

FEDERAL HOUSING FINANCE AGENCY



STATEMENT

For Immediate Release
July 6, 2010

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FHFA Statement on Certain Energy Retrofit Loan Programs

After careful review and over a year of working with federal and state government agencies, the 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. Specifically, programs denominated as Property Assessed Clean Energy (PACE) seek to foster lending for retrofits of residential or commercial properties through a county or city's tax assessment regime. Under most of these programs, such loans acquire a priority lien over existing mortgages, though certain states have chosen not to adopt such priority positions for their loans.

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. The size and duration of PACE loans exceed typical local tax programs and do not have the traditional community benefits associated with taxing initiatives.

FHFA urged state and local governments to reconsider these programs and continues to call for a pause in such programs so concerns can be addressed. First liens for such loans represent a key alteration of traditional mortgage lending practice. 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.

While the first lien position offered in most PACE programs minimizes credit risk for investors funding the programs, it alters traditional lending priorities. Underwriting for PACE programs results in collateral-based lending rather than lending based upon ability-to-pay, the absence of Truth-in-Lending Act and other consumer protections, and uncertainty as to whether the home improvements actually produce meaningful reductions in energy consumption.

Efforts are just underway to develop underwriting and consumer protection standards as well as energy retrofit standards that are critical for homeowners and lenders to understand the risks and rewards of any energy retrofit lending program. However, first liens that disrupt a fragile housing finance market and long-standing lending priorities, the absence of robust underwriting standards to protect homeowners and the lack of energy retrofit standards to assist homeowners, appraisers, inspectors and lenders determine the value of retrofit products combine to raise safety and soundness concerns.

On May 5, 2010, Fannie Mae and Freddie Mac alerted their seller-servicers to gain an understanding of whether there are existing or prospective PACE or PACE-like programs in jurisdictions where they do business, to be aware that programs with first liens contrary to the Fannie Mae-Freddie Mac Uniform Security Instrument and that the Enterprises would provide additional guidance should the programs move beyond the experimental stage. Those lender letters remain in effect.

Today, FHFA is directing Fannie Mae, Freddie Mac and the Federal Home Loan Banks to undertake the following prudential actions:

1. For any homeowner who obtained a PACE or PACE-like loan with a priority first lien prior to this date, FHFA is directing Fannie Mae and Freddie Mac to waive their Uniform Security Instrument prohibitions against such senior liens.
2. In addressing PACE programs with first liens, Fannie Mae and Freddie Mac should undertake actions that protect their safe and sound operations. These include, but are not limited to:
 - Adjusting loan-to-value ratios to reflect the maximum permissible PACE loan amount available to borrowers in PACE jurisdictions;
 - Ensuring that loan covenants require approval/consent for any PACE loan;
 - Tightening borrower debt-to-income ratios to account for additional obligations associated with possible future PACE loans;
 - Ensuring that mortgages on properties in a jurisdiction offering PACE-like programs satisfy all applicable federal and state lending regulations and guidance.

Fannie Mae and Freddie Mac should issue additional guidance as needed.

3. The Federal Home Loan Banks are directed to review their collateral policies in order to assure that pledged collateral is not adversely affected by energy retrofit programs that include first liens.

Nothing in this Statement affects the normal underwriting programs of the regulated entities or their dealings with PACE programs that do not have a senior lien priority. Further, nothing in these directions to the regulated entities affects in any way underwriting related to traditional tax programs, but is focused solely on senior lien PACE lending initiatives.

FHFA recognizes that PACE and PACE-like programs pose additional lending challenges, but also represent serious efforts to reduce energy consumption. FHFA remains committed to working with federal, state, and local government agencies to develop and implement energy retrofit lending programs with appropriate underwriting guidelines and consumer protection standards. FHFA will also continue to encourage the establishment of energy efficiency standards to support such programs.

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The Federal Housing Finance Agency regulates Fannie Mae, Freddie Mac and the 12 Federal Home Loan Banks. These government-sponsored enterprises provide more than \$5.9 trillion in funding for the U.S. mortgage markets and financial institutions.

Bulletin

NUMBER: 2010-20

TO: Freddie Mac Sellers and Servicers

August 31, 2010

**SUBJECT: MORTGAGES SECURED BY PROPERTIES WITH AN OUTSTANDING
PROPERTY ASSESSED CLEAN ENERGY (PACE) OBLIGATION**

This *Single-Family Seller/Servicer Guide* ("Guide") Bulletin provides guidance to our Seller/Servicers regarding Freddie Mac's purchase of Mortgages secured by properties with a Property Assessed Clean Energy (PACE) or PACE-like obligation.

BACKGROUND

In our Industry Letter dated May 5, 2010, *First Lien Mortgages and Energy Efficient Loans*, Freddie Mac reminded Seller/Servicers that an energy-related lien may not be senior to any Mortgage delivered to Freddie Mac. We also indicated that we would provide additional guidance regarding our requirements on energy retrofit lending programs in the future, should they move beyond the experimental stage.

On July 6, 2010, the Federal Housing Finance Agency (FHFA) issued a Statement on Certain Energy Retrofit Loan programs, such as PACE programs ("the FHFA Statement"). The FHFA Statement advised that First Liens offered by most PACE programs "pose unusual and difficult risk management challenges for lenders, servicers and mortgage securities investors," and change customary lending priorities.

The FHFA Statement further provides that First Liens created by PACE programs raise safety and soundness concerns. Other regulators share these concerns. For example, a Bulletin issued July 6, 2010 by the Office of the Comptroller of the Currency (OCC 2010-25) states, "This lien infringement raises significant safety and soundness concerns that mortgage lenders and investors must consider."

Freddie Mac supports the goal of encouraging responsible financing of energy efficient and renewable energy home improvements, and we believe this goal may be achieved without altering the lien priority status of first Mortgages or other underwriting requirements. To the extent necessary to mitigate greater risks associated with PACE and PACE-like programs, Freddie Mac will take additional actions. These actions could include adjusting loan-to-value and debt-to-income ratios for Mortgages secured by properties located in jurisdictions that permit such programs.

REQUIREMENTS

The requirements of this Bulletin apply to PACE obligations that provide for First Lien priority.

Mortgages secured by properties subject to PACE obligations that provide for First Lien priority

Freddie Mac will not purchase Mortgages secured by properties subject to PACE obligations that provide for First Lien priority. Seller/Servicers are responsible for monitoring State and local laws to determine whether a jurisdiction has a PACE program that provides for First Lien priority.

Mortgages secured by properties subject to PACE obligations originated before July 6, 2010 that provide for First Lien priority

For Mortgages with Freddie Mac Settlement Dates before **July 6, 2010** that are secured by properties subject to PACE obligations originated before **July 6, 2010** that provide for First Lien priority, Freddie Mac will waive the Uniform Security Instrument requirement that these obligations be subordinate to the First Lien. Otherwise, our requirements regarding Mortgages secured by properties subject to PACE obligations that provide for First Lien priority remain unchanged.

Refinance of Mortgages secured by properties subject to PACE obligations originated before July 6, 2010 that provide for First Lien priority

To mitigate the risk posed by PACE obligations that provide for First Lien priority over the Mortgage, we are implementing additional requirements with respect to the refinance of Mortgages with Freddie Mac Settlement Dates before July 6, 2010 that are secured by properties subject to PACE obligations originated before July 6, 2010 that provide for First Lien priority.

For such Mortgages (except when refinanced under Freddie Mac's Relief Refinance MortgagesSM offering as described below), Freddie Mac will require that Borrowers who have sufficient equity pay off the existing PACE obligation in full as a condition to obtaining a new Mortgage. In addition, Sellers must qualify the Borrower using the steps below that are designed to mitigate Freddie Mac's exposure and minimize Borrower hardship:

- Sellers must first attempt to refinance the Mortgage either as:
 - A cash-out refinance Mortgage under the requirements of Guide Section 24.6, *Requirements for Cash-Out Refinance Mortgages*, or
 - A "no cash-out" refinance Mortgage under the requirements of Guide Section 24.5, *Requirements for "no cash-out" refinance Mortgages*, except that pay-off of the PACE obligation will be permitted in the same manner that secondary financing that is used in its entirety to purchase the subject property may be paid off

Proceeds from the cash-out refinance Mortgage or the "no cash-out" refinance Mortgage must be used to pay off the PACE obligation in full.

- If the Mortgage does not meet the requirements for a cash-out refinance Mortgage or a "no cash-out" refinance Mortgage, as described above, with sufficient proceeds to pay off the PACE obligation in full, the Seller may then underwrite the Mortgage under Freddie Mac's Relief Refinance MortgageSM – Open Access offering under the requirements of Guide Chapter B24, *Freddie Mac Relief Refinance MortgagesSM – Open Access*, with the PACE obligation remaining in place. In underwriting under such offering, it will not be necessary to include the PACE obligation in the calculation of the total loan-to-value ratio; however, the PACE obligation must be included in the monthly debt payment-to-income ratio.

Special delivery requirements

For Relief Refinance Mortgages - Open Access when the PACE obligation remains in place, in addition to complying with the special delivery requirements provided in Chapter B24, the Seller must deliver special characteristics code "H28."

GUIDE REVISIONS

Applicable Guide sections will be updated in a future Bulletin to reflect these changes.

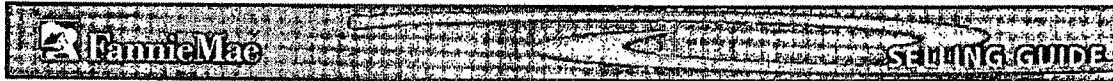
CONCLUSION

If you have any questions, please contact your Freddie Mac representative or call (800) FREDDIE.

Sincerely,

A handwritten signature in black ink, appearing to read "Patricia J. McClung". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Patricia J. McClung
Vice President
Offerings Management



Announcement SEL-2010-12

August 31, 2010

Options for Borrowers with a PACE Loan

On July 6, 2010, the Federal Housing Finance Agency (FHFA) issued a statement regarding Property Assessed Clean Energy (PACE) loan programs. PACE loans are made by localities to finance residential energy improvements and are generally repaid through the homeowner's real estate tax bill. In its July 6 statement, FHFA advised that PACE programs that provide for automatic lien priority over mortgage loans pose safety and soundness risk to mortgage investors.

The purpose of this Announcement is to issue additional lender requirements to address these risks, and to issue special instructions regarding Fannie Mae borrowers who obtained PACE loans prior to July 6, 2010. The *Selling Guide* will be updated to incorporate these policy changes at a future date.

Requirements for PACE loans originated prior to July 6, 2010

Fannie Mae is implementing specific requirements for lenders regarding borrowers who obtained PACE loans prior to July 6, 2010. These requirements are intended to address safety and soundness concerns caused by PACE loans originated prior to the issuance of statements by FHFA and other banking regulators.

Fannie Mae is waiving the uniform security instrument prohibition against PACE loans with lien priority for whole loans purchased before July 6, 2010 and for loans in an MBS pool with an issue date on or before July 1, 2010.

Additionally, the following requirements apply to borrowers with loans that are owned or securitized by Fannie Mae who seek to refinance and who obtained a PACE loan prior to July 6, 2010. To mitigate the risk posed by PACE obligations that take lien priority over the mortgage, Fannie Mae is requiring that borrowers with sufficient equity pay off the existing PACE obligation as a condition to obtaining a new mortgage loan. If a lender determines that a borrower does not have sufficient equity to pay off the existing PACE obligation, the lender may underwrite the loan as described in the second bullet below. This "waterfall" approach is designed to mitigate Fannie Mae's exposure, while avoiding borrower hardship.

- Lender must first attempt to qualify the borrower for either a cash-out or limited cash-out refinance option, with the PACE loan being paid off as part of the refinance. The prohibition against using the proceeds of a limited cash-out refinance to pay off a loan not used to purchase the property will not apply. (See the *Selling Guide*, B2-1.2-02, Limited Cash-Out Refinance Transactions, for structure and eligibility requirements.)
- If the borrower is unable to qualify for a cash-out or limited cash-out refinance with sufficient proceeds to pay off the PACE loan, the lender may underwrite the loan as a limited cash-out refinance, DU Refi Plus™, or Refi Plus™ loan, as applicable, with the PACE loan remaining in place. In these cases, it will not be necessary to include the PACE loan in the calculation of the combined loan-to-value ratio, however the PACE loan payment must be included in the monthly housing expense calculation.

Note: The PACE loan must be included on the Uniform Residential Loan Application (Form 1003) as an installment debt with the balance and payment reflected. If the PACE loan will not be paid off with the transaction, the payment must be included in the total expense ratio.

Due to the complexity of data entry options for limited cash-out refinance transactions in which the PACE loan is being paid off with mortgage proceeds, these transactions must be manually underwritten.

Requirements for PACE loans originated on or after July 6, 2010

Fannie Mae will not purchase mortgage loans secured by properties with an outstanding PACE obligation unless the terms of the PACE program do not permit priority over first mortgage liens.

Lenders are responsible for monitoring state and local law to determine whether a jurisdiction has a PACE program that provides for lien priority.

Fannie Mae supports the need for programs to help homeowners fund energy efficiency improvements, and believes it may be accomplished without altering the lien status of first mortgages. In the event that PACE or similar programs with automatic lien priority proliferate, Fannie Mae will consider further limitations as necessary to address safety and soundness concerns posed by PACE programs, in line with the July 6 FHFA statement. These restrictions may include tightening borrower debt-to-income ratios or loan-to-value ratios in jurisdictions offering such programs.

Effective Date

This Announcement is effective immediately.

Lenders who have questions about this Announcement should contact their Customer Account Team.

John S. Forlines
Vice President
Single-Family Chief Risk Officer