AMERICAN
LAND TITLE
ASSOCIATION

March 26, 2012

Mr. Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
1700 G Street, NW
Washington, DC 20552

Re: (RIN) 2590–AA53

Dear Mr. Pollard:

On behalf of the more than 4,000 member companies of the American Land Title Association (ALTA), we appreciate the opportunity to offer comments on the Federal Housing Finance Agency's (FHFA) Advanced Notice of Proposed Rulemaking ("ANPRM"), published at 77 Fed. Reg. 3958 (Jan. 26, 2012), regarding "Mortgage Assets Affected by PACE Programs." The ANPRM presents important questions that are essential for understanding both the benefits and risks of PACE programs to property owners, mortgage holders and investors.

Founded in 1907, ALTA is the national trade association and voice of the real estate settlement services, abstract and title insurance industry. With more than 8,000 offices throughout the country, ALTA members operate in every county in the United States to search, review and insure land titles to protect home buyers and mortgage lenders who invest in real estate. ALTA members conduct real estate settlements and include title insurance companies, title agents, independent abstracters, title searchers and attorneys, ranging from small, one-county operations, to large national title insurers.

**Real Property Ownership in the United States**

Real property is the greatest source of wealth in the United States. Access to that wealth is only possible because of a strong set of property rights that determine how property can be used and owned. By establishing legal rights to property, an economy produces the surety necessary to allow real property to be used as collateral for loans.

The "ownership" of real estate involves the interest in a bundle of rights relating to the use and disposition of real property. This concept is called title, and each of these rights can be transferred separately or collectively.

There are two hallmarks of our property rights system: private contracts and public notice. In the United States, real property is conveyed by a private contract that is most commonly called a deed. These private agreements are memorialized in local public records to provide appropriate public notice of the agreement.

1828 L Street, N.W. ■ Suite 705 ■ Washington, DC 20036 ■ (202)296-3671 ■ 202-296-3671 ■ 800-787-ALTA
E-mail: service@alta.org ■ Web: www.alta.org ■ Fax: 888-FAX-ALTA ■ Local Fax: (202)223-5843

A lien (or mortgage) is an interest in personal (or real) property to secure the payment of a debt or other obligation. When the debt is fully repaid according to it's agreed upon terms, the lien becomes void and the interest is extinguished. A lien gives a creditor the security to know that a debt will be satisfied.

Lien priority is the legal structure that determines which creditor has the right to be paid in which order when a property must be sold to satisfy a debt. State law determines the priority of liens. A general rule of thumb is that the first lien that appears in the public record has the highest priority. This structure assures creditors of their rights when property is used to secure a debt. The priority of a lien is one of the most important factors in determining the value of (1) the lien itself and (2) the debt secured by the lien.

Typically, creditors lending money to finance the purchase of real property require that they will have the first right (also called first lien priority) to foreclose upon the property in the event of default. To do this, the borrower is required to execute a mortgage (or deed of trust), which grants the creditor the right to foreclose upon and sell the property if the borrower defaults on their mortgage obligation. Thus, mortgage creditors record their interests in public land records in order to secure the priority of their lien and the value of the property right.

**The Advanced Notice of Proposed Rule Making**

ALTA has followed the development of PACE programs and FHFA's response to those programs with great interest. ALTA members recognize the value in lowering energy costs for consumers, creating jobs for the economy and reducing buildings' carbon footprint for the environment. Despite this, the ANPRM recognizes that there are a number of unanswered questions surrounding PACE financing that are essential to understanding the impact of these programs on consumers and mortgage holders. We answer questions 2, 1 and 9 in that order below.

**Question 2: How does the lienpriming 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?**

The value of the mortgages held by the regulated entities, Fannie Mae and Freddie Mac, is dependent on three risks: (1) default risk, (2) interest rate risk and (3) collateral risk, which includes legal title risk. While all three risks can be impacted by PACE programs, we will focus on legal title risk.

In mortgage lending, legal title risk refers to risks posed to two separate parties: (1) the title of the property owner who posts the property as collateral in exchange for a loan or (2) the validity of the creditors' mortgage and the priority of that mortgage. For creditors, this risk can greatly impact the value of the mortgage or underlying debt for the investor. A foreclosure, an unpaid mechanics lien or homeowners association lien may require the creditor to either expend costs clearing these defects or accept a lower value at a foreclosure sale.

Typically, the regulated entities mitigate this risk at origination by requiring the purchase of a loan title insurance policy. A loan policy insures the holder of the promissory note that it will have a valid, enforceable lien on the property in accordance with the mortgage rights created by the loan; that the person to whom the loan is being made has title to the property used as collateral; and that no other claimant, other than those specifically noted in the policy, has a prior, superior claim. The title insurance policy protects against existing title defects that arise before the policy is issued. While the claim is not asserted until after the policy is issued, it must be based on matters that existed prior to the date the policy was issued.

In the typical mortgage transaction, this valuable protection is sufficient to manage the risk for Fannie Mae and Freddie Mac. Once the mortgage is recorded, the priority of the mortgage is firmly established as a first lien, and that priority cannot easily be altered by obligations created after closing. Unfortunately, the priority priming feature of PACE loans introduces a new level of risk above and beyond the scope of the standard title insurance policy.

Understanding this extraordinary risk, and its impact on the value of mortgages held by the regulated entities, is essential to determining the appropriate and necessary conditions and restrictions for the safe and sound operation of Fannie Mae and Freddie Mac.

**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?**

To determine what conditions and restrictions would be appropriate for FHFA-regulated entities' dealing in mortgage participating in PACE programs, it is important to understand how PACE currently programs operate. The answers to the questions below will be helpful for FHFA when determining what further conditions to place on PACE programs before the regulated entities are permitted to deal in mortgages on these properties.

- What is the process by which a PACE lien is created?
- How is the PACE lien administered and satisfied to repay the obligation?

Understanding when a PACE lien is deemed to arise, when the assessment or loan is given, or when the assessment for periodic repayment is certified to the current year's taxes, is important for understanding the risks presented to the regulated entities by PACE lending. The answer to these questions is neither clear or uniform based on a reading of state PACE laws.

In a typical real estate and mortgage finance transaction, ALTA members search and examine land records to determine the marketability and insurability of the title. In order to properly advise consumers and creditors about the rights a lien conveys, this process requires the title agent to review recorded liens to determine the size of the debt the lien(s) secure, when a lien arose and how it operates under state law. These facts allow the consumer to make an informed decision about purchasing a property and the creditor to make an informed decision about providing mortgage financing. Without additional information and clarity regarding PACE liens, ALTA members will not be able to properly assure consumers that they have title to their

property or creditors of their lien priority. The result is a likelihood of unnecessarily delayed or canceled real estate transactions.

- Must PACE liens be recorded in the local property records in order to provide the public proper notice of the lien to all current and future owners of an interest in the property as required by state real property law?

- If so, when must the lien be recorded?

PACE statutes are unclear about the recording obligations associated with these liens. Without ensuring that PACE liens are properly recorded in local property records, ALTA members cannot properly identify risks in order to protect the interests of consumers and creditors.

- How do localities determine whether PACE applicants have title to property and ability to create the lien under state law?

- How do localities determine that the property is located in the PACE financing district?

The U.S. Department of Energy, May 7, 2010, "Guidelines for Pilot PACE Financing Programs" document is unclear as to the method by which PACE programs determine that the applicant has clear title to property and the property is actually located in the financing district. A property owner must have title in order to grant a lien against the property. In most parts of the country, this is accomplished by land title professionals who search local property records to determine title. Without establishing standards for determining title to property, PACE loans run the risk of significant losses due to fraud. In addition to harming PACE participants, it also damages the accuracy of local property records, and results in increased costs of underwriting, claims, escrow services and compliance for the land title industry.

**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?**

Like FHFA, we are concerned about the level of consumer protections and disclosures in place to protect homeowner-borrowers. Federal law provides a myriad of protections for consumers who use their homes as collateral for a loan. However, it is not clear whether federal consumer protection statutes apply to PACE financing because we do not know whether PACE financing constitutes a loan or a tax assessment.

If PACE transactions are secured loans, then PACE programs may need to comply with the requirements of federal consumer protection laws, such as the Truth in Lending Act and the Real Estate Settlement Procedures Act (RESPA). Under RESPA, the consumer is entitled to a Good

Faith Estimate and Uniform Settlement Statement (called the HUD-1) for all transactions, “which involve federally related mortgage loans.” 12 USC § 2603. RESPA defines a federally related mortgage loan as any loan which, “is secured by a first or subordinate lien on residential real property.” 12 USC § 2602(1)(A). A loan is generally defined as an agreement between parties, in which a lender gives money or property to a borrower who agrees to repay the money or return the property with interest.

According to PACENow, PACE programs appear to have all the hallmarks of a loan: agreement by a local government (or lender) to give money to a property owner’s (the borrower) and to then repay that money with interest as an additional line on their tax assessment.[1] The repayment of a PACE loan is secured by a tax lien against the property. Based on a simple reading of the statute, and a description of the program, it would appear that that PACE financing is a loan, which would fall under the purview of RESPA.

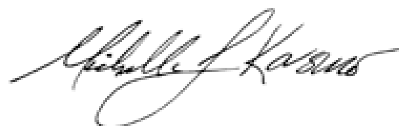
However, if PACE financing is not considered to be secured by a first or subordinate lien, it may still be defined as a federally related mortgage because it, “is made in whole or in part, or insured, guaranteed, supplemented, or assisted in any way, by the Secretary or any other officer or agency of the Federal Government” 12 USC § 2602(1)(B)(ii). Thus the assistance of any Federal Government official or agency in the funding or operations of a PACE program, including granting of Federal tax benefits for the interest paid by borrower or for the interest earned by any investor in a bond backed by PACE loans, may require that the requirements of RESPA be followed for each PACE transaction.

**Conclusion**

ALTA members support promoting all potential tools for property owners to finance energy efficiency upgrades to their property. For PACE to be a viable option, FHFA and the public require further clarity of PACE financing, including answers to the questions asked in ANPRM and above. ALTA encourages FHFA to work with localities and states to design PACE programs with effective safeguards that will promote energy efficiency property upgrades, while also protecting consumers, mortgage holders and investors.

While there may be additional questions necessary to resolve uncertainty surrounding PACE programs, we thank you for taking steps to resolve these issues. For additional information, please contact ALTA Vice President of Government and Regulatory Affairs Justin Ailes at 202-261-2937 or justin@alta.org.

Sincerely,



Michelle L. Korsmo
Chief Executive Officer