Housing Finance and Regulatory Affairs
David L. Ledford
Executive Vice President
dledford@nahb.org

March 13, 2020

Mr. Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
400 7th Street, SW
Washington, DC 20024

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

Submitted via Electronic Delivery to:
RegComments@fhfa.gov

Dear Mr. Pollard,

On behalf of the National Association of Home Builders (NAHB), I appreciate the opportunity to respond to the Federal Housing Finance Agency's (FHFA) Notice and Request for Input (RFI) on the Property Assessed Clean Energy (PACE) Program. FHFA states that in considering changes to its current policies regarding residential PACE, its primary concerns are to ensure and protect the safety and soundness of Fannie Mae and Freddie Mac (the "Enterprises") and the Federal Home Loan Banks. NAHB agrees this is of utmost importance and also considers the potential consequences to consumers, lenders and the broader secondary mortgage market to be of critical interest.

NAHB is a Washington-based trade association representing more than 140,000 members involved in all aspects of single-family and multifamily residential construction, including the building, operation, and management of market rate and affordable rental properties. NAHB and its members have a strong interest in supporting a housing finance system that offers access to homebuyers for affordable mortgage financing in all geographic areas in all economic conditions.

Background on Property Assessed Clean Energy Programs

The PACE program was developed in 2008 to mitigate homeowners' cost and financing impediments to the installation of energy efficient and renewable energy systems. A PACE lien is a financing option for homeowners who want to live in a more energy efficient home, but either choose not to pay out-of-pocket for costly improvements or do not have the money to pay for the extensive retrofits that would provide the desired benefits of lower utility bills and energy conservation. PACE eliminates the upfront payment for energy efficient improvements and makes the cost of the improvements more affordable to homeowners by stretching out the repayment period over 10, 15 or 20 years.

PACE liens generally are financed through bonds issued by a local jurisdiction. Homeowners apply for PACE financing through their local government and repay the lien over time through a special assessment on their tax

bills. The PACE-enabling legislation passed by most states calls for PACE liens to take a first-lien position and requires an existing or subsequent mortgage loan to be subordinated to the PACE lien.
Since PACE financing is tied to the property and not the homeowner, the homeowner who makes the improvements to the home is not necessarily responsible for the entire cost of the improvements. If the home is sold prior to the PACE lien being paid in full, the payments on the lien become the obligation of the new homeowner.

California passed the first legislation to allow PACE financing and started the program in Berkeley in 2008. Since then, PACE-enabling legislation has passed in 36 states and Washington, D.C., but residential PACE financing currently is offered only in certain jurisdictions in California, Florida, and Missouri. As of 2019, over 200,000 homeowners have financed just over $5 billion in energy efficient home upgrades through PACE programs.

<u>FHFA's Treatment of Property Assessed Clean Energy Programs</u>

From its beginning, the PACE financing program has struggled to gain broad support. As early as May 2010, in response to concerns expressed by FHFA, Fannie Mae and Freddie Mac urged their seller-servicers to be aware of the existence of PACE liens in jurisdictions where they do business and reminded them that the first-lien status of PACE liens was contradictory to the Fannie Mae-Freddie Mac Uniform Security Instrument.

In July 2010, FHFA was more direct. The agency released a statement urging state and local governments to reconsider the PACE programs and wrote, in part, first liens for PACE programs "present significant risk to lenders and secondary market entities, may alter valuations for mortgage-backed securities and are not essential for successful programs to spur energy conservation." Among other actions, Fannie Mae and Freddie were instructed to 1) adjust loan-to-value (LTV) ratios to reflect the maximum permissible PACE lien amount available to borrowers in PACE jurisdictions, and 2) tighten borrower debt-to-income (DTI) ratios to account for additional obligations associated with possible future PACE liens. The Federal Home Loan Banks were cautioned that PACE liens could have an adverse impact on the valuation of the mortgage collateral used by Federal Home Loan Banks as security for advances in jurisdictions with PACE programs.

In January 2012, FHFA issued an Advanced Notice of Proposed Rulemaking that proposed to direct the Enterprises not to purchase any mortgage loan subject to a first-lien PACE obligation or that could become subject to a first-lien PACE obligation without the consent of the mortgage holder. This essentially proposed to preclude the Enterprises from purchasing mortgage loans in any jurisdictions that had passed legislation authorizing PACE programs that required a PACE lien to have first-lien status over the mortgage loan.

The proposed rule, when issued in June 2012, did not include the language that would have prohibited the Enterprises from purchasing any mortgage that *could become* subject to a first-lien PACE obligation without the consent of the mortgage holder. The Proposed Rule recommended three restrictions to protect the Enterprises from first-lien PACE obligations. The Proposed Rule stated:

1) The Enterprises shall immediately take such actions as are necessary to secure and/or preserve their right to make immediately due the full amount of any obligation secured by a mortgage that becomes, without the consent of the mortgage holder, subject to a first-lien PACE obligation. Such actions may include, to the extent necessary, interpreting or amending the Enterprises' Uniform Security Instruments.
2) The Enterprises shall not purchase any mortgage that is subject to a first-lien PACE obligation.

3) The Enterprises shall not consent to the imposition of a first-lien PACE obligation on any mortgage.

The proposed rule of June 2012 was never finalized. The current treatment of PACE programs by Fannie Mae and Freddie Mac was dictated to the Enterprises by FHFA in December 2014, when the FHFA released a statement clarifying that it would not allow either Fannie Mae or Freddie Mac to purchase single-family home mortgage loans that are subject to a primary lien assessed through the PACE program. This statement prevents borrowers with a first-lien PACE loan from refinancing into a mortgage guaranteed by Fannie Mae or Freddie Mac and prohibits the Enterprises from guaranteeing a loan to purchase a home that has a first-lien PACE loan already placed on it.

NAHB Concerns with PACE Liens

NAHB believes it is important to support initiatives that seek to help homeowners finance energy efficient and renewable retrofits for residential properties. However, we have the same concerns expressed by FHFA in the Notice and Request for Input regarding PACE obligations.

PACE liens that take a primary lien position could impair the safety and soundness of market participants

As designed, most PACE liens take a primary lien or “super lien” position ahead of a pre-existing mortgage loan or ahead of a new mortgage loan originated on a property with an outstanding PACE obligation. Even more troubling to NAHB is that these programs allow the PACE lien to be attached to a property after the mortgage loan has been originated without the notification of the owner or guarantor of the mortgage. Placing the original mortgage loan in a second-lien position without the knowledge of the entity at risk if the loan defaults undermines the integrity and safety and soundness of the mortgage market.

A mortgage loan that originally had a loan-to-value ratio (LTV) of 80 percent, could, when combined with a subsequent PACE lien, result in a total LTV of 90, 95, 100 percent or higher without the knowledge of the owner or the guarantor of the mortgage. This possibility may alter valuations for mortgage-backed securities issued by the Enterprises and on the valuation of the mortgage collateral used by Federal Home Loan Banks as security for advances in jurisdictions with PACE programs by introducing uncertainty in the market regarding the severity of loss on a home that goes to foreclosure. The first-lien position of the PACE lien obligates the foreclosing party to pay past-due amounts outstanding on the PACE lien prior to paying the the former first-lien holder.

PACE liens are difficult to detect

PACE liens generally are not recorded in local land records and therefore are difficult to discover through title searches. Without being aware a PACE lien is attached to the property, a lender qualifying a new borrower for a mortgage loan would underestimate the amount of debt relative to the property’s value (the combined LTV) as well as the borrower’s DTI ratio because the lender would not know to include the PACE lien amount and payment in the calculation of the total LTV and the borrower’s mortgage and other debt/tax payments. This omission could negatively impact both the borrower and the lender, neither of whom would have an accurate understanding of the borrower’s financial obligations. When the mortgage is sold, this could negatively impact the investor who has not received an accurate picture of the lien amount on the property or the borrower’s DTI ratio and, thus, the potential for default and increased risk of loss in the event of foreclosure.

PACE liens lack consumer protection standards

PACE liens are not originated under the same strict underwriting standards that apply to mortgage loans originated by independent mortgage lenders and financial institutions. These originators are held to the Ability-to-Repay (ATR) underwriting requirements and other consumer disclosure requirements intended to ensure a borrower understands and can afford the mortgage obligation he or she is undertaking.

Soon, ATR will apply to PACE financing. Under the mandate of Section 307 of the Economic Growth, Regulatory Relief and Consumer Protection Act of 2018, the Bureau of Consumer Financial Protection (the Bureau) is required to issue regulations that apply the Truth-in-Lending Act's ATR and general civil liability provisions for violations of the regulations to PACE financing. The Bureau's Advanced Notice of Proposed Rulemaking (ANPR) issued in May 2019 asked for information to help it understand the nature of PACE financing and best implement an ATR requirement. The ANPR did not address the issue of the first-lien status of PACE financing.

Furthermore, homeowners taking on a PACE lien probably do not understand they may be acting in violation of their mortgage agreement with their current lender. Also, it is unlikely PACE lien sales representatives would make it clear to borrowers considering a PACE lien that they would be unable to refinance their mortgage with Fannie Mae and Freddie Mac. Borrowers also would be unlikely to learn that when they want to sell their home, a buyer cannot use a Fannie Mae or Freddie Mac mortgage loan for the purchase unless the balance of the PACE lien is paid off prior to or at closing. These restrictions may reduce the marketability of the house and/or the profitability of the sale for the seller.

<u>NAHB response to FHFA's Notice and Request for Input</u>

FHFA's Notice and Request for Input poses questions asking whether the agency should take various actions to protect the Enterprises from potential negative consequences of PACE financing. Generally speaking, NAHB opposes actions that would have broad direct and negative impacts on homebuyers or homeowners and supports actions required of PACE program administrators, lenders, servicers and the Enterprises that would introduce more transparency into the PACE program.

NAHB recommends FHFA maintain the current restrictions regarding the Enterprises' purchase of mortgage loans with PACE financing structured as a first lien. We recommend these restrictions remain in place until PACE program administrators address FHFA's primary concerns by eliminating the requirement that a PACE lien have a primary lien position, developing borrower disclosures and employing prudent underwriting requirements such as confirming the borrower's ability-to-repay and a maximum combined LTV that ensures a PACE borrower would have equity remaining in the property.

NAHB opposes the idea that FHFA would direct the Enterprises to decrease LTV ratios and/or levy increased Loan Level Price Adjustments (LLPAs) on all new loan purchases in states or communities where PACE liens are available. This would punish all potential homebuyers in those states or in the specific cities and counties with higher downpayments or increased fees simply because PACE financing is an option. The proposal would do nothing to alleviate predatory and misleading information to borrowers and may not adequately improve the risk position of Fannie Mae, Freddie Mac or an investor. FHFA has shown no data to indicate what LTV ratio or increase to fees it believes would protect the Enterprises or investors. It is very possible the necessary levels would pose significant harm to the housing markets in the affected areas. NAHB believes both options would have the most negative impact on low- and moderate-income and first-time homebuyers who often seek financing options with low downpayments and low fees.

NAHB supports a potential requirement for servicers of the Enterprises' guaranteed mortgage loans to provide periodic disclosures to borrowers in PACE-eligible states informing them that under the terms of their mortgage PACE liens are not permitted and explaining the difficulties they may face when selling their home or refinancing their mortgage if a PACE lien exists on their property. Under current PACE lien origination practices, it is quite possible a borrower would not have been given this information by the PACE lien originator when considering PACE financing. NAHB believes borrowers in PACE-eligible states need this information and it could prevent serious consequences for homeowners, servicers and the Enterprises. For these reasons, NAHB also supports a requirement for a similar disclosure in the documents a home buyer or homeowner reviews and signs when closing on a mortgage loan in a PACE-eligible state.

NAHB believes states with authorized PACE programs should require a to-be-determined entity to maintain a registry of properties with outstanding PACE financing. The registry would be accessible to authorized lenders and secondary market participants who demonstrate a need to know if a property is encumbered with a PACE lien.

Should either Enterprise learn a PACE lien has been placed retroactively on a property with a mortgage loan the Enterprise already has guaranteed, NAHB recommends the Enterprise be allowed to declare the loan in violation of its security instrument. While NAHB understands this penalizes a homeowner and not the entity who may be more directly at fault, without this option there is no reason for the Enterprises to have a prohibition against purchasing mortgage loans with PACE financing.

In the event an Enterprise learns it has purchased a loan with a PACE lien attached to the property prior to the Enterprise's mortgage loan being originated, NAHB recommends the Enterprises be allowed to require the lender to repurchase the mortgage loan.

NAHB knows it is possible for PACE liens to be structured without taking a first-lien position and to include consumer protections. Four states, Maine, New Hampshire, Oklahoma, and Vermont, have passed legislation allowing PACE liens to take a subordinate position to the first mortgage loan. These programs also incorporate some combination of consumer and industry protections thereby allowing Fannie Mae and Freddie Mac to purchase loans with PACE liens in these states.

NAHB recommends FHFA reach out to PACE program administrators and state and local officials in California, Florida, Missouri and other states to urge the restructuring of PACE programs to allow subordinate-lien PACE financing and important consumer protections – many of which also would protect other industry participants. This would preserve the positive components of the programs for borrowers but allow PACE program administrators the opportunity to create a PACE program that would benefit from acceptance by FHFA, Fannie Mae and Freddie Mac and the housing finance system broadly.

Conclusion

NAHB believes it is incumbent on PACE program administrators and FHFA to work together to resolve consumer-focused concerns and the first-lien impasse if PACE programs are to gain broad support from the housing finance system. NAHB would be happy to work with FHFA, the Enterprises and other stakeholders in the housing and mortgage lending industries to help resolve current impediments to the effective use of PACE programs. We continue to believe there are ways PACE programs can be structured to finance energy retrofits in a manner that neither harms consumers nor impairs the functioning of the housing finance system.

Thank you for your consideration of NAHB's comments. If you have questions, please contact Becky Froass, Director, Financial Institutions and Capital Markets at 202.266.8529 or email at rfroass@nahb.org.

Sincerely,

David L. Ledford

David L. Ledford
Executive Vice President
Housing Finance and Regulatory Affairs