Moody's

Rating Action: Moody's assigns definitive ratings to five classes of notes issued by Bauhinia ILBS1 Limited

30 May 2023

US$364.35 million of securities rated

Hong Kong, May 30, 2023 -- Moody's Investors Service has assigned definitive ratings to five classes of notes issued by Bauhinia ILBS1 Limited (the Issuer).

The complete rating action is as follows:

Issuer: Bauhinia ILBS1 Limited

US$100,000,000 Class A1-SU Senior Secured Floating Rate Notes due 19 October 2044 (the "Class A1-SU Notes"), Definitive Rating Assigned Aaa (sf)

US$199,600,000 Class A1 Senior Secured Floating Rate Notes due 19 October 2044 (the "Class A1 Notes"), Definitive Rating Assigned Aaa (sf)

US$36,500,000 Class B Senior Secured Floating Rate Notes due 19 October 2044 (the "Class B Notes"), Definitive Rating Assigned Aa1 (sf)

US$18,250,000 Class C Senior Secured Floating Rate Notes due 19 October 2044 (the "Class C Notes"), Definitive Rating Assigned A2 (sf)

US$10,000,000 Class D Senior Secured Floating Rate Notes due 19 October 2044 (the "Class D Notes"), Definitive Rating Assigned Baa3 (sf)

The Class A1-SU Notes, Class A1 Notes, Class B Notes, Class C Notes and Class D Notes are referred to herein as the "Rated Notes." In addition to the Rated Notes, the issuer also issued US$40,432,000 of subordinated floating rate notes.

RATINGS RATIONALE

This is a project finance and corporate infrastructure collateralized loan obligation (CLO) cash flow securitization. The notes are collateralized by a portfolio of 35 bank-syndicated senior secured project finance and corporate infrastructur loans to 25 projects in Asia-Pacific, the Middle East, and South America. The portfolio is not expected to be actively traded during the replenishment period.

All the loans in the initial portfolio do not have a Moody's rating. Moody's has assigned credit estimates to each of these unrated loans to evaluate the credit quality of the initial portfolio. The weighted average rating factor (WARF) of the initial portfolio is 772 before applying the credit estimate notching adjustments, and 936 after applying the credit estimate notching adjustments.

Moody's ratings of the Rated Notes have taken into account the following key characteristics of the initial portfolio at closing.

1. High credit quality portfolio: The WARF of the identified portfolio is 772 before applying the credit estimate notching adjustments, and 936 after applying the credit estimate notching adjustments.

2. Mostly project finance loans with high asset recovery prospects: The portfolio consists of predominantly bank-syndicated senior secured project finance loans (80.8% of the pool), which historically have had high recovery rates. The remaining portion of the pool consists of telecommunication and utilities corporate infrastructure loans (15.5%) and corporate- guaranteed project finance loans (3.7%). About 3.8% of the portfolio also benefit from external credit support, which will improve loan recovery prospects.

3. High project and sector concentrations: With only 25 projects, the portfolio is highly concentrated, with a large exposure to a few projects and in energy-related sectors such as power generation renewables, power generation non-renewables, schools and education, and liquefied natural gas (LNG). Certain projects also involve common off-takers, operators or sponsors. The exposure to the largest obligor group in the power generation renewables sector comprises about 11.8% of the portfolio, greater than the subordination of the Class D Notes. There are six other projects where each comprises between 6% and 8% of the initial portfolio. A significant credit deterioration of any of these projects would have a negative rating impact on the Rated Notes. In Moody's analysis, the agency considered several stress scenarios assuming default of the largest borrower or higher asset correlation.

4. High country risk: Of the identified portfolio, about 30% of the portfolio is exposed to projects that are in countries with single-A or below foreign-currency country ceilings (FCC). The geographical distribution of the portfolio is widely diversified across 12 countries in different regions, including Asia-Pacific, the Middle East, and South America. Exposures to the top-three countries that have non-Aaa FCC are China (about 14%, Aa1 FCC), India (about 12%, A3 FCC), and Brazil (about 12%, Baa2 FCC).

5. High participation exposures: The issuer invested in about 18% of the portfolio via funded participation Agreements with The Hong Kong Mortgage Corporation Limited (HKMC, rated Aa3/P-1), the sponsor and collateral manager, or with rated bank(s) at closing, instead of being the lender of record. The issuer will rely on HKMC or the rated participation bank(s) to enforce its rights against the borrowers and be exposed to the credit risk of HKMC and these rated bank(s).

6. Undrawn commitment amount: Of the identified portfolio, about 1.5% of the portfolio are pending to be drawn prior to the first note payment date. The issuer set aside cash in its bank account to ensure it has sufficient liquidity to fulfil its lending obligation.

7. Construction risk: Two projects, representing around 12.5% of the portfolio, are still under construction, but these projects are nearing completion.

8. Floating rate basis mismatch: The issuer is exposed to floating rate basis mismatch as all the rated notes' interest payments are linked to Secured Overnight Financing Rate (SOFR), while about 32% of the initial portfolio are still linked to USD-Libor, and the remaining about 68% are linked to SOFR. As USD-Libor will cease on 30 June 2023, the benchmark rate of loans that are currently USD-Libor may transition to other floating rate indices such as term SOFR or daily non-cumulative compounded SOFR or costs of funds of the lenders. In Moody's analysis, the agency considered zero credit adjustment spread except for loans that have executed terms for USD-Libor transition.

Moody's used a loan-by-loan Monte Carlo simulation framework in Moody's CDOROM™ to model the portfolio default distribution and asset-type specific recovery assumptions for this project finance CLO. Moody's has assumed three years of recovery delay for the project finance loans and 1.5 years of recovery delay for the corporate loans. In the cash flow model, for each tranche, Moody's used a separate fixed recovery rate assumption for each sub-pool (project finance loans and corporate loans) together with the default distribution generated by CDOROM. For the project finance loan sub-pool, Moody's determined the certainty equivalent fixed recovery rate for each tranche.

At a portfolio level, Moody's notes that:

1. The WARF of the portfolio, after applying the credit estimate notching adjustments, is 936.

2. The weighted average mean recovery rate (WARR) of project finance loans is about 70%. The weighted average fixed recovery rate (WARR) of corporate infrastructure loans is about 39%.

3. The average asset correlation of the portfolio is about 21.5%.

In addition to the quantitative factors that Moody's explicitly models, the agency has also considered qualitative factors.

Moody's has considered the structural protections in the transaction, the risk of an event of default, the legal environment and specific documentation features. All information available, including macroeconomic forecasts, inputs from other Moody's analytical groups, market factors, and judgments regarding the nature and severity of credit stress on the transaction, influenced the rating decision.

The target portfolio is fully acquired on the closing date, with 98.5% of loans fully drawn and the remaining 1.5% pending to be drawn by borrowers. The transaction has a three-year reinvestment period, during which the collateral manager may direct the issuer to use unscheduled principal collections, undrawn lending commitments that are cancelled or have expired, and proceeds from the sale of credit-risk, defaulted or non-eligible sustainability assets to purchase new assets. The purchase of new assets is subject to certain conditions, including satisfying interest and par coverage tests.

After the reinvestment period, the collateral manager may no longer direct the issuer to purchase additional assets, and unscheduled principal collections and proceeds from the sale of assets will be used to amortize the notes in sequential order.

The transaction incorporates interest and par coverage tests that, if triggered, divert interest and principal proceeds to pay down the notes in the order of seniority. Apart from this, the issuer will use scheduled principal collection to amortize the Rated Notes in sequential order. The Class A1-SU Notes and Class A1 Notes rank pari passu to each other.

This is the first CLO transaction of The Hong Kong Mortgage Corporation Limited (HKMC, rated Aa3/P-1), the collateral manager of the transaction. The CLO transaction is managed by the Infrastructure Financing and Securitisation Division of HKMC. HKMC was established in Hong Kong SAR, China in 1997 and is wholly owned by the Hong Kong Government through the Exchange Fund, with reported total assets of HKD173.2 billion as of the end of December 2021. HKMC invested in the subordinated notes issued by the issuer and provided a sponsor loan to th issuer at closing to support the liquidity of the issuer in meeting interest payments on the rated notes on the first payment date.

RATINGS METHODOLOGY:

The principal methodology used in these ratings was "Project Finance and Infrastructure Asset CLOs Methodology" published in November 2021 and available at https://ratings.moodys.com/rmc-documents/355059. Alternatively, please see the Rating Methodologies page on https://ratings.moodys.com for a copy of this methodology.

Factors that would lead to an upgrade or downgrade of the ratings:

The performance of the Rated Notes is sensitive to the performance of the underlying portfolio and the credit quality of the counterparties to the transaction, which in turn depend on uncertain economic and credit conditions that may change. The collateral manager's investment decisions and management of the transaction will also affect the performance of the Rated Notes.

Further details regarding Moody's analysis of this transaction may be found in the related new issue report, available soon on www.moodys.com.

REGULATORY DISCLOSURES

For further specification of Moody's key rating assumptions and sensitivity analysis, see the sections Methodology Assumptions and Sensitivity to Assumptions in the disclosure form. Moody's Rating Symbols and Definitions can be found on https://ratings.moodys.com/rating-definitions.

Moody's took into account one or more third party due diligence assessment(s) regarding the underlying assets or financial instruments (the "Due Diligence Assessment(s)") in this credit rating action and used the Due Diligence Assessment(s) in preparing the ratings. This had a neutral impact on the ratings.

The Due Diligence Assessment(s) referenced herein were prepared and produced solely by parties other than Moody's. While Moody's uses Due Diligence Assessment(s) only to the extent that Moody's believes them to be reliable for purposes of the intended use, Moody's does not independently audit or verify the information or procedures used by third-party due-diligence providers in the preparation of the Due Diligence Assessment(s) and makes no representation or warranty, express or implied, as to the accuracy, timeliness, completeness, merchantability or fitness for any particular purpose of the Due Diligence Assessment(s).

In rating this transaction, Moody's CDOROM™ is used to model the expected loss for each tranche. Moody's CDOROM™ is a Monte Carlo simulation tool which takes each underlying asset default probability as input. Each underlying asset default behavior is then modeled individually with a standard multi-factor model incorporating both intra- and inter-industry correlation. The correlation structure is based on a Gaussian copula. Each Monte Carlo scenario simulates defaults and if applicable, recovery rates, to derive losses on a portfolio. For a synthetic transaction, the model then allocates losses to the tranches in reverse order of priority to derive the loss on the tranches. By repeating this process and averaging over the number of simulations, Moody's can derive the expected loss on the tranches. For a cash transaction, the portfolio loss, or default, distribution produced by Moody's CDOROM™ may be input into a separate cash flow model in accordance with its priority of payment to determine each tranche's expected loss.

Moody's quantitative analysis entails an evaluation of scenarios that stress factors contributing to sensitivity of ratings and take into account the likelihood of severe collateral losses or impaired cash flows. Moody's weights the impact on the rated instruments based on its assumptions of the likelihood of the events in such scenarios occurring.

For ratings issued on a program, series, category/class of debt or security this announcement provides certain regulatory disclosures in relation to each rating of a subsequently issued bond or note of the same series, category/class of debt, security or pursuant to a program for which the ratings are derived exclusively from existing ratings in accordance with Moody's rating practices. For ratings issued on a support provider, this announcement provides certain regulatory disclosures in relation to the credit rating action on the support provider and in relation to each particular credit rating action for securities that derive their credit ratings from the support provider's credit rating. For provisional ratings, this announcement provides certain regulatory disclosures in relation to the provisional rating assigned, and in relation to a definitive rating that may be assigned subsequent to the final issuance of the debt, in each case where the transaction structure and terms have not changed prior to the assignment of the definitive rating in a manner that would have affected the rating. For further information please see the issuer/deal page for the respective issuer on https://ratings.moodys.com.

For any affected securities or rated entities receiving direct credit support from the primary entity(ies) of this credit rating action, and whose ratings may change as a result of this credit rating action, the associated regulatory disclosures will be those of the guarantor entity. Exceptions to this approach exist for the following disclosures, if applicable to jurisdiction: Ancillary Services, Disclosure to rated entity, Disclosure from rated entity.

The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

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Moody's considers a rated entity or its agent(s) to be participating when it maintains an overall relationship with Moody's. Unless noted in the Regulatory Disclosures as a Non-Participating Entity, the rated entity is participating and the rated entity or its agent(s) generally provides Moody's with information for the purposes of its ratings process. Please refer to https://ratings.moodys.com for the Regulatory Disclosures for each credit rating action, shown on the issuer/deal page, and for Moody's Policy for Designating Non-Participating Rated Entities, shown on https://ratings.moodys.com.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moodys.com/documents/PBC_1288235.

The Global Scale Credit Rating on this Credit Rating Announcement was issued by one of Moody's affiliates outside the EU and is endorsed by Moody's Deutschland GmbH, An der Welle 5, Frankfurt am Main 60322, Germany, in accordance with Art.4 paragraph 3 of the Regulation (EC) No 1060/2009 on Credit Rating Agencies. Further information on the EU endorsement status and on the Moody's office that issued the credit rating is available on https://ratings.moodys.com.

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