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**TESIMTONY OF KENNETH GEAR, EXECUTIVE DIRECTOR,  
LEADING BUILDERS OF AMERICA  
BEFORE  
THE U.S. SENATE  
COMMITTEE ON BANKING, HOUSING  
AND URBAN AFFAIRS  
SUBCOMMITTEE ON HOUSING, TRANSPORTATION AND COMMUNITY DEVELOPMENT**

**“GREEN HOUSING FOR THE 21<sup>ST</sup> CENTURY: RETROFITTING THE PAST AND BUILDING AN  
ENERGY-EFFICIENT FUTURE.”  
JUNE 30, 2010**

Thank you for the opportunity to express the views of Leading Builders of America (LBA) regarding “Green Housing for the 21<sup>st</sup> Century: Retrofitting the Past and Building An Energy-Efficient Future.”

LBA commends Chairman Menendez and Ranking Member Vitter for focusing on this critical issue.

Leading Builders of America is a newly formed trade group representing sixteen of the nation’s largest homebuilding companies. In 2009, our members sold more than 99,000 homes in thirty-four states accounting for 27% of the new homes sold in the U.S.

LBA member companies are building green houses every day throughout the country and are active participants in voluntary energy efficiency programs like Energy Star, The Builders Challenge, and Environments for Living.

LBA member companies are committed to building an energy-efficient future. They are on the front lines of this effort and recognize the important role that housing can play in reducing energy consumption in the United States.

A prospective homebuyer looking at an energy efficient home should be facing a win-win situation. An energy efficient home is good for the environment and the homebuyer will enjoy reduced energy costs. However, while the homebuyer may value the energy efficient features of the new home, the current mortgage underwriting and appraisal process does not, and this serves as a disincentive. LBA believes that providing tools to help homebuyers pay for energy efficiency features and ensuring that those features are properly valued in appraisals must be at the heart of any legislation aimed at reducing energy consumption in homes.

LBA commends Senators Whitehouse, Bennet, Bingaman, Menendez, Merkley, Schumer and Udall, sponsors of S. 1379, the *Energy Efficiency in Housing Act of 2009*, for recognizing the need to help homebuyers pay the incremental costs associated with purchasing energy efficient new homes.

S. 1379 calls for the refinement and expansion of Energy Efficient Mortgages, or “EEM’s.” We fully support this effort and look forward to working with the bill sponsors and members of this Committee to strengthen the concept so that it can be implemented on a timeline that is in sync with the anticipated imposition of new energy efficient mandates for new homes. Along with the Alliance to Save Energy (ASE) and the Institute for Market Transformation (IMT), we are concerned that a delay in implementing a robust energy efficient mortgage proposal would be counterproductive and would have the perverse effect of actually creating a disincentive for homebuyers to buy energy efficient homes.

LBA’s analysis shows that a 30% mandated increase in efficiency would increase the cost of the typical new home by more \$5,000; and at a 50% level cost would increase by an average of \$15,000. These costs vary significantly depending on climate zone. Unless a strong energy efficient mortgage program is in place and universally available, homebuyers will be unable to obtain financing to cover the increased up front costs, making them more likely to purchase a less efficient home that does not have those incremental costs.

LBA believes that the effectiveness of any energy efficient mortgage program is closely linked to reforms in the appraisal process to ensure that the value of energy saving features are consistently and accurately reflected in the value of a home, and we have a proposal, based on the well-established Home Energy Rating System (HERS), that would do just that.

As Congress looks at mandates to increase energy efficiency standards for new homes, there is an opportunity to make modest changes to the mortgage underwriting and appraisal process that will give homebuyers meaningful tools needed to help pay for energy efficiency features and make the increased energy efficiency standards a success. LBA looks forward to working with the Committee and the bill sponsors to accomplish the goal of building an energy-efficient future.

### **Outdated Underwriting & Appraisal Standards Discourage Energy Efficiency**

One of the first steps in the mortgage underwriting process is calculating the cost of homeownership. This analysis typically involves summing the total annual expenses for principal and interest and property tax and insurance premiums. This calculation is commonly called PITI and has been used by the mortgage industry for over sixty years. Conspicuously absent from this calculation is the anticipated annual energy cost for operating the home.

In our view, the current cost of homeownership test creates an incomplete picture of the actual costs associated with owning and operating a home. To illustrate this point, a recent analysis conducted by the Institute for Market Transformation (IMT) found that average energy costs exceed both insurance and property taxes. The failure to account for energy costs in mortgage underwriting is a significant deficiency that must be addressed to improve the quality of underwriting and provide an accurate picture of repayment risk.

Failing to account for energy costs in the underwriting process also has the unintended effect of discouraging consumers from purchasing energy efficient homes. Since energy costs are not factored into mortgage underwriting it stands to reason that energy *savings* cannot be factored in either. The result is that today's homebuyer cannot use energy savings to help offset the incremental cost associated with purchasing a home.

Of equal concern are current residential appraisal standards which do not provide for a consistent and accurate way to value energy saving features in a home. The result is that homeowners and homebuilders are discouraged from installing energy saving features since they will not be considered in the appraisal. Similarly, homebuyers are discouraged from buying homes that have energy saving features since those features are not considered in an appraisal and as a result cannot be financed in a mortgage.

Our conclusions are that any effort to increase energy efficiency in homes will not succeed unless the problems described above are addressed at a systemic level.

### ***The Power of E***

Since January, LBA has been working to develop a more robust and universally available approach for making energy efficiency affordable to consumers and ensuring that energy saving features are accurately and consistently valued in appraisals. We have partnered with The Alliance to Save Energy (ASE) and the Institute for Market Transformation (IMT) to develop specific proposal to accomplish these goals. Our plan has two components:

**Update and Improve the Accuracy of Mortgage Underwriting.** Mortgage underwriting criteria must be updated to include energy in the cost of ownership test. A PITI+E test would have two immediate and dramatic impacts in the marketplace. First, the quality of mortgage underwriting would improve with the addition of energy in factoring the cost of homeownership. Second, this change would encourage consumers to buy energy efficient homes by allowing energy savings to be used to offset the increased up-front cost of an energy efficient home.

This goal could be accomplished simply by using the HERS Index, a well-established and universally accepted energy efficiency standard. Using it will enable us to reach our goals of building an energy efficient future faster than waiting for another system to be developed. An equivalent rating system is also an option; however, developing an entirely new system could take considerable time and even more time to be understood and rolled out in the marketplace. This would delay efforts to encourage consumers to buy energy efficient homes.

Unlike proposals to measure other operating costs, a HERS energy assessment provides quantifiable data and is well-established and understood. HERS raters would provide their data (a “score” of 1-100) which could be used by appraisers.

**Create a Uniform System for Valuing Energy Saving Features** Homebuyers, builders, appraisers and mortgage underwriters need a uniform methodology for accurately and consistently calculating the value of energy saving features in a home. This can be accomplished relatively simply by basing value on

the amount of money the homeowner can expect to save through reduced energy costs over the life of the mortgage discounted to the current net present value. This methodology was devised a number of years ago by Fannie Mae as a cornerstone of their original Energy Efficient Mortgage Pilot Program.

The Fannie Mae pilot program never really took off, in part because at the time, credit was relatively easy to obtain, and as a result, there was not a real demand for the program. Tightening credit markets combined with growing foreclosures and a growing need to reduce energy consumption have changed marketplace dynamics.

**Implement a Comprehensive Solution Now.** Congress is considering sweeping energy legislation that could include efficiency mandates for new homes. These changes will increase the cost of new homes and in turn make them less attractive to homebuyers. However, if the mortgage and appraisal reforms described above are included in the same legislation, the added cost of energy saving features would be fully offset and appropriately valued in appraisals. In our view mortgage and appraisal reforms **must** be part of any legislation that mandates increased energy efficiency in new homes.

The federal government is currently in a unique position to drive these much needed changes through the highly fractured home building, mortgage and appraisal industries. The vast majority of new mortgages today are either insured or owned by the federal government. Requiring that these loans consider energy costs in the underwriting process and accurately value energy saving features would dramatically accelerate the supply of and demand for energy efficient new homes.

Thank you for taking our thoughts into consideration.

## **Appendix: Summary of Required Legislative Changes**

### *Updating Federal Mortgage Programs to Encourage Energy Efficiency*

#### **Public Policy Goals**

Reduce the amount of energy that is consumed by homes. Encourage the development of energy efficient building technologies, materials and components. Facilitate the growth of “green jobs” in the residential construction and remodeling sector.

#### **Summary of Legislative Objectives**

- 1.) Update underwriting standards for federally insured mortgages to accurately reflect energy costs. Ensure that demonstrable operating savings are factored into underwriting to offset the incremental expense of making homes more energy efficient.
  
- 2.) Adjust appraisal standards for federally insured mortgages to accurately reflect the added incremental value of energy efficiency.

#### **Detailed Discussion – Mortgage Underwriting Standards**

“Covered Agencies” are defined as federal agencies and federally chartered entities.

“Federal Insurance” is defined as insurance provided by federal agencies and federally chartered entities.

Direct the Administration to develop enhanced energy efficiency underwriting criteria for all federally insured mortgages as follows:

- Any mortgage underwriting system that is used to originate a federally insured mortgage must take into consideration energy costs in determining the portion of gross income that can be used to service mortgage debt
  - To facilitate this consideration, mortgage underwriting platforms must include a line item for “estimated annual energy costs.”
  - Annual energy operating costs shall be determined using one of two methods. A default annual estimated energy cost shall be calculated for each home and shall be based on the size of the home and on the most current version of the *Energy Information Administration’s Residential Energy Consumption Survey*. The default annual estimated energy cost shall be used when an energy efficiency report is not provided.
  - An energy efficiency report may be supplied by the buyer or seller. Such a report shall be prepared by a qualified third-party and include an estimate of annual energy costs specific to the home being purchased. If an energy efficiency report is provided, it shall be used as the basis for estimating annual energy costs.
- The criteria for calculating the cost of homeownership, (principal, interest, taxes & insurance) shall be expanded to include energy costs. Qualifying income ratios shall be adjusted accordingly. If an energy efficiency report is provided, it shall be used as the basis for estimating annual energy costs. In consultation with DOE, EPA and Covered Agencies, the

Department of Housing and Urban Development (HUD) shall study the feasibility of adding water costs and location-based transportation costs to mortgage underwriting calculations. HUD shall report back to Congress within 18 months of enactment. Covered agencies shall fully cooperate in this analysis.

### **Safeguards & Limitations**

- Any federal mortgage insurance program subject to this act shall be prohibited from modifying other underwriting criteria so as to negate any benefit that results from the use of enhanced energy efficiency underwriting criteria.
- Covered Agencies are prohibited from imposing greater buy back requirements or credit overlays on loans that utilize enhanced energy efficiency underwriting criteria.
- Covered Agencies are prohibited from adding additional private mortgage insurance premiums for loans that utilize enhanced energy efficiency underwriting criteria.
- Enhanced energy efficiency underwriting criteria may be used for both new and resale homes and shall be available for all housing types that would normally qualify for federal insurance.

### **Detailed Discussion – Appraisal Standards**

Direct the Administration to develop enhanced energy efficiency appraisal guidelines for all federally insured mortgages as follows:

- Appraisals used to underwrite federally insured mortgages must include a line item that quantifies annual energy costs.
- An energy efficiency report prepared by a qualified third-party may be supplied by the buyer or seller. Such a report shall include an estimate of annual energy costs specific to the home being purchased. If an energy efficiency report is provided, it shall be used as the basis for estimating annual energy costs.