The Rise of Sustainable Bonds for Affordable Housing.

The pandemic worsened the U.S. affordable-housing crisis. Increasingly, public and private entities are tapping the bond market to finance development.

The shortage of affordable housing has long plagued low-income families in the U.S., and racial inequity is one significant factor that's contributed to the crisis. Minority groups, especially Blacks and Hispanics, suffer higher rates of housing insecurity due to homeownership discrimination—particularly in the mortgage application process—which leaves them disproportionately exposed to the increasingly unaffordable rental market, according to a recent Morgan Stanley Research report.1

The affordable housing deficit has only worsened since the pandemic. The country now lacks as many as 6.8 million homes for households with income at or below the poverty guideline, or 30% of the local median income. That's nearly double the 3.6 million shortfall in 2019, according to a recent report from the National Low Income Housing Coalition.2

"The housing affordability crisis in the U.S. has grown acute over the years, and only became more so during the pandemic, amid the spike in unemployment and homelessness," says Joan Tally, Managing Director in Morgan Stanley's Community Development Finance, which helps the firm meet obligations to lend, invest in and provide services to low- and moderate-income communities.

The long-term solution entails an obvious, if costly, solution: Build more affordable housing. One increasingly promising model of financing taps into the growing investor appetite for sustainable bonds, especially those that target projects tied to social equality. That's prompted more issuers of this debt to enter the market, including state housing finance agencies, community development financial institutions (CDFIs), affordable-housing developers and corporations.

DEMAND FOR AFFORDABLE-HOUSING BONDSThe focus on racial and economic justice during the pandemic has elevated social bonds and sustainability bonds in this space. Traditionally, allocators financed affordable housing projects through green bonds tailored to deliver positive environmental impact through LEED certification or energy-saving infrastructure to combat climate change.

Now, affordable housing is also included in social and sustainability bonds. In 2020, green, social and sustainability bonds raised more than $600 billion from investors, nearly double the $326 billion issued in 2019; the majority of growth came from an increase in social and sustainability bonds.3 In particular, robust demand came from investors who prioritized financing for social inequities exacerbated by COVID-19, such as decreased nonprofit funding, falling health-care system revenues and unequal access to resources and opportunities.

"Affordable-housing finance has been an important part of the 'E' in ESG—environmental, social and governance—investing for more than 15 years," says Geoff Proulx, Managing Director and Co-Head of the Affordable Housing and Community Development Group in the Public Finance Banking Group within the Fixed Income Division at Morgan Stanley. "Now the 'S' is emerging as a driver of demand for those interested in investing in affordable housing."

NEW ISSUERS IN THE SUSTAINABLE BOND MARKETSome nontraditional organizations also have started to tap capital markets to fund affordable housing. CDFIs, Treasury-certified private financial institutions, are increasingly turning to the bond market to raise money for affordable-housing projects, according to Grace Chionuma, Executive Director and Co-Head of the Public Finance Affordable Housing and Community Development Group.

Only in recent years have CDFIs issued bonds to access longer-term capital. In 2017, Local Initiatives Support Corp. issued the first-ever CDFI bond—a $100 million offering underwritten by Morgan Stanley to help fuel new businesses, jobs and large-scale redevelopment efforts. Since then, Morgan Stanley has underwritten four other bond offerings for CDFIs, totaling $332 million, as investors sought new and additional forms of sustainable investing, Chionuma says.

Other entities continue to broaden the sustainability bond market. In December, Morgan Stanley underwrote the first taxable social bond by BRIDGE Housing, a nonprofit affordable-housing developer that builds, owns and manages properties in high-cost, high-density areas on the West Coast, including San Francisco, San Diego, Los Angeles, Seattle and Portland. The proceeds of that $100 million issue will go toward developing and acquiring multifamily affordable housing, transit-oriented development, green building and energy efficiency.4

“Demand is extreme for this type of housing in areas that have average median incomes at these levels,” says Chionuma, and the goal is to help facilitate more capital to additional nonprofit affordable-housing developers like BRIDGE Housing. “Given the maturity of the sector, with the right execution, we’ll be able to enable more capital flow from public markets into these projects,” she says.

HOMEOWNER LENDING AND SINGLE-FAMILY HOUSINGSocial bonds are also starting to fund homeownership programs that extend affordable loans to first-time homebuyers, says Proulx, with many programs devoting a significant portion of lending specifically to minority homeowners. Examples of housing finance agencies that aim to help mitigate the racial homeownership gap include the Massachusetts Housing Finance Agency, Florida Housing Finance Corp. and Rhode Island’s RIHousing, he says.

In the past year, Morgan Stanley has facilitated inaugural bonds to finance single-family affordable housing by underwriting social bonds for agencies in several states, including Iowa, Florida, Massachusetts, Rhode Island and New York, Proulx says. A recent example is the Massachusetts Housing Finance Agency’s first-ever social bond, which Morgan Stanley underwrote in December. Proceeds will fund new mortgages, including down-payment assistance loans to first-time homebuyers for owner-occupied, single-family affordable housing for low- and moderate-income households throughout the state.

MORE CORPORATES ISSUE AFFORDABLE-HOUSING BONDSCompanies have also issued affordable-housing bonds in response to growing investor demand, according to Cristina Lacaci, Morgan Stanley’s Head of ESG Structuring in Global Capital Markets. “Investor desire, especially from younger generations, is driving the growth of sustainable investing in both mainstream funds and sustainability funds,” she says.

One recent example: last August, Alphabet issued a $10 billion offering, underwritten by Morgan Stanley, that included $5.75 billion of sustainability bonds, the largest-ever corporate sustainable financing deal. A portion of the proceeds from the sustainability bonds will finance the repurposing of land owned by Alphabet to develop affordable housing across the Bay Area.

And Morgan Stanley offered its own inaugural $1 billion social bond in October to finance housing at affordable rates for low- or moderate-income individuals or families. Proceeds will support a range of affordable housing developments across the U.S., including a project for homeless veterans in Washington, D.C., and the construction of new affordable homes close to high quality public transit in South Salt Lake, Utah.

"As the recovery from the pandemic continues, our clients and our firm have a unique opportunity to address issues of systemic injustice through the capital markets," says Audrey Choi, Morgan Stanley's Chief Sustainability Officer. "Morgan Stanley is excited about our ability to both underwrite and issue innovative financial solutions like social bonds that continue to gain traction with investors demanding to address societal challenges by providing capital that makes a positive impact on a large scale."

Morgan Stanley's social bond is one of the most recent examples of the firm's decade-long leadership in sustainable finance, which includes the establishment in 2013 of the Institute for Sustainable Investing, which accelerates the mainstream adoption of sustainable investing. That same year, Morgan Stanley helped support the first corporate green bond and, in 2017, priced the first public market bond deal for a CDFI to help advance economic opportunity in underserved neighborhoods in the U.S.

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1 American Community Survey (ACS), Home Mortgage Disclosure Act (HMDA), Morgan Stanley Research.

2 https://reports.nlihc.org/sites/default/files/gap/Gap-Report_2019.pdf

3 https://www.environmental-finance.com/assets/files/research/sustainable-bonds-insight-2021.pdf

4 https://bridgehousing.com/press_releases/bridge-housing-issues-100m-in-serie--2020-sustainability-bonds/

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