Research Update:

HI-C Issuer Trust 'A-' Issuer Credit And Senior Unsecured Ratings Affirmed; Outlook Stable

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Overview

- S&P Global Ratings affirmed its 'A-' issuer credit and senior unsecured issue-level ratings on HI-C Issuer Trust (HIT or the trust), an Ontario-based public-sector funding agency that lends to affordable and social housing providers.
- The ratings reflect HIT's expected purchase of a portfolio of affordable housing loans with the associated increase in projected lending activity in the next two years and the potential support for the trust's weak business position that the purchase brings.
- The stable outlook reflects our view that the expected expansion of the loan book will somewhat strengthen HIT's enterprise risk profile in the next two years as the trust builds its customer base, and that its management becomes more seasoned capital adequacy will remain very strong, and liquidity adequate.

Rating Action

On Feb. 17, 2022, S&P Global Ratings affirmed its 'A-' long-term issuer credit and issue-level ratings on HI-C Issuer Trust (HIT or the trust), a lender to affordable and social housing providers based in the Province of Ontario. The outlook is stable.

Outlook

The stable outlook reflects our expectation that HIT's loan book will expand substantially in 2022 and 2023, strengthening the trust's business position and the enterprise risk profile over our two-year outlook horizon. A larger loan book should improve profitability and lead to a strengthening of the management team and its capabilities. As well, we expect HIT's financial profile will remain strong, bolstered by very strong capital adequacy and adequate liquidity.

Upside scenario

We could raise the rating in the next two years if an expanding customer base and sustained gains in market share lead to a clear improvement in the trust's business position and management capabilities. Improving market share and management capabilities could lead us to re-evaluate HIC's start-up status and put upward pressure on the ratings.

Downside scenario

The failure to expand the loan book in line with issuance plans (and our expectations) in the next two years could call into question the trust's policy mandate and the viability of its business model, leading us to lower our assessment of HIT's business position. Alternatively, if capital adequacy declined and persisted at some substantially lower level or if HIT took on greater transformational risk (such as counterparty or market risk from the use of derivatives), we could lower our ratings.

Rationale

Growth in the loan book in the last two years has been minor and below our expectations. We understand that HIC is in advanced discussions to purchase a portfolio of affordable housing loans of approximately C$200 million. We expect that HIT will complete this transaction in 2022. In addition, the loan book should get a boost from increased loan aggregation activity. We expect that the trust will have access to a new lending facility to finance smaller loan values. We believe the facility will enhance HIT's ability to aggregate, on a volume basis, more smaller loans to affordable housing providers.

We view HIT's enterprise risk profile as adequate based on the trust's strong public-sector industry and country risk assessment (PICRA), weak business position, and moderate management and governance assessment. Like many start-ups, the trust's business position is weak and management and governance is relatively untested despite the management team's considerable experience in the sector. However, despite HIT's slow progress and almost static loan book, we believe the trust's ability to match loan length with project lifespans will be attractive to borrowers and will lead to healthy long-term growth in the loan book and further improvements in the business position and management policies and practices.

We expect HIT's financial risk profile will remain strong, as it has been throughout the trust's short history. Strong capital levels and an absence of transformation risk support our favorable view of capital adequacy. We project HIT's risk-adjusted capital (RAC) ratio after adjustment for concentration to be 36% at year-end 2023. This includes the expected CHF portfolio purchase from the British Columbia government. We assess funding and liquidity as adequate. Canada's stable capital markets are deep and diversified and can handily accommodate the trust's borrowing intentions.

HIT is a public-sector lender that provides long-term funding to affordable housing providers in Canada. It is a limited-purpose trust established in 2018 in Ontario by its parent (or settlor), HPC Housing Investment Corp. (HIC). BC Housing, Manitoba Housing, Housing Services Corp. (HSC; a provincially established corporation that serves Ontario's social housing providers), and Housing Partnership Canada (a cooperative organization that is a forum for the major social and affordable housing providers) founded HIC in 2016. HIT issues long-term bonds and lends the proceeds to affordable housing providers.

Enterprise risk profile: The loan book should expand rapidly in 2022 as the trust acquires a portfolio of affordable housing loans and loan aggregation

activity steps up

- HIT expects substantial growth in its loan book in 2022 as the acquisition of the CHF portfolio is executed and loan aggregation activity increases, which should lead to some improvement in its business position and strengthening of management capabilities.
- The ability to match loan term with project lifespans is HIT's chief competitive advantage, the strength of which is offset somewhat by the trust's start-up status.
- The COVID-19 pandemic has not affected our assessment of the PICRA, which we view as strong.

We assess the trust's PICRA as strong owing to the affordable and social housing sector's low industry risk and leverage levels together with Canada's very strong economic resilience, and the low industry risk of the Canadian banking system. The low industry risk of the social housing sector reflects the effective barriers to entry, minimal risk of substitution, and overall stable trends in growth and margins. Canada's economic resilience has remained strong during the pandemic. The country has high GDP per capita of US$54,400 in 2022 (forecast). Economic growth has resumed following a 5.3% contraction in real GDP in 2020. S&P Global Economics projects real GDP growth will rebound to 5.0% for 2021 and will moderate to a still strong 3.7% in 2022 (see "Economic Outlook Canada Q1 2022: Economy Set To Expand Strongly, COVID-19 And Inflation Risks Remain," published Nov. 29, 2021, on RatingsDirect). As well, we believe the risks to operating a bank in Canada remain low, overall. The Canadian banking sector's low industry risk reflects the country's stable and streamlined regulatory regime and the sector's long-established market structure, dominated by a small number of universal banks with low net fiscal debt and a manageable external profile. Although combined data for the housing sector are sparse, we believe that sectorwide leverage is likely low. However, the sector has high funding needs, in our view, because of high demand for social and affordable housing, some historical constraints in accessing capital, and the unfavorable economics in the supply of social housing.

Despite a weak business position, HIC's public policy mandate is clear-cut. Provincial housing agencies have strong public policy mandates, which stem from their provinces' responsibility for housing under the constitution and the strong demand for affordable and social housing. Because it is their responsibility, provinces provide or support the funding of housing provision, ranging from shelters to affordable home ownership. HIT is the creation of BC Housing, Manitoba Housing, and HSC and derives its public policy mandate from the housing agencies and their provinces. However, HIC is not critical in funding affordable or social housing, because, historically, providers have been able to fund new housing projects using financing from banks and credit unions. Nevertheless, we expect that HIT's role in the social housing sector will become important in time because of the trust's ability to provide funding with terms matched to project lifespans, which should reduce uncertainty, lower costs, and stimulate the provision of new social housing construction. Canada Mortgage and Housing Corp.'s (CMHC) C$20 million credit enhancement fund (CEF), which the trust uses as a first-loss cushion, is early recognition by the federal government that HIT will play an important role in the affordable housing sector. In the same vein, B.C., Manitoba, and Ontario (through their housing agencies) provided seed capital to establish HIC and HIT.

The trust's revenue stability and customer base constrain the business position. HIT made one loan in 2020, followed by another in 2021. The pandemic delayed the completion of projects to which HIT was going to make construction takeout loans. We expect that the purchase of the loan portfolio will go ahead in 2022 and HIT's loan book will increase rapidly, followed by robust growth in 2023. The loan book could also be boosted by increased loan aggregation activity. HIT expects to have access to a lending facility from a major Canadian bond investor in 2022 to fund, on a volume basis, smaller loan values.

We expect that HIT's loan book will continue to expand beyond 2023 because of the attractiveness of its offering. The banks and credit unions, whose lending is typically on relatively short terms (five-seven years) compared with project lifespans of 30-40 years, dominate lending to housing providers. The mismatch of loan terms with project lifespans is problematic for providers because it exposes them to refinancing and interest rate risk and creates uncertainty in the business cases of their projects. We believe HIT will have an advantage in lending to providers because it issues long-term amortizing bonds matched to the lifespan of the projects. The trust expects that its loan book will increase to about C$365 million by the end of 2022 and about C$400 million by the end of 2023. Revenues should rise steadily as the trust builds its loan book. HIT charges a one-time commitment fee and an annual administration fee. It receives administration fees monthly for each loan up until bond maturity. It also earns continuing revenues on the CEF.

Management and the board have considerable sector experience. The CEOs of BC Housing, Manitoba Housing, and HSC together with four independent directors from large housing providers are the directors of HIC's board and the trustees for HIT. BC Housing and Manitoba Housing have seconded staff to HIC. BC Housing and HSC provide underwriting, loan origination, administrative, and clerical services to HIT pursuant to HIT's management agreement with HIC.

We expect that strategic positioning will strengthen in time. Broadly, we expect that HIT will capitalize on its advantages in the length of term of its lending and its status as a lender run by social housing professionals. Risk management practices are conservative: Assets (principally loans) are matched back-to-back with obligations to bondholders. Underwriting standards are conservative. Thanks to the experience of the board and management, the trust has considerable expertise in all facets of social and affordable housing. We do not expect it will be a large organization with depth and breadth across all facets of its operations, but a larger loan book should increase profitability and deepen management capabilities. It should have the ability, as well, to access specialized expertise from BC Housing, Manitoba Housing, and HSC. As it is a small organization, there is some amount of key-man risk, which the experience of the three founders mitigates to a degree.

Financial risk profile: Capital adequacy remains very strong and liquidity adequate

- We project HIT's capital adequacy ratio after adjustment will be 36% at year-end 2023.
- HIT has no transformation risk because assets are matched back-to-back with liabilities.
- Liquidity remains adequate, with some funding concentration.

HIT's RAC ratios are very strong. The two-year ratios before and after adjustment are 50.7% and 36%, respectively, for 2022. They improved on an increase in total adjusted capital (TAC). Portfolio concentration lessened in 2022 as one large loan has fallen out of the lending pipeline and we no longer incorporate it as part of our projections. We believe that the after-concentration ratio should strengthen in the long term as the loan book increases, with more large and midsize loans and with continuing growth in TAC. TAC scales up with each new bond issuance.

TAC consists of the CEF, commitment fees, and a debt service reserve (DSR). The C$20 million CEF is the first-loss cushion against housing loan losses. The CEF remains in place if bonds are outstanding and is not subject to clawback. Borrowers pay a commitment fee to HIT, and those fees are available to absorb loan losses. There is no requirement to return the commitment fees to the borrowers and they can be considered permanent and not subject to clawback. Borrowers, on receiving their loans, establish blocked accounts to hold their DSR amounts. HIT has complete control over the blocked accounts to make payments in case of default and invest in permitted investments. The individual DSRs are sized to equal six months of debt service for each loan. DSR accounts are unblocked, and amounts returned to borrowers upon loan maturity. The DSRs are the first line of defense in the case of nonpayment by borrowers.

Under CMHC's agreement with HIC, CMHC provided a C$20 million CEF. It is held in an escrow account and funds are released to the trust upon the determination that a loan is uncollectible. All amounts allocated from the CEF remain with HIT until loan maturity and cannot be clawed back. The CEF is invested in permitted investments, including federal and provincial government bonds and the bonds of Schedule I banks (subject to minimum rating requirements). Income from these investments is revenue for HIT to be used by the trust at its discretion. The trust pays a facility fee annually to CMHC, which it recovers from the borrowers through an administration fee that HIT charges annually.

We view HIT as a pass-through vehicle between bondholders and providers, similar to U.K. peers. The trust borrows at fixed rates in the domestic market and does not take on any additional risk to transform the proceeds of its funding to the needs of providers, which further bolsters our assessment of HIT's very strong capital adequacy. The trust has no interest or foreign exchange exposure or refinancing risk, as its bonds are amortizing.

HIT provides security to bondholders with a first lien on real property. As security for each loan, each borrower delivers security documents typical for a mortgage loan, including a freehold or leasehold charge/mortgage, general assignment of rents, and general security agreement. Trustees and directors have the power under the declaration and management agreement to exercise all rights under loan agreements, including foreclosure.

Overall, we assess HIT's funding and liquidity profile as adequate. Canada's deep and diversified capital markets are very large in relation to HIT's funding needs, and we believe that the trust has unfettered access to them. Building liquidity in the secondary market is crucial to lower borrowing costs, so we expect that HIT will issue only plain vanilla, 30-year or 40-year amortizing bonds in the domestic market. We expect the investor base will increasingly diversify. We believe that the structural stability of the trust's funding commitments relative to its lending commitments is good. If, for some reason, the trust cannot fund its lending plan in the market, it will not lend to providers. Funding diversification is likely to be lower than that of some peers due to HIT's expected concentration in the Canadian bond market. All of the trust's loans and bond payment obligations are long-dated. The five-year funding ratio increased modestly to 1.10x in 2022. Funding and liquidity ratios are supported by the back-to-back matching of assets with liabilities. Accordingly, we expect HIT to maintain adequate funding and liquidity. We expect liquidity ratios will be 1.0x or higher in 2022.

Table 1

HI-C Issuer Trust -- Financial Statistics

	--Year ended December 31--	
Mil. (C$)	**2020**	**2019**
Business position		
Total assets	33.45	33.69
Gross receivables	32.12	32.49
Growth in loans (%)	N.M.	N.M.
Interest revenues	1.48	1.29

Table 1

HI-C Issuer Trust -- Financial Statistics (cont.)

	--Year ended December 31--	
Mil. (C$)	**2020**	**2019**
Noninterest expenses	0.70	0.81
Capital and risk position		
Total liabilities	35.67	35.63
Total adjusted capital	(2.22)	(1.93)
Assets/capital	N.M.	N.M.
RAC ratio before diversification (%)	N.M.	N.M.
RAC ratio after diversification (%)	N.M.	N.M.
Gross nonperforming assets/gross loans	N/A	N/A
Common + preferred dividends/net income (%)	N/A	N/A
Funding and liquidity		
Liquidity ratio with loan disbursement (one year)	N.M.	N.M.
Liquidity ratio without loan disbursement(one year)	N.M.	N.M.
Funding ratio (one year)	N.M.	N.M.

RAC--Risk-adjusted capital. N/A--Not applicable. N.M.--Not meaningful.

Ratings Score Snapshot

Table 2

HI-C Issuer Trust -- Ratings Score Snapshot

Issuer Credit Rating	A-/Stable/--
SACP	a-
Enterprise Risk Profile	Adequate (3)
PICRA	Strong (2)
Business Position	Weak (5)
Management & Governance	Moderate (4)
Financial Risk Profile	Strong (2)
Capital Adequacy	Very Strong (1)
Funding	Neutral
Liquidity	Adequate (3)
Support	0
GRE Support	0
Group Support	0
Additional Factors	(-1)

PICRA--Public-sector and industry country risk assessment.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | International Public Finance: Public-Sector Funding Agencies: Methodology And Assumptions, May 22, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

Related Research

- Social Housing Outlook 2022: Green Agenda Takes Root In Investment Plans, Nov. 23, 2021
- Global Regulatory Framework Report Card: Public And Nonprofit Social Housing Providers, June 8, 2021
- Global Social Housing Ratings Score Snapshot: December 2020, Dec. 10, 2020
- Global Social Housing Ratings Risk Indicators: December 2020, Dec. 10, 2020
- Outlook 2021: Strong Liquidity Should Help Social Housing Providers Remain Resilient, Dec. 8, 2020

Ratings List

Ratings Affirmed	
HI-C Issuer Trust	
Issuer Credit Rating	A-/Stable/--
Senior Unsecured	A-

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.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.

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