



**U.S. DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT**  
WASHINGTON, DC 20410-8000

ASSISTANT SECRETARY FOR HOUSING-  
FEDERAL HOUSING COMMISSIONER

May 6, 2005

**MORTGAGEE LETTER 2005-21**

**TO: ALL APPROVED MORTGAGEES**

**SUBJECT: HUD's Energy Action Plan and Energy Efficient Mortgages**

The Department of Housing and Urban Development's Energy Action Plan calls for the promotion of the FHA's Energy Efficient Mortgage (EEM) as a priority single family insured loan product. The EEM program recognizes that the improved energy efficiency of a house can increase its affordability by reducing the operating costs. Cost-effective energy improvements result in lower utility bills, conserve energy and, thus, make more income available for the mortgage payment. This Mortgagee Letter consolidates and clarifies existing policies on the EEM program and describes enhancements to the EEM product that have been made to make it more widely available. In addition, this Mortgagee Letter announces that to obtain "stretch ratios" for qualifying borrowers, the property must meet the 2000 International Energy Conservation Code (IECC).

The EEM program allows a borrower to finance 100 percent of the expense of a cost-effective "energy package," i.e., the property improvements to make the house more energy efficient. A cost-effective energy package is one where the cost of the improvements, including maintenance, is less than the present value of the energy saved over the useful life of those improvements. The borrower does not need to qualify for the additional financing or provide additional downpayment. There is also no need for a second appraisal that reflects the expense of the energy package and the improvements may be applied to retrofit an existing house or improve the energy efficiency of proposed construction. The present value test is a statutory requirement and, thus, actual energy savings cannot be used to determine cost effectiveness in lieu of the present value calculation of the energy savings.

The EEM may be used with Sections 203(b), 203(k)(rehabilitation mortgages), 234(c)(units in condominium projects), and 203(h)(mortgages for disaster victims) loans for both purchases and refinances, including streamline refinances. Both new and existing 1-4 family unit properties are eligible, including 1-unit condominiums and manufactured housing. The allowable EEM dollar amount is for the entire property and not based on a per unit basis for multiple unit properties.

**How is the energy package designed?**

The energy package is the set of improvements agreed to by the borrower based on

recommendations and analysis performed by a qualified home energy rater using a tool known as a Home Energy Rating System (HERS). The HERS must both meet the minimum requirements of the Department of Energy (DOE) approved ratings guidelines and must have achieved passing results from DOE's Building Energy Simulation Test (BESTTEST) or subsequent testing requirements.

The home energy rater must be trained to perform the physical inspection and/or diagnostic test that provide the data on the home used to develop the energy package. The home energy rater using the HERS prepares a written home energy rating report. The report, which must be provided to the homebuyer/homeowner as well as the mortgage lender, is based on the information developed from a physical inspection of the existing property to be retrofit, or from the plans and specifications of the house to be built. It provides estimates of both the costs of the improvements and the expected energy savings.

For new construction, the energy package includes those cost-effective energy improvements over and above the requirements of the 2000 International Energy Conservation Code, formerly known as the Model Energy Code. More information on this energy code can be obtained from the Department of Energy's website at <http://www.energycodes.gov>. The details of the energy package and supporting information are presented in a HERS Rating Report.

### **How is the EEM underwritten?**

The mortgage is initially underwritten as if the energy package did not exist, i.e., by using standard FHA underwriting standards, qualifying income ratios, and maximum mortgage/minimum cash investment requirements without regard to the energy package. For an EEM on new construction, as well as those homes that were built to the 2000 IECC or are being retrofitted to that standard, the borrower, in addition to the cost of the improvements, can get "stretch ratios" of 31% and 43%. Also, for new construction, when qualifying the borrower, the cost of the energy package should be subtracted from the sales price (since the builder has included those improvements in the sales price) and the qualifying ratios calculated on this lower amount.

Once it is determined that both the borrower and the property qualify for a mortgage to be insured by FHA, the mortgage lender, using the energy rating report and an EEM worksheet<sup>1</sup> will determine the dollar amount of the cost-effective energy package that may be added to the loan amount. This dollar amount cannot exceed 5 percent of the property's value (not to exceed \$8,000) or \$4,000, whichever is greater. Regardless of the property's value, every borrower who otherwise qualifies can finance at least \$4,000 of the costs of the Energy Package if the cost exceeds \$4,000. The calculated amount will be added to the approved base loan amount to total the final FHA insured loan amount before adding any upfront mortgage insurance premium. The FHA maximum loan limit for the area may be exceeded by the cost of the energy efficient improvements.

For a streamline refinance, the borrower's principal and interest (P&I) payment on the new loan including the energy package may be greater than the principal and interest (P&I) payment on the current loan, provided the estimated monthly energy savings as shown on the HERS report exceeds

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<sup>1</sup> See Attachment A for suggested format

the increase in the P&I.

FHA's TOTAL mortgage scorecard may also be used for underwriting EEMs. If the lender obtains an "accept" or "approve" on a mortgage loan application, FHA will recognize the risk rating from TOTAL and permit the increase to the mortgage payment without re-underwriting or rescoring provided that the lender's Direct Endorsement (DE) underwriter attests that he or she has reviewed the calculations associated with the energy efficient improvements, and found the mortgage and the property to be in compliance with FHA's underwriting instructions.

The appraisal does not need to reflect the value of the energy package that will be added to the property for either new or existing construction. On a streamline refinance made without an appraisal, the original principal balance substitutes for an appraised value. On a Section 203(k), the after-improved value is to be used for the EEM process.

For existing properties, energy-related weatherization items (see handbook HUD 4155.1, Rev 5,1-7(C)(2) for maximum additions to the mortgage amount) may be combined with the Energy Efficient Mortgage, where the maximum dollar amount allowed under an EEM does not cover the cost of the entire energy package. The weatherization amount would be the cost of the improvements not covered by the EEM amount. With a 203(k), the excess improvements would be included in the rehabilitation work.

### **When is the EEM mortgage eligible for endorsement?**

On *existing* properties, the FHA EEM is insurable immediately after closing. The installation of the energy package does not need to be completed before FHA insures the mortgage. However, for *new construction* the energy package must be completed before the mortgage is eligible for insurance (or after construction is complete when using FHA's Construction-Permanent mortgage).

### **What are FHA's requirements for escrow accounts under the EEM Program?**

For *existing properties*, the lender at closing is to establish an escrow account for the energy improvements. Any funds remaining in the escrow account at the end of the construction period must be applied to pay down the loan principal. For *new construction*, there will not be an escrow account as the energy package is to be installed as part of the total construction, which must be completed prior to loan closing.

If the energy package is part of a Section 203(k) rehabilitation loan, then the escrowed amounts of the energy package must be included in the Rehabilitation Escrow Account.

In all cases, the lender is to execute form HUD 92300, Mortgagee Assurance of Completion, to indicate that the escrow for the energy efficient improvements has been established.

### **What are the requirements for installing the energy package?**

On *existing construction*, the energy package is to be installed within 90 days of the loan closing. If the work is not completed within 90 days (180 days is allowed for Section 203(k) rehabilitation

mortgages), the lender must apply the EEM funds to a prepayment of the mortgage principal. The borrower cannot be paid for labor (sweat equity) on work that they perform, and the borrower cannot receive cash back from the mortgage transaction. On *new construction*, the installation of the energy package is included in the total construction of the house, and therefore is to be complete at loan settlement.

If the work that is done differs from the approved energy package, a change order along with a revised HERS Report must be submitted to the DE Underwriter for approval. If the changes still meet the cost-effectiveness test, no further analysis is required. If not, the funds for the work not included in the approval energy package must be used to pay down the loan principal.

### **What are the requirements for assuring completion of the energy package as proposed?**

The lender is responsible for notifying FHA through the FHA Connection or equivalent that the improvements have been made and that the escrow has been cleared. The lender, the rater, or an FHA fee inspector may inspect the installation of the improvements. The borrower may be charged an inspection fee in accordance with the appropriate Homeownership Center (HOC) fee schedule.

### **What is included in the Report on the energy package?**

The energy package report must provide the following information:

1. Address of the Property
2. Name of client
3. FHA Case number (if applicable)
4. Name of Lender (if applicable)
5. Type of Property
6. Whether the property is new construction or existing
7. Date of the physical inspection of the existing property or, for new construction, the date of the plan review.
8. Description of the current energy features of the property or proposed features if new construction. This must include, at a minimum, a description of the insulation R values in ceilings, walls, and floors; infiltration levels and barriers (caulking, weather-stripping, and sealing); a description of the windows (storm windows, double pane, triple pane, etc.) and doors; and a description of the heating (including water heating) and cooling systems.
9. Description of the energy package - For existing properties, those cost-effective improvements recommended to improve the energy efficiency of the property. For new construction, those cost-effective improvements to be included in the home that are over and above the requirements of 2000 IECC.
10. Estimated cost of the energy package, the useful life, and the costs of any maintenance over the useful life of the improvements.
11. The estimated present annual utility cost before the installation of the energy package (for existing property). For new construction, the estimated annual utility costs of a reference house built to 2000 IECC.
12. Estimated expected annual utility costs after the installation of the energy package.

13. Estimated annual savings in utility costs after the installation of the energy package, including the present value of the savings.
14. Names and signatures of the person(s) who inspected the property and of the person(s) who prepared the report, and the date the report was prepared.
15. The following Certification, signed by the person(s) who inspected the property and the person(s) who prepared the report:

*“I certify to the best of my knowledge and belief, the information contained in this report is true and accurate and I understand that the information in this report may be used in connection with an application for an Energy Efficient Mortgage to be insured by the Federal Housing Administration of the U.S. Department of Housing and Urban Development.”*

### **Are there additional fees associated with the EEM program?**

FHA does not set the fees for the Home Energy Rating, including the physical inspection, the HERS Report, and any post-installation tests. The fees charged to the borrower for the Home Energy Rating must be customary and reasonable for the area. These fees may be included and financed as part of the energy package if the entire package, including those fees, is cost-effective. If not, such fees are considered allowable closing costs. With a Section 203(k), the rating fee and inspections would be in addition to the consultant’s fee.

### **How will FHA know that this is an EEM?**

There are two EEM designations in the FHA Connection and each is described below. Also, a copy of the HERS report is to be included in the case binder submitted for endorsement and placed behind the mortgage credit analysis worksheet (MCAW). In the Remarks section of the MCAW, the lender is to indicate that the loan is for an EEM, show the cost of the energy package and the final loan calculations.

The categories of EEMs available in the FHA Connection are:

- New Construction/HERS Improvements: For homebuyers purchasing a home to be built and financing the cost of eligible energy efficient improvements into the mortgage. The borrower is also eligible for stretch ratios when manually underwriting the loan application if the property is built according to the 2000 IECC.
- Existing Construction/HERS Improvements: For homebuyers and those refinancing their mortgages and financing the eligible energy efficient improvement into the mortgage. The borrower is also eligible for stretch ratios when manually underwriting the loan application if the property was built to or is now being retrofitted to the 2000 IECC.

HUD has requested public comment on the information collection requirements contained in this mortgagee letter and upon expiration of the comment period will submit the requirements to the Office of Management and Budget (OMB) for approval under the Paperwork Reduction Act of 1995 (44 U.S.C. 3501-3520). When assigned, the OMB control number will be announced by

HUD. In accordance with the Paperwork Reduction Act, HUD may not conduct or sponsor, and a person is not required to respond to, a collection of information unless the collection displays a currently valid OMB control number.

If you have any questions regarding this Mortgagee Letter, please contact your Homeownership Center (HOC) in Atlanta (888-696-4687), Denver (800-543-9378), Philadelphia (800-440-8647), or Santa Ana (888-827-5605).

Sincerely,

Assistant Secretary for Housing-  
Federal Housing Commissioner

**Energy Efficient Mortgage Worksheet**

Borrower's Name: \_\_\_\_\_ FHA Case #: \_\_\_\_\_

Property Address: \_\_\_\_\_

A. Qualifying Mortgage Amount	1. Mortgage (w/o MIP) (line 11d of the MCAW-PUR or line 10g from MCAW WS)	A. \$ _____
B. EEM Amount	<p><i>The Home Energy Rating Report will provide the information on the Recommended Energy Package, its cost, and the present value of the energy saved.</i></p> <p>The cost of the Energy Package (not to exceed \$8,000) can be added to A if the cost is less than the Present Value of the energy saved:</p>	
	<p>Compare Cost and PV of energy savings:</p> <p>1. Cost of Energy package \$ _____</p> <p>2. PV of Energy Saved \$ _____</p> <p>3. Is PV more than Cost? Y / N</p> <p>If Yes, Continue:</p>	
	1. If Cost is less than \$4,000, enter the Cost in B. (or)	B. \$ _____
	2. If the Cost is more than \$4,000, but 5% of the value is less than \$4,000, enter \$4,000 in B. (or)	
	3. If the Cost is less than 5% of the value, but 5% of value is more than \$4,000 enter the lesser of the cost or \$8,000 (or)	
	4. If the Cost is greater than 5% of value, enter the lesser of 5% of value or \$8,000 in B	
<b>C. Final EEM Mortgage Amount (w/o MIP)</b>	<b>Add A and B</b>	<b>C. \$ _____</b>

REMARKS:

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