MOODY'S
PUBLIC SECTOR EUROPE

CREDIT OPINION
19 November 2018

Rate this Research

RATINGS

Hastoe Housing Association

Domicile	United Kingdom
Long Term Rating	A3
Type	LT Issuer Rating - Fgn 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

Zoe Jankel +44.20.7772.1031
VP-Senior Analyst
zoe.jankel@moodys.com

Francesco Mazzoni +44.20.7772.1073
Associate Analyst
francesco.mazzoni@moodys.com

Sebastien Hay +34.91.768.8222
Senior Vice President/Manager
sebastien.hay@moodys.com

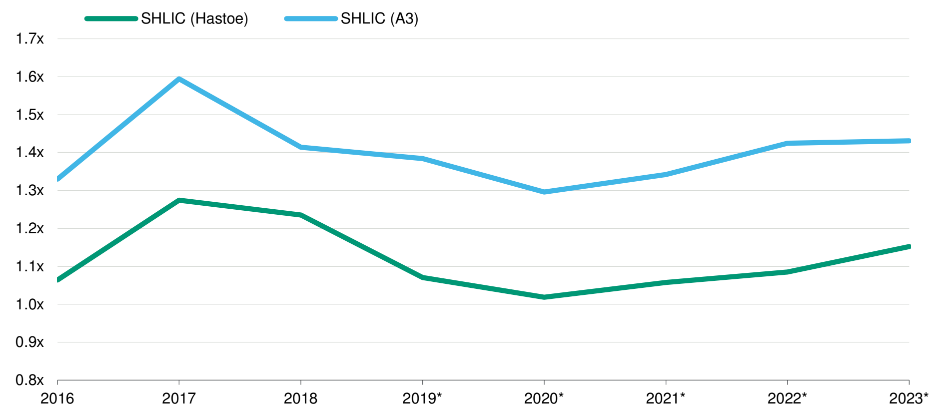
Hastoe Housing Association (United Kingdom)

Update to credit analysis

Summary

The credit profile of Hastoe Housing Association (Hastoe) (A3 stable) reflects its strong operating margins and market position, weak social housing letting interest coverage, high and increasing debt levels and growing exposure to market sales. In addition, it benefits from our assessment that there is a strong likelihood that the UK government (Aa2 stable) would intervene in the event that Hastoe faced acute liquidity stress.

Exhibit 1
Hastoe's social housing letting interest coverage (SHLIC) is expected to weaken over the next two years



*Source: Hastoe Housing Association, Moody's. (*Forecast)*

Credit Strengths

- Strong operating margins
- Market niche as a rural housing specialist
- Strong regulatory framework and stable operating environment

Credit Challenges

- Debt levels expected to remain structurally high
- Development programme increases exposure to market sales
- Weak social housing interest coverage

Rating Outlook

The stable outlook on Hastoe reflects the currently stable operating environment, the HA's stable and strong operating margins, 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: debt falling below 4.0x revenue and 40% of assets at cost; social housing letting interest coverage structurally exceeding 1.5x; and cash flow volatility interest coverage structurally exceeding 2.0x.

Factors that Could Lead to a Downgrade

Negative pressure could be exerted on the rating by a more ambitious development plan than currently expected as evidenced by revenue from open market sales reaching more than 25% of total revenue over a sustained period of time; liquidity coverage falling structurally below 1.0x; social housing letting interest coverage structurally below 1.0x; and/or debt levels that move towards 8.0x revenue. 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

Exhibit 2

Hastoe Housing Association

	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.)	6,969	7,171	7,390	7,220	7,292	7,331	7,452
Operating margin, before interest (%)	36.5	38.7	38.1	43.2	41.7	38.6	32.8
Net capital expenditure as % turnover	71.2	85.6	24.1	7.6	19.9	64.7	26.3
Social housing letting interest coverage (x times)	1.0	1.1	1.1	1.3	1.2	1.1	1.0
Cash flow volatility interest coverage (x times)	1.2	1.3	1.5	1.7	1.6	1.2	1.4
Debt to revenues (x times)	7.5	7.1	6.7	6.6	6.6	7.7	5.8
Debt to assets at cost (%)	52.2	55.7	55.8	54.6	54.3	55.2	55.0

*FY2019 and FY2020 are forecasted figures.
Note that FY2015 and onwards are prepared in FRS102 format while those before were prepared as per the old UK GAAP
Source: Hastoe Financial Statements, Moody's

Detailed Credit Considerations

Hastoe's credit profile, as expressed in an A3 stable rating combines (1) its baseline credit assessment (BCA) of baa2, and (2) a strong likelihood of extraordinary support coming from the UK government in the event that Hastoe faced acute liquidity stress.

Baseline Credit Assessment

Strong operating margins

Hastoe's operating margins were among the strongest in its rated peer group at 41.7% in FY2018 (FY2018 expected peer median: 30.6%). Hastoe attributes its strong margins to the rural nature of its portfolio, which carries the advantage of lower management costs. Hastoe also benefits from lower arrears and voids relative to Moody's rated peers. Hastoe has managed to keep margins high throughout the rent cut period which ends in FY2020, facilitated by tight cost control. We expect Hastoe's operating margin to fall towards 33% by FY2020 mainly as a result of the execution of an increased development pipeline (which tend to be margin dilutive) and the continued impact of the rent cut.

Market niche as a rural housing specialist, with housing stock located in areas of high demand

Hastoe had 7,292 units under management as of FY2018, with slightly more than half of its stock in rural areas. While small in size, its operations are geographically dispersed across London, south-east England and East Anglia, covering 70 local authorities and almost 300 villages across the South of England. Hastoe's distinct feature lies with its focus on rural developments. Hastoe is typically contacted by local authorities/parish councils before building houses in order to support rural affordable housing demand. The rural housing development process also has a lower speculative nature compared to other HAs. As a consequence, rural building sites are typically small scale and demand is high. Total sales margin in FY2018 was recorded at 32.6%, above the 27% peer median.

Hastoe is a traditional housing association with a recently changed group structure, which occurred in October 2017, when the parent Hastoe Housing Association adopted charitable status. Although remaining the main asset holder and operating company, it transferred its development and open market sales operations to a newly incorporated company, Lowen Homes. The parent has effective control over all subsidiaries by board appointment.

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 of 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 of Social Housing has powers to make board member and manager appointments where there has been a breach of Regulatory Standards. The regulator has charged fees for social housing regulation since October 2017, as a means of enhancing its independence and maintaining effectiveness.

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 have been proactive to mitigate the impacts.

Debt levels expected to remain structurally high as a result of its development programme

As of FYE2018, Hastoe's gross debt remained stable at £226.2 million compared to £226.1 million in FY2017, equivalent to 6.6x revenues and 54% of assets at cost. This level of debt is considerably above the 4.2x median debt-to-revenue level of Hastoe's A3 peer group. Hastoe's interest payments remained stable at £10.7 million in FY2018 compared to the previous year, although are projected to grow and peak at £13.4 million in FY2022 due to its increasing borrowing plans.

Debt is expected to grow from FY2019, and peak at £260 million by FY2021. This increasing gross debt reflects its extensive capital investment over the next few years and will increase debt to revenues temporarily to around 7.7x by the end of March 2019. Gross capex is expected to be an average of 68% of turnover between FY2019 to FY2021, above the expected A3-rated peer median average of 57% over the same period. We expect Hastoe's debt-to-revenues ratio to remain at above 6.5x of turnover until FY2021 and only in FY2023 start to decline as a result of increased turnover stemming from execution of its development programme.

Hastoe's debt structure is conservative with 96% of debt being held at fixed rates in 2018 with no standalone swaps. As of FYE2018, 88.8% of Hastoe's outstanding debt was due after five years, limiting its refinancing risk, while its amortisation profile is fairly smooth with no repayment peaks.

As of March 2018, immediately available liquidity totalled £38.5 million (£5.8 million cash holdings and £32.7 million of undrawn secured loan facilities). This current liquidity level fully covers Hastoe's estimated two-year-cash-net-capital needs (£33 million), with Hastoe's liquidity metric at 1.2x at 31st March 2018. Hastoe also has a high level of unencumbered assets (£138 million), which represents an adequate buffer for future borrowings.

Hastoe is planning to augment its cash balances through new financing in FY2019, and options are currently being explored by management, including a tap on its £125 million bond issuance (originally issued at £100 million in 2012, with a tap of £25 million in 2014).

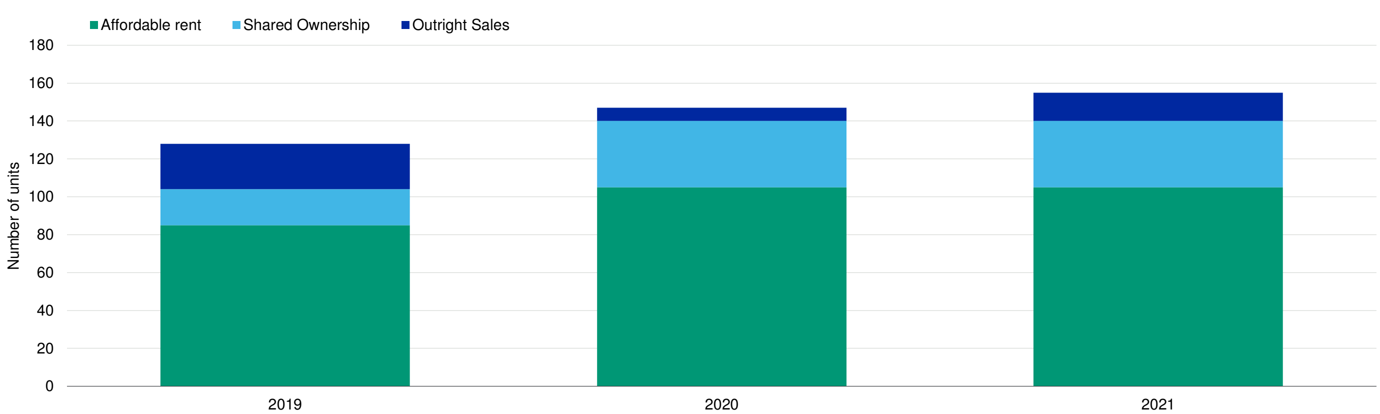
We also note Hastoe''s "Golden Rules" that require cash and loan facilities, which excludes anticipated cash receipts from sales, to cover all contractually committed expenditure.

Development programme increases exposure to market sales, although remains moderate compared to peers in the sector

Hastoe's 5 year development programme to FY2023 is for 535 units. This represents a decrease of around 50 units from last year's business plan. The programme is expected to be financed by a combination of 45% debt funding and 45% from the successful delivery of outright sales, with the remainder funded by fixed asset disposals and capital grants. Any under-performance in the sales programme would therefore be likely to have an impact on debt levels. However, sales risk will be partially mitigated by Hastoe's track record of development delivery and experience in rural areas, where competition from private real estate developers is limited. In addition, Hastoe is specialised in delivering detached and semi-detached houses, which tend to report lower price volatility when compared to flat sales.

Of the new units around 10% are for outright sale (55 units) and 23% for shared ownership (123 units) increasing Hastoe's exposure to volatility in market prices. Hastoe's projections for FY2019-2021 include a significantly increasing element of outright sales revenue, that is expected to peak at around £10 million (23% of turnover) in FY2020, from £1 million (2%) in FY2018. However, over the course of its five year development programme, the average proportion of market sales (including first tranche shared ownership) is 16% which remains a moderate level of exposure compared to peers in the sector. Hastoe has a strong track record in achieving high margins for outright sales, with margins of 18% and 23% in FY2017 and FY2018 respectively, and first tranche shared ownership margins of 33% and 36% in the same years. Its track record in delivering profitable development, and strong demand in its areas of operation partially mitigate the risk of its exposure to market sales activities.

Exhibit 3
Hastoe's development programme
Number of new build homes



Source: Hastoe Housing Association

Weak social housing interest coverage

The improved surplus in Hastoe's social housing activity, lead to an increase in its social housing letting interest coverage (SHLIC) to 1.3x in FY2017, up from a slim average of 1.1x for the preceding four years. However, in FY2018 SHLIC declined to 1.2x, and it is projected to weaken to 1.0x in FY2020, as a result of a combination of weaker social housing letting margins due to the rent cut and high debt levels to finance its development programme. This is below the expected A3-rated peer median, which is projected to be above 1.3x for the next 2 years. Hastoe will still remain compliant with its covenanted interest coverage of 110% as the covenant takes into account the whole operating surplus, as opposed to the social housing surplus. In Hastoe's base case forecast scenario, the lowest projection is around 145% in 2022, with a headroom of 35 percentage points. We also consider that Hastoe would have sufficient time to put in place mitigation measures to improve its surplus position, in the event that operating performance was projected to be worse than currently expected.

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 (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 Hastoe and the UK government reflects their strong financial and operational linkages.

Rating Methodology and Scorecard Factors

The assigned BCA of baa2 is the same as the scorecard suggested BCA of baa2 for FY2018.

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

Hastoe Housing Association			
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%	7,292	baa
Factor 3: Financial Performance			
Operating Margin	5%	41.7%	aa
Social Housing Letting Interest Coverage	10%	1.2x	baa
Cash-Flow Volatility Interest Coverage	10%	1.6x	baa
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	6.6x	b
Debt to Assets	10%	54.3%	b
Liquidity Coverage	10%	1.2x	a
Factor 5: Management and Governance			
Financial Management	10%	baa	baa
Investment and Debt Management	10%	baa	baa
Suggested BCA			**baa2**

Source: Hastoe Housing Association, Moody's Investors Service

Ratings

Exhibit 5

Category	Moody's Rating
HASTOE HOUSING ASSOCIATION	
Outlook	Stable
Issuer Rating	A3
HASTOE CAPITAL PLC	
Outlook	Stable
Senior Secured -Dom Curr	A3

Source: Moody's Investors Service

REPORT NUMBER 1145170

Contacts

Zoe Jankel +44.20.7772.1031
VP-Senior Analyst
zoe.jankel@moodys.com

Sebastien Hay +34.91.768.8222
Senior Vice President/ Manager
sebastien.hay@moodys.com

Francesco Mazzoni +44.20.7772.1073
Associate Analyst
francesco.mazzoni@moodys.com

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