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Capital Impact Partners, DC; General Obligation

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Rating Action

S&P Global Ratings revised the outlook to positive from stable on Capital Impact Partners (CIP), D.C., and affirmed its 'A' issuer credit rating (ICR) on the company and its 'A' long-term rating on CIP's existing notes.

The outlook revision reflects the increase in CIP's net equity in recent years, due partly to an influx of grants and contributions and an increase of net equity as a result of combining its operations with CDC Small Business Finance. Its net equity-to-assets ratio in fiscal 2021 reached about 20.3% and averaged 12% between fiscal years 2017 and 2021. We believe the ratio will remain over 17% over the next two years while the combined organization's management remains strong.

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 April 1, 2021, CIP and CDC aligned their operations under the same CEO. Between April 1 and July 15, 2021, CIP and CDC made additional changes to establish substantially overlapping executive management teams and boards of directors. 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 (2017-2021) 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 rating reflects our opinion of CIP's:

- Improved net equity-to-assets ratio, due largely an increase of \$58 million in unrestricted net assets (UNA) from CDC Small Business Finance Corp. (CDC) in fiscal 2021;
- Improved and diversified revenue (i.e., net processing and servicing fees from CDC) that increases its net operating income to \$23.2 million in fiscal 2021, compared to \$11 million in fiscal 2020 even as CIP's asset quality remains

very strong, with delinquencies averaging close to zero and nonaccrual loans averaging about 0.6% over the same five-year period;

- Proactive management of its loan portfolio with comprehensive underwriting guidelines, low-risk debt profile with manageable variable-rate debt exposure, and strong oversight of interest rate risk; and
- Diversified lending portfolio reaching across multiple geographic markets and a variety of sectors, including charter schools, commercial real estate, health care, housing, small business lending, and other community facilities.

Partially offsetting these factors, in our view, are CIP's:

- Susceptibility to fluctuations in grant revenue that might not be recurring, which could lead to volatility in net asset growth and profitability, as measured by return on assets; and
- Exposure to early financing and small business loans, though relatively comparable with that of industry peers, which we view as carrying inherently more risk than permanent loans secured by cash-flowing projects.

The positive outlook reflects our opinion that CIP's five-year average net equity-to-assets ratio will generally remain near or above 17% over the next two years. The strength of its balance sheet to absorb our assumed loan losses has increased, resulting in improvement in net equity in recent years. We believe this trend will continue over the outlook period while profitability, liquidity, and our assessment of management remain strong at levels in line with fiscal 2021.

Founded in 1982, CIP is a 501(c)(3) nonprofit corporation headquartered in Arlington, Va., and certified as a community development finance institution (CDFI) by the U.S. Treasury Department. CIP is a mission-driven financial institution that leverages capital, analytics, and partnerships to build strong, healthy, and more equitable communities. CIP and its affiliates are related by common board members and management, operating as a unified organization with focused vision, strategy, and management systems.

Environmental, social, and governance

We have analyzed the environmental, social, and governance (ESG) factors relative to CIP's and CDC's financial strength, management and legislative mandate, and local economy. We view health-and-safety risks related to COVID-19 as social risks, which have broadly affected the U.S. economy and its workforce. However, in addition to increased federal funding to individuals and CDFIs throughout the pandemic, we believe CIP's and CDC's strong underwriting and loan performance insulate the organization from near-term negative financial effects resulting from COVID-19. At the same time, CIP and CPC exhibit strengths related to other social factors through its effects on various communities; over the past five years, this has included helping finance 173 grocery stores and other healthy food retailers; over 4,000 minority- or women-owned/controlled businesses; health care facilities with serving 150,000 patients annually; and the creation or preservation of 4,788 homes, of which 60% are affordable.

We believe CIP and CDC's loan portfolio may be exposed to certain environmental factors, such as climate transition and physical risks; this may include property damage from severe storms and flooding, particularly for projects. The company partially mitigates these risks through assessing potential collateral loss from climate events and requiring flood insurance and additional hazard-level insurance coverage on projects where necessary. We view governance risk to be in line with the sector standard.

Positive Outlook

Upside scenario

We could raise the rating if the company were to demonstrate consistent and steady growth in its net equity ratios compared with its peers, particularly with an average net equity-to-assets ratio exceeding 15%, as well as very strong, consistent profitability metrics. We could also do so if we see exceptional loan performance and the preservation of sufficient capital available to absorb potential loan losses.

Downside scenario

If the company were to experience a significant reduction in capital adequacy as a result of weak loan performance, increased debt, or lower net equity, this would demonstrate volatility and weakness in its capitalization and debt positions. In this scenario, we could lower the rating or return the outlook to stable. Further, a significant reduction in net income, potentially from a decreasing interest spread, or continued high reliance on volatile grant income, could also lead us to take a negative rating action. If secured debt were to increase significantly, we could lower the rating on the existing notes based on the availability of unpledged assets to cover unsecured GO bonds.

Credit Opinion

Financial Strength

Capital adequacy

CIP's capital adequacy (including CDC, beginning in fiscal 2021) has strengthened since fiscal 2018, with a five-year average net equity-to-assets ratio of 12%, which we view as above our benchmark for the 'A' rating category, and which marks an increase from the previous five-year average of 10%. Net equity has improved in fiscal 2021 due largely to the receipt of additional grants and contributions, along with an increase of \$58 million in UNA from CDC.

A portion of CIP's revenue is derived from its contributions and grants receivables. Unrestricted grants are contributions that can be expended as best determined by CIP and CDC, and grants with donor restrictions are funds that can only be used as determined by the donor. Therefore, in our capital adequacy analysis for CIP and CDC, we deducted a portion of net assets with donor restrictions 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.

As of December 2021, CIP's loan portfolio has generally improved in credit quality relative to past years as measured by strength of project cash flows and the presence of factors which we would view as risk mitigants. However, we assume 100% of capital charge on CDC's small business loan portfolio given its collateral and riskier loan characteristics. Together, we estimate total potential loan losses for its full loan portfolio was approximately 26.9% at the 'A' stress level. After applying our loan-loss assumptions to the company's equity ratio, our calculated net equity-to-total assets reached a high of 20.2% in fiscal 2021. Reflecting our capital adequacy analysis, we posit CIP will continue to demonstrate sufficient equity to cover potential losses over the next two years. Part of its strategy to

strengthen equity remains its emphasizing off-balance-sheet lending through partnerships.

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 maintain 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.

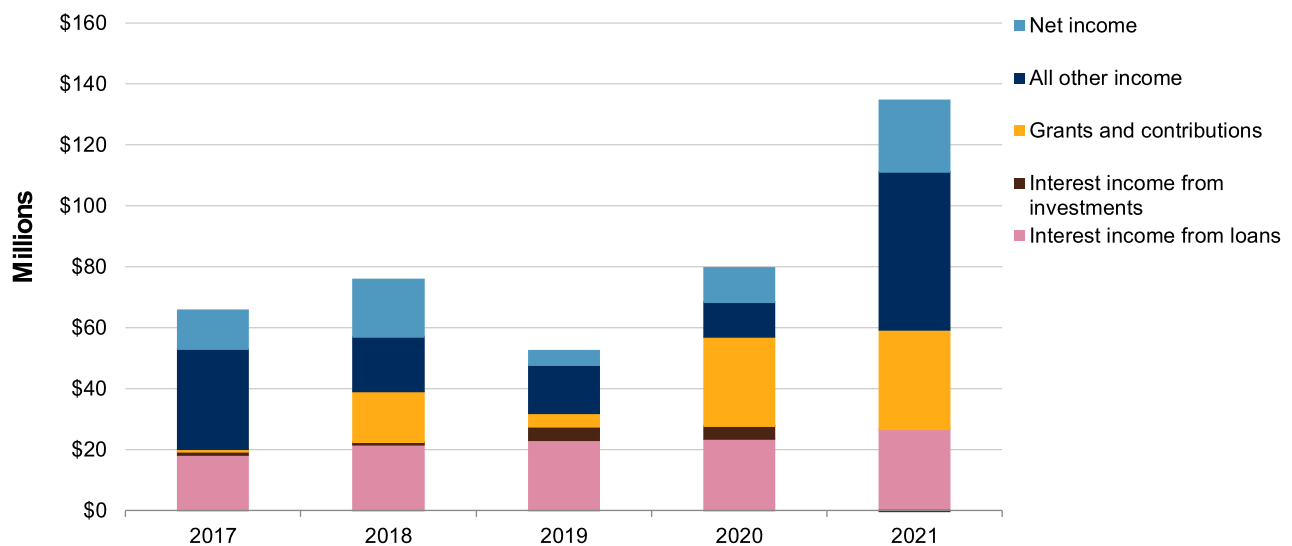
In our view, the company has a strong debt structure. Management has a clear strategy and is working toward building a financially self-sufficient business model to mitigate volatility of grants and net assets. As of Dec. 31, 2021, total liabilities were \$423 million (\$405 million--CDC and CIP parent only), up 30% from \$325 million in fiscal 2017. We expect this increase would lighten somewhat in the next two years depending on the company's debt financing, including using existing and future note issuances. We will monitor the company's debt profile and any future debt obligations.

Profitability

We view the company's profitability as strong, in absolute terms, and comparable with other rated CDFIs. Largely fluctuating as a result of trends in grant revenue and additional \$36 million 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 (see chart 1), even as total year-over-year expenses increased by 154% in fiscal 2021 from fiscal 2020. Still, the company's net interest margin for loans has remained between 3.1%-3.6% over the past five years. This is in line with the median rated CDFI's net interest margin on a five-year average (3.6%).

Chart 1

CIP and CDC -- Revenue Composition



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Through the volatility in grant income, the company maintained a positive return on assets in 2021 of 3.6%, with a strong five-year average of 2.6%. It records grant income as donor-restricted assets, given the limitations on the grant funds' usage. Grant income is also received in lump sums in a single year, although the grant terms may extend to multiple years. Per required accounting procedures, CIP records the grant income in the year the grant is received, and records the grant expenses, or release from temporary restriction, in the year the money is spent.

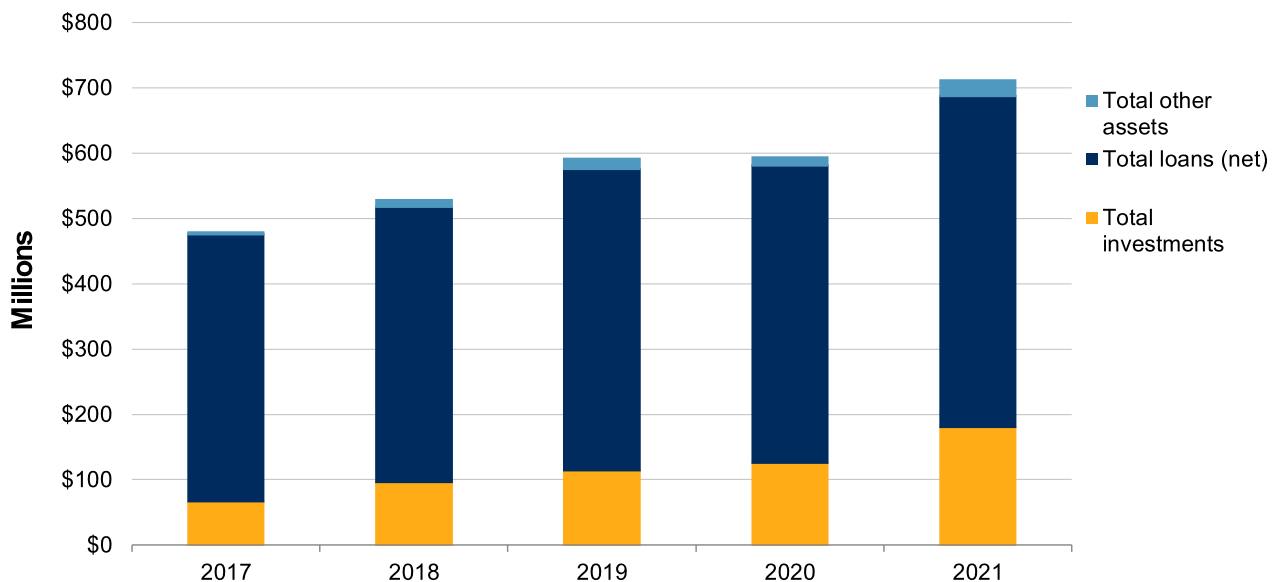
We believe the company remains susceptible to year-over-year volatility in the level of grants and contributions received, reflecting a common trend among other CDFIs. In our view, however, it is more reliant on these revenue sources to meet its mission than other comparably rated peers, despite senior management indicating 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.

Liquidity

Short-term investments made up 20.5% of the company's total assets in fiscal 2021, the highest level over the past five years, which averaged 15.6%. About 71% of its assets consist of its diverse lending portfolio (see chart 2). Among other rated CDFIs, short-term investments made up a median of 17% of total assets. The company's investment portfolios consist mostly of highly rated U.S. Treasury notes and bills and mortgage-backed securities. In a strategy to bolster its liquidity to address risks related to COVID-19, the company had increased its undrawn line of credit to meet short-term working capital needs to \$137 million (compared to \$73 million in fiscal 2019), which we view as a strength in its liquidity profile. In addition, the balance of loans maturing over the next five years exceeds each year's debt service payments, according to the company's current debt profile.

Chart 2

CIP and CDC -- Asset Base



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Asset quality

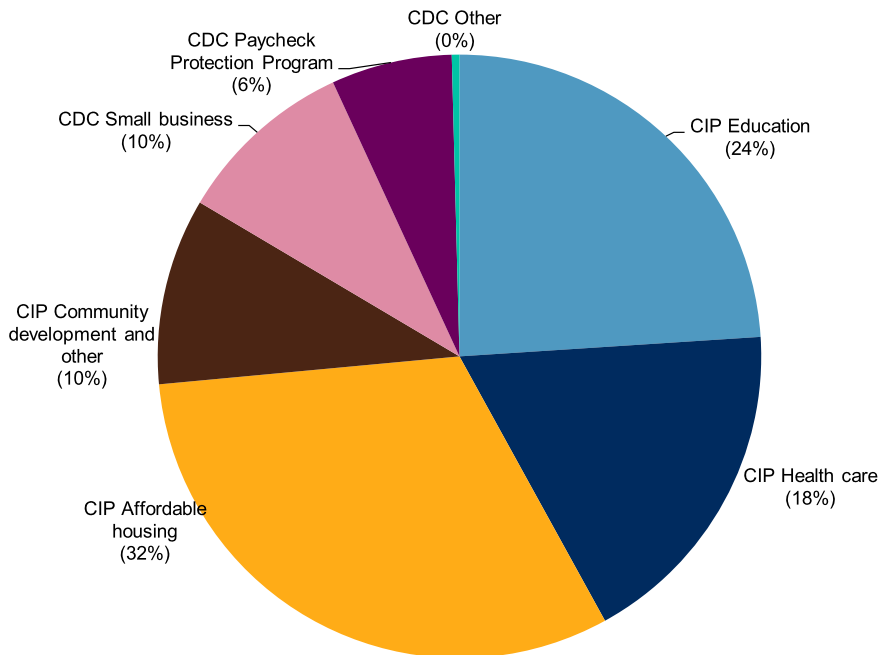
We believe the company's asset quality is very strong. Its five-year average nonperforming assets (NPAs)-to-total loans ratio of 0.6% compares favorably with those of other CDFIs that we rate. The company does not typically have real estate-owned (REO) property, as it prefers to work out loans without resorting to foreclosure.

In our opinion, the company's allowance for loan-loss practice and underwriting shows that it has prudent risk management, and is one factor in keeping its NPAs low. It 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 where loans with similar credit and risk factors are grouped. CIP uses this quarterly 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, 2021, the company's asset base stood at \$511 million, up %19.9 year over year, mainly due to additional assets from CDC. Its total assets have increased year over year, jumping 48.6% from 2017 to year-end 2021.

Chart 3

CIP and CDC -- Loan Portfolio By Property Type As Of June 2021



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CIP has a diverse asset base that consists of multiple lending products, which we view as a strength. As of Dec. 31, 2021, affordable housing loans made up the largest share, or 32%, of company's total loan portfolio, followed by

education, health care, and community development, at 24%, 18%, and 10%, respectively (see chart 3). 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 investment strategy, we believe the company has developed an aggressive investment (19% of total investment holdings) that is not comparable with the investment guidelines provided by other comparable 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.

Market position: Strategy and management

We believe the company's vision is well defined and positions it to effectively implement its overall three-year strategic plan that 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. We base this on the financial ratios, and the effects of more than \$2.7 billion invested nationwide for more than 35 years. This financing has led to the creation of over 37,000 jobs and has included:

- \$970 million deployed to health care centers, serving more than 3.5 million patients;
- \$900 million of charter school financing, serving more than 270,000 students;
- \$200 million to support healthy food initiatives, expanding access to healthy food for 1.2 million people; and
- Financing of 39,000 units of housing.

Executive management

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), the remaining 16 directors are independent of NCB. CDC has a separate 16-member board of directors consisting of the same 16 non-NCB affiliated directors 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 a 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 of, and approves, the combined organization's strategic plan; sets annual corporate goals, which are measured against the strategic plan; approves and monitors progress against the annual company budget; and ensures 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, head of capital deployment, chief external affairs officer, chief operating officer, chief human resources officer, and general counsel/chief compliance officer/corporate secretary.

CIP -- Financial Statistics (%)						
%	CIP only				Combined	
	2017	2018	2019	2020	2021	Average
Capital adequacy						
Equity/total assets	29.5	30.2	27.8	29.6	35.7	30.6
Net equity/total assets	7.5	9.1	11.3	15.0	20.1	12.6
Equity/total debt	43.4	44.7	40.7	44.7	60.0	46.7
Net equity/total debt	10.9	14.0	17.1	22.6	35.6	20.0
Profitability						
Return on average assets	3.2	3.7	0.8	1.9	3.6	2.6
Net interest margin	2.9	2.5	3.0	2.8	2.3	2.7
Net interest margin (loans)	3.5	3.2	3.2	3.1	3.6	3.3
Asset quality						
NPAs (delinquencies + non-accrual loans)/total loans + REO	0.4	0.6	0.2	0.1	1.5	0.6
Loan loss reserves/total loans	3.0	3.1	3.2	3.4	3.7	3.3
Liquidity						
Total loans/total assets	75.3	69.7	66.3	65.5	62.9	67.9
Short-term investments/total assets	12.7	16.9	12.8	15.1	20.5	15.6
Total investments/total assets	13.9	18.2	19.4	21.2	25.3	19.6

NPAs--Nonperforming assets. REO--Real estate-owned.

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