

Research Update:

The Housing Finance Corp. Ltd. Upgraded To 'A+'; Outlook Stable; Off UCO On Implementation Of Revised PSFA Criteria

September 19, 2024

Overview

- On July 26, 2024, S&P Global Ratings published its revised "Methodology For Rating Non-U.S. Public-Sector Funding Agencies," (PSFA methodology) and placed its ratings on The Housing Finance Corp. Ltd. (THFC) under criteria observation (UCO).
- Under our updated PSFA methodology, we are more closely linking our analysis of PSFAs to the credit risks of the underlying sector or sectors.
- We assess the risks associated with THFC's lending portfolio as overall low, supported by sovereign guarantees against more than 40% of its loan book.
- Having completed our review of THFC, we have raised our long-term issuer credit rating on the company by one notch to 'A+' from 'A'. We also upgraded THFC's core subsidiary, THFC Sustainable Finance PLC, to 'A+' and raised our issue ratings on debt issued by THFC's three orphan funding vehicles to 'A+': 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. We have removed all the ratings from UCO.
- The outlook is stable.

PRIMARY CREDIT ANALYST

Ekaterina Ermolenko
Stockholm
46 708 770 286
ekaterina.ermolenko
@spglobal.com

SECONDARY CONTACTS

Abril A Canizares
London
+ 44 20 7176 0161
abril.canizares
@spglobal.com

Noa Fux
London
+ 44 20 7176 0730
noa.fux
@spglobal.com

Rating Action

On Sept. 19, 2024, S&P Global Ratings took the following rating actions:

- Raised its long-term issuer credit ratings (ICRs) on THFC to 'A+' from 'A' and affirmed the short-term ICR at 'A-1'.
- Raised its long-term debt rating on THFC's core subsidiary THFC Sustainable Finance PLC to 'A+' from 'A' and affirmed the short-term ICR at 'A-1'.
- Raised its issue ratings on debt issued by THFC's three orphan funding subsidiaries to 'A+' from 'A': 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.
- Removed the ratings from UCO, where they were placed on July 26, 2024.

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

The outlook is stable.

Outlook

The stable outlook indicates that THFC's leading U.K. Social Housing pass-through vehicle (which operates under a match-funding principle) position and its low-risk operating environment will offset the pressure coming from the strong competition from banks and own-name placements by the social housing providers and some decline in THFC's balance sheet over the past two years.

Downside scenario

We could lower the rating if THFC's risk management policies became less prudent and if the company's relevance diminished, reflected by a substantial decrease of THFC's loan portfolio. We could also lower our rating if credit quality in the U.K. social housing sector deteriorated significantly.

Upside scenario

We could raise the rating if THFC significantly strengthened its market position while maintaining strong risk management standards and asset quality.

Rationale

The rating actions follow a revision to our methodology for rating PSFAs (see "Methodology For Rating Non-U.S. Public-Sector Funding Agencies," published July 26, 2024).

Under our updated PFSA methodology, we are more closely linking our analysis of PSFAs to the credit risks of the underlying sector or sectors. THFC's sector risk profile (SRP) benefits from the low industry risk in the social housing sector globally, and also from the fact that 42% of its loan book is guaranteed by the U.K. government and ultimately carries the risks of an 'AA' entity.

Our rating on THFC also reflects THFC's prudent risk management policies, diversified pool of borrowers, and the company's robust funding and liquidity ratios.

Sector risk profile: underpinned by direct exposure to U.K. based social housing providers and supported by guarantees from the U.K. government. We view the overall SRP of THFC as strong. THFC's loan book has direct exposure to U.K. social housing providers (45% to English providers, small shares in Scotland and Northern Ireland, and 7% to Welsh providers), with the rest being ultimately guaranteed by the U.K. government (AA/Stable/A-1+). Because of this, we apply a weighted-average approach to assess the SRP of the company.

For the unguaranteed part of the loan book, we generally view the industry risk for all U.K.-based social housing sectors as low, which forms the starting point of our assessment. We negatively adjust the SRP component for English social housing providers, to reflect country specific adverse considerations, which are captured in our regulatory framework assessment (see "Regulatory Framework Assessment: Social Housing Providers In The U.K. Benefit From Strong Regulatory Frameworks," published Oct. 23, 2023). Conversely, we think the regulatory frameworks under

which SHPs in the devolved regions operate are stronger, and the risk exposure to them is well captured within the sector low industry risk.

The remaining 42% of the loan book (£3.2 billion), is lent via AHF and benefits from a guarantee that complies with our Guarantee Criteria Conditions. We therefore consider this part of the portfolio to carry very low sector risk profile.

Individual credit profile: projected modest loan portfolio growth is counterbalanced by the prudent risk management and robust liquidity thanks to the assets and liabilities matching principle.

We believe the THFC loan portfolio growth will likely be modest in the near term. U.K. social housing providers have scaled down their development programs as they prioritize investments in existing stock. Nevertheless, we believe the company will likely preserve its market share and will remain the largest pass-through vehicle in the market. As of the fiscal year 2024 (ending March 31, 2024), THFC had a loan book of £7.95 billion, slightly decreasing from £8.1 billion in fiscal 2023 and providing funding to 160 borrowers. THFC accounted for about 7% of the social housing sector's total debt stock and for only 0.1% of the sector's funding needs in fiscal 2024 compared with 2.2% in fiscal 2023. We believe this decline is temporary and THFC will resume its lending in the medium term. The company has the longest track record compared with other peers and has historically enjoyed strong portfolio growth. We think future growth will be supported by new products offerings and flexibility to borrowers.

While THFC's loan portfolio underperformed management's targets for the past two years, we expect this to be temporary and anticipate some rebound in the medium term. We think this will be supported by THFC's continued strategy to enhance internal processes and introduce innovative products to adapt to market needs and conditions.

In our view, THFC's management has expertise and experience in operating its major business lines. We understand that there is clear succession planning following several changes in the executive management team recently, and that changes were prepared for and included a transition period.

THFC also benefits from 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. THFC's credit and risk team closely monitors the performance of its borrowers by reviewing their reports and business plans. It also oversees the borrower watch-list and has its own grading system. The team scrutinizes all loan proposals and also provides a credit opinion.

THFC's business model limits interest-rate, currency, and funding risks. This is because lending is broadly at the same interest rates and on the same repayment schedule as the funds that it borrows. The group follows a strict matched-funding approach to minimize asset-liability risk. It also does not have 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.

We now assess THFC's initial capital adequacy as adequate, because it operates as a pass-through vehicle and we therefore view it as neutral for our rating on THFC. While under our updated criteria we don't calculate the risk-adjusted capital ratios for pass-through vehicles, we note that THFC has increased its reserves to £63 million in fiscal 2024 from £57 million a year ago.

We assess THFC's funding and liquidity position as strong, supported by its robust capacity to cover its liabilities, even under severe liquidity stress scenarios. Furthermore, conservative

match-funding policies ensure that liquidity ratios will remain structurally well above 1x, meaning that the group has ample cushion to cover its liabilities under a severe liquidity stress scenario without accessing capital markets. Further supporting this view is a one-month gap between the group's obligation to pay investors and payments received from its borrowers.

Selected Indicators

Table 1

The Housing Finance Corp. Ltd. -- Selected Indicators

| (Mil. £) | --Year ended March 31-- | | | | | |
|---|-------------------------|---------|---------|---------|---------|---------|
| | 2024 | 2023 | 2022 | 2021 | 2020 | 2019 |
| Business position | | | | | | |
| Total adjusted assets | 8,147.0 | 8,359.8 | 8,549.1 | 8,004.4 | 7,572.6 | 7,456.8 |
| Customer loans (gross) | 7,952.0 | 8,129.8 | 8,220.5 | 7,874.1 | 7,453.8 | 7,333.0 |
| Growth in loans (%) | (2.2) | (1.1) | 4.4 | 5.6 | 1.7 | 4.9 |
| Interest revenues | 281.0 | 282.0 | 267.6 | 262.0 | 261.5 | 258.6 |
| Noninterest expenses | 7.2 | 6.5 | 6.0 | 5.2 | 5.2 | 4.6 |
| Capital and risk position | | | | | | |
| Total liabilities | 8,085.0 | 8,302.9 | 8,496.8 | 7,957.9 | 7,530.9 | 7,418.7 |
| Total adjusted capital | 63.0 | 56.8 | 52.3 | 46.4 | 41.6 | 38.0 |
| Assets/capital | 129.3 | 147.1 | 163.4 | 172.5 | 181.9 | 196.3 |
| Gross nonperforming assets/gross loans | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Funding & liquidity | | | | | | |
| Liquidity ratio with loan disbursement (one year) | 4.0 | 1.4 | 2.9 | 1.2 | 2.3 | 1.6 |
| Liquidity ratio without loan disbursement(one year) | 4.0 | 1.4 | 2.9 | 1.2 | 2.3 | 1.6 |
| Funding ratio (one year) | 4.3 | 1.5 | 3.3 | 1.5 | 2.5 | 1.8 |

Ratings Score Snapshot

| | |
|-----------------------------|----------------------|
| Issuer credit rating | A+/Stable/A-1 |
| Sector risk profile | Strong |
| Individual credit profile: | |
| Business position | Adequate |
| Management & governance | Adequate |
| Capital adequacy | Adequate |
| Funding & liquidity | Strong |
| Anchor | a+ |
| Overriding factors and caps | 0 |
| Holistic analysis | 0 |

| | |
|-----------------------------------|-----------|
| Stand-alone credit profile | a+ |
| Extraordinary support | 0 |

Related Criteria

- Criteria | Governments | International Public Finance: Methodology For Rating Non-U.S. Public-Sector Funding Agencies, July 26, 2024
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- 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

- Ratings On The Housing Finance Corp. Ltd. Placed Under Criteria Observation After Publication Of New Criteria, July 26, 2024
- U.K. Social Housing Borrowing 2024 Borrowing capacity remains constrained, March 6, 2024
- Regulatory Framework Assessment: Social Housing Providers In The U.K. Benefit From Strong Regulatory Frameworks, Oct. 23, 2023
- Housing Finance Corp. Ltd. 'A/A-1' Ratings Affirmed; Outlook Stable, Sept. 27, 2023

Ratings List

Upgraded

| | To | From |
|--|----|------|
|--|----|------|

T.H.F.C. (Funding No. 1) PLC

| | | |
|----------------|----|---|
| Senior Secured | A+ | A |
|----------------|----|---|

T.H.F.C. (Funding No. 2) PLC

| | | |
|----------------|----|---|
| Senior Secured | A+ | A |
|----------------|----|---|

T.H.F.C. (Funding No. 3) PLC

| | | |
|----------------|----|---|
| Senior Secured | A+ | A |
|----------------|----|---|

Upgraded; Ratings Affirmed

| | To | From |
|--|----|------|
|--|----|------|

Housing Finance Corp. Ltd. (The)

| | | |
|----------------------|---------------|--------------|
| Issuer Credit Rating | A+/Stable/A-1 | A/Stable/A-1 |
|----------------------|---------------|--------------|

THFC Sustainable Finance PLC

| | | |
|----------------------|---------------|--------------|
| Issuer Credit Rating | A+/Stable/A-1 | A/Stable/A-1 |
|----------------------|---------------|--------------|

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.spglobal.com/ratings for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceid/504352>. Complete ratings information is available to RatingsDirect subscribers at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.spglobal.com/ratings. Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

Copyright © 2024 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, www.spglobal.com/ratings (free of charge), and www.ratingsdirect.com (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at www.spglobal.com/usratingsfees.

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.