



HUD No. 16-110
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FOR RELEASE
Tuesday
July 19, 2016

FHA TO INSURE MORTGAGES ON CERTAIN PROPERTIES WITH PACE ASSESSMENTS

New guidance intended to stimulate access to clean energy financing

WASHINGTON - In order to enable homeowners seeking clean energy technologies in their homes to leverage a range of financing options, the Federal Housing Administration (FHA) today announced guidance that makes clear the circumstances under which it will insure mortgages on properties that include Property Assessed Clean Energy (PACE) assessments. FHA will now approve purchase and refinance mortgage applications in states that treat PACE obligations as special assessments similar to property taxes. [**Read more about FHA's new guidance.**](#)

FHA's action is part of a larger Administration effort to expand access to clean energy technologies to every American family with the option to transition to solar energy and make improvements to their homes to cut their energy bills. [**Read more.**](#)

PACE is showing promise as an effective way to finance energy efficiency, renewable energy, water conservation, and other resilience upgrades to homes, including new heating and cooling systems, lighting improvements, solar panels, water pumps, and insulation. PACE pays the costs for such enhancements and is repaid through an assessment added to the property's tax bill. State and local governments sponsor PACE financing to encourage energy efficiency, solar energy deployment, advance resilience, create jobs, promote economic development, and protect the environment.

"Today, we're seizing the opportunity to shape a cleaner and more sustainable nation," said Ed Golding, HUD Principal Deputy Assistant Secretary for Housing. "Using PACE, families will be able to make their homes more energy efficient and sustainable in the long run, while still keeping their costs affordable today. As PACE programs continue to develop across the nation, the positive impact on families, jobs, and the environment will only grow."

FHA's new guidance addresses PACE programs where the PACE obligation is treated like a property tax and does not allow the full obligation to have priority or 'prime' status over the FHA mortgage lien. By law, FHA cannot accept a first lien PACE structure (except for past due amounts as is the case for all tax assessments). In accordance with existing guidance, lenders will be responsible for escrowing PACE payments as they would property taxes. In addition, purchasers of homes with existing PACE obligations will be responsible for any unpaid balance of the obligation.

The guidance protects FHA from risk in a variety of ways. Lenders must escrow payments for PACE assessment so FHA should never be at risk of losing collateral in a tax sale. FHA is also

protected as its appraisal policy requires that appraisals take into account the PACE assessment and the value of the improvements.

The Department of Energy is updating its Best Practices Guidelines for Residential PACE Financing, which may be used by states and counties to align with their consumer protection goals.

To qualify for FHA insurance on mortgages for properties that include PACE assessments, lenders must determine that the following requirements have been met under the laws in the state where the property is located:

- The PACE obligation must be collected (escrowed) and secured by the creditor in the same manner as a special assessment against the property.
- The PACE obligation cannot accelerate - namely, the entire amount of the obligation cannot become due in the event of delinquency after endorsement of the FHA-insured mortgage. The property may be subject to an enforceable claim or lien that is superior to the FHA-insured mortgage but only for the delinquent portion of the PACE obligation.
- There are no terms or conditions that limit the transfer of the property to a new homeowner.
- The existence of a PACE obligation on a property is readily apparent to mortgagees, appraisers, borrowers and other parties to an FHA-insured mortgage transaction, and information on PACE obligations must be readily available for review in the public records where the property is located.
- In the event of the sale, including a foreclosure sale, of the property with outstanding PACE financing, the PACE assessment remains with the property. In cases of foreclosure, priority collection of delinquent payments for the PACE assessment may be waived or relinquished. Unless a payoff is negotiated, the buyer will assume the obligation and will be responsible for the payments on the outstanding PACE amount.



U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-
FEDERAL HOUSING COMMISSIONER

July 19, 2016

Mortgagee Letter 2016-11

To All FHA Approved Mortgagees
All Direct Endorsement Underwriters
All FHA Roster Appraisers
All FHA Roster Inspectors
All FHA Approved 203(k) Consultants
All HUD Approved Housing Counselors
All HUD Approved Nonprofit Organizations
All Governmental Entity Participants
All Real Estate Brokers
All Closing Agents

Subject Property Assessed Clean Energy (PACE)

Purpose This transmits updates to the following sections of HUD Handbook 4000.1, *Single Family Policy Handbook*:

- Section II.A.1.a.i(E)(1)(a)(iii), Sales Contract and Supporting Documentation
- Section II.A.1.a.iii(B)(6)(e), Additional Requirements When Ordering an Appraisal
- Section II.A.1.b.iv(A)(6), Property Assessed Clean Energy (PACE)
- Section II.A.4.a.iii(A)(1), Automated Underwriting System Data Entry Requirements
- Section II.A.4.d.iii(G)(2), Interested Party Contributions (TOTAL)
- Section II.A.5.c.iii(G)(2), Interested Party Contributions (Manual)
- Section II.A.5.d.vii(B), Calculating Total Mortgage Payment
- Section II.A.6.a.viii(A), Monthly Escrow Obligation
- Section IID.12.d.iv, Property Assessed Clean Energy (PACE)

Mortgagee Letter 2016-11, Continued

Effective Date These Handbook sections are effective for all case numbers assigned on or after 60 days from publication of this Mortgagee Letter; however, Mortgagees may begin using the policy immediately.

4000.1 FHA Single Family Housing Policy Handbook The attached updates to HUD's Single Family Housing Policy Handbook 4000.1 will be incorporated in a future publication of the Handbook.

Background FHA supports the goals of clean energy, energy efficiency, and resilience. Property Assessed Clean Energy (PACE) programs may provide an alternative means of financing energy and other PACE-allowed improvements to residential properties using financing provided by private enterprises in conjunction with state and local governments.

The terms and conditions of the PACE obligation may vary by state, local government, and PACE program. PACE programs also determine the scope of allowable improvements made under their respective PACE programs. Generally, the repayment of the PACE obligation is collected in the same manner as a special assessment is collected by the local government, rather than paid directly by the Borrower to the party providing the PACE financing. Generally, the PACE obligation is also secured in the same manner as a special assessment against the property. In the event of the sale, including a foreclosure sale, of the property with outstanding PACE financing, the obligation will continue with the property causing the new homeowner to be responsible for the payments on the outstanding PACE amount. In cases of foreclosure, priority collection of delinquent payments for the PACE assessment may be waived or relinquished.

The Department of Energy is updating its Best Practices Guidelines for Residential PACE Financing, which may be used by states and counties to align with their consumer protection goals.

FHA regulations at 24 CFR §203.32(a) require, in part, that with certain exceptions, at the time the mortgage is offered for insurance, the property must be free and clear of any liens other than the FHA-insured mortgage. In addition, FHA regulations at 24 CFR §203.41(c)(2) require that any restrictions on conveyance automatically terminate if title to the mortgaged property is transferred by foreclosure or deed-in-lieu of foreclosure, or if the FHA-insured mortgage is assigned to the Secretary.

Continued on next page

Attached to this ML are additions and revisions to the Handbook 4000.1. The following is a summary of Title II Forward Mortgage policy changes, which is provided for informational purposes only.

Outstanding PACE Obligations

Properties which will remain encumbered with a PACE obligation may be eligible for FHA-insured mortgage financing, provided that the mortgagee determines that the following requirements have been met:

- under the laws of the state where the property is located, the PACE obligation is collected and secured by the creditor in the same manner as a special assessment against the property;
- the property may only become subject to an enforceable claim (i.e., a lien) that is superior to the FHA-insured mortgage for delinquent regularly scheduled PACE special assessment payments. The property shall not be subject to an enforceable claim (i.e., lien) superior to the FHA-insured mortgage for the full outstanding PACE obligation at any time (i.e., through acceleration of the full obligation.) However, a notice of lien for the full PACE obligation may be recorded in the land records;
- there are no terms or conditions that limit the transfer of the property to a new homeowner. Legal restrictions on conveyance arising from a PACE obligation that could require the consent of a third party before the owner can convey the real property are prohibited, unless such provisions may be terminated at the option of, and with no cost to, the homeowner;
- the existence of a PACE obligation on a property is readily apparent to mortgagees, appraisers, borrowers and other parties to an FHA-insured mortgage transaction in the public records and must show the obligation amount, the expiration date and cause of the expiration of the assessment, and in no case may default accelerate the expiration date; and
- in the event of the sale, including a foreclosure sale, of the property with outstanding PACE financing, the obligation will continue with the property causing the new homeowner to be responsible for the payments on the outstanding PACE amount.

Disclosure of PACE Obligation, Terms and Conditions upon Sale

For properties with existing PACE obligations, the property sales contract must indicate whether the obligation will remain with the property or be satisfied by the seller at, or prior to closing. Where the obligation will

Continued on next page

Mortgagee Letter 2016-11, Continued

(continued) remain, all terms and conditions of the PACE obligation must be fully disclosed to the borrower and made part of the sales contract between the seller and the borrower.

Appraisal Requirements

Where energy and other PACE-allowed improvements have been made to the property through a PACE program, and the PACE obligation will remain outstanding, the appraiser must analyze and report the impact on the value of the property, whether positive or negative, of the PACE -related improvements and any additional obligation (i.e., the PACE special assessment).

Home Equity Conversion Mortgages And Title I Loans

These policies are not applicable to Home Equity Conversion Mortgages (HECM) or Title I Loans. Properties with PACE obligations are not eligible for an FHA-insured HECM or Title I Loan.

Information Collection

The information collection requirements contained in this document have been approved by the Office of Management and Budget (OMB) under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520) and assigned OMB control number 2502-0059 and OMB Control number 2502-0538. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number.

Questions

Please address any questions about the topics addressed in this Mortgagee Letter to the FHA Resource Center at (800) 225-5342. Persons with hearing or speech impairments may reach this number via TTY by calling the Federal Relay Service at (800) 877-8339. For additional information on this Mortgagee Letter, please visit www.hud.gov/answers.

Signature

Edward L. Golding
Principal Deputy Assistant Secretary for Housing

Attachments

[1](#), [2](#), [3](#), [4](#), [5](#), [6](#), [7](#), [8](#), [9](#), [10](#)

(Download [zip file](#))

Property Assessed Clean Energy (PACE) Loan Processing

1. **Purpose.** The purpose of this Circular is to address origination and loan processing requirements for Department of Veterans Affairs (VA) guaranteed loans when a property is subject to PACE obligations.
2. **Background.** VA supports the overall goal of clean energy. PACE programs may provide an alternative means of financing clean energy improvements to residential properties using financing provided by private enterprises in conjunction with state and local governments.
 - a. Generally, the repayment of the PACE obligation is collected and secured in the same manner as a special assessment is collected by the local government, rather than paid directly by the borrower to the party providing the PACE financing. In the event of the sale of the property with outstanding PACE financing, the obligation may continue with the property, and the new homeowner will be responsible for the payments on the outstanding PACE amount. The terms and conditions of the PACE obligation may vary by state, local government, and PACE program.
 - b. Pursuant to 38 U.S.C. § 3703(d)(3)(A), a VA-guaranteed loan must be secured by a first lien on the realty. Lenders are responsible for properly securing the first-lien position of a VA-guaranteed loan.
3. **Policy.** Properties that are or will remain encumbered with a PACE obligation may be eligible for VA-guaranteed financing provided that the lender satisfies the requirements in Section 4 of this Circular.
4. **Action.** Properties that are or will remain encumbered with a PACE obligation may be eligible for VA-guaranteed financing provided that the lender determines that the following requirements are met:
 - a. Under the laws of the state where the property is located, the PACE obligation must be collected and secured by the creditor in the same manner as a special assessment against the property.
 - b. 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.
 - c. 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. (Note: If VA acquires ownership of a property that is subject to a PACE obligation, or if VA is assigned a VA-guaranteed loan that is secured by such a property, nothing in this policy should be construed as a waiver or release of VA's federal property rights or legal claims related to such property rights.)

d. The PACE obligation must not include terms or conditions that limit the transfer of the property to a new homeowner. Legal restrictions on conveyance arising from a PACE obligation that could require the consent of a third party before the owner can convey the real property are prohibited, unless such provisions may be terminated at the option of, and with no cost to, the owner.

e. The existence of a PACE obligation on a property is readily apparent to mortgagees, appraisers, borrowers, and other parties to a VA-guaranteed loan transaction; information on PACE obligations must be readily available for review in the public records where the property is located.

f. At the time of purchase, the sales contract must indicate whether the PACE obligation will remain with the property or be satisfied by the seller at, or prior to closing. Where the PACE obligation will remain, all terms and conditions of the PACE obligation must be fully disclosed to the borrower and made part of the sales contract between the seller and the borrower.

g. Where energy improvements have been made to the property through a PACE program, and the PACE obligation will remain outstanding, the appraiser must analyze and report the impact on the value of the property, whether positive or negative, of the energy-related improvements and any additional obligation (i.e., increased tax payments).

h. If the lender requires a borrower to escrow funds to ensure the PACE obligation is paid timely, the lender must open and manage the escrow accounts in a manner consistent with federal, state, and local law.

5. Questions. Inquiries in this regard may be directed to Gerald Kifer via e-mail at: colenders@vba.va.gov.

6. Rescission: This Circular is rescinded July 1, 2018.

By Direction of the Under Secretary for Benefits

Michael J. Frueh
Director, Loan Guaranty Service

Distribution: CO: RPC 2022

SS (26A1) FLD: VBAFS, 1 each (Reproduce and distribute based on RPC 2022)