FEDERAL HOUSING FINANCE AGENCY

12 CFR Part 1254

RIN 2590–AA53

Enterprise Underwriting Standards

AGENCY: Federal Housing Finance Agency.

ACTION: Notice of proposed rulemaking; request for comments.

SUMMARY: The Federal Housing Finance Agency (''FHFA'') hereby issues this Notice of Proposed Rulemaking (NPR) concerning underwriting standards for the Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac), (together, the Enterprises) relating to mortgage assets affected by Property Assessed Clean Energy (''PACE'') programs.

The NPR reviews FHFA's statutory authority as the federal supervisory regulator of the Enterprises, reviews FHFA's statutory role and authority as the Conservator of each Enterprise, summarizes issues relating to PACE that are relevant to FHFA's supervision and direction of the Enterprises, summarizes comments received on subjects relating to PACE on which FHFA has considered alternative proposed rules, sets forth FHFA's responses to issues raised in the comments, presents the proposed rule and alternatives FHFA is considering, and invites comments from the public.

DATES: Written comments must be received on or before July 30, 2012.

ADDRESSES: You may submit your comments, identified by regulatory information number (RIN) 2590–AA53, by any of the following methods:

- *Federal eRulemaking Portal: http://www.regulations.gov:* Follow the instructions for submitting comments. If you submit your comment to the *Federal eRulemaking Portal,* please also send it by email to FHFA at *RegComments@fhfa.gov* to ensure timely receipt by FHFA. Please include ''RIN 2590–AA53'' in the subject line of the message.
- *Email:* Comments to Alfred M. Pollard, General Counsel may be sent by email to *RegComments@fhfa.gov.* Please include ''RIN 2590–AA53'' in the subject line of the message.
- *U.S. Mail, United Parcel Service, Federal Express, or Other Mail Service:* The mailing address for comments is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2590–AA53, Federal Housing Finance Agency, Eighth Floor, 400 Seventh Street SW., Washington, DC 20024.
- *Hand Delivered/Courier:* The hand delivery address is: Alfred M. Pollard, General Counsel, Attention: Comments/RIN 2590–AA53, Federal Housing Finance Agency, Eighth Floor, 400 Seventh Street SW., Washington, DC 20024. The package should be logged at the Seventh Street entrance Guard Desk, First Floor, on business days between 9 a.m. and 5 p.m.

FOR FURTHER INFORMATION CONTACT: Alfred M. Pollard, General Counsel, (202) 649–3050 (not a toll-free number), Federal Housing Finance Agency, Eighth Floor, 400 Seventh Street SW., Washington, DC 20024. The telephone number for the Telecommunications Device for the Hearing Impaired is (800) 877–8339.

SUPPLEMENTARY INFORMATION:

Executive Summary

The Federal Housing Finance Agency (''FHFA'') hereby issues this Notice of Proposed Rulemaking (NPR) concerning underwriting standards for the Federal National Mortgage Association (Fannie Mae), and the Federal Home Loan Mortgage Corporation (Freddie Mac), (together, the Enterprises) relating to mortgage assets affected by Property Assessed Clean Energy (''PACE'') programs.

FHFA is an independent federal agency created by the Housing and Economic Recovery Act of 2008 (HERA) to supervise and regulate the Enterprises and the twelve Federal Home Loan Banks (the ''Banks''). FHFA is the exclusive supervisory regulator of the Enterprises and the Banks. Both Enterprises presently are in conservatorship under the direction of FHFA as Conservator.

PACE programs involve local governments providing property-secured financing to property owners for the purchase of energy-related home-improvement projects. PACE programs have been encouraged by investment firms that intend to provide financing for local governments to support their lending programs. Homeowners repay the amount borrowed, with interest, over a period of years through ''contractual assessments'' secured by the property and added to the property tax bill. Repayment goes either to a county or other funding source or to pay principal and interest on bonds. Under most state statutory PACE programs enacted to date, the homeowner's obligation to repay the PACE loan becomes in substance a first lien on the property, thereby subordinating or ''priming'' the mortgage holder's security interest in the property. On July 6, 2010, FHFA issued a Statement concerning such first-lien PACE programs (the Statement), which directed the Enterprises and the Banks to take certain prudential actions to limit their exposure to financial risks associated with first-lien PACE programs. In a directive issued February 28, 2011 (the Directive), FHFA reiterated the direction provided to the Enterprises in the Statement and expressly directed the Enterprises not to purchase mortgages affected by first-lien PACE obligations.

Several parties brought legal challenges to the process by which FHFA issued the Statement and the Directive, as well as to their substance. The United States District Courts for the Northern District of Florida, the Southern District of New York, and the Eastern District of New York all dismissed lawsuits presenting such challenges. The United States District Court for the Northern District of California (the California District Court), however, allowed such a lawsuit to proceed and has issued a preliminary injunction ordering FHFA ''to proceed with the notice and comment process'' in adopting guidance concerning mortgages that are or could be affected by first-lien PACE programs. Specifically, the California District Court ordered FHFA to ''cause to be published in the **Federal Register** an Advance Notice of Proposed Rulemaking relating to the statement issued by FHFA on July 6, 2010, and the letter directive issued by FHFA on February 28, 2011, that deal with property assessed clean energy (PACE) programs.'' The California District Court further ordered that ''[i]n the Advance Notice of Proposed Rulemaking, FHFA shall seek comments on, among other things, whether conditions and restrictions relating to the regulated entities' dealing in mortgages on properties participating in PACE are necessary; and, if so, what specific conditions and/or restrictions may be appropriate.'' The California District Court also ordered that ''After considering any public comments received related to the Advance Notice of Proposed Rulemaking, * * * FHFA shall cause to be published in the **Federal Register** a Notice of Proposed Rulemaking setting forth FHFA's proposed rule relating to PACE programs.'' The California District Court neither invalidated nor required FHFA to withdraw the Statement or the Directive, both of which remain in effect.

In response to and in compliance with the California District Court's order, FHFA sought comment through an Advanced Notice of Proposed

Rulemaking, published in the **Federal Register** at 77 FR 3958 (January 26, 2012), on whether the restrictions and conditions set forth in the July 6, 2010 Statement and the February 28, 2011 Directive should be maintained, changed or eliminated, and whether other restrictions or conditions should be imposed. FHFA has appealed the California District Court's order to the U.S. Court of Appeals for the Ninth Circuit (the Ninth Circuit). Inasmuch as the California District Court's order remains in effect pending the outcome of the appeal, FHFA is proceeding with the publication of this NPR pursuant to and in compliance with that order. The Ninth Circuit has stayed, pending the outcome of FHFA's appeal, the portion of the California District Court's Order requiring publication of a final rule. FHFA will withdraw this NPR should FHFA prevail on its appeal and will, in that situation, continue to address the financial risks FHFA believes PACE programs pose to safety and soundness as it deems appropriate.

The NPR reviews FHFA's statutory authority as the federal supervisory regulator of the Enterprises, reviews FHFA's statutory role and authority as the Conservator of each Enterprise, summarizes issues relating to PACE that are relevant to FHFA's supervision and direction of the Enterprises, summarizes comments received on subjects relating to PACE on which FHFA has considered alternative proposed rules, sets forth FHFA's responses to issues raised in the comments, presents the proposed rule and alternatives FHFA is considering, and invites comments from the public.

I. Comments

Pursuant to the Preliminary Injunction, FHFA invites comments on all aspects of this NPR. Copies of all comments will be posted without change, including any personal information you provide, such as your name and address, on the FHFA Web site at *https://www.fhfa.gov.* In addition, copies of all comments received will be available for examination by the public on business days between the hours of 10 a.m. and 3 p.m. at the Federal Housing Finance Agency, Eighth Floor, 400 Seventh Street SW., Washington, DC 20024. To make an appointment to inspect comments, please call the Office of General Counsel at (202) 649–3804.

II. Background

A. FHFA's Statutory Role and Authority as Regulator

FHFA is an independent federal agency created by HERA to supervise and regulate the Enterprises and the Banks. 12 U.S.C. 4501 *et seq.* Congress established FHFA in the wake of a national crisis in the housing market. A key purpose of HERA was to create a single federal regulator with all the authority necessary to oversee Fannie Mae, Freddie Mac, and the Banks. 12 U.S.C. 4511(b)(2).

The Enterprises operate in the secondary mortgage market. Accordingly, they do not directly lend funds to home purchasers, but instead buy mortgage loans from original lenders, thereby providing funds those entities can use to make additional loans. The Enterprises hold in their own portfolios a fraction of the mortgage loans they purchase. The Enterprises also securitize a substantial fraction of the mortgage loans they purchase, packaging them into pools and selling interests in the pools as mortgage-backed securities. Traditionally, the Enterprises guarantee nearly all of the mortgage loans they securitize. Together, the Enterprises own or guarantee more than $5 trillion in residential mortgages.

FHFA's ''Director shall have general regulatory authority over each [Enterprise] * * *, and shall exercise such general regulatory authority * * * to ensure that the purposes of this Act, the authorizing statutes, and any other applicable law are carried out.'' 12 U.S.C. 4511(b)(2). As regulator, FHFA is charged with ensuring that the Enterprises operate in a ''safe and sound manner.'' 12 U.S.C. 4513(a). FHFA is statutorily authorized ''to exercise such incidental powers as may be necessary or appropriate to fulfill the duties and responsibilities of the Director in the supervision and regulation'' of the Enterprises. 12 U.S.C. 4513(a)(2). FHFA's Director is authorized to ''issue any regulations or guidelines or orders as necessary to carry out the duties of the Director * * *.'' *Id.* 4526(a). FHFA's regulations are subject to notice-and-comment rulemaking under the Administrative Procedure Act.

B. FHFA's Statutory Role and Authority as Conservator

HERA also authorizes the Director of FHFA to ''appoint the Agency as conservator or receiver for a regulated entity * * * for the purpose of reorganizing, rehabilitating or winding up [its] affairs.'' *Id.* 4617(a)(1), (2). On September 6, 2008, FHFA placed Fannie Mae and Freddie Mac into conservatorships. FHFA thus ''immediately succeed[ed] to all rights, titles, powers, and privileges of the shareholders, directors, and officers of the [Enterprises].'' *Id.* 4617(b)(2)(B).

In its role as Conservator, FHFA may take any action ''necessary to put the regulated entity into sound and solvent condition'' or ''appropriate to carry on the business of the regulated entity and preserve and conserve the assets and property of the regulated entity.'' *Id.* 4617(b)(2)(D). The Conservator also may ''take over the assets of and operate the regulated entity in the name of the regulated entity,'' ''perform all functions of the entity'' consistent with the Conservator's appointment, and ''preserve and conserve the assets and property of the regulated entity.'' *Id.* 4617(b)(2)(A), (B). The Conservator may take any authorized action ''which the Agency determines is in the best interests of the regulated entity or the Agency.'' *Id.* 4617(b)(2)(J). ''The authority of the Director to take actions [as Conservator] shall not in any way limit the general supervisory and regulatory authority granted'' by HERA. 12 U.S.C. 4511(c).

HERA also provided for assistance by the U.S. Department of the Treasury in the event that financial aid was needed by an Enterprise. On September 7, 2008, the Treasury Department executed Senior Preferred Stock Agreements (SPSAs) to provide such assistance following the imposition of conservatorships by FHFA. A purpose of the agreements was to maintain the Enterprises at a level above the statutory level of ''critically undercapitalized,'' which would trigger receivership and remove the Enterprises from providing market services as was the purpose of the conservatorships. In effect, the Enterprises maintain nominal positive net worth through the infusion of taxpayer funds by the Treasury Department; losses the Enterprises incur increase the draws they make under the SPSAs and the concomitant burden on taxpayers.

C. Issues Relating to PACE Programs Relevant to FHFA's Supervision and Direction of the Enterprises

PACE programs provide a means of financing certain kinds of home-improvement projects. Specifically, PACE programs generally permit local governments to provide financing to property owners for the purchase of energy-related home-improvement projects, such as solar panels, insulation, energy-efficient windows, and other technologies. Homeowners agree to repay the amount borrowed, with interest, over a period of years through ''contractual assessments'' paid to the municipality and often added to their property tax bill. Over the last three years, more than 25 states have enacted legislation authorizing local governments to set up PACE-type programs. Such legislation generally leaves most program implementation and standards to local governmental bodies and, but for a few instances, provides no uniform requirements, standards, or enforcement mechanisms.

In most, but not all, states that have implemented PACE programs, the liens that result from PACE program loans have priority over mortgages, including pre-existing first mortgages.[1] In such programs, the PACE lender ''steps ahead'' of the mortgage holder (*e.g.,* a Bank, Fannie Mae, or Freddie Mac) in priority of its claim against the collateral, and such liens ''run'' with the property. As a result, a mortgagee foreclosing on a property subject to a PACE lien must pay off any accumulated unpaid PACE assessments (*i.e.,* past-due payments) and remains responsible for the principal and interest payments that are not yet due (*i.e.,* future payments) on the PACE obligation. Likewise, if a home is sold before the homeowner repays the PACE loan, the purchaser of the home assumes the obligation to pay the remainder. The mortgage holder is also at risk in the event of foreclosure for any diminution in the value of the property caused by the outstanding lien or the retrofit project, which may or may not be attractive to potential purchasers. Also, the homeowner's assumption of this new obligation may itself increase the risk that the homeowner will become delinquent or default on other financial obligations, including any mortgage obligations.[2]

Funding for PACE programs may come from local funds, grants, bond financing, or such other device as is available to a county or municipality. PACE programs generally anticipate that private-sector capital would flow through the local government to the homeowner-borrower (or the homeowner-borrower's contractors). While PACE programs may vary in the particular mechanisms they use to raise capital, in many instances private investors would provide capital by purchasing bonds secured by the payments that homeowner-borrowers make on their PACE obligations. From the capital provider's perspective, a critical advantage of channeling the funding through a local government, rather than lending directly to the homeowner-borrower or channeling the funds through a private enterprise, is that the local government utilizes the property-tax assessment system as the vehicle for repayment. Because of the ''lien-priming'' feature of most PACE programs authorized to date, the capital provider effectively ''steps ahead'' of all other private land-secured lenders (including mortgage lenders) in priority, thereby minimizing the financial risk to the capital provider while downgrading the priority and ultimate collectability of first and second mortgages, and of any other property-secured financial obligation.

Proponents of first-lien PACE programs have analogized the obligations to repay PACE loans to traditional tax assessments. However, unlike traditional tax assessments, PACE loans are voluntary and have other features not typical of tax assessments—homeowners opt in, submit applications, and contract with the city or county's PACE program to obtain the loan and repay it. Each participating property owner controls the use of the funds, selects the contractor who will perform the energy retrofit, owns the energy retrofit fixtures, and bears the cost of repairing the fixtures should they become inoperable, including during the time the PACE loan remains outstanding. PACE program loans are repaid and end on a set term determined for the specific PACE assessment. In contrast, the duration for or the number of installments for many other assessments for municipal improvements for a locality or a special assessment district are not specific to the affected parcel or property but are instead aggregated across all affected properties based on the structure of the bond or other financing vehicle. Further, each locality sets its own terms and requirements for homeowner and project eligibility for PACE loans; no national standards exist, nor, in many instances, are all standards uniform even for programs within the same state. Nothing in existing PACE programs requires that local governments adopt and implement nationally uniform financial underwriting standards, such as minimum total loan-to-value ratios that take into account either: (i) Total debt or other liens on the property; or (ii) the possibility of subsequent declines in the value of the property. Many PACE programs also fail to employ standard personal creditworthiness requirements, such as limits on credit scores or total debt-to-income ratio, although some include narrower requirements, such as that the homeowner-borrower be current on the mortgage and property taxes and not have a recent bankruptcy history.

Some local PACE programs communicate to homeowners that incurring a PACE obligation may violate the terms of their mortgage documents.[3] Similarly, some cities and counties provide forms that participants can use to obtain the lender's consent or acknowledgment prior to participation.[4] State laws may or may not be specific on whether such loans must be recorded.

The first state statutes authorizing PACE programs were enacted in 2008. As PACE programs were being considered by more states, FHFA began to evaluate the potential impact of these programs on the asset portfolios of FHFA-regulated entities. On June 18, 2009, FHFA issued a letter and background paper raising concerns about first-lien PACE programs. To better understand the risks presented by PACE programs to lenders and the Enterprises as well as borrowers, FHFA met over the next year with PACE stakeholders, other federal agencies, and state and local authorities around the country.

On May 5, 2010, in response to continuing questions and concerns about PACE programs, Fannie Mae and Freddie Mac issued advisories (Advisories) to lenders and servicers of mortgages owned or guaranteed by the Enterprises.[5] The May 5, 2010 Advisories referred to Fannie Mae's and Freddie Mac's jointly developed master uniform security instruments (USIs), which prohibit liens senior to that of the mortgage.[6]

[1] In at least four states—Maine, New Hampshire, Oklahoma, and Vermont—legislation provides that the PACE lien does not subordinate a first mortgage on the subject property. FHFA understands that under legislation now pending in Connecticut, PACE programs in that state also would not subordinate first mortgages.

[2] In many PACE programs, the allowable amount of a loan is based on assessed property value and may not consider the borrower's ability to repay. States have considered permitting loan levels of 10% to 40% of the assessed value of the underlying property.

[3] *See, e.g.,* Yucaipa Loan Application at 2–3, 10, *http://www.yucaipa.org/cityPrograms/EIP/PDF_Files/Application.pdf* (last visited Jan. 12, 2012); Sonoma Application at 2, *http://www.sonomacountyenergy.org/lower.php?url=reference-forms-new&catid=603* (document at ''Application'' link) (last visited Jan. 12, 2012).

[4] Sonoma Lender Acknowledgement, *http://www.sonomacountyenergy.org/lower.php?url=reference-forms-new&catid=606* (pp. 4–7 of document at ''Lender Info and Acknowledgement'' link) (last visited Jan. 12, 2012).

[5] Fannie Mae Lender Letter LL–2010–06 (May 5, 2010), *available at https://www.efanniemae.com/sf/guides/ssg/annltrs/pdf/2010/ll1006.pdf;* Freddie Mac Industry Letter (May 5, 2010), *available at http://www.freddiemac.com/sell/guide/bulletins/pdf/iltr050510.pdf.*

[6] The relevant provision appears in Section 4. *See, e.g.,* Freddie Mac Form 3005, California Deed of Trust, *available at http://www.freddiemac.com/uniform/doc/3005-CaliforniaDeedofTrust.doc;* Fannie Mae Form 3005, California Deed of Trust, *available athttps://www.efanniemae.com/sf/formsdocs/documents/secinstruments/doc/3005w.doc.*

Shortly after the Advisories were issued, FHFA received a number of inquiries seeking FHFA's position.[7] On July 6, 2010, FHFA issued the Statement, which provided:

> [T]he Federal Housing Finance Agency (FHFA) has determined that certain energy retrofit lending programs present significant safety and soundness concerns that must be addressed by Fannie Mae, Freddie Mac and the Federal Home Loan Banks. * * *
>
> First liens established by PACE loans are unlike routine tax assessments and pose unusual and difficult risk management challenges for lenders, servicers and mortgage securities investors. * * *
>
> They present significant risk to lenders and secondary market entities, may alter valuations for mortgage-backed securities and are not essential for successful programs to spur energy conservation.[8]

The Statement directed that the Advisories ''remain in effect'' and that the Enterprises ''should undertake prudential actions to protect their operations,'' including: (i) Adjusting loan-to-value ratios; (ii) ensuring that loan covenants require approval/consent for any PACE loans; (iii) tightening borrower debt-to-income ratios; and (iv) ensuring that mortgages on properties with PACE liens satisfy all applicable federal and state lending regulations. However, FHFA directed these actions on a prospective basis only, directing in the Statement that any prohibition against such liens in the Enterprises' USIs be waived as to PACE obligations already in existence as of July 6, 2010.

On February 28, 2011, following additional inquiries from the public, PACE supporters, and PACE opponents, the Conservator issued a Directive stating the Agency's view that PACE liens ''present significant risks to certain assets and property of the Enterprises—mortgages and mortgage-related assets—and pose unusual and difficult risk management challenges.'' FHFA thus directed the Enterprises to ''continue to refrain from purchasing mortgage loans secured by properties with outstanding first-lien PACE obligations.'' *Id.*

III. Summary of Responses to the Advance Notice of Proposed Rulemaking

A. Volume and General Nature of Comments

In response to the Advance Notice of Proposed Rulemaking of January 2012 (the ''ANPR'') issued pursuant to the Preliminary Injunction, FHFA received a large number of comments. Some 33,000 comments were short, one- or two- page, organized-response submissions, usually termed ''form letters.'' Some additional 400 comments came in the form of substantive response letters that fell into several categories that are described herein. Samples of the form letters and several hundred other comments were posted to FHFA's Web site.[9] FHFA notes that the majority of comments did not respond directly to the questions presented in the ANPR, a number responded directly to only a few questions, and only a few responded to all the questions.

1. Organized-Response Form Letters

The 33,000 organized-response form letters fell into five categories of comments, samples of which were posted to the FHFA Web site. Generally, these comments included support for PACE programs, noting their contribution to energy efficiency, environmental benefits, job creation, and other economic or climate benefits. The comments called for FHFA to withdraw its July 2010 directive. Others included assertions that PACE programs represent assessments, like those made by local governments for years, that they are not loans, and that these assessments pose ''minimal'' risks to lenders, investors, and homeowners. Some cited guidelines from the Council on Environmental Quality (CEQ),[10] the U.S. Department of Energy (DOE),[11] and legislation proposed in Congress regarding PACE programs (most frequently to legislation pending in the U.S. House of Representatives as H.R. 2599, the ''PACE Assessment Protection Act of 2011''). These comments contained little supporting information or results of any testing or data, and were generally limited to information from certain homeowners of their experiences with PACE programs or expressions of general support for such programs. The comments in the ''prepared input'' responses almost uniformly called on FHFA to change its position to permit the Enterprises to purchase such loans encumbered by PACE loans that created liens with priority over first mortgages.

2. Substantive Responses

The roughly 400 substantive responses (*i.e.,* submissions other than form letters) took various approaches. Most but not all expressed support for PACE programs. Some expressed only limited or qualified support for PACE programs, and a few expressed opposition to or reservations about first-lien PACE programs.

B. Specific Issues Raised in Comments

1. Financial Risks First-Lien PACE Programs Pose to Mortgage Holders and Other Interested Parties

Many commenters addressed the extent of incremental financial risk first-lien PACE programs pose to mortgage holders and other interested parties; some such submissions included direct responses to Questions 2 and 3 of the ANPR. PACE proponents generally asserted that first-lien PACE programs pose little, if any, incremental financial risk to mortgage holders. Examples of such submissions include the following:

- Letters submitted by Rep. Nan Hayworth and several other members of Congress, and by Sen. Michael Bennet and several other U.S. Senators each asserted that ''PACE assessments present minimal risks to lenders.''
- The Town of Babylon, NY reiterated that it had previously communicated to FHFA its view that: ''If you revisit and reevaluate the potential of ELTAPs {PACE obligations}, we believe you'll find they will enhance the value of participating homes and, in fact, reinforce, rather than 'impair', the first mortgages. In reality, these programs will help homeowners stay in their houses by reducing their utility bills while providing a hedge against rising energy costs in the future. Consider that if 5% of houses whose mortgages are guaranteed by Fannie Mae and Freddie Mac were retrofitted through Green Homes programs, the dollar amount would add up, approximately, to an infinitesimal 0.3% of the total guaranteed by Fannie and Freddie.''
- Sonoma County, CA asserted that ''There is no demonstrable risk to the Enterprises from the existing PACE programs; instead, it appears that the Enterprises are enjoying increased security on loans they own because of the added value of the improvements (over $45 million in Sonoma County); with de minimus exposure to risk on any individual project.'' The County also asserted that ''Participants in the PACE program have low tax

[7] Letter from Edmund G. Brown, Jr. to Edward DeMarco (May 17, 2010); Letter from Edmund G. Brown, Jr. to Edward DeMarco (June 22, 2010). These letters are available for inspection upon request at FHFA.

[8] FHFA Statement on Certain Energy Retrofit Loan Programs (July 6, 2010), *available at http://www.fhfa.gov/webfiles/15884/PACESTMT7610.pdf.*

[9] The comments can be viewed at *http://www.fhfa.gov/Default.aspx?Page=89* (1/26/2012 ''Mortgage Assets Affected by (Property Assessed Clean Energy) PACE Programs'' link).

[10] Council on Environmental Quality, Middle Class Task Force, Recovery Through Retrofit (October 2009), *available at http://www.whitehouse.gov/assets/documents/Recovery_Through_Retrofit_Final_Report.pdf.*

[11] Department of Energy, Guidelines for Pilot PACE Financing Programs (May 7, 2010) (hereinafter, ''DOE Guidelines''), *available at http://www1.eere.energy.gov/wip/pdfs/arra_guidelines_for_pilot_pace_programs.pdf.*

delinquency rates and low mortgage default rates. The PACE improvements add extra value, and thus extra security, to the mortgage.'' The County further asserted that it ''does not believe PACE assessments impose any additional risk on mortgage holders or investors in mortgage-backed securities. In fact, the total value of improvements, compared to the risk of possible default or delinquency, almost certainly leaves such investors better protected over all.''

- The Natural Resources Defense Council asserted that ''Even if we assume, against the weight of existing evidence, that the existence of a PACE lien on a property does create an incremental risk to mortgage holders, it can be shown that this risk is de minimis. If a property owner whose home is valued at $300,000 with a $250,000 mortgage is seeking $20,000 in PACE financing, at an interest rate of 7% and a 20-year assessment period, the annual PACE assessment would be $1,960. In the event of foreclosure, under the law of California and most states, and under the DOE Guidelines, only the amount of the PACE payment in arrears would be due and take priority over the first mortgage. Thus, if the owner had failed to pay their property taxes for a year, only $1,960 would be owed, and the new owner would be responsible for the remaining stream of assessments. Assuming an extremely high foreclosure rate of 10% across the Enterprises' portfolio of mortgages on properties with PACE financings and one year of delinquency on the assessment, the risk of loss to existing lenders from PACE liens would average $196 per home across the portfolio of PACE-financed properties. Assuming a more reasonable foreclosure rate of 5%, the risk to existing lenders from PACE liens across the PACE-financed portfolio would average less than $100 per home.''
- The Great Lakes Environmental Law Center asserted that ''The lien-priming feature of first-lien PACE obligations lowers the financial risks borne by holders of mortgages affected by PACE obligations or investors in mortgage-backed securities based on such mortgages. * * * PACE reduces Fannie Mae and Freddie Mac's exposure to risk and loss by encouraging private, market driven solutions for our nation's mortgage industry.''
- The Office of the Mayor of the City of New York noted that funding alternatives to PACE programs, such as utility bill financing, do not work because of high customer turnover and that PACE programs avoid this problem as the obligation runs with the land. The comment urged FHFA to adopt reasonable underwriting standards. The comment stated that, contrary to FHFA's statement that PACE liens lack ''traditional community benefits associated with taxing initiatives,'' PACE liens do provide community benefits such as improved air quality and aiding in the fight against climate change. Further, the letter noted that PACE default rates are ''vanishingly small.''
- The City of Palm Desert, CA asserted that ''The lien-priming feature of first-lien PACE obligations does not adversely affect the financial risks borne by holders of mortgages affected by PACE obligations or investors in mortgage-backed securities if appropriate underwriting standards and program designs are implemented. Indeed, given proper PACE program design, the financial risks borne by such mortgage holders may actually be decreased.''
- Placer County, CA asserted that ''[T]he installation of PACE improvements is anticipated to reduce property owners' utility costs (offsetting the contractual assessment installments), increases their property's value, and allows them to hedge themselves against rising fuel prices.'' The County also stated that ''the FHFA [should] 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 * * * may purchase or insure a mortgage loan secured by a property that is encumbered by a PACE lien. * * *''. The letter noted that PACE programs present no greater risks than other assessments: ''The County has levied taxes and assessments to achieve important public purposes, such as the construction of schools, the installation of water and sanitary sewer systems and the undergrounding of public utilities, for more than 100 years. * * * PACE is a safe and sound financing mechanism for energy retrofitting the country's existing building stock.''
- Leon County, FL asserted that ''PACE programs increase property values, [and] they essentially provide an 'extra layer' of scrutiny on the borrower and the improvements proposed, because most programs, including LEAP, require positive cash flow. In short, PACE programs like LEAP will not authorize financing, and thus establish priority liens, on risky properties or property owners.'' The County further stated that its PACE program ''has minimized the financial risk to the holder of any mortgage interest because the specific types of information in the audit are prescribed to assure the estimated utility savings are known and the return on investment is fully disclosed to the applicant.''
- The Environmental Defense Fund asserted that ''PACE will simultaneously mitigate other, more significant risks'' such as energy price increases, ''to yield a net decline in the chance of mortgage default.''

Many such submissions provided little if any analysis to support such assertions, while others proffered discussion of some or all of the subjects noted below in paragraphs (a) through (e).

Other commenters asserted that first-lien PACE programs would pose material incremental financial risk to mortgage holders. For example,

- Freddie Mac asserted that ''The priority lien feature of many PACE programs has the impact of transferring the risk of loss, without compensation or underwriting controls, from the PACE lender to the mortgage lenders and investors who have neither priced for, nor accepted the risk * * *. In virtually all cases, our recovery in the event of a default would be lower than if the PACE loan did not have a priority lien. Potential losses to Freddie Mac could be substantial and would include payment of the outstanding loan amount, expenses associated with the possible extension of the foreclosure process, and the impact of the encumbrance on the resale value of the property.''
- Fannie Mae asserted that ''There are significant risks associated with PACE Programs because of the potential to increase the frequency and severity of credit losses to Fannie Mae (or any other mortgage loan investor), as well as other possible adverse consequences for borrowers. The most significant risks derive from the lien priority of PACE loans, potential increases in loss severity as a result of PACE loans, and increases in credit risk because of the limited assessment of a borrower's ability to repay a PACE loan.''
- The Federal Home Loan Bank of NY asserted that ''The automatic priority lien status typically granted to PACE lending undermines not only the FHLBNY member-lenders' lien priority but also therefore, the FHLBNY's pre-established lien priority which presents a key disruption to well-established first mortgage home lending.''
- The Joint Trade Association (American Bankers Association *et al.*) asserted that ''The lien-priming feature of first-lien PACE obligations greatly increases the credit exposure of mortgage-backed securities, to mortgage investors, taxpayers, and mortgage markets themselves. Mortgage investors rely on their lien position. Losing it

unknowingly, in exchange for nothing, substantially harms the value of mortgage investments. The GSEs so dominate the mortgage market today that losses from super-lien loans would be heavily concentrated in two GSEs.''

• The National Association of Realtors asserted that ''The presence or potential presence of a PACE loan, taking the first lien position ahead of the mortgage, invariably leads to the devaluation of the mortgage as a secured asset.''

• The National Association of Home Builders (NAHB) noted that first lien PACE programs would alter ''the valuations for mortgage-backed securities by increasing the severity of loss to the mortgage lender in the event a mortgage goes to foreclosure and the lender is obligated to pay past-due amounts outstanding on the PACE lien.''

• The National Multi Housing Counsel and National Apartment Association comment stated, ''First lien matters are fundamental and must be addressed if Property Assessed Clean Energy (PACE) programs are to move forward. As our industry relies on non-recourse loans subject to property cash-flow, protecting the lien holder interest is critical to maintaining cost-effective liquidity in the market. Any cloud on the lien through debt or local tax provisions that jeopardize the first lien could have material implications on a broad basis.''

• SchoolsFirst Federal Credit Union stated that ''The concern which we have with PACE relates to the lien-priming feature which typically attaches to these programs. In the event of foreclosure, this lien-priming could have a significant adverse impact on the holder of the first mortgage on the secured property. This is particularly true in the current market.'' The Credit Union further stated that ''short of obtaining a blanket insurance policy to insure against this risk (and assuming that one is available) we can think of no other protections short of retiring the lien * * *.''

• The Federal Home Loan Bank of Indianapolis noted that alteration of lien priority ''after the fact could have an adverse impact on the valuation of the Bank's collateral in jurisdictions with PACE programs, forcing the Bank to apply loan market value adjustments * * *.''

a. Effects of PACE–Funded Projects on the Value of the Underlying Property

Many commenters asserted that PACE-funded projects would add value to the underlying property, and suggested that such incremental value would protect mortgage holders. Such comments generally did not, however, assert that the purported increase in property value would exceed the amount of the PACE obligation. For example,

• Renewable Funding asserted that ''Numerous studies show that energy efficiency and renewable energy improvements increase a home's value.'' Renewable Funding's submission asserts that ''An April 2011 study of 72,000 homes conducted by the Lawrence Berkeley National Laboratory * * * showed an average $17,000 sales price premium for homes with solar P[hoto]V[oltaic] systems,'' and ''Another 2011 study published in the Journal of Sustainable Real Estate of homes with Energy Star ratings showed purchase prices to be nearly $9.00 higher per square foot for energy efficient homes.''

• Placer County, CA asserted that ''Efficiency and comfort generated from PACE improvements increase property value. A study by Earth Advantage Institute concluded that new homes certified for energy efficiency sold for 8% more than non-certified new homes, and existing homes with energy certification sold for 30% more during the period May 2010–April 2011. (*See* Commenter's Exhibit 1, *Banks may overlook value of energy efficiency, Harney, August 26, 2011, Tampa Bay Times.*).'' The County also asserted that ''There is wide recognition that the cost savings and comfort from PACE-type improvements adds value to property. A recent survey (*See* Commenter's Exhibit 1) of reliable sources identifies increased value related to PACE-type improvements. This survey did not find any instance of decreased value caused by PACE-type improvements.''

• Sonoma County, CA stated that it ''is not aware of *any* evidence that energy efficiency and renewable energy improvements cause a decline in property value'' and asserted that several ''studies support the conclusion that these improvements add value to property.''

• The Board of County Commissions for Leon County, Florida asserted that ''The overwhelming weight of the data reflects that energy efficiency and renewable energy improvements reduce homeowners' energy costs and increase property values. The State of Florida long has recognized the increase in property values caused by the installation of renewable energy projects.''

• Chris Fowle, a member of Environmental Entrepreneurs asserted that ''PACE can further reduce risk to existing lenders by improving the value of their properties. Numerous studies show that energy efficiency and renewable energy improvements increase a home's value. For example, an April 2011 study of 72,000 homes by the Lawrence Berkeley National Laboratory showed that homes with solar PV systems had an average $17,000 sales price premium.''

• California State Senator Fran Pavley and California Assembly member Jared Huffman asserted that, with energy efficiency retrofits, ''[p]roperty values go up, strengthening owners' financial position and increasing the value of a lender's collateral.''

• The City of Palm Desert, CA asserted that ''Studies have shown that energy efficiency and renewable energy measures increase a home's value. For instance, a 2011 statistical study published in the *Journal of Sustainable Real Estate* of homes with ENERGY STAR ratings showed purchase prices to be $8.66 higher per square foot than non-ENERGY STAR homes in the study area. An April 2011 statistical study of 72,000 California homes by the Lawrence Berkeley National Laboratory concludes that there is strong evidence that homes with photovoltaic (PV) systems in California have sold for a premium over comparable homes without PV systems, corresponding to a premium of approximately $17,000 for a 3,100 watt PV system. * * *''

• The Sierra Club asserted that ''Clean energy improvements often provide substantial increase in resale value to homes, thus lessening risk to homeowners.''

Other commenters questioned the net effect of PACE projects and liens on the value of the collateral available to protect mortgage holders. For example:

• Freddie Mac asserted that ''we are not aware of reliable evidence supporting a conclusion that energy efficiency improvements increase property values in an amount equal to the cost of the improvement. Rather, our experience with other home improvements suggests that any increase in property values is likely to be substantially less than such cost, meaning that homeowners who take on PACE loans are likely to increase the ratio of their indebtedness relative to the value of their properties.''

• The Joint Trade Association asserted that ''PACE loans decrease the value of the property by encumbering it with a lien. Non-equity forms of financing do not do so. * * * The cost of home improvements, energy-related or otherwise, are very often not reflected in the property's market value.'' The Association stated that in some states the ten percent fee permitted to localities for administering a PACE loan is subtracted from the financed amount, potentially making the ''entire retrofit purchase a net financial loss to homeowners.'' The letter challenged an assertion by PACE supporters that home values increase ''$20 for each $1 in annual energy savings.'' The source of the statement was attributed to a 1998 study, conducted at a time when home costs were much greater; the comment considered the study, given current market conditions, to be obsolete.

Additional commenters asserted that market conditions and data limitations have made it difficult or impossible to determine the net effect of PACE-financed projects on the underlying property. For example:

- The U.S. Department of Energy noted that FHFA had expressed concern about ''The potential impact of PACE on residential property values.'' DOE then asserted that ''there is insufficient data and analysis available to provide conclusive answers.''
- Representatives of Malachite, LLC and Thompson Hine LLP asserted that ''Single-family home values remain in too great a state of flux to perform 'apples-to-apples' valuations of retrofitted versus non-retrofitted buildings,'' and ''additional research is necessary to more accurately determine the effect of energy-efficiency and green features on home values across a variety of markets and residential price points.''
- The National Association of Realtors asserted that ''Many markets are still determining what, if any, value green features add to real property,'' and that ''it is unclear at best whether the resulting improvements add enough value to compensate for the additional risks.''

b. Cash-Flow Effects of PACE-Funded Projects

Many commenters asserted that PACE programs are cost-effective and, if they are administered with the proper standards, a homeowner's PACE obligations would be offset by cost savings leading to increased free cash flow over the life of the project, thereby purportedly enhancing the borrower's ability to repay financial obligations and reducing the financial risk to mortgage holders. Such comments included responses to Questions 1, 2, 3, and 4 set forth in the ANPR. Examples of these comments include the following:

- Sonoma County, CA asserted that it ''strongly encourages applicants to engage a trained auditor to evaluate the most economic, cost-effective measures that can be taken to achieve the property owner's desired energy savings. Properly sized projects result in no additional annual cost to the property owner, and overall should achieve cost savings.''
- Placer County, CA asserted that: ''The installation of PACE improvements is anticipated to reduce property owners' utility costs (offsetting the contractual assessment installments), increases their property's value, and allows them to hedge themselves against rising fuel prices.''
- Boulder County, CO asserted that ''Savings: Because energy efficiency and renewable energy improvements reduce homeowners' energy bills, they are inherently safe investments for homeowners and lenders. * * * Cost Effective: Projects must pay for themselves by having a savings-to-investment ratio greater than one (SIR >1).''
- Renovate America stated ''homeowners already spend the equivalent of 25% of their mortgage payments on utility bills. With the PACE lien, at least to start, the payments should generally be offset by utility bill savings, so there is little or no increase in their overall expenses. Over time, the savings should increase as the utility rates increase, and the PACE lien has the potential to increase the homeowner's income or cash flow, not the reverse.''

Most such comments were not accompanied by supporting data, but instead relied upon the assumption that PACE-funded projects that are anticipated to provide cash-flow benefits will actually deliver those benefits.

Some comments recognized that the actual cash-flow effects of PACE-funded projects depend upon future contingencies.

- Leon County, FL stated that ''As energy prices are expected to rise for the foreseeable future, the difference between the cost of improvements and energy savings should widen positively. At the extremes, while a dramatic reduction in energy prices might negatively affect the cost/benefit analysis for energy efficient product purchases, a dramatic reduction in energy prices likely would make it easier for homeowners to afford mortgage payments through increased cash on hand and an improving economy. On the other hand, a dramatic increase in energy prices, which is more plausible than a dramatic reduction, would place a premium on energy efficient products and homes.''
- The City of Palm Desert, CA asserted that ''This strong upward trend'' in energy prices ''indicates that the risk of changes in energy prices adversely affecting the projected savings-to-investment ratio is relatively low. If anything, this data indicates that the energy prices are likely to change in a way that positively affects the projected savings-to-investment ration, therefore positively affecting the borrower's cash revenues and the safety and soundness of a mortgage loan.''

Other commenters questioned whether PACE can generate savings sufficient to make the retrofit cost-effective. Examples of these comments include the following:

- The Joint Trade Association asserted that ''Any disclosures about future utility costs are conjecture and are unreliable. It would be more appropriate and more accurate to disclose that any future savings are unknown. If a PACE loan does not produce the savings hoped for, the result is an increased risk of default on the PACE loan, the mortgage, or both because of the increased CLTV, a strong predictor of mortgage default.''
- The Joint Trade Association also asserted that ''PACE loan programs do not require that the loan proceeds be used in a cost-effective manner. * * * The amount of energy savings from one piece of equipment varies from building to building. The cost of electricity varies by location and sometimes by time of day. The cost of fuel can vary seasonally. The amount of electricity that air conditioners use varies by indoor and outdoor temperatures, and it varies during rainfall. A solar panel in sunny regions will produce different savings than one in cloudy areas, or in a location near tall buildings or trees. Its sun exposure varies by the angle at which it is installed. Whether an individual retrofit would be cost-effective would require an engineering analysis, but PACE programs do not require engineering analyses.''
- The National Association of Realtors asserted that ''The energy efficiency and renewable energy investments are designed to 'pay for themselves,' which is to say that the homeowner's utility bill goes down by more than their property tax bill goes up. However, it is difficult to measure the benefits of these improvements because the way an owner uses energy in a home may change over time, depending on variables such as weather and family composition and whether or not the energy efficiency retrofit has become technologically outdated, or was ever as efficient as it was supposed to be.''

c. Effect of Non-Acceleration of PACE Obligations Upon Default or Foreclosure

Many commenters asserted that the fact that PACE obligations do not accelerate upon default or in foreclosure mitigates or eliminates any financial risk first-lien PACE programs would otherwise pose to mortgage holders. The economic reasoning advanced in such comments was generally that because the obligation is assumed by the successor owner, even in a foreclosure the mortgage holder will only be liable for the past-due payments, not the entire obligation. Such comments included responses to Questions 1 and 4 set forth in the ANPR. Examples of these comments include the following:

- Boulder County asserted that ''Non-Acceleration'' was a positive feature of PACE because ''Future, unpaid PACE assessments remain with a property upon sale or other transfer to a new owner, protecting lenders from total extinguishment of unsecured debt or home equity lines in defaults when a home is worth less than its outstanding mortgage balance.''
- Connecticut Fund for the Environment asserted that ''the non-acceleration design of PACE assessments means that in the unlikely case of a default only the amount past due would have seniority on the mortgage. The outstanding balance would remain with the property to be paid in due course.''
- City of Palm Desert, CA asserted that ''In California, payment of PACE assessments may not be accelerated by the local government if there is a delinquency in the payment of the assessment, similar [to] treatment of other property taxes in California. We believe non-acceleration of PACE assessments is [an] important condition for the protection of homeowners, mortgage lenders, and government-sponsored enterprises. Non-acceleration is an important mortgage holder protection because liability for the assessment in foreclosure is limited to any amount in arrears at the time; the total outstanding assessed amount is not due in full, therefore greatly mitigating the effect of the 'lien-priming' feature of the PACE assessment upon mortgage lenders and subsequent investors in mortgage interest.''
- Placer County, CA asserted that ''The County's PACE program also incorporates other safeguards. For example, California law does not permit acceleration of the unpaid principal amount of a contractual assessment; in the event of delinquencies in the payment of contractual assessment installments, the County is authorized to initiate judicial foreclosure of delinquent installments only (plus penalties and interest). This safeguard makes it more affordable for private lienholders to protect their liens in the event the County forecloses delinquent contractual assessment installments.''
- Sonoma County, CA asserted that ''most state laws, including California law, do not allow a local government to accelerate the amount due on an assessment in the event of a delinquency. Only the unpaid, overdue amount would be due. Lenders can protect their interest by paying this amount * * *.''
- The Natural Resources Defense Council explains that its calculations purporting to establish ''de minimis'' risk are based on the premise that ''[i]n the event of foreclosure, under the law of California and most states, and under the DOE Guidelines, only the amount of the PACE payment in arrears would be due and take priority over the first mortgage. Thus, if the owner had failed to pay their property taxes for a year, only $1,960 would be owed, and the new owner would be responsible for the remaining stream of assessments.''
- Florida PACE Funding Agency asserted that it ''does not believe that the PACE assessments in Florida will increase any financial risk to the holder of the mortgage or investors in mortgage backed securities. * * * Since the PACE assessments are not subject to acceleration (unlike many loans) the mortgage holder or investors in mortgage backed securities would look at each year's assessment amount, not the total principal of the assessment.''
- Jonathan Kevles asserted that ''The requirement for non-acceleration of the PACE bond payment in the event of foreclosure makes the downside of foreclosure to mortgage holders negligible.''

Other commenters asserted that the fact that PACE obligations do not accelerate upon default or in foreclosure does not insulate the mortgage holder from risk. Such comments included responses to Question 6 set forth in the ANPR. Examples of these comments include the following:

- The Appraisal Institute asserted that ''From a valuation perspective, it is important to understand whether a seller paid assessment influenced the sales price. The appraiser would have to look at the sales price and decide if the buyer assuming the loan affected the price paid by the buyer. The appraiser must ask whether the buyer paid a higher price because the seller paid off the loan amount. In the converse situation where the buyer assumes responsibility for the assessment, the appraiser would ask, did the buyer pay less because the buyer assumed the loan? * * * This is likely a form of sales or seller concession, and if so, recognized appraisal methodology would deduct this concession dollar for dollar under a 'cash equivalency' basis, or if the market suggests the amount is less than market based on a paired sales analysis, the market-derived adjustment would be applied.''
- Fannie Mae asserted that ''PACE loans would increase the severity of Fannie Mae's losses in the event of foreclosure on the mortgage loan. Subsequent owners of PACE-encumbered properties are liable for continuing payments on the PACE loan. In selling real estate owned (REO), Fannie Mae will need to: (i) Cure any arrearages on the PACE loan and keep it current to convey clear and marketable title to a purchaser; and (ii) in Fannie Mae's opinion, pay off the entire amount of the PACE loan to attract purchasers, given the number of properties on the market which are not encumbered by PACE loans.''
- The Joint Trade Association asserted that ''If a homeowner were to sell the property before the PACE lien is extinguished, the property value would be reduced accordingly, so the homeowner would realize less on the sale * * *. [PACE advocates] also argue[ ] that the PACE lien would be largely immaterial to the GSEs, even in a mortgage foreclosure, because PACE loans do not accelerate upon default. This ignores the fact that the property would retain an unsatisfied PACE lien that diminishes the property value. That diminished value would be a cost to the GSE.''
- The NAHB asserted that ''A home buyer who wants to purchase a home with a PACE first lien is at a disadvantage * * *. Potentially, the home cannot be sold or the sales price might be reduced by the amount necessary to pay off the PACE lien.''

d. Underwriting Standards for PACE Programs

Many commenters asserted that underwriting standards for PACE programs would mitigate or eliminate any financial risk first-lien PACE programs would otherwise pose to mortgage holders. Such comments included responses to Questions 14, 15, and 16 set forth in the ANPR.

- Placer County, CA asserted that ''The FHFA undervalues the measures built into the County's PACE program to protect private lienholders. The FHFA is inappropriately discounting the safeguards built into the County's PACE program. As explained above, the County's underwriting criteria are designed to protect the entire range of County constituents.''
- Sonoma County, CA asserted that ''Like every other PACE program,

Sonoma County has adopted a set of conditions and restrictions for eligibility for PACE programs. These restrictions and conditions appear to work well, and in our view adequately protect the interest of mortgage lenders.''

• The Florida PACE Funding Agency, an interlocal agreement between Flagler County and City of Kissimmee, cites no impact from PACE programs on the regulated entities, cites the legislative history of Florida's PACE statute, notes the ''prequalification'' standards that mirror the core ''consumer'' protections noted by other PACE supporters—no delinquent taxes, no involuntary liens, and no default notice and current on debt—and that lending is limited to 20% of the ''just value'' of the property, an appraised value that is reportedly less than fair market value. Property owners must provide holders or mortgage servicers 30 days prior notice of entering ''into a financing agreement.'' The Agency appended several studies on the attractiveness of energy-efficient properties, with many improvements as part of deferred property maintenance that reduces the impact of a PACE financing, as work would be required in any event. The Agency asserted that its guidelines for entering into a financing agreement is undertaken in a protected environment, noting that Florida's approach ''unlike the enabling legislation in most (if not all) of the other states which authorize PACE type programs, deliberately undertook the adoption of a statutory regimen designed to protect property owners, local governments and mortgage lenders.'' As to alternative programs, the comment letter advances that government grants can be a viable alternative, but that such programs are either not available or not available on a sustainable basis.

• The letters from Senators Bennet, Chris Coons, Jeff Merkley and Mark Udall indicated that while PACE assessments are not loans, and ''reasonable safety and soundness standards can be developed that both encourage widespread use of PACE, but also maintain the security of home mortgage lenders.''

Many such comments suggested that FHFA should adopt certain existing guidance as standards (often Guidelines published by the U.S. Department of Energy or set forth in H.R. 2599) or participate in initiatives with the government and private sector to develop appropriate standards.

• The City of Palm Desert, CA directed FHFA to ''the DOE Guidelines and H.R. 2599, for the factors recommended for eligible PACE financing.''

• Leon County, FL asserted that ''PACE program 'best practices' have been developed that ensure stability and manage risk for both governments and mortgage lenders concerning PACE programs. These best practices include: White House Policies, Department of Energy's ongoing Guidelines for Home Energy Professionals project establishing strong national standards for retrofit work, and efforts by states and local governments to develop their own best practices during PACE program implementation.''

• The Sierra Club asserted that ''DOE issued guidelines for PACE programs on May 7th, 2010 after meeting with Fannie Mae, Freddie Mac, financial regulators and PACE stakeholders. Further standards can be incorporated from H.R. 2599, the PACE Assessment Protection Act of 2011 from the current Congress.''

• The Solar Energy Industries Association indicated support for the DOE and White House guidelines for PACE as well as H.R. 2599. The comment adds that improvements to PACE programs could be made by allowing them to include ''pre-paid purchase agreements'' and leasing programs. For solar energy leasing, SEIA indicated that ''The system owner may be able to provide solar energy for less than it would cost the homeowner to purchase a system outright, thereby needing a lesser PACE lien.'' Both pre-paid purchase agreements and leases ''leave[] the homeowner with no additional costs to pay [for] monitoring, maintenance, and insurance of the system, as these elements are included within a PPA or lease contract.''

• PACE*Now* stated that FHFA ''fails to note that no such 'uniform national standards' exist for any other type of municipal assessment project and ignores the extensive efforts among PACE proponents, the White House, and the U.S. Department of Energy (among others) to do exactly that.'' PACE*Now* then proceeds to endorse standards set forth in H.R. 2599 that would establish certain standards, indicating that ''The risks of lenders and homeowners are clearly intertwined, and PACE programs have and can be designed to mitigate them.'' Similarly, the U.S. Department of Energy notes in a cover letter to its comment letter that it urges FHFA to work with the Department and others to ''ensure that pilot PACE programs are implemented with appropriate safeguards as outlined in the DOE Guidelines for Pilot PACE Financing Programs.''

• The DOE urged FHFA to work with the Department and others to ''ensure that pilot PACE programs are implemented with appropriate safeguards as outlined in the DOE *Guidelines for Pilot PACE Financing Programs.''*

• The Great Lakes Environmental Law Center asserted that ''if federal level conditions and restrictions should be found necessary, the Department of Energy (DOE) has already outlined ten PACE program design best practice guidelines in 2010 that minimize the risk to all parties.''

Other comments suggested specific underwriting criteria that the commenter asserted would be appropriate.

• The City of Palm Desert, CA asserted that ''One important underwriting standard we believe should be included in a national set of underwriting standards is an expected savings-to-investment ratio greater than one. Calculated as estimated savings on the borrower's cash flow due to the energy improvement, divided by the amount financed through the PACE assessment, a projected savings-to-investment ratio of greater than one increases the projected income of the borrower and places a mortgage lender in a more secure position than without the PACE participation.'' The City also asserted that ''In some respects, a projected savings-to-investment ratio for a PACE improvement, while not constituting a guarantee of results, may be more predictable than a borrower's continued level of income over the term of a mortgage,'' and that ''There are very minimal costs attendant to requiring PACE programs to include the protections of a savings-to-investment ratio of greater than one, a maximum term of the PACE assessment not exceeding the reasonably expected useful life of the financed energy improvements, non-acceleration of the PACE assessment, eligibility criteria for improvements that are climate-specific, and a minimum equity requirement such as the 15% requirement in H.R. 2599.''

Some comments asserted that common PACE program underwriting standards may not take into account common indicia of good credit or ability to repay the obligation out of income.

• A joint letter from the National Consumer Law Center and the Consumer Federation of America asserted that PACE underwriting to exclude bankruptcy was inadequate and PACE programs ''are usually not engaging in full underwriting nor assessing the homeowner's actual ability to pay.'' The letter notes that ''PACE proposals would require that estimated energy savings equal or exceed the monthly PACE obligations, but these are estimates only.''

e. Empirical Data Relating to Financial Risk

Many commenters suggested that existing data and metrics support PACE programs, while others asserted that the absence of reliable metrics and data supports the need to implement PACE programs, including as pilot programs.

Submissions by PACE proponents often asserted that the default experience of existing PACE programs suggests that first-lien PACE programs do not materially increase the financial risks borne by mortgage holders. For example:

- Sen. Leahy, Sen. Sanders, and Congressman Welch asserted that ''a study by the American Council for an Energy-Efficient Economy demonstrated that default rates by participants in energy efficiency finance programs are 'extremely low.' ''
- Sonoma County, CA asserted that ''Actual experience of existing programs does not support FHFA's assumption of added risk. Rather, Sonoma County's experience demonstrates that properties enrolled in PACE programs have fewer tax and mortgage delinquencies than the general public * * * The County took the initiative to review any changes in the mortgage status of properties with PACE assessments. Of the 1,459 assessments placed on properties in Sonoma County, only 16 properties showed recorded documents demonstrating uncured mortgage defaults, an average of 1.1%. During the same timeframe (2009 through 2011), the average mortgage delinquency rate in Sonoma County varied from 8% to over 10%. As compared, then, the default rate of properties with a PACE assessment was much lower in comparison with overall properties.'' The County also asserted that ''given the very low tax delinquency rate and mortgage default rate on PACE properties, the County does not believe PACE assessments impose any additional risk on mortgage holders or investors in mortgage-backed securities. In fact, the total value of improvements, compared to the risk of possible default or delinquency, almost certainly leaves such investors better protected over all.''
- City of New York, Office of the Mayor asserted that ''The value of PACE-financed energy installations (less than $9,000 on average, or some 10% of the value of a typical underlying property) relative to residential mortgage debt levels also illustrates the very small risk posed by PACE programs to the senior lien status enjoyed by GSEs and other mortgage lenders. As was noted in the comments of others received in this proceeding, the American Council for an Energy-Efficient Economy conducted a study that demonstrates that default rates by PACE program participants are 'extremely low.' ''
- Jordan Institute asserted that ''Early evidence suggests that there is a very low risk of default for PACE assessments. Since many of New Hampshire's loan programs are in their infancy, it is difficult to obtain true default rate numbers. However, anecdotal evidence in New Hampshire indicates that default rates for energy loans in general are low or non-existent. People's United Bank has a current default rate of 0% for their commercial loan program. Additionally, a study conducted for the New Hampshire legislature showed that neighboring state energy loan programs had default rates much lower than the typical unsecured default rate of 3.5% and concluded that the data shows that, 'the perception that energy loans carry an unacceptable level of risk is incorrect.' ''
- The Natural Resources Defense Council asserted that ''Early data from existing PACE programs appears to support the proposition that energy improvements made through a PACE program will improve the position of the first-mortgage holder. PACE administrators from residential PACE programs in Babylon, New York, Palm Desert, California, Sonoma, California, and Boulder, Colorado, report that of 2,723 properties with PACE liens there have been 24 known defaults, translating to a default rate of 0.88%. In comparison, the national percentage of mortgage loans in foreclosure at the end of the fourth quarter 2011 was 4.38%.''
- Placer County, CA stated that ''A survey of reliable sources (*See* Commenter's Exhibit 1) indicates that there is no evidence to suggest that PACE programs are greater risks than other types of assessments.''
- Leon County, FL asserted that ''In a recent study, the American Council for an Energy-Efficient Economy ('ACEEE') found that energy efficiency financing programs 'have one of the lowest default rates of any loan program.' The ACEEE study analyzed 24 different loan programs and found default rates ranging from zero to three percent, which it noted 'compares very favorably with residential mortgage default rates of 5.67 percent.' ''

Other submissions made reference to studies of mortgage default rates on properties with energy-efficient characteristics that may or may not have been financed through a PACE program.

- Placer County, CA stated that ''According to a report by the Institute for Market Transformation *Removing Impediments to Energy Efficiency from Mortgage Underwriting and Appraisal Policy,* 'Mortgages on Energy Star homes have an 11% lower default and delinquency rate than do comparable mortgages on other homes.' ''

However, some submissions recognized that the lack of a substantial track record for first-lien PACE programs limits the amount of reliable data available.

- The U.S. Department of Energy stated that ''Because there is insufficient data and analysis available to provide conclusive answers, DOE seeks FHFA cooperation to facilitate work with government-sponsored entities in the housing sector that would inform answers with appropriate data analysis.'' DOE further asserted that ''Insufficient data and analysis is available to validate a view that implementation of PACE programs would increase financial risk to mortgage lenders or that it would decrease financial risk to mortgage lenders.''
- The Environmental Defense Fund, in its comment letter, indicated that analytic standards are absent for PACE programs and suggested that FHFA's analysis ''may be hamstrung as a consequence of the lack of analytic standards for projecting, ensuring, and measuring/verifying the anticipated and realized energy savings in residential PACE programs nationwide.'' The comment continued, ''Our experience has led us to identify the lack of uniform, accepted methods as a crucial barrier to such financing by banks in several other sectors, including large commercial buildings and multifamily residential buildings.'' The Fund then explored its efforts in support of an Investor Confidence Project to develop specifications for baseline energy use and other measuring devices and ''a more uniform approach to project engineering [which] can be expected to generate more comparable data, facilitating the actuarial-level analysis that the Agency and other interested parties will want to perform * * *. We recommend the promulgation of best practices for M&V [measurement and verification].'' The Fund calls on FHFA to use its powers to ''advance the understanding of energy and climate risks as well as the value and cost of mitigation measures * * *''
- The Town of Babylon, NY asserted that: ''FHFA has pointed out that over two dozen states have passed PACE enabling legislation. No note was taken, however, that but a handful of PACE programs have gone operational. This consequence is due primarily to various statements issued by Fannie Mae and

Freddie Mac in May of 2010 followed by warnings issued by FHFA and OCC on July 6, 2010. Therein lies the Catch-22; FHFA requires a caliber of credible data that can only be forthcoming from clinical trials which it has, effectively, prohibited.''

2. PACE Programs and the Market for Financing Energy-Related Home-Improvement Projects

Many commenters asserted that PACE programs address a market failure by overcoming barriers to financing cost-effective projects, most frequently citing the high up-front costs of energy-efficiency improvement and the possibility that a homeowner would move before the payback period of such a project was complete as barriers that PACE would overcome. Such comments included responses to Questions 5, 6, 7, and 8 set forth in the ANPR. Examples of these comments include the following:

- The California Attorney General asserted that California's legislature, in authorizing PACE programs, had found that ''The upfront cost of making residential, commercial, industrial, or other real property more energy efficient prevents many property owners from making those improvements.''
- The Natural Resources Defense Council asserted that ''Compared to other available energy efficiency and renewable energy financing mechanisms, PACE is attractive to homeowners because it provides for 100% of the upfront costs for home energy improvements and PACE liens are transferable to subsequent owners in the event of sale or transfer of the property.'' The Council stated ''In contrast to 'home equity' financing or traditional asset-backed debt, PACE financings provide full upfront costs for the energy improvements and, by design, in the event of sale or transfer of the property, the remaining balance on the PACE lien can be transferred to subsequent owners or paid off in full. This will be attractive to some property owners who would otherwise be concerned that they would be responsible for paying off the full PACE lien when subsequent owners will be the beneficiaries of the energy improvements. Moreover, equity and traditional debt both require some financial outlay from property owners (such as down payments), but neither of those options nor are necessarily or automatically transferable to subsequent owners.''
- Sonoma County, CA asserted that ''Although * * * there are energy mortgage products available, they do not appear to have captured any significant market segment. Thus in the current market there appears to be a stark choice: If PACE programs can proceed, energy improvement projects can be done.''
- Leon County, FL asserted that ''Without access to private capital, there will be limited funding for efficiency retrofits * * * The single family residential sector is not restricted by a lack of financial products. Numerous unsecured second[-] and first-lien products are available to finance energy efficiency improvements. However, the sector is restricted by: (1) High interest rates associated with the financing; and (2) the fact that many of these financing products are cumbersome and difficult to access.'' The County also asserted that ''Because of the extended payback periods of many energy efficiency retrofits and because many energy efficiency lending products come with lending terms of less than 10 years, it is difficult or impossible to offer borrowers positive cash flow (in which periodic energy savings exceed debt service payments) as soon as they install their retrofits. As a result, a homeowner rarely will purchase an energy efficiency retrofit based only on energy savings. Long loan terms and low interest rates are the 'answer,' which PACE programs provide.''
- Boulder County, CO asserted that ''Many residents are unwilling to take on debt for energy efficiency upgrades because the benefits of the investment do not follow them if they decide to sell in the future. Unlike traditional financing, PACE-financed improvements have the notable advantage that the assessment stays with the property upon sale * * *. This overcomes one of the strongest traditional barriers to implementing energy efficiency and renewable energy projects in American homes today.''
- Alliance to Save Energy *et al.* asserted that ''The primary lien provides further assurance to investors and is a much safer investment than an unsecured loan, allowing for lower interest rates and better access to secondary markets; most other financing programs require subsidization to get to workable financial terms. As the financing is tied to the property, rather than to the property owner, the owner can consider payback periods that may be longer than his or her tenure at the property.''
- Renewable Funding LLC asserted that ''PACE is uniquely attractive as a financing tool because it solves the two big problems that have prevented wide scale adoption of energy efficiency and renewable energy retrofit projects: [1] Upfront Cost: PACE financing eliminates the high upfront cost of energy efficiency and renewable energy upgrades and provides attractive long-term financing that makes projects cost effective much sooner. [2] Transfer on Sale: Because the average homeowner moves every 5–7 years, many are reluctant to invest in large energy upgrades unless they are certain they will remain in their home. Because PACE, like other municipal assessments, stays with the property upon sale, the new owner will assume the assessment payments if the property is sold.''
- National Association of Realtors asserted that ''PACE is an innovative approach that helps to resolve on[e] [of] the major obstacles to market-wide spread of energy efficiency improvements—*i.e.,* the split incentives market failure: Owners opt not to invest because they are afraid they won't be able to recoup the full investment if they are planning to sell the property. By having access to financing that conveys with the sale of the property, there is a potential to improve the energy efficiency of homes.''
- The Sierra Club asserted that PACE reduces ''uncertainty for a homeowner that does not know how long they will remain in their home.''

Other commenters asserted that there are alternatives to first-lien PACE programs in the existing marketplace for credit-worthy borrowers to finance cost-effective projects.

- The Joint Trade Association comment noted that ''For homeowners with the means to finance an energy retrofit project without a PACE loan, the alternative financing likely would have a lower cost and much more flexibility, such as a shorter term and the ability to prepay the loan. A shorter term and the ability to prepay the loan would both reduce its cost. This flexibility would also permit the homeowner to sell the property without diminishing the sales price to reflect the outstanding PACE loan * * *. PACE loans, then, are directed at those who cannot qualify for non-PACE financing. These are the borrowers for whom PACE loans would be the most dangerous.'' The comment also noted that alternative financing would likely have lower costs, more flexibility in loan term periods and lower risk to homeowners; the comment cited alternatives such as the Section 203(k) insured home improvement loan from the Federal Housing Administration and other energy efficient mortgage products. The comment criticized any PACE program that prohibited pre-payments as running contrary to the spirit of Dodd-Frank Act limitation on pre-payment penalties.

• A joint letter from the National Consumer Law Center and the Consumer Federation of America asserted that PACE loan rates were not that competitive and a survey found that ''many homeowners with equity in their homes would likely have been able to borrow against their home equity at lower rates.'' The comment also stated ''Homeowners who could take out a PACE loan may also have other routes for borrowing funds which do not raise the same concerns as PACE loans do.'' Finally, the comment stated, ''we are concerned that state and local governments will be unequal to the task of monitoring the sales tactics and behavior of the many contractors who will no doubt be attracted by the availability of PACE financing * * *. With PACE loans having a senior position, [consumer] ownership of their homes could be jeopardized.''

3. Legal Attributes of PACE Assessments

Many commenters asserted that PACE assessments reflect a legally proper use of state taxing authority.

• Boulder County, CO asserted that ''Other special districts allow property owners to act voluntarily and individually to adopt municipally financed improvements to their property that are repaid with assessments. PACE special assessment districts are not significantly distinguishable from special assessment districts in other contexts, including special assessment districts designed to fund septic systems, sewer systems, sidewalks, lighting, parks, open space acquisitions, business improvements, seismic improvements, fire safety improvements, and even sports arenas. Such special districts have been in existence since 1736, and are typically created at the voluntary request of property owners who vote to allow their local governments to finance improvements that serve a public purpose, such as energy efficiency improvements. * * * All special assessments collected for special improvement districts are secured by liens which are senior to the first mortgage, and therefore FHFA's characterization of PACE as having a 'lien-priming' feature is misleading.''

• Alliance to Save Energy et al. asserted that ''While the FHFA frequently has referred to PACE assessments as 'loans,' they are, in fact, property assessments. Much of the rationale offered against PACE financing could be applied to a range of traditional property tax assessments upon which municipalities depend for critical infrastructure projects. As such, the precedent set by the FHFA's rejection of the PACE financing model raises serious concerns for other land-secured financing, *e.g.* for municipal sewer upgrades or seismic strengthening, which have a long history in the United States and have been consistently upheld by courts.''

• Placer County, CA asserted that ''The County's PACE program involves assessments of the type that have been lawful in California and in use in the County since the 1800s. * * * Chapter 29 authorizes the use of these assessments to finance the installation of renewable energy, energy efficiency and water efficiency improvements * * * on private property. The County PACE program simply represents the County's exercise of its long-held and used tax and assessment power for a public purpose. * * * The FHFA's response is unprecedented. The County has levied taxes and assessments to achieve important public purposes, such as the construction of schools, the installation of water and sanitary sewer systems and the undergrounding of public utilities, for more than 100 years. The FHFA's response to the County's exercise of its taxing power, as evidenced by the Statements and the Advance Notice of Proposed Rulemaking, is an unprecedented interference with the County's exercise of its taxing power to achieve valid and important public purposes.''

• Sonoma County, CA asserted ''FHFA's objection to PACE programs begins with the assumption that PACE assessments are different than 'traditional' assessments. This assumption is incorrect.'' The County also stated ''FHFA contends that PACE assessments are different because a property owner voluntarily joins the program and agrees to install the energy improvements. This is no different from many existing assessment statutes. Generally, initiation of assessment proceedings requires a petition by some percentage of affected property owners.'' The County advanced that ''FHFA contends [PACE] financing is a loan, therefore requiring treatment and evaluation as a loan, with focus on the creditworthiness of the borrower. However, as a matter of law, the PACE transaction is an assessment, not a loan. It is a land-based and land-secured transaction.''

• Leon County, FL asserted ''The authorization for these land-secured assessments and the creation of districts to effectuate those purposes is a function of state law. State legislatures have the power to create tax liens and determine their priority relative to that of other types of liens and property interests, even if the tax lien was created after other property interests came into existence. Under Florida law, a local government is expressly authorized to levy assessments for 'qualifying improvements,' including energy efficiency and related improvements. There is longstanding precedent in federal and state law regarding a local government's authority to levy non ad valorem or special assessments. Recasting these assessments as 'loans' runs counter to these long-established principles of law protecting local governments' rights to create PACE programs.''

Several of the comments asserted that the voluntary nature of a PACE transaction does not distinguish PACE assessments from other, more traditional assessments.

• The Natural Resources Defense Council noted that ''As of 2007, there were more than 37,000 special assessment districts in the United States. For decades, municipalities have utilized these districts to create financing mechanisms for voluntary improvements to private property that serve a public purpose.'' The NRDC stated that ''Given this long-standing existence of special assessment districts which mirror the intent and structure of PACE, the legality of PACE programs rests on firm legal and historical precedent. FHFA's effort to single out PACE programs for disapproval, alone out of all the other special assessment programs that exist across the country, is illogical and unsupportable.''

• The Sierra Club asserted that ''The ability to opt-in [is] not a distinguishing feature of land secured municipal finance. Many past programs have allowed participation according to preference, without requiring it to gain full benefit.''

• Vote Solar asserted that ''In 1988, the City of Torrance, California, created a special assessment district which allowed private property owners to voluntarily apply to receive funding for seismic retrofits on their buildings. Assessments were made only against parcels for which the property owner applied to become a part of the district, and the property owners individually contracted for the projects.'' The commenter also asserted that ''Under the Massachusetts 'Community Septic Management Plan,' the purpose of which is to prevent water pollution, property owners can voluntarily undertake upgrades to their septic systems and receive financing from the local government, and assessments, secured by a property lien, are placed on the participating owners' parcels. And since 2001 in Hamburg Township, Michigan, property owners can apply to receive financing for the cost of connecting to the local sewer system by agreeing to participate in a 'Contract Special Assessment District.' ''

• Renewable Funding asserted that ''recent examples include voluntary programs for septic upgrades in Virginia and seismic strengthening for homes in California.''

Other commenters found the voluntary nature of PACE assessments to be a distinguishing feature.

• The Real Estate Roundtable asserted that ''As a voluntary program to finance retrofits of private buildings, PACE is unlike other common forms of tax assessment financing.''

Additional commenters asserted that first-lien PACE programs present challenges to the legal structures and processes associated with residential property transfers.

• The American Land Title Association (ALTA) asserted that the ''priority priming feature of PACE loans introduces a new level of risk above and beyond the scope of the standard title insurance policy.'' ALTA noted that PACE statutes are unclear on the recording of PACE obligations in local property records and that loans or refinancing may be delayed as searches would have to be undertaken to find indication of whether a PACE loan had been placed upon the property.

• Further, ALTA noted that ''Without establishing standards for determining title to property, PACE loans run the risk of significant losses due to fraud. In addition to harming PACE participants, it also damages the accuracy of local property records, and results in increased cost of underwriting, claims, escrow services and compliance for the land title industry.

• ALTA also raised the issue of whether the Real Estate Settlement Procedures Act should apply to PACE financing as pursuant to 12 U.S.C. 2602(1)(B)(ii) any assistance by the federal government to a PACE program, including federal tax benefits for the interest paid by the borrower or interest earned by an investor on a bond backed by PACE loans may require compliance with RESPA because such benefits would make the PACE financing a ''federally related mortgage loan.''

• The National Association of Realtors asserted that ''Because these PACE loans runs with the property and not with the property owner, the information on the tax assessment about the loan will need to be explained for each new buyer. If we assume that the average home is sold every five years, and the average length of the PACE loan is 20 years, then the Realtor will be responsible for explaining this special tax assessment an average of four times over the life of the loan. Once the prospective buyer learns about this new cost to purchasing the home, this information may cause delays in the completion of the transaction or even a cancellation.''

4. Public Policy Implications of PACE Programs

a. Environmental Implications of PACE Programs

Many commenters asserted that PACE programs are environmentally beneficial.

• Citizens Climate Lobby advanced that ''There are significant environmental impacts that must be fully evaluated and mitigated for the project rule making. FHFA's rule to prohibit PACE programs nationwide results in measureable and significant air pollution emissions that impact human health and the environment. Blocking the PACE Program nationwide has resulted in significant losses in otherwise saved energy efficiency. The significant air pollution emissions discriminately impact poorer communities of color living closer to the energy combustion sources nationwide. In the alternative of not prohibiting PACE programs measurable GHG emissions reductions would have been realized and climate change mitigated. This is a critical concern because there is scientific support showing that we closely approach a tipping point to unredeemable destruction.''

• Placer County, CA stated that ''The California Legislature and the County believe that PACE will accelerate the installation of PACE improvements 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 PACE improvements, share this expectation.''

• Center for Biological Diversity noted that ''PACE programs are critical tools in addressing climate change because energy related home improvements reduce greenhouse gas emissions. Reduction of greenhouse gas emissions protects biological diversity, the environment, and human health and welfare.''

• Ygrene Energy Fund asserted that with respect to ''recent weather disasters,'' ''hurricane and tidal surges,'' ''heat waves and associated fires,'' and ''long term public health issues,'' ''PACE programs can reduce the occurrence of such tragedies and loss by providing a means for making homes more energy efficient from something as simple as better insulation and modern heating units. This directly furthers the stated FHFA goal of maintaining or increasing both asset value and actual property protection.''

• Decent Energy Incorporated noted that the environmental impact of energy efficiency measures should be identical without regard to the financing mechanism, except where lower cost financing permits a homeowner to expand the number of improvements. The commenter supported energy audits performed by auditors certified by the Building Performance Institute and present prospective financial information on the performance of renewable energy systems. He cited the absence of strong protections for homeowners with respect to home improvement projects, which PACE might address. Finally the commenter noted the value of using the National Renewable Energy Lab BESTEST–EX, an energy analysis tool, developed for DOE.

Other commenters asserted that environmental effects flow from the underlying projects, not the method of finance.

• The Joint Trade Association comment letter challenged whether financing methods have anything to do with environmental benefits. Other financing methods might prove ''more advantageous'' for homeowners and the environment.

b. Implications of PACE Programs on Energy Security and Independence

Many commenters asserted that PACE programs support goals relating to United States energy security and independence.

• Metropolitan Washington Council of Governors asserts that ''PACE is an essential state and local public policy tool that promises to conserve natural resources, increase energy security, reduce the health and environmental impacts of energy consumption, stabilize residential energy spending, and promote economic growth in our communities.'' The Council continues, urging FHFA ''to reconsider your position on PACE programs to enable use of this innovative municipal financing tool, thereby encouraging homeowners to increase our nation's energy independence and clean energy generation.''

• Board of Supervisors, County of Santa Clara, CA asserts that ''PACE financing * * * is a means to grow the green economy that now drives the economic expansion of other countries, to promote energy efficiency and independence, and to redirect unnecessary energy expenditures to the pressing needs of families.''

• Renewable Funding LLC asserted that ''PACE also helps achieve important state and local government energy policy goals that may include: * * * [1] Energy independence from foreign sources; [2] Energy security for states by limiting reliance on inter-state energy transfers and strain on distribution systems; [3] Avoided costs of building new power plants; [4] Lower demand on the energy grid * * *.''

c. Macroeconomic Implications and Effects of PACE Programs

Many commenters asserted that PACE programs would bring macroeconomic benefits such as increased domestic employment generally and/or employment in specific sectors such as ''green jobs.''

• Boulder County, CO asserted that Boulder's ClimateSmart Program ''generated green-collar jobs and stimulated the local and state economy. Nearly $6 million of the total money distributed in 2009 funded energy efficiency upgrades and almost $4 million went to renewable energy projects, all of which boosted the local economy and provided job opportunities for more than 290 installers, contractors and vendors. In addition, 75% of the ClimateSmart Program bonds were sold locally, providing excellent local green investment opportunities. Finally, given that a vast majority of the work was completed by the local workforce, we believe that recirculation of project dollars within our community has occurred, producing a positive economic ripple effect. In contrast, approximately 75 cents on the dollar currently leaves the Boulder County community when residents and businesses pay their utility bills.''

• Boulder County, CO asserted that ''according to a May 2011 Department of Energy study, the Boulder County ClimateSmart Program created more than 290 jobs, generated more than $20 million in overall economic activity, and reduced consumers' energy use by more than $125,000 in the first year alone. In developing a rule that serves the public interest, the FHFA should weigh perceived risks associated with this lending model against the proven economic benefits that may reduce default rates.''

• Renewable Funding LLC noted that ''A national study conducted by Portland-based economics consulting firm EcoNorthwest concluded that if $1 million were spent on PACE improvements in each of four American cities, it would generate $10 million in gross economic output; $1 million in combined Federal, state and local tax revenue; and 60 jobs. A simple extrapolation from this study shows that if just 1% of America's 75 million homeowners completed a typical PACE project, it would create more than 226,000 jobs, generate more than $4 billion in Federal, state and local tax revenue and stimulate more than $42 billion in new economic activity.''

• CA Energy Efficiency Industry Council: ''If PACE is fully implemented, tens of thousands of much-needed green jobs will be created, and the financial health of our residential mortgage portfolio will be improved.''

• The National Resources Defense Council noted that it ''recognizes that retrofitting our existing building stock can be a key driver of economic recovery in the United States through the proliferation of green jobs and by saving property owners (including NRDC's members) thousands of dollars annually on energy bills.''

• The Sierra Club asserted that ''PACE programs can potentially provide significant economic benefits to communities * * * [and] [l]ocal government can implement these programs through long-accepted land secured municipal finance districts.

IV. FHFA's Response to Issues Raised in the Comments

FHFA appreciates the time and effort of the commenters in preparing the submissions, and has considered the comments carefully. The many perspectives and varied information offered in the comments have assisted FHFA in its consideration, pursuant to the Preliminary Injunction, of whether the restrictions and conditions set forth in the July 6, 2010 Statement and the February 28, 2011 Directive should be maintained, changed or eliminated, and whether other restrictions or conditions should be imposed. FHFA's views and judgments as to the principal substantive issues raised in the comments are set forth below.

A. Risks PACE Programs Pose to Mortgage Holders and Other Interested Parties

FHFA's supervisory judgment continues to be that first-lien PACE programs would materially increase the financial risks borne by mortgage holders such as the Enterprises.

1. Effects of PACE-Funded Projects on the Value of the Underlying Property

Having reviewed the comments, FHFA is of the opinion that first-lien PACE programs allocate additional risk to mortgage holders such as the Enterprises because it is uncertain whether PACE-funded projects add value to the underlying property that is commensurate to the amount of the senior property-secured PACE obligation and that could be realized in a sale (including a sale resulting from a foreclosure). Because of the lien-priming attribute of first-lien PACE programs, if the dollar amount of a first-lien PACE obligation exceeds the amount which the PACE-funded projects increases the value of the underlying property, the collateral has been impaired, which causes the mortgage holder to bear increased financial risk.

Many commenters asserted that PACE-funded improvements increase the value of the underlying property. Several such comments cited studies suggesting that the presence of energy-efficient features or improvements correlates positively with property value as reflected in sales price data. *See, e.g.,* Vote Solar submission at 6–7 & nn. 20–22. However, these studies did not directly compare the purported value increment with the cost of the underlying project, and, therefore, these studies do not directly address the question of the net (rather than gross) valuation effects of such projects. FHFA considers net valuation effects (*i.e.,* the increment in the value of the property less the amount of the additional obligation) to be of far greater relevance to the issue of the financial risk posed to mortgage holders.

Having reviewed the cited studies, FHFA's judgment is that the available information does not reliably indicate that PACE-funded projects will generally increase the value of the underlying property by an amount commensurate with their cost. As Freddie Mac stated in its submission, ''We are not aware of reliable evidence supporting a conclusion that energy efficiency improvements increase property values in an amount equal to the cost of the improvement. Rather, our experience with other home improvements suggests that any increase in property value is likely to be substantially less than such cost, meaning that homeowners who take on PACE loans are likely to increase their ratio of indebtedness relative to the value of their properties.'' Freddie Mac submission at 4.

A publicly available cost-versus-value report illustrates the point. *See* Remodeling/NAR Cost-vs.-Value Survey 2011–12.[12] That report indicates that

[12] *Available at http://www.remodeling.hw.net/2011/costvsvalue/national.aspx* (last visited June 11, 2012).

window-replacement projects—which are approved for financing under many PACE programs—typically add less than 70% of the cost of the project to the value of the property. *Id.* More specifically, the survey reports that, as a national average for 2011, mid-range wood window-replacement projects cost about $12,200 while adding only about $8,300 of value to the property. *Id.* A PACE-financed window-replacement project with those cost and value effects would diminish the amount of property value securing the mortgage by about $3,900—the difference between the $12,200 cost and the $8,300 increment to value.

Moreover, FHFA's judgment is that PACE-funded projects create financial risk and uncertainty for mortgage holders because the future value of the project depends on an array of events and conditions that cannot be predicted reliably. In part, this is because the principal channel by which PACE projects could affect property value is by reducing the homeowner's utility expense. The amount of any such reduction depends, in large part, on the level of energy prices over the life of the project. Energy prices are variable and unpredictable, and therefore any forward-looking estimate of utility-cost savings is inherently speculative. *See* NRDC, PACE*Now,* Renewable Funding, LLC, and The Vote Solar Initiative, *PACE Programs White Paper* (May 3, 2010) at 18 (noting that because ''the PACE assessment remains fixed,'' cash-flow ''benefits'' to homeowners depend upon movements in the ''cost of energy'').[13] Further, whether the retrofit equipment is effective, is maintained by the homeowner or is covered by hazard insurance are important factors in the valuation of an improvement. Accordingly, the effect a PACE-financed project might have on property values is likely to be similarly variable and speculative. Additional discussion of the cash-flow effects of PACE-funded projects appears *infra* in section IV.A.2.

In addition, the effect a PACE-financed project will have over time on the value of the underlying property also depends on the preferences of potential home purchasers, which can change over time. Indeed, prominent PACE advocates have publicly acknowledged ''uncertainty as to whether property buyers will pay more for efficiency improved properties.'' *See* PACE Finance Summary Sheet at 1.[14]

Many PACE-financed projects, such as solar panels or replacement windows, have a relatively long engineering life, and technological advances or changing aesthetic preferences will likely affect their desirability to potential homebuyers. If such features fall out of favor or become obsolete, any positive contribution to property value could dissipate, and indeed the presence of such features could reduce the value of the property. As the Joint Trade Association explained, ''Early in the life of a PACE loan, the technology used in a retrofit application may become obsolete, but the PACE loan would remain because it is not prepayable. As technology advances, consumers' preferences will change. A solar panel that seemed attractive at first but that became obsolete will hurt property liquidity and value, both because the property has an undesirable and obsolete solar panel, and because the PACE lien would still be outstanding.'' For example, many buyers do not want solar systems or other expensive energy improvements because the assumed savings may not materialize, and they may have concerns about the aesthetics, maintenance requirements, or technology that may become outdated or fall in price. The cost of solar systems has come down substantially in recent years; if prices continue to fall, a homeowner that locked-in a higher cost system would have difficulty getting a buyer to assume that higher balance assessment, without a pricing concession.

Many commenters also assert that the fact that PACE obligations do not accelerate upon default mitigates the risk to mortgage holders, since only the past due amounts rather than the entire obligation would become immediately due in foreclosure. *See supra* Section III.B.1.c (summarizing comments). FHFA believes that such comments are based on flawed economic analysis; whether PACE obligations are accelerated in a foreclosure is, in FHFA's judgment, of limited economic irrelevance. Upon any transfer of a property to which a PACE obligation has attached, the new owner assumes the continuing obligation to pay the PACE assessments as they come due. Accordingly, the new owner—*i.e.,* the purchaser in a foreclosure sale—will reduce the amount he or she bids for a given property to account for his or her assumption of the continuing obligation to pay PACE assessments. A rational purchaser will treat the PACE obligation as a component of their cost, and will reduce their cash bid correspondingly. Because the cash paid by the new owner is the source of all funds the mortgage holder will realize upon foreclosure, the reduction in purchase price corresponding to the PACE debt will be borne entirely by the foreclosing mortgage holder, not by the new owner.

2. Cash-Flow Effects of PACE-Funded Projects

FHFA believes first-lien PACE programs allocate risk to mortgage holders such as the Enterprises because it is uncertain whether PACE-funded projects increase the borrower's free cash flow. If the borrower's free cash flow does not increase, then (all else equal) his or her ability to service financial obligations including the mortgage and the PACE obligation does not increase. Some solar systems or geothermal systems with life cycle periods that may exceed the term of a loan, which PACE advocates favorably cite, may require intervening replacement of system elements and repairs; these further highlight the need for a free cash flow analysis that is positive for homeowners. Having reviewed the comments and the sources cited therein, FHFA's judgment is that the available information does not reliably indicate PACE-funded projects will generally increase the borrower's ability to repay his or her financial obligations, including mortgage loans.

First, estimating utility cost savings is inherently uncertain due to the variability and unpredictability of energy prices, as PACE advocates have previously acknowledged to FHFA. *See* Memo from Tannenbaum to PACE Federal Regulatory Executives (June 8, 2010) at 4.[15] Indeed, the May 7, 2010 DOE Guidelines (which many commenters urge FHFA to adopt) concede that computing the ''Savings-to-Investment Ratio,'' or ''SIR,'' which is meant to determine whether ''projects * * * 'pay for themselves' * * * over the life of the assessment, depends upon assumptions about future energy prices.'' DOE Guidelines for Pilot PACE Financing Programs (May 7, 2010) at 2 & n.4. Many commenters asserted that energy retrofits will be economic and will not fail to produce benefits due to rising energy costs, but no guarantee exists that energy costs will increase; even a period of energy price stability or moderation could significantly affect the value of an energy retrofit. *See, e.g.,* Comments of the Joint Trade Associations (asserting that ''The price of natural gas has fallen since the advent of extracting it from shale rock,'' and that energy prices ''can depend on

[13] *Available at http://pacenow.org/documents/PACE%20White%20Paper%20May%203%20update.pdf.*

[14] *Available at http://pacenow.org/documents/PACE%20Summary%20Description%20for%20Legislators.pdf* (last visited June 11, 2012).

[15] This document is available for inspection upon request at FHFA.

international and domestic politics and technology advances''); Decent Energy (acknowledging that the ''direction and magnitude of energy prices are uncertain''); Great Lakes Environmental Law Center (acknowledging that energy costs are ''highly volatile'').

Second, accurately estimating in advance the energy savings that would result from a particular PACE project at a particular property is difficult because of design and construction features of the existing property that may not be apparent until the retrofit project is undertaken. As the United States Department of Energy explained in a publicly available document:

> It is extremely difficult (and potentially expensive) to guarantee the forecasted level of savings for residential efficiency projects * * *. You can encourage quality retrofits by requiring specialized training for contractors and having an aggressive quality assurance program that checks the work. However, there is a tradeoff between ensuring quality and ensuring affordability. If work is faulty (not performing as designed), contractors need to be either fix their work or face consequences (such as ineligibility to participate in the program).[16]

Similarly, as the University of California's Renewable and Appropriate Energy Laboratory, which favors PACE, explained in a publicly available document, ''Homeowners and businesses may not trust that the improvements will save them money or have the other benefits claimed.'' *See* Univ. of Cal. Renewable and Appropriate Energy Laboratory, Guide to Energy Efficiency and Renewable Energy Financing Districts at 6 (Sept. 2009).[17] *See also, e.g.,* comments of the Joint Trade Associations (''disclosures about future utility costs are conjecture and are unreliable''); National Association of Realtors (''it is difficult to measure the benefits of these improvements because the way an owner uses energy in a home may change over time, depending on variables such as weather and family composition and whether or not the energy efficiency retrofit has become technologically outdated, or was ever as efficient as it was supposed to be'').

Third, some homeowners may choose to consume rather than monetize energy efficiency gains, as by adjusting their thermostat to realize efficiency gains as comfort rather than as monetary savings. As the U.S. Department of Energy explained in a publicly available document, ''There is great variation in how occupants respond to a retrofit (some may turn up the heat for example), and behavior is a large factor especially in residential energy use.''[18] Similarly, as the National Association of Realtors noted more generally, ''the way an owner uses energy in a home may change over time.'' Hence, the possibility that PACE-financed projects—even projects as to which the savings-to-investment ratio as computed at the planning stage exceeds one—will reduce rather than enhance the homeowner's free cash flow and consequent ability to repay his or her existing obligations cannot be disregarded. Reducing the homeowner's ability to repay his or her existing obligations plainly increases default risk and thereby reduces the value of those obligations—which include mortgages—to their holders.

Fourth, PACE advocates have publicly acknowledged that it may take several years before projected cash-flow effects turn positive. For example, the City of Palm Desert California published a flyer promoting its PACE program, which included a ''How Does It Actually Work?'' section setting forth an example involving installation of ''a 3.1 kW photovoltaic system for a net cost of $20,000.'' According to that document, ''The monthly loan cost of $160 exceeds the initial monthly utility savings of $120.'' Palm Desert adds that ''However, by the seventh year, savings exceed costs.'' Palm Desert, ''A Pathway to Energy Independence.''[19] In FHFA's judgment, undertaking first-lien PACE financed projects expected to have negative cash-flow effects for the first several years in hopes that they will generate positive cash-flow effects thereafter will not reliably enhance homeowner ability to pay financial obligations including mortgage loans.

Comment letters favorable to PACE programs cited economic and other benefits with recent studies. Many such comments cited studies purporting to summarize benefits of solar systems. One of the weaknesses of the cited studies was whether they compared the cost-effectiveness of solar to that of other sources of energy. Despite the rapid fall in the price for solar panels since 2008 (due to lower raw material costs, large-scale production in Asia and excess supply), solar is still more expensive than electricity produced from coal, oil, natural gas, nuclear, or wind. The studies did not take into account the substantial government subsidies for new solar installations. Tax incentives and other subsidies are generally necessary for solar to be affordable for homeowners. The main federal subsidy covers 30 percent of the total solar installation costs. Other subsidies from the states and local governments can increase the total subsidy to more than 50 percent. Thus, the true benefit of an energy retrofit involving solar may omit certain key factors that may or may not remain in place. The studies generally did not compare PACE financing of solar systems to alternative methods of financing, such as cash payments or leasing. Financing alternatives have varying cost structures, and may include administrative costs, finance charges, and maintenance charges as part of the package. In addition, any cost analysis of solar must account for the particular energy dynamics for the specific solar installation. The benefits to be realized are site specific (roof orientation and pitch, tree shading, sun hours), and region specific (electricity costs vary greatly throughout the country, as well as the state or local subsidy levels); general or typical performance metrics may not be applicable for a given property.

Commenters advance that the Savings to Investment Ratio (SIR) is the most relevant measure for comparing the costs and benefits of PACE-funded projects, but SIR is an assumption-driven estimate that, in FHFA's judgment, does not adequately reflect changes that a PACE-funded project may cause in the borrower's ability to repay financial obligations, especially in early periods after the project installation. For any financing, the ability of a homeowner to repay clearly is an established approach that has been found to be the most appropriate safeguard. Further discussion relating to SIR is presented below in Section IV.A.3.

3. Underwriting Standards for PACE Programs

Many comments favorable to PACE programs asserted that the existence of appropriate underwriting guidance or guidelines for PACE programs would serve to protect homeowners and lenders, reducing the risk of default or loss. Three primary documents were referenced—the Council on Environmental Quality: Middle Class Task Force ''Recovery Through Retrofit'' (October 2009) [CEQ]; the Department of Energy, Guidelines for Pilot PACE Financing Programs (May 7, 2010) [DOE Guidelines]; and, H.R. 2599, the PACE

[16] U.S. Department of Energy, Q&A from the November 18[, 2009] Energy Financing Webinar, *available at http://www1.eere.energy.gov/wip/solutioncenter/pdfs/pace_webinar_qa_111809.pdf.*

[17] *Available at http://rael.berkeley.edu/sites/default/files/old-site-files/berkeleysolar/HowTo.pdf.*

[18] U.S. Department of Energy, Q&A from the November 18[, 2009] Energy Financing Webinar, *available at http://www1.eere.energy.gov/wip/solutioncenter/pdfs/pace_webinar_qa_111809.pdf.*

[19] *Available at http://rael.berkeley.edu/files/berkeleysolar/PalmDesertBrochure.pdf.*

Assessment Protection Act of 2011 [H.R. 2559]. FHFA believes that these documents show that the underwriting standards PACE advocates propose are complex, incomplete, and impractical to implement, and that they would not adequately protect mortgage holders such as the Enterprises from financial risk.

For example, H.R. 2599 includes dozens of sections and subsections purporting to create standards for acceptable PACE projects, many of which involve complex calculations based on unstated assumptions and unspecified methodologies. One of the principal standards that H.R. 2599 would impose is that ''The total energy and water cost savings realized by the property owner and the property owner's successors during the useful lives of the improvements, as determined by [a mandatory] audit or feasibility study, * * * are expected to exceed the total cost to the property owner and the property owner's successors of the PACE assessment.'' But no methodology for actually computing the costs and savings is provided.

Such calculations would not, in FHFA's judgment, be simple or straightforward. As with any calculation of financial effects over time, simply summing up projected nominal costs and benefits without discounting to reflect the timing of their realization would be improper—a dollar of incremental income realized at a point some years in the future does not completely offset a dollar of incremental cost incurred today. For that reason, assumptions as to applicable discounts rates are significant and could be determinative—especially given that it may take a period of several years for benefits to exceed costs. Given the uncertainty associated with important elements of calculating the costs and benefits of PACE-funded projects (such as uncertainty as to the course of future energy prices, the costs of maintaining and repairing equipment, and the pace of advances in energy-efficiency technology), an effective standard incorporating financial metrics must be based on reasonable and accepted financial methodologies for computing those metrics. In FHFA's judgment, neither H.R. 2599 nor any of the comments suggesting that FHFA adopt its substance provided sufficient guidance concerning the appropriate discount rates or rates to be applied in the calculation (or suggested a sufficient methodology for determining such rates).

In addition, H.R. 2599 proposed that standards should deny loans to homeowners where property taxes are not current, where recent bankruptcy filings have occurred, or where the homeowner is not current on all mortgage debt. This definition of the ability-to-repay is not that of normal credit extension, but a reflection of the standard already employed by certain PACE programs. In FHFA's judgment, these criteria do not adequately address the significant ability-to-repay element of normal credit underwriting, a critical element cited in the 2010 Dodd Frank Wall Street Reform and Consumer Protection Act. Moreover, H.R. 2599 permits PACE loans to include expenses of homeowners such as undertaking mandated energy audits; this, in addition to administrative fees of up to ten percent of the loan amount, further lowers the amount of the energy improvement that may be purchased or requires a higher PACE loan, adding more exposure of lenders to financial risks in a subsequent sale of the property. Finally, H.R. 2599 endorses a cap of ten percent of the estimated value of the property, which (in the absence of a complementary ability-to-repay standard) is collateral based lending. The subprime crisis of recent has demonstrated such lending to present different, and in FHFA's judgment, greater risks than lending based on ability to repay supplemented by the protection of adequate collateral.

Similarly, the DOE Guidelines (attached to DOE's submission and referenced by numerous commenters) set forth a formula for computing the Savings-to-Investment Ratio (SIR), and suggest that PACE programs should adopt an underwriting standard that SIR be ''greater than one.'' DOE's definition of SIR incorporates an ''appropriate discount rate,'' but offers no guidance for determining what such a rate would be.[20] Moreover, DOE's definition of SIR permits ''quantifiable environmental and health benefits that can be monetized'' to be treated as ''savings'' for purposes of the calculation. The Guidelines do not define ''quantifiable environmental and health benefits that can be monetized,'' nor do they explain whether such benefits must have a real, rather than a potential or theoretical, effect on the borrower's actual cash-flows in order to be factored into the calculation. Accordingly, FHFA perceives uncertainty as to whether even those PACE projects that meet the DOE-recommended standard of SIR greater than one can reliably be expected to have an actual, positive effect on the borrower's net cash flow. The DOE Guidelines also specify that ''SIR should be calculated for [an] entire package of investments, not individual measures.'' [21] The Guidelines thereby suggest that projects with a SIR of less than one would nevertheless be eligible for PACE funding if they were ''package[d]'' with other projects at the same property that have a SIR sufficiently greater than one. *Id.* In FHFA's view, this undermines the utility of SIR as an underwriting criterion.

Without a reasonable, reliable, and consistent methodology for making the calculations that purport to determine whether proposed projects are financially sound (including a reasonable and reliable method for determining the applicable metrics and discount rate), a standard based on the purported financial soundness of PACE-funded projects would not, in FHFA's judgment, adequately protect the Enterprises from financial risk.

The DOE Guidelines illustrate other underwriting issues of concern to FHFA. *First,* the document provides ''best practice guidelines'' only; they have no force of law and are not backed by any supervisory or enforcement mechanism. States and localities may choose to adopt some, all, or none of the guidelines. Accordingly, the DOE guidance itself does not propose uniform, national standards.

Second, although the DOE Guidelines purport to incorporate ''Property Owner Ability to Pay'' into their ''Underwriting Best Practices,'' FHFA is concerned that the suggested practices almost entirely disregard ability-to-repay as a meaningful criterion. The only three ''precautions'' the DOE Guidelines recommend as a means of ensuring ''ability to pay'' are (1) ''[SIR] greater than one,'' (2) ''Property owner is current on property taxes and has not been late more than once in the past 3 years, or since the purchase of the house if less than three years,'' and (3) ''Property owner has not filed for or declared bankruptcy for seven years.'' DOE Guidelines at 6–7. As explained above, the DOE SIR calculation depends upon unstated assumptions, implements an unspecified methodology, and may treat items that have no actual effect on cash-flow as if they were real cash savings. Given the uncertainty that even PACE-funded projects with SIR greater than one will be cash-flow positive immediately upon implementation, or even for years thereafter, FHFA is

[20] The formula is ''SIR = [Estimated savings over the life of the assessment, discounted back to present value using an appropriate discount rate] divided by [Amount financed through PACE assessment].'' DOE Guidelines (May 7, 2010) at 2.

[21] DOE Guidelines at 3.

concerned that the DOE SIR criterion may not adequately reflect the immediate, real-world consequences of PACE-funded projects on borrowers' ability to repay their financial obligations, including their mortgage loans. To the same effect, while being current on property taxes and having a clean bankruptcy history provide some limited evidence of a borrower's ability to pay, FHFA is concerned that they are not sufficient to adequately protect mortgage holders from material increases in financial risk. As noted, many PACE commenters favorable to the program, while citing current ''standards, actually advocate additional standards be set forth by FHFA in any rulemaking. The omission by PACE advocates of such common credit metrics as debt-to-income ratios and credit scores from their proposed underwriting standards suggests to FHFA that PACE programs are relying principally on the value of the collateral and their prime lien position, rather than on the borrower's ability to service its debt obligations out of income, as assurance of repayment. In FHFA's judgment, this reflects collateral-based lending that could tend to increase the financial risk borne by subordinate creditors such as mortgage holders. Indeed, the promotional materials for Boulder County, Colorado's PACE program state that ''You may be a good candidate for a ClimateSmart Loan Program loan if you: Are not likely to qualify for a lower-interest loan through a private lender (*e.g.* home equity loan) due to less-than-excellent credit. * * *'' [22]

Third, the DOE Guidelines specify that ''Estimated property value should be in excess of property owner's public and private debt on the property, including mortgages, home equity lines of credit (HELOCs), and the addition of the PACE assessment, to ensure that property owners have sufficient equity to support the PACE assessment.'' [23] This appears to permit the imposition of PACE liens that would leave the property owner with only nominal equity in the property. As recent experience has shown, circumstances in which homeowners have little or no equity in the property can be extremely risky for mortgage holders; FHFA does not believe that an underwriting criterion that allows a PACE project to reduce a homeowner's equity in the property to essentially zero provides adequate protection to mortgage holders.

The Council on Environmental Quality (''CEQ'') document indicates that the first priority of the CEQ was improving access for consumers to ''straightforward and reliable information on home energy retrofits * * *.'' CEQ then noted, ''Homeowners face high upfront costs and many are concerned that they will be prevented from recouping the value of their investment if they choose to sell their home. The upfront costs of home retrofit projects are often beyond the average homeowner's budget.'' The report then cites favorably municipal energy financing costs added to a property tax bill with ''payment generally lower than utility bill savings.'' This presupposes that such savings will be greater than increased property tax bills. But, of note, the CEQ continues and states ''Federal Departments and Agencies will work in partnership with state and local governments to establish standardized underwriting criteria and safeguards to protect consumers and minimize financial risks to the homeowners and mortgage lenders. Additionally, CEQ noted the need to ''* * * advance a standard home energy performance measure and more uniform underwriting procedures; develop procedures for more accurate home energy appraisals; and streamline the energy audit process.'' FHFA is unaware that any of these conditions attendant to the CEQ endorsement of municipal financing programs has been met. Regarding PACE, the report notes that ''DOE will be funding model PACE projects, which will incorporate the new principles for PACE program design * * * [and this f]unding will encourage pilots of PACE programs, with more developed homeowner and lender protections than have been provided to date.'' Again, the pilot and model projects, that do not impose risk on lenders, have not been developed, nor have the protections that were called for by CEQ been addressed.

Many commenters suggested that FHFA promulgate underwriting standards. In FHFA's judgment, such comments confirm the current absence of adequate consumer protection, program and contract requirements, energy product, contractor qualifications and performance requirements and the absence of uniformity of such standards and of an enforcement or compliance mechanisms. In FHFA's judgment, these circumstances would cause first-lien PACE programs to pose significant financial risk to the Enterprises. Mortgage products lacking in metrics, market performance and safeguards are routinely rejected for purchase by the Enterprises. Even the majority of PACE supporters endorse additional homeowner protections.

Moreover, FHFA considers such suggestions impractical for several reasons. *First,* FHFA notes the absence of many of the proposed standards, which commenters suggest could be developed by other regulators or standard-setting organizations. Many of the comments propose varying standards on a wide variety of subjects outside FHFA's field of expertise. For example the DOE Guidelines—which many commenters advocate FHFA should adopt—propose that PACE programs ''limit eligibility [for funding] to those measures with well-documented energy and dollar savings for a given climate zone.'' [24] However, FHFA as a financial institution regulator is not in a position to evaluate and reevaluate whether a given type of retrofit will consistently produce cost savings ''for a given climate zone,'' particularly in light of the fact that PACE programs have proliferated across the country. Moreover, as many commenters acknowledge, there is insufficient data to support reliable conclusions about the valuation and cash-flow effects of energy-retrofit projects. *See, e.g.,* comments of the Joint Trade Associations (''disclosures about future utility costs are conjecture and are unreliable''); National Association of Realtors (''it is difficult to measure the benefits of these improvements because the way an owner uses energy in a home may change over time, depending on variables such as weather and family composition and whether or not the energy efficiency retrofit has become technologically outdated, or was ever as efficient as it was supposed to be''). In the absence of such data FHFA would be challenged to formulate standards that will reliably protect the safety and soundness of the Enterprises' mortgage asset portfolios. *Second,* FHFA believes that many of the metrics underlying proposed standards depend upon assumptions and are of unproven reliability. For example, many commenters propose standards relating to the cash-flow effects of projects, but they do not provide a reliable methodology for projecting the determinants of such effects, such as future energy prices and homeowner behavioral changes. *Third,* FHFA does not establish standards for PACE programs. FHFA regulates the Enterprises and the Federal Home Loan Banks; PACE programs are established

[22] ClimateSmart Loan Program Eligibility FAQs, *available at http://climatesmartloanprogram.org/eligibility.htm (last visited June 2, 2012).*

[23] DOE Guidelines at 6.

[24] DOE Guidelines at 3.

with few standards and these are left to localities, in most cases, either to create or to enlarge. *Fourth,* FHFA believes that even if such standards could be devised, implemented, and applied, mortgage holders such as the Enterprises would still bear significant financial risk associated with future contingencies such as unexpected movements in energy prices, advances in energy-efficiency technology, and changes in the aesthetic and practical preferences of potential homebuyers.

4. Empirical Data Relating to Financial Risk

Many comments provide their own findings or conclusions about PACE, but without adequate data or support. The support that is provided in many cases is of a general nature addressing the benefits of energy retrofitting and energy savings. However, there was often no causal link established between the purported savings and the use of PACE as a financing vehicle. Most studies presented are estimations, not reports of actual findings.

As with any product or program brought to the Enterprises, proponents offer product descriptions, including safeguards, financing features, target markets, risk management procedures, prior experience in managing projects, test marketing or pilot programs, return on capital and profitability metrics and other details. Comment letters reflected an absence of such information even three years after the promulgation of PACE statutes. Commenters provided no data on the resale performance of PACE properties, and the sample size of the data repeatedly cited is likely too small to draw reliable conclusions in any event. Moreover, an analysis of resales in one area of the country may not reliably indicate resale performance in another area, since customer acceptance may vary greatly depending upon the penetration rate of solar or other types of retrofit projects within an area. The absence of such data would normally be a basis for rejection of a product or program by the Enterprises.

Many commenters pointed to high-level summaries of default data relating to PACE programs as support for their contention that PACE programs do not materially increase the risk borne by mortgage holders. FHFA finds the summaries of default data proffered in the comments generally unhelpful. As an initial matter, underlying data and definitions generally were not provided, leaving FHFA unable to determine such basic matters as whether the referenced ''defaults'' refer to non-payment of PACE assessments, other property tax obligations, or mortgage obligations. Nor is it apparent what criteria were used to define a default, *e.g.,* whether default requires a 30-day delinquency, a 90-day delinquency, some fixed number of missed payments, some fixed or relative amount of non-payment, or other indicia of default.

Moreover, serious methodological problems permeate the analysis of default data reflected in the comments. For example, the sample size was very small, with only a small number of defaults among the PACE homes during the limited term period, rendering the statistical reliability of the analysis doubtful. Further, PACE homes were likely subject to certain additional underwriting requirements, skewing the comparison, yet the summary presentations provided in the comments generally did not address this issue. It is likely that the PACE borrowers had a lower risk profile than the non-PACE borrowers, and that the projected energy savings did not factor materially into the lower default rate. PACE loans are also relatively new, so they have not been as affected by the economic downturn as the more seasoned non-PACE loans. A robust analysis would have matched the PACE sample to a group of non-PACE homes in the area having a similar set of risk attributes (*e.g.* LTV ratio, credit score, DTI ratio, product type, loan age, home value, borrower income, etc.). In the absence of such an analysis, FHFA cannot agree that the default experience of PACE jurisdictions provides sufficient support to the views of PACE supporters.

Most supporters of PACE that addressed default rates cited data provided by Sonoma County and the cities of Boulder and Palm Desert. PACE supporters have previously noted that these programs probably are not representative. For example, in a March 15, 2010 letter, PACE*Now* acknowledged that ''early PACE programs that were launched in 2008 and 2009—Berkeley, Boulder, Palm Desert, and Sonoma—were extremely small and all in fairly wealthy communities.'' [25] In its comment submission, Sonoma County, California makes a similar point: ''[I]t has been Sonoma's experience that delinquency and default rates on properties with PACE mortgages are extremely low, possibly reflecting a self-selecting group of participants * * *.'' Similarly, the Town of Babylon, NY noted in its submission that ''FHFA has, in its 1/26/12 request for comment, sought very exacting data on the operational soundness of PACE programs. Credible results can only be forthcoming from a wide, representative sample of programs that are all actually operating within a set of uniform parameters.''

The Town of Babylon comment is a clear assertion, with which FHFA concurs, that credible information does not exist. FHFA would differ in a conclusion, however, that deploying an unfettered array of programs that would impact potentially billions of dollars in existing home mortgages, and do so without uniform parameters and metrics is a method for securing such information.

FHFA believes that such comments cast doubt upon PACE advocates' assertions that first-lien PACE programs pose only ''minimal'' or ''immaterial'' risk to mortgage holders such as the Enterprises.

PACE program endorsements by certain federal agencies have been limited to calls for pilots, development of underwriting standards, production of metrics and creating no harm to homeowners or lenders. However, no document produced by PACE commenters or by any government agency has provided a fully specified plan for an actual pilot program. FHFA notes that programs such as Sonoma County's Energy Independence Program are continuing to fund energy-retrofit programs for homeowners that meet their underwriting guidelines. FHFA believes that these and other programs may create a track record of data that may permit further analysis of the energy and financial effects of PACE-funded projects.

B. PACE Programs and the Market for Financing Energy-Related Home-Improvement Projects

As noted above, many commenters asserted that PACE programs overcome barriers to financing energy-related home improvement projects. In FHFA's judgment, some of the barriers PACE programs purport to overcome actually reflect reasonable credit standards that operate to protect both homeowners and mortgage holders from financial risk. It is also FHFA's judgment, PACE is unlikely to overcome other of the purported barriers. Finally, FHFA notes that the U.S. Department of Energy, which is generally supportive of PACE programs, has identified factors other than available means of finance as inhibiting consumer acceptance of energy retrofit projects.

Many commenters cited ''high upfront cost'' as a barrier that PACE purportedly overcomes. But PACE is not unique in this regard; any method of finance that allows repayment over time overcomes

[25] *Available at http://pacenow.org/documents/PACE%20Concerns%20and%20White%20House%20Solutions.pdf* (last visited June 11, 2012).

the purported barrier of ''high up-front cost.'' Further, PACE program designs include up to a ten percent administrative fee for counties and financing of audit and inspections that represent very high up-front charges and reduce the amount of retrofit purchase by a homeowner. Accordingly, FHFA believes that in many instances, the more relevant barrier for homeowners is a lack of credible information, as noted by government entities as their first concern and, for those who wish to finance energy-efficiency retrofit projects, is poor credit or lack of demonstrable ability to repay the obligation. Several PACE programs have made public statements suggesting that they might appeal to borrowers with substandard credit. For example, as of May 2012, Sonoma County California's ''SCEIP'' program noted, in a presentation that it required potential borrowers to view, that ''No credit check [is] required'' and ''no income qualifications'' are applied.[26] Similarly, Boulder, Colorado has marketed its ''ClimateSmart'' PACE program in terms that appear to invite applicants with substandard credit: ''You may be a good candidate for a ClimateSmart Loan Program loan if you: Are not likely to qualify for a lower-interest loan through a private lender (*e.g.* home equity loan) due to less-than-excellent credit * * *.''[27] In any event, lending to applicants with ''less-than-excellent credit'' based on ''no credit check'' and ''no income qualifications'' amounts to collateral based lending, which the subprime crisis of the past several years has demonstrated to present different and, in FHFA's judgment, greater risks than lending based on ability to repay which may be supplemented by holding adequate collateral.

Relatedly, many commenters asserted that the relatively long payback periods associated with PACE-funded projects may present a barrier to homeowners who are not certain they will continue to reside at the property over the entire period. Some commenters referred to this as the ''split incentives'' problem. Commenters suggested that because PACE assessments ''run with the land,'' a successor purchaser would assume the obligation and the original borrower therefore need not be concerned about making a large upfront investment. FHFA believes that this economic reasoning is flawed. A successor purchaser of a property will consider the value of the PACE project and the amount of the PACE obligation he or she will assume in determining the purchase price. SchoolsFirst Federal Credit Union, which gave qualified support to PACE programs in the abstract, explained in its comment that ''subsequent purchasers may reduce the amount they would pay to purchase the property by the amount of the outstanding PACE obligation.'' The Credit Union stated that this is most likely to be the case where ''the subsequent purchaser could not obtain attractive financing * * *, [and t]he purchaser is likely to request an offset.'' In FHFA's judgment, that is correct—the proceeds the initial borrower will realize upon a sale of the property will reflect expectations about the future financial consequences of the PACE project. In effect, the buyer will require the seller to pay off some or all of the PACE obligation—either directly or by accepting a commensurately lower price—in exchange for the then-present value of the PACE project. For that reason, PACE financing should not, in FHFA's view, materially change the incentives of homeowners who may not expect to reside in the same property over the entire life of a PACE-financed project and the corresponding financial obligation.

The Department of Energy's publicly available Request for Information regarding the development of national energy ratings for home retrofits indicates that financing is not the only impediment to energy retrofits.[28] The DOE RFI notes that its goal was to ''* * *establish a rating program that could be broadly applied to existing homes and provide reliable information at a low cost to consumers.'' As the Department noted, ''Lack of access to credible, reliable information on home energy performance and cost effective improvement opportunities limit consumers from undertaking home energy retrofits.'' Even energy audits could be improved to provide information to consumers on what improvements were desirable. As the DOE RFI noted, ''Energy audits and assessment can provide useful information on the extent of energy savings possible from home improvements and recommendations for the types of improvement to make that are cost-effective* * * While recommendations for improvements are useful, there is not currently a standardized approach to providing and prioritizing these recommendations.'' Thus, consumer information based on uniform base data has not been available, leaving localities, utilities, auditors, inspectors and building contractors to provide advice, with various capacities and perspectives to provide such advice.

C. Legal Attributes of PACE Assessments

FHFA believes that the legal attributes of PACE programs are immaterial to the exercise of its supervisory judgment because FHFA's views as to the incremental financial risk first-lien PACE programs pose to the Enterprises does not depend upon a conclusion that PACE obligations are, in a legal sense, loans, tax assessments, or some hybrid of the two. Neither FHFA's existing directives relating to PACE nor the Proposed Rule nor any of the Alternatives challenge the legal authority of states and localities to implement first-lien PACE programs if they wish. Rather, FHFA is exercising its statutory mandate to protect the safety and soundness of the Enterprises by directing that they not purchase assets that create unacceptable incremental financial risk. The ability of other market participants such as banks, securities firms, independent investors and others to buy and hold or to buy and repackage for sale such loans is in no way affected. Indeed, FHFA made clear that PACE programs with liens accruing when recorded, as is the case for four states, would not run contrary to the FHFA position.

However, FHFA believes the commenters overlook important differences between PACE assessments and other, more traditional assessments. Most significantly, PACE assessments are voluntary obligations created in the course of a commercial transaction involving a single property. In that regard, they differ from more typical property-tax assessments, such as special assessments for sidewalks or other community-wide improvements that individual property owners generally cannot opt into or out of. As PACE advocate and commenter Renewable Funding explained in a prior, publicly available statement, under PACE programs, ''willing and interested property owners voluntarily elect to receive funding and have assessments made against their property. * * * This opt-in feature does not typically appear in local government

[26] SCEIP_Residential_Energy_Education Presentation at p. 6, *available at http://www.sonomacountyenergy.org/apply-for-financing.php,* ''Presentation'' link (last visited May 31, 2012).

[27] ClimateSmart Loan Program Eligibility FAQs, *available at http://climatesmartloanprogram.org/eligibility.htm* (last visited June 2, 2012).

[28] Department of Energy, Energy Efficiency and Renewable Energy, National Energy Rating Program for Homes, Request for Information (June 8, 2010), *available at http://apps1.eere.energy.gov/buildings/publications/pdfs/corporate/rating_rfi_6_2_10.pdf.*

improvement financing authority.'' [29] Accordingly, as PACE gained public attention, many states began ''pursuing enabling legislation,'' as one PACE advocate stated in a September 2009 report.[30] Commenters typically did not explain why new ''enabling legislation'' was necessary if PACE programs merely made use of pre-existing powers. As Fannie Mae explained in its comments, the voluntary or ''opt-in'' attribute is material to the risk borne by the mortgage holder and to the mortgage holder's ability to protect against such risk. ''Real estate taxes are known and accounted for at the time of mortgage origination. As a result, a mortgage lender can factor the tax payment into its underwriting analysis of the borrower's ability to repay the loan. * * * In contrast, PACE loans may be originated at any point during the term of a mortgage loan without the knowledge of the current servicer or investor, making escrowing for PACE loans practically impossible.''

PACE*Now* and other commenters cite a long-standing history of over 37,000 assessment districts nationwide that function efficiently. In those special districts, the liens also have priority over the single-family mortgage loans, and lenders have avoided additional losses. A voluntary assessment for a PACE project is different from a mandatory assessment for an essential service that cannot be easily purchased on an individual basis. Traditional assessments for water and sewer, sidewalks, street lighting, and other purposes add value to an entire community or special taxing district. A PACE assessment is simply an alternative means of financing energy improvements that is assumable. PACE ultimately does not change the consequences to the homeowner of purchasing a solar system in terms of the ability to recover the expended funds at resale. Unlike a home equity loan or leasing (which may also offer lower costs of financing), a PACE assessment shifts the risk to the lender in the event of default because of the lien-priming feature. A future buyer may prefer a home without the added assessment, despite any projected energy savings. While some buyers may be incented by the prospect of new technology, contributing to energy efficiency, and energy savings, other buyers may be disincented for a number of other reasons. Moreover, the rapid proliferation of PACE programs distinguishes the magnitude of the risks they pose to the Enterprises from that of the risks that may be associated with smaller, isolated assessment-based financing programs that PACE proponents assert involve similar voluntary transactions, such as programs for seismic upgrades in California or septic upgrades in Massachusetts, Virginia, and Michigan.

D. Public Policy Implications of PACE Programs

1. Environmental Implications of PACE Programs

As described above, many commenters cited possible environmental benefits of PACE programs. As a general matter, FHFA supports programs and financing mechanisms designed to encourage energy-efficient home improvements, as well as other environmentally-friendly initiatives. *See, e.g.,* Fannie Mae Selling Guide, Section B5–3.2–01 HomeStyle Renovation Mortgage: Lender Eligibility (May 15, 2012).[31] However, as some of the comments acknowledge, any environmental effects of an energy-efficiency retrofit flow from the retrofit itself, not from the method by which that retrofit is financed. *See, e.g.,* Decent Energy Inc. (''The environmental impact of the same set of energy efficiency measures should be identical without regard to financing mechanism.''); Joint Trade Association (''The environment does not react to the financing methods people elect.''). In other words, if a given retrofit is going to benefit the environment, it will produce the same benefit if funded by a PACE program or a traditional home equity loan. To the extent the commenters assert or suggest that PACE programs will result in retrofits that would not otherwise have been undertaken, thus creating a net increase in the number of retrofits and a net benefit to the environment, the comments have failed to demonstrate that PACE programs would cause such a net increase in energy-efficiency retrofits. Even if such a net increase were established, it would come at the expense of subordinating the financial interests of the Enterprises, lenders and holders of mortgage backed securities. *See* Joint Trade Association (noting that PACE programs ''may well cause more energy retrofits to be made, but it will also increase the risk and severity of defaults''). Accordingly, absent more information, FHFA cannot elevate purported environmental benefits over the financial interests of the Enterprises, which FHFA is statutorily bound to protect.

2. Implications of PACE Programs on Energy Security and Independence

As described above, many commenters cited energy security and independence as possible benefits of PACE programs. Though FHFA recognizes the importance of energy security and independence, FHFA also recognizes—as with any purported environmental benefits—that such a benefit flows (if at all) from the retrofit itself, not from the method by which that retrofit is financed. To the extent the comments assert or suggest that PACE programs will result in retrofits that would not otherwise have been undertaken, thus creating a net increase achieving energy security and independence, these comments fail to demonstrate that PACE programs would cause such a net increase in energy-efficiency retrofits. Even if such a net increase were established, it would come at the expense of subordinating the financial interests of the Enterprises. Accordingly, absent more information, FHFA cannot override the financial interests of the Enterprises, which FHFA is statutorily bound to protect, with purported environmental benefits.

3. Macroeconomic Implications and Effects of PACE Programs

As described above, many commenters assert that PACE programs will have macro-economic benefits, such as increasing the amount of ''green jobs'' in the United States. Placer County estimated that the suspension of its PACE program prevented the creation of 326 jobs and saving 36 billion BTU per year. Placer County contends that it complies with all applicable consumer protection laws for home improvement financing, including 3-day rescission rights and the PACE program requires energy efficiency training to help achieve maximum energy reductions.

Many comments cited a study that purported to conclude that PACE would facilitate an economic gain of $61,000 per home, and that $4 million in PACE spending will generate, on average, $10 million in gross economic output, $1 million in tax revenue, and 60 jobs. *See, e.g.,* Renewable Funding LLC 9. FHFA has concluded that these assertions are neither supported nor relevant.

First, the study simply attributes to PACE programs all of the economic

[29] Property Assessed Clean Energy (PACE) Enabling Legislation (Mar. 18, 2010) at 2, *available at http://pacenow.org/documents/PACE_enablinglegislation%203.18.10.pdf* (last visited June 11, 2012).

[30] Renewable and Appropriate Energy Laboratory at the University of California, Berkeley, Guide to Energy Efficiency & Renewable Energy Financing Districts (September 2009), available at *http://rael.berkeley.edu/sites/default/files/old-site-files/berkeleysolar/HowTo.pdf,* at p. 40.

[31] *Available at https://www.efanniemae.com/sf/guides/ssg/sg/pdf/sel051512.pdf.*

activity related to PACE projects, but it does not examine how the economic resources employed in those projects would have been deployed in the absence of PACE programs. Accordingly, the study does not even purport to measure the incremental economic activity associated with PACE programs, which would be necessary if net economic effects were to be determined. True economic gains are more likely when energy improvements have short payback periods and appropriate reflect the existence and possible reduction or removal of government subsidies.

Additionally, the model used to estimate the jobs, taxes, and flow-through into the economy of PACE improvements contained a number of assumptions (50/50 split for solar/other energy efficiency projects, certain geographic localities, etc.), and sought to measure the economic impacts in a very broad way:

- Direct impacts (labor/materials for projects, taxes from installations including payroll taxes and income taxes on employees),
- Indirect impacts (supply-chain impacts since the direct purchase activity results in the purchase of goods/services from other businesses), and
- Induced impacts (the multiplier effect from the consumption expenses of those who enjoy income from the direct and indirect activities).

The study did not look at whether solar is economically cost effective compared to other sources of energy. Despite the rapid fall in the price for solar panels since 2008 (due to lower raw material costs, large-scale production in Asia, and excess supply), solar is still more expensive than electricity produced from coal, oil, natural gas, nuclear, or wind. *See, e.g.,* Citizens Climate Lobby 43 (acknowledging that the cost of solar ''is double to quadruple what most people pay for electricity from their utilities'').

The study also did not take into account the substantial government subsidies for new solar installations. In order for solar to be affordable for homeowners, it requires tax breaks and other subsidies.

- The main federal subsidy covers 30 percent of the total solar installation costs.
- Other subsidies from the states and local governments can increase the total subsidy to more than 50 percent.

Whether government subsidies are appropriately considered in a calculation of economic costs and benefits is questionable. To the extent they are considered, it is important to recognize the risk that changes in the public policy and/or political environment could affect their continued availability.

V. Discussion of the Proposed Rule and Alternatives Being Considered

In the ANPR, FHFA stated that its proposed action ''would direct the Enterprises not to purchase any mortgage that is subject to a first-lien PACE obligation or that could become subject to first-lien PACE obligations without the consent of the mortgage holder.'' In light of the factors discussed above, the Proposed Rule has been revised as reflected below. Pursuant to the preliminary injunction requiring APA rulemaking, FHFA is also considering a number of alternatives to mitigate the risks to the Enterprises resulting from the lien-priming feature of first-lien PACE programs. FHFA invites comments suggesting modifications to these alternatives or identification of other alternatives that FHFA has not considered, which would address FHFA's duty to ensure that the Enterprises operate in a safe and sound manner.

A. The Proposed Rule

The Proposed Rule would provide for the following:

1. The Enterprises shall immediately take such actions as are necessary to secure and/or preserve their right to make immediately due the full amount of any obligation secured by a mortgage that becomes, without the consent of the mortgage holder, subject to a first-lien PACE obligation. Such actions may include, to the extent necessary, interpreting or amending the Enterprises' Uniform Security Instruments.
2. The Enterprises shall not purchase any mortgage that is subject to a first-lien PACE obligation.
3. The Enterprises shall not consent to the imposition of a first-lien PACE obligation on any mortgage.

In light of the comments received in response to the ANPR and FHFA's responses to those comments, FHFA believes that the Proposed Rule is reasonable and necessary to limit, in the interest of safety and soundness, the financial risks that first-lien PACE programs would otherwise cause the Enterprises to bear.

B. Risk-Mitigation Alternatives

FHFA is considering three alternative means of mitigating the financial risks that first-lien PACE programs would otherwise pose to the Enterprises. FHFA solicits comments supported by reliable data and rigorous analysis showing that any of these alternatives, or any other alternative to the Proposed Rule, would provide mortgage holders with equivalent protection from financial risk to that of the Proposed Rule, and could be implemented as readily and enforced as reliably as the Proposed Rule.

1. First Risk-Mitigation Alternative—Guarantee/Insurance

The first such Risk-Mitigation Alternative is as follows:

a. The Enterprises shall immediately take such as actions as are necessary to secure and/or preserve their right to make immediately due the full amount of any obligation secured by a mortgage that becomes, without the consent of the mortgage holder, subject to a first-lien PACE obligation. Such actions may include, to the extent necessary, interpreting or amending the Enterprises' Uniform Security Instruments.

b. The Enterprises shall not purchase any mortgage that is subject to a first-lien PACE obligation, except to the extent that the Enterprise, if it already owned the mortgage, would consent to the PACE obligation pursuant to paragraph (c) below.

c. The Enterprises shall not consent to first-lien PACE obligations except those that (a) are (or promptly upon their creation will be) recorded in the relevant jurisdiction's public land-title records, and (b) meet any of the following three conditions:

i. Repayment of the PACE obligation is irrevocably guaranteed by a qualified insurer,[32] with the guarantee obligation triggered by any foreclosure or other similar default resolution involving transfer of the collateral property; or

ii. A qualified insurer insures the Enterprises against 100% of any net loss attributable to the PACE obligation in the event of a foreclosure or other similar default resolution involving transfer of the collateral property; [33] or,

iii. The PACE program itself provides, via a sufficient reserve fund maintained for the benefit of holders of mortgage interests on properties subject to senior obligation under the program,[34]

[32] The Enterprises shall determine reasonable criteria by which ''qualified insurers'' can be identified.

[33] Net loss attributable to the PACE obligation shall be the greater of (a) the amount of the outstanding PACE obligation minus any incremental value (which could be positive or negative) that the PACE-funded project contributes to the collateral property, as determined by a current qualified appraisal, or (b) zero.

[34] A ''sufficient reserve fund'' shall be a reserve fund that provides, on an actuarially sound basis, protection at least equivalent to that of a qualified insurer.

substantially the same coverage described in paragraph (ii) above.

In providing such consent, the Enterprises shall reserve the rights to revoke the consent in the event the subject PACE obligation ceases to meet any of the conditions, and to accelerate the full amount of the corresponding mortgage obligation so as to be immediately due in that event.

FHFA has reservations about the First Risk-Mitigation Alternative, including whether the referenced guarantees and/or insurance would be available in the marketplace. Moreover, even to the extent the referenced guarantees and/or insurance were available in the marketplace, the First Risk Mitigation Alternative might not effectively insulate the Enterprises from the range of material financial risks that first-lien PACE programs otherwise would force them to bear. For example, the Enterprises would be exposed to the risk that the insurance provider may fail, potentially leaving the Enterprises to bear the very risks they were to be insured against. While an appropriate definition of ''qualified insurer'' can reduce this risk, it cannot eliminate it.

Notwithstanding these reservations, and pursuant to the Preliminary Injunction, FHFA is considering the First Risk-Mitigation Alternative, and solicits comments regarding its potential benefits, detriments, and effects, as well as modifications that could make it more beneficial and effective or otherwise address FHFA's reservations.

2. Second Risk-Mitigation Alternative—Protective Standards

The second Risk-Mitigation Alternative is as follows:

a. The Enterprises shall take such actions as are necessary to secure and/or preserve their right to accelerate so as to be immediately due the full amount of any obligation secured by a mortgage that becomes, without the consent of the mortgage holder, subject to a first-lien PACE obligation. Such actions may include, to the extent necessary, interpreting or amending the Enterprises' Uniform Security Instruments.

b. The Enterprises shall not purchase any mortgage that is subject to a first-lien PACE obligation, except to the extent that the Enterprise, if it already owned the mortgage, would consent to the PACE obligation pursuant to paragraph (c) below.

c. The Enterprises shall not consent to first-lien PACE obligations except in instances where, based on the Enterprise's underwriting definitions, the following five conditions are met—

i. The PACE obligation is no greater than $25,000 or 10% of the fair market value of the underlying property, whichever is lower;

ii. Current combined loan-to-value ratio (reflecting all obligations secured by the underlying property, including the putative PACE obligation, and based on a current qualified appraisal [35]) would be no greater than 65%; and

iii. The borrower's adequately documented back-end debt-to-income ratio (including service of the putative PACE obligation) would be no greater than 35% using the calculation methodology provided in the Enterprises' guides;

iv. The borrower's FICO credit score is not lower than 720; and

v. The PACE obligation is (or promptly upon its creation will be) recorded in the relevant jurisdiction's public land-title records.

d. The Enterprises are to treat a home-purchaser's prepayment of an existing first-lien PACE obligation as an element of the purchase price in determining loan amounts and applying underwriting criteria.

FHFA has reservations about the Second Risk-Mitigation Alternative, including whether it would reduce but not eliminate the material financial risks that first-lien PACE programs would otherwise pose to the Enterprises. In particular, because the mechanism by which the Second Risk-Mitigation Alternative would protect the Enterprises is the imposition of a substantial equity cushion as a prerequisite to consent to creation of a senior PACE lien, market conditions in which equity is substantially eroded (*i.e.,* severe declines in home prices) would cause the risks associated with such liens and borne by the Enterprises to become even more material.

Notwithstanding these reservations, and pursuant to the Preliminary Injunction, FHFA is considering the Second Risk-Mitigation Alternative, and solicits comments regarding its potential benefits, detriments, and effects, as well as modifications that could make it more beneficial and effective or otherwise address FHFA's reservations.

3. Third Risk-Mitigation Alternative—H.R. 2599 Underwriting Standards

The third Risk-Mitigation Alternative would adopt the key underwriting standards set forth in H.R. 2599, which many commenters proffered as a reasonable source of standards FHFA could adopt, and is as follows:

a. The Enterprises shall take such actions as are necessary to secure and/or preserve their right to make immediately due the full amount of any obligation secured by a mortgage that becomes, without the consent of the mortgage holder, subject to a first-lien PACE obligation. Such actions may include, to the extent necessary, interpreting or amending the Enterprises' Uniform Security Instruments.

b. The Enterprises shall not purchase any mortgage that is subject to a first-lien PACE obligation, except to the extent that the Enterprise, if it already owned the mortgage, would consent to the PACE obligation pursuant to paragraph (c) below.

c. The Enterprises shall not consent to first-lien PACE obligations except those that (a) are (or promptly upon their creation will be) recorded in the relevant jurisdiction's public land-title records, and (b) meet all of the following conditions—

i. The PACE obligation is embodied in a written agreement expressing all material terms;

ii. The agreement requires that, upon payment in full of the PACE obligation, the PACE program promptly provide written notice of satisfaction to the owner of the underlying property and the holder of any mortgage on such property as reflected in the relevant jurisdiction's land-title records and take all necessary steps to extinguish the PACE lien;

iii. All property taxes and any other public assessments on the property are current and have been current for three years or the property owner's period of ownership, whichever period is shorter;

iv. There are no involuntary liens, such as mechanics liens, on the property in excess of $1,000;

v. No notices of default and not more than one instance of property-based debt delinquency have been recorded during the past three years or the property owner's period of ownership, whichever period is shorter;

vi. The property owner has not filed for or declared bankruptcy in the previous seven years;

vii. The property owner is current on all mortgage debt on the property;

viii. The property owner or owners are the holders of record of the property;

ix. The property title is not subject to power of attorney, easements, or subordination agreements restricting the authority of the property owner to subject the property to a PACE lien;

x. The property meets any geographic eligibility requirements established by the PACE program;

[35] A ''current, qualified appraisal'' shall be an appraisal that is (1) no more than 30 days old, and (2) in compliance with the Enterprises' published appraisal standards.

xi. The improvement funded by the PACE transaction has been the subject of an audit or feasibility study that:

a. Has been commissioned by the local government, the PACE program, or the property-owner and completed no more than 90 days prior to presentation of the proposed PACE transaction to the mortgage holder for its consent; and

b. Has been performed by a person who has been certified as a building analyst by the Building Performance Institute or as a Home Energy Rating System Rater by a Rating Provider accredited by the Residential Energy Service network; or who has obtained other similar independent certification; and

c. Includes each of the following:

1. Identification of recommended energy conservation, efficiency, and/or clean energy improvements;

2. Identification of the proposed PACE-funded project as one of the recommended improvements identified pursuant to paragraph 1. *supra;*

3. An estimate of the potential cost savings, useful life, benefit-cost ratio, and simple payback or return on investment for each recommended improvement; and,

4. An estimate of the estimated overall difference in annual energy costs with and without the recommended improvements;

xii. The improvement funded by the PACE transaction has been determined by the local government as one expected to be affixed to the property for the entire useful life of the improvement based on the expected useful lives of energy conservation, efficiency, and clean energy measures approved by the Department of Energy;

xiii. The improvement funded by the PACE transaction will be made or installed by a contractor or contractors determined by the local government to be qualified to make the PACE improvements;

xiv. Disbursal of funds for the PACE transaction shall not be permitted unless:

a. The property owner executes and submits to the PACE program a written document requesting such disbursement;

b. The property owner submits to the PACE program a certificate of completion, certifying that improvements have been installed satisfactorily; and

c. The property owner executes and submits to the PACE program adequate documentation of all costs to be financed and copies of any required permits;

xv. The total energy and water cost savings realized by the property owner and the property owner's successors during the useful lives of the improvements, as determined by the audit or feasibility study performed pursuant to paragraph xi. *supra* are expected to exceed the total cost to the property owner and the property owner's successors of the PACE assessment;

xvi. The total amount of PACE assessments for a property shall not exceed 10 percent of the estimated value of the property as determined by a current, qualified appraisal;

xvii. As of the effective date of the PACE agreement, the property owner shall have equity in the property of not less than 15 percent of the estimated value of the property as determined by a current, qualified appraisal and calculated without consideration of the amount of the PACE assessment or the value of the PACE improvements;

xviii. The maximum term of the PACE assessment shall be no longer than the shorter of a) 20 years from inception, or b) the weighted average expected useful life of the PACE improvement or improvements, with the expected useful lives in such calculations consistent with the expected useful lives of energy conservation and efficiency and clean energy measures approved by the Department of Energy.

In providing such consent, the Enterprises are to reserve the rights to revoke the consent in the event the subject PACE obligation ceases to meet any of the conditions, and to accelerate so as to be immediately due the full amount of the corresponding mortgage obligation in that event.

FHFA has reservations about the Third Risk-Mitigation Alternative, including whether it could practically be implemented by FHFA and the Enterprises given that certain elements of the alternative appear to be inherently vague and/or dependent upon assumptions that FHFA lacks a sound basis (and the requisite staff and resources) to provide or evaluate.

For example, while the alternative would require that ''The total energy and water cost savings realized by the property owner and the property owner's successors during the useful lives of the improvements, as determined by [a mandatory] audit or feasibility study * * * are expected to exceed the total cost to the property owner and the property owner's successors of the PACE assessment,'' no methodology for computing the costs and savings is provided. Assumptions as to applicable discounts rates are significant and indeed can be determinative—especially since PACE-funded projects may be cash-flow negative for the first several years. Given the uncertainty associated with important elements of calculating the costs and benefits of PACE-funded projects (such as uncertainty as to the course of future energy prices, the costs of maintaining and repairing equipment, and the pace of advances in energy-efficiency technology), determining an appropriate discount rate is a non-trivial undertaking, and FHFA lacks a sound basis to provide one. Without a reasonable, reliable, and consistent methodology for making the calculations that purport to determine whether proposed projects are financially sound (including a reasonable and reliable method for determining the applicable discount rate or rates), the alternative would not adequately protect the Enterprises from financial risk. Similarly, while the maximum term of the PACE obligation is determined with reference to a ''weighted average expected useful life of the PACE improvement or improvements,'' neither H.R. 2599 nor any of the commenters explained how the weights are to be determined, and most appear to assume that ''expected useful lives of energy conservation and efficiency and clean energy measures approved by the Department of Energy'' will be available and reliable for all PACE-funded projects, which FHFA believes is uncertain. Indeed, in many respects, the deployment of pilot programs tied to determining energy efficiency, providing metrics of such efficiency, training appraisers and inspectors, establishing standards based on such pilot programs in the area of energy efficiency and consumer protections and then providing a source of reliable information to consumers would appear more productive than selecting among financing mechanisms at this time. Additionally, a clear method for enforcing standards set forth in such a program would be beneficial.

Notwithstanding these reservations, and pursuant to the Preliminary Injunction, FHFA is considering the Third Risk-Mitigation Alternative, and solicits comments regarding its potential benefits, detriments, and effects, as well as modifications that could make it more beneficial and effective or otherwise address FHFA's reservations.

VI. Paperwork Reduction Act

The proposed rule does not contain any collections of information pursuant to the Paperwork Reduction Act of 1995 (44 U.S.C. 3501 *et seq.*). Therefore, FHFA has not submitted any information to the Office of Management and Budget for review.

VII. Regulatory Flexibility Act

The proposed rule applies only to the Enterprises, which do not come within the meaning of small entities as defined in the Regulatory Flexibility Act (*See* 5 U.S.C. 601(6)). Therefore, in accordance with section 605(b) of the Regulatory Flexibility Act (5 U.S.C. 605(b)), FHFA certifies that this proposed rule, if promulgated as a final rule, will not have a significant economic impact on a substantial number of small entities.

List of Subjects in 12 CFR Part 1254

Government-sponsored enterprises, Housing, Lien-priming, Mortgages, Mortgage-backed securities, Property Assessed Clean Energy Programs.

For the reasons stated in the preamble, and under the authority of 12 U.S.C. 4526, the Federal Housing Finance Agency proposes to amend Chapter XII of Title 12 of the Code of Federal Regulations by adding a new part 1254 to subchapter C to read as follows:

PART 1254—ENTERPRISE UNDERWRITING STANDARDS

Sec.

Authority: 12 U.S.C. 4526(a).

§ 1254.1 Definitions.

As used in this part,

Consent means to provide voluntary written assent to a proposed transaction in advance of the transaction, and includes the documentation embodying such assent.

First-lien means having or taking a lien-priority interest ahead of or senior to a first mortgage on the same property, or otherwise subordinating the security interest of the holder of a first mortgage to that of another financial obligation secured by the property.

PACE obligation shall mean a financial obligation created under a Property Assessed Clean Energy (PACE) Program or other similar program for financing energy-related home-improvement projects through voluntary and/or contractual assessments against the underlying property.

§ 1254.2 Mortgage assets affected by first-lien Property Assessed Clean Energy (PACE) Programs.

(a) The Enterprises shall immediately take such as actions as are necessary to secure and/or preserve their right to make immediately due the full amount of any obligation secured by a mortgage that becomes, without the consent of the mortgage holder, subject to a first-lien PACE obligation. Such actions may include, to the extent necessary, interpreting or amending the Enterprises' Uniform Security Instruments.

(b) The Enterprises shall not purchase any mortgage that is subject to a first-lien PACE obligation.

(c) The Enterprises shall not consent to the imposition of a first-lien PACE obligation on any mortgage.

§ 1254.3 [Reserved]

Dated: June 12, 2012.

Edward J. DeMarco,

Acting Director, Federal Housing Finance Agency.

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