March 16, 2020

The Honorable Mark Calabria
Director
Federal Housing Finance Agency
400 7th Street SW
Washington, DC 20219

ATTN: PACE Request for Input, Notice No. 2020-N-1

Director Calabria:

The undersigned organizations appreciate the opportunity to comment on the Federal Housing Finance Agency's (FHFA) Notice and Request for Input (RFI)[1] on residential energy retrofitting programs financed through special state legislation enabling a ''super-priority lien'' over existing and subsequent first mortgages—largely put in place through Property Assessed Clean Energy (PACE) financing programs. In particular, FHFA seeks input on potential changes to its policies for its regulated entities based on safety and soundness concerns.

Our organizations recognize the commitment of communities across the nation to reduce energy consumption and improve energy efficiency in residential and commercial properties and the need for policymakers, community leaders, and consumers to pursue and promote energy sustainability. The push to increase awareness and utilization of more energy efficient products and practices, however, must also protect consumers from unsafe and unaffordable arrangements, such as PACE financing programs, that pose a risk to consumers and communities alike. Documented experiences with these highly unregulated loans and the companies offering them is troubling, and consumer abuses have been reported widely.[2]

PACE financing is structured differently from traditional financing in that homeowners are able to finance energy efficient home improvements, such as solar panels, insulation, and window upgrades, through special property tax assessments rather than through loans, installment contracts, or home equity lines of credit (HELOCs). PACE programs vary by state, county, and municipality, but most result in a property tax lien, which is often a super-priority lien over other liens on the property.

Our organizations believe that many of the problems with PACE financing are the result of decisions to treat it differently from traditional mortgage financing. Unique features such as tax lien treatment, specific project eligibility guidelines, and repayment through tax bills do not change the fundamental character of PACE financing—in practice, if not in the law, PACE financing structures are mortgages. As such, the need for consumer protections is similar to that associated with traditional mortgage financing. Whether through a tax sale or a foreclosure, the result of homeowners' inability to repay is the same—they lose their homes.

While the challenges posed by PACE financing are significant and warrant consideration, restricting access to low down payment mortgage credit would penalize even more consumers, rather than address the problem at hand. Further, without a substantial and perpetual information campaign from

[1] 85 Federal Register 2736 (January 16, 2020).
[2] National Consumer Law Center on PACE: https://www.nclc.org/issues/pace-loans.html

federal regulators such as FHFA and the Consumer Financial Protection Bureau (CFPB), we believe that additional reporting and disclosure requirements would have marginal impact, confuse borrowers, and create undue regulatory burden on parties not responsible for this problematic practice. FHFA instead should continue to work with industry and consumer advocates to educate state and local lawmakers about the risks of PACE financing, and support wherever possible efforts to establish Ability-to-Repay (ATR) requirements for PACE lending, create licensing requirements for PACE administrators and contractors, and ensure subordination of PACE liens to mortgages.

Challenges Posed by PACE Financing are Significant and Warrant Consideration. As stated in FHFA's RFI, there are a number of distinctions between PACE financing and traditional mortgages that raise important consumer protection concerns. Private contractors typically arrange PACE financing agreements for tens of thousands of dollars with consumers through door-to-door sales within a matter of hours. Many consumers—particularly the elderly or those with limited English proficiency—have lodged complaints regarding their limited understanding of the nature of the agreement and the true cost of the financing. For example, some consumers have reported sales techniques that left them with the impression that the loans would "pay for themselves" through energy savings or tax benefits. Others have reported that they were led to believe PACE financing represented a form of government assistance.

Often consumers do not grasp the implications of the financing for their ability to refinance or sell the property. If the PACE lien prevents a refinance, consumers are prevented from improving their financial condition by taking advantage of lower interest rates. Upon sale, the new owner would have to accept the higher tax bill on a PACE-encumbered home in relation to comparable homes in the neighborhood. If the higher monthly payment structure influences the overall price of the home, in this case incentivizing a discount, the PACE lien has in effect stripped equity away from the borrower.

FHFA also correctly notes that PACE financing increases the potential for homeowner defaults because PACE loan underwriting frequently does not include a standard analysis of the borrower's ATR capacity and instead merely relies on the property value or other limited factors. Further, PACE financing terms and risks associated with the transaction are frequently unclear to borrowers. Issues such as elevated interest rates, excessive administrative fees, and repayment terms of up to 30 years are all areas that raise additional risk and concern with respect to PACE financing.

PACE financing also presents safety and soundness concerns for lenders and investors due to potential greater risk exposure on properties for which there is a PACE lien, as the PACE financing often dilutes the value of a security interest held by the lender or investor if the borrower defaults. Because of these concerns, the GSEs have issued guidance and updates to their seller-servicer guides to expressly state that they will not acquire and guarantee mortgages with PACE liens. Further, FHFA has also urged caution to the Federal Home Loan Banks in accepting collateral for advances where PACE liens may be attached.

As highlighted by FHFA in the RFI, while the GSEs do not currently allow purchase or refinance loans with PACE liens, these products still present concerns, as it can be difficult for lenders and regulators to determine whether a PACE lien is present on a specific property. PACE financing is not always obvious to the GSEs as the liens are not always recorded in local land records and are therefore only discoverable in tax records, which may not always be presented clearly. Further, lenders' standard first-lien mortgage instruments generally prohibit a homeowner from granting a superior lien, however this has not prevented homeowners from securing PACE financing and permitting super liens to be attached to their properties.

Restricting Access to Low Down Payment Mortgage Credit Would Raise Much Greater Concern and Harm Entire Communities. Our organizations agree with the consumer protection and GSE safety and soundness concerns raised by FHFA in the RFI, and we understand the need to consider ways to mitigate the risk that PACE financing poses to consumers and to the GSEs. We jointly write, however, to express our significant concern with FHFA's consideration of options to limit access to conventional financing for borrowers with less than a 20% down payment simply because they live in jurisdictions where PACE financing may be available.

A decrease in allowable loan-to-value (LTV) ratios for new home purchases in jurisdictions that permit PACE financing would be unnecessarily punitive to the millions of consumers who live in those jurisdictions and who would be affected negatively due to the presence of PACE financing in that area. The residential PACE loan market is limited today and only some areas of California, Florida, and Missouri operate active residential PACE loan programs.[3] For these three states that currently maintain active residential PACE programs, state-wide GSE restrictions would have affected more than 200,000 low down payment borrowers in the last year alone.[4] Contemplating a further curtailment in LTVs because of an increase in the volume of PACE financing would constrain the market even further.

Given that some PACE programs allow up to 20% financing, these policies would limit homeownership options for every borrower in a given market that would want to use low down payment mortgages. Such policies, if implemented, would disproportionately harm low- and moderate-income borrowers, minority borrowers, and first-time homebuyers who typically rely on low down payment mortgages to purchase their homes. In fact, in recent years approximately 80% of first-time homebuyers used low down payment mortgage products and nearly 60% of low down payment conventional purchase mortgages with private mortgage insurance have gone to first-time homebuyers.[5]

The RFI also considers the merits of increasing Loan Level Price Adjustments (LLPAs) or requiring other credit enhancements for all GSE acquisitions in jurisdictions that permit PACE financing. Our organizations oppose this policy, as increased LLPAs would be an unnecessary and burdensome fee for homebuyers that is unrelated to their personal credit profiles. This policy would amount to an arbitrary and speculative tax on homebuyers in select jurisdictions and is not grounded in the reality of the risk posed by any one borrower's loan. If this policy had been in place in 2019, the arbitrary fees could have applied to nearly one million home purchase transactions in the three states that permit residential PACE financing.[6]

Additional Reporting and Disclosure Requirements Would Have Marginal Impact, Confuse Borrowers, and Create Undue Regulatory Burden on Parties Not Responsible for Problematic Practices. Our organizations are concerned with the possible implications and complexities related to potential

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[3] Media reports reveal that PACE lenders are actively seeking multiple community ordinances in Ohio to expand PACE lending in that state. e.g. https://www.cleveland.com/business/2020/02/new-home-repair-loan-becomes-available-in-ne-ohio-but-advocates-urge-stronger-consumer-protections.html

[4] Number of low down payment GSE-guaranteed mortgages with private mortgage insurance is based on GSE Aggregate Data for 4Q2018 – 3Q2019.

[5] Genworth Mortgage Insurance First-Time Homebuyer Reports and GSE Aggregate Data.

[6] California Association of REALTORS®; Florida REALTORS®; Missouri REALTORS®.

disclosure and reporting requirements for lenders and real estate professionals at closing and for mortgage servicers on an annual or more frequent basis. Requiring these parties to either solicit information on current PACE liens or systematically warn consumers about PACE financing restrictions would impose significant operational costs on institutions not responsible for generating the risk to the investor. Additionally, these efforts are not likely to produce the desired outcomes and would likely have adverse effects on the consumer.

First, because a PACE lien runs with the property and is included in the tax record regardless of the property owner, the information on the tax assessment would need to be explained to each potential buyer. The PACE financing, and the corresponding energy improvement, could be complicated or difficult to identify and explain, and the buyer could be confused about the value of the improvement or the nature of the PACE financing, thereby injecting an element of uncertainty into the purchase transaction. Further, if the average length of PACE financing is 20 years, real estate professionals and mortgage lenders in some cases would be responsible for explaining the special, and often complicated, tax assessment several times over the life of the PACE lien. This process could cause significant delays in the completion of the transaction.

Second, servicers do not have access to the information necessary to satisfy a periodic reporting requirement. Currently, servicers do not receive tax reports detailed enough to identify PACE payments made through the tax roll. Significant operational changes, likely including renegotiation of contracts with vendors who handle relationships with local tax authorities, would have to be made to even attempt to acquire this information. Given the immense difficulty associated with communicating with a vast set of localities, there is no certainty that full data would be available. Alternatively, an attempt to survey borrowers regarding use of PACE financing for project improvements would likely result in even more limited data given the likelihood of borrower fear of repercussion upon self-reporting. This same fear would likely diminish the efficacy of a periodic disclosure requirement. Rather than require individual servicers to obtain information on existing PACE liens, it would be far more efficient to require the GSEs to obtain this data from commercial data providers that have developed robust tracking of PACE liens, including information on terms and conditions as well as performance.

Requiring mortgage servicers to issue a periodic disclosure informing borrowers about PACE financing would be limited at best in its ability to be received and comprehended, and at worst be threatening to borrowers who may have already endorsed a PACE-financed improvement project. Servicing regulations already require periodic disclosures on topics considered difficult to understand by the average borrower. PACE liens rely on an unusual structure—as their non-traditional financing is complicated even for industry professionals. Borrowers who have already approved a PACE lien would likely be anxious to know if their mortgage servicer intends to take legal action against them and ultimately would be more incentivized to hide their PACE status from the servicer.

In review, neither proposal's estimated impact justifies the adverse effects it would impose on consumers and the industry. Regulation of PACE activity would be more justifiably directed at the authorities and industry participants who generate the risk to consumers and investors.

FHFA Should Work with Industry and Consumer Advocates to Combat PACE Financing at the State and Local Levels. Our organizations thank FHFA for efforts already underway to educate state and local lawmakers about consumer abuses and financial risks associated with PACE financing, and we encourage FHFA to continue to pursue these efforts. The most effective strategy to combat these problematic lending practices is to target their source. FHFA and other regulators concerned with PACE financing should continue to advise those lawmakers and other policymakers at the state and local levels with the authority to effect change in their jurisdictions.

As state governing bodies become more aware of the consumer abuses related to PACE financing, PACE administrators have begun focusing their marketing and outreach efforts on local governments to petition municipalities to gain legal permission to produce these kinds of property tax assessments. Local lawmakers should be aware of consumer protection issues regarding PACE financing, as well as the costs associated with enabling PACE programs in their counties or municipalities.

FHFA can support state efforts to establish their own standards while the industry awaits completion of the CFPB's rulemaking on federal ATR requirements for PACE financing. Until there is a robust federal framework, FHFA can encourage states to develop regulations extending all consumer protection rules that are required in a traditional mortgage transaction to PACE financing transactions. Additionally, FHFA should support state-level efforts to enact legislation or regulation that establishes licensing requirements for PACE administrators and contractors as well as guaranteed subordination of PACE financing liens to mortgages. Some of our organizations have participated in extensive advocacy to encourage passage of state-level legislation that would ensure subordination of PACE financing, and we will continue to do so.[7]

Conclusion

We appreciate FHFA's initiatives to address the weighty concerns posed by PACE financing as it is currently structured, and we welcome the opportunity to work with FHFA and the GSEs to consider various ways that these concerns can be mitigated. Our organizations do not, however, support proposals that would arbitrarily and punitively limit access to low down payment mortgage finance credit for consumers who live in jurisdictions where PACE financing is available. FHFA should encourage the CFPB to finalize its rulemaking on ATR requirements for PACE lending and extend all consumer protection rules that are required in a mortgage transaction to PACE financings. Our organizations also encourage FHFA to work with state and local leaders to communicate the risks of PACE programs, require licensing of PACE administrators and contractors, and establish clear regulations pertaining to the subordination of PACE liens to mortgages.

Sincerely,

California Mortgage Bankers Association
Credit Union National Association
Housing Policy Council
Leading Builders of America
Mortgage Bankers Association
Mortgage Bankers Association of Florida
Mortgage Bankers Association of Missouri
National Association of Federally-Insured Credit Unions
National Association of REALTORS®
Real Estate Services Providers Council, Inc. (RESPRO)
U.S. Mortgage Insurers

[7] Mortgage Bankers Association PACE advocacy page: https://www.mba.org/advocacy-and-policy/residential-policy-issues/government-housing-finance-programs/property-assessed-clean-energy-(pace)-lending