American Land Title Association
National Association of Real Estate Investment Trusts
The Real Estate Roundtable

September 23, 2010

The Honorable Jeff Bingaman
Chairman
U.S. Senate Committee on
Energy and Natural Resources
304 Dirksen Senate Office Building
Washington, DC 20510

The Honorable Lisa Murkowski
Ranking Member
U.S. Senate Committee on
Energy and Natural Resources
304 Dirksen Senate Office Building
Washington, DC 20510

RE: Department of Energy Loan Guarantees for Building Retrofits
Mortgage Lien Priority; ENR Hearing Scheduled for September 23, 2010

Dear Chairman Bingaman and Ranking Member Murkowski:

On behalf of our members in the commercial, residential, and financing sectors for real estate, we commend the Senate Energy and Natural Resources Committee for holding a hearing on the Loan Guarantee Program administered by the Department of Energy (DoE) to spur deployment of clean energy technologies. We support efforts to incentivize energy efficiency retrofits in residential and commercial buildings. However, we urge careful review to ensure that any such proposals do not alter traditional lending priorities that would subvert the security interests long held by mortgage banks in properties they finance. Such alterations would put the availability of credit at risk.

Two recent bills would authorize DoE to administer a federal loan guarantee program that backs debt for building retrofit projects. S. 3746, introduced by Chairman Bingaman and co-sponsored by Senators Shaheen, Boxer, and Feinstein, renders "[e]nergy efficiency projects … including projects to retrofit residential, commercial, and industrial buildings" eligible for DoE loan guarantees. Likewise, S. 3780, the "Recovery Through Building Renovation Act" introduced by Senator Shaheen and co-sponsored by Senator Landrieu, would establish a DoE "Building Retrofit Financing Program." Both bills would amend Title XVII of the Energy Policy Act of 2005 (EPAct), the statutory authority for DoE's existing loan guarantee program. The EPAct contains provisions requiring that debt obligations backed by federal guarantees must not be subordinate to other financing.[1]

When these provisions were adopted in 2005 with nuclear plants, wind farms and large-scale solar projects in mind, Congress did not consider their effect on the proper functioning of traditional commercial and residential mortgages (such as the sale of mortgages on secondary markets). A fundamental tenet of real estate finance is that, in the event of a property owner's

[1] See 22 U.S.C. 16512(d)(3) ("The obligation shall be subject to the condition that the obligation is not subordinate to other financing"); *id.* § 16512(g)(2)(B) ("The rights of the [Energy] Secretary, with respect to any property acquired pursuant to a guarantee or related agreements, shall be superior to the rights of any other person with respect to the property").

default on the mortgage and/or foreclosure, the lender (or "mortgagee") will receive payments outstanding on the loan ***before*** sums are paid to any other secondary security interest in the property. In other words, the first mortgagee has a superior lien taking precedence over secondary security interests in the collateral. This principle of "mortgage superiority" is an industry standard written into deeds of trust and other mortgage documents, including Fannie Mae's uniform security instruments. Borrowers would likely be in breach of contract if they allowed a secondary lender (such as one extending a home equity loan) occupy a more favorable lien position on the asset to the detriment of the bank providing a mortgage loan in the first instance. Similarly, junior mortgagees receive lien priority based on "first in time" principles after the first mortgage. Junior lienholders also expect that their liens will not be subordinated to other financiers that come later in time.

We strongly urge the Committee to study how this principle of mortgage lien priority is impacted by existing Title XVII provisions as amended by S. 3746 and S. 3780. It appears that the EPAct sections referenced in footnote 2 above, if applied to a loan guarantee for building retrofits, would put DoE's interests in conflict with the rights of lenders in mortgaged properties. Building owners considering retrofits and contemplating loan guarantee financing for efficiency upgrade projects will find themselves in untenable positions. Such borrowers could not simultaneously respect their contractual obligations to allow mortgagees to maintain a higher interest in the collateral, while also ensuring that a retrofit loan is "not subordinate to other financing" or that the Energy Secretary has superior interests compared to the "rights of any other person" in the property.[2]

Indeed, S. 3780 would direct the Energy Secretary to establish "guidelines" for credit support for building retrofit loans, which shall include "any lien priority requirements that the Secretary determines to be necessary."[3] We recommend that the legislation should direct the Energy Secretary to develop guidelines where federal loan guarantees can support retrofit debt occupying a ***secondary*** security interest in the underlying collateral according to traditional lien priority rules of law. Indeed, many of the principles DoE has already developed for Property Assessed Clean Energy (PACE) financing have equal applicability to determine appropriate circumstances when the agency could offer a guarantee to back a secondary retrofit loan while preserving the lien position of mortgagees.[4]

To that end, in the context of the PACE platform, the Federal Housing Finance Agency,[5] Fannie Mae,[6] Freddie Mac,[7] and the Office of the Comptroller of the Currency[8] have all stated that the security interests of mortgage lenders must not be subordinated to the lien position of retrofit financiers. For loans originated on or after July 6, 2010, Fannie Mae has announced it will not purchase mortgages on properties encumbered with retrofit debt that takes priority over

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[2] 22 U.S.C. §§ 16512(d)(3), (g)(2)(B).

[3] S. 3780, p, 4, lines 4-5.

[4] "Guidelines for Pilot PACE Financing Programs" (May 7, 2010), available at www1.eere.energy.gov/wip/.../arra_guidelines_for_pilot_pace_programs.pdf.

[5] See www.**fhfa**.gov/webfiles/15884/**PACE**STMT7610.pdf.

[6] See https://www.e**fanniemae**.com/sf/guides/ssg/annltrs/pdf/2010/ll1006.pdf;

[7] See www.**freddiemac**.com/sell/guide/bulletins/pdf/bll1020.pdf.

[8] See http://www.occ.treas.gov/ftp/bulletin/2010-25.html.

first mortgage liens.[9] While the general concept of DoE credit support can be a viable way to spur building efficiency upgrades, we must caution the Committee to avoid the same mortgage subordination controversies surrounding PACE initiatives when considering the soundness of loan guarantees.

Our organizations firmly support efforts to create meaningful and workable financial incentives to help underwrite the expense of residential and commercial building retrofits. Such energy efficiency projects can have many benefits. They can create jobs in the hard-hit construction industry, help small businesses weather the recession, and drive our country forward into a new energy economy that favors technological achievement while reducing greenhouse gas emissions. However, while any loan guarantee product specifically for building retrofits might be a significant agent to spur retrofits, it must safeguard traditional lien priorities and avoid unnecessary risks to the mortgage investment community. We look forward to continuing to work with you on this important issue.

For more information, please contact: Justin Ailes at American Land Title Association (202/261-2937 -- jailes@alta.org); Kirk Freeman at National Association of Real Estate Investment Trusts (202/739-9400 -- kfreeman@nareit.com); or Duane Desiderio at The Real Estate Roundtable (202/639-8400 -- ddesiderio@rer.org).

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CC: The Honorable Barbara Boxer
The Honorable Dianne Feinstein
The Honorable Mary Landrieu
The Honorable Jeanne Shaheen

[9] See www.aba.com/NR/rdonlyres/...6541.../**FannieMaePace**Announcement.pdf.