MOODY'S
RATINGS

Rating Action: Moody's Ratings assigns definitive ratings to five classes of notes issued by Bauhinia ILBS 2 Limited

11 Sep 2024

US$386.70 million of securities rated

Hong Kong, September 11, 2024 -- Moody's Ratings (Moody's) has assigned definitive ratings to five classes of notes issued by Bauhinia ILBS 2 Limited (the Issuer).

The complete rating action is as follows:

Issuer: Bauhinia ILBS 2 Limited

US$107,000,000 Class A1-SU Senior Secured Floating Rate Notes due 19 October 2044 (the "Class A1-SU Notes"), Definitive Rating Assigned Aaa (sf)

US$209,500,000 Class A1 Senior Secured Floating Rate Notes due 19 October 2044 (the "Class A1 Notes"), Definitive Rating Assigned Aaa (sf)

US$34,000,000 Class B Senior Secured Floating Rate Notes due 19 October 2044 (the "Class B Notes"), Definitive Rating Assigned Aa1 (sf)

US$20,500,000 Class C Senior Secured Floating Rate Notes due 19 October 2044 (the "Class C Notes"), Definitive Rating Assigned A2 (sf)

US$15,700,000 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 issued US$36,591,000 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 initially collateralized by a portfolio of 28 bank-syndicated senior secured project finance loans and corporate infrastructure loans to 26 projects predominantly in Asia-Pacific, the Middle East and Latin America. The portfolio is not expected to be actively traded during the replenishment period.

To evaluate the credit quality of the initial portfolio, we assigned credit estimates to most loans, while a handful of loans are assessed by reference to our ratings. The weighted average rating factor (WARF) of the target portfolio is 836 before applying the credit estimate notching adjustments, and 1004 after applying the credit estimate notching adjustments. The WARF incorporates the latest change in the credit estimate level of a loan in accordance with our credit estimate update process.

Our ratings of the Rated Notes have taken into account the following key characteristics of the initial target portfolio at closing.

1. High credit quality portfolio: The WARF of the identified portfolio is 836 before applying the credit estimate notching adjustments, and 1004 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 (78.1% of the pool), which historically have had high recovery rates. The remaining portion of the pool consists of corporate and corporate guaranteed project finance loans (21.9%). About 1.3% of the portfolio benefit from external credit support and 0.7% of the portfolio benefit from credit support from highly rated entity, which will improve loan recovery prospects.

3. High project and sector concentrations: With only 26 projects, the portfolio is highly concentrated, with a large exposure to a few projects and in sub-sectors such as regulated telecom (15.6% of the pool), LNG (15.3%) and oil (12.9%). Certain projects also involve common off-takers, operators or sponsors. The exposures to the two largest obligor groups are about 9.4% and 9.0% of the portfolio, respectively, greater than the subordination of the Class D Notes. There are four other projects which each of them comprises between 7% and 9% of the portfolio. A significant credit deterioration of any of these projects would have a negative rating impact on the Rated Notes. In our analysis, we considered several stress scenarios assuming default of the largest obligor or higher asset correlation.

4. High country risk: Of the identified portfolio, about 50% portfolio exposure is to projects that are exposed to countries with single-A or below foreign-currency country ceilings (FCC). The geographical distribution of the portfolio is widely diversified across 14 countries in different regions, and exposure to top three countries which have non-Aaa FCC are India (16.8%, A3 FCC), Indonesia (11.8%, A3 FCC), and Mexico (9.4%, A1 FCC).

5. High participation exposures: The issuer invested in 23.8% of the portfolio via funded participation agreements with Hong Kong Mortgage Corporation Limited (HKMC, rated Aa3 with negative outlook), 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 0.45% of the portfolio are pending to be drawn by the relevant borrower. The availability period of the undrawn commitment will expire in March 2026. The issuer set aside cash in its bank account at closing to ensure it has sufficient liquidity to fulfil its lending obligation.

7. Construction risk: One project, representing around 8.0% of the portfolio, is still under construction, but this project is 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 six-month term Secured Overnight Financing Rate (SOFR), while 59% of the initial target portfolio are linked to daily compounded overnight SOFR, 33% are linked to term SOFR, and the remaining 8% linked to USD-Libor. In our analysis, we considered this mismatch, and also assumed zero credit adjustment spread for loans linked to USD-Libor.

We used a loan-by-loan Monte Carlo simulation framework in our CDOROM™ to model the portfolio loss distribution for this project finance CLO.

At a portfolio level, we note that:

1. The WARF of the portfolio, after applying the credit estimate notching adjustments, is 1004.

2. The weighted average mean recovery rate of the portfolio is about 62.5%.

3. The average asset correlation of the portfolio is about 25.3%.

We have assumed three years of recovery delay for the project finance loans and 1.5 years of recovery delay for the corporate loans.

In addition to the quantitative factors that our explicitly models, we have also considered qualitative factors, including 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 our other 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 99.55% of loans fully drawn and the remaining 0.45% pending to be drawn by the relevant borrower. 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, principal amount of loans refinanced, 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 the satisfaction of the 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 second CLO transaction of HKMC, 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 HKD219.3 billion as of the end of December 2023. HKMC invested in the subordinated notes issued by the issuer.

HKMC provided a bridging sponsor loan to the issuer at closing to fund the transaction's fees and expenses reserve account, and to support the liquidity of the issuer in meeting interest payments on the rated notes on the first payment date. In addition, HKMC provided a risk protection sponsor loan to the issuer at closing to fund payments to procure and/or renew risk protections as and when necessary to safeguard the issuer against risks associated with the underlying assets.

RATINGS METHODOLOGY:

The principal methodology used in these ratings was "Project Finance and Infrastructure Asset CLOs" published in July 2024 and available at https://ratings.moodys.com/rmc-documents/425583 . 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 our 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 .

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.

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