



SF Environment

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A Department of the City and County of San Francisco



EDWIN M. LEE
Mayor

Melanie Nutter
Director

March 23, 2012

Mr. Alfred Pollard
General Counsel
Attention: Comments/RIN 2590-AA53
Federal Housing Finance Agency
Eighth Floor
400 7th St., S.W.
Washington, DC 20024

RE: *RIN 2590-AA53 Mortgage Assets Affected by PACE Programs (“Advance Notice of Proposed Rulemaking”)*

Dear Mr. Pollard:

On behalf of the City and County of San Francisco (“San Francisco”), I write to explain why San Francisco believes that (i) the restrictions and conditions contained in the July 6, 2010 statement of the Federal Housing Finance Agency (“FHFA”), and the February 28, 2011, letter directive of the FHFA (collectively, the “Statements”), should be eliminated and (ii) the FHFA should not impose any other restrictions that would impede PACE programs.

This letter and the attached Appendix A contain some general comments and responses to some of the specific questions posed in the Advance Notice of Proposed Rulemaking.

San Francisco’s PACE Program represents a lawful exercise of taxing power that it has used for more than 100 years. San Francisco established its PACE program in January 2010. However, San Francisco suspended its residential program as a result of the Statements. The Property Assessed Clean Energy (“PACE”) program implemented by San Francisco does not contain any unique features that justify the restrictions and conditions imposed by the Statements.

1. San Francisco’s PACE program involves an exercise of the taxing power that has been lawful in California and in use in San Francisco since the 1800s. San Francisco initiated its PACE program pursuant to an Administrative Code provision that authorizes the levy of special taxes to finance installation of energy efficiency, water efficiency and renewable energy improvements (“PACE Improvements”) that are attached to or on real property and in buildings, whether privately or publicly owned. The Administrative Code incorporates the Mello-Roos Community Facilities Act of 1982, as amended (the “Mello-Roos Act”), which authorizes local agencies to levy special taxes to finance (i) a variety of public capital facilities, such as schools, streets, sidewalks and sanitary sewers and (ii) a handful of privately-owned improvements, including PACE improvements. San Francisco’s PACE program simply represents San Francisco’s exercise of its long-held and used taxing power for a public purpose.

2. The financing of private improvements for public purposes is not a unique feature of PACE. The Mello-Roos Act is not the only instance in which the California Legislature has authorized local agencies to exercise their taxing power to finance privately-owned improvements for a public purpose. For example, among others, the California Legislature has passed the following laws:

- (i) the Improvement Act of 1911 allows the levy of assessments to finance PACE improvements and improvements on private property to prevent, mitigate, abate or control geologic hazards;
- (ii) the Municipal Improvement Act of 1913 authorizes the levy of special assessments to finance, among other things, seismic- and fire safety-related improvements on private property; and
- (iii) the Public Resources Code authorizes a geologic hazard abatement district to levy assessments to finance improvements to public or private structures.

San Francisco considered a broad spectrum of government interests when it designed its PACE program. When it designed its PACE program, San Francisco considered a variety of public policy issues, including public purposes cited by the California Legislature when it amended the Mello-Roos Act to authorize the financing of PACE improvements: the creation of jobs for San Francisco residents and businesses during challenging economic times; the reduction of congestion on the California power grid; the improvement of national energy independence; the potential economic benefits to property owners; and the protection of existing lenders. San Francisco and FHFA share a commitment to a strong and secure housing market and mortgage industry.

The underwriting requirements of San Francisco's PACE program, which are summarized in Appendix A, reflect San Francisco's focus on achieving a broad range of public policy goals while protecting San Francisco's many constituents. Significantly, San Francisco's PACE program is consistent with the White House's policy framework for PACE programs (see "Policy Framework for PACE Financing Programs," October 18 2009) and the program design best practice guidelines promulgated by the Department of Energy (see "Guidelines for Pilot PACE Financing Programs," May 2010). Consistent with San Francisco's focus on the interests of its many constituents, San Francisco's PACE program is designed to comply with all applicable consumer protection laws.

The FHFA undervalues the measures built into San Francisco's PACE program to protect private lienholders. The FHFA is inappropriately discounting the safeguards built into San Francisco's PACE program. As explained above, San Francisco's underwriting criteria are designed to protect the entire range of San Francisco's constituents. San Francisco's PACE program also incorporates other safeguards. For example, California law does not permit acceleration of the unpaid principal amount of a special tax obligation; in the event of delinquencies in the payment of special tax installments, San Francisco is authorized to initiate judicial foreclosure of delinquent special tax installments only (plus penalties and interest). This safeguard makes it more affordable for private lienholders to protect their liens in the event San Francisco forecloses delinquent special tax installments.

In addition, the installation of PACE improvements has enormous potential to reduce property owners' utility costs (offsetting the special taxes) and increase their properties' value, and allows them to hedge themselves against rising fuel prices. Well-designed programs that allow only proven energy efficient technologies and that are backed by robust quality assurance protocols better ensure realization of energy

savings. These savings mean the owner is in a better position to cover other payments and obligations, including the property's mortgage.

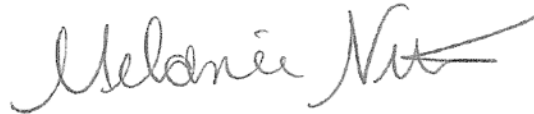
The FHFA's response is unprecedented. San Francisco has levied taxes and assessments to achieve important public purposes, such as the construction of government buildings, the installation of water and sanitary sewer systems and the undergrounding of public utilities, for more than 100 years. The FHFA's response to San Francisco's exercise of its taxing power, as evidenced by the Statements and the Advance Notice of Proposed Rulemaking, is an unprecedented interference with San Francisco's exercise of its taxing power to achieve valid and important public purposes.

For the reasons explained above and on the attached Appendix A, we believe that the Statements are misguided and unnecessary. The FHFA should not have attempted to use its power to regulate the Enterprises (as that term is defined in the Advanced Notice of Proposed Rulemaking) to prohibit senior lien PACE programs altogether; instead, the FHFA should have been part of the broader dialogue to define responsible PACE programs that resulted in the White House's policy framework and the Department of Energy best practice guidelines.

San Francisco urges the FHFA to adopt a rule to the effect that if a PACE program complies with the White House's policy framework and the Department of Energy's best practice guidelines, then the Enterprises (i) may purchase or insure a mortgage loan secured by a property that is encumbered by a PACE lien and (ii) may not take remedial action under a mortgage as a result of the imposition of a PACE lien.

Thank you for the opportunity to respond to the Advance Notice of Proposed Rulemaking.

Sincerely,

A handwritten signature in cursive script, appearing to read "Melanie Nutter". The signature is written in dark ink and is positioned above the typed name and title.

Melanie Nutter
Director
Department of the Environment
City and County of San Francisco

Appendix A

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?*

No, for the various reasons expressed in the cover letter to which this Appendix A is attached.

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?*

Answer: For the reasons detailed below, San Francisco believes that the priority of the lien that secures the special taxes levied under its PACE program does not justify the restrictions and conditions imposed by the FHFA in the Statements.

First, after consulting with a broad range of constituents in San Francisco (including financial institutions) and studying the White House's policy framework and the Department of Energy's best practice guidelines, San Francisco adopted the following underwriting standards for non-residential properties (San Francisco suspended its residential program as a result of the Statements, but anticipates that the underwriting standards would be similar or more restrictive for residential properties):

1. The property owner must certify that it (and its corporate parent if the property owner is a single-purpose entity) is solvent and that no proceedings are pending or threatened in which the property owner (or the corporate parent, as applicable) may be adjudicated as bankrupt or become the debtor in a bankruptcy proceeding, or discharged from all of the property owner's (or corporate parent's, as applicable) debts or obligations, or granted an extension of time to pay the property owner's (and the corporate parent's, as applicable) debts or subjected to a reorganization or readjustment of the property owner's (and the corporate parent's, as applicable) debts. The property owner must also certify that the property owner (or any corporate parent if the property owner is a single-purpose entity) has not filed for or been subject to bankruptcy protection in the past three years.
2. The property owner must be current in the payment of all obligations secured by the subject property, including property taxes, assessments and tax liens, within the past 3 years (or since taking title to the subject property if it has been less than 3 years). Certain allowances may be made for property tax payment delays that do not reflect financial distress. Properties that are currently appealing a property tax assessment will be reviewed and eligibility will be determined on a case-by-case basis.
3. There must be no notices of default or foreclosure, whether in effect or released, due to non-payment of property taxes or loan payments filed against the subject property within the last 5 years (or since ownership, if less than 5 years). Exceptions may be granted on a case-by-case basis.

4. The property owner must not have any involuntary liens, defaults or judgments applicable to the subject property. A property owner with an involuntary lien(s) may be allowed to participate in the Program if it can demonstrate an acceptable reason for the lien, default or judgment and a path for resolution along with supporting documentation.
5. The value of the property (based on current assessed value, appraised value determined by a San Francisco-approved appraiser within 90 days of Program application, or market value calculated according to a method identified by San Francisco) plus the value of the PACE improvements must be equal to or greater than the sum of (i) the total private property debt including mortgages and equity lines of credit secured by the property, (ii) the principal amount of any PACE indebtedness attributable to the property, and (iii) the aggregate principal amount of any fixed assessment liens or other special tax debt on the property.
6. The property owner must certify that the property owner is not party to any litigation or administrative proceeding of any nature in which the property owner has been served, or is pending or threatened which, if successful, would materially adversely affect the property owner's ability to operate its business or pay the special taxes when due.

Second, California law generally, and San Francisco's PACE program in particular (consistent with the White House policy framework and the Department of Energy's best practice guidelines), include a number of features that are designed to protect a broad range of interests, including private lenders:

1. California law does not permit the acceleration of a special tax obligation in the event a property owner is delinquent in the payment of installments. Consequently, the principal amount of any bonds issued to finance PACE improvements and paid from special taxes on a participating property overstates the burden of the special taxes on the property.
2. The financed improvements must be affixed to the assessed property.
3. The term of the special tax obligation may not exceed the useful life of the financed PACE improvements.
4. Residential property owners must provide written notice of the proposed special tax lien to and request consent from existing lenders; the residential property owner may notify a lender that the residential lender will be deemed to have consented to the proposed special tax lien if the lender does not respond within 30 days.
5. San Francisco's PACE program will only provide financing for a limited set of PACE improvements (generally, those energy improvements that are eligible for rebates from the State of California) and requires them to be installed by a licensed contractor.
6. The property owner must have a professional energy and/or water audit conducted on the property that corresponds to the types of PACE improvements the owner is seeking to finance, and, except in limited circumstances, those PACE improvements must appear as identified opportunities or recommendations within the resulting audit report.

7. San Francisco provided extensive in-person training to prospective property owners; over the course of the first two months of the program, 14 training sessions were provided to more than 400 residents throughout the City to provide education about the program, and to allow approved contractors to discuss their work. In addition, the website for the residential program serves to provide detailed program information to potential participants, including information about how the financing works, eligible improvements, approved contractors, and the application process.
8. The property owner must make pre and post-project utility bills available to the City for ongoing monitoring, reporting, and measurement and evaluation purposes.
9. If a renewable energy system is financed, the property owner must implement energy efficiency measures resulting in a 10% improvement in building energy performance.

Third, the installation of PACE improvements is anticipated to reduce property owners' utility costs (offsetting the special taxes), increase their property's value, and allow them to hedge themselves against rising fuel prices. Well-designed PACE programs (such as San Francisco's) allow only proven energy efficiency measures and are backed by robust quality assurance protocols to better ensure realization of energy savings. These savings mean the owner is in a better position to cover other payments and obligations, including the property's mortgage.

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?*

Answer: As described above, San Francisco helps educate applicants to San Francisco's PACE program about the range of financial incentives available to them, including rebates and other financing options. However, it is important to recognize that San Francisco implemented its PACE program in response to widespread interest in PACE from its constituents, including property owners and contractors that install PACE improvements. These constituents believe that PACE is necessary to accelerate the adoption of clean energy projects. The California Legislature made a similar finding when it authorized special assessments to be used to provide financing for PACE improvements.

In California, the advantages of PACE financing over other conventional forms of financing include the following: (i) it provides property owners 100% financing of a PACE improvement over its useful life; (ii) the security features embedded in applicable law attract affordable market rate financing; and (iii) the full amount of the special tax obligation is not due on sale because it is an obligation of the property, rather than the property owner.

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?*

Answer: See response to Question 8 below.

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?*

Answer: The California Legislature and San Francisco believe that PACE will accelerate the installation of clean energy projects and, as a result, accelerate the environmental benefits achieved by PACE improvements. Many of our constituents, including contractors who install PACE improvements and have been frustrated by the absence of affordable financing for clean energy projects, share this expectation. Unfortunately, the FHFA's Statements effectively halted San Francisco's residential PACE program, so San Francisco cannot offer empirical data on this point.

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?*

Answer: San Francisco's PACE program complies with all applicable consumer protection laws, which, in the residential context, is expected to result in disclosure and protections (including the three-day rescission right) on par with those required to be provided by lending institutions that finance home improvements.

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?*

Answer: Property owners decide whether to install PACE improvements, and San Francisco makes it clear in its program materials that property owners are responsible for installation, operation and maintenance of the PACE improvements they decide to install. However, as described above, San Francisco (i) provides financing for only a limited set of PACE improvements (generally, those energy improvements that are eligible for rebates from the State of California), (ii) requires the improvements to be installed by a licensed contractor, and (iii) encourages applicants to participate in San Francisco training sessions. The training sessions provide information to potential applicants details about the PACE program, how it was created, terms and conditions for participation, the availability of other financial incentives, as well as general information about the benefits of energy efficiency and renewable energy.

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?*

Answer: See the answer to Question 10.

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?

Answer: See the answer to Question 10. In addition, San Francisco’s PACE program is designed to emphasize “best practice” building improvements that directly help the home perform from an energy standpoint (e.g. sealing the envelope, adding insulation, repairing or replacing leaky ducts, etc.). These types of projects do not require servicing and maintenance; in fact, they reduce maintenance and repair needs, prevent building deterioration, and increase building longevity and usability. Other equipment upgrades and installations, from basic furnaces to solar photovoltaic systems, are backed by the same contractor and manufacturer warranties as any other projects would be. Contractors and projects are subject to the quality assurance protocols of reputable programs such as Building Performance Institute (BPI) standards, utility rebate programs, and City building permit and inspections processes.

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?*

Answer: See the answer to Question 10.

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?*

Answer: Please see the answer to Question 2 for a summary of San Francisco’s underwriting standards, including standards related to creditworthiness of property owners and loan-to-value ratios, and other features of San Francisco’s PACE program. Please also see the answer to Question 9.

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?*

Answer: Please see the answer to Question 2 for a summary of San Francisco’s underwriting standards and other program features that impact whether a property will qualify for PACE financing from San Francisco.

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 pre-existing 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?*

Answer: Please see the answer to Question 2.