



AERIS

**INSIDE
AERIS®
RATINGS**

**FOR CDFIS &
OTHER LOAN FUNDS**

2023 ED.



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INTRODUCTION AND HISTORY

Aeris® provides comprehensive, third-party assessments of community development financial institutions (CDFIs) and other private impact loan funds. We help investors align their investments with their values, while meeting their financial goals.

CARS®, the CDFI Assessment and Ratings System, was developed in 2004 as an independent project of Opportunity Finance Network (OFN), the largest membership organization for CDFIs. On January 1, 2012, CARS, Inc. was incorporated as a nonprofit corporation to strengthen its independence and to launch new products and services in support of community development investing. In June 2014, we became Aeris Insight, Inc. to further expand our services into impact investor markets.

Since 2004, Aeris has issued Financial Strength and Performance and Impact Management ratings on 125 CDFI loan funds. More than 250 institutions have used Aeris' ratings and analyses in their investment/lending decision process and their portfolio management activity.

In 2013, Aeris introduced two new services for investors:

- *Aeris Performance Maps* provide quarterly financial statements, impact performance data, and key financial analytical ratios as well as tables and graphs on CDFIs.
- *The Aeris Explorer* provides comparative longitudinal peer group information for 20 key performance indicators.

In 2016–2017, in response to the most frequent requests from our clients, Aeris launched a multi-pronged strategic initiative¹ for our CDFI ratings. The resulting changes included:

- the introduction of standardized impact metric definitions²—aligned with the Global Impact Investing Network (GIIN)'s widely-accepted IRIS metric catalogue;
- an annual rating cycle (previously three-year) and a streamlined rating process to support annual ratings;
- the introduction of a new rating scale for financial strength and performance, which more closely aligns with those of Nationally Recognized Statistical Rating Organizations (NRSROs) and that is more granular and familiar to a larger universe of investors; and
- an improved Aeris Rating Report with additional standardized tables and graphs in a format enabling subscribers to easily find the information most important to them.

At the beginning of 2017, all existing ratings were mapped to the new scale, and during 2017, Aeris successfully applied the new process and scale to all new and re-rated loan funds.

¹ We are deeply grateful for the vision, guidance, and generosity of our advisory committee of CDFIs, who helped shape many aspects of the initiative, as well as the invaluable feedback that we received from our investor clients. CDFI Advisory Committee on Aeris Ratings (2016):

- Janie Barrera, Chief Executive Officer, LiftFund
- Grace Fricks, Chief Executive Officer and Joshua Brackett, Chief Financial Officer, Access to Capital for Entrepreneurs, Inc.
- Jess Brooks, SVP Development and Communication, Boston Community Capital
- Mike Crist, Chief Financial Officer, Reinvestment Fund
- Dave Glaser, Chief Executive Officer, Montana and Idaho CDC
- Calvin Holmes, President, Chicago Community Loan Fund
- Trinita Logue, retired President and founder, IFF
- Fran Lutz, Interim Chief Executive Officer, Opportunity Finance Network
- Ana Thompson, Chief Financial Officer, Opportunity Fund

² A Guidance Paper on Standardized Impact Metrics is on Aeris' website.



As of December 31, 2022, 156 CDFI loan funds participated in Aeris' CDFI database, with combined total on-balance-sheet assets of \$17.6 billion, representing 88% of aggregate total assets of all U.S. Treasury-certified CDFI loan funds.

AERIS CDFI LOAN FUND RATINGS

Aeris performs separate and complementary ratings on Impact Management and Financial Strength and Performance. These ratings are based on an in-depth analysis of extensive data and information, documented in a Rating Report that is issued in conjunction with the rating. Aeris ratings encompass both quantitative and qualitative factors.

Aeris' rating methodology has been tested through two major economic downturns.

THE AERIS IMPACT MANAGEMENT RATING

The Impact Management Rating assesses the loan fund's capacity to pursue and accomplish its mission as evidenced by strategies, programs, and services; investment financing resources; post-investment impact measurement; and impact monitoring and management. Both quantitative and qualitative factors are taken into account to provide a comprehensive assessment of the CDFI's impact management effectiveness.

The Report includes some elements that are not components of the rating. These are: (1) the CDFI's contribution to public policy change that benefits the advancement of community development and related social impact, (2) the organization's diversity, equity, and inclusion policies and practices, and (3) environmental policies and practices.

THE AERIS FINANCIAL STRENGTH AND PERFORMANCE (FSP) RATING

The Aeris FSP Rating is an entity (versus an instrument) rating. The Aeris analysis covers a rolling period of five fiscal years and the most recent quarter available, performed from the perspective of an unsecured general recourse creditor with a three- to five-year horizon.

The analysis assesses overall creditworthiness of the loan fund, examining the five CAMEL elements—capitalization, asset quality, management, earnings, and liquidity. It examines the areas of risk in each CAMEL component and how the loan fund manages them.

In addition to a standardized quantitative evaluation of FSP, the analysis takes into account meaningful qualitative indicators such as capitalization strategy, loan portfolio management policies and practices, quality of revenue, information systems, and governance and management.

The analysis is based on actual financial and operational performance. It also examines strategic initiatives and programs, and business and capital planning to identify key risk factors and opportunities that are likely to affect the CDFI's future. While Aeris does not model future performance, it identifies external factors such as interest rate environment, changes to the national or local economy, public policy and support, etc. that are most likely to have a significant impact on the CDFI's performance in the near future, and opines on near- to mid-term earnings prospects.

For CDFIs with complex corporate structures, Aeris will determine, prior to beginning an analysis, the most appropriate entity or entities to be rated, based on Aeris' determination of where the organizational risks reside. Aeris may rate one or more related entities separately, several entities together, or an entire family of entities.



GUIDING PRINCIPLES OF AERIS RATINGS

Independence and Cooperation. Throughout the rating process, from data gathering to the publication of the Rating Report, the Aeris team maintains highly cooperative but arms-length interaction with the CDFI being rated.

No Benchmarks. In Aeris' experience, the loan fund sector has too few organizations and too wide a variety of business models and operating environments to support statistically valid benchmarks. Therefore, Aeris ratings are based on how the CDFI performs against a proprietary scoring grid and definitions for each analysis component and rating, developed by Aeris and refined since 2004.

Risk Management Effectiveness is Relative. Aeris evaluates financial strength and risk in the context of the CDFI's characteristics such as size, complexity, capital structure, types of lending, nonlending activities, and target markets.

CDFI Loan Fund Industry Focus. While Aeris's FSP ratings use a similar format to that of NRSRO agencies, the rating definitions are intended for and applied strictly within the CDFI loan fund sector. For instance, although an AAA rating indicates a very strong institution in both instances, an AAA NRSRO rating for a commercial bank does not equate an Aeris AAA rating for a CDFI loan Fund.

AERIS RATING PROCESS

Annually, Aeris Analysts follow a proprietary Aeris manual to guide their analyses and to ensure consistency across the rated portfolio. This manual defines a standard scope of analysis and includes a standardized set of ratios and factors for each component of the Impact Management and FSP analyses. The Aeris manual is reviewed and updated regularly to ensure that new and emerging issues and practices in the field are discussed and codified.

- Aeris relies on the CDFI to provide data and information, which is reviewed multiple times by the Aeris team and verified by the CDFI in the analysis process.
- Aeris encourages and expects candor in its interviews with the board, management, and staff.
- Although the CDFI has no input into the opinions and rating, it is required to review the data and narratives of the report and to provide any factual updates before the finalization of opinions and the rating.
- Aeris invites the leadership of the CDFI to write a response to the rating, which is published as a part of the Rating Report.
- The Analyst conducting the analysis participates but does not vote in the Rating Committee.

PHASE 1 – MATERIAL AND DATA COLLECTION, INITIAL REVIEW AND MANAGEMENT INTERVIEWS

- Aeris collects corporate, organizational, audits and financial data from the CDFI. To make providing this information as easy as possible to, we use standardized metric labels and formats that facilitate the updating of data from year to year.
- Aeris reviews financial data and breakouts for completeness and accuracy, and produces a set of financial spreads for the CDFI to review and verify before analysis begins.
- The Aeris Analyst reviews all the material and conducts in-depth management and board interviews up to 14 hours on-site or by phone, to discuss significant issues in the CDFI's impact management and financial performance, as well as any emerging initiatives and strategic direction.

PHASE 2 – ANALYSIS AND REPORT WRITING

- Using the Aeris manual as a guide, and a standard report template (customized when necessary) the Analyst writes a detailed Rating Report setting out material findings and developing opinions to support a rating.
- The Quality Reviewer (an Aeris staff member) partners with the Analyst to review and ensure that the draft report meets all the requirements of Aeris' quality standards for completeness of analysis, accuracy of facts and data, soundness of opinions, and clarity of writing. The Quality Reviewer also acts as a sounding board for the analyst on complex, new, or controversial issues.



- Before the opinions are finalized, the CDFI reviews the opinions-redacted draft report to ensure that facts and numbers are correct. Suggested corrections are reviewed and acted upon by both the Analyst and the Quality Reviewer to produce a finalized Rating Report for the Rating Committee.
- The Analyst prepares a scoring recommendation for each analysis component, which is shared with the Rating Committee, but these scores are excluded from the calculation of the final scores from which the Rating is derived.

PHASE 3 – EVALUATION AND RATING

- A Rating Committee is convened by teleconference to determine the rating for each analysis. Four members of Aeris' Analyst team and the committee chair (who is an Aeris management member or senior analyst), make up the Rating Committee. The Analyst participates to answer questions and provide scoring recommendations.
- Using Aeris' proprietary scoring grid and definitions, committee members individually score each rating component. The members' component scores must be within a narrow band and are also compared to previous component scores to ensure consistency.
- A composite score is derived from the component scores and is used to calculate a rating, and the corresponding rating description is reviewed for an overall fair and accurate match. Any discrepancies are discussed to come to a majority conclusion. The chair casts the deciding vote if the other committee members are tied in their rating assessment.
- In the rare instance when the average component score or final rating of the committee deviates significantly from the Analyst's recommendations, the Rating Report opinions may be refined to reflect the final rating of the committee.
- Aeris shares the finalized Rating Report and rating with the CDFI before publication, inviting the leadership to write a response, which is published with the Rating Report.



AERIS CDFI AND LOAN FUND RATINGS DESCRIPTIONS

IMPACT MANAGEMENT

The Impact Management rating is an assessment of how well a loan fund pursues and achieves positive change related to its mission and impact goals. The assessment is based on four key criteria:

- Strategies, programs and services: how well the CDFI's strategies, programs and services align with its stated mission and impact goals.
- Investment of financing resources: how well the CDFI uses its financing resources, both on-balance sheet and off-balance sheet, in pursuit of its mission and impact goals.
- Post-investment impact measurement: how well the fund tracks outcome data relevant to its mission and impact goals and whether the data indicate that the fund is accomplishing those goals.
- Impact monitoring and management: how well the fund collects and uses output and outcome data to better achieve its mission and impact goals.

The Aeris rating committee scores the loan fund's performance in each of the above areas. Using the scores as a guide, the rating committee assigns the Impact Management Rating based on which of the following descriptions best fits the loan fund.

Rating

★★★★ The CDFI has exceptional alignment of its mission, strategies, programs and services. It fully and effectively uses its financial resources in alignment with its mission, both directly with its portfolio investments and indirectly leveraging off-balance sheet financial resources. Its processes and systems accurately track comprehensive output and outcome data, on an ongoing basis. Impact metrics show positive changes toward achieving its impact goals. Board and management consistently use the data to adjust strategies and activities to improve its effectiveness in achieving its mission.

★★★ The CDFI has strong alignment of its mission, strategies, programs and services, and portfolio investments with its mission. It effectively uses its financial resources in alignment with its mission, primarily with portfolio investments; investment activities beyond its loan portfolio may be minimal. Its processes and systems accurately track output data, on an ongoing basis. Longer term outcome metrics may be limited. Impact metrics show positive changes toward achieving its impact goals. Board and management use the data on a regular basis to improve strategies and activities in pursuit of mission.

★★ The CDFI has reasonable strategies, programs and services, and portfolio investments that are in alignment with its mission. It has basic systems in place to track essential output data that indicate its resources are used consistent with its mission. Board and management use the data on a limited basis to adjust strategies and activities in pursuit of mission.

★ The CDFI may lack alignment of its mission, strategies, programs and services, and portfolio investments. Either it lacks impact data, the data is unsatisfactory, or data systems are weak. It also may have a history of underutilizing its financial resources consistent with its mission. Board and management rarely use data to adjust strategies and activities in pursuit of mission.

Policy Plus Policy change is an integral part of this CDFI's strategies. The CDFI leads initiatives to change government policy to benefit the CDFI industry or disadvantaged people and communities. The CDFI can provide evidence of its leadership role in recent policy changes that produced benefits beyond additional resources for the CDFI itself, and management can clearly articulate the CDFI's leadership role in current policy activities.



FINANCIAL STRENGTH AND PERFORMANCE

The FSP Rating Scale aligns with NRSRO raters in that:

- AAA to BBB- indicates “investment grade” and financially sound, and
- Less than a BBB- is financially vulnerable.

	RATING	DESCRIPTION
Sound	AAA	The CDFI has exceptional financial strength, performance and risk management practices. Any weaknesses are minor and can be handled in a routine manner by the board of directors and management. The CDFI is resilient to significant changes in its operating environment.
	AA+	The CDFI has very strong financial strength, performance and risk management practices relative to its size, complexity, and risk profile. Challenges are well within the board of directors' and management's capabilities and willingness to strengthen. The CDFI is capable of withstanding fluctuations in its operating environment.
	AA	
	AA-	
	A+	The CDFI has strong financial strength, recent performance and risk management practices relative to its size, complexity, and risk profile. It is stable but more vulnerable to fluctuations in its operating environment than higher rated CDFIs.
	A	
	A-	
	BBB+	The CDFI has satisfactory financial strength, performance and risk management practices relative to its size, complexity, and risk profile. It is stable but sensitive to fluctuations in its operating environment.
	BBB	
	BBB-	
Vulnerable	BB+	The CDFI exhibits inadequate financial strength, performance, or risk management practices relative to its size, complexity, and risk profile. It exhibits weaknesses in one or more areas that could compromise its financial situation in the medium term, even in a stable operating environment.
	BB	
	BB-	
	B	The CDFI exhibits weaknesses in several areas that compromise its financial viability. Although the CDFI may be able to sustain operations for a period of time, its financial stability is extremely sensitive to any fluctuation in its operating environment.



EXPLANATION OF IMPACT METRIC TERMS

To understand the Aeris® approach to Impact Management Ratings, it is important to understand how Aeris uses the terms impact, output, outcome, and target beneficiaries.

Impact in the Aeris report refers to the broad concept of positive social and environmental results associated with investments or business activities. It does not imply the narrower definition used in the field of monitoring and evaluation where the term 'impact' typically refers only to long-term effects that can be attributed to a specific intervention.

Output data refers to activities or services provided by the CDFI. Any data that can be collected at the time of the CDFI's intervention is considered output data. Output data include things such as: characteristics of borrowers, loan amounts, number of existing jobs in a business, estimated number of jobs to be created, number of housing units in the financed project, estimated number of childcare slots to be created, number of participants trained, ethnicity or income level of participants, and so on.

Outcome data refers to information that is gathered at some point after the CDFI's intervention. It is information related to what has happened since the CDFI provided capital or training or any other activity or service. Outcomes include things such as the number of jobs actually created in financed businesses, the number of training participants who started a business (or became employed), the number of housing units occupied by low-income families, changes in the affordability of housing in a certain neighborhood, information about how access to affordable housing has changed the lives of low-income families, changes in access to affordable childcare in a community, and so on. Aeris examines both intermediate outcomes and end outcomes.

Target Beneficiaries describe the people and places that are intended beneficiaries of the CDFI's activities. Examples of CDFI target beneficiaries that are relevant and common for CDFIs include low-income households, rural communities, women, and people of color.



CDFI METRICS, IRIS+ METRICS, AND THE UNITED NATIONS' SUSTAINABLE DEVELOPMENT GOALS

CDFIs have a primary mission of positively benefiting under-resourced and economically disadvantaged populations and communities. They provide capital, financial services and other products and services to address gaps in conventional financial services. CDFI activities directly address many of the goals and objectives targeted by the United Nations' Sustainable Development Goals (SDGs). CDFIs have participated in the development of and utilize impact metrics aligned with IRIS+ to measure the performance of their investments.

In 2015, the United Nations adopted a set of 17 goals to end poverty, protect the planet, and ensure prosperity for all, as part of a new sustainable development agenda. Each goal has specific targets to be achieved by 2030. For a complete list of the SDGs and specific targets, visit the United Nations' website. In 2020, Aeris began aligning the impact focus of CDFIs with the SDGs in the Introductory section of the Aeris Impact Management report.

In 2018, Aeris began presenting common impact metrics for CDFIs including outputs, outcomes and target beneficiaries. These metrics are organized by Impact Themes and Sub-Impact Themes, which were identified and defined through a partnership with Aeris, CDFI leaders, and the GIIN. These metrics were selected because of their relevance to CDFIs' impact strategies as well as a range of community investments and are in common use across the industry. These common metrics were published in a July 2017 guidance paper titled Community Investing Impact Metric Set. For the full report, visit aerisinsight.com.

In partnership with industry leaders, the GIIN has developed and manages IRIS+, a taxonomy of common impact metrics. The latest iteration was released in May 2019. The common CDFI impact metrics are aligned with IRIS+, with related metric codes included in the Key Output and Key Outcome data table in this report. As part of IRIS+, the GIIN developed "generally accepted impact categories" based on input from hundreds of stakeholders in the impact investing space. The IRIS+ metric set aligns with these impact categories and with the SDGs. For additional information, visit iris.thegiin.org.

For a detailed set of tables that shows the relationship between CDFI impact, the SDGs and IRIS+, visit aerisinsight.com.

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