Fact Sheet: Green Mortgages Are Good Mortgages

Research from Lawrence Berkeley National Lab and Berkeley's Haas School of Business demonstrates that the more energy used per square foot in a commercial building, the higher the likelihood of mortgage default. Given this increase in default risk for high energy-consuming buildings, researchers say, lenders should finance energy efficiency measures along with other building improvements during renovation or rehabilitation, and these green mortgages should be preferentially priced.[1] But multifamily mortgage lenders have been slow to pursue increased energy efficiency in buildings as a risk management approach.

One of the first questions that multifamily housing mortgage lenders interested in financing efficiency measures ask is: How do I know that those new efficiency measures will perform as expected? If the savings do not materialize, will the borrower be able to repay the mortgage, especially if I underwrite the loan based on projected savings from efficiency?

Of course, lenders should follow best practices to ensure that efficiency improvements are installed and maintained well, just like any other type of capital improvement work. But just like other capital improvements, the details of how a particular piece of technology performs is not the primary interest of the lender. Aside from mission-related goals, lenders are primarily concerned with being repaid in full and on time. A lot of things can delay repayments on a loan: personal issues with the property owner, sub par general operations and high vacancy due to poor maintenance, among many other things.

So we asked lenders with a track record of green mortgage lending: In your experience, does including efficiency measures in the scope of capital improvements covered by a mortgage make it more likely that payments on the loan will be delayed or that the loan will go into default? Does underwriting to projected savings from efficiency increase those chances?

As detailed below, experience of multifamily green mortgage lenders shows that the answer is no. In fact, the relatively positive performance of green mortgages drive these lenders to incentivize efficiency upgrades by underwriting projected savings so that more borrowers can access the capital needed to do retrofits.

Community Preservation Corporation

"Given the influence a lender can have on the economics and quality of the building stock, CPC continuously looks for opportunities to promote high performance building measures as a part of the first mortgage for construction, acquisition or refinancing. High performing buildings, which include energy and water savings measures, present an owner the opportunity to lower utility and maintenance costs, improve net operating income and in turn, strengthen their ability to

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[1] https://buildings.lbl.gov/sites/default/files/mortgage-default-risk-and-energy_12-3-18.pdf

make debt payments. Given increasing regulation on greenhouse gas emissions from the building sector, energy efficiency and decarbonization measures also reduce a project's future financial risk from potential emissions penalties.

The evidence is clear – high performance and energy efficiency measures benefit both the borrower and the lender by ensuring long-term financial stability and enhanced loan performance. They also improve tenant health and comfort and ensure superior overall property condition and marketability. When one factors in the improved resiliency and added climate benefits like reduced heat island effect, it's really a win-win-win!"

- Sadie McKeown, Executive Vice President and Head of Construction Lending and Initiatives at CPC

Community Investment Corporation

"CIC originally financed multifamily efficiency upgrades through a separate pilot loan pool called Energy Savers. The program started as a pilot because financing multifamily retrofit activity based on projected energy savings and using a second mortgage was untested, and potential investors perceived the strategy as too risky. The Chicago Metropolitan Agency for Planning and the city of Chicago provided $2.75 million and $1 million, respectively, to the pilot's loan loss reserve. CIC also secured $6 million and $8.5 million in additional loan capital from the MacArthur Foundation and Bank of America, respectively.

After a successful pilot, CIC staff recommended transitioning energy efficiency lending into the regular mortgage program. This decision came in response to a low delinquency rate--matching that of the regular program--and borrower demand. Many borrowers preferred energy efficiency retrofits concurrent with a refinancing event and/or larger rehabilitation project. CIC's board of directors approved rolling Energy Savers lending into CIC's primary multifamily loan pool in 2017.

To date, CIC has financed $24.5 million to retrofit 11,095 units, leading to substantial energy savings. The delinquency rate of Energy Savers loans remains level with CIC's regular lending programs, approximately 3-5 percent."

- Stacie Young, Director of the Preservation Compact at CIC

Fannie Mae

Fannie Mae provided more than $70 billion in financing to support the multifamily market in 2019.[2] As a key actor in the multifamily housing finance sector, the government-sponsored enterprise has long recognized that beyond the important social and environmental benefits,

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[2] https://www.fanniemae.com/portal/media/financial-news/2020/multifamily-volume-2019-6973.html

improving energy efficiency in affordable housing properties leads to lower credit risk, higher cash flows, and higher property values.[3]

“It’s groundbreaking, but it needs to be put in context. The influence of that underwriting may move the loan size by very little, by approximately 1-2%. There are many other assumptions that underwriters make- such as about projected rents, occupancy rates, etc. - that move the needle more than that. Rather than looking at this innovation in isolation, as something new and therefore risky, we need to think about it in relation to other technical levers that can also influence loan proceeds.”[4]

- Chrissa Pagitsas, Former Director of Green Financing, Fannie Mae

Fannie Mae’s green financing programs reflect its belief in improving borrowers’ financial stability by reducing utility consumption. But that belief is not unconditional: Fannie Mae has eligibility requirements in place that limit the potential new risks associated with green financing.

Green Rewards, for example, offers borrowers a lower interest rate than on a conventional loan and more loan proceeds by underwriting projected energy and water cost savings (75% of the owner and 25% of the tenant projected savings). The required energy and water audit report is 100% paid for by Fannie Mae.[5] Fannie Mae balances the opportunity presented by this newer offering with requirements that mitigate potential risks. First, Fannie Mae has detailed requirements for the High Performance Building (HPB) report that must be conducted to identify efficiency opportunities in a property. Second, those HPB reports can only be delivered by pre-qualified consultants that are known to deliver reliable projections. Third, a DUS lender can extend only up to 5% additional loan proceeds without going through Fannie Mae pre-review. Green Rewards mortgage loans that are projecting greater than 5% additional loan proceeds or include a solar PV system as a selected efficiency measure requires pre-review from the Multifamily Credit Team.[6]

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[3] https://multifamily.fanniemae.com/financing-options/specialty-financing/green-financing/green-bonds
[4] https://www.environmental-finance.com/content/the-green-bond-hub/bringing-billions-and-housing-to-the-green-bond-market.html
[5] https://multifamily.fanniemae.com/sites/g/files/koqyhd161/files/2020-03/greenrewards.pdf
[6] https://multifamily.fanniemae.com/sites/g/files/koqyhd161/files/2019-10/register-quote-close-deliver-green-mortgage-loan_0.pdf