Natural Resources Defense Council

The Save Act -- Correcting a Blind Spot in Federal Mortgage Policy

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The Save Act (S. 1737), introduced by Senators Michael Bennet (D-CO) and Johnny Isakson (R-GA), corrects a significant flaw in the way lenders determine whether a loan applicant can afford a mortgage loan. The flaw is this: lenders today are required to ignore the energy expenses a person will have as homeowner in order to qualify for a mortgage backed by one of the federal mortgage agencies. The lender will look at the loan applicant's income as compared to his or her expenses – the new mortgage payment, car loans, property taxes, and insurance premiums – but when it comes to the regular monthly utility bills, the lender simply assumes everyone will have average expenses.

This is a relic of an era of low energy costs. Today, energy expenses for any given homeowner can vary widely depending on the house they choose. This blind-spot in underwriting has been highlighted in the recent foreclosure crisis.

The Save Act would correct this flaw. The Act would require the federal mortgage agencies to include energy expenses when evaluating whether the loan applicant can afford homeownership. It also would deliver to property appraisers the information necessary to account for how differences in operating costs affect home values.

Correcting this flaw in the current mortgage process will produce several valuable results:

i. It will lead to better mortgages, as lenders have more information about the actual expenses a loan applicant can expect as a homeowner.
ii. It will enable home buyers to shop for homes with more information about expected energy expenses.
iii. It will enable homeowners and builders to invest in energy efficient materials and measures, such as more insulation, knowing future buyers and lenders will account for the monthly savings produced by these measures.

The Save Act actually *reinstates* a conservative, traditional approach to underwriting. From 1930's forward, the Federal Housing Administration required loan officers to assess the energy expenses of loan applicants. In addition, the standard method of underwriting commercial properties, used by all major banks and investors, includes the owner's energy expenses as part of the affordability analysis.

Many American homeowners, faced with high home energy bills, could save money by investing to improve the efficiency of their house – more insulation, better windows and doors, better lights, installing a high-efficiency air conditioner. Today, these market incentives are suppressed by an out-dated mortgage policy. The Save Act would correct this problem.

Residential homes account for about 20% of our nation's total energy use. Increased investment in residential energy efficiency will improve our nation's energy security and reduce toxic pollution from wasted energy.

The SAVE Act (S. 1737) – Some Frequently Asked Questions

1. *What exactly does the Bill do?*

The Bill requires federal mortgage agencies to implement processes to enable lenders to account in two ways for the energy expenses a loan applicant is expected to have as homeowner: (i) Lenders will estimate the monthly energy expenses expected for a loan applicant in a given house. Lenders would use the information on energy expenses in the process of determining whether the applicant can afford the loan. (ii) Where the property appraiser has access to a detailed home energy audit, the appraiser would be instructed to include the value of efficiency in the valuation of the house.

The rules would apply to the various federal entities that make or guarantee or securitize loans, including Fannie Mae, Freddie Mac, and the Federal Housing Administration. These agencies currently make available to lenders automated tools to pre-clear loans for eligibility, and these tools would be used to automatically include the energy expense information in the process.

2. *Does the Bill instruct a lender how determine future energy expenses?*

The Bill instructs the Department of Housing and Urban Development to work with the loan agencies and other experts to determine how the mortgage agencies would implement new processes. The legislation gives HUD and the agencies wide latitude to determine the best method to implement the new process.

The Bill provides a lengthy period (5 years) for the agencies to test various models, collect information on energy expenses and energy audits, and implement systems to accomplish these goals.

3. *How could a lender estimate future energy expenses for a loan applicant?*

For one large subset of loans, refinance loans, the new loan is based on the same homeowner and same house. The lender could look to the homeowner's prior monthly expenses to estimate future monthly expenses.

Another large subset of loans -- loans for the purchase of new homes – frequently come with a detailed home energy audit that delivers the necessary information to the lender.

For loans for the purchase of existing homes and homes without a home energy audit, the lender could use the square footage of the house and information on the average energy use per square foot in the local region to estimate expenses.

The objective is not to perfectly predict the monthly energy bills for any given applicant. Rather, the objective is to give the loan underwriter an estimate of whether the house selected by the mortgage borrower is likely to present low, average, or high energy expenses.

4. *What effect would this Bill have on the typical homebuyer?*

For the vast majority of people, the Save Act would have little to no effect on the mortgage process – the lender would assess energy expenses in the affordability analysis and it would not affect the borrower's eligibility.

For some people buying houses with low energy expenses, the mortgage process would reveal monthly income that would not be spent on energy expenses. For some people intended to buy a house with very high energy expenses, the mortgage process would confirm that they can, in fact, afford those high expenses.

Here's the key – for persons who apply for a loan for a house with unaffordably high expenses, the problem can be cured by finding a house with lower energy expenses. IN contrast, the mortgage process today does not detect a person intending to buy a house a house with very high energy expenses.

If the Save Act were implemented, a person applying for a mortgage would receive from a lender an estimate of the monthly energy expenses expected for the house chosen.

5. *If utility expenses are relevant to the family's credit profile, why do lenders not use this approach today?*

The current approach (excluding energy expenses) became standard and entrenched in an era of low energy expenses and manual underwriting. So, lenders assumed the work required to estimate energy expenses would not deliver much value. Today, the differences between houses are greater. And, with automated tools, energy expenses can be estimated and included without any additional work for the lender.

Second, some lenders do use this more complete approach. FHA did employ this approach to underwriting single family mortgages for many years. Today, many banks use a similar approach when underwriting mortgages on commercial property. The U.S. Veterans Administration also uses a similar approach in their residential mortgage program. VA guidelines instruct lenders to add into their underwriting assessment an amount for "Utilities and Maintenance" expenses, which are estimate based upon the square footage of the house. VA loans experienced substantially better loan performance (i.e., fewer delinquencies and defaults) during the recent default crisis.