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Second Party Opinion

# Fannie Mae Single Family Green Bond Framework

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| **Location:** U.S. | **Sector:** Financial services |
|---|---|

## Alignment With Principles

Aligned = ✔ Conceptually aligned = ○ Not aligned = ✖

✔ Green Bond Principles, ICMA, 2021 (with June 2022 Appendix 1)

See Alignment Assessment for more detail.

**Light green**

Activities representing transition steps in the near-term that avoid emissions lock-in but do not represent long-term low-carbon climate resilient solutions.

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## Strengths

**Fannie Mae's investments encourage higher investments directed towards energy use and emissions reductions.** Eligible projects must demonstrate energy use reductions beyond what is required by state codes. Given Fannie Mae's national reach and influence, and the scale of its green MBS program, it would encourage property developers and other financiers to direct investments towards similar projects in the U.S.

**Fannie Mae has a successful track record of green MBS financing.** Fannie Mae has more than a decade of track record of green MBS investments and is one of the largest issuers of green financing in the U.S. The framework includes commitments to verify certifications and energy use reductions for financed properties, and Fannie Mae has a demonstrated history of impact reporting.

## Weaknesses

**Eligible projects may include new construction with fossil fuel boilers, which may reduce the potential emissions savings.** Although we note the predominance of natural gas heating systems in the U.S, the long useful life of these properties nevertheless locks in GHG emissions from such boilers, which may be significant especially when accumulated across the issuer's large and far-reaching green MBS program.

## Areas to watch

**Physical climate risk is a significant issue not directly addressed in the financing framework.** Fannie Mae's portfolio faces diverse physical climate risks including floods, wildfire, extreme weather, and sea level rise. Such impacts could undermine the benefits achieved through energy efficiency enhancements financed through the framework.

**The framework lacks considerations for the embodied and end-of-life materials management of the properties financed.** These concerns may be addressed on an individual property basis but are not directly included in the framework itself.

**Water stress and scarcity definitions can vary.** Given Fannie Mae's broad service area, the achieved environmental benefit from water certifications will depend largely on where the financed projects are located.

## Eligible Green Projects Assessment Summary

Eligible projects under Fannie Mae's Single-Family Green Bond Framework are assessed based on their environmental benefits and risks, using Shades of Green methodology.

| **Green Buildings** | **Light green** |
|---|---|
| Green Building Certification loans: Financing loans backed by properties that have been awarded eligible Green Building Certifications (GBC), that achieve 10% more energy efficiencies than residential properties built to state energy codes, at the time construction is completed or within five years from the date Fannie Mae purchased the loan. | |
| Solar Loans: Financing loans backed by newly constructed properties or existing homes which use solar photovoltaic (PV) systems as a source of renewable energy generation that produce a minimum of a 20% reduction of the home's electricity consumption. | |
| Water Efficiency Loans: financing loans backed by properties located in water stressed or water scarce areas with a Water Certification that achieves a water use reduction of at least 30%, at the time of construction or retrofits are completed or within five years from the date Fannie Mae purchased the loan. | |

See Analysis Of Eligible Projects for more detail.

# Issuer Sustainability Context

This section provides an analysis of the issuer's sustainability management and the embeddedness of the financing framework within its overall strategy.

## Company Description

The Federal National Mortgage Association (Fannie Mae), chartered in 1938 by the United States Congress, is the largest U.S. government-sponsored enterprise (GSE). Fannie Mae's mission is to facilitate equitable and sustainable access to homeownership and quality affordable rental housing across the U.S., supporting both single-family and multifamily housing. It provides market liquidity by purchasing mortgages from qualified originators which it then securitizes and sells to investors as mortgage-backed securities (MBS) with guarantees. Fannie Mae does not lend directly to consumers.

Fannie Mae serves the US housing market through its single family (1-4 residential units) and the multifamily mortgage businesses. It began issuing single-family Green MBS in April 2020 as an expansion of the company's existing Green Bond Program. The single-family business segment supports liquidity in the mortgage market by acquiring and securitizing single family loans into Fannie Mae MBS, as well as by issuing structured Fannie Mae MBS backed by single-family mortgage assets and buying and selling single-family agency MBS.

## Material Sustainability Factors

### Climate transition risk

Energy use in buildings is a major contributor to climate change, representing approximately a third of global GHG emissions on a final-energy-use basis for all building types, according to the IEA, but we note that Fannie Mae's financed properties are strictly residential. Embedded emissions from building materials and new construction may also adversely affect progress toward future low-carbon climate resiliency goals. This leaves the sector highly susceptible to the growing public, political, legal, and regulatory pressure to accelerate climate goals. Building occupiers may face higher energy bills as power prices rise, and higher capital expenditures as upgrades are required to accommodate the energy transition and meet more stringent efficiency standards. Incremental climate-related investments can require significant capital outlays but will potentially reduce the risk of obsolescence due to changes in regulation or climate goals.

### Physical climate risk

The geographically fixed nature of real estate assets exposes them to physical climate risks. While varying by location, these could include acute risks like wildfires, floods, and storms, which are becoming more frequent and severe, as well as chronic risks such as long-term changes in temperature and precipitation patterns and rising sea levels. Acute and chronic risks could damage properties or place tenant health and safety at risk, as well as require investments to manage potential effects or, in severe cases, relocation of tenants. The aggregate impact is moderate since the type, number, and magnitude of these risks varies by region, but highly exposed regions may be subject to material physical climate risk exposure. Most participants have some insurance coverage, but it could become more difficult to secure insurance for the most exposed assets in the future, absent adaptation.

### Access and affordability

Low housing stock and lack of affordable options can severely influence people's livelihoods, especially vulnerable, low-income populations who can face the threat of homelessness. Access and affordability is especially important for residential tenants in areas where rents can account for a large percentage of residents' incomes. While not addressed by Fannie Mae's program, which targets the residential real estate space, lack of accessibility and affordability of commercial properties can also hinder the sustainable growth of local communities.

### Impact on communities

Properties, and by extension the owners, are inherently part of the communities in which they operate because they provide an essential service and can shape communities economically and socially. The residential sector is particularly meaningful to communities, where affordable housing and gentrification pressures can alter communities' social fabric and can be challenging to remediate.

# Issuer And Context Analysis

The green building project categories aim to address climate transition risk, which we consider to be a material sustainability factor for Fannie Mae. We note that because the green projects do not prohibit the use of fossil fuels there is slight risk of emissions lock-in, although this is partially mitigated by demanding energy efficiency requirements of the eligible projects.

**Fannie Mae addresses climate transition risk through its single-family green financing program, which finances building that are environmentally sustainable, having either green building certifications or use of onsite renewable energy.** While water is not considered a material sustainability factor for Fannie Mae as a whole given the diversity of water stress challenges, the presence of a water-stress requirement means that these loans will be made in parts of the U.S. where the issue is more material. Fannie Mae aims to mitigate climate transition risk through the projects financed under its single-family Green Bond framework. The framework's focus on financing single-family housing green building projects ties directly to transition risk for the issuer's loan portfolio through financed risk and the exposure of the buildings themselves. As regulations on buildings' sustainability performance become more stringent, owners and building managers face pressure to improve the energy, water, and emissions performance of the assets. Buildings with improved environmental attributes can afford lower operating costs and preempt the requirements of new legislation. Fannie Mae has a track record of over a decade of achieving a positive environmental impact in terms of energy efficiency, avoiding greenhouse gas (GHG) emissions, through its financed projects. However, at a corporate level, we note that Fannie Mae's emissions metrics and target reporting is limited, as the company does not report its scope 1, 2, or 3 emissions, nor does it have emissions reduction targets.

**The framework does not directly address physical climate risk in Fannie Mae's loan portfolio, although we note the issuer's climate strategy is built around quantifying its financial and business exposure, mitigation capabilities, and awareness among its stakeholders.** Buildings across the US are exposed to many physical climate impacts including damage from acute events such as floods, intense storms, and wildfires and chronic impacts from rising sea levels. In our view, the inclusion of physical climate risk criteria and mitigation parameters in future financings could help reduce the risk of damage to buildings underlying the loan portfolio and thereby help ensure that the full sustainability benefits of the financings are realized. The framework lacks criteria to address these risks, although we note the issuer's climate strategy to address these risks is built around quantifying its financial and business exposure, mitigation capabilities, insurance requirements, and awareness among its stakeholders.

**Fannie Mae manages access and affordability of housing in the U.S. by indirectly funding affordable housing through various programs.** While this topic is not the target of the framework, Fannie Mae indirectly supports affordable housing in the U.S. through its purchase and securitization of mortgages and has extensive programs in place that aim to lower the cost of housing. Considering the declining affordability of housing in the U.S., the role of entities such as Fannie Mae that support liquidity in the mortgage market is rising in importance. Apart from providing liquidity to affordable housing market, it offers unique housing solutions to make loans affordable for low-income and first-time buyers, with schemes such as low down-payments home mortgage offerings to credit-deprived and underserved population through its proprietary automated underwriting system.

# Alignment Assessment

This section provides an analysis of the framework's alignment to the Green Bond principles.

## Alignment With Principles

Aligned = ✔ Conceptually aligned = ○ Not aligned = ✖

✔ Green Bond Principles, ICMA, 2021 (with June 2022 Appendix 1)

### ✔ Use of proceeds

The framework's project categories are assessed as light green, and Fannie Mae commits to finance properties that meet certain Green Building Certifications, properties that use solar photovoltaic systems as a source of renewable energy, and water efficiency loans for properties in water stressed or water scare areas that achieve a water certification with a water use reduction of at least 30%. Please refer to Analysis of Eligible Projects section for more information on our analysis of the environmental benefits of the expected use of proceeds.

### ✔ Process for project evaluation and selection

The process for project evaluation and selection is described in the framework. Loans purchased by Fannie Mae from its lenders must be identified as receiving, at a minimum, an approved GBC from the list of 32 eligible certifications mentioned in the framework having minimum energy efficiency performance improvement of 10% over the state energy code, achieving an at least 20% reduction in a home's electricity usage offset by solar PV generation, and/or an eligible water certification with a minimum 30% reduction in consumption for a property built in a water stressed or water scarce area. For Fannie Mae to buy a mortgage loan from a lender, the lender is required to represent and warrant that the loans it is selling Fannie Mae meet general criteria described in the Fannie Mae Single-Family Selling Guide. These projects clearly provide energy transition benefits and serve climate mitigation objective. In addition, before the MBS is issued, Fannie Mae will independently verify the GBCs by validating the existence of a valid certification and a minimum of 20% reduction in electricity usage by reviewing property data, which we view favorably.

### ✔ Management of proceeds

The management of proceeds from the Green MBS is consistent across Fannie Mae's single-family securitization programs. Fannie Mae commits to acquire the mortgage loan from the lender if it conforms to all requirements stated in the Fannie Mae Single-Family Selling Guide. Once acquired, Fannie Mae securitizes the loan into a fully guaranteed MBS and sells it to the general MBS investor community. For each pool of loans to be securitized, a separate trust is created, the purchased loans are placed in this trust and a Green MBS backed by the loans in the trust is issued. The process differs from the typical use and management of proceeds associated with green bond issuances, in that Fannie Mae Single-Family has already made the eligible investments prior to green bond issuance and uses green bond proceeds to recoup the funds. According to the issuer, there will be no unallocated proceeds.

### ✔ Reporting

Fannie Mae commits to report high-level overview of the program and a list of all Single-Family Green MBS issued to date through a dedicated page on its website. Proceeds from MBS issued under the framework will be used to finance mortgage loans identified that are consistent with the criteria set forth in the framework, eliminated the need for reporting until full allocation of proceeds. The framework includes a commitment to publish certain green disclosures included in the green MBS documentation as a part of impact reporting. Additionally, on an annual basis Fannie Mae publishes the green MBS assets for preceding year and associated actual impact metrics in its impact report. Fannie Mae has a successful track record of impact reporting for the past issuances with metrics for both environmental and social outcomes, which we view favorably.

# Analysis Of Eligible Projects

This section provides details of our analysis of eligible projects, based on their environmental benefits and risks, using the Shades of Green methodology.

Under the current framework, Fannie Mae Single-Family expects to use the majority of proceeds under the GBC project category, with proceeds going to the solar loans and water efficiency loans categories expected to grow slowly over time.

**Light green**

Activities representing transition steps in the near-term that avoid emissions lock-in but do not represent long-term low-carbon climate resilient solutions.

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### Overall Shades of Green assessment

Based on the project category shades of green detailed below, and consideration of environmental ambitions reflected in Fannie Mae's Single-Family Green Bond Framework, we assess the framework as light green.

## Green project categories

### Green Buildings

| Assessment | Description |
|---|---|
| Light green | i. **Green Building Certification Loans:** Financing loans backed by properties that have been awarded eligible Green Building Certifications (GBC), at the time construction is completed or within five years from the date Fannie Mae purchased the loan, including certifications with the following criteria:<br>a. Main Group: at least a 10% improvement in energy savings over the state energy code where the property is located.<br>b. Towards Zero Group: greater than 50% reduction in energy use over the state energy code where the property resides.<br>ii. **Solar Loans:** Financing loans backed by properties which use solar photovoltaic (PV) systems as a source of renewable energy generation, which produce a minimum of a 20% reduction of the home's electricity consumption on an annual basis. Solar loans can be used by borrowers who are:<br>a. financing a home with an existing solar PV system,<br>b. refinancing a home with the proceeds paying off outstanding debt used for solar PV installation, or<br>c. purchasing or refinancing a home with the loan proceeds being used to add solar PV to the property.<br>iii. **Water Efficiency Loans**: Loans backed by properties in water stressed or water scarce areas with Water Certifications achieving a water use reduction of at least 30%. Eligible certifications maximize water efficiency at the lowest-cost intervention point (e.g., for new construction, when the home is being designed and built) and reduce the impact on existing water resources while providing utility savings for homeowners. |

**Analytical considerations**

- Green buildings support climate change mitigation by alleviating greenhouse gas emissions. They also have other benefits such as increasing energy efficiency, reducing water consumption, and ensuring waste management. However, construction activities introduce other issues like energy performance and emissions associated with building materials. Physical climate risks are material considerations for buildings, and new construction may raise biodiversity issues. The project's eligibility criteria do not exclude properties with fossil fuel heating.
- Fannie Mae's eligibility criteria allow new and existing buildings to qualify for the green MBS program through green building certifications, solar self-generation, and water use certifications. While the required energy, electricity, and water use performance improvements have quantitative thresholds for eligibility and may represent near-term transition measures, leading to a green shade, in their current state they are not sufficiently ambitious to be fully consistent with a long-term view of a low-carbon and climate resilient future. In addition, they do not address issues such as embodied emissions and physical climate risks. The potential emissions savings from improved energy performance, use of onsite solar PV, and water efficiency savings may also be curtailed by the eligibility of homes with fossil fuel boilers, which may lock in emissions over the lifetime of the home, limiting our assessment of the overall category to Light green.
- Fannie Mae's eligible GBC loans category supports the construction of new homes with energy efficiency requirements that go beyond minimum regulatory requirements to achieve a minimum energy savings of 10% over the state energy codes. During initial financings under the framework, the issuer expects higher capital allocation from GBC loans to go toward the "Main Group" (with less ambitious energy performance improvements) but over a period expects increasing capital allocation toward the "Towards Zero Group," having relatively ambitious energy performance improvements.
- According to the issuer, only loans backed by newly constructed homes are eligible for GBC loans. Given the long useful life of buildings, all new construction must be state-of-the-art and zero-carbon-ready by 2030 in order to align with a 1.5-degree climate scenario, which entails having both on-site renewable energy systems and very high levels of energy efficiency. While it is possible that some certifications in the "Towards Zero Group" may deliver such levels, those in the "Main Group" will not.
- With respect to the solar loans, while we view investments in solar PV systems as Dark Green due to the criticality of renewable energy in the green transition, the issuer is unable to only finance the investments in solar PV systems and will use green proceeds to finance the full value of the eligible property loans. Such a financing arrangement may offer relatively limited energy use reduction benefits in relation to the total energy use of a home. All borrowers to undertake the U.S. Department of Energy's Home Energy Score (HES) assessments in order for the solar loans to be eligible under the framework. We view positively that the solar PV systems must produce a minimum of 20% reduction of the home's electricity consumption on an annual basis, but we note that the total energy use reduction will depend on other characteristics of the individual property and will likely not be uniform across states. While we believe that the environmental benefit of this category is sufficient to be assessed as Light green, we are unable to quantify the exact benefit because of these variations.
- For water efficiency loans, Fannie Mae will finance properties that achieve a 30% reduction in water use through an eligible water certification and are located in water stressed or water scare areas, as defined by existing industry recognized sources. Eligible certifications include U.S. Environmental Protection Agency's WaterSense and International Living Future Institute (ILFI) Living Building Challenge Core and Living Building Challenge Water Petal.
- In our view, the most material sustainability consideration for green buildings is related greenhouse gas emissions, followed by energy use. While there may be accompanying energy use reductions due to the 30% water use reduction, the extent of these energy use reductions is unknown and will depend strongly on the characteristics of each individual property, but we note that a 30% reduction in water use leads to an energy use reduction of 8% on average. That said, limiting eligible properties under this category to water scarce or water stressed areas means that the environmental benefit of these water use reductions is highly material and significant, which is reflected in the assessment of Light green.
- Fannie Mae may create new single-family green MBS securities by resecuritizing previously issued single-family green MBS or by comingling green MBS with green MBS issued by the Federal Home Loan Mortgage Corp. (Freddie Mac). Such Freddie Mac securities would include only eligible mortgages that meet the criteria under Freddie Mac's single-family green MBS framework. Importantly, the environmental impact benefits of such resecuritizations will be reported separately for Fannie Mae and Freddie Mac's underlying mortgages in the event they are comingled.
- The climate and environmental impacts of new buildings and the associated supply-chain, such as construction materials, is linked with deforestation and biodiversity loss. The framework does not directly address these environmental risks.
- The issuer confirmed that physical risk management for the single-family green MBS program is the same as for all other loans in the company's portfolio. The issuer is currently working to improve its physical and transition risk analysis and has committed to re-evaluating metrics at a minimum every three years as it updates the framework.

## S&P Global Ratings' Shades of Green

| | | | | | | |
|---|---|---|---|---|---|---|
| **Assessments** | **Dark green** | **Medium green** | **Light green** | **Yellow** | **Orange** | **Red** |
| **Description** | Activities that correspond to the long-term vision of an LCCR future. | Activities that represent significant steps toward an LCCR future but will require further improvements to be long-term LCCR solutions. | Activities representing transition steps in the near-term that avoid emissions lock-in but do not represent long-term LCCR solutions. | Activities that do not have a material impact on the transition to an LCCR future, or, Activities that have some potential inconsistency with the transition to an LCCR future, albeit tempered by existing transition measures. | Activities that are not currently consistent with the transition to an LCCR future. These include activities with moderate potential for emissions lock-in and risk of stranded assets. | Activities that are inconsistent with, and likely to impede, the transition required to achieve the long-term LCCR future. These activities have the highest emissions intensity, with the most potential for emissions lock-in and risk of stranded assets. |
| **Example projects** | Solar power plants | Energy efficient buildings | Hybrid road vehicles | Health care services | Conventional steel production | New oil exploration |

Note: For us to consider use of proceeds aligned with ICMA Principles for a green project, we require project categories directly funded by the financing to be assigned one of the three green Shades.

LCCR--Low-carbon climate resilient. An LCCR future is a future aligned with the Paris Agreement; where the global average temperature increase is held below 2 degrees Celsius (2 C), with efforts to limit it to 1.5 C, above pre-industrial levels, while building resilience to the adverse impact of climate change and achieving sustainable outcomes across both climate and non-climate environmental objectives. Long term and near term--For the purpose of this analysis, we consider the long term to be beyond the middle of the 21st century and the near term to be within the next decade. Emissions lock-in--Where an activity delays or prevents the transition to low-carbon alternatives by perpetuating assets or processes (often fossil fuel use and its corresponding greenhouse gas emissions) that are not aligned with, or cannot adapt to, an LCCR future. Stranded assets--Assets that have suffered from unanticipated or premature write-downs, devaluations, or conversion to liabilities (as defined by the University of Oxford).

# Related Research

- Analytical Approach: Second Party Opinions: Use of Proceeds, July 27, 2023
- FAQ: Applying our Integrated Analytical Approach for Use-of-Proceeds Second Party Opinions, July 27, 2023
- Analytical Approach: Shades of Green Assessments, July 27, 2023
- S&P Global Ratings ESG Materiality Maps, July 20, 2022

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