



Rating_Action: Moody's has taken rating actions on 13 UK housing associations

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London, January 30, 2023 – Moody's Investors Service ("Moody's") has today taken rating actions on 13 housing associations (HAs), and nine special purpose vehicles (SPVs) domiciled in the United Kingdom (UK).

Moody's has downgraded the Baseline Credit Assessments (BCAs) of 12 HAs by one notch and of one HA by two notches. The BCA of Alliance Homes Group (Alliance) was downgraded to a3 from a2; the BCAs of Citizen Housing Group Limited (Citizen), and Sovereign Housing Association (Sovereign) were downgraded to baa1 from a3; the BCAs of Great Places Housing Group (Great Places), The Guinness Partnership Ltd. (Guinness), L&Q Group (L&Q), Paragon Asra Housing Ltd (PA Housing), Saffron Housing Trust (Saffron), Saxon Weald and Yorkshire Housing Limited (Yorkshire) were downgraded to baa2 from baa1; the BCA of Newlon Housing Trust (Newlon) was downgraded to baa3 from baa2; and the BCA of Poplar HARCA was downgraded to ba1 from baa3. Moody's has also downgraded the BCA of Riverside Group (Riverside) by two notches to baa2 from a3. At the same time, Moody's has affirmed the ratings of Great Places, Guinness, L&Q, PA Housing, Saffron, Saxon Weald and Yorkshire, as well as their SPVs, at A3. Moody's simultaneously downgraded the ratings of six issuers and their SPVs: Alliance to A2 from A1; Citizen, Riverside and Sovereign to A3 from A2; Newlon to Baa1 from A3; and Poplar HARCA to Baa2 from Baa1. The outlooks remain negative on all affected issuers.

Please click on this link https://www.moody's.com/viewresearchdoc.aspx?docid=PBC_ARFTL472528 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and identifies each affected issuer.

RATINGS RATIONALE

RATIONALE FOR DOWNGRADING THE RATINGS OF SIX HOUSING ASSOCIATIONS AND FOUR SPVS

The downgrade of Alliance's issuer rating to A2 from A1 reflects metrics more in line with A2-rated peers due to rising debt levels and lower interest coverage ratios.

The downgrade of the issuer and debt ratings of Sovereign, Citizen and Riverside and their SPVs to A3 from A2 reflects their increased risk profile and weakened credit metrics, which are now more in line with A3-rated peers.

The downgrade of Newlon's issuer rating to Baa1 from A3 reflects the anticipated worsening of its debt and interest cover metrics.

The downgrade of the issuer and debt ratings of Poplar HARCA and its SPV to Baa2 from Baa1

reflects its weaker metrics than peers, including weak operating margins and interest covers as well as higher exposure to market sales, which make it more vulnerable to weaker economic conditions.

RATIONALE FOR AFFIRMING THE RATINGS OF SEVEN HOUSING ASSOCIATIONS AND FIVE SPVS AT A3

The rating affirmations of Great Places, Guinness, L&Q, PA Housing, Saffron, Saxon Weald and Yorkshire, as well as their SPVs, reflect their credit metrics remaining in line with A3 rated peers, despite them weakening compared with previous years. Whilst the operating margins have weakened for all these issuers, Saffron and Saxon Weald continue to outperform the median for A3 rated peers and PA Housing is still in line with the median of A3 rated peers. Guinness, Great Places, L&Q and Yorkshire retain strong balance sheets, with gearing in line with or below peers. All continue to display solid liquidity coverage, with liquidity policies in line with the sector – typically covering more than 24 months of net cash needs.

RATIONALE FOR DOWNGRADING THE BASELINE CREDIT ASSESSMENTS OF 13 HOUSING ASSOCIATIONS

The downgrades of the BCAs reflect the HAs' high exposure and lower resilience to weakening economic conditions, including prolonged high inflation, capped social rent increases, a housing market downturn and higher interest rates. This is predominantly due to these HAs having one or more of the following characteristics making them more vulnerable to these factors: weak operating performance going into the current weaker economic environment; a high level of necessary expenditure which limits spending flexibility; a high reliance on revenues from market sales; substantial development programmes; or a high proportion of variable rate debt or financing (including refinancing) needs.

Some HAs have lower operating margins than rated peer medians, making them less resilient to the weaker operating environment. In fiscal 2022, L&Q, Poplar HARCA, Riverside and Yorkshire had operating margins below 20% and Alliance, Citizen, Guinness and PA Housing below 25%. These HAs have less headroom to manage further deterioration in margins stemming from the adverse differential between social rent increases (4.1% in fiscal 2023 and 7% in fiscal 2024) and cost increases, with inflation currently at 10.5% (Consumer Prices Index as of December 2022).

The downgrades also reflect the exposure to high cost inflation for the HAs with less flexible cost bases - primarily due to high levels of expenditure related to fire safety, building quality and decarbonisation - which limits their ability to contain higher costs, driving lower surpluses and higher debt. Although many rated HAs are near completion on their works in relation to fire and building safety, some still have considerable expenditure anticipated. Those include Citizen, Guinness, L&Q, PA Housing, Newlon, Riverside and Sovereign, for which the provision for spending related to fire and building safety over the next five years will be significantly higher than the median of 10% of fiscal 2022 operating revenue for rated HAs. There is also considerable variation in exposure to decarbonisation costs. Whereas some HAs have almost 100% of stock at EPC-C or above, others are at levels of 50-65% including Poplar HARCA, Saffron, Saxon Weald and Yorkshire whose position compares poorly with the median of 72% for rated HAs.

The downgrades also incorporate the greater exposure to a housing market downturn for some HAs. Moody's expects house prices to contract by 5% in both 2023 and 2024 in the UK. HAs with higher exposure to market sales (first tranche shared ownership and outright sales) are unlikely to achieve forecast income, leading to lower surpluses and tighter interest cover covenants, as well as reduced funds to finance development. Poplar HARCA and L&Q are the most exposed

HAs in Moody's portfolio, expecting over 30% of turnover from market sales (including joint ventures) over the next three years; a very high exposure. Similarly, Guinness, Great Places, PA Housing, Saffron, Sovereign and Yorkshire are more exposed than the rated peer median, expecting to generate over 20% of their turnover from market sales.

The downgrades also reflect continued high levels of development risk, which generally drives higher debt, for some HAs. Most rated HAs have scaled back development programmes due to rising interest rates and weakening market conditions. However, Great Places, PA Housing, and Sovereign continue to have substantial and ongoing capital spending needs due to their more ambitious development programmes. Their net capital expenditure is anticipated to average over 60% of turnover over the next three years, compared with the rated peer median of 40%. Alliance, Newlon and Saxon Weald also anticipate high net capital expenditure over the next three years, at 40% to 60% of turnover. Interest coverage ratios will weaken for these HAs, given higher interest rates.

Lastly, the downgrades highlight higher treasury risks faced by some HAs, including high levels of variable rate debt and high medium-term refinancing needs, which will result in higher financing costs, weakening interest coverage ratios and covenant headroom. With less than 70% of drawn debt at fixed rates, L&Q and Riverside are the most exposed followed by Guinness, Alliance and Newlon which all have less than 80% of drawn debt at fixed rates. L&Q, Riverside and PA Housing are more exposed to refinancing risks than rated peers, with more than 20% of their debt due in the next five years. Headroom on covenants, especially interest cover covenants have also weakened for many, with Citizen, Great Places, L&Q, PA Housing, Poplar HARCA, Riverside, and Saxon Weald forecasting tight headroom on at least one interest coverage covenant over the next two fiscal years, a credit negative.

The ratings also reflect underlying sector strengths, including high demand for social housing, strong asset bases, a track record of proactive cost control, effective oversight by the regulator, and generally high liquidity and high proportion of long-dated fixed rate debt.

The ratings incorporate a one to two notch uplift based on Moody's assessment of a strong likelihood of extraordinary support from the UK government.

RATIONALE FOR MAINTAINING THE NEGATIVE OUTLOOKS

The negative outlooks reflect the high uncertainty over future economic and financial conditions – including the risk of further below-inflation social rent caps, the risk of persistently high cost inflation throughout fiscal 2024 and into fiscal 2025, the depth of the housing market downturn and the pace of interest rate rises. The negative outlooks also reflect the negative outlook on the UK Government.

ESG CONSIDERATIONS FOR HOUSING ASSOCIATIONS

The overall impact of ESG risks on ratings varies for rated HAs. For a majority, the impact is neutral to low (CIS 2), but some have a moderately negative (CIS 3) impact.

Environmental risks are neutral-to-low or moderately negative for the sector. The primary environmental risk facing HAs is carbon transition risk resulting from the legislative requirement to improve the energy efficiency of existing housing stock, leading to increased expenditure. However, some HAs already meet energy efficiency requirements on the vast majority of their housing stock and therefore have relatively minimal levels of required decarbonisation expenditure over the medium term, limiting credit impacts.

Social considerations have a moderate to highly negative impact on the sector's credit profile. This mainly reflects exposure to risks from responsible production and demographic and societal trends. Responsible production risks include the requirement to improve the safety of the existing housing stock, which increases expenditure. Demographic and societal trend risks reflect the vulnerability of the sector to government policy which controls rent setting as well as to affordability challenges. HAs with weaker issuer profile scores for social risks typically have higher costs for building and fire safety due to the nature of their housing stock.

Governance risks are neutral-to-low to moderately negative. Governance in the sector is generally fit for purpose, with good oversight of business risks, strong financial planning and risk management processes, detailed reporting and simple organisational structures. The regulatory framework also supports good governance. HAs with moderately negative issuer profile scores for governance risks typically have weaker financial management and/or weaker investment and debt management policies and practices.

FACTORS THAT COULD LEAD TO AN UPGRADE OR DOWNGRADE OF THE RATINGS

Rating upgrades are unlikely given the negative outlooks. The negative outlooks could be changed to stable if the HAs are able to maintain relatively stable financial metrics over the medium term. This could be driven by better operating performance than anticipated, including the ability to contain cost pressures, and reductions in development plans leading to lower debt levels than anticipated.

The ratings could be downgraded as a result of one or a combination of the following: a further significant sustained weakening in operating margins and interest coverage ratios; material increases in debt levels beyond that currently anticipated; significant deterioration in liquidity; significant scaling up in market sales exposure beyond what is planned; or any weakening of the regulatory framework or dilution of the overall level of support from the UK government. A downgrade of the UK sovereign rating would also place downward pressure on the ratings.

The methodologies used in these ratings were European Social Housing Providers published in April 2018 and available at <https://ratings.moodys.com/api/rmc-documents/64685>, and Government-Related Issuers Methodology published in February 2020 and available at <https://ratings.moodys.com/api/rmc-documents/64864>. Alternatively, please see the Rating Methodologies page on <https://ratings.moodys.com> for a copy of these methodologies.

REGULATORY DISCLOSURES

The List of Affected Credit Ratings announced here are all solicited credit ratings. For additional information, please refer to Moody's Policy for Designating and Assigning Unsolicited Credit Ratings available on its website <https://ratings.moodys.com>. Additionally, the List of Affected Credit Ratings includes additional disclosures that vary with regard to some of the ratings. Please click on this link https://www.moodys.com/viewresearchdoc.aspx?docid=PBC_ARFTL472528 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and provides, for each of the credit ratings covered, Moody's disclosures on the following items:

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- Lead Analyst
- Releasing Office
- Person Approving the Credit Rating

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.moody's.com/rating-definitions>.

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The ratings have been disclosed to the rated entity or its designated agent(s) and issued with no amendment resulting from that disclosure.

Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

Moody's general principles for assessing environmental, social and governance (ESG) risks in our credit analysis can be found at https://ratings.moody's.com/documents/PBC_1288235.

At least one ESG consideration was material to the credit rating action(s) announced and described above.

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