Announcement SEL-2010-15 December 1, 2010

New Energy Improvement Feature and Other Related Updates

Fannie Mae supports energy efficiency in residential housing, and encourages the development of viable financing and securitization opportunities that do not place undue risk on lenders, investors, or homeowners. Fannie Mae's commitment to serving this sector of the housing finance market has continued since the 1970s when energy-related mortgage flexibilities were first offered on a negotiated basis.

In an effort to provide assistance to more borrowers seeking financing for energy improvements, Fannie Mae has re-evaluated its energy improvement guidelines in light of current market conditions. As a result, the *Selling Guide* is being updated to incorporate a new energy improvement feature as a standard offering available to all lenders. The energy improvement feature provides an option to fund energy-efficient home upgrades while aligning with the principles of borrower sustainability. Other updates related to home energy improvements are also covered in this *Selling Guide* update, including revisions to the HomeStyle® Renovation mortgage product and clarification of postponed improvement requirements for new or proposed construction.

The energy improvement feature has been added to the *Selling Guide* within the "Construction and Energy Financing" Chapter. (This Chapter was previously titled "Construction-Related Products"). The new feature and the other updates are described below. The affected topics (and specific paragraphs) are noted and are linked to the updated *Selling Guide* posted on eFannieMae.com. Lenders should review each topic within the *Selling Guide* to gain a full understanding of the changes. The topics are dated December 1, 2010.

Energy Improvement Feature on Existing Properties

The key requirements for mortgage loans with the energy improvement feature are summarized in this Announcement. In general, Fannie Mae is allowing loan proceeds to be used to finance energy improvements under certain conditions. Fannie Mae is also providing lenders with a loan-level pricing adjustment (LLPA) credit of $250 (to be passed on to the borrower) for loans with the energy improvement feature. The $250 credit is intended to provide a borrower incentive that will help to offset the costs associated with the required energy audit report. Lenders must refer to B5-3.3-01, Mortgage Loans with Energy Improvement Features on Existing Properties, and B4-1.2-04, Requirements for Postponed Improvements, for complete details.

Eligible transactions: All transactions and products are permitted with the exception of cash-out refinances, Refi Plus™, and DU® Refi Plus™. Loans with energy improvements are subject to the applicable LTV, CLTV, and HCLTV ratios found in the Eligibility Matrix.

- Purchases: The proceeds can be used to finance the acquisition of the property and the energy improvements. The LTV ratio is determined by dividing the loan amount (including the cost of the energy improvements) by the lesser of the "as completed" appraised value of the property or the sum of the purchase price of the property and the cost of the energy improvements.

- Limited cash-out refinances: The loan must meet all of the standard requirements for limited cash-out refinances except for the following:
  - The borrower can finance energy improvements in the loan amount.
  - The borrower may only receive $250 cash back to accommodate rounding of the loan amount at closing. (The 2%/$2,000 cash back policy is not applicable.) When the lender passes on the $250 LLPA credit from Fannie Mae to the borrower as is expected, the maximum cash back is $500.
  - The LTV ratio is determined by dividing the loan amount (including the cost of the energy improvements) by the "as completed" appraised value of the property.

Eligible properties and occupancy types: All one-unit existing properties are eligible for the energy improvement feature with the exception of manufactured homes and units in a co-op project. All occupancy types are permitted.

Energy improvements: The amount of the financed energy improvements is limited to 10% of the "as completed" appraised value of the property. There is no minimum dollar amount for the energy improvements.

- Borrowers must obtain an energy report prepared by a Home Energy Rating Systems (HERS) energy rater. The energy report must:
  - identify the recommended energy improvements and expected costs of the completed improvements,
  - specify the monthly energy savings to the borrower, and
  - verify that the recommended energy improvements are cost-effective.
- If the cost of the energy report is paid for by the borrower, the cost may be financed as part of the mortgage by including it in the cost of the energy improvements.
- Mortgages may be delivered before the energy improvements are completed if the lender represents and warrants that the postponed improvements will be completed within 180 days of the date of the mortgage note.
- Acceptable postponed items include items that will not require an occupancy permit.
- The value of sweat equity and do-it-yourself improvements cannot be financed.
- Lenders and borrowers must execute an escrow agreement that states how the escrow account will be managed and how funds from the escrow account will be disbursed.
- See B4-1.2-04 for additional requirements related to postponed improvements.

Appraisal and completion requirements:

- The lender is responsible for ensuring that the appraiser has been provided with a copy of the energy report.
- All mortgage loans with energy improvement features require an appraisal based on an interior and exterior property inspection.
- Appraisers must determine the "as completed" value of the property subject to the energy improvements being completed.
- Lenders are responsible for managing the escrow account in which improvement funds are held, and for monitoring the completion of the energy improvement work.
- A certification of completion is required to verify the work was completed and must:
  - be completed by the appraiser,
  - state that the improvements were completed in accordance with the requirements and conditions in the original appraisal report, and
  - be accompanied by photographs of the completed improvements.

Underwriting with Desktop Underwriter® (DU®): Mortgage loans with an energy improvement feature can be underwritten manually or through DU. However, DU is unable to identify the transaction as having an energy improvement feature and as such, will not issue any specific verification messages.

- The lender must confirm outside of DU that all requirements of the energy improvement feature are met.
- DU will apply the standard limited cash-out refinance cash back policy and, as a result, the loan casefile may receive an Ineligible recommendation if it appears that the borrower is receiving more than 2%/$2,000 cash back. The lender may deliver the loan with the Ineligible recommendation and retain the DU limited waiver of underwriting representations and warranties provided the mortgage loan meets certain requirements.
- See B5-3.3-01 for additional information about underwriting with DU.

Delivery and Pricing:

- Special Feature Code (SFC) 375 is required for all mortgage loans delivered with the energy improvement feature.
- Fannie Mae will credit the lender a $250 LLPA for mortgage loans with energy improvements on existing properties. Lenders are expected to pass the $250 credit on to the borrower. See the Loan-Level Price Adjustment (LLPA) Matrix and Adverse Market Delivery Charge (AMDC) Information.

New and Updated *Selling Guide* Topics

B5-3.3-01, Mortgage Loans with Energy Improvement Features on Existing Properties (new topic)
B4-1.2-04, Requirements for Postponed Improvements (revised topic title) (Overview, Postponed Improvements for New or Proposed Construction, Requirements for the Energy Improvement Feature on Existing Construction)
E-2-07, Post-Closing Mortgage Loan File Documentation (Post-Closing Review File Submission Documentation)

Effective Dates:

Lenders may begin delivering mortgage loans with an energy improvement feature effective immediately.

Updates to HomeStyle® Renovation Mortgages

Combining the Energy Improvement Feature with HomeStyle Renovation Mortgages

Borrowers have always been able to finance the cost of energy-related improvements with a HomeStyle Renovation Mortgage. If the HomeStyle Renovation loan is used to finance energy-related improvements and the loan meets the requirements of the energy improvement feature (with the exception of the 10% maximum limit requirement for costs financed under the energy improvement feature - which may be exceeded for HomeStyle Renovation loans), the lender will receive the $250 LLPA credit. In order to receive the credit, the lender must deliver the loan with SFC 375 along with all other special feature codes that may apply. Lenders are expected to pass the LLPA credit on to the borrower.

Changes to the LTV Ratio Calculation for HomeStyle Renovation Refinances

Currently, Fannie Mae requires the calculation of the LTV ratio for HomeStyle Renovation refinances to be based on the *lesser of* the "as completed" appraised value of the property, or the sum of the unpaid principal balances of all eligible liens and the total renovation costs.

Fannie Mae is simplifying this calculation. For refinance transactions, the LTV ratio is now determined by dividing the loan amount by the "as completed" appraised value of the property. The LTV ratio calculation for purchase transactions remains unchanged.

Updated *Selling Guide* Topics

B5-3.2-01, HomeStyle Renovation Mortgage: Lender Eligibility (Overview, Delivery and Recourse Requirements)
B5-3.2-02, HomeStyle Renovation Mortgages: Borrower Eligibility (Renovation-Related Costs, Eligibility)
B5-3.2-03, HomeStyle Renovation Mortgages: Underwriting and Collateral Considerations (LTV Ratios, Energy Report Requirements)

Updated HomeStyle Renovation Forms

The following Fannie Mae forms have been revised and can be found on eFannieMae.com:

HomeStyle® Approval Form (Form 1000A): The name of this form has been changed to *Special Lender Approval Form*. In addition, changes have been made to eliminate extraneous information and clarify the information required by the form.

HomeStyle® Renovation Maximum Mortgage Worksheet (Form 1035): Extraneous information was removed and changes were made to the names of several line items.

Effective Dates

Lenders may deliver HomeStyle Renovation loans with energy improvement features and SFC 375, and begin using the revised forms immediately. Lenders may also begin applying the updated LTV calculation immediately.

Note: The DU message that reminds lenders to enter the lesser of the "as completed" appraised value or the sum of the unpaid principal balances of all outstanding liens and the total renovation costs will be retired with DU Version 8.2. Lenders may apply the updated LTV calculation to their DU loan casefiles immediately, although the retirement of the message will only be reflected on those HomeStyle Renovation loan casefiles underwritten through DU Version 8.2.

Clarification of Postponed Improvement Requirements for New and Proposed Construction

The contents of the table titled "Requirements for New or Proposed Construction" have been re-arranged for clarity. In addition, the statement that required a certification of completion before loan delivery has been corrected. (The very nature of postponed improvements allows completion after loan delivery to Fannie Mae).

Updated *Selling Guide* Topic

B4-1.2-04, Requirements for Postponed Improvements (revised topic title) (Overview, Postponed Improvements for New or Proposed Construction)

Effective Date

The clarification and correction are effective immediately.

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Lenders who have questions about this Announcement should contact their Customer Account Team.

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