Shining a light on the just path forward

JUST SOLUTIONS

Energy-Efficient Mortgages:

A Unique Opportunity for Environmental Justice

The many benefits of adopting updated building energy codes are well-established, including:

> Reduced energy costs for owners and residents,
> Improved resilience in the case of power outages and disasters,
> Reduced demand on the electrical grid,
> Better comfort, safety, and health for residents,
> Reduced climate-warming impacts.

That is why we joined many of our partners in urging the Federal Housing Finance Agency (FHFA), which oversees Fannie Mae and Freddie Mac, the Government-Sponsored Enterprises (GSEs), to require that the home mortgages they back meet updated energy efficiency standards. This move would complement a determination issued in April 2024 by the Department of Housing and Urban Development (HUD) and the Department of Agriculture (USDA), which has the effect of adopting the 2021 IECC and ASHRAE 90.1-2019 codes for new housing construction financed or assisted by these agencies.[1]

The Inflation Reduction Act (IRA), enacted in 2022, marked the biggest climate action that Congress has ever taken, and agencies have spent the last two years working to implement the law's suite of tax credits and grant programs. Of particular significance among the IRA's programs is the $27 billion Greenhouse Gas Reduction Fund, the single largest appropriation that Congress has ever made to the Environmental Protection Agency. This program is intended to jumpstart a decentralized network of green lending throughout the country, supporting all kinds of clean energy, energy efficiency, and other projects that promote climate mitigation and resilience.

This brief explains the role of GSEs in mortgage markets and green financing, introduces the federal Greenhouse Gas Reduction Fund and highlights planned green mortgage products supported by it, and discusses how FHFA's adoption of building energy code requirements for mortgages would complement green lending supported by the Greenhouse Gas Reduction Fund, with a particular focus on benefits for low-income and disadvantaged communities.

GSEs Set The Standard for Home Mortgages

The GSEs play a major role in the United States' housing and mortgage market, supporting about 70 percent of mortgages.

The GSEs buy mortgages from banks and credit unions and then bundle those mortgages together into securities, which they then sell to investors. Because the GSEs guarantee the repayment of these mortgages and mortgage-backed securities (MBS) generally provide stable and predictable returns, they are an attractive investment option for institutional investors, including pension funds, mutual funds, insurance companies, and commercial banks. The lenders that originate mortgages benefit from selling them because it shifts the risk of default to the GSEs and frees up their balance sheets so they can make more loans. Lenders may also hold these securities to generate income to support operations and further lending activities.

This process enables enormous investor demand for mortgage-backed securities, leading to lower interest rates on mortgages for homebuyers. Because GSEs use standardized loan terms and underwriting guidelines for the mortgages they buy, the entire process is streamlined and also more transparent for borrowers, making the home-buying process much more predictable and accessible.

Because of the GSEs' giant footprint within the mortgage market, the loan terms and underwriting requirements — such as 30-year terms and minimum down payment amounts — they set the standard for mortgages in the United States. Adding energy efficiency into the mix would have far-reaching effects for buyers of new homes, adding up to billions saved in energy costs and huge amounts of greenhouse gas emissions avoided.

Fannie Mae is well-established as one of the largest issuers of green financing in the country and has over a decade of experience offering green mortgage products and mortgage-backed securities. These green mortgages offer lower interest rates for borrowers, making it more accessible to buy new, energy-efficient homes.

For single-family homes, the ENERGY STAR® Certification for New Homes serves as the baseline for loans making up Fannie Mae's Single-Family Green MBS, along with other kinds of green loans. This ENERGY STAR® Certification is designed to exceed the latest model energy code requirements by at least 10 percent.[2]

Since its first issuance in 2012 through 2023, Fannie Mae's multifamily green financing program[3] has surpassed $117 billion in green MBS issuances. For multifamily buildings, Fannie Mae offers two kinds of green mortgages: Green Rewards, which requires owners of existing buildings, including senior and workforce housing, to commit to installing energy and water efficiency equipment that are expected to reduce combined energy and water consumption by at least 30 percent, including a minimum 15 percent reduction in energy consumption, and Green Building Certification, which requires the property to achieve an eligible, third-party green building certification.

The GSEs are Congressionally mandated to improve mortgage access to low-income families in underserved markets, support affordable housing, and promote fair lending. In line with regulations[4] promulgated by the FHFA, the GSEs have developed three-year Equitable Housing Finance Plans to address the barriers that drive disparities in homeownership, as well as housing access and stability, including for renters. Because these disparities tend to coincide with the racial, ethnic, and income divides that characterize communities with disproportionate pollution burden, there is significant overlap among the households served by GSEs and those within the low-income and disadvantaged communities that the GGRF is designed to benefit. Actions outlined in Fannie Mae's 2025-2027 Equitable Housing Finance Plan are designed to reduce up-front cost burdens for homebuyers, improve access to credit for historically underserved customers, and improve residents' financial resilience by lowering ongoing costs of housing, among other objectives.[5]

The Greenhouse Gas Reduction Fund and the Opportunity to Address Equity

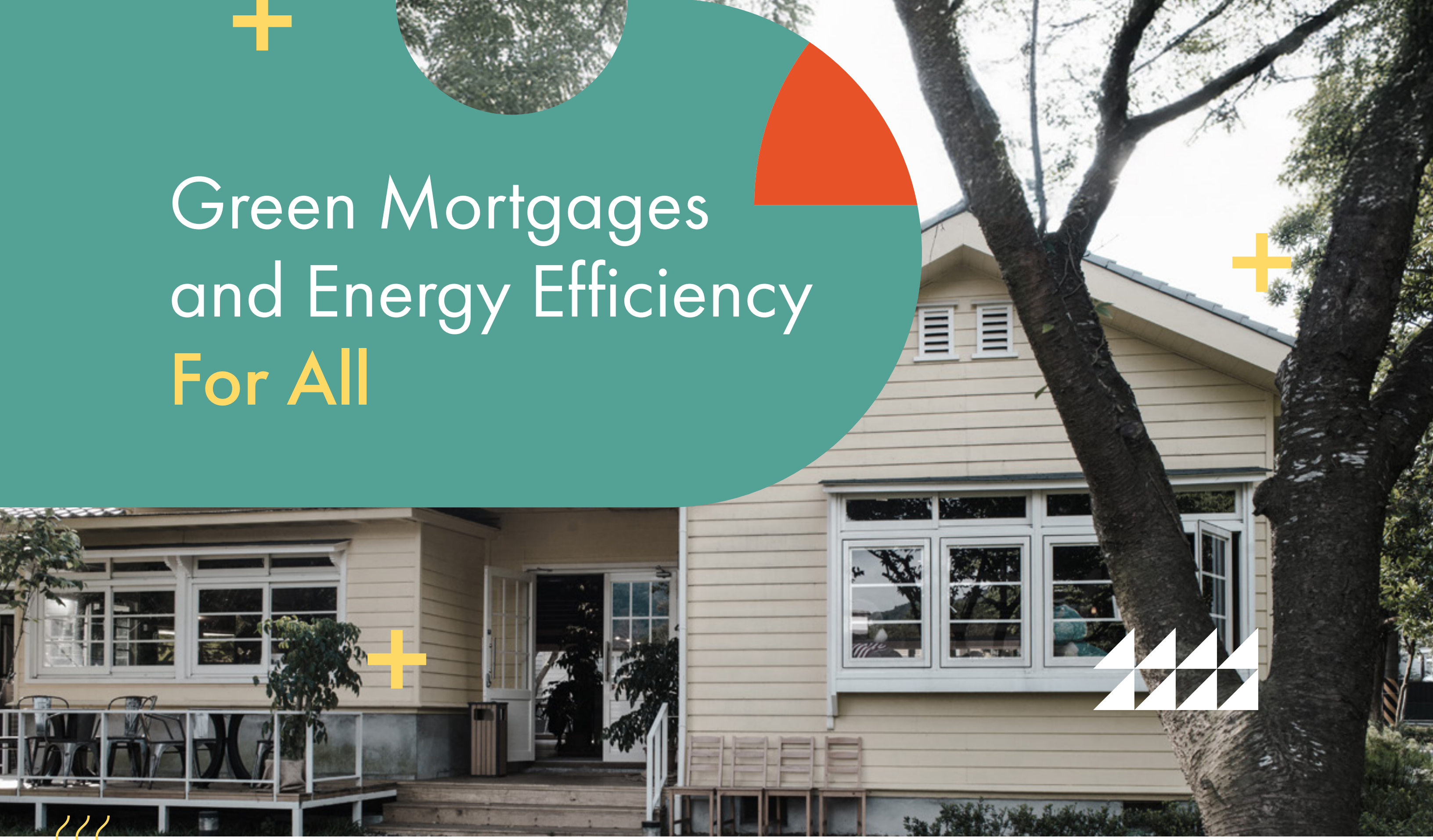
FHFA's adoption of an updated energy code requirement would coincide with the truly historic opportunity presented by the Greenhouse Gas Reduction Fund (GGRF), one of the most groundbreaking programs created by the Inflation Reduction Act. While the GGRF is often described as a "national green bank," it is better understood as seeding an entirely new green finance ecosystem, powered by $20 billion from the federal government and intended to crowd in private investments. Through two separate programs, the National Clean Investment Fund (NCIF) and the Clean Communities Investment Accelerator (CCIA), these dollars will flow through intermediaries and lenders primarily[6] to provide financial assistance for projects that avoid or reduce emissions of greenhouse gases and other air pollutants.[7]

The statutory language in the IRA requires that all $6 billion of the CCIA must be provided in "low-income and disadvantaged communities."[8] In the case of the $14 billion NCIF, EPA has required that 40 percent of funds be provided for financial assistance in low-income and disadvantaged communities, consistent with the Biden Administration's Justice40 initiative. In other words, a total of $5.6 billion is set aside for climate investments in the communities that need it the most. In addition, all three intermediaries that have been awarded funds from NCIF have committed to even higher set-asides in these communities, ranging from 50 to 75 percent.

Climate United, a coalition of Self-Help, Community Preservation Corporation, and Calvert Impact, was awarded $6.97 billion under the NCIF and is unique among the NCIF intermediaries in their plan for standardized green mortgages for new homes, among other loan products. According to their workplan, these green mortgages will be offered through partner lenders throughout the country, prioritizing new multifamily construction in low-income and disadvantaged communities.[9]

Climate United's planned loan products for new single-family and multifamily construction require that buildings meet advanced energy performance standards, in addition to being all-electric and either solely powered by renewable energy or ready to be solely powered by renewable energy.[10] To qualify for these loans, new buildings must have 10 percent lower modeled energy use than the latest energy code, and multifamily properties must also meet the National Definition of a Zero Emissions Building.[11] Notably, these criteria appear to be compatible with the requirements for Fannie Mae's existing green mortgages and MBS, which have proven track records of success and growing investor interest over time.

Key to Climate United's strategy is their plan to scale their impact in the mortgage markets by building on established relationships with the GSEs, as well as with mortgage lenders and homebuilders. For single-family homes, Climate United's plan is for lenders to originate high loan-to-value mortgages, without mortgage insurance, making these loans more accessible to homebuyers. Climate United will purchase these loans at a slight premium, in order to cover the origination costs that are normally passed on to borrowers as a higher interest rate. Climate United will then sell the mortgages to the GSEs, along with a "top loss guaranty" backed by a loan loss reserve funded by the NCIF grant, meaning that Climate United will cover potential losses on these loans, using dollars set aside from the funds they were awarded from EPA. Next, the GSEs will bundle these loans into MBS to be sold to investors. The sale of mortgages to the GSEs will free up Climate United's capital to conduct further lending. Ultimately, the desired outcomes include not only environmental benefits like reduced greenhouse gas emissions and improved air quality, but also economic benefits for residents, including homeownership and wealth creation among communities that have historically been excluded from such opportunities.



Green Mortgages and Energy Efficiency For All

The introduction of Climate United's standardized green mortgages funded by the GGRF is poised to supercharge affordable and healthy housing for residents in environmental justice communities, facilitating a much-needed increase in construction of highly energy-efficient and resilient homes while also growing the GSEs' existing green financing activities.[12]

Adopting the latest energy code as a requirement for all GSE-backed mortgages has the potential to make affordable mortgages for energy-efficient homes significantly more accessible to broader swaths of Americans. Combining these two actions would have a synergistic effect, stimulating the green building industry and reducing up-front construction costs via increased demand. The increased property values and lowering operating costs associated with energy efficient buildings would also reduce the overall credit risk in the mortgage pool, adding further downward pressure on interest rates and mortgage costs. For renters, more energy-efficient buildings financed with preferentially-priced green financing can lead to reduced energy and housing burdens. GSEs can also leverage their existing initiatives to make homeownership more accessible, like promoting first-generation homeownership by committing to acquire increasing numbers of loans to first-generation buyers. In the current era of overlapping housing, climate, and energy affordability crises, the FHFA and GSEs should seize the opportunity to boost energy efficient homes alongside the rollout of billions of dollars of green financing to benefit environmental justice communities.

END NOTES

[1] Campaign for Lower Energy Costs, "Our Goals," accessed December 17, 2024; Tik Root, "This tweak to mortgage rules could save homeowners thousands in energy bills," *Grist*, September 23, 2024; National Archives, "Final Determination: Adoption of Energy Efficiency Standards for New Construction of HUD- and USDA-Financed Housing," *Federal Register*, April 26, 2024.

[2] Energy Star, "Single-Family Program Requirements," accessed December 17, 2024; Fannie Mae, "Single-Family Green MBS," accessed December 17, 2024.

[3] Fannie Mae, "Multifamily Green MBS," accessed December 17, 2024.

[4] 12 CFR Part 1293 (2024).

[5] Federal Housing Finance Agency, "Equitable Housing Finance," accessed December 17, 2024; Fannie Mae, "Equitable Housing Finance Plan 2025 – 2027," 2024.

[6] Some funds may be used for predevelopment, market-building, and program administration activities.

[7] The GGRF's third program, Solar for All, provides $6 billion for solar and storage in low-income and disadvantaged communities but functions more like a traditional grant program and is not designed to directly interact with the green finance ecosystem created by the NCIF and CCIA.

[8] As defined in the Notice of Funding Opportunity and Terms and Conditions for both the NCIF and CCIA, "low-income and disadvantaged communities" is defined by five categories: Climate and Economic Justice Screening Tool-identified disadvantaged communities; EJScreen-identified disadvantaged communities; geographically dispersed low-income households (generally, households with incomes not more than 80% of the Area Median Income, 200% of the Federal Poverty Level, and or 80% of the Statewide Non-Metropolitan AMI); properties providing affordable housing; and Federally Recognized Tribal entities.

[9] Climate United, "About Us," accessed December 17, 2024; Climate United, "Climate United Fund NCIF Workplan," August 2024.

[10] Climate United, "Frequently Asked Questions about the National Clean Investment Fund (NCIF) and Climate United's Strategy," August 16, 2024.

[11] U.S. Department of Energy, Office of Energy Efficiency & Renewable Energy, "National Definition of a Zero Emissions Building, Part 1: Operational Emissions from Energy Use, Version 1," June 2024.

[12] American Council for an Energy Efficient Economy, "EPA Can Supercharge Affordable, Healthy Rental Housing with Climate Law Funds," October 3, 2023.

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Author: Sylvia Chi, Senior Policy Analyst, Just Solutions

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