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Submitted via electronic delivery to http://www.regulations.gov and via email to RegComments@fhfa.gov

September 13, 2012

Mr. Alfred Pollard
General Counsel
Federal Housing Finance Agency
Eighth Floor
400 Seventh Street, SW
Washington, DC 20024

Re: Notice of Proposed Rulemaking: Enterprise Underwriting Standards; RIN 2590-AA53

Dear Mr. Pollard:

Freddie Mac is pleased to submit these comments in response to the Notice of Proposed Rulemaking published by the Federal Housing Finance Agency ("FHFA") on June 15, 2012 (the "NPR").[1] The NPR requests comment on underwriting standards for Freddie Mac and Fannie Mae (together, the "Enterprises") relating to mortgage assets affected by Property Assessed Clean Energy ("PACE") programs.

PACE programs are typically implemented as a way to permit local governments to provide financing to homeowners for energy-related home improvements. As described in greater detail below, FHFA has directed the Enterprises to refrain from purchasing mortgage loans secured by properties with outstanding first-lien PACE obligations because of the significant safety-and-soundness risks such loans pose.[2] On January 26, 2012, FHFA requested comment on an Advanced Notice of Proposed Rulemaking (the "ANPR") on whether the restrictions set forth in the Directive should be maintained, changed, or eliminated, and whether other restrictions or conditions should be imposed.[3] Freddie Mac submitted a comment (the "ANPR Comment") to FHFA on March 26, 2012 in which we described our concerns with PACE programs that incorporate a lien-priming element and supported the maintenance of FHFA's current position.[4] In the NPR, FHFA now requests comments on a proposed rule that would essentially codify its earlier Directive. In addition, FHFA requests comments on three alternative proposals that it is considering.

As we stated in the ANPR Comment, Freddie Mac generally supports energy efficiency initiatives. However, we have significant concerns regarding PACE loan programs, particularly

[1] 77 Fed. Reg. 36086.
[2] February 28, 2011 Directive (the "Directive").
[3] 77 Fed. Reg 3958.
[4] *See* ANPR Comment *available at* *http://www.fhfa.gov/Default.aspx?Page=89&ListNumber=5&ListID=21591&ListYear=2012&SortBy=#21591 (see comment 302).*

those that feature first-priority liens. Accordingly, we support the adoption of FHFA's rule as proposed and we recommend that FHFA not adopt any of the alternatives presented.

Freddie Mac was chartered by Congress in 1970 with a public mission to stabilize the nation's residential mortgage markets and expand opportunities for homeownership and affordable rental housing. Our statutory mission is to provide liquidity, stability, and affordability to the U.S. housing market. Freddie Mac currently operates under the direction of FHFA as our Conservator.

Comments

As we outlined in our ANPR Comment, Freddie Mac encourages the development and adoption of energy efficient and renewable energy home improvements. We have included consideration of energy efficient features in our mortgage underwriting criteria and we allow a borrower to finance the purchase of a property that the borrower plans to retrofit or refurbish with energy efficient improvements, including financing the cost of the improvements with the mortgage.[5] In addition, we have incorporated energy efficient and "green" practices into our day-to-day business and operations.

Notwithstanding our general support for energy efficient home improvements, we believe that the PACE-related underwriting restrictions proposed by FHFA are appropriate. Accordingly, we believe that the proposed rule, and not any of the alternatives, should be adopted. We reiterate our concerns set forth in more detail in the ANPR Comment that PACE loan programs present an increased mortgage credit risk due to the loss of our primary lien position and the lack of adequate borrower underwriting. FHFA's proposed rule would codify our existing policy and effectively protect mortgage holders and the taxpayers that support us during conservatorship.

Background of PACE Programs

Approximately twenty-eight states have enacted laws allowing localities to create energy loan assessment programs for the purpose of financing energy efficient home improvements. While the specific terms vary under these programs, private lenders generally provide borrowers with loans to undertake energy efficient or renewable energy home improvements. "Energy efficient," or an equivalent term, is typically defined broadly. Each individual borrower voluntarily participates in the PACE program and typically determines the amount and use of the funds borrowed. However, the full amount of the energy loan is generally treated as a special assessment, and payment on the loan is collected in the same manner as a property tax assessment, allowing the locality to place a lien on the underlying property for the full amount of the assessment at the time that the borrower receives the loan. In most instances, this new energy lien has priority over all existing liens, other than liens related to real property taxes, effectively subordinating any existing first-lien mortgage interest in the property.[6] In addition, many PACE programs do not require recordation of the lien or notice to a preexisting mortgage owner.

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[5] *See* Freddie Mac Single-Family Seller/Servicer Guide (the "Guide") Sections 37.15, 37.16, 44.15 and 23.8.
[6] At least four states – Maine, Vermont, Oklahoma and New Hampshire – have adopted PACE programs that would not subordinate existing liens.

Since May of 2009, Freddie Mac has consistently advised FHFA of our concern that certain PACE loan programs present an increased risk to Freddie Mac. In response to the increase in the number of states adopting such programs, on May 5, 2010, Freddie Mac issued an Industry Letter reminding our Seller/Servicers that an energy-related – or any other – lien may not be senior to any mortgage delivered to Freddie Mac.[7]

On July 6, 2010, FHFA issued its Statement on Certain Energy Retrofit Loan Programs (the "Statement"), which described the safety-and-soundness concerns raised by most PACE programs, but directed that Freddie Mac waive its prohibition against such senior loans that were originated prior to the date of the Statement. On August 31, 2010, Freddie Mac issued further guidance to its Seller/Servicers emphasizing that we would not purchase mortgages secured by properties subject to a first-lien PACE obligation. In addition, Freddie Mac provided guidelines for refinancing of mortgages secured by properties subject to first-lien PACE obligations prior to July 6, 2010. On February 28, 2011, FHFA issued its Directive prohibiting the Enterprises from purchasing mortgage loans encumbered by first-lien PACE loans. Finally, FHFA requested comment in a January 26, 2012 ANPR on whether the restrictions set forth in the Directive should be maintained, changed, or eliminated, and whether other restrictions or conditions should be imposed.

Proposed Rule

The NPR considers the comments received on the ANPR and proposes a rule that affords Freddie Mac the most protection from the assumption of unnecessary and unanticipated risk of loss. The FHFA proposed rule and each of the proposed alternatives requires that the Enterprises take any action necessary to secure their rights to make immediately due the full amount of any mortgage loan owned by either Enterprise that becomes, without their consent, subject to a first-lien PACE loan. The proposed rule provides that the Enterprises shall not consent to the imposition of a first-lien PACE loan. Further, the proposed rule prohibits the Enterprises from purchasing any mortgage already subject to a first-lien PACE loan. For the reasons described below, we believe that the requirements set forth in the proposed rule are appropriate and desirable.

Freddie Mac operates in the secondary mortgage market. Accordingly, we do not lend directly to home purchasers, but rather buy mortgage loans from the original lenders, thereby providing funds those entities can use to make additional loans. We securitize a substantial amount of the mortgage loans that we purchase, packaging them into pools and selling interests in the pools as mortgage-backed securities.

Freddie Mac has a long-standing requirement that mortgages we purchase have first-lien positions.[8] This requirement has been part of our normal business practices for many years and was not developed in reaction to the proliferation of PACE loan programs. The prohibition against subordinate liens protects Freddie Mac from the risks associated with a secondary lien position, including an increased risk of borrower default, and enables us to properly value loans that we purchase.

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[7] There are limited exceptions for the general prohibition, such as for liens for real estate taxes and special assessments not yet due. *See* Guide Section 22.3.
[8] *See* Guide Sections 8.11, 22.3 and 6.12.

PACE programs rely on the creation of a new priority lien in order to provide private lenders with a low risk investment in which the PACE lien holder is able to recover the amount owed from the proceeds of any foreclosure before any other lien holder, including Freddie Mac. The priority lien feature has the impact of transferring the risk of loss, without compensation or underwriting controls, from the PACE lender to the mortgage lenders and investors who have neither priced for, nor accepted, the risk. In the case of a default, depending on the value of the property at the time, Freddie Mac would likely be required to pay off the balance of the PACE loan in order to recover on our loan. In virtually all cases, our recovery in the event of a default would be lower than if the PACE loan did not have a priority lien. Potential losses to Freddie Mac could be substantial and would include payment of the outstanding loan amount, expenses associated with the possible extension of the foreclosure process, and the impact of the encumbrance on the resale value of the property.

While each of the alternatives proposed could mitigate the risk of loss posed by first-lien PACE loans, we believe each has potentially fatal flaws. In contrast to the proposed rule, none of the alternatives would eliminate entirely the risk of loss to the Enterprises. The first alternative would permit the Enterprises to consent to the imposition of a first-lien PACE loan if certain insurance guarantees are in place. The second alternative would permit the Enterprises to consent if certain protective standards—including LTV ratios and recordation requirements – are met. The third alternative would permit the Enterprises to consent if certain key underwriting standards are met.

The first alternative relies for its effectiveness on the development of a market for private insurance of PACE obligations. Further, such a guarantee would only be as sound as the insurer. It is far from clear that insurance markets would develop to support the first alternative. Even if such markets did develop, this alternative still does not completely eliminate the risk to Freddie Mac.

The second and third alternatives do not address the critical issue of lien-priority. In addition, while both alternatives could potentially mitigate the borrower's risk of default, they impose additional burdens on servicers, including requiring ongoing diligence or compliance with inherently vague underwriting standards. Because of their complexity, both alternatives would introduce uncertainty and may prove unworkable to implement. In addition, neither completely eliminates risk to Freddie Mac.

In contrast to the three alternative proposals, the proposed rule would not require ongoing diligence on the part of our servicers, which diligence would inevitably lead to increased costs associated with mortgages in areas that permit PACE loans. Significantly, the proposed rule maintains the status quo; it simply provides for no special exception for PACE loans from Freddie Mac's policy not to accept a secondary lien position. We believe we would not have to take any action to secure our interests and comply with the rule as proposed. Accordingly, we support the adoption of the rule as proposed and do not believe that FHFA should modify its proposed rule to include any of the three alternatives.

Conclusion

Freddie Mac remains supportive of the goal of increased energy efficiency. However, PACE programs that include a lien-priming element have the potential to increase losses to us and to

the taxpayers who are supporting us during conservatorship. For these reasons, we believe FHFA should maintain its current position on PACE programs and adopt the rule as proposed.

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Freddie Mac appreciates the opportunity to provide our views in response to the NPR. Please contact me if you have any questions or would like further information.

Sincerely,

Wendell J. Chambliss
Vice President and Deputy General Counsel
Mission, Legislative and Regulatory Affairs Department
Legal Division