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Ratings

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Capital Impact Partners, District of Columbia; General Obligation

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Capital Impact Partners, District of Columbia; General Obligation

Credit Profile		
Capital Impact Partners ICR		
Long Term Rating	A+/Negative	Downgraded
Capital Impact Partners Senior Unsecured Debt Obligations with tenors or 1-10 years		
Long Term Rating	A+/Negative	Downgraded

Rationale

S&P Global Ratings lowered its issuer credit rating (ICR) and long-term rating on Capital Impact Partners (CIP), D.C.'s existing notes to 'A+' from 'AA-'. The outlook is negative.

The downgrade reflects our view of increased debt obligations incurred by CIP as a strategy for growing its outstanding loan balance, which have exceeded increases in net assets, and weakened CIP's capitalization and leverage ratios in absolute terms and relative to rated peers. Specifically, S&P Global Ratings' adjusted net assets after projected loan losses was about 7% of total assets and 10.3% of total debt in fiscal year 2018, which are lower ratios than in previous years, and below the median for other rated community development financial institutions (CDFIs). These lower capital adequacy levels could impair the corporation's ability to sustain operations during difficult circumstances.

The negative outlook reflects our view of CIP's growth strategy that is likely to result in lower capital adequacy levels as substantial loan portfolio growth has outpaced the growth in net assets.

Overall, the ratings reflect CIP's:

- Strong history of loan performance evidenced by nonperforming assets (NPAs) including troubled debt restructurings (TDRs) over total loans below 0.6% and very strong underwriting guidelines;
- Diverse asset base and ongoing growth in less-risky assets such as mortgage-backed securities (MBS); and
- 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.

We believe CIP's weaknesses include:

- Weakening capitalization and leverage ratios as growth in CIP's loan portfolio has largely been funded with debt, with a 163% increase in debt outstanding and 90% increase in total assets between 2014 and 2018;
- Susceptibility to year-over-year government and private grants and contributions that may not be recurring, which leads to significant volatility in profitability, such as a 3.7% return on assets in 2018 following a 0.18% ratio in 2016 and 3.16% in 2017; and
- Exposure to a high balance of early financing loans.

Outlook

The negative outlook reflects our opinion that CIP's portfolio growth strategy will likely lead to further debt financing based on the institution's 2019-2020 baseline and budget information. An increase in debt outstanding without a larger increase in net position would result in a lower S&P Global Ratings' adjusted net assets-to-debt ratio, and would mean less capital resources available to absorb losses in a distressed credit scenario. We believe CIP's management of its net assets and debt position is critical to the stability of the rating.

Downside scenario

Since fiscal 2013, CIP's adjusted net assets-over-total assets has trended negatively. This has largely been attributed to an increased debt burden resulting from CIP's strategic plan to grow its lending portfolio at a fast pace. If the institution pursues a strategy that includes further debt increases that significantly reduces its capital adequacy levels, we may take negative rating action. Loan deterioration, or a significant decline in grant income that makes up a substantial portion of net income, could also result in a negative rating action.

Upside scenario

If CIP maintains positive net income and strong profitability metrics while continuously building up its net assets level proportionately to asset growth, as well as preserving strong capital available to absorb loan losses, we could take a positive rating action. In addition, should CIP's net assets level rise while loan performance remains exceptional, a positive rating action could also result.

Issuer Credit Rating Overview

CIP is a nonprofit CDFI, with a 30-year history of delivering strategic financing, social innovation programs, and capacity building that creates social change and financial effects nationwide. Its mission is to provide financial services and technical assistance to underserved communities throughout the U.S. The institution focuses on developing and preserving affordable housing, senior housing/care, education (charter schools), public health centers, marketplaces/food, and community/mixed-use centers.

We believe CIP's level of financial support is sufficient to warrant an 'A+' rating, which, in our view, reflects the institution's overall asset quality, debt profile, liquidity, and sufficient net assets to cover potential losses at the 'A+' stress scenario. Using our commercial MBS model, we assess the risk associated with CIP's loan portfolio based on the characteristics of the loans. We estimate credit enhancement required for the institution's existing loans (as of December 2018) at approximately 35.9% at the 'A+' stress level, reduced from 38.1% in the previous review at the 'AA-' stress level.

Although CIP's loan loss history is very low (annually 0.4% in the past five years), our loss assumptions reflect a recovery based analysis, which estimates the proportion of loans that can be recovered under the 'A+' stress level. Potential losses are high, in our view, because of CIP's concentration in early financing loans, which we view as risky relative to its remaining portfolio. In addition, we assume a 100% writeoff to 4% of existing loans with non-real estate secured or based collateral. We will monitor CIP's capital adequacy and the effects that its high concentration of early financing loans will have on the portfolio. However, we believe that it has sufficient net assets to cover potential losses in the two-year outlook period. We believe CIP's S&P Global Ratings' adjusted net assets (as a percentage of its total assets) of 7% is adequate given the institution's proactive management of its loan portfolio with comprehensive underwriting guidelines.

A portion of CIP's revenue is derived from its contributions and grants receivables, which can be volatile year-to-year. Unrestricted grants are contributions that can be expended as best determined by CIP, and temporarily restricted grants are funds that can only be used as determined by the donor. Therefore, in our capital adequacy analysis, we deducted a portion of temporarily restricted net assets when grant and contribution sources were not fully available to absorb loan losses.

CIP's net income increased to $12.7 million in 2017 and $18.8 million in 2018. These increases were partially due to a cash infusion related to the creation of two newly created entities in which CIP is a managing member and holds 20% ownership, called Community Investment Impact Fund, LLC (CIIF) and CIIF II. Upon the creation of these funds in 2017 and 2018, respectively, the nonmanaging member contributed cash to CIP, which helped increase the corporation's cash position, in exchange for CIP selling a total of approximately $30 million in outstanding loans into these funds. These loans are seasoned and well-performing, although should loans in the funds fail to meet certain performance measures, such as no more than 30 days delinquent, CIP may replace those loans with other well-performing loans from its balance sheet. By the end of fiscal year 2018, CIP's noncontrolling interest in CIIF and CIIF II was approximately $25 million.

We deducted this noncontrolling interest related to CIIF and CIIF II from S&P Global Ratings' adjusted net assets, as the net assets gained from the funds are not available for CIP's general loan loss. In addition, CIP still maintains recourse on the loans sold to the funds and is expected to ensure loans in the funds meet performance thresholds. As a result, we included projected losses associated with loans in CIIF and CIIF III in our total loss assumptions for CIP.

CIP participates in residential and commercial real estate lending (focusing on affordable housing, senior housing, retailers, and supermarkets), community facilities, co-ops, charter schools, and community health centers/mixed-use facilities. While we believe such lending diversity limits the likelihood of CIP being tied to one particular sector or industry, the risk associated with lending remains, given the institution's vulnerability to real estate performance and the collection of net cash flows to meet debt service.

Company Overview

CIP is a District of Columbia nonprofit institution, formed in 1982 pursuant to Title 2 of the National Consumer Cooperative Bank Act of 1978, as amended, at the direction of the U.S. Congress. CIP is a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code, as amended ("the Code"), and a public charity, as described in Section 509(a)(1) and Section 170(b)(1)(A)(vi) of the Code. CIP's principal executive office is in Arlington, Va.; it also has offices in Oakland, Calif. and Detroit. Its mission is to provide financial services and technical assistance to underserved communities throughout the U.S.

CIP runs several community development programs, including serving as Program Administrator for the Healthier

California Fund, Detroit Neighborhoods Fund, Woodward Corridor Investment Fund, Age Strong Fund, National Cooperative Grocers Fund, and Michigan Good Food Fund, through which it finances projects to expand underserved communities' access to healthy food. CIP has used its depth of experience, cooperative approach, and diverse network of alliances to generate more than $2 billion in critical investments that create a high quality of life for low-income people and communities. Products and services include: financing for health care, charter schools and healthy food enterprises; co-op development; resources to create better options for low-income elders to age in their community; and support for homeownership programs that help more people buy homes, maintain them, and keep them affordable.

Table 1

CIP--Parent And Subsidiary

Subsidiary	Ownership percentage	Purpose	Included in consolidated financials
Community Solutions Group, LLC	100	Fosterdevelopment and provide technical assistance to coop organizations and provide capital in support of projects by making strategic grants and business planning advances. Includes the three technical assistance groups: Green House Replication Initiative, Cornerstone Partnershi pand Center for Long Term Support Innovations.	Yes
NCBCI Education Conduit, LLC	100	Facilitate, encourage and assist in financing charter schools.	Yes
Community Economic Development, LLC (CED)	100	Single Purpose Entity to make qualified investments in Qualified Active Low-Income Community Businesses under the New Market Tax Credit Program	Yes
Impact V CDE 7, LLC (Lakepoint/CHC, Inc.)	100	Single Purpose Entity to make qualified investments in Qualified Active Low-Income Community Businesses under the New Market Tax Credit (NMTC) program.	Yes
Impact NMTC Holdings LLC	100	Act as non-managing member for New Market Tax Credit Community Development Entities with NCBCI acting as managing member. (Owns 0.01% of Impact V CDE 7 LLC)	Yes, through Impact V CDE 7's ownership of this subsidiary.
California FreshWorks Fund, LLC (CAFW)	100	Provide financing for eligible fresh food retailers/distributors to overcome barriers and higher costs in unerserved areas. Supports renovation/expansion of existing stores.	Yes
Impact VII CDE 11, LLC	100	Act as taxable, non-managing member of CDEs upon the unwind of NMTC transactions.	Yes
Woodword Corridor Investment Fund, LLC (WWCF)	100	Support Community Development Projects benefitting low nad moderate income populations. Provide financing to developers of multi-family rental housing and mixed use facilities in Detroit. No activity in 2013-2014	Yes
Detroit Neighborhoods Fund, LLC (DNF)	100	Provide financing for mixed-use and multi-family rental housing in Detroit.	Yes
FPIF, LLC	100	Channel funds to a predonominately low income population aged 50 plus. Currently negotiating with Calvert Foundation on a term sheet, plan to come ot agreement in 2015.	Yes
Community Investment Impact Fund (CIIF), LLC	20	Established in 2017 and jointly owned by CIP and Annaly Social Impact LLC (non-managing member with 80% ownership). The loans in the fund are wholly-owned by CIP and CIP will invest that equity from CIIF in various social loans.	Yes
Community Investment Impact Fund II, LLC	20	Established in 2018 and jointly owned by CIP and Annaly Social Impact LLC (non-managing member with 80% ownership). The loans in the fund are wholly-owned by CIP and CIP will invest that equity from CIIF in various social loans.	Yes

Asset Quality

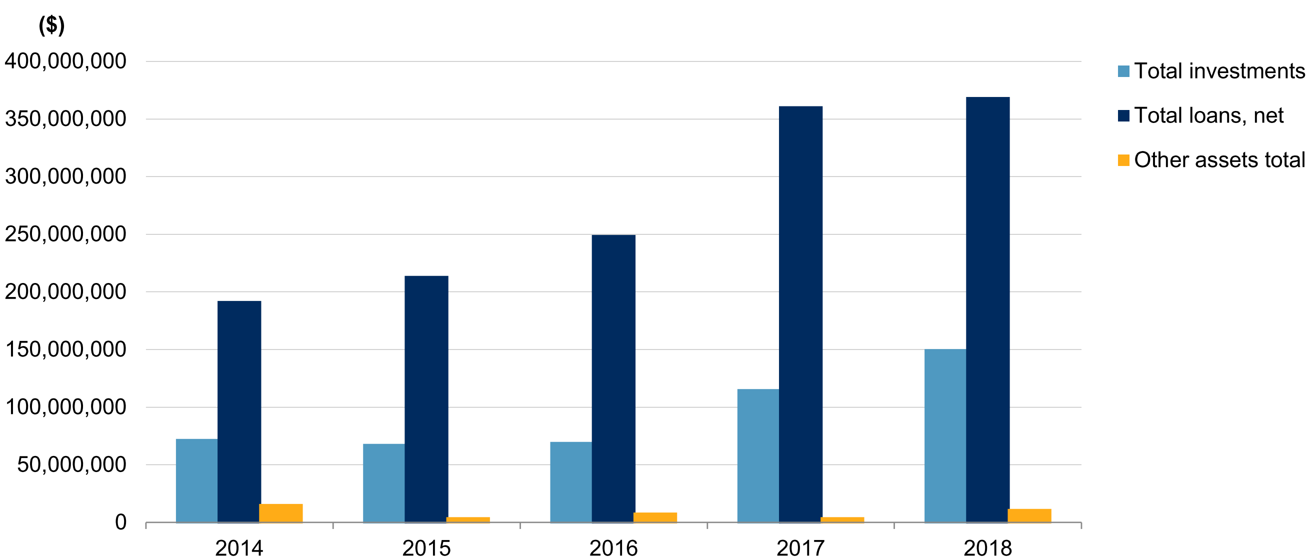
We believe CIP's asset quality is very strong. CIP's five-year average NPAs-to-total loans ratio of 0.4% compares favorably with other CDFIs that we rate. Furthermore, this ratio has declined significantly to 0.28% in 2017 and 0.5% in 2018 from 1.13% in 2013 due to a series of nonrecurring events such as a large nonaccrual loan in 2011-2012 and a drop in real estate-owned (REO) property in 2013. The institution 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 institution 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 where loans with similar credit and risk factors are grouped. 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, 2018, CIP's asset base stood at $528.7 million, up 1% year over year. Its total assets have increased year over year, jumping 90% from 2014 to year-end 2018. This growth pattern differs substantially from that of other entities that we rate, including CDFI peers. CIP's growth pattern reflects a strategy that differs substantially from that of other entities that we rate, including CDFI peers. A focus on MBS assets, and using debt to finance growth in its loan portfolio, have characterized CIP's strategy in recent years.

Chart 1

CIP--Asset Growth



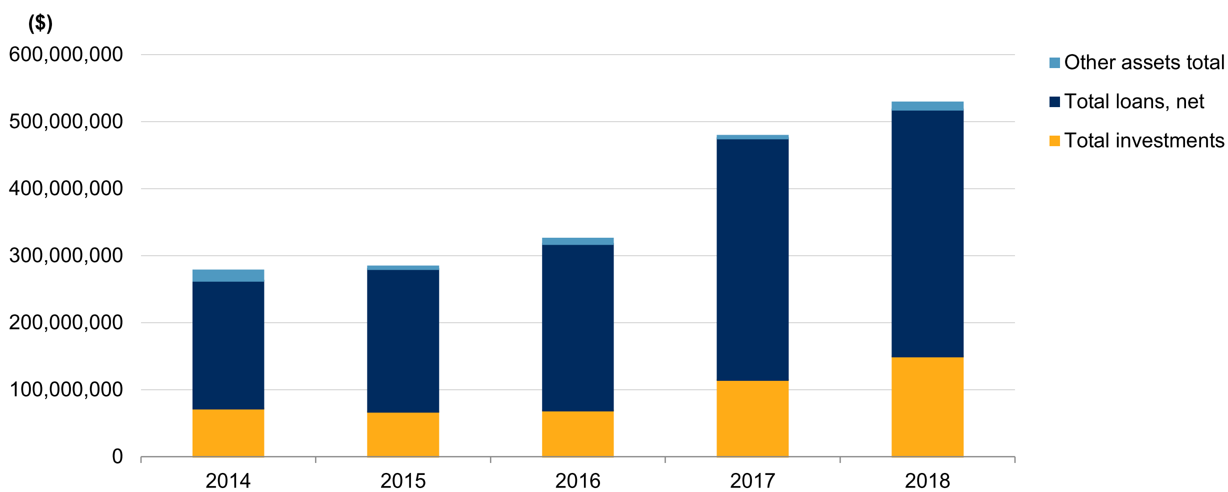
Source: S&P Global Ratings

CIP's asset portfolio consists largely of $368 million in a diverse lending portfolio (69.7%), investments and cash (together, 28.3%), and other assets (2.0%) (see chart 2). CIP offers financing for a variety of community development projects but with an emphasis on the following categories:

- Affordable housing: Lending to develop as well as preserve existing affordable housing and provide support to disadvantaged neighborhoods through the Cornerstone Partnership (spun off at the end of 2015), Department of Housing Community Development Fund, and public policy.
- Co-ops: CIP provides lending, grant funding, and technical assistance to co-op developers in the food, worker, and housing sectors through strategic financing, policy, and partnerships.
- Senior housing/care: Financing for projects that benefit low-income, older adults.
- Education: Financing for charter schools--CIP has directly financed 30% of all charter school lending nationwide while bringing in technical assistance and philanthropic partnerships.
- Health care: Financing for the development and maintenance of community health centers providing a full range of health-related services for patients.
- Commercial development: Financing for nonresidential real estate such as retailers and marketplaces, focusing on bringing fresh food to neighborhoods.
- Mixed-use development: Financing for various combination projects that include residential, commercial, cultural, and industrial development with a focus on revitalizing neighborhoods.
- Other: Financing developments or project lending that is not captured in the preceding categories.

Chart 2

CIP--Asset Base

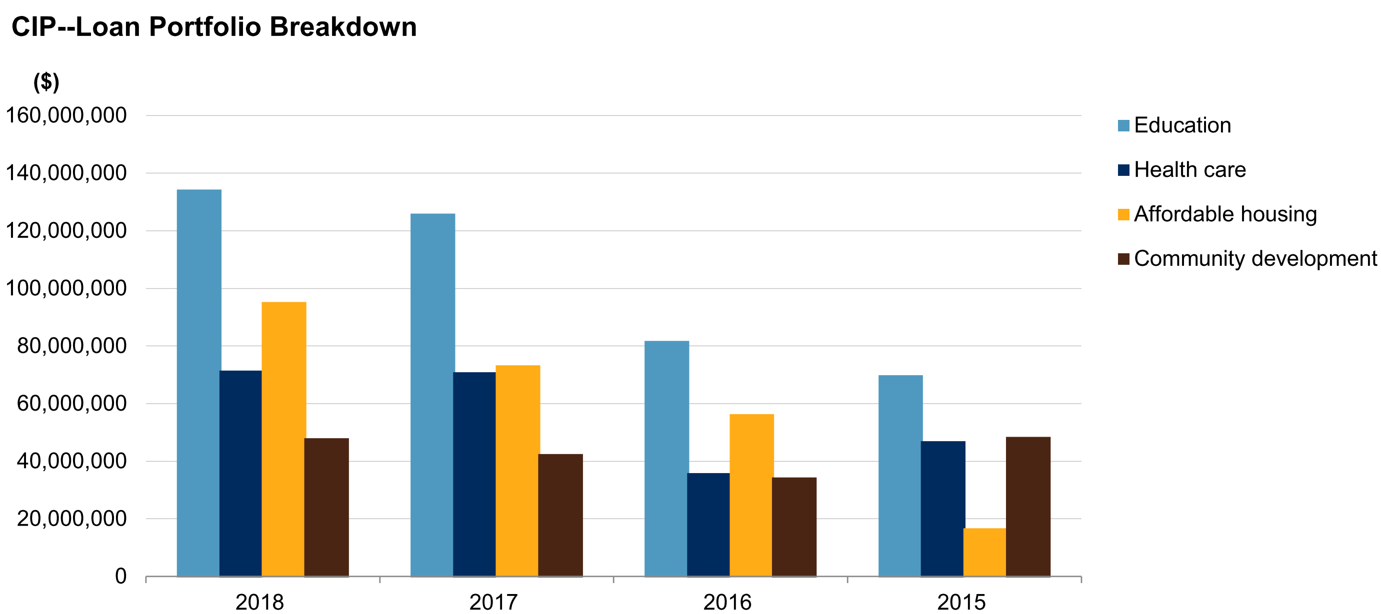


Source: S&P Global Ratings

CIP has a diverse asset base that consists of multiple lending products, which we view as a strength. As of Dec. 31, 2018, education loans comprised the largest share, or 38.5%, of CIP's total loan portfolio, followed by affordable housing, health care and community development, with 27.3%, 20.5%, and 13.7%, respectively (see chart 3). We believe that this diversified lending model allows CIP to provide capital financing to all aspects of community development while limiting its industry concentration. This also enables the institution to sustain its effects within communities while hedging its revenue streams across sectors and maintaining profitability. The institution's principal revenue sources are interest income and loan fees earned from investing and lending activities, program and service fees, and grants and contributions.

We believe CIP has a well-diversified business model with appropriate risk management. CIP has a highly conservative investment policy that provides guidance on how funds should be invested when not tied to an asset. S&P Global Ratings believes these guidelines and polices are evidence of the institution's prudent management of risk.

Chart 3



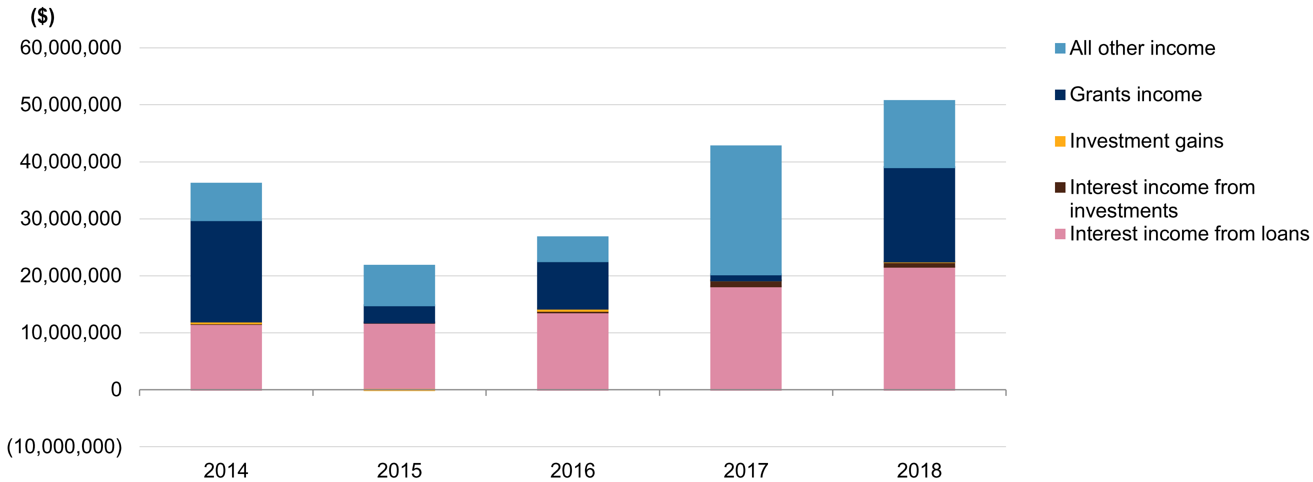
Source: S&P Global Ratings

Operating Performance

CIP has experienced volatile operating performance, given inconsistencies in year-over-year grants from both the public sector and private foundations (see chart 4). The institution depends on grant income to sustain its profitability, and the volatility of such income presents itself as a weakness, especially with regard to public grants. Its five-year average return on assets of 1.3% is lower than that of its CDFI peers, but CIP's net interest margin is still strong.

Chart 4

CIP--Revenue Mix



Source: S&P Global Ratings

In 2015, CIP's overall growth in expenses outstripped revenue gains due to increased loan expenses, program and general expenses, and one-time expenses related to the institution's information technology transformation, as well as other expenses due to rebranding, general ledger system conversion costs, and, to a lesser extent, consulting fees, among others.

CIP's net income increased to $12.7 million in 2017 and $18.8 million in 2018 from negative $9.7 million in 2015. These increases were partially due to an equity contribution from newly created CIIF. We adjusted noncontrolling interests net assets related to CIIF, since capital resources temporarily gained from the partnership are not available for credit enhancement. We believe CIP's operating performance is strong, despite some reliance on contributions and grants, which is common for CDFIs. We believe CIP maintains a profitable loan business, as measured by its 3.2% net interest margin on loans in 2018, which is comparable with that of other CDFIs.

Debt Obligations

In our view, CIP has a strong debt structure but its debt burden has expanded. Management has a clear strategy and plans to build a financially self-sufficient business model to mitigate volatility of grants and net assets. As of Dec. 31, 2018, total liabilities were $357.6 million, up 162% from $136 million in fiscal 2014. We expect this significant increase will continue in 2019-20 depending on the institution's debt financing, including using existing and future note issuances. CIP's total net assets-to-total debt ratio of 57% (five-year average) has dramatically decreased to 44.7% in 2018 from 98.7% in 2013 as the institution's debt position has increased since 2015. Furthermore, we do not consider capital available for loan loss comparable with that of its 'AA-' rated peers. We will monitor CIP's debt profile and any future potential debt obligations.

Market Position: Strategy And Management

We believe that CIP's vision is defined and sets out the institution's overall strategic plan. With its national footprint, the institution is positioned to respond to the needs of underserved communities and has identified the following strategic pillars through its five-year strategic plan that takes CIP through 2020:

- Address systemic poverty by effecting systemic change at scale, from social systems to government programs.
- Create net assets by supporting equitable access to quality services and economic opportunity regardless of demographic.
- Build healthy communities by fostering connections and social supports that strengthen the links among health, education, housing, and opportunities that help people and communities thrive together.
- Promote inclusive growth by building diverse, mixed-income communities that promote economic mobility and empower individuals to break the barriers to success.

The institution plans to execute on its strategic pillars through a roadmap that aims to:

- Implement lending efforts that support connections across multiple sectors.
- Advance equitable growth and access through local, state, and federal advocacy.
- Convene cross-sector leaders, and expand programs that scale innovative practices.
- Establish policy to practice (P2P), which supports innovation within business sectors, as well as across the CDFI industry.
- Strengthen its financial position by expanding lending and capital diversification, and affect investing strategies.

CIP 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. It furthers its mission with P2P, a range of non-lending activities, including technical assistance and thought leadership. P2P is accomplished through research, meetings, and participation in coalition and industry working groups, as well as development of policy briefs and white papers. CIP is intensively focused on revitalizing Detroit, as evidenced in 2015, when 26.6% of closed loans were in that region, and it plans to continue to increase its engagement in the area to:

- Catalyze and stabilize the markets,
- Support mixed-income neighborhood development,
- Improve access to housing and services in a place, and
- Improve economic mobility for residents.

We view CIP's commitment to community development in relation to the institution's 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 to the construction or expansion of:

- 541 health centers, serving more than 2.7 million patient visits annually;
- 259 charter schools, with a total of over 260,000 new school seats;
- 88 healthy food retailers, expanding access to healthy food for 1.1 million people;
- 38,000 units of affordable housing; and
- 221 cooperative businesses, serving 869,000 customers

Executive Management

An 11-member board of directors oversees CIP. Five directors are elected from among the then-current senior executive officers or directors of the National Cooperative Bank (NCB), the remaining directors (a majority) are independent of NCB. The directors include senior executives from the nation's largest private and nonprofit community development lenders, policy makers, and practitioners. The board is self-perpetuating, with annual elections held in May of each year; directors serve for a term one-year terms and for no more than eight-consecutive terms. The executive officers meet formally on a weekly basis to review corporate strategy, prioritize corporate initiatives, monitor mission-critical projects, and address operational issues.

The board includes the following standing committees: an Executive Committee; Finance, Audit and Risk Committee; and a Lending and Policy-to-Practice 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 institution, and for supervising management. Accordingly, it participates in the development of, and approves, CIP's strategic plan; sets annual corporate goals, which are measured against the strategic plan; approves, and monitors progress against, the annual corporate budget; and ensures that appropriate financial controls are in place.

There are three operating officers prescribed by the bylaws: president, corporate secretary, and treasurer. The president, who 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 executive management team composed of the CEO , chief financial and administrative officer, chief strategy and innovation officer, chief risk officer, chief lending officer, general counsel, chief compliance officer, and corporate secretary.