Capital Impact Partners, D.C.; General Obligation

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Credit Highlights

- S&P Global Ratings raised to 'A+' from 'A' its issuer credit rating (ICR) on Capital Impact Partners (CIP), D.C., and its long-term rating on CIP’s investment notes outstanding.
- The outlook is stable.
- The rating action reflects our opinion of CIP’s strengthening capital adequacy and financial ratios in recent years, partly as a result of an increase in net equity from CIP’s combining its operations with CDC Small Business Finance. Its net equity-to-assets ratio in fiscal 2022 reached about 19.8% and averaged 14.5% between fiscal years 2018 and 2022. We believe the ratio will remain over 15% over the next two years.

Security

The ICR reflects our view of the obligor’s general creditworthiness, focusing on its capacity and willingness to meet financial commitments as they come due. It does not apply to any specific financial obligation because it does not consider the obligation's nature and provision, standing in bankruptcy or liquidation, statutory preferences, or legality and enforceability.

CIP’s bonds were issued 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 underserved communities, and for its general operating purposes. The bonds are general obligations (GOs) of CIP; therefore, its credit pledge supports the bonds. Bonds 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.

Effective July 15, 2021, CIP and CDC aligned their operations under the same CEO. 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 of both organizations. We have reviewed the past five years of CIP’s audited financial statements (2018-2022) for its parent only, which represents nearly 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 we understand that CIP has affiliates, we have not analyzed their creditworthiness and ongoing financial trends. Therefore, in our analysis, we have excluded the effects of a couple of subsidiaries (including Detroit Neighborhoods Fund LLC and FPIF LLC) from our financial ratios.
Credit overview
The ICR and long-term rating reflect our opinion of CIP's:

- Strong capital adequacy ratios, which have sustained five-year levels higher than our benchmarks for the 'A' rating category and are stronger than those of similarly rated peers, and availability of capital to absorb loan losses and withstand economic volatility.

- Strong history of loan performance, as evidenced by nonperforming assets (NPAs) including troubled debt restructurings (TDRs) over total loans below 0.54% in the past five years and very strong underwriting guidelines;

- Diverse asset base and an available undrawn line of credit for general use; and

- Very strong strategy and management assessment based on the experience, expertise, and proficiency of the organization's senior management team, as well as on proactive management of its loan portfolio with comprehensive underwriting guidelines.

We believe somewhat offsetting factors are what we consider CIP's:

- Susceptibility to year-over-year government and private grants and contributions that may not be recurring, which may lead to significant volatility in profitability; and

- An investment strategy that gives the company the framework to invest in what we believe could be risky investments.

Environmental, social, and governance
We have analyzed CIP's environmental, social, and governance risks relative to its financial strength, management and legislative mandate, and the local economy. We consider these risks to be neutral to the credit analysis.

Outlook
The stable outlook reflects our view of CIP's continued very strong operating performance, equity base, and overall management. We believe that at the 'A+' rating, CIP has ample equity to cover projected loan losses and liquidity to cover near-term needs. Furthermore, we believe CIP's experienced management team has demonstrated the effectiveness of its strategy to meet its mission while increasing capital and profitability and mitigating loan losses.

Downside scenario
Should CIP's financial strength, as evidenced by trailing five-year average capital adequacy and profitability ratios and loan performance, deteriorate to levels that are no longer commensurate with the current rating and comparable with those of peers, we could take negative rating action on the ICR.

Upside scenario
We could raise the ICR or revise the outlook to positive if CIP demonstrates consistent and steady improvement in its capital adequacy ratios compared with those of its peers while building its net equity proportionately to loan growth. Improvements in CIP's operating efficiency and potential future financial performance, as is evident in consistent return on assets (ROA), would also support a positive rating action.
Credit Opinion

Financial Strength

Capital adequacy
CIP maintains strong equity ratios as a result of its highly capitalized position and low debt. CIP’s total equity increased by 1.7% a year, on average, in fiscal years 2018 to 2022. CIP’s five-year average equity to assets and net equity to assets—32.2% and 14.5%, respectively—are strong compared with those of peers. While both ratios have fluctuated year over year, primarily as a result of increased leverage, five-year net equity to assets has improved in the past five years as a result of decreased risk in the loan portfolio as well a decline in our loss assumptions given changes in our criteria and our view of loan portfolio characteristics. CIP has demonstrated robust financial strength in the past two years, an ability to implement strategic objectives, and sufficient net equity. We believe it is preserving strong capital available to absorb potential loan losses.

CIP’s growth strategy has led to its debt outstanding more than doubling (166%) from fiscal 2015 and 2020; however, its debt decreased by 11%, to $378 million, during fiscal 2022. CIP’s loan portfolio also decreased by 1.1%, to $460 million, between fiscal years 2022 and 2021, its slow growth compared with 84% growth from fiscal 2015 to fiscal 2019. Equity has remained relatively stable during this time, decreasing modestly to 1.3% in fiscal 2022. Part of CIP’s strategy of strengthening equity remains its emphasizing of off-balance-sheet lending through partnerships and structuring transactions with subordinate debt to offset some risk.

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

Community Investment Impact Fund LLC (CIIF) and CIIF II are two entities in which CIP is a managing member and held 20% ownership in 2019, but increased its ownership to 30% in 2020 and combined the entities into one in 2020 as well. We deducted this 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. After applying our loan-loss assumptions, CIP’s net equity-to-debt ratio was 34.6% in fiscal 2022, an increase from 33.0% in fiscal 2021, and we expect its ratio might stay above 30%. 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. See chart 1 for a trend analysis of CIP’s financial ratios.
Chart 1
Equity/total assets vs. net equity/total assets

Profitability
In order to assess an entity's operating efficiency and potential future financial performance, we first examine profitability ratios—primarily, ROA. We view CIP’s profitability metrics as below average compared with those of rated peers and as demonstrating a relatively higher degree of volatility. We calculated ROA as negative 0.5% in fiscal 2022, primarily due to increased operating expenses related to the lending program and $4.7 million of investment losses. Consequently, we calculated the organization's five-year average ROA as 1.9% for fiscal years 2018 through 2022. While we expect that ROA may continue to demonstrate variability in the future as grant revenues and expenses fluctuate, we nevertheless believe CIP will continue to be profitable in the near term, net of depreciation and amortization, and be able to pursue its mission.
Chart 2

Profitability metrics

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Chart 3

CIP and CDC—Revenue composition

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Lastly, in our assessment of an organization’s profitability, we include net interest margin (NIM), which indicates an entity’s ability to issue debt at a low enough interest rate to support loans at a higher rate, or earnings spread. We view the company’s NIM as strong, in absolute terms, and comparable with those of other rated community development financial institutions (CDFIs). Largely fluctuating as a result of trends in grant revenue and an additional $36 million in revenue from CDC, net income increased significantly, to $23.2 million in fiscal 2021 from $4.5 million in fiscal 2019 and $11.2 million in fiscal 2020, even as total year-over-year expenses increased by 54% in fiscal 2021 from fiscal 2020. Still, the company’s NIM for loans has remained at 3.1%-3.6% over the past five years. This is in line with the median rated CDFI’s NIM, on a five-year average, of 3.5%.

We believe the company remains susceptible to year-over-year volatility in the level of grants and contributions received, reflecting a common trend among other CDFIs. In our view, however, it is more reliant on these revenue sources to meet its mission than other comparable rated peers, despite senior management’s indications that grant income does not fund its general or administrative operations. Multiyear decreases in grant income could lead to significant stress on the company’s profitability ratios and a shift in its lending strategy.

**Asset quality**

We believe CIP’s asset quality is very strong. CIP’s loans have historically exhibited very strong performance. CIP’s five-year average NPAs-to-total loans ratio of 0.5% compares favorably with those of other CDFIs that we rate. The company does not typically have REO property, as it prefers to work out loans without resorting to foreclosure.

In our opinion, CIP’s allowance for loan loss practice and underwriting shows that the company has prudent risk management and is one factor in keeping its NPAs low. The company has a risk rating system for its portfolio that takes into consideration various risk factors that are specific to a particular borrower. The system involves seven numerical grades grouping loans with similar credit and risk factors. CIP uses this analysis to determine what the loan loss reserves will be for each loan in the portfolio by borrower and loan type. In addition, it revisits its loan loss and risk rating migration annually to determine if it is accounting for the perceived and present risk on a year-to-year basis.
As of Dec. 31, 2022, CIP’s asset base stood at $662 million, down by 6.9% year over year. CIP’s asset portfolio consists largely of $392 million in a diverse lending portfolio (67%), investments and cash (together, 29%), and other assets (4%; see chart 2).
CIP has a diverse asset base that consists of multiple lending products, which we view as a strength. As of Dec. 31, 2022, affordable housing loans made up the largest share, at 37%, of the company's total loan portfolio, followed by education, health care, and CDC small business, at 21%, 20%, and 11%, respectively (see chart 5). We believe that this diversified lending model allows the company to provide capital financing to all aspects of community development while limiting its industry concentration. This also enables it to sustain its effects within communities while hedging its revenue streams across sectors and maintaining profitability.

With regard to its recent investments, we believe the company has developed an aggressive investment strategy (19.5% of total investment holdings, including equity securities, real estate investment trust [REIT], and equity method investments) that is not comparable with the investment guidelines provided by other similar companies and agencies. Due to the wide variety of permitted asset classes, we will continue to monitor the risk associated with CIP’s investments portfolio.

Management
We believe the company's vision is well-defined and positions it to effectively implement its overall three-year strategic plan, which takes it through 2024. With its national footprint, it is positioned to respond to the needs of underserved communities.
The company will continue to invest in the comprehensive revitalization of communities and to 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. We view the company's commitment to community development in relation to its core values, mission, and overall strategy as very strong.

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. CDC has a separate 18-member board of directors, consisting of the same directors as on the CIP board. The directors include senior executives from the nation's largest private and nonprofit community development lenders, policy makers, and practitioners. The CIP and CDC boards are self-perpetuating and are 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.

The 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 board is responsible for setting the mission, vision, and direction of the combined companies and for supervising management. Accordingly, it participates in the development and approval of the combined organization's strategic plan, as well as setting annual corporate goals, which are measured against the strategic plan; approving and monitoring progress against the annual company 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. With the approval of the board, supporting the main board of directors is an established CDC and CIP combined executive management team, currently composed of the president and CEO, CFO, chief investment officer, chief operating officer (COO), chief human resources officer, and general counsel/chief compliance officer/corporate secretary.

Table 1

<table>
<thead>
<tr>
<th>Capital adequacy</th>
<th>2018--CIP only</th>
<th>2019--CIP only</th>
<th>2020--CIP only</th>
<th>2021 combined</th>
<th>2022 combined</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>Equity/total assets</td>
<td>30.2%</td>
<td>27.8%</td>
<td>29.8%</td>
<td>35.7%</td>
<td>37.8%</td>
<td>32.2%</td>
</tr>
<tr>
<td>Net equity/total assets (adjusted)</td>
<td>8.4%</td>
<td>10.6%</td>
<td>14.2%</td>
<td>19.6%</td>
<td>19.8%</td>
<td>14.5%</td>
</tr>
<tr>
<td>Equity/total debt</td>
<td>44.7%</td>
<td>40.7%</td>
<td>44.7%</td>
<td>60.0%</td>
<td>66.2%</td>
<td>51.3%</td>
</tr>
<tr>
<td>Net equity/total debt (adjusted)</td>
<td>12.5%</td>
<td>15.5%</td>
<td>21.4%</td>
<td>33.0%</td>
<td>34.6%</td>
<td>23.4%</td>
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Profitability

| Return on average assets                       | 3.7%           | 0.8%           | 1.9%           | 3.6%          | -0.5%         | 1.9%    |
| Net interest margin                           | 2.8%           | 2.8%           | 2.6%           | 3.1%          | 3.1%          | 2.9%    |
| Net interest margin (loans)                   | 3.2%           | 3.2%           | 3.1%           | 3.6%          | 3.5%          | 3.3%    |
Table 1

CIP and CDC—Financial statistics (cont.)

<table>
<thead>
<tr>
<th>Asset quality</th>
<th>2018--CIP only</th>
<th>2019--CIP only</th>
<th>2020--CIP only</th>
<th>2021 combined</th>
<th>2022 combined</th>
<th>Average</th>
</tr>
</thead>
<tbody>
<tr>
<td>NPAs (delinquencies + nonaccrual</td>
<td>0.6%</td>
<td>0.2%</td>
<td>0.1%</td>
<td>1.5%</td>
<td>0.2%</td>
<td>0.5%</td>
</tr>
<tr>
<td>loans)/total loans + REO</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Loan loss reserves/total loans</td>
<td>3.1%</td>
<td>3.2%</td>
<td>3.4%</td>
<td>3.7%</td>
<td>3.8%</td>
<td>3.4%</td>
</tr>
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</table>

Liquidity

| Total loans/total assets          | 69.7%          | 66.3%          | 65.5%          | 62.9%          | 66.8%          | 66.2%   |
| Short-term investments/total assets| 16.9%          | 12.8%          | 15.1%          | 20.5%          | 18.4%          | 16.7%   |
| Total investments/total assets    | 18.2%          | 19.4%          | 21.2%          | 25.3%          | 24.8%          | 21.8%   |

Related Research

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