BlackRock

# Accessing Impact in Agency Mortgages


## Key points

Impact Mortgage-Backed Securities (“MBS”) are designed to support sustainable access to homeownership and seek to provide an attractive yield and liquidity profile

Specific mortgage programs help facilitate equal access to homeownership for mortgage-ready borrowers, helping to remove barriers to mortgage credit and reach underserved populations

The BlackRock Agency MBS Team has developed Impact reporting to monitor key Impact metrics to capture, evaluate and report on tangible key performance indicators

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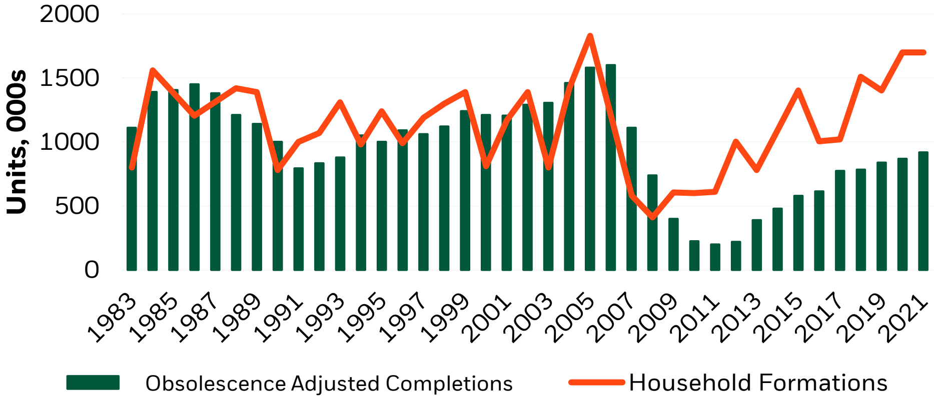
# Introducing Impact Mortgages

## Foreword

While many aspects of the U.S. consumer balance sheet show signs of resilience in our view, the pressures of inflation pushing through in the form of higher food and gas prices coupled with the rising cost of shelter has the potential to strain many households. In the U.S., the cost of both rental housing and homeownership have reached multi-decade highs, which in our view has stemmed from an underbuilding of affordable housing units rather than the unhealthy source of too much demand.

**The U.S. built fewer homes in the 2010's than in any decade since 1960's**




Source: Morgan Stanley as of 30 June 2022

Housing is about more than just where we live; homeownership has been an important driver of wealth creation across generations – but not everyone has had equal access to that opportunity, and with the pressures of today top of mind, the legacy of that inequity may continue to grow and worsen. In the paper that follows we highlight the features of Impact MBS, a subset of the U.S. Agency MBS market.

1. Impact MBS will literally hit home for many households – as we outline in the following piece Impact MBS may play a direct and critical role in individual housing finance.
2. As with all Agency MBS, Impact MBS have a similar credit and liquidity profile as U.S. Treasuries – but seek to provide a greater yield than U.S. Treasuries bonds. That pick-up in yield is compensation for prepayment risk, which is the central risk for mortgages and may reduce the yield and market value of those securities. One way to think about prepayment risk is the unknown speed in which cash flows are received by the investors – will they be slow when investors want them to be fast? Will they be fast when investors want them to be slow? This differs from the central risk of other fixed income sectors which may reduce the yield and market value of those securities but plays an important role in diversifying one's fixed income allocation.

We believe diversification alongside the added feature of sustainability will offer a new lens to view this sector. Thanks for taking the time to learn more, and as always, we'd appreciate any feedback and thoughts.

**Matthew Kraeger**
Agency MBS Lead Portfolio Manager

Capital at risk. The value of investments and the income from them can fall as well as rise and are not guaranteed. Investors may not get back the amount originally invested. Diversification may not fully protect you from market risk. Investing in mortgage-backed securities ("MBS") entails various risks which include: credit risk associated with the performance of the underlying mortgage properties and of the borrowers owning these properties; risks associated with their structure and execution (including the collateral, the process by which principal and interest payments are allocated and distributed to investors and how credit losses affect the issuing vehicle and the return to investors); risks associated with the servicer of the underlying mortgages; adverse changes in economic conditions and circumstances, which are more likely to have an adverse impact on MBS secured by loans on certain types of commercial properties than on those secured by loans on residential properties; prepayment risk, which can lead to significant fluctuations in the value of the MBS; loss of all or part of the premium, if any, paid; and decline in the market value of the security, whether resulting from changes in interest rates, prepayments on the underlying mortgages; adverse changes in economic conditions and circumstances, which are more likely to have an adverse impact on MBS secured by loans on certain types of commercial properties than on those secured by loans on residential properties; prepayment risk, which can lead to significant fluctuations in the value of the MBS; loss of all or part of the premium, if any, paid; and decline in the market value of the security, whether resulting from changes in interest rates, prepayments on the underlying mortgage collateral or perceptions of the credit risk associated with the underlying mortgage collateral. MBS generally are classified as either residential MBS ("RMBS") or commercial MBS ("CMBS"), each of which are subject to certain specific risks.

# Housing is about more than just where we live

**The Agency MBS market has an expansive reach – from the doorstep of one of the most valuable financial assets many individuals will access over their lifetime to playing a critical role in fixed income asset allocation.**

The Agency MBS market supports the U.S. housing finance market by helping to facilitate access to credit for homeownership. The depth of liquidity, homogeneity and credit profile of the Agency MBS market attracts an audience from around the globe.

Ginnie Mae, Freddie Mac, and Fannie Mae seek to provide liquidity, stability, and sustainable access to homeownership. The role the U.S. government plays in the housing market has yielded an $8 trillion USD fixed income market providing comparable liquidity and credit quality to that of U.S. Treasuries. The depth of the Agency mortgage market can be primarily attributed to the 'explicit' guarantee in the case of Ginnie Mae, and the 'effective' guarantee of Freddie Mac and Fannie Mae mortgage-backed securities[†].

The Agency MBS market may provide significant social benefits but may also be used to support environmental goals. BlackRock has identified an opportunity set to frame sustainable investing within the space, spanning both environmental and social factors. Increasing the energy efficiency of residential and commercial housing has an important role in transitioning our energy usage to be net zero, as a large part of any city's emissions are related to its buildings and Agency MBS may be used to support that objective.

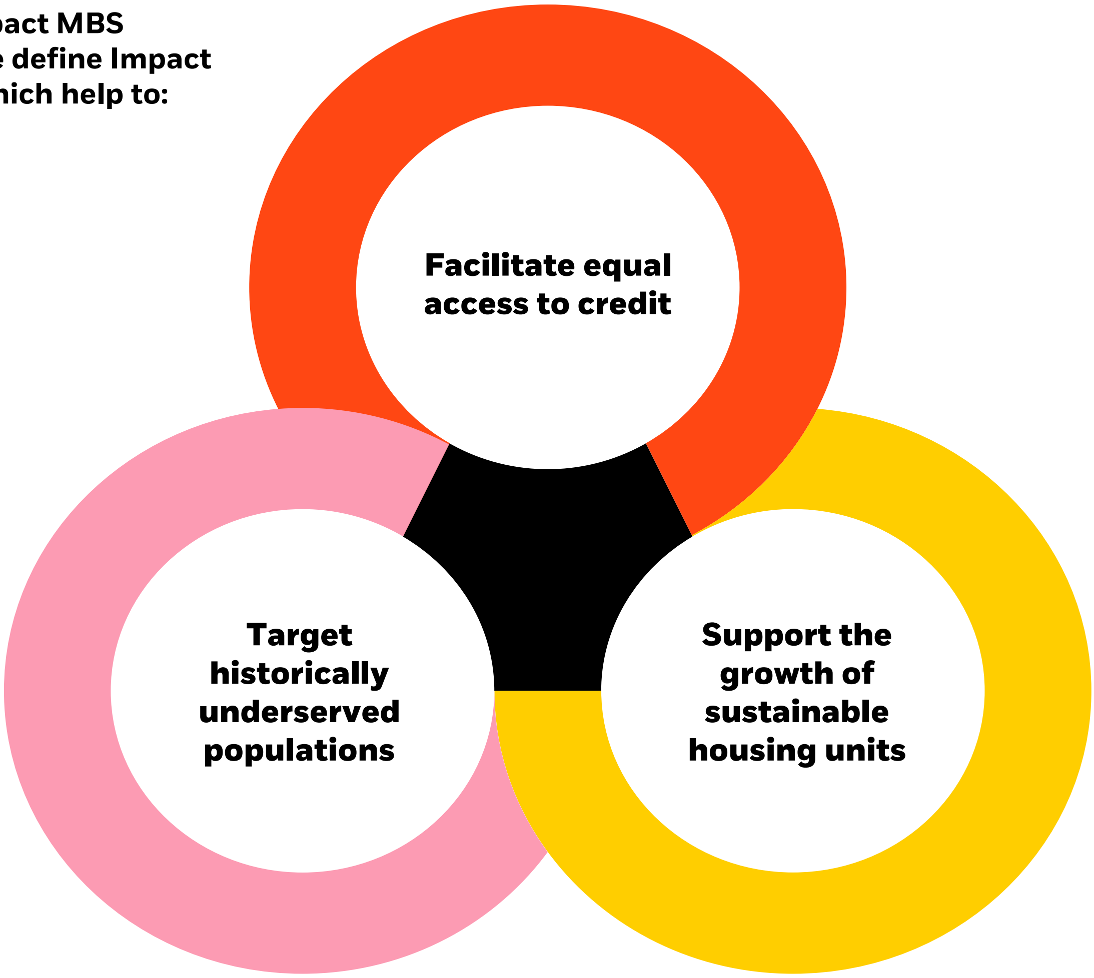
However, the framework we've developed is centered around supporting positive societal impact, which in our view is an area that can also provide value to our clients. Homeownership has been one of the primary drivers of wealth creation in the U.S. across the last three generations – but not everyone has had equal access to this tool. The legacy of discriminatory housing policies, alongside unfair lending practices have left out large segments of the population.[1] One result of this is a racial wealth gap that is three times larger than the income gap.[2] To bring focus to the social and environmental issues the Agency mortgage market can address, the BlackRock Agency MBS team, in partnership with BlackRock's Sustainable Investing ("BSI") team, developed a framework to identify mortgages that seek to deliver positive and measurable environmental and social impact.

† While only Ginnie Mae MBS carry an 'explicit' guarantee backed by the full faith and credit of the US Government, Fannie Mae and Freddie Mac MBS are considered to only be 'effectively' guaranteed by the US Government. Since Fannie and Freddie were placed in Conservatorship in 2008 the bond with the US Government has only strengthened. One of the starkest examples of this occurred in 2011 when Congress extended the Payroll Tax Holiday by raising insurance premiums on new loans backed by Fannie Mae and Freddie Mac

1. The Federal Reserve of Chicago, "The Effects of 1930s HOLC "Redlining" Maps (REVISED August 2020", 2020 link
2. Brookings, "Examining the Black-white wealth gap" February 2020 link

We define Impact MBS as those which help to 1) facilitate equal access to credit or, 2) target historically underserved populations, or 3) support the growth of sustainable housing units (sustainability encompasses both affordability and environmental aspects). In addition, these programs seek to provide an expected financial return to our clients which seek to meet or exceed that of a similar MBS in the Bloomberg Agency MBS benchmark. Our framework seeks to ensure financing of loans with these attributes through existing lending programs as well as the ongoing review of new lending programs and practices that help to deliver a positive social or environmental Impact. In this paper, we highlight three Impact MBS opportunities we believe may achieve positive and measurable impact: State Housing Finance Authorities whose programs focus on down payment assistant, Rural Housing in which eligibility is based on certain area median income and rural geographies, and Manufactured Housing, a sustainable property type.

**BlackRock's Impact MBS Framework – We define Impact MBS as those which help to:**



# State Housing Finance Authorities (“HFA”)

***State Housing Finance Agencies (“HFA”)*** are considered quasi-government entities, each with a focus on the housing needs within their respective state. They are “global” in their ability to navigate the intricacies of federal housing programs, but also “local” in their focus on issues specific to their communities. As such they have been incredibly effective at breaking down barriers to credit and reaching underserved communities.[4] Through targeted outreach and building networks with community organizations, local lenders, and realtors, HFA’s help future homeowners overcome the most frequently cited barrier to homeownership – large cash down payments.[5] There is significant dispersion in the types of down payment assistance offered through the 54 different HFA’s. These loan programs focus on “mortgage-ready” individuals – this is an important distinction because often cost burdened and income constrained households are confused with poor credit worthiness – research suggests that this is not the case.

> For example, households may be paying an amount in rent which is equivalent to a monthly mortgage, but haven’t been able to accumulate enough savings for a down payment. Additionally, timely rent and utility payments are typically not considered in a potential borrower’s credit score.[6]

HFA’s pride themselves on delivering high quality financing and are more likely to require full documentation and have more rigorous underwriting standards as well as pre- and post-purchase borrower education – these practices are tied to lower rates of delinquency and foreclosure.

State HFAs are just one program focused on breaking down barriers to credit through down payment assistance.

> **Large cash down payments are the most frequently cited barrier to first generation homeownership**

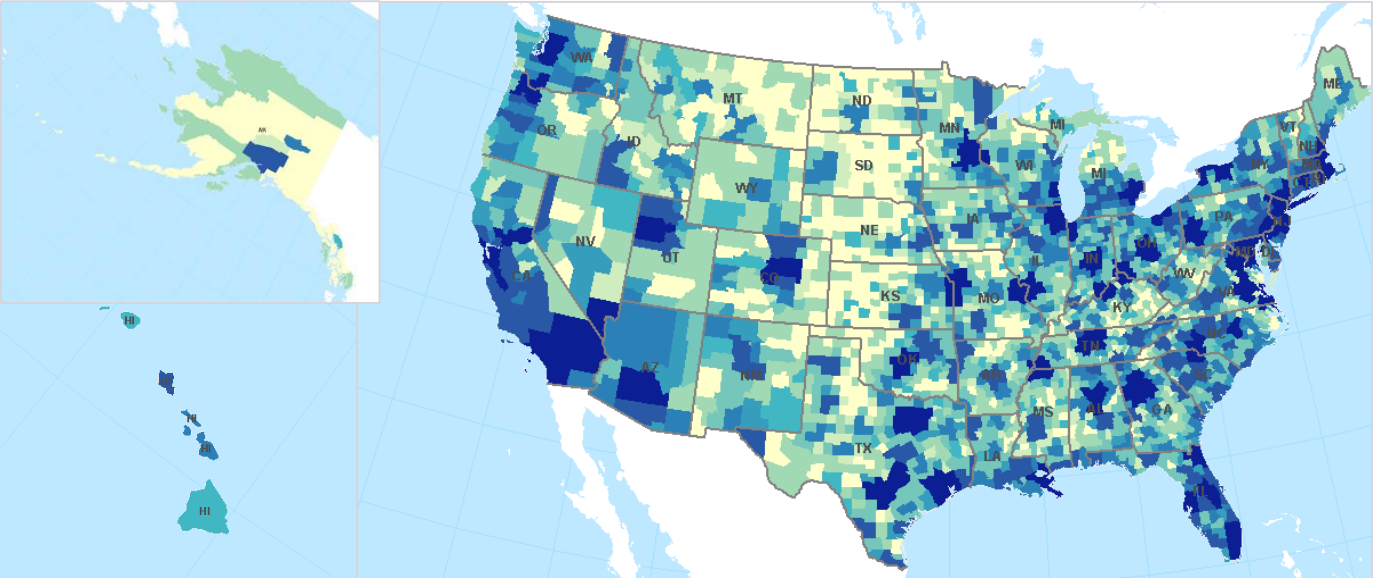
| **$550** | **8** |
|---|---|
| **Billion USD in financing** | **million households** |

**State HFAs collectively have delivered more than $550 billion USD in financing to make possible nearly eight million affordable homes and rental apartments for low- and middle-income households**

Source: National Council of State Housing Agencies accessed 31 July 2022

4. National Council of State Housing Agencies, State Housing Finance Agencies: At the Center of the Affordable Housing System 2021 link
5. Joint Center or Housing Studies of Harvard University, “The State of the Nation’s Housing”, 2022 link
6. Urban Institute, “Adopting Alternative Data in Credit Scoring Would Allow Millions of Consumers to Access Credit”, 2021 link

## Rural Housing




**Rural-Urban continuum code, 2013**

- Metro – population 1 million or more
- Metro – population 1 mln – 250,00
- Metro – fewer than 250,000 pop.
- Urban pop. 20,000 + adjacent
- Urban pop. 20,000 + not adjacent
- Urban pop. 2,500-19,999 adjacent
- Urban pop. 2,500-19,999 adjacent
- Completely rural – adjacent
- Complete rural – not adjacent

Source: USDA Economic Research Service, ESRI
Accessed 30 June 2022

For more information:
http://ers.usda.gov/data-products/atlas-of-rural-and-small-town-america.aspx

Rural communities represent approximately 20% of the nation's population but cover 90% of the US land mass.[7] With poverty rates above the national average, and access to broadband internet below the national average, households within rural communities can have particular difficulty accessing mortgage credit.[8,9] There are approximately 150 rural counties with one or fewer physical bank branches.[10] Additionally*, mortgage denial rates are higher in these regions, sometimes citing limitations of appraisal comparisons.[11] Providing affordable homeownership opportunities promotes prosperity, which in turn creates thriving communities and improves the quality of life in rural areas.[12] Part of the additionality* Impact MBS seeks to achieve is to bring awareness to – and grow the market share of - affordable and sustainable homeownership. This can be particularly powerful in areas such as rural housing where directing capital to loan programs focused on these communities can encourage mortgage originators and lenders to focus on further growth and access to mortgage credit in rural areas.

**Rural areas at 10 times more likely than urban areas to have zero bank branches in a 10-mile radius**

Consumer Financial Protection Bureau – April 2022

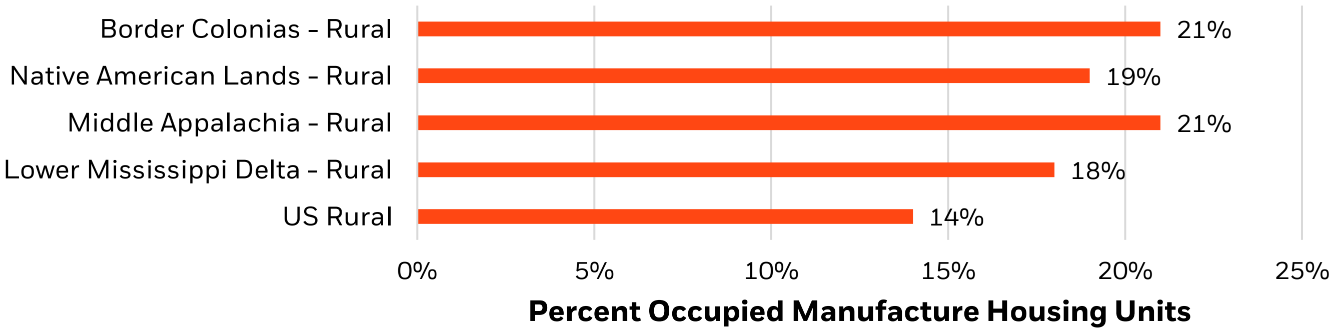
7. Federal Reserve System of St. Louis, "Investing in Rural Prosperity" – Geographic Equity Belongs in Federal Policy Making by David Lipsetz 2021 link
8. USDA Rural America At a Glace 2019 Edition link
9. Federal Communications Commission, 2020 Broadband Deployment Report, 2020 link; Federal Reserve Bank of Richmond, "Bringing Broadband to Rural America", 2020 link
10. Federal Reserve System of St. Louis, "Investing in Rural Prosperity" – Geographic Equity Belongs in Federal Policy Making by David Lipsetz 2021 link
11. Freddie Mac 2020 Rural Housing Research Symposium, "Rural Homeowners: Examining the Attributes" November 2020 link
12. USDA Rural Development Programs & Services link

*Additionality refers to whether an intervention (investment) has an effect on an activity when compared to a baseline. The mechanism by which the strategy achieves impact is by directing capital to specific affordable loan programs, underserved borrower's and/or sustainable property types. Part of the additionality BlackRock seeks to achieve is to bring awareness to and grow the market share of these types of programs.

# Manufactured Housing

The trend of underbuilding residential housing units following the 2008 Global Financial Crisis has exacerbated the supply and demand imbalance resulting in reduced housing affordability.[13] Supporting more efficient, cost effective, and environmentally friendly ways of building housing units is a step in the right direction to solve this.

## Manufactured Homes are Commonplace in High-Needs Regions



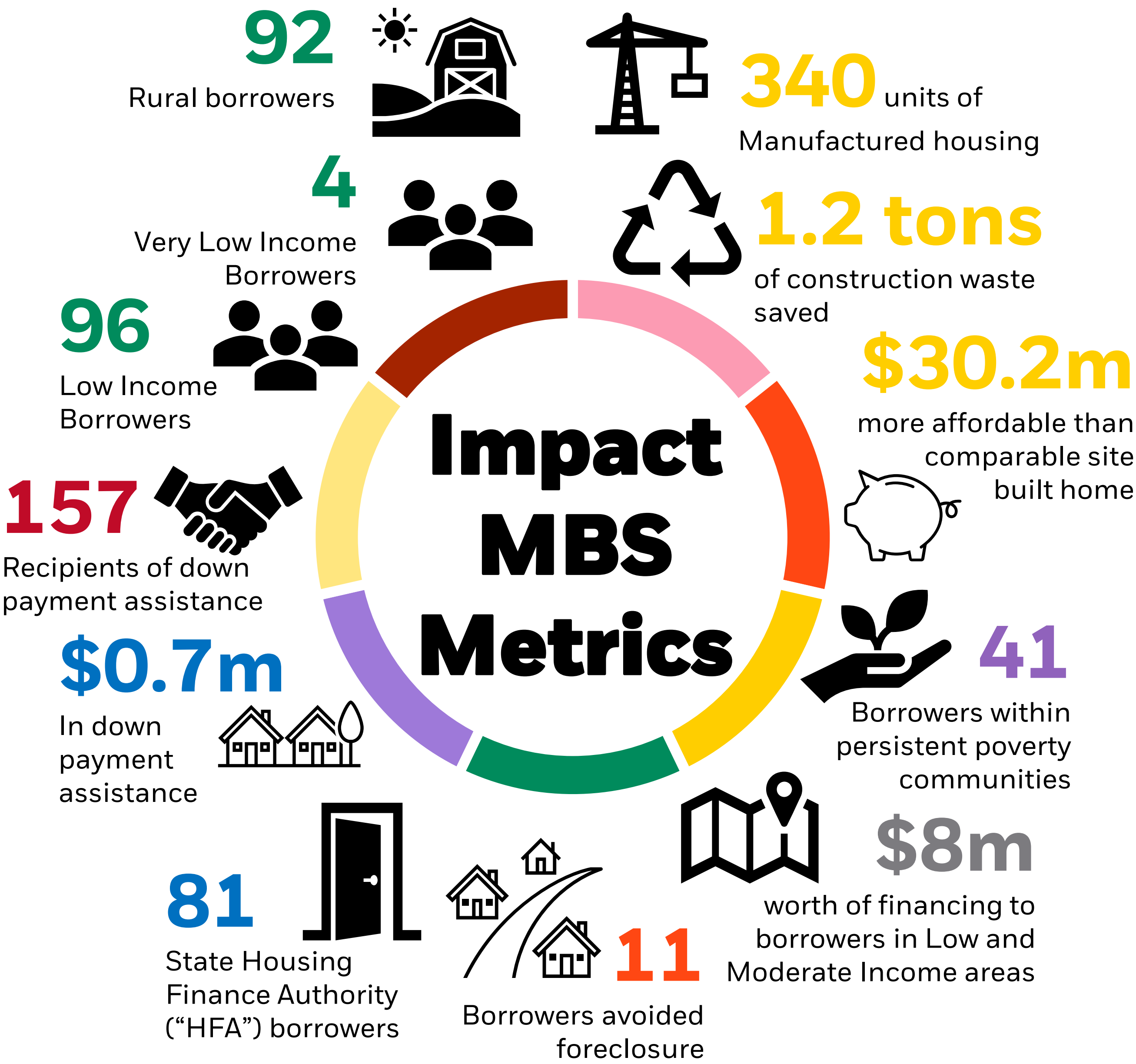

Source: Freddie Mac Rural Research Symposium 5 November 2019; Housing Assistance Council and American Community Survey 2017 data

The predominant method of new single-family home construction in the U.S. is referred to as 'stick framing' - in which lumber, materials, and a construction crew arrive on site and construction begins. Manufactured homes, on the other hand, are partially constructed in a factory setting and then shipped to the site for assembly. Because of the factory-controlled setting, material usage is optimized and work is weather independent resulting in an estimated 60% savings in construction waste relative to a stick framed house.[14] It's estimated that off-site manufacturing can reduce overall construction time by up to 50%.[15] What's more is that manufactured housing is nearly half the cost per square foot of a traditional stick framed home, offering potential homeowners a more affordable option at a time when the costs of shelter, either in the form of renting or homeownership are at decade highs.[16] Manufactured housing units are a frequently relied upon by households with a median annual income of around $35,000 USD and are more frequently utilized in high needs regions. Therefore, we believe that increased access to responsible financing for manufactured housing units, with borrower protections, can unlock meaningful wealth building opportunities for households.[17,18]

13. Freddie Mac, The Housing Supply Shortage: State of the States, February 2020 link
14. Center for Sustainable Systems University of Michigan, "Preliminary Life Cycle Analysis of Modular and Conventional Housing in Benton Harbor", Michigan, Doyoon Kim, April 2008 link
15. McKinsey & Company, "Modular Construction: From Projects to Products", June 2019 link
16. U.S. Census Bureau, Manufacturing Housing Survey, Annual Data June 2022 link
17. Fannie Mae, Manufactured Housing Landscape 2020, May 2020; link
18. Freddie Mac 2019 Rural Housing Research Symposium, Keith Wiley of the Housing Assistance Council "Manufactured Housing and High Needs Regions ", November 2019 link

**The BlackRock Agency Mortgage Team has developed reporting metrics to monitor progress towards achieving the positive social and environmental impact discussed in this paper. We have identified specific key impact metrics for each Impact MBS Story to capture, evaluate and report on the tangible impacts.**

## BlackRock Impact MBS Reporting Metrics:




THE EXAMPLE IS FOR ILLUSTRATIVE PURPOSES ONLY AND NOT ACTUAL OUTCOMES *SEE IMPACT MBS METRICS METHODOLOGIES AND ASSUMPTIONS IN IMPORTANT NOTES SECTION. THIS INFORMATION IS FOR ILLUSTRATIVE PURPOSES ONLY AND NOT INTENDED TO BE RELIED UPON AS A RECOMMENDATION, OFFER OR SOLICITATION TO BUY OR SELL ANY SECURITIES OR TO ADOPT ANY INVESTMENT STRATEGY. SUBJECT TO CHANGE WITHOUT NOTICE. ALL $ FIGURES ARE IN USD.

## Concluding Remarks

We believe Impact MBS may provide the financial and diversification features accessed through traditional Agency MBS, while also helping to achieve positive social and environmental Impact. Additionally, we believe the positive impacts of the strategy are following:

### 1 Potential growth of lending in Impact programs, helping to reduce financing costs for borrowers

By directing liquidity to lending programs within the Impact MBS framework, we seek to facilitate equal access to homeownership for mortgage-ready borrowers, remove barriers to mortgage credit, and reach underserved populations.

### 2 Supporting and preserving potential wealth creation

The gaps in generational wealth accumulation through homeownership are clear. Removing barriers to credit can expand the benefits of homeownership to borrowers that are currently and historically underserved.

### 3 Visibility

We intend our focus on sustainable property types as well as sustainable and innovative construction methods, to bring more understanding and visibility to segments of the housing market that are often overlooked but can provide benefits to our clients and potential homeowners.

**Impact Investing Is really about innovation supporting people towards a sustainable future...**

**Quyen Tran**

Head of Impact Investing at BlackRock and Fundamental Equities Sustainable Investing Research

Diversification does not assure a profit and may not protect against loss of principal.
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# Appendix

As an asset class, Agency MBS provide distinct features and unique risks. Prepayment and interest rate risk are the central types of risk for Agency MBS investors – this is in contrast with most other non-Treasury U.S. Fixed Income spread products which may carry greater credit and liquidity risk. Typically, these different risk profiles produce less correlated returns to other spread products (**Exhibit 1**) , while striving to produce an attractive USD yield.

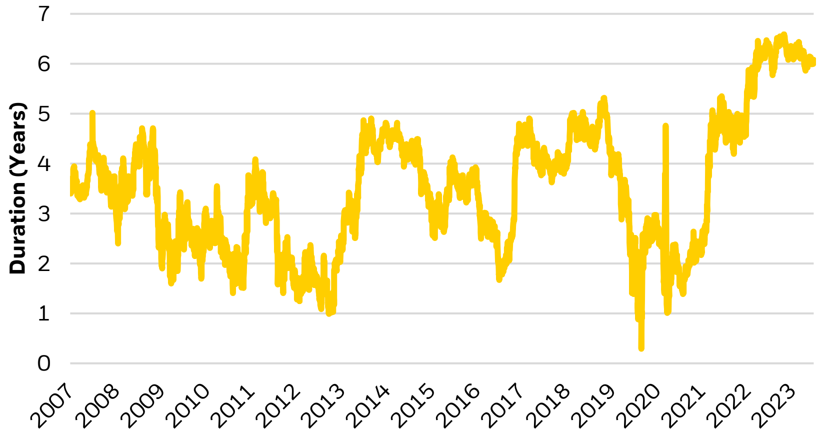
Prepayment and interest rate risk each stem from the Homeowner's ability to pay off their mortgage early. Since the borrower may opt to refinance when mortgage rates fall — and the coupon on the current mortgage securities becomes more valuable to the investor — the duration of the security, or the time that the investor has to collect this attractive coupon, will shorten. This is referred to as the callability risk of a mortgage. In the case of rising rates, the borrower may choose to hold onto the mortgage for an extended period of time, given the attractive mortgage rate. Thus, the duration of the security lengthens as an investor holds onto a lower coupon for a longer time and cannot take advantage of higher reinvestment rates. This is referred to as the extension risk of a mortgage. This shifting duration is what gives mortgage securities "negative convexity" — the propensity of mortgage securities to increase in duration as interest rates rise and decrease in duration as interest rates fall (**Exhibit 2**). This negative convexity is also the main reason why investors in Agency MBS seek a higher spread relative to risk-free assets such as US Treasuries or interest rate swaps.

**Exhibit 1: Monthly correlation of excess returns (12/31/2001-6/30/2023)**

| Monthly Correlation Coefficient | MBS | US CMBS | US ABS | US Credit | US HY |
|---|---|---|---|---|---|
| MBS | 1.00 | 0.34 | 0.32 | 0.44 | 0.46 |
| US CMBS | 0.34 | 1.00 | 0.48 | 0.54 | 0.66 |
| US ABS | 0.32 | 0.48 | 1.00 | 0.63 | 0.64 |
| US Credit | 0.44 | 0.54 | 0.63 | 1.00 | 0.86 |
| US HY 2% Capped | 0.46 | 0.66 | 0.64 | 0.86 | 1.00 |

The figures shown relate to past performance. **Past performance is not a reliable indicator of current or future results.**
Source: Barclays and Bloomberg as of 6/30/2023
Analysis uses Bloomberg Index data US Mortgage-Backed Securities "MBS", US Commercial Mortgage-Backed Securities "CMBS" (ERISA Eligible) , US Asset-Backed Securities "ABS" , US Credit, and US High Yield "HY" 2% Issuer Capped. Index performance returns does not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index.
Credit risk refers to the possibility that the bond issuer will not be able to make principal and interest payments. While liquidity risk may be subject to significant restrictions on transfers. These risks may reduce returns and increase volatility.

**Exhibit 2: Historical Duration for the Bloomberg US MBS Index**




Source: BlackRock using Bloomberg US MBS Index data as of June 30 2023

**Past performance is not a guarantee of future results**. Indexes are unmanaged, are used for illustrative purposes only and are not intended to be indicative of any fund's performance. It is not possible to invest directly in an index. Investment involves risk, including a risk of total loss.

# Impact MBS Metrics Methodologies and Assumptions

| Output | Input | Impact MBS Story |
|---|---|---|
| **Amount of financing for borrowers in Low- and Moderate-Income Areas ($USD)** | Low- and Moderate-Income areas as defined by the Department of Housing and Urban Development ("HUD")<br>Ginnie Mae - New MBS Single Family Pool Stratification Data | Across all Ginnie Mae Impact MBS Stories |
| **Number of Borrowers** | Current face of mortgage pools in respective story divided by the simple average loan size of all active loans created in the last 24 months as of November 2021 (using LoanVault data) for each respective Impact MBS story | Across all Impact MBS Stories |
| **Amount of Down Payment Assistance received ($USD)** | Average down payment assistance is based on research and disclosures including the Urban Institute, the Federal Housing Finance Authority ("FHFA") and BlackRock and is multiplied by the Number of Borrowers | State HFA's Borrower Focused pools |
| **Number of recipients of Down Payments Assistance** | Number of Borrowers in lending programs in which down payment assistance is a feature | State HFA's Down Payment Assistance Borrower Focused pools |
| **Number of Low Income Borrowers[1]**<br>Area Median Income (AMI) at or below 80% | Number of Borrowers in lending programs in which an area median income equal to 80% or less is required to qualify | Rural housing Down Payment Assistance Borrower Focused pools |
| **Number of Very Low Income Borrowers[1]**<br>Area Median Income (AMI) at or below 50% | Number of Borrowers in lending programs in which an area median income equal to 50% or less is required to qualify | Rural housing |
| **Number of Borrowers within persistent poverty communities** | Number of Borrowers within persistent poverty communities as designated by Federal Housing Finance Authorities ("FHFA") | Persistent Poverty |
| **Number of borrowers who avoided foreclosure** | Number of Borrowers in loss mitigation programs (such as partial claim loans and modified loans) | Foreclosure Prevention |
| **Cost Savings of Manufactured Housing vs. Traditional Construction ($USD)** | Cost Savings of Manufactured Housing compared to traditional construction is based the 1) average price of a site-built home, 2) average prices of a Manufactured Home, and 3) average size of a new manufactured as disclosed in the Housing Survey Annual Data from the U.S. Census Bureau and U.S. Department of Housing and Urban Development, Survey of Construction | Manufactured Housing |
| **Construction waste saved** | Construction waste saved is based on the percentage of waste reduction during the construction and fabrication of manufactured homes compared to traditional site-bult homes, as well as the pounds per square foot of construction waste generation from the construction of new residential buildings as released by the Environmental Protection Agency ("EPA") and the Center for Sustainable Systems at the University of Michigan | Manufactured Housing |

1. Low Income and Very Low Income – See glossary of terms in 2021 FHFA Mission Report: Affordable Housing Activities of Regulated Entities https://www.fhfa.gov/AboutUs/Reports/ReportDocuments/FHFA-2021-Mission-Report.pdf ; *Low-income Household* is defined as borrowers/households whose income is 80 percent or less of AMI (Area Median Income); *Very Low Income* is defined as borrower/household whose income is 50 percent or less of AMI (Area Median Income)



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## Risk Warnings and Important Information

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**Past performance is not a reliable indicator of current or future results and should not be the sole factor of consideration when selecting a product or strategy.**

**Changes in the rates of exchange between currencies may cause the value of investments to diminish or increase. Fluctuation may be particularly marked in the case of a higher volatility fund and the value of an investment may fall suddenly and substantially. Levels and basis of taxation may change from time to time.**

Investing involves risks, including possible loss of principal.

Fixed income risks include interest-rate and credit risk. Typically, when interest rates rise, there is a corresponding decline in bond values. Credit risk refers to the possibility that the bond issuer will not be able to make principal and interest payments. Learn more about how consistent investment performance and low fees are critical to achieving your fixed income goals in today's environment.

International investing involves risks, including risks related to foreign currency, limited liquidity, less government regulation and the possibility of substantial volatility due to adverse political, economic or other developments. These risks often are heightened for investments in emerging/developing markets and in concentrations of single countries.

Non-investment-grade debt securities (high-yield/junk bonds) may be subject to greater market fluctuations, risk of default or loss of income and principal than higher-rated securities. Investing in the bond market is subject to certain risks including market, interest-rate, issuer, credit, and inflation risk; investments may be worth more or less than the original cost when redeemed. Mortgage and asset-backed securities may be sensitive to changes in interest rates, subject to early repayment risk, and while generally backed by a government, government-agency or private guarantor there is no assurance that the guarantor will meet its obligations. Investors will, at times, incur a tax liability.

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