MOODY'S
INVESTORS SERVICE

ANALYSIS

Great Places Housing Group

United Kingdom

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This Credit Analysis provides an in-depth discussion of credit rating(s) for Great Places Housing Group and should be read in conjunction with Moody's most recent Credit Opinion and rating information available on Moody's website.

Rating

Great Places Housing Group

Category	Moody's Rating
Outlook	Negative
Issuer Rating	
Global Scale, Domestic Currency	Aa3

Summary Rating Rationale

The Aa3 issuer rating of Great Places Housing Group (GPHG) reflects:

- The strong regulatory framework governing English housing associations;
- The high proportion of its revenues derived from government subsidies (housing benefit), which adds to revenue stability;
- Strong cash flows, with recent acquisitions supporting growing social housing letting;
- Growing exposure to development-for-sales;
- An ambitious development strategy, with a requirement for strong rental growth to support rising debt levels;
- Geographical concentration in the north of England;
- Moody's assessment of a very high likelihood that the UK government (Aaa, negative) would act to prevent a default by GPHG.

Peer Comparison

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, its adequate coverage from low-risk social housing letting and lower debt-to-asset ratio, but weaker margins, an ambitious development strategy, a regional focus in operations and a rising exposure to sales.

Rating Outlook

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

What Could Change the Rating – Up

Whilst unlikely in the near term given its planned expansion and the uncertainties in the economy, a stronger operating performance and more robust interest coverage, particularly from low-risk social housing letting, along with a reduction in debt would be considered credit positive. An ability to deliver in full its development targets while generating the strong rental growth as per its current forecasts would be essential for any rating upgrade. A reduced tolerance to interest rate risk and an increased margin on minimum liquidity, given an expectation of continuing developments, could also support future consideration for a rating upgrade.

What Could Change the Rating – Down

Weaker results in social housing letting, higher-than-projected debt and/or sustained lower coverage ratios, particularly from its social-housing-letting activities, could prove negative for the rating. Negative pressure could also develop from cash-flow instability resulting from (i) interest rates rising faster than current projections, (ii) margin calls on its stand-alone swap portfolio, and (iii) the direct payment of welfare benefits, including housing benefits, to tenants. 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.

Key Rating Considerations

Issuer Overview

Medium-sized, regional provider of social housing in the north of England

GPHG is a medium-sized social housing provider, managing around 16,000 homes as at March 2011. Operations are concentrated in the north of England, with core activities in and around Greater Manchester across 37 local authorities (see Figure 1), where demand for social housing is generally high and social housing rents are typically below market rates.

However, there are some pockets of economic weaknesses where social rents are closer to market rates, which increases competition with the private sector, adding pressure on costs and service delivery. This represents a marginal weakness against its peers, particularly those based in London and the South East, where social rents are reported to be significantly lower than market rates.

Great Places Housing Group is the non-asset owning parent of the group, which comprises two registered providers of social housing (Great Places Housing Association and Plumlife Homes Limited).

FIGURE 1
Map of Housing Stock

Source: Great Places Housing Group

Institutional Framework

Strong regulatory framework

English housing associations operate, and we believe will continue to operate, in a highly regulated environment, with strong oversight exercised by the sector's regulator – previously, the Tenant Services Authority, TSA, and now its successor under the new regulatory framework.

The regulator'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 inspections.

The regulator's powers of intervention to redress underperforming associations are wide-ranging and enable the regulator to direct various corrective actions to either prevent the occurrence of a full-blown crisis or, if a liquidity crisis draws nearer, ultimately to limit losses to investors. Amongst other things, the regulator can provide financial assistance, place restrictions on disposals or transfer of property, direct a transfer of management, appoint new officers and/or independent board members and make/execute mergers with healthier associations, including the transfer of all assets and liabilities.

Financial oversight retained under new regulatory framework

The Localism Act (recently enacted) introduces changes to the regulatory framework for English housing associations and provides for the abolition of the TSA, with the transfer of its regulatory functions to the Homes and Communities Agency (HCA), currently the national housing and regeneration delivery agency for England.

The move is intended to rein in government spending and to transfer the regulatory functions of the TSA to an independent financial regulatory committee within the HCA. The new regulatory regime retains many of the key features of the existing regime, including the strong financial oversight, but a lower emphasis on consumer regulation.

Revenue flexibility is limited, but "affordable rent" provides some leeway in the long term

An annual increase in social housing rent, which makes up 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. Housing associations can also offer fixed-term tenancy of a minimum of two years. Greater rent flexibility is credit positive as it should generate higher rental income to fund new social development.

To gain full credit strength from the rent reform, housing associations will be required to set new affordable rent levels to avoid a permanent rise in arrears and voids from their tenants. In the short to medium term, the impact of rent reform is anticipated to be limited. New tenants and re-lets, to whom the new rent regime will apply, make up a minor proportion of total income and most of the rental increase should be absorbed by a corresponding or similar amount in housing benefits from the government.

Government subsidies support revenue stability

A high share of social housing rental income (around 60% for GPHG) is made up of housing benefit attributable to tenants, most of which is transferred directly from local governments to housing associations. With the adoption of affordable rent, housing benefits to tenants (particularly those on full benefit and for some low-income workers on partial benefit) might rise further to absorb the additional rent increase.

Universal credit is credit negative; impact to be assessed on a case-by-case basis

The Welfare Reform Act (recently enacted) provides for the introduction of a "universal credit" system, whereby benefits (including housing benefits) are paid directly to tenants on a monthly basis. As a result of the application of universal credit, housing associations lose the advantage of direct payment – a credit strength in the sector – for a share of their rental income. This could expose housing associations to a rise in arrears and voids as rent collection becomes less stable, impacting cash flow and interest coverage. At the same time, costs associated with an increase in housing association staff to monitor and collect from tenants, as well as increased legal costs from disputes and an increase in evictions, could also arise.

Moody's expects the costs of "universal credit" to vary between housing associations depending on tenant profiles and overall reliance on government benefits. However, the following factors provide some comfort around implementation risk of the reform: (i) its applicability is limited to working age tenants only, with the remaining share of tenants over working age being exempt under the new system, hence direct payment to housing associations continue for a share of revenues to be assessed on a case-by-case basis; (ii) safeguards mechanisms are currently being tested under pilot schemes across

the country to limit the accumulation of arrears from tenants; and (iii) the new act provides for a gradual implementation of universal credit from October 2013, which adds flexibility and limits the implementation risk of the new IT driven system.

Financial Position and Performance

Lower sales drive down revenues; diverse revenue base

GPHG's revenue fell slightly to GBP67 million in FY2011 (2010: GBP69 million), due to lower sales.

» Revenue from social-housing letting (largely general needs) grew to GBP51 million in FY2011 (77% of revenue) from GBP48 million in FY 2010 (69%), largely due to inflation adjustments on its existing rents and new builds coming online.

» Revenue from sales (largely first-tranche shared-ownership sales) fell to GBP2 million (3% of revenue) in FY2011 from GBP7 million (10%), reflecting the deliveries tailing off against a pipeline, which has been scaled down to adjust against weaker market conditions.

The remaining share of revenues comes from a variety of activities, including supporting-people income (6% of revenues), development activities (4%), properties managed on behalf of other organizations (4%) and Homebuy direct income (2%). All of these activities are broadly market-driven and may fluctuate with the economy, adding potential volatility to revenues.

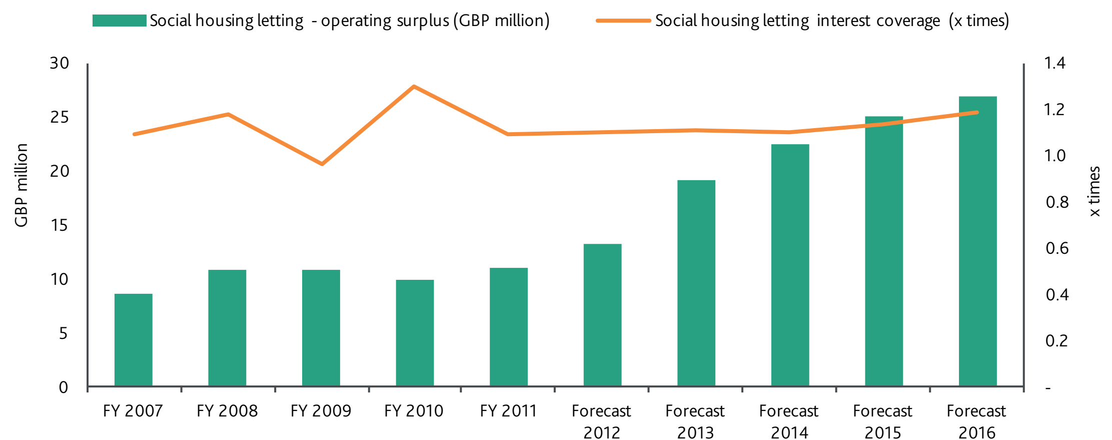
Stable operating margin; strong cash flows

Over the past five years, GPHG's operating margin has remained overall stable within its current levels, balancing strong revenue growth against higher maintenance costs in recent acquisitions.

Social-housing letting, a low-risk activity, contributed the bulk of total group surplus in 2011. As shown in Figure 2, GPHG's operating surplus from this form of letting has remained overall stable over the past five years, providing for a narrow interest coverage of 1.1x in 2011; this demonstrates GPHG avoided any reliance on sales and/or any other higher-risk activities to cover its interest costs.

FIGURE 2

Social-housing letting: operating surplus and coverage for total interest costs in FY2007-FY2011 and forecast for 2012-16



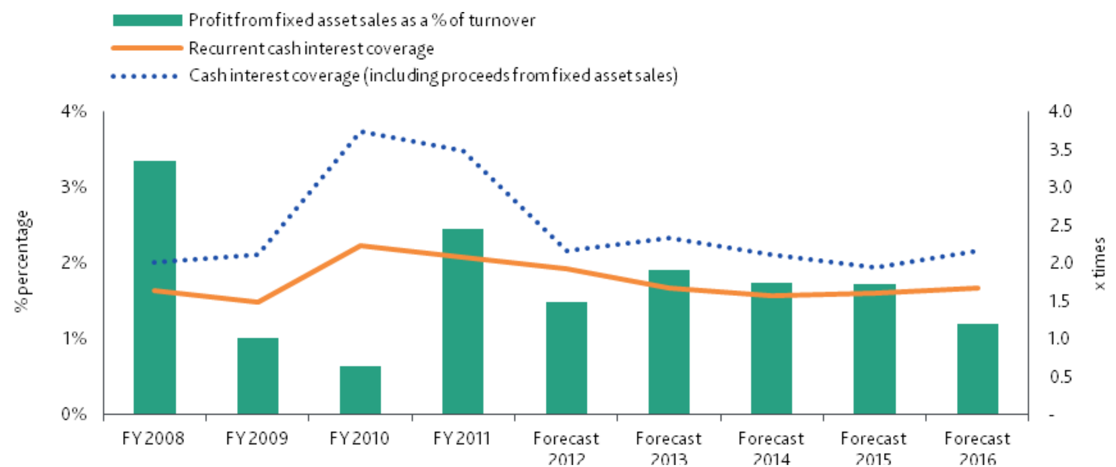
Source: Great Places Housing Group

Sales reported an operating surplus of 47% in 2011 (2010: -2%), which was a one-off and related solely to one well-performing scheme, with extra HCA grants reducing historic cost. At the same time, the lower cost of sales in FY2011 pushed down operating costs, and allowed operating surplus to reach 22% of revenues (2010: 19%), which is slightly above the sector average, but still below the average for Moody's-rated peers.

Cash flow from total operations (including sales) was stable in 2011, contributing to a recurrent cash-interest coverage of 2.1x (2010: 2.2x), which is strong against peers. Cash coverage has remained robust, even at the worst of the financial crisis in 2008, reflecting good working capital management, effective management of sales turnover and ongoing asset disposals (see Figure 3).

FIGURE 3

Profit from fixed-asset sales and cash-flow coverage in FY2008 – FY2011 and forecast for 2012-16



Source: Great Places Housing Group

Ambitious rental growth underpins stable social housing letting interest coverage; rising sales

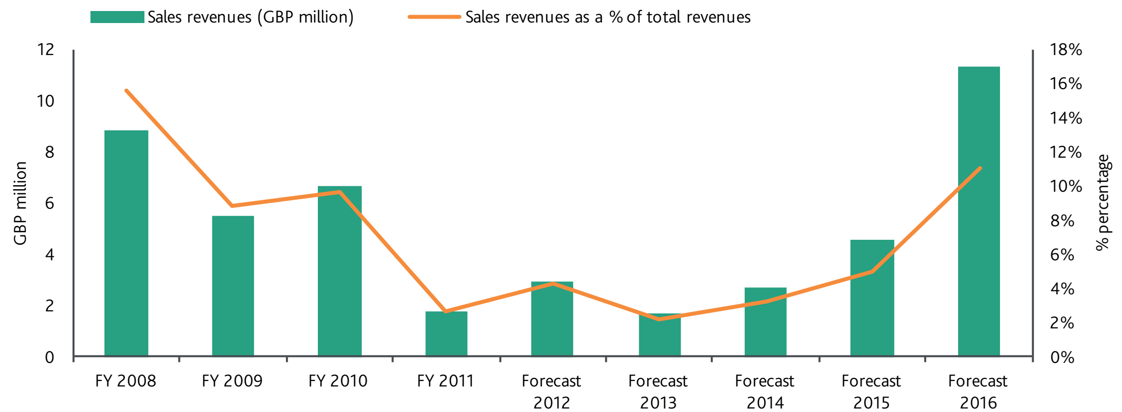
Social-housing letting is expected to remain the key source of GPHG's revenues and surplus and is expected to grow significantly from 2012 (see Figure 2), contributing to a stable interest coverage of around 1.1x-1.2x in 2012-16, in line with past results. GPHG anticipates rental growth to come from the delivery of its existing and new development pipeline, with social housing letting surplus expected to more than double over the next five years. This is an ambitious target as it relies on strong cost efficiencies and a steady development delivery. Until now, the track record of delivery with the HCA has been good. However, future potential downside risks may come from (i) cost overruns, particularly under weakening economic conditions, and (ii) delays in property delivery, which could trigger lower grant funding, which is largely paid on completion. In addition, interest rate assumptions against GPHG's sizable floating debt provide limited margin were rates to rise faster than current forecasts.

Most of the new development will come from affordable homes, with rent being set at 80% of market rates, including half of GPHG's re-lets. The rental increase from affordable rent is expected to remain modest, contributing little to GPHG's planned rental growth, particularly in early years of the plan.

Current projections account for some sales growing to 11% of revenues in 2016 (see Figure 4). Most of these sales are for shared ownership homes in and around the Greater Manchester area. Whilst this

level is not particularly high against Moody's rated peers, sales add risks to projections as they require tight cash flow management during construction and marketing, particularly in a weaker economy.

FIGURE 4
Sales revenues in FY2008 – FY2011 and forecast for 2012-16



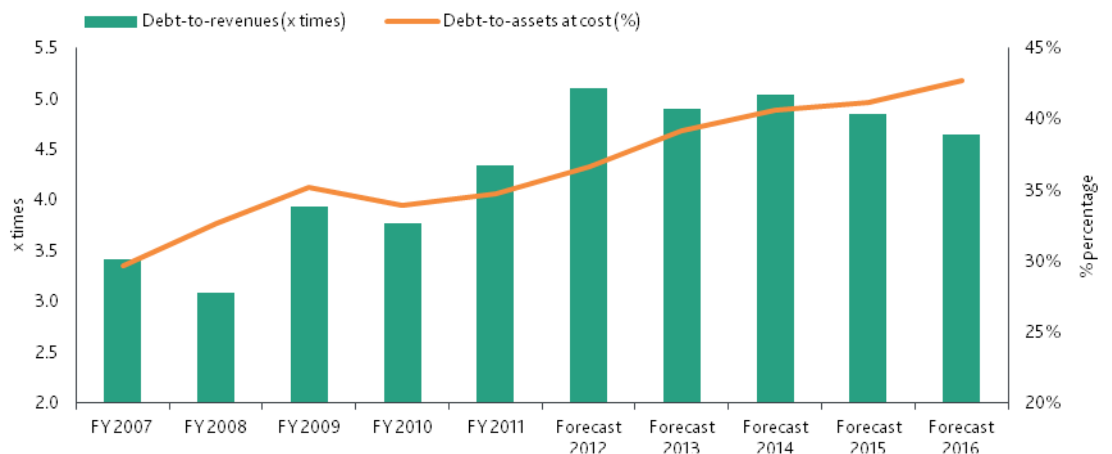
Source: Great Places Housing Group

Debt & Liquidity

Rising debt to support new development

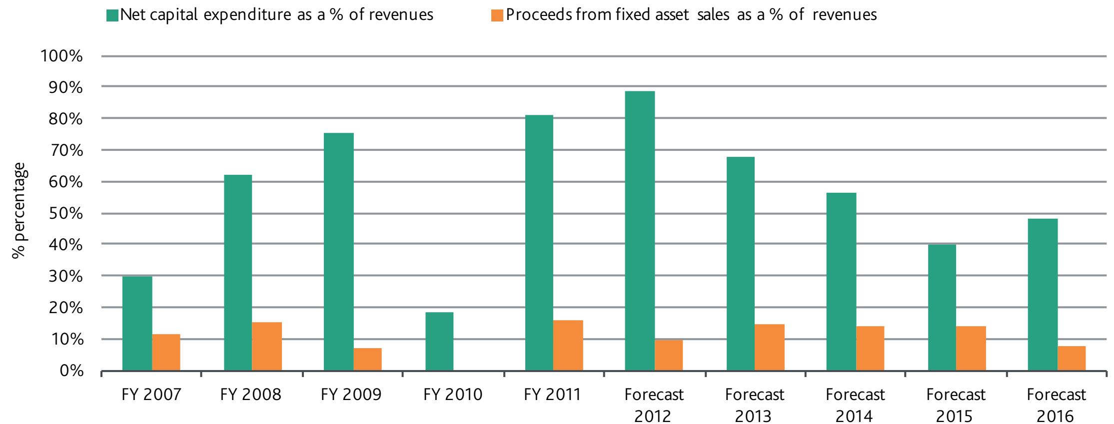
At FY2011, debt was GBP291 million, equal to around 4.3x revenues and 35% of assets (at cost). Over the past five years, debt has grown due to recent acquisitions, despite large capital grants from the government and ongoing asset disposals. The increase in the development programme is expected to push debt to around 5x revenues and 45% of assets in 2016 (see Figure 5). Capex will peak at 89% of revenues in 2012, which is above the average for Moody's rated peer. Proceeds from fixed asset disposals are expected to remain significant, averaging 12% of revenues in 2012-16 (see Figure 6).

FIGURE 5
Debt-to-revenue and debt-to-assets in FY2007 – FY2011 and forecast for 2012-16



Source: Great Places Housing Group

FIGURE 6
Capex burden and fixed-asset sales in FY2007 – FY2011 and forecast for 2012-16



Note: (i) Capex burden calculated as cash capital investment from housing and non-housing, net of grants and operating cash flow, as a % of revenues; if negative, burden from capital investment is nil, meaning capital investments are self-funded by operating cash flow and grants. Fixed asset sales calculated as proceeds from fixed asset sales as a % of revenues. (ii) Capex for FY 2007 includes first-time shared ownership sales as per the application of SORP 2005; from FY2008, figures are based on SORP 2008, with first-tranche shared ownership sales treated as ongoing activities/ current assets.
Source: Great Places Housing Group

Refinancing risk is low against its peers, with only 2% coming due within 5 years at end of March 2011. Management is currently seeking new source of financing to meet future refinancing exposures, and to lengthen its maturity profile.

Interest-rate risk is relatively high compared with Moody's rated peers, with 34% of GPHG's debt held at floating rates as of December 2011. Given expectations of continuing low rates, this exposure provides no imminent risk to GPHG's cash flow and coverage in the near-term; the low rates on a significant share of debt has helped reduce interest costs over the past three years. In the medium to long term, were rates to rise above current forecasts, and with no remedial actions being undertaken to reduce this floating rate exposure, projected levels of coverage and surplus might prove difficult to achieve, exerting pressure on the rating.

Immediately available liquidity is strong compared with its peers (GBP92 million, equal to around 137% revenues as of end of December 2011) and, with recently agreed lines, more than sufficient to cover the next three years cash requirements.

Governance and Management Factors

Stable management; leading developer in the north; appetite for sales and new debt

GPHG has a stable management team, with regional expertise in operations and development and an ambition for growth. Since its formation in 2006, the group has expanded rapidly both from direct development and by new acquisitions, doubling its size from around 8,000 to 16,000 homes under management. In November 2009, the group simplified its governance structure, which has helped support cost controls and risk management. GPHG is one of the leading developers in north of England. Its development strategy has been and remains ambitious and has historically been supported by high grant levels and asset disposals, which limited debt growth. Going forward, risk appetite has had to increase to respond to lower grant rates, which underlies plans including higher development-for-sales and debt levels.

Despite conservative practices, tolerance for liquidity and interest-rate risks; changes in counterparty policy reduces risk from margin call on derivatives

Despite strong levels of liquidity to date, liquidity guidelines allow for a lower threshold of liquidity, which is one of the lowest within Moody's rated peer, particularly for large developer. Cash is required to be maintained at a minimum of GBP10 million (17% of revenues).

Management targets maintaining up to 60% of its debt as fixed; currently exceeding the range to ensure extra fixing. Cancellable options cover 6% of debt, with a total potential exposure to floating rate rising to 40%, were rates to rise over strike prices. Business plan assumptions on LIBOR rates, averaging 2.6% in 2013-14, do not provide deep insulation against rapidly rising interest rates, were this to occur as a leading factor in a economic recovery or due to an external shock.

Half of GPHG's hedging portfolio includes stand-alone swaps. Margin calls have previously been manageable for GPHG, with recent declines in long-term rates pushing margin calls to a peak of around GBP10 million, which GPHG met with cash. Future exposure to margin calls are mitigated by (i) management's commitment to replace cash with property collateral, of which it has plenty (currently work in progress); (ii) the addition of derivative counterparties to facilitate greater diversification; and (iii) the introduction of term limits for new stand-alone hedging to a maximum of 10 years, which will limit duration risk.

Application of Joint-Default Analysis

As a reflection of the application of Moody's Joint Default Analysis methodology for government-related issuers, GPHG's rating is composed of three principal inputs:

» a baseline credit assessment (BCA) of 9 (on a scale of 1 to 21, where 1 represents the lowest credit risk);

» a very high likelihood that the UK government (Aaa, negative) would act to prevent a default by GPHG; and

» a very high level of default dependence between the UK government and GPHG.

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.

Company Annual Statistics

Great Places Housing Group

(GBP million)	31-Mar-07 Realized	31-Mar-08 Realized	31-Mar-09 Realized	31-Mar-10 Realized	31-Mar-11 Realized
INCOME & EXPENDITURE ACCOUNT					
Turnover	42.9	56.6	62.1	68.7	66.9
Operating costs	33.3	44.3	49.2	55.6	52.0
Operating surplus	9.6	12.3	12.9	13.1	14.9
Surplus on disposal of property and other fixed assets	1.1	1.9	0.6	0.4	1.6
Interest receivable and similar income	0.7	0.8	0.9	0.1	0.1
Interest payable and similar charges	8.0	10.5	10.3	9.4	11.3
Other income/(expenses)	0.0	0.1	0.1	0.1	0.0
Surplus on ordinary activities before taxation	3.3	4.6	4.2	4.2	5.3
Tax on surplus on ordinary activities	-0.1	0.0	0.0	0.2	0.2
Surplus/(deficit) for the year	3.4	4.6	4.2	4.1	5.2
BALANCE SHEET					
Fixed assets	184.9	206.1	277.4	318.1	355.0
of which, Properties	178.3	199.4	269.5	309.7	347.2
Current assets	24.6	41.3	58.2	46.7	44.1
of which, Cash at bank and in hand	12.1	9.5	16.0	15.5	10.8
Creditors: amounts falling due within one year	18.6	23.5	28.8	40.5	37.2
of which, Short-term debt	2.1	1.5	1.4	2.6	1.7
Long term liabilities	149.2	175.7	244.5	258.2	290.8
of which, Long-term debt	144.3	173.3	242.6	256.4	288.9
Capital and reserves	41.7	48.2	62.2	66.0	71.2
CASH FLOW STATEMENT					
Net cash flow from operating activities	14.7	9.9	19.5	28.8	24.3
Returns on investments and servicing of finance	-7.8	-9.2	-11.3	-7.6	-10.1
Net cash flow from operating activities after interest	6.9	0.7	8.3	21.3	14.2
Capital expenditure	-14.8	-27.5	-50.7	-34.4	-57.9
of which, social housing and non-social housing development	-39.7	-56.5	-87.2	-87.8	-111.1
of which, social housing grants	20.0	20.5	32.3	54.0	42.5
of which, fixed-asset sales	4.9	8.5	4.2	-0.6	10.8
Net cash flow before management of liquid resources and financing	-7.9	-26.8	-42.4	-13.1	-43.7
Management of liquid resources	1.3	0.0	-3.1	-1.6	8.4
Financing	7.1	24.1	51.0	14.2	30.8
Increase/(decrease) in cash	0.4	-2.7	6.6	-0.6	-4.7

Great Places Housing Group

(GBP million)	31-Mar-07 Realized	31-Mar-08 Realized	31-Mar-09 Realized	31-Mar-10 Realized	31-Mar-11 Realized
RATIOS					
Units under management	10,811	13,858	14,781	14,969	15,722
Housing asset (GBP million)	178.3	199.4	269.5	309.7	347.2
Low-risk social housing letting: % revenues	77%	70%	73%	69%	77%
Low-risk social housing letting: operating margin	26%	27%	24%	21%	22%
Low-risk social housing letting: coverage for total interest	1.1	1.2	1.0	1.3	1.1
Sales: % revenues	3%	16%	9%	10%	3%
Sales: % margin	18%	11%	9%	-2%	47%
Operating margin %	22%	22%	21%	19%	22%
Total margin before tax (%)	8%	8%	7%	6%	8%
Recurrent cash interest coverage (x times)	1.6	1.6	1.5	2.2	2.1
Cash interest coverage (x times)	1.9	1.1	1.7	3.8	2.4
Net capex burden (adding back operating cash flow and capital grants) as % turnover	30%	62%	75%	18%	81%
Debt to revenues (x times)	3.4	3.1	3.9	3.8	4.3
Debt to assets at cost (%), adding back grants	30%	33%	35%	34%	35%

Moody's Related Research

Credit Opinions:

» Affinity Sutton Group Ltd
» Amicus Horizon
» Circle
» East Thames
» Genesis Housing Association
» Hastoe
» Hyde Group
» L&Q Group
» Midland Heart
» Moat Homes
» Notting Hill Housing Group
» Peabody Trust
» PfP Homes
» Radian
» Sanctuary Housing Association
» Sovereign Housing Group

Issuer Comments:

» UK Housing Benefit Reforms: Credit-Negative Impact, but Rating Outlooks on UK Housing Associations Remain Stable, March 2011 (131801)
» English Housing Associations: No immediate rating impact from changes, although rent flexibility is credit-positive, November 2010 (129017)

Special Comments:

» Vestia's Margin Calls Not Indicative of Moody's Rated English Housing Associations, March 2012 (140804)
» Adjusting European Sovereign Ratings to Better Capture Credit Susceptibility to Downside Risks, February 2012 (139752)
» Key Drivers of Moody's Actions on European Sub-Sovereign Ratings, February 2012 (139829)
» English Housing Associations: Negative Sector Outlook Mirrors UK Sovereign Rating, Given Strong Linkages, February 2012 (139568)

Rating Methodologies:

» English Housing Associations, September 2010 (122575)
» Government-Related Issuers: Methodology Update, July 2010 (126031)

Rating Implementation Guidance:

» How Sovereign Credit Quality May Affect Other Ratings, February 2012 (139495)

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