Residential New Construction Attitude and Awareness Baseline Study

Lender Survey

Report on Findings

Prepared for the New Jersey Residential New Construction Working Group

January 2001

NQTQ03

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Executive Summary

This Report presents the findings from the Lender Survey for the New Jersey Residential New Construction Awareness and Attitudinal Baseline Study (RNC study). A summary report consolidates information from this and other research conducted for the Baseline Study.

A. Background

The New Jersey Residential New Construction Working Group (Working Group), which consists of PSE&G, GPU Energy, Conectiv Power Delivery, Elizabethtown Gas Company, South Jersey Gas, Rockland Electric Company, and New Jersey Natural Gas Company, is charged with developing and implementing a coordinated, statewide utility residential new construction program that will increase the energy efficiency of new homes constructed in New Jersey. In support of that effort, the Working Group has commissioned a comprehensive study of New Jersey's residential new construction market with the following goals.

- *Baseline Measurement*: The primary objective of the study is to establish a baseline that documents the current market for ENERGY STAR homes.

- *Program Design and Implementation*: The secondary objective of the study is to enhance the Working Group's understanding of the residential new construction market.

- *Customer Sited Clean Generation*: In addition, this study will support the work of the Customer Sited Clean Generation Working Group (CSCG Working Group).

The Working Group contracted with Roper Starch Worldwide Inc. and XENERGY Inc. to conduct the RNC study. The purpose of this study is to obtain information on the current and potential roles of lenders in encouraging the construction of energy efficient homes. In phase one, we collected background information on lending institutions in New Jersey. In phase two, we conducted 15 interviews with lending officers responsible for the development of new mortgage products for the residential new construction market in New Jersey.

B. Background on the Lending Market in New Jersey

We collected background information on New Jersey mortgage lenders, energy efficiency lending products, and secondary mortgage market actors. This information helped us to develop the sample frame and the data collection instruments for the Lender Survey. However, the information we collected may also prove useful to the Working Group.

1. Energy Efficiency Lending Products

Energy Efficiency Mortgages (EEMs) are a residential lending product that allows homebuyers to include the cost of energy efficiency improvements in the purchase value of a new or existing housing unit and to qualify for a mortgage that is 30% of gross income (instead of the market standard of 28%). These products are currently offered by a number of lending institutions within and outside New Jersey. They can be used with any home purchase.

ENERGY STAR is a program sponsored by the U.S. Environmental Protection Agency (EPA). To offer ENERGY STAR loans, a lender must sign a Partnership Agreement with the EPA and complete a Commitment Form. ENERGY STAR lenders must offer homebuyers financial incentives, such as lower application fees, closing costs, or interest rates. ENERGY STAR loans can only be used on ENERGY STAR certified homes.

2. Secondary Market Actors

FHA furnishes a mortgage insurance program that helps to improve lending terms for low and moderate income households. In 1999, FHA loans were about 20% of the New Jersey market. FHA insures EEMs. Conventional mortgages are insured by other commercial organizations. It is not clear if any of these organizations insure EEMs.

Fannie Mae, Freddie Mac, and Ginnie Mae purchase and securitize mortgages and thereby infuse capital into the mortgage industry. All three mortgage purchasers will purchase EEMs and ENERGY STAR mortgages.

3. New Jersey Lending Institutions

Over one hundred institutions are active in the New Jersey mortgage market. However, in 1999 the top five lenders issued 26% of the residential mortgages in the state and the top 75 lenders issued over 80% of the mortgages. The Appendix to this report includes the list of the top 75 lenders.

C. Awareness of Programs

The primary goal of the Lender Survey is to establish a baseline against which market changes resulting from the utilities' residential new construction program can be measured. To meet this goal, the survey collected information on awareness of the ENERGY STAR Homes program and the existing utility residential new construction programs. The awareness and attitude findings include the following.

- *Awareness of Existing Programs*: About half of the lenders have heard of the EPA ENERGY STAR program. About one-fifth of the lenders are aware of each existing utility program and about two thirds of the lenders have heard of at least one program. Those lenders who have not heard of the EPA ENERGY STAR program are unlikely to have any awareness of any of the utility programs.

- *Awareness of Program Requirements and Benefits*: Only a limited number of lenders characterize RNC program homes as energy efficient homes that have lower energy bills. Very few are aware of the existing utility programs' home rating requirements or think of the homes as offering homeowners any benefits, other than lower utility bills.

There is a moderate, but apparently superficial level of awareness of the existing utility residential new construction programs. Lenders do not appear to be very knowledgeable about energy efficiency.

D. Mortgage Product Development

We asked lenders if their institution offered preferential mortgage products and, if so, what the process is through which these products are developed and marketed to homebuyers. Most lenders that we interviewed said that their institutions offer at least one type of preferential mortgage product. The products most commonly mentioned were mortgages for low income families and for affinity groups. Lenders said that they offer these programs either because they are required by law, or as a way to improve their position in the market. Most lenders said that the process by which preferential mortgage products are developed is lengthy and complicated.

E. ENERGY STAR Mortgage Product Potential

In this section, we focused on issues that pertain to the development of an ENERGY STAR mortgage product. Most lending officers reported that the development of an ENERGY STAR mortgage product would follow a similar process as the development of any other mortgage product. Lenders said that they would consider offering an ENERGY STAR mortgage product if they were convinced that the program had financial value to them. Lenders believe that the concept of ENERGY STAR should be first marketed to builders and homebuyers and only later to lending institutions. Lenders respond to changes in demand, so if they see a significant increase in demand for the product, they will consider developing an ENERGY STAR mortgage.

F. Market Acceptance of ENERGY STAR Mortgages

Most lenders are confident that an ENERGY STAR mortgage product will enjoy high levels of acceptability among homebuyers once a number of important barriers are overcome. Lenders believe that there is no reason why homebuyers should have a negative predisposition toward this type of mortgage product. However, homebuyer education on the existence of the ENERGY STAR program, energy efficiency and ultimately on ENERGY STAR mortgages must come before any lender activity.

G. Attitudes of ENERGY STAR Lenders

Four of our interviews were conducted with lenders who are involved with the ENERGY STAR program. Two of the lenders have signed an ENERGY STAR Partnership Agreement. However, one of those lenders was unaware of the Agreement and the other reported that his institution has had inadequate support has not issued any ENERGY STAR mortgages. The other two lenders are in the process of developing ENERGY STAR mortgage packages and appear quite enthusiastic.

H. Recommendations for RNC Programs

The Lender Survey demonstrated that there is some interest on the part of lenders in supporting the RNC programs. However, specific marketing efforts appear to be required to recognize the market potential.

1. Secondary Mortgage Market Actors

Our research demonstrated that the secondary mortgage market is generally supportive of EEMs and ENERGY STAR loans. The Working Group may wish to obtain a formal statement of policies from each of those market actors for use in marketing energy efficiency lending products.

2. EEM and ENERGY STAR Mortgage Marketing

If the new RNC program is to effectively market energy efficiency mortgage products in New Jersey, there needs to be a change in the marketing procedures. First, lenders need to be informed of the support available from secondary market actors. Second, lenders need to be convinced that the RNC program will bring concrete financial benefits to them. Third, there need to be ongoing contacts with participating lenders to ensure that issues are resolved in a timely way. Third, lenders need better linkages to other ENERGY STAR market actors.

3. Community Reinvestment Act Funds

Many of the lenders that we interviewed told us that their preferential mortgage products are developed in response to requirements under the Community Reinvestment Act. Most of these institutions have existing plans for how those funds are to be distributed. However, there may be some opportunity to develop more attractive energy efficiency loan packages through use of CRA funds.

I. Introduction

The purpose of this report is to furnish information on the findings from the Lender Survey for the New Jersey Residential New Construction Awareness and Attitudinal Baseline Study (RNC study). This report furnishes background information on the lending industry in New Jersey, an overview of survey procedures, and an analysis of the findings from the Survey. A separate report presents detailed information on the survey methodology. A summary report consolidates the information from the series of research tasks conducted for the RNC Study.

A. Background

The New Jersey Residential New Construction Working Group (Working Group), which consists of PSE&G, GPU Energy, Conectiv Power Delivery, Elizabethtown Gas Company, South Jersey Gas, Rockland Electric Company, and New Jersey Natural Gas Company, is charged with developing and implementing a coordinated, statewide utility residential new construction program that will increase the energy efficiency of new homes constructed in New Jersey. In support of that effort, the Working Group has commissioned a comprehensive study of New Jersey's residential new construction market with the following goals.

- *Baseline Measurement:* The primary objective of the study is to establish a baseline that documents the current market for ENERGY STAR homes against which market changes can be measured.

- *Program Design and Implementation:* The secondary objective of the study is to enhance the Working Group's understanding of the residential new construction market and to identify the opportunities and barriers associated with market transformation efforts.

- *Customer Sited Clean Generation:* In addition, this study will support the work of the Customer Sited Clean Generation. (CSCG Working Group) in its efforts to understand the market for CSCG technologies.

The Working Group contracted with Roper Starch Worldwide Inc. and XENERGY Inc. to conduct the RNC study. The study consists of 13 research components:

- Nonparticipating Homebuyer Study
- Participating Homebuyer Study
- Nonparticipating Homebuilder Study
- Participating Homebuilder Study
- Lender Study
- Residential Real Estate Appraiser Study
- Residential Real Estate Agent Study
- Building Inspector Study
- Trade Ally Study
- CSCG Analysis
- Residential New Construction Statistics
- Affordable Housing Organizations
- CSCG Industry Statistics

The 13 research tasks were conducted independently, since each required research and interviews with different market actors. However, all of the studies used common language and definitions so that the results are comparable across market sectors.

B. Study Goals and Objectives

The purpose of this study is to obtain information on the current and potential roles of lenders in encouraging the construction of energy efficient homes. The study achieves this goal in three ways.

- *Background Information*: The project team collected background information on lenders who provide mortgage financing in New Jersey, how they are ranked and the types of products they provide. In addition, the project team studied the structure of the primary and secondary mortgage markets, as well as Energy Efficient Mortgages (EEMs) and ENERGY STAR Mortgages.

- *Baseline Attitudes and Awareness*: To measure baseline awareness of and attitudes toward the ENERGY STAR Homes program and the existing utility-sponsored residential new construction programs, the survey asked lenders to discuss their awareness of and experiences with these programs. Lenders were also asked about their views of the market potential of an ENERGY STAR mortgage product, the barriers that such a product may face in the marketplace, and the best ways to promote it to homebuyers and other market actors.

- *Understanding the Mortgage Product Development Process*: The survey developed additional information on the residential new construction market to assist the utilities in their market transformation efforts. The survey asked lenders to furnish insights into mortgage product development procedures, preferential mortgage products, and the most effective ways for utilities to promote energy efficient new homes to homebuyers.

The study also supported the work of the CSCG Working Group. The survey asked lenders questions regarding their awareness of and attitudes toward CSCG technologies.

C. Target Population

Lending institutions play a significant role in the residential new construction market because they provide mortgage financing to builders and individual homebuyers. They can facilitate the development of energy efficient housing by including Energy Efficient Mortgages (EEMs) and ENERGY STAR mortgages in their product line.

In this market sector, a small number of lenders comprise a very large share of the market. The top 25 lenders issued 60% of all mortgages. In addition, the information that we seek from industry informants (i.e., a strategy for getting lenders to offer new mortgage products) requires in-depth discussions with senior lending officers. Therefore, we designed a study that involved a small number of in-depth interviews with lending offices.

D. Study Methodology

The study consisted of 15 telephone interviews with senior new product development officers from the mortgage department of lending institutions that do business in New Jersey. The interviewed lenders comprised about 22% of the New Jersey mortgages in 1999. The *Lender Survey Methodology Report* furnishes detailed information on the survey. The following are the most important aspects of the design and implementation of the survey.

- *Sample Frame*: Respondents were selected based on the volume of residential mortgages that they originated in New Jersey in 1999 and on their share of the New Jersey residential mortgage market. We identified the top 75 lenders in terms of mortgage volume and we divided them two groups; the top 25 lenders were one group and the next 50 lenders were the second group. We complete eight interviews in the first group and seven interviews in the second group.

- *Respondent Contact*: We attempted contacts with all of the lenders for whom we could obtain a contact name and address. Forty-three advance letters were sent to senior new mortgage product development officers describing the purpose of the survey. We then contacted the officers and tried to schedule an appointment for an in-depth interview. We called at the appointed date and time and conducted the interview.

- *Interview*: The interview was administered over the telephone by a Roper Starch Worldwide Research Manager. The interviewer requested permission from the respondent to tape the interview. The taped interviews along with interviewer notes were used to write summary reports for each participating lending officer. The summary reports provided an in-depth understanding of each lender's perceptions and attitudes.

- *Incentive*: Each respondent was sent a $100 check for his/her participation in the interview. We offered respondents the option of having the check written out to them or to a charity of their choice.

II. Background on the Lending Market in New Jersey

In this Section, we furnish background information on the lending market. We discuss Energy Efficiency Mortgages (EEMs) and the ENERGY STAR Mortgage Program, identify the major secondary lending market actors, and furnish statistics on the major lenders in New Jersey. This information provides a context for the findings from the Lender Survey.

A. Lending Programs

Lending programs that support residential energy efficiency take two forms. First, there is a generic class of lending products called Energy Efficient Mortgages. Though the specifics of these products can vary among institutions, these mortgage products offer special treatment for the costs of energy efficiency improvements to new or existing homes. In addition, there is a specific program sponsored by the Environmental Protection Agency (EPA) named the ENERGY STAR Mortgage Program. To offer ENERGY STAR loans, a lender must sign a Partnership Agreement with the EPA and complete a Commitment Form.

Energy Efficient Mortgages usually include two important features: they allow a homebuyer to add the cost of energy efficiency improvements into the mortgage and they allow the homebuyer to have a higher mortgage to income ratio.

- *Home Value*: The lender automatically adds (subject to certain limitations) the cost of efficiency improvements to the value of the home for computation of the assessed value of the home. This is particularly important for existing homes, since it allows the buyer of an existing home to borrow to pay for efficiency improvements as part of the mortgage, rather than through higher interest rate personal or home equity loans.

- *Stretch*: Since the lender knows that the homebuyer will have lower monthly utility bills, the mortgage to income ratio can be raised from 28% to 30%. This allows the homebuyer to get the larger mortgage that might be required to pay for the energy efficiency improvements.

These features can be used for either new or existing homes. There is no requirement that the home be an ENERGY STAR home to use an EEM.

ENERGY STAR Mortgages are offered only by ENERGY STAR lenders for the purchase of ENERGY STAR homes. In order to be able to use the ENERGY STAR label, the lender must offer buyers of ENERGY STAR homes some financial incentive. The lender designs the specific financial incentive. Examples of some incentives currently offered are a $200 reduction in the application fee, $500 off closing costs, and a _% interest rate discount.

According to the EPA web site, 32 lending institutions offer ENERGY STAR mortgages. We attempted to make direct contacts with these 32 institutions, and were only able to find the ENERGY STAR loan officer for 12 lenders. Some lenders were no longer offering the program, while others could not be reached from the information on the EPA web site. According to the web site, only two ENERGY STAR lenders issue ENERGY STAR mortgages in New Jersey. Active marketing of the existing programs has led to interest by a number of other New Jersey lenders.

B. Secondary Lending Market Actors

Two types of secondary market actors affect the types of mortgage products offered by banks. FHA furnishes a mortgage insurance program that helps to improve lending terms for low and moderate income households. Fannie Mae and Freddie Mac purchase mortgages, package them into securities, and sell the securities on the global capital markets.

FHA supports the development of EEM products by having a mortgage insurance program that explicitly sets guidelines for an EEM. In New Jersey, FHA loans are about 20% of the loan market and are used mainly by low and moderate income households. Higher income households may obtain mortgage insurance from other sources. It is not clear that those mortgage insurers offer EEMs as a lending option.

Fannie Mae and Freddie Mac support the development of EEM products. Fannie Mae and Freddie Mac will buy EEMs from lending institutions. Therefore, any lender who wishes to develop an EEM product will find that they can sell those mortgages.

C. New Jersey Lending Institutions

Over one hundred lending institutions are active in the New Jersey mortgage market. However, in 1999, the top five lenders issued 26% of the residential mortgages in the state. The top 25 lenders issued about 60% of the residential mortgages. According to data provided by CBMI, the total amount of residential mortgages issued by the top 75 lenders in New Jersey was $17.2 billion. The average value of mortgages was about $177,000.

Table 1.1: Top Ten Residential Mortgage Lenders in New Jersey

Lender Name	E-Star	1999 Mortgages	Market Share
Norwest Mortgage Inc Des Moines IA	Yes	9,422	7.69%
Cendant Mortgage Mt. Laurel, NJ	No	9,499	7.03%
Hudson City Savings Bank Paramus, NJ	Yes	3,654	3.94%
Countrywide Home Loans Calabasas, CA	Yes	5,783	3.69%
National City Mortgage Miamisburg, OH	No	5,762	3.66%
Mortgage Access Corp Morris Plains, NJ	No	4,439	3.11%
Summit Bank Bordentown, NJ	No	3,388	2.96%
Chase Manhattan Mortgage Edison, NJ	Yes	3,447	2.7%
Bank of America Dallas, TX	No	3,462	2.68%
First Union Mortgage Corp Charlotte, NC	No	3,843	2.55%

Table 1.1 provides detailed information on the top ten residential mortgage lenders in New Jersey in 1999. The addresses listed in the table represent the address from which information is reported to CBMI. It is useful to note that only half of the top ten lenders report New Jersey statistics from a New Jersey office. Moreover, most of the lenders on this list do business in other states.

III. Baseline Awareness of Programs

The primary goal of the Lender Survey is to establish a baseline against which market changes resulting from the utilities' residential new construction programs can be measured. To meet this goal, the survey collected information on awareness of and attitudes toward the ENERGY STAR Homes program and the existing utility residential new construction programs. In this section, we identify the key awareness indicators, and furnish baseline statistics on their current levels.

Three New Jersey electric utilities have had residential new construction programs; GPU Energy's Good Cents program, Conectiv Power Delivery's ENERGY STAR Homes program, and PSE&G's EEH Five Star Program. Each program had different goals, objectives, and procedures. As a result of restructuring legislation, all of New Jersey's electric and gas utilities are participating in a coordinated, statewide residential new construction program. The new program will have a common set of goals, objectives, and procedures. In the baseline survey, we look at awareness of the existing utility programs. In any follow-up research, one would study the change in awareness and attitudes resulting from the implementation of the statewide program.

In the survey, we assessed awareness separately for each of the three existing utility programs and for the national ENERGY STAR Homes program. We assessed awareness at three levels.

- *Awareness of Program*: the lenders' awareness of the named program.
- *Awareness of Program Requirements*: knowledge of how a home qualifies for the named program.
- *Awareness of Program Benefits*: the knowledge of benefits that the named program delivers to homeowners.

These indicators give us a cursory understanding of lenders' awareness of the programs and their depth of knowledge about these programs.

A. Awareness of Programs

The baseline awareness indicators show that many lenders have heard of the ENERGY STAR program but fewer are aware of the existing utility residential new construction energy efficiency programs. Very few lenders have a good understanding of the existing programs' requirements or the benefits that they offer to homebuyers.

Table 2.1 summarizes lender awareness of the national ENERGY STAR program and of the three existing utility residential new construction programs. About half of the lenders reported being aware of the ENERGY STAR program. Each of the existing utility programs was known to about one-fifth of lenders. Lenders who had never heard of the ENERGY STAR program were not aware of the utility sponsored programs either.

Table 2.1: Program Awareness

	Program Sponsor				
Response	**Conectiv**	**GPU**	**PSE&G**	**EPA**	**Any Program**
Aware	3	4	3	8	8
Not aware	12	11	12	7	7

B. Awareness of Program Requirements

Although name recognition of the ENERGY STAR label was high among lenders, very few of them seemed to have anything more than a superficial awareness of the requirements of the ENERGY STAR program and even fewer reported awareness of the existing utility sponsored program requirements.

Very few respondents indicated that an ENERGY STAR home is certified as energy efficient by a utility or a third party. Among the few who did, one lending officer offered the following explanation.

> *To qualify for the program, [a home must come with] a document prepared by the builder demonstrating the efficiency of the home. [The document] includes information regarding walls, ceilings, storm windows, heating*

Another respondent who rated himself as very knowledgeable about ENERGY STAR had a similar description.

You have a home that is certified to be more energy efficient than a typical home

C. Awareness of Program Benefits

A number of lenders were aware that an important benefit of an energy efficient home is lower utility bills. Some lenders also said that an ENERGY STAR home conserves energy or is energy efficient. One participant stated:

[an ENERGY STAR home] is cheaper to operate than a home without the ENERGY STAR label

Some also noted that a homebuyer who can demonstrate that his/her utility bills are lower may get the benefit of a larger mortgage, or a “stretch”. Only one lending officer mentioned any of the non-financial benefits of an energy efficient home such as higher level of comfort, and environmental benefits. No lending officer mentioned indoor air quality or improved workmanship as other possible benefits of an ENERGY STAR home.

D. Program Awareness Among ENERGY STAR Lenders

Four of the fifteen lending institutions in our sample are involved with ENERGY STAR. Two lenders are listed as partners on the EPA web site and currently offer ENERGY STAR mortgages[1]. However, the officer at one of these lending institutions was surprised to find out that his institution was a partner to the program. He said that his awareness of the program is limited and he seemed to have minimal understanding of the program requirements. We later found out that the ENERGY STAR loan program at that institution was limited to a single loan officer who took financial responsibility for the ENERGY STAR incentive. The officer at the other listed lending institution said that his bank had not made any ENERGY STAR loans.

Two other lenders were in the process of designing ENERGY STAR loan programs and seemed very enthusiastic about the concept of

[1] A fifth lender mentioned that he offers energy efficient mortgages as required by FHA guidelines. However, the officer stated that these mortgages are not currently offered in New Jersey.

energy efficiency and of the benefits it can provide to homebuyers. In rating PSE&G's EEH 5 Star program, one of these lenders offered the following opinion.

5 Star is a good concept [and] it has a number of advantages. The homeowner gets the advantage of an efficient design and economic advantages- monthly utility bills are reduced. The advantage to developers is an economic advantage. They get some rebate from the utility

The other officer from an institution that was developing an ENERGY STAR loan program mentioned that he was so impressed with the program that he would consider buying an ENERGY STAR house himself.

E. Sources of Information About the Programs

Lenders received information about ENERGY STAR from a variety of sources. A number of lending officers said that they found out about the existing utility programs from utility marketing materials, or presentations, or even utility bills. Two officers mentioned Macgrann Associates as their source of information on energy efficiency programs, while another two said that they found out about the programs through their work with Fannie Mae or HUD.

Other sources of information that lenders mentioned include TV and print advertisement, convention presentations, and work with out-of-state builders who build energy efficient homes.

In summary, most lenders are aware of the ENERGY STAR name, but few have any in-depth knowledge of what the name means or of the benefits associated with it. Few lenders are aware of the existing utility sponsored programs. Furthermore, very few lenders know that a participating home has to be rated or certified. The main source of information for lenders are utility companies, Macgrann Associates, and Fannie Mae or HUD programs that promote the concept.

IV. Mortgage Product Development

We asked lenders to describe the process through which a new mortgage product is developed. We also asked if their institution offers preferential mortgage products, defined as loans with special terms offered only to specific groups. The purpose of these questions was to understand how new mortgage products are developed and thus identify the individuals and departments that utilities would need to approach with the concept of an ENERGY STAR mortgage.

A. Preferential Mortgage Products

All but one of the fifteen lenders than we interviewed, offer at least one preferential mortgage product. Most lenders indicated that they offer mortgages with special terms to low income families as part of their Community Reinvestment Act obligations[2]. About a third of the lenders said that they have programs for first-time homebuyers, and about one-fifth indicated that they have special mortgages for affinity groups, such as employees of companies that do business with the lending institution, trade unions, professional organizations, etc. Two lenders mentioned that they have "good credit" programs which reward mortgage applicants who have good credit with either a higher debt to income ratio, or with lower application fees. Three institutions offer an ENERGY STAR mortgage that offers a higher debt to income ratio. About one third of lenders also mentioned other smaller programs that offer lower application fees, stretch mortgages or other small incentives.

When asked about the reasons why their institution offers preferential mortgages, lending officers offered three types of justifications: 1) regulatory requirements; 2) competition; 3) social concerns. For example, most lenders said that they offer mortgages to low income

[2] The Community Reinvestment Act is intended to encourage banking institutions to help meet the credit needs of the communities in which they operate, including low- and moderate-income neighborhoods, consistent with safe and sound banking operations. It was enacted by the Congress in 1977 (12 U.S.C. 2901) and is implemented by Regulations 12 CFR parts 25, 228, 345, and 563e. The Regulation was revised in May 1995 The CRA requires that each insured depository institution's record in helping meet the credit needs of its entire community be evaluated periodically. That record is taken into account in considering an institution's application for deposit facilities, including merges and acquisitions.

families to fulfill federal requirements but also "to meet community needs" and "to be good citizens". A number of officers indicated that they use these products to build relationships with current clients and to increase their share of the market. One lender explained how the company views itself.

We like to see ourselves as the high volume dealer with very low mark ups. . . [We] seek to lure competitors' customers by bringing something special to our product line. We want to cater to all consumers of mortgage products"

Another lending officer offered a slightly different view.

[We offer preferential mortgage products] because we are filling a void in the marketplace

B. Mortgage Product Development Process

Many lenders reported that the process of new mortgage product development is lengthy and includes several steps. Some lenders mentioned that they may be approached by Fannie Mae or Freddie Mac with a new concept for a product. According to one officer who provided us with a very detailed account of the procedures followed by her institution, the process is long and complicated.

[The process begins with] a competitive assessment. We view what our competitors are offering, analyze our clients' needs, and, if a market opportunity exists, we put together a business case. . . Once the business case is put together, it is submitted to senior management for review. Financial impact studies are conducted, including cost/benefit analysis and gain on sale/profitability analysis. Another consideration when developing a new mortgage product is how the new product will affect products [already in the market]. The final stage of new product development is a corporate review, including a legal analysis conducted by counsel in all fifty states

Another officer mentioned that, once the product is ready to go on the market, the company trains its lending officers on the specifics of the program. Then program success is monitored and evaluations and adjustments are made. Yet another lender said that his institution was particularly concerned about regulatory oversight since a new mortgage product has to be reviewed by federal auditors, secondary market auditors and internal auditors.

The one lender that does not offer preferential mortgage products discussed the product development of general mortgages. According to this lending officer, since his institution sells 100% of their loans to investors, the focus is on developing a product in line with the guidelines set by the investors who buy the loans.

We have to research what our investors' guidelines are as far as loan to value, types of borrower, etc. We have to work within the guidelines. . . to make sure that the loan . . . is sellable

In summary, most lenders offer at least one preferential mortgage product. Lending institutions offer these products either because it is a regulatory requirement or because they are looking to increase their share of the market by catering to the needs of specific groups. Lenders report that the process of new product development is lengthy and cumbersome, involving several steps.

V. ENERGY STAR Mortgage Product Potential

This section addresses issues that deal with the development of an ENERGY STAR mortgage product. First, we asked lenders to describe the process through which an ENERGY STAR mortgage product would be developed. Then we asked lending officers to discuss the reasons why a lender may choose to develop an ENERGY STAR mortgage product and the ways that lenders would use to market an ENERGY STAR mortgage.

A. *ENERGY STAR Mortgage Product Development*

We asked lending officers to discuss the process through which their institution would develop an ENERGY STAR mortgage product. The purpose of this question was to assess whether lenders believe that such a product would need a special product development process, or whether it would follow the regular development process that lending institutions use for all of their products.

A number of lending officers mentioned that no special product development process would be necessary for the establishment of an ENERGY STAR mortgage product. An ENERGY STAR mortgage product would need to go through the regular product development channels, which include a planning stage, an evaluation stage and an implementation stage.

One lending officer strongly stated that large lending institutions would show interest in such a mortgage product only if they would be able to offer it in several markets. The officer suggested that New Jersey utilities contact utilities in other states and work with them to develop similar programs.

Another lending officer suggested that the first step to developing an ENERGY STAR mortgage product would be to get a major federal organization such as Fannie Mae involved so as to secure the success of this product in the secondary or investment markets. This view was echoed by another respondent.

> *Within my institution, I wouldn't develop this product from scratch. I wouldn't even be involved if I couldn't sell them in a secondary market*

We also asked lending officers to discuss the special features or terms that an ENERGY STAR mortgage product may offer to homebuyers. Most lenders said that homebuyers would be lured by lower interest rates and lower closing costs. However, most lending institutions would be unlikely to consider a discount rate because it would cut into their profits. Only if utilities can subsidize the rate reduction, would lenders consider offering a lower rate for ENERGY STAR homes.

A number of lenders suggested that they could offer a higher debt to income ratio as a special feature of an ENERGY STAR mortgage. However, one lender argued that a stretch may not be seen as a very attractive offer since many institutions already offer debt to income ratios that can reach 50% of a person's gross income.

B. Reasons to Offer ENERGY STAR Mortgages

Lenders were asked to identify reasons why an ENERGY STAR mortgage product would be an attractive concept to lending institutions and to homebuyers.

The vast majority of lending officers focused on "dollars and cents" reasons, arguing that lenders would agree to market such a mortgage product if they are convinced that ENERGY STAR mortgages would bring in more business for them, or allow them to tap into a new part of the market.

I would offer reduced fees [for ENERGY STAR mortgages] to get my foot in the door. . . [It] could open an opportunity to do more business with the buyers

Some lending officers argued that offering an ENERGY STAR mortgage product could have potential public relations value for the lender and help them in their relationship with their local communities.

It's a good community awareness thing to do, PR-wise

A small number of lending officers also mentioned that offering an ENERGY STAR mortgage would be good for environmental reasons.

Environmentally, it would help reduce out reliance on foreign energy sources

However, it is not clear if this line of argument is meant to be used as a marketing message to homebuyers, or if it can also be used internally, to convince the higher echelons of the institutions about the viability and desirability of an ENERGY STAR mortgage product.

C. Marketing of ENERGY STAR Mortgages

There is significant agreement among lending officers that an ENERGY STAR mortgage concept should first be marketed to builders, real estate agents and homebuyers, not lenders. Lenders will be convinced to offer this product only if they see significant demand for it in the market.

The utility has to go to the builder, then the builder to the lender. It has to be driven that way, not by PSE&G coming to us like it happened a few years ago. They tried to market to us, but they couldn't say they had a builder working on "x" number of homes

Other lending officers suggested that federal organizations such as Fannie Mae and Freddie Mac should get involved. The top 25 lending institutions that control 50% of the market could be approached by Fannie Mae or Freddie Mac with the ENERGY STAR mortgage concept. According to at least one lender, it would be easier to sell the concept, if some of the big players are involved.

In discussing messages that could be used to promote ENERGY STAR mortgages to different market actors, most lenders focused on "dollars and cents" ideas. A number of lending officers suggested that an ENERGY STAR marketing campaign targeting lenders should focus on building relationships and increasing market share. Another concern was the level of security that these loans may involve and some lenders mentioned that a successful message should state that these loans are secured and thus create no risks for the lender.

This is an opportunity to make more loans and more profitable loans to an untapped market. . . [Focus on] that these are fully secured loans. . . These loans may be more profitable to the extent that the energy efficiency improvements will enhance the value of the property and make it more likely that the loan will be repaid

When marketing to homebuyers, most lenders said that utilities should focus on consumer energy savings, or affordability.

In summary, most lending officers reported that the development of an ENERGY STAR mortgage product would follow a similar process as the development of any other mortgage product. Lenders said that they would consider offering an ENERGY STAR mortgage if they were convinced that the program had financial value to them. The "dollars and cents" reasons that many lending officers mentioned include increased market share, or access to a new and untapped market. Lenders believe that the concept of ENERGY STAR should be first marketed to builders and homebuyers and only later to lending institutions. Lenders respond to changes in demand, so if they see a significant increase in demand for the product, they will consider developing an ENERGY STAR mortgage. The participation of major federal organizations such as Fannie Mae or Freddie Mac in the program could also help convince lenders to develop an ENERGY STAR product.

VI. Market Acceptance of ENERGY STAR Mortgages

In this section we focused on the market acceptability of ENERGY STAR mortgages and what lenders consider to be the barriers that the development of an ENERGY STAR mortgage product may face. We also asked lending officers to discuss their views on the potential incentives that utilities should offer to encourage the success of an ENERGY STAR mortgage program.

Most lenders are confident that an ENERGY STAR mortgage product will enjoy high levels of acceptability among homebuyers once a number of important barriers are overcome. Lenders believe that there is no reason why homebuyers should have a negative predisposition toward this type of mortgage product. However, homebuyer education on the existence of the ENERGY STAR program, energy efficiency and ultimately on ENERGY STAR mortgages must come before any lender activity. Lending officers believe that a series of demand-side issues must first be resolved, before lending institutions jump on the ENERGY STAR wagon.

A. Barriers to ENERGY STAR Mortgages

Lenders identified several types of barriers to the success of an ENERGY STAR mortgage product. Demand side barriers include low levels of awareness among different market actors, lack of training and lack of education. On the supply side, lenders argued that the success of an ENERGY STAR mortgage may be impeded by the low levels of energy efficient new construction in New Jersey, the high cost of energy efficiency improvements, and the possibility of paperwork delays and fraud. Lenders also said that their offering an ENERGY STAR mortgage would depend on the types of terms that utilities sought for this product.

Some lenders did not think that there is a strong basis for preferential treatment in designing energy efficiency mortgages. Lenders may be willing to offer lower application fees, or higher debt to income ratios, but it will be hard to convince them to offer lower interest rates or fewer points.

> *The case might be made that by having lower utility bills, a homebuyer will have more disposable income but that won't help much in terms of interest or points*

Another lending officer expressed a similar view.

> *Have to define what we're looking for- a lower rate or higher qualifying ratio; lower rates would be more difficult but getting more people to qualify wouldn't be as difficult*

A number of lenders wondered whether the level of energy efficient new construction in New Jersey was high enough to make the development of an ENERGY STAR mortgage product worthwhile. One lending official said that her institution would be interested only if the product could be offered in several markets across the United States. Another stated his concern in the following way.

> *[A barrier to implementing an ENERGY STAR mortgage product would be] having homes available. No one has called me to say they have these homes available. . . Someone has to say how many energy efficient homes they've built to indicate that we've missed out on those loans because there's no program offered by us*

Yet another lending officer argued that lending institutions make decisions about credit using an automated model that currently does not incorporate energy efficiency. Thus energy efficiency is not a factor in the lender's decision to extend credit to an individual. This lending officer felt that if energy efficiency needs to be added as a factor, the process will become more complicated.

> *A lot of lenders would view this as a step backward in processing the loan, a complication*

B. Utility Incentives for ENERGY STAR Mortgages

Most lenders agree that incentives offered by utility companies would make ENERGY STAR mortgages more attractive to both lending institutions and to homebuyers. Lenders offered a number of different suggestions regarding the types of incentives that utility companies could offer to lending institutions. Some lenders said that if ENERGY STAR mortgages offer homebuyers a lower interest rate, then utilities should be responsible for making up the difference between the lender's regular rate and the discounted rate. This way, the mortgages will become more competitive and both homebuyers' and lenders' interest will increase. Similar suggestions were made regarding lower closing costs and other mortgage-related expenses that homebuyers incur.

If the mortgage reduces costs, the utility could pick up a piece of that. . . Could give grants to buyers or pick up a piece of the closing costs. Doing that in combination with the lender reducing fees or rate makes a good deal for buyers

Another lender mentioned that utilities could provide their own financing directed specifically to energy efficiency improvements.

In addition to bank loans, they could offer a portion of financing or a special financing for home energy improvements working in tandem with the bank. Maybe 80% of the financing would come from the bank and 20% from the utility company

Joint marketing incentives were also among the suggestions that lenders made. Lenders seemed to think that a joint marketing campaign with utilities could lead to more customers and thus a larger market share for their lending institution. An official from one of the ENERGY STAR lenders recommended that utility companies develop ENERGY STAR marketing materials that mention the participating lending institution as a partner.

If they could, in their marketing, mention our bank. Or, if I got in my statement from PSE&G a notice saying that they have partnered with "x" bank to help you finance your home. They need to help us get more customers

A similar approach was offered by another ENERGY STAR lender who emphasized that his institution does not expect financial incentives so much, as it hopes for greater accessibility to customers, and particularly builders. This officer also mentioned that even though his institution is an ENERGY STAR participant, he never received any marketing materials from the ENERGY STAR program and he does not have the necessary information to respond to inquiries from homebuyers or builders.

A different suggestion was made by one lender who thought that an appropriate incentive to lenders who offer ENERGY STAR mortgages may be a discount on lender utility bills. This lending officer suggested that utilities could offer monetary savings on the lender's utility bills to lenders who offer ENERGY STAR mortgages.

In a limited number of cases, the question about incentives that utility companies could offer, seemed to confuse some lending officers who misunderstood the purpose of the question. Some lending officers seemed to interpret the word "incentives" as something akin to special perks or some form of bribery. One official said that rewards to bank employees for promoting one mortgage product over another are inappropriate. This view was echoed by another lending officer.

We would not accept anything from a utility because it would look like impropriety

VII. ENERGY STAR Lenders' Attitudes

We interviewed four lenders who are ENERGY STAR partners and offer ENERGY STAR mortgages to New Jersey homebuyers. However, only three of the four lending officers were aware of their institution's affiliation with ENERGY STAR and could discuss their experience with the program.

ENERGY STAR lenders reported that the development of an ENERGY STAR mortgage product is not much more complicated than the development of any other preferential mortgage product. Two lenders said that they were initially approached by the utility companies regarding the ENERGY STAR mortgage concept. Both lenders are in the final stages of developing an ENERGY STAR mortgage.

In discussing the reasons why his institution decided to offer this product, one lending officer mentioned that the utility company informed him about the program and about the competitive advantage that his institution would get by offering an ENERGY STAR mortgage.

> *[They told me] there are some lenders out there offering preferential mortgage products [for energy efficient construction]. Since [name of institution] is a state-wide lender, it can handle all geographies of the state, yet still be able to provide certain benefits for ENERGY STAR mortgages*

The second ENERGY STAR lender was more focused on the benefits to the homebuyer and he reported that the reason why lenders should offer preferential mortgages for energy efficient homes is that these product is beneficial to the homeowner.

> *It gives us an opportunity to offer a product with an economic advantage to the buyer*

This lender focused more on the need to market the product to homebuyers. His view was that those homebuyers who are the target population for ENERGY STAR mortgages must be informed and educated about the benefits of the program.

> *You need to prepare people. It's not just educating the developers, but also the consumer. . . What got my attention in*

> *looking at 5 Star was clearly understanding that the benefit falls into the homeowner's pocket. If a lending institution understands the importance of doing that, it improves the marketability*

The other ENERGY STAR lender also agreed on the importance of advertising to homebuyers and suggested the message focuses on the energy cost savings that an energy efficient home offers to the homebuyer.

When discussing barriers to offering ENERGY STAR mortgages, one lender focused on the lack of information and thus the lack of an adequate understanding that exists among lenders.

> *Not having an accurate understanding of the program [is a barrier]. I did not look at the stuff for years because my perception was that it cost me money and I didn't see an economic gain. . . Not understanding the advantages is a barrier.*

This lender argued that ENERGY STAR may face similar barriers not only among lenders, but also among consumers and builders who may shun the program out of fear of accruing additional costs.

The one lender whose institution has already implemented the ENERGY STAR program, reported that he was contacted by the EPA and Macgrann Associates. This lending officer reported that he was very interested in the initial concept as it was outlined to him by Macgrann Associates. Macgrann Associates informed him about the activities of other lending institutions in this field and pitched the ENERGY STAR mortgage program as a way to improve his institution's competitive advantage relative to other lenders.

This officer felt that the message and its delivery were both very effective. He decided that ENERGY STAR could work a vehicle for his institution to access more effectively the new construction market. However, he was not satisfied with the program implementation process and felt that the EPA and Macgrann Associates were slow in providing him and his institution with information and assistance. His institution never received any marketing materials from either the EPA, or PSE&G.

This lending officer had expected that the program sponsors would provide him with a list of ENERGY STAR builders in New Jersey so that he could contact the builders directly and market his institution's ENERGY STAR mortgage program to them. The officer also mentioned that in the past two years, there has been very little interest in this program from borrowers. Thus, he felt that taking the program directly to builders would help make it more successful.

This officer also reported that he took his request for a comprehensive list of construction companies that build energy efficient housing in New Jersey, to PSE&G. The utility officials gave him a link to a website and a password to access it, but the password never worked.

As far as utility incentives are concerned, this officer stated that his institution was never offered any incentives to encourage them to offer ENERGY STAR. The officer reported that incentives would be useful as a means to promote the program, but insisted that the most useful incentive would be access to customers, especially builders.

VIII. Recommendations to RNC Working Group

The lender survey demonstrated that there is some awareness, but limited understanding of the ENERGY STAR program among lenders. In addition, it showed that the lenders have very little awareness of the existing utility RNC programs. However, many lenders appear to feel that there is market potential for both ENERGY STAR loans and EEMs. Since there is significant support for these loans in the secondary mortgage market and there are funds available through the Community Reinvestment Act, it may be appropriate for the Working Group to recommend some additional activity with lenders.

A. Secondary Mortgage Market Actors

Our research demonstrated that the secondary mortgage market is generally supportive of EEMs and ENERGY STAR loans. The mortgage market purchasers, Fannie Mae and Freddie Mac will purchase EEMs. In addition, since most ENERGY STAR loans are essentially the same as conventional loans (the incentive is usually associated with the application fee or closing costs), there are no secondary mortgage market barriers to these loans either.

FHA, the federal mortgage insurer, also supports EEMs and ENERGY STAR loans. It is not clear whether commercial mortgage insurers are willing to support these products. The Working Group may need to work with commercial insurers in New Jersey to help support this part of the market.

B. EEM and ENERGY STAR Mortgage Marketing

In order to support financing for energy efficiency in the residential sector, the Working Group should consider marketing EEMs and ENERGY STAR loans in New Jersey. However, the responses from lender suggest that marketing efforts need to be reorganized and refocused in order to be successful. Specific recommendations from lenders include:

- *Secondary Mortgage Market*: Lenders are very concerned about their ability to sell their mortgages in the secondary market and to insure their mortgages. Any attempt to market these products to lenders should include a clear statement of the secondary market implications.

- *Contacts with Lenders*: Contacts with lenders need to be much more systematic and consistent. There is considerable turnover and movement in the lending industry. In order to ensure that a product is developed and used, there needs to be regular contact to ensure that lenders have all the information that they need about a program and to ensure that new loan officers are given information about these lending products.

- *Support for Lenders*: One of the lenders expressed dissatisfaction with the support received under the ENERGY STAR program. Others expressed that they would need ongoing support to make this loan product attractive. It appears that lenders are not getting this support from the federal ENERGY STAR program. To be successful, an ongoing support mechanism would be needed, particularly with marketing materials and establishing linkages with ENERGY STAR builders.

- *Incentives*: A number of lenders suggested that incentives supplied by the utilities would be the most effective marketing device.

The lenders appear to think that the loan products could be attractive to both lenders and homebuyers. However, they would expect significantly more support from utilities through the RNC programs.

C. Community Reinvestment Act Funds

Many of the lenders that we interviewed told us that their preferential mortgage products are developed in response to requirements under the Community Reinvestment Act. Most of these institutions have existing plans for how those funds are to be distributed. However, there may be some opportunity to develop more attractive energy efficiency loan packages through use of CRA funds.