S&P Global Ratings

RatingsDirect®

Century Housing Corp., California; General Obligation

Primary Credit Analyst:
Jose M Cruz, San Francisco + 1 (415) 371 5053; jose.m.cruz@spglobal.com

Secondary Contact:
Alan Bonilla, San Francisco + 1 (415) 371 5021; alan.bonilla@spglobal.com

Table Of Contents

Century Housing Corp., California; General Obligation

Credit Profile		
US$50.0 mil Century Sustainable Impact Nts		
Long Term Rating	AA-/Stable	New
Century Hsg Corp ICR		
Long Term Rating	AA-/Stable	Affirmed
California Municipal Finance Authority, California		
Century Hsg Corp, California		
California Municipal Finance Authority (Century Hsg Corp) Sustainabilty Bonds		
Long Term Rating	AA-/Stable	Affirmed

Rating Action

S&P Global Ratings assigned its 'AA-' long-term rating to Century Housing Corp. (Century), Calif.'s series 2020 sustainable impact notes. At the same time, we affirmed our 'AA-' rating on Century's series 2019 and 2020 bonds, and our 'AA-' issuer credit rating (ICR) on Century. The outlook is stable.

Century plans to issue up to approximately $50 million in fixed-rate notes to refinance its existing debt facilities. Note proceeds could also be used to originate affordable multifamily housing loans in California, in pursuit of Century's mission in expanding affordable housing.

Credit overview

The 'AA-' ratings reflect our view of Century's continued very strong operating performance, equity base, and overall management. We believe that at the 'AA-' rating level, Century has sufficient equity to cover projected loan losses. Compared with those of rated peers, Century's equity ratios are very strong and above the medians. Furthermore, we believe Century's experienced management team has demonstrated its proactive strategy to grow profitability, increase the corporation's capital, and mitigate loan losses.

Partially offsetting Century's strengths are its operation and lending activity, which we view as higher risk compared with those of other community development financial institutions (CDFIs) in the 'AA' rating category. Century participates in multifamily housing lending, with its loan portfolio primarily in short-term acquisition, bridge, predevelopment, and construction loans (early-financing loans). We view these loans as inherently riskier than long-term or permanent loans due to greater exposure to repayment and takeout risk. Century's loan portfolio consists primarily of early-financing loans, which exposes Century to higher loan-loss risk compared with that of other rated peers.

The ratings reflect our view of Century's:

- Very strong equity ratios and available capital to absorb loan losses and various loan-loss stress scenarios;

- Financially self-sufficient business model, evidenced by very strong return on average assets (ROA), and a net interest margin ratio that is strongest among those of rated peers; and
- Very strong investments position that is core to Century's operations, with approximately $109 million, as of June 30, 2020. However, with an investment allocation that we view as aggressive, which includes equities and speculative-grade debt, we believe Century could be exposed to greater risk compared with that of rated peers.

Offsetting these strengths, in our view, are the following weaknesses:

- A loan portfolio containing primarily early-financing loans, which could result in higher repayment and takeout risk compared with other rated CDFIs; and
- A negative trend in asset quality over the past two fiscal years, driven by increases in nonperforming assets (NPAs).

The stable outlook reflects our view of Century's experienced leadership and management as well as its strategy of mitigating financial risk and maximizing opportunity for a variety of communities. Century's total-equity-to-assets ratio is well above medians of rated peers. We attribute this to Century's capital strategy of low leverage (albeit increasing over the past year, but still commensurate with the rating) and high liquidity, and use of its investments for reserves, liquidity, and operations if required.

Environmental, social, and governance (ESG) factors

We have analyzed Century's ESG risks relative to its ICR in terms of economic fundamentals, financial performance, asset quality, and strategy and management, and determined that all are in line with our view of the sector standard. We believe that health and safety social risks exist related to the COVID-19 pandemic. We consider the environmental and governance risks generally to be in line with those of the sector as a whole. Measures taken to prevent the spread of COVID-19, such as social distancing and the closing of nonessential businesses, have led to a spike in unemployment and the higher likelihood of nonpayment of rent and mortgages as well as a delay in housing construction projects. This could create a liquidity crunch for some issuers in the sector, and, in our view, elevate the social risk in the near term. We will continue to monitor developments and the effects of COVID-19 as a health and safety social risk under our ESG factors by updating assumptions and stress tests as we gain more information related to the evolving situation and stimulus-package provisions, and through ongoing discussions with management. We also analyzed Century's governance and environmental risks and determined that they are in line with our view of the sector standard. However, Century's projects are all in California, which presents heightened seismic and wildfire risk.

Stable Outlook

Downside scenario

In recent years, substantial loan portfolio growth for CDFIs has outpaced the growth in equity, leading to decreasing equity-over-assets ratios. As we do for other CDFIs, we recognize Century's negative trend on its equity-over-assets ratio and a reduction in its capital adequacy level as a result of Century's increasing debt burden. If Century experiences a significant reduction in capital adequacy due to increased debt or declining loan performance, we could lower the ratings. Loan deterioration, or a significant decline in revenues that compose some portion of net income, could also result in lower ratings.

Upside scenario

Conversely, if Century continues to improve its profitability ratios, resulting in continued growth in net assets, as well as preserving strong capital available to absorb loan losses in the most stressful scenario, we could take a positive rating action. Furthermore, we could take a positive rating action if Century's loan portfolio shifts to loans that we view as less risky (e.g., long-term and permanent loans), resulting in lower assumed loan losses.

Credit Opinion

Financial Strength

Capital adequacy

Century maintains very strong equity ratios driven by its highly capitalized position, low debt levels, and continued profitability. Total equity grew at a steady pace of 46.7% over the past five years, and Century's five-year average equity-to-assets ratio of 53.4% is very strong compared with the median ratio of 34.2%. While its equity-to-assets ratio has declined over the last five years (to 46.57% in 2019 from 60.88% in 2015)--primarily due to increased leverage--Century's lowest equity ratio of 46.57% in 2019 is still well above the median peer ratio.

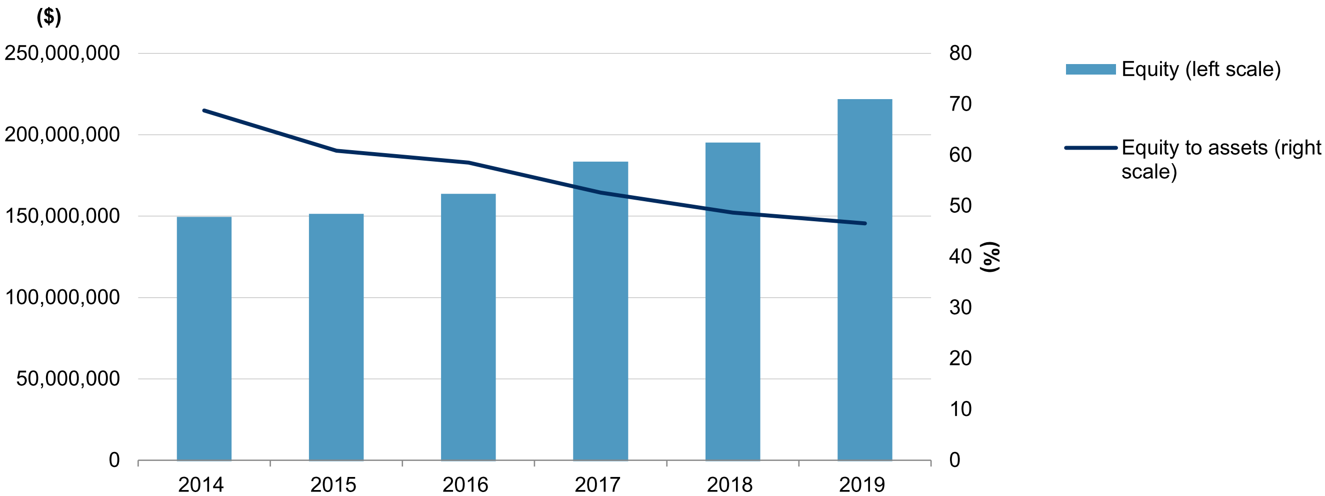
Century's investments also contribute to its very strong equity position. Unique compared with our other rated CDFIs, Century's investments are core to its capital strategy, used for reserves, liquidity, and operations if required. Century's investments grew 30.4% over the past five years, and its five-year average total-investments-to-total-assets ratio of 33.51% is above the 13.7% median ratio of its rated peers. Century's policies mandate it to maintain at least 20% of consolidated net assets in investments (in fiscal 2019, Century's investments to net assets was 58%)--reflecting the importance of investments in its capital strategy.

Century's investment policies are, in our view, focused on growth, which exposes the corporation to additional risk, unlike those of similar institutions and agencies. Partially mitigating Century's aggressive investment strategy is a recent adjustment to its investment allocations. Century's updated investments portfolio contains approximately 29% in equities (compared with 34% as per its previous policy) and 71% in fixed assets (compared with 66% as per its previous policy). Furthermore, Century can monetize its investments within 30 days. However, as of June 30, 2020, the corporation holds approximately 8% of its investments in non-U.S. equities, and approximately 11% in high-yield bonds--which in our view exposes Century to greater risk compared with its rated peers.

Due to the stock market downturn beginning March 2020, Century's investments portfolio suffered unrealized losses. According to management, the derisking of its investment portfolio mitigated some of the losses due to market volatility.

Chart 1

Century Housing Corp., Calif.--Equity



Source: S&P Global Ratings.

Our view of Century's debt position is very strong. In fiscal 2019, the housing corporation had approximately $247 million in debt outstanding, up 22% from fiscal 2018. Growth in liabilities reflects Century's asset growth over the past five years, although an increase in liabilities outpaced asset growth. Borrowing seems to have stabilized in fiscal 2019 and 2018, with 22% and 24% year-over-year increase, respectively, compared with a 42% increase in debt in fiscal 2017 from fiscal 2016. Century's recent debt activity includes the issuances of the $100 million series 2019 and $85 million series 2020 bonds. The series 2020 notes will refund portions of Century's existing debt obligations.

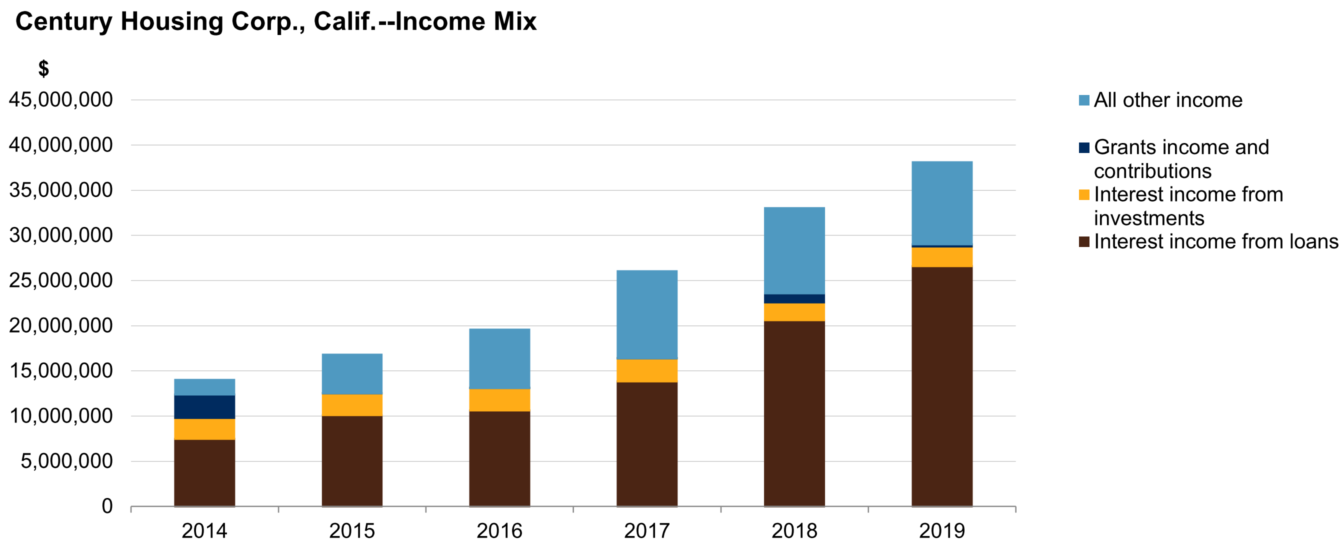
Century's debt profile consists of predominantly fixed-rate debt. As of June 30, 2020, approximately 83% of Century's debt is fixed rate, and 69% of total debt is rated bond obligations. Variable-rate debt makes up approximately 15% of Century's debt, which declined from 37% in fiscal 2019 and 71% in fiscal 2018. The proceeds from the 2019 and 2020 bonds refunded Century's previous variable-rate obligations, lowering its floating-rate exposure to 15%. Furthermore, Century lowered its borrowing rate for its variable-rate line of credit.

While the corporation's debt profile converted to primarily fixed-rate debt in recent years, it lends primarily variable-rate loans. In our view, interest-rate risk is mitigated by the structure of the loans, which includes a fixed-rate spread in addition to LIBOR.

Profitability

In our opinion, Century's operating performance is very strong, reflected through its profitability and self-sufficient business model with minimal reliance on grants income. In fiscal 2019, net income increased 128.6% from fiscal 2018. The growth is primarily driven by realized and unrealized gains on financial investments. Excluding realized and unrealized gains on financial investments, Century's profitability is very strong compared with that of peers, with its five-year average 3.9% ROA well above the 2.5% median of rated peers. Furthermore, Century's lending program is very profitable compared with that of peers, demonstrated by its five-year average net-interest-margin-from-loans ratio of 5.4%, which is above the 3.9% median ratio.

Chart 2



Source: S&P Global Ratings.

Asset quality

The majority of Century's total assets consist of its housing lending portfolio (70.4%). Its niche in the housing market is to provide early financing multifamily loans to repeat clients in California. Century offers acquisition, bridge, construction, predevelopment, and more recently permanent financing, and its loan portfolio comprises projects located in California, with approximately 70% of borrowers maintaining past relationships with Century.

Century's total loan portfolio consists of primarily early financing loans, which we view as riskier than permanent loans. As of September 2020, Century's early financing loans represented 95% of total loans outstanding, with the majority in acquisition loans. According to our rental housing bonds criteria, we assess the risk associated with Century's loan portfolio based on loan characteristics. We view early financing loans as riskier than permanent loans due to greater exposure to repayment and takeout risks. S&P Global Ratings' potential loan-loss assumptions estimated at approximately 12% at the 'AA-' rating category stress level. Pressuring its equity by applying our assumed loan losses to Century's net total loans of approximately $322 million results in a net-equity ratio of 36.16%, which we consider very strong compared with the 12.4% median ratio of rated peers.

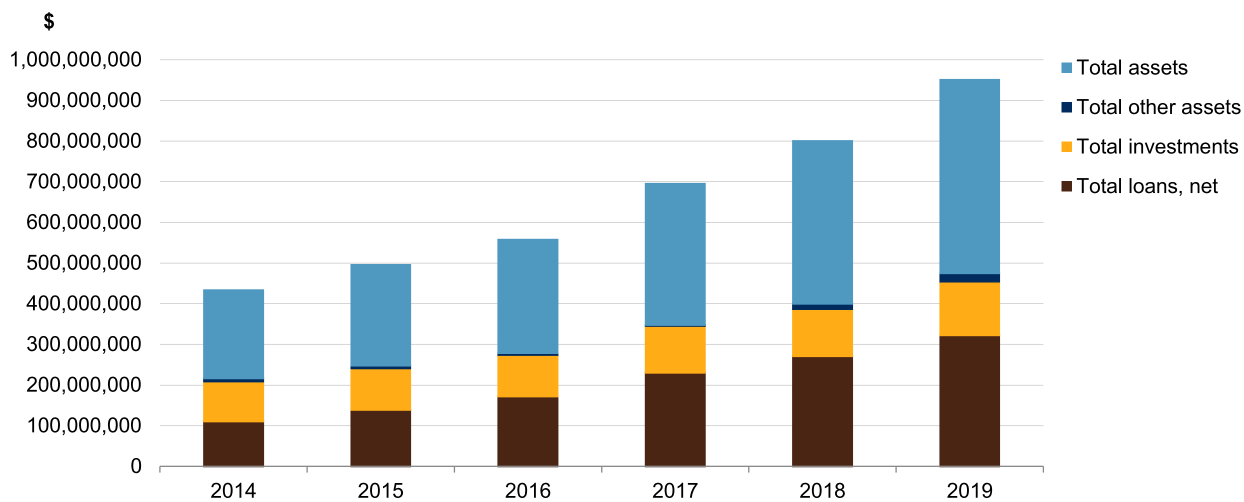
Century's loans have generally exhibited very strong performance throughout its history. Over the past five years, the corporation's average ratio of NPAs to total loans outstanding is 2.54%. However, while Century historically demonstrated very strong loan performance, fiscal 2018 and 2019 NPAs-to-total-assets ratio grew to 3.91% and 5.58%, respectively, driven by a loan in forbearance. As of September 2020, Century's NPAs-to-total-assets ratio improved to 1.00%. Furthermore, Century's loan-loss-reserves-to-NPAs ratio also decreased in 2019 to 25.17% from 34.48% in

2018. We believe Century's highly capitalized position, with equity of approximately $221 million, and equity-to-assets ratio of 46.57% offset occasional pressure on its loan portfolio performance. However, while the corporation has maintained very strong loan performance over the years, the NPA in 2018 and 2019 demonstrated that a poor performance of one loan could severely affect its asset quality.

We view Century's loan underwriting and monitoring policies as sufficient, reflected by low NPAs throughout its history. Its underwriting policy consists of identifying key risks (e.g. takeout risk, construction risk, interest-rate risk, etc.), and applying risk ratings on the borrower and project (e.g. borrower's experience, past relationship with Century, financial strength and leverage, etc.). Century also performs a loan review in its underwriting, which analyzes the proposed project, site characteristics, market analysis, and third-party reports. Loan monitoring is performed at least semiannually. While we view Century's loan underwriting and monitoring policies as less robust than those of its rated peers, its experienced team has successfully managed loan performance, as evidenced by very low NPAs.

Chart 3

Century Housing Corp, Calif.--Asset Base



Source: S&P Global Ratings.

Liquidity

Century maintains very strong liquidity, with a five-year average of short-term investments to total assets of approximately 33.5%. Short-term investments over total assets was 27.9% in fiscal 2019, down from 29.1% in fiscal 2018. Total loans to total assets was 70.4% in fiscal 2019, and five-year average was 67.2%. These levels are above the median of other CDFIs in that rating category.

Management, legislative mandate or federal designation

Century originated as a state agency, formed due to the construction of the Century Freeway. In development beginning in 1972, the planned Century Freeway would displace local residents and businesses on its path between Los Angeles International Airport and the City of Norwalk. As a result of Keith v. Volpe, a lawsuit against the construction of the freeway due to its impact on the local community, Century Freeway Housing Program was created to replace the housing lost from the construction of the freeway, and to provide social services to minorities and women. Century was privatized to Century Housing Corp. following the completion of construction of the freeway in 1993 and meeting its housing development and social service goals. In 2010, Century spun off its social services divisions, focusing primarily on housing development and lending. Also in 2010, Century received CDFI designation from the U.S. Treasury.

Century's core business activities are affordable housing lending and affordable housing development. The corporation's lending operations are through Century Housing, and affordable housing development and preservation through Century Villages at Cabrillo Inc. and Century Affordable Development Inc. Our ICR is only on the stand-alone Century Housing, the lending portion of Century.

In our view, Century's vision is clearly defined and sets forth the corporation's overall strategic plan. Among its strategic priorities are:

- Maintaining its financial strength;
- Investing in development and preservation of affordable housing through its housing development affiliates; and
- Continuing to support local communities and organizations.

In addition, the lending operations will continue to grow, considering Century's overall strategy and management. We view Century's lending operations as generally self-supporting, and contributing to its overall mission. We believe collaboration with public and private entities, external relations, and financial self-sufficiency demonstrate that Century has solid growth potential as it explores expansion opportunities in lending activities. Public and private partnerships are vital to Century's continued success, as they play a key role in expanding its financial position. This includes partnerships with other CDFIs, foundations, and government agencies to source potential expansion opportunities.

Century is committed to developing and preserving affordable housing in California through its lending and development divisions. It uses its own criteria to set general parameters for assessing future opportunities designed to further its impact on the communities it serves. These parameters include likelihood of repayment, sector and project risk, collateral analysis, and financial health. We view Century's commitment to community development in relation to the corporation's core values, mission, and overall strategy and management as very strong.

A nine-member board of directors oversees Century. The board members come from a wide array of backgrounds that include housing, nonprofits, public and private enterprises, legal, finance, and government. The board meets every other month, and its responsibilities include executive, governance, finance, investments, and audit. Supporting the main board of directors is an established senior management team, comprising the CEO, CFO, senior vice president of lending, senior vice president of finance and treasury, and senior vice president of housing. Senior staff members work closely with one another to meet Century's mission and bring operations and projects into compliance with overall strategic goals.

Economy

The housing market in California continues to have extreme shortages of affordable housing stock, making housing moderate- and low-income residents a more pressing issue as well as the continued challenge of a rising homeless population. According to IHS Markit, home prices are now 94.3% of their 2006 peak, as a result of built homes not keeping up with demand. Housing starts reached 116,523 in 2018 and are expected to reach 118,891 in 2019, a 2% increase year over year. In our view, other factors that can affect the housing supply are natural disasters that could hit the state. The 2018 wildfire season was the worst on record, resulting in thousands of lost homes and billions of dollars in damages.

As can typically occur, the affordable housing crisis in California is paired with a thriving economy. The state's diverse economy is performing well and is forecast to continue to do well over the next two years. Preliminary state unemployment was 4.0% as of September 2019, while average unemployment in 2018 was 4.2%, slightly above the nation's 3.9%. California's real gross state product (GSP) increased by a good 3.5% in 2018, compared with 2.9% for the nation, while the state population rose 0.4% in 2018 (slightly below the nation's 0.6% growth) to 39.6 million. Good economic growth boosted the median home price to $617,410 in August, up 3.6% from a year ago, and up 1.5% from July, and high home prices have become a political issue. IHS Markit forecasts real GSP growth of 2.1% in 2020, compared with national real GDP growth of 2.0% in 2020.

Up to now, California's diverse economy had been performing well, and is still forecast to continue to do well after COVID-19 restrictions are lifted. Average unemployment in 2019 was 4.0%, slightly above the nation's 3.7%. California's real GSP increased by 2.59% in 2019, compared with 2.33% for the nation, while state population rose 0.13% in 2019 (slightly below the nation's 0.48% growth) to 39.5 million based on U.S. Census Bureau data. Good economic growth caused the median home price to reach $575,160 in January, down slightly from the previous month, but up 10.3% from a year ago. High and increasing home prices have become a political issue. Also, China is California's third-largest trading partner, and while we don't anticipate a significant impact on the state from trade tariffs, the potential remains that this could create slower growth.

Table 1

Century Housing Corp., Calif.--Financial Statistics

	2015	2016	2017	2018	2019	Five-year average
Asset quality (%)						
NPAs/total loans + REO	0.28	0.23	2.57	3.77	5.38	2.45
Net charge-offs/average NPAs	0.00	0.00	0.00	0.00	0.00	0.00
REO/total loans	0.94	0.10	0.07	2.38	1.94	1.09
Loan loss reserves/total loans	1.30	1.11	1.15	1.33	1.38	1.26
Loan loss reserves/NPAs	468.08	475.04	44.81	34.48	25.17	209.52
Net charge-offs/average loans	0.00	0.00	0.00	0.00	0.00	0.00
Liquidity (%)						
Total loans/total assets	61.24	64.92	68.93	70.28	70.35	67.15
Short-term investments/total assets	40.98	36.47	33.16	29.08	27.87	33.51
Long-term investments/total assets	0.00	0.00	0.00	0.00	0.00	0.00
Total investments/total assets	40.98	36.47	33.16	29.08	27.87	33.51

Table 1

Century Housing Corp., Calif.--Financial Statistics (cont.)

	2015	2016	2017	2018	2019	Five-year average
Other assets/total assets	2.79	1.72	0.48	3.17	4.29	2.49
Profitability (%)						
Return on average assets	3.43	3.33	4.30	4.45	3.91	3.89
ROA before loan loss provisions and extraordinary items	3.21	3.24	4.15	4.44	3.79	3.77
Return on average equity	5.31	5.59	7.79	8.81	8.23	7.15
Net interest margin	4.73	4.20	3.87	4.19	4.50	4.30
Net interest margin (loans)	6.46	5.27	4.62	5.28	5.58	5.44
Leverage (%)						
Equity/assets	60.88	58.49	52.62	48.66	46.57	53.44
Net equity/assets	N/A	N/A	29.46	28.62	36.16	31.41
Equity + reserves/loans	100.71	91.20	77.49	70.57	67.57	81.51
Equity/debt	157.56	142.69	112.38	96.34	89.54	119.70
Net equity/debt	N/A	N/A	62.93	56.66	69.53	63.04

NPAs--Nonperforming assets. REO--Real estate owned. ROA--Return on assets. N/A--Not applicable.

Related Research

Through The ESG Lens 2.0: A Deeper Dive Into U.S. Public Finance Credit Factors, April 28, 2020