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

March 26, 2012

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

Re: Advance Notice of Proposed Rulemaking: Mortgage Assets Affected by PACE Programs; RIN 2590-AA53

Dear Mr. Pollard:

Freddie Mac is pleased to submit these comments in response to the Advance Notice of Proposed Rulemaking published by the Federal Housing Finance Agency ("FHFA") on January 26, 2012 (the "ANPR").¹ The ANPR requests comment on FHFA's position on 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. FHFA has directed Freddie Mac and Fannie Mae (the "Enterprises") to continue 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 In the ANPR, FHFA requests comment on whether its existing position on PACE programs should be maintained, changed, or eliminated and whether other restrictions or conditions should be imposed.

While Freddie Mac generally supports energy efficiency initiatives, we have significant concerns regarding PACE loan programs, particularly those that feature first-priority liens. As we describe in greater detail below, such programs have the potential to increase credit losses and may have other undesirable impacts on the mortgage market and homeowners. Accordingly, we recommend that FHFA maintain its existing position on PACE programs as set forth in the Directive.

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.

¹ 77 Fed. Reg. 3958.

² February 28, 2011 Directive (the "Directive").

Comments

Freddie Mac supports the goals of encouraging development and adoption of energy efficient and renewable energy home improvements. We have incorporated energy efficient and “green” practices into our day-to-day business and operations. We have recently been working with HUD to develop a “Green Refinance Program” that aims to make credit more available to owners of affordable housing rental properties who are undertaking energy efficient property upgrades. Moreover, for over twenty years, we have included consideration of energy efficient features in our mortgage underwriting criteria by allowing our Seller/Serviceicers to qualify borrowers using higher housing expense-to-income ratios and higher debt payment-to-income ratios if the underlying property is energy efficient or if the property contains energy efficient features that will result in lower utility charges for the borrower.³ Freddie Mac also allows a borrower to finance the purchase of a property that the borrower plans to retrofit or refurbish with energy efficient improvements and allows the borrower to finance the actual cost of the improvements with the mortgage.⁴

PACE Programs

Approximately twenty-seven states have thus far 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 defined extremely broadly in typical PACE programs. Many PACE programs permit homeowners to finance improvements that range from simple low-cost modifications to substantially more expensive projects, such as installation of solar panels. Some programs even permit financing of improvements such as planting shade trees or adding automatic swimming pool covers.

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.⁵

Potential Impacts of PACE Programs on Freddie Mac

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.

³ See Freddie Mac Single-Family Seller/Serviceicer Guide (the “Guide”) Sections 37.15, 37.16 and 44.15.

⁴ See Guide Section 23.8.

⁵ At least four states – Maine, Vermont, Oklahoma and New Hampshire – have adopted PACE programs that would not subordinate existing liens.

Freddie Mac has a long-standing requirement that mortgages we purchase have first-lien positions.⁶ 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.

Since May of 2009, Freddie Mac has consistently advised FHFA of our concern that certain 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. Responding 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 reiterated the safety-and-soundness concerns raised by the 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.

Greater Risks to Freddie Mac

As noted above, Freddie Mac has expressed its concerns with PACE loan programs that establish a priority over existing liens. The various state laws generally treat these energy loans as tax assessments with the same priority as, or priority only below, real property taxes. In the case of a loan purchased by Freddie Mac, this means that the locality, often on behalf of a private lender and without notice to us, takes a lien position senior to our existing first mortgage lien, requiring us to satisfy the PACE lien in the event of default or risk losing our position in a foreclosure.

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. This feature substantially increases the likelihood that the PACE lien holder will recoup the maximum amount possible on the obligation it is owed. Risks to PACE lenders are further reduced because PACE liens typically run with the property.

The priority lien feature of many PACE programs 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

⁶ See Guide Sections 8.11, 22.3 and 6.12.

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.

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. To the extent that any losses occur, these will ultimately be borne by the taxpayers who support us during conservatorship.

Additional Concerns

In addition to our concerns about PACE lien priority, we note that many state laws implementing or authorizing PACE programs do not include requirements that energy lenders apply sound underwriting principles. Such underwriting principles protect both lenders and borrowers by, among other matters, establishing that the borrower is likely to be able to repay the loan. Because the relative value of PACE loans can be substantial (up to 40 percent of the underlying property's value in at least one state)⁸ the lack of uniform prudent and customary underwriting standards in most PACE loan programs is a significant concern.

Further, we are not aware of reliable evidence supporting a conclusion that energy efficiency improvements increase property values in an amount equal to the cost of the improvement. Rather, our experience with other home improvements suggests that any increase in property values is likely to be substantially less than such cost, meaning that homeowners who take on PACE loans are likely to increase the ratio of their indebtedness relative to the value of their properties. This increase in indebtedness is of particular concern at a time when almost 23 percent of all mortgage holders owe more than their homes are worth.⁹

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. In addition, the absence of sound and uniform underwriting in connection with typical PACE loans creates risk both for Freddie Mac and for the borrower. For these reasons, we believe FHFA should maintain its current position on PACE programs.

* * * *

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

Sincerely,



Matthew G. McGuire
Acting Deputy General Counsel – Legislative and Regulatory Affairs

⁸ See NM Stat § 4-55C-1.

⁹ CoreLogic Press Release, "CoreLogic Reports Negative Equity Increase in Q4 2011" (Mar. 1, 2012).