GCR affirms Trust for Urban Housing Finance Limited's Issuer Long Term national scale rating at $BBB_{(ZA)}$, Outlook Negative.

Rating Action

Johannesburg, 12th September 2019 – GCR Ratings ('GCR') has affirmed Trust for Urban Finance Limited's long-term and short-term South African national scale ratings at $BBB_{(ZA)}$ and $A3_{(ZA)}$ respectively, with the outlook accorded as Negative. At the same time, the long-term international scale rating has been withdrawn without review.

Rated Entity / Issue	Rating class	Rating scale	Rating	Outlook / Watch
Trust for Urban Housing Finance Limited	Issuer Long Term	National	$BBB_{(ZA)}$	Negative Outlook
	Issuer Short Term	National	A3	–

GCR has reviewed the ratings on Trust for Urban Housing Finance Limited under the Criteria for Rating Financial Institutions and Criteria for Rating Financial Services Companies, May 2019. The ratings were placed "Under Criteria Observation" at the time of criteria publication. Subsequently, GCR has finalised the review under the two new methodologies, and the ratings have been removed from 'Under Criteria Observation'.

Rating Rationale

The ratings reflect TUHF's relatively weak competitive position in comparison to rated peers, balancing its track record operating in South Africa's otherwise neglected inner city property market, and adequate revenue stability; with a monoline business model, difficult to defend niche, and limited geographic diversification. We also take into account TUHF's strong Environmental, Social and Governance ('ESG') characteristics and impact, which boosts competitive advantage and provides additional access to sources of funding.

With a GCR leverage ratio of 12.4% for FY19, GCR considers TUHF's capital position to be adequate. We expect TUHF to gradually erode capital buffers, over the next two years, as internal capital generation fails to keep up with risk asset growth. Whilst revenues are stable TUHF's bottom line has faced pressure over the past couple of years, with thinning margins and increasing prepayments bring the return on assets to 1.2% at FY19 from 1.6% at FY18.

Historically, TUHF have operated with low levels of credit losses (below 0.5%), low non-performing loans (below 3%) and a good level of reserve coverage (well above 80%). At the same time, very high loan book concentrations are an inherent part of the business (with the loans to top 5 clients c. 30% of total loans, and more than 2x capital at FY19) leaving TUHF vulnerable to shocks from large single obligor defaults. The gross NPL ratio increased sharply to 9.2% at FY18 from 2.5% at FY17, partially due a change in accounting methodology but also due to the failure of one large borrower. At the same time, loan loss reserve coverage reduced to c. 28% of non-performing loans at FY18, which is considered to be low, however we continue to factor in a strong recovery of bad debts due to the generally good levels of collateral.

GCR views TUHF's funding structure and liquidity to be a ratings weakness. TUHF is exclusively wholesale funded, with cost of funding high relative to peers and commercial banks. However, we do expect a slight decrease in the cost of funding over the next 12-18months, as a result of diversifying the funding structure through the ZAR 2 billon debt programme and MBS programme. Currently, funding concentrations remain high but improving, with the top 1 and 5 funders at 30% (FY18: 43%) and 56% (FY18: 78%) of total funding (excluding mortgage backed securities) respectively. At the same time, the liquidity position remains tight. With the level of GCR liquid assets/ short-term wholesale funding coverage at c. 0.15x, TUHF is reliant on the timeous repayment of principle and interest, alongside access to the wholesale market for ongoing liquidity, which is of some concern.

Outlook Statement

The Negative outlook reflects the risk of a diminishing competitive position as a result of a difficult to defend niche, the resultant prepayments and a loss of market share, high loan book concentrations, and a weak funding and liquidity position.

Rating Triggers

A downgrade could arise from the failure to stabilise and maintain the asset quality at historical levels along with a reduction in the loan book concentration, and a reduction in cost of funding as expected to support the competitive position. Any deterioration in liquidity ratios could also bring the rating down. Due to the current balance of rating factors, we consider there to be limited upward ratings potential over the ratings horizon.

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Related Criteria and Research

Criteria for the GCR Ratings Framework, May 2019
Criteria for Rating Financial Institutions, May 2019
GCR Ratings Scale, Symbols & Definitions, May 2019
GCR Country Risk Scores, June 2019
GCR Financial Institutions Sector Risk Score, July 2019

Ratings History

Trust for Urban Housing Finance Limited

Rating class	Review	Rating scale	Rating class	Outlook	Date
Issuer Long Term	Initial	National	$BBB-_{(ZA)}$	Stable	September 2013
	Last	National	$BBB_{(ZA)}$	Negative	October 2018
Issuer Short Term	Initial	National	$A3_{(ZA)}$		September 2000
	Last	National	$A3_{(ZA)}$		October 2018

Risk Score Summary

Risk score	10.5
Operating environment	**12.5**
Country risk score	7.5
Sector risk score	5
Business profile	**-1.5**
Competitive position	-1.5
Management and governance	0

Financial profile	**-0.5**
Capital and Leverage	1
Risk	0.5
Funding structure and Liquidity	-2
Comparative profile	**0**
Group support	0
Government support	0
Peer analysis	0

Glossary

Capital	The sum of money that is invested to generate proceeds.
Cash	Funds that can be readily spent or used to meet current obligations.
Cash Flow	The inflow and outflow of cash and cash equivalents. Such flows arise from operating, investing and financing activities.
Credit Rating	An opinion regarding the creditworthiness of an entity, a security or financial instrument, or an issuer of securities or financial instruments, using an established and defined ranking system of rating categories.
Debt	An obligation to repay a sum of money. More specifically, it is funds passed from a creditor to a debtor in exchange for interest and a commitment to repay the principal in full on a specified date or over a specified period.
Liquidity	The speed at which assets can be converted to cash. It can also refer to the ability of a company to service its debt obligations due to the presence of liquid assets such as cash and its equivalents. Market liquidity refers to the ease with which a security can be bought or sold quickly and in large volumes without substantially affecting the market price.

Salient Points of Accorded Ratings

GCR affirms that a.) no part of the ratings were influenced by any other business activities of the credit rating agency; b.) the ratings were based solely on the merits of the rated entity, security or financial instrument being rated; c.) such rating was an independent evaluation of the risks and merits of the rated entity, security or financial instrument.

The credit rating has been disclosed to Trust for Urban Housing Finance Limited. The ratings above were solicited by, or on behalf of, the rated entity, and therefore, GCR has been compensated for the provision of the rating.

Trust for Urban Housing Finance participated in the rating process via telephonic communications, and other written correspondence. Furthermore, the quality of information received was considered adequate and has been independently verified where possible. The information received from Trust for Urban Housing Fund Limited and other reliable third parties to accord the credit rating included:

- Audited financial results of TUHF Holdings Limited as at 31 March 2019;
- Audited financial results of TUHF Limited as at 31 March 2019;
- Audited financial results of TUHF Urban Finance (RF) Limited as at 31 March 2019;
- Loan book analysis information as at March 2019;
- Environmental, Social and Governance Quarterly Report June 2019.