Department of Energy
Washington, DC 20585

September 13, 2012

Mr. Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
400 Seventh St, SW
Washington, DC 20024

Dear Mr. Pollard:

The U.S. Department of Energy has prepared the enclosed comments for your attention regarding the Notice of Proposed Rulemaking on Enterprise Underwriting Standards (RIN 2590-AA53).

DOE supports solutions for investments in residential energy efficiency that are compatible with a stable and strong housing market in America. Residential buildings consume more than 20% of US energy, and inefficient housing stock imposes a major financial burden on homeowners. There are multiple barriers to the adoption of energy efficiency measures in residential buildings, and DOE supports policies and programs to overcome those barriers that are consistent with conditions for a sound housing market.

In its June 15, 2012 Notice of Proposed Rulemaking, FHFA sets forth three alternatives for mitigating the risk to Enterprises that it associates with first-lien PACE programs. The third alternative proposes establishing strong underwriting standards, which is consistent with the approach that DOE had encouraged in 2010 when it issued *Guidelines for Pilot PACE Financing Programs.* The standards proposed by FHFA are even more rigorous than those in the DOE guidelines, and while DOE is not in a position to require adoption of specific underwriting standards by PACE programs, FHFA's rule would have the effect of ensuring adoption and implementation.

DOE strongly urges FHFA to partner with relevant stakeholders, including DOE, to implement a rule that would ensure that pilot PACE programs can proceed. DOE appreciates the opportunity to engage FHFA on the important matter of improving the energy performance of housing in America, and we hope that FHFA will take these views into consideration in preparation of the rule.

Sincerely,

David Sandalow
Assistant Secretary for
Policy & International Affairs
Acting Undersecretary for Energy

David Danielson
Assistant Secretary for
Energy Efficiency & Renewable Energy

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Comments on the FHFA Notice of Proposed Rulemaking on Mortgage Assets Affected by PACE Programs

Prepared by U.S. Department of Energy

September 13, 2012

DOE supports solutions for investments in residential energy efficiency that are compatible with a stable and strong housing market in America.

Residential buildings consume more than 20% of US energy, and inefficient housing stock imposes a major financial burden on homeowners. Overall, a 10% improvement in energy performance in the residential sector would save more than $20 billion each year[1], and would result in economic, environmental, and energy security benefits to communities and the nation. There are multiple barriers to the adoption of energy efficiency measures in residential buildings that could realize such potential, and DOE supports policies and programs to overcome those barriers that are consistent with conditions for a sound housing market.

Energy efficiency improvements to homes may improve the performance of the overall mortgage market, reducing risk to mortgage holders.

Due partly to a lack of access to large samples of anonymized data, there is insufficient analysis on the link between mortgage performance and home energy performance to address the contrasting views on this point.

FHFA has unique access to data that could be used to evaluate the relationship between energy efficiency and mortgage performance.

Following FHFA's recommended approach in the proposed rule, a robust analysis would compare mortgage performance by matching a sample of Energy Star homes and a group of non-Energy Star homes in an area having a similar set of risk attributes. With cooperation from FHFA, similar analysis could be undertaken to examine the performance of homes with energy efficiency loans held by Fannie Mae. DOE would like to work with FHFA to undertake this data analysis, which could also inform FHFA's views about whether or not the benefits of energy efficiency upgrades are realized by homeowners in a way that also benefits mortgage holders.

[1] EIA Annual Energy Review 2011, Table 3.6.

PACE is one among multiple types of residential energy efficiency finance programs. However, PACE has an important and relatively unique attribute that allows responsibility for the property upgrade to be transferred with the property along with the benefits of that investment.

Buildings are long-lived assets. However, homeowners may not anticipate residing in their current residence long enough to realize the full benefits of an upgrade to home energy performance. Transferability of PACE obligations to new homeowners allows current residents to consider a broader suite of efficiency measures that would include those with longer payback periods. As a result, PACE programs can support projects that achieve greater energy benefits, and they have the potential to interest more homeowners. It is important for PACE pilot programs to proceed in order to evaluate this potential.

DOE recognizes that FHFA is primarily concerned about the effect of first-lien PACE programs on the valuation of the underlying property.

FHFA holds a view that potential buyers of a property participating in a PACE program will factor the future tax assessments into their valuation of the property, and that by contrast, they will *not* value the resulting benefits of energy efficiency savings. DOE grantees across the country are among the many stakeholders advancing programs and tools that support more accurate valuation of real estate properties, helping home owners take energy performance into account. These market transformation activities are well underway and include implementation of a Home Energy Rating System, a Home Energy Score, a green addendum to standard residential appraisal forms, a tool kit for adding fields to Multiple Listing Service databases that reflect home energy performance.

Under market conditions in which home buyers would not value future energy savings commensurately with future payments that cover the costs of the efficiency upgrades, it is possible to incorporate reserve funds or insurance products into a PACE program to address potential losses attributable to PACE in the case of default. This approach is reflected in the proposed rule as FHFA's first option for risk mitigation. Alternatively, strengthening underwriting standards for PACE programs can drive down the mortgage default rate among the pool of participating PACE properties in a way that diminishes the need for an insurance product, and this is FHFA's third proposed option. DOE has implicitly supported the third approach by working with stakeholders to develop guidelines for underwriting standards for PACE programs. FHFA has articulated concerns about those guidelines in the proposed rule, and as a result, FHFA's proposed standards are even stronger.

If FHFA moves forward with its third alternative, DOE can work with FHFA and stakeholders to develop guidelines for underwriting standards that conform to the FHFA proposal.

DOE has subject matter expertise that can help inform guidance for implementation of the third alternative. For example, this technical assistance can address FHFA's interest in the use of sound and consistent methods for calculating estimated costs and savings of energy performance upgrades across PACE programs. DOE recognizes that development of guidance that conforms to FHFA's third alternative could also benefit other types of energy efficiency finance programs that also have the potential to benefit the overall performance of the mortgage market.

If local governments adopt underwriting standards that conform to FHFA's third alternative, they should also be assured by FHFA that their participating homeowners would have the consent of the Enterprises.

As noted above, DOE stands ready to work with FHFA to develop standards that conform to the third alternative in order to ensure that homeowners qualified to participate in PACE programs have met criteria for receiving consent for PACE tax assessments from the Enterprises under FHFA supervision.

DOE strongly urges FHFA to adopt a rule that would allow implementation of PACE programs by local governments piloting this policy approach to improving residential energy efficiency.

PACE programs have unique attributes that could result in greater improvements to residential energy efficiency, and these improvements could result in better performance of the mortgages for those homes. There would be no way to validate this potential if the rule FHFA adopts effectively prohibits local governments with an interest in PACE from moving forward. The scale of these programs is very small compared to the overall mortgage market, and therefore, the degree of potential financial risk to the Enterprises supervised by FHFA would be small compared to the potential benefits of sound PACE programs that could improve the performance of the market overall.