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LLP

July 23, 2013

VIA EMAIL AND U.S. MAIL

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**Re: REMEDIES FOR RESIDENTIAL MORTGAGE HOLDERS WITH
PACE OBLIGATIONS**

Dear Bart:

I have reviewed your memo regarding PACE obligations as such obligations relate to residential mortgages and have the following comments with regard to it.

Upon reviewing the memo and associated documents, I believe that there is no merit to the concern that a residential mortgagor who participates in a legally validated PACE district violates such mortgagor's Deed of Trust and in particular the FHFA claims that the safety and soundness of the property subject to the Deed of Trust has been adversely affected.

First, Ygrene Energy Fund, Inc. ("Ygrene") and its government partners implement program policies that thoroughly and responsibly underwrite projects and the participants in the programs. This critical factor vitiates the purported concerns over the safety and soundness of FHFA's secured portfolio. The fact that Ygrene's standards will, under most circumstances, enhance the value of the security renders its position baseless. The fact that under no circumstances will it be diminished appears to make it

arbitrary. It is important to recognize that at the time FHFA issued its restrictions and prohibitions, PACE providers did not have Ygrene's uniform standards for qualifying properties, measuring energy efficiency, evaluating costs and benefits of improvements, etc.

Secondly, we concur with your conclusion that federal and state laws, numerous regulations, and a number of Court decisions support the legality and necessity of first-position tax liens.

In California, the relationship between the holder of the security (the lender or a subsequent purchaser of the loan, in either case the "Lender") and the borrower is governed by the deed of trust and applicable law. As you have accurately described, the "PACE" or Clean Energy Financing transactions are entitled to and share "super-priority" with other California tax liens. That in itself does not, however, impair the security of the Lender. While it is true that the Lender's interest is subordinated to another obligation, under the Ygrene program that obligation cannot exist unless the property securing the lien has *already* been improved by at least the value of the lien. That is a function of the Ygrene underwriting standards.

California law has a long history of both statutes and case law that prohibit under various situations a Lender's enforcement of restrictions on subsequent financing if that Lender's security interest is not impaired. In this case, the security of the Lender will not be impaired and may actually be enhanced. Moreover, it is an express requirement of California Codes that tax liens of this type, including Mello-Roos district financing, must be senior to mortgages.

The Deed of Trust form used by FHFA specifically provides a mechanism by which a Lender automatically secures its position by demanding that borrowers impound monthly the payments needed to fulfill "senior" tax lien requirements ("Escrow Items"). Thus FHFA has a built-in mechanism for insuring that not only new liens but all prior tax obligations are paid currently. More importantly for borrowers, they are required under the terms of the Deed of Trust to impound Escrow Items as prevention against a Lender's contention that a "senior" tax lien violates the provisions of its loan covenants. Lenders are obligated by the terms of the Deed of Trust to require and accept the borrower's impound of the payments for the "senior" PACE lien.


For the reasons set forth above, we believe that your memo presents an accurate assessment of the practical and legal issues regarding the described position and actions

Bart Van Voorhis
Ygrene Energy Fund, Inc.
July 23, 2013
Page 3

of FHFA. I hope that you find our commentary interesting and/or helpful. Please let us know if you have any further questions or concerns.

Very truly yours,

TIMKEN JOHNSON LLP



Leslie A. Johnson

LAJ/lb

cc: Heidi Timken