Research Update:

Housing Finance Corp. Ltd. 'A/A-1' Ratings Affirmed; Outlook Stable

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Overview

- Throughout the COVID-19 pandemic, The Housing Finance Corp. Ltd. (THFC) has maintained strong access to capital markets, which has contributed to a stable market position and stronger capitalization.
- Although the U.K. social housing sector is experiencing increasing leverage, it benefits from low cyclicality and low market volatility, which have supported its resilience throughout the pandemic.
- We expect THFC to face increasing competition, but we consider that its robust record as a well-established issuer and lender will enable it to maintain a solid business position.
- We affirmed our 'A/A-1' long- and short-term issuer credit ratings on THFC.
- The outlook is stable.

Rating Action

On Sept. 15, 2021, 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: THFC (Funding No. 1) PLC, THFC (Funding No. 2) PLC, and THFC (Funding No. 3) PLC. This rating mirrors the 'A' long-term issuer credit 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 we expect THFC to remain a leading aggregator despite a potential increase in competition from the 2020 Affordable Homes Guarantee Scheme, awarded to ARA Venn, and the deep U.K. bank and capital market, which housing associations can access directly. In our view, THFC's very conservative risk management practices will enable it to maintain a strong financial risk profile.

Downside scenario

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.

Upside scenario

We could raise the ratings if THFC's market position strengthened significantly, with the group successfully navigating the increasingly competitive environment and maintaining strong financial indicators.

Rationale

THFC's long record as a well-established issuer and lender have enabled it to achieve strong access to the markets throughout the pandemic. As a result of robust new business generation, THFC has managed to maintain its market position, despite operating in an increasingly competitive environment. In addition, higher earnings have strengthened the capital position.

Conservative risk management policies, and regulatory stewardship based on its ownership structure, have put THFC in a better position to perform its role and fulfill its policy mandate than its domestic peers.

THFC is a finance company founded in 1987. Legally, it is a community benefit society. THFC onlends predominantly long-term debt to housing associations in the U.K. As of the fiscal year ending March 31, 2021 (FY2021), THFC had a loan book of £7.9 billion--increasing by 5.6% from £7.5 billion in FY2020--providing funding to 161 borrowers. Most of its funding comes from issuing debt in the sterling capital markets.

The 'A' issuer credit rating is based on THFC's strong financial profile and adequate enterprise profile. THFC is the parent company of several wholly owned subsidiaries. Since THFC is the parent company, we view it 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 an increasingly competitive market, with robust risk management practices that protect the group against the downside risks of the U.K. social housing sector

- We assess industry risk in the U.K. social housing sector as low. Although the sector is experiencing increasing leverage, it still benefits from low cyclicality and more predictable revenue.
- As a frequent and well-established issuer, THFC enjoyed strong access to the markets throughout the pandemic and arranged funding at a low cost which help sustain its market position.
- Management policies and governance standards are adequate, supporting robust financial

ratios by mitigating the potential weakening of asset quality.

Our U.K. public-sector industry and country risk assessment (PICRA), which remains low, takes into consideration that leverage has increased the risk to the U.K. social housing sector. Offsetting this, we note that the sector benefits from low cyclicality, high barriers to entry, and strong government oversight via regulators. As a result of these factors, the pandemic has so far only had a limited effect on the sector. Our PICRA also considers the wealthy, open, and diversified U.K. economy, and we note that the government's furlough scheme has supported strong rent collection.

Even under a competitive environment, THFC has built a strong track record in fulfilling its mandate as demonstrated in FY2021. It has issued £605 million through eight separate bond transactions and achieved a competitive average fixed rate pricing of 2.2%.

Historically, loan growth was supported by the strong business activity coming from the underwriting of loans under the Affordable Housing Finance Guarantee Scheme, which ended in 2018. However, following the completion of the scheme, we note that THFC has maintained a steady market share of about 8% of the sector's total debt stock and provided about 3% of the sector's funding needs during FY2021.

Compared to local peers, THFC has been the most frequent issuer in the market, mainly through its subsidiary, bLEND. Launched in 2018 with a £1 billion five-year target, bLEND has exceeded that by placing £1.2 billion of bonds in the market as of September 2021. Moreover, all of bLEND's existing bonds have been redesignated as social bonds, since it has increased its efforts on ESG alignment and has now obtained a second party social bond accreditation.

Although we note that THFC operates in a competitive environment, we think its name recognition will enable it to sustain a robust business pipeline. The main competition for THFC comes from housing associations being able to tap the markets at favorable terms through own-name placements to take advantage of increased appetite from investors during the pandemic. In addition, we expect increased competition to come from the implementation of the Affordable Homes Guarantee Scheme 2020 (AHGS 2020), which was awarded to ARA Venn.

In our view, management has above-average levels of expertise and experience in operating its major business lines. Management continues enhancing internal processes and introducing innovative products to adapt to the market needs. For example, we note that it took part in the development of the social housing sector's Sustainability Reporting Standard and subsequently became an early adopter of this framework.

THFC also enjoys a robust governance framework since, unlike other U.K.-based public-sector funding agencies, the group has board nominees from the regulator of the English social housing sector and from the National Housing Federation, the English housing sector's trade body. This enhances THFC's oversight and underpins its asset quality. The group 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, which limits our assessment.

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

Financial risk profile: Consistently strong financial indicators, combined with robust policies to mitigate potential risks on asset quality, ensure a sustainable financial profile

- THFC's capital ratios have steadily strengthened thanks to robust accumulated reserves. Our assessment of the group's very strong capital adequacy also considers its 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.

Strong business generation in FY2021 resulted in accumulated reserves growing to £46.5 million at year-end and outpacing the increase in risk-weighted assets. THFC's risk-adjusted capital (RAC) ratio therefore strengthened to 18.6% from 17.7% in FY2021. Furthermore, after adjusting for single name concentration on the loan book, the RAC ratio strengthened to 12.4% in FY2021 from 11.4% in FY2020.

We assess THFC's capital adequacy as very strong, supported by a strong 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 about 150%-200%. The group also has no exposure to derivatives.

THFC has the highest diversification when compared to its local peers and we note that £3.2 billion of its portfolio benefits from the double guarantee scheme provided by the U.K. government to its subsidiary, AHF. Therefore, almost half of its exposure is to the central government instead of to the sector directly.

Surpluses of above £5 million in FY2021--up from £2.7 million in FY2020--contributed to the strengthening of THFC's accumulated reserves, since the group does not distribute dividends. We consider these reserves to be loss-absorbing and include them in our estimate of THFC's total adjusted capital.

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. Further supporting this view, we note that there is a 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 issuances; its static funding gap was 1.5x at the one-year horizon at the start of FY2021. The reduction on the ratio is attributed to the large maturity of liabilities over the next 12 months, which will smooth out over the coming years.

THFC holds considerable levels of liquid investments--as of March 2021, our 12-month liquidity ratio was 1.2x, meaning that the group has an ample cushion to cover its liabilities under a severe liquidity stress scenario without accessing the capital markets.

Key Selected Indicators

Table 1

The Housing Finance Corp. Ltd. -- Selected Indicators

	--Year ended March 31--				
(Mil. £)	**2021**	**2020**	**2019**	**2018**	**2017**
Business position					
Total adjusted assets	8,004.26	7,572.60	7,456.70	7,107.90	5,977.70
Gross receivables	7,874.15	7,453.80	7,333.00	6,991.50	5,885.10
Growth in loans (%)	5.64	1.70	4.90	18.80	15.70
Interest revenue	262.03	261.50	258.60	237.20	232.90
Noninterest expenses	5.23	5.20	4.60	4.30	4.10
Capital and risk position					
Total liabilities	7,957.85	7,530.90	7,418.70	7,073.40	5,948.80
Total adjusted capital	46.41	41.60	38.00	34.50	28.80
Assets/capital	172.46	181.90	196.30	206.10	207.90
RAC ratio before diversification (%)	18.60	17.80	16.60	15.80	N/A
RAC ratio after diversification (%)	12.40	11.40	10.70	11.90	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)	1.15	2.30	1.60	1.70	N/A
Liquidity ratio without loan disbursement(one year)	1.15	2.30	1.60	1.70	N/A
Deposits to total financial liabilities (%)					
Funding ratio (one year)	1.46	2.50	1.80	1.90	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)

Table 2

The Housing Finance Corp. Ltd. -- Ratings Score Snapshot (cont.)

Capital adequacy	Very strong
Funding and liquidity	Neutral and 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 Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers Published, June 8, 2021
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, April 23, 2021
- Building Up Debt: U.K. Social Housing Sector Braces Itself For Borrowing, March 16, 2021
- Global Social Housing Ratings Score Snapshot: December 2020, Dec. 10, 2020
- Global Social Housing Ratings Risk Indicators: December 2020, Dec. 10, 2020
- Outlook 2021: Strong Liquidity Should Help Social Housing Providers Remain Resilient, Dec. 8, 2020
- U.K. Social Housing Providers Should Remain Largely Resilient To Short-Term Economic Difficulties From COVID-19, April 23, 2020

Public-Sector Funding Agencies Risk Indicators: May 2019, May 13, 2019

- Credit FAQ: A Closer Look At The New Public-Sector Funding Agencies Criteria, May 22, 2018
- Public-Sector Funding Agencies Risk Indicators: May 2019, May 14, 2019
- Assumptions For Liquidity Gap Analysis Under "Public-Sector Funding Agencies: Methodology And Assumptions", May 22, 2018

Ratings List

Ratings Affirmed	
Housing Finance Corp. Ltd. (The)	
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