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Leading Builders of America Comments in Response to the Preliminary Determination to Adopt Updated Energy Efficiency Standards for HUD and USDA Financed Housing

Leading Builders of America (LBA), is a trade association representing 21 of the largest production home builders in the United States. We offer the following comments about the feasibility of the HUD/USDA preliminary determination as its potential effects on the availability of homes and the affordability of newly constructed homes for buyers in these programs.

Leading Builders of America

Our members collectively build approximately 35% of all new homes in the nation at all price points ranging from \$150,000 to over \$1,000,000 per home. Many of our members have affiliated mortgage companies. Our members have sold over 100,000 homes in the past two years that were financed through the FHA or the USDA Rural Housing programs. Approximately 75% of these were first-time buyers and more than half were people of color. LBA members strive to build homes that are both highly energy efficient and affordable for average Americans. Today, newly built homes are approximately 50% more energy efficient than homes built only 20 years ago.

Background

In recent years, mortgage rates are up substantially, but land prices, building materials and labor have all risen substantially; making affordability a daunting challenge in virtually every market in the country. Indeed, the worthy goals of energy efficiency and affordability are often at odds due to the up-front costs of energy efficient features and equipment.

Every day in the marketplace, home builders compete with existing homes that are less efficient but often lower priced because they are not subject to today's energy code requirements or building material and labor costs. A substantial risk of adding further costs only to new construction is that new homes will be priced out the market as buyers opt for cheaper less efficient homes. It is clear that today's buyers are stretched thin and we know that downpayment requirements often drive home purchase decision making. This is especially true for FHA and USDA buyers with high LTV ratios.

Despite these market realities, LBA members are committed to finding ways to build more efficient homes. Many of our members are leaders in building Energy Star certified homes, most of the homes we build are HERS rated and our collective scores are getting lower every year. It is common practice today for LBA members to use Energy Star appliances; high efficiency HVAC systems; energy efficient roof barriers, insulation and lighting; drought resistant landscaping; low-E windows; smart thermostats; tankless water heaters; sealed insulated ducts and solar. They are also looking to the future by investing in new technologies like micro-grids, advanced water treatment technologies, off-site panel construction, geothermal systems, heat pumps and other innovations designed to increase the

sustainability and efficiency of new homes. LBA members are also working toward electrification of new homes by preparing new homes to operate without fossil fuels.

Preliminary Determination Exacerbates Affordability Challenges

While we applaud HUD for pursuing increased energy efficiency especially for lower income families and first-time home buyers, our analysis demonstrates that the current proposal will substantially inhibit both affordability and availability of homes for the participants in the FHA and USDA rural housing programs.

Leading Builders of America (LBA) worked with NAHB to collect and analyze proprietary mortgage data from home builder-affiliated mortgage companies to evaluate the impact the preliminary determination would have on FHA and USDA borrowers seeking to purchase a newly built home. The data on mortgage originations used to purchase new single-family homes from 2020-2022 showed that, of all FHA-backed mortgages, 71 percent were to first-time homebuyers and 42 percent were to people of color.

This analysis also demonstrates that the preliminary determination would have a disproportionate impact on the lower-priced end of the market, as 44 percent of FHA-backed new home sales were priced at or below \$300,000, where the cost impact of moving to the 2021 IECC will be proportionally larger.

While buyers using USDA financing were a smaller share of overall originations, this product is important in rural markets for buyers with limited funds for down payments (average LTV for USDA loans was 100 percent) and for first time home buyers (63 percent of USDA loans were to first-time homebuyers). For many of these buyers, even modest increases in downpayments will push them out of the market and make new home ownership unavailable. This is especially true for buyers in rural buyers where any downpayment increase will reduce availability.

Operational Concerns

1. Buyers will be driven to less efficient homes: The regulation applies only to new, already very efficient homes, while less-efficient existing homes in the marketplace are not subject to the rule. Due to the added costs, this will drive buyers to less efficient existing homes. There are 142 million homes in the United States and we build about 1 million new homes per year. This preliminary determination applies only to efficient new homes, which are already 50% more efficient than 20-year-old homes, and ignores the 142 million less efficient homes. In fact, a recent Stanford University study found that a 5% energy savings for existing CA homes has the same impact as driving 10 years of new homes at Net Zero.¹ Increasing costs of new homes, as contemplated by this preliminary determination, will leave lower-income buyers with no choice but to buy older less efficient homes with higher utility bills and large carbon footprints along with repair and maintenance costs they would not spend with new construction home.
2. Will limit Availability. The increased downpayment requirements will limit affordability and availability of newly constructed homes for lower income families. Downpayment requirements

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<https://sccc.stanford.edu/sites/g/files/sbiybj17761/files/media/file/Pathways%20to%20Carbon%20Neutrality%20in%20CA%20-%20Interview%20and%20Workshop%20Summary%20Report%20rev%202%20Jan%202022.pdf>

are the single biggest challenge facing first-time home buyers. Many buyers, especially those served by the FHA and USDA programs, simply cannot afford even modest increases in up-front costs no matter how much they'll save in operating costs. We see this play out in the market everyday – this regulation will make this more challenging and will move more buyers into less efficient older homes. This should give the agency pause. The upfront costs of energy efficiency are a very real obstacle that must be addressed as part of this proposal. More on that below.

3. No transition period is contemplated. The last time HUD imposed energy efficiency requirements in 2015, it chose the 2009 IECC as the baseline even though both the 2012 IECC and 2015 IECC had already been published. We assume this was done to ease the transition as 30+ states were already on the 2009 or newer code at the time. The preliminary determination breaks with that precedent, by requiring newly constructed homes, financed through the FHA or the USDA Rural Housing program, be built to the most recent code when only six states have adopted this version of the code. This will create substantial market disruption at the local level. Furthermore, at the time construction begins, builders have no way of knowing what financing program a buyer will use. If they build to an earlier version of the IECC, USDA and FHA buyers will lose the ability to buy that home. With supply challenges at all-time highs, this will unfairly reduce availability even further only for lower income families and first-time buyers. This is the opposite of what our public policy programs should accomplish. HUD and USDA should consider waiting until more states adopt the most recent version of the code or set IECC 2018 as an acceptable benchmark.
4. Local Building Code Officials need time to train. Local building code officials are trained on the version of the code in effect in their jurisdiction. They are not able to certify to newer versions of the code with which they are unfamiliar and untrained. In those states, it's unclear, who will certify that a home is built to the newest version of the code. For example, the Commonwealth of Pennsylvania has adopted the 2018 code. Builders there are required to build to the 2018 code and building code officials certify that they have done so. Under this proposal, if a homebuilder were asked to build to the 2021 IECC (to allow and FHA or USDA buyer to purchase their home), the building inspector will not be able to certify because he or she is not trained on the 2021 IECC. HUD should provide guidance to both builders and code officials to help reduce market disruption in these areas. Allowing for the "two most recent versions" of the model would substantially alleviate the problem but guidance will still be needed for states that choose not to adopt more recent model codes and be consistent with precedent.

The local codes adoption and implementation process is a time-consuming one and is necessarily tailored to consider local markets, terrain, climate zone, potential for weather events, and available building conditions and local consumer preferences. Building in the Arizona desert is far different than building in Minnesota, so model codes must be amended to account for those differences. In some instances, states have already adopted the 2021 IECC with amendments that will likely be deemed to not be equivalent and will be deemed out of compliance with HUD/USDA requirements. This will complicate the regulatory environment for homebuyers, builders, building code officials, appraisers, and lenders. Federal agencies must take these differences in code requirements into consideration when requiring the latest codes at the national level.

5. Alternative Compliance Options. Alternative compliance paths are a must for builders that have committed to build to above code programs and the alternatives should be comprehensive, provided that they require energy efficiency levels that meet or exceed the two most recent versions of the IECC or ASHRAE 90.1-2019. These should include Energy Star Certified Homes, DOE Zero Energy Ready homes, ANSI/RESNET/ICC standard 301, the ICC-700 National Green Building Standard, Enterprise Green Communities, Energy Star Indoor Air Plus, Leadership in Energy and Environmental Design (LEED), Living Building Challenge or Passive House, as well as one or more regional or local standards such as Earthcraft, Earth Advantage, or Greenpoint Rated New Home.

AFFORDABILITY IMPACTS

HUD's cost increase estimates are significantly lower than actual costs required to bring entry level homes up to the most recent model code. LBA commissioned a comprehensive survey in 2020, (for internal purposes), updated in 2023, to calculate the costs of moving to the 2021 IECC. In states moving from 2009 IECC to 2021 IECC the additional costs range, depending upon climate zone, from \$8,859 to \$22,572 per home. This is substantially higher than the preliminary determination estimates of \$2,813.49 to \$6,796.21.

The preliminary determination considers research from PNNL that accounts for impacts to the average borrower, rather than the average FHA or USDA borrower. These families have very different profiles. HUD and USDA must adjust the assumptions made in the PNNL model to reflect actual cost implications for their average program participant. For example, the PNNL study uses an assumed down payment of 12 percent to represent the average borrower in estimating the additional cost from the increased costs of moving to the 2021 IECC. The preliminary determination notes that the average FHA borrower has a down payment of only 4.5 percent. Our members report that the USDA program's average down payments are as low zero. HUD and USDA must reevaluate the cost effectiveness based on the actual down payment data of their lending programs or they risk pricing their target borrower out of the new home market.

When accurate estimates are used, we find that first time buyers and rural area buyers, lower income buyers and people of color across the country will experience cost and downpayment increases. Buyers in Climate Zone 4 will experience the highest cost increases of as much as \$22,572 per home. Climate Zone 4 includes parts of Ohio, West Virginia, Virginia, Washington, DC, Tennessee, Kentucky, Illinois, Missouri, North Carolina, Maryland, Delaware, Kansas and New Mexico.

In Section 481 of EISA, Congress directed the Secretaries of Agriculture and Housing and Urban Development to establish joint energy efficiency standards for "new construction – not all homes. This statute also requires the agencies to determine that the revised codes "do not negatively affect the availability or affordability of new construction" of single and multifamily housing covered by EISA.² The preliminary determination appears to have missed the mark by basing their analysis on the entire market and therefore HUD and USDA must reevaluate their affordability and availability estimates before moving forward.

Current appraisal practices are an enormous obstacle

² 42 U.S.C. § 12709(a)(2).

It's critically important to understand that the value of energy efficient features, generally do not increase the appraised value of a home. Adding \$5,000 to \$23,000 in energy efficient features and equipment, as mandated by this preliminary determination, will increase the purchase price BUT not appraised values. So, in most cases, the buyer will not be able to finance those costs as part of their mortgage; instead, they will need to increase their downpayment to cover these additional up-front costs. FHA and USDA buyers simply cannot afford substantial increased up-front costs. Our USDA buyers average 100% LTV's – any downpayment requirement will likely make an energy efficient new home unavailable to them.

Appraisal Trap Illustration

Purchase Details	Current Rules	Proposed Rule
Purchase Price	\$383,558	\$383,558 \$19,750 (energy upgrades) \$403,308
Appraised Value	\$390,058	\$390,058
Loan Amount	\$364,380 (95% of purchase price)	\$370,555 (95% of appraised value)
Downpayment	\$19,178	\$32,753
Increase in Downpayment		\$13,575 (71% increase)

- 1) First-time FHA buyer, Columbus, OH
- 2) Energy cost mandate \$19,750 reflects cost of moving from 2009 to 2021 in climate zone 4
- 3) Loan amount calculated based on the lower of appraised value or purchase price per FHA requirements

As a result, we estimate that nearly 100,000 first-time, moderate income and people-of-color buyers will be priced out of the newly constructed and highly energy efficient home market each year. These buyers will be forced to purchase less efficient existing homes with higher utility costs generating larger carbon footprints. This should not be acceptable to HUD.

Requiring first-time buyers and lower income buyers to bear the burden of higher utility bills while only middle- and higher-income families enjoy lower operational costs, exacerbates the affordable housing problem by making it harder for these families to move up the economic ladder. Indeed, these are precisely the families that FHA and USDA rural housing program are designed to help, yet as written, the preliminary determination would affect them the most.

Simply put, as written, the new rule places moderate income, first-time and buyers of color in a no-win situation. Forced to stay in an older home with higher operating and repair expenses because they will no longer be able to purchase an efficient new home with lower operating costs.

Upfront Cost Solution

LBA has long advocated for the establishment of workable and vibrant energy efficient mortgage programs at FHA and USDA. We call on HUD to substantially resolve the decades long conundrum of paying for the increased up-front costs of energy efficient features as part of this rulemaking. See a visual description of how it works here : <https://app.frame.io/presentations/9a8f2a36-eafe-4365-9d23-65a5b2e8c15a>

As part of this rulemaking, HUD should require appraisers of energy efficient homes (those homes with a third-party energy audit), to include the Net Present Value (NPV) of the expected energy savings in the appraised value of the home. Furthermore, HUD and USDA should allow for flexibility in qualifying ratios to accommodate this modest increased borrowing capacity. In fact, Congress recently passed a bill with bi-partisan support, to require the VA loan program to create such a program.³

HUD's preliminary determination includes:

A study by the University of North Carolina (UNC) Center for Community Capital and the Institute for Market Transformation (IMT) shows a correlation between greater energy efficiency and lower mortgage default risk for new homes. The UNC study surveyed 71,000 Energy Star-rated homes and found that mortgage default risks are 32 percent lower for these more energy efficient homes than homes without Energy Star ratings.

We agree! Mortgages on energy efficient homes present a lower credit risk and they provide operational saving during the life of the home, so let's account for that lower cost and risk.⁴

Requiring appraisals and qualifying ratios to account for energy efficiency would be transformational. It would allow buyers of new homes to finance the up-front costs of increased efficient features and equipment by paying slightly more on their mortgages each month without increasing the downpayment. Doing so would save them money on the operational costs of the home through substantially lower energy costs. These costs will greatly outweigh any modest increase in mortgage payment; leaving lower income and rural buyers with more disposable income and a more efficient home.

Keep in mind, new homes are already very efficient and they already include energy efficient systems of the home in the base price, so only incremental costs of energy upgrades would need to be financed. For instance, builders already provide water heaters in every home, but if they were able to upgrade to higher efficiency tankless water heater the incremental cost may only be \$400 not the entire \$1,200 replacement cost. This is true for insulation, lighting, HVAC systems as well. Incremental investments in each system add up to thousands of dollars in additional upfront cost but result in big savings on utility bills overtime.

Solving the up-front cost issue will be transformational. It will unlock the ability of lower income buyers to purchase energy efficient homes, encourage innovation and drive scale from product manufacturers as demand for their most efficient products increases, allow for increased competition among builders based upon efficiency, reduce electricity usage and utility bills for lower income borrowers, reduce every home's carbon footprint and lower default risk for FHA and USDA insured loans!

If we want to make energy efficient new homes available to lower income and first-time buyers, we need to replace existing appraisal and underwriting procedures with new ones that fully reflect the value and operational savings of energy efficient new homes.

³ 2023 Omnibus Budget Bill H.R. 2617, section 203.

⁴ https://sf.freddiemac.com/docs/pdf/fact-sheet/energy_efficiency_white_paper.pdf

Such a solution has broad bi-partisan support. These concepts, included in the SAVE Act were endorsed by home builders, product manufacturers, dozens of leading environmental advocacy groups.

Solution for Energy Standard

While we applaud HUD's intention to further increase the energy efficiency of highly efficient new homes, we respectfully suggest that more refinement of the preliminary determination is required to achieve that goal without significantly reducing affordability and availability of newly constructed homes.

HUD and USDA should delay implementation of this rule until the following concerns are addressed:

1. The affordability and availability estimates for new construction must be revised with more accurate data reflecting current market conditions, costs and buyer profiles for newly constructed homes.
2. The preliminary determination should allow for the two most recent published versions of the model code to limit market disruption.
3. Guidance is needed for stakeholders on how to certify homes in jurisdictions where building officials are not trained on the two most recent versions.

We stand to work with HUD to craft and implement a rule that is truly transformational, to do so we must address the appraisal issue as part of the rule making. We simply cannot achieve affordability and efficiency without addressing the upfront costs of energy efficiency. We also feel it's impractical to move to the 2023 IECC when most states have not adopted it. We look forward to working with you on these refinements.

Please let us know if we can help with the further cost and affordability analysis and direct any questions to me at ken.gear@leadingbuildersofamerica.org.