September 13, 2012

To: FHFA General Counsel Alfred M. Pollard
RegComments@fhfa.gov.

Subject: RIN 2590-AA53

From: Leanne Tobias, Malachite LLC
Michael Zimmer, Thompson Hine LLP

Thank you, Mr. Pollard, for this opportunity to present our professional views on implementation alternatives for Property Assessed Clean Energy (PACE) programs by Fannie Mae, Freddie Mac, and the Federal Home Loan Bank system (together, the "Enterprises") and their regulatory oversight by the Federal Housing Finance Administration. We welcome the outreach from the FHFA, and sincerely appreciate its efforts as a prudent conservator of the Enterprises on behalf of American taxpayers.

Please find below our response to FHFA's request for comments on three alternative risk- mitigation approaches that might govern the Enterprises' potential participation in PACE programs, as published in the Federal Register on June 15, 2012. These comments represent the professional views and expertise of the individual commentators, and do not represent necessarily the views of their firms or their individual clients.

We believe that it is important for FHFA to permit the Enterprises to purchase PACE mortgages as part of FHFA's mission to "support housing finance and… a stable and liquid mortgage market."[1] We also believe that PACE program participation can and should be structured in a manner consistent with FHFA's mission to support the safety and soundness of the Enterprises, and that this goal is achievable by FHFA. Please see our March 26, 2012 comments to FHFA (attached) on these points.

Our comments on the three alternative risk-mitigation approaches follow immediately below.

First Risk-Mitigation Alternative: Guarantee/Insurance. The first risk-mitigation alternative proposed by FHFA would preclude FHFA's purchase of first-lien PACE obligations unless any such obligation met at least one of the following three conditions: (1)guaranteed for repayment by a qualified insurer in the event of foreclosure or similar default resolution; (2)100% guaranteed against net loss by a qualified insurer in the event of foreclosure or similar default resolution; or (3) secured by a program reserve fund against 100% of net losses. We believe that FHFA and other investors in first-lien PACE-encumbered mortgages might appropriately give preference to programs backed by insurance or reserve funds, and support the use of insurance and/or program reserves as an element of a well-designed PACE program. We also note that combinations of these alternatives—for example a program that combines a reserve fund with an insurance guarantee—should also be permitted for purchase by FHFA. As discussed below, we further believe that insurance and government-supported reserves or loan guarantees could be used in combination to permit participation in PACE programs by under-served sectors, such as affordable housing.

For conventional properties, we believe that appropriate underwriting standards may sufficiently insulate Fannie Mae and Freddie Mac from loss in cases in which insurance or program reserves do not meet the first risk-mitigation standard. We would therefore encourage a flexible process in which FHFA and its regulated enterprises could also participate in PACE programs in which insurance or program reserves do not meet the first risk-mitigation standard. Again, we believe that FHFA would be well-justified in giving preference to PACE programs backed by appropriate insurance or program reserves, and point out that FHFA purchasing preferences will encourage the development of private insurance and/or PACE program reserve structures that will guarantee against loss.

[1] FHFA mission, from FHFA Strategic Plan (2009-2014), http://www.fhfa.gov/Default.aspx?Page=38.

Second and Third Risk-Mitigation Alternatives: Underwriting Standards. The second and third risk-mitigation alternatives offer competing underwriting standards that, if met, could be used to structure FHFA participation in PACE programs. The Third Risk Mitigation standard is a foundational requirement, while the Second Risk Mitigation Alternative focuses on more stringent project and borrower credit requirements.

Foundational Requirement. The Third Risk-Mitigation Alternative offers acceptable foundational requirements that could be applied widely across the United States, and provides basic safeguards concerning the borrower's credit standing (no bankruptcies for at least seven years; current on all mortgage debt); requirements that the underlying mortgage and property taxes be current and no involuntary liens be present; and minimum PACE program guidelines, including the use of energy audits and the imposition of financial feasibility and contractor requirements. The Third Risk-Mitigation standard also suggests that the total amount of the PACE lien be limited to 10% or less of the property's assessed value.

Higher Stringency Requirement. The Second Risk-Mitigation Alternative limits PACE obligations to the lesser of $25,000 or 10% of fair market value; sets a loan-to-value ratio of no greater than 65%, establishes a borrower debt-to-income ratio, including the PACE lien, of no greater than 35%, and requires a borrower credit score of 720 or better.

Recommendations. We recommend that the Second and Third Risk Mitigation alternatives be combined to develop a robust underwriting standard for the Enterprises, as follows:

- Incorporate the following features of the Third Risk Mitigation Alternative, the foundational standard: borrower's credit standing (no bankruptcies for at least 7 years; current on all mortgage debt); underlying mortgage and property taxes must be current; no involuntary liens; minimum PACE program guidelines, including acceptable energy audit standards, contractor credentials and financial feasibility requirements; PACE obligation no greater than 10% of fair market value of the underlying property.
- Incorporate the following features of the Second Risk Mitigation Alternative: loan-to-value ratio of mortgage debt, including the PACE lien, of no greater than 65%; borrower debt-to-income ratio of no greater than 35%.
- Borrower credit scores. While we understand the caution of restricting borrower credit scores to 720 or above (a score attained by approximately 43% of Americans), we feel that a cut-off of 700 would be equally or more reasonable. A 700 credit score standard would put PACE program participation within reach of a majority (53%) of American borrowers.
- Absolute limits on PACE loan amounts. Our suggested requirements include LVR and debt-to-income ratios, and further restrict the PACE obligation to no greater than 10% of the fair market value of the underlying property. In the presence of these requirements, we do not support a dollar ceiling on the amount of the PACE loan, such as the $25,000 limit proposed in the Second Risk Mitigation Alternative.
- Energy audit and contractor requirements. We recommend that FHFA permit the use of a range of broadly accepted underwriting and contractor requirements in developing PACE program requirements. These include, but are not necessarily limited to, energy audit and professional requirements established by ASHRAE, HERS, ASTM, and similar organizations.
- Support for lower-income borrowers and affordable housing. We recommend that FHFA and the Enterprises also develop program guidelines whereby the Enterprises would participate in PACE financing programs for lower-income households and affordable housing projects. Insurance, supplemental program reserves or loan guarantees from federal, state or local public agencies are tools that can be used in this context. Such an initiative could also be implemented in a pilot context and are in keeping with the FHFA's mission of to provide support to affordable housing.

Conclusions. In sum, we recommend that FHFA adopt PACE program participation standards in keeping with its mission of promoting the safety and soundness of the Enterprises, while supporting housing finance, affordable housing and a stable and liquid mortgage market. In that context, we recommend that FHFA develop and implement foundational requirements for the purchase of PACE mortgages that combine the Proposed Second and Third Risk-Mitigation Alternatives in the areas of borrower credit and debt-to-income levels; the currency of underlying mortgage and property taxes; the lack of involuntary liens; LVR limitations on combined mortgage debt and the PACE borrowing; and minimum PACE program

guidelines, including acceptable energy audit standards, contractor credentials and financial feasibility requirements.

We further recommend that FHFA give first purchase priority to PACE programs which utilize insurance and/or program reserves to minimize risk, and that FHFA permit the use of insurance, supplemental program reserves or loan guarantees from federal, state or local governments to provide financial support to PACE programs for lower-income households and affordable housing projects.

Mr. Pollard, we thank you again for this opportunity to provide our input to FHFA's decision-making process on the PACE financing program, and would appreciate any opportunity to provide clarification and specificity around any of the points raised. You may contact us through Leanne Tobias, leanne.tobias@malachitellc.com.

March 26, 2012

To: FHFA General Counsel Alfred M. Pollard
RegComments@fhfa.gov.

Subject: RIN 2590-AA53

From: Martha Paschal, Malachite LLC
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Michael Zimmer, Thompson Hine LLP

Thank you Mr. Pollard, for this opportunity to present our professional views on an implementation of PACE programs by Fannie Mae, Freddie Mac, and the Federal Home Loan Bank system and their regulatory oversight by the Federal Housing Finance Administration. We welcome the outreach from the FHFA, and sincerely appreciate its efforts as a prudent conservator of the Government-Sponsored Entities on behalf of the US taxpayers.

We believe that the Property-Assessed Clean Energy (PACE) bond financing programs that are presently in development would be significantly aided by the establishment of a series of pilot programs by the GSEs to explore optimal underwriting, deal flow process, and the bolstering of a secondary market execution for PACE bonds. The GSEs have unparalleled expertise in all of these arenas, and creating a PACE product that can achieve measurable cost savings for property owners, stimulate job creation and economic development opportunities at the state and local levels, promote energy independence and security, avoid the need for additional power plants and lower demand on the energy grid, as well as promote environmental protection from reduced burning of fossil fuels, would create positive effects throughout the economy.

Please find detailed below our response to the questions raised by FHFA in its request for comments. These comments represent the professional views and expertise of the individual commentators, and do not represent necessarily the views of their firms or their individual clients.

Question 1:

Are conditions and restrictions relating to FHFA-regulated entities' dealings in mortgages on properties participating in PACE programs necessary? If so, what specific conditions and/or restrictions may be appropriate?

The Federal Housing Finance Agency and the GSEs can play a critical role in the implementation of PACE financing, in that PACE underwriting standards which meet with their approval carry an imprimatur akin to a "Good Housekeeping Seal" for the capital markets. It is therefore important that pilot programs involving the GSEs and the regulatory authorities be implemented to test underwriting standards for residential PACE liens and to help establish a more robust format for conducting energy audits.

If a GSE and FHFA-approved process for implementing PACE loans can be established, this will provide benefits to a wide range of real estate market participants, including homeowners of one-to-four family and multi-family properties, residential lenders, and home energy improvement professionals, who have been adversely affected by the real estate market downturns of the last five years. There exist some Washington, DC area piloting opportunities for close study of PACE lien financing, as both Arlington County, Virginia and the District of Columbia are working to start up PACE programs. Additional local jurisdictions that might be appropriate pilot opportunities for the FHFA and the GSEs include Miami-Dade County, Los Angeles, San Francisco and Sonoma County, California. Those pilots can develop standards, collect data and experience that can be optimized for a national roll out thereafter.

Question 2:

How does the lien-priming feature of first-lien PACE obligations affect the financial risks borne by holders of mortgages affected by PACE obligations or investors in mortgage-backed securities based on such mortgages? To the extent that the lien-priming feature of first-lien PACE obligations increases any financial risk borne by holders of mortgages affected by PACE obligations or investors in mortgage-backed

securities based on such mortgages, how and at what cost could such parties insulate themselves from such increased risk?

While the PACE lien can be attached to tax receipts, which would place them into an effective senior lien position, the risks associated with having these structures operate at a senior lien status can be mitigated with careful underwriting. Proposed standards that FHFA and the GSEs can use to develop a pilot program already exist and include those suggested by the PACE Now coalition, in recommendations from the U.S. Environmental Protection Agency's Environmental Finance Advisory Board (2009 and 2011), and in an October 18, 2009 White House Policy Framework study The recommendations of these organizations provide guidance on how to strengthen and standardize the structuring of these loans, and mechanisms for their prompt retirement without creating undue or increased risks to mortgage holders or investors.

Given the continued sluggishness of the real estate market and the impacts that current conditions have had on the construction, lending and realtor communities, we feel that the regulatory community and the GSEs have an obligation to develop and test pilot PACE underwriting standards.

Question 3:

How does the lien-priming feature of first-lien PACE obligations affect any financial risk that is borne by holders of mortgages affected by PACE obligations or investors in mortgage-backed securities based on such mortgages and that relates to any of the following:

The total amount of debt secured by the subject property relative to the value of the subject property (i.e., Combined Loan to Value Ratio for the property or other measures of leverage);

The amount of funds available to pay for energy-related home-improvement projects after the subtraction of administrative fees or any other program expenses charged or deducted before funds become available to pay for an actual PACE-funded project (FHFA understands such fees and expenses can consume up to 10% or more of the funds a borrower could be obligated to repay under some PACE programs);

The timing and nature of advancements in energy-efficiency technology;

The timing and nature of changes in potential homebuyers' preferences regarding particular kinds of energy-efficiency projects;

The timing, direction, and magnitude of changes in energy prices; and,

The timing, direction, and magnitude of changes of property values, including the possibility of downward adjustments in value?

We believe that residential properties that participate in PACE programs will likely increase in value because of the nature of the improvements. We recommend that PACE program standards require appropriate energy benchmarking (via metering or paper records review) and that programs rely on consensus standards (such as ASHRAE, ASTM BEPA, and RESNET) to guide audit and retrofit practices. As well, we suggest that energy savings measures, such as improving the building shell, be utilized first before renewables are installed in a property. These measures would ensure that PACE funds are utilized in accordance with best industry practices and would focus on proven, effective energy conservation measures. With respect to administrative fees, these will decline through standardization as PACE programs become more common and additional lenders enter the market. GSE participation in this market will itself standardize requirements and reduce administrative fees.

Question 4:

To the extent that the lien-priming feature of first-lien PACE obligations increases any financial risk that is borne by holders of mortgages affected by PACE obligations or investors in mortgage-backed securities based on such mortgages and that relates to any of the following, how and at what cost could such parties insulate themselves from that increase in risk:

The total amount of debt secured by the subject property relative to the value of the subject property (i.e., Combined Loan to Value Ratio for the property or other measures of leverage);

The amount of funds available to pay for energy-related home-improvement projects after the subtraction of administrative fees or any other programs expenses charged deducted before funds become available to pay for an actual PACE funded project (FHFA understands such fees and expenses can consume up to 10% or more of the funds a borrower could be obligated to repay under some PACE programs);

The timing and nature of advancements in energy-efficiency technology;

The timing and nature of changes in potential homebuyer preferences regarding particular kinds of energy-efficiency projects;

The timing, direction, and magnitude of changes in energy prices; and,

The timing, direction, and magnitude of changes of property values, including the possibility of downward adjustments in value?

We feel that careful underwriting which depends on utility cost savings will mitigate these investor risks, and in fact believe that the success of PACE depends on regulatory and GSE buy-in to assure investors of the viability of these investments. This underwriting depends on a robust and tested energy audit to both pay back the PACE lien over a dependable period of time and provide a return to the property owner. Only added-value energy conservation measures/assets should be financed by the investment, and the project should seek to never create negative equity financing. A favorable savings to investment ratio should be shown. And the useful life of the asset/investment must exceed the term of the financing.

As a further element of risk mitigation, there are insurance products which are coming onto the market which would insure against liability associated with energy audits which do not predict accurate paybacks. The insurance industry has worked with energy auditors to strengthen their reporting in instances in which this insurance is used, and regulatory and GSE involvement in this process would assure a speedier and more standardized energy audit format. This constructive cooperation by key stakeholderswould benefit the industry as a whole.

Question 5:

What alternatives to first-lien PACE loans (e.g., self-financing, bank financing, leasing, contractor financing, utility company "on-bill" financing, grants, and other government benefits) are available for financing home-improvement projects relating to energy efficiency? On what terms? Which do and which do not share the lien-priming feature of first-lien PACE obligations? What are the relative advantages and disadvantages of each, from the perspective of (i) The current and any future homeowner-borrower, (ii) the holder of an interest in any mortgage on the subject property, and (iii) the environment?

Home improvement finance has not yet recovered from the recent recession, and banks have tightened underwriting standards around their HELOC products. While self-financing, some contractor financing, and some utility company financing is available, there is a lack of a secondary market for these loan products. Such a secondary market would serve to lower financing costs and make a better and more predictable process for underwriting and processing, which goes to the reason the GSEs were established. We believe that PACE program development and participation is an important, new aspect of the GSEs' mission that supports and maintains the original mortgage risk management support.

Question 6:

How does the effect on the value of the underlying property of an energy-related home-improvement project financed through a first-lien PACE program compare to the effect on the value of the underlying property that would flow from the same project if financed in any other manner?

Single-family home values remain in too great a state of flux to perform "apples-to-apples " valuations of retrofitted versus non-retrofitted buildings. There is substantial case study data from the single-family and multi-family markets, however, that suggest that homeowners and renters prefer green and energy-efficient dwellings, suggesting that energy retrofits will enhance, rather than detract from, property values. That said, additional research is needed to more accurately determine the effect of energy-

efficiency and green features on home values across a variety of markets and residential price points. As well, the residential PACE vehicle is too new to compare PACE financing to other financing alternatives., and current appraisals look at yesterday's prices that are heavily distorted by the foreclosure experience since 2008. Additional research is needed on this point, and would be appropriate to include in the evaluation of a pilot program.

Question 7:

How does the effect on the environment of an energy-related home-improvement project financed through a first-lien PACE program compare to the effect on the environment that would flow from the same project if financed in any other manner?

PACE financing should have an underwriting focus on utility cost savings – reduction of energy and water expenses – and these savings would flow into - local savings on water treatment ,energy, and power generation costs. Typical home improvement projects do not carry this level of focus on post-retrofit building performance, and with the rise in energy and utility costs this will become a higher priority at both the household level and at the local government level.

Question 8:

Do first-lien PACE programs cause the completion of energy-related home improvement projects that would not otherwise have been completed, as opposed to changing the method of financing for projects that would have been completed anyway? What, if any, objective evidence exists on this point?

Given the previously noted dearth of bank financing for home improvements, PACE represents a focused initiative to address high energy and water costs, which would offer significant benefits to homeowners, localities, building trades and others in the real estate community. There are currently few lending options available for this type of targeted retrofit, and none operating on a nationwide level. Consolidation of state and regional banking over the prior decade in the U.S. accelerates the need for financing to address escalating energy and water costs. The national family median income only has available currently $1800 of discretionary income to manage such family budgetary cost increases.

Question 9:

What consumer protections and disclosures do first-lien PACE programs mandate for participating homeowners? When and how were those protections put into place? How, if at all, do the consumer protections and disclosures that local first-lien PACE programs provide to participating homeowners differ from the consumer protections and disclosures that non-PACE providers of home-improvement financing provide to borrowers? What consumer protection enforcement mechanisms do first-lien PACE programs have?

Standardization of energy audits and underwriting for PACE, which FHFA and the GSEs could establish with a strong pilot program, would provide the ancillary benefit of establishing stronger consumer protection by ensuring that paybacks are realistic and loan-to-value ratios are kept to a realistic level.

Question 10:

What, if any, protections or disclosures do first-lien PACE programs provide to homeowner-borrowers concerning the possibility that a PACE-financed project will cause the value of their home, net of the PACE obligation, to decline? What is the effect on the financial risk borne by the holder of any mortgage interest in a subject property if PACE programs do not provide any such protections or disclosures?

As noted earlier, we believe that home valuations nationwide remain in a state of flux and it is difficult to determine what the long-term effects of PACE debt might be on home values. As noted above, however, case study data suggest that energy-efficient and green homes sell more rapidly and at higher price points than conventional comparables. Further, underwriting to ensure that PACE debt service requirements are below energy cost savings should render this argument irrelevant.

Question 11:

What, if any, protections or disclosures do first-lien PACE programs provide to homeowner-borrowers concerning the possibility that the utility-cost savings resulting from a PACE-financed project will be less than the cost of servicing the PACE obligation? What is the effect on the financial risk borne by the

holder of any mortgage interest in a subject property if first-lien PACE programs do not provide any such protections or disclosures?

As we noted previously, the process of underwriting of PACE loans to energy and water cost savings would benefit from the expertise and high level of scrutiny that an FHFA/GSE pilot program could provide. As an interim step until energy audit formats and metrics are more solidly established, the insurance industry offers a product that insures against losses resulting from overly aggressive cost savings projections by energy audits. These underwriting issues are being addressed by the first round of PACE programs, but testing would be enhanced by an FHFA/GSE pilot program.

Question 12:

What, if any, protections or disclosures do first-lien PACE programs provide to homeowner-borrowers concerning the possibility that over the service life of a PACE-financed project, the homeowner-borrower may face additional costs (such as costs of insuring, maintaining, and repairing equipment) beyond the direct cost of the PACE obligation? What is the effect on the financial risk borne by the holder of any mortgage interest in a subject property if first-lien PACE programs do not provide any such protections or disclosures?

As most items installed under energy retrofitting are high-efficiency upgrades to existing systems, we would assume that the service, maintenance and repair costs and associated risks to investors would be no greater than that of any other home improvement loan. As suggested above, underwriting guidelines adhering to best industry benchmarking, audit and retrofit practices and focusing first on energy conservation (rather than on the installation of renewables) will help to control ongoing costs.

Question 13:

What, if any, protections or disclosures do first-lien PACE programs provide to homeowner-borrowers concerning the possibility that subsequent purchasers of the subject property will reduce the amount they would pay to purchase the property by some or all of the amount of any outstanding PACE obligation? What is the effect on the financial risk borne by the holder of any mortgage interest in a subject property if first-lien PACE programs do not provide any such protections or disclosures?

As most items installed under energy retrofitting are high-efficiency upgrades to existing systems, we would assume that costs of these upgrades would be reflected on subsequent sale pricing of the home, and associated risks to investors would be no greater than that of any other home improvement loan. As well, we would expect that the values of energy-efficient homes—including those financed through PACE programs—would exceed those of less-efficient comparable properties. We have also suggested that PACE debt be underwritten conservatively, so that PACE-related energy savings exceed debt service. In the presence of such underwriting, the PACE debt would not be expected to reduce resale values.

Question 14:

How do the credit underwriting standards and processes of PACE programs compare to that of other providers of Home-improvement financing, such as banks? Do they consider, for example: (i) Borrower creditworthiness, including an assessment of total indebtedness in relation to borrower income, consistent with national standards; (ii) total loan-to-value ratio of all secured loans on the property combined, consistent with national standards; and (iii) appraisals of property value, consistent with national standards?

These items identified are all components of prudent underwriting, and should be part of PACE underwriting. Again, there is an opportunity for FHFA and the GSEs to drive standardization and further prudent underwriting of this program in an exercise of national leadership. To our knowledge, the developers of local PACE programs are considering borrower creditworthiness, total loan-to-value ratios of all property-secured debt, and appraised value, in setting program standards. Insurance can be added as can other forms of required credit enhancement, if necessary.

Question 15:

What factors do first-lien PACE programs consider in determining whether to provide PACE financing to a particular homeowner-borrower seeking funding for a particular project eligible for PACE financing? What analytic tools presently exist to make that determination? How, if at all, have the methodologies, metrics, and assumptions incorporated into such tools been tested and validated?

Energy audits are becoming more standardized, but additional research is required to evaluate their adequacy in the context of loan underwriting. PACE presents a unique opportunity for FHFA and the GSEs to standardize and improve analytics and metrics of these studies. As an interim step, we have previously mentioned the insurance products appearing in the marketplace, which insure against overly aggressive cost savings from energy audits.

Question 16:

What factors and information do first-lien PACE programs gather and consider in determining whether a homeowner-borrower will have sufficient income or cash flow to service the PACE obligation in addition to the homeowner-borrower's pre-existing financial obligation? What analytic tools presently exist to make that determination? How, if at all, have the methodologies, metrics, and assumptions incorporated into such tools been tested and validated?

PACE loans should reflect prudent underwriting of the borrower, and the same level of robust due diligence in reviewing borrower qualifications should be undertaken as is performed with any other type of household lending. One major difference should be the process of underwriting energy audits and the basing of loan paybacks on savings in projected utility usage and costs, which would mitigate borrower-associated risks as these costs are already being expended by the borrower.

Question 17:

What specific alternatives to FHFA's existing statements about PACE should FHFA consider? For each alternative, as compared to the Proposed Action, what positive or negative environmental effects would result and how would the level of financial risk borne by holders of any interest in a mortgage on PACE-affected properties change?

FHFA's Proposed Action would be a continuation of its existing policy, and would deny the agency and the GSEs a role in helping to create a model for these retrofit programs through scale and standardization which could gain wider acceptance by both the primary and secondary capital markets. The GSEs possess considerable financial expertise and market share for residential lending, and while PACE bond programs might continue serving the commercial and industrial real estate sector, the ability of PACE to have high impact on the single-family and multifamily markets would be much reduced should FHFA decide to continue in the same course with its Proposed Action. Conversely, a series of pilot programs in participating jurisdictions undertaken with the GSEs and overseen by FHFA would have significant benefits to standardizing and strengthening due diligence and underwriting standards, and these benefits would flow through to property owners, investors, states and municipalities. Those benchmarks and lessons could be incorporated into a wider regional or national launch thereafter.

Mr. Pollard, we thank you again for this opportunity to provide Malachite's input to FHFA's decision-making process on the PACE financing program, and would appreciate any opportunity to provide clarification and specificity around any of the points raised.