

IEN Q&A: Wielding Alternative Debt Towards a Resilient Future

Opportunities within private debt impact investment strategies continue to attract greenbacks.

For example, the [Global Impact Investing Network's 2019 Annual Impact Survey](#) indicated that private debt and private equity investors expected to increase the amount of capital they invest in 2019 (versus last year) by 36% and 22% respectively. The survey's 266 respondents collectively represented more than \$239 billion of investment dollars, of which \$35 billion was allocated to impact investments in 2018. Further, last year, over a third of the impact capital was poured into private debt strategies; in comparison, public debt and private equity respectively accounted for about 16% and 14% of the capital invested respectively.

Given the interest in private debt impact strategies, the **Intentional Endowments Network** approached industry specialists on their perspective on the current climate of the private debt market and where environmental, social, and governance (ESG) factors fit in this landscape. Such experts included:



Nicole Downer, Managing Partner and



Helene Barikmo, member of the Deal Team, **MV Credit Partners (MV CP)**, Affiliate of Natixis with \$5.3BN in AUM



Ken Kunhardt, Director of Investor Relations, **New Hampshire Community Loan Fund**

Q1: WHY INCORPORATE ESG WITHIN YOUR INVESTMENT PROCESS?

Downer/Barikmo: ESG is a key risk consideration in preserving downside protection within our investment process. Generally, ESG investing seeks to quantify risk that cannot be measured by traditional financial metrics. For example:

- (i) The risk that government regulation will force a company to rectify poor but profitable environmental practices?;
- (ii) The risk to workers of unsafe working conditions?;
- (iii) The risk of controversies such as lawsuit, sanctions etc.?

Furthermore, responsible investing has been a core value of MV CP since inception. From both an ethical and moral obligation standpoint there is a clear balance in delivering positive social and environmental impact alongside investment returns.

Kunhardt: We were established in 1983 with two powerful ideas: that many people with low and moderate incomes could become more self-sufficient if they had access to fair credit, and that community-minded people and organizations would invest in providing that access if they were confident their money would be used wisely, responsibly, and for maximum impact.

We were created to bridge those two groups. We think of it as neighbors helping neighbors. Through us, our investors provide the capital people use to have affordable homes, quality jobs, and childcare, and to become financially independent. In return, investors earn interest while creating opportunity and real, observable, impact, often in their own communities.

Q2: CAN YOU TALK ABOUT ANY UNIQUE STRATEGIES OR BESPOKE INVESTMENTS YOU'VE CONSIDERED OR ALLOCATED FUNDS TOWARDS?

Downer/Barikmo: MV Credit only invests alongside Private Equity sponsors whose ESG values and principles align with our own. Respectively, MV Credit ESG strategy adopts:

- (iv) **Negative Exclusion** (i.e. Excluding entire sectors, companies or countries from a fund or portfolio based on ESG criteria, moral or ethical views, or religious beliefs.). The objective here is to align MVCP and investors' (LPs) money with their perception of ESG risk or broader beliefs, and to mitigate ESG risks as investors exit "no" sectors, such as tobacco or gambling companies.
- (v) **Positive Screening** (i.e. Investing in companies demonstrating positive ESG performance relative to peers). The objective here is to invest in superior, performing assets by mitigating ESG risks and acting on opportunities provided by companies demonstrating good ESG behaviors
- (vi) **ESG integration** (i.e. the inclusion of ESG factors alongside financial analysis of assets by investment managers). The objective here is to improve long-term risk-adjusted returns, mitigate ESG risks and identify investment opportunities created or supported by positive ESG change.

Examples include:

- **Project Payments:** This opportunity was declined during the initial screening as the company provides payment services primarily for online gaming and gambling clients. The Funds have LPA constraints which prohibit investment in this sector.
- **Project Nursing:** This project relates to a Nordic healthcare and social care business. The opportunity was declined due to sector concerns focused on the social care side of the business. There had been historical lapses in patient care under previous ownership; and the wider sector had suffered a number of scandals related to quality of patient care. Overall it was felt by the Investment Committee that a highly leveraged capital structure was not appropriate for a business operating in the social care sector, and hence MV Credit declined to participate in the financing.

Kunhardt: Financial barriers keep people, families, and communities from participating in the economy, and we think about what tools may help to surmount those barriers.

For example, residents of manufactured-home (mobile-home) parks in the United States own their houses, but they don't own or control the land beneath them. As a result, they can be trapped in parks with failing water or wastewater systems, rising rents (for use of the land under their homes), or, worst case, lose their homes to development.

Since 1984, we have helped homeowners form cooperatives to purchase and manage their communities. We work with them through the purchase process and create a financing package that keeps homeownership there affordable. Then, because few people living in manufactured-home communities have run multi-million-dollar businesses, we provide ongoing and customized training and technical assistance to help them succeed.

Now there are 131 resident-owned communities (ROCs) in New Hampshire. Banks routinely loan with us on park purchases. Along with resident groups, we successfully advocated for sale-notification and right-of-refusal state laws for park residents. Our strategy is embraced as an innovative retooling of a sector that can provide a long-term source of affordable and decent rural housing to millions of Americans.

IENT: WHAT ARE SOME OF THE CHALLENGES IN FINDING GOOD OPPORTUNITIES?

Downer/Barikmo: The increased focus and attention given to ESG credit consideration has not impacted origination opportunities. In terms of potential challenges, in the private debt space overall the format for ESG reporting is very individual, and information is not always widely distributed (i.e. vs listed equity). On the other hand, whilst ESG information may not be readily available in a standardized framework, as a private lender we are able to receive very detailed information about the underlying companies we lend to, which from time-to-time can uncover ESG issues which a public company wouldn't reveal. Typically, both pre- and post-investment queries concerning ESG are directly addressed by PE Sponsors and/or company management, allowing for a level of detail otherwise not available. In the past MV Credit has turned down opportunities due to ESG concerns raised during the due diligence stage.

Finally, whilst there is still significant room for improvement across ESG reporting in the private sector, over the past 12 months we have seen a significant turnaround in existing portfolio companies stepping up in their dedication to ESG reporting.

Kunhardt: One challenge is raising our own permanent capital, or equity. For every \$4 of investments we need to raise \$1 of permanent capital donations to help further shape our lending to our borrowers' needs. This remains a challenge and is critical to our ability to respond to our borrowers' demand to finance mission-worthy projects.

Investors can participate with us in several ways. They can make a regular investment at our published rate schedule. They can invest at a lower interest rate with the understanding that they're enabling us to make more-flexible loans. Or they can take a blended approach, combining an investment with a permanent capital donation.

IEN: HOW DO YOU MEASURE IMPACT? WHAT ARE THE CRITERIA GOING INTO AN INVESTMENT AND WHAT FACTORS ARE CONSIDERED IN DETERMINING ITS SUCCESS?

Downer/Barikmo: MV Credit's ESG Committee is currently in the process of creating a detailed ESG roadmap, ESG asset scoring system, and annual report which will be implemented during 2019. This inaugural report will further aid MV in assessing and determine how we measure ESG initiatives' impact, development, and success. There are currently no specific ESG criteria imposed on our portfolio companies other than the standards and principles of [UN Principles for Responsible Investment \(PRI\)](#). Nevertheless, as part of the wider roadmap exercise and improving our ESG reporting we continuously request more structured information from our portfolio companies.

Kunhardt: We measure the return of our loans by what we want to accomplish with them—affordable homes, jobs, and child care slots created or retained. Since our founding we have created/preserved over 10,000 units of affordable housing, 3,734 jobs, and 4,350 child care spaces.

Our loan loss rate for our entire loan portfolio since inception is about 3%, which means our borrowers repay their loans 97% of the time. The portfolio includes loans to manufactured-home parks, consumers for residential real estate mortgages, small businesses, child care centers, nonprofit facilities and affordable housing development projects.

As mentioned, our investors also have the option of obtaining a financial return on their capital, up to 3%, depending upon the length of their investment.

IEN: CAN YOU SHARE ANECDOTALLY THE "INCREASED" INTEREST IN PRIVATE DEBT ESG STRATEGIES OVER THE PAST FEW YEARS?

Downer/Barikmo: Compared to a few years ago, when only a minority of our predominantly European client base (LP's) would raise ad-hoc ESG/corporate social responsibility queries, today almost all our global investor base raise questions around responsible investing and our ESG strategies. There has truly been a significant transformation in the last few years.

Kunhardt: During the five years ending in May 2019, our loan portfolio grew 64% to \$128 million, while our investment pool grew 75% to \$130 million.

The number of investors grew 25% to 684. About three-quarters of them are individuals, a segment that grew by 30%. We're fortunate to have a high renewal rate of 80% among investors when their investments mature. When they see what their money is accomplishing they often add additional investments, and sometimes at lower interest rates.