Announcement SEL-2010-12 August 31, 2010

Options for Borrowers with a PACE Loan

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

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

Requirements for PACE loans originated prior to July 6, 2010

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

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

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

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

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

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

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

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

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

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

Effective Date

This Announcement is effective immediately.

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

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