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June 22, 2010

Edward DeMarco, Acting Director
Federal Housing Finance Agency
1700 G. Street, N.W.
Washington, D.C. 20552-0003 FAX: (202) 414 3823

RE: Energy Efficiency and Renewable Energy Assessments (PACE) and Lien Priority

Dear Acting Director DeMarco:

On May 17, 2010, we sent you a letter expressing concern about lender and industry advice letters issued by Fannie Mae and Freddie Mac on May 5, 2010. These advice letters equated financing under Property Assessed Clean Energy (PACE) programs with "loans," and strongly suggested that such "loans," because they have lien priority, would preclude sale of mortgages to Fannie and Freddie. As we have repeatedly made clear to FHFA General Counsel, Alfred Pollard, under California law, PACE financing is achieved through special assessments, not loans. The distinction is key. Like other special assessments, such as those used by California's local governments since the beginning of the last century to finance road paving and sidewalk improvements, unpaid PACE assessments take priority over mortgages. Fannie Mae's and Freddie Mac's own standardized documents recognize the priority of assessment liens.

While the advice letters are ambiguous, the effect they have had in this state is not. The letters have had a devastating impact on PACE programs in California, placing at risk hundreds of millions of dollars of federal stimulus funding, hundreds of millions of dollars of state, local and private funding, and impacting California's efforts to promote green jobs and greenhouse gas emission reductions. Despite requests from the California Attorney General, the Governor, the Vice President, Members of Congress, the Department of Energy, the private lending community, and the Council on Environmental Quality, your agency has taken no action to resolve the situation or even identify a process by which the matter will be resolved.

The FHFA has raised a potentially serious issue – that PACE programs may increase the risk of default by increasing homeowner debt. As the attached hypothetical establishes, however, the practical effect on Fannie Mae's and Freddie Mac's portfolios is minimal, given the relatively small liens that may result from missed PACE assessments and the default rate that reasonably can be expected in PACE communities. Nonetheless, California and the local governments that are attempting to move forward with PACE programs are prepared – immediately – to discuss with you how those risks have already been addressed and minimized through detailed program requirements and "best practices." Depending on what further

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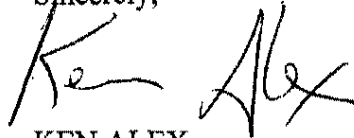
concerns the FHFA may have, we commit to working with you to identify and implement further actions as needed. We cannot, however, afford your agency's continued silence. The time to act on this matter is at hand.

There is a great deal at stake here for California and for the nation's economy. We take seriously the FHFA's concerns about mortgage security and are prepared to address those concerns. We ask you to take seriously the need to move forward immediately with California's PACE programs, with energy efficiency and renewable energy retrofit efforts, with federal stimulus funding, and with California's determined efforts to create jobs and economic momentum.

We would like to set up a meeting as soon as possible in order to resolve this matter. We believe that the meeting would benefit from the participation of the Vice President's Office, the Governor's Office, and other officials who have been working extensively on this matter. Please contact me at your earliest convenience by the end of this month so that we can move forward in the most constructive manner possible.

Thank you for your immediate attention.

Sincerely,

Handwritten signature of Ken Alex, consisting of the letters 'Ke' followed by 'Alex' in a cursive style.

KEN ALEX

Senior Assistant Attorney General

For EDMUND G. BROWN JR.
Attorney General

Attachments

cc: Joseph R. Biden Jr., Vice President
Dianne Feinstein, U.S. Senator
Barbara Boxer, U.S. Senator
Steven Chu, Secretary, U.S. Department of Energy
Shaun Donovan, Secretary, U.S. Department of Housing and Urban Development
Timothy Geithner, Secretary, U.S. Department of the Treasury
Carol Browner, Director, White House Office of Energy and Climate Change
Nancy Sutley, Chair, Council on Environmental Quality
Michael J. Williams, President and Chief Executive Officer, Fannie Mae
Charles E. Haldeman, Jr., Chief Executive Officer, Freddie Mac
Arnold Schwarzenegger, Governor, State of California
Bill Lockyer, State Treasurer and Chair, CAEATFA
Karen Douglas, Chair, California Energy Commission

Hypothetical Exploring Risk Associated with PACE Liens
Averaged Over a Portfolio of Mortgages

The impact of the PACE financing on the risk borne by mortgage lenders is minimal. The following mortgage foreclosure scenario shows why:

A homeowner of a house valued at \$300,000 with a \$250,000 mortgage seeks \$15,000 in PACE financing, reflecting the costs of a renewable energy system and energy efficiency upgrades, less all available rebates and incentives. (Some large solar projects may cost more; efficiency-only upgrades will be substantially less.)

With a 7% interest rate (which is on the high side) and a 20-year payback period, the estimated annual PACE assessment would be \$1,470.¹

The homeowner stops paying the mortgage and property taxes, including assessments. Delinquency on the mortgage occurs when the home owner is less than three monthly payments behind in the mortgage, and default when the homeowner is three or more monthly payments behind; default triggers foreclosure.²

At the time of foreclosure for failing to pay the mortgage, it is likely that at most, one PACE assessment of ~\$1,500 would have achieved priority lien status. (This is because under California law, there is no acceleration of the entire amount financed for failure to pay an assessment, including a PACE assessment; rather, the new owner assumes the continuing obligation to pay the assessments as they become due.)

If we run the same hypothetical with PACE financing of \$20,000, the PACE lien consisting of one missed annual assessment would be \$1,960.

This exercise suggests that with a "portfolio" of Fannie/Freddie mortgages that have PACE liens, assuming a high foreclosure rate of 10%, PACE seniority would average \$150 per home (10% x \$1,500). Using a more reasonable foreclosure rate of 5%, average PACE seniority per home would be a mere \$75.

¹ Results obtained by using Sonoma County's annual payment calculator, available at <http://sonomacountyenergy.org/lower.php?url=calculator>.

² See California Urban Strategies Council, *California Foreclosure Timeline*, available at http://www.urbanstrategies.org/foreclosure/Timeline/ForeclosureProcessTimelineandInterventions_7_11_07.pdf.