

PACE NOW

Date: June 8th, 2010

To: PACE Federal Regulatory Executives – Edward DeMarco, Susan Eckert, Suzy Gardner, Virginia Gibbs, Patricia McClung, Alfred Pollard, Marvin Shaw, Marianne Sullivan

From: Jeffrey Tannenbaum

RE: PACE Lender Letter Clarifications

I want to thank many of you for taking the time to talk with me about PACE and crafting a solution so that the existing PACE programs and the Department of Energy funded PACE programs can move forward. A number of questions were raised during these discussions and below is an attempt to answer those questions below (see list). Please note that many of the answers are based upon estimates and judgments. A long list of municipalities, politicians and government officials have been eagerly awaiting the GSE clarifying letter since the initial letters more than a month ago. I understand and appreciate your concerns regarding PACE – as I had similar reservations when I first learned of it - and hope that after reading the enclosed materials, you will see that the potential risk is de minimis and that new PACE programs must have strong consumer and lender protections. I would welcome an opportunity to discuss this in person at your earliest convenience and to answer any further questions you may have. I can be reached at 212-659-4917.

Thank you for working on our nation's PACE programs.

Sincerely,

Jeffrey Tannenbaum
President

Key questions raised:

- 1. What is my background and my role with PACE?**
- 2. What is happening with the PACE programs since the GSE lender letters were published?**
 - a. Given the large number of DOE PACE programs/large populations covered (i.e. California) how can this be viewed as a Pilot?**
- 3. How is the PACE potential senior lien exposure in foreclosure for existing mortgage lenders only \$100- \$200 per home?**
- 4. What is the scope of PACE/How is the total potential PACE senior lien exposure from existing PACE programs and the DOE funded programs only \$20 million to \$ 70 million?**
- 5. What is the difference between the original PACE programs and new best practice PACE programs (the DOE grant recipient programs)?**
- 6. Safety and soundness**
 - a. How should the Best Practice PACE programs impact borrower ability to pay?**
 - b. Are there long term large studies and meaningful data that shows homeowner energy savings from efficiency and the various payback periods for different investments?**
- 7. Is PACE finance an assessment or a loan and is it constitutional?**

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8. Non-acceleration: Is it true that if a homeowner PACE retrofits their house in California and then suffers a foreclosure that only the delinquent assessment gets paid and not the entire assessment amount?

9. Over the long term can the existing White House Policy Framework/Department of Energy PACE guidelines be improved?

1. What is my background and my role with PACE? My involvement with PACE began when I hosted at my home many of President Obama's Cabinet members for their 100 day planning retreat on our nation's energy policy. It became clear during the retreat that our nation had not yet created a successful mechanism to finance home and building retrofits. Since I earn my livelihood as an investor, I offered to dedicate a portion of my pro bono time to think about novel ways to solve the retrofit finance barrier. My day job is running Fir Tree Partners, which is a value oriented investment firm that focuses on loan investments and which I formed many years ago after a career with the founder of Kohlberg Kravis Roberts. My work on PACE is part of my philanthropic efforts and motivated by a desire to help our nation and improve the legacy that we leave our children. The Fir Tree business has no plan to be involved in the PACE industry.

I first learned of the PACE model about eighteen months ago and quickly recognized its appeal and the ways in which it needed to be improved to benefit homeowners and mortgage lenders. Areas that I thought needed to be addressed included: The size of a PACE retrofit relative to the home's value, eligible projects, homeowner cash flow impact from PACE, whether the entire assessment amount accelerated upon a foreclosure, duration of the PACE financing, and consumer protections. A little more than a year ago I formed PACENow.org and helped organize a PACE coalition in order to develop best practice standards so that PACE could benefit the various stakeholders – with a primary focus on existing lenders and consumers. Since then, the PACE coalition has worked extraordinarily hard to develop best practices that address virtually all of the issues outlined above.

2. What is happening with the PACE programs and the DOE PACE grantees since the GSE lender letters were published? Since the May 5th lender letters were published virtually all of our nation's PACE programs (both existing and the DOE grant recipients) have been put on hold as they await the GSE clarification letter.

a. Given the large number of DOE PACE programs/large populations covered (i.e. California) how can this be viewed as a Pilot? Though I cannot speak for the government agencies that have designed the PACE programs, my sense is that the grantees are defined as pilots due to the limited timeline (approximately 24 months) and the limited penetration that will happen within that period (see below estimates). By the end of 2012, information will have been gathered and decisions can be made then by the overseeing agencies/regulators about the future of PACE. To the extent unanticipated yet significant problems emerge before the end of 2012, the government has the clear power to stop the programs.

3. How is the PACE potential senior lien exposure in foreclosure for existing mortgage lenders only \$100- \$200 per home? The small seniority risk is due to the fact that PACE typically represents a retrofit of \$15,000 (average of 5% of a home's value or less – best practices cap PACE at 10%) and that as per best practices ONLY the delinquent payment (1 to 1.5 years of payments out of 15 years) gets paid ahead of the mortgage – the remaining assessment balance transfers to the new owner of the property.

Senior lien exposure math:

Sample assumptions - \$300,000 home value, \$15,000 retrofit, 8% interest rate, 15 year amortization, 5% foreclosure rate, 1 year of delinquent payments

1) Base Case

Rough foreclosure math: 5% of home value * 6.7% (1/15th of the PACE amount gets seniority treatment) * 5% foreclosure rate = .02% of the Homes value = **\$50**

Actual math: Includes amortization and interest expense

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Step 1: 1 year of interest expense: \$1,200 * 5% foreclosure rate = \$60 per home

Step 2: Add amortization: \$534 annual amort. * 5% foreclosure rate = \$26 per home

Total Per Home Senior Lien Exposure **\$86 Per Home**

2) Sensitivity: Assuming the foreclosure rate goes to 8% and average foreclosure stretches to 1.5 years the \$86 per home rises to \$208 per home and with a 10% foreclosure rate the potential exposure becomes **\$260** per home. Note: Sonoma's initial delinquency rates for PACE are lower than its county wide rates. Attached Exhibit 1 is a PACE exposure excel model which will enable you to vary the assumptions and see the results.

4. What is the scope of PACE/How is the total potential PACE senior lien exposure from existing PACE programs and the DOE funded programs only \$20 million to \$ 70 million? In order to estimate the scope of PACE there are five steps we have taken:

1) Determine the "PACE Municipalities" - List existing PACE jurisdictions and estimate the new jurisdictions slated to receive the DOE PACE grants (see Exhibit 2). Please note these are our estimates and the Department of Energy will have better estimates of the municipalities.

2) Determine potential "owner occupied units" - From the PACE Municipality list, we estimate the total number of "owner occupied units", which is approximately 9 million (again, see Exhibit 2). Note that this number is most likely very high as it assumes that PACE programs will be up and have 100% coverage throughout each municipality which is unlikely.

3) Estimate penetration rates - One must then estimate penetration rates. Sonoma County, the most successful PACE program to date, is averaging less than 1% penetration. Our belief is that 1% penetration would be a reasonable success over a 24 month period, 2% penetration would be a large success and 3% would be extraordinary success.

4) Estimate "Total PACE Homes" based upon penetration rates - Based upon the above penetration rates, there would be between 90,000 and 270,000 PACE homes two to three years from now (1%-3% times 9 million).

5) Calculate scope of potential senior lien exposure - Assuming the senior lien exposure "per home" from item 3. above, this results in total scope exposure on the low end of about \$18 million (\$86 per home * 90,000 homes) to \$70 million on the very high end (\$260 per home * 270,000 homes). Please note that we believe the best means to look at PACE scope is to estimate penetration rates as opposed to "leverage ratios" on the DOE approximately \$153 million in awards. The reason for this is that in many PACE jurisdictions there is not a precise metric for how many PACE loans can be issued for each DOE grant e.g. a grant might be used to pay for marketing costs while a bank funds the PACE retrofits entirely with no link to the DOE grant size.

5. What is the difference between the original PACE programs and new best practice PACE programs (the DOE grant recipient programs)? Listed below are some of the most material differences between early PACE, and the newer PACE programs/DOE grantee requirements. There were no standard rules for the early PACE programs so the protections for lenders and consumers varied from jurisdiction to jurisdiction. The White House Framework/DOE Guidelines provide standardization and represent substantial improvements specifically designed to benefit existing lenders and consumers.

	<u>Some Early PACE Programs</u>	<u>Best Practice/DOE Grantee PACE Programs</u>
<u>Lender protections</u>		
Annual savings targeted to exceed annual assessment (to improve borrower cash flow and reduce the risk of default)	No	Yes
10% Cap on PACE retrofits as % of property value	No	Yes
Non-acceleration of total PACE future assessment		

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payments upon foreclosure (so that only delinquent assessments get paid) No (not required by guidelines) Yes

Positive equity requirement No Yes

Consumer protections

Annual savings targeted to exceed annual assessment No Yes

Assessment should match useful life of measures No Yes

Quality assurance mandated No (note: most programs had) Yes

6. Safety and soundness

a. How should the Best Practice PACE programs impact borrower ability to pay? The PACE best practices/DOE grantee requirements have been designed so that homeowners choose PACE projects where the annual energy savings exceeds the annual tax assessment. In effect, the objective is to improve the borrower's ability to make mortgage payments and therefore decrease the risk of borrower default. Note, however, that the cash flow positive nature of retrofits over the short term can be impacted, positively and negatively, by changing energy prices.

b. Are there long term large studies and meaningful data that shows homeowner energy savings from efficiency and the various payback periods for different investments? To my knowledge there are not very long term studies and deep analyses of payback periods. My understanding is that the Department of Energy/HUD/CEQ/NEC/and the White House intend for the PACE grantees to provide data over the next several years that can be used to analyze the efficacy and payback from retrofits.

7. Is PACE finance an assessment or a loan and is it constitutional? The California Attorney General and Paul Hastings law firm believe strongly that PACE is both an assessment and constitutional (see Exhibit 3 legal opinion from Paul Hastings and Exhibit 5 California Attorney General letter).

8. Non-acceleration: Is it true that if a homeowner PACE retrofits their house in California and then suffers a foreclosure that only the delinquent assessment gets paid and not the entire assessment amount? Yes, this is very clearly settled law. See attached legal opinion from Jones Hall (Exhibit 4)

9. Over the long term can the existing White House Policy Framework/Department of Energy PACE guidelines be improved? The guidelines can certainly be improved over the long term. A lot of resources from the inter-agency task force were put into developing the existing guidelines over several months and they represent substantial improvements for consumers and existing lenders. But more will be learned over time as the PACE market develops and data is gathered. If there are future items that the regulators believe should be required improvements it would be prudent to seek municipal feedback to understand the cost, feasibility of administration and how to best achieve the additional objectives.

Attachments:

Exhibit 1 – PACE Potential Seniority Per Home

Exhibit 2 – PACE Penetration Analysis

Exhibit 3 – PACE Legal Opinion on Assessment & Constitutionality

Exhibit 4 – Jones Hall Opinion

Exhibit 5 – California Attorney General Letter