S&P Global
Ratings

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Summary:

BlueHub Loan Fund Inc., Massachusetts; General Obligation

Primary Credit Analyst:
David Greenblatt, New York + 1 (212) 438 1383; david.greenblatt@spglobal.com

Secondary Contact:
Lauren B Carter, Boston + 1 (212) 438 0376; lauren.carter@spglobal.com

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Long Term Rating	A+/Stable	Upgraded
BlueHub Loan Fund ICR		
Long Term Rating	A+/Stable	Upgraded

Credit Highlights

- S&P Global Ratings raised its issuer credit rating (ICR) on BlueHub Loan Fund Inc. (BHLF), Mass. one notch to 'A+' from 'A'.
- S&P Global Ratings also raised its rating on BHLF's series 2020 taxable sustainability bonds one notch to 'A+' from 'A'.
- The outlook is stable.
- The rating action reflects our opinion of the stronger capital adequacy with a net equity-to-assets ratio averaging more than 16% during the past five years, demonstrating sufficient equity to sustain our assumed loan losses and continued strengths in other key credit factors relative to rated peers.

Security

The series 2020 bonds are an unsecured general obligation (GO) 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

BHLF's equity has increased during the past two years by 26% as overall debt outstanding decreased slightly while grant funding helped total assets increase by 7% despite slower loan originations. This has added more resources on-balance sheet to absorb our assumed loan losses to result in capital adequacy in-line with similar-rated peers while other key credit factors remain relative strengths, in our opinion. We expect the net equity-to-assets ratio will likely remain comparable with this rating through the two-year outlook.

The rating reflects our view of BHLF's:

- Improved capital adequacy with a net equity-to-assets ratio of 22.5% in fiscal 2022 after year-over-year equity increased by 13% with a five-year average we consider in-line with other 'A+' rated community development financial institutions (CDFIs);

- Above-average profitability with an average return-on-assets (ROA) ratio of 4.2% during the past five fiscal years and a five-year average net interest margin for loans of about 3.6%;
- Very strong asset quality, measured by a nonperforming-assets (NPAs)-to-total-loans ratio of about 1% in fiscal 2022 and a five-year average of 0.7%, in-line with other rated CDFIs;
- Sufficient liquidity to cover short-term financial needs with short-term investments accounting for a high of about 35% of total assets in fiscal 2022--However, we expect a return to the past five-year average of about 21% during the next few years; and
- Proactive loan-portfolio management with thorough underwriting guidelines and a strong internal culture centering on risk mitigation, 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 that we think could remain comparable with 'A+' rated peers. The availability of low-cost capital following COVID-19 and the use of on-balance sheet funds from grants and other sources had contributed to a general pause in the accumulation of additional debt obligations in fiscal 2022. We think the added equity on its balance sheet and BHLF's near-term lending strategy will likely help net equity to remain strong and withstand expected debt increases in the coming years. As of June 2023, BHLF's equity was about 35% of total assets, less than 75 basis points down from fiscal year-end 2022. Debt outstanding increased by 12% in the first six months of 2023 while the gross loan balance increased by 20% with some loan closings planned for fourth-quarter 2022 flipped into first-quarter 2023.

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 structure risk 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, bringing our calculated net equity-to-assets ratio below levels we consider consistent with this rating. We could also lower the rating if capital adequacy were to decrease significantly 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 during the next few years with lower ROA or net interest margins could also lead us to consider lowering the rating.

Upside scenario

We could raise the rating further 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 2022, the net-equity-to-assets ratio averages 16.5%, after adjusting for our projected loan losses. Balance-sheet equity has grown more than debt obligations since fiscal 2018 because low-cost grants and money from loan prepayments financed much of the recent loan portfolio growth. For the second consecutive year, gross loan balance contracted due to market conditions; muted loan originations and increased prepayments led to an 8% decrease in gross loan balance and a 41% increase in short-term investments, including year-over-year cash from prepayments in fiscal 2022. Combined with debt outstanding that stayed relatively flat since fiscal 2021, this led to equity finishing at nearly 36% of total assets in fiscal 2022, up from 33% in fiscal 2021.

We estimate credit enhancement required for existing loans, as of March 2023, was approximately 23% 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 $176.5 million in fiscal 2022, the lowest since fiscal year-end 2018. Net equity was about 37% of total debt in fiscal 2022, which we view as a neutral rating factor in our analysis and in-line with other rated CDFIs. Approximately 12% of BHLF's debt outstanding is fully subordinate with indeterminate maturity dates in the form of EQ2s from local banks and institutions. In addition, we think BHLF sufficiently matches its asset and liability terms; approximately $23.1 million in debt service is due by fiscal year-end 2023 while $25.9 million in loans mature by that time, and all loans and existing debt carry fixed interest rates.

BHLF plans to originate more than $550 million in loans, averaging $110 million annually, and finance 200 high-impact community development projects between fiscal years 2022 and 2026. By June 2023, its gross loan balance reached a peak of more than $223 million, about $37 million above the 2022 year-end balance, while debt outstanding increased by $21 million during the same period. We expect BHLF to incur additional debt to achieve its five-year plan; management indicates the equity-to-assets ratio could decrease to near 28% during this period, in-line with its ratio from fiscal 2019, partially depending on the availability of grants.

Profitability

BHLF has very strong profitability, in our opinion, with a five-year average ROA of 4.2%, and 4.3% in fiscal 2022, well above our 'A' rating category benchmark. This five-year average was a slight decrease from our prior review that included an 8.8% ROA in fiscal 2017. This ratio can fluctuate for CDFIs due to changes in the receipt of grants and contributions; for instance, BHLF received about $7 million in donor-restricted grants in fiscal 2022, up from $3.8 million in fiscal 2021. However, BHLF's net operating income has been relatively stable during the past five years.

At the same time, the five-year average net interest margin for loans was 3.6%, relatively in-line with other rated CDFIs. BHLF's interest spread decreased in fiscal 2022 to about 3.3%, its lowest point during the past five years; such a decrease is not uncommon for rated CDFIs due to the lending slowdown in fiscal 2022, following the years of higher-rate loans prepaying early. Interest income from loans decreased by 10% between fiscal years 2021 and 2022 while interest expenses decreased by 5% during that period. As interest rates on short-term U.S. Treasuries increased during the past 12 months, BHLF used debt issuance to generate a spread. Management plans to use those proceeds to finance more loans as needed. The target to cover operating costs is between 2.5% and 3%; the weighted-average rate of interest on loans was 5.7% in fiscal 2022. According to its 2022-2026 strategic plan, BHLF is exploring ways to increase and develop new sources of fee income to diversity revenue beyond mainly loan interest income.

Asset quality

BHLF's total assets reached a new high in fiscal 2022 of nearly $290 million, 4% higher than fiscal 2021, because the receipt of loan prepayments and grants more than compensated for the decrease in loan balance. As part of its geographic expansion strategy, BHLF recently nearly doubled its loan balance outstanding in Texas; doubled lending in Ohio; expanded into Indiana; and pulled back totals in Connecticut, New York, and New Jersey due partially to loan prepayments in fiscal 2022. As of March 2023, Massachusetts remained the highest concentration of loans with 25% of the gross balance; however, Texas and Tennessee rounded out the three states with the highest loan balances outstanding. The asset-class distribution in BHLF's loan portfolio remains relatively consistent with past years; housing and charter school projects represent most of the balance outstanding.

In our opinion, BHLF's loans perform very strong with minimal NPAs during the past five years. Its five-year average NPAs were 0.7% of the loan balance; 1.02% was reported as delinquent past 90 days in fiscal 2022, still below the average among rated CDFIs. BHLF's loan-loss reserves are smaller than other rated CDFIs, not including board-designated net assets for general loan losses. In fiscal 2022, the allowance for loan losses was about 1.9% of total loans, below the 3.3% average among other rated CDFIs. Impairments among BHLF's portfolio involved financial difficulty for borrowers of construction, permanent, and organizational financings.

Liquidity

BHLF, in our view, has adequate liquidity to cover short-term financial needs. The influx of grants and loan prepayments during the past two years led loans to account for 63% of total assets by Dec. 31, 2022, down from 79% in fiscal 2020 and 71% in fiscal 2021. The remaining assets include a larger balance of short-term investments than in years past, about 35% of total assets. Management expects to draw down cash in the near term for lending activities, which will likely bring its percent of loans and short-term investments in-line with recent five-year averages of 74% and 21%, 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, 2023, there was also $20 million in unused lines of credit for loan-capital purposes with an additional $10 million available for capital and operations. We think access to external liquidity, such as these facilities, could be a credit strength should unexpected, short-term needs occur.

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 BlueHub Capital's CEO. 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's current president, newly hired in July 2023, has experience as a senior leader for a peer CDFI, as well as the chief business officer of a housing finance agency. This has not, and is not expected to, alter our view of BHLF's strategy or management strengths. BlueHub Capital's CEO also focuses on building and maintaining a deep bench within the BHLF team, which could lead to strength and stability in later years. BHLF's 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, 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.

Table 1

BlueHub Loan Fund, Massachusetts select key financial ratios

%	2022	2021	2020	2019	2018	Five-year average
Capital Adequacy						
Equity/total assets	36.0	33.0	30.6	27.9	28.0	31.1
Net equity/total assets	22.5	18.8	20.2	13.2	7.7	16.5
Equity/total debt	59.1	52.0	45.9	39.9	40.8	47.5
Net equity/total debt	36.9	29.7	30.3	18.9	11.3	25.4
Profitability						
Return on average assets	4.3	3.2	4.5	4.6	4.5	4.2
Net interest margin	2.3	2.7	3.0	2.9	3.4	2.8
Net interest margin (loans)	3.3	3.7	3.6	3.5	4.1	3.6
Asset Quality						
Nonperforming assets (NPAs)/total loans + real estate owned	1.0	1.1	1.0	0.1	0.4	0.7
Net charge-offs/average NPAs	0	0	0	0	0	0
Loan loss reserves/total loans	1.9	1.7	1.6	1.3	1.6	1.6
Liquidity						
Total loans/total assets	62.9	71.3	78.8	80.6	78.3	74.4
Short-term investments/total assets	34.6	25.5	17.9	15.5	13.5	21.4
Total investments/total assets	34.6	25.5	17.9	15.5	13.5	21.4

Related Research

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