# GREEN RMBS ON HOLD BUT PIECES COMING TOGETHER

Decarbonisation of Australia's housing sector has been slow to gather momentum and funding the process has made little impression on capital markets. But evolving standards, data availability and definitions may give mortgage lenders the tools they need to build a bigger green securitisation market.

BY KATHRYN LEE

In June, Firstmac privately placed a A$1.2 billion (US$794.4 million) residential mortgage-backed securities (RMBS) transaction that included A$306 million of senior green notes. The inclusion of green bonds in an RMBS is not unprecedented but the deal marked a new development in the type of collateral offered.

These are loans extended to borrowers on the basis that they will install rooftop solar on the home within six months. Only when the installation has been verified does Firstmac add the loan to its green home loan pool.

James Austin, Firstmac's Brisbane-based chief financial officer, says this requirement for the first time brings materiality into the green RMBS discussion and is a step-change from what has been the market standard. Past green RMBS issuance has been based on Climate Bonds Initiative (CBI) proxies, which for the most part concentrate on minimum jurisdictional standards for recent builds.

"The reality is that the base CBI approach – by building code – doesn't change anything in and of itself because the homes are already built when the loan is written," Austin told *KangaNews* in the wake of the latest Firstmac transaction. "The 'mark two' collateral we are using can only qualify as green if it is actively reducing carbon emissions."

The loan product Firstmac is offering is not unique. Brighte has built a securitisation programme on its lending to homeowners to add energy-efficiency features. Commonwealth Bank of Australia offers a A$5,000-30,000 green loan that customers can add to their existing mortgage to buy and install clean-energy products such as solar panels, battery packs, heat pump hot water systems and energy-efficient window treatments – though it has not used this as securitisation collateral.

Meanwhile, Bank Australia offers a discounted rate clean-energy home loan but does not fund it using RMBS, though it has issued some sustainability bonds. RACQ Bank and Gateway Bank also offer green home loan products but have limited presence in wholesale capital markets and no green-labelled issuance.

In short, most lenders that are incentivising home energy upgrades are not offering this collateral to the wholesale funding market in green format.

Mark Robinson, National Australia Bank (NAB)'s Sydney-based head of climate, technical advisory, believes lack of issuance demonstrates how hard it is to meet the hurdle requirements for green securitisation. Specifically, he believes it reflects the data challenges financial institutions face as the rigour around green standards evolves.

Scale has also been an issue. Jane Kern, Bank Australia's Melbourne-based head of impact management, says: "Building a pool of high-integrity green mortgages that is large enough for a green RMBS is a barrier for us at the moment."

Banks, especially the majors, also have plenty of wholesale funding options against which labelled funding has to stack up – which can be hard in a world in which the labelled option rarely if ever offers the issuer a pricing advantage (see box on p54).

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**GRACE TAM** CLEAN ENERGY FINANCE CORPORATION

## ASSET GROWTH

Even so, many market users believe the fundamental challenge for building green residential funding lies not at the capital markets end but in the product space – specifically, in the volume of suitable lending. Some sustainable finance specialists are changing their focus as a result.

In 2021, Clean Energy Finance Corporation (CEFC) provided investment support to Australia's first all-green RMBS transaction – a A$750 million deal from Firstmac. But CEFC has now turned its attention to getting direct support to consumers rather than incentivising labelled securitisation in the wholesale funding market.

Grace Tam, CEFC's Sydney-based head of consumer finance, says the early green RMBS transactions established proof of concept – that there is demand for labelled funding, and that labelled issuance best practice is to have a second-party opinion and ongoing reporting. However, she says CEFC now believes its resources are best dedicated to supporting investors' growing expectation of demonstrable impact. This means helping to create new lending products that improve the energy performance of underlying assets.

It takes time to build up these portfolios. Until the market has built up enough volume to meet capital-market expectations, Tam says it makes sense to encourage securitisers and lenders to put their efforts into the consumer product side.

Tam says a significant uptick in labelled securitisation is not yet possible. "Originators need to offer green consumer loan products and wait for their pools to build enough volume to be able to securitise," she confirms. "The sooner originators start turning their minds to it, the better positioned they will be to establish processes and systems – including upskilling their workforce on sustainability, and implementing new data collections and reporting functions."

An example of this product focus is CEFC's collaboration with nonbank lender Plenti via CEFC's A$1 billion Household Energy Upgrades Fund (HEUF). The fund has committed A$60 million to Plenti to support a discounted rate on the lender's standard green loan. This product finances the purchase and installation of clean energy products such as solar panels and home batteries.

This is not just about developing a product and putting it on the shelf in the hope that it will resonate with borrowers. Tam says CEFC is working with lenders to understand what drives consumer uptake and, by doing so, help them build green consumer loan portfolios. "We are also willing to work with lenders to refine their product offering to support their customers' uptake of home energy technologies," she adds.

For instance, the Plenti collaboration is also designed to help households work out where investment in their property will pay off. A key purpose of HEUF is to work with the finance sector to establish consumer loan products that offer borrowers an interest rate discount and also tools to help households navigate the home energy ecosystem.

Tam says it is not enough to offer a discounted interest rate – the guidance part is also vital. "Households want to receive tailored advice to help them install fit-for-purpose systems, including staging installations to meet the budget," she says. "It is quite complicated for a household to determine if it needs to couple solar with a battery, at what system size, and if it should replace or install other appliances such as a heat pump hot water system."

## DATA TROVE

A vital component in developing products that borrowers want – and one that can also facilitate the link through to funding of such products in capital markets – is the quality and availability of household emissions data. The same data that can allow households to work out where investment in energy efficiency will be rewarded could also help lenders demonstrate materiality and impact to debt investors.

Tam says: "When we work with a lender, we require that it updates systems and processes so it can collect data from its green consumer loans, including attributes such as the type of technologies that have been installed and system capacity size. Lenders are able to report on this in future if they choose to undertake a green-labelled funding transaction."

Data has traditionally been a challenge in the Australian residential market. Home building standards are set and administered on a state level rather than nationally, which made even the most primitive form of green RMBS – inclusion of loans based on the build date of the property – restricted to collateral from New South Wales, Tasmania and Victoria.

Lenders, meanwhile, freely acknowledge that they typically have little or no visibility of the energy efficiency of properties they lend against, or of incremental improvements made to them. This is why the recent Firstmac RMBS represents a step forward: it ties pool inclusion to a verified improvement in the energy efficiency of the green loan collateral.

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**MARK ROBINSON** NATIONAL AUSTRALIA BANK

## *GREEN DESIRABLE* BUT FOR THE SAME PRICE

The labelled bond and securitisation markets have not developed a demonstrable 'greenium' for issuers, and the value of the additional investment dollars attracted to such transactions is marginal for most financial institutions.

Columbus Capital (ColCap), has issued three residential mortgage-backed securities (RMBS) transactions that incorporate green notes. Its last deal, in June, included a A$100 million (US$66.2 million) green tranche in a A$700 million private placement.

David Carroll, treasurer at ColCap, says robust interest in the green tranche did not translate to a discount. "We would like to see this change, but we expect little movement in the short term. When investors get to the crunch of choosing between price or green, price usually wins – even if they are really keen on green," he comments.

This can leave lenders directly out of pocket. James Austin, Firstmac's chief financial officer, explains: "The market doesn't offer a greenium for green tranches. We provide a 60 basis point discount to the [green loan] borrower and there needs to be a benefit for us to do so."

Firstmac used the green tranche in its recent privately placed RMBS as an inducement to allocate to the whole pool. Including the green loans therefore gave access to a bigger volume of capital. "It would not be economic to sell green tranches to the market with no other benefit – there would be no point," Austin concludes.

Liz Harrison, Melbourne-based fixed interest strategist, ESG at Janus Henderson Investors, suggests it is hard for the market to develop with such limited supply. "If there was more product available and green was available across the whole capital structure – which gives us more flexibility in how we invest – we would be very keen for it. But there is a supply issue," she tells *KangaNews*.

Harrison says Janus Henderson supports the idea of a greenium in principle, but for one to emerge would likely require further market developments including a taxonomy, better availability of data, and more issuance.

"At core, we want to reduce the cost of financing for the issuer so this can be passed onto the mortgagee," she says. "We know reporting requirements and other aspects can be quite onerous for the issuer. Unless there is an economic incentive – which could include diversity of funding as well as lower cost of funding – the only other incentive is good reputational value."

Meanwhile, Austin is doubtful the Australian green RMBS market will offer a greenium unless there is a push from external forces. "It is possible but it would likely need to be regulatory-driven, or driven by the end retail investor who is putting money into funds and demanding the investment be green," he tells *KangaNews*. "Unless factors like this drive it, it probably won't develop. Greeniums are more likely to exist overseas because regulation requires funds to hold a certain amount of green assets, and this creates demand."

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**LIZ HARRISON** JANUS HENDERSON INVESTORS

There may be more potential for issuers to demonstrate this type of materiality in future. In June, CoreLogic launched the RapidRate tool for financiers that use its property data. Developed by the Commonwealth Scientific and Industrial Research Organisation (CSIRO), the tool uses machine learning coupled with property data from CoreLogic to assign dwellings an estimated star rating out of 10 that is aligned with Nationwide House Energy Rating Scheme (NatHERS).

At the moment, the estimate is only based on the thermal shell. But CoreLogic and CSIRO plan to add an interface so users can feed in information to allow the tool to estimate a property's total energy consumption, including carbon emissions from lighting, fixed appliances and pools, and energy generation by solar panels. RapidRate data demonstrate that Australian homes' reputation for poor energy efficiency is richly deserved. Analysis completed during the tool's pilot period estimate the average Australian residential dwelling has an energy rating of 2.3-3 stars out of 10. The National Construction Code (NCC) required a minimum 6-star energy rating for new residential construction from 2016, and 7 stars from 2018.

Independently, the Australian government is working on methodology to officially expand NatHERS assessments to existing homes – allowing for an actual rating rather than an estimate. At present, a formal NatHERS rating is only available for new builds or major renovations. The update is expected to be completed in mid-2025.

In addition, the federal government is also looking to establish a national framework for energy efficiency disclosure. If implemented, home energy performance information could be disclosed at the point of sale or lease, similar to the UK where properties are required to have an energy performance certificate before being listed to sell or rent.

David Carroll, Sydney-based treasurer at Columbus Capital (ColCap), says information like this would make it easier for the lender to filter its portfolio and increase its proportion of green RMBS. Currently, ColCap's green RMBS notes are based on new-build proxies. "We have a business in the UK, where all property valuations have a green rating – which makes it a lot easier to do green RMBS. We want to be able to classify more of our Australian loans as green and build a bigger pool," he says.

Ché Wall, Sydney-based director at Flux Consultants, co-founded the Green Building Council of Australia, is a technical expert for buildings on the CBI building sector criteria, and is construction and built environment technical lead for the Australian sustainable finance taxonomy. He says a similar disclosure model to the one that has been developed in the UK would work well in Australia.

However, Wall stresses that the information must be made available on a central database. "Some countries in Europe have similar rating schemes but don't centralise them: there is no way of accessing the information. It is a requirement to get a rating at the point of sale or to get building approval – but that's it. It then sits in a drawer," he comments.

## CLASSIFYING GREEN

Alongside advancements in residential dwelling energy-efficiency data, the forthcoming Australian sustainable finance taxonomy aims to make it clearer what activities are climate-aligned.

Nicole Yazbek-Martin, the Australian Sustainable Finance Institute's Canberra-based head of taxonomy and natural capital, says three main categories are relevant to residential lenders. The highest standard will be for new homes, which will need to meet the energy-efficiency requirements set out in 2022's NCC – regardless of state-based variations – to count as green under the taxonomy. This means they must be all electric, and have low emissions and high-performing fixed appliances such as hot water heating.

For renovation works to be classified as green under the taxonomy, the renovation will need to enable the home to meet the same criteria as new builds. Renovation works that are not able to meet the green criteria can have a transition label if the works improve the operational efficiency of the home by 30 per cent and do not include the installation of any new fossil fuel appliances or extend the current operating life of existing fixed fossil fuel appliances.

Finally, existing homes that do not undertake renovation works can still be eligible for green finance for the purchase and installation of new equipment, appliances and infrastructure that support emissions reduction or energy efficiency – including electrification and solar panels.

The taxonomy will be voluntary, as is CBI's taxonomy. The idea, though, is for the local taxonomy to become the green residential standard for Australia. Yazbek-Martin says the combination of criteria in the Australian draft taxonomy for the built environment better aligns it with Paris Agreement trajectories than the CBI standards or the EU taxonomy (see box on p56).

"The most recent NCC is a high standard and only two jurisdictions in Australia have fully adopted the code for residential buildings so far," she suggests. "It will entail a significant uplift in residential energy efficiency across the board, and not every house will be compliant. It is aligned with a current 1.5-degree trajectory with ongoing improvements expected in future iterations."

For banks, Yazbek-Martin says the taxonomy will clearly show which activities are aligned with green criteria and which encourage improvement. She argues that banks will want as much existing housing stock to move into the green home category as possible. But even with green product incentives they will still be able to demonstrate that their lending portfolios encourage the installation of new green products and services.

For borrowers, Yazbek-Martin argues: "Whether or not an individual is accessing green finance to make their home more energy efficient or is accessing a loan that helps them renovate to the extent that they move into the green home loan category, consumers will have options and access to green finance."

## NEXT FRONTIER

As data become easier to access and definitions more robust, market users believe households will become more aware of their energy efficiency and more interested in making positive changes. With clearer information on what sorts of upgrades are effective and more guidance for what product offerings lenders can tout, there is a degree of optimism about uptake of specialist financing – and, therefore, capital market potential.

NAB's Robinson says this represents the next stage of the net zero transition. "Most banks have sustainable finance teams but they have historically been focused on bespoke transactions for

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**JAMES AUSTIN** FIRSTMAC

## *MATERIALITY* OF ADDITIONALITY

Increased certainty on the climate alignment of specific activities could be an important input in making sure capital and resources are directed to areas of maximum impact. Market users say it will also help avoid concentrating efforts where no further help is needed.

One of the first rules of comedy is 'don't put a hat on a hat'. By the same token, sustainable finance is not optimsed when it is funnelling resources and capital toward activities that are already sufficiently green.

Nicole Yazbek-Martin, the Australian Sustainable Finance Institute (ASFI)'s head of taxonomy, says the local taxonomy makes an important distinction between climate alignment and additionality. "We are defining green as activities that are aligned with a 1.5-degree trajectory," she says. "We don't want to be incentivising energy efficiency to the nth degree with no end. Holistically, we want to allocate capital to entice value, including from climate perspectives."

The two main ways to ensure homes are on a 1.5-degree aligned trajectory, Yazbek-Martin continues, is to build them for optimal energy efficiency and ensure they are all electric. "Once we get to a point in the building code where the energy efficiency of the building is optimised for 1.5-degree alignment, we don't need to incentivise continually above this. It feeds into additional cost and misallocation of capital when there are other areas to focus on."

In the draft taxonomy consultation, ASFI asked users if the taxonomy should allow for a 10 per cent energy efficiency uplift on National Construction Code (NCC) requirements, as is required by Climate Bonds Initiative (CBI)'s green star buildings criteria and in the same manner as the EU's taxonomy requires benchmarking against its "nearly zero energy" building standard.

Given the strength of the NCC standard, Yazbek-Martin says the requirement for an uplift above it may not necessarily be required by the Australian taxonomy criteria.

In particular, adding this further requirement would likely not produce a significant impact. According to the draft taxonomy, a 10 per cent uplift on NCC requirements would reduce energy consumption in the building sector by 3 per cent in 2050 and greenhouse gas emissions by 0.013 per cent from a 2024 baseline.

"It creates a tiny reduction in emissions but also a lot of potential usability hurdles. We have to ask what the value of this trade-off really is," Yazbek-Martin explains. "Our proposed criteria use the building code for energy-efficiency threshold, which is a 1.5-degree-aligned standard, and eliminates the use of fossil fuels by requiring electrification. This combination makes very strong criteria, which are more climate-aligned than current criteria like CBI and the EU."

ASFI hopes the taxonomy will become the green criteria for residential mortgage-backed securities. Yazbek-Martin tells *KangaNews*: "It is highly credible and its linkage to the building code to demonstrate energy efficiency provides a clear and easily identifiable benchmark for banks to use."

Ché Wall, director at Flux Consultants, says a 10 per cent uplift is largely arbitrary in the case of the EU's taxonomy. He asks: "What is the science behind 10 per cent – why not 15 per cent or 20 per cent? How much of a difference does it make? When building codes are written, they do a lot of work on societal cost benefits. It may not be perfect, but there is substance. There is no indication that a 10 per cent uplift is in the best interest of the planet."

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**NICOLE YAZBEK-MARTIN** AUSTRALIAN SUSTAINABLE FINANCE INSTITUTE

the corporate and institutional end of town. The industry is now starting to focus on green labelled product at mass market scale," he says.

As an example, he says NAB recently launched its green finance for commercial real estate lending product to add to a suite that already includes green finance for vehicles and equipment, and green finance for agribusiness. "We are really focusing on how we can help business banking customers engage with green finance and, in doing so, tapping into a larger slice of the real economy."

Reliable, freely available data and clear direction will be crucial if this push into the retail space is to work. "We are working toward and deploying the next horizon of sustainable finance, and we are going to do it with the next generation of sustainable finance taxonomies and standards," Robinson continues. "On one hand, this is more scientifically credible – but it is also more challenging. Data become much more important."

While data and definitions evolve, lenders will likely be constrained in their ability to pursue green RMBS issuance. It may take all aspects to develop further before the door to sustainable issuance opens more significantly. "Once consumer offerings, data and taxonomy are available, I believe we will start to see more labelled issuance – at least, when issuers are able to build up a large enough pool of green assets," says CEFC's Tam. •