Financing Energy Efficiency

ND Statewide Housing Conference
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Why Do We Need to Finance Energy Efficiency?

- Energy efficient homes are higher quality, more comfortable, more durable, and have lower monthly operating costs, but...
- Energy efficient homes cost more to build
- The higher initial cost means fewer people can qualify to purchase the home
- The quality builder, being unable to compete, goes out of business

The Solution: Give Credit for Lower Housing Costs

- If you could lower a buyer’s energy costs, they would have more income available each month to pay the mortgage
- More monthly income means they could qualify for a higher mortgage
- Give the buyer credit for the fact that their energy efficient home will have lower energy costs

Why Should You as a Lender Be Interested?

- More Competitive Environment
- Larger & More Profitable Loans
- New Business from Trade Ally Partnerships
- Lenders Can Qualify More Buyers
- No Great Increase in Paper Work
- Lower Utility Bills Can Lead to Lower Client Defaults

Energy Efficient Mortgages

Borrowing More Money for an Energy Efficient Home

The EEM is Born

- The Energy Efficient Mortgage was born in 1979 when President Carter signed an Executive Order directing federal lenders to offer consumers incentives for energy-efficient homes.
- Fannie Mae & Freddie Mac responded by expanding the qualifying ratios.

The 2% Stretch

- Since owners of energy efficient homes had more monthly income to put towards their mortgage, the 2% stretch allowed lenders to stretch both the housing debt-to-income ratio and the total debt-to-income ratio by 2% points
- These ratios are typically 28% & 36%. They could now be stretched to 30% & 38%
- How does this work...

Let’s Look at an Example

- Two similar houses are built in your town
- One is typical construction and costs $100K
- The other is built by a builder who has invested time and materials to build a comfortable, energy-efficient home. Cost $105K
- The buyers annual income is $35,500
- Which house can they afford...

Which House Can They Afford?

Typical Home	Component	Energy Eff Home
$100,000	Home Price	$105,000
$10,000	Down Payment	$10,500
$90,000	Mortgage Amount	$94,500
8%	Interest Rate	8%
30	Term (Years)	30
$660	Monthly Mortgage Payment	$693
$167	Taxes	$167
$17	Insurance	$17
$844	PITI	$877
$109	Monthly Energy Bills	$72
$953	PITI+Energy	$949
$3,013	Monthly Income Required EEM	$2,922
$36,159	Annual Income Required EEM	$35,070

Analysis

- Four dollars isn’t much, but their mortgage is fixed for 30 years
- Can you guarantee that their energy bills will be fixed for 30 years
- Also mortgage interest is tax deductible, energy bills are not
- EEMs open new homes up to more people

Another Advantage

- Clients can qualify for a larger mortgage
- Client income: $36,159
- Conventional home = $90,000 mortgage
- Energy efficient home = $98,213 mortgage
- Energy efficiency features = $2-5000
- Extra $3-6000 to spend on other features like whirlpool bath, larger kitchen, better flooring, large deck, etc.

Mortgage File Must Contain...

- HERS Efficiency Rating Form
- List of energy features in the property
- An estimate of utility savings

Energy Improvement Mortgages

An Option for Existing Homes

EIMs

- EIMs allow the buyer of an existing home to borrow more money at time of purchase or refinance to make a home more energy efficient
- Lenders have the option of using the 2% stretch or … Increase the borrower's ratios by the $ amount of the estimated monthly energy savings
- Improvements must increase the HERS rating by 10 points

EIM Guidelines

- If energy improvements are not completed before loan delivery, the seller may escrow the funds under the following terms:
  - Must be completed in 120 days
  - Escrow account controlled by lender
  - Escrow amount = 110% of estimate

Example:

Typical Home	Component	Energy Improved
$100,000	Home Price	$100,000
$10,000	Down Payment	$10,000
	Energy Improvements	$4,000
$90,000	Mortgage Amount	$94,000
8%	Interest Rate	8%
30	Term (Years)	30
$660	Monthly Payment	$690
$167	Taxes	$167
$17	Insurance	$17
$844	PITI	$873
$120	Monthly Energy Bills	$80
$964	PITI + Energy	$953

Mortgage File Must Contain...

- HERS Efficiency Rating Form showing a minimum of 10 rating point increase
- List of energy features in the property
- The weighted life of the energy features
- The present value factor & the mortgage rate used in the calculation
- Installed cost of the improvements
- The expected monthly savings and the present value of those savings

Mortgage File Must Contain...

- Appraisal Addendum to the URAR showing the market value and the energy efficiency increment to value and total value
- Certificate of completion signed by the certified rater, homeowner, and contractor.

The Problem…

Who Determines What is Efficient?

What is Efficient?

- There are many out there claiming to build energy efficient homes
- Can lending institutions just take their word for it?
- No…to solve the problem a new energy efficiency evaluation tool was developed called the Home Energy Rating System (HERS)

What is a HERS?

- HERS programs use certified raters to determine the energy efficiency of a home
- The NASEO/RESNET Accreditation Task Force has developed standards for accreditation of HERS programs
- There are currently 19 states that have accredited HERS programs accepted by national lending organizations

What's a HERS Rating?

- An Independent Rater measures a home and checks the insulation levels, the air tightness of the building envelope using a blower door, and the equipment efficiencies
- The rater submits the information collected to an accredited HERS program for analysis
- The HERS programs issues a rating, usually on a 100 point scale, 80 points or higher is considered energy efficient and qualifies the home for an EEM

What is a HERS Rating?

- Some programs use stars. Four stars or greater = energy efficient
- The rating also includes a financial analysis of savings
- The rating also includes a list of things that can be done to the home to improve its energy rating
- HERS ratings typically cost around $250

HERS Certificate Contains...

- The existing rating
- Existing energy features of property
- Recommended improvements
- Estimate of utility savings
- The present value of the savings
- The mortgage rate used for the present value calculation
- The estimated rating after improvements have been made

Options for North Dakota

Where Do We Go From Here?

Options for North Dakota

- Start your own Energy Rated Homes of North Dakota program
  - Colorado is part of Housing Finance Authority
  - Iowa is part of CAP agency
  - Some states run them out of the Energy Office
  - Some are run by private for-profit organizations
- Join with an already accredited rating system

Join with an Accredited Rating System

- Contact Accredited Rating System
- Work out Agreement
- Identify Potential Raters
- Arrange Rater Training Session
- Arrange Lender Training Session
- Post Lenders and Raters on a web site

How to Set Up an Energy Efficient Financing Program?

Where Do You Start

Getting Started

- Make a Commitment to Energy Efficiency
- Contact the organization that offers energy ratings
- Contact your local utility to see if they have any energy efficiency programs
- Align yourself with local trade allies
- Set energy financing program procedures
- Train staff

Energy Efficiency Loan Process

- Contact local energy rater to rate home
- Attach rating and financial analysis of savings to loan application before sending it to the underwriter
- Obtain normal loan underwriting approvals

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