MORTGAGE BANKERS ASSOCIATION

March 20, 2017

The Honorable Benjamin S. Carson, Sr., M.D.
Secretary, U.S. Department of
Housing and Urban Development
451 Seventh Street SW
Washington, DC 20410

Dear Secretary Carson,

The Mortgage Bankers Association[1] would like to congratulate you on your recent confirmation as the 17th Secretary of the U.S. Department of Housing and Urban Development. We appreciate your expressed commitment to bolster America's real estate markets and assist communities nationwide, and MBA looks forward to working with you and your staff to ensure that families across our country have access to safe, decent, and affordable housing.

Today, we write to express our concern over guidance implemented by HUD on July 19, 2016—on behalf of the Federal Housing Administration—with regard to Property Assessed Clean Energy (PACE) loans. For the reasons emphasized below, we urge HUD to rescind Mortgagee Letter 2016-11[2] and to instead implement guidance that prohibits FHA approval of future mortgages for the purchase or refinance of properties with PACE loan obligations.[3]

PACE Background and Structure:

PACE loans were developed to help finance energy efficient retrofits on real property—e.g., solar panels, energy efficient appliances and windows, etc. PACE program specifics vary by state/municipality, but typically these loans are initiated by the private companies approving contractors to make these improvements. The contractors in turn market these products in conjunction with financing from proceeds raised by issuing

[1] MBA is the national association representing the real estate finance industry, an industry that employs more than 280,000 people in virtually every community in the country. Headquartered in Washington, D.C., the association works to ensure the continued strength of the nation's residential and commercial real estate markets; expand homeownership; and extend access to affordable housing to all Americans. MBA promotes fair and ethical lending practices and fosters professional excellence among real estate finance employees through a wide range of educational programs and a variety of publications. Its membership of over 2,200 companies includes all elements of real estate finance: mortgage companies, mortgage brokers, commercial banks, thrifts, REITs, Wall Street conduits, life insurance companies and others in the mortgage lending field. For additional information, please visit MBA's website: www.mba.org.

[2] Available at https://portal.hud.gov/hudportal/documents/huddoc?id=16-11ml.pdf.

[3] If new HUD guidance is established in this manner, Mortgagee Letter 2017-06—concerning the servicing of FHA-insured mortgages on properties encumbered with a PACE loan obligation—would need to be addressed accordingly. ML 2017-06 is available at https://portal.hud.gov/hudportal/documents/huddoc?id=17-06ml.pdf.

municipal revenue bonds. The bonds are secured by the payments on the PACE loan obligations; the loan payments are added to the borrower's property tax bill and paid through property tax installments—typically over 15 or 20 years at interest rates substantially higher than existing mortgage products and other available financing options. The PACE loan obligation then runs with the property (not the borrower) going forward.[4]

While MBA believes that energy efficient home improvements can be beneficial for some homeowners, we have significant concerns with the prevailing PACE financing structure—including the risk it poses to traditional lien priority, the risks created for FHA, and the lack of consumer protections typically associated with real estate financing. Unfortunately, ML 2016-11 does not reduce these concerns—it amplifies them.

Lien Priority Concerns:

Prior to HUD's PACE guidance, FHA policy had appropriately barred the financing or refinancing of a home with FHA financing unless the property was free and clear of any liens other than the FHA-insured mortgage. Because PACE loan obligations are collected as an assessment through property tax payments, they rest in a senior lien position to an FHA mortgage. Thus, prior FHA policy had been designed to ensure that obligations like a PACE "super lien" would not erode the value of the collateral supporting the FHA loan in the event of foreclosure and the eventual sale of the property.

Without any public notice and comment opportunity, FHA reversed its policy with the issuance of ML 2016-11—which now allows for FHA approval of mortgages for the purchase or refinance of properties with PACE loan obligations, provided they meet certain requirements. Among the requirements in the guidance is the stipulation that the outstanding PACE loan obligation cannot take a first lien position ahead of the FHA-insured mortgage. However, the guidance does provide that delinquent PACE loan amounts retain a first lien position. Allowing any PACE loan amount to hold a senior priority undermines the lender's (and the government's) collateral position and disrupts the very nature of secured lending.

Rather than requiring definitive subordination of the full PACE loan obligation to the FHA mortgage, current HUD guidance simply allows it to be deemed a tax assessment rather than a consumer loan. But this policy leaves the FHA Mutual Mortgage Insurance

[4] It is important to note, although outstanding PACE loan obligations technically "run with the property," real estate professionals report that many subsequent purchasers of these homes reject the presence of a PACE loan obligation and insist that the seller extinguish the PACE financing before consummating the purchase. This leaves the original borrowers with a closing table surprise and far less in sale proceeds than they anticipated. The presence of the PACE loan obligation may also negatively impact home values, especially in foreclosure situations.

Fund (MMIF) needlessly exposed to losses brought on by delinquent PACE loan amounts.

<u>Consumer Protection Concerns</u>:

In addition, ML 2016-11 does not sufficiently address the serious consumer protection concerns which PACE loans present. The guidance does allude to the U.S. Department of Energy "updating its Best Practices Guidelines for Residential PACE Financing, which may be used by states and counties to align with their consumer protection goals"—but these now-released DOE Guidelines[5] are merely non-binding recommendations for states/municipalities. Notwithstanding limited disclosure requirements,[6] HUD's PACE guidance does not require that enumerated consumer protections be present, in order for a particular jurisdiction's PACE program to be deemed satisfactory. In other words, ML 2016-11 leaves what is appropriate FHA borrower consumer protections for countless others to determine with no consistency from state-to-state, municipality-to-municipality.

Nationwide protections are needed for PACE, to streamline the "patchwork" of consumer standards that exist (or have yet to develop)—ensuring that consumers are treated fairly and consistently wherever they happen to live. More specifically, MBA believes that a comprehensive assessment of a borrower's income, credit history, outstanding credit obligations, expected monthly payments, and more should be conducted for all loans originated—including PACE loans. Instead, PACE financing today is often based on a borrower's equity in their property and their mortgage and property tax payment history, rather than on their true ability to repay their financial debt. Moreover, MBA believes that individuals engaged in PACE loan origination activities should be subject to licensing requirements—including education, testing, and a background check. Licensing would reduce the likelihood that bad actors would be engaged in the PACE financing business.

It is vital to underscore that PACE loans <u>are not</u> currently subject to the federal mortgage financing rules of the Consumer Financial Protection Bureau—including "Ability-to-Repay," the Truth in Lending Act (containing the Home Ownership and Equity Protection Act), "Know Before You Owe," the Secure and Fair Enforcement for Mortgage Licensing Act of 2008, etc. This is because PACE financing has been conveniently classified as a tax assessment rather than a loan. MBA believes that PACE loans are—in substance—mortgage-related financing and should be subject to

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[5] DOE Best Practice Guidelines for Residential PACE Financing Programs (November 18, 2016), available at https://energy.gov/sites/prod/files/2016/11/f34/best-practice-guidelines-RPACE.pdf.

[6] E.g., ML 2016-11, page 3: "the existence of a PACE obligation on a property [must be] readily apparent to mortgagees, appraisers, borrowers and other parties to an FHA-insured mortgage transaction in the public records and must show the obligation amount, the expiration date and cause of the expiration of the assessment, and in no case may default accelerate the expiration date."

federal mortgage financing rules, not dependent on a patchwork of state/municipal consumer protections that may or may not adequately protect borrowers.

To our aforementioned consumer protection concerns, we encourage HUD to review the attached articles recently published by the *Wall Street Journal* (Exhibits One and Two). We also urge HUD to join us in arguing these consumer protection points before the CFPB, in order to secure the CFPB's own supervision of PACE.

Conclusion:

As policy, ML 2016-11 leaves FHA exposed to higher default and MMIF loss risk than if PACE loans were required to be properly underwritten, disclosed, and definitively subordinate to the FHA mortgage and other existing liens (consistent with the longstanding secured lending principle of "first in time, first in right").

MBA supports responsible efforts to provide homeowners with affordable and accessible financing for energy efficient home improvements, but sounder alternatives to PACE loans already exist—which do not interfere with traditional lien priority and are accompanied by consumer protections. Accordingly, we urge HUD to rescind ML 2016-11 and to prohibit FHA financing on PACE-encumbered properties—unless the PACE lien is definitively subordinated to the FHA loan and national, standardized consumer protections are in place.

Sincerely,

Pete Mills
Senior Vice President, Residential Policy
Mortgage Bankers Association

Exhibit One

https://www.wsj.com/articles/americas-fastest-growing-loan-category-has-eerie-echoes-of-subprime-crisis-1484060984?mod=itp&mod=djemITP_h

America's Fastest-Growing Loan Category Has Eerie Echoes of Subprime Crisis

Lenders offering energy-conscious loans care little about borrowers' creditworthiness, contractors function as loan brokers—and investors can't get enough

By KIRSTEN GRIND

Updated Jan. 10, 2017 2:41 p.m. ET

Deanna White told a contractor she couldn't afford the $42,200 loan he recommended for improvements to her house in Inglewood, Calif. The contractor, she recalled, said she wouldn't be on the hook because the loan was part of a "government program." She applied and was approved.

Two years later, Ms. White is struggling to make payments on the loan, which was packaged with more than 10,000 similar loans into bonds and sold to investors. Under its terms, Ms. White's five-bedroom house could be foreclosed on if she defaults.

Her loan is part of a booming corner of the lending industry called Property Assessed Clean Energy, or PACE. Such loans, set up by local governments across the U.S., are designed to encourage homeowners to buy energy-efficient solar panels, window insulation and air-conditioning units.

About $3.4 billion has been lent so far for residential projects, and industry executives predict the total will double within the next year. That would likely rank PACE loans as the fastest-growing type of financing in the U.S.

As the loans spread, so do problems that echo the subprime mortgage crisis. Plumbers and repairmen essentially function as loan brokers but have scant training and oversight. They often pitch PACE loans to help land contracting jobs and earn referral fees from lenders, according to loan documents and more than two dozen borrowers, industry executives and employees.

Creditworthiness matters little to lenders, because loans are based on the value of a homeowner's property. PACE loans typically require no down payment, and the debt is added to property-tax bills as an assessment. Ms. White's annual property taxes soared to $6,500 from $1,215.

Loan growth is fueled partly by investor appetite for bonds created from PACE loans, especially among mutual funds and insurers. Investors like the bonds' relatively high payouts, environmentally friendly reputation and lofty credit ratings. On the other hand, rating firms have said there aren't enough historical data on PACE loans to forecast potential defaults.

Some local governments that embraced the loans as a way to bring clean energy to the masses didn't anticipate the messy consequences.

"We wanted to put ourselves in the thick of this," says Rick Bishop, executive director of the Western Riverside Council of Governments, a group of city and county governments in California that helps run the largest PACE program. "The downside is now we hear about these stories from people who feel like they've been misinformed in some fashion."

The government group tries to resolve problems for borrowers. Riverside County, Calif., has opened an investigation into marketing practices for PACE loans, and California Gov. Jerry Brown signed into law in September new requirements establishing uniform disclosures for PACE loans, an effort to make lending terms closer to those for mortgages. Homeowners who get a PACE loan now have three days to back out.

The largest PACE lender, Renovate America Inc., is accused in three lawsuits filed in November by borrowers of double-charging interest and administrative fees and failing to immediately credit loan payments. The suits seek class-action status. The company denies the allegations and says it will “defend PACE, our company and the program vigorously.”

In November, the Energy Department urged administrators of the loan programs to clearly explain loan costs and other terms, allow borrowers to cancel their loan during a short period and deter kickbacks to contractors.

Industry executives say most borrowers are satisfied with their loans and defaults are rare.

Lenders are working with consumer groups to create nationwide standards “to prevent things that wouldn’t benefit consumers,” says JP McNeill, Renovate America’s founder and chief executive.

The growing pains are largely the result of the industry’s young age, the executives say. The first PACE program was started in 2007 by Cisco DeVries, then chief of staff to the mayor of Berkeley, Calif.

Thirty-four states and Washington, D.C., have passed legislation allowing the creation of PACE programs, according to PACENation, an industry trade group in Pleasantville, N.Y.

Mr. DeVries, who calls himself a “capitalist hippie” and now is chief executive of Renew Financial Group LLC, a clean-energy finance company in Oakland, Calif., says he is “really proud of what we’ve accomplished.” He adds: “We set out to help people save money and save energy, and it’s under way.”

The industry could get a new growth spurt from a July decision by the Department of Housing and Urban Development to allow the Federal Housing Administration to purchase mortgages on homes with PACE loans.

PACE loans range in size from about $5,000 to more than $100,000, with an average of about $25,000, and charge interest rates of 6% to 9% over a repayment period of usually five to 25 years.

Instead of making monthly mortgage payments, PACE borrowers pay what they owe once or twice a year along with their property taxes. Cities and counties collect the loan payments and pass along the money to lenders.

Local governments collect fees from finance companies. In the fiscal year that ended June 30, the Western Riverside Council of Governments collected revenue of $7.1 million, or about 15% of its budget, from the PACE program.

Another quirk of PACE loans is that the debt usually goes to the front of the line, ahead of the homeowner’s mortgage. Like a typical tax assessment, that means if a homeowner defaults on the PACE loan, the property can be seized as collateral and sold to repay the lender.

That setup puts local governments in the awkward position of potentially foreclosing on their constituents. If that happens and the house turns out to be worth less than the amount owed by the homeowner, other taxpayers could be stuck with a loss on the difference. So far, that hasn’t happened.

Some investors say the extensive involvement in PACE loans by governments across the country amounts to an implicit financial backstop. The belief that governments stand behind the loans is a major reason why investors are attracted to the bond deals, according to investors.

“There is such big national and state backing,” says Mike Warmuth, portfolio management vice president at FBL Financial Group Inc., the owner of Farm Bureau Life Insurance Co. in West Des Moines, Iowa. The insurer owned $22 million of PACE bonds at the end of September.

Mr. Warmuth says the insurer’s broker suggested the bonds, which generally yield about 4%. He says he isn’t aware of any underwriting deficiencies with the loans, adding that Farm Bureau only had access to aggregate loan data before buying the bonds.

Defaults on loans in PACE bond deals overall have been less than 1%, according to Kroll Bond Rating Agency Inc. Cecil Smart, a senior director at the ratings firm, says the bond deals are structured so that lenders bear the brunt of any losses, rather than investors.

Germany’s Deutsche Bank AG is one of the largest packagers of PACE loans into securities and led a $284 million deal in mid-December, which drew far more investor demand than expected. The bank is aware of problems stemming from the role of contractors, says a person familiar with the matter.

Contractors often line up loans while on house calls and can earn a referral fee of at least $500 per borrower, according to current and former employees. The loans also are marketed at county fairs and by cold calling, borrowers say.

Renovate America uses about 8,000 contractors to help line up loans, according to bond documents. Those contractors are overseen by 23 employees at the San Diego company.

The company says it recently put in place a more-stringent contractor management program. Renovate America says only about 200 contractors are actively arranging PACE loans.

Cindi Ventura, 65 years old, says she was urged last summer by her plumber to apply for a PACE loan after sewer pipes eroded underneath her three-bedroom house in San Jose, flooding the property. She said she had recently filed for personal bankruptcy, didn't have the money to make all the repairs and couldn't qualify for a home-equity line of credit.

She and her mother, 83, received a $16,732 loan for five years from Ygrene Energy Fund Inc. with a 6.5% interest rate. Ygrene ("energy" spelled backward), based in Santa Rosa, Calif., is the second-largest provider of PACE financing in the country, based on loan volume.

Ms. Ventura, a receptionist, says she was confused about the loan's terms because it was called an assessment. She says she called and emailed Ygrene several times with questions about her loan documents and never heard back. "I still don't really understand what the program is," she says.

Louis Lalonde, chief marketing officer of Ygrene, says company representatives had a call with Ms. Ventura and her mother to answer all their questions before the loan was signed. He says he has no record of any further attempts to contact them.

The 3,200 contractors who drum up business for Ygrene are regularly screened for compliance with contractor licensing requirements and receive training before they are allowed to pitch loans to homeowners, he adds.

Malcolm Scott, 61, was planning to pay in cash the $34,000 it would cost for a new air-conditioning unit, furnace and other improvements at his house in Woodland Hills, Calif. His contractor suggested applying for a PACE loan.

Mr. Scott was surprised to find out less than 24 hours later that he had been approved for $94,000. Renovate America says he qualified for the larger loan based on the amount of equity in his house. He decided to borrow just the $34,000.

Michael Gardner, who runs Mediterranean Heating & Air Conditioning, which lined up the loan, says he has been recommending loans for about two years and got “an hour or two” of online training from Renovate America.

The program “is real nice because there are no FICO score requirements or anything like that,” says Mr. Gardner.

Some lenders have taken steps to strengthen underwriting practices, make loan documents more transparent and boost contractor oversight. Renovate America now requires in-house representatives to speak with a borrower by phone—outside of the room and away from the contractor—before signing a homeowner up for a PACE loan.

Renovate America, which is backed by nine private-equity and venture-capital firms, says it has spent the last several months working with consumer groups and regulators to come up with national lending standards for PACE. The new standards could include a year with no payments for borrowers who are suffering from an economic hardship.

“At the end of the day, PACE is an unregulated industry, and it’s just a matter of time before we get regulated,” says Mr. Lalonde of Ygrene.

Phil Adleson, a lawyer in San Jose, Calif., who represents borrowers, says PACE is “a very great idea implemented in a dangerous fashion.”

Ms. White, the borrower in Inglewood, a neighborhood in Los Angeles County, says a contractor from a company named the House Next Door told her in late 2014 not to worry that she couldn’t afford the $42,200 loan because “it wouldn’t be coming out of my pocket.”

The company says no one there would ever describe PACE loans like that and says Renovate America has held weekly training sessions for its contractors for “more than a year.”

Ms. White says the contractor finished the drought-resistant landscaping at her house only after being contacted by a Journal reporter. Renovate America says the contractor has been “under suspension” for the past several weeks.

Her loan went into a pool of 11,282 PACE loans that are collateral on bonds issued by the Western Riverside Council of Governments. Deutsche Bank packaged the bonds into a $240 million deal called “HERO Funding Trust 2015-1.” Kroll gave it a AA rating, the firm’s third-highest.

According to the latest available figures, fewer than 70 of the underlying PACE loans have defaulted, and Kroll said the transaction “has performed as projected.”

Ms. White’s next loan payment is due in April. She says she doesn’t know how she will be able to pay it.

Exhibit Two

https://www.wsj.com/articles/renovate-america-one-of-americas-fastest-growing-lenders-didnt-disclose-it-made-payments-to-some-borrowers-1488969001

Renovate America, One of America's Fastest-Growing Lenders, Didn't Disclose It Made Payments to Some Borrowers

The company's corporate culture favored loan production over homeowner protection, former compliance employees say

Ron Wallis, a former compliance employee at Renovate America, was one of several employees who say they complained to executives about a sales-focused culture at the San Diego company.

By KIRSTEN GRIND

March 8, 2017 5:30 a.m. ET

Renovate America Inc. is the biggest player in America's fastest-growing type of loan. The San Diego-based company enjoys the backing of municipalities and big-name Wall Street investors, thanks in part to its record of ultralow customer defaults.

But Renovate America, which finances purchases of solar panels and energy-efficient appliances, has masked problems with some borrowers by paying off their debts if they struggle to keep up with payments, according to former Renovate America employees.

Renovate America hasn't disclosed that fact to investors who buy bonds backed by the company's loans, say three former employees in the company's compliance department.

The company's investors include mutual funds run by J.P. Morgan Chase & Co. and DoubleLine Capital LP, which have been told customer default rates are less than 1%, according to fund documents and credit-rating firms. A J.P. Morgan spokeswoman declined to comment, and a DoubleLine spokesman didn’t respond to a request for comment.

JP McNeill, Renovate America’s chief executive, said the company made a small number of payments between 2014 and 2016 on behalf of 83 borrowers. He said the payments weren’t disclosed to investors because the number of recipients was a fraction of a percent of the 90,000 homeowners who got loans from Renovate America and wasn’t considered “material.”

Executives at two asset managers that bought Renovate America’s bonds said their firms would have liked to know about the payments before investing. The payments make it harder for investors to gauge the true default rates of the loans.

Securities laws require companies to disclose all information that investors would consider to be material, said Erik Gerding, a professor at the University of Colorado law school. In Renovate America’s case, “the conservative approach would have been to disclose,” he said.

Renovate America makes its loans through state-run programs known as Property Assessed Clean Energy, or PACE. The high-interest-rate loans are brokered by plumbers and contractors, financed by private lending companies, backed by county governments and purchased by investors.

Loans, averaging about $25,000, are placed on a homeowner’s tax bill as an assessment that needs to be paid along with property taxes. In a default, the loans are given priority over a homeowner’s mortgage.

PACE lenders have made about $3.4 billion in loans since 2008. Industry participants expect more than $2 billion in loans to be made this year as more states sign on.

Wall Street's appetite for PACE bond deals is fueling growth. Investors are attracted to the bonds' roughly 4% return despite maturities that can stretch more than two decades. A key selling point is the perceived safety of the loans backing the bonds, even though credit-rating firms say there is little historical default data.

The Wall Street Journal reported in January that some borrowers in the PACE program said they were misled about their loan terms and can't afford their debt. Renovate America and other PACE lenders told the Journal they are putting more rules in place to protect homeowners.

PACE lenders rely on partnerships with state and local governments. The municipalities, eager to offer clean-energy savings to their constituents, are responsible for collecting homeowners' tax payments.

Renovate America was co-founded in 2008 by Mr. McNeill. It is backed by venture-capital firm DFJ Growth and private-equity firm Silver Lake Kraftwerk, among others. Renovate America has raised about $175 million in three financing rounds. The most recent, in 2015, valued it at about $500 million. The company's lenders, including Bank of America Corp. and Credit Suisse Group AG, are helping finance a nationwide expansion.

A spokeswoman for DFJ didn't return a request for comment, and a spokesman for Silver Lake Kraftwerk declined to comment. Bank of America and Credit Suisse representatives declined to comment.

Last year, Renovate America originated about $1 billion in loans, up 35% from 2015, the company said. It uses about 8,000 contractors to source loans across the country.

In late 2014, as some borrowers started missing payments, Renovate America launched a program dubbed “first payment assistance,” according to the former compliance employees. The program paid a homeowner’s first tax assessment or even a full year of debt, the former employees said.

The ad hoc program lacked formal guidelines. Borrowers were more likely to receive aid if they threatened to go to the media with their complaints, one former employee said.

A Renovate America spokeswoman said that payments weren’t made in a “programmatic or formal way” and that homeowners who received payments had misunderstood their loan terms or hadn’t saved enough to pay off their tax assessments.

Mr. McNeill, the CEO, said the payments made on behalf of the 83 homeowners totaled $175,000 between 2014 and 2016.

The former compliance employees said they believe the sum is higher. One who worked with people responsible for the payments estimates the company paid out about $1 million to homeowners in a seven-month period beginning in fall 2015. The Renovate America spokeswoman disputed that number.

Renovate America stopped the payments late last year at the suggestion of its capital-markets division, which manages the company’s bond deals, the spokeswoman said.

The former compliance employees said Renovate America made the payments to deal with problems stemming from a corporate culture that favored loan production over homeowner protection.

Mr. McNeill said the company’s culture is focused on helping homeowners.

“We need to close as many projects as possible because that makes the investors happy,” a former compliance officer said she was told by Mike Anderson, the firm’s senior director of compliance operations. Mr. Anderson said through a spokeswoman that he doesn’t recall the conversation.

Renovate America encouraged sales staff to tell borrowers that the loans would generate tax rebates that would essentially cancel out the loans’ costs, according to former executives and homeowners. Some homeowners said the savings didn’t materialize.

Mr. McNeill said that tax benefits are a relevant data point for homeowners, who “are happier if they’re informed of benefits that exist.”

Contractors who receive customer complaints about the quality of their work typically weren’t penalized if they brought in a high volume of business, former employees said.

“We’re not here to put contractors out of business,” Renovate America’s chief legal officer, Scott McKinlay, told a group of employees last fall, according to an attendee.

Mr. McKinlay said in an interview that his comments were meant to encourage employees to “find ways to improve ourselves.”

Ron Wallis, a former compliance manager, said he told Mr. McNeill about what he described as predatory lending to senior citizens who didn’t understand loan terms. Roughly 25% of Renovate America’s loans go to elderly borrowers, former employees said. The Renovate America spokeswoman confirmed the figure, saying the percentage is less than the percentage of homeowners who are 65 and older in California, the company’s largest market.

Mr. Wallis—who said he was fired in September for unauthorized vacation use—said Renovate never took action in response to his claims.

Mr. McNeill said that elderly borrowers go through additional vetting before receiving loans. “We absolutely, unequivocally do not advocate targeting any protected class,” he said.