Nation's PACE Solar Loan Programs Run Into Trouble on Mortgage Issue

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Two brief letters have thrown solar-financing programs across the country into turmoil.

The letters were issued by the government-regulated mortgage financing organizations known as Fannie Mae and Freddie Mac in May, as a typically busy season for solar photovoltaic installations was getting under way.

The notes were in reference to tax-assessed financing mechanisms for solar PV and other energy improvements that have been adopted in 22 states. The financing method is often referred to as property assessed clean energy, or PACE, loans.

These programs allow property owners to borrow money for energy-efficiency upgrades, such as solar PV systems, and repay the amount through property-tax bills over periods as long as 20 years. If the property is sold, the solar system and the loan obligation stay with the property.

Typically, the jurisdictions that have enacted such programs, such as towns, cities and counties, have made the PACE loans the first-priority debt on the property, which helps keep the interest rates down.

The Federal National Mortgage Association and the Federal Home Loan Mortgage Corp., the formal names for Fannie Mae and Freddie Mac, both issued letters May 5 saying that PACE loans may not be made the first-priority debt on the mortgages they accept for financing.

"The terms of the Fannie Mae/Freddie Mac Uniform Security Instruments prohibit loans that have senior lien status to a mortgage," Fannie Mae said in its letter to home mortgage lenders and servicers.

Freddie Mac said in its note: "The purpose of this Industry letter is to remind Seller/Servicers that an energy-related lien may not be senior to any Mortgage delivered to Freddie Mac."

The letters have prompted some PACE programs to put new loans on hold. It's not clear whether or how existing holders of tax-assessed energy loans may be affected.

In California, where PACE loans began in 2008 and have become popular in places where public awareness of them is high, officials are fighting back.

A May 18 press release issued by state Attorney General Edmund G. Brown Jr. said he "demanded that federal authorities keep their hands off a popular California program that allows property owners to install solar panels and other energy efficiency improvements and repay the cost later on their property taxes."

There is a trace of irony in the regulatory zeal suggested in the letters, since many Americans associate Fannie Mae and Freddie Mac with the housing crisis. Both organizations were placed into conservatorship and are overseen by the new Federal Housing Finance Agency.

The May 5 letters followed months of back-and-forth communications between the housing finance agency and PACE supporters over questions that the agency and its two mortgage financing groups were raising.

On Oct. 13, 2009, the Boulder County, Colo., Board of Commissioners and New Mexico Gov. Bill Richardson wrote to President Barack Obama to express concern that PACE programs could be restricted by the mortgage financing organizations.

The White House published a "policy framework" for PACE programs on Oct. 18, 2009, which included suggested guidelines that most if not all PACE programs already were following.

Why Fannie Mae and Freddie Mac waited until May 5 to send letters to lenders on the status of mortgages with PACE financing was unclear.

Although both the Fannie Mae and Freddie Mac letters described PACE programs as new and "experimental," the first such loans were made available in Palm Desert, Calif., in August 2008 and about a month later in Berkeley, Calif. The idea had been developed by Cisco DeVries, then an aide to Berkeley's mayor, in 2007.

It's believed that at least 1,000 tax-assessed energy loans have been made in California, with more than 800 issued in Sonoma County alone. A total of 22 states now permit some form of tax-assessed financing for energy loans. Los Angeles County is preparing to launch a program this summer that would be available to nearly 10 million people.

Although tax-assessed programs have been popular in some places, adoption has not been as widespread as some solar advocates hoped. The interest rates have typically been about 7 or 8 percent, higher than the rates some property owners may be able to obtain through mortgage refinancing.

In his recent letter to the Federal Housing Finance Agency, Mr. Brown, the California attorney general, said: "We request that FHFA immediately confirm in writing that participants in California PACE programs are not in violation of Fannie Mae/Freddie Mac Uniform Security Instruments prohibiting loans that have a senior lien status to a mortgage. We are open to discussing with you what form that confirmation should take, including, but not limited to, withdrawal of the May 5, 2010, letters.

"We would prefer not to have to pursue some form of declaratory relief to resolve the confusion, but, because of the importance of the issue to California, we certainly reserve that as an option if a clear and unequivocal response is not forthcoming."

The agency has not yet responded to the letter.