S&P Global Ratings

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Capital Impact Partners, DC; General Obligation

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Credit Highlights

- S&P Global Ratings' issuer credit rating (ICR) on Capital Impact Partners (CIP), D.C., and its long-term rating on CIP's investment notes outstanding is 'A+'.
- The outlook is stable.

Security

An ICR reflects the obligor's general creditworthiness and its capacity and willingness to meet financial commitments when they come due. It does not apply to any specific financial obligation and does not consider the obligation's nature and provisions, bankruptcy standing, liquidation, statutory preferences, or legality and enforceability.

CIP's investor notes program began in 2017, with a plan to issue multiple notes totaling $100 million. Since then, CIP issued notes from 2018 through 2023, and the cumulative par value of the notes increased to a maximum of $250 million in 2024. The notes are unsecured, general obligations of CIP. Notes are payable from all available revenue and CIP's assets, and are not secured by a reserve fund, mortgage lien, or security interest on or in CIP funds or other revenue or assets.

As of Dec. 31, 2023, investor notes carried interest rates that ranged between 1% and 5.2%, and maturities that range through July 2037. Proceeds may be used to pay down maturing debt and other debt facilities, finance loans to organizations and businesses in pursuit of CIP's mission to expand economic opportunity in low-wealth communities, and for CIP's general operating purposes. According to management, lending activity originated from the note issuance is expected to expand CIP's loan portfolio and increase unrestricted equity available for general use. Lending activities originated from the note are expected to resemble CIP's existing portfolio.

Credit overview

The rating reflects our opinion of CIP's:

- Net equity-to-assets ratio, averaging 15.4% during the past five years, which we view as being somewhat in line with community development financial institutions (CDFIs) rated in the 'A' category, with approximately a 13% ratio in fiscal 2023 following an increase in debt that outpaced growth in its asset base;
- Weaker profitability than peers as measured by return on average assets (ROA) with a five-year average of 0.9%, a ratio that at least partly reflected the timing of grant revenue and expenses, though its net interest margin (NIM) and NIM for loans averaged 2.6% and 3.3%, respectively, which is more comparable with the median for other rated CDFIs;

- Nonperforming assets (NPAs) averaging 0.6% over the past five years, which we view as low, with loan-loss reserves averaging 3.4% of total loans;
- Adequate liquidity, measured by total loans representing an average of 67% of total assets over the past five years and short-term assets making up 16% over that same period, reflecting a diverse asset mix and comparable ratios with the averages for other rated CDFIs, in addition to the approximately $57 million in undrawn external liquidity that was available for general use by the end of fiscal 2023;
- Investment strategy that may lead CIP to invest in what we consider more risky investments; and
- Very strong management and strategic planning capabilities based on the experience, expertise, and proficiency of the organization's senior management team, as well as for proactive oversight of its loan portfolio with comprehensive underwriting guidelines.

Effective July 15, 2021, CIP and CDC Small Business Finance (CDC), a California nonprofit corporation and certified development company as certified by the U.S. Small Business Administration, aligned their operations under the same CEO and joint board of directors. In July 2022, the alliance between CIP and CDC, including CDC's subsidiary (Venture Lending Technologies), was rebranded as Momentus Capital, although CIP and CDC continue operations as separate legal entities and audited financials. CIP and CDC cross-guarantee most of the other party's debt and are co-borrowers on other obligations to enable each organization to benefit from the combined financial strength.

Our analysis reflects the past five years of CIP's audited financial statements (2019-2023) for its parent only, which represents most of the corporation and its subsidiaries' total assets and liabilities. Beginning in fiscal 2021, our analysis is based on a combined financial statement of CIP and CDC. Although CIP has affiliates, we have not analyzed their creditworthiness and ongoing financial trends. Therefore, our financial ratios and analysis exclude the effects of subsidiaries (e.g., Detroit Neighborhoods Fund LLC and FPIF LLC).

Environmental, social, and governance

We have analyzed environmental, social, and governance factors relative to CIP's financial strength, management and legislative mandate, and local economy, which we view as neutral to our credit analysis. We think CIP's loan portfolio may have exposure to certain environmental factors, such as climate transition and physical risks, particularly for projects in California. These risks are partially mitigated CIP's loan portfolio and diversity of lending area inside and outside California and utilization of strong underwriting practices.

Outlook

The stable outlook reflects our view that CIP's financial and operational performance will remain consistent with the current rating during the two-year outlook period. CIP's equity declined relative to total assets in fiscal 2023, the first year-over-year decrease since 2019, as total debt outstanding increased faster than total assets. Subsequent declines in the equity-to-assets ratio may result in the near term as Momentus Capital scales its lending through 2030, focused partly on small business loans. We expect its net equity, profitability, asset quality, and liquidity ratios will remain in line with the current rating, and comparable with similarly rated CDFIs. Further, we believe CIP's management will maintain its diverse asset mix and sufficient access to capital, while mitigating risk to its balance sheet.

Downside scenario

We could consider taking a negative rating action should CIP's capital adequacy substantially weaken to levels no longer commensurate with the current rating, as a result of material, unexpected decreases in equity or increases in risk within its loan portfolios. Lower profitability ratios, a reduction in liquidity available to cover short-term needs, or an aggressive debt strategy that results in a mismatch of terms between its assets and liabilities could also be signs of credit pressure, which may lead us to consider lowering the rating or revising the outlook to negative.

Upside scenario

We could consider taking a positive rating action should CIP's net equity-to-assets ratio consistently average well above 15% such that its capital adequacy ratios are more in line with higher rated peers. Improvements in CIP's operating efficiency and potential financial performance, with consistent ROA and lower-risk investment profile, could also lead us to raise the rating or revise the outlook to positive.

Credit Opinion

Financial Strength

Capital adequacy

We consider CIP's capital adequacy below average compared with other similarly rated peers based on a five-year average net equity-to-assets ratio of 15.4%. It is stronger than our benchmark for the 'A' rating category but below most of its higher-rated peers. Net equity increased between fiscal years 2019 and 2021 before declining over the past two years as CIP's growth strategy involved debt-financing loan growth.

This recent decline was partly mitigated by the lower loan losses we assumed in fiscal 2023 compared with the prior year, based on the strength of the properties and the presence of mitigants to repayment risk. While the gross loan balance outstanding for much of CIP's community development lending increased by 30% between fiscal years 2022 and 2023, our assumption for the loan balance that we assumed would not repay increased by less than 2%, reflecting a lower percentage of assumed loan losses than in fiscal 2022 based on the portfolio characteristics. Our assumed losses for the CDC small business loans also decreased slightly from past years, based on improved loan characteristics and their industries. Management indicated that its lending strategy includes deploying over $500 million in loans and investments in 2024 and grow annual deployment to $2 billion by 2030, much of which would expand its small business lending.

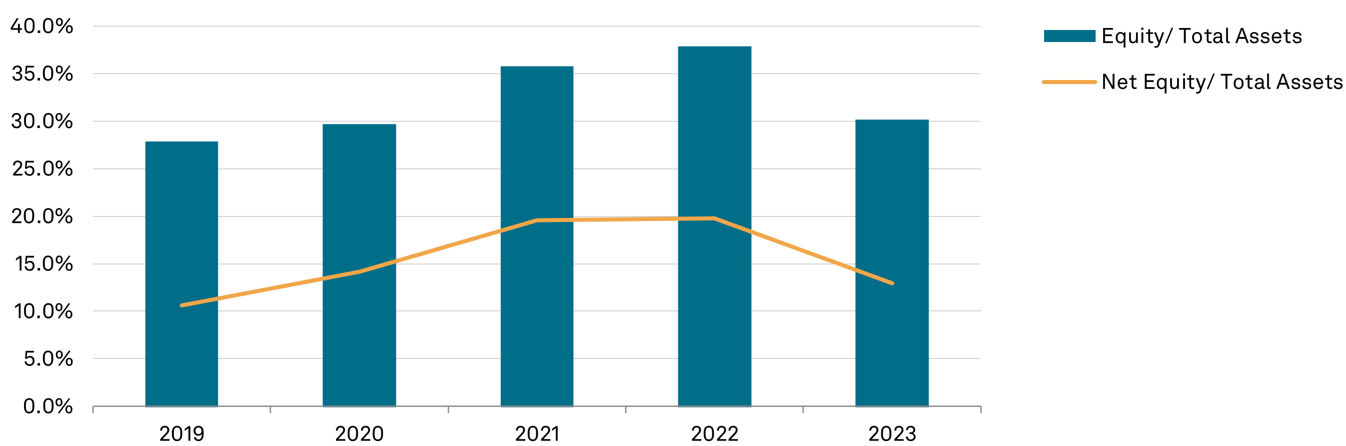
In determining net equity ratios, we applied certain adjustments to the audited balances (e.g., loan loss assumptions and fair value adjustments for investment securities). We deducted a portion of donor-restricted net assets when grant and contribution sources were not available for loan losses. Most contributions and grants receivables are multiyear, so our adjustment on net assets with donor restrictions may vary year to year.

CIP's loan growth strategy resulted in its debt outstanding reaching a high of about $512 million at the end of fiscal 2023, a 35% increase from a fiscal 2022. . The loan portfolio and CIP's financial performance reflected more repayments than new debt following the receipt of more loan prepayments and grants. Many other rated CDFIs are also in periods of growth, whereby they're taking on more debt to expand their needs-based lending. About 84% of CIP's debt outstanding is fixed, with its revolving lines of credit the only variable-rate debt. Part of CIP's strategy of strengthening equity involves off-balance-sheet lending through partnerships and structuring transactions with subordinate debt to offset some risk.

Community Investment Impact Fund LLC (CIIF) and CIIF II are two entities that merged in January 2020 and in which CIP is a managing member and holds 30% ownership. We deducted noncontrolling interest related to CIIF and CIIF II from net equity, as the equity gained from the funds is not available for CIP's general loan loss. However, CIP does not retain recourse on the loans sold to the funds. As a result, we excluded projected losses associated with loans in CIIF I and II in our total loss assumptions for CIP. Reflecting our capital adequacy analysis, we posit CIP will continue to demonstrate sufficient equity to cover potential losses at the 'A+' stress scenario over the next two years.

Chart 1

Equity/Total assets (%) versus net equity/total assets (%)



Profitability

Increases in expenses have outpaced those in revenue in recent years for CIP, leading to declines in net income over the last two years after pandemic-related factors led to a spike in fiscal 2021. Net income decreased further in fiscal 2023 as CIP scaled up its organization to meet its strategic goals and from the treatment of grant revenue and expenses year to year. Fees collected from loan servicing became a driver for other income starting in fiscal 2021, which partly offsets decreases in revenue recognized from grants. Multiyear grants supporting technical assistance activity with developers have also contributed to the negative net income in fiscal 2023, which resulted in a ROA of nearly negative 1.1%. However, a much higher ROA in fiscal 2021 helped its five-year average stay positive at 0.9%, which exceeds the benchmark for the 'A' rating category but is well below that of other rated CDFIs. Conversely, the five-year average NIM of 2.6% has only slightly lagged the average of peers. Whereas the NIM for loans is more consistent with peers', indicating CIP's ability to issue debt at sufficiently low enough interest rates to support loans at a higher rate, or earnings spread.

We expect that ROA may continue to demonstrate variability as grant revenue and expenses fluctuate. However, based on our review of CIP's unfunded loan commitments and conversations with management about the strategy, we expect net income to improve from fiscal 2023 levels, which may match profitability that was already higher through the first quarter of 2024.

Chart 2

Profitability metrics

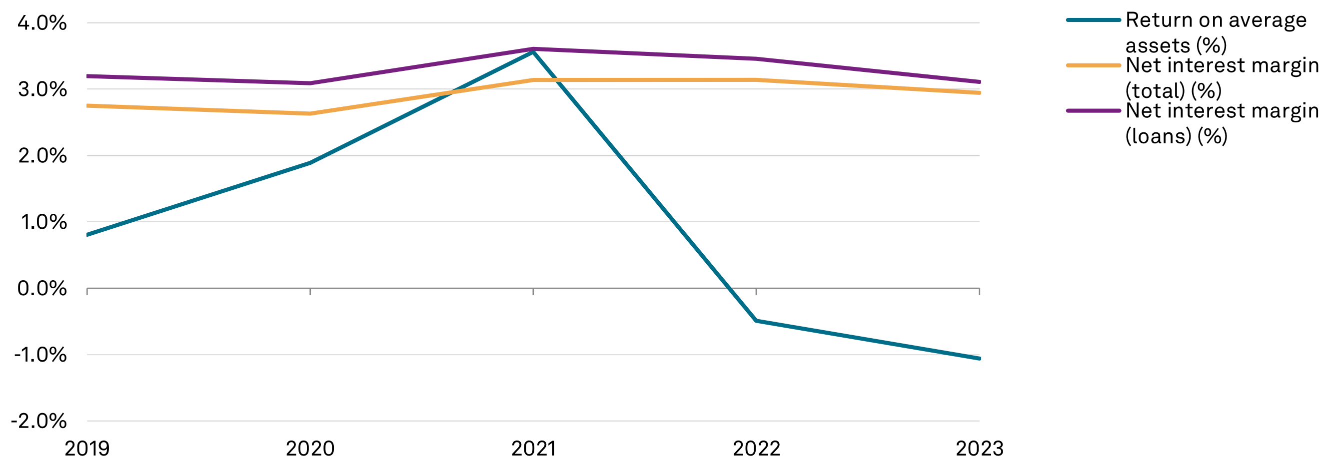
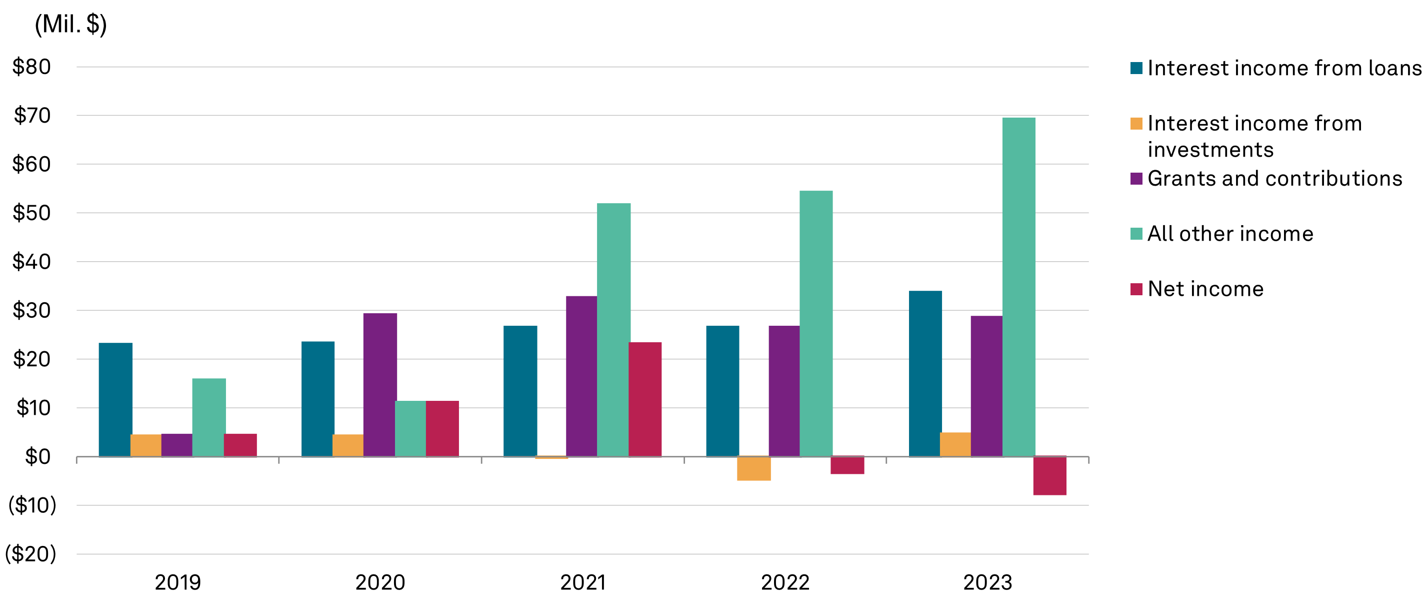


Chart 3

CIP and CDC--Revenue composition



Asset quality

CIP's total assets reached a high of $798.6 million in fiscal 2023, up 21% from fiscal 2022. The growth in total assets was largely due to a 31% increase in the gross loan balance outstanding.

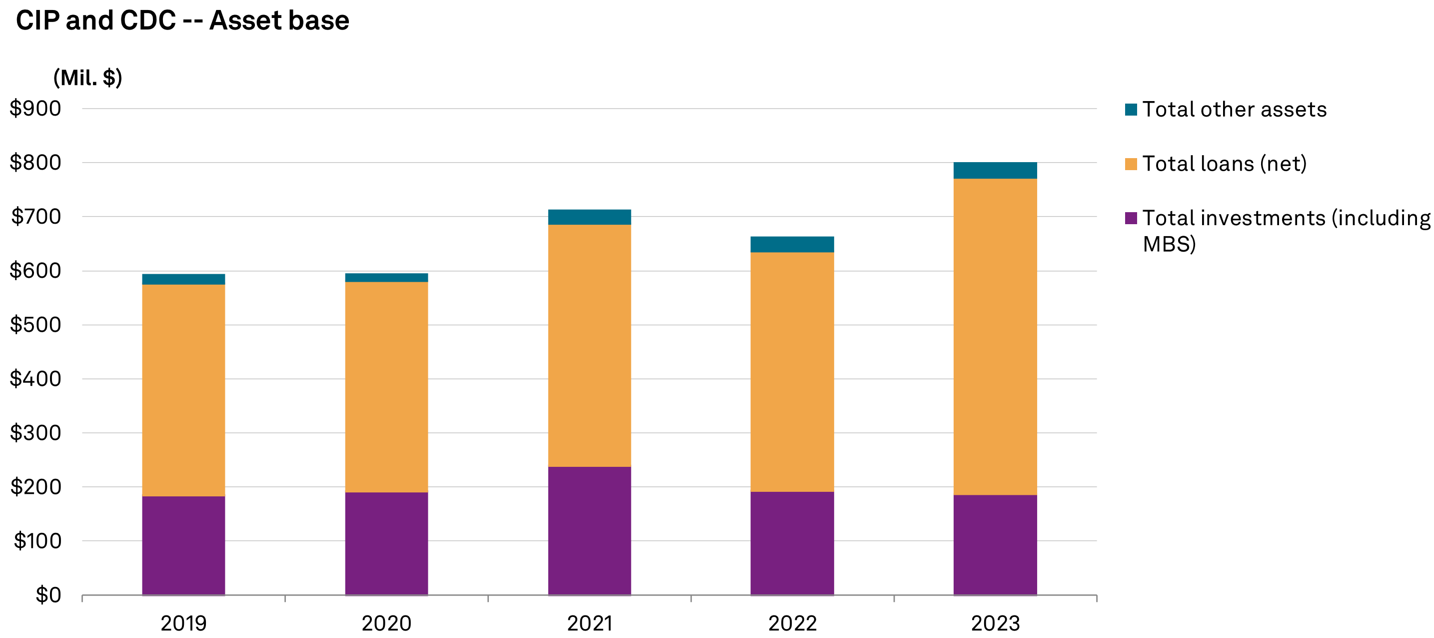
CIP has a diverse asset base consisting of multiple lending products, which we view as a strength. We believe that this diversified lending model allows CIP to provide capital financing to all aspects of community development, limit its industry concentration, and sustain its effects within communities while hedging its revenue streams across sectors and maintaining profitability.

Most (74%) of CIP's assets consist of a diverse lending portfolio (including small business loans) net of an allowance for loan losses, investments and cash (together, 19%), MBS (4%), and other assets (3%). Most of CIP's outstanding loans are for affordable housing projects, with commercial lending such as for charter schools and health care making up much of the remaining portfolio; balances for affordable housing and health care-related loans increased the most over the past five years. The six focus regions for CIP's place-based development are the District of Columbia and surrounding states, Detroit, Atlanta, Los Angeles, the San Francisco Bay Area, and Dallas-Fort Worth. More than two-thirds of the loan portfolio as of fiscal 2023 involved permanent financing, and another quarter of the balance was for construction loans.

We believe CIP's asset quality is very strong, with NPAs remaining below 1% (0.7% in fiscal 2023) of total loans and real estate owned, and a five-year average of 0.6% that is lower than most other rated CDFIs. CIP prefers to work out loans without resorting to foreclosure, thus limiting REO on its balance sheet. Loans on nonaccrual status remained relatively low in the aftermath of the pandemic, hitting a high of about 2% in fiscal 2021 before declining to below 1%. Loans delinquent between 30 and 59 days increased as of December 2023, mostly consisting of housing loans with either a maturity default or another form of covenant violation. Loan loss reserves average 3.4% of total loans over the past five years, which is in line with peers.

In our opinion, CIP's allowance for loan loss practice and underwriting shows that it has prudent risk management and is one factor helping keep its NPAs low. CIP has a risk rating system for its portfolio that takes into consideration various risk factors that are borrower specific. The system has seven numerical grades that group loans with similar credit and risk factors. CIP uses this analysis to determine the loan loss reserves for each loan in the portfolio by borrower and loan type. In addition, it revisits its loan loss and risk rating migration annually to account for the perceived and present risk on a year-to-year basis.

Chart 4



With regard to its recent investments, we believe CIP's investment strategy is aggressive, though its exposure to such investments has decreased in recent years. In fiscal 2023, 7% of total investment holdings consisted of equity securities, real estate investment trust (REIT), and equity method investments. We believe this strategy does not compare with the investment guidelines typically provided. Due to the wide variety of permitted asset classes, we will continue monitoring the risk associated with CIP's investments portfolio. CIP also invests a portion of its liquid assets in MBS, which represents about 4% of its total assets.

Liquidity

While loans represent a larger portion of total assets than for some other rated CDFIs, we think CIP's liquidity strengths include in its availability of funds to meet short-term needs, such as a potential mismatch in debt service due and loans maturing.

Short-term assets decreased by 13% between fiscal years 2022 and 2023 as prepayments and grants received in prior years were drawn on for loan financings, with a five-year average of about 16% of total assets. However, compared with fiscal 2022, CIP had more assets available to meet general expenditures within one year due partly to unfunded loan commitments and the balance of loans maturing within one year. Furthermore, it maintains about $57 million in undrawn lines of credit with two different financial institutions.

Management

We view the company's commitment to community development in relation to its core values, mission, and overall strategy as very strong.

We believe CIP's vision and that it will effectively implement its existing and upcoming strategic plans. With its national footprint, it can respond to the needs of underserved communities by investing in the comprehensive revitalization. In addition, CIP can further its effects on the communities it serves through various financing options, such as acquisition, construction, tenant improvement, and equipment loans, as well as government programs to offer new market tax credits and federally guaranteed bonds.

An 18-member board of directors oversees CIP. Two directors are elected from among the then-current senior executive officers or directors of the National Cooperative Bank (NCB), and the remaining 16 directors are independent of NCB. The directors include senior executives from the nation's largest private and nonprofit community development lenders, policy makers, and practitioners. CDC has a separate 18-member board but membership overlaps with CIP. The CIP and CDC boards are self-perpetuating and divided into three classes with staggered three-year terms. Nonemployee directors become ineligible for nomination after having served as director for nine years or more since July 15, 2021. The executive officers meet formally on a regular basis to review company strategy, prioritize company initiatives, monitor mission-critical projects, and address operational issues.

Each board includes the following standing committees: an executive committee, finance and risk committee, and audit committee. The board and each of its committees meet at least quarterly.

The boards are responsible for setting the mission, vision, and direction of the combined companies and for supervising management. Accordingly, they participate in the development and approval of the combined organizations' strategic plan, as well as setting annual corporate goals, which are measured against the strategic plan; approving and monitoring progress against the annual budget; and ensuring that appropriate financial controls are in place.

There are three operating officers prescribed by the bylaws: president, company secretary, and treasurer. The president, whom the board appoints, selects the rest of the operating officers as well as other executive officers. CDC and CIP are managed by a single, cross-appointed executive management team, currently composed of the president and CEO, CFO, chief operating officer, chief technology officer, chief human resources officer and general counsel, chief compliance officer, and corporate secretary.

CIP and CDC--Financial statistics

%	2019 - CIP only	2020 - CIP only	2021 combined	2022 combined	2023 combined	Average
Capital Adequacy						
Equity/total assets	27.8%	29.6%	35.7%	37.8%	30.1%	32.2%
Net equity/total assets (adjusted)	10.6%	14.2%	19.6%	19.9%	13.0%	15.4%
Equity/total debt	40.7%	44.7%	60.0%	66.2%	46.9%	51.7%
Net equity/total debt (adjusted)	17.1%	23.2%	35.3%	37.1%	21.2%	26.8%
Profitability						
Return on average assets	0.8%	1.9%	3.6%	(0.5%)	(1.1%)	0.9%
Net interest margin	3.0%	2.8%	2.3%	1.6%	2.9%	2.6%
Net interest margin (loans)	3.2%	3.1%	3.6%	3.5%	3.1%	3.3%

CIP and CDC--Financial statistics (cont.)						
%	**2019 - CIP only**	**2020 - CIP only**	**2021 combined**	**2022 combined**	**2023 combined**	**Average**
Asset Quality						
NPAs (delinquencies + non-accrual loans)/total loans + REO	0.2%	0.1%	1.5%	0.2%	0.7%	0.6%
Loan loss reserves/total loans	3.2%	3.4%	3.7%	3.8%	2.7%	3.4%
Liquidity						
Total loans/total assets	66.3%	65.5%	62.9%	66.8%	73.4%	67.0%
Short-term investments/total assets	12.8%	15.1%	20.5%	18.4%	13.9%	16.1%
Total investments/total assets	19.4%	21.2%	25.3%	24.8%	19.2%	22.0%

NPA--nonperforming asset. REO--Real estate owned.

Related Research

- Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022