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IMPACT Seeks Alliance with California's Banking Industry

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With billions to invest, the insurance industry in California is poised to become a powerful force in financing significant social and economic needs. IMPACT Community Capital is a new community investment management firm in California that intends to revolutionize the way the insurance industry invests in the state.

Currently owned by ten major insurance companies, IMPACT was formed to infuse capital into underserved, blighted neighborhoods by dramatically increasing insurance industry community investments. It intends to do this in a way that provides to its insurer-investors a stable, attractive, market-driven rate of return. Community development lenders are invited to play a key role in this joint venture.

Historically, insurer-investors have shied away from investing in community development projects. The risks and layered financing structures of these deals can be an institutional investor's worst nightmare. The are often individually too small, do not merit an investment-grade rating from a nationally recognized credit rating agency, and may be structured in widely varying, idiosyncratic ways.

Insurers have instead invested heavily in municipal bonds that provide consistently structured securities and are usually rated by one or more credit-rating agencies. Municipal bonds are also traded in denominations large enough to be economically and efficiently handles by institutional investors like insurers.

In addition, the investments of insurance companies are closely regulated in ways that limit how and where insurers invest. And, perception or reality, community development investments are often viewed as too risky on their own to meet prudent investor requirements.

IMPACT Creates Liquidity

IMPACT serves as a secondary investor for community development loans. IMPACT purchases loans made by banks, non-bank financial institutions, and non-profit organizations; it then packages them into loan pools. Loans of all sizes are considered, either individually or as securitized packages or pools. Portions of these pools are then rated by one of the major credit rating agencies, allowing IMPACT to market them as investment-grade securities. The portion of the loan pools that are below investment grade remain in IMPACT's investment portfolio.

This structure is not merely a theory or plan. After a one-year planning and recruitment phase, IMPACT is in the process of finalizing an initial $40 million transaction with the California Community Reinvestment Corporation (CCRC), a non-profit lender that specializes in multi-family projects. IMPACT is purchasing 12 CCRC loans, the proceeds of which were used to build more than 1,500 units of affordable rental housing throughout California. Standard and Poors is expected to rate a significant portion of these loans. The unrated portion will represent approximately 35 percent of the transaction, and will likely remain in IMPACT's portfolio. The rated portion will be sold to IMPACT's member investors.

In the future, IMPACT intends to do much more than merely purchase existing, performing loans. To encourage investments in projects and activities that are considered higher risk, like those that finance health care centers, mixed-use facilities, child care centers and small business loans in low-income communities, IMPACT hopes to partner with the California banking community and others who originate such loans. IMPACT wants to work directly with banks, non-profits, and other community development practitioners to identify sound, but perhaps unconventional, investment opportunities.

Further, IMPACT would like to help banks structure the financing of these projects so they can more easily be pooled, rated, and ultimately securitized. In this manner, IMPACT will be able to use the "muscle" of the insurance industry in California to purchase as many community development loans as possible, allowing the dollars tied up in those loans to be recycled back into the communities.

There is a simple elegance to this partnership. It allows each partner to do what it does best. For example, banks have special expertise and an enviable loan origination track record in California that IMPACT couldn't begin to replicate. The banking community understands where and how to identify lending opportunities and how to communicate effectively with the community development marketplace. That's their business.

Insurers, on the other hand, are long-term investors. They have no particular expertise or desire to originate loans, and don't have loan officers in the field or large staffs to service these loans. In addition, they lack familiarity with many of the key community players.

By working with IMPACT on the front end of the process, the banking community can better leverage its lending on "tough loans" with the confidence that they will be purchased by an already identified secondary market maker. IMPACT envisions agreeing to purchase loans before they are made, and issuing to its banking partners a "commitment to purchase" letter. Final purchase approval will occur within four-to-six weeks from the time IMPACT receives all the loan information and documentation.

In return, IMPACT will bring a common set of guidelines to the process that will probably result in better execution, better loan performance, and a more efficient use of capital. IMPACT will also give banks the latitude and time to originate, package, and hold these loans for whatever time is deemed appropriate by both parties. This will give banks and other originators the flexibility to broaden the types of community investments they can make, and could dramatically increase their capability to make higher risk loans. The existence of a secondary market also assures banks and other financial institutions that they will be able to liquidate their community development loans at the appropriate time.

The beauty of this partnership model is that everyone wins. Financial institutions and non-profit organizations win because valuable capital is freed up to make additional community development loans. The insurance industry wins because they now have a solid investment management firm that can handle these kinds of loans. And most importantly, the people who live in under-served neighborhoods gain access to affordable housing, day care centers, neighborhood shopping facilities and health clinics. Small business owners gain access to capital.

IMPACT Is A Voluntary Solution

As you may know, the California Legislature is considering a measure that would impose upon insurers an affirmative obligation to invest in low-income and underserved communities in a manner similar to the federal Community Reinvestment Act. (see Wall Street Journal, California Section, May 12, 1999). The state proposal, called the California Reinvestment Act, would require the state's Insurance Commissioner to monitor the community development activities of insurers. In 1996, the California Organized Investment Network (COIN) was organized within the California Department of Insurance to act primarily as a clearinghouse/broker, informing insurance companies about investment opportunities in low-income communities. The measure under consideration would give the state the power to mandate these kinds of investments.

IMPACT is the insurance industry's voluntary solution to the legislative proposal, and is based on the belief that a market-driven investment program is superior to a state-mandated one. Although IMPACT's investment activities have only just begun, it is already clear that strategic alliances will benefit insurance investors, banks, community development organizations, and underserved communities all over the state.

IMPACT Member Companies
Allstate Insurance Company
Beneficial Standard Life Insurance Co.
20th Century Insurance Company
Farmers Insurance Companies
Pacific Life Insurance Company
PM1 Mortgage Insurance Co.
SAFECO Insurance
State Farm Insurance Companies
Teachers Insurance and Annuity Association
Zenith Insurance Company

If you would like more information about IMPACT, please call Daniel Sheehy at (415) 981-1074 or (888) 548-5485, fax (888) 548-5489.

About the Author

Dan Sheehy is currently president and chief executive officer of IMPACT Community Capital, LLC. He has held several positions at the Federal Reserve Bank of New York and the Federal Reserve's Board of Governors in Washington, DC. Mr. Sheehy served as executive vice president of a large commercial bank and as a general partner in a major Wall Street investment banking and securities trading firm.

From 1987 to 1997, Mr. Sheehy was senior vice president of the State of New York Mortgage Agency, commonly known as SONY MA. It is one of the nation's largest originators of residential mortgages for affordable housing with a portfolio in excess of $4 billion. At SONY MA, Mr. Sheehy managed the Mortgage Insurance Fund and developed it into a highly rated mortgage insurer and credit enhancer with an insurance portfolio of more than $2.5 billion in community development-type mortgage loans.

Mr. Sheehy also served as a financial advisor to the Florida Housing Finance Corporation and the Housing Finance Authority of Hillsborough County, Florida. He has been involved in two consulting firms that have provided advisory and consulting services in the area of housing finance programs and credit enhancement structures to state and local government throughout the United States, Guam and the Caribbean.