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OAKLAND

UNITED STATES DISTRICT COURT

FOR THE NORTHERN DISTRICT OF CALIFORNIA

PEOPLE OF THE STATE OF CALIFORNIA, *ex rel.* EDMUND G. BROWN JR., ATTORNEY GENERAL, Plaintiff, v. FEDERAL HOUSING FINANCE AGENCY; EDWARD DeMARCO, in his capacity as Acting Director of FEDERAL HOUSING FINANCE AGENCY; FEDERAL HOME LOAN MORTGAGE CORPORATION; CHARLES E. HALDEMAN, JR. in his capacity as Chief Executive Officer of FEDERAL HOME LOAN MORTGAGE CORPORATION; FEDERAL NATIONAL MORTGAGE ASSOCIATION; MICHAEL J. WILLIAMS, in his capacity as Chief Executive Officer of FEDERAL NATIONAL MORTGAGE ASSOCIATION, Defendants.	Case No. C10-03084 BZ **COMPLAINT FOR DECLARATORY AND EQUITABLE RELIEF (UNFAIR BUSINESS PRACTICES; VIOLATION OF THE NATIONAL ENVIRONMENTAL POLICY ACT)** ADR **(42 U.S.C. §§ 4321 *et seq.*; 28 U.S.C. 2201; Cal. Code Civ. Proc. § 1060; Cal. Bus. & Prof. Code § 17200 *et seq.*)**

INTRODUCTION

1. California has pioneered financing for solar power systems, and energy and water efficiency retrofits for homeowners. These programs, called Property Assessed Clean Energy

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INTRODUCTION

1. California has pioneered financing for solar power systems, and energy and water efficiency retrofits for homeowners. These programs, called Property Assessed Clean Energy

("PACE") programs, reduce energy and water use, provide clean power, and are part of California's efforts to promote clean energy and green jobs. PACE programs do not operate using loans in a traditional sense. Instead, under PACE, local governments finance the upfront installation costs, and homeowners repay those costs over a period of years through assessments on the property tax bill. The California Legislature has declared that "[e]nergy conservation efforts, including the promotion of energy efficiency improvements to residential, commercial, industrial, or other real property are necessary to address the issue of global climate change"; "[t]he upfront cost of making residential, commercial, industrial, or other real property more energy efficient prevents many property owners from making those improvements"; and that, therefore, PACE serves "a public purpose[.]"[1]

2. Now, by misrepresenting the nature of the PACE programs and municipal financing, in violation of California law, Defendants Federal National Mortgage Association (commonly known as "Fannie Mae") and the Federal Home Loan Mortgage Corporation (called "Freddie Mac"), are severely hampering California's efforts to assist thousands of California homeowners to reduce their energy and water use, help drive the state's green economy, and create significant numbers of skilled, stable and well paying jobs. The actions of these government-sponsored, shareholder-owned private corporations have placed California's PACE programs – and the hundreds of millions of dollars in federal stimulus money supporting them – at immediate risk while benefitting their own pecuniary interests.

3. On May 5, 2010, Fannie Mae and Freddie Mac each issued advice letters to all lending institutions stating that mortgages for residences that also have PACE "loans" with first lien priority (providing PACE funders with priority in recovering unpaid assessments in case of foreclosure) are not allowed under these entities' standardized mortgage documents. Fannie Mae and Freddie Mac together own or guarantee about half of all residential home mortgages in the United States. Fannie Mae and Freddie Mac purchase home loans from banks and other lenders, in theory freeing up more capital for additional home mortgage lending. Because Fannie Mae

[1] Cal. Streets & Hwy. Code § 5898.14.

and Freddie Mac control the mortgage resale market, lenders will not issue mortgages that do not meet Fannie Mae's and Freddie Mac's requirements. As a result, Fannie Mae's and Freddie Mac's determination – which misrepresents California law – essentially forecloses residential PACE programs.

4. On July 6, 2010, the Federal Housing Finance Agency ("FHFA") affirmed these entities' loan purchase restrictions for residences with PACE funding. Fannie Mae, Freddie Mac, and FHFA mischaracterize PACE funding as "loans," rather than "assessments" as they are unequivocally defined under California law. The FHFA acknowledged that, by affirming Fannie Mae's and Freddie Mac's position, the agency was effectively stopping PACE programs in California – in its words, effecting a "pause" in PACE – with no clear indication of when, if ever, such programs would be allowed to move forward in the future. At this critical juncture, this "pause" will cause permanent, irreparable damage to PACE, threatening tens of millions of dollars of federal stimulus monies currently allocated for California PACE programs. FHFA has effectively precluded PACE programs in California and deprived California and its citizens of the associated residential energy and water efficiency and renewable energy benefits, thereby significantly impacting the human environment, without completing the required environmental review under the National Environmental Policy Act ("NEPA").

5. Accordingly, California seeks a prompt judicial declaration as against Fannie Mae and Freddie Mac that, under California law: (a) PACE programs operate by assessments, not loans, and such assessments are valid; (b) liens that may result from PACE assessments, like those resulting from other types of assessments, have priority over mortgages; and (c) participation in PACE programs is compatible with, and not in violation of, Fannie Mae's and Freddie Mac's standardized mortgage documents. California also seeks a declaration that FHFA is required to conduct the required environmental review under NEPA before taking any action that will limit or foreclose PACE in California.

JURISDICTION AND VENUE

6. This Court has jurisdiction pursuant to 28 U.S.C. § 1331 (action arising under the laws of the United States), 5 U.S.C. §§ 701-706 (Administrative Procedure Act), 12 U.S.C.

1452(f) (original jurisdiction in federal district court for actions involving Freddie Mac), and 28 U.S.C. § 1367 (supplemental jurisdiction).

7. An actual controversy exists between the parties within the meaning of 28 U.S.C. § 2201(a). This Court may grant declaratory relief, injunctive relief, and any additional relief pursuant to 28 U.S.C. §§ 2201, 2202 and 5 U.S.C. §§ 705, 706 and under any relevant state laws pursuant to its supplemental jurisdiction.

8. The FHFA has made a final administrative determination that is subject to review under the APA. 5 U.S.C. § 702.

9. Venue lies in this judicial district by virtue of 28 U.S.C. § 1391(e) and Civil Local Rule 3-2(d), because a substantial part of the events or omissions giving rise to the claims occurred in this district.

PARTIES

10. Defendant Fannie Mae is a federally chartered, private corporation, of a type commonly referred to as a government-sponsored enterprise ("GSE"). Fannie Mae facilitates the secondary market in residential mortgages. Together with Freddie Mac, another GSE, Fannie Mae owns or guarantees about half the home loans in the U.S. and California. Fannie Mae is publicly traded, has a Board of Directors, and is required to report to the Securities and Exchange Commission. By statute, Fannie Mae has the power to sue and be sued in both state and federal court. 12 U.S.C. § 1723a(a).

11. Defendant Michael J. Williams is the Chief Executive Officer of Fannie Mae and is sued in that capacity.

12. Defendant Freddie Mac is a federally chartered, private corporation and also a GSE. Freddie Mac facilitates the secondary market in residential mortgages. Together with Fannie Mae, another GSE, Freddie Mac owns or guarantees about half the home loans in the U.S. and California. Freddie Mac is publicly traded, has a Board of Directors, and is required to report to the Securities and Exchange Commission. By statute, Freddie Mac has the power to sue and be sued. 12 U.S.C., § 1452(c).

13. Defendant Charles E. Haldeman, Jr. is the Chief Executive Officer of Freddie Mac and is sued in that capacity.

14. Defendant FHFA is a federal government agency created on July 30, 2008, to oversee Fannie Mae, Freddie Mac, and the Federal Home Loan Banks. As of June 2008, the combined debt and obligations of these entities totaled $6.6 trillion, exceeding the total publicly held debt of the United States by $1.3 trillion.

15. Defendant Edward DeMarco is the Acting Director of the Federal Housing Finance Agency and is sued in that capacity.

16. California brings this action by and through Attorney General Edmund G. Brown Jr. Attorney General Brown is the chief law enforcement officer of the state. This complaint is brought pursuant to the Attorney General's independent constitutional, common law, and statutory authority to represent the public interest. Cal. Gov. Code §§ 12600–12612; Cal. Const., art. V, § 13.

MISCHARACTERIZATION OF CALIFORNIA LAW

17. The actual controversy at issue in this complaint arises out of Fannie Mae's and Freddie Mac's participation in, and influence over, the residential mortgage market in California and, more specifically, actions taken by Fannie Mae and Freddie Mac on May 5, 2010 and by FHFA on July 6, 2010.

18. For well over 100 years, local governments in California have used their assessment powers to finance improvements that serve a public purpose, such as the paving of roads, sidewalk improvements, and the undergrounding of utilities. Under California law, it is well established that in some instances, privately-owned improvements, *e.g.*, seismic and fire-related improvements, can also serve a valid public purpose.

19. Under longstanding California law, assessments create liens that have priority over mortgages.

20. By their practices and documents, Fannie Mae and Freddie Mac have for decades accepted and agreed that in California, assessments constitute priority liens.

21. Under California law, local governments in California may finance the installation on private property of roof-top solar, other distributed generation renewables, and energy and water efficiency improvements using the same assessment mechanism. Charter cities are authorized to establish PACE programs under the Communities Facilities District Act (commonly known as Mello-Roos Act), which has been in existence since 1982.[2] With the passage of California Assembly Bill 811 (AB 811) in 2008,[3] all other local governments in California are similarly authorized. Under the plain language of California law, any liens that result from PACE assessments have priority over mortgages, operating in the same way as other assessments.

22. PACE programs have been multiplying rapidly since the passage of AB 811. One very successful example is Sonoma County's Energy Independence Program. Since March of 2009, Sonoma County's program has financed nearly 1,000 projects – including, solar panels, tankless water heaters, reflective roofing, smart irrigation controllers, and attic insulation – totaling over $30 million.

23. The White House highlighted PACE in its "Recovery Through Retrofit" initiative in October 2009. In the accompanying report,[4] the White House noted the benefits of PACE: "Property tax or municipal energy financing allows the costs of retrofits to be added to a homeowner's property tax bill, with monthly payments generally lower than utility bill savings. This arrangement attaches the costs of the energy retrofit to the property, not the individual, eliminating uncertainty about recovering the cost of the improvements if the property is sold." The White House further stated that "Federal Departments and Agencies will work in partnership with state and local governments to establish standardized underwriting criteria and safeguards to protect consumers and minimize financial risks to the homeowners and mortgage lenders." On October 18, 2009, the White House released its "Policy Framework for PACE Financing

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[2] Cal. Gov. Code § 53311 *et seq*.

[3] Cal. Streets & Hwy. Code §§ 5898.12, 5898.14, 5898.20, 5898.21, 5898.22, and 5898.30.

[4] Available at http://www.whitehouse.gov/assets/documents/Recovery_Through_Retrofit_Final_Report.pdf.

Programs,"[5] in which Vice President Joseph Biden announced support "for the use of federal funds for pilot programs of PACE financing to overcome barriers for families who wish to invest in energy efficiency and renewable energy improvements."

24. The Department of Housing and Urban Development ("HUD") and Department of Energy ("DOE") expressly identified PACE as eligible for receipt of hundreds of millions of dollars in federal stimulus funds. Through the American Recovery and Reinvestment Act's Energy Efficiency and Conservation Block Grant Program, DOE awarded over $300 million directly to larger California local governments, and an additional $35 million for disbursement through the California Energy Commission ("CEC") to smaller local governments. The Recovery Act also funded the State Energy Program, under which California received more than $226 million. Both DOE and the CEC expressly supported the use of these funds for PACE programs, and, accordingly, dozens of counties and cities across California were poised to launch their own PACE programs in part with federal dollars.

25. On May 5, 2010, Fannie Mae and Freddie Mac each unexpectedly issued a "Lender Letter" directed to the home mortgage industry. Fannie Mae's Lender Letter (Exhibit A to this Complaint) provides in relevant part:

> Fannie Mae has received a number of questions from seller-servicers regarding government-sponsored energy loans, sometimes referred to as Property Assessed Clean Energy (PACE) *loans*. PACE *loans* generally have automatic first lien priority over previously recorded mortgages. The terms of the Fannie Mae/Freddie Mac Uniform Security Instruments prohibit *loans* that have senior lien status to a mortgage. As PACE programs progress through the experimental phase and beyond, Fannie Mae will issue additional guidance to lenders as may be needed from time to time.

(Emphasis added.)

26. Freddie Mac's May 5, 2010 Lender Letter (also attached as Exhibit A) provides in relevant part:

> The purpose of the Industry Letter is to remind Seller/Servicers that an energy-related lien may not be senior to a Mortgage delivered to Freddie Mac. Sellers/Servicers should determine whether a state or locality in which they originate mortgages has an energy loan program and whether a first priority lien is permitted.

[5] Available at http://www.whitehouse.gov/assets/documents/PACE_Principles.pdf.

27. On May 7, 2010, DOE, after consultation within the federal government and with other stakeholders, issued its "Guidelines for Pilot PACE Financing Programs"[6] to "help ensure prudent financing practices during the current pilot PACE programs."

28. On July 6, 2010, FHFA issued a definitive Statement on PACE, together with a cover letter addressed to the California Attorney General. FHFA's Statement provides that the May 5, 2010 Fannie Mae and Freddie Mac "lender letters remain in effect." Further, both the cover letter and the Statement expressly acknowledge that by affirming Fannie Mae's and Freddie Mac's May 5, 2010 Lender Letters, the FHFA is effecting a "pause" in California PACE programs. While the Statement holds open the possibility that at some time in the future, the FHFA may allow PACE programs to resume, there is no schedule for the agency to revisit its determination and no guarantee that it will authorize PACE to proceed. In addition, as discussed in the immediately following paragraphs, any pause in PACE at this critical juncture likely is the death knell of widespread, effective PACE programs in California. The FHFA's Statement and cover letter to the California Attorney General are attached to this Complaint as Exhibit B.

29. The May 5, 2010, Lender Letters and the FHFA's Statement misrepresent the law governing PACE programs in California. California state law is clear: PACE financing is not accomplished through loans, but through assessments.

30. Under California law, liens resulting from PACE assessments, like other assessments, have priority over mortgages. Defendants seek to change that priority for their own benefit in violation of California law.

31. Fannie Mae's and Freddie Mac's longstanding business practices in California, reflecting their interpretation of their Uniform Security Instruments (including the California Deed of Trust), recognize that assessments can attain priority over mortgages, and that a mortgage holder subject to assessments that can attain priority is not inherently in violation of the California Deed of Trust. The Lender Letters and the FHFA Statement intentionally mischaracterize California law relating to PACE in order to support their unfounded contention

[6] Available at http://www1.eere.energy.gov/wip/pdfs/arra_guidelines_for_pilot_pace_programs.pdf.

that participating in PACE is contrary to the Fannie Mae's and Freddie Mac's Uniform Security Instruments.

UNFAIR AND UNLAWFUL ACTS OR PRACTICES

32. The May 5, 2010 Lender Letters and the July 6, 2010 FHFA Statement have seriously disrupted existing and incipient PACE programs in California, as shown by the following examples. Sonoma County's Energy Independence Program, discussed above, is California's largest operating local PACE program. Defendants' actions have adversely affected the program. Among other things, since Fannie Mae and Freddie Mac issued their Lender Letters in May, several property owners participating in Sonoma County's PACE program have been unable to refinance or transfer their property without paying off the amount financed in full, notwithstanding that the property owners were current in their payment of PACE assessments. Before Fannie Mae's and Freddie Mac's Lender Letters, 22 participants in Sonoma County's PACE program were able to refinance without difficulty. Defendants' actions create substantial uncertainty for Sonoma County PACE participants going forward. San Francisco's PACE program launched in April of this year, and San Francisco scrupulously followed the DOE guidelines for PACE programs. San Francisco has now been forced to suspend operations indefinitely. In May of this year, Placer County was ready to begin its PACE program. Because of the Lender Letters, it has now suspended the residential portion of the program indefinitely. Placer County's Treasurer estimates that as a direct result of Defendants' action, $4.74 million in energy efficiency retrofitting and solar jobs related to Placer County's program alone will be cancelled. The CaliforniaFIRST program is a joint PACE program that includes over 140 cities and counties in California. The program was scheduled to launch in August of this year, but is now on indefinite hold. Every prospective PACE participant who now cannot participate in the program is being denied economic benefits, including, but not limited to, lower energy and water bills and the opportunity to obtain favorable financing under PACE.

33. Defendants' actions are, in addition, endangering the majority of the $110 million in American Recovery and Reinvestment Act of 2009 State Energy Program funds awarded by the CEC to local governments. After the FHFA's July 6, 2010 Statement, the CEC asked for

clarification from DOE on distribution of federal stimulus funds for PACE programs in California. DOE responded that, while it and the Administration continue to support PACE, in light of Defendants' actions, "prudent management of the Recovery Act compels DOE and Recovery Act grantees to consider alternatives to programs in which the PACE assessment is given a senior lien priority." CEC now must consider whether to reallocate federal stimulus funds to avoid the loss of tens of millions of dollars currently allocated for use in California PACE programs. In addition, the CEC reports that Defendants' actions threaten California's ability to obtain an infusion of funding from the Home Star Energy Retrofit Act of 2010 (H.R. 5019). Defendants' actions also are interfering with the CEC's ability to complete its duties under California Assembly Bill 758, a state law that requires the CEC to develop a comprehensive energy efficiency program for all existing residential and commercial buildings.

34. Fannie Mae's and Freddie Mac's actions are unfair as defined in California Business and Professions Code § 17200, in that they have issued Lender Letters knowing that the effect will be effectively to stop PACE in California, depriving California homeowners of the ability to participate in the program and the State of California of the larger benefits of PACE. Fannie Mae's and Freddie Mac's action are unlawful as defined in California Business and Professions Code § 17200, in that they constitute intentional interference with the prospective economic advantage, including the advantage that otherwise would flow to homeowners, in the form of lower energy and water bills and favorable financing, and to the State of California in the form of federal monies.

FAILURE TO CARRY OUT ENVIRONMENTAL REVIEW

35. After Fannie Mae and Freddie Mac issued the May 5, 2010, Lender Letters, the California Attorney General's Office sought clarification from FHFA through letters dated May 17, 2010, May 19, 2010, and May 22, 2010. The Attorney General's letters are attached to this Complaint as Exhibit C.

36. On July 6, 2010, the FHFA responded with its final, definitive Statement that ends the effective operation of PACE in California. The Statement, discussed above, is attached to this Complaint as Exhibit B.

37. Under the National Environmental Policy Act ("NEPA"), 42 U.S.C. §§ 4321 *et seq.*, a major federal action that may significantly impact the human environment cannot be approved without an Environmental Assessment ("EA") or Environmental Impact Statement ("EIS").

38. NEPA is the "basic national charter for protection of the environment." 40 C.F.R. §1500.1. NEPA's purpose is to ensure "public officials make decisions that are based on understanding of environmental consequences, and to take actions that protect, restore, and enhance the environment" and to "ensure that environmental information is available to public officials and citizens before decisions are made and before actions are taken." 40 C.F.R. § 1500.1(b)-(c). NEPA is designed to "encourage and facilitate public involvement in decisions which affect the quality of the human environment." 40 C.F.R. § 1500.2(d). "Human environment" is defined "comprehensively to include the natural and physical environment and the relationship of people with that environment." 40 C.F.R. § 1508.14.

39. To achieve these purposes, NEPA requires all federal agencies to prepare a "detailed statement," the EIS, regarding all "major federal actions significantly affecting the quality of the human environment." 42 U.S.C. § 4332(c).

40. Where an agency does not know whether the effects of its proposed action will be "significant," it may prepare an EA. 40 C.F.R. § 1501.4(b). An EA consists of an analysis of the need for the proposed action, of alternatives to the proposed action, and of the environmental impacts of both the proposed action and the alternatives. 40 C.F.R. § 1508.9. If the EA indicates that the federal action may significantly affect the quality of the human environment, the agency must prepare an EIS. 40 C.F.R. § 1501.4(c).

41. Under Ninth Circuit precedent, an agency must prepare an EIS if substantial questions are raised as to whether a project may have significant effects.

42. If an agency decides not to prepare an EIS, it must prepare a Finding of No Significant Impact explaining the reasons for the agency's decision. 40 C.F.R. § 1508.13.

43. Here, the FHFA's Statement puts an end to the effective operation of PACE in California, wiping out in a single action a state-law sanctioned program designed to assist homeowners and improve and protect the environment. FHFA has taken this action without

considering even a single, less drastic alternative or conducting the required environmental review.

FIRST CAUSE OF ACTION

(For Declaratory Relief; Against All Defendants)

44. California realleges and incorporates by reference the allegations of the preceding paragraphs.

45. Under 28 U.S.C. § 2201 and Cal. Code of Civ. Proc. § 1060, California seeks a declaration of legal rights and duties with respect to Defendants' characterization of PACE programs established under California law as "loans" as opposed to "assessments." More specifically, California seeks a declaration that:

a. PACE programs operate through assessments, not loans;

b. Assessments receive lien priority under California law;

c. Lien priority for assessments does not violate and does not run contrary to Fannie Mae's or Freddie Mac's Uniform Security Instruments;

d. The GSE's May 5, 2010 Lender Letters, and FHFA's July 6, 2010 Statement mischaracterize California law and the operation of the GSE's own Uniform Security Instruments.

46. Without a prompt judicial declaration, PACE programs in California will be substantially reduced or eliminated, to the detriment of current and prospective PACE participants and the many green industries that serve PACE, and the operation of an important state law designed to serve California's energy conservation, water conservation, and greenhouse gas reduction objectives will be thwarted.

SECOND CAUSE OF ACTION

(For Unfair Business Practices, Cal. Bus. & Prof. Code § 17200; Against Fannie Mae and Freddie Mac)

47. California realleges and incorporates by reference the allegations of the preceding paragraphs.

48. From May 5, 2010 and continuing to the present, Fannie Mae and Freddie Mac, and each of them, have engaged in and continue to engage in, aided and abetted and continue to aid and abet, and conspired to and continue to conspire to engage in acts or practices that constitute unfair competition as defined in California Business and Professions Code section 17200. In each instance, Fannie Mae's and Freddie Mac's acts or practices have interfered and are interfering with homeowners' ability to participate in PACE and to achieve the economic benefits of the program, and, by effectively stopping PACE, are depriving California and its residents of the economic and environmental benefits of this state law-based program. Fannie Mae's and Freddie Mac's act or practices, which were intended to, and/or had the effect of creating lien priority and a more favorable financial position for Fannie Mae and Freddie Mac, include, but are not limited to, the following:

a. characterization of PACE assessments as loans without support for such characterization under California law; and

b. claims that PACE assessments providing first lien priority are contrary to Fannie Mae's and Freddie Mac's Uniform Security Instruments.

THIRD CAUSE OF ACTION

(For Violation of National Environmental Policy Act, 42 U.S.C. §§ 4321 *et seq.* and the Administrative Procedure Act, 5 U.S.C. §§ 701 *et seq.*; Against FHFA)

49. California realleges and incorporates by reference the allegations of the preceding paragraphs.

50. NEPA, 42 U.S.C. § 4332(2)(c), and its implementing regulations require all federal agencies to prepare environmental impact analysis (an EA or an EIS) for any major action that may significantly affect the quality of the human environment.

51. The FHFA is a federal agency. Its July 6, 2010 Statement on PACE, which for all intents and purposes, forecloses residential PACE programs in California and across the nation, is a major federal action within the meaning of NEPA.

52. The FHFA's Statement may significantly affect the human environment within the meaning of 42 U.S.C. § 4332(2)(c). The Statement ends in a single action a state-law sanctioned program designed to assist homeowners and improve and protect the environment.

53. By failing to evaluate the effects of its action on the human environment through an EA or an EIS, the FHFA has taken final agency action in violation of NEPA.

54. The Administrative Procedure Act, 5 U.S.C. § 701 *et seq.*, entitles a party to seek judicial review of an agency action where a legal wrong is alleged and the party alleging the violation is adversely affected or aggrieved by the agency action. Pursuant to 5 U.S.C. § 706, a reviewing court shall hold unlawful and set aside agency action found to be arbitrary, capricious, or otherwise not in accordance with the law, and compel agency action illegally withheld or unreasonably delayed.

55. FHFA's failure to comply with NEPA and its supporting regulations constitutes arbitrary and capricious agency action, is an abuse of discretion, and is contrary to law and to procedures required by law. 5 U.S.C. § 706(2)(A), (D).

PRAYER

For the foregoing reasons, California prays for judgment as follows:

1. That the Court declare that under California law, PACE financing is accomplished through assessments and not "loans," and nothing in Fannie Mae's or Freddie Mac's Uniform Security Instruments, as reflected in Fannie Mae's and Freddie Mac's longstanding business practices, prohibits participation in PACE programs;

2. That the Court issue a temporary restraining order, preliminary injunction, and permanent injunction restraining and enjoining Fannie Mae or Freddie Mac from taking any adverse action against any mortgagee who is participating, or may participate, in a PACE program under California law, or other action that has the effect of chilling PACE programs in California;

3. That Defendants Freddie Mac and Fannie Mae and all persons who act in concert with them be permanently enjoined from engaging in unfair competition or in any practice that facilitates unfair competition as defined in California Business and Professions Code section

17200, including, but not limited to, the acts and practices alleged in this Complaint, under the authority of California Business and Professions Code section 17203;

4. That the Court issue a declaratory judgment that Defendant FHFA violated NEPA and the APA by acting arbitrarily, capriciously, in an abuse of discretion, not in accordance with law and/or without observance of proper procedures required by law by failing to prepare appropriate environmental review before issuing its July 6, 2010 Statement and that the Court set aside FHFA's July 6, 2010 Statement;

5. That the Court award the costs of suit incurred; and

6. That the Court award such other and further relief as it may deem proper.

Dated: July 14, 2010

Respectfully Submitted,

EDMUND G. BROWN JR.
Attorney General of California

KEN ALEX
Senior Assistant Attorney General
JANILL L. RICHARDS
Supervising Deputy Attorney General
Attorneys for the People of the State of California, ex rel. Edmund G. Brown Jr.

EXHIBIT A

Lender Letter LL-2010-06 **May 5, 2010**

TO: All Fannie Mae Single-Family Sellers and Servicers

Property Assessed Clean Energy Loans

Fannie Mae has received a number of questions from seller-servicers regarding government-sponsored energy loans, sometimes referred to as Property Assessed Clean Energy (PACE) loans. PACE loans generally have automatic first lien priority over previously recorded mortgages. The terms of the Fannie Mae/Freddie Mac Uniform Security Instruments prohibit loans that have senior lien status to a mortgage. As PACE programs progress through the experimental phase and beyond, Fannie Mae will issue additional guidance to lenders as may be needed from time to time.

Fannie Mae supports energy-efficiency initiatives, and is willing to engage with federal and state agencies as they consider sustainable programs to facilitate lending for energy-efficiency home retrofits, while preserving the status of mortgage loans originated as first liens.

Questions should be directed to Resource_Center@fanniemae.com with the subject line "PACE." Lenders may also wish to consult with their federal regulators, who share concerns about PACE programs.

*****

Marianne E. Sullivan
Senior Vice President
Single-Family Chief Risk Officer

Freddie Mac
We make home possible®

Industry Letter

TO: Freddie Mac Seller/Servicers May 5, 2010

SUBJECT: First Lien Mortgages and Energy Efficient Loans

Several states have recently enacted laws that authorize localities to create new energy efficient loan programs that generally rely on the placement of a first priority lien to secure energy efficient home improvements. Programs under these laws are sometimes referred to as Energy Loan Tax Assessment Programs or Property Assessed Clean Energy programs. Freddie Mac has begun to receive questions about these new energy loan programs.

The purpose of this Industry Letter is to remind Seller/Servicers that an energy-related lien may not be senior to any Mortgage delivered to Freddie Mac. Seller/Servicers should determine whether a state or locality in which they originate mortgages has an energy loan program, and whether a first priority lien is permitted. Freddie Mac will provide additional guidance in the event that these energy loan programs move beyond the experimental stage.

Freddie Mac supports the goal of encouraging responsible financing of energy efficient and renewable energy home improvements. We continue to work with federal and state agencies and with Seller/Servicers on initiatives for developing workable energy retrofit programs.

CONCLUSION

Please contact your Freddie Mac representative or call (800) FREDDIE if you have any questions. Seller/Servicers may also wish to contact their federal regulators, who share concerns about energy liens.

Sincerely,

Patricia J. McClung
Vice President
Offerings Management

EXHIBIT B

Federal Housing Finance Agency

1700 G Street, N.W., Washington, D.C. 20552-0003
Telephone: (202) 414-3800
Facsimile: (202) 414-3823
www.fhfa.gov

July 6, 2010

Honorable Edmund G. Brown, Jr.
Attorney General
State of California
1515 Clay Street
20th Floor
Oakland, California 94612-0550

Dear Attorney General Brown:

Thank you for speaking with me this weekend. I was sorry to take time away from your holiday. I indicated that I will contact you again and see what specifics can be addressed per our discussion.

As you know, in earlier communications, you indicated concerns about the Property Assessed Clean Energy (PACE) programs and actions by Fannie Mae and Freddie Mac. The Federal Housing Finance Agency (FHFA) has reviewed the PACE programs again, considered safety and soundness issues that they present in their current form, carefully reviewed the status of current underwriting and energy standards, had further discussions with federal and state officials and undertaken to clarify the position of Fannie Mae and Freddie Mac on existing PACE program loans.

FHFA has determined that the first liens associated with PACE loans undertaken as tax assessments present a safety and soundness issue. Nevertheless, FHFA has directed the Enterprises to waive the clauses in their Uniform Security Instrument, prohibiting loans with a senior priority, for loans made prior to today's date, thereby addressing the concerns of existing homeowners with such first lien PACE loans.

Because of safety and soundness concerns, FHFA is directing Fannie Mae, Freddie Mac and the Federal Home Loan Banks to undertake certain actions that address PACE programs with first lien provisions. These are described in the attached FHFA Statement. In the meantime, FHFA believes a pause in PACE and PACE-like programs would be beneficial to permit a complete review of the relevant issues set forth in the attached Statement. FHFA intends to continue working with all parties toward a cooperative and well developed model for energy retrofit lending.

While these actions are taken as a prudential matter, FHFA supports energy retrofit lending programs. As we have for the past year, FHFA remains committed to working with federal and state government agencies and with the private sector to assess what programs could be deployed

or what currently existing programs may be modified that would operate to protect consumers, to facilitate lending while avoiding risks to lenders, to provide clarity on energy efficiency and to make energy conservation a goal that is being actively pursued at the residential level.

If you have any questions, you may contact me at 202 414 3788.

With all best wishes, I am

Sincerely,

Alfred M. Pollard
General Counsel

Attachment

cc: Clifford Rechtschaffen
Janill L. Richards

FEDERAL HOUSING FINANCE AGENCY

STATEMENT

For Immediate Release
July 6, 2010

Contact: Corinne Russell (202) 414-6921
Stefanie Mullin (202) 414-6376

FHFA Statement on Certain Energy Retrofit Loan Programs

After careful review and over a year of working with federal and state government agencies, the Federal Housing Finance Agency (FHFA) has determined that certain energy retrofit lending programs present significant safety and soundness concerns that must be addressed by Fannie Mae, Freddie Mac and the Federal Home Loan Banks. Specifically, programs denominated as Property Assessed Clean Energy (PACE) seek to foster lending for retrofits of residential or commercial properties through a county or city's tax assessment regime. Under most of these programs, such loans acquire a priority lien over existing mortgages, though certain states have chosen not to adopt such priority positions for their loans.

First liens established by PACE loans are unlike routine tax assessments and pose unusual and difficult risk management challenges for lenders, servicers and mortgage securities investors. The size and duration of PACE loans exceed typical local tax programs and do not have the traditional community benefits associated with taxing initiatives.

FHFA urged state and local governments to reconsider these programs and continues to call for a pause in such programs so concerns can be addressed. First liens for such loans represent a key alteration of traditional mortgage lending practice. They present significant risk to lenders and secondary market entities, may alter valuations for mortgage-backed securities and are not essential for successful programs to spur energy conservation.

While the first lien position offered in most PACE programs minimizes credit risk for investors funding the programs, it alters traditional lending priorities. Underwriting for PACE programs results in collateral-based lending rather than lending based upon ability-to-pay, the absence of Truth-in-Lending Act and other consumer protections, and uncertainty as to whether the home improvements actually produce meaningful reductions in energy consumption.

Efforts are just underway to develop underwriting and consumer protection standards as well as energy retrofit standards that are critical for homeowners and lenders to understand the risks and rewards of any energy retrofit lending program. However, first liens that disrupt a fragile housing finance market and long-standing lending priorities, the absence of robust underwriting standards to protect homeowners and the lack of energy retrofit standards to assist homeowners, appraisers, inspectors and lenders determine the value of retrofit products combine to raise safety and soundness concerns.

On May 5, 2010, Fannie Mae and Freddie Mac alerted their seller-servicers to gain an understanding of whether there are existing or prospective PACE or PACE-like programs in jurisdictions where they do business, to be aware that programs with first liens run contrary to the Fannie Mae-Freddie Mac Uniform Security Instrument and that the Enterprises would provide additional guidance should the programs move beyond the experimental stage. Those lender letters remain in effect.

Today, FHFA is directing Fannie Mae, Freddie Mac and the Federal Home Loan Banks to undertake the following prudential actions:

1. For any homeowner who obtained a PACE or PACE-like loan with a priority first lien prior to this date, FHFA is directing Fannie Mae and Freddie Mac to waive their Uniform Security Instrument prohibitions against such senior liens.

2. In addressing PACE programs with first liens, Fannie Mae and Freddie Mac should undertake actions that protect their safe and sound operations. These include, but are not limited to:

   - Adjusting loan-to-value ratios to reflect the maximum permissible PACE loan amount available to borrowers in PACE jurisdictions;

   - Ensuring that loan covenants require approval/consent for any PACE loan;

   - Tightening borrower debt-to-income ratios to account for additional obligations associated with possible future PACE loans;

   - Ensuring that mortgages on properties in a jurisdiction offering PACE-like programs satisfy all applicable federal and state lending regulations and guidance.

   Fannie Mae and Freddie Mac should issue additional guidance as needed.

3. The Federal Home Loan Banks are directed to review their collateral policies in order to assure that pledged collateral is not adversely affected by energy retrofit programs that include first liens.

Nothing in this Statement affects the normal underwriting programs of the regulated entities or their dealings with PACE programs that do not have a senior lien priority. Further, nothing in these directions to the regulated entities affects in any way underwriting related to traditional tax programs, but is focused solely on senior lien PACE lending initiatives.

FHFA recognizes that PACE and PACE-like programs pose additional lending challenges, but also represent serious efforts to reduce energy consumption. FHFA remains committed to working with federal, state, and local government agencies to develop and implement energy retrofit lending programs with appropriate underwriting guidelines and consumer protection standards. FHFA will also continue to encourage the establishment of energy efficiency standards to support such programs.

###

The Federal Housing Finance Agency regulates Fannie Mae, Freddie Mac and the 12 Federal Home Loan Banks. These government-sponsored enterprises provide more than $5.9 trillion in funding for the U.S. mortgage markets and financial institutions.

EXHIBIT C

EDMUND G. BROWN JR.
Attorney General

State of California
DEPARTMENT OF JUSTICE

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May 17, 2010

Via Facsimile and U.S. Mail

Edward DeMarco
Acting Director
Federal Housing Finance Agency
1700 G Street, N.W.
Washington, DC 20552-0003
FAX: (202) 414-3823

RE: Fannie Mae Lender Letter LL-2010-06 (May 5, 2010) and
Freddie Mac Industry Letter (May 5, 2010) re Property Assessed Clean Energy (PACE) Programs

Dear Acting Director DeMarco:

Property Assessed Clean Energy (PACE) programs authorize local governments to finance energy efficiency and renewable energy improvements to the benefit of homeowners and small businesses. In California, PACE financing is not accomplished through loans in the traditional sense, but rather through local governments' long-standing and well-recognized powers to assess and tax. PACE programs in California can assist thousands of individual participants statewide, help to drive the State's green economy, and create thousands of jobs.

On May 5, 2010, Fannie Mae and Freddie Mac issued short, somewhat cryptic lender and industry advice letters concerning PACE programs. While the advice letters do not expressly mention California PACE programs, they have nonetheless caused confusion and concern among California PACE stakeholders. By this letter, we request that the Federal Housing Finance Authority (FHFA) immediately confirm in writing that the advice letters do not affect PACE in California.

As you are likely aware, the California Attorney General's Office at the end of last year began a discussion with FHFA staff about PACE in California. During these discussions, your staff assured this Office that we would continue to work together on issues related to PACE. Relying in part on this assurance, California has invested substantial resources in PACE programs, consistent with the White House's "Recovery Through Retrofit" policy document and with the express support of the Department of Energy. A substantial portion of the approximately $300 million in Energy Efficiency and Block Grant funding, and a substantial portion of the over $220 million in additional American Recovery and Reinvestment Act funds administered by the California Energy Commission through its State Energy Program, have been dedicated to PACE programs. Moreover, California recently passed legislation creating a $50 million state reserve fund that will allow participating local governments to obtain financing for PACE on more favorable terms.

The disruption caused by Fannie Mae's and Freddie Mac's recent actions may have serious financial implications for participating local governments and the homeowners and small businesses participating in these programs in California. To take just one example, Sonoma County, through its PACE program, already has financed over 800 energy improvement projects. But the repercussions will be wider still. PACE programs in California create reliable markets for new technologies in energy efficiency, renewable energy, and water efficiency. They thus support green manufacturing jobs and thousands of additional jobs associated with installation and maintenance of energy efficiency and renewable energy projects. Now is not the time to create unnecessary uncertainty in these important emerging businesses and industries.

Based on our recent conversation with your General Counsel, Alfred Pollard, we understand that the May 5, 2010, letters were not intended in any way to signal a change in the position of FHFA, Fannie Mae or Freddie Mac regarding PACE in California. Accordingly, we request that FHFA immediately confirm in writing that participants in California PACE programs are <u>not</u> in violation of Fannie Mae/Freddie Mac Uniform Security Instruments prohibiting loans that have a senior lien status to a mortgage. We are open to discussing with you what form that confirmation should take, including, but not limited to, withdrawal of the May 5, 2010, letters.

We would prefer not to have to pursue some form of declaratory relief to resolve the confusion, but, because of the importance of the issue to California, we certainly reserve that as an option if a clear and unequivocal response is not forthcoming.

– continued –

Once this immediately pressing matter is resolved, we look forward to discussing with you what longer-term solutions may be warranted to foster the continued responsible development of PACE programs in California.

Sincerely,

/s

CLIFFORD RECHTSCHAFFEN
Special Assistant Attorney General

/s

JANILL L. RICHARDS
Supervising Deputy Attorney General

For EDMUND G. BROWN JR.
Attorney General

cc: Joseph R. Biden Jr., Vice President
Dianne Feinstein, U.S. Senator
Barbara Boxer, U.S. Senator
Steven Chu, Secretary, U.S. Department of Energy
Shaun Donovan, Secretary, U.S. Department of Housing and Urban Development
Timothy Geithner, Secretary, U.S. Department of the Treasury
Carol Browner, Director, White House Office of Energy and Climate Change
Nancy Sutley, Chair, Council on Environmental Quality
Michael J. Williams, President and Chief Executive Officer, Fannie Mae
Charles E. Haldeman, Jr., Chief Executive Officer, Freddie Mac
Arnold Schwarzenegger, Governor, State of California
Bill Lockyer, State Treasurer and Chair, CAEATFA
Karen Douglas, Chair, California Energy Commission

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Attorney General

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May 19, 2010

Via Facsimile and U.S. Mail

Alfred M. Pollard
General Counsel
Federal Housing Finance Agency
1700 G Street, N.W.
Washington, DC 20552-0003
FAX: (202) 414-3823

RE: Federal Housing Finance Authority (FHFA) Letter of May 18, 2010
Property Assessed Clean Energy (PACE) Programs

Dear Mr. Pollard:

Thank you for your letter confirming receipt of the California Attorney General's letter dated May 17, 2010. We appreciate your promise to respond to our specific request for confirmation that the Fannie Mae and Freddie Mac advice letters of May 5, 2010, were not intended to affect California PACE programs. We are, however, concerned that FHFA did not commit to providing that response within a specific timeframe. As we stated in our previous correspondence, the advice letters are causing unacceptable disruption to PACE in California, to the detriment of participating homeowners and small businesses and the many green industries that support the program.

To expedite this process, we request a telephone meeting with you and Acting Director DeMarco, preferably before the end of this week.

Sincerely,

JANILL L. RICHARDS
Supervising Deputy Attorney General

For EDMUND G. BROWN JR.
Attorney General

EDMUND G. BROWN JR.
Attorney General

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June 22, 2010

Edward DeMarco, Acting Director
Federal Housing Finance Agency
1700 G. Street, N.W.
Washington, D.C. 20552-0003 FAX: (202) 414 3823

RE: Energy Efficiency and Renewable Energy Assessments (PACE) and Lien Priority

Dear Acting Director DeMarco:

On May 17, 2010, we sent you a letter expressing concern about lender and industry advice letters issued by Fannie Mae and Freddie Mac on May 5, 2010. These advice letters equated financing under Property Assessed Clean Energy (PACE) programs with "loans," and strongly suggested that such "loans," because they have lien priority, would preclude sale of mortgages to Fannie and Freddie. As we have repeatedly made clear to FHFA General Counsel, Alfred Pollard, under California law, PACE financing is achieved through special assessments, not loans. The distinction is key. Like other special assessments, such as those used by California's local governments since the beginning of the last century to finance road paving and sidewalk improvements, unpaid PACE assessments take priority over mortgages. Fannie Mae's and Freddie Mac's own standardized documents recognize the priority of assessment liens.

While the advice letters are ambiguous, the effect they have had in this state is not. The letters have had a devastating impact on PACE programs in California, placing at risk hundreds of millions of dollars of federal stimulus funding, hundreds of millions of dollars of state, local and private funding, and impacting California's efforts to promote green jobs and greenhouse gas emission reductions. Despite requests from the California Attorney General, the Governor, the Vice President, Members of Congress, the Department of Energy, the private lending community, and the Council on Environmental Quality, your agency has taken no action to resolve the situation or even identify a process by which the matter will be resolved.

The FHFA has raised a potentially serious issue – that PACE programs may increase the risk of default by increasing homeowner debt. As the attached hypothetical establishes, however, the practical effect on Fannie Mae's and Freddie Mac's portfolios is minimal, given the relatively small liens that may result from missed PACE assessments and the default rate that reasonably can be expected in PACE communities. Nonetheless, California and the local governments that are attempting to move forward with PACE programs are prepared – immediately – to discuss with you how those risks have already been addressed and minimized through detailed program requirements and "best practices." Depending on what further

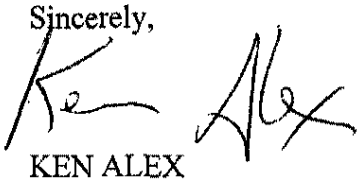
concerns the FHFA may have, we commit to working with you to identify and implement further actions as needed. We cannot, however, afford your agency's continued silence. The time to act on this matter is at hand.

There is a great deal at stake here for California and for the nation's economy. We take seriously the FHFA's concerns about mortgage security and are prepared to address those concerns. We ask you to take seriously the need to move forward immediately with California's PACE programs, with energy efficiency and renewable energy retrofit efforts, with federal stimulus funding, and with California's determined efforts to create jobs and economic momentum.

We would like to set up a meeting as soon as possible in order to resolve this matter. We believe that the meeting would benefit from the participation of the Vice President's Office, the Governor's Office, and other officials who have been working extensively on this matter. Please contact me at your earliest convenience by the end of this month so that we can move forward in the most constructive manner possible.

Thank you for your immediate attention.

Sincerely,



KEN ALEX
Senior Assistant Attorney General

For EDMUND G. BROWN JR.
Attorney General

Attachments

cc: Joseph R. Biden Jr., Vice President
Dianne Feinstein, U.S. Senator
Barbara Boxer, U.S. Senator
Steven Chu, Secretary, U.S. Department of Energy
Shaun Donovan, Secretary, U.S. Department of Housing and Urban Development
Timothy Geithner, Secretary, U.S. Department of the Treasury
Carol Browner, Director, White House Office of Energy and Climate Change
Nancy Sutley, Chair, Council on Environmental Quality
Michael J. Williams, President and Chief Executive Officer, Fannie Mae
Charles E. Haldeman, Jr., Chief Executive Officer, Freddie Mac
Arnold Schwarzenegger, Governor, State of California
Bill Lockyer, State Treasurer and Chair, CAEATFA
Karen Douglas, Chair, California Energy Commission

Hypothetical Exploring Risk Associated with PACE Liens
Averaged Over a Portfolio of Mortgages

The impact of the PACE financing on the risk borne by mortgage lenders is minimal. The following mortgage foreclosure scenario shows why:

> A homeowner of a house valued at $300,000 with a $250,000 mortgage seeks $15,000 in PACE financing, reflecting the costs of a renewable energy system and energy efficiency upgrades, less all available rebates and incentives. (Some large solar projects may cost more; efficiency-only upgrades will be substantially less.)
>
> With a 7% interest rate (which is on the high side) and a 20-year payback period, the estimated annual PACE assessment would be $1,470.[1]
>
> The homeowner stops paying the mortgage and property taxes, including assessments. Delinquency on the mortgage occurs when the home owner is less than three monthly payments behind in the mortgage, and default when the homeowner is three or more monthly payments behind; default triggers foreclosure.[2]
>
> At the time of foreclosure for failing to pay the mortgage, it is likely that at most, one PACE assessment of **~$1,500** would have achieved priority lien status. (This is because under California law, there is no acceleration of the entire amount financed for failure to pay an assessment, including a PACE assessment; rather, the new owner assumes the continuing obligation to pay the assessments as they become due.)

If we run the same hypothetical with PACE financing of $20,000, the PACE lien consisting of one missed annual assessment would be $1,960.

This exercise suggests that with a "portfolio" of Fannie/Freddie mortgages that have PACE liens, assuming a high foreclosure rate of 10%, PACE seniority would average $150 per home (10% x $1,500). Using a more reasonable foreclosure rate of 5%, average PACE seniority per home would be a mere $75.

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[1] Results obtained by using Sonoma County's annual payment calculator, available at http://sonomacountyenergy.org/lower.php?url=calculator.

[2] See California Urban Strategies Council, *California Foreclosure Timeline*, available at http://www.urbanstrategies.org/foreclosure/Timeline/ForeclosureProcessTimelineandInterventions_7_11_07.pdf.