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PACE and the Federal Housing Finance Agency (FHFA)

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The FHFA regulates Fannie Mae, Freddie Mac, and the 12 Federal Home Loan Banks (the government-sponsored enterprises – GSEs). On June 18, 2009, James B. Lockhart III, then Director of FHFA, released a letter expressing concern about the negative impact of energy loan tax assessment programs (ELTAPs) – also known as Property Assessed Clean Energy (PACE) programs – on both the housing finance system and homeowner program participants.

Subsequently, a number of PACE proponents responded to the concerns laid out in the FHFA letter. In early Fall 2009, word circulated that FHFA was planning to follow its June letter with guidance to other agencies, possibly including Fannie Mae and Freddie Mac, discouraging them from buying loans on properties subject to PACE-type assessment liens. This triggered a second round of stakeholder letters, several of which were addressed to President Obama.

On October 18, 2009, the White House, in what some believe was an attempt to obviate the need for FHFA guidance, released a Policy Framework for PACE Financing Programs that outlined best practices guidance for homeowner and lender protection.

As of February 2010, FHFA and the GSEs have agreed to monitor PACE programs and work with stakeholders and the Administration to consider additional guidance beyond the Policy Framework and to collect more information on PACE program efficacy and risks. A summary of the communications timeline and highlights of the communications are provided below. [1]

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FHFA-related Communications Timeline

June 18, 2009-*Letter from FHFA Director James Lockhart III to National Governors Association, National Association of Credit Union Supervisors, National Conference of State Legislatures, American Association of Residential Mortgage Regulators, and Conference of State Bank Supervisors*

July 30, 2009-*PACE Program Group Letter to FHFA*

August 3, 2009-*United States Senate letter to FHFA*

August 6, 2009-*Director James Lockhart resigned as FHFA Director; Edward Demarco appointed Acting Director*

September 18, 2009-*Fannie Mae Lender Letter to all Fannie Mae single-family sellers and servicers*

October 12, 2009-*Letter from State of California Attorney General Edmund Brown, Jr (written by Deputy Attorney General Janill Richards) to James Lockhart III*

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October 13, 2009-*Letter from Boulder County Board of Commissioners to President Barack Obama*

October 13, 2009-*Letter from New Mexico Governor Bill Richardson to President Barack Obama*

October 18, 2009-*White House Releases "Policy Framework for PACE Financing Programs"*

October 29, 2009-*Letter of response from Federal Housing Finance Agency (FHFA) Acting Director Edward J DeMarco to State of California Deputy Attorney General Janill Richards*

Letter Summaries and Links

June 18, 2009-Letter from FHFA Director James Lockhart to National Governors Association, National Association of Credit Union Supervisors, National Conference of State Legislatures, American Association of Residential Mortgage Regulators, and Conference of State Bank Supervisors

Director Lockhart urged careful consideration of the unintended consequences of ELTAPS (a.k.a. PACE Financing Programs). He argued that the effect of the superior lien status of PACE assessments to existing first mortgages is to impair the value of the first mortgage to creditors and subsequent holders as well as to create risks for homeowners. Highlighted risks included:

Homeowner Risks

- Additional potential for the loss of a home through a tax sale or foreclosure due to larger debt burden
- Negative impact on home marketability, reduced consumer choice if lenders limit products offered in market with ELTAP legislation, higher interest rates, high origination and application fees, fraud and long repayment periods which could exceed the useful life of the energy improvements.

Lender Risks

- Poor PACE loan underwriting process that may ignore prudent underwriting standards
- Lender avoidance of ELTAP districts.

- Post mortgage closing increase of debt forces lenders to take this risk into account when deciding whether and in what fashion to make new mortgages and refinancing available.

July 30, 2009-PACE Program Group letter to FHFA

This letter (signatories below) responded in detail to Mr. Lockhart's concerns about ELTAP risks. It argued that land-secured financing is neither new nor particularly risky, and that existing PACE programs should not be held to a new standard. It went on to highlight mechanisms that PACE programs have to protect property owners and lenders not mentioned in FHFA's June letter and to point out that the offsetting energy savings cash flow from PACE-financed improvements makes these programs likely to provide greater protection to property owners, lenders, and the secondary mortgage market than a standard special tax or assessment district.

Key Points

- PACE programs are not the first to use land-secured financing districts to finance privately owned improvements with a public purpose
- Congress and the President supported PACE financing programs by amending federal tax law and by authorizing tax credit subsidies for PACE bonds in The American Recovery and Reinvestment Act of 2009. In addition, the U.S. Department of Energy, U.S. Environmental Protection Agency and the U.S. Department of Housing and Urban development have hosted workshops and trainings for cities interested in setup up PACE financing programs
- The majority of improvements made through PACE programs will offer immediate energy savings and have a positive net present value. In addition, there are a host of indirect costs-many of which are externalized- that may be avoided through widespread adoption of energy efficiency improvements.
- PACE programs do not ignore prudent underwriting standards, and have robust safeguards
- PACE programs do not impair the value of first mortgages to creditors and any subsequent holder of first mortgages
    - Financed improvements will increase the value of the property, and that is particularly true with PACE as it reduces the cost of operating the assessed properties
    - Special tax and assessment liens are already part of the standard underwriting criteria in the U.S.
- Concern about the impact on existing lenders of foreclosure of PACE liens should be muted as, unlike a mortgage, in most jurisdictions PACE taxes/assessments are not accelerated in the event of delinquency (only the amount of delinquent tax/assessment installments not the entire cost of the financed improvements is due)

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Signatories:
Gavin Newsom, Mayor, City of San Francisco, CA--Chuck Reed, Mayor, City of San Jose, CA--Rodney A Dole, Auditor-Controller-Treasurer-Tax Collector, Sonoma County, CA--Alice Lai-Bitker, President, Alameda County Board of Supervisors--Tom Bates, Mayor, City of Berkeley, CA--Henry Gardner, Executive Director, Association of Bay Area Governments--Ann Livingston, Sustainability Coordinator, Boulder County, CO Commissioners Office--Patrick Conlon, Director, Office of Energy Management, City of Palm Desert, CA

August 3, 2009-United States Senate letter to FHFA

Senators Bernard Sanders, Jeff Merkley, Michael Bennet, Jeff Bingaman, and Mark Begich sent a letter to FHFA Director Lockhart urging FHFA to support state and local governments in their efforts to use ELTAPs to

finance residential energy efficiency and renewable energy improvements. They asked that FHFA work expeditiously with states and localities to resolve concerns and allow these entities to move forward in implementing these critical programs.

September 18, 2009-Fannie Mae Lender Letter to all Fannie Mae single-family sellers and servicers

This letter noted that Fannie Mae is reviewing its underwriting guidelines to determine appropriate requirements in jurisdictions that have enacted legislation establishing ELTAPs. The letter stated that until such guidelines are issued, lenders should treat ELTAPs as any tax or assessment that may take priority over Fannie Mae's lien.

October 12, 2009-Letter from State of California Attorney General Edmund Brown, Jr (written by Deputy Attorney General Janill Richards) to James Lockhart III

In this response to FHFA's June 18, 2009 letter, the California Attorney General's office noted that local governments implementing PACE programs in California have successfully worked with a number of lenders, including the reverse home mortgage program for seniors operated by the Department of Housing and Urban Development, and that this cooperation suggests that FHFA's concerns may be overcome through proper PACE program design. The letter went on to question FHFA's concern that PACE assessments would take priority over existing first lien mortgages given that special taxes and assessments that take priority over existing first lien mortgages have long been used by local governments. Lastly, the letter argues that proper education, outreach, and oversight will obviate homeowner "risk" resulting from such things as increased debt; negative impact on marketability of homes; and potential fraud by ensuring that PACE programs result in net economic benefits to homeowners, improved property values, and full protection for homeowners (through, e.g., permitting of work and monitoring).

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October 13, 2009-Letter from Boulder County Board of Commissioners to President Barack Obama

This letter was written after the Boulder County Board of Commissioners learned that FHFA was proposing to follow up its June letter with PACE-related guidance to other agencies, potential including Fannie Mae and Freddie Mac. The letter focused on three of Boulder County's particular concerns about the impact of this guidance on the viability of its PACE program.

Acceleration: Boulder County's program requires loan acceleration in the event of default, and the County was advised that removal of assessment acceleration would reduce bond financings below investment-grade and, in doing so, make the program impossible finance.

Energy Audits: Boulder County's program does not require energy audits. It believes these audits create unnecessary administration burdens and costs and are not an effective way to measure the impact of many energy efficiency and renewable energy improvements.

Cost Effectiveness Analyses: Boulder County's program does not require cost effectiveness analyses. The letter argues that they are difficult and costly to perform on individual homes and businesses, and that developing a list of measures that make sense of specific local jurisdictions, as Boulder did, is a better approach

October 13, 2009-Letter from New Mexico Governor Bill Richardson to President Barack Obama

Governor Richardson urged the Administration to fully support PACE programs, including support from FHFA, Fannie Mae and Freddie Mac. He expressed particular concern about indications that FHFA-regulated entities may take action to penalize homeowners that make use of PACE programs by making homes with PACE liens less eligible for GSE mortgages or reducing the amount of mortgage eligibility. He also mentioned concern that

GSEs will break a century of precedent by attempting to restrict local and state government taxation powers by forcing the subordination of tax levies.

October 18, 2009-White House releases Policy Framework for Pace Financing Programs

This document announced Obama Administration support for the use of federal funds for pilot PACE financing programs, and provided a framework of recommended safeguards for homeowners and mortgage lenders.

Homeowner Protections

- Positive savings to investment ratio
- Limit financing to high-value investments
- Quality assurance in retrofit selection and construction

Lender Protections

- Non-acceleration of loan upon delinquency
- Assessment reserve fund
- Length of time for repayment of PACE assessments should not exceed energy efficiency improvement life expectancy

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- Size of financing should generally not exceed 10% of appraised value of the home
- PACE participants must demonstrate clear title to their property
- PACE financing only where no current default exists
- No negative equity financing
- Local governments should not use the PACE model in areas experiencing large home price declines where larger numbers of underwater mortgages may exist
- Homeowners should escrow PACE program payments in situations in which other property taxes/assessments are escrowed

October 29, 2009-Letter of response from Federal Housing Finance Agency (FHFA) Acting Director Edward J DeMarco to State of California Deputy Attorney General Janill Richards

Director DeMarco noted that FHFA has been working with other Federal departments and agencies to identify and promote best practices in this area so that the goals of improved energy efficiency, consumer protection, and prudent lending practices may be aligned. He went on to welcome an opportunity to have his staff work the Attorney General's office to achieve these objectives.