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CREDIT OPINION
22 November 2023

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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.

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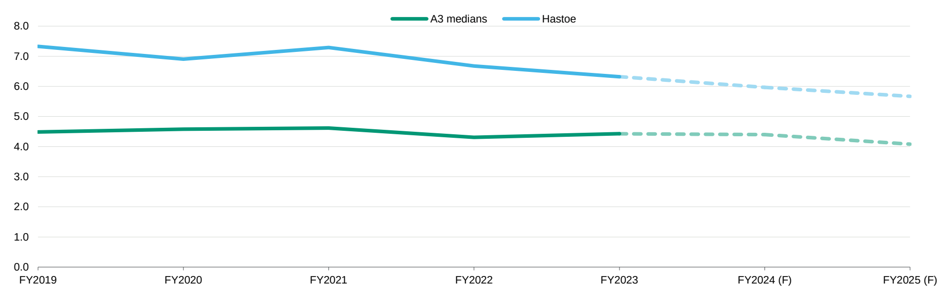
Hastoe Housing Association (UK)

Update to credit analysis

Summary

The credit profile of Hastoe Housing Association (Hastoe, A3 stable) reflects its solid operating margins counterbalanced by its high debt levels. The HA is a rural housing specialist with a niche market characterised by very strong demand. In addition, it benefits from our assessment that there is a strong likelihood that the government of the United Kingdom (UK, Aa3 stable) would intervene in the event that Hastoe faced acute liquidity stress.

Exhibit 1
Hastoe's debt to revenue is expected to continue to decrease, but remains above peers
Debt to revenue (x times)



F: Forecast.
Source: Hastoe and Moody's Investors Service

Credit Strengths

» Strong operating performance

» Market niche as a rural housing specialist

» Supportive institutional framework in England

Credit Challenges

» Debt levels expected to remain higher than peers

» Capital expenditure expected to increase, but liquidity remains strong

Rating Outlook

The stable outlook reflects the expected gradual reduction in inflation and associated cost pressures as well as the proactive actions taken by Hastoe to mitigate the adverse effects of the weaker operating environment, thereby limiting development risk.

Factors that Could Lead to an Upgrade

Upward pressure on the ratings could result from a material reduction in debt or a significant increase in government support for the sector, especially significantly higher levels of capital grants.

Factors that Could Lead to a Downgrade

Downward pressure on the ratings could result from a prolonged weakening in operating performance, debt growing more quickly than forecasts, weaker liquidity or a failure to adapt strategies and risk appetite to mitigate against weaker economic conditions. Lower government support for the sector or a dilution of the regulatory framework could also lead to downward pressure on the ratings.

Key Indicators

Exhibit 2

Hastoe Housing Association

	31-Mar-19	31-Mar-20	31-Mar-21	31-Mar-22	31-Mar-23	31-Mar-24 (F)	31-Mar-25 (F)
Units under management (no.)	7,630	7,669	7,681	7,737	7,769	7,827	7,933
Operating margin, before interest (%)	37.8	33.6	41.9	37.5	40.5	39.0	39.5
Net capital expenditure as % turnover	26.7	(1.4)	(5.0)	20.5	12.3	39.9	37.0
Social housing letting interest coverage (x times)	1.1	0.9	1.1	1.1	1.2	1.2	1.2
Cash flow volatility interest coverage (x times)	1.0	1.4	1.3	1.3	1.4	1.5	1.5
Debt to revenues (x times)	7.3	6.9	7.3	6.7	6.3	6.0	5.7
Debt to assets at cost (%)	55.8	54.0	53.2	52.7	51.9	50.8	50.6

Debt figures exclude bond premium and loan arrangement fees. F: forecast.
Source: Hastoe and Moody's Investors Service

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 performance

Despite the elevated cost pressures due to high inflation and sub-inflation rent cap in fiscal 2024, we expect Hastoe to maintain the strongest operating margin in our rated portfolio. Hastoe's margin stood at 41% in fiscal 2023 (A3-rated peer median: 20%). The increase compared to 38% in fiscal 2022 is driven by maintained control on operating costs and decreased major repairs as Hastoe caught up on its covid backlog in fiscal 2022.

Operating margin is expected to remain very high at around 40% over the next three years. In line with the sector, the HA faces increased costs of responsive repairs, energy and consultancy as well as increased volume of repairs. Besides, Hastoe is reviewing its responsive repairs approach to address recent poor tenant satisfaction. Despite those pressures, as of September 2023, Hastoe reports an operating margin above budget thanks to a lot of its costs being fixed and flexibility on salary increases, typically below rent cap.

Hastoe's strong margins reflect its lower maintenance requirements, with around half of its stock built within the last twenty years and the absence of aluminium composite material cladding on its units/schemes, which limit its decarbonisation and fire and building safety costs compared to peers. Hastoe also benefits from the rural nature of its portfolio which carries the advantage of lower management costs. This is demonstrated in its continued strong margin on its social housing letting business, which has averaged 42% over the last five years, well above the A3-rated peer median (30% over the same period).

The strong performance in profitability has counteracted the pressure of high interest payments due to Hastoe's high indebtedness. Hastoe's social housing letting interest coverage (SHLIC) improved to 1.2x in fiscal 2023, slightly above previous year's 1.1x and above A3 rated peers 1.0x. SHLIC is forecasted to average 1.2x over the next three years, with higher social housing surplus counteracting increased interest payments.

Similarly, cash flow volatility interest coverage (CVIC) improved to 1.4x in fiscal 2023 from 1.3x in the previous year, but remains slightly below A3 rated peers at 1.6x. CVIC is anticipated to average 1.5x over the next three years, in line with peers, as Hastoe's cash flow from operations outpaces interest payments.

Hastoe forecasts a sufficient headroom with its interest coverage covenant, with the lowest projection at 179% in fiscal 2025. The covenant (100% in a year, 110% over three years) takes into account the whole operating surplus, as opposed to the social housing surplus.

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

Hastoe had 7,769 units under management as of fiscal 2023, with slightly more than half of its stock in rural areas. While small in size, its operations are geographically dispersed across London, south England and East Anglia, covering 71 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 and 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, which limits concentration risks, and demand is high.

Hastoe will maintain a low exposure to market sales (outright sales (OS) and first-tranche shared ownership (FTSO)), which we define as in between 0-5% of turnover. Hastoe's market sales will average to 5% of turnover over the next three years. The exposure will only consist of FTSO as the HA divested from its OS sites in fiscal 2020 and does not plan to build others, following a board decision. Hastoe anticipates its market sales margin to average 17% over the next 3 years, from 32% in fiscal 2023.

Hastoe is a traditional housing association with a charitable status for the parent Hastoe Housing Association. Although remaining the main asset holder and operating company, its open market sales development are carried out by Sustainable Homes Limited. The parent has effective control over its 3 subsidiaries (the other 2 are a financing vehicle, Hastoe Capital plc, and a building company, Hastoe Homes Limited) by board appointment. The structure is simpler than most rated peers, a credit strength.

Supportive institutional framework in England

The sector's credit quality will continue to benefit from the strong institutional framework governing English housing associations (HAs) reflected in an Operating Environment score of a3 and a Regulatory Framework score of a1. These scores are assigned at a national level and reflect the following credit considerations:

The regulator maintains strong oversight through quarterly returns, long-term business plans, annual reviews, and by undertaking biennial In-Depth Assessments (IDAs) for large and complex HAs. The regulator has a strong track record of intervention in cases of mismanagement or financial stress with powers to provide financial assistance and/or make manager appointments where there has been a breach of regulatory standards.

The operating environment for English HAs remains supportive. Demand for social housing remains very high and the government has committed to increased capital grant on more flexible terms for new social housing. English HAs retain some expenditure flexibility and have a track record of reducing costs to mitigate lower income.

However, due to presently very high rates of inflation, the government has intervened on social rent policy with a 7% ceiling on social rent increases implemented from April 2023 for one year. The ceiling of 7% will likely result in an adverse differential between rental income and cost growth, driving lower margins and interest coverage. The intervention introduces policy volatility to the sector as the ceiling will supersede the allowable increase of consumer price inflation (CPI) plus 1% under the current rent standard, which is in place until March 2025.

Debt levels expected to moderate, but remain higher than peers

We anticipate Hastoe's debt metrics to moderate as debt growth will be limited, but they will remain higher than peers. Hastoe's gross debt is projected to increase to £255 million by fiscal 2026, from £221 million in fiscal 2023, after five years of deleveraging. The deleveraging came from a board's decision in fiscal 2020 to consolidate its financial position after a period of sustained growth, whilst other HAs were increasing their development ambitions.

Hastoe's 2023 debt is equivalent to 6.3x revenues, which remains considerably above the A3-rated peer median of 4.4x. Hastoe's gearing ratio (debt to assets at cost) stood at 52% in fiscal 2023, now closer to peers than historically thanks to deleveraging (A3-rated peer median of 51%). Both ratios are expected to continue their downward trends reaching respectively 5.8x and 51% in fiscal 2026. Current delays in development programme could push back debt increases, allowing for a faster deleveraging.

Hastoe's debt structure is simple, with few facilities and counterparties, and conservative with 94% of debt being held at fixed rates in fiscal 2023, after swaps. As of fiscal 2023, 93% of Hastoe's outstanding debt was due after five years, limiting its immediate refinancing risk. Its amortisation profile however peaks in 2042, when its bullet bond of £150 million matures.

Capital expenditure expected to increase but liquidity remains strong

Hastoe plans to build 452 new units over the next five years, with no committed units after fiscal 2025 as Hastoe operates by rolling three-year forecast. Despite being a relatively modest development programme (1% of existing units per year), net capital expenditure will rise significantly at an average at 37% of turnover in the next three years. While this is in line with A3 peers, it is higher than historical ratios, with an average of 9% between fiscal 2021 and fiscal 2023. However, Hastoe experienced development delays in line with the sector, which will limit spending for the year.

More than two-thirds of developed units will be social or affordable rented housing, the rest shared ownership units. Any underperformance in the sales programme would therefore be likely to have an impact on debt levels. However, market sales risk is small (£5 million expected to fund the development programme) and partially mitigated by Hastoe's track record of development delivery and experience in rural areas, where competition from private real estate developers is limited and demand for social homes is high. The HA also operates on small schemes, which limit concentration risks. 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, a credit positive.

In addition to its development plan, Hastoe's anticipated capital expenditure also incorporates investment in existing homes. Hastoe is committed to improving the energy efficiency of their homes, with a target of increasing the percentages of homes above EPC C by 5% every year.

Despite the increased capital expenditure, as of September 2023, Hastoe held sufficient cash to cover 6 months of expenses and sufficient liquidity to cover 21 months, a credit positive. Development delays and strategic decisions to reduce development have helped consolidating its liquidity position.

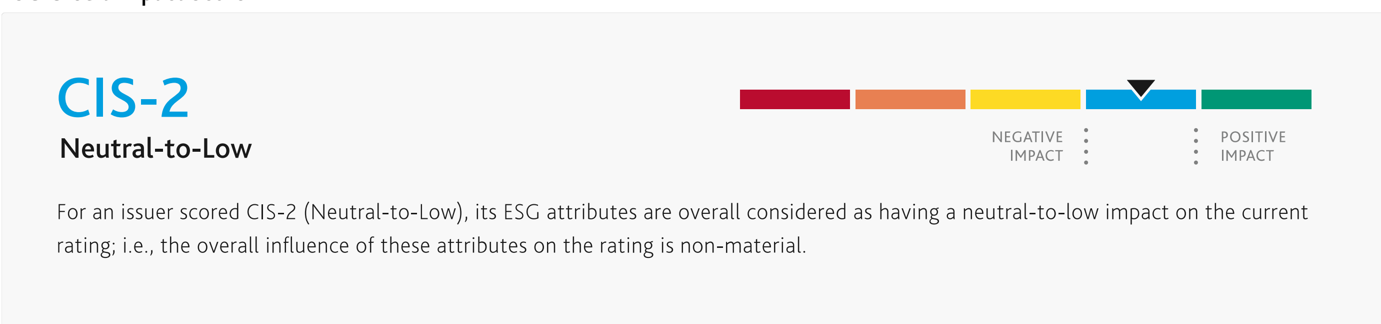
Extraordinary Support Assumptions

The strong level of extraordinary support factored into the rating reflects the wide-ranging powers available to the regulator in cases of financial distress, with the possibility of a facilitated merger or a transfer of engagements. However, the process can be protracted and is reliant on HAs agreeing to merge, which could be more challenging in a weakening operating environment. 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 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.

ESG considerations

Hastoe Housing Association's ESG Credit Impact Score is Neutral-to-Low CIS-2

Exhibit 3
ESG Credit Impact Score



Source: Moody's Investors Service

Hastoe's **CIS-2** indicates that ESG risks have a limited impact on its rating. Although social risks and carbon transition risks are prevalent we consider that Hastoe has the ability to effectively mitigate them through its strong governance and management practices. We also consider that the supportive regulatory framework for the sector offsets some ESG risks.

Exhibit 4
ESG Issuer Profile Scores

Source: Moody's Investors Service

Environmental

Hastoe has a material exposure to environmental risks (**E-3**) relating to a significant proportion of its stock requiring retrofit to meet energy efficiency standards by 2035 (carbon transition risks), leading to increased expenditure.

Social

Hastoe has a material exposure to social risks (**S-3**) through sector-wide legislative requirements to improve the safety of existing housing stock (responsible production risks) which weighs on expenditure and operating margins, and the impacts of cost of living or affordability pressures on social tenants (demographic and societal trends) which led to the UK government capping social rent increases below inflation in fiscal 2024 in England, which will also have a negative impact on margins.

Governance

Hastoe has limited governance risks (**G-2**). Its governance is fit for purpose, with strong financial management policies and processes, detailed reporting and a simple organisational structure. The regulatory framework also supports good governance in the sector.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating Methodology and Scorecard Factors

The assigned BCA of baa2 is the same as the scorecard suggested BCA of baa2 for FY2023.

The methodologies used in this rating were European Social Housing Providers, published in April 2018 and Government Related Issuers, published in February 2020.

Exhibit 5
Fiscal 2023 scorecard

Hastoe Housing Association			
Baseline Credit Assessment	**Sub-factor Weighting**	**Value**	**Score**
Factor 1: Institutional Framework			
Operating Environment	10%	a	a
Regulatory Framework	10%	a	a
Factor 2: Market Position			
Units Under Management	10%	7,769	baa
Factor 3: Financial Performance			
Operating Margin	5%	40.5%	aa
Social Housing Letting Interest Coverage	10%	1.2x	baa
Cash-Flow Volatility Interest Coverage	10%	1.4x	baa
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	6.3x	b
Debt to Assets	10%	51.9%	b
Liquidity Coverage	10%	1.3x	a
Factor 5: Management and Governance			
Financial Management	10%	baa	baa
Investment and Debt Management	10%	baa	baa
Scorecard - Indicated BCA Outcome			**baa2**
Assigned BCA			**baa2**

Source: Hastoe Housing Association and Moody's Investors Service

Ratings

Exhibit 6

Category	Moody's Rating
HASTOE HOUSING ASSOCIATION	
Outlook	Stable
Baseline Credit Assessment	baa2
Issuer Rating	A3
HASTOE CAPITAL PLC	
Outlook	Stable
Senior Secured -Dom Curr	A3

Source: Moody's Investors Service

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