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The Real Estate Roundtable

March 26, 2012

Mr. Alfred M. Pollard, General Counsel
Attention: Comments/RIN 2590-AA53
Federal Housing Finance Agency
Eighth Floor
400 Seventh Street, S.W.
Washington, D.C. 20024

Re: *PACE Financing Programs*

Dear Mr. Pollard:

On behalf of The Real Estate Roundtable, I am pleased to provide these comments on the Advanced Notice of Proposed Rulemaking (“ANPRM”) published at 77 Fed. Reg. 3958 (Jan. 26, 2012), regarding “Mortgage Assets Affected by PACE Programs.”

Background on The Real Estate Roundtable

The Real Estate Roundtable (www.rer.org) brings together leaders of the nation’s top publicly-held and privately-owned real estate ownership, development, lending and management firms with the leaders of major national real estate trade associations, to jointly address key national policy issues relating to real estate and the overall economy. By identifying, analyzing and coordinating policy positions, The Roundtable’s business and trade association leaders seek to ensure a cohesive industry voice is heard by government officials and the public about real estate and its important role in the global economy. Collectively, Roundtable members’ portfolios contain over 5 billion square feet of office, retail and industrial properties valued at more than \$1 trillion; over 1.5 million apartment units; and in excess of 1.3 million hotel rooms. Participating trade associations represent more than 1.5 million people involved in virtually every aspect of the real estate business.

Commercial Real Estate Economic Conditions

The ANPRM requests input on Property Assessed Clean Energy (PACE) programs to underwrite “retrofit” upgrade projects for improved energy and water efficiency in existing buildings. The Roundtable is a leading advocate for policies that save building owners and tenants money on utility bills, enhance America’s energy independence, and minimize the carbon footprint of our built environment. PACE programs have the potential to achieve all of these laudable goals with up-front, off-balance sheet financing for retrofit projects. Building owners, investors, lenders, and mortgagees can all stand to gain from this platform as deployed in particular transactions. However, the ANPRM must be placed in context of the vastly greater asset financing challenges presently confronting the commercial real estate sector, which pose broad economic implications far beyond the narrow purview of PACE.

The Roundtable's most recent "Sentiment Survey" for 1Q-2012 suggests that this year will see some improvements in capital availability for real estate financing.¹ But such advances are compared to record lows from the Great Recession, and expectations for improved liquidity are largely restricted to major urban "gateway" markets and Class A assets. There is a clear, bifurcated division between the "haves" and "have-nots" in U.S. real estate in terms of prospects for equity and debt financing, as well as underlying asset value. Moreover, the Government Accountability Office (GAO) reports that as much as \$1.7 trillion in commercial real estate mortgages are expected to mature between 2011 and 2015, with about half of that held at banks – and up to 60% of this maturing debt is "underwater" with outstanding loans exceeding asset values.² Issuance of commercial mortgage-backed securities (CMBS), a key source of commercial real estate credit, is only beginning to recover from near-zero issuance levels in 2009.

Thus, as waves of commercial mortgages come due in the next several years, and as the "equity gap" must be filled between outstanding loans and depressed property values, the need for capital to refinance maturing debt has serious implications for our national and international economies. The banking and real estate sectors must focus policy makers on strategies to unleash constrained financing capacity in great sums. There is no silver-bullet in the regard, and PACE programs could play some role in an "all of the above" strategy to help improve asset values and spur more lending activity – while also making buildings energy efficient. But a vibrant *retrofit financing* market will not arise until our country has a functioning *financing* market – in major urban gateways as well as secondary locales, and across all commercial real estate asset classes.

With that larger economic perspective, The Roundtable appreciates this opportunity to comment on the ANPRM.

PACE-Specific Points

Litigation against FHFA, Fannie Mae, and Freddie Mac, over advisories stating that the Government-Sponsored Enterprises ("GSEs") would not purchase residential mortgages encumbered by outstanding first-lien PACE obligations, prompted the ANPRM's issuance. Although PACE commercial real estate programs are neither directly implicated in the lawsuit nor are they the ANPRM's immediate focus, any future federal PACE announcements could have impacts outside of the single-family residential stock. We thus offer these comments with an eye toward PACE platforms that may apply to commercial and large multifamily properties:

¹ Released Feb. 23, 2012 (available at http://www.rer.org/Q1_2012_Sentiment_Index_News_Release.aspx).

² GAO-11-489, "Banking Regulation – Enhanced Guidance on Commercial Real Estate Risks Needed," May 2011, at p. 18 (available at <http://www.gao.gov/new.items/d11489.pdf>).

- **As a voluntary program to finance retrofits of private buildings, PACE is unlike other common forms of tax assessment financing.**

PACE programs provide a means of voluntary, opt-in financing where building owners, banks, and investors may determine that tax bill financing is appropriate in any given case to underwrite upgrade projects to enhance particular assets. The Roundtable is not aware of any PACE program that *mandates* use of tax-based financing to retrofit buildings, and we would oppose such an approach if it exists.

“Special tax” or “special assessment” districts are common tools in municipal finance, where a government body issues a bond to fund projects such as streetlights, utility lines, roads, sewer lines, or open space. On a district-wide basis, property owners use such infrastructure and thus repay the bond through assessments secured by a property lien and paid as an addition to their tax bill.

Some PACE advocates maintain that tax assessments associated with building retrofits are no different than other common municipal assessments. The Roundtable disagrees. We caution FHFA to distinguish between public *use* of community infrastructure as compared to potential *benefits* that may accrue from a private building retrofit that reduces energy consumption. The PACE model is viable only to the extent that individual property owners voluntarily choose to add the costs of energy efficiency improvements to their own tax bill, which is unique as to their own buildings. Any PACE-wide assessment district must not be structured where increased tax burdens are spread among *all* property owners, including those who do not elect to pursue PACE-financed retrofits.

- **Consent from existing mortgagees is key to first-lien PACE programs.**

First-lien PACE programs that subordinate an existing mortgage holder’s security interest in collateral may increase the financial risks borne by the GSEs, banks, investors, and borrowers.³ Yet, we do not believe FHFA and the GSEs should issue a blanket directive to prohibit, in all instances, purchases of mortgages with PACE obligations in a prime position on an asset. Rather, there may be given circumstances where a borrower negotiates with a first mortgagee to procure consent for a superior PACE lien.

The Roundtable believes that consent from prior mortgagees, if it can be procured by property owner seeking retrofit tax financing, is critical to the success of PACE programs with existing senior-lien structures. Mortgage lien priority is a universal principle in the United States which is written into deeds of trust and other mortgage documents including Fannie Mae’s uniform security instruments, and recorded against property title. Likewise, where mortgages are securitized, the underlying pooling and servicing agreements (which dictate how bundled loans will

³ Properties that are not encumbered by mortgages or other debt may see a real benefit in PACE programs. In these cases, owners can get access to up-front capital for building efficiency upgrades, pay it back via tax assessments over time, and need not worry about whether any prior lien holders must provide consent to the PACE transaction. Of course, if a property has no debt, ordinary financing would likely be available for any asset improvement which is economically justified, including improvements for energy efficiency in which the premise is that the financing will be paid over time with the resulting energy savings.

be serviced, and bondholders' rights and priorities and shares of gains and losses) without exception prohibit subordination of senior liens by those in junior position, without the senior lien holders' permission.

According to the Federal Reserve, there is over \$13.5 trillion of commercial, residential, and other property mortgages⁴ on the balance sheets of banks, life insurance companies, pension funds, individuals, and others in the form of whole loans or securities. In the case of either stand-alone or pooled mortgages, any law authorizing lien jumping would set a terrible precedent and massively disrupt the balance sheets of mortgage and mortgage bond owners. Further, property owners could find themselves in breach of contract if they unilaterally allowed a PACE lien to occupy a more favorable position on the asset to the detriment of the bank or investors who provided mortgage proceeds in the first instance. The mere execution of a PACE contract could be a breach of the first mortgage if the underlying mortgage documents includes language to preclude the borrower from engaging in actions to the detriment of the prior mortgagee's rights. First-lien PACE programs can only work where building owners seek and procure consent from first mortgagees that otherwise hold superior collateral interests.

Admittedly, requiring a property owner to obtain consent from a prior mortgagee may pose significant obstacles to widespread use of PACE programs. The pursuit of energy efficiency retrofits is an important goal and wholly supported by The Roundtable and its members.⁵ This objective, however, must not be achieved at the expense of placing property owners in a breach of contract situation, forcing prior mortgage holders to subordinate their collateral interests without opportunities to provide consent for (or receive notice of) a superior PACE lien, and disrupting the \$13.5 trillion mortgages which are assets on the books of American financial institutions, pension funds, and investors worldwide.

As a practical matter, the relative ease for home and building owners to obtain first mortgagee consent will vary. Anecdotally, for example, commercial real estate firms owning and managing large asset portfolios who have a transactional history with institutional lenders may be in a better bargaining position to obtain consent for PACE liens, compared to a home owner who must pursue one-off negotiations with a mortgage lender. In the case of securitized loans, a property owner considering PACE financing would likely approach the mortgage servicer for consent – but whether a servicer would even have authority to allow a PACE lien to “jump ahead” on a particular asset, or whether it would ever be in the servicer's financial interest to spend the time and effort to conduct due diligence to consent to a superior PACE lien, are important questions that require further analysis by FHFA and the GSEs.

⁴ “Mortgage Debt Outstanding” for all property holders, based on Federal Reserve System 2011Q3 figures: <http://www.federalreserve.gov/econresdata/releases/mortoutstand/current.htm>.

⁵ Roundtable members are at the vanguard of innovation in the energy efficiency arena and are proven leaders on retrofit projects that save money on utility bills and lower consumption. The current chair of our Sustainability Policy Advisory Committee is responsible for the groundbreaking retrofit at the Empire State Building: http://www.esbnyc.com/sustainability_energy_efficiency.asp. Thirteen Roundtable members are among the key corporate partners in the Obama Administration's “Better Building Challenge” (<http://www4.eere.energy.gov/challenge/partners/better-buildings>). Our leaders also have a history of “sustained excellence” and as “partners of the year” in the EPA ENERGY STAR program (http://www.energystar.gov/index.cfm?fuseaction=pt_awards.showawardlist&year=2012).

The Roundtable believes that borrowers, lenders and investors should at least be given the chance to determine if their interests align in specific cases to favor PACE financing for building enhancements. Indeed, even though a prior collateral interest may be subordinated in a given case, the lender may nonetheless benefit from a PACE retrofit if the asset's underlying appraised value results in a net increase due to the energy efficiency upgrade (as offset by overall project costs). In short, FHFA should create policies that provide transacting parties the opportunity to make the business case for PACE financing in specific instances for particular buildings.

- **FHFA and the GSEs should develop guidelines for when mortgagee consent for PACE liens may be appropriate.**

Rather than a blanket prohibition to preclude the GSEs' purchase of mortgages encumbered by first-position PACE obligations, The Roundtable recommends that FHFA develop guidelines for appropriate conditions whereby a prior mortgagee may consent to property tax retrofit financing. As the next public comment phase following this ANPRM, FHFA should propose "consent guidelines" for further stakeholder input. The U.S. Department of Energy's May 10, 2010 "Guidelines for Pilot PACE Financing Programs" is a good place to start.⁶ FHFA and the GSEs should tailor DOE's guidelines to more specifically address appropriate circumstances where a lender may offer consent for first-lien PACE financing. Such considerations should effectively operate as underwriting standards to limit mortgagee, investor and borrower risks in the event of default, as follows:

- (1) recording PACE obligations in accord with applicable state lien laws and procedures, so title insurers, appraisers, prospective purchasers, and other stakeholders can be notified of additional energy retrofit tax assessments;
- (2) educating building owners that they must obtain consent of prior mortgagees to allow first-position PACE liens to attach to the property;
- (3) notice to first mortgagees and other prior lien holders when energy efficiency improvements are funded using a PACE assessment;
- (4) minimum debt to income levels of the borrower, as impacted by the added increment of PACE assessments to current monthly principal, interest, tax, and insurance payments;
- (5) non-acceleration in the event of foreclosure, so that building owners are only responsible for PACE assessments in arrears and not for all future tax amounts to cover total retrofit project costs;
- (6) minimum levels of value relative to outstanding mortgage or other debt on a building eligible for tax financing efficiency improvements;
- (7) allowable maximum thresholds for the percent of the PACE assessment (not more than 10%), relative to the amount of any mortgage or other debt on an eligible building;
- (8) analysis of historic and anticipated occupancy levels and rental income of an eligible building;
- (9) whether a retrofit will be undertaken by third-party contractors that will guarantee energy savings to result from the efficiency upgrade;
- (10) enabling building owners to decide for themselves the best mix of retrofit strategies for their assets, through a technology-neutral program that does

⁶ Available at http://www1.eere.energy.gov/wip/pdfs/arra_guidelines_for_pilot_pace_programs.pdf.

- not support financing for specific products, manufacturers, or technologies;
- (11) requiring the package of PACE financed improvements are designed to pay for themselves over the life of the assessment, and assurance that the term of the PACE assessments do not exceed the useful life of the improvements;
 - (12) requirements that the retrofit project incorporate protocols to measure and verify energy savings; and
 - (13) requirements that the amount of PACE financing are net of any rebates, tax incentives, or other proceeds assembled to underwrite retrofit costs.

FHFA and the GSEs should consider these factors and further propose a standard first mortgagee consent or release document in the next round of public comment on this matter. Similarly, as much as feasible and possible, DOE should propose standardized analyses and models for projected energy savings to result from a retrofit as compared to PACE repayment schedules. While lenders must not be compelled to respond to a borrower's request for PACE consent, standard forms and analyses will better socialize the PACE platform in the banking and investor communities, and focus stakeholders on those conditions where it may be appropriate to provide the necessary consent to bring a retrofit tax financing deal to fruition.

- **FHFA, the GSEs, and other federal agencies should support retrofit financing models and tools that do not have lien-priming features like most PACE programs.**

Of course, PACE's prime lien feature is precisely what attracts retrofit investors. A secondary, unsecured position on an asset presents greater financial risks that understandably dampen enthusiasm in the retrofit finance community. As the ANPRM notes, however, legislation in Maine, New Hampshire, Oklahoma, and Vermont provides that a PACE lien does not subordinate a first mortgage on the subject property. It thus behooves policy makers to consider how efficiency financing programs may be structured in a way that simultaneously mitigates risks of subordinated retrofit financiers, while also preserving the first mortgagee's prime collateral position.

The Roundtable thus encourages efforts like the "Green Refinance Plus" program of Fannie Mae and the U.S. Department of Housing and Urban Development (HUD).⁷ Under this program, funds are provided for energy efficiency retrofits of older affordable housing properties in Fannie Mae's or the Federal Housing Administration's portfolio. Green Refi Plus uses Fannie Mae's underwriting requirements to generate additional proceeds for energy retrofits, in addition to refinancing a project's outstanding loan balance. As the added increment for efficiency upgrades is wrapped-up in the context of overall building refinancing from a single lender, the dueling interests of first mortgagees and second-in-time retrofit investors inherent to most PACE platforms are not a concern.

⁷Available at http://portal.hud.gov/hudportal/HUD?src=/press/press_releases_media_advisories/2011/HUDNo.11-106.

Policy makers should explore how the Green Refi Plus structure can apply throughout the commercial and market-residential stock. As noted above, as much as \$1.7 trillion of commercial real estate loans are expected to become due between 2011 and 2012. Refinance could be an ideal point of entry into the commercial retrofit market, and federal programs should consider how to take advantage of these opportunities to incent upgrades in our nation's commercial buildings.

To that end, The Roundtable has long advocated that the Department of Energy's current loan guarantee program, enacted as Title XVII in the 2005 Energy Policy Act, should be mobilized to provide private sector credit enhancement for building retrofits. We believe that existing Title XVII authorities can be deployed to assist building retrofit projects – which are far less expensive and pose much lower financial and performance risks compared to renewable and nuclear projects that have been the focus of DOE's financing programs to date. In any event, legislation has been introduced in both the Senate and House to explicitly provide DOE with loan guarantee authority for energy efficiency building retrofits.⁸ DOE loan guarantees could be structured along the lines of Green Refi Plus, to provide federal backing only for the increment of proceeds to underwrite a retrofit that are issued as part of a comprehensive building refinance. Or, DOE loan guarantees could be structured to support PACE programs where retrofit debt takes second-position to the security interests of first-in-time mortgagees. In either event, federal credit support for building retrofits can be expected to leverage far greater amounts of private sector financing to spur a more vibrant retrofit market.

Additionally, The Roundtable encourages reforms to the current tax deduction for energy efficient commercial buildings at Section 179D of the Internal Revenue Code. This incentive was also passed as part of the 2005 Energy Policy Act, but has fallen short of its potential to encourage whole-building efficiency improvements in a meaningful way. In brief, the 179D incentive should be modified so it spurs technology-neutral retrofit projects by rewarding actual gains in building energy efficiency performance; provide a sliding scale of incentives, with greater rewards at the top end for major efficiency improvements that are realized; and adapted so that real estate investment trusts (REITs), limited liability partnerships, and other real-estate holding structures with minimal ability to benefit from tax incentives can allocate the award to project stakeholders that can actually use the benefit.

An analysis completed by The Real Estate Roundtable, U.S. Green Building Council, and Natural Resources Defense Council estimates that over 117,000 jobs can be created by modest reforms to the DOE loan guarantee program and the 179D tax deduction, to gear them to incent retrofits of existing buildings.⁹ Whether these measures are stand-alone or complements to PACE programs, they must be priorities as the Administration and Congress consider policies to boost employment, lower energy consumption, and minimize greenhouse gas emissions.

⁸ See S. 1000, "Energy Security and Industrial Competitiveness Act" (passed Senate Energy and Natural Resources Committee by 18-3 vote on July 14, 2011; available at <http://thomas.loc.gov/cgi-bin/query/z?c112:S.1000>); H.R. 4017, "Smart Energy Act" (introduced on Feb. 14, 2012; available at <http://thomas.loc.gov/cgi-bin/query/z?c112:H.R.4017>).

⁹ "A New Retrofit Industry," available at <http://www.c4bb.org/issues/jobs/>.

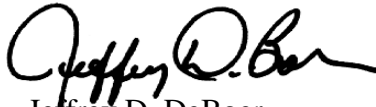
Mr. Alfred M. Pollard
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- **Conclusion**

To conclude, PACE programs may someday be a useful means for property owners to finance efficiency project costs without bearing up-front capital expenses. But PACE is not a panacea, and uptake of retrofit tax financing will continue to pose significant challenges in the great majority of cases where properties are already encumbered by pre-existing mortgage and other debt. Nonetheless, FHFA should refrain from pronouncements that seriously undermine the PACE platform. The Roundtable encourages FHFA and the GSEs to establish guidelines that give building owners, lenders, and investors the chance to “work it out” and explore whether first-mortgagee consent allowing a superior PACE lien may be obtained in a given circumstance in light of transaction-specific conditions.

The Real Estate Roundtable appreciates this opportunity to provide comments. For additional information, please contact Duane Desiderio, Vice President and Counsel (ddesiderio@rer.org; (202) 639-8400).

Sincerely,

A handwritten signature in black ink, appearing to read "Jeffrey D. DeBoer". The signature is fluid and cursive, with the first name being the most prominent.

Jeffrey D. DeBoer
President and CEO