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Ratings

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The Reinvestment Fund Inc., Pennsylvania; General Obligation

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Long Term Rating	A+/Positive	Affirmed

Credit Highlights

- S&P Global Ratings affirmed its 'A+' issuer credit rating (ICR) on The Reinvestment Fund Inc. (RF), Pa.
- S&P Global Ratings also affirmed its 'A+' rating on RF's series 2017 and 2018 taxable impact investment bonds.
- The outlook is positive.

Security

The bonds are a general obligation (GO) 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 other revenue or assets. As of June 2022, there was approximately $122 million outstanding on the series 2017 and 2018 bonds. The bonds were issued to pay down existing debt obligations and finance new loans to expand economic opportunity in low-wealth communities in pursuit of RF's mission.

Credit overview

The rating reflects our opinion of RF's:

- Growing equity, which remains sufficient to absorb assumed loan losses based on our assessment of risks in its on-balance-sheet loan portfolio, partially from significant grants and contributions since 2019--These trends contribute to a net equity-to-assets ratio of 24.1% in fiscal 2021 and a five-year average ratio of 17.3%;
- Conservative approach to loan-loss reserves that continues to average about 5% of total loans between 2017 and 2021, which is higher than the median reserve level of about 3.5% for other rated community development financial institutions (CDFIs), even as RF's portfolio oversight remains very strong, resulting in delinquencies and nonaccrual loans averaging about 1.1% during the same five-year period;
- Experienced senior management and prudent capitalization strategy that has supported RF's ability to resolve difficult situations during its operating history while remaining a mission-driven lender in a variety of sectors and geographic markets nationwide;
- Susceptibility to fluctuations in grant revenue, which could lead to equity volatility growth and profitability; and
- Exposure to early financing loans, which we view as carrying inherently more risk than permanent loans secured by cash-flowing properties.

Reinvestment Fund Inc. is a 501(c)(3) nonprofit corporation headquartered in Philadelphia with offices in Baltimore and Atlanta. The U.S. Treasury Department certifies it as a CDFI. 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. For the purposes of this ICR, we have analyzed only Reinvestment Fund Inc., which represents nearly all of the fund and its affiliates' total assets.

Environmental, social, and governance

We have analyzed environmental, social, and governance (ESG) risks relative to RF's financial strength, management and legislative mandate, and local economy; we view these risks as neutral to our credit analysis.

Outlook

The positive outlook reflects S&P Global Ratings' opinion that RF likely will maintain sufficient on-balance-sheet equity to maintain net equity-to-asset ratios more than 15% during the next two years, but it could face economic and market challenges outside its control. Following a relative slowdown in loan production and an uptick in prepayments in fiscal 2021 that led to a smaller loan portfolio, RF is likely to end fiscal 2022 with a larger loan portfolio balance than even fiscal 2020. We expect its equity during the two-year outlook to remain sufficient to absorb our assumed loan losses based on RF's lending strategy.

However, we expect the U.S. will fall into a shallow recession in the first half of 2023. (For further information, see "Economic Outlook U.S. Q4 2022: Teeter Totter," published Sept. 26, 2022, on RatingsDirect.) A challenging economic environment could make loan repayments more difficult for RF's borrowers, such as pressure on operators of commercial developments, which could lead to more charge-offs and provisions for credit losses and, potentially, weaker profitability. In our opinion, RF's management and portfolio oversight strengths partially mitigate the potential risks posed by a recession such that we continue to think we could raise the rating during the next few years.

Downside scenario

If RF were to experience a significant reduction in capital adequacy due to weak loan performance, increased debt, or lower net equity, this would demonstrate some weakness in its capitalization and debt positions. In this scenario, we could lower the rating or revise the outlook to stable. We could also lower the rating or revise the outlook to stable if RF were to reduce net income significantly, potentially from a decreasing interest spread, or if RF were to continue its high reliance on volatile grant income. In addition, we could lower the rating on the series 2017 and 2018 bonds based on the availability of unpledged assets to cover unsecured GO bonds if secured debt were to increase.

Upside scenario

We could raise the rating if RF were to demonstrate consistently strong capital adequacy compared with its peers, particularly with an average net equity-to-assets ratio exceeding 15%, as well as strong and consistent profitability metrics. We could also raise the rating if we see exceptional loan performance and the preservation of sufficient capital available to absorb potential loan losses, particularly through any effects from a potential recession in 2023.

Credit Opinion

Financial Strength

Capital adequacy

We consider RF's capital adequacy to be improving based on a five-year average that continues to increase, reaching 17.3% in fiscal 2021. This follows increases in on-balance-sheet equity that grew to 38% of total assets in fiscal 2021, the highest level since fiscal 2016. Despite a slowdown in loan production in 2021, RF has also lowered its debt outstanding to levels not seen since before 2018. A 7% decrease in total liabilities exceeded the 3% decrease in total assets, leading to a year-over-year increase in equity, which has increased each year since 2018. Competition from other lenders and lower demand from potential borrowers were supporting factors in reduced loan balance. However, June 2022 unaudited financials indicate a 9% increase in loan balance to the highest amount in four years: The recent influx of grants and contributions largely financed loan growth. Therefore, RF's debt outstanding should remain lower than past years and, therefore, potentially result in an even stronger equity-to-assets ratio.

Our view of risks posed by RF's loan portfolio is another factor supporting the net equity increase relative to assets in fiscal 2021. RF's loan portfolio has generally improved in credit quality relative to past years, measured by strength of project cash flow and the presence of factors we view as risk mitigants. We estimate total potential loan losses for its full loan portfolio were approximately 21% at the 'A+' stress level. After applying our loan-loss assumption to RF's equity ratio, we calculate net equity was 24.1% of total assets in fiscal 2021. Looking ahead, applying our current credit-loss analysis to year-to-date financials as of June 30, 2022, results in a relatively similar net equity-to-assets ratio. Reflecting our capital-adequacy analysis, we posit RF will likely continue to demonstrate sufficient equity to cover potential losses during the next two years. However, weaker project cash flows, delayed loan repayments, or the projects' reserve funds drawdown could lead to higher assumed losses with a backdrop of challenging macroeconomic factors.

One of RF's strategic objectives has been to finance off-balance-sheet loans through separate managed funds: RF Impact advisors Inc. (RFIA). RFIA is a fund-management subsidiary of RF that raises, deploys, and manages funds on a fee-for-service basis. Funds that RFIA manages are off RF's balance sheet; this arrangement was partially designed to absorb loans we view as riskier, such as early financing or unsecured loans, through a transfer from RF, which would simultaneously remove those loans from our assumed losses. RF transferred about $12 million in loans into this fund in fiscal 2020.

RF's debt obligations are mostly from the CDFI Fund's bond guarantee program, financial institutions such as CRA-motivated banks, and taxable series 2017 and 2018 impact investment revenue bonds. As of June 2022, about 56% of total debt is due by fiscal year-end 2026 and 55% of loan balance will mature by fiscal year-end 2026, which would help meet debt obligations. As of June 2022, no variable-rate debt is outstanding and 17% of loan balance has floating interest rates. This could sacrifice some matching in its assets and liabilities in exchange for the potential of higher loan interest income while keeping lending costs down. We do not see this as a credit weakness due to RF's expertise and record of managing debt, maintaining sufficient funds for upcoming debt-service payments, and ensuring interest costs are manageable for borrowers.

RF's debt outstanding totaled $341.4 million in fiscal 2021, a 7% decrease from fiscal 2020 with another 3% decrease by June 2022. RF's strategy has been to absorb debt obligations to expand its loan portfolio during the past few years; this, however, shifted recently with the receipt of additional lending capital. As of June 2022, about 35% of debt was secured through the CDFI Fund's bond guarantee program or Federal Home Loan Bank of Pittsburgh; RF has assigned those lenders a lien on, or a security interest in, all of the fund's rights, title, and interest to 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 repay its GO bonds.

Profitability

In fiscal 2021, RF's net income decreased from fiscal 2020 to levels more in-line with fiscal 2019 because it received a large sum of grants and contributions in fiscal 2020. These changes in net income resulted in a return-on-average-assets ratio of about 1.4% in fiscal 2021 and a five-year average of 2.1%, lower than the 2.9% five-year average in fiscal 2020 and below the median of other rated CDFIs. We do not view RF's return on average assets as a weakness because volatility is due to grant income fluctuations and fiscal 2020 was a particularly strong year in that regard.

RF recognizes grant income as donor-restricted assets due to limitations on the grant funds' usage. RF also receives grant income in lump sums in a single year, but grant terms could extend to multiple years. According to required accounting procedures, RF records grant income in the year it receives the grant and records grant expenses or releases from temporary restrictions in the year it spends the money. We think RF remains susceptible to year-over-year volatility in the level of grants and contributions received, reflecting a common trend among other CDFIs. Multiyear decreases in grant income could lead to significant stress on RF's profitability ratios and a shift in its lending strategy.

The spread RF earns on its loans remains strong, in our opinion: The net interest margin (NIM) decreased slightly in fiscal 2021 to 2.5%, but NIM for loans reached 3.6%, the highest level since fiscal 2016. The five-year average NIM and NIM for loans in fiscal 2021 were 2.8% and 3.4%, respectively, both in-line with other CDFIs. NIM for loans should increase in fiscal 2022 following the general decrease in borrowing costs.

Asset quality

RF's total assets in fiscal 2021 were $601.1 million, about $20 million lower than fiscal 2020. Management attributes much of this decrease to a lower loan balance with some decrease in liquid cash on the balance sheet. More than half (58%) of RF's $447 million loan balance, as of June 2022, was for projects in Pennsylvania, New Jersey, and Maryland with the remaining 42% for projects in 21 other states.

We view RF's overall asset quality as strong with low delinquencies, manageable nonaccrual totals, and proactive management overseeing loan performance. The combination of loans past 31 days due and those in nonaccrual status still represent a small percent of RF's total loans despite increasing to 1.2% in fiscal 2021 and averaging about 1.1% since fiscal 2017. Most of the recent increase in nonaccruals includes commercial development loans. At the same time, no loans entered the troubled-debt-restructuring (TDR) process in fiscal 2021; existing loans in TDR, which received an extension in loan repayment, were for education, early learning, and commercial-development projects.

The total TDR balance, as of Dec. 31, 2021, was about 1% of 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 achieve accrual status.

RF had about $21.3 million in loan-loss reserves in fiscal 2021, or 5.2% of loans outstanding. On a five-year average at about 5.1%, this is higher than the 3.4% median for other rated CDFIs. We view RF's approach to loan-loss reserves, used to manage risk according to the 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 think these methods ensure RF adequate reserves for potential losses.

As of June 2022, loans for education and early learning projects represented the largest share at a combined 31% of RF's loan portfolio, which is consistent with the 32% in 2021. Housing loans accounted for about 11% of the balance outstanding: one of the smaller exposures to housing loans among our rated universe of CDFIs. About 70% of the portfolio includes permanent loans and 20% are construction loans. While we think such lending diversity limits the likelihood of its ties to one particular industry, risk associated with lending activity remains due to RF'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 market aspects.

Liquidity

RF, in our view, has adequate liquidity to cover short-term financial needs. Short-term investments made up about 18% of total assets in fiscal 2021, down from a high of 21% in fiscal 2020 with the grant and other liquid fund drawdown. During the past five years, short-term investments have averaged about 19% of total assets while loans averaged 72%, among the higher levels relative to other rated CDFIs. RF's asset composition in fiscal 2021 was likely not indicative of a shifting long-term trend with loans accounting for just 64%, below its five-year average; this does not include the $37 million in loans held for sale in fiscal 2021. As of June 2022, loans and short-term investments were about 71% and 18% of total assets, respectively.

Management

We view RF'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. Board members come from a wide array of backgrounds, including public and private nonprofit and for-profit enterprises, legal, finance, technology, health care, and education. The board has four main committees:

- Executive,
- Nominating and governance,
- Finance, and
- Audit.

Board members have specific terms with renewals on a rolling-term basis. An established senior management team that includes the CEO, chief financial officer, chief of strategic initiatives, and a chief investment officer supports the main board of directors. A formal succession strategy exists with planned transitions for normal and emergent circumstances.

Senior staff work closely with each other to meet RF's mission and bring operations and projects into compliance with overall strategic goals. RF has internal, institutionalized policies and procedures built into all operations. In addition, it maintains a cyber-insurance policy. We also think RF effectively leverages partnerships with equity providers, partners, and other redevelopment organizations in the Mid-Atlantic region; this provides an income stream not solely reliant on grants and subsidies.

In RF's "Strategy 2023," key strategic priorities look to:

- Capitalize future impact,
- Support and develop the team,
- Strengthen systems, and
- Increase partnerships and programs for greater effect.

We think collaboration with public and private entities, external relations, and financial self-sufficiency show RF has solid growth potential as it explores expansion opportunities in lending activities outside the Mid-Atlantic region. Public and private partnerships are vital to RF's success because they play a key role in expanding finances, including 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 competitiveness of its 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.

The Reinvestment Fund Inc., Pennsylvania Select Financial Statistics

(%)	2021	2020	2019	2018	2017	Average
Capital adequacy						
Equity/total assets	38.1	35.5	32.8	30.7	34.9	34.4
Net equity/total assets	24.1	20.6	20.1	14.5	6.9	17.3
Equity/total debt	67.1	59.8	52.8	47.7	57.9	57.1
Net equity/total debt	42.5	34.7	32.3	22.5	11.5	28.7
Profitability						
Return on average assets	1.4	6.1	1.2	2.9	(1.3)	2.1
Net interest margin	2.5	2.7	3.1	2.9	2.8	2.8
Net interest margin (loans)	3.6	3.2	3.4	3.4	3.3	3.4
Asset quality						
Nonperforming assets (delinquencies + nonaccrual loans)/total loans + real estate owned	1.2	0.5	0.2	1.4	2.3	1.1
Loan loss reserves/total loans	5.2	5.1	4.8	5.1	5.0	5.0

The Reinvestment Fund Inc., Pennsylvania Select Financial Statistics (cont.)

(%)	2021	2020	2019	2018	2017	Average
Liquidity						
Total loans/total assets	64.3	67.3	74.0	73.9	79.7	71.8
Short-term investments/total assets	18.5	21.1	20.1	20.2	14.1	18.8
Total investments/total assets	27.5	30.7	24.4	24.1	19.1	25.1

Related Research

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