American Bankers Association
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G. Joseph Pigg
Senior Vice President
Regulatory Compliance and Policy
Phone: 202-663-5480
E-mail: jpigg@aba.com

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

Dear Director Calabria

The American Bankers Association is pleased to comment on the request for input from the Federal Housing Finance Agency (FHFA) on potential changes to policies for entities regulated by FHFA based upon safety and soundness concerns posed by Property Assessed Clean Energy (PACE) loans with super-priority liens.

Residential PACE programs have become moderately popular in recent years as a method of financing energy efficient and other related home improvements. While the goals of these programs are laudatory, the financing mechanism employed by many PACE programs, as they are currently authorized, presents significant safety and soundness concerns for both primary and secondary mortgage market entities. While there are residential PACE guidelines published by the US Department of Energy, those guidelines have not been adopted by all jurisdictions authorizing PACE. We note that PACE programs authorized by individual states vary, and thus, our comments below are general in nature and may not be applicable to all residential PACE programs.

Our primary concern with PACE programs is their authorization of a super priority lien, which takes precedence over any first lien mortgage and attaches to the property, not the borrower. Super priority liens make the property harder to sell or refinance, and undermine the value of the collateral used to secure the mortgage, with deleterious effects on the entire mortgage market.

FHFA has been on the forefront in raising concerns about the threat that super priority liens pose to the functioning of the mortgage markets. Having previously barred Fannie Mae and Freddie Mac from purchasing loans with PACE loans subject to a super priority lien, the agency now is considering adopting measures to protect against PACE loans that are entered into by property owners after the underlying mortgage loan has been purchased by Fannie Mae or Freddie Mac. We fully concur with FHFA's concerns about the potential safety and soundness problems posed by PACE loans with super priority liens, not just to Fannie Mae and Freddie Mac but also to other mortgage lien holders including portfolio lenders. We appreciate the work that FHFA has done to alert states to the problems created by super priority liens and to encourage them to consider other options. That effort has paid off in some states, such as Minnesota. Because of the hard work by the Minnesota Bankers Association and others, the Minnesota legislature established a residential PACE program that does not include a super priority lien.

PACE loans typically share troubling commonalities with asset based lending, including the lack of a requirement to assess a borrower's ability to repay. These loans pose potentially significant risks to borrowers. Loans with a super priority lien also complicate both escrowing and loss mitigation, which increase the risk of harm to borrowers and increase complexity and costs for servicers. Adding a PACE loan to an existing loan with an escrow account will cause a shortage in the escrow account. In cases requiring loss mitigation, a PACE loan will make it more complex to determine the net present value of a property and changes the parameters for determining what a troubled borrower seeking assistance can afford.
For these reasons, we appreciate the request for input and the opportunity to provide the following comments. We also note at the outset that a more effective and direct way to address the problems posed by super priority liens would be for states and other jurisdictions authorizing PACE programs to avoid the use of the super priority lien altogether. Additionally, and as discussed below, the application of the Truth in Lending Act's (TILA) Ability to Repay standard by the Consumer Financial Protection Bureau (CFPB) will likely significantly alter the financing methods for residential PACE loans, providing borrowers with greater protections and reducing risks to lenders. Application of TILA's Ability to Repay standard was mandated in the Economic Growth and Regulatory Relief Act signed into law in 2017, but the CFPB has yet to implement it.

We offer comments on the questions 1 through 7 posed by FHFA.

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? 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? Should loan-to-value (LTV) 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?**

FHFA previously barred the Enterprises from purchasing loans with super priority PACE liens attached. However, that action does not protect against the future application of a super priority PACE lien in a jurisdiction where such liens are or become authorized. Reduction of loan to value ratios in such jurisdictions presents potential problems for lenders and borrowers, primarily by creating a potential patchwork of lending standards that will complicate the lending process, which in turn may, increase underwriting and servicing costs and reduce credit availability. Reducing loan to value ratios will be particularly harmful to low and moderate (LMI) borrowers who may carry more debt.
While taking this approach is not a preferred outcome, it is far less punitive than an outright ban on loan purchases by Fannie Mae and Freddie Mac in jurisdictions that allow super priority PACE liens (whether the property is subject to a PACE lien or not) as some have suggested Both approaches penalize *all* borrowers in jurisdictions that authorize super priority

PACE liens regardless of whether those borrowers avail themselves of such programs or not. Both approaches, however, would be a strong deterrent to states or other jurisdictions considering authorizing super priority PACE liens.

Assuming that FHFA believes that super priority PACE loans will result in losses to the Enterprises, taking an approach of reducing loan to value ratios is a proactive approach that could limit potential losses and would have the added benefit of being targeted only to borrowers in jurisdictions creating the potential for loss through their public policy choices. Nevertheless, the public policy question FHFA must answer is this: is it more appropriate to limit potential losses by reducing credit availability to all borrowers in jurisdictions that have authorized super priority PACE loans, as opposed to exposing borrowers (and taxpayers) nationwide to the costs associated with the losses that would result from failed loans subject to super priority liens in jurisdictions that have authorized them? If FHFA decides to limit losses and target borrowers in jurisdictions whose policies have increased the potential for such losses, FHFA will need to calibrate the reduction in credit availability to the degree of potential loss. Until FHFA has data to support the need for such an approach and to quantify the loan to value adjustments that would be necessary in each jurisdiction with an authorized PACE program, we cannot recommend taking such action.

2. **Should FHFA direct the Enterprises to increase their Loan Level Pricing Adjustments (LLPA's) or require other credit enhancements for mortgage loans or re-financings in communities with available PACE financing? What increased levels would be appropriate for such LLPAs in light of the risk of PACE financing posed to the Enterprises?**

Requiring increases in LLPA's in jurisdictions authorizing super priority PACE loans would also punish all borrowers in those jurisdictions, whether they avail themselves of PACE loans or not, by increasing the cost of their credit (which also has the potential to reduce credit availability). Like reducing loan to value ratios, it targets only borrowers in jurisdictions authorizing super priority PACE loans, and should be appropriately calibrated to the potential losses created by such authorization. Adjusting LLAPs may be somewhat less burdensome and disruptive than reducing loan to value ratios. Thus, it may be a more appropriate tool for managing risks posed by super priority PACE loans, as LLAPs may be able to be adjusted more quickly than loan to value ratios, making them more readily calibrated to the potential for loss. Nevertheless, we cannot recommend taking such action until and unless FHFA has the data necessary to accurately calibrate the appropriate pricing adjustments for each jurisdiction authorizing PACE programs.

3. **Should FHFA consider other actions regarding Enterprise purchase or servicing requirements in jurisdictions with PACE programs?**

Before taking action that may reduce credit availability or increase costs for borrowers, FHFA should engage in further research to quantify potential risks associated with super priority PACE loans, so that any actions required of the Enterprises can be appropriately calibrated to the actual risk posed. Because most super priority residential PACE programs have been authorized only in the recent past, it is unlikely that borrowers or lenders associated with PACE loans have faced the consequences of an extended financial downturn or other stressors. We recommend that FHFA examine foreclosure rates in states that have authorized other types of super priority loans (to the degree that they exist) or states with higher than average real estate or other taxes that take priority over the first lien mortgage to gauge the degree to which borrowers are more likely to pose default risk in those jurisdictions.

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? 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?**

Before FHFA considers imposing any additional safety and soundness standards on the Federal Home Loan Banks with regard to PACE loans, it is essential for FHFA to engage in more research to quantify the actual risk posed by PACE liens so that any new standards can be calibrated to the actual risk posed. Additionally, any standards must consider that portfolio lenders who pledge collateral to the Federal Home Loan Banks underwrite loans using conservative standards, which in many, if not most, instances will already account for potential risks associated with PACE liens. Nevertheless, we urge FHFA undertake more research both to better understand and quantify the risks to the entities that it regulates and to assist those served by those entities, including portfolio lenders who pledge collateral to the FHLBs, with more information on potential risks posed by PACE loans.

5. **How might the Enterprises best gather or receive information on their existing guaranteed or owned mortgage loan portfolios to understand which loans have PACE liens and in what amount? Should mortgage loan servicers be required to gather and report such information to the Enterprises on a periodic basis? What would the costs and implications be of such a requirement?**

Tasking servicers with gathering and reporting information on PACE liens will likely come at a significant cost. In addition to the implementation costs, which will vary depending upon the peculiarities of each state's PACE recordation practices, there will be potential liability costs for servicers for failure to accurately gather or report on PACE liens, as lenders and investors may hold servicers accountable for any errors in reporting PACE liens in the event of a foreclosure. All of this will drive up costs to borrowers and lenders alike in ways similar to, but perhaps even less predictable than requiring reduction in loan to value ratios or increases of LLPAs. For these reasons, we cannot recommend such a requirement on servicers.

6. **Would it be most effective for states that authorize PACE programs to require a registry of PACE lending so that information currently only held by PACE vendors or local tax rolls could be available and maintained on an ongoing basis? What data should be included in such a registry? What access would be permitted while protecting consumer privacy? Should a**

federal agency provide for such a registry? What minimum information would be available to allow credit reporting agencies to include PACE obligations in credit reports obtained in connection with mortgage origination and servicing?

Establishing a PACE registry would be the most effective method for determining the risks posed by PACE loans and for providing lenders, the Enterprises, and the Federal Home Loan Banks with information necessary to measure and offset that risk. A registry could take any number of forms, but we recommend that the following information be included in a registry: the property subject to a super priority PACE lien, the term of such lien, and the maximum potential liability secured by such lien.

Requiring each state that authorizes PACE loans to establish and maintain a registry would place the burden and cost of the registry on the entity authorizing the increased risk. Alternatively, a federal agency, including the FHFA, could create and maintain a registry. In that instance the costs would likely be passed along to FHFA's regulated entities, and ultimately to borrowers. Regardless of who is charged with creating and maintaining such a registry or registries, there must be incentives or requirements for their creation and use. A preferred approach may be for FHFA to prohibit the Enterprises from purchasing any loan in a jurisdiction that does not have or does not report to such a registry, and to set standards for the adequacy of such registry.

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?**

We support further consideration of the value of providing borrowers with a notice. Because many borrowers have opted for automatic payments and do not receive monthly written statements, such a notice should likely be made annually, and might be included with privacy or other required annual statements. We would note that any notice will need to be carefully crafted to ensure that borrowers are provided with accurate information both about the prohibitions on PACE loans for loans purchased by Fannie Mae and Freddie Mac, and the implications of violating such prohibitions.

One drawback to the notice proposal is that there are few immediate repercussions to borrowers who get a PACE loan after the loan has been purchased by Fannie Mae or Freddie Mac, and thus, it may not dissuade a borrower from proceeding with a PACE loan. The repercussions that do exist (potential difficulty in selling or refinancing the home) should, therefore, be highlighted as part of the disclosure.

A more drastic step that FHFA may want to consider (and which has been proposed by some portfolio lenders to protect their collateral) would be to require the execution of an agreement that taking on a PACE loan after the primary mortgage has been made is a violation of the terms of the mortgage which could result in penalties, including a possible due upon demand or acceleration of the mortgage. However, this is not a step that should be undertaken lightly, and one which if employed too liberally could result in unnecessary foreclosures, harming both borrowers and the overall market.

FHFA poses a number of questions related to the Consumer Financial Protection Bureau's advance notice of proposed rulemaking on disclosures related to residential PACE loans under the Truth in Lending Act (TILA). While the scope of those questions is beyond our ability to answer with a high level of detail or specificity as the answer will vary from jurisdiction to jurisdiction, we appreciate FHFA seeking this input. With regard to the CFPB's ANPR, we would note that applying the "Ability to Repay" standard under the Truth In Lending Act to residential PACE liens will be likely to force a substantial restructuring of these loans going forward, making defaults far less likely, and forcing a change in the funding and structure of these loans. While the goals of residential PACE loans are generally positive, the funding, marketing and repayment structure of residential PACE loans is deeply flawed. At their core these programs are asset based lending.

One hard earned lesson of the financial crisis is that asset based lending without documentation of ability to repay is high risk and can cause great damage to consumers. In many instances bank funded alternatives such as closed end home equity loans are a far safer, more affordable and transparent alternative. Because residential PACE loans are often marketed by product vendors they have a built in marketing force that banks do not. Consumers are presented with a salesperson in their home, with paperwork ready, offering them financing that is less than transparent and which can be frequently misunderstood. Applying ability to repay standards, at a minimum, would provide consumers with greater transparency, and in many instances would result in the vendors seeking alternative, more affordable, and more transparent funding partners.

To be clear, subjecting residential PACE loans to ability to repay standards applicable to banks and other lenders will not make the products (energy efficient improvements) disappear from the marketplace. Quite to the contrary, applying ability to repay standards will likely make them more transparent, more affordable, and if offered through a home equity or similar financing product, will remove the troublesome aspects inherent in super priority loans – thereby making many of the potential actions being contemplated by FHFA unnecessary. We strongly urge FHFA to work with the CFPB toward proposing and finalizing a robust ability to repay requirement for residential PACE loans.

Again, we appreciate this opportunity to provide input on this important topic. Please do not hesitate to contact the undersigned if you have questions or wish to discuss any of our comments further.

Sincerely,

G. Joseph Pigg
Senior Vice President, Fair & Responsible Banking
Regulatory Compliance and Policy