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Credit Opinion: Great Places Housing Group

Global Credit Research - 03 Oct 2012

United Kingdom

Ratings

Category	Moody's Rating
Outlook	Negative
Issuer Rating -Dom Curr	Aa3
Senior Secured -Dom Curr	Aa3

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Key Indicators

Great Places Housing Group

	31-Mar-08	31-Mar-09	31-Mar-10	31-Mar-11	31-Mar-12
Units under management (no.)	13,858	14,781	14,969	15,722	16,147
Housing assets (GBP million)	199	270	310	318	360
Operating margin, before interest (%)	21.7	20.8	19.0	18.6	24.5
Net capital expenditure as % turnover	62.3	75.2	18.3	81.4	72.2
Social housing letting interest coverage (x times)	1.2	1.0	1.3	0.9	1.4
Recurrent cash interest coverage (x times)	1.6	1.5	2.2	2.1	2.3
Debt to revenues (x times)	3.1	3.9	3.8	4.3	4.6
Debt to assets at cost (%)	32.6	35.2	33.9	36.0	37.0

Opinion

SUMMARY RATING RATIONALE

The Aa3 issuer rating assigned to Great Places Housing Group (GPHG) reflects (i) the strong regulatory framework governing English housing associations; (ii) the high proportion of its revenues derived from government subsidies (housing benefit), which adds to revenue stability; (iii) strong cash flows from a robust foundation of low-risk social housing letting; and (iv) Moody's assessment of a very high likelihood that the UK government (Aaa, negative) would act to prevent a default by GPHG. The rating also takes into account (i) moderate, although rising sales; (ii) GPHG's steady development against rising debt levels; and (iii) risks from universal credit, which we currently assess as manageable for GPHG.

GPHG is rated in the middle range of English housing associations, whose ratings span from Aa2 to A1. GPHG's relative position reflects its stronger cash flows and interest coverage, and lower debt-to-asset ratio, but a weaker social housing letting margin, larger development, a regional focus in operations, and larger exposures to floating rates, refinancing as well as rising sales.

Credit Strengths

Credit strengths for GPHG include:

- Strong regulatory framework

- Subsidies from the UK government support stability of cash flows

- Strong cash flow, supported by growing social-housing letting and no planned reliance on sales to cover interest costs

- Very high likelihood of extraordinary support from the UK government

Credit Challenges

Credit challenges for GPHG include:

- Rising sales, albeit from a very low level

- Rising debt levels

- Manageable risks from universal credit

- Limited revenue flexibility, which is typical for the sector

Rating Outlook

The rating outlook is negative, mirroring the outlook on the UK sovereign rating, given GPHG's strong financial, operational and economic linkages with the central government.

What Could Change the Rating - Up

Whilst unlikely in the near term given GPHG's planned development growth, a stronger operating margin above 30%, a more robust social-housing letting interest coverage above 1.5x, and a reduction in debt below 4x revenues would be considered credit positive. Reduced exposure to interest-rate risk could also support future consideration for a rating upgrade.

What Could Change the Rating - Down

A weaker operating margin below 20%, lower recurrent-cash interest coverage below 1.5x or social-housing letting interest coverage below 1x, and higher-than-projected debt above 5x could prove negative for the rating. Additionally, any weakening of the regulatory framework, any dilution of the overall level of support from the UK government or a downgrade of the UK sovereign ratings would also exert downward pressure on the rating.

DETAILED RATING CONSIDERATIONS

The rating assigned to GPHG reflects the application of Moody's Joint Default Analysis (JDA) rating methodology for Government-Related Issuers. In accordance with this methodology, Moody's first establishes the baseline credit assessment (BCA) for GPHG and then considers the likelihood of support coming from the UK government to avoid an imminent default by GPHG, should this extreme event ever occur.

Baseline Credit Assessment

GPHG's BCA of baa2, on a scale of aaa-c, where aaa represents the lowest credit risk, reflects the following factors:

Institutional Framework

English housing associations operate in a highly regulated environment, with strong oversight exercised by the sector's regulator - the Homes and Communities Agency or HCA (formerly the Tenant Services Authority). The HCA's levers of control are extensive and currently range from monitoring the quality of accommodation, to vetting governance and financial viability and arranging short-term property inspections.

Revenue flexibility is limited, but "affordable rent" provides some leeway in the long term. An annual increase in social housing rent, which represents the bulk of revenues for most housing associations, is capped at a rate of the retail price index (RPI) + 0.5%. Recent reforms have granted greater rent flexibility to English housing associations, allowing social housing rent to rise up to 80% of market rent ("affordable rent") for new tenants and re-lets. In the short to medium term, we expect the impact of the rent reform to be limited.

Government subsidies support revenue stability. A high share of social-housing rental income (around 60% for

GPHG, which is slightly above the average for its Moody's-rated peers) is composed of housing benefit attributable to tenants, most of which is transferred directly from local authorities to housing associations. Under universal credit, benefits (including housing benefits) to working-age tenants will be paid directly to tenants. As a result, housing associations will lose the advantage of direct payment - a credit strength in the sector - for a share of their income (estimated at around 35% for GPHG, which is slightly above the average for Moody's rated peers). This is a manageable risk for GPHG given (i) its good rent collection rates, with current rent arrears now 4.7%; and (ii) its recent initiatives to increase awareness of the reform to tenants, to improve tenant data, strengthen collection processes and promote direct debit (currently 44% of residents).

Issuer Profile

GPHG is a medium-sized social housing provider, managing around 16,000 homes as at March 2012. Operations are concentrated in the north west of England, with core activities in and around the city of Manchester across 37 local authorities, where demand for social housing is high and social housing rents may go up to half market rates.

Financial Performance

GPHG's revenue grew to GBP72 million in 2012 (2011: GBP67 million), supported by stable growth in social-housing letting (81% of revenues) and minimal sales (3%). Its operating margin widened to 24% of revenues in 2012 (2011: 19%; average 2008-2012: 21%), which is in line with the average of Moody's-rated peers and above the sector average. Its bottom-line margin (before tax) also improved to 10% of revenues in 2012 (2011: 4% average 2008-2012: 7%), with minimal contributions from fixed assets disposal.

GPHG's recurrent cash-interest coverage ratio was strong at 2.3x in 2012 (2011: 2.1x; average 2008-2012: 1.9x; peak/trough 2008-2012: 2.3x/1.5x), which is above the average of Moody's-rated peers. The social-housing-letting interest coverage ratio, including depreciation, improved to 1.4x in 2012 (2011: 0.9x, restated following adoption of component accounting; average 2008-2012: 1.2x; peak/trough 2008-2012: 1.4x/0.9x), eliminating a previous reliance on higher-risk activities to cover interest costs.

GPHG forecasts that a strong rise in social-housing letting and a rising contribution from sales, peaking at 11% in 2016, will continue to drive revenue. Its operating margin is projected to widen to around 30% revenues, reflecting significant cost efficiencies and a steady development delivery. Cash flows are projected to remain strong, with a social-housing-letting interest coverage hovering around 1.1x/1.2x in 2013-17 and a recurrent cash-interest coverage well above 1.5x. The reduction in interest coverage largely reflects a rise in interest costs from a planned bond issuance of GBP200 million in Autumn 2012 to support GPHG's future capex.

Debt and Liquidity

At FY2012, debt was GBP331 million, equivalent to around 4.6x revenues and 37% of assets at cost. Going forward, higher capex, peaking at 69% revenues in 2013, should push debt to around 5x revenues and 45% of assets by 2017. Proceeds from fixed-asset disposals are expected to remain significant, averaging 13% of revenues in 2013-17.

GPHG's refinancing risk is minimal, with 98% of outstanding debt coming due after five years at FY2012. However, the payment profile includes a peak repayment of GBP30 million in 2018 and, accounting for planned draw-downs of currently undrawn revolving bank facilities, further peak repayments of GBP10 million and GBP60 million in 2016 and 2017, respectively. Management anticipates to cover these refinancing exposures through a planned bond in late 2012. At end of March 2012, interest-rate risk was relatively high, with 37% of the debt held at floating rates. Immediately available liquidity totalled GBP107million, equivalent to 149% of revenues.

Governance and Management

GPHG's stable management team achieved strong results in 2012, which were better than the forecasts provided to Moody's, thanks to lower LIBOR and stronger cash flows associated with higher grants from bringing forward some of its planned schemes. Overall, financial performance for 2012 was better than we expected. The business plan for 2013-2017 is a prudent central case, based on LIBOR at 2.0% in 2013 (3.25% in 2014, rising to 5% from 2015), rent RPI at 5.6% in 2013 (2.5% from 2014), real growth in maintenance costs of 0.5% from 2014, rising bad debts from 2014, falling supported-people income and nil property price inflation in 2013-14.

GPH is one of the leading developers in the north west of England. Its development strategy has been and remains significant and has historically been supported by high grant levels and asset disposals, which limited debt growth. Going forward, risk appetite has increased to respond to affordable rent / lower grant rates, which underlies plans

including higher development-for-sales and debt levels.

GPHG adheres to a conservative liquidity strategy, with total liquidity required to cover 12 months cash requirements, in addition to minimum cash of GBP10 million (14% of revenues). Both requirements are currently met.

GPHG targets to maintain up to 60% of its debt fixed (currently exceeding). Its loan portfolio includes cancellable options of GBP19 million, adding to floating-rate risk. A large share of its hedging is carried out by standalone swaps (notional of GBP127 million), with continued exposure to margin-call risk (until now met fully by cash). Ample unencumbered assets (estimated to support GBP176 million of new secured debt at EUV/MVT, post security charging for the planned 2012 bond) ensures further margin calls (in excess of 100bps) could be met.

Management sets internal buffers for its financial performance and covenants (interest cover and gearing). All debt covenants are fully met and allow for strong headroom within the business plan.

Extraordinary Support Considerations

The very high level of extraordinary support factored into the rating reflects the wide-ranging powers of redress available to the regulator in cases of financial distress, with an enforced merger or a transfer of engagements being possible. Recent history has shown that the UK government is willing to support the sector and it has, in the past, provided a guarantee for a housing association's overdraft facility. Moreover, housing remains a politically sensitive issue, contributing to the high potential for support.

Moody's also assigns a very high default dependence between GPHG and the UK government, reflecting their strong financial and operational linkages.

ABOUT MOODY'S SUB-SOVEREIGN RATINGS

National and Global Scale Ratings

Moody's National Scale Ratings (NSRs) are intended as relative measures of creditworthiness among debt issues and issuers within a country, enabling market participants to better differentiate relative risks. NSRs differ from Moody's global scale ratings in that they are not globally comparable with the full universe of Moody's rated entities, but only with NSRs for other rated debt issues and issuers within the same country. NSRs are designated by a ".nn" country modifier signifying the relevant country, as in ".mx" for Mexico. For further information on Moody's approach to national scale ratings, please refer to Moody's Rating Methodology published in March 2011 entitled "Mapping Moody's National Scale Ratings to Global Scale Ratings".

The Moody's Global Scale rating for issuers and issues allows investors to compare the issuer's/issue's creditworthiness to all others in the world, rather than merely in one country. It incorporates all risks relating to that country, including the potential volatility of the national economy.

Country Ceilings for Foreign Currency Obligations

Moody's assigns a ceiling for foreign-currency bonds and notes to every country (or separate monetary area) in which there are rated obligors. The ceiling generally indicates the highest rating that can be assigned to a foreign-currency denominated security issued by an entity subject to the monetary sovereignty of that country or area. In most cases, the ceiling will be equivalent to the rating that is (or would be) assigned to foreign-currency denominated bonds of the government. Ratings that pierce the country ceiling may be permitted, however, in cases where foreign-currency denominated securities benefiting from special characteristics are judged to give them a lower risk of default than is indicated by the ceiling. Such characteristics may be intrinsic to the issuer and/or related to Moody's view regarding the government's likely policy actions during a foreign currency crisis.

Baseline Credit Assessment

Moody's baseline credit assessment incorporates the Government Related Issuer's (GRI) intrinsic credit strength and accounts for all aspects of the entity's existing (or anticipated) activities, including benefits (such as regular subsidies or credit extension) and/or detriments associated with the government relationship. In effect, the baseline credit assessment reflects the likelihood that a GRI would require extraordinary support.

Extraordinary Support

Extraordinary support is defined as action taken by a supporting government to prevent a default by a Government

Related Issuer (GRI) and could take different forms, ranging from a formal guarantee to direct cash infusions to facilitating negotiations with lenders to enhance access to needed financing. Extraordinary support is described as either low (0 - 30%), moderate (31 - 50%), strong (51 -70%), high (71 - 90%) and very high (91 - 100%).

Default Dependence

Default dependence reflects the likelihood that the credit profiles of two obligors may be imperfectly correlated. Such imperfect correlation, if present, has important diversifying effects which can change the joint-default outcome. Intuitively, if two obligors' default risks are imperfectly correlated, the risk that they would simultaneously default is smaller than the risk of either defaulting on its own.

In the application of joint-default analysis to GRIs, default dependence reflects the tendency of the GRI and the supporting government to be jointly susceptible to adverse circumstances leading to defaults. Since the capacity of the government to provide extraordinary support and prevent a default by a GRI is conditional on the solvency of both entities, the more highly dependent -- or correlated -- the two obligors' credit profiles, the lower the benefits achieved from joint support. In most cases GRIs demonstrate moderate to very high degrees of default dependence with their supporting governments, which reflects the existence of institutional linkages and shared exposure to economic conditions that draw credit profiles together.

Default dependence is described as either low (30%), moderate (50%), high (70%) and very high (90%).

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