March 24, 2012

Mr. Alfred Pollard
General Counsel
Federal Housing Finance Agency
400 7th St., N.W.
Washington, DC 20024

RE: RIN 2590-AA53 Mortgage Assets Affected by PACE (Property Assessed Clean Energy) Programs

Dear Mr. Pollard:

Thank you again for the return phone call last month and your very pleasant/informative conversation. In seeking new information, it's critical the rulemaking process not fall to the pressure of existing financial systems. The main purpose of my letter is to differ with the FHFA in its claim to have a statutory role or authority to oversee PACE programs. FHFA has no regulatory authority outside of its mission unless its to exercise its incidental powers only as necessary or appropriate to fulfill its duties and responsibilities in supervising and regulating the Enterprises. Neither criteria are the case. Local government has the right to establish programs for sustainable financing to enable private property owners that what to invest in clean energy improvements. This role of government is not a charge of the Enterprises. As such, I hope you concede that FHFA cannot lawfully set up rules or guidelines outside of its mandated role established by Congress.

In serving over 10 years on the Board of Trustees of the Alameda County Employees' Retirement Association, a $5 Billion pension fund and thirty years as an urban planner in Alameda County, I'm somewhat familiar with sound fiscal policy and governance issues. Investment in building performance upgrades is an intelligent business decision. Building performance upgrades lower operating costs, improve occupant comfort, hedge against utility price increases, demonstrate commitment to tenant well-being, reduce exposure to regulation, help the environment, and ultimately boost property values. Moreover, our county Board of Supervisors has determined that PACE improvements constitutes a "benefit" under special assessment laws because climate change is a critical sustainability issue facing our community. PACE improvements reduce greenhouse gas emission which is directly, uniquely and specifically the result from the public financing of energy efficiency or distributed renewable energy generation improvements that are permanently fixed to the property. This is the role of local government and not the role of the FHFA in protecting "the Enterprises" or ensuring that the Enterprises operate in a ''safe and sound manner" because PACE "tax assessments" and not "loans" as asserted by FHFA.

Loans versus Tax Assessment

I trust the FHFA agrees that common loans such as mortgages, car loans, student loans, home equity lines of credit, credit cards, installation loans as well as payday loans are all credit-based. The credit score of the borrower is a major component in the underwriting and interest rates of these loans. Acting as a provider of loans is certainly one of the principal tasks for financial institutions. Where funding is obtained from bank loans, the funding can be used for any purpose, whether for a car, home improvement or for personal matters including "personal property". Since the loan is made to a borrower, it is the borrower that has the obligation to repay the loan. This type of credit-based funding is one where an asset (the funding) has been converted into a different asset (a promise to repay the loan). On the other hand, funding of PACE improvements is not obtained by a borrower, but directly funded by the local municipality. PACE tax assessments run with the land – not a borrower – with characteristics similar to those of more than 37,000 other land-secured special assessment districts in the United States that are rooted in hundreds of years of state and local law.

PACE financing effectively allows the local municipality to pay for permanent energy improvements on real property within the PACE special district. The amount financed is typically repaid via a special assessment on the property over a period of years. Financing may be used for improvements to developed property only if the current property owner agrees to a contractual assessment (that is, agrees to pay the increased tax levy on the property) on his/her property tax bill for up to 20 years. To be eligible, a property owner must have a clean property title and must be current on property taxes and mortgages. Participating local governments authorize the property owner to contract for the improvements or purchase equipment directly. However, there is no "borrower" that has the obligation to repay the loan in the traditional sense of a bank loan. That responsibility goes to the party responsible for the issuance of limited obligation bonds, notes or other forms of indebtedness to fund all PACE projects. This type of asset-based funding is one where the funding goes directly to improvements that address the "public benefit" under special assessment laws. Local governments determine which permanent energy projects are eligible for financing but eligible improvements typically include photovoltaic (PV), geothermal heat pumps, fuel cells, high-efficiency HVAC systems, insulation, and high-efficiency windows as eligible PACE projects. As the Enterprises buy mortgage loans from original lenders so those entities can make more loans, PACE financing provides funding for the installation of improvement which provide a public benefit. PACE does not directly lend funds for borrower/personal property.

For most PACE programs, the amount of funding available and the interest rate of bonds sold is determined by an index, but fixed at the time the bonds are issued. The assessments levied, interest and any penalties constitute a lien against the improved property until the tax assessment is paid. It appears that FHFA sees this new PACE financing as a point of entry into the mortgage market. As such, it is understandable how the Agency could seen PACE programs as a means of shifting default risk from another creditor to the mortgage lender—as LOAN programs do — making mortgages and mortgage-related assets riskier and less valuable. However, such districts are typically created at the voluntary request of the property owner who allows their local government to finance public improvements such as sewer systems, sidewalks, lighting, parks, open space acquisitions, and business improvements on their private property. Allowing property owners to act voluntarily and individually to adopt municipally financed improvements to their property is sound public policy and increases the market value of the benefited property. There is no study or supporting documentation that I'm aware of showing when PACE financing "steps ahead" of the mortgage holder in priority of its claim against the property, in the event of foreclosure, there is any reduction in the value of the property because of the outstanding lien or yet the retrofit project. If fact, data is starting to show property sales where energy retrofits have been installed, property is more attractive to potential purchasers. The FHFA's assumption PACE liens increase the risk that the homeowner will become delinquent or default on other financial obligations, including any mortgage obligations is simply unfounded and not factual.

From the capital provider's perspective, it should be an advantage to channel funding through a local government, rather than lending directly to the property owner or channeling the funds through a private enterprise because local government is able to use the property-tax assessment system as the vehicle for repayment. The Agency has referred to this advantage as "lien-priming". The FHFA's concern is the senior position of property tax liens which the Agency believes minimizes the financial risk to the capital provider by down-grading the priority of first and second mortgages, and little to do with concerns related to lien-priming by levying a tax assessment to secure the PACE financial obligation.

In referring to lien priming, is it FHFA meaning to use a term of art in bankruptcy that refers to a concept in debtor-in-possession financing ("DIP financing"). My understanding is that DIP financing is a very large topic in itself, but simply put, when a business debtor is trying to reorganize in bankruptcy, it often needs cash. A large industry exists to fund these cash requirements, but special protections for these lenders have emerged to ensure that cash will continue to flow to reorganizing debtors. Lien priming is when a DIP lender is put ahead or at the same level of a preexisting lien. I assume this is the context in which the Agency uses the term.

In response to the question, lien priming can occur even over the preexisting lender's objection if certain requirements are met. First, a debtor shows that a loan was unavailable without lien priming. Since PACE financing is not a loan to a borrower, concerns about seeking the availability of other financing appears to be outside the regulatory authority of the FHFA. Second, the debtor must show that the prepetition secured lender is adequately protected. This last point is where most of the battles are fought. If there is no pay-down of the prepetition secured debt as part of the DIP financing and no equity cushion in the collateral, a debtor would likely be hard pressed to prime a lender's lien over its objection. That fact, in itself, could ultimately doom the property owner's chance to reorganize in bankruptcy. Given the funded amount (not to exceed 10% of property's market value) and the tax commonly levied on real property for PACE improvement, concerns related to lien priming appear minor and consistent with the terms of typical mortgage documents.

In Summary, FHFA has no foundation for determining PACE programs present significant safety and soundness concerns. To the contrary, FHFA has no regulatory responsibility of over cities and counties that are municipal taxing themselves. PACE programs are property tax assessments with characteristics similar to those of more than 37,000 other land-secured special assessment districts in the United States that are rooted in hundreds of years of state and local law.

PACE has enormous potential to save homeowners money, create local jobs and dramatically reduce energy use. Because of its unique ability to spur homeowner investment in energy efficiency and clean, on-site renewable energy, PACE legislation was passed by 28 states in just two and a half years. It has strong bi-partisan support at the local, state and Federal levels. PACE programs have been received with such overwhelming public support because they address one of the most important problems facing America, and offer an ability to scale that is unmatched by other alternatives.

I believe that FHFA's action to unilaterally halt local government PACE programs on July 6, 2010 was unwarranted. This rulemaking provides an opportunity to establish a fact-based record and correct misinformation and misunderstandings, to the benefit of all stakeholders: local governments, mortgage lenders, homeowners, and our nation. I appreciate the opportunity, and urge you to look for ways to accommodate these broadly beneficial programs.

Sincerely,

L Darryl Gray

L. Darryl Gray
21778 Tanglewood Drive
Castro Valley, Ca 94546