and extensive role that PACE companies play in PACE financing by creating incentives for those companies to ensure that TILA's ATR requirements are met for PACE transactions and enhancing consumers' remedies in the event that the ATR requirements are not met.

PACE companies play an extensive role in PACE financing programs. As noted in the section-by-section analysis of proposed § 1026.2(a), it is the Bureau's understanding that PACE creditors are typically government entities. At present in the PACE industry, these government creditors generally contract with PACE companies to perform many of the day-to-day operations of PACE financing programs. This encompasses tasks such as marketing PACE financing to consumers, training home improvement contractors to sell PACE transactions to consumers, overseeing originations, performing underwriting, and making decisions about whether to extend the loan. The PACE companies may also contract with third-party companies to administer different aspects of the loans after origination. Some ANPR commenters indicated that it is also common for PACE companies to help raise the private capital needed to fund PACE financing programs through the acquisition and securitization of PACE bonds issued by PACE creditors. In exchange for their role, PACE companies typically receive part of the profit from PACE financing.

Given the unique role that PACE companies play in PACE financing, the Bureau preliminarily concludes that application of § 1026.43 to PACE companies, in addition to creditors, is both appropriate and consistent with the Congressional mandate in EGRRCPA section 307 to implement regulations that carry out the purposes of TILA's ATR provisions.

The Bureau similarly believes that it is appropriate to implement section 307's mandate to apply section 130 to PACE transactions by extending the applicability of section 130 of TILA for violations of the ATR requirements to PACE companies that are substantially involved in making credit decisions. As described above, PACE companies are the entities most likely to perform or oversee the credit decision making, including any ability-to-repay analysis, and to receive much of the profit from operation of PACE financing programs. Applying section 130 to PACE companies that are substantially involved in the credit decision making, therefore, would extend the economic incentive to comply to a party that bears substantial responsibility for the credit decision and that is likely to profit from the transaction.

In addition, application of section 130 to covered PACE companies would enhance consumers' ability to obtain remedies for violation of the ATR rules. TILA section 113(b) [231] provides that no civil or criminal penalties may be imposed under TILA upon any State or political subdivision thereof, or any agency of any State or political subdivision. PACE creditors are generally government entities that would be subject to section 113(b)'s protection, and therefore, without application of section 130 to PACE companies, PACE consumers would be limited in their ability to obtain remedies for violations of the ATR requirements. By specifically directing the Bureau to apply section 130's liability provision as well as the ATR requirements to PACE, while ''account[ing] for the unique nature'' of PACE financing, Congress intended the Bureau to do more than simply apply the ATR requirements to PACE financing. To apply the ATR requirements but not change the liability framework would mean section 130's penalty provisions would be less effective as to ATR violations, since the only creditor available in a consumer civil action is the state or local government entities who are not subject to civil penalties.

The Bureau proposes to use its authority under EGRRCPA section 307 to apply the requirements of § 1026.43 to PACE companies and to apply section 130 of TILA to PACE companies for violations of § 1026.43. For the reasons described above, the Bureau believes that the unique nature of PACE financing supports its proposal to add § 1026.43(i)(3). The Bureau seeks comment on this proposed provision and how best to define when a PACE company should be subject to proposed § 1026.43(i)(3). For example, the Bureau invites feedback on whether ''substantially involved in making the credit decision for a PACE transaction'' is the best way to define the type of involvement a PACE company should have in the PACE transaction to be subject to proposed § 1026.43(i)(3).

[230] 15 U.S.C. 1640.

[231] 15 U.S.C. 1612(b).

Appendix H—Closed-End Forms and Clauses

The Bureau proposes to add forms H–24(H) and H–25(K) to appendix H to Regulation Z. Forms H–24(H) and H–25(K) would provide blank model forms for the Loan Estimate and Closing Disclosure illustrating the inclusion or exclusion of the information as required, prohibited, or applicable under §§ 1026.37 and 1026.38 for PACE transactions. The proposed forms are generally based on existing forms H–24(G), Mortgage Loan Transaction Loan Estimate—Modification to Loan Estimate for Transaction Not Involving Seller, and H–25(J), Mortgage Loan Transaction Estimate—Modification to Closing Disclosure for Transaction Not Involving Seller. The Bureau plans to publish translations of Forms H–24(H) and H–25(K) if the Bureau finalizes the proposed additions to appendix H. The Bureau is also considering modifying proposed forms H–24(H) and H–25(K) in the final rule to provide additional pages for variations in the information required or permitted to be disclosed. For example, existing form H–24(G) contains four versions of page two to reflect the possible permutations of the disclosures under § 1026.37(i) and (j). The Bureau proposes forms H–24(H) and H–25(K) pursuant to the authority and for the reasons described above in the discussion of §§ 1026.37(p) and 1026.38(u), as well as pursuant to its authority to publish such integrated model disclosure forms under TILA section 105(b) and RESPA section 4(a).

VIII. Effective Date

The Bureau proposes that the final rule, if adopted, would take effect at least one year after publication in the **Federal Register**, but no earlier than the October 1 which follows by at least six months the date of promulgation.[232] The final rule would apply to covered transactions for which creditors receive an application on or after this effective date. The Bureau tentatively determines that a one-year period between **Federal Register** publication of a final rule and the final rule's effective date would give creditors enough time to bring their systems into compliance with the revised regulations. The Bureau requests comment on this proposed effective date.

[232] Under TILA section 105(d), Bureau regulations requiring any disclosure which differs from disclosures previously required by part A, part D, or part E, or by any Bureau regulation promulgated thereunder, shall have an effective date of that October 1 which follows by at least six months the date of promulgation, subject to certain exceptions. 15 U.S.C. 1604(d). To the extent TILA section 105(d) applies, the proposed effective date would be consistent with it.

IX. CFPA Act Section 1022(b) Analysis

A. Overview

In developing this proposed rule, the Bureau has considered the proposed rule's potential benefits, costs, and impacts in accordance with section 1022(b)(2)(A) of the CFPA.[233] The Bureau requests comment on the preliminary analysis presented below and submissions of additional data that could inform the Bureau's analysis of the benefits, costs, and impacts. In developing the proposed rule, the Bureau has consulted or offered to consult with the appropriate prudential regulators and other Federal agencies, including regarding the consistency of this proposed rule with any prudential, market, or systemic objectives administered by those agencies, in accordance with section 1022(b)(2)(B) of the CFPA.[234] As discussed in part V.C above, the Bureau also has consulted with State and local governments and bond-issuing authorities, in accordance with EGRRCPA section 307.[235]

Provisions To Be Analyzed

Although the proposal has several parts, for purposes of this 1022(b)(2)(A) analysis, the Bureau's discussion groups the proposed provisions into two broad categories. The provisions in each category would likely have similar or related impacts on consumers and covered persons. The categories of provisions are: (1) the proposal to apply the ATR provisions of § 1026.43 to PACE transactions, with certain adjustments to account for the unique nature of PACE, including denying eligibility for any QM categories; and (2) the proposal to clarify that only involuntary tax liens and involuntary tax assessments are not credit for purposes of TILA, such that voluntary tax liens and voluntary tax assessments that otherwise meet the definition of credit, such as PACE transactions, are credit for purposes of TILA.

Economic Framework

Before discussing the potential benefits, costs, and impacts specific to this proposal, the Bureau provides an overview of its economic framework for analyzing the impact and importance of creditors and PACE companies considering a consumer's ability to repay prior to an extension of credit. The Bureau has previously discussed the general economics of ATR determinations in the January 2013 Final Rule and elsewhere,[236] and focuses here on economic forces specific to PACE.

[233] 12 U.S.C. 5512(b)(2)(A).

[234] 12 U.S.C. 5512(b)(2)(B).

[235] 15 U.S.C. 1639c(b)(3)(C)(iii)(II).

In normal lending markets, such as the non-PACE mortgage market, creditors generally have an intrinsic profit motive to set loan pricing based in part on ability to repay and in turn have an economic incentive to determine ability to repay. Indeed, in the January 2013 Final Rule, the Bureau noted that even prior to the then-new ATR requirements of Regulation Z, most mortgage lenders voluntarily collected income information as part of their normal business practices. Economic theory says that, to be profitable, a lender must apply high enough interest rates to its loans such that the average *ex ante* expected value of the loans in its portfolio is positive. The higher the likelihood of nonpayment, the higher the interest rate must be to make a profit.[237] Lenders may price based on the average ability to repay in the population, or may price on individual risk after making an effort to determine ability to repay, but they cannot typically remain profitable in a competitive market if they set interest rates while ignoring ability to repay entirely.[238]

The market for PACE financing has some notable differences from the typical non-PACE mortgage market that dampen or eliminate the economic incentive to price based on ability to repay. Those who stand to receive revenues from PACE transactions are shielded from losses in ways that are not common in the mortgage market. First, for the more than 70 percent of PACE borrowers with a pre-existing

[236] *See, e.g.,* 78 FR 35430, 35492–97 (June 12, 2013).

[237] This holds empirically as well. In the General QM Final Rule, the Bureau noted that loan pricing for non-PACE mortgages is correlated both with credit risk, as measured by credit score, and with early delinquency, as a proxy for affordability. *See* 85 FR 86308, 86317 (Dec. 29, 2020).

[238] A lender that conducts an ability-to-repay analysis will have a more precise measurement of the risk of non-payment, and can thus profitably price loans to consumers with high ability to repay at a low interest rate, being reasonably assured of repayment, while pricing riskier loans at a higher rate to compensate for the higher risk of default. A lender that does not conduct an ability-to-repay analysis must price loans consistent with the average risk of default in the population in order to make a profit. This pooled risk rate will involve an interest rate higher than the low rates that could otherwise be profitably offered to low-risk consumers. Note that this logic applies even if loans are ultimately sold on the secondary market and securitized. A rational investor will not pay market rate for an asset-backed security where the component mortgages are priced at levels consistent with low risk if the lender cannot verify that the loans are actually low risk.

non-PACE mortgage,[239] it is unlikely that the PACE transaction would ever cause a loss to the PACE company or its investors because mortgage servicers for the non-PACE mortgage will often pay a property tax delinquency on behalf of a borrower. Second, PACE companies generally will be made whole in the event of foreclosure, whether that foreclosure is initiated by the taxing authority or a non-PACE mortgage holder, because PACE transactions are structured as tax liens, and will typically take precedence over any non-tax liens, such as those securing pre-existing mortgage loans. Third, PACE companies may be made whole even if the foreclosure proceeds are insufficient. Because PACE transactions are technically structured as obligations attached to the real property, rather than the consumer, any remaining amounts that are not paid through foreclosure proceeds generally will not be extinguished and will instead remain on the property for subsequent owners to pay.

The empirical evidence on PACE transactions is consistent with the unusual protection from loss that the structure of PACE transactions provides for the parties receiving revenue from the loans. The PACE Report shows that PACE companies largely did not collect income information from applicants when they were not required to by State law, consistent with the lack of an economic incentive to verify ability to repay.[240] Moreover, the PACE Report finds that PACE transactions are not priced based on individual risk.[241] The PACE Report notes that estimated APRs for PACE transactions are tightly bunched, with about half of estimated PACE APRs between 8.3 and 9 percent.[242] The Report also notes the PACE APRs are at best weakly correlated with credit score, with an average difference of less than five basis points between loans made to consumers with deep subprime credit scores and consumers with super-prime credit scores.[243]

B. Data Limitations and Quantification of Benefits, Costs, and Impacts

The discussion below relies on information that the Bureau has obtained from industry, other regulatory agencies, and publicly available sources, including reports published by the Bureau. These sources form the basis for the Bureau's consideration of the likely impacts of the proposed rule. The Bureau provides estimates, to the extent possible, of the potential benefits and costs to consumers and covered persons of this proposal, given available data.

Among other sources, this discussion relies on the Bureau's PACE Report, as described in part IV above. The Report utilizes data on applications for PACE transactions initiated between July 2014 and June 2020, linked to de-identified credit record information through June 2022. As described above, the Report estimates the effect of PACE transactions on consumers by comparing approved PACE applicants who had an originated PACE transaction to those who were approved but did not have an originated transaction. The Report uses a difference-in-differences regression methodology, essentially comparing the changes in outcomes like mortgage delinquency for originated PACE borrowers before and after their PACE transactions were originated to the same changes for applicants who were approved but not originated. In this discussion of the benefits, costs, and impacts of the proposal, the Bureau focuses on results from what the Report refers to as its ''Static Model'' which considers outcomes over the period between zero to two years prior to the PACE transaction and the period between one to three years after. The Report also estimates the effect of the 2018 California PACE Reforms on PACE lending in that State, using Florida as a comparison group in a difference-in-differences methodology. The Bureau also relies on publicly available data on PACE from State agencies and PACE trade associations, as well as on public comments in response to the ANPR.

The Bureau acknowledges several important limitations that prevent a full determination of benefits, costs, and impacts. The Bureau relies on the PACE Report for many parts of this discussion, but as discussed in the PACE Report itself, the data underlying the Report have limitations.[244] The data used in the report are restricted primarily to consumers with a credit record, with respect to consumer impacts. Further, the comparison groups used in the difference-in-differences analysis are reasonable but imperfect. In addition, while the 2018 California PACE Reforms are informative to the Bureau's consideration of the impacts of the proposed rule on consumers and covered persons, the proposed rule has different requirements from the State laws that made up the 2018 California PACE Reforms, such that the potential impacts may differ.

In light of these data limitations, the analysis below provides quantitative estimates where possible and a qualitative discussion of the proposed rule's benefits, costs, and impacts. General economic principles and the Bureau's expertise, together with the available data, provide insight into these benefits, costs, and impacts. The Bureau requests additional data or studies that could help quantify the benefits and costs to consumers and covered persons of the proposed rule.

C. Baseline for Analysis

In evaluating the proposal's benefits, costs, and impacts, the Bureau considers the impacts against a baseline in which the Bureau takes no action. This baseline includes existing regulations, State laws, and the current state of the market. In particular, the baseline assumes no change in the current State laws and regulations around PACE financing. Also, notwithstanding the proposed clarification that only involuntary tax liens and involuntary tax assessments are excluded from being credit under Regulation Z (such that the commentary would not exclude PACE transactions), the baseline assumes that the current practices of PACE industry stakeholders generally are not consistent with treating PACE financing as TILA credit.

D. Potential Benefits and Costs to Consumers and Covered Persons

This section discusses the benefits and costs to consumers and covered persons of the two main groups of provisions discussed above: the proposed ATR provisions, and the proposal to clarify that only involuntary tax liens and involuntary tax assessments are excluded from being treated as credit under TILA.

Potential Benefits and Costs to Consumers and Covered Persons From the Proposed ATR Provisions

The Bureau proposes amendments under § 1026.43, which generally requires an ability-to-repay analysis before originating a mortgage loan, to explicitly include PACE transactions, with several adjustments for the unique nature of PACE. The Bureau also proposes to provide that a PACE transaction is not a QM as defined in § 1026.43.

Potential Benefits and Costs to Consumers of the Proposed ATR Provisions

Under the proposed rule, consumers who are not found to have a reasonable

[239] PACE Report, *supra* note 12, at 18.

[240] *Id.* at Table 1.

[241] *Id.* at 23.

[242] *Id.* at Table 2.

[243] *Id.* at 23.

[244] *Id.* at 52.

ability to repay the loan would not be able to obtain a PACE loan. In general, the Bureau expects that consumers who would be denied PACE transactions due to the required ATR determination would otherwise struggle to repay the cost of the PACE transaction. These consumers generally would benefit from the proposal.

The evidence in the PACE Report helps to partially quantify the potential benefits to consumers who cannot afford a PACE transaction. The difference-in-differences estimation in the Report finds that, for consumers with a pre-existing non-PACE mortgage, entering into a PACE transaction increases the probability of becoming 60-days delinquent on the pre-existing mortgage by 2.5 percentage points in the two years following the first due date for a tax bill including the PACE transaction.[245] For consumers without a pre-existing non-PACE mortgage, the Report finds that, following a PACE transaction, such consumers' monthly credit card balances increase by over $800 per month.[246]

Additional evidence from the PACE Report indicates that requiring an ability-to-repay analysis could improve outcomes specifically for consumers who would otherwise struggle to repay the PACE transaction. The PACE Report finds that the effect of a PACE transaction on mortgage delinquency is higher for consumers with lower credit scores. The average effect of a 2.5 percentage point increase in the rate of non-PACE mortgage delinquency over a two-year period is composed of a 0.3 percentage point increase for consumers with super-prime credit scores (11.1 percent of all PACE borrowers), a 1.7 percentage point increase for consumers with prime credit scores (42 percent of borrowers), a 3.8 percentage point increase for consumers with near-prime credit scores (23.4 percent of borrowers), and a 6.2 percentage point increase for consumers with subprime credit scores (20.4 percent of borrowers).[247] The consumers with subprime credit scores would be the most likely to be excluded by the ability-to-repay analysis that the proposal would require. Credit score tends to be correlated with income. Moreover, credit scores are based on credit history, and the proposed ATR requirements would require consideration of credit history.

The evidence from the PACE Report also suggests that collecting income information from potential PACE borrowers can lead to better outcomes. The evidence is less direct on this point because PACE companies did not collect income information from a large majority of applicants during the period studied by the Report. For example, the Report indicates PACE companies collected income information from less than 24 percent of originated borrowers in California prior to April 2018, and a little more than 10 percent of originated borrowers in Florida during that time.[248] Income information was primarily available in the data used in the Report for consumers in California after April 2018. After this point, the Report finds that essentially all originated borrowers in California had income information collected, likely because the 2018 California PACE Reforms required consideration of income by PACE companies as part of an analysis that considered consumers' ability to pay the PACE loan. As a result, the PACE Report's analysis of income is largely based on consumers whose PACE transactions were originated under requirements that resemble the proposed ATR requirements in some respects.

The PACE Report finds that PACE transactions increase non-PACE mortgage delinquency less for consumers where the PACE company collected income information.[249] The Report also finds that PACE transactions increased non-PACE mortgage delinquency rates more for consumers in California before the 2018 California PACE Reforms, compared to consumers in California after 2018, with the effect falling by almost two-thirds after the 2018 California PACE Reforms required consideration of income by PACE companies, from a 3.9 percentage point increase to a 1.5 percentage point increase.[250] However, the Report also finds that the effect of PACE on mortgage delinquency decreased somewhat in Florida as well around 2018, which suggests the change could be in part the result of other nationwide trends, rather than solely the requirements of the 2018 California PACE Reforms.[251] The PACE Report was inconclusive with respect to whether income or a calculation of DTI predicted negative effects of PACE on financial outcomes, because income information was not available for enough consumers to draw statistically reliable conclusions about subgroups of the population with income information.[252]

The facts documented by the PACE Report, described above, indicate that the proposed ATR provisions would likely protect some consumers who cannot afford a PACE transaction from entering into a PACE transaction and potentially suffering negative consequences as a result of that transaction. The Bureau does not have data available to precisely determine the number of consumers who would benefit, or the monetary value of those benefits, but the Bureau provides some rough estimates below.

Consumers who become delinquent on their mortgages will, at a minimum, incur late fees on their payments. If a PACE transaction causes a longer delinquency, the consequences could include foreclosure or a tax sale. Consumers' credit scores could also be affected, although the PACE Report finds only small impacts of PACE on credit scores—perhaps in part because PACE borrowers tended to already have relatively low credit scores prior to the PACE transaction. The Bureau quantifies the individual and aggregate monetary benefits of avoiding these consumer harms below to the extent possible. The Bureau uses the estimates from the PACE Report of the average effect of PACE on consumer outcomes to estimate these benefits but notes that these estimates may overstate aggregate benefits to the extent that existing laws in California already protect consumers in that State from some unaffordable PACE transactions.

The PACE Report finds that the average monthly mortgage payment for consumers with PACE transactions originated between 2014 and 2020 was $1,877.[253] Assuming a late fee of five percent, avoiding a PACE transaction would save the average PACE consumer who experiences a 60-day mortgage delinquency at least $188 over a two-year period. The average benefit to such consumers would likely be higher, as many would likely have more than a single 60-day mortgage delinquency caused by the PACE transaction.

Foreclosure is extremely costly, both to the consumer who experiences foreclosure and to society at large. In its 2021 RESPA Mortgage Servicing Rule, the Bureau conservatively assumed the cost of a foreclosure was $30,100 in 2021 dollars, consisting of both the up-front cost to the foreclosed consumer and the resulting decrease in property values for their neighbors, but no other pecuniary or non-pecuniary costs.[254] The Bureau adopts the same assumption here with an adjustment for inflation,

[245] *Id.*

[246] *Id.* at 41–42.

[247] *Id.* at Figure 10.

[248] *Id.* at Table 1.

[249] *Id.* at 45.

[250] *Id.* at 46.

[251] *Id.* at 46–47.

[252] *Id.* at 47–48.

[253] *Id.* at 16.

[254] *See* 86 FR 34889 (June 30, 2021).

noting as it did in the 2021 rule that it is likely an underestimate of the average benefit to preventing foreclosure. Adjusting for inflation to 2023 dollars, the benefit of an avoided foreclosure is $33,169.

The Bureau does not have data available to estimate the benefits to consumers of preventing a reduction in credit score but notes again that the PACE Report finds that PACE transactions only lower scores by an average of about one point,[255] suggesting that such benefits would be negligible in magnitude.

In 2019, the last full year of data studied in the PACE Report, the four PACE companies whose data were included in the Report originated about 2,000 PACE transactions per month, for a total of about 24,000 per year.[256] For the 71.1 percent of such borrowers with a pre-existing non-PACE mortgage,[257] a 2.5 percentage point increase in mortgage delinquency would mean about 600 consumers per year struggling to pay the cost of their PACE transaction and incurring at least a 60-day delinquency. Most loans that become delinquent do not end with a foreclosure sale.[258] The PACE Report finds that PACE transactions increase the probability of a foreclosure by 0.5 percentage points over a two-year period.[259]

Assuming that 0.5 percent of consumers who engage in a PACE transaction would ultimately experience foreclosure as a result of the PACE transaction, the proposed rule could prevent about 120 foreclosures per year, for an aggregate annual benefit of about $4 million per year. If the proposed rule were to prevent a minimum of two months of late fees for each of the 600 consumers who would otherwise become 60-days delinquent as a result of a PACE transaction, that would result in additional aggregate benefits of at least $112,000 per year.

As discussed above, the difference-in-differences analysis in the PACE Report also finds that credit card balances increased significantly for PACE borrowers who did not have a pre-existing non-PACE mortgage, compared to the change in balances for PACE applicants who did not originate a loan and also did not have a pre-existing non-PACE mortgage.[260] The additional credit card balances incurred by consumers without a pre-existing non-PACE mortgage could result in interest charges if they are not paid in full on time.[261] If the proposed rule prevented the 29.9 percent of PACE consumers without a pre-existing non-PACE mortgage from revolving an additional $833 in average credit card balances for an average of one year, with an APR of 24 percent this could result in about $1.4 million in aggregate benefit annually.

The proposed ATR requirements may also benefit consumers by increasing the likelihood that they understand the nature of PACE transactions, particularly in combination with the required TILA–RESPA integrated disclosures discussed below in the next section. Commenters responding to the ANPR, as well as stories in the media, have indicated that some PACE borrowers do not realize they are committing to a long-term financial obligation when they agree to a PACE transaction. This may occur, for example, due to deceptive conduct on the part of a home improvement contractor marketing the PACE transaction, or due to the complexity and unfamiliarity of the PACE transaction itself. Whatever the cause, it is more likely that a consumer who is asked to produce documentation of their income will realize that they are signing up for a loan that must be repaid over time. As such, the proposed rule may benefit consumers who would otherwise misunderstand the nature of a PACE transaction. Consumers who would not agree to a PACE transaction if they understood its nature as a financial obligation they would need to repay may be more likely to understand the nature of the transaction, and thus decline it. In addition, even consumers who would still agree to the transaction understanding its nature as a financial obligation would be more likely to prepare for the increase to their property tax bill caused by the PACE transaction.

For consumers who would not, with full understanding, agree to a PACE transaction, the potential benefits of the proposed rule to each such consumer would depend on whether the consumer would still agree to the home improvement contract the PACE transaction was intended to fund. For consumers who would have been willing to proceed with the home improvement project without a PACE transaction, the Bureau assumes that at least some would seek to pay off the PACE transaction after the first payment becomes due.[262] In this case, the benefit to the consumer would be saving the first year of interest on the PACE transaction, as well as up-front fees and any capitalized interest accrued prior to the first payment. The PACE Report finds that the average fee amount for PACE transactions made between 2014 through 2020 was $1,301, and the average capitalized interest was $1,412.[263] The average interest rate was 7.6 percent.[264] On the average original balance of $25,001,[265] this would result in interest payments of $1,900 in the first year. Thus, each consumer would save about $4,600 in interest and fees if they avoided a PACE transaction rather than repaying it after the first payment becomes due. Further, if the consumer otherwise would not have agreed to the home improvement project (*i.e.,* the consumer only agreed to the project based on a misunderstanding about the

[255] PACE Report, *supra* note 12, at 41.

[256] *Id.* at Figure 16.

[257] *Id.* at 18.

[258] Because of generally favorable conditions in both the housing market and the non-PACE mortgage market in recent years, PACE borrowers may have been more able to avoid foreclosure by either selling or refinancing their homes, compared to the non-PACE mortgage borrowers studied in the Assessment Report using earlier data. Indeed, the PACE Report finds that PACE loans increased the probability of a consumer closing a mortgage (indicating some kind of prepayment), with no increase in new mortgages, suggesting a subset of PACE borrowers may have been induced to sell their homes. Although they would avoid the cost of foreclosure by doing so, moving is also expensive, with real estate agents' fees alone representing typically 5 to 6 percent of the home's value, in addition to other closing costs and the costs related to moving.

[259] *See* PACE Report, *supra* note 12, at 33. The PACE Report notes that the credit record data used in the PACE Report are limited with respect to measuring foreclosures. Nonetheless, the size of this effect relative to the Report's estimate of the effect of PACE transactions on 60-day delinquencies is consistent with prior CFPB research on the share of 60-day delinquencies that end in a foreclosure. The Bureau's 2013 RESPA Servicing Rule Assessment Report found that, for a range of loans that became 90-days delinquent from 2005 to 2014, approximately 18 to 35 percent ended in a foreclosure sale within three years of the initial delinquency. Focusing on loans that become 60-days delinquent, the same report found that, 18 months after an initial 60-day delinquency, between eight and 18 percent of loans had ended in foreclosure sale over the period 2001 to 2016. *See* CFPB, *2013 RESPA Servicing Rule Assessment Report* (Jan. 2019), *https://files.consumerfinance.gov/f/documents/cfpb_mortgage-servicing-rule-assessment_report.pdf.*

[260] PACE Report, *supra* note 12, at 41.

[261] Interest charges generally do not result if a balance is paid in full and on time, but it stands to reason that if balances increased in response to another financial obligation, the consumer does not have the resources available to pay the balance in full. The PACE Report does not distinguish between revolving balances and "transacting" balances that are paid in full.

[262] If the consumer did not realize they had effectively agreed to a loan at origination, this would become clear when their next property tax bill became due. The PACE Report finds that on average a consumer's total property taxes likely increased by almost 88 percent as a result of the PACE loan payment. PACE Report, *supra* note 12, at 13.

[263] Capitalized interest is calculated using the APR, the fee amounts, and the term and interest rate of the PACE transactions provided in the PACE Report. *See id.* at Table 2.

[264] *Id.*

[265] *Id.*

financing), the benefit of preventing misunderstanding is greater still, depending on the value the consumer nonetheless receives from the project.[266]

The Bureau does not have data indicating how often consumers currently misunderstand the nature of a PACE transaction or what share of those consumers would have, in the counterfactual, opted not to agree to the PACE transaction or the related home improvement project had they understood the nature of the PACE transaction. The data used in the PACE Report do not capture when and whether PACE transactions were paid off. However, publicly available data for California indicate that a significant fraction of PACE transactions to date were paid off early in the term of the transaction. The California Alternative Energy and Advanced Transportation Financing Authority (CAEATFA) manages a loss reserve fund for California PACE programs and requires PACE companies to submit information on new PACE transactions semi-annually, and to report their overall portfolio size as of June 30th of each year.[267] CAEATFA reports aggregate statistics from this collection publicly on its website.[268] Using this information, the Bureau can calculate the number of PACE transactions paid off each year as the sum of the prior year's total portfolio and the current year's new transactions, less the current year's total portfolio. This is shown in Table 1.

According to the CAEATFA data, there were 17,401 PACE transactions outstanding in California as of June 30, 2014, and 202,901 new transactions originated after that through June 30, 2020. However, about 89,000 transactions were paid off during this time, based on the change in total outstanding portfolios, meaning that up to 40 percent of PACE transactions may have been paid off early. This likely overstates somewhat the share of transactions that were paid early, and it very likely overstates the share of consumers who misunderstood the nature of the transactions. PACE transactions can have terms as short as five years, such that some transactions may have simply reached maturity. However, the PACE Report shows that only about six percent of PACE transactions have terms of five years.[269] PACE transactions may be paid off early for reasons other than misunderstanding the nature of the transaction, including if the consumer sells their home and is required by the buyer to pay off the PACE transaction.[270] Still, given the frequency of early repayments and the substantial potential benefits to individual consumers of preventing a misunderstanding about the nature of PACE as a financial obligation, the aggregate benefits could be substantial. For instance, if just 10 percent of early repayments on PACE transactions (*i.e.,* 4 percent of all PACE borrowers) were due to a misunderstanding that the proposal could address, the aggregate benefits would be over $4.4 million annually.[271]

TABLE 1

Year	(a) Actual total outstanding portfolio through June 30th, prior year	(b) New financings July 1st–December 31st prior year	(c) New financings January 1st–December 31st, current year	(d) Actual total outstanding portfolio through June 30th, current year	(e) Number paid off ((a) + (b) + (c) − (d))
2015	17,401	7,022	11,515	34,308	1,630
2016	34,308	23,206	32,743	83,904	6,353
2017	83,904	34,036	25,850	119,082	24,708
2018	119,082	25,764	15,482	146,403	13,925
2019	146,403	9,982	6,967	146,525	16,827
2020	146,525	5,541	4,793	131,200	25,659
Total	N/A	97,350	105,551	N/A	89,102

Source: CAEATFA, *https://www.treasurer.ca.gov/caeatfa/pace/activity.pdf.*

To the extent that some consumers continue to receive PACE transactions that they are not able to afford, the proposal would benefit those consumers by providing an avenue for obtaining relief under the civil liability provisions of TILA and Regulation Z. The Bureau does not have data indicating how often this would occur, although as noted below in its discussion of litigation costs to covered persons, the Bureau expects that in the long run this would be infrequent.

If the rule is finalized as proposed, consumers would face the time costs of gathering the required documentation for an ability-to-repay analysis, such as finding and producing W–2s to document proof of income. The Bureau has previously noted in the context of

[266] Generally, the economic loss to a consumer from being induced to purchase something they would not otherwise purchase is the difference between the price paid and the consumer's willingness to pay for the good or service. If the consumer is not willing to make the purchase, by definition their willingness to pay is less than the price. In the context of a PACE transaction for an otherwise unwanted project, the consumer's willingness to pay would be less than the price paid to the contractor, which in turn is less than the full original balance due to fees and capitalized interest. Potentially a consumer's willingness to pay for a project could be zero, or even negative (*i.e.,* the consumer would have to be paid to be willing to permit the project, had they understood). However, consumers may frequently have willingness to pay greater than zero for projects funded by PACE transactions, if only due to realized energy, water, or insurance savings.

[267] *See* Cal. State Treasurer, *Property Assessed Clean Energy (PACE) Loss Reserve Program, https://www.treasurer.ca.gov/caeatfa/pace/activity.asp* (last visited Apr. 6, 2023).

[268] *Id.; see also* Cal. State Treasurer, *PACE Loss Reserve Program Enrollment Activity, https://www.treasurer.ca.gov/caeatfa/pace/activity.pdf* (last visited Apr. 20, 2023).

[269] *See* PACE Report, *supra* note 12, at Figure A1.

[270] The Bureau does not have data indicating how often homeowners are required to pay off a PACE transaction when selling their home. However, as noted in part II.A.4, some mortgage lenders or investors prohibit making a new loan on a property with an outstanding PACE transaction. *See supra* note 16.

[271] Similar to the discussion above regarding the benefits of avoiding unaffordable PACE transactions, this calculation may overstate the aggregate benefits to the extent that existing State law in California prevents consumers from misunderstanding the nature of PACE transactions in that State. Given that the number of PACE transactions paid off each year remained high after the implementation of the 2018 California PACE Reforms, and given that the Bureau is being conservative in assuming that only 10 percent of early repayments were due to misunderstandings, the Bureau preliminarily determines that this estimate is, on balance, likely an underestimate.

non-PACE mortgages that the time required to produce pay stubs or tax records should not be a large burden on consumers. This may differ in the case of PACE transactions, as these transactions are typically marketed in conjunction with home improvement contracts, and consumers may not be prepared to produce income documentation at the point of sale for a home improvement. In any event, the proposal likely would not increase time costs in a meaningful way for PACE applicants in California, because these consumers already must produce documentation similar to what might be necessary for an ATR determination as part of a PACE application under the proposal. In addition, the PACE Report indicates that at least some PACE companies have collected income information from applicants even in Florida, so again there may be little change for some consumers in that State.[272] Further, the Bureau understands that, even in California after the effective date of the 2018 California PACE Reforms, PACE companies do not always collect full income documentation if other eligibility standards are not met. For instance, State laws governing PACE often prohibit PACE transactions from being made to consumers with evidence of recent payment difficulty, such as a recent bankruptcy, mortgage delinquency, or property tax delinquency. The Bureau understands that PACE companies in California set up their eligibility determination process to check these criteria before requesting income documentation from the consumer. The evidence in PACE Report is consistent with this—the Report finds that income information was not available for a sizeable minority of applications in California after 2018 where the application did not result in an originated PACE transaction.[273]

The PACE Report shows that, in 2019, the last full year for which data are available, the PACE companies that participated in the voluntary data collection received about 45,500 applications from prospective borrowers in Florida.[274] As discussed further below, the number of applications would likely fall significantly if the proposal is finalized, possibly by as much as half. In addition, the PACE Report indicates that about a third of PACE applications in Florida after April 2018 included income information.[275] Moreover, about one quarter of PACE applications in California after April 2018 (*i.e.,* when the 2018 California PACE Reforms took effect and began requiring such income information as part of the ability-to-pay analysis) did not,[276] indicating that such consumers in California were rejected before being asked for income information. Together, this suggests that, on average, approximately 11,400 additional consumers might be asked to provide income documentation annually under this rule as proposed.[277] The Bureau does not have data indicating the average amount of time it takes a PACE applicant to produce the documentation for an ATR determination as would be required under the proposed rule. Assuming the time to be one hour and using the median hourly wage in Florida of $18.63,[278] the aggregate time cost to consumers would be about $212,000 annually.

Consumers would also face costs under the proposed rule due to losing access to PACE financing. This would include consumers whose PACE applications are denied due to failing the proposed ATR determination, as well as consumers who do not apply for PACE as a consequence of the proposal.[279] For consumers who cannot, in fact, afford the cost of a PACE transaction, being denied is likely a benefit on net. However, no ATR determination can perfectly predict ability to repay, and some consumers who could, in fact, afford and benefit from a PACE transaction may be denied as a result of the proposed rule, if finalized.

To quantify the cost to consumers of having applications for PACE transactions denied, the Bureau would need to be able to calculate the number of consumers that could afford the cost of a PACE transaction but would be denied as a result of the proposed rule, and the cost to the average consumer of being denied. The Bureau can roughly quantify the number of consumers and discusses this below, but it does not have the data necessary to quantify the average cost, and thus its discussion is ultimately qualitative in nature.

The experience of California under the ability-to-pay regime of the 2018 California PACE Reforms provides a possible benchmark as to how the proposed rule might affect PACE application approval rates. The PACE Report shows that approval rates dropped sharply in California following the effective date of the 2018 California PACE Reforms in April 2018, falling from around 55 percent to around 40 percent.[280] However, the Report also finds that approval rates recovered over time, rising back to around 55 percent by the end of 2019. Using Florida as a comparison group, the Report finds that the 2018 California PACE Reforms lowered the approval rate for PACE applications in California by about seven percentage points, although this average includes both the initial drop and the later recovery.[281] Although the provisions of the proposed rule differ from the requirements of the 2018 California PACE Reforms, it is likely that the rule would have limited additional effect on PACE transaction approval rates in California. Instead, the proposal, if finalized, would primarily reduce approval rates in Florida.

As noted above, the PACE Report indicates that PACE companies in Florida received about 45,500 applications in Florida in 2019, the last full year of data available. Again assuming that the proposed rule would lead to about half as many applications, and assuming that approval rates fall by seven percentage points, that would mean at most about 1,600 consumers annually might have a beneficial PACE application denied. This is an overcount, as many of these consumers in fact would not be able to afford a PACE transaction, and, moreover, the PACE Report shows that approval rates recovered over time. Some of the expected reduction in PACE applications may represent a cost to consumers as well, to the extent this arises from PACE financing being less available in general to consumers who could afford and benefit from it. However, as discussed above, one benefit of the proposal would be that consumers would be less likely to misunderstand the nature of a PACE

[272] *See* PACE Report, *supra* note 12, at Table 1. As noted in part II.A.6, in 2021, the main trade association for PACE companies announced a set of consumer protection policy principles that includes considering ability to pay, although the Bureau does not know to what extent this translates to requiring documentation from consumers where it is not required by State law.

[273] PACE Report, *supra* note 12, at Table 1.

[274] *Id.* at 50.

[275] *Id.* at 10.

[276] *Id.* at Table 1.

[277] The calculation is the product of 45,500 current applications, 0.5 (the assumed reduction due to proposal), 0.67 (the share of Florida applications that do not currently collect income), and 0.75 (the share of the remaining applications that would collect income, based on the share in California that currently collect income), which equals 11,375.

[278] *See* Bureau of Lab. Stats., *May 2021 State Occupational Employment and Wage Estimates, Florida, https://www.bls.gov/oes/current/oes_fl.htm* (last visited Mar. 6, 2023).

[279] Consumers might not apply for PACE due to the effect of the proposal if home improvement contractors who otherwise might have marketed PACE withdraw from that market, or if they opt not to proceed with a PACE transaction as a consequence of the provisions of the proposed rule.

[280] PACE Report, *supra* note 12, at Figure 16.

[281] *Id.* at Table 13.

transaction, which would also reduce PACE applications. As also noted above, a substantial fraction of PACE transactions are paid off early in the term of those transactions, which may be related to such misunderstandings. Although the Bureau expects the volume of PACE transactions in Florida and other States would decline if the proposed rule were finalized, it does not have data that would indicate how much of this decline would be a cost to consumers who miss out on a transaction they would prefer to engage in, and how much is a benefit to consumers who had no interest in participating in a PACE transaction once they understood its true nature or would not have been able to afford the PACE transaction.

The Bureau can characterize qualitatively the consumer costs of not receiving a PACE transaction. The immediate impact to a consumer who might otherwise have agreed to a PACE transaction but is either denied or is not offered a PACE transaction due to the proposed rule is that the consumer either must pay for the home improvement project in cash or with another financing product, or else the consumer must forgo the home improvement project.

Paying in cash for a home-improvement project is not likely to be costly to consumers who choose to do so. Although this involves a large, upfront expenditure, it is unlikely that consumers will frequently agree to pay cash for a home improvement project they cannot afford—they will generally forgo the project instead, the costs of which are discussed below, or find other means of financing. Moreover, even if a consumer's budget might be strained in the short term by the expenditure, the consumer would then save on the—potentially substantial—cost of interest and fees on a loan.

The impact on consumers, relative to the baseline, of using another credit product may be either a cost or a benefit depending on the cost of the other credit product. If the next best alternative has a lower APR than the relevant PACE transaction, consumers who may have received a PACE loan but did not due to the proposed rules relating to ATR could be better off than they would be without the proposed rule. Conversely, if the next best alternative for a consumer has a higher APR, those consumers would be worse off. The PACE Report shows that estimated APRs for PACE transactions averaged 8.5 percent.[282] This is greater than typical rates for home equity lines of credit, but less than typical rates for credit cards.[283] The interest rate on PACE transactions may be more or less than the cost of an unsecured loan for the same home improvement project, which can vary widely depending on the consumer's credit score.

The PACE Report suggests that under the proposal, many consumers who would not receive a PACE transaction would be able to obtain credit through another source, potentially at a better APR than the PACE transaction. The Report shows that the vast majority of PACE borrowers had other credit available. The report shows that almost 99 percent of PACE borrowers have sufficient credit history to have a credit score, almost 90 percent of PACE borrowers had a credit card pre-PACE, and on average PACE borrowers had more than seven unique credit accounts of any type pre-PACE.[284] More than half of PACE borrowers had prime or super-prime credit scores at the time they entered into a PACE transaction.[285] The Bureau notes, however, that this aspect of the PACE Report's analysis was limited to consumers who had a credit report. The Report had to exclude roughly a quarter of the consumers in the data submitted to the Bureau because they could not be matched to a credit report with the credit reporting company that acted as the Bureau's contractor. Some of these consumers may simply have had a mismatch in name or address with the credit reporting company's database, but likely at least some of these consumers had no credit report and were credit invisible. The true share of PACE borrowers with substantial access to credit is likely smaller than what is noted above.

If the consumer does not opt to proceed with the home improvement project, the cost is the loss of the benefits of that project. The nature of these costs would depend on the type of project and the reasons the consumer was considering the project. For the types of home improvement projects that might be eligible for PACE financing, the benefit of the project is primarily the energy, water, or insurance savings the project would have delivered.[286] Other projects may be used to replace critical home equipment such as an HVAC system, without which the consumer would face the cost of not having that equipment. The Bureau does not have data available to estimate the average energy, water, or insurance savings actually obtained by PACE borrowers, nor is the Bureau aware of any research to estimate real-world savings from PACE transactions. One study the Bureau is aware of estimates aggregate energy savings from customers of one PACE company, but this is based on engineering estimates of the savings from each project.[287] The academic literature has found that engineering estimates can frequently overestimate real-world savings from energy efficiency programs.[288] Public comments from consumer advocacy groups in response to the ANPR also cited instances where consumers received smaller energy savings than what was advertised to them.

Potential Benefits and Costs to Covered Persons of the Proposed Ability-to-Repay Provisions

The proposed ATR provisions would primarily affect PACE companies. Although the Bureau understands that local government sponsors are generally the creditor, as defined in TILA, for PACE transactions, the Bureau expects that the required ATR determination, and in practice the liability for any failures to make that determination, would fall on the PACE companies that

[282] *Id.* at Table 2.

[283] Average credit card interest rates on accounts assessed interest were between 13 and 17 percent during the period studied by the PACE Report. *See* Fed. Rsrv. Econ. Data, Fed. Rsrv. Bank of St. Louis, *Commercial Bank Interest Rate on Credit Card Plans, Accounts Assessed Interest* (Apr. 8, 2023), *https://fred.stlouisfed.org/series/TERMCBCCINTNS.* Interest rates for personal loans averaged around 10 percent. *See* Fed. Rsrv. Econ. Data, Fed. Rsrv. Bank of St. Louis, *Finance Rate on Personal Loans at Commercial Banks, 24 Month Loan* (Apr. 8, 2023), *https://fred.stlouisfed.org/series/TERMCBPER24NS.* The median interest rate on home equity lines of credit was 5.34 percent in 2019 based on HMDA data. *See* CFPB, *An Updated Review of the New and Revised Data Points in HMDA: Further Observations using the 2019 HMDA Data,* (Aug. 2020), *https://files.consumerfinance.gov/f/documents/cfpb_data-points_updated-review-hmda_report.pdf.*

[284] *See* PACE Report, *supra* note 12, at Table 6.

[285] *See id.* at Figure 1.

[286] Home values may also increase as a result of the home improvement projects, but generally this will be the consequence of capitalizing the value of future energy, water, or insurance savings already considered here. With respect to insurance savings, industry stakeholders and local government stakeholders in Florida have asserted to the Bureau that consumers may have difficulty obtaining homeowners' insurance for homes in Florida with roofs above a certain age. If a consumer cannot obtain homeowners' insurance on real property that secures a non-PACE mortgage, lenders may force-place insurance, generally at higher premiums than consumer-purchased insurance. PACE transactions may be used for roof replacements in Florida, and consumers may save on insurance costs if they utilize a PACE transaction for this purpose.

[287] Adam Rose & Dan Wei, *Impacts of Property Assessed Clean Energy (PACE) program on the economy of California,* 137 Energy Pol'y 111087 (2020).

[288] *See, e.g.,* Meredith Fowlie, Michael Greenstone & Catherine Wolfram, *Do Energy Efficient Investments Deliver? Evidence from the Weatherization Assistance Program,* 133 Q J of Econ. 3 (Aug. 2018).

run PACE programs.[289] Although the PACE Report provides some information on potential impacts of the ATR provisions on PACE companies, many of the potential benefits and costs to PACE companies are outside the scope of the Report. The Bureau discusses these benefits and costs qualitatively here.

PACE companies may benefit from legal clarity provided by the proposed ATR provisions. As described above in part II.A, some PACE companies have been targets of legal actions from consumers and regulators. Some PACE companies have exited the industry citing such actions as at least a partial cause.[290] These legal actions were not necessarily related to PACE companies consideration of consumers' ability to repay—many related to conduct by home improvement contractors who marketed the PACE transactions. However, as described above in reference to benefits to consumers, the act of collecting income documentation as part of the proposed ATR provisions may make it more likely that consumers correctly understand the nature of a PACE transaction, potentially preventing some legal actions. Again, the required TILA–RESPA integrated disclosures (discussed in more detail below) would also assist in this respect. The Bureau does not have data on the frequency of lawsuits facing PACE companies currently, nor does it have data on the claims in those lawsuits that would allow the Bureau to determine what share might be prevented by following the proposed ATR provisions.

By providing a Federal ability-to-repay standard, the proposal may also encourage greater consistency across States. For example, the Bureau understands that PACE companies currently adhere to different processes for determining consumer eligibility for PACE transactions in California, involving some collection and verification of income and other documentation, than in Florida, where eligibility determinations generally involve less documentation. If the proposed rule encourages more standardized processes across States, this could result in reduced operating cost for PACE companies, which may offset some of the costs described below.

More broadly, the nationwide minimum standard provided by the proposed rule could make it easier for PACE companies to expand into additional States, leading to additional business. As noted above, the Bureau understands that many States have legislation authorizing PACE transactions,[291] but currently PACE companies are primarily active in just two States. Local governments in States with legislation authorizing PACE transactions may have a variety of reasons for opting not to engage with a PACE company to start a PACE program. However, the Bureau finds it plausible that controversies and consumer protection concerns discussed in part II.A.4 above may in part hold some government entities back from engaging in PACE. To the extent this is the case, the proposed rule could address those concerns and provide opportunities for PACE companies to grow, or for new PACE companies to enter the market. To the extent this occurs, the benefits could be considerable. The PACE Report documents that PACE origination volumes grew rapidly in both California and Florida when PACE companies entered those States.[292] However, rapid growth may not materialize to the same extent in other States if the rapid growth in California and Florida was premised on business practices that would be prohibited by the proposal.

Although PACE companies would likely receive some of the benefits discussed above from the proposed ATR provisions, PACE companies would also likely experience significant costs under the proposal, including reduced lending volumes in Florida and Missouri, one-time adjustment costs, and ongoing costs for training and compliance.

The PACE Report documents that, following the effective date of the 2018 California PACE Reforms, PACE applications and originations fell sharply in that State, with no corresponding decline in Florida around the same time.[293] Using Florida as a control group, the Report finds that PACE applications in California declined by more than 3,400 per month due to the provisions of the 2018 California PACE Reforms, from an average of over 5,300 per month in that State prior to the reforms.[294] The Report finds that the number of originated PACE transactions in California declined by about 1000 per month due to the 2018 California PACE Reforms, representing about a 63 percent decrease from a pre-reform average of about 1600 originations per month in California.[295] The specific requirements of the 2018 California PACE Reforms differ from those of the proposal, even with respect to provisions having to do with the California ability-to-pay requirements and the proposal's Federal ATR requirements, but the Bureau expects that PACE companies would see a similar decline in originated loans in other States if the proposal is finalized. Conversely, the Bureau does not expect that the ATR requirements in the proposal would cause an additional reduction in PACE transactions in California due to the mechanisms discussed above.

In addition, the decline in PACE applications in California following the 2018 California PACE Reforms that is documented in the PACE Report may have been accentuated by adjustments to firm behavior. That is, it is possible that PACE companies refocused marketing and other efforts on Florida following the implementation of the 2018 California PACE Reforms. This type of shifting would not occur in response to a Federal regulation that applies nationwide, such as the proposed rule.

PACE companies will also likely experience one-time adjustment costs to update their systems and processes to accept and consider income and other information related to the proposed ATR requirements. These costs may include software and development, training of both PACE company staff and home improvement contractor affiliates, and costs for legal and compliance review of the changes to ensure compliance with the regulations. The Bureau does not have data indicating the magnitude of these costs. However, the Bureau notes that some of these costs may be ameliorated by the existing requirements in California. The Bureau understands that all currently active PACE companies are engaged in PACE financing in California and thus

[289] The Bureau is aware that there may be programs authorized or administered by government entities that are not commonly understood as PACE, but that nonetheless meet the definition of PACE financing established in EGRRCPA section 307 and implemented under the proposed 12 CFR 1026.43(b)(15). Data on such programs is dispersed, and so the Bureau does not have sufficient information to reliably estimate how many such programs exist or to assess their current practices in providing financing. The Bureau understands these programs to operate independently of one another, under differing laws and practices. Consequently, the Bureau is unable to quantify (1) the number of such programs that are not commonly understood as PACE, but would meet the definition of PACE financing; (2) how many of those programs are operated by covered entities; or (3) the effects the proposed rule would have on each such covered entity. Any such program's additional costs under the proposed ATR provisions would depend on its current procedures. The Bureau requests comment on how the proposed rule may affect such programs.

[290] *See, e.g., Decl. of Shawn Stone, CEO of Renovate America, In Support of Chapter 11 Petitions and First Day Motions*, Case No. 20–13172 (Bankr. D. Del. 2020).

[291] *See* part II.A.2, *supra.*

[292] PACE Report, *supra* note 12, at Figure 16.

[293] *Id.*

[294] *Id.* at Table 13.

[295] *Id.*

must already have systems in place to allow for collection of income information and other documentation needed for the ATR determination the proposal would require. The Bureau thus expects that costs related to software changes would be relatively small, and that costs for training would likely be less than if there were no existing ability-to-pay requirements for PACE in any jurisdiction. The Bureau acknowledges that legal and compliance review costs would likely apply in all States, as the specific proposed requirements differ from the requirements of California State law and regulation.

PACE companies may also experience additional litigation costs due to alleged violations of the proposed ATR provisions. As noted earlier in this analysis, the Bureau is proposing to apply civil liability in TILA section 130 to PACE companies that are substantially involved in making the credit decision. As the Bureau stated in the January 2013 Final Rule, even creditors making good faith efforts when documenting, verifying, and underwriting a loan may still face some legal challenges from consumers ex-post. This will occur when a consumer proves unable to repay a loan and wrongly believes (or chooses to assert) that the creditor failed to properly assess the consumer's ability to repay before making the loan. This will likely result in some litigation expense, although the Bureau believes that over time, that expense will likely diminish as experience with litigation yields a more precise understanding regarding what level of compliance is considered sufficient. After some experience, litigation expense will most likely result where compliance is insufficient or from limited novel sets of facts and circumstances where some ambiguity remains. Moreover, as Bureau also stated in the January 2013 Final Rule, the Bureau believes that even without the benefit of any presumption of compliance, the actual increase in costs from the litigation risk associated with ability-to-repay requirements would be quite modest. This is a function of the relatively small number of potential claims, the relatively small size of those claims, and the relatively low likelihood of claims being filed and successfully prosecuted. The Bureau notes that litigation likely would arise only when a consumer in fact was unable to repay the loan (*i.e.,* was seriously delinquent or had defaulted), and even then only if the consumer elects to assert a claim and, in all likelihood, only if the consumer is able to secure a lawyer to provide representation; the consumer can prevail only upon proving that the creditor lacked a reasonable and good faith belief in the consumer's ability to repay at consummation or failed to consider the statutory factors in arriving at that belief.

Beyond PACE companies, the proposed ATR provisions would impose some costs on local government entities and home improvement contractors.[296]

Some local government entities would also experience costs due to the proposed ATR provisions, if finalized. The Bureau understands that local government entities receive some revenues from originated PACE transactions, in the form of fees, or a small percentage of the PACE payments collected through consumers' property tax bills. The Bureau does not have data indicating the average revenue that government entities receive from each PACE transaction. To the extent that the proposal reduces the volume of PACE transactions, the Bureau expects that it would also reduce revenue to such government entities, in proportion to the revenue they currently receive from such transactions. Similar to the discussion above related to PACE companies, the Bureau expects that government entities in California would be less affected by the proposed rule than government entities in other States. If, as discussed above, the proposal were to facilitate growth of PACE transactions in States that do not currently have active programs, local government entities in those State might benefit as a result.

Home improvement contractors involved in PACE transactions would experience costs under the proposal due to the additional staff time required to collect the required information for the proposed ATR determination. As with time costs for consumers discussed above, the Bureau assumes these costs would primarily affect home improvement contractors in Florida and that the volume of applications in Florida would decrease from current levels if the proposal is finalized; see above for details. The PACE Report indicates that roofs and disaster hardening are the most common type of project for PACE transactions in Florida, and so the Bureau uses the median wage for roofers in Florida, $18.43 per hour,[297] to value the time costs to home improvement contractors. Under these assumptions, the total costs to home improvement contractors from additional staff time would total about $210,000 annually.[298]

Potential Benefits and Costs to Consumers and Covered Persons of Clarifying That PACE Financing Is Credit

The proposal would revise the official commentary for Regulation Z to clarify that PACE transactions are credit for purposes of TILA.[299] In practice, this would impose a number of new requirements on PACE companies and other covered persons. Some relevant provisions whose benefits and costs are discussed below include (1) a three-day right of recission;[300] (2) disclosure requirements, including provision of relevant TILA–RESPA integrated disclosure forms and a mandatory waiting period between provision of the disclosure and consummation;[301] (3) requirements related to loan originators;[302] and (4) certain requirements for PACE transactions that meet the definitions of a high-cost mortgage or a higher-priced mortgage loan.[303] The Bureau is not addressing in depth certain other provisions.[304]

[296] Local government entities and home improvement contractors currently involved in PACE transactions may or may not be covered persons depending on the specific facts and circumstances of their involvement in PACE financing; to the extent they are not covered persons the Bureau exercises its discretion to consider benefits, costs and impacts to these entities.

[297] *See* Bureau of Lab. Stats., *May 2021 State Occupational Employment and Wage Estimates, Florida, https://www.bls.gov/oes/current/oes_fl.htm* (last visited Mar. 6, 2023).

[298] In the January 2013 Final Rule, the Bureau noted that most non-PACE mortgage lenders already collected income information as part of the normal course of business, and so assumed no significant costs relative to the baseline. *See* 78 FR 6546 (Jan. 30, 2013). This likely would not be the case for PACE companies outside of California. The Bureau requests comment on the actual time costs of gathering this information and typical wages of staff employed to collect it.

[299] *See* section-by-section analysis of proposed § 1026.2(a)(14), *supra.*

[300] Consumers have the right to rescind within three business days of consummation, delivery of the notice informing the consumer of the right to rescind, or delivery of all material disclosures, whichever occurs last. If the notice or disclosures are not delivered, the right to rescind expires three years after consummation. *See* 12 CFR 1026.23(a)(3)(i).

[301] *See, e.g.,* 12 CFR 1026.37, 1026.38.

[302] *See, e.g.,* 12 CFR 1026.36(a)(1)(i), 1026.36(d)–(g).

[303] 12 CFR 1026.32, 1026.34.

[304] For instance, PACE companies would also be required to comply with the prohibition on prepayment penalties under 12 CFR 1026.43(g), but the Bureau does not expect this would create significant costs or benefits for consumers or covered persons, as the Bureau understands that PACE loans being made currently do not include these penalties. PACE contracts would also be prohibited from requiring the use of mandatory arbitration under 12 CFR 1026.36(h), but the Bureau does not have information sufficient to determine the extent to which PACE contracts currently include mandatory arbitration clauses. To the

Continued

The right of recission could benefit consumers and impose costs on covered persons to the extent that consumers decide a PACE transaction is not appropriate for them during the rescission period and exercise the right. As discussed above, many PACE borrowers pay off their PACE transactions early, which suggests that some of these consumers may decide they do not want a PACE transaction after origination, or may not have intended to take out the PACE transaction at all. A rescission period could give consumers more time to exercise such preferences. However, the Bureau does not have data indicating whether PACE borrowers typically realize such a preference during the three-day period following origination of a PACE transaction. In addition, PACE borrowers in California already have a three-day right to cancel under State law,[305] and PACE companies may currently voluntarily provide a recission option outside of California. As a result, the Bureau expects the application of this provision of TILA to impose few benefits or costs on consumers and covered persons.

The disclosure requirements would likely benefit consumers by increasing their understanding of the terms of the PACE transaction and mandating a waiting period between disclosure and consummation. As discussed above in the context of collecting income information, mandating disclosures and a waiting period for PACE transactions conforming with TILA–RESPA integrated disclosure requirements would make it more likely that consumers understand the terms of their proposed PACE transactions. The disclosure requirements would also likely increase understanding of the fundamental nature of PACE transactions as financial obligations that must be repaid over time. The potential benefits of avoiding consumer misunderstanding of the nature of a PACE transaction are discussed above.

By providing detailed information about the terms and payment amounts expected in a PACE transaction, TILA–RESPA integrated disclosures may also assist consumers in preparing for their first PACE payment, which can be a significant shock to their finances regardless of whether the consumer pays their property taxes directly or through a pre-existing mortgage escrow account. The PACE Report finds that the average PACE consumer's property tax bill likely nearly doubles as a result of the PACE assessment.[306] Particularly for consumers who do not pay property taxes through an escrow account, this can be a major expenditure shock. For consumers who do pay property taxes through an escrow account, the Report finds that mortgage payments increase substantially over the two years following the PACE transaction, indicating an expenditure shock as well.[307] Some of the disclosures on the proposed modified TILA–RESPA integrated disclosure form for PACE transactions may prompt consumers with a pre-existing non-PACE mortgage to inform their mortgage servicer of the PACE transaction. This, in turn, could prompt the servicer to conduct an escrow analysis to account for the PACE payment sooner than it otherwise would have and thus create a smaller monthly payment increase for the consumer.

PACE companies would experience one-time adjustment costs related to the TILA–RESPA integrated disclosure if the proposal is finalized. The Bureau understands that PACE companies generally provide some disclosures with similar information at the point of sale, but not in the format or with precisely the same information as the disclosure that would be required under the proposal. The Bureau expects that ongoing costs will be minimal relative to the baseline, since PACE companies already provide disclosures. To the extent that the proposed TILA–RESPA integrated disclosures for PACE require that PACE companies gather information that they do not currently collect, they may face additional costs of gathering that information if the proposal is finalized.

The required seven-day waiting period between provision of the Loan Estimate and consummation may also impose costs on both PACE companies and the home improvement contractors who market PACE transactions. As discussed in part II.A.4 above, the Bureau understands that, currently, PACE transactions are frequently originated on the spot, on the same day as the home improvement contractor approaches the consumer about a potential project. PACE industry stakeholders have expressed to the Bureau that this speed of origination is necessary to compete with unsecured financing options. It is possible that the seven-day waiting period would lead to a further reduction in PACE transaction volume due to reduced contractor participation if contractors prefer to offer only credit options that do not have such a waiting period. No States currently have a similar mandatory waiting period under State law as far as the Bureau is aware, so this aspect of the proposal would likely affect PACE lending volumes in all States. The Bureau does not have data to indicate how large this effect might be.

TILA and Regulation Z include a variety of provisions that apply to loan originators. With current PACE industry practices, the Bureau understands that, if the proposal is finalized, these provisions would primarily apply to home improvement contractors. If home improvement contractors continue in their current roles and act as loan originators for PACE transactions, both the individual contractors and related companies would face compliance costs, including costs relating to applicable State or Federal licensing and registration requirements.[308] The Bureau does not have data available to quantify the costs to home improvement contractors from complying with TILA as loan originators.

It is possible that, if the proposal is finalized, home improvement contractors would opt not to bear the cost of complying with TILA provisions to the extent they apply and would instead exit the PACE market. The home improvement contractors themselves would incur costs in this case. The Bureau does not have data available to estimate these costs. The costs to home improvement contractors from exiting the PACE industry depend on what would happen to prospective home improvement contracts for which PACE financing would no longer be an option. If contractors are able to make the sale of the home improvement contract based on a cash payment or another financial product, they generally would not experience any cost.[309] However, contractors could lose some sales due to the unavailability of a PACE transaction as a financing option. The Bureau does not have data that would indicate how frequently this would happen. It is also possible that, if the proposal enables PACE financing to expand into additional States, home improvement contractors in those States would benefit from additional business. Again,

extent mandatory arbitration clauses are currently in use, consumers and covered persons could incur benefits and costs as a result of this prohibition.

[305] Consumers have the option to cancel within three business days after signing the agreement, receipt of the Financing Estimate and Disclosure, or receipt of the cancellation notice, whichever occurs last. *See* Cal. Sts. & Hwys. Code sec. 5898.16.

[306] PACE Report, *supra* note 12, at 13.

[307] *Id.* at 18–20.

[308] 12 CFR 1026.36(f).

[309] The Bureau's understanding is that home improvement contractors do not receive a commission from PACE companies for originating a PACE contract. To the extent that contractors do receive commissions, exiting the PACE market would cost them these commissions, although they might be replaced by commissions from an alternate financial product, if any.

the Bureau does not have data that would indicate how many contractors might benefit if this were to occur, or how much they would benefit.

Consumers may experience both costs and benefits due to the proposed application of TILA's loan originator provisions to PACE, if finalized. The costs and benefits to consumers of not being offered a PACE transaction are discussed above in this analysis; that discussion also applies to cases where consumers are not offered a PACE transaction because the home improvement contractor has exited the PACE market. To the extent that home improvement contractors opt to remain in the PACE market or PACE transactions are marketed by PACE companies or local governments directly as a result of the proposal being finalized, consumers may benefit from such changes to the way PACE transactions are marketed. Many consumer protection issues identified in the comments responding to the ANPR are related to conduct by home improvement contractors. Either mandatory compliance with TILA's loan originator provisions by home improvement contractors, or a shift to marketing PACE transactions directly by PACE companies or local governments could ameliorate some of these issues.

Finally, under TILA, certain additional protections apply to high-cost mortgages as defined by HOEPA. High-cost mortgages generally include those that: (1) have an APR 6.5 or 8.5 percentage points higher than the APOR for a comparable transaction, depending on whether it is a first- or subordinate-lien mortgage; (2) have points and fees exceeding 5 percent of the total loan amount or the lesser of 8 percent of the total loan amount or $1,000 (adjusted annually for inflation), depending on the size of the transaction; or (3) include certain prepayment penalties.[310] Few PACE transactions have appear to have APRs high enough to meet the first prong,[311] and the Bureau understands that more recent PACE transactions generally do not include prepayment penalties, although certain early PACE contracts did include prepayment penalties. The PACE Report finds that about 35 percent of PACE transactions in the data the Report studies had up-front fees exceeding the relevant HOEPA points-and-fees threshold.[312] However, this varied sharply by State, with over half of all PACE transactions in California having fees exceeding the threshold, compared to just 8 percent of PACE transactions in Florida.[313]

Some of the requirements of HOEPA may be difficult for PACE companies to comply with. This could lead to PACE companies declining to make PACE transactions that would be high-cost mortgages. Given the variation in fees across States, it seems possible that PACE companies could make PACE transactions profitably with lower fees than they currently do. As a result, the Bureau expects that, if the proposal is finalized, PACE companies would reduce fees or interest rates on PACE transactions that would otherwise exceed HOEPA thresholds rather than declining to make a PACE transaction at all. This would impose costs on PACE companies and the affiliated local government entities in the form of lost revenue and will benefit PACE consumers by the same measure.

PACE companies may also experience costs due to the requirements of Regulation Z with respect to higher-priced mortgage loans. Regulation Z generally requires creditors to obtain a written appraisal of the property to be mortgaged prior to consummating higher-priced mortgage loans if the amount of credit extended exceeds a certain threshold—currently $31,000 in 2023—and to provide the consumer with a written copy of the appraisal.[314] The PACE Report indicates that about a quarter of PACE transactions originated between June 2014 and July 2020 had original principal amounts above that threshold, and moreover shows that most PACE transactions have APR–APOR spreads above the threshold for higher-priced mortgage loans.[315] The Bureau understands that PACE companies typically do not obtain written appraisals for properties securing PACE transactions, relying instead on automated valuation models. Switching to written appraisals, or lowering loan amounts to be under the threshold, would impose costs on PACE companies. Consumers may also experience costs to the extent that the price of conducting an appraisal is passed on to them. The Bureau does not have data on the amount of these costs, and requests comment on this.

E. Potential Specific Impacts of the Proposed Rule on Access to Credit

As discussed above, the proposal, if finalized, may reduce access to PACE credit. Potential PACE borrowers who cannot qualify for a PACE transaction due to the proposed ATR analysis will not have access to PACE credit. As also noted above, the PACE Report finds that the implementation of the 2018 California PACE Reforms, which included a required ability-to-pay analysis, resulted in a substantial reduction in new PACE transactions.[316] Some of the decrease in California was likely due to increased denials of PACE applications, and some was likely due to reduced marketing of PACE transactions, such as reduced participation by home improvement contractors. It seems likely that, if the rule is finalized as proposed, a similar reduction would occur in other States. However, it is not clear how much of the reduction in PACE transactions in California was due to credit supply factors, versus reduced demand for PACE transactions. As discussed above, a substantial fraction of PACE transactions are paid off early, suggesting that at least some consumers who engage in a PACE transaction currently may not desire to have a long-term financial obligation. Some provisions of the proposed rule could prompt some consumers to avoid the transaction, which would reduce the volume of PACE transactions, but this would be due to a reduction in demand for credit, not a change in access to credit. In addition, consumers who have a PACE application denied, or who are not offered an opportunity to apply for a PACE transaction, may be able to access other forms of credit, potentially at more favorable APRs.

To the extent that the legal clarity provided by the proposal were to enable PACE financing to expand into additional States, this would increase access to PACE credit for consumers in those States.

The Bureau quantifies the potential impacts of the proposal on access to credit in its discussion above in part IX.D where possible but seeks comment on this issue, particularly in the form of additional studies or data that might inform the potential impact of the proposal on access to credit.

[310] *See* TILA section 103(bb)(1)(A); 12 CFR 1026.32(a)(1).

[311] *See* PACE Report, *supra* note 12, at 15 (finding that 96 percent of PACE transactions made between 2014 and 2020 had estimated APR–APOR spreads below 6.5 percent).

[312] *Id.* at Table 5.

[313] *Id.*

[314] *See generally* 12 CFR 1026.35(c); comment 35(c)(2)(ii)–3.

[315] *See* PACE Report, *supra* note 12, at Table 2, Table 5.

[316] *Id.* at 45.

F. Potential Specific Impacts on Consumers in Rural Areas and Depository Institutions With Less Than $10 Billion in Assets

The proposed rule would not have a significant impact on consumers in rural areas. If anything, the proposed rule would impact consumers in rural areas less than consumers in non-rural areas. The PACE Report shows that consumers who take part in PACE transactions are less likely to live in rural areas than other consumers in their States. Moreover, the Report notes that California and Florida, the States with the most PACE lending to date, have the smallest and sixth-smallest rural population shares among all States, respectively.

The Bureau understands that depository institutions of any size are not typically involved with PACE transactions, and thus the proposed rule would have no direct impact on such entities, regardless of asset size.

X. Regulatory Flexibility Act Analysis

The Regulatory Flexibility Act (RFA) generally requires an agency to conduct an initial regulatory flexibility analysis (IRFA) and a final regulatory flexibility analysis of any rule subject to notice-and-comment rulemaking requirements unless the agency certifies that the rule will not have a significant economic impact on a substantial number of small entities (SISNOSE).[317] The Bureau is also subject to specific additional procedures under the RFA involving convening a panel to consult with small business representatives before proposing a rule for which an IRFA is required.[318] As the below analysis shows, an IRFA is not required for this proposal because the proposal, if adopted, would not have a SISNOSE.[319]

Small entities, for purposes of the RFA, include both small businesses as defined by the Small Business Administration, and small government jurisdictions, defined as jurisdictions with a population of less than 50,000.[320]

For the reasons discussed below, the Bureau does not believe that the proposed rule will have a SISNOSE. While it is possible that the proposed rule would have a significant impact on some entities, based on the information available it appears that most of those entities are not ''small'' as defined by the RFA, and that any small entities that may be impacted, significantly or otherwise, are unlikely to constitute a substantial number of small entities.

The Bureau understands that any economic impact from the proposed rule would primarily fall on PACE companies, as defined under proposed § 1026.43(b)(14). Most of these entities are private firms. A small number of local government entities administer their own PACE programs, and may be affected in similar ways as PACE companies. The proposed rule may also have a direct economic impact on the local government entities that authorize PACE programs within their jurisdictions and are parties to the financing agreements but do not otherwise administer the originations, and it may also have a direct economic impact on the home improvement contractors who market PACE to consumers.

The Bureau is aware of five entities that currently are administering PACE programs as commonly understood, including four private firms and one local government entity. Based on the information available to the Bureau, none of these entities currently are small entities. The local government entity that directly originates PACE transactions has population greater than 50,000.[321]

For private firms, Small Business Administration (SBA) size standards differ by industry based on the 6-digit North American Industry Classification System (NAICS) industry code that represents the primary business of a firm.[322] For private firms whose primary business is originating PACE transactions, the relevant SBA threshold is $47 million in annual receipts.[323] The Bureau's understanding is that PACE companies' annual receipts for purposes of the SBA criteria are based on the principal balance of the financing obligations they originate in a given year.[324] This is consistent with how PACE companies tend to describe the volume of their business.[325]

Based on the evidence available to the Bureau, it does not appear likely that any of the currently active private PACE companies averaged less than $47 million in annual receipts over the past five years.[326] Moreover, even if some PACE companies are small entities, PACE companies would not represent a substantial number of the small entities in any of the industries they could reasonably be classified in, which have between hundreds and thousands of small firms.[327] Even if all currently

[317] 5 U.S.C. 601 *et seq.*

[318] 5 U.S.C. 609.

[319] This analysis considers collectively the potential impacts of all aspects of the proposal on small entities, including both the affirmative proposed new requirements and the proposed revisions to the official commentary.

[320] 5 U.S.C. 601(3), 601(5).

[321] Sonoma County operates its own PACE program, called Sonoma County Energy Independence Program. Sonoma County, California had population 485,887 in 2021, according to the Census Bureau. *See* U.S. Census Bureau, *Annual Estimates of the Resident Population for Counties in California: April 1, 2020 to July 1, 2021, https://www2.census.gov/programs-surveys/popest/tables/2020-2021/counties/totals/co-est2021-pop-06.xlsx.*

[322] The NAICS system is produced by a partnership between the Office of Management and Budget and partner agencies in Canada and Mexico, with the aim of providing a consistent framework for analyzing industry statistics.

[323] The SBA generally defines receipts as '' 'total income' . . . plus 'cost of goods sold', as these terms are defined and reported on Internal Revenue Service (IRS) tax return forms.'' The SBA provides that the classification should be based on a five-year average of receipts, with adjustments if a firm has been in business for less than five full fiscal years. *See* 13 CFR 121.104. PACE is a small and relatively new industry that began around 2008, and there is more than one 6-digit NAICS industry that could reasonably apply to PACE companies (the NAICS system is comprehensive, such that every firm should fit into exactly one 6-digit industry code). The 6-digit NAICS industry codes that private PACE companies could arguably belong to include codes 522292 (Real Estate Credit), code 522299 (International, Secondary Market, and All Other Nondepository Credit Intermediation), or code 523910 (Miscellaneous Intermediation). *See* U.S. Census Bureau, *North American Industry Classification System 2022, https://www.census.gov/naics/?58967?yearbck=2022.* For all these industries the SBA size threshold is $47 million in annual receipts. 13 CFR 121.201.

[324] This will somewhat undercount annual receipts, which would also include revenues the firms receive from the sale of PACE securities to the secondary market.

[325] *See, e.g.,* Ygrene Energy Fund Inc., *RE: Advanced Notice of Proposed Rulemaking on Residential Property Assessed Clean Energy (RIN 3170–AA84)* (May 7, 2019) (describing the change in the volume of PACE assessments following the 2017 California PACE statute legislation in terms of the change in number of assessments and dollar value of those assessments).

[326] Although the data used in the Bureau's PACE Report did not identify revenue separately by individual companies, publicly available data from CAEATFA indicates that the currently active PACE companies generally averaged over $50 million in new PACE transactions in California alone between 2018 and 2020. *See* Cal. Alt. Energy & Advanced Transp. Fin. Auth., *PACE Loss Reserve Program Enrollment Activity* (Mar. 2021) *https://www.treasurer.ca.gov/caeatfa/pace/activity.pdf.* Moreover, the PACE Report shows that PACE lending in Florida exceeded that in California after 2018. Similarly, statistics from the PACE trade association indicate that the PACE industry made around $500 million in new PACE transactions in 2021. *See* PACE Nation, *PACE Market Data* (updated Dec. 31, 2021), *https://www.pacenation.org/pace-market-data/.* Even if these revenues were not evenly distributed among the four companies, it seems unlikely that any one company had revenues less than $47 million averaged over five years.

[327] The Bureau can determine the approximate number of small firms active in each industry through the 2017 Economic Census (the most recent version available at this writing), which gives counts of firms categorized by NAICS code and annual revenues. *See* U.S. Census Bureau, *2017 Economic Census, Finance and Insurance (NAICS Sector 52), Establishment and Firm Size Statistics, https://www.census.gov/data/tables/2017/econ/economic-census/naics-sector-52.html.* The revenue categories in the public Economic Census data do not line up perfectly with the SBA size thresholds, but even excluding categories that overlap the threshold, the 2017 Economic Census indicates that there were at least 2,372 small firms in the Real

operating PACE companies were small, they would not represent a substantial number within any of the relevant 6-digit NAICS industries.

The Bureau also considered whether a substantial number of small government entities could experience a significant impact if this proposal were finalized. As noted above, the Bureau is only aware of one government entity that is currently acting as its own administrator to provide PACE financing as it is commonly understood, and it is not small under the RFA. However, other government entities authorize and oversee PACE programs, are parties to the financing agreements, and receive some revenues from the program.[328] To the extent that the proposed rule could directly impact these other government entities, the Bureau must consider whether the proposed rule would create a significant economic impact on a substantial number of these entities.

As discussed above, under the RFA, government entities are small if they have populations of less than 50,000. The 19 States plus the District of Columbia which the Bureau understands currently have legislation authorizing PACE contained 17,209 total small governments, consisting of 715 counties, 7,716 incorporated places and 8,778 minor civil divisions.[329] Of these small governments, currently, only small governments in California, Florida, and Missouri would be directly impacted by the proposed rule in any meaningful way because they are the only States with active PACE programs.[330] There are exactly 2,000 small government entities in those three States combined, consisting of 134 counties, 1,583 incorporated places, and 283 minor civil districts. Even if all government entities in the three States were significantly impacted by the rule (which is unlikely, as not all local governments in those States sponsor PACE programs), this would be only about 11.6 percent of small government entities in States with active PACE legislation, which the Bureau does not consider to be a substantial number. In addition, those small government entities that would be directly impacted by the proposed rule are unlikely to receive a significant proportion of their revenue from PACE financing, such that even eliminating this revenue stream would not cause a significant economic impact.[331]

The proposed rule may impact the home improvement contractors who market and help originate PACE financing. Here again it appears that the rule would not directly impact a substantial number of small entities, even assuming that any small home improvement contractor would experience a significant economic impact. In the most recent Economic Census there were more than 233,000 small entities in the relevant NAICS codes for home improvement contractors.[332] By comparison, there are currently approximately 2,000 firms registered in California as PACE solicitors.[333] Even if all of these entities are small and there were a similar number of small entities acting as PACE solicitors in Missouri and Florida, this would be less than three percent of all relevant small entities, and so not a substantial number.[334]

Accordingly, the Director hereby certifies that this proposal, if adopted, would not have a significant economic impact on a substantial number of small entities. Thus, neither an IRFA nor a small business review panel is required for this proposal. The Bureau requests comment on the analysis above and requests any relevant data.

XI. Paperwork Reduction Act

The information collections contained within TILA and Regulation Z are approved under OMB Control Number 3170–0015. The current expiration date for this approval is May 31, 2023. The Bureau has determined that this proposed rule would not impose any new information collections or revise any existing recordkeeping, reporting, or disclosure requirements on covered entities or members of the public that would be collections of information requiring approval by the Office of Management and Budget under the Paperwork Reduction Act.

XII. Severability

The Bureau preliminarily intends that, if any provision of the final rule, or any application of a provision, is stayed or determined to be invalid, the remaining provisions or applications are severable and shall continue in effect.

Estate Credit industry, at least 1,725 small firms in the International, Secondary Market, and All Other Nondepository Credit Intermediation industry, at least 1,573 small firms in the All Other Nondepository Credit Intermediation industry and at least 6,715 in the Miscellaneous Intermediation industry.

[328] As discussed in part VII above, the Bureau understands that government entities are legally the ''creditor'' for purposes of the TILA requirements as implemented in Regulation Z. *See* 12 CFR 1026.2(a)(17). However, for programs administered by PACE companies, in general the Bureau does not expect significant economic impact on these government entities from these provisions, as the Bureau expects that the private PACE companies will continue to administer origination activity on behalf of the government entities, such that most of the economic burden will fall on the private entities. As discussed above, an exception to this would be small government entities running programs that are not commonly understood as PACE but meet the definition of PACE financing under proposed 12 CFR 1026.43(b)(15). Even in this case, the Bureau does not believe the rule would impose a significant economic impact, as such programs represent a small fraction of any given entity's overall revenue.

[329] The States used for this calculation are Arkansas, California, Colorado, Connecticut, Florida, Georgia, Illinois, Maine, Maryland, Minnesota, Missouri, Nebraska, New Jersey, New Mexico, New York, Ohio, Rhode Island, Vermont, and Wyoming.

[330] *See* PACENation, *PACE Programs, https://www.pacenation.org/pace-programs/* (''Residential PACE is currently offered in California, Florida, and Missouri.'') (last visited Mar. 16, 2023).

[331] The Bureau understands that local government entities are typically funded in large part by property taxes. Although the PACE Report finds that PACE assessments can nearly double property tax payments for individual homeowners, the Bureau understands that most of the revenue of those payments accrues to the investors in the resulting PACE bonds. Moreover, the vast majority of residential properties in any given jurisdiction do not have PACE assessments. As such, revenue related to PACE received by small government entities will typically be a small fraction of overall revenue.

[332] Home improvement contractors that serve as solicitors for PACE fall under NAICS industry codes 236118, (''Residential Remodelers''), 238150 (''Glass and glazing contractors''), 238160 (''Roofing contractors''), 238170 (''Siding Contractors''), 238210 (''Electrical contractors''), and 238220 (''Plumbing, heating, and air-conditioning contractors''). *See* U.S. Census Bureau, *North American Industry Classification System 2022, https://www.census.gov/naics/?58967?yearbck=2022.* The relevant SBA threshold for industry 236118 is $45 million per year in annual receipts; for the other industries the threshold is $19 million. 13 CFR 121.201. According to the 2017 Economic Census, these industries had at least 70,000, 4,600, 14,000, 6,000, 58,000, and 81,000 small entities, respectively. *See* U.S. Census Bureau, *2017 Economic Census, Construction (NAICS Sector 23), Establishment and Firm Size Statistics, https://www.census.gov/data/tables/2017/econ/economic-census/naics-sector-23.html.* The Economic Census data does not disaggregate firm counts by State at the 6-digit NAICS level.

[333] *See* Cal. Dep't of Fin. Prot. & Innovation, *Enrolled PACE Solicitors Search* (updated Feb. 27, 2023), *https://dfpi.ca.gov/pace-program-administrators/pace-solicitor-search/?emrc=63ee970c63d06* for California's database of solicitors, however note that many companies are duplicated to the extent they are enrolled with multiple PACE companies. California law and regulation defines a ''PACE solicitor'' as a person authorized by a program administrator to solicit a property owner to enter into an assessment contract. Cal. Fin. Code sec. 22017(a); *see also* 10 Cal. Code Regs. sec. 1620.02(f).

[334] Limiting consideration to contractors operating in States with PACE legislation is not appropriate in this case. Unlike local governments, contractors can and do operate across State lines, so contractors currently operating in non-PACE States could possibly be affected by the proposed rule if finalized. As a result, it makes sense to consider all home improvement contractors as part of the total for purposes of the ''substantial number'' calculation. In addition, the Economic Census does not provide industry-level data disaggregated by State in a way that would allow the Bureau to determine the number of firms by industry and annual revenue.

List of Subjects in 12 CFR Part 1026

Consumer protection, Credit, Housing, Mortgage servicing, Mortgages, Truth-in-lending.

Authority and Issuance

For the reasons set forth in the preamble, the CFPB proposes to amend Regulation Z, 12 CFR part 1026, as set forth below:

PART 1026—TRUTH IN LENDING ACT (REGULATION Z)

■ 1. The authority citation for part 1026 continues to read as follows:

Authority: 12 U.S.C. 2601, 2603–2605, 2607, 2609, 2617, 3353, 5511, 5512, 5532, 5581; 15 U.S.C. 1601 *et seq.*

Subpart E—Special Rules for Certain Home Mortgage Transactions

■ 2. Amend § 1026.35 by adding paragraph (b)(2)(i)(E) to read as follows:

§ 1026.35 Requirements for higher-priced mortgage loans.

* * * * *

(b) * * *

(2) * * *

(i) * * *

(E) A PACE transaction, as defined in § 1026.43(b)(15).

* * * * *

■ 3. Amend § 1026.37 by adding paragraph (p) to read as follows:

§ 1026.37 Content of disclosures for certain mortgage transactions (Loan Estimate).

* * * * *

(p) *PACE transactions.* For PACE transactions as defined in § 1026.43(b)(15), the creditor must comply with the requirements of this section with the following modifications:

(1) *Escrow account.* The creditor shall not disclose the information in paragraph (c)(2)(iii) of this section.

(2) *Taxes, insurance, and assessments.* (i) In lieu of the information required by paragraph (c)(4)(iv), the creditor shall disclose a statement of whether the amount disclosed pursuant to paragraph (c)(4)(ii) of this section includes payments for the PACE transaction, labeled ''PACE Payment''; payments for other property taxes, labeled ''Property Taxes (not including PACE loan)''; amounts identified in § 1026.4(b)(8); and other amounts described in paragraph (c)(4)(ii) of this section, along with a description of any such other amounts;

(ii) In lieu of the information required by paragraph (c)(4)(v) and (vi), a statement that the PACE transaction, described as a ''PACE loan,'' will be part of the property tax payment and a statement directing the consumer, if the consumer has a pre-existing mortgage with an escrow account, to contact the consumer's mortgage servicer for what the consumer will owe and when.

(3) *Contact information.* If the PACE company as defined in 12 CFR 1026.43(b)(14) is not otherwise disclosed pursuant to paragraphs (k)(1) through (3) of this section, the creditor shall disclose the name, NMLSR ID (labeled ''NMLS ID/License ID''), email address, and telephone number of the PACE company (labeled ''PACE Company''). In the event the PACE company has not been assigned an NMLSR ID, the creditor shall disclose the license number or other unique identifier issued by the applicable jurisdiction or regulating body with which the PACE company is licensed and/or registered, with the abbreviation for the State of the applicable jurisdiction or regulatory body stated before the word ''License'' in the label, if any.

(4) *Assumption.* In lieu of the statement required by paragraph (m)(2) of this section, a statement that, if the consumer sells the property, the buyer or the buyer's mortgage lender may require the consumer to pay off the PACE transaction, using the term ''PACE loan'' as a condition of the sale, labeled ''Selling the Property.''

(5) *Late Payment.* In lieu of the statement required by paragraph (m)(4) of this section:

(i) A statement detailing any charge specific to the transaction that may be imposed for a late payment, stated as a dollar amount or percentage charge of the late payment amount, and the number of days that a payment must be late to trigger the late payment fee, labeled ''Late payment,'' and

(ii) For any charge that is not specific to the transaction:

(A) A statement that, if the consumer's property tax payment is late, the consumer may be subject to penalties and late fees established by the consumer's property tax collector, and directing the consumer to contact the consumer's property tax collector for more information, or

(B) A statement describing any charges that may result from property tax delinquency that are not specific to the PACE transaction. The statement may include dollar amounts or percentage charges and the number of days that a payment must be late to trigger the late payment fee.

(6) *Servicing.* In lieu of the statement required by paragraph (m)(6) of this section, a statement that the consumer will pay the PACE transaction, using the term ''PACE loan,'' as part of the consumer's property tax payment, and a statement directing the consumer, if the consumer has a mortgage escrow account that includes the consumer's property tax payments, to contact the consumer's mortgage servicer for what the consumer will owe and when.

(7) *Exceptions*—(i) *Unit-period.* Wherever form H–24(H) of appendix H uses ''annual'' to describe the frequency of any payments or the applicable unit-period, the creditor shall use the appropriate term to reflect the transaction's terms, such as semi-annual payments.

(ii) *PACE nomenclature.* Wherever this section requires disclosure of the word ''PACE'' or form H–24(H) of appendix H to this part uses the term ''PACE,'' the creditor may substitute the name of a specific PACE financing program that will be recognizable to the consumer.

■ 4. Amend § 1026.38 by adding paragraph (u) to read as follows:

§ 1026.38 Content of disclosures for certain mortgage transactions (Closing Disclosure).

* * * * *

(u) *PACE transactions.* For PACE transactions as defined in § 1026.43(b)(15), the creditor must comply with the requirements of this section with the following modifications:

(1) *Transaction information.* In addition to the other disclosures required under paragraph (a)(4) of this section under the heading ''Transaction Information,'' the creditor shall disclose the name of any PACE company involved in the transaction, labeled ''PACE Company.'' For purposes of this paragraph (u)(1), ''PACE company'' has the same meaning as in § 1026.43(b)(14).

(2) *Projected payments.* The creditor shall disclose the information required by paragraph (c)(1) of this section as modified by § 1026.37(p)(1) through (2) and shall omit the information required by paragraph (c)(2).

(3) *Assumption.* In lieu of the information required by paragraph (l)(1) of this section, the creditor shall use the subheading ''Selling the Property'' and disclose the information required by § 1026.37(p)(4).

(4) *Late payment.* In lieu of the information required by paragraph (l)(3) of this section, under the subheading ''Late Payment,'' the creditor shall disclose the information required by § 1026.37(p)(5).

(5) *Partial payment policy.* In lieu of the information required by paragraph (l)(5) of the section, under the

subheading ''Partial Payments,'' the creditor shall disclose a statement directing the consumer to contact the mortgage servicer about the partial payment policy for the account if the consumer has a mortgage escrow account for property taxes and to contact the tax collector about the tax collector's partial payment policy if the consumer pays property taxes directly to the tax authority.

(6) *Escrow account.* The creditor shall not disclose the information required by paragraph (l)(7) of this section.

(7) *Liability after foreclosure.* The creditor shall not disclose the information required by paragraph (p)(3) of this section. If the consumer may be responsible for any deficiency after foreclosure or tax sale under applicable State law, the creditor shall instead disclose a brief statement that the consumer may have such responsibility, a description of any applicable protections provided under State anti-deficiency laws, and a statement that the consumer should consult an attorney for additional information, under the subheading ''Liability after Foreclosure or Tax Sale.''

(8) *Contact information.* If the PACE company is not otherwise disclosed pursuant to paragraph (r) of this section, the creditor shall disclose the information described in paragraph (r)(1)–(7) of this section for the PACE company, as defined in § 1026.43(b)(14) (under the subheading ''PACE Company'').

(9) *Exceptions*—(i) *Unit-period.* Wherever form H–25(K) of appendix H uses ''annual'' to describe the frequency of any payments or the applicable unit-period, the creditor shall use the appropriate term to reflect the transaction's terms, such semi-annual payments.

(ii) *PACE nomenclature.* Wherever this section requires disclosure of the word ''PACE'' or form H–25(K) of appendix H to this part uses the term ''PACE,'' the creditor may substitute the name of a specific PACE financing program that will be recognizable to the consumer.

■ 5. Amend § 1026.41 by adding paragraph (e)(7) to read as follows:

§ 1026.41 Periodic statements for residential mortgage loans.

* * * * *

(e) * * *

(7) *PACE transactions.* PACE transactions, as defined in § 1026.43(b)(15), are exempt from the requirements of this section.

* * * * *

■ 6. Amend § 1026.43 by adding paragraphs (b)(14), (b)(15), and (i) to read as follows:

§ 1026.43 Minimum standards for transactions secured by a dwelling.

* * * * *

(b) * * *

(14) *PACE company* means a person, other than a natural person or a government unit, that administers the program through which a consumer applies for or obtains a PACE transaction.

(15) *PACE transaction* means financing to cover the costs of home improvements that results in a tax assessment on the real property of the consumer.

* * * * *

(i) *PACE transactions.* (1) For PACE transactions extended to consumers who pay their property taxes through an escrow account, in making the repayment ability determination required under paragraphs (c)(1) and (2) of this section, a creditor must consider the factors identified in paragraphs (c)(2)(i) through (viii) of this section and also must consider any monthly payments that the creditor knows or has reason to know the consumer will have to pay into any escrow account as a result of the PACE transaction that are in excess of the monthly payment amount considered under paragraph (c)(2)(iii) of this section, taking into account:

(i) The cushion of one-sixth (1⁄6) of the estimated total annual payments attributable to the PACE transaction from the escrow account that the servicer may charge under 12 CFR 1024.17(c)(1), unless the creditor reasonably expects that no such cushion will be required or unless the creditor reasonably expects that a different cushion amount will be required, in which case the creditor must use that amount; and

(ii) If the timing for when the servicer is expected to learn of the PACE transaction is likely to result in a shortage or deficiency in the consumer's escrow account, the expected effect of any such shortage or deficiency on the monthly payment that the consumer will be required to pay into the consumer's escrow account.

(2) Notwithstanding paragraphs (e)(2), (e)(5), (e)(7), or (f) of this section, a PACE transaction is not a qualified mortgage as defined in this section.

(3) For a PACE transaction, the requirements of this section apply to both the creditor and any PACE company that is substantially involved in making the credit decision. A PACE company is substantially involved in making the credit decision if it, as to a particular consumer, makes the credit decision, makes a recommendation as to whether to extend credit, or applies criteria used in making the credit decision. In the case of any failure by any such PACE company to comply with any requirement imposed under this section, section 130 of the Truth in Lending Act, 15 U.S.C. 1640, shall be applied with respect to any such failure by substituting ''PACE company'' for ''creditor'' each place such term appears in each such subsection.

■ 7. Appendix H to part 1026 is amended by adding the entries for Model Forms H–24(H) and H–25(K) to read as follows:

Appendix H to Part 1026—Closed-End Model Forms and Clauses

* * * * *

H–24(H) Mortgage Loan Transaction Loan Estimate—Model Form for PACE Transactions

BILLING CODE 4810–AM–P

Save this Loan Estimate to compare with your Closing Disclosure.

Loan Estimate

DATE ISSUED
APPLICANTS

PROPERTY
EST. PROP. VALUE

LOAN TERM
PURPOSE
PRODUCT
LOAN TYPE ☐Conventional ☐FHA ☐VA ☐ ____________
LOAN ID #
RATE LOCK ☐NO ☐YES, until
Before closing, your interest rate, points, and lender credits can change unless you lock the interest rate. All other estimated closing costs expire on

Loan Terms

Loan Terms		Can this amount increase after closing?
Loan Amount		
Interest Rate		
Annual Principal & Interest *See Projected Payments below for your Estimated Total Annual Payment*		
		Does the loan have these features?
Prepayment Penalty		
Balloon Payment		

Projected Payments

Payment Calculation	
Principal & Interest Mortgage Insurance	
Estimated Total Annual Payment *PACE payments will be part of your property tax payment*	
Estimated Taxes, Insurance & Assessments *Amount can increase over time*	**This estimate includes** ☐ PACE Payment ☐ Property Taxes (not including PACE loan) ☐ Homeowner's Insurance ☐ Other: *Your PACE loan will be part of your property tax payment. If you have a mortgage with an escrow account, contact your mortgage servicer for what you will owe and when.*

Costs at Closing

Estimated Closing Costs		Includes in Loan Costs + in Other Costs – in Lender Credits. *See details on page 2.*
Estimated Cash to Close		Includes Closing Costs. See Calculating Cash to Close on page 2 for details ☐ From ☐ To Borrower

Visit **www.consumerfinance.gov/mortgage-estimate** for general information and tools.

Closing Cost Details

Loan Costs

A. Origination Charges

% of Loan Amount (Points)

B. Services You Cannot Shop For

C. Services You Can Shop For

D. TOTAL LOAN COSTS (A + B + C)

Other Costs

E. Taxes and Other Government Fees

Recording Fees and Other Taxes
Transfer Taxes

F. Prepaids

Homeowner's Insurance Premium (__ months)
Mortgage Insurance Premium (__ months)
Prepaid Interest (per day for days @)
Property Taxes (__ months)

G. Initial Escrow Payment at Closing

Homeowner's Insurance	per month for	mo.
Mortgage Insurance	per month for	mo.
Property Taxes	per month for	mo.

H. Other

I. TOTAL OTHER COSTS (E + F + G + H)

J. TOTAL CLOSING COSTS

D + I
Lender Credits

Calculating Cash to Close

Loan Amount
Total Closing Costs (J)
Estimated Total Payoffs and Payments

Estimated Cash to Close ☐ **From** ☐ **To Borrower**

Estimated Closing Costs Financed
(Paid from your Loan Amount)

Additional Information About This Loan

LENDER
NMLS/__LICENSE ID
LOAN OFFICER
NMLS/__LICENSE ID
EMAIL
PHONE
PACE COMPANY
NMLS/__LICENSE ID
EMAIL
PHONE

MORTGAGE BROKER
NMLS/__LICENSE ID
LOAN OFFICER
NMLS/__LICENSE ID
EMAIL
PHONE

Comparisons		Use these measures to compare this loan with other loans.
In 5 Years		Total you will have paid in principal, interest, mortgage insurance, and loan costs. Principal you will have paid off.
Annual Percentage Rate (APR)		Your costs over the loan term expressed as a rate. This is not your interest rate.
Total Interest Percentage (TIP)		The total amount of interest that you will pay over the loan term as a percentage of your loan amount.

Other Considerations

Selling the Property	If you sell the property, the buyer or their mortgage lender may require you to pay off the PACE loan as a condition of the sale.
Late Payment	If your property tax payment is late, you may be subject to penalties and late fees established by your property tax collector.
Refinance	Refinancing this loan will depend on your future financial situation, the property value, and market conditions. You may not be able to refinance this loan.
Servicing	You will pay your PACE loan as part of your property tax payment. If you have a mortgage escrow account that includes your property tax payments, contact your mortgage servicer for what you will owe and when. Otherwise, you will pay your taxing authority directly.

Confirm Receipt

By signing, you are only confirming that you have received this form. You do not have to accept this loan because you have signed or received this form.

Applicant Signature Date Co-Applicant Signature Date

LOAN ESTIMATE PAGE 3 OF 3 • LOAN ID #

* * * * *

H–25(K) Mortgage Loan Transaction Closing Disclosure—Model Form for PACE Transactions

Closing Disclosure

This form is a statement of final loan terms and closing costs. Compare this document with your Loan Estimate.

Closing Information	Transaction Information	Loan Information
Date Issued	**Borrower**	**Loan Term**
Closing Date		**Purpose**
Disbursement Date		**Product**
Settlement Agent	**Lender**	
File #		**Loan Type** ☐ Conventional ☐ FHA ☐ VA ☐ ________
Property	**PACE Company**	**Loan ID #**
Estimated Prop. Value		**MIC #**

Loan Terms

Loan Terms		Can this amount increase after closing?
Loan Amount		
Interest Rate		
Annual Principal & Interest *See Projected Payments below for your Estimated Total Annual Payment*		
		Does the loan have these features?
Prepayment Penalty		
Balloon Payment		

Projected Payments

Payment Calculation	
Principal & Interest Mortgage Insurance	
Estimated Total Annual Payment	
Estimated Taxes, Insurance & Assessments *Amount can increase over time*	**This estimate includes** ☐ PACE Payment ☐ Property Taxes (not including PACE loan) ☐ Homeowner's Insurance ☐ Other: *Your PACE loan will be part of your property tax payment. If you have a mortgage with an escrow account, contact your mortgage servicer for what you will owe and when.*

Costs at Closing

Closing Costs	Includes in Loan Costs + in Other Costs – in Lender Credits. *See details on page 2.*
Cash to Close	Includes Closing Costs. *See Calculating Cash to Close on page 3 for details* ☐ From ☐ To Borrower

Closing Cost Details

Loan Costs	Borrower-Paid At Closing	Borrower-Paid Before Closing	Paid by Others
A. Origination Charges			
01 % of Loan Amount (Points)			
02			
03			
04			
05			
06			
07			
08			
B. Services Borrower Did Not Shop For			
01			
02			
03			
04			
05			
06			
07			
08			
09			
10			
C. Services Borrower Did Shop For			
01			
02			
03			
04			
05			
06			
07			
08			
D. TOTAL LOAN COSTS (Borrower-Paid)			
Loan Costs Subtotals (A + B + C)			

Other Costs			
E. Taxes and Other Government Fees			
01 Recording Fees Deed: Mortgage:			
02			
F. Prepaids			
01 Homeowner's Insurance Premium (mo.)			
02 Mortgage Insurance Premium (mo.)			
03 Prepaid Interest (per day from to)			
04 Property Taxes (mo.)			
05			
G. Initial Escrow Payment at Closing			
01 Homeowner's Insurance per month for mo.			
02 Mortgage Insurance per month for mo.			
03 Property Taxes per month for mo.			
04			
05			
06			
07			
08 Aggregate Adjustment			
H. Other			
01			
02			
03			
04			
05			
06			
07			
08			
I. TOTAL OTHER COSTS (Borrower-Paid)			
Other Costs Subtotals (E + F + G + H)			

J. TOTAL CLOSING COSTS (Borrower-Paid)			
Closing Costs Subtotals (D + I)			
Lender Credits			

Payoffs and Payments Use this table to see a summary of your payoffs and payments to others from your loan amount.

TO	AMOUNT
01	
02	
03	
04	
05	
06	
07	
08	
09	
10	
11	
12	
13	
14	
15	
K. TOTAL PAYOFFS AND PAYMENTS	

Calculating Cash to Close Use this table to see what has changed from your Loan Estimate.

	Loan Estimate	Final	Did this change?
Loan Amount			
Total Closing Costs (J)			
Closing Costs Paid Before Closing			
Total Payoffs and Payments (K)			
Cash to Close	☐From ☐To Borrower	☐From ☐To Borrowe	Closing Costs Financed (Paid from your Loan Amount)

Additional Information About This Loan

Loan Disclosures

Selling the Property
If you sell the property, the buyer or their mortgage lender may require you to pay off the balance of this obligation as a condition of sale.

Demand Feature
Your loan
- ☐ has a demand feature, which permits your lender to require early repayment of the loan. You should review your note for details.
- ☐ does not have a demand feature.

Late Payment
If your property tax payment is late, you may be subject to penalties and late fees established by your property tax collector.

Negative Amortization (Increase in Loan Amount)
Under your loan terms, you
- ☐ are scheduled to make monthly payments that do not pay all of the interest due that month. As a result, your loan amount will increase (negatively amortize), and your loan amount will likely become larger than your original loan amount. Increases in your loan amount lower the equity you have in this property.
- ☐ may have monthly payments that do not pay all of the interest due that month. If you do, your loan amount will increase (negatively amortize), and, as a result, your loan amount may become larger than your original loan amount. Increases in your loan amount lower the equity you have in this property.
- ☐ do not have a negative amortization feature.

Partial Payment
If you pay your property taxes directly to your tax collector, contact your tax collector about its partial payment policy. If you have a mortgage escrow account for your property taxes, contact your mortgage servicer about the partial payment policy for the account.

Security Interest
You are granting a security interest in ____________________________

____

____

You may lose this property if you do not make your payments or satisfy other obligations for this loan.

Loan Calculations

Total of Payments. Total you will have paid after you make all payments of principal, interest, mortgage insurance, and loan costs, as scheduled.	
Finance Charge. The dollar amount the loan will cost you.	
Amount Financed. The loan amount available after paying your upfront finance charge.	
Annual Percentage Rate (APR). Your costs over the loan term expressed as a rate. This is not your interest rate.	
Total Interest Percentage (TIP). The total amount of interest that you will pay over the loan term as a percentage of your loan amount.	

?

Questions? If you have questions about the loan terms and costs on this form, use the contact information below. To get more information or make a complaint, contact the Consumer Financial Protection Bureau at **www.consumerfinance.gov/mortgage-closing**

Other Disclosures

Appraisal
If the property was appraised for your loan, your lender is required to give you a copy at no additional cost at least 3 days before closing. If you have not yet received it, please contact your lender at the information listed below.

Contract Details
See your note and security instrument for information about
- what happens if you fail to make your payments,
- what is a default on the loan,
- situations in which your lender can require early repayment of the loan, and
- the rules for making payments before they are due.

Refinance
Refinancing this loan will depend on your future financial situation, the property value, and market conditions. You may not be able to refinance this loan.

Tax Deductions
If you borrow more than this property is worth, the interest on the loan amount above this property's fair market value is not deductible from your federal income taxes. You should consult a tax advisor for more information.

Contact Information

	Lender	Mortgage Broker	Settlement Agent	PACE Company
Name				
Address				
NMLS ID				
___License ID				
Contact				
Contact NMLS ID				
Contact___License ID				
Email				
Phone				

Confirm Receipt

By signing, you are only confirming that you have received this form. You do not have to accept this loan because you have signed or received this form.

Applicant Signature Date Co-Applicant Signature Date

CLOSING DISCLOSURE PAGE 5 OF 5 • LOAN ID #

BILLING CODE 4810–AM–C

* * * * *

■ 8. Amend Supplement I to Part 1026—Official Interpretations, as follows:

■ a. Under *Section 1026.2—Definitions and Rules of Construction,* in *2(a)(14) Credit,* revise comment 2(a)(14)1.ii;

■ b. Under *Section 1026.37—Content of disclosures for certain mortgage transactions (Loan Estimate),* add as a heading *37(p) PACE transactions* and add the following comments: *37(p)(3) Contact information; 37(p)(5) Late payment; 37(p)(7) Form of disclosures—Exceptions;* and *37(p)(7)(ii) PACE nomenclature;*

■ c. Under *Section 1026.38—Content of disclosures for certain mortgage transactions (Closing Disclosure),* add as headings *38(u) PACE transactions* and *(u)(9) Exceptions* and add the following comment: *38(u)(9)(ii) PACE Nomenclature;*

■ d. Under *Section 1026.43—Minimum standards for transactions secured by a dwelling,*

■ i. in *43(b)(8) Mortgage-related obligations,* revise comment *43(b)(8)–2,*
■ ii. add as a heading *43(b)(14) PACE company* and add comment *43(b)(14)–1,*
■ iii. in *43(c) Repayment ability,* add comment *43(c)(2)(iv)*–4, and revise comment *43(c)(3)*–5; and
■ e. Under *Appendix H—Closed-End Forms and Clauses,* revise comment–30.

The additions and revisions read as follows:

Supplement I to Part 1026—Official Interpretations

* * * * *

Section 1026.2—Definitions and Rules of Construction

* * * * *

2(a)(14) Credit.

1. *Exclusions.* The following situations are not considered credit for purposes of the regulation:

i. * * *

ii. Involuntary tax liens, involuntary tax assessments, court judgments, and court approvals of reaffirmation of debts in bankruptcy. However, third-party financing of such obligations (for example, a bank loan obtained to pay off an involuntary tax lien) is credit for purposes of the regulation.

* * * * *

Section 1026.37—Content of disclosures for certain mortgage transactions (Loan Estimate).

* * * * *

37(p) PACE transactions.

37(p)(3) Contact information.

1. Section 1026.37(p)(3) requires disclosure of information about the PACE company if the PACE company is not otherwise disclosed pursuant to § 1026.37(k)(1) through (3). For example, if a PACE company is a mortgage broker as defined in § 1026.36(a)(2), then the name of the PACE company is disclosed as a mortgage broker and the field for PACE company may be left blank. See comments 1026.37(k)–1 and–2 for more guidance.

37(p)(5) Late payment.

1. For purposes of § 1026.37(p)(5), a charge is specific to the PACE transaction if the property tax collector does not impose the same charges for general property tax delinquencies.

37(p)(7) Form of disclosures—Exceptions.

37(p)(7)(ii) PACE nomenclature.

1. Wherever § 1026.37 requires disclosure of the word ''PACE'' or form H–24(H) in appendix H uses the term ''PACE,'' § 1026.37(p)(7)(ii) permits a creditor to substitute an alternative name for the specific PACE financing program that will be recognizable to the consumer. For example, if the name XYZ Financing is used in marketing and branding a PACE transaction to the consumer, such that XYZ Financing will be recognizable to the consumer, the creditor may substitute the name XYZ Financing for PACE on the Loan Estimate.

Section 1026.38—Content of disclosures for certain mortgage transactions (Closing Disclosure).

* * * * *

38(u)—PACE transactions

38(u)(9) Exceptions.

38(u)(9)(ii) PACE nomenclature.

1. Wherever § 1026.38 requires disclosure of the word ''PACE'' or form H–25(K) in appendix H uses the term ''PACE,'' § 1026.38(u)(9)(ii) permits a creditor to substitute an alternative name for the specific PACE financing program that will be recognizable to the consumer. For example, if the name XYZ Financing is used in marketing and branding a PACE transaction to the consumer, such that XYZ Financing will be recognizable to the consumer, the creditor may substitute the name XYZ Financing for PACE on the Closing Disclosure.

* * * * *

Section 1026.43—Minimum standards for transactions secured by a dwelling

* * * * *

43(b)(8) Mortgage-related obligations.

* * * * *

2. *Property taxes.* Section 1026.43(b)(8) includes property taxes in the evaluation of mortgage-related obligations. Obligations that are related to the ownership or use of real property and paid to a taxing authority, whether on a monthly, quarterly, annual, or other basis, are property taxes for purposes of § 1026.43(b)(8). Section 1026.43(b)(8) includes obligations that are equivalent to property taxes, even if such obligations are not denominated as ''taxes.'' For example, governments may establish or allow independent districts with the authority to impose levies on properties within the district to fund a special purpose, such as a local development bond district, water district, or other public purpose. These levies may be referred to as taxes, assessments, surcharges, or by some other name. For purposes of § 1026.43(b)(8), these are property taxes and are included in the determination of mortgage-related obligations. Any payments for pre-existing PACE transactions are considered property taxes for purposes of § 1026.43(b)(8).

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43(b)(14) PACE company.

1. Indicia of whether a person administers a PACE financing program for purposes of § 1026.43(b)(14) include, for example, marketing PACE financing to consumers, developing or implementing policies and procedures for the origination process, being substantially involved in making a credit decision, or extending an offer to the consumer.

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43(c) Repayment ability.

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43(c)(2) Basis for determination.

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Paragraph 43(c)(2)(iv).

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4. *Knows or has reason to know—PACE transaction.* In addition to the guidance provided under comment 43(c)(2)(iv)–2, a creditor originating a PACE transaction knows or has reason to know of any simultaneous loans that are PACE transactions if the transactions are included in any existing database or registry of PACE transactions that includes the geographic area in which the property is located and to which the creditor has access.

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43(c)(3) Verification using third-party records.

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5. *Verification of mortgage-related obligations.* Creditors must make the repayment ability determination required under § 1026.43(c)(2) based on information verified from reasonably reliable records. For general guidance regarding verification see comments 43(c)(3)–1 and –2, which discuss verification using third-party records. With respect to the verification of mortgage-related obligations that are property taxes required to be considered under § 1026.43(c)(2)(v), a record is reasonably reliable if the information in the record was provided by a governmental organization, such as a taxing authority or local government. The creditor complies with § 1026.43(c)(2)(v) by relying on property taxes referenced in the title report if the source of the property tax information was a local taxing authority. A creditor that knows or has reason to know that a consumer has an existing PACE transaction does not comply with § 1026.43(c)(2)(v) by relying on information provided by a governmental organization, either directly or indirectly, if the information provided does not reflect the PACE transaction. With respect to other information in a record provided by an entity assessing charges, such as a homeowners association, the creditor complies with § 1026.43(c)(2)(v) if it relies on homeowners association billing statements provided by the seller. Records are also reasonably reliable if the information in the record was obtained from a valid and legally executed contract. For example, the creditor complies with § 1026.43(c)(2)(v) by relying on the amount of monthly ground rent referenced in the ground rent agreement currently in effect and applicable to the subject property. Records, other than those discussed above, may be reasonably reliable for purposes of § 1026.43(c)(2)(v) if the source provided the information objectively.

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Appendix H—Closed-End Forms and Clauses

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30. *Standard Loan Estimate and Closing Disclosure forms.* Forms H–24(A) through (H), H–25(A) through (K), and H–28(A) through (J) are model forms for the disclosures required under §§ 1026.37 and 1026.38. However, pursuant to §§ 1026.37(o)(3) and 1026.38(t)(3), for federally related mortgage loans forms H–24(A) through (H) and H–25(A) through (K) are standard forms required to be used for the disclosures required under §§ 1026.37 and 1026.38, respectively.

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