March 16, 2020

The Honorable Mark Calabria
Director
Federal Housing Finance Agency
400 7th Street SW
Washington, DC 20219

ATTN: PACE Request for Input, Notice No. 2020-N-1

Director Calabria:

U.S. Mortgage Insurers (USMI)[1] represents America's leading providers of private mortgage insurance (MI) and our members are dedicated to a housing finance system backed by private capital that enables access to prudent, sustainable, and affordable mortgage finance for borrowers while protecting taxpayers. As takers of first-loss credit risk and the largest counterparties to Fannie Mae and Freddie Mac (the GSEs) with more than 60 years of expertise in underwriting and managing mortgage credit risk, MI companies are uniquely situated to provide insights into matters affecting low down payment mortgages and the broader conventional mortgage market. USMI appreciates the opportunity to comment on the Federal Housing Finance Agency's (FHFA) Request for Input (RFI) on Property Assessed Clean Energy (PACE) programs.[2] The RFI identifies numerous concerns associated with PACE financing programs as it relates to potential risks to the GSEs' safety and soundness. Responses to specific questions presented in the RFI can be found on the following pages.

USMI recognizes that energy efficiency is an increasingly important issue as communities across the country consider how to best address growing resource shortages, including large-scale electricity outages and extreme water shortages, that result in the rationing of use in some communities, and other significant challenges that arise from growing populations, outdated technologies, and climate change. Understandably, policymakers at the federal, state, and local levels are seeking ways to address these growing concerns and to implement energy efficiency policies that promote the sustainability of important resources. Energy-efficient products continue to grow in use and popularity with many homeowners who continue to increase their environmental consciousness, but who also aim to save money and improve the market value of their homes. In recognition of the need to conserve resources and the natural progression of consumers to more energy-efficient products, some communities have sought to promote these energy efficiencies through PACE financing programs.

PACE financing programs are unique from traditional financing in that homeowners are able to finance energy-efficient projects, such as solar panels, insulation, and window upgrades, that are paid through special property tax assessments rather than through loans, installment contracts, or home equity lines of credit (HELOCs). PACE programs vary by state and municipality, but most result in a property tax lien, which is often a "super lien," over other liens on the property.

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[1] USMI is a trade association composed of the following private mortgage insurance companies: Essent Guaranty, Inc.; Genworth Mortgage Insurance Corporation; Mortgage Guaranty Insurance Corporation; National Mortgage Insurance Corporation; and Radian Guaranty, Inc.
[2] 85 Fed. Reg. 2736 (January 16, 2020).

While Goals May be Laudable, Challenges Posed by PACE Financing are Significant and Warrant Careful Consideration. As stated in RFI, there are a number of distinctions between PACE financing and other loans that raise consumer protection concerns, as well as safety and soundness concerns for the GSEs. Most notable, there may be much greater exposure to risk on loans where there is a PACE lien, as a PACE lien often dilutes the value of a lender or investor's security interest if the borrower defaults. This is why the GSEs have issued guidance and updates to their seller-servicer guides to expressly state that they will not acquire and guarantee mortgages for properties with PACE liens.[3] Separately, FHFA has also urged caution to the Federal Home Loan Banks in accepting collateral for advances where PACE liens may be attached.

As highlighted in the RFI, while the GSEs do not currently allow purchase or refinance loans with PACE liens, PACE liens can still present concerns as it can be difficult for lenders to determine if a PACE lien applies to a specific property. PACE financing is not always obvious to the GSEs, mortgage lenders, real estate professionals, and/or sellers as the liens are not always recorded in local land records, but are only discoverable in tax records, which may not always be clearly presented. Further, lenders' standard first-lien mortgage instruments generally prohibit a homeowner from granting a superior lien, however this has not prevented homeowners from having these super liens through PACE financing transactions.

As it relates to prudent underwriting and determining a borrower's ability-to-repay their loan obligations, PACE financing increases concerns about potential homeowner defaults due to the fact that underwriting for PACE financing does not always involve a standard analysis of the borrower's ability-to-repay, and instead relies on the borrower's property value. Further, the transaction's terms and risks associated with the financing are not always completely clear to borrowers and issues such as higher interest rates for PACE liens, high administrative fees, and repayment terms of up to 30 years are all areas that create additional risk and concern.

Problematic "Super Lien" Status of PACE Financing. Private MI typically covers the first-loss risk for mortgage loans with greater than 80 percent loan-to-value (LTV) ratios. For the MI industry, one of the biggest concerns with PACE financing is the "super lien" status, which increases the credit risk borne by the existing first-lien and any potential junior liens. Private MI is typically considered to be Mortgage Guaranty Insurance under state regulatory frameworks and is thus confined to insuring first-lien exposures. Only if the private MI were to set up a separate company for providing credit insurance could it insure a second lien. Thus, while private MI will pay the claim on the first-lien residential mortgage, it would not pay losses associated with PACE liens, as MIs are prohibited by state law. Further, through the PACE lien structure, lienholders are not compensated for their additional risk, resulting in an underpriced (essentially cost-free) credit enhancement subsidy for the investors who facilitate PACE financing. This distorts markets, misprices credit risk, and creates an un-level playing field.

Restricting Borrowers' Access to Conventional Low Down Payment Mortgages Would Harm Entire Communities and States. USMI agrees with the FHFA's consumer protection and GSE safety and soundness concerns articulated in the RFI. We fully recognize the need to consider policies to mitigate potential risks posed by PACE financing but strongly oppose proposals that would decrease or eliminate

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[3] Fannie Mae Selling Guide (May 1, 2019), Lender Letter (September 18, 2009), and announcements (February 27, 2018; December 1, 2010l and August 31, 201); Freddie Mac Single-Family Seller/Servicer Guide (May 1, 2019), Freddie Mac Single-Family Refinancing and Energy Retrofit Programs page, Selling Guide Bulletin (August 24, 2016), and Lender Letter (August 20, 2014).

access to the conventional mortgage market for borrowers with less than a 20 percent down payment merely based on the fact they live in a jurisdiction that has authorized residential PACE financing.

A required decrease in the maximum allowable LTV ratio for home purchases and mortgage refinances in jurisdictions that permit residential PACE financing would amount to a punitive policy for millions of consumers in those states who would be negatively affected due to the mere permissibly of a niche loan product. USMI further opposes any proposal that would require additional loan level price adjustments (LLPAs) for home purchases or mortgage refinances in jurisdiction that allow PACE financing. Any increase in LLPAs as a means to mitigate potential risks associated with PACE financing would be an unnecessary and burdensome fee applied to borrowers without any nexus to their personal credit profiles or likelihood of obtaining PACE financing in the future.

A key component to ensuring the safety and soundness of the GSEs is to avoid undertaking actions and implementing policies that increase the likelihood of default for the mortgages that they guarantee. Significantly constraining access to credit in markets that allow PACE financing would have a significant impact on the demand for housing due to the exclusion of a substantial number of potential homeowners from the market—and would be overly punitive to homeowners and potential homeowners who do not have PACE financing. A reduction in demand directly translates to softer support of existing home price levels, undermining future growth as well as creating the conditions for home price declines with an associated increase in the risk of default—all of which are counter to the GSEs' mission to "foster liquid, efficient, competitive, and resilient national housing finance markets."

Conclusion

USMI and our member companies appreciate FHFA's initiatives to address the significant concerns posed by PACE financing as it is currently structured, and want to underscore our opposition to proposals that would arbitrarily and punitively limit access to low down payment mortgage finance credit for consumers who live in jurisdictions where PACE financing is available. Questions or requests for further information may be directed to Lindsey Johnson, President of USMI, at ljohnson@usmi.org or 202-280-1820. USMI welcomes the opportunity to serve as a resource and work with FHFA and the GSEs to identify and assess various ways to mitigate the concerns raised in the RFI.

Sincerely,

Lindsey D. Johnson
President

Question 1

Should FHFA direct the Enterprises to decrease loan-to-value ratios for all new loan purchases in states or in communities where PACE loans are available?

No. The potential for PACE financing does not automatically result in utilization of PACE financing. Decreasing the maximum allowable LTV ratio serves to punish a significant number of people for the risk posed by a select few. PACE financing programs, while more popular and more utilized in certain communities, are still very niche products and a decrease in LTV ratios would negatively impact many prospective borrowers. The residential PACE market is very small – as of 2019, approximately $5.6 billion in financing has been issued for approximately 235,000 home upgrades[4]– and only California, Florida, and Missouri have active residential PACE financing programs.[5] Compared to the overall conventional mortgage lending in those three states, including more than 200,000 low down payment mortgages guaranteed by the GSEs over the past year, it is abundantly clear that changes to LTV policies would harm a significant number of borrowers in the name of protecting against a niche risk that does not even exist at the time of origination.[6]

By how much should available loan to-value ratios be reduced to address the increased risk of such liens being placed on the property and what related implications would result from such actions?

There should be no such reduction, as the risk of a reduction in allowable LTVs could pose a greater risk than the status quo.

Should loan-to-value ratios be reduced for all loan purchases sufficient to take into account the maximum amount of a PACE financing available in that community? Should potential future increases in permitted percentage of available PACE financing-to-assessed value be considered?

Given that some PACE financing programs allow up to 20 percent financing, this would equate to eliminating homeownership for every borrower in a given market who would want to use low down payment conventional mortgages with private MI, which is a considerable figure. For the three states that currently have active residential PACE programs, that would have affected more than 200,000 borrowers in the last year alone.[7] Contemplating a further curtailment in LTV ratios because of an increase in the number of PACE financing transactions would constrain the market even further. This policy, if implemented, would disproportionately harm low- and moderate-income, minority, and first-time homebuyers who typically rely on low down payment mortgages to purchase their homes. In fact, in recent years approximately 80 percent of first-time homebuyers used low down payment mortgage products and nearly 60 percent of conventional purchase mortgages with private MI went to first-time homebuyers.[8]

Question 2

Should FHFA direct the Enterprises to increase their Loan Level Price Adjustments (LLPAs) or require other credit enhancements for mortgage loans or re-financings in communities with available PACE

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[4] U.S. Department of Energy Office of Energy Efficiency & Renewable Energy; PACENational PACE Market Data.

[5] As of February 2019, 36 states and DC had passed PACE-enabling legislation and only three states offered residential PACE programs: California (10 active programs); Florida (4 active programs); and Missouri (3 active programs).

[6] Number of GSE-guaranteed mortgages with private mortgage insurance is based on GSE Aggregate Data for 4Q2018 – 3Q2019.

[7] *Id*.

[8] GSE Aggregate Data and Genworth MI First Time Homebuyer Market Reports.

financing? What increased levels would be appropriate for such LLPAs in light of the risks of PACE financing posed to the Enterprises?
Since PACE financing and the associated super lien do not exist at the time that a mortgage is guaranteed by the GSEs, any attempt to impose an additional LLPA would be purely speculative and not grounded in the reality of the risk posed by any one borrower. Any additional LLPA would be an unnecessary and burdensome fee applied to homebuyers that would not correspond to a concrete credit risk and would essentially be an arbitrary tax on homebuyers in certain jurisdictions. If such a policy had existed in 2019, this arbitrary tax could have affected nearly one million home purchase transactions in the three states that permit residential PACE financing.[9]

While credit enhancement is a possibly solution, it is important to note that neither private MI nor existing credit risk transfer (CRT) structures at the GSEs will provide the proper credit enhancement. While we strongly disagree with some of the ideas proposed in the RFI, we think that credit enhancement offers the best path forward. Given that private MI and CRT do not mitigate potential risk associated with PACE financing, FHFA could explore whether a new form of credit enhancement needs to be developed. Although the form of licensure may vary by state, credit enhancing PACE financing would generally be handled by an entity that writes credit insurance.

Question 3

Should FHFA consider other actions regarding Enterprise purchase or servicing requirements in jurisdictions with PACE programs?
Ultimately, this speaks to the question of whether the federal government should exercise coercive power through its regulation of the housing finance system to override local policy. While we will leave this question for others to debate, we would like to note that homeowners and potential homeowners should not be the victims of collateral damage relating to disagreements between state, local, and federal governments.

Question 4

Should FHFA establish safety and soundness standards for the Federal Home Loan Banks to accept as eligible advance collateral mortgage loans in communities where PACE loans are available? How might those standards best address the increased risk of such collateral? Should such standards be in line with actions that FHFA would undertake for the Enterprises, recognizing the difference in business structures between the Enterprises and the Banks?
Our fundamental disagreement with the proposals contained in the RFI applies equally to the Federal Home Loan Bank system as well as to the GSEs.

Question 7

Should servicers of mortgage loans for the Enterprises provide an annual or more frequent notice to existing borrowers in PACE-eligible communities informing them that, under the terms of their mortgage, PACE liens are not permitted? Should borrowers be informed of the difficulties that may arise in selling or refinancing their home when a PACE lien has been placed on their property? What other information, if any, should be provided by servicers to borrowers with regard to PACE liens? Should borrowers in PACE jurisdictions be required to execute any additional agreements or certifications in connection with mortgages for the Enterprises, Home Loan Banks or FHA guaranteeing the borrowers will not accept PACE financing for energy efficiency improvements?

[9] California Association of REALTORS®; Florida REALTORS®; Missouri REALTORS®.

It seems logical for the FHFA to require servicers of mortgages guaranteed by the GSEs to provide periodic reminders to homeowners in PACE-eligible communities that PACE liens are not currently permitted according to the terms of their mortgage and to identify the complications a PACE lien could create should the homeowner seek to sell or refinance their home. At the same time, we are also sensitive to the additional cost burden and compliance risk that this would place on mortgage servicers, and urge the FHFA to carefully engage in cost-benefit analysis to determine the path forward. One possible solution could be direct communications from the GSEs themselves, although we would also encourage the same cost-benefit analysis. Additional disclosures would undoubtedly increase education about PACE financing, thus making consumers more vigilant and potentially reducing the risk to the GSEs. With regard to requiring homeowners and borrowers in PACE-eligible communities to certify that they acknowledge that PACE liens are not permitted on GSE-guaranteed mortgages, we are not sure of the value that would be provided by such a certification in the absence of any enforcement mechanisms.