

## CREDIT OPINION

18 December 2018

✓ Rate this Research

### RATINGS

#### Great Places Housing Group

Domicile	United Kingdom
Long Term Rating	A3
Type	LT Issuer Rating - Dom Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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## Great Places Housing Group (United Kingdom)

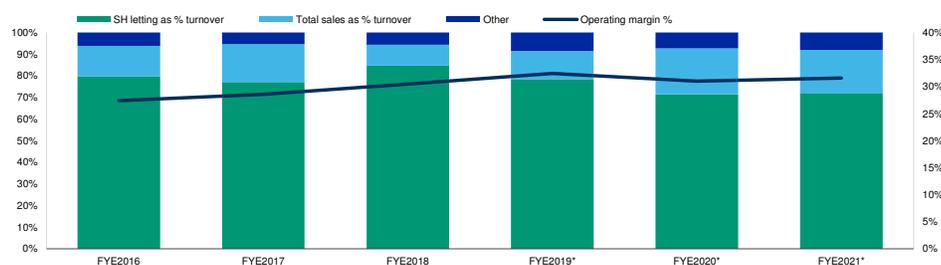
Update to credit analysis

### Summary

The credit profile of [Great Places Housing Group \(Great Places, A3 stable\)](#) reflects its ample liquidity, stable financial performance and debt levels, in addition to increasing exposure to market sales. Great Places' credit profile also benefits from our assessment that there is a strong likelihood that the [Government of the United Kingdom \(Aa2 stable\)](#) would intervene in the event that Great Places faces acute liquidity stress.

Exhibit 1

**Great Places' operating margin will stabilise to FY2021, as exposure to market sales increases**  
 Great Places' operating margin (%), social housing lettings as a percentage of turnover, sales as a percentage of turnover



FYE2016 has been restated in FRS102 format. \*FY2019-21 are forecasts.  
 Sources: Great Places, Moody's

### Credit strengths

- » Ample liquidity and low interest rate risk
- » Stable financial performance
- » Strong regulatory framework and stable operating environment

### Credit challenges

- » Moderate, but increasing, exposure to market sales
- » Relatively high, but stable, debt levels

### Rating outlook

The stable outlook on Great Places reflects its stable core financial performance and the stable outlook on the sovereign rating.

## Factors that could lead to an upgrade

We would consider upgrading Great Places' rating from one or a combination of the following: (1) a structural improvement in its operating margin to at or above 35%, (2) there is a significant reduction in its debt levels, or (3) social housing letting interest coverage structurally exceeds 1.6x.

## Factors that could lead to a downgrade

Negative pressure on the rating could result from one or a combination of the following: (1) a weakening in financial performance, with social housing letting interest coverage falling below 1.0x on a structural basis, (2) a sustained increase in debt to above 5.5x revenue, (3) a significant increase in exposure to market sales beyond what is planned to date. In addition, a weaker regulatory framework, a dilution of the overall level of support from the UK government or a downgrade of the UK's sovereign rating could also exert downward pressure on the rating.

## Key indicators

Exhibit 2

Great Places Housing Group								
	31-Mar-14	31-Mar-15	31-Mar-16	31-Mar-17	31-Mar-18	31-Mar-19*	31-Mar-20*	
Units under management (no.)	16,785	17,515	18,409	18,908	19,171	19,344	19,750	
Operating margin, before interest (%)	29.8	34.2	27.4	28.6	30.5	32.4	31.0	
Net capital expenditure as % turnover	45.5	84.8	41.9	24.3	16.2	39.2	33.6	
Social housing letting interest coverage (x times)	1.1	1.4	1.3	1.2	1.3	1.2	1.2	
Cash flow volatility interest coverage (x times)	1.5	2.1	0.9	1.9	1.6	1.5	1.7	
Debt to revenues (x times)	4.8	5.2	4.8	4.9	5.5	5.0	4.8	
Debt to assets at cost (%)	39.6	46.2	47.2	47.8	46.6	46.7	47.2	

FY2019\* and FY2020\* are forecast figures. Note that FY2015 and onwards are prepared in FRS102 format while prior years were prepared using the UK GAAP.  
Sources: Great Places, Moody's

## Detailed credit considerations

### Baseline Credit Assessment

#### Ample liquidity and low interest rate risk

Great Places' liquidity position is strong at 2.14x as of 31 March 2018, higher than the A3 peer median of 1.6x. This level of liquidity is equal to its forecast net cash requirements for the next four years. The association's cash and cash equivalents were equal to £55.1 million as of the year end, and immediately available facilities provided an additional £118.9 million. In addition, Great Places also has access to an extra £17.8 million of cash on a 30-day deposit. However, the association is somewhat hindered by a low level of unencumbered assets, which would provide an additional borrowing capacity of £93.5 million. This limits Great Places' funding flexibility in the future, and it expects to use this borrowing capacity to fund its development programme to FY2023, although we also consider that its development programme will add more uncharged stock over time.

Great Places maintains a strong liquidity policy, including four main targets, which have all been met during the year. The targets include holding a minimum of £20 million in cash at all times, liquid funds equal to the forecast net outflow for the next six months, short-term funds equal to the forecast net outflow for the next calendar year and medium-term funds equal to the forecast net cash flow for the next three years.

Great Places expects to fund most of its development programme from its net cash flow and market sales receipts — around £252 million out of a total development spend of £481 million between FY2019 and FY2023. The remainder of funding includes capital grant receipts of £82 million and net debt of £117 million.

Great Places has a low level of interest rate risk. Less than 10% of its debt is exposed to variable rates, with the remainder on fixed rates or hedged using standalone swaps. The latest position is in line with Great Places' treasury policy, which requires a minimum of 75%

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of total debt at fixed rates. The association hedges a sizeable share of its interest-rate risk using standalone swaps. These contracts have a notional value of £127 million and had a negative mark-to-market value of just under £41 million as of the end of March 2018. It currently has collateral of £17 million posted in a mixture of property and cash. Its treasury policy ensures that the group maintains cash balances to a minimum of £20 million. It has recently secured a new, immediately available, £30 million facility from NatWest to act as a standby facility to fully cover their outstanding mark-to-market exposure if a margin call materialised overnight. Although cash posting is more flexible than using property as security, it adds complexity to cash management, requires strict monitoring and limits liquidity.

#### **Stable financial performance**

Great Places' operating margin has increased from 29% in FY2017 to 30% in FY2018. It is expected to remain stable between 30% and 32% until FY2023. The margin is slightly below the median of its A3-rated peers of 32% in FY2018, but is expected to be slightly above the median level (29%-31%) from FY2019 to FY2023. The improvement in the margin is largely dependent on the transformation programme it is currently implementing - "Building Greatness" - which intends to mitigate the impact of the 1% rent cut until FY2020. To date, the transformation programme has realised £7 million of savings (from FY2016), with savings of £5 million expected in FY2019, when the focus will be on streamlining Great Places' investment systems and head office functions. Great Places' management highlights the operating margin as one of their four golden rules, aiming to maintain a minimum level of 28%.

Great Places' social housing letting interest coverage is slim, but stable. The measure was 1.3x in FY2018 and is expected to be between 1.2x and 1.3x until FY2023. This ratio reflects the stability of its debt metrics and also the relatively high level of debt. It is moderately below the A3 peer median of 1.4x in FY2018 and the expected average peer median of 1.4x until FY2023.

However, its cash flow volatility interest coverage is stronger, with a coverage of 1.6x in FY2018, and is expected to remain strong at an average of 1.8x until FY2023, reflecting the stability of its cash flows and the moderate risk exposure of its development programme.

#### **Strong regulatory framework and stable operating environment**

The sector's credit quality will continue to benefit from the strong regulatory framework and oversight by the Regulator for Social Housing. The regulator maintains strong oversight through quarterly returns, long-term business plans, annual reviews and undertaking in-depth assessments of entities, where deemed necessary. Additionally, the regulator has powers to make board member and manager appointments where there has been a breach of regulatory standards. Since October 2017, the regulator has charged fees for social housing regulation as a means of enhancing the independence and maintaining the effectiveness of the regulator.

We do not expect additional material adverse policy shifts for the sector and consider the operating environment to be stable in the medium term. Adverse policies announced in the last few years will continue to strain revenue, especially the effects of the 1% annual decrease in social rents (until FY2020) and Universal Credit (a pillar of broader welfare reform measures). However, housing associations have demonstrated resilience to adverse policies to date and been proactive in mitigating the impact. A reduction in capital grant for new social housing over the last five years has led to increased exposure to market sales activity, which has more than doubled since 2012 to reach 17% of turnover in FY2018 for housing associations that we rate.

#### **Moderate, but increasing, exposure to market sales**

Social housing letting as a percentage of Great Places' turnover was around 85% in FY2018, but is expected to fall to an average of 73% over the next five years. Total sales (first tranche shared ownership and outright sales) accounted for 10% of turnover in FY2018 and will account for around 19% on average over the next five years. This remains a moderate exposure to market sales, even though total levels have increased on a historical basis.

Great Places' development programme is for 3,290 units over the next five years. The development pipeline has a projected tenure mix that includes 50% affordable housing, 35% shared ownership, 1% market rent and 14% outright sales. Net capital spending was 16% of turnover in FY2018, below the A3 peer median of 25%, indicating that the development programme remains in line with peers. Great Places secured a Homes England Strategic Partnership in July 2018, which runs from 2018 to 2022 and includes 750 additional affordable homes and around £30 million of grant.

**Relatively high, but stable, debt levels**

Great Places' debt was £545.5 million as of FYE2018, around 5.5x revenue and 47% of assets at cost — debt-to-revenue has increased from 4.9x in FY2017 because of the debt issuance in the year, although debt net of cash has decreased from £482.5 million in FY2017 to £479 million in FY2018. According to the business plan, debt will grow to £622.4 million in FY2021, equivalent to 5.1x the forecast FY2021 revenue and 47% of assets at cost. While Great Places' debt is increasing in quantum, the association's gearing is projected to remain stable and below its A3 peers (FY2017 A3 debt-to-assets median: 54.6%). This is, however, contingent on the successful implementation of the group's development programme, in which assets are forecast to grow proportionally with total debt.

In FY2018, Great Places issued a £145 million tap issue on its bond, taking its total bond facility amount to £345 million. This included a retained element of £70 million, which can be issued at any time up until March 2020, subject to market conditions at the time. The bond matures in 2042. In FY2019, Great Places replaced its £60 million revolving credit facility with the Royal Bank of Canada (expired in November 2018) with a new £30 million revolving credit facility with Natwest as planned in last year's treasury strategy.

Refinancing risk is very low — no debt is due within the next five years.

**Extraordinary support assumptions**

The strong 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 the possibility of a facilitated merger or a transfer of engagements. Recent history has shown that the UK government is willing to support the sector, as housing remains a politically and economically sensitive issue. The strong support assumption also factors in the increasing exposure to non-core social housing letting activities in the sector that add complexity to housing association operations and the weakening of the sovereign's financial resilience, making an extraordinary intervention slightly more challenging. In addition, our assessment that there is a very high default dependence between Great Places and the UK government reflects their strong financial and operational links.

## Rating methodology and scorecard factors

The assigned Baseline Credit Assessment (BCA) of baa1 is the same as the scorecard-suggested BCA.

The methodologies used in this rating were [European Social Housing Providers](#) rating methodology, published in April 2018, and [Government Related Issuers](#) rating methodology, published in June 2018.

Exhibit 3

### Rating factors

#### Great Places Housing Group

Baseline Credit Assessment	Sub-factor Weighting	Value	Score
Scorecard			
<b>Factor 1: Institutional Framework</b>			
Operating Environment	10%	a	a
Regulatory Framework	10%	a	a
<b>Factor 2: Market Position</b>			
Units Under Management	10%	19,171	baa
<b>Factor 3: Financial Performance</b>			
Operating Margin	5%	30.5%	a
Social Housing Letting Interest Coverage	10%	1.3x	baa
Cash-Flow Volatility Interest Coverage	10%	1.6x	baa
<b>Factor 4: Debt and Liquidity</b>			
Debt to Revenue	5%	5.5x	b
Debt to Assets	10%	46.6%	ba
Liquidity Coverage	10%	2.1x	aa
<b>Factor 5: Management and Governance</b>			
Financial Management	10%	baa	baa
Investment and Debt Management	10%	baa	baa
<b>Suggested BCA</b>			<b>baa1</b>

Sources: Moody's Investors Service, Great Places Housing Group

## Ratings

Exhibit 4

Category	Moody's Rating
<b>GREAT PLACES HOUSING GROUP</b>	
Outlook	Stable
Issuer Rating - Dom Curr	A3
Senior Secured - Dom Curr	A3

Source: Moody's Investors Service

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