April 4, 2012

# Using Credit Enhancements to Leverage Existing CDFI Capacity: Indianapolis EcoHouse Project Loan Program

As part of the American Recovery and Reinvestment Act (ARRA), Indianapolis received a $10 million grant through the Department of Energy's Better Buildings Neighborhood Program initiative. The City of Indianapolis Office of Sustainability partnered with the Indianapolis Neighborhood Housing Partnership (INHP), a community development financial institution (CDFI) focused on affordable housing, to design a financing program for low and middle income Indianapolis homeowners. Launched in June 2011, the $6 million EcoHouse Project Loan Program is available to Indianapolis households earning up to 120 percent of Area Median Income (AMI).[1]

Unsecured loans are available for up to $4,000 and four years, and secured loans are available for up to $15,000 and 10 years. According to INHP, eligible homeowners typically have little access to anything but credit card financing – often at rates from 15-25 percent, so the EcoHouse Project's mid-single digit fixed interest rate loans are an attractive tool for enabling energy improvements among households who are otherwise unlikely to be able to access affordable financing.[2] Program managers expect that they will make a minimum of 400 loans, utilizing up to $6 million over the next two years.

## Finding the Right Partners

John Hazlett, Director of the City of Indianapolis Office of Sustainability, pointed out that understanding INHP's mission and ensuring that the program served both City and INHP objectives was critical to the partnership. INHP was an ideal partner because of its long history working in the City and its substantial internal program and capital delivery infrastructure. Since the year 2000, INHP has facilitated the delivery of over $220 million of financing for mortgages and home improvements to Indianapolis homeowners. In addition, INHP has provided home ownership assistance, including lending and education programs to over 17,500 households. The city of Indianapolis got an experienced lending partner with extensive knowledge of what type of program structure and financing tools have the greatest potential to drive energy improvements among the city's low and middle income households.

*This paper is part of the LBNL Clean Energy Financing Policy Brief series. To join the email list to receive these policy briefs, please click HERE or visit http://eetd.lbl.gov/EAP/EMP/. The work described in this Policy Brief was funded by the Department of Energy Office of Energy Efficiency and Renewable Energy, Weatherization and Intergovernmental Program under Contract No. DE-AC02-05CH11231. Please direct questions or comments to Mark Zimring (mzimring@lbl.gov)*

[1] INHP is targeting 80 percent of its EcoHouse lending to households at or below 80 percent of AMI and the remaining 20 percent to households earning between 80 percent and 120 of AMI. 120 percent of AMI for Indianapolis household of four is $79,200 and 80% AMI for an Indianapolis household of four is $52,800.
[2] Loan interest rates are based on U.S. Treasuries. In July 2011, fixed interest rates on secured loans were 5.97 percent and on unsecured loans were 6.66 percent.

This Policy Brief is an excerpt from the report: "Delivering Energy Efficiency to Middle Income Single Family Households." For the full report and other resources visit: http://middleincome.lbl.gov

The City of Indianapolis has also engaged the community center in one of its target neighborhoods, Indianapolis' Near Eastside for a neighborhood sweeps initiative. Indianapolis Office of Sustainability Director John Hazlett pointed out that representatives from the community center have been working in the Near Eastside for years delivering services, and that some low and middle income residents distrust local government, "Having a physical presence in the neighborhood is important. Everyone knows the community center – the trust and name recognition associated with it has helped to drive interest." City of Indianapolis staffers emphasized that working through INHP and other community organizations has been a key driver of middle income household interest in the first few months of the program.[3]

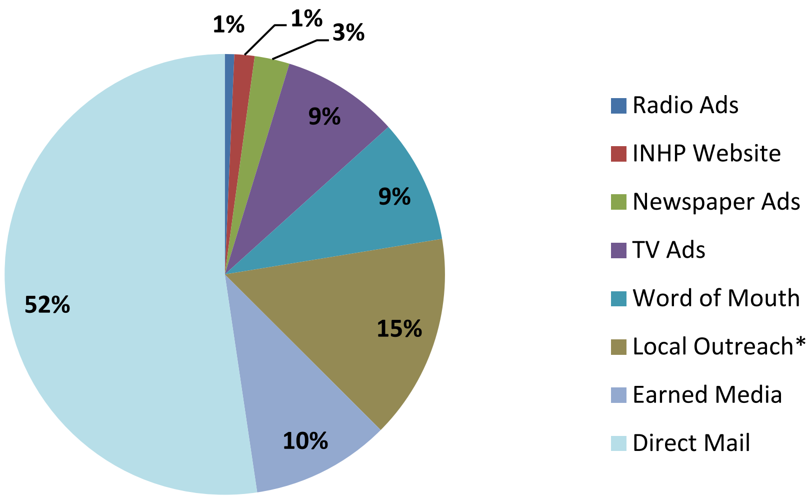
## Tailoring Outreach & Messaging to Middle Income Households

EcoHouse messaging was initially informational, with a soft green message. Program managers quickly revised messaging in response to what was driving program interest – potential participants were inquiring about the program based on a need – to lower their utility bills, to reduce the discomfort of their homes, to replace a broken furnace – rather than a proactive interest in greening their homes. Program messaging now focuses on enabling Indianapolis homeowners to make needed upgrades, save money and improve the comfort of their homes.


**Figure 1.** INHP EcoHouse website messaging (Source: INHP).

About a quarter of the 1,000+ inquiries from potential EcoHouse Project participants have come through outreach strategies like block parties, neighborhood meetings and word of mouth (See Figure 2). The program has complemented these tailored efforts with more traditional marketing – tv, radio & newspaper advertisements and direct mailers. The direct mailers have led to over 500 inquiries, 80 percent of which were in response to INHP's Q4 2011 mailing to over 68,000 middle income owner-occupied households.

[3] Neighborhood associations have been a major driver of program interest. More so than in suburban neighborhoods, Indianapolis's neighborhood associations are very well-organized and INHP has have worked hard to get association leaders connected to the Eco House Project so that they can communicate the benefits to their members.




*Local outreach includes a range of local events including employee fairs, block parties, neighborhood association meetings

**Figure 2.** How households inquiring about INHP's EcoHouse Project learned about the program (n=1,016 – 208 "no response") (Source: INHP).

## Increasing Access to Financing

INHP targets its financial products and services primarily to low and middle income households – in 2010, over half of INHP lending went to households earning between 50-80 percent of AMI (see Figure 3).[4]

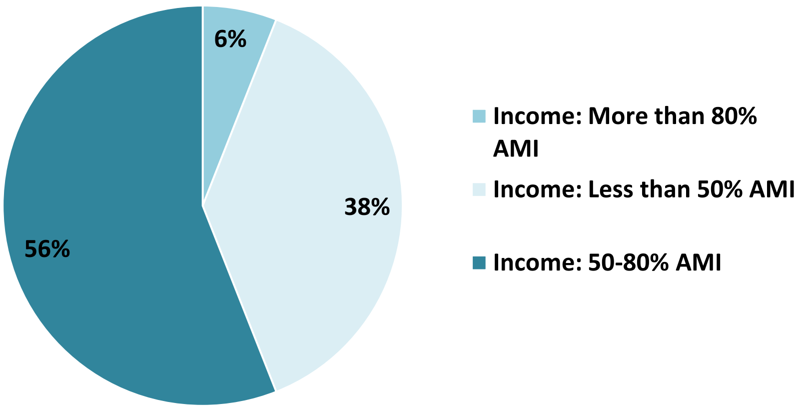



**Figure 3.** 2010 distribution of Indianapolis Neighborhood Housing Partnership customer funding (Source: TAP Webcast 2011)

[4] Department of Energy Webinar. "Community Development Financing Institutions – Opportunities for Partnerships with Energy Efficiency Programs". March 17, 2011. Available here: http://www1.eere.energy.gov/wip/solutioncenter/media/CDFI%20Webinar%20Slides.pptx

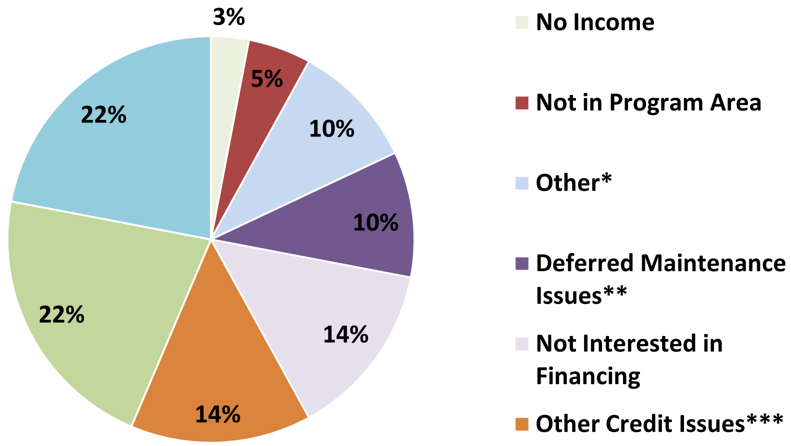
In an attempt to deliver financing to these households, INHP permits credit scores down to 580 (secured) and 615 (unsecured) (see Table 1).

| | Unsecured | Secured |
|---|---|---|
| Loan Amount | • $1,000-$4,000 | • $4,000-$15,000 |
| Loan Term | • Up to four years | • Up to 10 years |
| Lien Position | • N/A | • First, second or third |
| Interest Rate | • 6% over the 3 year Treasury (currently 6.66 %) | • 3% over the 10 year Treasury (currently 5.97 %) |
| Minimum Credit Score | • 615 | • 580 |
| Income Eligibility | • Up to 80 or120% of AMI depending on property location[5] | |
| Maximum Debt-to-Income Ratio (DTI) | • 45 percent | |
| Maximum Combined Loan-to-Value (CLTV) | • 100 percent | |
| Other Underwriting Criteria | • Bankruptcy Limitations: At least 24 months since Chapter 7 discharge and/or At least 12 months into Chapter 13 payout, with letter from court representative<br>• No Foreclosure within most recent 30 months<br>• No Repossessions within most recent 24 months<br>• No Outstanding Collections, unless medical, only up to $3,000<br>• Judgments/Liens may be allowed case-by-case, must be current in repayment | |
| Other Eligibility Restrictions | • Single family homeowners primary residence<br>• Units occupied by borrower for at least 12 months<br>• US citizen or permanent resident alien | |
| Eligible Improvements | • Items identified in energy audit report may be included and/or required<br>• Applicable health & safety measures may be included, up to 25% of the total project | |

**Table 1.** Indianapolis EcoHouse Project Loan Program loan terms and eligibility. (INHP)

Even with lenient underwriting standards, INHP is unable to accommodate a significant number of potential program participants – more than one in three program applicants is turned away because their credit scores are too low or because of other outstanding credit issues (see Figure 4).

[5] A maximum of 20 percent of loan funds may go to residents with income between 80 and 100 percent of AMI – at least 80 percent must go to residents with income between 100 and 120 percent of AMI.




*Other includes not a homeowner, not in home for 12 months, land contact, mobile home & investment property.
** INHP refers households with significant deferred maintenance or health and safety issues to another program within the organization.
***Other credit issues include bankruptcy, outstanding lien or judgment, and recent late loan payments.
**Figure 4.** Reason for INHP EcoHouse Loan Project non-participation (n=200) (INHP)

## Make it Easy, But Not Too Easy (to Weed Out "Tire Kickers")

INHP Vice President of Lending, Capital and Corporate Development Joe Huntzinger argued that, "You have to make this program extremely attractive, so that it's hard to say no in a weak economy. Today, there is tremendous debt aversion and people generally want to deleverage not add leverage." To make this program palatable, INHP is delivering low interest rate loans and eliminating fees for energy assessments, title searches, and lien recordings.

Once INHP receives an inquiry, program staff does extensive pre-screening – explaining the details of the program by phone before bringing applicants in for a meeting. At the meeting, INHP collects $50 to reserve an energy assessment (valued at $650), which is refunded if customers move forward with an energy upgrade. This nominal fee is primarily intended to ensure customer commitment to participating in the program. While this fee is small, INHP is very careful *not* to advertise low cost audits. EcoHouse Loan Program manager Becca Murphy noted that, "We don't want to give away free assessments because these audits are expensive. We need a way to weed out the tire kickers." And INHPs experience to date suggests that there are a lot of tire kickers – just 16 loans have closed;[6] "We have to go through a lot of leads to identify someone who is both interested and qualified so that when we do an (assessment) it's for a homeowner that is very likely to act."

To further simplify the customer experience, INHP has selected qualified program contractors (three types – HVAC, insulation and air sealing, and windows and doors) who have all agreed to set pricing for energy improvement measures. While the homeowner is free to select one of these contractors, INHP plays an active role in helping to facilitate this process. Murphy emphasized that program staff must be

[6] As of January 2012.

hands on throughout the upgrade process, "In INHPs target income range, households can become passive very quickly."

## Leveraging Private Capital

INHP has structured a number of loan pools in the past to fund residential mortgages, and participating banks have always been paid back in full. Banks are motivated to participate in INHP's loan pools because of their safety, their social objectives and because these investments help meet their Community Reinvestment Act (CRA) requirements. Like its past loan pools, the $6 million EcoHouse loan pool is structured such that INHP borrows money from the pool and then relends it to participating homeowners. The underlying credit for these loan pools is INHP, not customer mortgages – for the EcoHouse Loan Program, INHP has agreed to purchase all delinquent loans from the pool after 180 days of non-payment. While this means that INHP bears most of the loan default risk, past investors have required INHP to have a 10 percent loan loss reserve (LLR) for its first mortgage lending programs (often funded with foundation grants). Once INHP has purchased delinquent loans from the pool, it may draw down funds from the LLR to cover 100 percent of each loss.

Because the EcoHouse Loan Program will make primarily unsecured and subordinated loans, investors and INHP's board required a larger credit enhancement – a $3 million (50 percent) LLR.[7] INHP has historically offered second mortgage products to finance emergency repairs for low income households. This experience suggested a large credit enhancement was necessary. Since the financial crisis, INHP found that secondary market investors are only willing to pay ~20 cents on the dollar for these loans, and INHP experienced non-payment of approximately 50 percent. While the credit profiles of EcoHouse Loan participants are likely to be better than those of past programs (many past loans, for example, were for elderly households on fixed incomes that couldn't afford to make interest or principal payments),[8] unsecured loans and second mortgages in an unstable housing market are still high risk. INHP believes the default rate may be lower than 50 percent, and the City has agreed to grant any funds remaining in the LLR once the loan pool is paid off to INHP. These grant monies will support affordable housing, and may include energy efficiency improvements that meet INHP's mission of increasing safe, decent, affordable housing opportunities that foster healthy, viable neighborhoods.

INHP program managers believe they could have gotten the deal done with investors at a significantly lower LLR, but that this would have required restricting product offerings and raising credit standards – likely offering only secured financing and increasing minimum credit scores. In the end, even with this robust credit enhancement, INHP's strong track record on past pool performance was key to attracting its four bank partners to this less-secure loan pool.

## Next Steps

INHP is testing this loan model in hopes that demand and loan performance will be strong enough for it to continue after Recovery Act monies are exhausted. Loan data so far suggests that INHP is attracting high credit-quality middle income households. The 16 closed loans have averaged $5,776, and participating households have had average income of $38,790, credit scores of 702 and Debt-to-Income (DTI) ratio of 27%. According to INHP President Moira Calrstedt, the program has many potential benefits, "The

[7] This loan loss reserve was funded from the City of Indianapolis's Better Buildings grant.
[8] The average INHP emergency loan borrower has historically earned about 40 percent of AMI.

EcoHouse Project is good for homeowners' financial situations, it's good for their personal comfort, and it's good for the environment and the neighborhood…Helping homeowners increase energy efficiency is also a way to help them remain as long-term assets to Indianapolis neighborhoods."

## Resources

| **Program Website & Contact** | |
|---|---|
| **Program Website** | https://www.inhp.org/EcoHouseProject/EcoHouseProject.aspx |
| **Program Contacts** | Becca Murphy<br>EcoHouse Project Manager, INHP<br>rmurphy@inhp.org<br><br>John Hazlett<br>Director, City of Indianapolis Office of Sustainability<br>John.Hazlett@indy.gov |
| **LBNL Reports & Policy Briefs** | |
| Zimring, M., M.G. Borgeson, I. Hoffman, C. Goldman, E. Stuart, A. Todd, and M. Billingsley. **"Delivering Energy Efficiency to Middle Income Single Family Households."** LBNL-5244E. December 2011. | http://middleincome.lbl.gov |