HUSCH BLACKWELL

THOUGHT LEADERSHIP

LEGAL UPDATES

PUBLISHED: DECEMBER 19, 2024

CFPB Finalizes Rule on Residential PACE Loans

Service

Consumer Financial Services

Industry

Financial Services & Capital Markets

Professionals

JUSTIN T. FEZZI
ST. LOUIS:
314.480.1664
JUSTIN.FEZZI@
HUSCHBLACKWELL.COM

MIKE G. SILVER
WASHINGTON:
202.378.5854
MIKE.G.SILVER@
HUSCHBLACKWELL.COM

LESLIE A. SOWERS
WASHINGTON:
202.378.2384
LESLIE.SOWERS@
HUSCHBLACKWELL.COM

JAKOB SEIDLER
MADISON:

On December 17, 2024, the Consumer Financial Protection Bureau (CFPB) issued its final rule implementing Section 307 of the 2018 Economic Growth, Regulatory Relief, and Consumer Protection Act (EGRRCPA) and amending Regulation Z to address how the Truth in Lending Act (TILA) applies to Residential Property Assessed Clean Energy (RPACE) transactions. The final rule amends Regulation Z's definition of credit to include RPACE financing, prescribes ability-to-repay requirements, and implements other amendments and exemptions to clarify how other rules in Regulation Z apply. The final rule becomes effective on March 1, 2026.

RPACE financing

RPACE financing is a program that allows consumers to finance energy efficiency, renewable energy, and, depending on state legislation, certain other clean energy improvements to their properties. The financing is repaid through an assessment added to the property owner's property tax bill, typically over a 10-to-20-year period, and is secured by a lien on the consumer's real property. The RPACE financing is tied to the property, not the property owner, and thus the repayment obligation remains with the property in the event the property is transferred. The RPACE lien typically takes super-priority over other mortgages on the property.

There are two types of property assessed clean energy (PACE) transactions: RPACE and commercial PACE (CPACE). The main difference between RPACE and CPACE transactions is the type of property being financed. RPACE finances eligible improvements to a homeowner's home, whereas, CPACE finances eligible improvements to a commercial property. The CFPB's final rule exclusively applies to RPACE financing.

The government's role in PACE financing initially involves enabling legislation at the state level, which authorizes local governments or intergovernmental organizations to establish PACE programs. These local governments or organizations may then develop and administer the programs themselves, but more typically, they contract with private PACE companies to operate the programs. Often, 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, in turn, frequently rely heavily on home improvement contractors to sell PACE loans to consumers and facilitate their origination.

Currently, 40 states and the District of Columbia have enacted legislation or established PACE financing programs; however, only California, Florida, and Missouri have established RPACE programs. Despite this limited geographic scope, RPACE financing has demonstrated considerable success since its inception. As of December 31, 2023, the RPACE financing industry had facilitated 371,000 home upgrades, amounting to over $9.1 billion in financing.

Consumer protection concerns

The CFPB's final rule describes how in the agency's view, the structure of RPACE transactions presents unique risks for consumers. For one, because RPACE assessment liens are granted the same lien priority status as ad valorem real estate taxes, RPACE companies face low repayment risk regardless of the consumers' ability to repay.

The CFPB cited consumer groups' assertions that this may incentivize RPACE companies to originate loans without proper regard for affordability or consumer understanding. These groups also cited deceptive sales tactics and aggressive practices and criticized the high cost of RPACE financing, excessive fees, and inadequate disclosures, which the groups argued can "cause unexpected and unaffordable tax payment spikes that lead to delinquency, late fees, tax defaults, and foreclosure." Other commenters raised concerns that RPACE financing involves targeting and exploitation of vulnerable groups, including those with limited English proficiency. Consumer groups, mortgage industry stakeholders, and environmental groups also asserted that treating PACE transactions like mortgages would ensure a level playing field for market participants.

At the same time, the CFPB described how various commenters—including PACE companies, members of Congress, home improvement contractors, and a group of State Attorneys General—raised contrary arguments which disputed these premises. They argued that the rate of consumer complaints involving PACE transactions were low, that the proposal was based on outdated premises, and that PACE transactions already have sufficient consumer protections in place.

Congressional action

Section 307 of the EGRRCPA, signed into law by President Trump on May 24, 2018, 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 required the CFPB to prescribe regulations that: (1) carry out the purposes of TILA section 129C(a) (TILA’s ability-to-repay provisions), and (2) apply TILA section 130 (TILA’s civil liability provisions) with respect to violations under TILA section 129C(a) regarding PACE financing. It also requires that the regulations account for “the unique nature” of PACE financing.

The final rule

The final rule implements Congress’s directive as follows.

Covered transactions

The final rule expands Regulation Z’s definition of credit in § 1026.2(a)(14) to include RPACE financing transactions. Previously, Regulation Z commentary to that section excluded tax liens and tax assessment from TILA coverage. The rule amends this exclusion to apply only to **involuntary** tax liens and tax assessments. Since RPACE transactions are voluntary financial obligations, TILA and Regulation Z will no longer exclude these transactions.

Covered persons

The final rule subjects both creditors, who typically are the government sponsors, and certain RPACE companies to the requirements in Regulation Z. The final rule provides that an RPACE company that is “substantially involved in making credit decision” for an RPACE transaction is subject to mortgage-related ability-to-repay requirements in Regulation Z. A company is “substantially involved” in making the credit decision if the company “makes the credit decision, makes a recommendation as to whether to extend credit, or applies criteria used in making the credit decision.” The CFPB cited the “role that PACE companies play in PACE financing, the incentive structure of PACE lending, and the fact that PACE companies will often be the parties implementing any ability-to-repay requirements” as the reasons for applying the requirements to PACE companies that are substantially involved in making the credit decision.

General TILA and Regulation Z applicability

Due to RPACE transactions now being recognized as credit under TILA and Regulation Z once the rule takes effect, the comprehensive provisions of these regulations will apply to RPACE transactions as well. For example, the Home Ownership and Equity Protection Act (HOEPA) and its implementing provisions in Regulation Z would apply to RPACE transactions that are classified as high-cost mortgages as defined in existing regulation.

However, the final rule introduces two specific exemptions from the broader TILA and Regulation Z requirements. First, RPACE transactions are exempted from the Higher-Priced Mortgage Loans (HPML) Escrow Rule. Additionally, the final rule exempts RPACE transactions from the periodic statement requirements stipulated in the Mortgage Servicing Rule.

Ability-to-repay requirements

The final rule mandates that covered parties apply the existing Regulation Z ability-to-repay requirements in § 1026.43 to RPACE transactions. These requirements mandate that covered parties: (1) make a reasonable and good faith determination of a consumer's ability to repay at or before the consummation of a covered mortgage loan; (2) consider eight required factors when determining repayment ability; and (3) verify the information relied on in determining a consumer's repayment ability using reasonably reliable third-party records. However, the rule provides that a PACE transaction is not a "qualified mortgage" as defined in Regulation Z.

Additionally, the final rule clarifies how the existing ability-to-pay requirements would apply to RPACE transactions. For instance, one factor requires the covered party to consider the consumer's monthly payment amount for the transaction. Because payments for RPACE transactions are generally due in annual or bi-annual intervals, and because they are typically made through an escrow account, the final rule directs the covered parties to consider increases to the consumer's escrow account payment as part of their repayment ability determination.

The final rule also contains a few elements that would apply to traditional mortgage lenders. It makes clear that pre-existing PACE transaction payments are considered property taxes for purposes of the definition of "mortgage-related obligation" as used in the existing ability-to-repay requirements. This would require mortgage lenders to update their underwriting processes to include consideration of any such existing transactions when evaluating a mortgage loan application. The rule also provides for a process for lenders to verify the existence of PACE transactions that must be considered in the ability to repay process.

TILA-RESPA Integrated Disclosure (TRID) rule provisions

The final rule adds a model Loan Estimate and Closing Disclosure for use with RPACE transactions, as well as Spanish-language translations of each. The final rule also includes certain modifications, clarifications, and exemptions related to disclosures in the Loan Estimate and Closing Disclosure requirements to account for the unique nature of PACE transactions, such as requiring the Contact Information Tables to include RPACE company contact information.

Initial industry reactions

As noted above, the enactment of Section 307 of the EGRRCPA resulted from a bipartisan effort in 2018 to apply TILA ability-to-repay and liability provisions to PACE loans.

Following the final rule's release, the Mortgage Bankers Association (MBA) and consumer advocacy groups issued an atypical joint statement in support of the final rule. They wrote, "[t]he CFPB's final rule is a significant step to protect consumers and reduce mortgage delinquencies by ensuring that consumers are both informed of the obligations they are signing up for when they take out a PACE loan and that they have the ability to repay the loan." They noted their continuing concern with RPACE loans' super-priority lien position.

Conversely, PACENation, a national association for RPACE providers, noted that they have "serious concerns" with the rulemaking and how it will impact the "hundreds of thousands of homeowners who rely on PACE as critical tool to safeguard their homes and families," and that the rule did not take into account the "unique nature" of PACE financing as EGRRCPA required.

The broad support for this rule (other than from the RPACE industry itself) suggests that, even with the uncertainty of the CFPB's agenda and high likelihood of a leadership change next year, the rule will likely survive into the new administration and withstand any possible Congressional Review Act challenges. As such, governments that are involved in PACE financing and RPACE companies—along with traditional mortgage lenders, given the changes to the ability-to-repay requirements affecting them—should be aware of the new regulatory requirements.

Contact us

We regularly advise clients on PACE transactions and on compliance with TILA's mortgage rules, including ability to repay and TRID. Consequently, we can assist creditors and PACE providers with implementing the requirements of this rule.

If you have any questions about this rule or other consumer financial issues, contact Justin Fezzi, Mike G. Silver, Leslie Sowers, Jakob Seidler or your Husch Blackwell attorney.