REGULATORY ALERT

NATIONAL CREDIT UNION ADMINISTRATION
1775 DUKE STREET, ALEXANDRIA, VA 22314

DATE: **July 2010** **NO: 10-RA-10**

TO: **All Federally-Insured Credit Unions**

SUBJECT: **Potential Risks of Property Assessed Clean Energy Loans**

Dear Board of Directors:

The purpose of this Regulatory Alert is to advise you of potential risks associated with certain energy retrofit lending programs, commonly known as Property Assessed Clean Energy (PACE) loans, which are available in many states.

Background

In an effort to advance public policy objectives relative to the environment, many states offer PACE loan programs to encourage owners to make building improvements that will increase energy efficiency. Under many programs, PACE loans receive status as a priority lien over previously existing mortgages.

The Federal Housing Finance Agency (FHFA) issued a statement on July 6, 2010 cautioning lenders of the potential for certain PACE loan programs to adversely affect a lender's security interest in collateral securing residential and commercial mortgages. FHFA's statement, in its entirety, is available on the Internet at the following link:

http://www.fhfa.gov/webfiles/15884/PACESTMT7610.pdf

Potential Safety and Soundness Concerns

FHFA found that in the absence of a sound control structure, certain PACE loan programs could usurp a lender's senior lien position on a mortgage, undermine the underwriting decisions made by the lender at the time of mortgage origination, and bypass consumer protections required prior to the extension of credit.

In addition to potentially affecting loans held in your credit union's portfolio, certain PACE loan programs could also adversely affect earnings and liquidity based upon factors such as:

- When a PACE loan could overtake the original mortgagor's superior lien position, the mortgage could become more difficult to sell to government-sponsored enterprises or private investors; and

- The superior lien position afforded to many PACE loans could diminish the value of certain mortgage-backed securities.

Potential Adjustments

It is imperative that you understand the implications of the PACE loan programs available in your credit union's service area. If the PACE loans available in your credit union's service area present potential safety and soundness concerns, management should make appropriate adjustments to the credit union's underwriting criteria and collateral monitoring practices. Some examples of potential adjustments include:

- Reducing real estate loan-to-value limits to account for the extent a PACE loan could undermine an original superior position;

- Considering the impact PACE loan payments could have on a borrower's ability to repay during the underwriting process;

- Adjusting home equity line of credit limits; and

- Requiring additional collateral when appropriate.

If you have questions concerning the potential safety and soundness concerns relative to PACE loan programs, please do not hesitate to contact your NCUA regional office or state supervisory authority.

Sincerely,

/s/

Debbie Matz
Chairman