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FEDERAL HOUSING FINANCE AGENCY

12 CFR Part 1254

RIN 2590-AA53

Mortgage Assets Affected by PACE Programs

AGENCY: Federal Housing Finance Agency.

ACTIONS: Advance notice of proposed rulemaking; request for comments; Notice of intent to prepare environmental impact statement; request for scoping comments.

SUMMARY: The Federal Housing Finance Agency ("FHFA") hereby issues this Advance Notice of Proposed Rulemaking ("ANPR") concerning mortgage assets affected by Property Assessed Clean Energy ("PACE") programs and Notice of Intent ("NOI") to prepare an environmental impact statement ("EIS") under the National Environmental Policy Act ("NEPA") to address the potential environmental impacts of FHFA's proposed action.

The United States District Court for the Northern District of California 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 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."

In response to and compliance with the California District Court's order, FHFA is

seeking comment 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 ANPR and NOI pursuant to 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 reserves the right to withdraw this ANPR and NOI should FHFA prevail in its appeal, and may in that situation continue to address the financial risks FHFA believes PACE programs pose to safety and soundness through means other than notice-and-comment rulemaking.

DATES: Written comments must be received on or before [INSERT DATE 60 DAYS AFTER PUBLICATION IN THE FEDERAL REGISTER].

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 e-mail to FHFA at RegComments@fhfa.gov to ensure timely receipt by FHFA. Please include "RIN 2590-AA53" in the subject line of the message.
- E-mail: Comments to Alfred M. Pollard, General Counsel may be sent by e-mail 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:

I. Comments

FHFA invites comments on all aspects of this ANPR and NOI. Commenters should identify by number, the question each of their comments addresses. Copies of all comments will be posted without change, including any personal information you provide, such as your name and address, on the FHFA website 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 the Housing and Economic Recovery Act of 2008 (HERA) to supervise and regulate the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), (together, the Enterprises), and the Federal Home Loan Banks (the "Banks"). FHFA is the exclusive supervisory regulator of the Enterprises and the Banks. Both Enterprises are presently in conservatorship under the direction of FHFA as Conservator. 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 of the authority necessary to oversee Fannie Mae, Freddie Mac, and the Banks. 12 U.S.C. 4511(b)(2).

Fannie Mae and Freddie Mac 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).

C. Issues Relating to PACE Programs that are 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 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 products. Homeowners repay the amount borrowed, with interest, over a period of years through "contractual assessments" added to their property tax bill. Over the last three years, more than 25 states have passed legislation authorizing local governments to set up PACE-type programs. Such legislation leaves most program implementation and standards to local governmental bodies and provides no uniform requirements 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

[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.

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 city or county, 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]

Typically, PACE programs serve as a channel through which private-sector capital flows through the local government to the homeowner-borrower (or the homeowner-borrower's contractors). While PACE programs vary in the particular mechanisms they use to raise capital, in many instances private investors provide the capital by purchasing bonds secured by the payments that homeowner-borrowers make on their PACE obligations. From the capital provider's perspective, one 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 is able to use the property-tax assessment system as the vehicle for

[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.

repayment. Because of the "lien-priming" feature of most PACE programs, 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 of first and second mortgages, and of any other property-secured financial obligation.

Proponents of PACE programs have analogized the obligations to repay PACE loans to traditional tax assessments. However, unlike traditional tax assessments, PACE loans are voluntary — homeowners opt in, submit applications, and contract with the city or county's PACE program to obtain the loan. 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 must repair the fixtures should they become inoperable, including during the time the PACE loan remains outstanding. Each locality sets its own terms and requirements for homeowner and project eligibility for PACE loans; no uniform national standards exist. Nothing in PACE 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 do not employ standard personal creditworthiness requirements, such as limits on FICO score 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 legislation authorizing PACE programs gained notoriety in 2008. As PACE programs were being considered by more states, FHFA began to evaluate their implementations and potential impact on the portfolios of FHFA-regulated entities. On June 18, 2009, FHFA issued a letter and background paper raising concerns about PACE programs that retroactively created first liens. To discuss the risks 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 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]

Shortly after the May 5, 2010 Advisories were issued, FHFA received a number

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[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 (pages 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 at https://www.efanniemae.com/sf/formsdocs/documents/secinstruments/doc/3005w.doc.

of inquiries seeking FHFA's position.[7] On July 6, 2010, FHFA issued the Statement, which provides:

> [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 May 5, 2010 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, the Conservator issued a directive stating the Agency's view that PACE liens "present significant risks to certain assets and property of the

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[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).

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

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. In all its statutory capacities, FHFA is empowered to act decisively to avoid risk to the Enterprises. In conservatorship, with taxpayer support, this obligation is emphasized by express Congressional directions on conservator duties.

Several parties brought legal challenges to the process by which FHFA issued the July 6, 2010 Statement and the February 28, 2011 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, has 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 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 "[t]he comment period shall not be less than 60 days." The California District Court neither invalidated nor required FHFA to withdraw the July 6, 2010 Statement or the February 28, 2011 Directive, both of which remain in effect.

In response to and compliance with the California District Court's order, FHFA is seeking comment 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 ANPR and NOI pursuant to 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 reserves the right to withdraw this ANPR and NOI should FHFA prevail in its appeal, and may in that situation continue to address the financial risks FHFA believes PACE programs pose to safety and soundness through means other than notice-and-comment rulemaking.

This ANPR and NOI 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, suggests subjects relating to PACE on which FHFA might issue a proposed rule or otherwise provide guidance to the Enterprises within the governing statutory framework, and invites comments from the public.

III. Issues as to which FHFA Seeks Comment

In light of the California District Court's order and the background information provided above, FHFA seeks comments on the following issues regarding the Enterprises' dealing in mortgages on properties that participate in PACE programs or that could participate in PACE programs.

A. Conditions and Restrictions Relating to PACE

The California District Court called upon FHFA to seek comments on whether conditions and restrictions relating to the regulated entities' dealing in mortgages on properties participating in PACE programs are necessary; and, if so, what specific conditions and/or restrictions may be appropriate. In the July 6, 2010 Statement and the February 28, 2011 Directive, FHFA imposed certain conditions and restrictions relating to the Enterprises' dealing in mortgages on properties participating in PACE programs. FHFA thus will take comments on whether those restrictions and conditions should be maintained, changed, or eliminated, and whether other restrictions or conditions should be imposed. Accordingly, FHFA requests comment on the following question:

Question 1: Are conditions and restrictions relating to FHFA-regulated entities' dealings in mortgages on properties participating in PACE programs necessary? If so, what specific conditions and/or restrictions may be appropriate?

B. Financial Risk to the Enterprises Resulting from Subordination of Mortgage Security Interests to PACE Liens

FHFA is concerned that PACE programs that involve subordination of any mortgage holder's security interest in the underlying property to that of the provider of PACE financing may increase the financial risk borne by the Enterprises as holders of mortgages on properties subject to PACE obligations, as well as mortgage-backed securities based on such mortgages. FHFA believes that any such increase in the financial risk on mortgages and mortgage-backed securities already in the Enterprise portfolios, especially if imposed without Enterprise consent, may present significant safety and soundness concerns. In light of that concern, FHFA requests comment on the following three questions regarding financial risks to the Enterprises relating to the subordination of mortgage security interests to PACE liens:

Question 2: How does the lien-priming feature of first-lien PACE obligations affect the financial risks borne by holders of mortgages affected by PACE obligations or investors in mortgage-backed securities based on such mortgages? To the extent that the lien-priming feature of first-lien PACE obligations increases any financial risk borne by holders of mortgages affected by PACE obligations or investors in mortgage-backed securities based on such mortgages, how and at what cost could such parties insulate themselves from such increased risk?

Question 3: How does the lien-priming feature of first-lien PACE obligations affect any financial risk that is borne by holders of mortgages affected by PACE obligations or investors in mortgage-backed securities based on such mortgages and that relates to any of the following:

- The total amount of debt secured by the subject property relative to the value of the subject property (i.e., Combined Loan to Value Ratio for the property or other measures of leverage);
- The amount of funds available to pay for energy-related home-improvement projects after the subtraction of administrative fees or any

other program expenses charged or deducted before funds become available to pay for an actual PACE-funded project (FHFA understands such fees and expenses can consume up to 10% or more of the funds a borrower could be obligated to repay under some PACE programs);

- The timing and nature of advancements in energy-efficiency technology;
- The timing and nature of changes in potential homebuyers' preferences regarding particular kinds of energy-efficiency projects;
- The timing, direction, and magnitude of changes in energy prices; and,
- The timing, direction, and magnitude of changes of property values, including the possibility of downward adjustments in value?

Question 4: To the extent that the lien-priming feature of first-lien PACE obligations increases any financial risk that is borne by holders of mortgages affected by PACE obligations or investors in mortgage-backed securities based on such mortgages and that relates to any of the following, how and at what cost could such parties insulate themselves from that increase in risk:

- The total amount of debt secured by the subject property relative to the value of the subject property (i.e., Combined Loan to Value Ratio for the property or other measures of leverage);
- The amount of funds available to pay for energy-related home-improvement projects after the subtraction of administrative fees or any other programs expenses charged deducted before funds become available to pay for an actual PACE funded project (FHFA understands such fees and expenses can consume up to 10% or more of the funds a borrower

could be obligated to repay under some PACE programs);

- The timing and nature of advancements in energy-efficiency technology;
- The timing and nature of changes in potential homebuyer preferences regarding particular kinds of energy-efficiency projects;
- The timing, direction, and magnitude of changes in energy prices; and,
- The timing, direction, and magnitude of changes of property values, including the possibility of downward adjustments in value?

C. PACE and the Market for Home-Improvement Financing

FHFA is concerned that the risks first-lien PACE programs present to mortgage holders may be unnecessary or unreasonable in light of other market options for financing home-improvement projects relating to energy efficiency that do not subordinate mortgage holders' security interests. In light of that concern, FHFA requests comment on the following four questions relating to PACE programs and the market for home-improvement financing:

Question 5: What alternatives to first-lien PACE loans (e.g., self-financing, bank financing, leasing, contractor financing, utility company "on-bill" financing, grants, and other government benefits) are available for financing home-improvement projects relating to energy efficiency? On what terms? Which do and which do not share the lien-priming feature of first-lien PACE obligations? What are the relative advantages and disadvantages of each, from the perspective of (i) the current and any future homeowner-borrower, (ii) the holder of an interest in any mortgage on the subject property, and (iii) the environment?

Question 6: How does the effect on the value of the underlying property of an energy-related home-improvement project financed through a first-lien PACE program compare to the effect on the value of the underlying property that would flow from the same project if financed in any other manner?

Question 7: How does the effect on the environment of an energy-related home-improvement project financed through a first-lien PACE program compare to the effect on the environment that would flow from the same project if financed in any other manner?

Question 8: Do first-lien PACE programs cause the completion of energy-related home improvement projects that would not otherwise have been completed, as opposed to changing the method of financing for projects that would have been completed anyway? What, if any, objective evidence exists on this point?

D. PACE and Protections for the Homeowner-Borrower

FHFA is concerned that PACE programs may not incorporate features that adequately protect the interests of the homeowner-borrower, and that the lack of adequate protection could result in homeowner-borrowers undertaking PACE projects or selecting PACE financing terms that increase the financial risks borne by mortgage holders such as the Enterprises. In light of that concern, FHFA requests comment on the following five questions relating to PACE and protections for the homeowner-borrower:

Question 9: What consumer protections and disclosures do first-lien PACE programs mandate for participating homeowners? When and how were those protections put into place? How, if at all, do the consumer protections and disclosures that local first-lien PACE programs provide to participating homeowners differ from the consumer protections and disclosures that non-PACE providers of home-improvement financing provide to borrowers? What consumer protection enforcement mechanisms do first-lien PACE programs have?

Question 10: What, if any, protections or disclosures do first-lien PACE programs provide to homeowner-borrowers concerning the possibility that a PACE-financed project will cause the value of their home, net of the PACE obligation, to decline? What is the effect on the financial risk borne by the holder of any mortgage interest in a subject property if PACE programs do not provide any such protections or disclosures?

Question 11: What, if any, protections or disclosures do first-lien PACE programs provide to homeowner-borrowers concerning the possibility that the utility-cost savings resulting from a PACE-financed project will be less than the cost of servicing the PACE obligation? What is the effect on the financial risk borne by the holder of any mortgage interest in a subject property if first-lien PACE programs do not provide any such protections or disclosures?

Question 12: What, if any, protections or disclosures do first-lien PACE programs provide to homeowner-borrowers concerning the possibility that over the service life of a PACE-financed project, the homeowner-borrower may face additional costs (such as costs of insuring, maintaining, and repairing equipment) beyond the direct cost of the PACE obligation? What is the effect on the financial risk borne by the holder of any mortgage interest in a subject property if first-lien PACE programs do not provide any such protections or disclosures?

Question 13: What, if any, protections or disclosures do first-lien PACE programs provide to homeowner-borrowers concerning the possibility that subsequent purchasers of the subject property will reduce the amount they would pay to purchase the property by some or all of the amount of any outstanding PACE obligation? What is the effect on the financial risk borne by the holder of any mortgage interest in a subject property if first-lien PACE programs do not provide any such protections or disclosures?

E. PACE and Underwriting Standards

FHFA is concerned that first-lien PACE programs may not incorporate underwriting standards that adequately ensure that the homeowner-borrower will be able to repay the obligation, and that as a result homeowner-borrowers may undertake PACE projects, or select PACE financing terms, that adversely affect the homeowner-borrower's ability to repay other debt, including mortgage debt. In light of that concern, FHFA requests comment on the following three questions relating to PACE and underwriting standards:

Question 14: How do the credit underwriting standards and processes of PACE programs compare to that of other providers of home-improvement financing, such as banks? Do they consider, for example: (i) borrower creditworthiness, including an assessment of total indebtedness in relation to borrower income, consistent with national standards; (ii) total loan-to-value ratio of all secured loans on the property combined, consistent with national standards; and (iii) appraisals of property value, consistent with national standards?

Question 15: What factors do first-lien PACE programs consider in determining whether to provide PACE financing to a particular homeowner-borrower seeking funding for a particular project eligible for PACE financing? What analytic tools presently exist to make that determination? How, if at all, have the methodologies, metrics, and assumptions incorporated into such tools been tested and validated?

Question 16: What factors and information do first-lien PACE programs gather and consider in determining whether a homeowner-borrower will have sufficient income or cash flow to service the PACE obligation in addition to the homeowner-borrower's pre-existing financial obligation? What analytic tools presently exist to make that determination? How, if at all, have the methodologies, metrics, and assumptions incorporated into such tools been tested and validated?

F. Considerations Relating to FHFA's Intent to Prepare an EIS

FHFA intends to prepare an EIS to address the potential environmental impacts of any proposed rule that FHFA may issue following its consideration of the comments submitted in response to this ANPR and NOI. To that end, this ANPR and NOI initiates the NEPA scoping process to identify the environmental issues and reasonable alternatives to be examined in the EIS, and requests comments regarding those and other matters related to the scope of the EIS ("EIS Scoping Comments").

To ensure that all relevant environmental issues and reasonable alternatives are addressed, FHFA invites and encourages EIS Scoping Comments. Interested parties are encouraged to submit their EIS Scoping Comments within a 60-day scoping period, which begins with publication of this notice. EIS Scoping Comments received after the end of the scoping period will be considered to the extent practicable. You may submit EIS Scoping Comments, identified by regulatory information number (RIN) 2590-AA53 and marked "EIS Scoping Comments," by any of the methods identified in the ADDRESSES section above. Submissions may include both EIS Scoping Comments and other comments, but the EIS Scoping Comments must be separately identified.

1. Proposed Action

FHFA's 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. FHFA believes that the Proposed Action is reasonable and necessary to limit, in the interest of safety and soundness, the financial risks that could be involuntarily borne by the Enterprises, thereby preserving and conserving the Enterprises' assets and property while protecting American taxpayers from further loss.

2. No Action Alternative

As required by the Council on Environmental Quality regulations that implement NEPA, the EIS will analyze and present the potential environmental impacts associated with reasonable alternatives, including the No Action Alternative.

The No Action Alternative is to withdraw the July 6, 2010 Statement and the February 28, 2011 Directive. This would allow the Enterprises to purchase mortgage loans secured by properties with outstanding first-lien PACE and PACE-like obligations.

3. Other Alternatives

In addition to the Proposed Action and No Action alternatives described above, FHFA invites comments on reasonable alternatives that would reduce or avoid known or potential adverse environmental impacts associated with the proposed action while ensuring that the Enterprises operate in a safe and sound manner. Accordingly, FHFA requests that for each reasonable alternative suggested, the commenter explain the positive, neutral or negative environmental impacts, as well as potential changes in the level of financial risk borne by holders of any interest in a mortgage on PACE-affected properties, associated with the suggested alternative. Accordingly, FHFA specifically requests comment on the following question:

Question 17: What specific alternatives to FHFA's existing statements about PACE should FHFA consider? For each alternative, as compared to the Proposed Action, what positive or negative environmental effects would result and how would the level of financial risk borne by holders of any interest in a mortgage on PACE-affected properties change?

4. Issues and Environmental Resources to be Examined

To facilitate the scoping process, FHFA has identified a preliminary approach and list of issues and environmental resources that it may consider in the EIS. This list is not intended to be all-inclusive or to predetermine the scope of the EIS, but is intended to serve as a starting point for public comment.

- FHFA intends to develop scenarios (high, medium, and low) that describe three potential levels of uptake of PACE program loans by homeowners (irrespective of the Agency's action). These scenarios would be developed at the regional level and would make assumptions on the types of home improvement projects (e.g., home insulation, solar panels, geothermal energy units, etc.) that could be installed. The "high" scenario would assume the potential for a high level of uptake of PACE projects by homeowners. The "medium" and "low" scenarios would assume medium and low levels of uptake. FHFA invites comment on how these scenarios should be developed.

- Potential effects of the Proposed Action and alternatives on the uptake of PACE home improvement projects will be considered. For each alternative analyzed in detail in the EIS, FHFA would estimate PACE project implementation for each of the scenarios listed above and then compare these estimates across the alternatives.
- Using assumptions on the types of home improvement projects that could be implemented, FHFA would estimate the potential energy and water consumption savings associated with each scenario at the regional level for each alternative.
- FHFA proposes to analyze the potential direct, indirect, and cumulative environmental impacts of the proposed action and alternatives for the following resource areas: greenhouse gas emissions; climate change; air pollutant emissions (including Clean Air Act criteria pollutant emissions); human health; water conservation; cultural and historic resources; and disproportionately high and adverse impacts to low-income and minority populations (environmental justice).

IV. Request for Comments

FHFA invites comments on all of the issues and questions discussed above, and will consider all comments in developing any proposed rule that FHFA may issue concerning the Enterprises' dealing in mortgages on properties participating in PACE programs. As to all questions enumerated above, commenters should provide supporting data and documentation for each of their responses, as these will assist FHFA in its consideration of comments.

Studies addressing relevant aspects of PACE programs may be submitted for the agency's consideration. FHFA is interested in studies analyzing:

- The effect of PACE-funded improvements on the value of the underlying property, including differential effects over time and across markets;
- The comparative costs of PACE programs with other means of financing such as home equity loans, refinance transactions, and leasing programs;
- Payback periods for projects eligible for PACE funding, considering costs, energy savings, and risks (including risk of changes in energy pricing or in the level of subsidies or tax credits available);
- The economic life of PACE-funded improvements, particularly in relation to the term of the PACE loan;
- Default rates of PACE and non-PACE loans based on populations with comparable borrower, loan and property characteristics; and

- Other subjects relating to PACE and the financial risks PACE programs pose to mortgage holders such as the Enterprises.

All study-related submissions should provide the complete study protocol; the date(s) the study was proposed, initiated, completed, and published or otherwise reported; all key assumptions; the sample size; the data; the results (including sensitivity of reported results to key assumptions); and any published report of the study. Study-related submissions should also identify the persons who developed, implemented, and published or otherwise reported the study, as well as the principal sources of funding for the study. All data should be provided in a reasonably accessible computer-readable format, such as Microsoft Excel files.

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Edward J. DeMarco, Date

Acting Director, Federal Housing Finance Agency.

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