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CREDIT OPINION
19 November 2018

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RATINGS

Moat Homes

Domicile	United Kingdom
Long Term Rating	A2
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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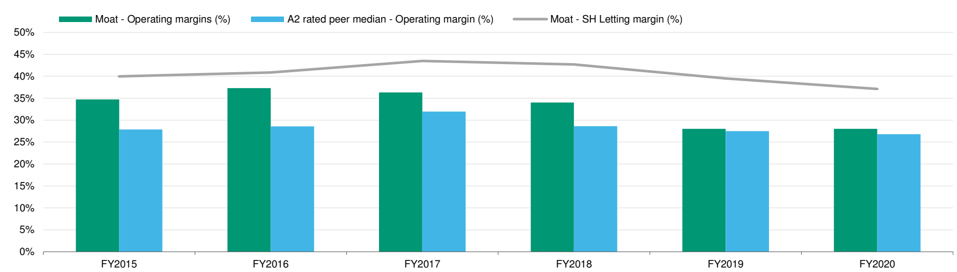
Moat Homes

Update to credit analysis

Summary

The credit profile of Moat Homes (A2 stable) (Moat) reflects its healthy margins, ample social housing interest coverage and modest levels of debt. The rating also takes into account Moat's forecast increase to market sales exposure and anticipated rise in debt to fund its development programme. In addition, Moat's A2 rating benefits from the strong regulatory framework governing English housing associations (HAs) and our assessment that there is a strong likelihood that the UK government (Aa2 stable) would intervene in the event that Moat faced acute liquidity stress.

Exhibit 1
Moat's historically strong operating margin is aligning more with peer medians; remains supported by strong margin on their core social housing business.
Operating margin (%) and social housing letting margin (%)



Source: Moat and Moody's Investors Service

Credit Strengths

» Medium-sized association with a simple governance structure

» Healthy margins and interest coverage metrics, although declining

» Strong regulatory framework

Credit Challenges

» Debt levels expected to rise from relatively low base

» Projected increase in exposure to riskier market sale activity

» Operating environment remains challenging but policy is more stable

Rating Outlook

The stable outlook on Moat reflects the currently stable operating environment, which is unlikely to undergo further material change in the medium-term, and the stable outlook on the sovereign rating.

Factors that Could Lead to an Upgrade

Positive pressure on the rating could result from one or a combination of the following; maintenance of an operating margin at or above 35%, maintaining social housing letting interest coverage (SHLIC) above 2.0x, scaling back in Moat's development plan that would translate to reduced exposure to market sales activities and enhanced debt metrics.

Factors that Could Lead to a Downgrade

Negative pressure could be exerted on the rating by one or a combination of the following; a material weakening in operating margin below 25%, SHLIC falling to below 1.5x, debt to revenue and gearing metrics weakening relative to peers, and increased exposure to shared ownership and outright sales above planned 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-14	31-Mar-15	31-Mar-16	31-Mar-17	31-Mar-18	31-Mar-19*	31-Mar-20*
Units under management (no.)	20,922	21,115	21,321	21,107	21,040	21,170	21,528
Operating margin, before interest (%)	36.7	34.7	37.3	36.3	34.1	27.5	28.0
Net capital expenditure as % turnover	53.4	55.1	36.9	49.1	69.9	65.3	44.6
Social housing letting interest coverage (x times)	1.6	1.5	1.7	1.8	2.0	2.0	1.5
Cash flow volatility interest coverage (x times)	2.3	1.7	2.6	2.4	3.1	2.3	2.0
Debt to revenues (x times)	3.9	3.7	3.6	3.5	3.7	3.8	3.7
Debt to assets at cost (%)	31.6	32.1	32.6	31.2	31.0	37.3	40.5

*Fiscal year ended March 2019 and 2020 (fiscal 2019 and 2020) are forecasted figures from Moat's Business Plan.
Source: Moat and Moody's Investors Service

Detailed Rating Considerations

The credit profile of Moat, as expressed in an A2 stable rating, combines (1) a baseline credit assessment (BCA) of a3, and (2) a strong likelihood of extraordinary support coming from the national government in the event that the entity faced acute liquidity stress.

Baseline credit assessment

Medium-sized association with a simple governance structure

Moat is a medium-sized provider of social housing in England, with around 21,000 units under management located in the South East of England. The HA has produced an asset management plan that would consolidate operations to 30 key local authority areas, identified as "growth areas", as a means of delivering operational efficiencies by fiscal year ended March 2020 (fiscal 2020).

Moat has a very straightforward structure. 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 (SHL) as a percentage of Moat's turnover fell slightly from last year to 78% (fiscal 2017: 79%), which is in line with Moody's A2 rated peers (78% in fiscal 2018). Moat's business plan forecasts SHL will deliver 69% of turnover in fiscal 2019, before dropping further to 62% in fiscal 2020. We note that this represents an increase in SHL as a proportion of turnover from last years business plan, which projected a contribution of 50% to total revenue from SHL by fiscal 2020. Moat plans to increase market sales development going forward, including FTSO and outright sales, which is set to contribute 35% of turnover by fiscal 2020, from 20% currently. Similarly, we note that the proportion of market sales has reduced from a projected 48% of turnover in last year's business plan.

Healthy margins and interest coverage metrics, although declining

Moat benefits from continued improvement in interest coverage metrics with SHLIC at 2.0x in fiscal 2018, in-line with the A2 peer median. Moat's Cash Flow Volatility Interest Coverage (CVIC) ratio was 3.1x in fiscal 2018. However, both metrics are set to gradually decline over the next two years, whilst still staying in line with the Moody's-rated peer median. The gradual weakening of both metrics is due to an upswing in development for sale leading to volatility in operating cash flow (CFO), as well as a reduction in SHL surplus, resulting from the ongoing rent cut. A key credit driver will be how effectively Moat can maintain interest coverage levels in-line with peers throughout their proposed development programme.

While operating margins declined slightly to 34% in fiscal 2018, from 36% in fiscal 2017, Moat's operating margins remain amongst the highest of Moody's rated peers, comparing favourably to an A2-rated peer median of 29%, because they are supported by exceptional performance in Moat's core SHL business, which recorded margins of 43% this year (Exhibit 1). Nonetheless, total operating margins are forecast to continue a downward trend to reach 28% in fiscal 2019, as Moat focuses more on market sales - a tenure delivering lower margins than its core business. Moat's business plan for fiscal 2019-21 projects operating margins will fall closer to the peer median in these years.

Strong regulatory framework

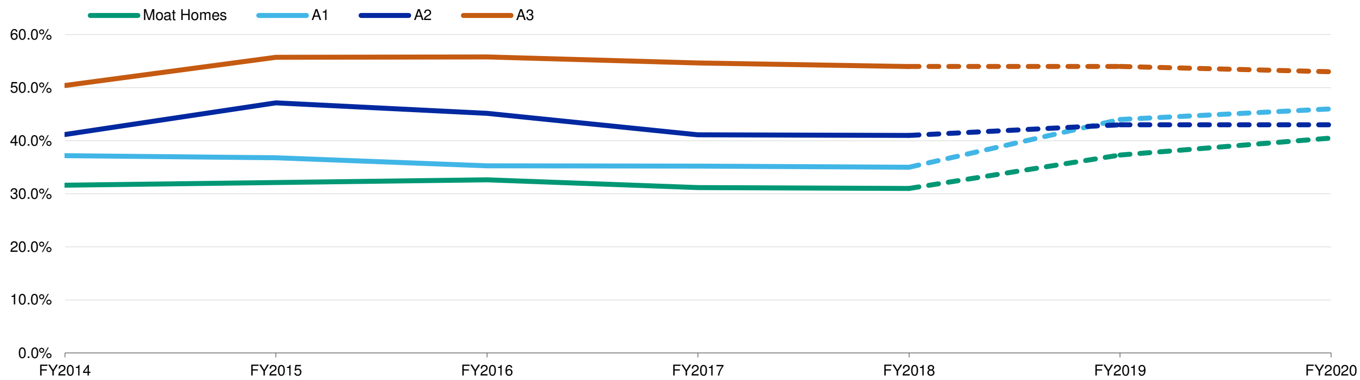
The sector's credit quality will continue to benefit from the strong regulatory framework and oversight by the Regulator of Social Housing (RSH). The regulator maintains strong oversight through quarterly returns, long-term business plans, annual reviews, and undertaking In-Depth Assessments of entities where deemed necessary. Additionally, the Regulator of Social Housing has powers to make board member and manager appointments where there has been a breach of Regulatory Standards.
On 14th November, the RSH announced it had downgraded Moat's governance rating to G2 compliant, from G1, following the sale of 26 tenanted units to a small (less than 1,000 units) for-profit provider. The RSH found the transaction would not have been approved under the previous consents regime, due largely in part to the non-charitable status of the purchaser, and found that this indicated a lack of Board oversight. Moat is in discussion with the RSH and is proactively compiling an Action Plan to remedy this downgrade. We find that Moat continues to have a sound governance structure.

Debt levels expected to rise from relatively low base

At fiscal 2018, Moat's debt was £457 million, equivalent to 3.7x revenues or 31% of assets at cost, which has remained stable since the previous year. Moat's business plan anticipates that debt will grow by 19% or approximately £85 million in fiscal 2019, which would be equivalent to 3.8x forecast fiscal 2019 revenues or 37% of assets at cost. Moat has historically performed better on debt metrics than A2 rated peers, a credit strength (Exhibit 3), however these debt metrics are forecast to deteriorate going forward, weakening from a strong position. While we expect Moat to take on additional debt over the next five years, with debt-to-assets reaching 41% by fiscal 2020, the organisation is forecast to retain sufficient headroom against covenants.

Moat's treasury policy allows for 60-90% debt to be at a fixed rate, and as of the end of August 2018 Moat held approximately 70% of its debt at fixed rates. Included in the fixed rate debt is a portfolio of stand-alone swaps with a notional value of £143 million, and a mark-to-market valuation of £62.2 million as of August 2018, with all security covered by property and cash. Moat's unencumbered assets position is strong, and would allow for approximately £443 million of additional borrowing, as of March 2018, which equated to 97% of Moat's debt stock in fiscal 2018.

Exhibit 3
Moat's debt metrics are forecast to weaken from a historically strong position
Debt-to-assets (%)



*Fiscal 2019 and 2020 are forecasted figures.
Source: Moat and Moody's Investors Service

Projected increase in exposure to riskier market sale activity

With market sales revenues at 20% of turnover in fiscal 2018 (currently consisting only of FTSO sales), we consider Moat's exposure to the cyclical property market as high[1] relative to peers. The business plan forecasts that sales revenue as a proportion of turnover would grow to 29% in fiscal 2019 and 36% in fiscal 2020. Moat has delivered shared ownership development for several years, and the receipts from the FTSO sales are set to make up the largest proportion of sales revenues up to fiscal 2021. Moat had no outright market sales this year, however, the development programme aims to deliver five units for market sale in fiscal 2019, and 32 units in the subsequent year, contributing 3% and 13% to total turnover, respectively, and surpassing the contribution to revenue made by FTSO sales in fiscal 2021. We consider SHL receipts to be more predictable than those generated from market sales, and as the increasing trend in market sales as a proportion of revenue continues to increase, this exposure will remain a credit challenge for Moat.

Moat's experience in the shared ownership market is demonstrated by an average margin of 31% margin on these sales over the last three years. However it is noted that operating margins on FTSO sales decreased to 20% in fiscal 2018, from 2017 levels of 31%, placing downward pressure on total operating margins (see 'Healthy margins and interest coverage metrics, although declining'), and are forecast to decrease further in fiscal 2019 to 17%. Moat's fiscal 2019-2023 development pipeline plans for approximately 3,100 units, of which shared ownership would make up approximately 55% of the tenure mix, 40% allocated as sub-market affordable rent, and 5% as outright sales.

Net capital expenditure (capex) as a percentage of turnover was 70% in fiscal 2018, up from 49% in fiscal 2017, driven by planned development and a significant regeneration project. Moat's liquidity is sufficient to cover this rise in expenditure, however, Moat's liquidity coverage metric, which measures the ability of immediately available liquidity to cover the following two years of net capex, in fiscal 2018 was somewhat weaker than peers, due to the anticipated sharp rise in net capex in fiscal 2019. Moat's liquidity coverage ratio at fiscal 2018 was 0.8x, compared to the A2 peer median of 1.3x. However, net capex is projected to decrease in fiscal 2020, contingent on sales revenues materialising as expected, providing an uplift to cash flows. The reduction in net capex combined with the availability of facilities leads to an expected improvement in the liquidity coverage metric to 2.1x in fiscal 2019.

Moat Homes Group Limited (MHG) is the group's commercial subsidiary overseeing outright sales activity. Moat has set an internal development cap on MHG of £70m, as well as an on-lending constraint from the Parent of £45m to limit exposure to market sales activity. The distributable reserves of £13.8m within MHG will enable the subsidiary to sustain market shocks, such as the extreme stressed case of a 30% fall in house prices.

Operating environment remains challenging but policy is more stable

Moody's does not expect additional material adverse policy shifts for the sector and considers the operating environment to be stable in the medium term. Adverse policies announced in the last few years will continue to negatively impact revenues, especially the effects of the 1% annual decrease in social rents (until fiscal 2020) and Universal Credit (a pillar of broader welfare reform measures). However, HAs have demonstrated resilience to adverse policies to date and been proactive to mitigate the impact. A reduction of 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 31% of turnover for Moody's rated HAs in fiscal 2017. Credit risk association with exposure to market sales is incorporated in BCAs.

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 (Aa2 stable) is willing to support the sector, as housing remains a politically and economically sensitive issue. The strong support assumption also factors increasing exposure to non-core social housing activities in the sector, that add complexity to HA 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 Moat and the UK government reflects their strong financial and operational linkages.

Rating Methodology and Scorecard Factors

The assigned BCA of a3 is the same as the scorecard suggested BCA.

The methodologies used in this rating were European Social Housing Providers, published in April 2018 and Government Related Issuers, published in June 2018.

Exhibit 4

Moat Homes			
Baseline Credit Assessment	**Sub-factor Weighting**	**Value**	**Score**
Scorecard			
Factor 1: Institutional Framework			
Operating Environment	10%	a	a
Regulatory Framework	10%	a	a
Factor 2: Market Position			
Units Under Management	10%	21,040	a
Factor 3: Financial Performance			
Operating Margin	5%	34.1%	a
Social Housing Letting Interest Coverage	10%	2.0x	aa
Cash-Flow Volatility Interest Coverage	10%	3.1x	aa
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	3.7x	baa
Debt to Assets	10%	31.0%	baa
Liquidity Coverage	10%	0.8x	baa
Factor 5: Management and Governance			
Financial Management	10%	baa	baa
Investment and Debt Management	10%	baa	baa
Suggested BCA			**a3**

Source: Moat Homes, Moody's Investors Service

Ratings

Exhibit 5

Category	Moody's Rating
MOAT HOMES	
Outlook	Stable
Issuer Rating -Dom Curr	A2
MOAT HOMES FINANCE PLC	
Outlook	Stable
Senior Secured -Dom Curr	A2

Source: Moody's Investors Service

Endnotes

1 We consider market sales exposure to be high when revenue sourced from market sales contributes 20% or more of turnover.

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