Update Regarding Possibility of Doña Ana County Solar District

City of Las Cruces
Community Development
Interoffice Memorandum

To: County Commission, City Council

From: Thomas Schuster, Sustainability Officer, City of Las Cruces
Chuck McMahon, Community Development Director, Doña Ana County

Thru: Terrence Moore, City Manager

Subject: Update Regarding Possibility of Doña Ana County Solar District (July 22 Joint Work Session)

Date: 7/8/2010

At the July 22 Joint Work Session, we will present staff findings to date on issues related to the creation of a Renewable Energy Finance District as enabled by recent State legislation.

Background

At the April 15th joint work session, County and City staff presented the options for creating a Property Assessed Clean Energy (PACE) program as allowed under state statute. Council and Commission directed staff to prepare the necessary resolutions and ordinances to create a Renewable Energy Finance District (REFD) in Doña Ana County, and for the City to opt into the REFD. The preparation and adoption of these ordinances would have minimal cost associated with them. However, the issuance of the bonds that would allow actual financing of projects could cost as much as $100,000. No funding source was identified for this, and staff was directed to pursue opportunities to either cut costs or secure outside funding.

Obstacles Posed by Secondary Mortgage Markets

Since the April 15th meeting, additional obstacles to PACE financing have come to light. On May 5th, Fannie Mae and Freddie Mac issued lender letters (attached) stating that PACE loans which are a senior lien to a mortgage violate the terms of their Uniform Security Instruments, and thus they cannot purchase and securitize these mortgages. Since most mortgages are sold to Fannie Mae and Freddie Mac, this effectively prohibits any PACE loans that have senior lien status.

The Federal Housing Finance Authority (FHFA) is the body that regulates Fannie Mae and Freddie Mac. On July 6th, the FHFA issued a notice (attached) that essentially validates the May 5th lender letter and urges a moratorium on PACE programs with senior

liens until “safety and soundness” concerns can be addressed. FHFA directs Fannie and Freddie to grandfather existing PACE loans. The letter indicates that PACE programs could be acceptable provided that they contain appropriate underwriting guidelines and consumer protection standards.

Per New Mexico state statute, PACE loans do enjoy senior lien status. Although a program could comply with the Uniform Security Instrument, and thus satisfy Fannie, Freddie, and the FHFA by making the PACE loan a junior lien, this is generally not considered a viable option, as it would result in bond interest rates that are completely unattractive to property owners considering participation in the program.

Funding and Cost Considerations

Assuming that the secondary market issues are resolved, an effort is underway at the state level to create a statewide administration program. There is nothing in the state statute that would prohibit REFDs throughout the state from entering into Joint Powers Agreements allowing them to pool financial resources into a single system of administration. This is expected to result in meaningful economies of scale which would lower administration costs, and therefore interest rates for participants.

With regard to grant opportunities, staff has found that federal grants generally prohibit the use of grant monies for creating loan reserve funds, or for direct lending activities, because the monies have to actually be spent in a specific timeframe. There are some recurring grants that could cover startup expenses, such as bond counsel. However, given the recent direction of the FHFA, such proposals would not be competitive until the issues discussed above are resolved.

Staff Recommendation

Staff recommends that no further action be taken to form an REFD until the FHFA issues with PACE are resolved at the federal level. Barring legislative or executive intervention, the development of national underwriting criteria and consumer protection standards are prerequisites for any PACE program moving forward. These standards would likely have an impact on the necessary language in the ordinance. As yet, no timeline has been established for determining these additional criteria, but staff will continue to monitor the situation and will inform Council and Commission when a viable path forward becomes clear. In the meantime, the public is encouraged to seek private financing for renewable energy projects.

Attachments:

Fannie Mae Lender Letter, 5/5/2010
FHFA statement on PACE, 7/6/2010

Lender Letter LL-2010-06 **May 5, 2010**

TO: All Fannie Mae Single-Family Sellers and Servicers

Property Assessed Clean Energy Loans

Fannie Mae has received a number of questions from seller-servicers regarding government-sponsored energy loans, sometimes referred to as Property Assessed Clean Energy (PACE) loans. PACE loans generally have automatic first lien priority over previously recorded mortgages. The terms of the Fannie Mae/Freddie Mac Uniform Security Instruments prohibit loans that have senior lien status to a mortgage. As PACE programs progress through the experimental phase and beyond, Fannie Mae will issue additional guidance to lenders as may be needed from time to time.

Fannie Mae supports energy-efficiency initiatives, and is willing to engage with federal and state agencies as they consider sustainable programs to facilitate lending for energy-efficiency home retrofits, while preserving the status of mortgage loans originated as first liens.

Questions should be directed to Resource_Center@fanniemae.com with the subject line "PACE." Lenders may also wish to consult with their federal regulators, who share concerns about PACE programs.

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Marianne E. Sullivan
Senior Vice President
Single-Family Chief Risk Officer

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 run 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.