NCLC

NATIONAL CONSUMER LAW CENTER®

Advancing Fairness in the Marketplace for All

March 26, 2012

Alfred M. Pollard
General Counsel
Federal Housing Finance Agency

By email: RegComments@fhfa.gov

RE: RIN 2590-AA53, Mortgage Assets Affected By PACE Programs

Dear Mr. Pollard:

The National Consumer Law Center ("NCLC"), on behalf of its low-income clients, and Consumer Federation of America ("CFA") wish to comment in response to the Advance Notice of Proposed Rulemaking and Request for Comments regarding PACE programs that appeared in the January 26, 2012 Federal Register (77 Fed. Reg. 3958). For over 40 years, NCLC's mission has been to advocate on behalf of low and moderate income consumers in the marketplace. Just as FHFA itself has raised a number of questions and concerns regarding the impact that PACE programs may have on homeowners and purchasers of mortgages – and issued "restrictions and conditions set forth" in its "July 6, 2010 Statement and the February 28, 2011 Directive"[1] to address its concerns – NCLC and CFA wish to raise some concerns as well.

At the outset, however, we wish to emphasize that PACE programs can offer many homeowners substantial advantages. The municipality offering the PACE program can help the homeowner understand the costs and benefits of contemplated investments in energy efficiency or renewable energy. The municipality may also be able to assist the homeowner in applying for any available federal or state tax credits or utility rebate programs, and locate qualified contractors. PACE loans can be structured so that the reductions in the homeowner's energy bills equal or exceed the amount of the loan repayments, leaving the homeowner with lower net costs of owning the home.[2] PACE programs can help homeowners reduce their energy consumption, and, at a large enough scale, can help municipalities and states achieve their energy efficiency and greenhouse gas reduction goals.

However, PACE programs are not without risks. In our still highly-distressed economy, many mortgages are underwater – the actual value of the house is less than the principal owed on the mortgage – and these homeowners should not take on more debt. Many other homeowners may not have mortgages that are actually underwater, but their finances are so fragile that taking on additional debt may lead to default on the PACE loan or other obligations, especially if the energy savings prove to be

[1] 77 Fed. Reg. 3958, col. 3.
[2] However, we are not aware of any PACE programs that actually guarantee this result, as it is very difficult to predict future energy savings with certainty.

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smaller than projected, or the installed energy measures do not perform as expected. While most PACE programs have rules to exclude homeowners who, e.g., have gone through bankruptcy, or are behind on their mortgage or property tax bills, or whose home value is not several times larger than the amount to be borrowed, PACE programs are usually not engaging in full underwriting nor assessing the homeowner's actual ability to pay.

FHFA is correct in expressing concern that widespread approval of PACE programs could lead to consumers having higher overall housing cost burdens and reduced equity stakes than before the improvements were financed. PACE proposals would require that estimated energy savings equal or exceed the monthly PACE obligations, but these are estimates only. To protect homeowners against adverse outcomes, FHFA should consider requiring PACE lenders to carry out a complete ability-to-repay underwriting exam before approving PACE financing.

In light of these benefits and risks of PACE programs, NCLC urges FHFA to take a cautious and balanced approach that protects homeowners yet impedes PACE programs as minimally as possible. However, there is inherent tension between the desire of lenders to obtain "the lien priming feature of first-lien PACE obligations,"[3] which allows them to offer lower cost capital and avoid more extensive underwriting, and the serious risk a homeowner faces whenever there is default on a first-priority lien. Therefore, PACE programs must "incorporate prudent programmatic safeguards to protect the interest of . . . property owners."[4]

Congress currently has before it H. R. 2599, which incorporates a number of protections for homeowners who would take out PACE loans.[5] NCLC agrees that the following provisions, most of which are embodied in H.R. 2599, are critical to protect the interests of consumers. FHFA should not consider revising its existing restrictions and conditions unless these provisions are met:[6]

- Local governments offering PACE programs must disclose the costs and risks associated with PACE programs, <u>especially the risks associated with defaulting on loan repayment amounts collected via property tax bills</u>. In many jurisdictions, failure to pay amounts due on a property tax bill can result in fees and interest penalties higher than would result from failure to repay other types of loans, e.g., a home equity loan. Moreover, in many states the foreclosure process when property tax bills are not paid can be quite different, and less favorable to the homeowner, than the process for a mortgage foreclosure. Local municipalities should fully disclose these risks.

[3] 77 Fed. Re. 3961, col. 3.
[4] H.R. 2599, PACE Assessment Protection Act of 2011, § 2 (introduced 112th Congress, 1st Session).
[5] NCLC notes that FHFA's questions 9 through 13 (77 Fed. Reg. 3962, col. 3) ask about "protections and/or disclosures" that PACE programs mandate or offer to homeowner-borrowers. While we do not directly answer those questions, we do address disclosures and protections which we believe PACE programs <u>should</u> offer.
[6] H.R. 2599, § 5.

- Homeowners should not be allowed to borrow under PACE programs unless: (1) all property taxes have been timely paid during the prior three years; (2) there are no involuntary liens on the property in excess of $1,000; (3) the property owner has not filed for or declared bankruptcy in the prior 7 years; and (4) the property owner is current on any mortgage debt on the property.

- PACE loans should not be offered unless an energy audit has been conducted by a certified energy auditing professional, and the resulting energy audit projects that the energy savings from the planned investments will exceed the loan repayment costs, including all interest and fees. To protect homeowners, loans should be capped so that the repayments are not more than, e.g., 85% of the expected savings.

- PACE programs should require that all energy work be performed by contractors who the municipality has determined are qualified to properly carry out energy efficiency and/or renewable energy work. We note that state and local governments have limited ability to enforce their current code inspection and enforcement regimes. We urge FHFA to consider their ability to monitor and verify the various obligations that would be necessary to protect the interests of homeowners who may participate in PACE programs.

- PACE loans should not exceed 10% of the value of the property, and the homeowner shall have equity in the property equal to at least 15% of the value of the property.

NCLC has looked at some exemplary PACE loan rates during the time PACE programs were most active (2008-2010) and compared them to exemplary rates for home equity loans and borrowing against home equity lines of credit during the same period. While PACE loan rates were reasonable, many homeowners with equity in their homes would likely have been able to borrow against their home equity at lower rates.[7]

Because we believe that PACE loans should only be taken by homeowners who have substantial equity in their homes (e.g., 15% of the value or more), and because homeowners with equity in their homes can often borrow against their equity at favorable rates, we urge the FHFA to be cautious in deciding whether to lift its current restrictions and conditions regarding PACE loans and FHFA-regulated entities.[8] Homeowners who could take out a PACE loan may also have other routes for borrowing fund which do not raise the same concerns as PACE loans do.

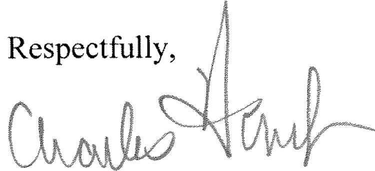
While we believe that PACE loans can be an attractive and worthwhile product for homeowners with substantial equity in their homes and who are interested in making investments in energy efficiency and renewable energy, we strongly believe that PACE programs must incorporate all of the consumer protections listed above. We also are concerned that allowing PACE loan repayments to be incorporated onto property tax bills and to have a first-lien position will place homeowners of limited means at risk, especially if the energy savings projected by the energy auditor do not in fact appear, or if there are problems with installed equipment or other contractor work. Lastly, we are concerned that state and local governments will be unequal to

[7] See Question 5, 77 Fed. Reg. 3962 (asking about "alternatives to first-lien PACE loans").
[8] See Question 1, 77 Fed. Reg. 3961.

the task of properly monitoring the sales tactics and behavior of the many contractors who will no doubt be attracted by the availability of PACE financing. Consumers – especially vulnerable elderly owners with significant equity but little extra monthly cash – could be victimized by vendors of these servicers overpromising and underdelivering energy savings. With PACE loans having a senior position, ownership of their homes could be jeopardized

We appreciate the opportunity FHFA has offered to offer these comments.

Respectfully,



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