
Fitch Ratings Rates Century Housing Corp., CA $100MM Rev Bonds 'AA'; Stable Outlook

Fitch Ratings – New York – 17 Jun 2020: Fitch Ratings has assigned a ‘AA’ Issuer Default Rating (IDR) with a Stable Rating Outlook to Century Housing Corporation (Century Housing or the CDFI). At the same time, Fitch assigned a ‘AA’ rating to the California Municipal Finance Authority Taxable Bonds, Series 2020 (Century Housing Corporation) (Sustainability Bonds) with a Stable Rating Outlook.

SECURITY

The Series 2020 Bonds are general obligations of Century Housing payable from all legally available revenues and assets of Century Housing. The proceeds of the Series 2020 Sustainability Bonds will be used to refinance certain existing obligations that principally financed loans made by Century Housing related to the development of affordable multi-family rental housing. Series 2020 bonds will be issued in an amount of $50 million up to $100 million with two-year and three-year tenors with the possibility of 10- to 20-year tenors depending on pricing available at the time of issuance.

KEY RATING DRIVERS

Century Housing Corporation’s rating reflects ongoing and continued demand for multifamily affordable housing within the state of California. In addition, Century Housing Corporation exhibits growing operating revenue and cash flow derived from its lending products, grants and other sources of investment income. Century Housing Corporation’s strong management of operations is evidenced by its solid financial performance and its good standing with the federal oversight provided by the Department of Treasury’s Community Development Financial Institution (CDFI) Fund, evidenced by its continued certification as a CDFI.

Revenue Defensibility: Stronger

Since 2014, Century Housing Corporation has shifted its lending operations from a commercial bank reliant Community Development Finance Institution (CDFI) to include a more robust lending operation using bonds which while maintaining their overall total assets well above their total liabilities. Century Housing’s demand is evident by the average increase in mortgage loans of 34% since 2015. The increase in Century Housing’s asset base is primarily due to affordable housing mortgage loans that the CDFI makes from the predevelopment to permanent phase financing of multifamily affordable housing. Century Housing operates in the State of California where there is a significant shortage in affordable housing units. When assessing the history of Century Housing Corporation over a span from 2006-2019, the CDFI’s overall financial position changed positively yoy to meet the demand of the affordable housing gap within the state. In the event of a future downturn in the national economy and the state’s economic position, the demand for Century Housing’s loan products become stronger.

Operating Risk: Stronger

Fitch's analysis considers the entity's operating profile, including predictability and volatility of costs, life-cycle/capital renewal risks, key resource cost risks and the ability to manage growth in costs over time. Century Housing Corporation's strong operating risk profile is evidenced by its overall positive financial performance, the high quality of its assets, with limited delinquencies and predictability in its interest income from loans. In addition, the overall demand for its products contributes to the growing income statement of the CDFI. Century Housing exhibits sophisticated and prudent risk management as it relates to their overall lending activity and liabilities. The CDFI has taken on debt in a prudent way to fulfill its mission. While Century Housing's leverage position is shifting based on new debt liabilities, this is directly correlated to how active their programs have become. In the wake of a more aggressive lending platform, the CDFI has issued debt without impacting its overall financial position and operating flexibility.

Financial Profile: Stronger

A criteria variation was made to the financial profile analysis by focusing on CDFI's debt-to-equity as the key metric for evaluating leverage and comparing it with other affordable housing lending organizations. Century Housing has recorded increases in several key ratios across its financial profile over the past five years (FY 2015-2019). The CDFI's total assets continue to grow; however, at the same time, the liabilities are growing as they issue debt to add new high quality assets to the balance sheet. Despite the growth in their liabilities, Century Housing's debt-to-equity ratio is strong at 1.1x, compared with the typical range of 0.0x-7.0x range for housing issuers rated in the 'AA' category.

Asymmetric Risk Additive Considerations

Asymmetric risk factors are neutral to the rating. Debt characteristics are manageable with level debt service payments with the ability to prepay debt early with high quality assets and repayment on predevelopment loans. In addition, the governing body is solid with sound extensive experience and stability.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

–Strengthened financial performance reflected in positive trends in financial ratios over a sustained period of time could have a positive impact on the rating;

–Century Housing Corporation's leverage position is strengthened by stronger asset quality yielding a greater percentage of net assets to total debt as well as a decline in its debt-to equity ratio.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

–The rating is sensitive to deterioration in Century Housing Corporation financial performance with a debt-to-equity ratio increasing to above 7x;

–Should Century Housing's revenue-generating programs, such as the short-term variable rate mortgage loans, show a major decline in interest earnings and fees the CDFI's assets and overall financial position may result in negative pressure on the rating;

–Though remote, given the current levels of total assets to total liabilities, the rating is also sensitive to potential loss in revenue producing assets, mainly mortgage loans for multifamily program losses. High levels of mortgage loan delinquency coupled with higher losses on income from investments and a reduction in grants that fall upon the corporation's revenue producing assets-to-total debt could strain the rating.

BEST/WORST CASE RATING SCENARIO

International scale credit ratings of Public Finance issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

CREDIT PROFILE

Century Housing Corporation is a mission-driven Community Development Financial Institution (CDFI) supporting quality affordable home development throughout California. With offices in Culver City and Oakland, Century provides end-to-end financing from predevelopment to permanent loans. Century Housing also serves as a reliable partner to state and local agencies, municipalities and other CDFIs in pioneering aggressive financing programs like the Golden State Acquisition Fund and L.A. County Housing Innovation Fund.

Century Housing finances affordable housing developments throughout California. From acquisition loans to bridge and construction loans, Century Housing has worked for more than 20 years to provide tax-credit developers and infill developers with loan solutions.

From its beginnings as a state agency and through the past 25 years of service as a private nonprofit, Century Housing's work has resulted in more than $1.9 billion in financing for over 42,000 new affordable and workforce homes, more than $600 million in capital under management, and nearly 4,700 construction jobs created in 2019 alone.

Revenue Defensibility

Since becoming privatized in the mid-90s, Century Housing has financed more than 43,000 affordable apartment homes with more than $1.9 billion in loan. Despite this, California's shortage of affordable housing persists. While no state has an adequate supply of affordable rental housing for the lowest income renters, the state of California has the most severe gap according to the National Low Income Housing Coalition, having less than the national level of affordable and available units per 100 households at or below the extremely low income threshold. California tops the list as of March 2020 with a deficit of 998,613 units for individuals at or below extremely low income threshold; this translates to about 26 available units per 100 households. The two metropolitan areas with the most severe deficit and demand for affordable housing are Los Angeles and San Francisco and the surrounding counties. Los Angeles' deficit of 377,117 translates to 20 available units per 100 households while San Francisco-Oakland area's deficit of 126,164 translates to 32 available units per 100 households.

There is strong demand across the state of California for affordable housing and Century Housing's competitive position is tied specifically to the types of products available to affordable housing providers along with its partnerships with other state and local agencies as well as non-profits that provide the same. The growth in Century Housing's asset base over the past five years demonstrates that they are responding to the overwhelming demand.

Affordable housing providers in general are price takers, which is the nature of their mission and lending model. The sophistication of Century Housing and its revenue generating assets is a key factor to offsetting the pricing characteristics. The variety of loan products, partnerships and investments are important to the overall model for the CDFI. Century Housing has an asset base made primarily of mortgage loans. The average net Interest spread, from 2015-2020 is 65%, which means that the nominal average difference between its borrowing and lending rates is strong. The spread is the difference between the average rates earned on assets minus the average rate paid on liabilities. This indicates that while they are price takers increasing their liabilities, they are making more on their low interest rate loan products than they pay for their overall liabilities. In 2019, Century Housing's total assets were $475 million — the highest over the five year period and as far back as 2006. Of this asset base $322 million were made up of mortgage loans. On average, (2015-2019) Century Housing's mortgage loan interest income was $16 million while the average interest expense during the same time period was $5 million.

Operating Risk

Century Housing Corporation has created a model to fulfill their mission that does not impede on their ability to operate. The fi-e year average of net operating revenue as a percentage of total revenues is 46%, which is an indicator of the CDFI's profitability. Century Housing's cost burden is low; creating flexibility in operations that contributes to positive margins. On a five-year average, Century Housing's operating revenue averaged $22 million while total operating expense during the same time period averaged $13 million.

Century Housing Corporation's net operating income on average is $9 million. In 2019, the CDFI's total operating revenue totaled $31 million while its expenses totaled $18 million and net operating income was $13 million. This is particularly strong considering Century Housing has taken on more debt in the last five years and still maintains a significant profitability margin. This is largely because the approach has been to tie the recent debt 1-1 to new mortgage assets creating a pass through concept.

Century Housing Corporation has a leverage model that they employ to account for annual volatility to cover at least three years of losses on the loan portfolio as well as its investments. In addition, while the CDFI's assets are mainly made up of mortgage loans they covenant that at all times 75% of the portfolio is made up of first lien mortgages. To date, the corporation has not added second lien mortgages to their portfolio above 10%, despite the 25% cap on those products. Lastly, the CDFI has maintained its sustainable revenue model of mortgage and investment income. They have experienced over the last five years extremely low delinquencies with the average current loans between 2016 and first quarter 2020 being 96.24%.

Financial Profile

Century Housing Corporation has four major components of income: Lending Operations, Investment Portfolio of Marketable Securities, Contingent Assets (which have no liabilities tied to them) and Grants. Year-over-year, the corporation's total assets increased on average by 17% at the same time total liabilities on average increased by 27%. However, over the previous five years the liabilities are about 50% less than total assets, creating a well-managed and stable leverage profile while at the same time growing the balance sheet with new assets derived from short-term bond liabilities.

Century has grown its balance sheet with new assets added by issuing debt and originating mortgage loans. The debt in most instances is short term in nature and is conterminous with the mortgage loans that are originated from it. Century Housing's debt obligations are also comprised of low interest rate notes payables and draws on lines of credit from Federal Home Loan Bank, Wells Fargo, US Bank and other local lending institutions. In 2019, Century issued $100 million of bonds for housing lending activities (a portion to be refunded by the current issue) and had a total of $240 Million in outstanding debt.

Century Housing's total cash, cash equivalents at the end of 2019 was $147 million all of which is available for debt service. As Century Housing increased its net liabilities, the CDFI's total mortgage loan interest income increased from $10.1 million in 2015 to $26.6 million in 2019. At the same time, Century Housing's interest expense from amortizing debt increased from $2 million in 2015 to $10 million in 2019. On a five-year average, the ratio of interest- expense to interest-income is 30%. Century Housing's mortgage assets are 68% of total assets, generating more than half of the organization's revenue. Average net operating income after servicing its debt is $11 Million, with 2019 being the highest ending at $13 million.

There are four components to Century Housing's revenue sources. Mortgage loan interest income made up 42% of operating revenue in 2019 and averaged 33% from 2015-2019. The total investment interest income made up 3% in 2019 and averaged 5% during the same five-year period. The remaining operating revenue is derived from grants and off balance sheet income from single family and multifamily properties.

Asset quality is important to the CDFI's lending platform. While loan losses from delinquencies and real estate owned (REO) can often occur with the portfolio, over the past five years Century Housing has, on average, maintained 96% of its loans in a current position. This demonstrates strong asset quality with only 4% of the loans having experienced 30+ days delinquent. In addition, the CDFI has demonstrated that the REOs they do experience from properties in their portfolio are quickly divested to maximize the value of Century furthermore creating more funding sources to contribute to its lending platform. The largest amount the agency was potentially subjected to over the last five years was $14 million in delinquencies at December 2019, which declined by 71% in the first quarter of 2020, with only $4 million in delinquencies as of March 31, 2020.

While income from interest and dividends remains fairly stable year to year, realized and unrealized gain and loss can be volatile, because of the portfolio's inclusion of allocations to equities and high yield bonds. Historically these investments have provided a sufficient long term rate of return to justify the investment of such a significant proportion of assets but they do expose the portfolio to volatility. Century Housing's low leverage and high liquidity have enabled it to weather annual volatility. Further, it has demonstrated its commitment to adjust the asset allocation of its investments continually to reduce volatility (and with it, expected return) as it increases leverage and/or confronts other risks over time. The effects of this de-risking of the asset allocation can be seen in the portfolio's relative performance during the market volatility associated with the current coronavirus pandemic. Century Housing's marketable securities were affected from the market conditions with a loss of $10.7 million (a 10% decline) in March, at the beginning of April the losses declined to $8 million (7% decline) and declined even further to $3 million (2.7% decline). As of June 5, 2020, Century Housing's investment portfolio regained all of its losses that it experienced to date.

Century Housing does maintain contingent assets without liabilities that are off balance sheet; however, revenue derived from these assets is made available and placed into overall revenue for the CDFI. Predicting the timing of pay offs from Century Housing's off balance sheet portfolio of contingent assets and residual receipt loans is difficult, and the CDFI does not depend on these assets for operations. While the assets are off balance sheet, Century Housing expects a significant proportion of the $103.1 million value of this portfolio ($62.7 million principal balance plus $40.4 million of accrued interest) to pay off in the next six years as these loan assets reach maturity. In 2019, Century realized $0.7 million in revenue from this off balance sheet portfolio and realized another pay off of $7.7 million in second quarter 2020.

Lastly, as with most non-profit organizations, grant revenue cannot be forecast with certainty. Century Housing's experience to date in applying for Department of Treasury CDFI Fund Capital Magnet Fund (CMF) and Financial Assistance (FA) grants has been positive; it received awards in all but one round of funding applied for, resulting in a cumulative grant total of $22.4 million through the first quarter of 2020. While continuing grant awards are not assured, some level of future grant income is probable. In 2019 the CDFI received $7.5 million in Capital Magnet Fund and $0.7 million in Financial Assistance grant proceeds plus an additional $0.3 million in contributions. Century Housing received an additional Capital Magnet Fund award of $4.8 million in May of 2020.

Asymmetric Risk Additive Considerations

Century Housing's debt characteristics are neutral to the rating given the type of debt outstanding as of 2019, including the issuance of the Series 2020 sustainability bonds. During 2019, the Corporation issued Century Housing Impact Investment Bonds, Taxable Series 2019 in the principal amount of $100,000,000 pursuant to the terms of an Indenture of Trust, dated as of Jan. 1, 2019, with the BNY Mellon as trustee. The Bonds are a general obligation of Century Housing payable from all legally available revenues and assets of Century. The proceeds were used to refinance existing obligations and finance loans related to the development of multi-family affordable housing. The bonds were issued in tranches, wherein $50 million, $40 million and $10 million bear interest rates of 3.824%, 3.995% and 4.148%, respectively, and have maturity dates of Nov. 1, 2020, Nov. 1, 2021 and Nov. 1, 2023, respectively. Interest incurred during 2019 was $3,532,320. Debt issuance costs are being amortized to interest expense over the term of the bonds.

Additionally, Century Housing's Series 2020 (Sustainability Bonds) will be issued in an amount up to $100 million to refinance certain existing obligations which principally financed loans made by Century Housing related to the development of multi-family rental housing in furtherance of Century Housing's goals to provide secure and affordable housing for families and individuals of modest means. A portion of the Series 2020 bonds will be used to refund $50 million of 2019 outstanding bonds. The bonds will have semi-annual interest payment dates of May 1 and Nov. 1 commencing Nov. 1, 2020. The bonds are expected to consist of term bonds due Nov. 1, 2022 and 2023 and may include some longer tenors, as well. The Series 2020 bonds are subject to optional redemptions in full and in part from prepayment of loan payments by the borrowers unless such bonds shall be deemed to have been paid in full. Fitch analyzed this debt issuance assuming $75 million with a three-year maturity and potential for a 20-year maturity for $25 million.

Century Housing is a well governed organization with experienced management and a nine member board with a variety of backgrounds in and around California. In addition, Century has an eleven member executive team all of which many have significant experience in affordable housing development and lending at Century Housing or other mission driven organizations.

Century Housing has a leverage model that allows them to determine what the expected increase in leverage will be over the next few years with increasing loan asset volume; the annual rate of increase should reduce over time. Fitch analyzed the financial statements dating back to 2006 when Century Housing was completely unlevered (except for a $2.8 million mortgage on Century's headquarters building). Century Housing provided Fitch with a leverage model that includes input ranges for stress testing scenarios based on the scenario analysis concept defined in Fitch's Public Sector, Revenue-Supported Entities Rating Criteria. Century does not anticipate that leverage will exceed 2.5x to 1.0x. Century Housing's revenue producing assets-to-debt was 1.9x in 2019 while the debt-to-cash available for debt Service, including the Series 2020 bonds, is 1.9x.

Century Housing is certified by the Community Development Finance Institutions Fund (a division of the Department of Treasury).

Century Housing's continuing disclosure includes audited financial statements and operating statistics for each fiscal year. In addition, they complete an annual report. These reports are complete timely and are made publicly available on their website dating back to 2006.

CRITERIA VARIATION
Variation from Published Criteria

The analysis includes a variation from the Rating Criteria for Public-Sector, Revenue-Supported Debt. As Century Housing is rated solely using the master criteria, Fitch determined the most appropriate comparability is with State Housing Finance Agencies, as these are also affordable housing lending. As such, Fitch has utilized debt to equity as the key metric in the financial analysis, as it is the most relevant for affordable housing lending organizations. Fitch has referred to other rated affordable housing lending organization for peer comparison. Century Housing's debt-to-equity ratio of 1.1x, compares favorably with the 0.0x-7.0x range for housing issuers rated in the 'AA' category.

DATE OF RELEVANT COMMITTEE
11 June 2020

In addition to the sources of information identified in Fitch's applicable criteria specified below, this action was informed by information from Century Housing Corporation.

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