American Bankers Association
Community Mortgage Banking Project
Consumer Mortgage Coalition
Housing Policy Council
Independent Community Bankers of America
Mortgage Bankers Association

March 26, 2011

Federal Housing Finance Agency
Alfred M. Pollard, General Counsel
Federal Housing Finance Agency
Eighth Floor, 400 Seventh Street SW.
Washington, D.C. 20024
RegComments@fhfa.gov

Re: Advance Notice of Proposed Rulemaking
Mortgage Assets Affected by PACE Programs
(RIN) 2590–AA53

Dear Mr. Pollard:

The undersigned trade associations appreciate the opportunity to submit comments to the Federal Housing Finance Agency (FHFA) in its Advance Notice of Proposed Rulemaking (ANPR) on Property Assisted Clean Energy (PACE) lending programs. FHFA asks whether its restrictions and conditions on PACE lending should be maintained, changed, or eliminated, and whether other restrictions or conditions should be imposed. We believe the GSEs should not purchase loans on properties that are, or could become, subject to a PACE super-lien, a lien that has priority over the mortgage lien. The GSEs were created to promote stability and liquidity in the secondary mortgage market. PACE super liens, as described below, threaten stability and liquidity, and are therefore inconsistent with the GSEs' mission and are inappropriate for them to purchase.

While energy efficiency is a worthy goal, PACE super-liens threaten the lien position on which mortgage lenders, servicers, and investors rely, and are disruptive to mortgage markets. PACE financing is not an appropriate method for financing energy efficiency improvements for homes.

Background on PACE loans

PACE loans, sometimes called Energy Loan Tax Assessment Programs (ELTAPs), are a relatively new type of financing for energy efficiency retrofits, commonly solar panels.

Under a PACE program, a municipality issues bonds, then lends the proceeds to homeowners and businesses for energy retrofit purposes. Property owners repay the PACE loans over a number of years, typically 15 or 20 years. They are commonly not prepayable.

The unusual feature of PACE loans is that the municipality collects loan payments through its tax assessments. Like unpaid property taxes, an unpaid PACE loan results in a lien on the property, and, in most states, the PACE lien has priority over a mortgage lien, even over a first mortgage lien that predated the PACE loan.

PACE loans lack basic consumer protections. PACE loans depend on the lien on the property, and therefore ***do not require a demonstration of the borrower's ability to repay the loan.***

The PACE super-lien priority over a mortgage lien significantly harms the interest of the GSEs and other mortgage investors. PACE programs can cause the amount of debt secured by a home to exceed the property value. Underwater mortgages are at much higher risk of default than loans with low loan-to-value (LTV) ratios. ***PACE loans can increase mortgage default rates.***

If the case of a foreclosure on the mortgage loan, the mortgage lienholder would need to pay past due amounts on the PACE loan, and would owe, or a subsequent purchaser would owe, the future PACE loan payments. The existence of a PACE loan with priority over the mortgage significantly and immediately reduces the value of the existing mortgage loan. When a mortgage loan defaults, the existence of ***a PACE super-lien increases the severity of loss to the mortgage holder***.

Fannie Mae and Freddie Mac together own or guarantee over $5 trillion in mortgage loans. The fact that PACE loans can increase both the rate of mortgage defaults and the severity of losses on defaulted mortgage loans could cause the GSEs enormous losses.

Residential mortgage loans are very commonly made using the GSEs' uniform security instrument, even when lenders do not intend to sell the loan to a GSE. The uniform security instruments make clear that if a new new lien with priority over the mortgage lien is created, the borrower must promptly discharge or subordinate the new lien, absent the mortgage lender's consent. Put another way, PACE liens with a priority over the mortgage lien can be a default on the mortgage obligation. Some PACE loan programs do not require advance notice to the borrower that the PACE loan may be a mortgage default.

PACE loan programs do not require that the loan proceeds be used in a cost-effective manner. Under some programs, the PACE loan is shorter than the expected life of the energy product, but that does not mean the loan and product are cost effective. The amount of energy savings from one piece of equipment varies from building to building. The cost of electricity varies by location and sometimes by time of day. The cost of fuel can vary seasonally. The amount of electricity that air conditioners use varies by indoor

and outdoor temperatures, and it varies during rainfall. A solar panel in sunny regions will produce different savings than one in cloudy areas, or in a location near tall buildings or trees. Its sun exposure varies by the angle at which it is installed. Whether an individual retrofit would be cost-effective would require an engineering analysis, but PACE programs do not require engineering analyses.

In June 2009, FHFA wrote a letter[1] to the American Association of Residential Mortgage Regulators, the Conference of State Bank Supervisors, the National Association of Credit Union Supervisors, the National Conference of State Legislatures, and the National Governors Association. This letter discussed FHFA's concerns with PACE programs. FHFA stated that a "central risk is that these loans create an additional potential for the loss of a home through a tax sale or foreclosure[.]" FHFA noted that these loans increase homeowner debt burdens, and thereby run counter to the goals of foreclosure prevention programs. FHFA noted a number of predatory lending concerns with PACE programs:

- The loans may be originated by unregulated parties such as home remodeling firms.
- The loans do not adequately take into account whether there is sufficient equity in the property to support the mortgage and the energy loans.
- The loan terms and structure represent serious risks to borrowers, including terms that may be longer than the useful life of the energy improvements, and significant points and fees on the loans, such that the borrower may never realize the energy cost savings.
- Marketing targeted to those who would not qualify for a loan in the amount of the energy loan plus the mortgage loan. FHFA was "particularly concerned" by marketing materials for one program targeted at borrowers who may not qualify for a lower-interest home equity loan through a private lender.
- Instances of interest rates above market rates.
- Diminished ability to refinance a mortgage or to sell a property encumbered by the energy lien.
- A great potential for fraud. FHFA noted one program in which payments for the improvements are made directly to the contractor, permitting unscrupulous contractors to be paid before the work is satisfactorily completed. FHFA noted another program in which the installer can seek a 20-year loan for a solar energy system that the homeowner may or may not have authorized.

On September 18, 2009, Fannie Mae issued a Lender Letter stating, "Fannie Mae is reviewing its underwriting guidelines to determine appropriate requirements in jurisdictions that have enacted legislation establishing ELTAPs. Until such Lender Letter guidelines are issued, lenders should treat ELTAP payments as a special assessment in underwriting a borrower[.]"[2] On May 5, 2010, Fannie Mae and Freddie Mac both issued letters. Fannie Mae's letter said, "The terms of the Fannie Mae/Freddie Mac Uniform Security Instruments prohibit loans that have senior lien status to a mortgage."[3] Freddie Mac's letter said, "The purpose of this Industry Letter is to remind Seller/Servicers that

[1] The letter is available here.
[2] Fannie Mae Lender Letter 07-2009, September 18, 2009.
[3] Fannie Mae Lender Letter 2010-06.

an energy-related lien may not be senior to any Mortgage delivered to Freddie Mac. Seller/Servicers should determine whether a state or locality in which they originate mortgages has an energy loan program, and whether a first priority lien is permitted."[4] Both GSEs indicated they would provide additional guidance in the future.

On July 6, 2010, FHFA released a statement:

> FHFA urged state and local governments to reconsider these programs and continues to call for a pause in such programs so concerns can be addressed. First liens for such loans represent a key alteration of traditional mortgage lending practice. They present significant risk to lenders and secondary market entities, may alter valuations for mortgage-backed securities and are not essential for successful programs to spur energy conservation.
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> While the first lien position offered in most PACE programs minimizes credit risk for investors funding the programs, it alters traditional lending priorities. Underwriting for PACE programs results in collateral-based lending rather than lending based upon ability-to-pay, the absence of Truth-in-Lending Act and other consumer protections, and uncertainty as to whether the home improvements actually produce meaningful reductions in energy consumption.

In that statement, FHFA directed Fannie Mae and Freddie Mac to waive the prior lien restrictions in their uniform security instruments for preexisting PACE loans. FHFA also directed the GSEs, including the Federal Home Loan Banks, to address PACE programs that create first liens, and to adjust loan-to-value ratios to reflect the maximum permissible PACE loan amount available, among other things.[5]

Also on July 6, 2010, the Office of the Comptroller of the Currency (OCC) released supervisory guidance, noting FHFA's release. The OCC's guidance stated:

> This [PACE] lien infringement raises significant safety and soundness concerns that mortgage lenders and investors must consider. . . . National bank lenders should take steps to mitigate exposures and protect collateral positions. . . . For new mortgage and home equity loans, mitigating steps may include:
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> - Reducing real estate loan-to-value limits to reflect maximum advance rates of PACE programs to the extent they create super-senior lien priorities; and
> - Considering the maximum amount of the PACE payment portion of the annual tax assessment in the institution's analysis of the borrower's financial capacity.
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> In addition, banks that invest in mortgage backed securities or that are considering the purchase of pools of mortgage loans should consider the impact of tax-assessed energy advances on their asset valuations. Finally, the OCC expects investment banking units to be cognizant of the impact of this type of funding

[4] Freddie Mac Industry Letter, May 5, 2010.
[5] FHFA Statement on Certain Energy Retrofit Loan Programs, July 6, 2010.

> vehicle on their respective institutions and on the mortgage market overall when making any decisions regarding associated bond underwriting. . . . Programs that fail to comply with these expectations pose significant regulatory and safety and soundness concerns.[6]

On August 31, 2010, Fannie Mae and Freddie Mac both announced that, effective for loans originated on or after July 6, 2010, they would no longer purchase loans on properties with PACE obligations unless the terms of the PACE program do not permit priority over first mortgages.[7]

On February 28, 2011, FHFA's General Counsel wrote a letter to the GSEs, under FHFA's authority as conservator, directing them to continue to refrain from purchasing loans secured by properties with first-lien PACE obligations.[8]

In a challenge to the FHFA's position, on August 26, 2011, the U.S. District Court for the Northern District of California held that "[s]ubstantive rule-making is not appropriately deemed action pursuant to the FHFA's conservatorship authority. The FHFA's policy-making with respect to PACE programs does not involve succeeding to the rights or powers of the Enterprises, taking over their assets, collecting money due or operating their business." The court did not agree with FHFA that it acted under its authority over significantly undercapitalized GSEs. The court found that FHFA's authority over significantly undercapitalized GSEs is available only if FHFA finds the GSEs to be significantly undercapitalized, and that FHFA has not made such a finding. The court found that conservatorship may be based on several grounds, so "it is not possible to infer from Fannie Mae or Freddie Mac's conservatorship that they were classified as significantly undercapitalized." The court found that the FHFA's policy on PACE programs was required to be developed through notice-and-comment rulemaking under the Administrative Procedure Act,[9] and the present rulemaking is the result of that decision.

FHFA has appealed the District Court's order, and reserves the right to withdraw the rulemaking should it prevail on appeal.

Background on GSE Conservatorships and FHFA's Authority

FHFA is conservator for Fannie Mae and for Freddie Mac. FHFA has the unenviable task of trying to minimize taxpayer losses resulting from the failure of these two GSEs.

By statute, the GSEs were permitted to operate with considerably lower capital levels than private financial institutions. The GSEs were regulated by agencies with very limited regulatory powers and resources. Their implicit federal backing permitted them

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[6] OCC Supervisory Guidance OCC 2010-25, July 6, 2010.
[7] Fannie Mae Announcement SEL-2010-12, August 31, 2010; Freddie Mac Bulletin 2010-20, August 31, 2010..
[8] FHFA letter to GSEs, February 28, 2011.
[9] The court's decision is here.

access to funding at lower cost than any fully private entity, and they grew largely unchecked. Their mismanaged credit risk, coupled with their lack of a capital cushion, led to their conservatorships in September 2008.

These are among the largest financial institution failures in history. The GSEs' failures dwarf the savings and loan crisis of the 1980s. The Resolution Trust Corporation (RTC) had the task of minimizing taxpayer losses from the savings and loan crisis. The RTC estimated that the total realized and expected losses, as of December 31, 1995, for resolving 747 failed institutions was $87.9 billion.[10] The losses at the two GSEs to date far surpasses that, and likely will continue to accrue for years. On October 27, 2011, FHFA projected that through 2014, the GSEs would together draw $220 billion to $311 billion from the U.S. Treasury.[11] This is more than twice, and possibly more than three times, the cost of the entire savings and loan crisis.

As FHFA stated in its Strategic Plan in February 2012:

> The two companies have received more than $180 billion in taxpayer support. . . . [I]t is clear that the draws the companies have taken from the Treasury are so large they cannot be repaid under any foreseeable scenarios.[12]

The GSEs are severely undercapitalized. The threat of losses from PACE loans is a pronounced risk to the Treasury and to U.S. taxpayers. FHFA has the duty to limit GSE losses, on PACE properties and otherwise.

The District Court for the Northern District of California found FHFA did not have authority to prohibit the GSEs from purchasing loans on properties subject to PACE super-liens. That question appears irrelevant because the GSEs individually could simply elect not to purchase such loans. It is not apparent, if FHFA were required to go through a formal rulemaking to *prohibit* the GSEs from purchasing super-lien PACE loans, why it would not likewise be required to go through a rulemaking to *permit* the GSEs to purchase them. The District Court found that FHFA does not have authority to act as it did because FHFA has not found the GSEs are significantly undercapitalized. This is an elevation of form over substance. It assumes that there is some room to question whether Fannie Mae and Freddie Mac are significantly undercapitalized, which is unrealistic. It also ignores FHFA's many other authorities to require the GSEs to operate safely and soundly.

There can be no serious question that FHFA has authority to prohibit the GSEs from purchasing loans on properties that are or could become subject to a PACE super-lien, just as it has authority to prohibit the GSEs from making any unsafe and unsound purchases. That is one of the purposes Congress created FHFA. We agree with the

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[10] *See* General Accounting Office Report, *Resolution Trust Corporation's 1995 and 1994 Financial Statements*, p. 10 (July 1996).

[11] *Projections of the Enterprises' Financial Performance*, *see* p. 7.

[12] *A Strategic Plan for Enterprise Conservatorships: The Next Chapter in a Story that Needs an Ending*, February 21, 2012.

discussion in the ANPR about FHFA's authority. FHFA has authority to require the GSEs to operate safely and soundly regardless of the conservatorships. The fact of the enormous losses the GSEs have incurred in conservatorship emphasizes the need for the PACE prohibition.

Questions FHFA Poses

In this advance notice of proposed rulemaking, FHFA poses several questions that we address below.

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?

> FHFA's restrictions relating to PACE liens, where PACE liens have priority over a first mortgage lien, are essential. This is essential for the U.S. taxpayers, for the GSEs, for the stability of the entire mortgage market, and for consumers who would otherwise be subjected to unregulated predatory lending practices that put them at risk of losing their homes.

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?

> The lien-priming feature of first-lien PACE obligations greatly increases the credit exposure of mortgage-backed securities, to mortgage investors, taxpayers, and mortgage markets themselves. Mortgage investors rely on their lien position. Losing it unknowingly, in exchange for nothing, substantially harms the value of mortgage investments. The GSEs so dominate the mortgage market today that losses from super-lien loans would be heavily concentrated in two GSEs. They have no capital cushion, so all their losses flow directly to the U.S. Treasury.
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> PACE programs could be improved so they would not disrupt the mortgage market's need to rely on lien positions. The programs could provide that a default on a PACE loan, or on a mortgage loan on the same property, requires acceleration of the PACE loan and its subordination to any mortgage lien that predated the PACE lien.

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?

The lien-priming feature of first-lien PACE obligations increases the financial risk to holders of related mortgages and MBS by doing all of the following:

- Increasing the combined loan-to-value ratio (CLTV). CLTV is a primary determinant of the value, and default risk, of a mortgage loan. PACENow has posted a template comment letter to FHFA for this rulemaking that asserts, "PACE financed improvements allow homeowners to hedge themselves against fuel price spikes and rising fuel costs over time. These factors lessen, if not eliminate, the safety and soundness risk than the FHFA has asserted."[13] This is unsupported. There is ample evidence that LTV and CLTV ratios are closely correlated with mortgage loan defaults, meaning that PACE liens increase mortgage default risk. PACE-financed improvements may reduce a homeowner's overall expenses in some cases, but that is not a requirement. In some cases, the PACE financing increases the homeowner's net expenses and that may increase the risk of a mortgage default. Further, PACENow assumes energy prices rise over time. The price of natural gas has fallen since the advent of extracting it from shale rock. As *The Wall Street Journal* reports, "U.S. energy companies are pumping so much natural gas out of the ground that prices are plummeting, and the cheap gas isn't likely to evaporate anytime soon. Natural-gas prices fell 5.7% Wednesday to their lowest level in over two years—good news for people who use gas to heat homes and for companies that use it to power factories. . . . Despite a 32% drop in prices last year, onshore production rose 10%, and it is expected to rise another 4% this year, according to Barclays Capital. As a result, prices are expected to remain low for at least the next couple years. . . . Earlier this week, Bank of America Merrill Lynch said gas prices could drop below $2 in the fall, a level unseen since 2002. Four years ago, it sold for around $9. . . . The current glut partly stems from the U.S. energy industry's

[13] The template is available here.

success with new exploration techniques—notably hydraulic fracturing of shale formations, or fracking. Shale formations full of gas keep turning up across the country, storage reservoirs are close to full and companies are now starting to try to export the excess gas."[14]

- Fees and expenses of ten percent on an energy loan risk making the entire retrofit purchase a net financial loss to homeowners. That would defeat the entire purpose of the project, from the consumer's perspective. From the investor's perspective, it would increase the risk of default because the mortgage loan was underwritten without regard to the energy loan or its fees, and the energy loan may put the consumer in a worse financial condition, making default on one or both loans more likely.
- The timing in energy-efficiency technology advancements is unknown, but it can happen rapidly. For this reason, PACE loans with terms of 15 to 20 years may be financially unsound investments. Early in the life of a PACE loan, the technology used in a retrofit application may become obsolete, but the PACE loan would remain because it is not prepayable. As technology advances, consumers' preferences will change. A solar panel that seemed attractive at first but that became obsolete will hurt property liquidity and value, both because the property has an undesirable and obsolete solar panel, and because the PACE lien would still be outstanding. Energy retrofit loans with such long terms seem predatory, absent a well-documented determination that the project will result in financial gain to the homeowner. Consumers themselves are not able to make such determinations without an experienced engineer.
- Energy prices are hard to predict. They can depend on international and domestic politics and technology advances.
- Property values are subject to fluctuation. They can increase or, especially lately, decrease. PACE loans increase the risk of default when property values are declining because CLTV is a strong predictor of default.

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

[14] Russell Gold, Daniel Gilbert, and Ryan Dezember, *Glut Hits Natural Gas Prices*, The Wall Street

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?

Mortgage investors will simply avoid investing in loans on properties that are, or could become, encumbered, by PACE liens.

Under the uniform security instrument, when a lien prior to mortgage is created, the mortgage lender can demand that the borrower promptly discharge it:

> Borrower shall promptly discharge any lien which has priority over this Security Instrument unless Borrower: (a) agrees in writing to the payment of the obligation secured by the lien in a manner acceptable to Lender, but only so long as Borrower is performing such agreement; (b) contests the lien in good faith by, or defends against enforcement of the lien in, legal proceedings which in Lender's opinion operate to prevent the enforcement of the lien while those proceedings are pending, but only until such proceedings are concluded; or (c) secures from the holder of the lien an agreement satisfactory to Lender subordinating the lien to this Security Instrument. If Lender determines that any part of the Property is subject to a lien which can attain priority over this Security Instrument, Lender may give Borrower a notice identifying the lien. Within 10 days of the date on which that notice is given, Borrower shall satisfy the lien or take one or more of the actions set forth above in this Section 4.

A borrower's failure to comply with the security instrument is a mortgage default.

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?

From the perspective of the current and future homeowner, and of any mortgage investor, most alternatives would be better than super-lien PACE loans.

For homeowners with the means to finance an energy retrofit project without a PACE loan, the alternative financing likely would have a lower cost and much more flexibility, such as a shorter term and the ability to prepay the loan. A

shorter term and the ability to prepay the loan would both reduce its cost. This flexibility would also permit the homeowner to sell the property without diminishing the sales price to reflect the outstanding PACE loan. Such loan products, such as § 203(k) insured home improvement loans from the Federal Housing Administration, Energy Efficient Mortgages, and general home improvement loans are more suitable to these ends.

PACE loans, then, are directed at those who cannot qualify for non-PACE financing. These are the borrowers for whom PACE loans would be the most dangerous. A borrower of limited means should not be put into a PACE loan because PACE loans are made without regard to the borrower's ability to repay the loan. Nor should such a borrower be put into a PACE loan without a clear and accurate engineering assessment beforehand by a neutral engineer that represents the borrower. The engineering assessment needs to demonstrate what the project will cost, what it will save, and when the savings will accrue. For example, a solar panel may help a homeowner save on winter heating bills, but only seasonally, and this should be made clear to the homeowner up front.

Further, all fees of the loan should be required to be fully disclosed before the consumer takes out the PACE loan, including their amount, timing, what they are for, and whether they are mandatory or optional. PACENow makes much of the fact that a solar panel would be guaranteed, but does not address the fact that guarantees need to be backed with capital. The product manufacturer may go out of business before the product fails. That would leave the homeowner with an outstanding PACE loan, with its payments and lien, but no energy savings.

Municipalities using PACE financing may consider the appropriateness of voluntary compliance with the Federal Trade Commission's holder in due course rule, or something similar, to protect consumers. This rule subjects certain holders of credit, that a consumer used to finance the purchase of goods or services, to the claims and defenses that the consumer could assert against the seller of the goods or services.[15]

Utility companies, governments, and charities commonly have programs for those who struggle to pay their utility bills.

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?

PACE loans decrease the value of the property by encumbering it with a lien. Non-equity forms of financing do not do so.

PACENow.org posts a "talking point" that says, "PACE, like other municipal

[15] 16 C.F.R. § 433.1 – 433.3.

assessments, stays with the property upon sale, so homeowners need not worry that a loan payoff on sale will ruin the cost-effectiveness of the project."[16] This ignores the best interests of consumers. Homeowners *should* worry about the cost-effectiveness of the project because they are paying for it. If a homeowner were to sell the property before the PACE lien is extinguished, the property value would be reduced accordingly, so the homeowner would realize less on the sale. The cost of home improvements, energy-related or otherwise, are very often not reflected in the property's market value. PACENow.org simply ignores that a diminished sales value is a direct consumer cost. Further, profits on home sales are often not subject to federal income tax, and the PACE lien would diminish that tax benefit to the homeowner.

PACENow also argues that the PACE lien would be largely immaterial to the GSEs, even in a mortgage foreclosure, because PACE loans do not accelerate upon default. This ignores the fact that the property would retain an unsatisfied PACE lien that diminishes the property value. That diminished value would be a cost to the GSE.

PACENow argues that "home values increase by $20 for each $1 in annual energy savings."[17] Its apparent source for this conclusion is a study conducted in 1998. The cost of housing has plummeted since then. Any correlation between energy savings and property valuations that existed in 1998 is subject to serious question given what foreclosures and reduced mortgage credit availability have done to property values. The study is simply obsolete.

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?

The environment does not react to the financing methods people elect.

Super-lien PACE loans are one way to finance energy retrofits. They are advantageous to suppliers of energy-efficiency products and contractors who install them because they are more assured of being paid. From the consumer's point of view, other financing methods would be more advantageous.

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?

Super-lien PACE financing spreads the cost of a project over a long period of time. This can reduce the monthly payments on energy retrofit projects. Some

[16] Available here.
[17] Available here, apparently relying on a study available here.

> consumers may be lured in by low payments, and by the PACENow position that "homeowners need not worry that a loan payoff on sale will ruin the cost-effectiveness of the project." This may well cause more energy retrofits to be made, but it will also increase the risk and severity of defaults. This does not support the view that consumers would benefit.

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?

> There are not sufficient protections. The Department of Energy released guidelines on the types of protections that should be in place, but they are not binding on the states.[18] At a minimum, full compliance with the Truth in Lending Act, the Real Estate Settlement Procedures Act, and their implementing regulations should be required. The Dodd-Frank Act amended the TILA to require that mortgage lenders determine a consumer's ability to repay a loan before closing the loan. That requirement alone would be inconsistent with PACE lending, which is collateral-based. Further, the Dodd-Frank Act largely limits prepayment penalties on mortgage loans so that consumers will be more able to refinance their loans or to pay them down faster than is required. This is another inconsistency with PACE loans, which are not prepayable under any circumstances – consumers cannot get out of them before maturity.

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?

> PACENow advocates the consumer benefits of PACE loans. "Over the useful life of the retrofit, homeowners can generate cash savings of $5,000 to $14,000."[19] We question the wisdom of using home equity to finance such small benefits, even if they were to materialize. The risk of losing a home through default and foreclosure is a significant concern. Even if it is not likely, it is still a concern because the severity of a foreclosure is high.
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> PACE program supporters do not address the fact that a lien immediately reduces

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[18] *Guidelines for Pilot PACE Financing Programs*, May 7, 2010.

[19] *Helping Achieve Environmental Sustainability and Energy Independence, Improving Homeowner Cash Flow and Credit Profile, Protecting Mortgage Lenders, and Creating Jobs*, by the National Resources Defense Council, PACE Now, Renewable Funding, LLC, and The Vote Solar Initiative, May 3, 2010.

a property's resale value. This is a direct harm to consumers. Any cash flow savings are realized, if at all, only over a number of years.

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?

Any disclosures about future utility costs are conjecture and are unreliable. It would be more appropriate and more accurate to disclose that any future savings are unknown.

If a PACE loan does not produce the savings hoped for, the result is an increased risk of default on the PACE loan, the mortgage, or both because of the increased CLTV, a strong predictor of mortgage default.

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?

Even if these future costs were disclosed, the disclosures would be nothing more than speculation. Energy-efficiency projects are often new, unproven technology, so repair costs are unknown. When repairs are necessary, the homeowner may find it more cost-effective not to pay for the repair. This would defeat the homeowner benefit of the program.

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?

PACE financing should be subject to the TILA and RESPA as are other consumer mortgage transactions. Characterizing the transactions as taxes to avoid these important protections is inappropriate. The lack of preclosing disclosures about the costs and nature of the loan is another reason that PACE lending can be inappropriate.

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?

> PACE financing is collateral-based. There is no requirement to underwrite the borrower's ability to repay the PACE loan because the collateral ensures repayment. There is no requirement to evaluate the LTV when the PACE lien is a super-lien. Collateral-based lending against a consumer's residence is inappropriate.

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?

> PACENow states that "actual results will [ ] depend on particular installations, locations, property types and other factors. . . . Careful program design and diligent program execution ensures that risks are prudently managed."[20]
>
> A professional, independent engineering analysis should be required before a homeowner incurs an obligation, especially one that puts the home at risk of loss.

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 preexisting 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 lending is collateral-based, and the collateral is peoples' homes. This type of financing is inappropriate for consumers.

Environmental Impact Statement

FHFA issued a Notice of Intent to prepare an environmental impact statement under the National Environmental Policy Act (NEPA) to address the potential environmental impacts of FHFA's proposed action. According to NEPA § 102(2)(C):

> [A]ll agencies of the Federal Government shall . . . include in every recommendation or report on proposals for legislation and other major Federal

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[20] *Id.*

actions significantly affecting the quality of the human environment, a detailed statement by the responsible official on—

(i) the environmental impact of the proposed action,
(ii) any adverse environmental effects which cannot be avoided should the proposal be implemented,
(iii) alternatives to the proposed action,
(iv) the relationship between local short-term uses of man's environment and the maintenance and enhancement of long-term productivity, and
(v) any irreversible and irretrievable commitments of resources which would be involved in the proposed action should it be implemented.[21]

FHFA's restrictions regarding PACE super-liens is a safety and soundness protection for the GSEs and a consumer protection to prevent risks of foreclosures. It is not an environmental action. It is certainly not an action "significantly affecting the quality of the human environment" within the meaning of NEPA.

FHFA's action does not prohibit the purchase or use of any energy-efficient device or service. It simply protects the lien status of mortgages, as provided in the mortgage obligation documents. It is designed to prevent the creation of super-liens, which are mortgage defaults. Energy-efficient products that are cost-effective can be financed by many alternative means. Even if FHFA did not act, the GSEs could themselves make the business decision not to purchase loans on properties that could become subject to a PACE lien.

While we would not object to preparation of an environmental impact statement, we do not believe FHFA's action requires one.

Conclusion

While we appreciate the concerns for energy efficiency, we cannot support a program that would risk adding to the default and foreclosure rate. Moreover, the GSEs should not be involved in any program that entails predatory lending. Finally, the FHFA must protect the GSEs from super-liens that would further erode their already dire financial condition, which is a cost to the U.S. taxpayers.

Sincerely,

American Bankers Association
Community Mortgage Banking Project
Consumer Mortgage Coalition
Housing Policy Council
Independent Community Bankers of America
Mortgage Bankers Association

[21] 42 U.S.C. § 4332(2)(C).