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HUD PowerSaver Pilot Loan Program

The U.S. Department of Housing and Urban Development (HUD) recently announced the creation of a pilot loan program for home energy improvements. The PowerSaver loan program is a new, energy-focused variant of the Title I Property Improvement Loan Insurance Program (Title I Program) and is planned for introduction in early 2011. The PowerSaver pilot will provide lender insurance for secured and unsecured loans up to $25,000 to single family homeowners. These loans will specifically target residential energy efficiency and renewable energy improvements. HUD estimates the two-year pilot[1] will fund approximately 24,000 loans worth up to $300 million; the program is not capped. The Federal Housing Administration (FHA), HUD's mortgage insurance unit, will provide up to $25 million in grants as incentives to participating lenders. FHA is seeking lenders in communities with existing programs for promoting residential energy upgrades.[2]

Title I Program Background

The federal government has used home loan insurance as a prescription for economic troubles and tight credit since the Great Depression and passage of the 1934 National Housing Act that created the Title I program and the much larger Title II program.[3] Title I is aimed primarily at financing improvements to the basic livability or utility of existing homes. PowerSaver is the latest iteration on Title I and is aimed specifically at home energy improvements.

Through the Title I Program, FHA insures secured and unsecured loans made by private lenders, offering consumers the opportunity to obtain more affordable home improvement loans. Lending institutions make loans from their own funds to eligible borrowers to finance these improvements. These loans may be unsecured if they are $7,500 or less and must be secured with a first or second property lien above $7,500. FHA insures private lenders against the risk of default for up to 90 percent of any single loan.[4] Loan volume under Title I has declined in the last decade from about 14,000 loans totaling $175 million in 2000 to about 4,000 loans totaling $58 million to date in 2010. Consumer

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[1] HUD may extend the duration of the pilot program beyond the two-year pilot for a fuller assessment of the performance of PowerSaver.
[2] The terms home energy upgrade and home energy retrofit are used interchangeably.
[3] Through Title II, FHA provides first mortgage insurance for a number of single-family loan products including 203k loans and Energy Efficient Mortgages (EEMs). These products are targeted at insuring financing and refinancing of home purchases and reconstruction. For more information on the range of loan products insured through Title II, visit: http://www.hud.gov/offices/hsg/sfh/insured.cfm
[4] FHA's liability is capped at 10 percent of the amount of all insured Title I loans in the financial institution's portfolio.

priorities for Title I borrowing have favored additions to their homes and repainting, for example, over energy-related investments such as insulation or more efficient central heating and air conditioning. In recent years, fewer than 1,000 Title I loans have been made annually for all purposes than include some energy improvement.[5]

The PowerSaver pilot will exclusively target secured and unsecured loans for residential energy efficiency and renewable energy improvements and aims to address a number of the lender and borrower issues that have limited the popularity of Title I loans. The existing Title I program will also remain in place during the PowerSaver pilot.

The PowerSaver Pilot

FHA developed PowerSaver using the statutory authority and regulatory framework for its Title I program. Through PowerSaver, HUD projects that approximately 24,000 FHA-insured loans worth approximately $300 million will be originated over the two-year pilot period, though there is no cap on this program. Like Title I loans, PowerSaver loans will be issued by private lenders and backed by FHA insurance that protects those lenders in the event of default.[6] In addition, two recent laws – the Act for an Energy Efficient Mortgage Innovation Fund and the Consolidated Appropriations Act of 2010 (CAA) – direct HUD to allocate $25 million towards catalyzing innovations in the residential energy efficiency sector with the potential to help create a standardized home energy upgrade market. FHA plans to deploy this $25 million primarily to provide incentive payments to participating lenders.

FHA's goals for the pilot program are to:

- Facilitate the testing and scaling of a mainstream financing product for home energy upgrade loans that includes liquidity options for lenders, resulting in more affordable and widely available loans than are currently available for home energy upgrades
- Establish a robust set of data on home energy improvements and their impact – on energy savings, borrower income, property value, and other metrics – for the purpose of driving development and expansion of mainstream mortgage products to support home energy upgrades

FHA plans to select a limited number of lenders and communities to participate in the PowerSaver pilot. Participating lenders must be approved as Title I lenders.[7] FHA is explicitly targeting communities participating in the Department of Energy's Better Buildings Program,[8] although lenders in other communities that have robust home energy upgrade infrastructure in place may be considered. This infrastructure generally includes an energy upgrade marketing plan, a qualified pool of contractors, and measurement and verification processes. FHA is actively seeking lender participation in the pilot.

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[5] LBNL analysis of Title I data supplied by HUD from the FHA Connection database. Home improvements identified as energy related are those coded for installation, repair or replacement of roofing; heating, ventilation and air conditioning (HVAC), insulation and solar systems. Borrowers may tag up to five types of improvements for each loan, but FHA does not verify that this coding is accurate, fully inclusive or prioritized by the chief rationale for the loan.

[6] Like the Title I program, this insurance covers 90 percent of any single loan, and FHA liability is capped at 10 percent of the amount of all insured PowerSaver loans in the financial institution's portfolio.

[7] Title II lenders may obtain Title I eligibility under an expedited process.

[8] Approximately $485 million was granted to 35 communities across the United States through the BetterBuildings Program, a competitive grant program funded through the American Recovery and Reinvestment Act. More information on Better Buildings is available here: http://www.eere.energy.gov/betterbuildings/

PowerSaver Loan Details

Proposed changes to the Title I program in the PowerSaver pilot fall into the following categories:

- Changes designed to enhance the underwriting of these loans
- Changes related to FHA administration of the program
- Changes to target the pilot program specifically at improving home energy performance
- Changes to provide additional benefits to borrowers

The table on the following page details these proposed changes, including these key elements:

- **Property Equity Requirement:** PowerSaver has a maximum loan-to-value ratio of 100% (including first mortgage and PowerSaver loan). Unlike Title I, homeowners without equity in their properties will not be eligible for the pilot.

- **Property Valuation Requirement:** Due to its property equity requirement, participating homeowners must attain a property valuation, likely an exterior-only inspection appraisal[9], to help lenders evaluate whether a property has sufficient equity to support a loan. FHA is seeking public comment on what form this property valuation requirement should take.

- **Energy Efficiency and Renewable Energy Measures Only** (orthose improvements that directly make such measures possible): Measures eligible for funding under the PowerSaver pilot are significantly more restrictive than the Title I program. A full list of the proposed eligible measures is available HERE.

- **Single Family Residential Homeowners Only**: Title I loans can be secured with a number of property types (including rental and multifamily units). The PowerSaver pilot will target only detached single-family, owner-occupied homes.

- **Minimum FICO Score**[10]: PowerSaver borrowers must have a FICO (or equivalent) score of >660.

- **Streamlined Insurance Claims Procedure:** The Title I program requires note holders to file fully documented insurance claims that confirm that no loan servicing errors occurred. This process often takes several months as lenders frequently outsource loan servicing, and lenders have cited difficulty recovering on defaulted loans as a key reason for their past lack of enthusiasm about Title I. The PowerSaver pilot will permit lenders to recover insurance claims without confirming proper loan servicing. Servicers will, however, still be accountable to FHA for servicing, including the failure to file claims in a timely fashion.

- **Financial Incentives for Participating Lenders:** FHA will provide $25 million of incentives to lenders. These incentive payments will, generally, be available to lower loan interest rates for

[9] Exterior-only inspection appraisals are also referred to as ‘drive-by’ appraisals.
[10] FHA has proposed using a minimum Decision Score. The Decision Score refers to a formula for evaluating FICO scores. Generally, lenders interpret minimum FICO score to mean using the Decision Score formula.

borrows and reduce servicing costs for lenders. Small loans can be expensive to service, and some lenders have mentioned high transaction costs as a key reason they have not been more active originating Title I loans.

Table 1. Comparison of Key HUD Title I and Proposed PowerSaver Pilot Terms

Terms	HUD Title I	PowerSaver Pilot
Eligible properties	Single Family, Manufactured, and Multifamily	Single Family (Detached, Owner-Occupied)
Loan term	Up to 20 years	Up to 15 years (up to 20 years for specified renewable energy improvements)
Scope of work	Permanent property improvements that protect or improve the basic livability or utility of the property	FHA published list of energy saving and renewable energy improvements
Interest	Fixed; negotiated with lender[11]	Fixed; negotiated with lender[12]
Loan amount	Up to $25,000 (for single family)	Up to $25,000
Loan security	Up to $7,500: Unsecured* Above $7,500: Secured by mortgage or deed of trust (not below second lien)	Up to $7,500: Unsecured* Above $7,500: Secured by mortgage or deed of trust (not below second lien)
Additional Costs	Upfront fee, loan insurance premiums	Upfront fee, loan insurance premiums
Minimum property age/occupancy	Structures completed & occupied for 90 days	Structures completed & occupied for 90 days
Third party permitted to pay discount points or financing charges on behalf of borrower?	No	Yes
Minimum FICO Score?	No	Yes, 660 minimum
Property valuation?	No	Appraisal or Other Approved Valuation Method
Maximum loan-to-value (LTV) ratio?	No	100%[12]
Maximum debt-to-income (DTI) ratio?	45%	45%
Lender reserve requirement	10% of each loan	10% of each loan
Dealer loans permitted	Yes	No
Loan disbursement procedure	100% at closing	50% at loan closing, 50% at energy upgrade completion
*Lenders have the option of issuing secured or unsecured loans up to $7,500. Above $7,500, loans must be secured.		

[11] Recent reported interest rates for Title I loans have been 6 to 8 percent. FHA anticipates that most borrowers under the Pilot Program will be able to access financing at rates at or below this range.

[12] If the PowerSaver loan is unsubordinated, the maximum LTV is 100%. If the Powersaver loan is in the second position (i.e. there is first mortgage on a property), the max combined LTV (CLTV) is 100%. Title I loans may not be in a lesser position than second.

Potential Areas of Outstanding Concern

- **10% Lender Reserve Requirement:** For all types of loans, regulators require lenders to hold cash in reserve equal to a percentage of their outstanding loan portfolio. This percentage varies based on the risk profile of the lender's assets but is typically in the mid-single digits. The PowerSaver program has a 10% reserve requirement. In the past, some lenders have expressed dissatisfaction with this higher-than-average reserve requirement because it acts to reduce the number of total loans that a lender may hold.

- **No Energy Assessment Requirement**:[13] FHA intends to fund cost-effective energy upgrades typically, an energy assessment is conducted to determine appropriate measures for a property. While the PowerSaver pilot does not include an explicit energy assessment requirement, FHA intends to run the pilot primarily in BetterBuildings communities. These communities have existing home energy upgrade programs, and many of these programs require energy assessments in order for homeowners to qualify for financial incentives.

- **Dealer Loans Not Permitted**: In the past, Title I "dealer loans" have been disproportionately correlated with poor loan performance. Dealer loans allow third parties, often contractors, to assist homeowners in preparing their credit applications and obtaining a loan from a lender. Contractors are usually the party presenting a homeowner with financing options, and the dealer loan impermissibility may limit the ease with which this product fits into contractors' sales process.

- **Questionable Ease of Customer Experience:** Title I loan origination often takes one to two weeks, and the PowerSaver property valuation requirement may extend this origination time further. Other financing products, particularly unsecured products like the Fannie Mae Energy Loan, take just 48 to 72 hours to complete. This long loan origination period coupled with high origination fees may limit the attractiveness of the PowerSaver pilot to homeowners. The origination period and fees are generally determined by lenders, and HUD has indicated that it will consider both anticipated time to close and borrower origination costs in evaluating lenders' PowerSaver applications and allocating incentive grant payments.

Next Steps

The PowerSaver pilot is a potentially promising makeover of FHA's Title I program. Still, a number of questions remain. How will the loans be marketed to consumers without the involvement of contractors or other dealers? Will lenders be more open to accepting the transactions costs of many small loans than they have been in the past? Since many Title I loans pay for energy improvements as part of a package of other improvements, such as room additions, how many homeowners will want an energy-only loan? Will the requirement of a minimum FICO score and maximum loan-to-value ratio reassure the secondary market sufficiently to pool and purchase these loans and provide lenders with liquidity? A similar energy-oriented pilot in the late 1990s with a Title II-type loan, energy efficiency mortgages, showed modest success in six states and was added to HUD's mainstream portfolio – and those instruments are rarely utilized today.

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[13] The term energy assessment is used interchangeably with the term energy audit.

However, the PowerSaver pilot has the potential to fill critical data gaps and increase lender confidence in the performance of home energy upgrade loans. In doing so, PowerSaver may catalyze a new wave of low-cost private capital into the marketplace. HUD is actively soliciting public comments on the proposed PowerSaver framework. It has specifically requested feedback in the following areas:

- Property Valuation Method
- Lender Incentive Payments
- Eligible Measures
- Goals and Scope of the Pilot Evaluation

These public comments should be submitted to HUD by December 27, 2010 at: FHAPowerSaver@hud.gov