

Residential PACE Consumer Protection Task Force

DRAFT Minutes

Thursday, September 7, 2017

Present: Anne O'Connor (Chair), Dylan Sievers (delegate of Will Nissen, Fresh Energy), Janet Johnson (MN Bankers Assn), Ryan Smith (MN Credit Union Network), Julie Padilla (Renovate America), Heather Corcoran (delegate of Craig Johnson, League of MN Cities), Chris Duffrin (Center for Energy & Environment), Paul Eger (MN Realtors), Peter Klein (St. Paul Port Authority), Mary Jo George – via phone (AARP), Emily Murray (Assn of MN Counties), Sue Basiago (MN Land Title Assn), John Kearney (MnSEIA), Ron Elwood (Legal Aid)

Chair O'Connor called the meeting of the Task Force to order at 9:00 AM

AGENDA:

- Welcome
- Introductions
- Lien Overview
- Panel
 - Kristine Kujala, Ramsey County Assessor's Office
 - Sue Basiago, MN Land Title Assn
 - Chris Anderson, Bank Cherokee
 - Bill Schwietz, MN Mortgage Assn
- Group Discussion and Public Comment
- Adjourn

The Task Force approved minutes from the meetings of August 24, 2017.

Lien Overview

Mark Hastie, Director of Non-Depository Financial Institutions with the Commerce Department, gave a presentation on PACE Liens. The presentation was included in members' folders.

Comments/Questions:

- A Member pointed out that the Federal Housing Finance Agency (FHFA) position on PACE liens was not mentioned during the presentation. They requested that FHFA's policy position be provided to the Task Force.
 - *Response:* There has been clear guidance from the Federal Housing Administration (FHA). Renovate America has been working closing with the FHFA to resolve their 2010 decision to not support first-lien PACE programs. They are hoping to have resolution prior to the end of the year.
- *Question:* What is the market share between FHFA, VA and FHA?
 - *Response:* FHFA holds approximately 80%.
- *Comment:* FHFA ignores special assessment law. There is no evidence of an increased risk to the mortgage holder. PACE assessed homes have a lower default rate than traditional. Homeowners can voluntarily assess their property for other issues, in which FHFA does not have a problem.

Panel

Kristine Kujala, Ramsey County Assessor's Office

Kris Kujala started the panel with an overview of the County's forfeiture process. She clarified that it is a forfeiture process for property tax, not a foreclosure. Here are highlights from her presentation:

- Property taxes become delinquent one year after they are due.
- Most counties give homeowners three years to pay delinquencies. If not paid, the property will forfeit to the State of Minnesota. There are "targeted communities" within St. Paul that accelerate the delinquency payback period to one year. A court proceeding can also accelerate and cut down to a 5 week period.
 - *Question:* In St. Paul areas, is it an area or specific to properties?
 - *Response:* Best described as census blocks. A property needs to meet 3 of 4 criteria to be included in those areas.
- There are two ways a lender could settle delinquencies on a property with a lien: 1) lender could pay remainder, then foreclose with the borrower and take title of the property; or 2) the lender would settle the debt, add delinquent amount on to mortgage and then repackage with the borrower.
- In the case of a forfeiture, the State will take the title to hold in trust for all taxing jurisdictions. The lien will take priority over all additional liens except federal or state. If there is a mortgage, it is wiped out at the point the property is forfeited. There is a remedy after foreclosure: a prior owner, an interested party or the mortgage holder can redeem the property by filing application to repurchase, but this is not an automatic right. It has to have approval by the county board after a series of reviews. Delinquency redemption is an automatic right, but once it forfeits to the state, it requires a county review & recommendation.
- *Question:* How do you assign payments? What happens if the payment is not paid in full and there is a balance left? Would the delinquency go to the special assessment or the base property tax?
 - *Response:* The property tax statement shows the full amount due in the one statement (property tax base plus the special assessment on top). The County does not divide the payment as it all pays down the singular balance.

- *Question:* How often does a lender pay the tax assessment off in a forfeiture situation so that they move into the first position?
 - *Response:* There has been a shift since the height of the foreclosures. The answer depends on whether the original lender still exists and how loans were previously packaged and sold off to other lenders. Currently it is about 50/50 as to whether it is the prior owner asking to redeem and filing the application or whether it is the lender. Over 2016 forfeitures, a couple lenders missed their timeframe. It's important to understand the timeframe for filing an application. There is a specific timeframe to redeem in which you have one year from date of forfeiture for vacant land (recent legislation reduced to 6 months as of Jan. 1, 2018) and until the property is sold to a third-party buyer for property that is homesteaded.
- *Question:* Whom does the county notify in the case of forfeiture?
 - *Response:* All interested parties that are of record are notified or parties that have asked to be notified and paid the filing fee on a yearly basis
- *Comment from Member:* Remember that the forfeiture does not happen until after the 3-year delinquency period, so you would have 3 years to pay. The likelihood of going into complete forfeiture is remote (as seen from the Commercial side).
- *Question:* When does the mortgage holder have the opportunity to pay off the delinquency and take priority?
 - *Response:* At any time during the delinquency period
 - *Follow-up Comment:* Theoretically, a foreclosure could happen prior to a forfeiture then.
- *Question:* Is there data on who is redeeming on delinquencies? Can you track on who is paying off delinquencies before forfeiture?
 - *Response:* No
 - *Comment from another Member:* If the lender steps in to pay the delinquency, generally they are working out an agreement with the borrower. This does not result in automatic foreclosure since a separate foreclosure process exists.
- *Question:* How does this work in California?
 - *Response from another Member:* California follows their own statutory procedure. Minnesota has a lower delinquency rate than California generally. As of today, there have been no foreclosures due to the existence of a PACE assessment.
- *Comment from Audience:* When a PACE lien gets put on in front of a mortgage, it is up to lender to make up default for the extra, special assessment in order to help borrower get back to good standing.
 - *Response from Member:* It's not up to the lender to pay for it, it is up to lender to determine if they want to work out an agreement with the borrower.
 - *Follow-up comment:* But if the lender has a \$300,000 mortgage and the PACE lien is \$10,000, the lender will do something to maintain their position. This seems unfair.
 - *Response from Member:* Some organizations have taken a clear position that they do not want to deal with PACE, but individual lenders have said they see the value of increasing property values, though. There is an industry position, but there is also an on-the-ground position.
- *Question:* In regards to the earlier comment that there have been no foreclosures due to PACE, if the County does not split up the property tax payment versus the special assessment, how can you track this to verify the statement is accurate?

- *Response:* Each state is unique. In all instances, the bank has foreclosed prior to forfeiture due to a homeowner's failure to pay the mortgage, not the property tax. These are two different processes. A homeowner will not choose to pay the property tax over their mortgage.
- *Question:* Can we get data on the number of homes lost through the traditional foreclosure process versus the forfeiture process?
 - *Follow-up comment:* The Task Force should look at whether Minnesota should track data differently. There is no way we will be able to evaluate in the future as to whether a PACE tax lien is resulting in a forfeiture.
- *Comment from Member:* There is a three-year redemption period in which the mortgager can foreclose for failure to pay property tax or mortgage. After the three-year period, there is a public auction. Most likely, the mortgager will not lose the home; rather will make the payments to bring the tax current.
 - *Response:* To clarify, the public auction only happens after the forfeiture to the State.
- *Question:* Out of the delinquencies, do we know what percent are escrow accounts?
 - *Response:* The County did not have that data on hand but can track it down.
- *Question:* Do all counties not assign payments?
 - *Response:* Yes
- *Question:* Is this the same process for other types of special assessments?
 - *Response:* Yes

Sue Basiago, MN Land Title Assn

The MN Land Title Assn is the industry that will be ensuring to the lender whether they are going to have clear title or not.

- Their main concern is that if a loan is provided by a private industry that is then going to be purchased through bonds, when does the transaction happen? In MN, we are a record notice state where everything has to be of record. If there are mortgages or liens of record prior to one's interest, they are in first lien position. If there is a loan out, when is it a loan versus an assessment? The loan must be satisfied before it goes to a bond. If someone does work on the property, from a title perspective, they need to make sure the work is completed and lien waivers are given. The contractor has the lien rights before anyone out there. Who has the lien rights is one problem that needs to be resolved.
- The Land Title Assn pulls assessment searches. When they get tax statements, they will see the assessment. They will contact local government to find the principal balance and the amount left including interest. They ask if it is payable. If payable, they want to make sure the real estate contract states whether the seller is going to pay or the buyer will. A deal can be done different ways: the amount is written in to the contract with the buyer, the seller will pay-off prior to transfer of title, or they split the cost. If it is not payable, will the lender let the transaction proceed and close?
- The MN Land Title Assn does not have concerns with Commercial PACE since commercial borrowers are more educated on the issues. The biggest concern is educating consumers. Most often, assessments are not realized until the buyer is at the closing table and they are now wondering what they are going to do.

- The Task Force needs to be careful when looking at how they are going to structure these in our statute.
- With any type of typical loan, there is going to be an escrow. Their concern is in a refinance, where you get to refinance and there is still balance owed under assessment. Someone's tax will go up immensely. People will sit down at the closing table with one tax amount, decide to take out a PACE lien a few months later and their escrow will not catch up for at least a year or more and then they will have an escrow balance. This is where they will see the delinquencies happen. Right now economy is doing well and they aren't seeing many delinquencies, but worried about when the economy is not so well.
- After talking with underwriters, they want to make sure that the lender understands that they will be a subordinate interest.
- *Comment from Member:* Relating to work on property, making sure that the work is done is part of Renovate America's process. They do not pay the contractor until the project is completed and the completion is signed off on. Renovate America fronts money to contractor. There are waivers in place. Renovate America takes projects and bundles together before they go to their bond-issuing partner. The bond-issuing partner issues the bonds that Renovate America purchases. They have also worked with realtor associations on requiring disclosures up front as to PACE assessment. Renovate America also calls everyone when a property with a PACE assessment goes on the market to make sure everyone understands the lien. PACE assessments are always payable. In 2/3rd of refinance situations, PACE assessment travels to the new loan. In 2/3rd of buyer/seller transactions, they are paid off prior to sale.
 - *Question:* This starts off as loan and then becomes assessment, is that correct?
 - *Response:* No. Private capital is added as financing to a public purpose. Bond issuing partner issues bonds that Renovate America is purchasing after putting upfront money in place. The recent court decision stated that this is not consumer lending, it is tax assessment financing.
- *Question for Renovate America:* Can you provide a copy of the court decision?
 - *Response:* Yes
- *Question:* What does it mean for consumers to have a clear title?
 - *Response:* If taxes or assessments are paid, people can lose their property. People should understand what their rights are and that taxes and assessments are paid.
 - *Follow-up:* If there is failure to disclose, how does that all play out?
 - *Response:* If it blows-up at closing table and it is a residential transaction involved with TRID, it will stop the closing for at least a week. Buyers and sellers will need to make agreements.
- *Question:* Is this a routine problem you have with assessment challenges, not PACE specific?
 - *Response:* Correct.
- *Comment from Member:* We do record entirety of assessment against the property, so it should be seen in a search. There was a study done last year that showed that PACE assessments added their most value in foreclosure. PACE is single purpose financing intended to increase the value of your home. It is often a choice between PACE or unsecured financing.

Chris Anderson, Bank Cherokee

Chris gave the perspective from a local, small community bank. They have a few concerns on the front end:

- FHA has allowed PACE liens to take priority over their loans, but Fannie & Freddie have not. From a bank perspective, this is a concern. Fannie & Freddie specifically say that any prior lien in front of their mortgage would be an event to default. General proceedings have been that banks are not exercising their right of calling a loan because of this, but nonetheless it does create that event. FHA loans are typically riskier borrowers, so from a bank perspective to allow additional financing in front of what may be small equity, they rely on the cushion to make them whole in event of default. It makes bank loss more likely.
- There are differing opinions on whether the improvements add tangible value to the property. Solar panels may limit a buyer's pool coming out of foreclosure; some people may think they are great but some may look elsewhere. Residential appraisers typically do not make adjustments for items such as windows, so how do you substantiate value?
- PACE is not required to notify lenders ahead of time.
- In California, the HOPE program allows borrowers to request subordination. Is this being considered in MN?
 - *Response from Renovate America:* Lender notification is not required by law in CA or MN. The challenge is time lag. The question is notification versus consent versus acknowledgment. The task force should consider this. If you are dealing with a replacement situation, there is no timeliness requirement for a lender to respond, no motivation for a lender to respond. We need to consider this. Some additional consumer protections will be coming out of CA hopefully this week. Renovate America did contractual subordination for a period of time, but it did not resolve FHFA's concerns so they do not do it anymore. They are seeking a holistic federal solution with FHFA.
- Until FHFA changes, it really limits what the bank can do with the property if they own it.
- *Question:* If notification requirement exists, and it is a FHFA backed loan but you still have a PACE assessment in place with superior position, what do you do?
 - *Response:* A notification process would be helpful. Typically, after notification, they would do a small amount of underwriting to determine loan to value. There is a possibility that the loan would need to be downgraded, ultimately leading to monetary impact to bank.
 - *Follow-up:* If you have mortgage for a buyer with a PACE assessment, what would be your requirements with an FHFA backed loan?
 - *Response:* I'm not sure we'd proceed with an FHFA backed loan.
- *Question:* If bank client has a Fanny/Freddie product and there is no requirement for notification of lender, and FHFA guidelines will not allow their lien to be subordinated, how will contractor at kitchen table with homeowner determine whether or not who has the loan on the house?
 - *Response from Renovate America:* General practice from FHFA has been to not call loan. Special assessments and many other liens generally violate FHFA rule. They are close to a solution with FHFA.

- *Follow-up:* Is there anything Renovate America could send regarding the progress with FHFA? FHFA does not say you cannot put a PACE loan on the house, what they say is that they will not finance a home with PACE financing. Minnesota should have a notification procedure.

Bill Schwietz, MN Mortgage Assn

Protection of 1st lien position is not just a PACE financing issue. Erosion of 1st lien position is of greater concern to consumers than to mortgage lenders. The first lien position keeps mortgage rates low and retirement accounts safe. Mortgages get bundled together with others and sold to Fannie or Freddie. Fannie/Freddie takes those mortgages and backs a security, then sells the mortgage-backed security to investment funds. Your mortgage payment could be helping to fund your retirement account. Ability to recoup losses in a foreclosure matters to everyone in this chain. If Fannie/Freddie do not have first lien rights, there is greater risk of loss. Taxpayers are financially responsible for Fannie/Freddie. PACE programs are charging second mortgage rates or higher, which are higher due to the higher risks, but are taking advantage of first lien priority. We need to understand economics and purpose of first lien priority.

- *Comment/Question:* Morningstar Report states that there is no additional risk due to a PACE assessment. Do you have data that reflects that PACE assessments create additional risk or is your conversation just based on priority liens in general?
- *Response:* Any additional risk is going to increase the cost of lending
 - *Follow-up:* But we are specifically talking about PACE here
 - *Follow-up:* This is an issue that isn't just PACE
- *Question from another member:* Looking at the Morningstar Report, can you help me understand misconception #2. Is the underlying argument that the mortgage is not in risk because the mortgage holder is going to pay off any assessment?
 - *Response:* The member is not a part of Morningstar and cannot tell what their underlying argument is meant to be or how to interpret. The statement by Morningstar is their statement. Delinquency rates are lower on PACE assessed homes than the average.
 - *Follow-up:* Morningstar language is clear. This is not beneficial to the mortgage holder.
 - *Follow-up Question to Bill:* Why do we care whether your risk is higher?
 - *Response:* To say that is just the lender that wants to maintain first lien position is wrong. As a borrower, you should be concerned with the erosion of first lien position. Higher interest rates could result.
 - *Response from Title Assn:* In order to sell the property, you're going to have to pay the assessments off
- *Question:* Does increased risk affect the availability of credit or the ability to get a loan?
 - *Response:* Yes
- *Question:* Morningstar report also discusses FHFA position but concludes that FHFA's policy has limited impact because owners have the ability to repay the assessment. This discounts FHFA's concerns because the owner can just pay it all off. A lot of owners will not be able to pay it off.
 - *Response:* PACE assessed homes are on market for fewer days and selling for more. Value is recouped. Renovate America has data to validate these points.

- *Question:* On the 1/3rd of sales transactions in which the buyer takes on the remaining assessment, is there tracking as to whether any of those transactions involved a discount in the sale price to take on the assessment?
 - *Response:* Renovate America can look into. They have not had reports of that creating a tension. Depends on how much is left on the assessment, the equipment that is installed and the payback time.
- *Comment:* Read all information that has been provided and look at it critically.

Group Discussion & Public Comment

- *Question:* From Renovate America's perspective, why would not they contractually subordinate lien?
 - *Response:* They did not see contractual subordination as fixing any of the real marketplace issues. They are looking for a more holistic resolution.
 - *Follow-up:* There is a lot of reservation on behalf of the Credit Unions. They do a lot of Fannie and Freddie loans but do a lot of loans in-house. The subordination issue is going to affect their underwriting standards and writing their loan portfolios. Things will become more expensive if they have to build in more loan loss protections.
 - *Response:* The lack of a program in MN drives many of these concerns. The CA legislature is providing a framework to address many of these concerns. Nationally they have not seen anyone show that there is a material risk due to a PACE assessment. They have heard the arguments but have not seen the data backing it up.
 - *Response:* You cannot say that this is tried and true because it has not been through any market downturns and has not been tested or weathered through market changes. Products like this can exasperate circumstances during a downturn.
 - *Response:* They haven't gone through a market downturn with a PACE assessment, but unlike other secured financing mechanisms that can be used for anything, PACE is single purpose financing that stays with the home and has to meet energy efficiency requirements. They are seeing the value retained, so with a downturn you will not see a PACE assessment diminish the value of a home.
- *Question from audience:* They do not understand why we need to change our law for a new program that comes along. First lien priority means that whoever is recorded first has the first lien. That should not be changed for a special purpose, low use and high cost program.
 - *Response:* This is not new in Minnesota. PACE has been on the books but was just suspended this year. PACE is a special assessment, not a loan. Minnesota already had some of the strongest consumer protections in the existing PACE statute. These protections do not extend to other types of special assessments. It is not accurate or fair to say that it is a mortgage of the same as other lending products.
 - *Follow-up:* A customer chooses financing and then goes through an underwriting procedure. The PACE assessments are then bundled together to back a security sold to investors on the secondary market. This sounds exactly like a mortgage.
 - *Response:* Our task here is to decide what additional consumer protections should exist for special assessments related to PACE.

- *Question:* How are special assessments done? Doesn't the city usually say what needs to be done and then gives the opportunity for a hearing prior to the special assessment?
 - *Response:* There is a difference between a voluntary or involuntary special assessment. If it is voluntary, the homeowner is asking for their property to be assessed and waive the hearings.
 - *Follow-up from another member:* It would be helpful to have more of a discussion on the assessment process. Can the League of Minnesota cities share information that may be helpful?
- *Question:* Shouldn't the public have the opportunity to buy the bonds?
 - *Response:* These are revenue bonds done in a private placement because they are fronting the money, not general obligation bonds.
- *Follow-up from earlier question:* The local governments for voluntary or involuntary assessments do not charge interest, so there are aspects of PACE that do not meet the definition of a normal special assessment. There is a financing piece to this.
- *Comment from Member:* The 2018 legislature could define this as a loan. One of our tasks is to determine whether we want to treat this more as a loan or an assessment. We need to decide how to treat this with the notion that we want to make PACE work.
 - *Response:* PACE is defined as property assessed clean energy. Every state treats this as a special assessment, not a loan. If we change the statutory mechanism of what PACE is and take the assessment mechanism away, it will no longer be PACE.
 - *Follow-up:* We can change what consumer protections exist and make it look more like a loan. There is something between being a loan and a regular special assessment.
 - *Response:* You can take aspects of TILA and put over PACE, but you cannot put PACE under TILA. It would kill the program. California legislative reflects the national conversation regarding consumer protections.