S&P Global
Ratings

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BlueHub Loan Fund Inc., Massachusetts; General Obligation

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Credit Profile		
US$60.505 mil GO bnds ser 2024A due 07/01/2029		
Long Term Rating	A+/Stable	New
US$29.35 mil GO bnds ser 2024B due 07/01/2044		
Long Term Rating	A+/Stable	New
BlueHub Loan Fund rev bnds (taxable sustainability bnds)		
Long Term Rating	A+/Stable	Affirmed
BlueHub Loan Fund ICR		
Long Term Rating	A+/Stable	Affirmed

Credit Highlights

- S&P Global Ratings assigned its 'A+' long-term rating to the Public Finance Authority, Wis.' series 2024A taxable sustainability bonds and series 2024B tax-exempt sustainability bonds, issued for BlueHub Loan Fund Inc. (BHLF), Mass.
- At the same time, we affirmed our 'A+' issuer credit rating (ICR) on BHLF, and our 'A+' long-term rating on BHLF's series 2020 taxable sustainability bonds.
- The outlook is stable.

Security

The ICR reflects our view of the obligor's general creditworthiness, focusing on its capacity and willingness to meet financial commitments as they come due. It does not apply to any specific financial obligation because it does not consider the obligation's nature and provision, standing in bankruptcy or liquidation, statutory preferences, or legality and enforceability.

Both the series 2020 and 2024 bonds are unsecured general obligations of BHLF, payable from all legally available revenue and assets, and are not secured by a reserve fund, mortgage lien, or security interest on or in any funds or other revenue or assets of BHLF. Currently none of BHLF's existing debt is secured, and it has no other obligations that may be viewed as senior to the series 2020 or 2024 bonds. In our opinion, the rating on these issues is at the same level as the ICR.

BHLF expects to use the approximately $60.5 million in series 2024A bond proceeds as working capital, to refinance existing loans, and for other uses consistent with its corporate purpose; these bonds carry a bullet maturity in 2029. The planned $29.4 million in proceeds from the tax-exempt series 2024B bonds are expected to provide long-term financing resources to existing charter school loans within BHLF's portfolio, and better match the duration of the loans with the duration of the bonds; the bonds have a maturity date in 2044.

Credit overview

The key credit factors that contributed to us raising BHLF's ICR one notch in our prior review in 2023 remain strengths in our current assessment of the organization. Balance sheet equity-to-total assets has increased year-over-year since fiscal 2020, as the receipt of low-cost grants and money from loan prepayments financed much of the recent loan portfolio growth. This has resulted in additional resources to absorb our assumed loan losses, resulting in a capital adequacy that is comparable with similarly rated peers. The series 2024 bonds will add new debt to BHLF's balance sheet and weaken certain ratios in the near-term, but not below levels we believe are in-line with the current rating. In our opinion, the strategy associated with the series 2024 bonds reflects sound, forward-looking management of BHLF's current and expected resources to meet its financial and social missions.

The rating reflects our view of BHLF's:

- Capital adequacy, with a net equity-to-total assets ratio of 22.2% in fiscal 2023 after equity increased year-over-year, with a five-year average ratio of 19.4% that we consider to be in line with that of other 'A+' rated community development financial institutions (CDFIs);
- Above-average profitability, with an return on average assets (ROA) ratio of nearly 5% during the past five fiscal years, with significant grant revenue received in fiscal 2023 that drove ROA higher that year to above 8%, and a five-year average net interest margin (NIM) for loans of about 3.5%;
- Very strong asset quality, as measured by a nonperforming assets (NPAs)-to-total loans ratio of about 0.3% in fiscal 2023 and a five-year average of 0.7%, below the average among other rated CDFIs;
- Sufficient liquidity to cover short-term financial needs, with short-term investments accounting for about 29% of assets in fiscal 2023, an expected decrease from the 35% in fiscal 2022; 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) factors relative to BHLF's financial strength, management, and legislative mandate, and view these factors as neutral in our credit analysis. We think BHLF's loan portfolio could have exposure to certain environmental factors, such as climate transition and physical risks, with about 50% of its existing loan balance for projects in Massachusetts, Texas, Tennessee, and New York. We believe BHLF's financial strength, strong underwriting guidelines, insurance requirements, and strategic decision-making mitigate these risks; in the past five years, BHLF has diversified its geographic footprint by moving into new markets in the southern and midwestern region of the country.

Outlook

The stable outlook reflects our expectation that BHLF's capital adequacy will remain in line with the current rating through periods of growth that are included within its strategic plan, which runs from fiscal 2022 through fiscal 2026. This plan involves originating $550 million in cumulative lending, and BHLF's loan closings have hit $307 million as of June 2024. Demonstrating prudent debt management, BHLF's capitalization strategy involves matching the duration of assets with lending capital and maintaining flexible capital to meet borrowers' needs. While this strategy and the series 2024 bonds might result in a weaker capital adequacy during the outlook period to near 15% net equity-to-total assets, we believe BHLF's equity ratios will remain comparable with those of similarly rated peers. Further, we expect BHLF's leverage ratio (net equity-to-total debt) will remain neutral. We expect BHLF will incur additional debt to achieve its current five-year plan; management indicates the equity-to-total 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.

At the same time, based on our view of management and the expected characteristics of an expanded loan portfolio, we believe BHLF's profitability, asset quality, and liquidity will remain on par with the current rating.

Downside scenario

We could lower the rating or revise the outlook to negative if unrestricted equity and other available capital prove insufficient to absorb assumed loan losses, bringing our calculated net equity-to-total assets ratio below levels that we consider consistent with this rating. We could also lower the rating if capital adequacy were to decrease significantly beyond our current expectations, weakening loan performance, or fewer unrestricted or donor-restricted net assets, which would demonstrate volatility and impede capitalization and debt. A limitation on its liquidity sources available for short-term needs and weaker profitability propelled by market conditions or lending strategy could also lead us to lower the rating.

Upside scenario

We could raise the rating or revise the outlook to positive if BHLF's net equity-to-total assets strengthen during the outlook period to levels that are more in line with those of higher-rated peers, while profitability appears average or slightly stronger compared with that of other rated CDFIs. We could also consider a positive rating actions 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 capital-adequacy ratios. Between fiscal years 2019 and 2023, the net-equity-to-total assets ratio averages 19.4%, after adjusting for our assumed loan losses, which is stronger than the five-year average in our previous review. Balance-sheet equity available to cover loan losses more than doubled between fiscal years 2018 and 2023, and our assumed loan losses percentage decreased materially over that time to reflect our view of risk within BHLF's loan portfolio. Over this time, BHLF benefitted from growth in unrestricted net assets, including an influx of loan prepayments following the onset of the pandemic, and low-cost grants that helped grow its lending capacity. The net equity-to-total assets ratio increased to 22.2% in fiscal 2023 from 7.7% in fiscal 2018.

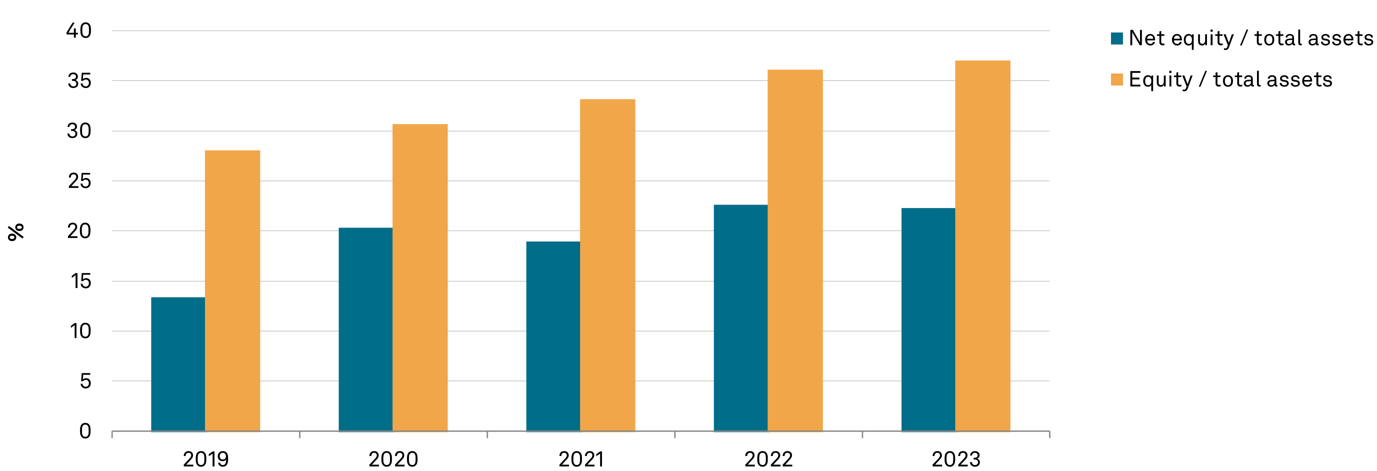
Following two consecutive years of gross loan balance contraction due to market conditions (e.g., muted loan originations and increased prepayments), BHLF's loan portfolio grew by 34% year-over-year in fiscal 2023, in its biggest loan production year on record. The biggest increases were among charter school and multifamily housing borrowers, and an almost doubling of the balance of construction loans outstanding. Since 2019, however, construction loans as a percentage of BHLF's loan portfolio have decreased to about 41% from 47%. Debt outstanding stayed relatively flat in fiscal years 2021 and 2022 before increasing 22% year-over-year in fiscal 2023 with more capital flowing from financial institutions, driving a slight increase in equity relative to assets.

We estimate credit enhancement required for existing loans, as of March 2024, was approximately 19.7% at the 'A+' stress level, an improvement from the approximately 23% loss we assumed in our previous analysis. Our loan 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 jumped to about $215.8 million in fiscal 2023 to help fund new loans that meet BHLF's social mission. Net equity was about 36% of total debt in fiscal 2023, which we view as a neutral rating factor in our analysis and in line with other rated CDFIs. Approximately 11% of BHLF's debt outstanding is fully subordinate with indeterminate maturity dates in the form of EQ2s from local banks and institutions, this percentage is expected to decline with the issuance of the series 2024 bonds. In addition, we think BHLF sufficiently matches its asset and liability terms, including the series 2024 bonds, approximately $53 million in debt service is due by fiscal year-end 2026 while $81 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.

Chart 1

Equity / total assets versus net equity / total assets



Source: S&P Global Ratings.

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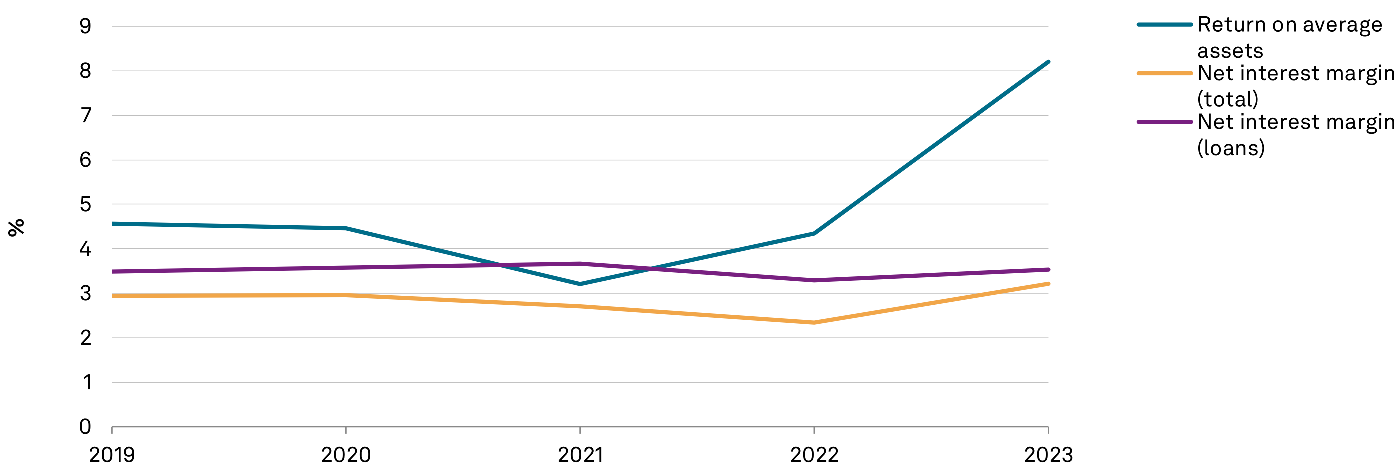
Profitability

BHLF has above-average profitability, in our opinion, with a five-year average ROA of nearly 5.0%, and spike to 8.2% in fiscal 2023, well above our 'A' rating category benchmark. During fiscal 2023, BHLF benefitted from an increase of about $12 million compared with the previous year in revolving loan capital from the donor-restricted credit enhancement through the U.S. Department of Education. A similar jump in ROA occurred in fiscal 2017--this ratio can fluctuate for CDFIs due to changes in the receipt of grants and contributions. Fiscal 2023 also brought an increase in investment income, with interest on cash and cash equivalents increasing to about $2.6 million from about $195,000.

At the same time, the five-year average NIM for loans remained relatively stable at 3.5%, which we view as in line with that of other rated CDFIs. BHLF's NIM for loans strengthened in fiscal 2023 as the increase in its loan interest income doubled the increase in interest expense. The target to cover operating costs is between 2.5% and 3.0%; the interest spread on loans in fiscal 2023 was 4.16%, and about 4.10% as of June 2024. As interest rates on short-term U.S. Treasuries were increasing in fiscal years 2022 and 2023, BHLF used debt issuance to support its spread. Management plans to use those proceeds to finance more loans as needed. According to its 2022-2026 strategic plan, BHLF is exploring ways to increase and develop new sources of fee income to diversify revenue beyond mainly loan interest income.

Chart 2

Profitability metrics



Source: S&P Global Ratings.

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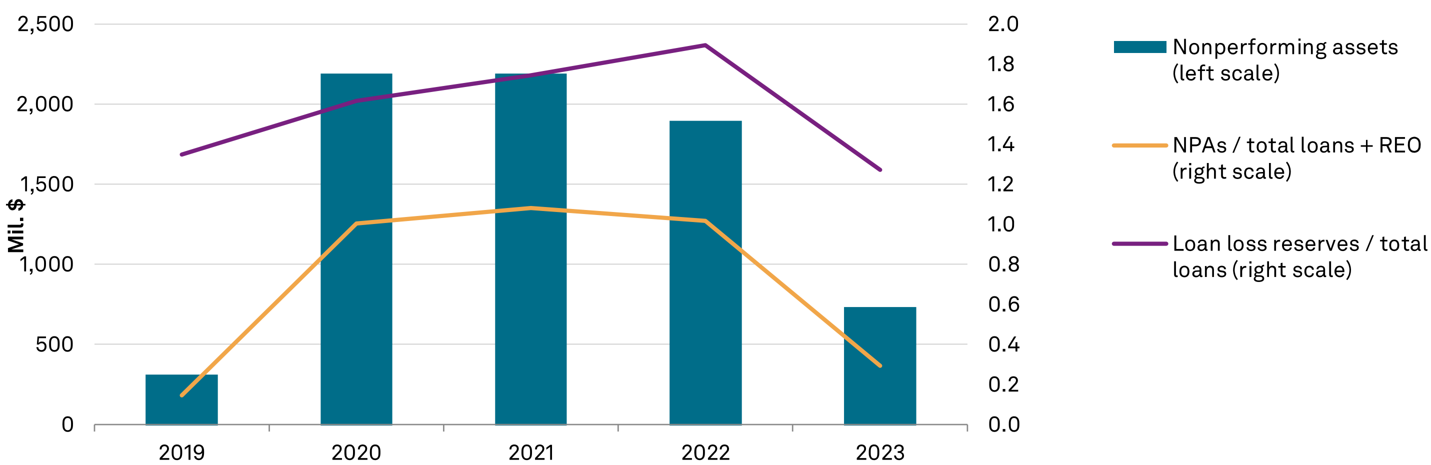
Asset quality

BHLF's total assets reached a new high in fiscal 2023 of about $353.9 million, 22% higher than in fiscal 2022, spurred largely by the loan portfolio expansion. As of March 2024, Massachusetts remained the highest concentration of loans with 20% of the gross balance, but 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 performed very strongly with minimal NPAs during the past five years. Its five-year average NPAs were 0.7% of the loan balance; 0.3% was reported as delinquent past 90 days in fiscal 2023, still below the average among rated CDFIs. BHLF's loan loss reserves are smaller than those of other rated CDFIs, not including the approximately $9.6 million in board-designated net assets for general loan losses. In fiscal 2023, the loan loss reserves were about 1.3% of total loans, below the average among other rated CDFIs. There were no loans that were deemed credit impaired, therefore requiring a troubled debt restructuring, in fiscal 2023; as of June 2024, such loans comprised 0.6% of the portfolio balance. Notably, BHLF's asset quality has remained a strength through its portfolio growth.

Chart 3

Asset quality



NPAs--Nonperforming assets. REO--Real estate owned. Source: S&P Global Ratings.

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Liquidity

BHLF, in our view, has sufficient liquidity to cover short-term financial needs. The influx of grants and loan prepayments in recent years led loans to account for 69% of assets in fiscal 2023, down from 79% in fiscal 2020. Short-term assets were nearly 29% of the balance sheet, which could be used for liquidity purposes. Management plans to draw down cash in the near term for lending activities so we anticipate these ratios will decline during the outlook period. In addition, following the deployment of series 2024 bond proceeds, loans are expected to account for more than 80% of assets, although conversely short-term investments are expected to approach 15% of assets, which would lag that of other rated CDFIs.

As part of its liquidity strategy, BHLF structures financial assets to be available as general expenditures, liabilities, and other obligations come due. By the close of fiscal 2023, there was $35 million in unused lines of credit for loan-capital purposes with an additional $10 million available for capital and operations. As of June 2024, the unused lines of credit totaled $25 million. 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 has had some turnover and new hires in recent years but has continued to execute on its strategic plan and expand its reach in underserved communities. BHLF's current president, hired in July 2023, has experience as a senior leader for a peer CDFI, as well as in the position of chief business officer of a housing finance agency. As BlueHub Capital prepares for the retirement of its former CFO in 2025, it hired a new CFO in Sept. 2024, who brings experience from several organizations over her career--this strategic hiring enables a transition period for the new CFO, which we think can be a strength. BHLF hired a senior vice president of climate lending in August 2024, and BlueHub Capital hired its first chief information officer in October 2024 as it operates with a forward-looking risk mindset.

BHLF's strategic plan fits within its organizational capabilities and expertise, and it is deliberate when committing capital to meet its social mission. Management's ability to resolve difficult situations during its operating history is strong, in our view, 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.

Economy

In our opinion, the diversity of BHLF's loan activity mitigates risks associated with state and local economic trends, particularly given the geographic expansion of its portfolio in recent years beyond its core market in New England and the Northeast. Sector exposure is also relatively diverse, in our view, with housing, charter school, and commercial/manufacturing related loans representing about 42%, 39%, and 8% of the portfolio as of June 2024. In our opinion, lending in larger areas with more-diverse economies is less affected by economic trends than lending in smaller geographic regions.

Table 1

Financial ratio analysis

%	2019	2020	2021	2022	2023	Five-year average
Capital adequacy						
Equity/total assets	27.95	30.56	33.04	35.98	36.94	32.89
Net equity/total assets	13.25	20.19	18.84	22.48	22.16	19.38
Equity/total debt	39.85	45.88	52.00	59.11	60.60	51.49
Net equity/total debt	18.89	30.31	29.65	36.94	36.34	30.43

Table 1

Financial ratio analysis (cont.)

%	2019	2020	2021	2022	2023	Five-year average
Profitability						
Return on average assets	4.56	4.46	3.21	4.34	8.20	4.96
Net interest margin	2.95	2.95	2.70	2.34	3.21	2.83
Net interest margin (MBS [loans] + loans)	3.49	3.57	3.66	3.29	3.53	3.51
Net interest margin (loans)	3.49	3.57	3.66	3.29	3.53	3.51
Asset quality						
NPAs/total loans + REO	0.15	1.00	1.08	1.02	0.29	0.71
Net charge-offs/average NPAs	0.00	0.00	0.00	0.00	0.00	0.00
Loan loss reserves/total loans	1.35	1.62	1.74	1.89	1.27	1.58
Loan loss reserves/NPAs	925.45	161.23	161.23	186.29	434.84	373.81
Net charge-offs/average loans	0.00	0.00	0.00	0.00	0.00	0.00
Liquidity						
Total loans/total assets	80.63	78.84	71.30	62.90	69.31	72.59
Total loan + MBS (loans)/total assets	80.63	78.84	71.30	62.90	69.31	72.59
Short-term investments/total assets	15.54	17.88	25.46	34.58	28.98	24.49
Total investments/total assets	15.54	17.88	25.46	34.58	28.98	24.49

REO--Real estate owned. NPAs--Nonperforming assets. MBS--Mortgage-backed securities.

Table 2

Five-year trend analysis

	2019	2020	2021	2022	2023
Total assets	255,156,204	271,825,520	278,445,233	289,989,268	353,897,293
% change	17.83	6.53	2.44	4.15	22.04
Total debt	178,928,233	181,046,203	176,899,437	176,491,365	215,759,109
% change	20.48	1.18	-2.29	-0.23	22.25
Total equity	71,303,977	83,064,570	91,992,817	104,325,483	130,739,629
% change	17.78	16.49	10.75	13.41	25.32
Total net equity	33,808,128	54,876,357	52,458,181	65,201,924	78,407,090
% change	102.11	62.32	-4.41	24.29	20.25
Revenues	12,601,000	14,108,678	13,470,121	12,417,116	17,145,612
% change	24.83	11.96	-4.53	-7.82	38.08
Expenses	9,533,088	11,014,362	10,209,661	9,735,665	11,542,813
% change	44.77	15.54	-7.31	-4.64	18.56
Net income	10,763,911	11,760,593	8,928,247	12,332,666	26,414,146
% change	61.93	10.64	-9.37	-4.68	7.50
Total gross loan balance	208,535,954	217,832,688	202,053,003	185,924,928	248,430,764
% change	21.32	4.17	-7.36	-8.12	34.47
Nonperforming assets	303,985	2,185,230	2,185,230	1,891,245	726,771
% change	-58.96	618.86	0.00	-13.45	-61.57

Related Research

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

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