MOODY'S
PUBLIC SECTOR EUROPE

CREDIT OPINION
1 December 2017

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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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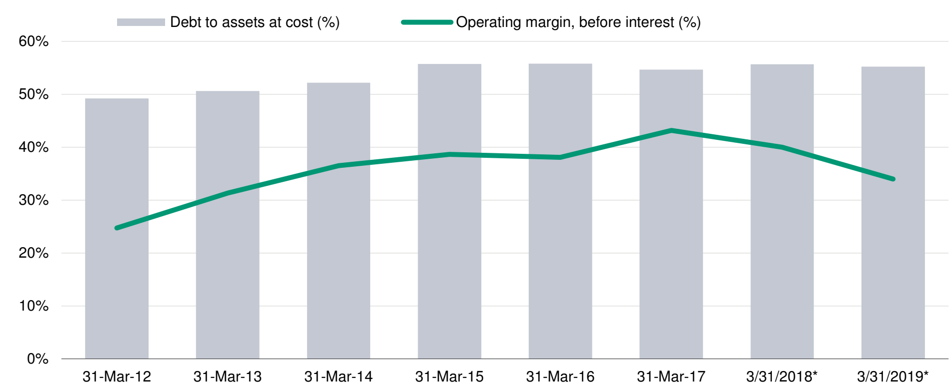
Hastoe Housing Association

Update to credit analysis

Summary

The A3 issuer rating assigned to Hastoe Housing Association (HST) reflects its strong operating margins, its position as a niche provider of rural social housing in areas of high demand, and moderate liquidity reserves. The rating also takes into account its high and increasing debt levels as a result of the development programme, its growing exposure to open market sales, and low social housing letting interest coverage. In addition, the ratings in the sector benefit 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 HST faced acute liquidity stress. HST is rated in the mid-range of Moody's-rated English housing associations, whose ratings span from A1 to Baa2. HST's position takes into account solid and stable margins, rural housing expertise and structurally high debt levels.

Exhibit 1
Hastoe has structurally high debt levels while operating margins will decline
Operating margin as % of revenues and debt-to-assets (at cost), FY2012 - FY2019



*FY2018 and FY2019 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

Credit Strengths

» Strong operating margins, albeit declining

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

» Good liquidity reserves albeit expected to fall

» Strong regulatory framework

Credit Challenges

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

» Development programme leads to growing exposure to market sales

» Narrow coverage levels

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

Rating Outlook

The stable outlook on HST reflects the currently stable operating environment, 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: (1) debt falling below 6.0x revenue; (2) a social housing letting interest coverage structurally exceeding 1.3x; (3) operating margin improving to levels above 40%; and/or (4) a reduced exposure to sales.

Factors that Could Lead to a Downgrade

Negative pressure could be exerted on the rating by one or a combination of the following: (1) 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; (2) liquidity coverage structurally below 1.0x; (3) a social housing letting interest coverage structurally below 1.0x; and/or (4) 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-12	31-Mar-13	31-Mar-14	31-Mar-15	31-Mar-16	31-Mar-17	31/03/2018*	31/03/2019*
Units under management (no.)	4,562	5,803	6,171	6,969	7,171	7,390	7,511	7,583
Operating margin, before interest (%)	21%	25%	31%	37%	39%	38%	43%	42%
Net capital expenditure as % turnover	159%	142%	70%	71%	86%	24%	8%	70%
Social housing Letting interest coverage (x times)	1.1	1.0	1.0	1.0	1.1	1.1	1.3	1.2
Debt to revenues (x times)	5.8	9.1	7.4	7.5	7.1	6.7	6.6	7.0
Debt to assets at cost (%)	45%	49%	51%	52%	56%	56%	55%	56%

*FY2018 and FY2019 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

The rating assigned to HST reflects the application of Moody's Joint Default Analysis (JDA) rating methodology for Government-Related Issuers. In accordance with this methodology, Moody's first establishes the baseline credit assessment (BCA) for HST and then considers the likelihood of support coming from the UK government in the event that HST faces acute liquidity stress.

Baseline Credit Assessment

HST's BCA of baa2 reflects the following factors:

STRONG OPERATING MARGINS, ALBEIT DECLINING

HST's operating margins were among the strongest in its rated peer group at 43.2% in 2017 (2016 peer median: 34%[1]). HST attributes these strong margins to the rural nature of its portfolio, which carries the advantage of lower management costs. HST also benefits from lower arrears and voids relative to Moody's rated peers. HST's margins have increased from 25% in 2012 to 43% in 2017 as the organisation has increased its turnover by almost 50% in the last five years. This was mainly driven by rental inflation and the completion of new homes. Meanwhile tight cost control to offset the rent reduction has been applied.

We expect HST's operating margins to fall towards 30% by 2020 mainly as a result of the execution of an increased development pipeline (which tend to be margin dilutive) and further rent cuts, only about half of which will be offset by cost reductions. Social housing margins should remain fairly stable. The turnover from social housing will decline towards 70% of total revenues over the next three years. Consequently, total turnover is expected to grow towards GBP 42 million in 2020.

MARKET NICHE AS A RURAL HOUSING SPECIALIST, WITH HOUSING STOCK LOCATED IN AREAS OF HIGH DEMAND

HST's units under management totalled around 7,511 as of March 2017, with slightly more than the 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. HST's distinct feature lies with its focus on rural developments. With a net 50,000 people moving from cities to rural areas, there is a real demand shortage for rural housing. HST are typically contacted by local authorities/parish councils before building houses in order to support rural affordable housing demand. The rural housing development process 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 FY2016 was recorded at 26%, slightly above the 22% median of the A3 rated peer group. In addition to healthy margins, demand for social housing in these areas is generally high. An annual GBP 60 million fund has been made available for community led developments in rural and coastal areas. We believe that HST will benefit from this fund.

HST is a traditional housing association with a simple group structure. The parent, Hastoe Housing Group Limited, is a non-charitable registered provider, main asset holder and operating company. There is an additional registered provider, and three smaller subsidiaries limited by shares and guarantee. The parent has effective control over all subsidiaries by board appointment.

GOOD LIQUIDITY RESERVES ALBEIT EXPECTED TO FALL

As of March 2017, immediately available liquidity totalled GBP 50.0 million (GBP 12.0 million cash holdings and GBP 38.0 million of undrawn secured loan facilities). This liquidity covers HST's estimated two-year-cash-net-capital needs (GBP 47.3 million). This illustrates that HST does not need to raise immediately additional capital to deliver their development plans. However, HST plans to draw down their cash levels considerably over the next years as they intend to fund upcoming developments by drawing down cash reserves and funding lines. Further, HST plans to engage in additional financing transactions during the course of the next year.

If not addressed, the existing strong liquidity position could become a credit concern as the organisation draws drown the majority of their cash reserves leaving only credit facilities as source of funding. We note and take comfort in HST''s `Golden Rules' that require cash and loan facilities, which excludes anticipated cash receipts from sales, to cover contractually committed expenditure.

Unencumbered assets grant HST an additional borrowing capacity of GBP 141.5 million at November 2017. This level of unencumbered assets is considered adequate given HST's size and is in line with levels of rated peers.

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.

DEBT LEVELS EXPECTED TO REMAIN STRUCTURALLY HIGH AS A RESULT OF THE DEVELOPMENT PROGRAMME

As at FYE2017, HST's gross debt remained stable at GBP 226.1 million compared to GBP 226.8 million in 2016, equivalent to 6.6x revenues and 55% of assets at cost. This level of debt is considerably above the 4.4x median debt-to-revenue level of HST's A3 peer group. HST's interest payments remained stable at GBP 10.9 million in FY2017 compared to the previous year.

Debt is expected to remain high throughout the next five years, peaking at around GBP 260 million - GBP 270 million by the end of March 2020. This increasing gross debt reflects the entity's extensive capital investment over the next few years and envisaged financing transactions, which will increase leverage temporarily to around 7.0x by the end of March 2018. Afterwards we expect HST's debt-to-revenues ratio to remain at above 6.0x of turnover until 2020 and only in 2021 start to decline as a result of increased turnover steaming from the development programme.

HST's debt structure is conservative with 96% of debt being held at fixed rates in 2017 with no standalone swaps. As at FYE2017, 94.5% of HST's outstanding debt was due after five years, limiting its refinancing risk, while its amortisation profile is fairly smooth with no peak repayments.

DEVELOPMENT PROGRAMME INCREASES EXPOSURE TO OUTRIGHT SALES

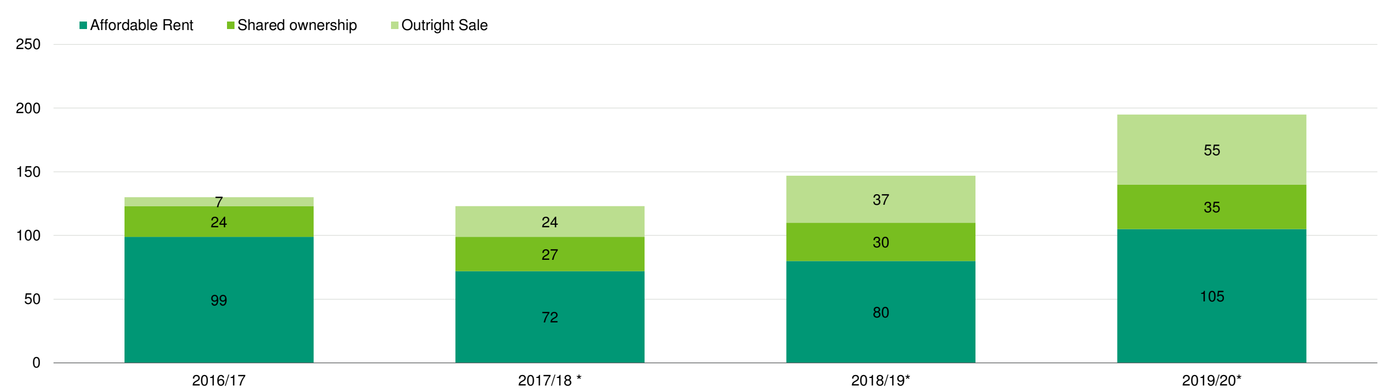
HST's new development programme aspires to increase the development programme to 195 units a year by 2020 (Exhibit 3), a 50% increase from the 130 units built in the fiscal year ending March 31, 2017.

Of the new units around 25% are for market sale and 20% for shared ownership increasing significantly the HA's exposure to market price movements. Sales risk will be partially mitigated by HST's track record of development delivery and experience in the rural areas, where competition from private real estate developers is limited. HST's projections for FY2017-2020 (budget) included a significantly increasing element of outright sales revenue, that is expected to peak at around GBP 16 million (32% of turnover) in FY2021.

Exhibit 3

Hastoe's plans to increase significantly its development programme

Number of budgeted new build homes



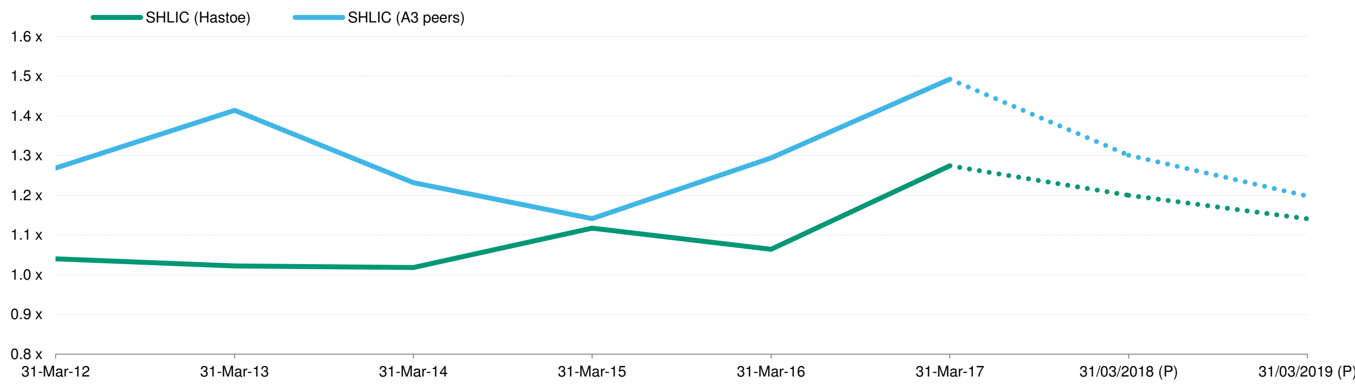
* budgeted

Source: Hastoe HA

WEAK SOCIAL HOUSING INTEREST COVERAGE

The improved surplus in HST's social housing activity, lead to an increase in the HA's social housing letting interest coverage ratio (including depreciation) to a strong 1.3x in 2017, up from a slim average of 1.1x for the past four years. This low level was due to high debt levels and interest payments on its 2012 borrowing. HST's social housing letting interest coverage is projected to remain weak at slightly below 1.2 over the next two years as a result of the higher debt issuance to finance the ambitious development programme as shown in Exhibit 2.

Exhibit 4
Social housing interest cover remains below A3 rated peers



*FY2018 and FY2019 are projected figures
Source: Hastoe / Moody's

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 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

European Social Housing Providers, July 2016 (190944)

Government Related Issuers, August 2017 (1047378)

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

Endnotes

1 All 2016 peer comparisons noted in this analysis have been computed under the old UK GAAP

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