

# The Development Fund

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*Executive Director*

## The Development Fund

- Nonprofit organization founded in 1963
- Creates innovative community development financing programs with private-sector risk/return standards
- Successful track record and expertise
- Thirteen programs nationwide totaling over \$1.25 billion to date

## The Development Fund

- Two Recent Programs that leveraged private sector capital for community development purposes:
  - Impact Community Capital (Impact)-Insurance companies
  - California Environmental Redevelopment Fund (CERF)-brownfields fund

I m p a c t  
Community Capital LLC

The Managed Approach to  
Community Investing by Insurers

Impact Community Capital was created by insurance companies to develop quality community investments that meet the specific needs of its owners and provide benefits to California's communities.

## Background on Impact

- Massachusetts
- 1995 California Legislative initiatives
- Industry and trade response

- CA Commissioner's COIN compromise
- COIN organizational issues and the approach to The Development Fund

## Impact's Origins

- Three original sponsoring companies:
  - Allstate
  - Pacific Life
  - State Farm

## Three companies: Funded research and feasibility effort

- Reviewed the current state of community development finance in California
- Documented a need for added liquidity among existing originators
- Reviewed possible structures for an insurance company investment effort
- Recognized insurance industry statutory and regulatory issues
- Established a potential structure with method to achieve a meaningful investment-grade component

## Some Research Observations

- Community development investments are:
  - Small in size
  - Complex in structure
  - Idiosyncratic in nature
  - Not usually individually "ratable"
  - Normally perform well

## The Impact Approach

Utilization of capital markets techniques and a focused investment management strategy to facilitate insurance company investor response to

community investment needs, such as. . .

- Structured finance
- Securitization
- Rated investments
- Secondary market

## Impact Investment Management

- Creates acceptable investments
- Provides dedicated, professional management
- Possesses specialized underwriting expertise
- Streamlines transaction costs
- Facilitates partnerships
- Leverages investment dollars
- Disperses risk
- Offers a coordinated capital delivery system

## Impact's Primary Functions

- Purchase a variety of community investments in:
  - affordable housing
  - small business development
  - community facilities
- Recycle limited capital
- Create Linkages; stimulate public/private partnerships
- Community development investment manager

## Impact's Market Role

- An investor; not an originator
- Interactive program planning, design and implementation
- Purchase pools of loans; purchase from portfolios
- Purchase newly originated loans
- Issue forward commitments; provide the permanent take out

## The Role for an Institutional Investor

- A mature primary origination industry already exists in California
- Liquidity and the ability to "recycle" capital is an issue
- Insurance companies normally buy investments originated by others

## Insurance Company Investment Criteria

- A response in scale judged to be important
- Admissibility of assets is also important
- Investment grade vs. Non-investment grade ratings
- Difficulty to reconcile with statutory requirements

## Investment Guidelines

- Affordable housing: single and multifamily
- Non shelter real estate
- Community facilities
- Economic Development

## The Securitization Model

- Structure mitigates credit and prepayment risk
- Insurance company balance sheet sensitive
- Medium to longer term maturities
- NAIC risk based capital structure
- Active portfolio management

## What Impact Is

- Limited liability company
- Buys community investments originated by others
- Provides reasonable returns
- Structured to achieve ratability

## Impact's Investors/Owners

Allstate Insurance Company  
Farmers Insurance Company  
Nationwide Mutual Insurance Company  
Pacific Life Insurance Company  
PMI Mortgage Insurance Company  
SAFECO Insurance  
State Farm Insurance Companies  
Teachers Insurance and Annuities Association  
21<sup>st</sup> Century Insurance Company

## Impact Investment Activity

- Completed - 2000:
  - \$40 million multifamily affordable housing first mortgage loans. Pool consists of 12 properties with 1450 housing units for low income families. Net yield to investors .... 8.15%

## Impact Investment Activity

- Completed – 2001:
  - \$25 million targeted single family homeownership mortgage program. 100% LTV and other enhancements. Mortgages swapped for Freddie Mac securities. Market yield. Impact funding of second mortgages is key element.

## Impact Investment Activity

- Closing in 2001:
  - \$180 million multifamily affordable housing mortgage loan pool. Low income families. 9,000 housing units. Approximate net yield is 8%. Rated by Standard & Poor's. 75% investment grade (51%) "AAA". Largest single COIN transaction to date.

## Impact Investment Activity . . .

- Closing in 2001:
  - \$50 million single family acquisition/rehabilitation mortgage loan program. Urban targeted. Freddie Mac swap for loans. Impact will hold \$1.5 million first loss position.

## The California Landscape

- Legislation, Mandates and Other Forms of Inducement
- California Organized Investment Network (COIN) and Insurance Commissioner Low's current initiatives
- Impact – a voluntary approach

## Proposed Mandates & Inducements

- Proposals to legislatively mandate investments by insurers surfaced in mid 1990s and continue to be in evidence
- Several proposals specified a percentage of premium written as the annual investment amount for companies
- Inducement proposals introduced in 2000
- Agreement by advocates to stand aside in 2001

## California Organized Investment Network (COIN)

- Established in 1995
- Insurance industry, Insurance Commissioner and community advocates
- Advisory Board
- Create a community investment clearinghouse
- Administrator of CDFI and premium tax credit programs

## Insurance Commissioner Low

- Appointed to office in fall 2000
- Proactive proponent of measurably increasing both company participation and level of investment dollars
- Initiated a study of COIN in late 2000
- Engaged community advocates and insurance industry groups in extensive discussions

## Action Plan Elements

- Commissioner Low taking an active role in promoting community investment by insurers
- Insurance companies requested to set voluntary goals for community investment
- Development of a program to publicly recognize and applaud insurance companies for making community investments

## Action Plan Elements . . .

- Exploring a requirement for insurance companies to report annually on their community investments
- Making administrative enhancements to the COIN program
- Letter to CEO's asking for voluntary commitment amounts in September

## Impact Companies Making a Difference

- Of total California premiums written, Impact members account for:
  - 28% of all premiums written
  - 34% of all personal lines premiums
  - 22% of all life & annuity premiums
- And .....

## Moving Forward

- Additional affordable housing investments and securitizations
- Investment partnerships with community banks
- New Markets Tax Credit Entity
- New Initiative ... a study to define targeted investment opportunities; to be designed in collaboration with community development professionals

## Lessons Learned from Impact

- Learn the language
- Recognize that scale matters
- Have a logical plan
- Know who they are

- Approach insurers where they are
- Voluntary or mandate?

## **CERF**

### **Innovative Financing for Brownfields, Environmental Cleanup and Smart Growth**

#### CERF's Goals

- To create an innovative private-sector response to three compelling issues
- To return properties to productive use on a large scale and create business opportunities
- To focus on disadvantaged communities
- To be a sound and attractive investment
- To provide a national model

#### The Company

- A private, for-profit company with a public purpose designed to finance the cleanup of contaminated sites anywhere in California
- Fund size is currently \$40 million and growing
- By ourselves or with our bank investor/members we can create a total financing package

#### Participating Investors

- Bank of America
- Washington Mutual Bank
- Bank of the West
- California Federal Bank
- Bank of Petaluma
- Bank of Santa Clara
- Bay Area Bank
- Bay Bank of Commerce
- Coast Commercial Bank
- Cupertino National Bank
- Golden Gate Bank
- Mid-Peninsula Bank
- Mt. Diablo National Bank

- Peninsula Bank of Commerce
- Bay View Bank

## TASK FORCE

- Initiated and directed by The Development Fund
- Made up of 38 financial, environmental and insurance professionals
- Funded by a number of California and national foundations
- Designed CERF and provided significant market research  
CERF Staff
- Peter Hollingworth, President & CEO
- Roxann Middleton Burns, Vice President & Senior Loan Officer

## Our Market Research indicates

- Over 90,000 contaminated sites in California
- Many are small sites (1 acre or less), which include both abandoned and operating businesses
- Also many are large, former industrial sites that are “mothballed” because of contamination
- A large proportion of these sites are economically viable but cannot be served by existing financing sources because of perceived risk-return limits, environmental liability risks, regulatory constraints or reopener risk and high transaction costs

## Distribution of Sites

### *Mission Statement*

Our primary mission is to create and use a private sector, dedicated fund to finance remediation and remediation-related activities in conjunction with contaminated sites throughout California, thereby recycling such sites to economic and productive use. In doing so we expect to:

- Help reduce urban sprawl
- Create/retain jobs
- Create housing opportunities
- Involve support from the public sector, community based organizations and local residents
- Leverage additional private resources.

## Real Estate Development

sites needing remediation for development, rehab or resale

- Target Borrowers:
    - Private Real Estate Developers or Investors
    - Community Development Corporations (CDCs)
    - Redevelopment Agencies
    - Other Nonprofit or Public Sponsors
- Loan Amounts Available: Up to \$5 million

## Operating Businesses & Site Owners

sites needing remediation for continuing operations, expansion or sale

- Target Borrowers:
  - Small Businesses
  - Multi-Family Property Owners
  - Commercial Property Owners

## Use of Funds

- Site Remediation *and* Site
  - Acquisition
  - Characterization
  - Improvement
  - Rehab/Construction
  - Development

- General business purpose
- Or combinations of the above
- (All of the above uses made in conjunction with a remediation/cleanup)

## Types of Financing

- Interest only...for the term, repaid from permanent loan from conventional source, or CERF
- Amortized loans...for the term, as negotiated
- Mezzanine financing...fully subordinated with an interest and fee/equity component
- Equity participation financing...possible repayment at sale
- Participation loans...as originator or participant with other lenders private or public
- Loan guarantees...for other qualified lenders
- Public entity financing

## Environmental Insurance

- Important risk management tool
- Reduces environmental risk for both borrower and CERF
- Will be considered on all deals; will require it on some, not on others
- Cost of insurance coverage can be financed
- CERF will take advantage of the state subsidized insurance program (FAIR) when and if available

## Types of Insurance

- Secured Creditor
  - Loan/Lender protections
- Third Party/Pollution Legal Liability
  - Property Damage/Bodily Injury; Cleanup, legal, reopeners
- Cleanup Cost Cap
  - Expenses beyond planned remediation; unknown conditions discovered
- Any Environmental Insurance
  - Pertinent to the deal & economically available

## Financing Terms

- Rates are market based and vary with level of risk on a deal

- Can offer flexibility on timing and level of return
- Collateral requirements vary with availability and risk
- On shared appreciation or equity participation transactions, little or no collateral may be required
- Personal guarantees are considered; required on some, not on others

## Conclusions

- Community development financing can be made attractive to the Private Sector
- Public subsidies can be used to leverage these private dollars