MOODY'S
PUBLIC SECTOR EUROPE

CREDIT OPINION

9 February 2017

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RATINGS

Moat Homes

Domicile	United Kingdom
Long Term Rating	A1
Type	LT Issuer Rating - Dom Curr
Outlook	Negative

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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Moat Homes

Update to Key Credit Factors

Summary Rating Rationale

The A1 issuer rating assigned to Moat Homes (MOA) reflects its healthy margins, ample social housing interest coverage and modest levels of debt. The rating also takes into account MOA's increasing exposure to market sales and anticipated rise in debt to fund its development programme.

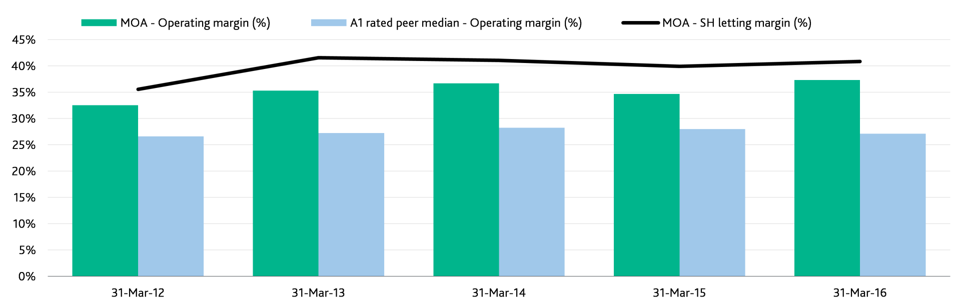
In addition, Moat's A1 rating benefits from the strong regulatory framework governing English housing associations and our assessment that there is a strong likelihood that the UK government (Aa1 negative) would intervene in the event that MOA faced acute liquidity stress.

MOA is rated at the upper end of Moody's-rated English housing associations, whose ratings span from Aa3 to Baa1.

Exhibit 1

Moat has benefited from a consistently stronger operating margin over its peers, this is driven by a strong margin on their core social housing business.

Operating margin (%) and social housing letting margin (%)



Note: FY2015 and FY2016 have been restated in FRS102 format.
Source: Moat and Moody's

Credit Strengths

» Solid Social Housing Letting Interest Coverage metrics and strong margins

» Medium-sized association with a straightforward structure

» Strong regulatory framework

Credit Challenges

» Projected increase in exposure to riskier market sale activity

» Debt levels expected to rise from relatively low base

» Government policy changes make operating environment more challenging for housing associations.

Rating Outlook

The negative outlook on Moat's rating reflects the negative impact of the vote to leave the European Union on housing associations as well as the negative outlook on the sovereign rating, reflecting the close institutional, operational and financial linkages between the central government and housing associations.

Factors that Could Lead to an Upgrade

Given the negative outlook, upward ratings pressure on HAs is unlikely to develop in view of the challenging operating environment and weakened sovereign credit conditions. Strengthening credit metrics of stand-alone credit profiles, however, could put stabilising pressure on Moat's rating. A combination of the following could have positive rating implications:

» reduced exposure to market sale activities;

» maintenance of a healthy operating margin;

» social housing letting interest coverage rising to, and remaining at or above, 1.9x.

Factors that Could Lead to a Downgrade

Downward ratings pressure on the affected HAs would be prompted by further deterioration of the UK sovereigns' creditworthiness. Additionally, any sector or issuer-specific risks emerging in this context would exacerbate downward ratings pressures. Negative pressure could be exerted on the rating by one or a combination of following:

» a deterioration of Social Housing Letting Interest Coverage ratio in relation to peers;

» persistent weakness in the Cash Flow Volatility Interest Coverage ratio;

» a slump in current liquidity position;

» increased reliance on shared ownership and outright sales above current levels.

In addition, a weaker regulatory framework, a dilution of the overall level of support from the UK government or a downgrade of the UK sovereign rating would also exert downward pressure on the rating.

Key Indicators

Moat Homes							
	31-Mar-12	31-Mar-13	31-Mar-14	31-Mar-15	31-Mar-16	31-Mar-17 *	31-Mar-18*
Units under management (no.)	20,700	20,951	20,922	21,115	21,321	21,189	20,803
Operating margin, before interest (%)	32.5	35.3	36.7	34.7	37.3	36.9	30.7
Net capital expenditure as % turnover	52.5	39.1	51.8	55.0	33.7	50.6	25.6
Social housing letting interest coverage (x times)	1.6	1.8	1.6	1.5	1.7	1.7	1.5
Cash flow volatility interest coverage (x times)	2.1	2.4	2.6	1.7	2.7	1.1	1.6
Debt to revenues (x times)	3.8	3.7	3.9	3.7	3.6	4.2	4.0
Debt to assets at cost (%)	29.7	30.0	30.8	33.9	33.9	35.3	37.6

* FY2017 and FY2018 are forecasted figures.
Note that FY2015 and onwards are prepared in FRS102 format while prior years were prepared using the old UK GAAP.
Source: Moat and Moody's

Recent Developments

As part of the new financial reporting framework, HAs in the UK were required to report FRS102-compliant accounts from March 2016, including comparatives for March 2015. Categories of the accounts which are most impacted include: housing assets, social housing grant, pensions, and financial instruments. Housing assets may be valued at cost or valuation as under the previous framework, or at deemed cost, which is a revaluation of housing assets at the date of transition. Social housing grant is no longer deducted from the cost of housing assets, but rather recognised as a long-term creditor and amortised. Moody's will continue to adjust gearing to exclude the revaluation reserve, whether an HA values its assets at deemed cost or valuation.

Detailed Rating Considerations

MOA's A1 rating combines a baseline credit assessment (BCA) of a3 and a strong likelihood of extraordinary support coming from the national government in the event that the entity faced acute liquidity stress.

SOLID SOCIAL HOUSING LETTING INTEREST COVERAGE AND STRONG MARGINS

MOA benefits from strong interest coverage metrics with social housing letting interest coverage (SHLIC) at 1.7x in FY2016, in-line with the A1 peer median. MOA's cash interest coverage reached 3.3x this year, above A1 peer median of 2.5x, and has been consistently above 2.0x in the last five years.

As part of our updated rating methodology we have incorporated a new metric termed Cash Flow Volatility Interest Coverage (CVIC), which reflects how effectively a housing association can cover net cash interest expense using operating cash flow (CFO), adjusted by the CFO's volatility over the past three years. The CVIC ratio accounts for movements in cash associated with market sales; during an investment phase of growth the ratio can weaken as cash is tied up in stock for sale. MOA's CVIC was 2.7x in FY2016, but is forecast to drop to 1.1x in FY2017, driven by an upswing in development for sale, and falling below Moody's-rated peer median (in FY2015) of 1.7x. A key credit driver will be how effectively MOA can achieve CVIC levels closer in-line with peers throughout their proposed development programme. Current projections show Moat's CVIC returning to 1.6x in FY2018 and remaining above that level in the following three years.

MOA's total revenue grew to £121 million in FY2016 (2015: £111 million), with improved operating margins of 37%, amongst the highest of Moody's rated peers, comparing favourably to an A1-rated peer median of 29%. Operating margins have registered a steady increase from FY2010's levels of 22%, driven by the impressive margins made from Moat's core social housing letting business which reached 41% this year (exhibit 1). Total margins displayed a similar trajectory, steadily increasing to 32% in FY2016 from 12% in FY2010. MOA's business plan for FY2017-21 projects that operating margins will fall closer to the peer median in FY2018, as interest expenses increase to service rising debt. We note, however, that MOA regularly out performs its business plan projections.

MEDIUM-SIZED ASSOCIATION WITH A STRAIGHTFORWARD GOVERNANCE STRUCTURE

MOA is a medium-sized provider of social housing in England, with around 21,000 units under management. Located in the south east of England, with 20% of MOA's stock located in the London area. Moat operates in areas where demand for social housing is high, supporting SHL turnover stability. Operations have been consolidated to 44 key local authority areas, down from 60 in 2009, as MOA works to achieve operational efficiencies. Moat's asset management plan aims to reduce operations to 30 local authorities that have been identified as "growth areas".

Moat Homes Limited is a charitable registered provider and the asset holding parent of the group. While there are currently six subsidiaries, two of these are dormant and one has been discontinued. The remaining three include Moat Foundation, a charitable arm that focuses on supporting community development activities, Moat Housing Group Limited (MHG), a non-charitable registered provider set up for the development of homes for market sale, and the group's financing vehicle named Moat Homes Finance PLC. The parent effectively retains control and oversight over the group.

Social housing letting as a percentage of MOA's turnover broadly remained stable from last year at 77% (FY2015: 78%), slightly lower than the median for Moody's A1 rated peers (79% in FY2016). This represents a moderate decrease from historical levels of 80% between FY2011-FY2014. As Moat rolls out its latest business plan, in which the housing association plans to increase development with an element of sale, including first-tranche shared ownership and outright sale, turnover from social housing letting is expected to fall to 68% of total turnover in FY2020.

STRONG REGULATORY FRAMEWORK

English housing associations operate in a highly regulated environment, with a strong oversight exercised by the sector's regulator, the Homes and Communities Agency (HCA). The Regulator is responsible for protecting the public investment in social housing and compliance with broad economic and consumer standards. Compliance with the standards is proactively monitored by the HCA through quarterly returns, long term business plan and annual reviews, and focuses on: governance, financial viability, value for money and rents. The HCA's levers of control are wide ranging and include the ability to award capital grant funding, levy financial penalties, and impose independent inquiries or appoint new managers and officers in extreme circumstances. The HCA emphasizes that their role is a co-regulatory one with the primary onus being on boards and executive teams to ensure compliance with the standards. As part of the Housing and Planning Act 2016, the Regulator's powers are expected to weaken in several areas including: removal of the consent to dispose of housing assets, removal of constitutional consents for group restructuring including mergers, and stricter conditions for appointing officers. The dilution of regulatory oversight and power is credit negative, although we expect the Regulator to continue to take an active role in managing risk in the sector.

PROJECTED INCREASE IN EXPOSURE TO RISKIER MARKET SALE

With sales revenues at 21% of turnover, we consider MOA's exposure to the cyclical property market as high relative to peers, and this is set to increase in the most recent business plan. Moat has been a provider of shared ownership housing for several years, and receipts from the first tranche sales comprised the largest portion of sales revenues. Outright market sales have been a small proportion of turnover - ranging between 0%-6% - as Moat considers itself a shared ownership specialist. However, looking forward, MOA plans to grow their proportion of outright market sales to 15% of turnover, matching approximately the proportion of FTSO sales. Market sales (FTSO and outright sale combined) are anticipated to account for 30% of total turnover by FY2020, a significant change of focus from last year's business plan in which market sales were expected to reach just 18% of turnover by FY2020. Given that social housing lettings receipts are far more predictable than those generated from market sales, this exposure will be a key credit challenge for Moat.

Moat's experience in the shared ownership market is demonstrated both the proportion of turnover from FTSO sales (21% - MOA had no outright sales in FY2016) as well as the 41% margin on these sales. Looking forward, shared ownership will make up 51% of the tenure mix in Moat's FY2017-2021 development plan of a total, 30% allocated to sub-market rent, 6% to market rent and 13% to outright sales. The FY2017-FY2021 plan provides for the total development of approximately 2,250 units. The strength of MOA's core social housing business combined with the conservative assumptions set out in the business plan, which assumes house price inflation at CPI+1.5%, will partially mitigate some of the risks associated with the market sales activity.

Net capital expenditure (capex) as a percentage of turnover was 34% in FY2016 and is forecast to rise to 51% in FY2017, driven by planned development and a significant regeneration project. Moat's liquidity is sufficient to cover this rise in expenditure, however, as measured by our liquidity metric, MOA's position in FY2016 was somewhat weaker than peers. The liquidity coverage metric measures the ability of available liquidity to cover the following two years of net capex. Due to the anticipated rise in net capex in FY2017, MOA's liquidity coverage ratio as of March 2016 was 1.15x. This is below Moody's rated peer median, 1.5x in FY2015. However, net capex is projected to decrease in subsequent years, contingent on sales revenues materialising as expected and providing a lift to cash flows. Combined with an increase in available facilities over the year, we expect Moat's liquidity coverage metric to improve to over 2x in FY2017.

Moat Homes Group Limited (MHG) will act as the group's commercial subsidiary overseeing outright sales activity. The subsidiary has four non-executive board members with expertise in property development that monitor activity on a scheme by scheme basis.

DEBT RISING, BUT FROM A RELATIVELY LOW BASE

At FY2016, MOA's debt was £430m, equivalent to 3.6x revenues or 34% of assets at cost. The business plan anticipates that debt will grow by just under £80 million in FY2017, the new total will be equivalent to 4.2x forecast FY2017 revenues or 35% of assets at cost. Moat benefits from a historically low level of debt, in FY2014 MOA's debt-to-assets stood at 31%, amongst the lowest of Moody's rated portfolio. While Moat's debt metrics are deteriorating, they remain in-line with A1 peers (FY2015 A1 debt-to-assets median: 36%), weakening from a strong position. While we expect Moat to take on additional debt over the next five years, with debt-to-assets reaching 40% by FY2020, the organisation will retain sufficient headroom against covenants.

As of August 2016 Moat held approximately 80% of its debt at fixed rates, within the organisation's treasury policy which allows for 60-90% of fixed debt. Included in the fixed rate debt is a portfolio of stand-alone swaps with a notional value of £143 million, with a mark-to-market of £93 million as of August 2016, covered by a combination of security and cash. We consider this as moderately high exposure to interest rate risk, mitigated however by estimated liquidity of close to 150% of projected FY2017 revenues, well above the 97% average of Moody's rated portfolio. Furthermore, total unencumbered assets would allow for more than £400 million of additional borrowing.

GOVERNMENT POLICY CHANGES MAKE OPERATING ENVIRONMENT MORE CHALLENGING FOR HOUSING ASSOCIATIONS

The operating environment for social housing providers is fundamentally shaped by government policy and announcements made in July 2015 as part of the UK Summer Budget made these circumstances more challenging. On 8 July 2015, the UK government announced (1) a change in the social housing rent formula to 1% annual reduction starting from April 2016 for four years (previously growing annually by CPI+1%) and (2) further reductions in the accessibility of certain welfare benefits. The effect of these measures is further magnified by the ongoing implementation of Universal Credit and the extension of Right to Buy for HA tenants. Overall, these policy shifts are gradually eroding the ties to the government by creating a more unpredictable operating environment and undermining the extent and stability of housing benefits contribution to revenues. We do note, however, that the 2016 Autumn Statement announced policies which are more supportive of HA development programmes, notably the availability of additional grants (£1.4 billion) and the relaxed tenure restrictions in the affordable homes grant programme, which will now include funding for rented social housing in addition to homeownership tenures.

Housing benefit paid to working age tenants, who are being affected by the implementation of Universal Credit represent on average 29% of total income (Moat: 22.5%) for Moody's rated peers. The agreed extension of the Right to Buy to housing associations tenants may in short term lead to positive cash inflows, but creates a risk of a longer term erosion of social housing stock if HAs are unable to replace sold properties.

Extraordinary Support Considerations

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 also factors housing associations' increasing exposure to non-core social housing activities, that add complexity to their operations and make an extraordinary intervention more challenging.

Rating Methodology and Scorecard Factors

European Social Housing Providers, July 2016 (190944)

Government Related Issuers, October 2014 (173845)

Ratings

Exhibit 4

Category	Moody's Rating
MOAT HOMES	
Outlook	Negative
Issuer Rating -Dom Curr	A1
MOAT HOMES FINANCE PLC	
Outlook	Negative
Senior Secured -Dom Curr	A1

Source: Moody's Investors Service

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