



Federal Housing Finance Agency

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Honorable Dan Lungren
U.S. House of Representatives
Washington, D.C. 20515

Honorable Mike Thompson
U.S. House of Representatives
Washington, D.C. 20515

Honorable Nan Hayworth
U.S. House of Representatives
Washington, D.C. 20515

RE: Property Assessed Clean Energy (PACE) Programs

Dear Representatives Lungren, Thompson and Hayworth:

Thank you for your letter regarding Property Assessed Clean Energy (PACE) programs. As the Federal Housing Finance Agency (FHFA) currently is in litigation regarding PACE programs, the Acting Director asked that I respond to your request for information.

As to your first request regarding data and financial modeling for safety and soundness determinations, FHFA's analysis was based on its investigation of PACE legislation and programs in line with prudential standards of regulation employed by the Agency and by other financial services regulators. This does not require rulemaking analysis and no rule was involved, rather the agency took note of the problems that PACE programs present and determined that it would be unwise for the regulated entities to be placed at risk by mortgages impacted by such programs. Indeed, existing Fannie Mae and Freddie Mac guidelines permit acceleration of mortgages where a superior lien is created following their purchase of a mortgage, such as the situation with PACE loans. While no econometric modeling was involved, information regarding PACE programs, discussions with PACE supporters and meetings with the Department of Energy and financial regulators led to the agency's conclusions.

An overview of the principal considerations supporting our determinations is set forth below:

PACE programs create several problems for those originating mortgages, for those in the secondary market that purchase such mortgages and for those investing in mortgage backed securities. PACE programs, through which governmental units extend credit to individual homeowners for energy retrofits, create a first lien that subordinates existing first mortgage liens. Thus, existing credit extensions are adversely affected by a subsequent credit extension that is placed in a senior lien position. This subordination transfers financial risk to the existing mortgage-lien holder; in the case of Fannie Mae and Freddie Mac this risk may be borne by taxpayers.

PACE programs have been deployed without adequate consumer protections and safeguards that, combined with a priority lien position, heighten the possibility of default and loss to creditors and securities investors. The lack of a centralized set of underwriting standards and a centralized enforcement administration places homeowners and their creditors at risk. Legislative proposals citing a May 7, 2010 statement of prudent best practices prepared by the Department of

Energy fail to recognize that (1) the statement is not a full set of consumer protections; (2) the best practices are not mandatory and have no oversight or enforcement entity; and (3) the best practices contemplate collateral-based lending, which contributed to the financial crisis. High interest rates on these loans, few programs with robust consumer protections and increasing debt-to-income ratios for borrowers in a troubled economy present significant safety and soundness concerns.

Finally, news articles have questioned the incremental value PACE-funded retrofits may add to the underlying property, particularly in the context of higher-cost retrofits. While some claim a dollar-for-dollar savings for homeowners, some have indicated homeowners will face increased costs for several years and a higher debt-to-income ratio. Although the increased costs associated with the PACE loan remain fixed and certain over the term of the obligation, the level of utility-cost savings will vary based on a number of volatile and unpredictable factors, including future energy prices. Further, if a home is placed on the market several years after a PACE-funded retrofit has been installed, but before the PACE obligation has been extinguished, intervening technological advances may lead potential homebuyers to prefer other similar houses with more current energy-efficiency technology— or even houses with no retrofits (since current technology could be adopted without the cost of removing and disposing of an obsolete retrofit) — thereby negatively affecting the value of the home with the PACE-funded retrofit. Finally, difficulty in assessing the value of energy retrofits, absent national standards, makes the work of appraisers and inspectors difficult, work that is critical to credit decisions.

As to your second request for our basis of characterizing PACE programs as lending or loan programs, our basis is found on the websites of many PACE programs and in certain states' legislative enactments on PACE. In all of these contexts, the extensions of credit are called loans, have a term for repayment, have an interest rate, in some cases have versions of Truth in Lending Act disclosures crafted by local counties and do not fit traditional assessments as to purpose or requirements. As to community benefit, the loans go to individual homeowners and are not maintained or repaired by or otherwise within the control of the government entity to the benefit of the community. Special assessments for a public purpose seldom have a "tax" increase that may amount to 10-40% of home value and most have a public purpose established by long precedent and experience. Moreover, the environmental benefits PACE proponents set forth are framed as "global" in nature, while traditional assessments create benefits limited to and able to be associated with a particular community.

As to your third request for a perspective on H.R. 5766, introduced in the 111th Congress, the bill presents a number of problems that remain unresolved. In general, the bill supports a first lien, cited above, that presents a major transfer of risk to existing mortgage holders, including small banks, larger institutions, secondary market parties and investors in mortgage backed securities.

Section 2(a) calls for the adoption of underwriting standards by Fannie Mae and Freddie Mac that would be consistent with the Department of Energy guidelines of May 2010. As noted above these guidelines are not complete or robust, particularly in light of the Dodd Frank Act's emphasis on borrower ability to repay, and there exists no enforcement or oversight of such standards. Underwriting standards are not the core issue, they already exist in banking regulations and even in the Dodd Frank Act. Finally, FHFA made DOE aware of the flaws in its guidelines

and Congress was made aware of these deficiencies, yet no responsive revisions have been made to the guidelines. More critically, DOE is not in the business of setting financial standards or providing consumer and lender protections. Ironically, the language of the bill provides a clear reflection of the transfer of risk to existing mortgage holders, noting that the unpaid tax assessment and “applicable penalties, interest and costs” are subject to foreclosure priority. While this section purports to limit harm to lenders to a fixed amount, the bill does not address the key point raised earlier that lenders may lose money not only on the outstanding taxes, let alone fees, charges and penalties, but as well on the value of a home that may decline if energy improvements have not been maintained or are deemed obsolete by a subsequent purchaser.

Section 2(b) prohibits discrimination if a PACE program exists. This language is so broad and vague that almost any legitimate denial of credit— for example, for lack of income or bankruptcy— could become a court test of whether the “real” reason for denial of credit was the existence of a PACE program.

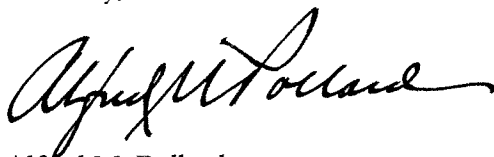
Section 2(c) defines a PACE program as property assessed clean energy program to finance installation of renewable energy and energy efficiency improvements, but sets no efficiency standards applicable to various types of property and geographic locations or form of equipment, leading that to a patchwork of county and municipality interpretations.

FHFA and the regulated entities remain committed to energy conservation and extending credit for appropriate lending programs. The regulated entities have a number of products in this area. The PACE program remains problematic and FHFA has been disappointed that some program advocates appear unwilling to seek alternatives that, as the Council on Environmental Quality indicated, would do no harm to homeowners or to lenders. Of note, several states have supported an approach to support lending for retrofits without the problems presented by PACE programs.

I believe that I have addressed the questions you posed and I remain ready to address these and any other questions you may have. My phone is 202 414 3788 and email is alfred.pollard@fhfa.gov.

With all best wishes, I am

Sincerely,

A handwritten signature in black ink, appearing to read "Alfred M. Pollard". The signature is fluid and cursive, with a long, sweeping tail on the final letter.

Alfred M. Pollard
General Counsel