



GOING GREEN, GAINING GREEN

Adding energy-efficient mortgages to your portfolio can be a boon for all involved

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Illustration: **Keith Negley**

IN A WORLD OF ACCELERATING energy costs, the energy-efficient mortgage (EEM) has become a timely lending tool. Not only does it address growing concerns about energy use and its impact on the environment — and the wallet — but the EEM also can help borrowers who face tightening lending requirements.

With this tool in their portfolio, mortgage brokers have another option to offer clients in cases of purchases and refinances. Here's a look at how EEMs work and when they work.

Brokers can't make oil and gas cheaper. They can't solve the credit crisis for their clients. But brokers can offer a loan that helps support efforts to make clients' homes more energy-efficient. The EEM offers some homeowners a way to hedge against increasing energy costs and protect the long-term value of their homes at the same time.

Consumer awareness of high energy costs, energy efficiency and green building is exploding. In fact, green improvement is one of the few

bright spots in the home-improvement market today. Legislation in the U.S. House also proposes to add incentives for lenders who offer lower-interest loans to energy-efficient borrowers (*Ed. note: At press time, the bill — House Resolution No. 6078 — was set for a full House vote this month*).

An EEM captures the savings the homeowner will receive from energy-efficient improvements over the life of the improvement and treats that savings as income. With more income, the borrower can qualify for a larger loan that covers a purchase or refinance as well as the cost of energy-efficient improvements.

The energy-efficiency improvements that make the most impact are not necessarily the most expensive. The average home loses as much as 30 percent of its heating or cooling through leaky air ducts, according to Energy Star. A few hundred dollars to repair leaky ducts can save thousands of dollars in a few years.

Most homeowners want to mix energy effi-

ciency and aesthetics, so energy-efficient windows are often packaged with sealing leaky ducts or attic insulation to make the overall package cost-effective.

The EEM-loan process also is designed to help homebuyers determine what work to undertake and how to manage the money for improvements until the work is completed and verified.

In turn, the search for an approved lender that offers an EEM often can prove fruitful.

How do they work?

The Federal Housing Administration (FHA) and U.S. Department of Veterans Affairs (VA) offer a version of the EEM. Clients who qualify for an FHA loan can add the cost of "cost-effective" energy improvements to their purchase or refinance mortgage.

The FHA allows for an additional \$4,000 or 5 percent of the loan amount, capped at \$8,000.

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EEMs: An FAQ

Why haven't I heard of the energy-efficient mortgage (EEM)?

The EEM has been around since 1979, but it has gone largely unnoticed.

Increasing energy costs have brought it to the forefront, however. The mortgages are available nationwide, but not all lenders offer them.

Why is the EEM important?

Most existing houses, especially those built before 1978, require some kind of upgrade. Energy codes from past decades also do not match today's energy-efficiency standards. These older homes are insufficiently insulated and built, and the costs to operate them can be high. The EEM can be a way to help complete improvements.

To what kinds of loans does the EEM apply?

EEMs work with government, conventional and jumbo financing, or for Federal Housing Administration, U.S. Department of Veterans Affairs, Fannie Mae, Freddie Mac and portfolio loans.

How do you qualify for EEMs?

EEMs can be used for home purchases or refinances. There is virtually no limit on home cost, but the building must be a residence of one to four units. To qualify for an EEM through an approved lender, the home must be audited by a Home Energy Rating System (H.E.R.S.) rater, and the cost of improvements must be less than the cost of the energy saved over the life of the improvement.

How much does a H.E.R.S. rating cost and what does it entail?

A typical H.E.R.S. rating ranges from \$150 to \$300. You may be able to roll the cost of the rating into the mortgage. The rater will look at everything in the house that affects energy efficiency, from water heaters to insulation.

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VA loans are capped at \$6,000.

Fannie Mae and Freddie Mac have EEM programs, as well. Approved lenders with Fannie Mae can expand ratios by 2 percent on debt-to-income requirements, while Freddie Mac permits lenders to use the projected energy savings as a "compensating factor."

A Home Energy Rating System (H.E.R.S.) audit of the property also is necessary. This audit identifies cost-effective improvements. The cost of the improvements must be less than the cost of the energy saved over the life of the improvement.

Brokers can process the EEM themselves, or they can hire an EEM processor/project manager to handle the required supporting documentation. This can include contractor bids for the work to be performed.

The EEM also requires supervision of improvements, verification and final release of funds.

EEM funds enter an escrow-holdback account after the loan closing. Borrowers have 90 days to accomplish the improvements. It usually takes less time.

Why do they work?

The elimination of most home-equity lines of credit and cash-out mortgages for home repairs make EEMs an even stronger opportunity for the lenders and brokers who offer them.

According to the Northeast Home Energy Rating System Alliance, the benefits of offering EEMs include:

- **Qualifying 10 percent to 15 percent more buyers;**
- **Making larger and more-profitable loans;**
- **Ensuring clients are less likely to default;** and
- **Establishing a "greener" company image.**

States are also supporting increased energy efficiency through incentives and mandates. Organizations such as California Home Energy Efficiency Rating Services (C.H.E.E.R.S.) and California Building Performance Contractors Association (CBPCA) are expanding the pool of H.E.R.S. raters and contractors who can determine and implement energy-efficiency upgrades.

EEMs can be great loans for specific client groups, such as real estate owned, short-pay buyers or first-time homeowners. Foreclosed-upon properties also often attract young, first-time homebuyers who care about energy efficiency and the environment. The EEM is a great tool

for these customers.

FHA and VA EEMs have a low downpayment policy and a structure that supports an energy audit during escrow. With an FHA EEM, first-time homebuyers can buy a house, have the upgrades installed within 90 days and live in a home that costs less to run every day thereafter.

FHA and VA programs also have specific steps to follow during underwriting and implementation — in other words, the process isn't a slam-dunk. On the other hand, organizations and specialists that have a clear understanding of the requirements can streamline the processing and take advantage of the growing interest.

Where to start?

To add EEMs to your portfolio of loan offerings, you must first determine which FHA or VA wholesale sources will accept and support your EEMs. If they don't do it now, request it. EEMs will expand their offerings and potentially bring them business.

Next, assemble your team for underwriting, processing and project management. You may choose to hire an EEM processor to help, or you may do it all in-house. There is quite a bit of training and manpower required to work with all that these specialty loans entail, from contractors to an escrow account.

Then, locate H.E.R.S. raters near you. Good, reliable energy raters are necessary to offer EEMs successfully. If you elect to use EEM processors, they can help you find a reliable rater. Otherwise, a state organization such as California's C.H.E.E.R.S. can be a good source of potential raters.

Next, you'll want to create a good EEM marketing plan. This should include information materials. There are clients out there who want to do an EEM and are looking for you. But there are others who are unaware of the potential mortgage and energy savings EEMs represent. If you suggest an EEM to these clients, they often will thank you. Beyond the utility savings, these upgrades frequently also improve the comfort and safety of clients' homes.

Finally, network with green Realtors and find those who are focusing on environmental issues and development. Let them know you are ready to go with your program of EEMs. They will be happy to hear from you.

In the end, delivering the usefulness of EEMs to first-time homebuyers and others can create new markets for brokers and lenders alike. ■

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