MOODY'S
PUBLIC SECTOR EUROPE

CREDIT OPINION
11 October 2017

Rate this Research

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.

Contacts

Edward Demetry 44-20-7772-1720
Analyst
edward.demetry@moodys.com

Matt Fawcett 44-20-7772-5326
Associate Analyst
matt.fawcett@moodys.com

Sebastien Hay 34-91-768-8222
Senior Vice President/ Manager
sebastien.hay@moodys.com

CLIENT SERVICES

Americas 1-212-553-1653

Asia Pacific 852-3551-3077

Japan 81-3-5408-4100

EMEA 44-20-7772-5454

Moat Homes

Update following downgrade to A2, outlook changed to stable

Summary Rating Rationale

The A2 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.

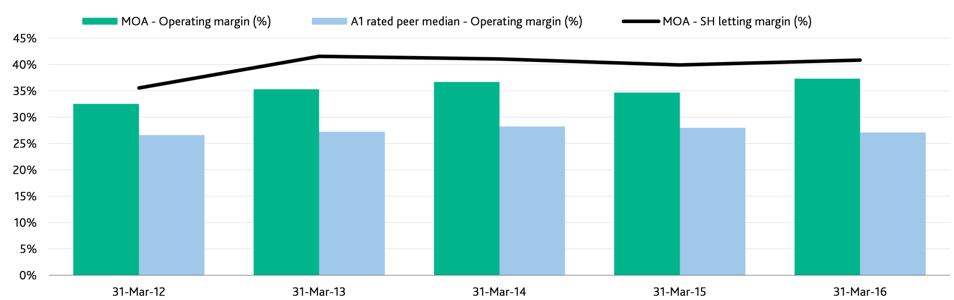
In addition, Moat's A2 rating benefits from the strong regulatory framework governing English housing associations and our assessment that there is a strong likelihood that the UK government (Aa2 stable) would intervene in the event that MOA faced acute liquidity stress.

MOA is rated at the upper end of Moody's-rated English housing associations, whose ratings span from A1 to Baa2.

Exhibit 1 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

» Operating environment remains challenging but policy is more stable

Rating Outlook

The stable outlook on MOA 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.

Recent Developments

On September 26th 2017, MOA's rating was downgraded to A2 from A1 to reflect the close institutional, operational and financial linkages between the central government and UK housing associations (HAs), and the reduced financial resilience of the sovereign as captured by Moody's recent decision to downgrade the UK's sovereign rating to Aa2 from Aa1. The outlook has been changed to stable from negative to reflect the stable outlook on the sovereign rating, and the HA sector adapting well to a challenging policy environment, which is not expected to undergo further material change in the medium-term.

Factors that Could Lead to an Upgrade

Positive pressure on the rating could result from one or a combination of the following:

» 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

Detailed Rating Considerations

MOA's A2 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 A2 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 A2-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 A2 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

The sector's credit quality will continue to benefit from the strong regulatory framework and oversight by the Homes and Communities Agency (HCA). The HCA maintains strong oversight through quarterly returns, long-term business plans, annual reviews, and undertaking In-Depth Assessments of entities where deemed necessary. Additionally, the HCA has powers to make board member and manager appointments where there has been a breach of Regulatory Standards. From October 2017, the HCA will charge fees for social housing regulation, as a means of enhancing the independence and maintaining the effectiveness of the regulator.

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 A2 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.

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 FY2020) 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 17% of turnover for Moody's rated HAs in FY2016. 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 (HA) and the UK government reflects their strong financial and operational linkages.

Rating Methodology and Scorecard Factors

European Social Housing Providers, July 2016 (190944)

Government Related Issuers, August 2017 (1047378)

Ratings

Exhibit 4

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

REPORT NUMBER 1093772

CLIENT SERVICES

Americas	1-212-553-1653
Asia Pacific	852-3551-3077
Japan	81-3-5408-4100
EMEA	44-20-7772-5454

MOODY'S PUBLIC SECTOR EUROPE