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National Association of Federally-Insured Credit Unions

March 13, 2020

Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
400 7th Street SW
Washington, DC 20219

RE: Notice and Request for Input Property Assessed Clean Energy (Notice No. 2020-N-1)

Dear Mr. Pollard:

On behalf of the National Association of Federally-Insured Credit Unions (NAFCU), I am writing in response to the Federal Housing Finance Agency's (FHFA) Request for Input (RFI) on residential Property Assessed Clean Energy (PACE) financing. NAFCU advocates for all federally-insured not-for-profit credit unions that, in turn, serve nearly 120 million consumers with personal and small business financial service products. NAFCU appreciates the FHFA's efforts in protecting Fannie Mae and Freddie Mac, the government-sponsored enterprises (GSEs), and Federal Home Loan Banks (collectively the FHFA-regulated entities) from risks posed by PACE loans. NAFCU recommends that the FHFA maintain the current policy of allowing the GSEs to adjust loan-to-value (LTV) ratios as necessary.

In addition, NAFCU suggests that the FHFA charge targeted Loan Level Pricing Adjustments (LLPA) to account for the higher risks associated with PACE loans in those states and communities where available. NAFCU is supportive of loan servicers providing annual disclosures for PACE loans to enhance consumer protections but only if the benefits outweigh the additional burdens. Lastly, NAFCU is supportive of the creation of a state-run registry that requires creditors to provide PACE loan information.

General Comments

NAFCU supports a sustainable and viable secondary mortgage market that is accessible for participants of all sizes. Credit unions are active participants in the secondary mortgage market and sell their mortgages to various FHFA-regulated entities in order to increase liquidity, manage interest rate and concentration risks. The ability to increase liquidity is especially important for smaller institutions with limited resources. According to 2018 *Home Mortgage Disclosure Act* (HMDA) data, 47 percent of credit union mortgages not retained in portfolio were sold to Fannie Mae and Freddie Mac. According to the 2019 NAFCU Annual Report on Credit Unions, 47 percent of respondents reported that pricing was the foremost consideration when deciding to sell to the GSEs. Another 34 percent of respondents reported that ease of access was a consideration. In

addition to selling mortgages to the GSEs, over 34 percent of respondents sell mortgages to the Federal Home Loan Banks (FHLBs). This data emphasizes the continued need for access to the secondary mortgage market for credit unions, and part of ensuring access entails mitigating risks posed by PACE loans.

Credit unions do not offer PACE financing but face negative implications when PACE-financed improvements impose a superior lien on properties with preexisting mortgages. PACE loans are riskier loans not only for the credit union industry but for the secondary mortgage market as well due to the superior lien priority status in certain jurisdictions. As a result, in jurisdictions with superior or first lien priority, the risk associated with PACE loans is higher in the event of a home loan foreclosure, or destruction of the home by a natural disaster and subsequent insurance claim. NAFCU members offer loans for green and energy-efficient improvements, as a substitute to PACE loans, that do not place a priority lien on the member's real property and are generally more consumer-friendly.

In general, credit unions would be supportive of changes to the current purchasing requirements that would allow credit unions to sell loans with PACE liens attached to the secondary mortgage market. Allowing these purchases would provide more liquidity for credit unions to inject vital resources into their local communities. This would also allow credit unions to remove riskier loans from their portfolios and include them in a larger and more diversified portfolio on the secondary market. However, the amount of PACE liens held in credit union portfolios is likely very small as historically the industry has been wary of PACE loans and has also taken an active role in reducing risks to the industry. In 2010, the National Credit Union Administration (NCUA) issued a regulatory alert regarding the risks of PACE loans, warning credit unions about the potential impact of such loans. The NCUA cautioned credit unions that not only could PACE loans affect mortgage loans in portfolio, but certain PACE programs could make it more difficult to sell to the GSEs or private investors.

NAFCU appreciates the steps taken by the FHFA and other agencies to mitigate risks posed by PACE loans, which ultimately reduces the risks to taxpayers. In 2010, the FHFA issued a statement cautioning lenders of the potential adverse effects of an outstanding PACE loan on a lender's security interest in collateral securing residential and commercial mortgages. As part of FHFA's 2010 statement, the agency provided the GSEs with the authority to adjust LTV ratios to reflect the maximum allowed PACE loan amounts available in areas with PACE lending. Subsequently, the FHFA barred the GSEs from purchasing mortgage loans with an outstanding PACE loan, unless the terms of the loan provide for subordinate lien priority. In addition, the Federal Housing Administration (FHA) announced in 2017 that it would stop insuring mortgages on homes with PACE loans.

NAFCU is supportive of the FHFA's efforts to combat the risks posed by PACE loans and maintain safety and soundness in the housing market by sharing some of that risk. Altering the LTV ratios or charging an LLPA or credit enhancement are certainly viable options to assist in reducing risk. However, NAFCU urges the FHFA to ensure that any measures taken target just those states and communities where PACE financing is available, do not impose additional burdens on lenders, and do not create disruption to the secondary mortgage market.

The FHFA Should Maintain the Agency's LTV Ratio Policy

NAFCU suggests that the FHFA maintain the current policy regarding LTV ratios that provides the GSEs with the authority to adjust as necessary but ensure that any adjustment in LTV ratio requirements is not arbitrarily imposed on communities that do not allow PACE financing. Any adjustment should also accurately reflect the risks posed. Understandably, the FHFA must evaluate risks that could adversely affect the FHFA-regulated entities, and LTV is an important factor in determining overall risk. Again, this issue is community-specific and those communities that do not partake in PACE lending should not be penalized.

The FHFA should not decrease the LTV ratios for all new loan purchases in states or communities where PACE financing is available, as this action may have unintended consequences such as inaccurate risk-based pricing which increases the GSEs' risk exposure. Accurate risk-based pricing models are predicated on accurate LTV ratios. Requiring borrowers to finance more of their mortgage up-front because of potential risks associated with available financing in the locale will likely cause homeownership to become further out of reach. This may negatively and disproportionately impact certain subsets of borrowers within these communities. Inaccurate risk-based pricing models may lead to potentially higher interest rates for borrowers without PACE financing who do not pose a higher risk to the FHFA-regulated entities. Understandably, the FHFA-regulated entities must reduce risks to the secondary mortgage market; however, NAFCU supports the FHFA maintaining its current policy of providing the GSEs with the authority to adjust LTV ratios to accurately reflect the risks posed in communities with PACE lending.

The FHFA Should Impose LLPAs Only on Risky PACE Loans

NAFCU recommends the FHFA impose Loan Level Pricing Adjustments (LLPAs) or other credit enhancements only on those communities and states that allow PACE financing based on the riskiness of the loan. Local communities decided to authorize PACE programs, therefore the imposition of LLPAs should be made at the community level. However, LLPAs or credit enhancements should target those loans that pose a risk to the FHFA-regulated entities and not spread across all loans in the community that do not have PACE liens attached. According to the FHFA's policy this could include loans where the GSEs have consented to purchasing a loan with a PACE lien attached, or a loan where the PACE lien is in the subordinate position.

The FHFA's RFI hypothetically suggests an increase to LLPAs or credit enhancements for all loans made in communities with available PACE financing. Increasing LLPAs or requiring other credit adjustments for all new loans in communities with available PACE financing does not consider the individual risk factors of that borrower and instead penalizes them for the actions of other members in the community or state for previously made PACE loans. LLPAs vary by loan characteristics and raise mortgage rates and payments for borrowers who engage in riskier mortgage borrowing practices without penalizing those who engage in safer borrowing.

Although a blanket increase in LLPAs may account for the risks posed to that community or state, requiring this for all borrowers would burden low- and moderate-income and first-time homebuyers. NAFCU has previously advocated that no borrower should face arbitrarily high

prices for mortgage credit. Thus, increases to LLPAs or credit enhancements should only target those loans that pose a risk and be imposed only upon those communities or states that allow PACE financing so as to not disrupt the remainder of the secondary mortgage market.

Consumer Impacts of PACE Financing

As the FHFA noted in this RFI, there are numerous consumer impacts from PACE financing. Consumers are not understanding key features of PACE loans, and this lack of understanding is resulting in severe consequences, including consumers losing their homes. Consumers have reported not understanding how to make payments, the amount of the payment they will owe, and what happens if missed payments occur. Current practices are unfair, opaque, and not subject to the same regulations as other traditional closed-end lending products.

NAFCU previously commented on the Bureau of Consumer Financial Protection's (CFPB) advanced notice of proposed rulemaking regarding PACE financing and supported the agency's efforts to bolster sound underwriting practices by requiring ability-to-repay (ATR) standards for PACE loans as an important consumer protection. Requiring lenders to make 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, and assessments will provide protections for the secondary mortgage market. In addition, NAFCU supported requiring PACE lenders to provide disclosures similar to those required by the *Truth in Lending Act* (TILA) and *Real Estate Settlement Procedures Act* (RESPA) Integrated Disclosures (TRID) to protect consumers entering into PACE contracts, and also mitigate risks for lenders and the secondary mortgage market.

Additional Disclosures in Communities That Allow PACE Financing

NAFCU is supportive of providing consumers in states or communities where PACE financing is available with additional disclosures to enhance transparency and consumer protections; however, credit unions often act as mortgage servicers for the GSEs and the FHFA should weigh the benefits of such disclosures against any burdens imposed upon mortgage servicers. An annual notice to existing consumers informing them of the prohibition of PACE loans pursuant to the terms of their mortgage agreement should sufficiently put consumers on notice. As a mortgage servicer, credit unions would incur significant additional expenses in providing a written disclosure to all existing borrowers in PACE-eligible communities. If the FHFA ultimately decides the benefits of providing a written disclosure outweigh the burdens, then the agency should provide a model disclosure to mortgage servicers. An FHFA-provided model disclosure form creates uniformity and eases regulatory burden on lenders and servicers. The FHFA should explore all options of disclosure or notification to determine the most efficient way to inform existing borrowers of the prohibition.

PACE Loan Registry

The availability of PACE loan information in a registry would assist both credit unions and other lenders processing mortgage applications in a timely and more efficient manner. Generally, credit union members seeking mortgage loans from a credit union will uncover a PACE lien at the time

of a title search. NAFCU members have experienced potential borrowers ultimately deciding to forgo loan origination because of the high cost of their outstanding PACE loan balance. If a PACE loan registry existed, this would assist consumers in deciding whether to proceed with their mortgage application.

It would be more prudent to have a state-run registry rather than require a federal agency to provide this service since PACE programs are only available through state-initiatives. The burden should be on the creditor to input PACE loan information, as they have access to the most updated and accurate information. Minimum information available in the registry should include the existence of a PACE loan and lien priority status. Thus, the registry should include the current status of the loan and whether there is a current outstanding balance. Making basic information available in a state-run registry would assist credit unions and potential borrowers.

The registry should also strike a balance between the need for transparency and the need for consumer privacy. Specifically, the personal identifiable information (PII) of consumers who have acquired a PACE loan should remain private. The registry should ensure the non-disclosure of PII. Measures must ensure protection for data transferred to and maintained in the registry from data breaches. Data protection measures must extend to any third-party service provider that a state may utilize in setting up and maintaining a registry. Moreover, state-run registries should adhere to any applicable state data protection and privacy laws. Thus, the FHFA should ensure that there are requirements in place for state-run registries that take into account cybersecurity and data protection measures.

Conclusion

NAFCU appreciates the opportunity to provide comments on the FHFA's RFI. NAFCU supports a strong and sustainable secondary mortgage market and understands the risks PACE loans pose. NAFCU suggests that the FHFA maintain the current LTV policy allowing the GSEs to adjust LTV ratios as necessary to account for risks, but not make arbitrary adjustments based solely on geographical location. In addition, NAFCU suggests the FHFA impose LLPAs on those communities that allow PACE financing. Lastly, NAFCU supports the FHFA's efforts to provide additional disclosures to consumers if the benefits outweigh the burdens, as well as the creation of a state-run registry of PACE lien information. Should you have any questions or require additional information, please do not hesitate to contact me at (703) 842-2249 or kschafer@nafcu.org.

Sincerely,

Kaley Schafer
Regulatory Affairs Counsel