Research Update:

The Housing Finance Corp. Ltd. Ratings Affirmed; Outlook Stable

September 14, 2020

Overview

- We expect conservative risk management practices by The Housing Finance Corp. Ltd. (THFC) to mitigate any adverse effect of a potential deterioration in the quality of its assets as housing associations face the aftermath of the COVID-19 pandemic and the lack of clarity regarding Brexit.
- Although we expect THFC to face increasing competition, we consider that its robust record as a well-established issuer and lender will enable it to maintain a solid business position.
- We are affirming our 'A/A-1' ratings on THFC.
- The outlook is stable.

PRIMARY CREDIT ANALYST

Abril A Canizares
London
(44) 20-7176-0161
abril.canizares
@spglobal.com

SECONDARY CONTACT

Richard E Kubanik
London
+ 44 (20) 71767031
richard.kubanik
@spglobal.com

ADDITIONAL CONTACT

EMEA Sovereign and IPF
SovereignIPF
@spglobal.com

Rating Action

On Sept. 14, 2020, S&P Global Ratings affirmed its 'A/A-1' long- and short-term issuer credit ratings on funding agency The Housing Finance Corp. Ltd. (THFC). The outlook is stable.

We also affirmed our 'A' issue rating on debt issued by THFC's three orphan funding subsidiaries--T.H.F.C. (Funding No. 1) PLC, T.H.F.C. (Funding No. 2) PLC, and T.H.F.C (Funding No. 3) PLC. This rating mirrors the 'A' long-term rating on THFC.

The 'AA' issue rating on debt issued by THFC's subsidiary Affordable Housing Finance (AHF) reflects the exclusive guarantee by the U.K. government, which we consider as timely, unconditional, and irrevocable.

Outlook

The stable outlook indicates that THFC's very conservative risk management practices and the relative resilience of the U.K. social housing sector will help it withstand the economic contraction that followed the COVID-19 pandemic, combined with Brexit. We expect THFC's role as a leading aggregator to remain relevant, even though it could see increased competition from the 2020 Affordable Homes Guarantee Scheme and a deep U.K. bank and capital market, which housing associations can access directly.

We could lower our ratings if credit quality in the U.K. social housing sector deteriorated significantly, or if THFC suffered losses on its loan portfolio that would erode its reserves enough to halve its capital ratio from its current level. We could also lower the rating if THFC's risk management policies became less stringent.

We could raise the ratings if the future credit quality of the U.K. social housing sector proves more resilient against the impact of the pandemic and Brexit than we anticipate. A strengthening of THFC's market position, while navigating the increasingly competitive environment successfully, could also lead to an upgrade.

Rationale

THFC's long record as a well-established issuer and lender, its conservative risk management policies, and the regulatory stewardship based on its ownership structure put it in a better position to perform its role and fulfil its policy mandate than its domestic peers.

THFC is a finance company founded in 1987. Legally, it is a community benefit society. THFC onlends predominately long-term debt to housing associations in the U.K. As of March 2020, it had over 145 individual borrowers and a loan portfolio of about £7.5 billion. Most of its funding comes from issuing debt in the sterling capital markets.

The 'A' rating is based on THFC's strong financial profile and adequate enterprise profile. THFC is the parent company of several wholly owned subsidiaries. As the parent company, we view THFC as a core and integral part of the larger THFC group and base our rating on it on the 'a' group credit profile (GCP).

Enterprise risk profile: Relevant role in the market, with robust risk management practices that protects the group against a potential weakening of the U.K. social housing sector

- As a frequent and well-established issuer, THFC can arrange funding at a low cost that helps sustain its market position.
- We assess industry risk in the U.K. social housing sector as low. In our view, the sector is resilient enough to weather the economic contraction associated with the COVID-19 pandemic and the uncertainties related to Brexit.
- Management policies and governance standards are adequate, supporting robust financial ratios by mitigating the potential weakening of asset quality.

Over the financial year ending March 31, 2020 (FY2020), loan growth has continued but, as expected, it was slower than in previous years, when business activity reflected the underwriting of loans under the Affordable Housing Finance Guarantee Scheme. Therefore, net lending decreased to £128.3 million in FY2020 from £348 million in FY2019.

THFC remained a relevant source of funding for the U.K. social housing sector--it provided around 3% of the sector's funding during FY2020. THFC's record as a well-established issuer and lender is longer than that of its local peers, which should support the group in maintaining its relevance in the market. However, in future, we expect it will find it harder to attract as many new customers as it did in previous years, when underwriting under the Affordable Housing Guarantee Scheme boosted lending.

Recently, more housing associations have been able to take advantage of increased appetite from investors to tap the markets at favorable terms through own-name placements. These issuances compete with THFC's group lending. Increased competition will come from the implementation of the Affordable Homes Guarantee Scheme 2020 (AHGS 2020), since THFC was not the selected bidder.

In our view, management has above-average levels of expertise and experience in operating its major business lines. Unlike other U.K.-based public-sector funding agencies (PSFAs), THFC has board nominees from the regulator of the English social housing sector and from the National Housing Federation (the English sector's trade body). This enhances its oversight and underpins its asset quality. THFC maintains prudent risk management policies and processes and focuses strongly on monitoring its borrowers' credit standing. However, unlike its global peers, THFC is not regulated by bank supervisors or financial services regulators and does not have to comply with any banking regulatory requirement or standards. This limits our assessment.

THFC follows a strict matched-funding approach, to minimize asset-liability risk. Given that lending is on almost exactly the same interest rates and repayment schedule as the funds THFC borrows, it has almost no structural interest-rate risk. Additionally, it does not face currency risk--its funding and lending are both denominated in sterling. It also receives payments from borrowers up to a month before payments to investors become due, providing a timing cushion.

We consider the U.K. social housing sector as low risk. Our public-sector industry risk and country risk assessment (PICRA) is favorable because of the sector's low industry risk, combined with a wealthy, open, and diversified economy and adequate leverage risk. We believe the adverse impact of COVID-19 on the sector will be limited because the sector is anticyclical in nature and has strong oversight from the government via regulators. Social housing providers generally experience an increase in demand for their core services in times of economic hardship, and demand typically remains strong throughout the business cycle. Moreover, social housing is usually a prominent part of most political agendas.

Increasing risks arising from Brexit and the aftermath of the pandemic could increase leverage at the housing associations and strain our PICRA. That said, we don't expect this will weigh on THFC's overall enterprise risk profile.

Financial risk profile: Consistently strong financial indicators, combined with robust policies to secure asset quality, ensures a sustainable financial profile

- We view THFC's capital adequacy as very strong due to its strong risk-adjusted capital (RAC) ratio after adjustment, combined with robust collateralization and the cash-flow pass-through nature of its operations.
- Conservative asset liability management, which follows a matched-funding principle, ensures the funding and liquidity ratios will remain structurally above 1x.

We assess THFC's capital adequacy as very strong, supported by a strong adjusted RAC ratio, its business construct as a cash-flow pass-through vehicle, and robust collateralization on its loan book through physical collateral and debt service reserves. The enforcement of social housing assets is subject to a special administration regime introduced in July 2018, and this regime has not been tested. However, compared with its domestic peers, THFC has the highest level of collateralization, at around 150%-200%. The group also has no exposure to derivatives.

As of FY2020, the group was still achieving strong surpluses that increased its reserves to over £40 million. We consider these reserves to be loss-absorbing and include them in our estimate of

THFC's total adjusted capital. The group's consolidated lending portfolio reached £7.5 billion, of which about half is guaranteed by the U.K. government under the Affordable Housing Guarantee Scheme.

Although increased reserves and the lower lending increased THFC's RAC ratio before adjustments, the significant concentration among its top 20 borrowers left the S&P Global Ratings-adjusted ratio for FY2020 largely untouched at 11.4%, in line with last year's result.

We assess THFC's funding and liquidity position as strong, supported by a robust capacity to cover its liabilities, even under severe liquidity stress scenarios. Furthermore, conservative match-funding policies ensure that liquidity ratios will remain structurally above 1x. Our view is further supported by the timing difference provided by the one-month gap between the group's obligation to pay investors and payments received from its borrowers.

We estimate that THFC is structurally able to cover its scheduled short-term debt liabilities without recourse to new issuance; its static funding gap was 2.5x at the one-year horizon at the start of FY2020.

THFC holds considerable levels of liquid investments--as of March 2020, our 12-month liquidity ratio was 2.3x, meaning that the group has an ample cushion to cover its liabilities under a severe liquidity stress scenario and without accessing the capital markets.

Key Selected Indicators

Table 1

The Housing Finance Corp. Ltd. Selected Indicators

	'--Year ended March 31--				
Mil. £	**2020**	**2019**	**2018**	**2017**	**2016**
Business position					
Total adjusted assets	7,572.6	7,456.7	7,107.9	5,977.7	5,186.3
Gross receivables	7,453.8	7,333.0	6,991.5	5,885.1	5,087.1
Growth in loans (%)	1.7	4.9	18.8	15.7	22.4
Interest revenue	261.5	258.6	237.2	232.9	217.1
Noninterest expenses	5.2	4.6	4.3	4.1	3.8
Capital and risk position					
Total liabilities	7,530.9	7,418.7	7,073.4	5,948.8	5,162.4
Total adjusted capital	41.6	38.0	34.5	28.8	23.9
Assets/capital	181.9	196.3	206.1	207.9	217.3
RAC ratio before diversification (%)	17.8	16.6	15.8	N/A	N/A
RAC ratio after diversification (%)	11.4	10.7	11.9	N/A	N/A
Gross nonperforming assets/gross loans	N/A	N/A	N/A	N/A	N/A
Common + preferred dividends/net income (%)	N/A	N/A	N/A	N/A	N/A
Funding & liquidity (%)					
Liquidity ratio with loan disbursement (one year)	2.3	1.6	1.7	N/A	N/A
Liquidity ratio without loan disbursement(one year)	2.3	1.6	1.7	N/A	N/A

Table 1

The Housing Finance Corp. Ltd. Selected Indicators (cont.)

	'--Year ended March 31--				
Mil. £	**2020**	**2019**	**2018**	**2017**	**2016**
Deposits to total financial liabilities (%)					
Funding ratio (one year)	2.5	1.8	1.9	N/A	N/A

N/A--Not applicable. RAC--Risk-adjusted capital.

Ratings Score Snapshot

Table 2

The Housing Finance Corp. Ltd. Ratings Score Snapshot

Issuer credit rating	A
Stand-alone credit profile	a
Enterprise risk profile	Adequate (3)
Public-sector industry risk and country risk assessment	Low risk (2)
Business position	Adequate
Management & governance	Adequate
Financial risk profile	Strong (2)
Capital adequacy	Very strong
Funding	Neutral
And liquidity	Strong
Support	-
Government-related entity support	-
Group support	-

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria | Governments | International Public Finance: Public-Sector Funding Agencies: Methodology And Assumptions, May 22, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Global Social Housing Ratings Score Snapshot: July 2020, July 14, 2020
- Global Social Housing Ratings Risk Indicators: July 2020, July 14, 2020
- U.K. Social Housing Providers Should Remain Largely Resilient To Short-Term Economic Difficulties From COVID-19, April 23, 2020
- COVID-19: Emerging Market Local Governments And Non-Profit Public-Sector Entities Face Rising Financial Strains, April 6, 2020
- Public-Sector Funding Agencies Risk Indicators: May 2019, May 14, 2019
- Public-Sector Funding Agencies Risk Indicators: May 2019, May 13, 2019
- Assumptions For Liquidity Gap Analysis Under "Public-Sector Funding Agencies: Methodology And Assumptions", May 22, 2018
- Credit FAQ: A Closer Look At The New Public-Sector Funding Agencies Criteria, May 22, 2018

Ratings List

Ratings Affirmed	
The Housing Finance Corp. Ltd.	
Issuer Credit Rating	A/Stable/A-1
T.H.F.C. (Funding No. 1) PLC	
Senior Secured	A
T.H.F.C. (Funding No. 2) PLC	
Senior Secured	A
T.H.F.C. (Funding No. 3) PLC	
Senior Secured	A