# Energy Efficient Mortgages

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Energy efficient mortgages (EEMs) include the cost of clean energy improvements, such as renewable energy and the installation of energy-efficient windows, into a single primary mortgage during the purchase or refinance of residential real estate.[1] EEMs, which are typically tax-deductible, expand underwriting to account for the increased cash flow resulting from the efficiency improvements. Several federal agencies and government-sponsored enterprises offer EEMs, including the Federal National Mortgage Association (Fannie Mae), the Federal Housing Administration (FHA), the Federal Home Loan Mortgage Corporation (Freddie Mac), the U.S. Department of Veterans Affairs (VA), and the U.S. Department of Agriculture. Typically, local and state governments offer credit enhancements for EEMs to encourage lending.

This profile explains two types of mortgages: conventional EEMs and specialty mortgages.

A **conventional EEM** is a standard loan product offered by Fannie Mae, Freddie Mac, FHA, and VA that follows a well-defined national standard. Although underwritten as a traditional mortgage, an EEM is usually more flexible in areas such as loan-to-value and debt-to-income ratios. A barrier to EEMs is that buyers will need technical assistance (e.g., an energy audit) to understand their current energy usage, available options, cost estimates, and anticipated payback timeframes.

**Specialty mortgages** are normally the product of collaboration between a lending institution and a local or state government. One or both parties agree to subsidize the mortgage if the borrower makes upgrades that meet energy efficiency requirements set by the program.

Uptake of EEMs has been modest due to limited lender guidance, benefits to lenders, and consumer information.[2] Despite the moderate adoption, the assessed value of potential efficiency improvements in the residential, public, and private sectors is estimated at approximately $300 billion.[3]

## Energy efficient mortgages generally share the following key features:

- They are tax-deductible.
- They include clean energy improvements in a single primary mortgage.

## Energy efficient mortgages may be administered by the following entities:

- **Federal government-sponsored enterprises**, such as Fannie Mae and Freddie Mac, play a key role in the administration of EEM mortgages because they are integral to mortgage lending. The institutions identify eligible clean energy technologies, develop guidance, conduct underwriting, issue mortgages, and collect monthly payments.
- **Lending institutions**, such as credit unions, may issue and administer EEMs. In these circumstances, lending institutions would complete the same tasks identified above for federal government-sponsored enterprises. Lenders may also work with local governments to issue specialty mortgages.
- **State government agencies and local governments** may work with lenders, educate consumers, and develop incentive programs to reduce barriers for communities. State agencies, such as state housing authorities, may also issue EEMs. In addition, state agencies may provide incentives to lenders and borrowers in the form of an interest rate buy-down or closing cost credit, which may mitigate the barriers for low- and moderate-income (LMI) households. Local governments may collaborate with lenders to issue specialty mortgages that allow borrowers to make energy efficiency upgrades.

# Examples from the Field

### Fannie Mae HomeStyle Energy Mortgage Program

<https://singlefamily.fanniemae.com/originating-underwriting/mortgage-products/homestyle-energy-mortgage>

- The HomeStyle Energy mortgage supports borrowers in increasing a home's energy efficiency and reducing utility costs by financing efficiency upgrades during a home purchase or refinance.
- The mortgage is open to all Fannie Mae-approved borrowers and does not require special approval.
- Financing for energy-related improvements can amount up to 15% of the "as-completed" appraised value.
- Borrowers may use the HomeStyle Energy loan for upgrades to energy and water systems, including solar equipment, property improvements for better resilience to natural disasters, new windows and doors; and to pay off energy-related debt.
- Starting January 2023, ENERGY STAR®- certified improvements will qualify HomeStyle Energy loans to be combined with HomeStyle Renovation, qualifying lenders for a $500 loan-level price adjustment (LLPA).

### EastRise Credit Union Mortgages <https://www.eastrise.com/personal/green-loans/home-energy/>

- EastRise Credit Union provides financing for projects or purchases that improve energy efficiency in a home or for a mode of transportation.
- The loans help finance larger projects that increase energy efficiency of a primary residence.
- With the ability to extend the energy efficient mortgage beyond traditional mortgage terms, homeowners can finance energy improvements while not increasing their monthly payments significantly.
- EastRise Credit Union also provides off-grid mortgages, which are designed to help finance a primary residence that is not powered by a traditional power source.

# Program Characteristics

Here are the typical characteristics of energy efficient mortgages.

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| Program types | Conventional energy efficient mortgage and specialty mortgage |
| Target sectors | Residential: Homeowners |
| Potential funding sources | Private lender and public funds |
| Security required of borrower | Senior lien on home (primary home mortgage) |
| Repayment mechanism | Monthly payment to bank or credit union |
| Funding needs | Typically, state sponsors must provide a moderate level of funding to make the program successful for a large number of participants |
| Enabling legislation requirement | Not required |

# Reaching Communities and Addressing Consumer Protections

When developing a financing program, considering the needs of communities early in the process can help decisionmakers create a comprehensive financing program and incorporate consumer protections. Decisionmakers can evaluate how and to what extent communities have been included in the policymaking process for developing a financing program by considering the following questions:

- Have communities participated meaningfully in the policymaking process?

- Does the policy help address the impacts of inequality, or does it widen existing disparities?
- How will the policy increase or decrease economic, social, and health benefits for communities?
- Does the policy make energy more accessible and affordable to communities?

Many of the financing programs covered in this *Clean Energy Financing Toolkit for Decisionmakers* resource can provide specific benefits to communities through increasing access to clean energy (e.g., lower energy bills, upgraded equipment, improved comfort). However, financing programs that put additional debt on customers could place LMI households at an increased risk if adequate consumer protections are not in place. For example, customers could face penalties for failing to repay program funds, including having their power shut off, adverse credit scores, and in some instances losing their homes. Decisionmakers can implement consumer protection frameworks to address these concerns, including increasing awareness, analyzing the applicant's ability to pay, and requiring disclosure of financing costs. Considerations for consumer protections are specific to each program.

Although underwritten as a traditional mortgage, an EEM is usually more flexible in areas such as loan-to-value and debt-to-income ratios, which are common barriers for LMI homeowners seeking financing for energy efficiency improvements. Some EEMs may provide financing specifically for LMI borrowers or other borrowers with special considerations, such as veterans or residents in rural areas. For example, the FHA EEM program allows borrowers to qualify for up to 33% of their debt-to-income ratio, which can increase the loan amount LMI households can borrow.[4] The VA offers competitive interest rate EEMs to qualified veterans and military personnel who are purchasing or refinancing a home. These qualified borrowers can receive a loan of up to $6,000 for energy efficiency upgrades if projected energy savings exceed the resulting increase in mortgage payments. Otherwise, borrowers can qualify for $3,000 based solely on the cost of the energy efficiency improvements.[5]

# Roles and Responsibilities

Government-sponsored enterprises and agencies can play a critical role in implementing and operating EEMs. Government entities can determine eligible clean energy technologies, develop mortgage eligibility requirements and underwriting standards, evaluate mortgage applications, and issue EEMs. Government issuers are also responsible for collecting monthly payments on mortgages.

State agencies and lending institutions, such as credit unions, can also play critical roles, particularly where they implement and operate their own EEMs. In these instances, lending institutions are responsible for the same activities outlined above for government-sponsored enterprises. Public agencies and municipalities can provide incentives to lenders and borrowers in the form of an interest rate buy-down or closing cost credit, which may mitigate these barriers for LMI communities.

Typically, local governments and utilities have a minor role in EEMs. Local governments may partner with lending institutions to provide specialty mortgages. Local governments and utilities may also advertise available offers to residents in the community.

# Getting Started

State and local governments should consider these steps and best practices during the design, approval, and management of EEMs:

- Identify experienced financing providers with a good history with ESPC or ESA projects to reduce risks for customers and create an action plan to develop provider interest in offering ESPCs or ESAs in your state or community. Consider developing a list of pre-qualified service providers.
- Create an action plan to develop provider interest in offering EEMs in your community. The action plan should outline the outreach and communications approach.
- Implement outreach strategies to inform potential borrowers.
- Engage with key stakeholders to inform the development of EEM policies and regulations.

- Develop consumer protection policies, regulations, and guidance for EEMs.
- Describe the program's potential economic and environmental benefits to the local, regional, or statewide area, depending on EEM volume.
- Monitor loan portfolio performance on energy savings and repayments to identify and resolve potential issues with lending practices.
- Monitor changes in financial markets that may make the EEM model less attractive and review options for adapting the program with financing partners.
- Communicate with clean energy providers, leading agencies, and consumers about the loan evaluation process so that they can make informed decisions about their options.

### Learn More

- Learn more about Energy Efficient Mortgages <https://www.energystar.gov/newhomes/energy-efficient-mortgages> from EPA's ENERGY STAR Program.
- Read EnergySage's Buyers Guide <https://www.energysage.com/energy-efficiency/buyers-guide/>.
- Read the Northeast Energy Efficiency Partnership's Home Buyers Energy Efficiency checklist (pdf) <https://neep.org/sites/default/files/resources/homebuyer_tri-fold_final.pdf>.
- Learn about the National Association of Realtor's Green Designation <https://www.nar.realtor/education/designations-and-certifications/green>.
- Learn more about energy efficiency programs <http://www.dsireusa.org/> from the Database of State Incentives for Renewables and Efficiency.

## References and Footnotes

[1] Energy Star. n.d. Energy Efficient Mortgages <https://www.energystar.gov/newhomes/energy-efficient-mortgages>.

[2] University of North Carolina Center for Community Capital and Institute for Market Transformation. 2013. Home Energy Efficiency and Mortgage Risks (pdf) <https://www.imt.org/wp-content/uploads/2018/02/imt_unc_homeeemortgagerisksfinal.pdf>. March.

[3] University of North Carolina Center for Community Capital and Institute for Market Transformation. 2013. Home Energy Efficiency and Mortgage Risks (pdf) <https://www.imt.org/wp-content/uploads/2018/02/imt_unc_homeeemortgagerisksfinal.pdf>. March.

[4] U.S. Department of Housing and Urban Development. 2011. Mortgage Credit Analysis for Mortgage Insurance - Borrower Qualifying Ratios Overview (pdf) <https://www.hud.gov/sites/documents/4155-1_4_secf.pdf>.

[5] Veterans United. 2023. How to Get a VA Energy Efficient Mortgage (EEM) <https://www.veteransunited.com/valoans/va-energy-efficient-mortgage/>.

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