



RMBS get an ESG vibe at The Change Company

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Securitized debt products aren't yet the top draw of dollars earmarked for assets with an environmental, social and governance angle but some mortgage lenders are looking to change that.

One of them is The Change Company, a Community Development Financial Institution whose loans are meeting social goals sought by banks and other corporations, and soon, securitized debt investors.

The company is laying groundwork for non-agency bonds that — while not defined as ESG assets — will have qualities attractive to buyers that must quantify their support of local communities, including low- and moderate-income neighborhoods.

The CDFI's new capital markets team run by loan and securitization veterans from Angelo Gordon, Hudson Advisors, JPMorgan and Kroll Bond Rating Agency is aiming for a debut RMBS that fulfill requirements of the 1977 Community Reinvestment Act, said Steven Sugarman, who founded the company in 2017. If more than 50% of the pool qualifies for CRA credit, the deal should be particularly attractive to banks, he said.

"We believe there's a critical role that CDFIs have to play in the non-agency market," said Sugarman. For The Change Company, that means helping banks fulfill CRA needs, and improving homeownership in Black, Latino and low-income communities, he said.

"It's not just serving the consumer," Sugarman said. "It's also working with capital markets, institutional investors, Wall Street and securitizations to find adequate liquidity and certainty of liquidity."

To date, The Change Company has been busy selling its loans to non-agency RMBS issuers including Angelo Gordon, which includes the loans in its GCAT non-QM deals. It will continue to sell loans but is also working on portfolio capabilities with an eye toward securitization in 4Q21 or 1Q22, Sugarman said.

The company has leveraged its status as a CDFI to apply for a US Treasury-backed 30-year bond that could help scale up the portfolio, he said.

Meantime, the company has raised capital from banks and insurers, and is about to expand fund raising from socially minded companies and individuals. In a few weeks, it will roll out its xChange platform that will facilitate investments similar to the USD 10m it received in March from Netflix for its Black Homeownership Initiative, Sugarman said.

It wouldn't be the first non-agency RMBS issuer trying to convince investors that their bonds have social goodness. Angel Oak in May priced its AOMT 2021-2 non-QM deal under a "social bond framework," with proceeds earmarked towards new lending to underserved borrowers, according to KBRA, the rating company.

PROPRIETARY

ABS

USA

Other

Angel Oak Companies, LLC



Other

The Change Company



To establish credibility, Angel Oak secured an opinion from the Institutional Shareholder Services group that attested to the program's alignment with the International Capital Markets Association's social bond principles, said Rob McDonough, Angel Oak's ESG director.

An investor and a capital markets executive said the SBF designation didn't seem to enhance the bond's pricing though they conceded it would be hard to isolate that impact when demand for mortgage credit is as strong as it has been during the Covid-19 pandemic.

Angel Oak will continue to issue social bonds and also deals backed by loans to borrowers that don't align with the target populations, McDonough said.

While quantifying demand for social mortgage bonds may be difficult, there's little doubt that the ESG movement has the attention of securitized market participants.

In agency MBS, Fannie Mae's green bonds backed by energy-efficient new homes have sufficient demand to command pay-ups in the specified pool market, according to Roger Ashworth, an analyst at Citigroup.

More broadly, the Structured Finance Association has undertaken an effort to assess how ESG investing and reporting can be applied to the securitization market. Any person visiting the website of the SFA's ESG Task Force is met with data that commands attention: USD 11.6 trillion — or one out of every four US dollars invested in the US — was invested under an ESG investment strategy.

Bond rating companies are busy identifying ESG qualities when grading new issues, meantime. KBRA senior managing director Jack Kahan said that investors are increasingly aware of ESG angles, and estimated that nine out of every 10 investor conversations he has tackles the subject.

In June's GCAT 2021-NQM3 backed partly by The Change Company's loans, KBRA analysts note that the CDFI exemption from Ability-to-Repay regulations frees those lenders from legal risks that might impede lending to underserved communities. But that exemption can also introduce risks, particularly when the exempt loans are contributed to a securitization, the analysts wrote.

Investors are indeed looking for ways to participate in lending to the underserved, Sugarman said. The demand will be evident, but investors first want to know that these loans are good investments, he said.

"There's enormous demand for ESG credit," Sugarman said. "It should get a premium but there is no expectation that in the first couple go-arounds in a securitization that you are going to get a premium. You need to put in the sweat and shoe leather and show people you understand credit."

Originations by The Change Company can meet CRA requirements but also the deeper needs sought by today's ESG-minded investors, Sugarman said. Instead of just "checking a box," as some banks have done for the CRA, he said more investors are demanding to know if the loans have "real ESG impact."

To Sugarman, The Change Company has proven itself in that regard.

In 2020, the company originated 20,000 home loans, 70% of which were to Black, Latino and other underbanked borrowers. Sugarman expects originations to grow to 30,000 loans, or USD 10bn in UPB, a year.

Loans are to underserved borrowers but that doesn't mean subprime. The average Fico credit score for The Change Company loans is 740 and the average loan-to-value ratio is close to 70%, both measures that mirror collateral in non-agency deals, Sugarman said.

"We can do loans that are not a race to the bottom because we have a unique situation," he said. The loans fall outside the ATR rule but are done with a "common sense approach" focused on the "five Cs" of credit principles: character, collateral, capital, capacity and conditions, he said.

He claimed that The Change Company loans performed well through the pandemic and that the performance has attracted more investors. The company declined to provide data on loan performance, however.

by Al Yoon

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