

VA Lenders Handbook (VA Pamphlet 26-7), Chapter 7, Topic 3 — Energy Efficient Mortgages

Register va-m26-7-ch07-t03

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3. Energy Efficient Mortgages Change Date March 11, 2019 • This chapter has been revised in its entirety. a. What are EEMs? Energy Efficient Mortgages (EEMs) are loans to cover the cost of making energy efficiency improvements to a dwelling. They can be made in conjunction with a: • VA loan for the purchase of an existing dwelling, or • VA refinancing loan secured by the dwelling. Acceptable energy efficiency improvements include, but are not limited to: • solar heating systems, including solar systems for heating water for domestic use; • solar heating and cooling systems; • caulking and weather-stripping; • furnace efficiency modifications limited to replacement burners, boilers, or furnaces designed to reduce the firing rate or to achieve a reduction in the amount of fuel consumed as a result of increased combustion efficiency, devices for modifying flue openings which will increase the efficiency of the heating system, and electrical or mechanical furnace ignition systems which replace standing gas pilot lights; • clock thermostats; • new or additional ceiling, attic, wall and floor insulation; • water heater insulation; • storm windows and/or doors, including thermal windows and/or doors; • heat pumps; and • vapor barriers. b. Borrower Notice on the NOV Information on EEMs is provided to a Veteran who applies for a loan which requires an NOV (a loan for a home purchase or regular “cash-out” refinance). The NOV includes the following notice to the Veteran: Continued on next page VA Pamphlet 26-7 Revised Chapter 7: Loans Requiring Special Underwriting, Guaranty, and Other Considerations 7-18 3. Energy Efficient Mortgages, continued b. Borrower Notice on the NOV, continued “The buyer may wish to contact a qualified person/firm for a home energy audit to identify needed energy efficiency improvements to the property. In some localities, the utility company may perform this service. The mortgage amount may be increased as a result of making energy efficiency improvements such as: Solar or conventional heating/cooling systems, water heaters, insulation, weather-stripping/caulking, and storm windows/doors. Other energy related improvements may also be considered.” The mortgage may be increased by: • Up to \$3,000 based solely on the documented costs, • Up to \$6,000 provided the increase in monthly mortgage payment does not exceed the likely reduction in monthly utility costs, or • VA does not permit EEMs more than \$6,000 (38 U.S.C. §3710(d)). c. Underwriting Considerations Energy efficiency improvements up to \$3,000: The resulting increase in loan payments will normally be offset by a reduction in utility costs. Energy efficiency improvements more than \$3,000, up to \$6,000: The lender must make a determination that the increase in monthly mortgage payments does not exceed the likely reduction in monthly utility costs, and must rely on locally available information provided by utility companies, municipalities, state agencies or other reliable sources, and document the determination. Energy efficiency improvements in conjunction with an Interest Rate Reduction Refinancing Loan (IRRRL). If the monthly payment (Principal, Interest, Taxes, and Insurance (PITI)) for the new loan exceeds the PITI of the loan being refinanced by 20 percent or more, the lender must certify to having determined that the Veteran qualified for the higher payment. Continued on next page VA Pamphlet 26-7 Revised Chapter 7: Loans Requiring Special Underwriting, Guaranty, and Other

Considerations 7-19 3. Energy Efficient Mortgages, continued d. Documentation Required with Closed Loan Package Energy efficiency improvements up to \$3,000: Evidence of the cost of improvements such as a copy of the bid(s) or contract itemizing the improvements and their cost. Improvements more than \$3,000, up to \$6,000: Evidence of the cost of improvements such as a copy of the bid(s) or contract itemizing the improvements and their cost, and the lender's determination that the increase in monthly mortgage payments does not exceed the likely reduction in monthly utility costs. IRRRL with significant increase in payments: If the cost of the improvements cause the new loan payment (PITI) to be 20 percent or higher than the old payment (on the loan being refinanced), then include the lender's certification that it has determined that the Veteran qualified for the higher payment. Continued on next page VA Pamphlet 26-7 Revised Chapter 7: Loans Requiring Special Underwriting, Guaranty, and Other Considerations 7-20 3. Energy Efficient Mortgages, continued e. How to Calculate Guaranty and Entitlement Use? Guaranty is calculated on an EEM as described in the following table. Step Action 1 Calculate guaranty on the loan without the portion attributable to the energy efficiency improvements. 2 Calculate guaranty on the energy efficiency improvements portion by applying the same percentage used in Step 1. 3 Add the results of Steps 1 and 2 to arrive at guaranty on the entire loan. However, the Veteran's entitlement will only be charged the amount arrived at in Step 1; it is based upon the loan amount before adding the cost of the energy efficiency improvements. Example 1: If a Veteran has full entitlement and applies for a loan of \$80,000, plus \$6,000 in energy efficiency improvements, VA will guarantee 40 percent of the full loan amount of \$86,000. Thus, the dollar amount of the guaranty will be \$34,400, even though the charge to the Veteran's entitlement is only \$32,000. Example 2: If a Veteran with full entitlement applies for a \$144,000 loan to purchase a home, and adds \$6,000 in energy efficiency improvements, the 25 percent guaranty on the loan will only require the use of \$36,000 entitlement, but the dollar amount of guaranty will be \$37,500. f. How to Calculate the Funding Fee Calculate the funding fee based on the full loan amount including the cost of the energy efficiency improvements. Continued on next page VA Pamphlet 26-7 Revised Chapter 7: Loans Requiring Special Underwriting, Guaranty, and Other Considerations 7-21 3. Energy Efficient Mortgages, continued g. Improvements Not Completed Before Closing If the energy efficiency improvements are not completed before closing, the lender may establish an escrow and close the loan. • A formal escrow is not required. • Only the amount needed to complete the improvements must be withheld. Check the appropriate block in item 23, VA Form 26-1820, Report and Certification of Loan Disbursement. • No additional documentation concerning the escrowed/earmarked funds must be submitted when reporting the closed loan. Generally, the improvements should be completed within 6 months from the date of loan closing. Provide written notification to VA when improvements are completed and the escrow funds are disbursed. Escrow requirements concerning completion of improvements are listed in Chapter 9 of this handbook. • Assure the funds are properly applied to the costs of improvements. If, after a reasonable time, the lender determines that the improvements will not be completed: • Apply the balance of the escrowed/earmarked funds to reduce the principal balance on the loan, and • Provide written notification to VA that this has been done. Continued on next page VA Pamphlet 26-7 Revised Chapter 7: Loans Requiring Special Underwriting, Guaranty, and Other Considerations 7-22 3. Energy Efficient Mortgages, continued h. Reimbursement to the Veteran out of IRRRL Proceeds The Veteran generally may not obtain cash proceeds from an IRRRL. There is one exception. Up to \$6,000 of IRRRL loan proceeds may be used to reimburse the Veteran for the cost of energy efficiency improvements completed within the 90 days immediately preceding the date of the loan. VA Pamphlet 26-7 Revised Chapter

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Source: VA Lenders Handbook (VA Pamphlet 26-7), Chapter 7, Topic 3 — Energy Efficient Mortgages · snapshot 0e2735cf8ca44400