S&P Global Ratings

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BlueHub Loan Fund, Massachusetts; General Obligation

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Long Term Rating	A/Stable	Upgraded

Rating Action

S&P Global Ratings raised its issuer credit rating (ICR) on BlueHub Loan Fund Inc. (BHLF), Mass. to 'A' from 'A-' and raised its long-term rating on BHLF's series 2020 taxable sustainability bonds to 'A' from 'A-'. The outlook is stable.

The rating action partially reflects our opinion of a stronger capital adequacy in fiscal 2020 than in past years with a net equity-to-asset ratio of about 20%, up from 7.7% based on fiscal 2018 financials. Between fiscal years 2018 and 2020, the net equity-to-asset ratio averages about 13.7%. This results from BHLF controlling its capital costs, as well as support from grant sources and our view of loan portfolio risks. The ratings also consider BHLF's continued profitability, asset quality, and liquidity resource strengths.

The rating affects roughly $75 million in series 2020 bonds, which are interest-only bonds until 2027, maturing in 2030. There is no reserve fund for the bonds. BHLF used bond proceeds to refinance previously issued fixed- and floating-rate debt obligations. The series 2020 bonds are an unsecured general obligation of BHLF, payable from unrestricted revenue and assets from certain funds.

Credit overview

The ratings reflect our view of BHLF's:

- Financial strength, following a fiscal 2020 that ended with $83 million in equity after increasing by 37% since fiscal 2018, compared with increases in assets and debt of 26% and 22%, respectively, over that period;
- Above-average profitability with a return on average assets of 5.4% during the past five fiscal years and a five-year average net interest margin for loans of about 3.9%, compared with median ratios of 1.8% and 3.6%, respectively, among other rated community development financial institutions (CDFIs);
- Very strong asset quality, measured by a nonperforming assets-(NPAs)-to-total assets ratio of about 1% in fiscal 2020 and a three-year average of 0.5%, which is in line with other rated CDFIs;
- Adequate liquidity based on loans and short-term investments consisting of 74% and 17%, respectively, of total assets on a five-year average, which are both relatively in line with rated peers; and
- Proactive loan portfolio management, with thorough underwriting guidelines and a strong internal culture centered on risk mitigation, which is partially responsible for its strong loan performance history.

BHLF is a 501(c)(3) nonprofit corporation based in Boston, certified as a CDFI by the U.S. Department of the Treasury in 1997. BHLF is an affiliate of BlueHub Capital, and it remains a core line of business. The CDFI operates with 12 full-time employees and receives supporting services from an additional 15 staff from BlueHub Capital; all BlueHub Capital employees are based in the Boston headquarters.

The stable outlook reflects S&P Global Ratings' view of BHLF's improved capital adequacy ratios. BHLF has continued to grow its loan portfolio while holding increases in debt obligations in check relative to its balance sheet. In addition, we assume lower potential loan losses due to portfolio characteristics, as of March 2021, compared with its portfolio from fiscal 2019; we think these near-term trends will likely continue. Based on our review of unaudited finances, as of June 30, 2021, and our understanding of BHLF's strategy through the remainder of the year, we expect fiscal 2021 to end in line with fiscal 2020 financial performance. At the same time, we expect BHLF's operating performance will likely remain at similar levels as fiscal 2020. We consider BHLF's debt and loan-portfolio management critical to rating stability.

Environmental, social, and governance factors

We have analyzed environmental, social, and governance (ESG) risks relative to BHLF's financial strength, management and legislative mandate, and local economy. We view health and safety risks related to COVID-19 as social risks, which have broadly affected the U.S. economy and its workforce. The resulting elevated unemployment and the greater likelihood of nonpayment of loans could create a liquidity crunch for some issuers and elevate near-term social risk. In addition to increased federal funding to individuals and CDFIs, we think BHLF's strong underwriting and improved capital adequacy insulate it from near-term volatility from COVID-19. We view governance and environmental risks as both in-line with the sector standard.

Stable Outlook

Upside scenario

We could raise the ratings further if BHLF were to demonstrate continued, consistent strength in its net equity-to-assets ratio compared with its peers while maintaining very strong profitability and asset quality. An exceptional loan performance, the preservation of sufficient capital available to absorb potential loan losses, and a strong balance sheet could also result in our raising the ratings further.

Downside scenario

We could lower the rating if equity were to prove insufficient to absorb additional potential loan losses; our calculated net equity-to-assets ratio could decrease below levels consistent with this rating and lead us to lower the rating. If BHLF were to experience a significant reduction in capital adequacy because of increased debt, weakening loan performance, or fewer unrestricted or donor-restricted net assets, this would demonstrate volatility and impede capitalization and debt positions; this could also lead to our lowering the rating.

Credit Opinion

Financial Strength

Capital adequacy

BHLF's capital adequacy improved during the past three fiscal years to a net equity-to-assets ratio of about 20% in fiscal 2020 and a three-year average of about 13.7%, which we view as in-line with our benchmark for the 'A' rating category and comparable with medians among other rated CDFIs. During the past three fiscal years, BHLF's equity grew by 37% and gross loan balance increased by 26%. During this period of loan growth, BHLF has managed to control capital costs, grow its equity, and maintain a relatively stable equity-to-asset ratio. BHLF has received credit enhancements from the U.S. Department of Education to support lending in the charter-school sector, as well as grants from the Capital Magnet Fund to help finance affordable housing loans.

We estimate credit enhancement required for its existing loans, as of March 2021, was approximately 15% at the 'A' stress level. After the application of our loan-loss assumptions, BHLF's equity-to-asset ratio of about 30% in fiscal 2020 decreased to about 20%. We think BHLF has sufficient net assets to cover potential losses at this 'A' stress scenario.

BHLF has managed its debt profile well, in our opinion. Total debt outstanding, bonds and loans payable, was $181 million in fiscal 2020. Net equity was about 30% of total debt in fiscal 2020, which is higher than other rated CDFIs, while 14% of BHLF's debt outstanding fully subordinate with indeterminate maturity dates in the form of EQ2s from local banks and institutions. This debt typically carries an interest rate of 3% with a 10-year rolling maturity date. Initial maturity dates automatically extend by one year at the end of each of the first five years of the loans' terms; thereafter, they are extended annually on anniversary dates, indefinitely, provided the investor does not call the loan. These investments are fully subordinated to the right of payment of all other creditors.

Capital to support BHLF's lending activity comes from four primary sources: investor funds lent to BHLF; bank debt, such as lines of credit; loan participations; and secondary market sales. BHLF has focused on matching the duration of assets with lending capital, managing interest rate risk, avoiding negative arbitrage, and maintaining flexible capital to meet borrowers' needs. For BHLF, BlueHub Capital uses an internal tool, provided monthly, called the portfolio-liquidity management report, to ensure appropriate matching of liabilities and assets; this tool is designed to identify in one report all of the information centered on liquidity, interest spread, and overall credit exposure.

Profitability

BHLF has very strong profitability, in our opinion. After decreasing in fiscal 2018, net income has increased annually to $11.8 million in fiscal 2020, the highest level since fiscal 2017. As BHLF grew its loan portfolio, interest income from loans increased by 86% between fiscal years 2017 and 2020 while management and general operating expenses increased by 68% over that time. This trend has resulted in a return-on-average assets of 4.5% in fiscal 2020 and a five-year average of 5.4%, above our benchmark for the 'A' rating category and ahead of other rated CDFIs. In addition, BHLF's net interest margin for loans was 3.6% in fiscal 2020 with a five-year average of 3.9%. BHLF's interest spread decreased slightly in fiscal 2019 with increases on senior debt, particularly on variable-rate debt indexed to LIBOR, and rate pressure on housing loans tied to projects funded through the Capital Magnet Fund grant. BHLF monitors the interest spread on loans both historically and forecast out at least 12 months. The target to cover operating costs is between 2.5% and 3%; the weighted-average rate of interest on loans was 5.9% in fiscal 2020.

Asset quality

BHLF's total assets reached nearly $272 million in fiscal 2020, about twice the total from fiscal 2016 due to a focus on geographic expansion of lending activities to fill unmet capital needs in underserved markets. As of March 2021, almost half of the loan balance outstanding was for projects in Massachusetts, Connecticut, and New York. The remaining portfolio spanned 17 other states, including loans in two new states in 2020 (Missouri and Texas). In our opinion, BHLF's loans perform strongly with minimal-to-no NPAs during the past five years. While other rated CDFIs exhibit strong asset quality, with median NPAs of 0.6% of total loans, BHLF's portfolio's five-year average NPAs were an even stronger 0.3% despite 1% of loan balance reported as delinquent in fiscal 2020, due largely to COVID-19-related challenges.

As loan performance has remained strong, and its portfolio has grown into new markets, BHLF's loan-loss reserves have decreased as a percent of total loans. In fiscal 2020, reserves were about 1.6% of total loans, trailing its five-year average of 2.1%, below the level of other rated CDFIs.

Liquidity

BHLF, in our view, has adequate liquidity to cover short-term financial needs. At Dec. 31, 2020, about 79% of total assets were loans, up from 62% in fiscal 2016. The remaining assets include mostly short-term investments (17% of total assets). BHLF also maintains access to external liquidity. As of June 2021, BHLF had about $17.5 million in committed and undrawn unrestricted lines of credit. Each line of credit carried a floating interest rate priced at LIBOR plus a spread.

Management

We view BHLF's management as strong overall due to experienced and strategic senior leadership. A 12-member board of directors, with an average tenure of service of more than 21 years, oversees BlueHub Capital. This includes the CEO of BlueHub Capital; the president of BHLF; and the president of BlueHub Managed Assets, all three are ex-officio board members. To ensure all affiliates are working toward shared financial and mission-driven goals, BlueHub Capital and each of its affiliates, including BHLF, have distinct boards of directors with identical members. The board represents a variety of business sectors and geographic locations.

The management team's autonomy and relatively continuous composition allow BHLF to meet its mission. We consider management's ability to resolve difficult situations during its operating history strong, evidenced by limiting delinquencies among its loans and proactively working with borrowers to overcome COVID-19-related challenges.

Behind BHLF's loan performance is its active loan and portfolio management, including management reviews of weekly delinquency, maturity, and conversion date reports and quarterly portfolio reviews. Active loan monitoring involves annual reviews and site visits, as needed, typically every three years. Staff also perform loan-level monitoring that involves high-touch relationships with borrowers, ongoing reviews of project progress, financial reports, and risk ratings (assigned at approval and reviewed during the loan's life). Risk ratings support the allowance for loan losses based on a range of loan characteristics.

Since 1985, BHLF has made loans totaling more than $1.5 billion with the following social outcomes:

- Affordable Housing: 26,500 units built, preserved, or enhanced;

- Health care: facilities offering a comprehensive range of care to 197,700 patients;
- Childcare: facilities serving 18,800 children;
- Education: schools and youth programs serving 52,600 students;
- Commercial real estate and community facilities: the development of more than 6.5 million square feet of commercial real estate and community facilities;
- Jobs: more than 16,900 jobs created or retained since 2012;
- Healthy food retail: facilities serving more than 1.7 million customers annually; and
- Sustainability: Collaboration with BlueHub Energy to bring energy resilience and cost savings to low-income communities.

BlueHub Loan Fund, MA -- Financial Ratio Analysis

(%)	2016	2017	2018	2019	2020	5-year average
Capital Adequacy						
Equity/total assets	28.6	30.7	28.0	27.9	30.6	29.1
Net equity/total assets			7.7	13.2	20.2	13.7
Net equity/total loans	48.2	44.7	9.7	16.2	25.2	28.8
Net equity/total loans + MBS (loans)	48.2	44.7	9.7	16.2	25.2	28.8
Equity/total debt	41.0	46.0	40.8	39.9	45.9	42.7
Net equity/total debt			11.3	18.9	30.3	20.2
Available Liquid Assets/ total loans	33.4	26.2	27.0	29.8	30.3	29.4
GO Debt/ total debt	0.0	0.0	0.0	0.0	0.0	0.0
Profitability						
Return on average assets	4.5	8.7	4.5	4.6	4.5	5.4
Net interest margin	3.4	3.3	3.4	2.9	3.0	3.2
Net interest margin (MBS (loans) + loans)	4.3	4.3	4.1	3.5	3.6	3.9
Net interest margin (loans)	4.3	4.3	4.1	3.5	3.6	3.9
Asset Quality						
NPAs/total loans + REO	0.0	0.0	0.4	0.1	1.0	0.3
Loan loss reserves/total loans	3.7	2.3	1.6	1.3	1.6	2.1
Net charge-offs/average loans	0.8	0.4	0.0	0.0	0.0	0.2
Liquidity						
Total loans/total assets	61.9	70.5	78.3	80.6	78.8	74.0
Total loan + MBS (loans)/total assets	61.9	70.5	78.3	80.6	78.8	74.0
Short-term investments/total assets	21.5	18.9	13.5	15.5	17.9	17.5
Total investments/total assets	21.5	18.9	13.5	15.5	17.9	17.5

Related Research

- Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020