To: All WFG Policy issuing agents; all WFG title examiners and officers
From: Underwriting Department
Date: March 19, 2018
Bulletin No. NB2018-03
Subject: Property Assessed Clean Energy (PACE) Liens
Home Energy Renovation Opportunity (HERO)

Property Assessed Clean Energy (PACE) Loans, also referred to as Home Energy Renovation Opportunity (HERO) loans, are a state or local government loan program made to finance residential and commercial energy-related improvements. These loans are generally repaid as special assessments through the property owner's real estate tax bill and typically have automatic first lien priority over PREVIOUSLY AND SUBSEQUENTLY recorded mortgages. [1]

Laws are in place to enable Commercial PACE programs in 32 states and Washington DC. Seventeen states and Washington DC have approved Residential PACE legislation as of the end of 2017.

Although most of the residential funding, to date, has been in California, Florida and Missouri, these are major programs affecting many properties. Through 2017, PACE has funded over $540 million on 1170 commercial projects, and over $4.3 Billion for energy improvements on more than 175,000 homes.[2]

We understand that some lenders are requesting the removal of PACE lien exceptions from Preliminary Title Reports and Commitments, either desiring the title insurer to insure that existing PACE liens will not affect them (something we cannot do) or arguing that future PACE assessments are excluded from coverage under the standard tax exception. (which they are)

WFG obviously cannot agree to assume liability for the PACE loans, and "hiding them" by omission creates problems for our lender customers – even when done at their specific request.

Most secondary market buyers of mortgages decline to purchase any mortgage with a currently outstanding PACE loan – because the PACE loan immediately puts them into a second lien position. A few secondary market purchasers and programs will accept an outstanding PACE loan, but usually subject to difficult to satisfy conditions. The attached sheet summarizes the positions of some of the major secondary market participants.

Unfortunately, the request to "remove" a PACE loan (other than by paying it off like any other senior lien) is usually coming from a loan processor who may not fully understand PACE loans or the consequences of the request on their own company. To help in educating, we have prepared a form

[1] Four states give residential first mortgages priority, whether recorded before or after the PACE lien. These are Nebraska, New Hampshire, Oklahoma, and Rhode Island per http://pacenation.us/pace-market-data/ as of 2/27/18
[2] http://pacenation.us/pace-market-data/ as of 2/27/18

e-mail to use in responding to such a request. We suggest you take a moment to review it to better understand the impact on our lender partners.

Underwriting Standards:

Under NO circumstances is the reference to a PACE or HERO loan to be removed from a Preliminary Title Report or a Commitment (other than upon satisfaction) without express underwriting approval.

If the loan closing is to proceed without paying off a PACE or HERO loan, you must document your file that the lender has specifically authorized the PACE or HERO loan to remain in place. Exception(s) must be taken as to the recorded notices of the PACE or HERO loan.

The Agent may be held responsible for any loss sustained as a result of the failure to follow the standards set forth above.

Secondary Market Restrictions on PACE/HERO Loans

Updated 2-27-18

FHA

In its Mortgagee Letter 2017-18[3], effective for mortgage case numbers issued after January 6, 2018, HUD made the following policy changes as to FHA insured mortgages:

- Properties encumbered with PACE obligations will no longer be eligible for FHA-insured forward mortgages.
- Refinances
  - Clarification is provided to identify PACE obligations as existing debt that may be paid off using a Rate and Term Refinance.
  - Current policies allowing the use of a Cash-Out refinance to pay off PACE obligations remain unchanged.
- HECMs - The existing prohibition of properties encumbered with PACE obligations remains unchanged for HECMs. Clarification is provided to identify PACE obligations as Mandatory Obligations that must be paid off at closing, and may be paid off using HECM proceeds.

Fannie Mae

Per the 2/27/2018 version of the Selling Guide:[4]

- Fannie Mae will not purchase mortgage loans secured by properties with an outstanding PACE loan unless the terms of the PACE loan program do not provide for lien priority over first mortgage liens. Lenders must monitor state and local law to determine which jurisdictions offer PACE loans that may provide for lien priority. [5]
- If the PACE loan is structured as a subordinate lien or unsecured loan, the first mortgage loan may be underwritten to Fannie Mae's standard guidelines.
- However, for PACE loans originated prior to July 6, 2010, Fannie Mae waives the uniform security instrument prohibition against a PACE loan with lien priority if the corresponding mortgage loan was purchased before July 6, 2010 or is in an MBS pool with an issue date on or before July 1, 2010.

Note that the terms of the Fannie Mae/Freddie Mac Uniform Security Instruments prohibit loans that have senior lien status to a mortgage. So future PACE loans may trigger a default and calling of the loan.

Freddie Mac

- Freddie Mac has substantially the same restrictions on PACE loans as Fannie Mae.[6]

---

[3] https://www.hud.gov/sites/dfiles/OCHCO/documents/17-18ml.pdf
[4] B5-3.4-01: Property Assessed Clean Energy Loans (02/27/2018) https://www.fanniemae.com/content/guide/selling/b5/3.4/01.html
[5] At 2/28/18, this is statutorily the case for residential loans only in Nebraska, New Hampshire, Oklahoma, and Rhode Island. Beyond that, a legal review of the underlying loan documents will be required.
[6] http://www.freddiemac.com/singlefamily/factsheets/sell/paying_off_PACE.html

Veterans Administration

- VA permits PACE loans to continue if certain conditions are met[7] including the following:
  - The property may be subject to the full PACE obligation; however, the property shall not be subject to an enforceable claim (i.e., a lien) superior to the VA-guaranteed loan for the full outstanding PACE obligation at any time. [This requires a careful legal department review of the PACE loan documentation and generally requires a subordination]
  - The property may, however, be subject to an enforceable claim (i.e., a lien) that is superior to the VA-guaranteed loan for delinquent regularly scheduled PACE special assessments.
  - There are no terms or conditions that limit the transfer of the property to a new homeowner.

The standards and requirements for sale into the secondary market change periodically. This summary was last updated on 2/28/18 and does not set forth all of the requirements, qualifications and exceptions that may apply. Prior to making any loan against property subject to a PACE Loan, check the current standards and requirements for your preferred secondary market purchaser.

[7] Circular 26-16-18 Department of Veterans Affairs July 19, 2016 https://www.benefits.va.gov/HOMELOANS/documents/circulars/26_16_18.pdf

SAMPLE COMMUNICATION TO LENDERS UPON DISCOVERY OF A PACE/HERO LOAN

Re: File:
Property Address:

Dear Lender:

We want to caution you that the property you are lending against is subject to an outstanding Property Assessed Clean Energy (PACE) loan. Depending on the specific program requirements, this may make your loan **unsaleable** in the secondary market or subject your company to demands to **"Buy Back"** the loan after closing. So we urge you to discuss this file with your internal loan underwriter or your manager.

Sometimes a lender will ask us to "remove" the specific reference to the PACE loan. Please understand that "removing" the specific reference to the PACE Loan does not move your loan into a first priority position, nor does it establish title insurance coverage over the PACE loan. Payments due on the Pace Loan will not be covered under your title policy under the standard future taxes and assessments exclusion.

The only way in which we can "remove" this lien from title is to arrange for its payment in full – much as we handle the payoff of senior mortgages on behalf of our lender clients.

We value our good relationship with your company. So we ask you to discuss this issue with your manager, or your legal and underwriting team, and advise us as to how you would like us to address the PACE loan on this property.

Many thanks