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PERSONAL PROPERTY

Green for Green

If you're looking for a break on your mortgage, energy efficiency might be just the ticket

By ANNA PRIOR

Want to make your home more energy efficient but can't afford the cost? There may be ways to save on a loan to get the work done.

A number of lenders and government agencies are offering mortgage deals to people who borrow money to make their homes more efficient, or who buy homes that already meet high efficiency standards. The programs work in a number of ways. Some offer a discount—often $500 or more—on the closing costs for a refinancing or new mortgage. Other plans offer a lower interest rate on the loan, sometimes a half-point or more below the current market rate.

Meanwhile, some programs give another kind of benefit: They factor potential energy-bill savings into qualifying income, which may allow people to borrow more money. Even minor efficiency upgrades can bring hundreds of dollars a year in savings and potentially help people qualify for a bigger loan.

The savings also provide an incentive for homeowners to get the work done now—since energy prices may become more of a burden in the near future. Energy prices "have already started to go back up," says Paul Ellis, a certified financial planner and senior financial adviser with Ameriprise. "Nothing is guaranteed, but as the economy recovers, energy costs will most likely start to rise again. Right now, while energy costs are still reasonable, there's more of an opportunity for people to plan without feeling under the gun."

A Big Boost

These energy-efficient mortgages have been around for years, but many lenders have been reluctant to offer them, since they involve much more paperwork and other complications than regular mortgages. For the lenders, "it's the same amount of profit for more work," says Mark Wolfe, director of the Energy Programs Consortium, a joint venture of four national organizations that represent local and state energy programs and policy directors.

Now the plans may get a boost from Washington—if a contentious bill makes it through the Senate. The American Clean Energy and Security Act of 2009, which narrowly passed the House in late June, includes provisions designed to encourage energy-efficient housing. Among other things, the bill requires Fannie Mae and Freddie Mac to offer incentives to get more borrowers to use energy-efficient mortgages. For private lenders that offer the mortgages, the bill streamlines some of the onerous work involved—for instance, by establishing a single set of rules for auditing buyers' homes to see how much energy they use.

To qualify for these plans, the first step is generally an energy audit. If borrowers are buying a new home, it must meet certain efficiency standards, often the federal government's Energy Star benchmarks. If they're looking for a refinancing or second mortgage, they must agree to reduce their current energy usage by a certain amount through upgrades like buying new appliances or insulation. The cost of the upgrades is bundled into the mortgage, and buyers pay it back over the life of the loan.

One of the most common incentives is a discount on closing costs. J.P. Morgan Chase & Co. gives customers $500 off the costs if they use the loan to make energy-efficient improvements or buy a new home that meets Energy Star standards. Borrowers can also get that discount on the purchase of Energy Star appliances when they tap the equity in their home with a cash-out refinancing. Likewise, Bank of America offers up to a $1,000 credit on closing costs if a newly constructed property meets Energy Star requirements.

Depending on the size of your mortgage, that could represent a big savings. Closing costs vary widely but can sometimes run up to about 3% of a loan, or $3,000 on a $100,000 mortgage, says Keith Gumbinger, vice president at mortgage education firm HSH Associates.

Meanwhile, a number of lenders—including Bank of America's Countrywide Financial, CitiMortgage and lenders who sell their loans to Fannie Mae and Freddie Mac—offer deals that take into account savings from monthly energy bills and allow those to be added into the qualifying income, possibly allowing the borrower to get a larger loan. So, if borrowers earn $3,000 a month and save $400 on bills, the lender would consider their income $3,400.

Borrowers can potentially add quite a bit to their qualifying income this way, since even simple fixes can bring big savings on energy bills. Air sealing, for instance, helps reduce heating and cooling costs by as much as 30%, and runs just $300 to $500 if you do it yourself, or $1,500 to $2,000 for a contractor.

The Federal Housing Administration offers a similar plan through its approved lenders that lets borrowers bundle the price of certain cost-effective efficiency improvements into a loan. But the cost of the improvements doesn't count toward the size of the mortgage when determining if a buyer qualifies. Let's say a borrower adds $5,000 of improvements onto a $100,000 loan. The borrower would have to qualify only for a $100,000 loan, not $105,000.

Cutting Your Rate

Other mortgage plans give borrowers a chance to save on interest rates. For instance, some local lenders work with programs like myEnergyloan, which lets borrowers buy down their interest rate on any mortgage product based on how much they improve their home's efficiency.

It works like this: Each percentage point of efficiency improvements means one basis point, or one one-hundredth of a percentage point of the principal cost of the mortgage. The savings can be used to buy down the interest rate or applied toward a discount on closing costs. How much the interest lowers will vary on the lender, the loan product and the amount of efficiency improvement.

For example, a 50% improvement in efficiency would give the homeowner a discount of one-half of one percentage point. On a $500,000 mortgage, this comes out to $2,500, which could result in a savings of 0.25 to 0.50 percentage point on the interest rate. This could bring a savings of more than $56,000 over the life of a 30-year fixed-rate loan with an original rate of 5.8%.

Other plans are in the testing stage. The Energy Programs Consortium is developing a program tied to Energy Star that gives borrowers incentives if their home improvements lead to at least 20% energy savings. Currently, Maine and Colorado offer loans through the program. The incentives vary; in Maine, for instance, the plan is structured as a second mortgage that lets eligible low- and moderate-income homeowners borrow as much as $30,000 at a fixed rate of 3.95%. In comparison, the average rate for a 15-year, $30,000 second mortgage in Bangor, Maine, recently was 5.41%, according to a Bankrate.com survey of lenders.

Apart from incentives, boosters of these plans argue that they have a big structural advantage: Tying the expense of upgrades to a 30-year mortgage rather than taking out a short-term loan means the payments will be stretched out over a longer period. That means people can also finance projects with a high cost and very long payback period, such as solar panels.

Another plus: Depending on the type of energy-efficient improvements, the savings on monthly energy bills could offset a part of the monthly mortgage payment. And some experts argue that the green upgrades may add value to a home.

While energy efficiency in its current form "hasn't been around long enough to know whether or not it ultimately adds value to a home," it makes sense that an energy-efficient home with low utility bills could be a big selling point for some home buyers, says Mr. Ellis.

What to Watch Out For

Still, energy-efficient mortgages aren't for everyone. Buyers should look carefully at the interest rate, the costs they'll be taking on and the potential savings, and figure out if the work is worth it. In general, these mortgages make the most sense for people without lots of debt who expect to live in their home for an extended period.

Moreover, one of these mortgages probably isn't worth your while if your energy bills are already low. "In practice, if you have a reasonable house that's in reasonably good shape, look to save between 25% and 40% on your energy bills" by making relatively affordable fixes through one of these mortgages, says Mr. Wolfe. "Fifty percent or deeper savings require a bigger investment and a longer payback period," which can end up negating the benefits of a lower interest rate or closing costs.

Another caveat: An energy audit can be pricey—potentially eating up your savings on closing costs. A comprehensive audit can run $400 to $500, says Howard Banker, managing director at the Energy Programs Consortium. However, he adds, "some contractors are getting away with charging crazy amounts."

On the other hand, many states have free energy-audit and weatherization programs in place, especially for low-income families. Check your state's energy department Web site or the Database of State Incentives for Renewables & Efficiency at www.dsireusa.org.

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