S&P Global Ratings

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Reinvestment Fund Inc. (The); General Obligation

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Reinvestment Fund, Inc [The] taxable rev bnds		
Long Term Rating	AA-/Stable	Upgraded

Credit Highlights

- S&P Global Ratings raised its issuer credit rating (ICR) on Reinvestment Fund Inc. (RF), Pa. one notch to 'AA-' from 'A+'.
- At the same time, S&P Global Ratings raised its rating on RF's series 2017 and 2018 taxable impact investment bonds one notch to 'AA-' from 'A+'.
- The outlook is stable.
- The rating action reflects our opinion of stronger capital adequacy with a net-equity-to-assets ratio averaging nearly 20% during the past five years, demonstrating sufficient equity to sustain our assumed loan losses comparable with similar-rated peers. We expect this ratio to average more than 15% during the next few years based on RF's lending strategy, portfolio oversight, and deliberate financing strategy.

Security

An ICR reflects the obligor's general creditworthiness and capacity and willingness to meet financial commitments when due.

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 December 2022, there was approximately $121.4 million outstanding on the series 2017 and 2018 bonds. RF issued the bonds to pay down existing debt obligations and finance new loans to expand economic opportunity in low-wealth communities in pursuit of its mission.

Credit overview

RF's equity reached a peak of 40% of total assets in fiscal 2022 after debt remained relatively flat with fiscal 2021, but the loan portfolio grew at the fastest year-over-year rate (13%) since fiscal 2018. We think RF can absorb assumed loan losses at the 'AA-' rating based on the availability of unrestricted and donor-restricted net assets relative to the loan portfolio's characteristics. Profitability was also stronger in fiscal 2022 than the prior year due to reduced interest expenses and increased interest income from new loans financed, partially supported by approximately 20% of the portfolio that carries variable-interest rates.

The rating reflects our opinion of RF's:

- Stronger capital adequacy than in years past, which we consider sufficient to absorb assumed loan losses based on our assessment of risks in its on-balance-sheet loan portfolio, with a net-equity-to-assets ratio of 21.8% in fiscal 2022 and five-year average of 19.9%;

- Conservative approach to loan-loss reserves that continues to average about 5% of total loans between 2018 and 2022, which is higher than median reserves of about 3.7% for other rated community development financial institutions (CDFIs) --However, we expect this to decrease slightly during the next few fiscal years;
- 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 grant revenue fluctuations, which could lead to equity volatility growth and profitability; and
- Exposure to early financing loans, accounting for a greater percent of loan balance outstanding in June 2023 than June 2022, which we view as carrying inherently more risk than permanent loans secured by cash-flowing properties.

RF is a 501(c)(3) nonprofit corporation and certified CDFI headquartered in Philadelphia with offices in Baltimore and Atlanta. 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 RF, 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. We think RF's loan portfolio may have exposure to certain environmental factors, such as climate transition and physical risks; this could include property damage from severe storms and flooding, particularly for projects in the Southeast and Mid-Atlantic regions of RF's lending. The organization 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.

Outlook

The stable outlook reflects S&P Global Ratings' opinion that RF will likely maintain sufficient on-balance-sheet equity to maintain net equity-to-asset ratios that average more than 15% through the two-year outlook, even with an expectation that this ratio will likely decrease slightly from fiscal 2022 as RF assumes more debt to grow lending capacity during the next few years.

Upon reviewing year-to-date finances, as of June 2023, we do not think the expected equity decrease relative to assets in the near term signals a material credit quality deterioration; rather, we view these changes as a reflection of RF's deliberate financing strategy to meet high loan demand.

We view management's strategy and portfolio oversight as strengths that partially mitigate potential risks posed by economic challenges through the two-year outlook. We believe RF's asset quality and profitability will likely remain strengths.

Downside scenario

If RF were to experience significantly lower capital adequacy due to elevated assumed loan losses, increased debt, or lower net equity, this would demonstrate some weakness in its capitalization and debt positions. In this scenario, we could lower the ICR or revise the outlook to negative. We could also do so if RF were to reduce net income significantly, potentially from a decreasing interest spread. 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 ICR or revise the outlook to positive if RF were to demonstrate consistently stronger capital adequacy compared with its peers, particularly with a sustained average net-equity-to-assets ratio of more than 20%, as well as strong and consistent profitability metrics. We could also raise the ICR or revise the outlook to positive if we were to see exceptional loan performance and the preservation of sufficient capital available to absorb assumed loan losses.

Credit Opinion

Financial Strength

Capital adequacy

RF's equity increased annually in fiscal 2022 for the fifth consecutive year, as gross loan balance increased by 13% year over year and debt outstanding remained relatively flat. This led the equity-to-assets ratio to reach a peak of 40%. As RF continued to work down its balance of grants, contributions, and loan prepayments received recently, there was a reduced reliance on financing new loans with debt. We expect the equity-to-assets ratio to decrease during the next few years to about its historical average of 30%-35% as RF's debt obligations increase; already through June 2023, this ratio is 38%. This will likely mean RF's net-equity-to-assets ratio in fiscal 2023 could be slightly lower than fiscal 2022, but we expect this ratio will likely remain comparable with the 'AA-' rating.

We estimate RF had about $131 million in net equity available in fiscal 2022 with most of that in the form of increased unrestricted net assets. This is after our assumed credit losses of about 23% of the loan portfolio at the 'AA-' stress level, which considers property performance, mitigants to repayment risk for early financing loans, and other loan characteristics. These loan assumptions resulted in a net-equity-to-total-assets ratio of about 21.8% in fiscal 2022, weaker than fiscal 2021 when rated 'A+'. The five-year average net-equity-to-total-assets ratio is 19.9%, which is stronger than the historical average in our last review. 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. RFIA had about $21.7 million of assets under management at fiscal year-end 2022.

RF's debt obligations are mostly from the CDFI Fund's bond-guarantee program, financial institutions such as Community Reinvestment Act-motivated banks, and taxable series 2017 and 2018 impact investment revenue bonds. About 41% of total debt is due by fiscal year-end 2025 while 55% of loan balance will mature by fiscal year-end 2026, which would help meet debt obligations. As of June 2023, 21% of loan balance has floating interest rates, up from 17% in June 2022, with minimal variable-rate debt outstanding. 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 about $343 million in fiscal 2022, just $1.6 million higher than fiscal 2021; however, June 2023 shows a 4% increase from fiscal 2022. RF's strategy had been to absorb debt obligations to expand its loan portfolio; this, however, shifted recently with the receipt of additional lending capital since COVID-19. As of December 2022, about 33% 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 2022, RF's net income nearly doubled from the previous year due to the receipt of $21.9 million in grants and contributions, as well as an increase in interest income from loans but a decrease in interest expenses. This resulted in a return-on-average-assets ratio of about 2.8% in fiscal 2022 and a five-year average of 2.7%, slightly below the median for 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 years 2020 and 2022 were particularly strong 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) increased to a high of about 3.2% in fiscal 2022 while NIM for loans reached a peak of about 4.1% with additional interest income received from variable-rate loans as interest rates increased. The five-year average NIM and NIM for loans in fiscal 2022 were 2.7% and 3.5%, respectively, both in-line with other rated CDFIs.

Asset quality

RF's total assets in fiscal 2022 were $602.8 million after considering the cumulative fair-market-value adjustment of unrealized gains on investments. This is about 1% higher than total assets in fiscal 2021 but still 2% below fiscal 2020. More than half (55%) of RF's $505 million loan balance, as of June 2023, was for projects in Pennsylvania, Georgia, and Maryland with the remaining 42% for projects in 19 other states. Between June 2022 and June 2023, RF funded a significant number of housing loans in Georgia as part of the Growing Diverse Housing Developers (GDHD) initiative. GDHD is a collaboration among RF and two other rated CDFIs to work with leading U.S. housing-development firms, led by BIPOC owners, to create racially, equitable, affordable, and adequate housing.

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 1.8% in fiscal 2022 and averaging about 1% since fiscal 2018. Most of the recent increase in delinquencies is attributed to housing loans. At the same time, two loans entered the troubled-debt-restructuring (TDR) process in fiscal 2022; existing loans in TDR, which received an extension in loan repayment resulting from financial difficulty, were for social programs, education, early learning, and commercial-development projects. The total TDR balance, as of Dec. 31, 2022, was 0.4% of the gross 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 $21.7 million in loan-loss reserves in fiscal 2022, or 4.7% of loans outstanding, down from 5.2% the prior year. On a five-year average at about 5%, this is higher than the 3.7% 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 2023, loans for education, such as charter schools, and commercial development projects represented the largest share at a combined 49% of RF's loan portfolio, which is slightly lower than the 55% in 2022. Housing loans accounted for about 20% of balance outstanding in June 2023, up from 11% the prior year due partially to the GDHD program and larger low-income-housing-tax-credit-related construction loans funded through its capital magnet fund award for projects in the Southeast. About 54% of the portfolio consisted of permanent loans while 36% were construction loans; in 2022, 70% of the portfolio was permanent loans and 20% were 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 17% of total assets in fiscal 2022, 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 nearly 20% of total assets while loans averaged 71%, in-line with the median among other rated CDFIs. In addition, RF had $60 million in undrawn debt at fiscal year-end 2022, including $20 million from an undrawn line of credit and $40 million available under committed credit lines with commercial banks.

Management

We view RF's management as strong due to its experienced, strategic, and proactive senior leadership and board members. This is despite a vacant chief financial officer position following a retirement and the departure of its chief investment officer, but it reflects the internal promotion of two people to the positions of chief credit officer and president of lending and investing. A formal succession strategy exists with planned transitions for normal and emergent circumstances.

A 13-member independent board of directors, all of whom are voting members, 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.

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.

RF's 2023-2028 strategic plan contains four priorities:

- Center its work in equity,
- Reinforce its practice and innovate within its business areas,
- Invest in its internal growth and transformation, and
- Amplify its impact in the field.

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 and Southeast regions. 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.

Reinvestment Fund Inc., Pennsylvania--financial ratio analysis

(%)	2022	2021	2020	2019	2018	Five-year average
Capital adequacy						
Equity/total assets	40.0	37.7	35.0	32.5	30.6	35.2
Net equity/total assets	21.7	23.6	20.0	19.6	14.4	19.9

Reinvestment Fund Inc., Pennsylvania--financial ratio analysis (cont.)						
(%)	**2022**	**2021**	**2020**	**2019**	**2018**	**Five-year average**
Equity/total debt	70.4	65.9	58.5	51.9	47.6	58.8
Net equity/total debt	38.2	41.2	33.5	31.4	22.4	33.3
Profitability						
Return on average assets	2.8	1.5	5.9	0.7	2.7	2.7
Net interest margin	3.2	2.8	2.5	2.6	2.5	2.7
Net interest margin (loans)	4.1	3.6	3.2	3.4	3.4	3.5
Asset quality						
Nonperforming assets/total loans + real estate owned	1.8	1.2	0.5	0.2	1.4	1.0
Loan loss reserves/total loans	4.7	5.2	5.1	4.8	5.1	5.0
Liquidity						
Total loans/total assets	72.8	64.8	67.8	74.4	73.9	70.7
Short-term investments/total assets	17.4	18.6	21.2	20.3	20.2	19.5
Total investments/total assets	24.5	26.9	30.2	24.0	24.1	25.9

Related Research

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