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## Research Update:

# Toronto Community Housing Corp., TCHC Issuer Trust 'AA-' Ratings Affirmed On Continued Low Debt; Outlook Stable

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## Research Update:

# Toronto Community Housing Corp., TCHC Issuer Trust 'AA-' Ratings Affirmed On Continued Low Debt; Outlook Stable

## Overview

- We are affirming our 'AA-' long-term issuer credit rating on Toronto Community Housing Corp. (TCHC).
- We are also affirming our 'AA-' senior secured debt rating on TCHC's affiliate, TCHC Issuer Trust.
- The affirmation reflects our view of the company's low debt levels, strong liquidity, adequate operating results and margins, and generally good relationship with its owner, the City of Toronto.
- The stable outlook reflects our expectations that debt levels will continue to be low, with the EBITDA interest coverage ratio remaining above 3x, cash and investment balances will stay strong despite any drawing down of unused bond proceeds, and that there will be no repeat of the turbulence seen in governance and senior management in the past two years.

## Rating Action

On Nov. 9, 2012, Standard & Poor's Ratings Services affirmed its 'AA-' long-term issuer credit rating on TCHC. The outlook is stable. At the same time, Standard & Poor's affirmed its 'AA-' senior secured debt rating on TCHC's affiliate, TCHC Issuer Trust.

## Rationale

The rating on TCHC reflects Standard & Poor's assessment of the company's relatively low debt levels, strong liquidity, good operating and EBITDA margins, and a historically good relationship with the City of Toronto (AA/Stable/A-1+). In our opinion, the company's relatively new board and senior management team and sizable state-of-good-repair backlog offset these strengths somewhat.

We rate TCHC in accordance with Standard & Poor's government-related entities (GRE) methodology. Accordingly, we view the likelihood of TCHC receiving extraordinary government support as "moderately high." This view reflects our assessment of the company's important role in discharging Toronto's responsibility for providing social housing and of having a "strong" link with the city. We believe that the company has a "strong" link with Toronto. The replacement of the board of directors at the mayor's request and the city's

current deliberations on the sale of some of the company's house-form properties and the use of those proceeds demonstrate this link.

TCHC's debt levels are low in our opinion. At year-end 2011, debt stood at C\$1.4 billion, which was down modestly from C\$1.5 billion a year earlier. Short-term debt, which rose slightly to about C\$70 million in 2011, represented less than 10% of total indebtedness. Debt ratios indicate debt levels we consider to be low. At year-end 2011, the EBITDA gross interest coverage ratio (Standard & Poor's-calculated) was 2.9x, unchanged from the year earlier. The debt-to-EBITDA ratio was 6.3x, down from 7.0x the year before. We do not expect that the company will issue debt in 2012 and debt outstanding should be close to C\$1.4 billion by the end of the year. We don't expect much change in 2013 and debt outstanding should range from C\$1.3 billion-C\$1.5 billion by the end of that year. Coverage ratios are not likely to change substantially; we expect the EBITDA coverage ratio to range from 3.0x to 3.2x in 2012 and 2013.

TCHC's liquidity is strong, in our view. The company had cash and investments holdings of about C\$245 million, excluding about C\$70 million of internally and externally restricted funds, at 2011 year-end. Liquidity levels fell about 20% in 2011 as unused bond proceeds were deployed for capital project financing. In addition, TCHC generates a considerable amount of cash each year (close to C\$100 million) from operations and it maintains a C\$200 million revolving credit facility, of which it had used about C\$75 million at year-end 2011. In our opinion, it has strong access to external liquidity as evidenced by its two bond series and bank loans and line. For 2012 and 2013, we expect that liquidity will remain strong despite any drawing down of remaining unused bond proceeds.

The company's 2011 results were in line with those of recent years with good operating and EBITDA margins in our opinion. The EBITDA margin improved slightly to 32% in 2011 from 31% a year earlier while the operating margin was unchanged at 15%. EBITDA reached about C\$220 million, increasing 4%, from C\$210 million in 2010. The increase was due to a small decline in operating expenses coupled with modest increases in rent and subsidies. Net income edged down below C\$25 million on higher depreciation expense. TCHC has a good track record of producing adequate and stable financial results, in our view, and we expect that EBITDA margins will remain above 30% and net income will be small but positive for 2012 and 2013.

Despite some management and governance turbulence in the past two years, we expect that TCHC's relationship with the city will remain good. Toronto has provided the company with a stable multiyear funding formula and clear operating direction that changes to senior management or the board have not affected. The operating direction permits TCHC to create debt as long as the new debt can be accommodated within the same debt service subsidy from the city. Furthermore, much of the framework that governs social housing provision in Ontario is established by provincial statute and is unlikely to change in the medium term.

In our opinion, a relatively new board and senior management team and a sizable state-of-good-repair backlog offset the company's business risk profile somewhat. TCHC board of directors was appointed in 2011 following the departure of the former board at the mayor's request. Furthermore, a number of the senior management team, including the CEO and CFO, are relatively new to the company. Board and team members do, however, have extensive private- and public-sector real estate experience. We believe that their relative collective inexperience with TCHC will vanish with time and that some members' experience in the real estate industry will benefit the company in the long term.

The company has a sizable state-of-good-repair backlog that it estimates to be about C\$750 million. The backlog has increased steadily: It was estimated to be only C\$300 million five years ago. TCHC has been reinvesting in its portfolio annually but not at a sufficiently high enough rate to stabilize or reduce the backlog. Council is considering plans to address the backlog. The company might issue debt to reduce some portion of the backlog in the next few years, which could diminish its strong financial risk profile somewhat if the debt issuance is large enough.

## **Outlook**

The stable outlook reflects our expectation that debt levels will continue to be low, with the EBITDA interest coverage ratio remaining above 3x and the debt-to-EBITDA ratio staying below 7x in the next two years. We expect that cash and investment balances will stay strong despite any drawing down of remaining unused bond proceeds. We further expect that there will be no repeat of the turbulence seen in governance and senior management in the past two years and that TCHC's relationship with the city should remain good. A significant adverse change in the relationship with the city, renewed governance and management turbulence, marked deterioration of EBITDA or cash generated from operations with substantial declines in interest coverage ratios, or a significant reduction in cash and investment balances could place downward pressure on the ratings. Conversely, a material and sustained improvement in operating results or substantial reduction in debt during our two-year outlook horizon could result in an upgrade.

## **Related Criteria And Research**

- Public And Nonprofit Social Housing Providers: Methodology And Assumptions , July 11, 2012
- Rating Government-Related Entities: Methodology And Assumptions, Dec. 9, 2010

## **Ratings List**

### Ratings Affirmed

Toronto Community Housing Corp.

Issuer credit rating AA-/Stable/--

TCHC Issuer Trust

Senior secured debt AA-

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