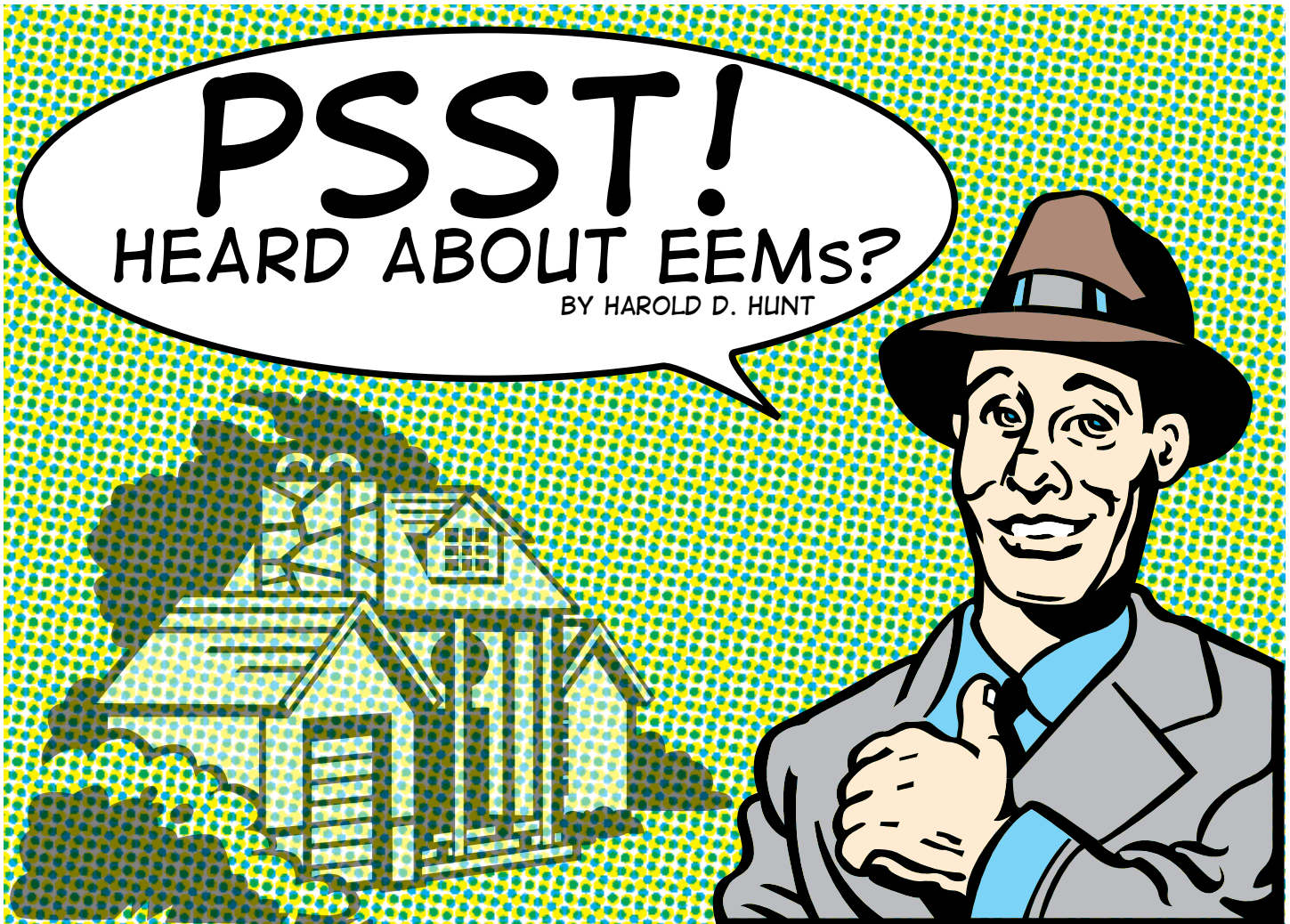


A Reprint from *Tierra Grande*

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nergy efficiency is an important component of the green movement sweeping the country. These days, homebuyers and homeowners are looking for ways to cut costs and protect the environment at the same time. One method of doing this is through the Federal Housing Administration's (FHA) Energy Efficient Mortgage (EEM) Program.

EEMs allow the costs of purchasing and installing energy-efficient features to be incorporated into

FHA-insured new home loans or refinancing loans. President Carter first encouraged the development of EEMs in 1979. Unfortunately, they have yet to catch on.

The subprime meltdown, the troubles at Fannie Mae and Freddie Mac and FHA's attractive down payment requirements have led to a renewed interest in FHA loans, but that interest has not carried over to EEM products.

Why aren't FHA's energy efficient mortgages more popular? Could their use benefit Texas licensees in this period of sluggish home sales?

IDENTITY CRISIS

In 1993, the Department of Housing and Urban Development (HUD) began offering energy efficient mortgages through the FHA to lenders in five states. The pilot program grew to ten states by 1994 and went nationwide by 1995.

But today, few of the 1,900 Texas lenders approved to originate FHA loan products are aware of the EEM program. Only 441 FHA-insured EEMs were originated in the United States in 2005, and a mere 1,066 in 2007.

Freddie Mac is effectively out of the EEM business. Fannie Mae handled an average of only 61 energy efficient loans annually from 2005 to 2007.

FHA EEMs FOR NEW, EXISTING HOMES

An FHA EEM, referred to as an "energy package" in FHA literature, is not a stand-alone product. Rather, it is added to an FHA loan used to purchase a new home or refinance an existing home, such as the Section 203(b) mortgage or 234(c) condominium loan. It can also be used with 203(k) or streamlined (k) rehabilitation loans or the 203(h) loan program for disaster victims.

BUILD AN ENERGY EFFICIENT HOME!



HAVING THE COSTS OF ENERGY EFFICIENT FEATURES ROLLED INTO A NEW FHA HOME MORTGAGE MEANS BUYERS CAN SAVE MONEY ON UTILITY BILLS AND RECOUP THE LOAN COSTS OVER TIME.

Although multiple mortgage products may be involved, the borrower makes only one loan payment each month.

As of Jan. 1, 2009, the maximum FHA purchase or refinance loan that can be originated in Texas changed to 115 percent of the county or metropolitan statistical area median home sale price. Loan limits can be exceeded by the amount of funds obtained through FHA's EEM program.

The FHA EEM program is restricted to new or existing one- to four-unit residential properties, including one-unit condominiums. Manufactured housing is eligible for the loans as well.

An initial, as-is physical inspection of the property by a Home Energy Rating System (HERS) rater or other qualified energy consultant who has permission to use Residential Energy Savings Network (RESNET) certified HERS rating software is required to qualify for the EEM energy package. A written report must list the cost of any proposed energy efficient improvements, including any long-term maintenance costs. The consultant must also estimate the present value of any future energy savings that could be achieved by making improvements.

If the cost of specified improvements is less than the present value of their future energy savings, the energy efficient improvements are considered to be "cost effective." Additional EEM funds are then estimated based on any cost-effective upgrades up to 5 percent of the maximum FHA purchase or refinance loan amount.

The amount of available funding to homeowners is substantial. For example, a \$250,000 loan translates into \$12,500 in additional EEM funds.

An appraisal of the energy-related improvements is not required. As a result, the appraised market value (value in exchange) of the energy efficiency package to any future homebuyers is not a factor.

FHA will insure the mortgage before the energy efficient improvements are installed, provided the lender establishes a separate escrow account and deposits the EEM funds. The escrow account may be administered by a lender, utility company, nonprofit organization or government agency.

The energy consultant's fee may be rolled into an EEM loan, assuming the proposed energy efficient improvements will be

cost effective. However, the amount rolled into the loan must not exceed what is customary and reasonable for the area.

A normal closing occurs and commissions are paid before the energy efficient improvements have been made. The lender is responsible for informing FHA within 90 days after the closing that all improvements have been completed and the EEM escrow account has been cleared. The period for installing the upgrades can be extended to 180 days if an EEM is coupled with a 203(k) rehabilitation loan.

If the actual cost of the energy efficient improvements turns out to be less than the escrowed EEM funds, the borrower cannot pocket the remaining funds. They must be applied to the loan balance, resulting in a principal reduction. However, the borrower's monthly

mortgage payment does not change.

The lender, a HERS representative or an FHA fee inspector may conduct the final inspection required to verify that the improvements have been completed. The lender must include a copy of the energy consultant's report in the closing package.

DISADVANTAGES OF EEMs

A number of drawbacks have contributed to the lack of enthusiasm for obtaining the extra EEM funds. If the repairs or improvements are not completed within 90 days, the lender must apply any unused EEM funds held in escrow to the original loan amount, resulting in a principal reduction. As a result, the contractors could have difficulty receiving payment.

A maximum of 100 percent of the estimated improvement costs can be escrowed, providing no cushion for cost overruns. Any additional costs are the responsibility of the homebuyer.

Lenders have little incentive to spend the extra time and effort to set up an individual escrow account for EEM funds and oversee installation of the energy efficient upgrades.

FHA EEM BENEFITS

If combined with FHA's rehabilitation loan products, financing for improved energy efficiency can be added to funds obtained for structural or cosmetic repairs. Unattractive and inefficient older homes can be made more attractive and more energy efficient without additional cash contributions from the homebuyer.

An EEM loan obtained in conjunction with a refinance mortgage can be beneficial to an existing homeowner. An owner already occupying a home will be familiar with its energy efficiency track record. If the home is inefficient, this can be addressed at the same time the home is refinanced for other reasons.

Even though the energy package may not bring an older home up to the 2000 International Energy Conservation Code (IECC) standard, homeowners would benefit from any cost-

effective energy efficient improvements. Buyers and owners of older, extremely inefficient homes often benefit the most from the EEM funds.

QUALIFYING RATIO 'STRETCH'

If a new or existing home is built or remodeled to meet 2000 IECC standards, the FHA permits the borrower's qualifying ratios to be "stretched" by 2 percent. As a result, the allowable payment-to-income and debt-to-income ratios increase from the standard 31 and 43 percent, respectively, to 33 and 45 percent.

The borrower is not required to qualify for the increased financing or contribute any additional down payment. He or she is only required to meet the initial qualifications for a standard FHA purchase or refinance product. The logic is that the increase in energy efficiency should reduce average monthly utility costs enough to cover an incremental mortgage increase from the ratio stretches.

A qualified energy consultant must prepare a written report based on a physical inspection of an existing home. If the home is yet to be built, the rater may use building plans and specifications. The consultant certifies that the home is or will be constructed to the 2000 IECC specifications.

PAYBACK, PERCEPTION BARRIERS

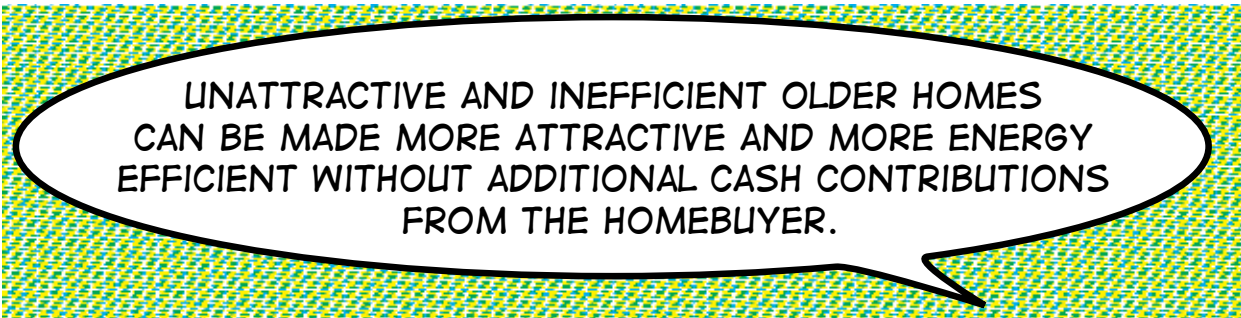
A provision in the Federal Housing Aid legislation passed by Congress in July directs the federal agencies involved in mortgage lending to identify barriers that have prevented widespread adoption of EEMs. It further requires that the agencies recommend ways to remove these barriers.

Congress has also authorized a public education and marketing campaign for energy efficient mortgages. Public awareness

of these products is critical. However, the success of EEMs may ultimately depend on the direction future utility costs take. Academic studies have discovered that homeowners will invest in energy efficiency only if:

- utility bills are burdensome and perceived to be a long-term problem;
- income is sufficient to afford an investment;
- the cost, payback period and return on the investment can be estimated and understood; and
- advice or information about energy efficiency investments is coming from a source perceived as credible.

Unless all four of these factors are in place, homeowners have historically chosen conservation measures over investing money to make their homes more energy efficient. No mone-



UNATTRACTIVE AND INEFFICIENT OLDER HOMES
CAN BE MADE MORE ATTRACTIVE AND MORE ENERGY
EFFICIENT WITHOUT ADDITIONAL CASH CONTRIBUTIONS
FROM THE HOMEBUYER.

tary cost is involved when homeowners make a conscious effort to turn off lights or lower the thermostat to cut utility bills.

Although the future of energy efficient mortgages is not assured, Texas licensees may want to inform their clients about the benefits EEMs offer. 📌

Dr. Hunt (hhunt@recenter.tamu.edu) is a research economist with the Real Estate Center at Texas A&M University.

THE TAKEAWAY

FHA's Energy Efficient Mortgage (EEM) Program allows the costs of purchasing and installing energy efficient features to be incorporated into FHA-insured new home loans or refinancing loans.



MAYS BUSINESS SCHOOL

Texas A&M University
2115 TAMU
College Station, TX 77843-2115

<http://recenter.tamu.edu>
979-845-2031

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