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Reinvestment Fund Inc. [The], Pennsylvania; General Obligation

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Rating Action

S&P Global Ratings revised the outlook to positive from stable on Reinvestment Fund (RF), Pa., and affirmed its 'A+' issuer credit rating (ICR) on the fund and its 'A+' long-term rating on RF's series 2017 and 2018 taxable impact investment bonds.

The outlook revision reflects the increase in RF's net equity in recent years, due partly to an influx of grants and contributions. Its net equity-to-assets ratio in fiscal 2020 reached about 21% and averaged 15% between fiscal years 2016 and 2020. As we tend to place the highest emphasis on net equity, we believe this five-year average ratio may remain near 15% in the next two years while RF's management remains strong.

As of May 2021, there was approximately $124 million outstanding on the series 2017 and 2018 bonds. The bonds were issued to pay down existing debt obligations, as well as to finance new loans to expand economic opportunity in low-wealth communities in pursuit of RF's mission. The bonds are general obligations of RF; therefore, its credit pledge supports the bonds. Bonds are payable from all legally available revenue and RF's assets, and are not secured by a reserve fund, mortgage lien, or security interest on or in RF funds or other revenue or assets.

Credit overview

The rating reflects our opinion of Reinvestment Fund's:

- Improved net equity-to-assets ratio due largely to the receipt of $107 million in grants and contributions over the past five years, including an increase of $29.5 million in unrestricted net assets in fiscal 2020;
- Conservative approach to loan-loss reserves that continue to average about 5% of total loans between 2016 and 2020, which is higher than the median reserve level of about 3.5% for other rated community development financial institutions (CDFIs), even as RF's asset quality remains very strong, with delinquencies averaging close to zero and nonaccrual loans averaging about 1.5% over the same five-year period;
- Experienced senior management team and prudent capitalization strategy for continuing to execute on its mission while producing a strong net position; and
- Diversified lending portfolio reaching across multiple geographic markets and a variety of sectors, including charter schools, commercial real estate, healthy food, housing, and other community facilities.

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

- Susceptibility to fluctuations in grant revenue that might not be recurring, but accounted for an average of 37% of total revenue in the past five years, which could lead to volatility in net asset growth and profitability, as measured by return on assets; and
- Exposure to early financing 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.

Founded in 1985, Reinvestment Fund Inc. is a 501(c)(3) nonprofit corporation headquartered in Philadelphia with offices in Baltimore and Atlanta, and certified as a CDFI by the U.S. Treasury Department. RF is a mission-driven financial institution that leverages capital, analytics, and partnerships to build strong, healthy, and more equitable communities. RF and its affiliates are related by common board members and management, operating as a unified organization with focused vision, strategy, and management systems. The organization finances housing, community facilities, schools, commercial real estate, businesses, and clean energy projects using loans, equity, and other financing tools. For the purposes of this ICR, we analyzed only Reinvestment Fund Inc., which represents nearly all of the fund and its affiliates' total assets.

The positive outlook reflects our opinion that Reinvestment Fund's five-year average net equity-to-assets ratio will generally remain near or above 15% over the next two years, even as it draws down equity from its balance sheet to meet its mission. The strength of RF's 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 2020.

Environmental, social, and governance

We have analyzed the environmental, social, and governance (ESG) factors relative to RF'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 RF's strong underwriting and loan performance insulate it from near-term negative financial effects resulting from COVID-19. At the same time, RF exhibits strengths related to other social factors through its effect on various communities; this includes helping finance 184 grocery stores and other healthy food outlets, 273 minority- or women-owned/controlled businesses, health care facilities with 1.5 million annual patient visits, and the creation or preservation of 24,400 homes.

We believe RF'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 in the Southeast and Mid-Atlantic regions of RF's lending. The organization 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 RF 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 RF 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, should RF's total on-balance-sheet loans receivable decline, we would expect to see a corresponding fall in interest income from loans, which could have negative implications for RF's profitability. 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, we could lower the rating on the series 2017 and 2018 bonds based on the availability of unpledged assets to cover unsecured general obligation (GO) bonds.

Credit Opinion

Financial Strength

Capital adequacy

Reinvestment Fund's capital adequacy has strengthened since fiscal 2016, with a five-year average net equity-to-assets ratio of 15%, which we view as above our benchmark for the 'A' rating category, and which marks an increase from the previous five-year average of 13%. Over the last five years, net equity has improved due largely to the receipt of additional grants and contributions, including a $20 million unrestricted grant from an individual donor in fiscal 2020, along with more than $20 million in restricted grants from foundations and awards from the CDFI Fund.

After realizing substantial declines in its total equity ratio as it expanded its loan portfolio using additional debt through 2018, RF's recent capitalization strategy includes emphasizing off-balance-sheet loan originations and minimizing exposure to on-balance-sheet lending that may contain higher repayment risk. This strategy helped sustain an increase in its equity-to-assets ratio, reflecting additional resources on the balance sheet to absorb potential loan losses.

As of June 2021, RF'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. We estimate total potential loan losses for its full loan portfolio as of June 2021 was approximately 23% at the 'A+' stress level. After applying our loan-loss assumptions to RF's equity ratio, our calculated net equity-to-total assets reached a high of 20.6% in fiscal 2020. Looking ahead, applying our current credit loss analysis to year-to-date financials as of June 30, 2021 similarly results in a net equity-to-assets ratio of about 20%. Reflecting our capital adequacy analysis, we posit RF will continue to demonstrate sufficient equity to cover potential losses over the next two years.

Contrary to recent years, during which RF financed loans on-balance-sheet using additional debt sources, one of its strategic objectives is to finance loans off-balance-sheet through separate managed funds (RF Impact advisors Inc. [RFIA]). RFIA is a fund management subsidiary of Reinvestment Fund that raises, deploys, and manages funds on a fee-for-service basis. Funds that RFIA manages are off RF's balance sheet, and this arrangement was designed in part

to absorb loans which we view as riskier (e.g., early financing or unsecured loans) through a transfer from RF, which would simultaneously remove those loans from our assumed losses. About $12 million in loans were transferred into this fund in fiscal 2020.

RF's debt obligations are mostly from the CDFI Fund's Bond Guarantee Program, financial institutions (e.g., CRA-motivated banks), and the taxable series 2017 and 2018 impact investment bonds. About 51% of its total debt is due by fiscal year-end 2025, whereas 58% of the loan balance will mature by fiscal year-end 2025, which would help meet debt obligations.

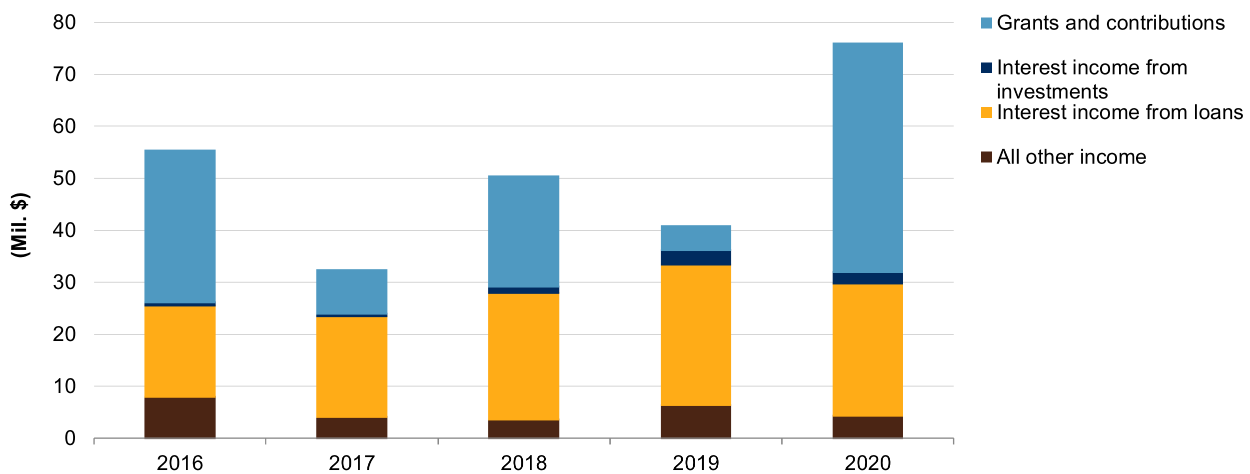
Reinvestment Fund's debt outstanding totaled $369 million in fiscal 2020, representing a 6% increase from fiscal 2019 and 58% above fiscal 2016 levels, whereas its total assets increased 11% and 47%, respectively. This reflects RF's strategy of absorbing debt obligations to expand its loan portfolio in past years, which we believe may shift with the receipt of additional lending capital. In fiscal 2020, about 30% of its debt was secured through the CDFI Fund's Bond Guarantee Program or FHLB of Pittsburgh, whereby Reinvestment Fund has assigned to those lenders a lien on, or a security interest in, all of the fund's rights, title, and interest to the related loan receivables. We do not view the current amount of secured debt and pledged assets as a credit weakness on RF's ability to pay its GO bonds.

Profitability

We view Reinvestment Fund's profitability as strong, in absolute terms, and comparable with other rated CDFIs. Largely fluctuating as a result of trends in grant revenue, net income increased significantly to $36.3 million in fiscal 2020 from $6.7 million in fiscal 2019 (see Chart 1), even as total expenses increased by 25%. Still, RF's net interest margin (NIM) for loans has remained between 3-4% over the past five years, ending 2020 with a decrease to 3.2% and capping a five-year average of about 3.4%. This is in line with the median rated CDFI's NIM on a five-year average (3.6%). When originating loans, RF targets an interest spread of around 250 basis points.

Chart 1

Reinvestment Fund, PA -- Revenue Composition



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Through the volatility in grant income, RF maintained a positive return on assets in 2020 of 6.2%, with a strong five-year average of 2.9%. 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, Reinvestment Fund 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.

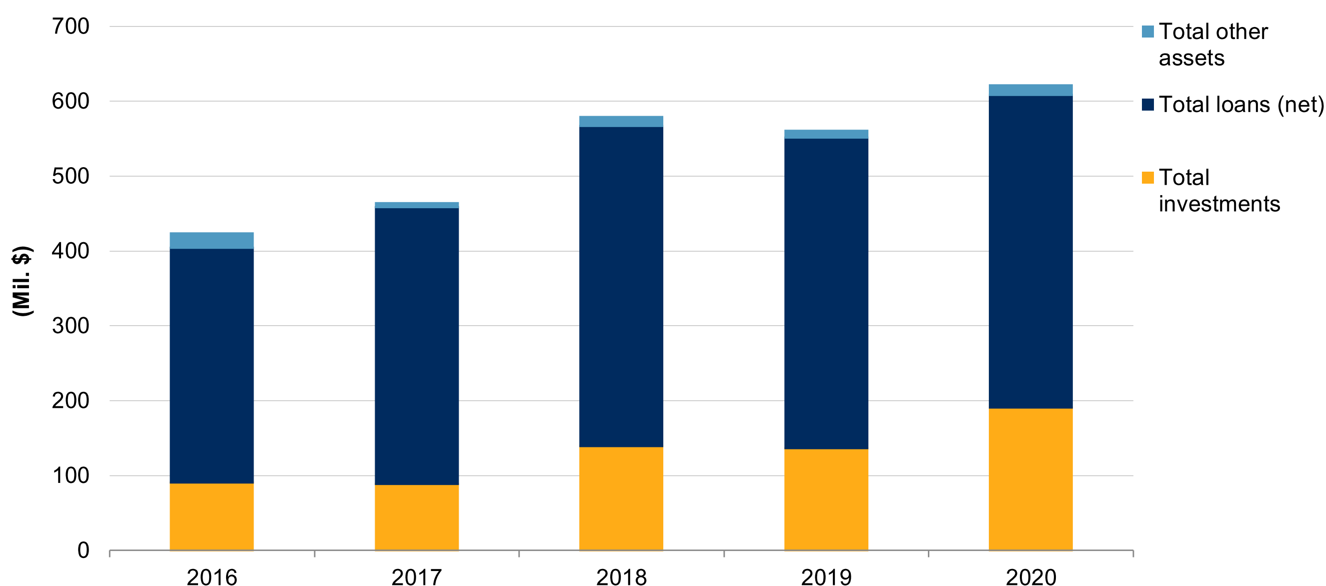
We believe RF remains susceptible to year-over-year volatility in the level of grants and contributions received, reflecting a common trend among other CDFIs. In our view, however, it is more reliant on these revenue sources to meet its mission than other comparably rated peers, despite senior management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

Liquidity

Short-term investments made up 21% of Reinvestment Fund's total assets in fiscal 2020, the highest level over the past five years, which averaged 18%. About 67% 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. RF's investment portfolios consist mostly of highly rated U.S. Treasury notes and bills. In a strategy to bolster its liquidity to address risks related to COVID-19, RF had increased its balance of short-term investments in fiscal 2020 by 16%. At the same time, it maintains access to an undrawn line of credit to meet short-term working capital needs, which it last used in fiscal 2016 and which we view as a strength to its liquidity profile. In addition, the balance of loans maturing over the next five years exceeds each year's debt service payments, according to RF's current debt profile.

Chart 2

Reinvestment Fund--Asset Base



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While still a majority, Reinvestment Fund's loan portfolio represents a smaller percentage of its total assets compared to fiscal 2019, or even the near 80% in fiscal 2017. This partly reflects a smaller annual increase in the outstanding loan balance since 2018, when the loan balance was growing by more than 10% annually, and a sizable increase in investments held in U.S. Treasury securities. We believe the percentage of short-term investments held on-balance-sheet will decrease in fiscal 2021 as RF spends down some of its cash through loan originations and to pay high interest rate debt.

Asset quality

Reinvestment Fund's total assets reached a new peak of $621.5 million in fiscal 2020, up 11% from fiscal 2019 and 47% from fiscal 2016, led initially by growth in the outstanding loan balance and more recently by increases in investments. About 62% of RF's $455.5 million loan balance is for projects in Pennsylvania, New Jersey, and Maryland, with the remaining 38% for projects in 23 states nationwide.

We view RF's asset quality as strong overall, with low delinquencies, manageable nonaccrual totals, and a proactive management team overseeing loan performance. From the early days of the COVID-19 pandemic, management communicated openly with potentially at-risk borrowers, offering full or partial payment deferrals. At October 2020, RF granted deferrals for 3.8% of the outstanding loan portfolio; by August 2021, less than 1% of the portfolio balance was deferred.

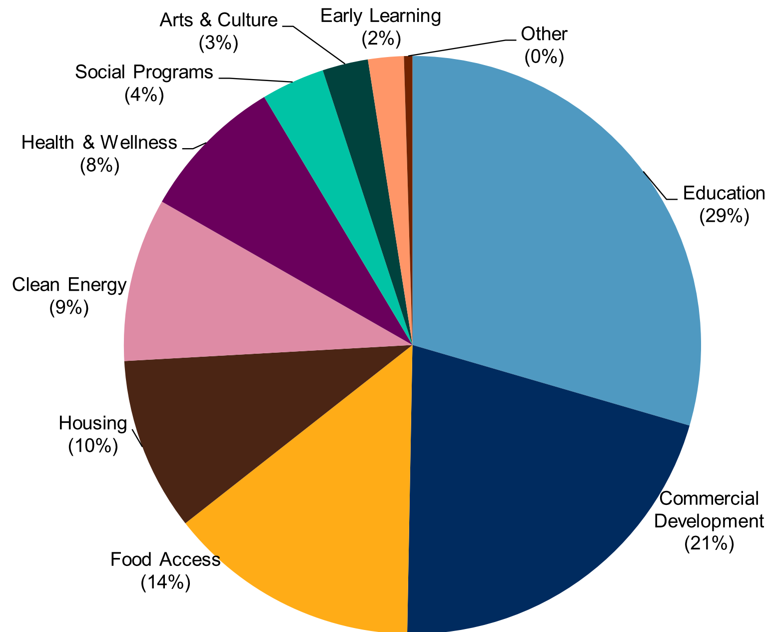
The combination of loans past 31 days due and those in nonaccrual status represent a small percentage of RF's total loans, at 0.5% in fiscal 2020 and averaging about 1.5% since fiscal 2016. Most of the increase in nonaccrual loans in fiscal 2020 consisted of commercial development loans. At the same time, one new loan ($3.8 million for a commercial development) went through the troubled debt restructuring (TDR) process and received an extension resulting from financial difficulty in fiscal 2020; otherwise, the existing loans in a TDR were for education and early learning projects. The total TDR balance as of Dec. 31, 2020 represented about 1% of the gross mortgage loan balance outstanding, which we view as very manageable. A borrower that has a loan restructured in a TDR, and is on nonaccrual status, must make six consecutive monthly regular debt service payments to be on accrual status.

Reinvestment Fund had about $22.5 million in loan-loss reserves in fiscal 2020, or 5.1% of loans outstanding, a similar percentage as of June 2021. On a five-year average at about 5.1%, this is more conservative than the 3.5% median for other rated CDFIs. We view RF's approach to loan-loss reserves, used to manage risk according to loans' internal risk ratings, as prudent despite its historically minimal loan-loss pattern. The organization assesses each loan individually and assigns an internal risk rating to determine the appropriate recovery method. We believe these methods ensure the organization of adequate reserves for potential losses.

As of June 2021, education- and early learning-related loans represented the largest share, at a combined 32%, of Reinvestment Fund's total loan portfolio, while about 10% were housing loans (see Chart 3). This contrasts with 40% and 7%, respectively, as of fiscal 2017. While we believe such lending diversity limits the likelihood of it being tied to one particular industry, the risk associated with lending activity remains, given the organization's vulnerability to real estate performance and the collection of net cash flows to meet debt service. The diversified community lending model and administration of tax credits allow RF to touch different aspects of the market.

Chart 3

Reinvestment Fund, PA -- Loan Portfolio By Property Type



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Management

We view Reinvestment Fund's management as strong due to its experienced, strategic, and proactive senior leadership and board members. A 13-member independent board of directors, all of whom are voting officers, oversees the organization. The board members come from a wide array of backgrounds, including public and private nonprofit and for-profit enterprise, legal, finance, technology, health care, and education. The board has four main committees: executive, nominating and governance, finance, and audit. Its powers and responsibilities, through these committees, include:

- Approving or disapproving loans on an exception basis;
- Setting policy and direction for Reinvestment Fund and the CEO, based on a review of the organization's financial risks and exposures;
- Reviewing operating budgets for each fiscal year, reviewing the integrity of the fund's financial statements; and
- Reviewing its compliance with legal and regulatory requirements.

Board members have specific terms, with renewals considered on a rolling-term basis. Supporting the main board of directors is an established senior management team that includes the CEO, CFO, chief of strategic initiatives, and a

chief investment officer. There is also a formal succession strategy, with planned transitions in place for normal and emergent circumstances.

Senior staff members work closely with each other to meet the fund's mission and bring operations and projects into compliance with overall strategic goals. Reinvestment Fund has internal policies and procedures that are institutionalized and built into all operations, and maintains a cyber insurance policy. We also believe the fund effectively leverages partnerships with equity providers, partners, and other redevelopment organizations in the Mid-Atlantic region, which provides the company an income stream that is not solely reliant on grants and subsidies.

In its "Strategy 2023," key strategic priorities include to:

- Capitalize future impact;
- Support and develop our team;
- Strengthen systems for impact; and
- Increase partnerships and programs for greater impact.

We believe collaboration with public and private entities, external relations, and financial self-sufficiency show that the organization has solid growth potential as it explores expansion opportunities in lending activities outside the Mid-Atlantic region. Public and private partnerships are vital to Reinvestment Fund's success, as they play a key role in expanding its financial position. This includes partnerships with other CDFIs, philanthropic institutions, and government agencies. RF has strategically identified three lending sectors for further expansion based on the availability of capital and the competitiveness of their rates: healthy food, charter schools, and health centers. Management indicates it will continue to explore these and other sectors in its commitment to respond to community needs.

Reinvestment Fund, PA -- Financial Statistics

(%)	2016	2017	2018	2019	2020	Average
Capital adequacy						
Equity/total assets	39.6	34.9	30.7	32.8	35.5	34.7
Net equity/total assets	12.9	6.9	14.5	20.1	20.6	15
Equity/total debt	72.1	57.9	47.7	52.8	59.8	58
Net equity/total debt	23.4	11.5	22.5	32.3	34.7	24.9
Profitability						
Return on average assets	5.5	(1.3)	2.9	1.2	6.1	2.9
Net interest margin	3.0	2.8	2.9	3.1	2.7	2.9
Net interest margin (loans)	3.7	3.3	3.4	3.4	3.2	3.4
Asset quality						
NPAs (delinquencies + non-accrual loans)/total loans + REO	2.9	2.3	1.4	0.2	0.5	1.5
Loan loss reserves/total loans	5.4	5.0	5.1	4.8	5.1	5.1
Liquidity						
Total loans/total assets	74.2	79.7	73.9	74.0	67.3	73.8

Reinvestment Fund, PA -- Financial Statistics (cont.)						
(%)	**2016**	**2017**	**2018**	**2019**	**2020**	**Average**
Short-term investments/total assets	16.6	14.1	20.2	20.1	21.1	18.4
Total investments/total assets	21.3	19.1	24.1	24.4	30.7	23.9

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020

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