AERIS

INSIDE AERIS® RATINGS

FOR CDFIS & OTHER LOAN FUNDS

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INTRODUCTION AND HISTORY

Aeris® provides comprehensive, third-party assessments of private alternative investments that pursue social and environmental goals, including loan funds such as community development financial institutions (CDFIs), small business lenders, development finance authorities, and bank consortia. 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 premier 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 and Impact Management ratings on more than 120 loan funds, with 83 loan funds rated in 2017. More than 150 institutional investors have used Aeris' ratings and analyses in their investment decision process and their portfolio management practices.

In 2013, Aeris introduced two new products for investors:

- *Aeris Performance Maps*, which provide, on a quarterly basis, financial statements, impact performance data, and tables and graphs from Aeris Rating Reports on loan funds; more than 145 loan funds, both Aeris-rated and non-rated, are in the data set as of FYE 2017.
- *The Aeris Explorer*, which provides comparative information for 20 performance metrics within loan fund peer groups; about 130 loan funds, both Aeris-rated and non-rated are in the data set as of FYE 2017.

In 2017, Aeris reached another milestone—it performed its first Impact Management Rating on a publicly-traded mutual fund.

In 2016–2017, Aeris launched a multi-pronged strategic initiative[1] for our CDFI and Loan Fund ratings, which responded to the most-frequent requests from our investor clients. The changes included:

- the introduction of standardized impact metric definitions[2]—aligned with the GIIN's widely-accepted IRIS metric catalogue;
- an annual rating cycle, (previously a three-year rating cycle), 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 Wall Street rating agencies and that is more granular and familiar to a larger universe of investors; and

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[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.

- an improved Aeris Rating Report with additional standardized tables and graphs, and 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.

AERIS CDFI AND 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 qualitative and quantitative factors. Although the evaluation of financial strength and performance is primarily quantitative, it also considers management quality, an important qualitative indicator. Likewise, although the impact evaluation may be more qualitative, Aeris examines important quantitative indicators such as deployment rates and leverage of off-balance-sheet resources.

Whereas past performance and current financial strength are the foundation of the analysis, it also examines strategic initiatives and programs, business and capital planning to identify key risk factors and opportunities that are likely to affect the loan fund's future. Aeris does not project future financial performance, although it opines on near to midterm earnings prospects.

For loan funds with complex corporate structures, Aeris will determine, prior to beginning an analysis and with input from the loan fund, the most appropriate entity or entities to be rated, based on the priorities and needs of investors. Aeris may rate one or more related entities separately, several entities together, or an entire family of entities.

THE AERIS IMPACT MANAGEMENT RATING

This rating assesses the loan fund's capacity to pursue and accomplish its mission as evidenced by strategies and products, use of resources, how impact is tracked and measured to demonstrate success, and how these metrics inform the refinement of the loan fund's strategies and products. The Aeris Impact Management methodology can be applied to any type of mission-driven entity because it assesses how effectively an organization achieves positive change related to its own mission and goals, rather than measuring the magnitude of that change or comparing it to other organizations.

The Impact Management analysis also recognizes the loan fund's commitment to, and leadership in, the area of policy change in a "Policy Plus" section of the Rating Report. These achievements are described separately, and are not a component of the Impact Management rating.

THE AERIS FINANCIAL STRENGTH AND PERFORMANCE (FSP) RATING

The Aeris FSP Rating assesses overall creditworthiness of the loan fund, examining the five elements often referred to as CAMEL — capitalization, asset quality, management, earnings, and liquidity. It analyzes areas of risk and how the loan fund responds to them, from the perspective of an unsecured, general recourse investor with a three- to five-year investment horizon.

The analysis and rating apply to the loan fund and its operations as a whole, rather than the risks associated with a specific debt instrument. It does not include an extensive analysis of external conditions (such as interest rate environment, changes to the national or local economy, public policy and support, etc.) but does attempt to highlight those external factors that are most likely to have a significant impact on the loan fund's performance in the near future.

GUIDING PRINCIPLES OF AERIS RATINGS

The Aeris analysis and rating process focuses on accuracy, transparency, and objectivity. Throughout the four to five months of production, from data gathering to the publication of the Rating Report, the Aeris team maintains highly cooperative but arms-length interaction with the loan fund being rated.

Because the loan fund sector is limited in size and represents a wide variety of business models and operating environments, Aeris ratings and analyses do not rely on statistically-generated benchmarks, comparisons to other rated loan funds, or any best practices. Each loan fund is rated based on how it performs against a proprietary scoring grid and definitions for each analysis component, developed by Aeris and refined since 2004.

Aeris evaluates financial strength and risk in the context of the loan fund sector and relative to the loan fund's size, complexity, financial status, and activities. For example, capital ratios are evaluated in the context of asset quality and earnings strength, and loan loss reserve adequacy is considered relative to portfolio risk. Liquidity policies and practices are judged in relationship to debt structure and portfolio characteristics. All loan funds are expected to manage their risks effectively, using policies, management systems, and controls that are appropriate for their size and complexity, but not necessarily the most sophisticated or automated.

AERIS RATING PROCESS

Aeris updates each rating 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. Analyses consider a loan fund's lending products (predevelopment, construction, working capital, etc.), lending sectors (affordable housing, small business, community facilities, etc.) and any additional lines of business (financial literacy, real estate development, economic development research, etc.). 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 loan fund to provide data and information, which is reviewed multiple times by the Aeris team and verified twice by the loan fund in the analysis process.
- Aeris encourages and expects candor in its interviews with board, management, and staff.
- Although the loan fund has no input into the opinions and rating, Aeris invites leadership of the loan fund 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 a large body of corporate, organizational, and financial data (including audits) from the fund. To make it as easy as possible for the fund to provide this information, 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 fund 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 fund'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.
- In the course of drafting the report, the Analyst partners with an Aeris Quality Reviewer. The Quality Reviewer evaluates the draft for completeness of analysis, accuracy of facts and data, soundness of opinions, and clarity of writing to ensure that the report meets all the requirements of Aeris' quality standards. The Quality Reviewer also acts as a sounding board for the analyst on complex, new, or controversial issues.
- Before the opinions are finalized, the fund reviews a copy of the 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 that leads to the Rating.

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 analysis 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, which is then considered against the rating description for a fair and accurate match to the fund's overall

condition. After reading the rating definitions, committee members are given the opportunity to change component scores or override their calculated Rating to derive the final Rating. 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 final Rating Report and Rating with the fund before publication, inviting leadership to write a response, which is published with the Rating Report.

AERIS CDFI AND LOAN FUND RATINGS AND 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:

- Alignment of strategy and operations: how well the loan fund's impact mission is reflected in its strategies, products, and data.
- Effective use of financing resources: how well the loan fund uses its financing resources, both on-balance sheet and off-balance sheet, in support of its impact goals.
- Tracking of output data that indicate effectiveness: how well the fund tracks output data relevant to its impact goals, whether the data indicate that the fund is accomplishing those goals, and how the fund uses the data to improve its effectiveness to achieve its impact goals.
- Tracking of outcome data that indicate effectiveness: how well the fund tracks outcome data relevant to its impact goals, whether the data indicate that the fund is accomplishing those goals, and how the fund uses the data to improve its effectiveness to achieve its 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 Loan Fund has exceptional alignment of its impact mission, strategies, activities, and data that guide its lending, programs and planning. It fully and effectively uses its resources, both directly and indirectly, in pursuit of its impact mission. Its processes and systems accurately track comprehensive data on an ongoing basis, including both output and longer-term outcome metrics, and it can provide data showing positive changes in achieving its impact goals. Board and management consistently use the data to adjust strategies and activities to improve its effectiveness.

★★★ The Loan Fund shows strong alignment of its impact mission, strategies, activities, and data that guide its lending, programs and planning. It accurately tracks relevant data that indicate that it effectively uses its resources to further its impact goals. However, it has may have limited activities beyond direct investments that support its mission and longer-term outcome metrics may be limited. Board and management use the data on a regular basis to adjust strategies and activities in line with the Fund's mission.

★★ The Loan Fund has reasonable strategies and activities given its impact mission. It tracks basic output data that indicate its resources affect change consistent with that mission. Board and management use the data on a limited basis to adjust strategies and activities.

★ The Loan Fund may lack alignment of its impact mission, strategies, activities, and data. Either it lacks data to form an opinion of its impact, or the data is unsatisfactory. It also may have a history of underutilizing its resources to further its impact goals. Board and management provide little oversight of impact strategies and activities.

Policy Plus

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

FINANCIAL STRENGTH AND PERFORMANCE

The FSP Rating Scale aligns with Wall Street 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 Loan Fund 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 Loan Fund is resilient to significant changes in its operating environment.
	AA+	The Loan Fund 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 Loan Fund is capable of withstanding fluctuations in its operating environment.
	AA	
	AA-	
	A+	The Loan Fund 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 loan funds.
	A	
	A-	
	BBB+	The Loan Fund 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 Loan Fund 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 Loan Fund exhibits weaknesses in several areas that compromise its financial viability. Although the Loan Fund 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 OUTPUTS, OUTCOMES, AND IMPACT

To understand the Aeris approach to Impact management rating, it is important to understand how Aeris uses the terms "output," "outcome," and "impact."

Output refers to activities or services provided by the CDFI or other loan funds. Any data that can be collected at the time of the loan fund's intervention is considered output data. Output data include things such as: characteristics of borrowers, loan amounts, number of existing jobs in the business, estimated number of jobs to be created, number of housing units in the financed project, estimated number of child care 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 loan fund's intervention. Outcomes describe the value of the loan fund's work for disadvantaged people or communities. It is information related to what has happened since the loan fund provided capital or training or any other output. 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.

According to academics, **impact** implies causality between the outputs and the observed change, which requires control groups and a level of rigor beyond most, if not all, loan funds. For the fourth impact rating criterion, "tracking of outcomes or impacts that indicate effectiveness," Aeris® examines both intermediate outcomes and end outcomes (as opposed to true impact), with the highest score for loan funds that are tracking some kind of "end outcomes." Table A provides a sample that shows the difference between outputs, intermediate outcomes, and end outcomes.

Table A. Outputs, Intermediate Outcomes, and End Outcomes

TYPE OF LENDER	OUTPUTS	INTERMEDIATE OUTCOMES	END OUTCOMES
Affordable Housing	• Number of loans • Number of units in funded projects • Number of community development corporations assisted	• Number of houses rehabbed • Number of units developed • Number of units occupied by low-income people	• Stable, revitalized neighborhoods • Low-income families spending less on affordable housing • Increased availability of affordable housing
Small Business	• Number of loans • Characteristics of borrowers (income level, gender, ethnicity, etc.) • Number of entrepreneurs trained	• Number of businesses with improved access to financing • Number of participants that start businesses	• Number of jobs actually created by borrowers • Increased income of borrowers/participants • Increased employment opportunities and economic activities in the community

AERIS® RATINGS

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