



August 24, 2015

Guidance for Use of FHA Financing on Homes with Existing PACE Liens and Flexible Underwriting through Energy Department's Home Energy Score

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Today, FHA announced anticipated guidelines for two new initiatives that will support borrowers seeking to make energy efficient improvements to their homes, including guidance that will allow borrowers to use Single Family FHA financing for properties with existing Property Assessed Clean Energy (PACE) loans that meet certain conditions. FHA also announced its new partnership with the Department of Energy (DOE) helping borrowers using Single Family FHA's Energy Efficient Home (EEH) program to take advantage of energy cost savings when measured by DOE's Home Energy Score.

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PACE Guidance

PACE programs have the potential to increase the accessibility and affordability of energy saving measures, consequently lowering energy bills to residents and reducing the environmental footprints of participating localities.

Single Family FHA supports responsibly expanding access to clean energy financing options for creditworthy borrowers. Single Family FHA PACE guidance has the potential to allow homeowners to benefit from energy cost savings while preserving the marketability of properties with PACE loans.

In 2009 and 2010, many states adopted legislation allowing local governments to fund home energy improvements that are repaid by assessments levied under their tax authority. While there are many versions, PACE programs generally allow homeowners to finance energy efficiency improvements for up to 20 years through tax assessments attached to the property. PACE allows homeowners to benefit from the improvements immediately and spread the cost over time.

When the property is sold, the PACE loan may transfer to the next owner who is responsible for repaying the loan. The ability to transfer the loan to the new owner allows for both the payment and the value of the retrofit to be transferred from one owner to the next.

Since in the event of default, the PACE loan as a tax assessment may have super lien status and/or take precedence over the first lien mortgage, some lenders have raised concerns. FHA is developing Single Family PACE guidance to overcome impediments in the purchase and sale of properties to which PACE loans are attached due to these concerns.

The Single Family FHA guidance will address the impact of PACE assessments on purchases, refinances and loan modification options available to borrowers experiencing distress and will require the subordination of PACE financing to the first lien FHA mortgage. The guidance will address the eligible methods of subordination of existing PACE liens.

Taking into account the variety of types of residential PACE programs, FHA is developing PACE guidance, which is also being informed by ongoing conversations with the Federal Housing Finance Agency (FHFA), that at a minimum will include the following:

- **Lien Position:** Only PACE liens that preserve payment priority for first lien mortgages through subordination;
- **PACE payment, structure, and term:** PACE financing must be a fixed-rate, fully amortizing loan;

- **Eligible Properties:** PACE assessments must be attached to single family properties, as defined by FHA, which are 1- to 4-unit dwellings, including detached, semi-detached and townhome properties;
- **Equity Requirement:** PACE liens that preserve payment priority for first lien mortgages will be eligible for financing that does not exceed FHA’s maximum combined loan-to-value (CLTV) ratio;
- **Record Keeping:** PACE liens must be formally recorded and be identifiable to a mortgage lender through a title search;
- **Additional Consumer Protections:** PACE programs must comply with applicable federal and state consumer laws and should include disclosures to and training for homeowners participating in the program.

PACE programs operate at the local level and vary widely. DOE PACE “Program Design Best Practice Guidelines” recommend key program requirements for acceptable PACE programs including the following:

- PACE programs should require notification of mortgage holders of record when a PACE assessment has been placed on the property;
- PACE programs should finance PACE projects that are cost-effective and reduce the net energy requirements as measured by approved DOE methods.

In finalizing guidance, FHA will work with the Consumer Financial Protection Bureau, DOE, Treasury and other industry stakeholders to advocate for strong consumer protections.

New Standards for FHA Single Family Energy Efficient Home – Incorporating DOE’s Home Energy Score

FHA has partnered with DOE on an initiative that allows consumers to qualify for a higher loan amount due to cost savings associated with energy efficient improvements. Under the new FHA and DOE partnership, FHA will provide flexible underwriting to recognize the reduced costs of utilities when those costs are established with the Department of Energy’s (DOE) Home Energy Score in areas where the Home Energy Score is available.

DOE’s new Home Energy Score is a low cost, reliable method for estimating the energy use of a home. The score is the equivalent of an easily-understood “miles per gallon” label for homes. The score measures the energy efficiency of homes on a scale of 1–10. Homebuyers or homeowners who want to obtain an FHA-insured purchase or refinance mortgage for a single family home that receives a Home Energy Score of 6 or higher will be eligible to increase their income qualifying ratio by 2 percentage points above the standard Single Family FHA limit. This means that FHA borrowers will be able to borrow slightly more when they buy or refinance a more energy-efficient home through FHA’s EEH program.

Through this partnership, FHA is supporting efforts to provide potential homeowners with an easy way to measure the energy efficiency of their homes and to identify the combination of investments that will help make their homes more energy efficient.

A Single Family FHA Mortgagee Letter with specific program requirements/details and an update to the Single Family Housing Handbook 4000.1 to address the guidance for both of these initiatives will be forthcoming in the next several months.