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BlueHub Loan Fund Inc., Massachusetts; General Obligation

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Credit Highlights

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

Security

The series 2020 bonds are an unsecured general obligation of BHLF, payable from unrestricted revenue and assets from certain funds. 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.

Credit overview

The rating reflects our view of BHLF's:

- Financial strength, following nearly $92 million in equity after increasing by 11% year-over-year at fiscal year-end 2021 with total assets increasing by 2% and total liabilities decreasing by 1% during that period--These results followed an influx of lending capital that reduced its need to issue additional debt;
- Above-average profitability with an average return on assets (ROA) of 5.1% during the past five fiscal years and a five-year average net interest margin for loans of about 3.8% compared with median ratios of 2.9% and 3.4%, respectively, among other rated community development financial institutions (CDFIs);
- Very strong asset quality, measured by a nonperforming assets (NPAs) to total loans ratio of about 1.1% in fiscal 2021 and a four-year average of 0.7%, which is in-line with other rated CDFIs;
- Sufficient liquidity to cover short-term financial needs based on loans and short-term investments consisting of 76% and 18%, 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 BHLF's successful record of managing programs, even during difficult circumstances.

Environmental, social, and governance

We have analyzed environmental, social, and governance (ESG) risks relative to BHLF's financial strength, management and legislative mandate, and local economy. We view these risks as neutral to our credit analysis.

Outlook

The stable outlook reflects S&P Global Ratings' view of BHLF's improved capital-adequacy ratios recently. Net equity, after our assumed loan losses, relative to total assets remained strong in fiscal 2021 at 18.8% after BHLF received an influx of grants and contributions, even as loan originations slowed, while the balance of outstanding debt obligations slightly decreased. At the same time, profitability and asset quality remain strengths of BHLF's credit quality, even through periods of macroeconomic challenges. As BHLF looks to grow its loan portfolio in the coming years, we do not expect new loans to introduce additional risks in terms or structure beyond what we have already considered in the current analysis. We consider BHLF's debt and loan-portfolio management critical to rating stability.

Downside scenario

We could lower the rating or revise the outlook to negative if unrestricted equity and other available capital were to prove insufficient to absorb potential loan losses since our calculated net equity-to-assets ratio could decrease below levels consistent with this rating. We could also 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, which would demonstrate volatility and impede capitalization and debt. Weaker profitability in the near term with lower ROA or net interest margins could also lead us to consider taking a negative rating action.

Upside scenario

We could raise the rating or revise the outlook to positive if BHLF were to continue to demonstrate strength in its net-equity-to-assets ratio compared with its peers while maintaining very strong profitability and ample liquidity to meet short-term needs. We could also raise the rating due to BHLF's exceptional loan performance, preservation of sufficient capital available to absorb potential loan losses, and strong balance sheet.

Credit Opinion

Financial Strength

Capital adequacy

We view BHLF as well capitalized with strong leverage and capital-adequacy ratios. Between fiscal years 2018 and 2021, the net-equity-to-assets ratio averages about 15%, after adjusting for projected loan losses. Balance sheet equity has grown by more than debt obligations since fiscal 2018 because low-cost grants and contributions have financed much of recent loan portfolio growth. Muted loan originations and an increased number of prepayments led to a 7% decrease in gross loan balance and a 46% increase in short-term investments, including cash from prepayments, year over year in fiscal 2021. This contributed to increased equity relative to assets, reaching 33% in fiscal 2021, up from about 30% in fiscal 2020. BHLF has recently increased capital available to absorb projected loan losses; unaudited finances, as of June 30, 2022, also reflect this trend.

We estimate credit enhancement required for existing loans, as of March 2022, was approximately 21% at the 'A' stress level. Our analysis considers projects' net cash flow and the presence of reserves or other provisions that could mitigate potential repayment risk. BHLF has received credit enhancement 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 think BHLF has sufficient net equity to cover potential losses at this 'A' stress scenario.

BHLF has managed its debt profile well, in our opinion. Total debt outstanding was about $177 million in fiscal 2021, the lowest since fiscal year-end 2018. Net equity was about 30% of total debt in fiscal 2021, which we view as a neutral rating factor in our analysis and in-line with other rated CDFIs. Approximately 14% of BHLF's debt outstanding is fully subordinate with indeterminate maturity dates in the form of EQ2s from local banks and institutions. This debt carries an interest rate averaging below 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, with a five-year average ROA of 5.1% and 3.2% in fiscal 2021, well above our 'A' rating category benchmark. This ratio can fluctuate for CDFIs due to changes in the receipt of grants and contributions. This five-year average includes an 8.8% ROA in fiscal 2017, bolstered by $10.4 million in grants and contributions that year. However, BHLF's ROA has been relatively stable recently, staying above at least 3%, which we view as very strong.

At the same time, the five-year average net interest margin for loans was 3.8%, relatively in-line with other rated CDFIs. 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 5.8%

in fiscal 2022.

Asset quality

BHLF's total assets reached nearly $278.4 million in fiscal 2021, about 2% higher than fiscal 2020 and 65% higher than fiscal 2017. The year-over-year increase was despite a modest decrease in loan balance outstanding; instead, it was due largely to the receipt of additional cash from principal loan prepayments. In years past, asset growth resulted from the geographic expansion of lending activities to fill unmet capital needs in underserved markets. As of March 2022, about half of the loan balance outstanding was for projects in Massachusetts, Connecticut, and New York. The remaining portfolio spanned 20 other states and the District of Columbia. The asset class distribution in BHLF's loan portfolio remains in-line with past years; housing and education-related projects represent most of the balance outstanding.

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 0.5% despite 1.1% of loan balance reported as delinquent in fiscal 2021 due largely to COVID-19-related challenges. BHLF's loan-loss reserves are smaller than other rated CDFIs; in fiscal 2021, reserves were about 1.7% of total loans, in-line with its five-year average but below the median of 3.6% among other rated CDFIs.

Liquidity

BHLF, in our view, has adequate liquidity to cover short-term financial needs. At Dec. 31, 2021, about 71% of total assets were loans, down from 79% in fiscal 2020. The remaining assets include a larger balance of short-term investments than in years past, about 25% of total assets. Management expects to draw down cash in the near term for lending activities, which we think will bring its percent of loans and short-term investments in-line with recent five-year averages of 76% and 18%, respectively. As part of its liquidity strategy, BHLF structures financial assets to be available as general expenditures, liabilities, and other obligations come due. As of June 30, 2022, the balance of maturing loans exceeds debt service due in each year until there is a bullet principal payment due in 2026.

Management

We view BHLF's management as strong overall due to experienced and strategic senior leadership. An 11-member board of directors, with an average tenure of service of more than 21 years, oversees BlueHub Capital, including the CEO of BlueHub Capital and the president of BlueHub Managed Assets, both 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.

BHLF is currently filling the vacated position of president, in which the interim president carries more than 25 years of experience with BlueHub. This has not, and is not expected to, alter BHLF's strategy or management strengths. Its updated strategic plan fits within its organizational capabilities and expertise, and it is deliberate when committing capital to meet its social 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 economic-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: 29,300 units built, preserved, or enhanced;
- Health care: facilities offering a comprehensive range of care to 197,700 patients;
- Childcare: facilities serving 20,400 children;
- Education: schools and youth programs serving 66,500 students;
- Commercial real estate and community facilities: the development of more than 6.9 million square feet of commercial real estate and community facilities;
- Jobs: more than 21,100 jobs created or retained since 2012;
- Healthy food retail: facilities serving more than 1.7 million customers annually; and
- Sustainability: a collaboration with BlueHub Energy to bring energy resilience and cost savings to low-income communities.

BlueHub Loan Fund, Massachusetts Select Key Financial Ratios

	2021	2020	2019	2018	2017	Five-year average
Capital adequacy						
Equity/total assets	33.0	30.6	27.9	28.0	30.7	30.0
Net equity/total assets	18.8	20.2	13.2	7.7		15.0
Net equity/total loans		25.2	16.2	9.7	44.7	24.0
Net equity/total loans + mortgage-backed securities (loans)		25.2	16.2	9.7	44.7	24.0
Equity/total debt	52.0	45.9	39.9	40.8	46.0	44.9
Net equity/total debt	29.7	30.3	18.9	11.3		22.5
Profitability						
Return-on-average assets	3.2	4.5	4.6	4.5	8.7	5.1
Net interest margin	2.7	3.0	2.9	3.4	3.3	3.1
Net interest margin (loans)	3.7	3.6	3.5	4.1	4.3	3.8
Asset quality						
Nonperforming assets/total loans + real estate owned	1.1	1.0	0.1	0.4	0.0	0.5
Loan loss reserves/total loans	1.7	1.6	1.3	1.6	2.3	1.7
Liquidity						
Total loans/total assets	71.3	78.8	80.6	78.3	70.5	75.9
Short-term investments/total assets	25.5	17.9	15.5	13.5	18.9	18.2

Related Research

Through The ESG Lens 3.0: The Intersection Of ESG Credit Factors And U.S. Public Finance Credit Factors, March 2, 2022