

CREDIT OPINION

23 October 2020

 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

Csaba Szontagh +44.20.7772.8738
 Associate Analyst
 csaba.szontagh@moodys.com

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

Hastoe Housing Association

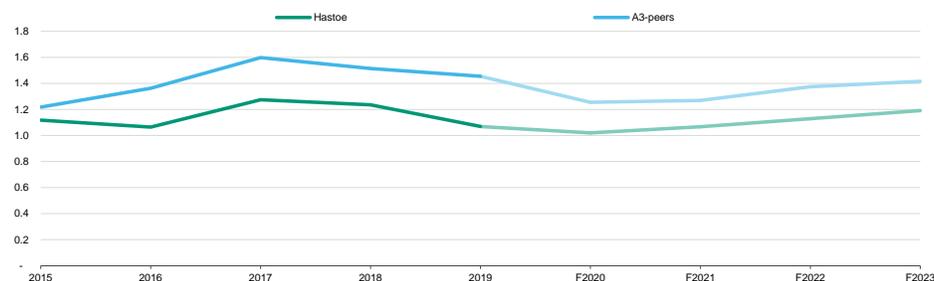
Update following affirmation of A3 stable

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 government of the [United Kingdom](#) (UK, Aa3 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 remain below peers



F: Forecast

Source: *Hastoe Housing Association, Moody's Investors Service*

Credit Strengths

- » Strong operating margins
- » Market niche as a rural housing specialist
- » Supportive institutional framework in England

Credit Challenges

- » Debt levels expected to remain structurally high
- » Exposure to market sales remains in short term
- » 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.

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 or a dilution of the overall level of support from the UK government would also exert downward pressure on the rating.

Key Indicators

Hastoe Housing Association							
	31-Mar-15	31-Mar-16	31-Mar-17	31-Mar-18	31-Mar-19	31-Mar-20 (F)	31-Mar-21 (F)
Units under management (no.)	7,171	7,390	7,220	7,595	7,630	7,383	7,451
Operating margin, before interest (%)	38.7	38.1	43.2	41.7	37.8	34.5	39.4
Net capital expenditure as % turnover	85.6	24.1	7.6	20.4	81.1	10.7	41.1
Social housing letting interest coverage (x times)	1.1	1.1	1.3	1.2	1.1	1.0	1.1
Cash flow volatility interest coverage (x times)	1.3	1.5	1.7	1.5	1.3	1.4	1.4
Debt to revenues (x times)	7.1	6.7	6.6	6.5	7.3	6.2	6.9
Debt to assets at cost (%)	55.7	55.8	54.6	53.7	54.9	53.2	53.6

Fiscal 2015-2019 are sourced from financial statements, fiscal 2020 and 2021 are forecast

Source: *Hastoe Financial Statements, Moody's Investors Service*

Detailed Credit Considerations

On 21 October 2020, Moody's affirmed Hastoe's ratings and stable outlook. The affirmation followed Moody's downgrade of the Government of the United Kingdom's rating to Aa3 from Aa2 and the change in outlook to stable from negative on 16 October 2020.

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 38% in FY2019 (FY2019 expected peer median: 30%). 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. Besides, half of Hastoe's stock was built in the last 20 years, which implies lower repair and maintenance costs. Hastoe regularly conducts survey to assess the quality of their stock and to anticipate maintenance costs.

Hastoe has managed to keep margins high throughout the rent cut period which ends in FY2020, facilitated by tight cost control, and throughout the new regulations on fire safety, which incurred unexpected additional expenditure. We expect Hastoe's operating margin to fall towards 34% by FY2020 mainly as a result of the sale of two open market sites at cost for £4 million and the continued impact of the rent cut.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moody's.com for the most updated credit rating action information and rating history.

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

Hastoe had 7,630 units under management as of FY2019, 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, south-west 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/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 FY2019 was recorded at 19% (a fall from 32.6% in FY2018), below the expected peer median of 22%. This fall in sales margin is due to (1) the slowdown in the housing market and (2) the high proportion in open market sales (with higher costs of land associated). As a consequence of the slowdown in the housing market, Hastoe has reduced its exposure to new build sales by deciding to sell its two open market led sites (£4 million) and is downscaling its development programme.

Hastoe is a traditional housing association with a charitable status for the parent Hastoe Housing Association (a structure change that occurred in 2017). Although remaining the main asset holder and operating company, it transferred its open market sales development to Lowen Homes (incorporated in 2017). The parent has effective control over all subsidiaries by board appointment.

Supportive institutional framework in England

The sector's credit quality will continue to benefit from the strong regulatory framework governing English HAs. 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. In response to the pandemic, the regulator adapted some aspects of its oversight temporarily, for example, extending its liquidity monitoring, briefly pausing the programme of IDAs and delaying regulatory submissions to reduce the operational burden on 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 has improved under more supportive policies for social rent increases and capital grant. Following four years of social rent reductions, HAs now benefit from a return to inflation-linked rent increases from April 2020 for five years. In addition, the government has committed to increased capital grant on more flexible terms for new social housing.

Counterbalancing the improvements, we expect policy to drive increased borrowing and development risk in the sector as it responds to the government's objective to deliver a significant increase in the construction of new homes.

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

As of FY2019, Hastoe's gross debt increased slightly at £239 million (compared to £222 million in FY2018), equivalent to 7.3x revenues and 56% of assets at cost. This level of debt is considerably above the 4.5x median debt-to-revenue level of Hastoe's A3 peer group. Hastoe's interest payments increased slightly on par with its debt increase at £11.7 million in FY2019 compared to the previous year. They are projected to grow and peak at £12.3 million in FY2023 due to its increasing borrowing plans.

Debt is expected to peak at £245 million by FY2022. This increasing gross debt reflects its capital investment over the next few years and will increase debt to revenues temporarily to around 6.6x on average for the next three years. Gross capex is expected to be an average of 53% of turnover between FY2020 to FY2022, in line with the expected A3-rated peer median average of 55% over the same period. We expect Hastoe's debt-to-revenues ratio to start declining in 2023 as a result of increased turnover stemming from execution of its development programme.

Hastoe's debt structure is conservative with 98% of debt being held at fixed rates in 2019 with no standalone swaps. As of FY2019, 80% of Hastoe's outstanding debt was due after ten years, limiting its refinancing risk, while its amortisation profile is fairly smooth with no repayment peaks.

As of March 2018, immediately available liquidity totaled £43.6 million (£21.8 million cash holdings and £21.7 million of undrawn secured loan facilities), an increase from last year's £38.6 million. This current liquidity level fully covers Hastoe's estimated two-

year-cash-net-capital needs (£18 million), with Hastoe's liquidity metric at 2.4x at 31st March 2019. Hastoe also has a high level of unencumbered assets (£144 million), which represents an adequate buffer for future borrowings.

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 positive.

Exposure to market sales, although moderate, to remain in the short term

Hastoe's development programme to FY2022 is for 240 units, a significant scale-down from last year's five-year plan of 535 units. This is due to the Board's wish to strengthen Hastoe's financial position and to reduce its exposure to market sales. Of the 240 new units, only 6 are for outright sales and 68 units for shared ownership. This is a moderate exposure compared to the 178 units previously planned for sales in the last development programme.

The programme is expected to be financed by a combination of 56% debt funding, 22% through sales proceeds and 22% through grants. Any under-performance in the sales programme would therefore be likely to have an impact on debt levels. However, sales risk (£11 million expected to fund the programme) 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. Finally, we note that in their budgets, the sale assumption of existing stock has been lowered to 5 sales per annum, from 15 sales, a prudent measure to reflect the slowing housing market.

Following its lower margin on sales (19% at FY2019 as opposed to an average of 27% in the last three years), Hastoe changed its business plan and reduced its expected market sale exposure. In FY2020, the market sales exposure will increase to 19% of turnover (from an average of 10% the three years before) due to committed sales from the previous development programme, a risk exposure we assess as moderate. Hastoe's track record in delivering profitable development, coupled with strong demand in its areas of operation partially mitigate the 2020 moderate risk of its exposure to market sales activities. Going forward its exposure will decrease back to an average of 8% of turnover in FY2021-2023, well below peers that are forecasting 19% on average around the same period, a credit positive given the volatility of sales revenue.

Weak social housing interest coverage

At 1.1x in FY2019, Hastoe's social housing letting interest coverage was well below its A3 peers (median of 1.45x), and is forecasted to remain at the same level, 1.1x over FY2020-22. This is the 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 at 1.3x for the next 3 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 154% in 2020, with a headroom of 54 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 (Aa3 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.

ESG considerations

How environmental, social and governance risks inform our credit analysis of Hastoe

Moody's takes account of the impact of environmental (E), social (S) and governance (G) factors when assessing sub-sovereign issuers' economic and financial strength. In the case of Hastoe, the materiality of ESG to its credit profile is as follows:

Environmental considerations are not material to HAs' credit profiles. In line with the rest of the UK, the sector's main environmental risk exposures relate to water shortage and flood risk. Flood risk is managed by country and national authorities, and therefore the financial burden of adapting to increased flood risk will not fall on individual housing associations.

Social risks are material to HAs' credit profiles. In particular, the sector is exposed to risks stemming from socially-driven policy agendas affecting social rents, benefits and capital grants in addition to the impact of demographic trends on demand which are captured in our assessment of the operating environment. We view the coronavirus outbreak as a social risk under our ESG framework given its impact on health and safety. Overall, we expect the outbreak to cause ongoing operational disruption for HAs but do not expect a material credit impact as higher arrears and lower market sales receipts will be offset by cash savings from reduced capital spending on development and repairs. HAs are also impacted by customer relations and product quality. The Grenfell fire tragedy in June 2017 has encouraged higher health and safety standards with many HAs planning on increasing spending on the quality of their existing stock.

Governance considerations are also material to HAs' credit profiles and are captured in our assessment of governance and management. In general, housing association governance is strong with multi-year strategies supported by detailed forecasts, conservative liquidity policies, and robust risk management including stress testing.

Further details are provided in the "Baseline credit assessment" section above. Our approach to ESG is explained in our cross-sector methodology [General Principles for Assessing ESG Risks](#).

Rating Methodology and Scorecard Factors

The assigned BCA of baa2 is in line with the scorecard suggested BCA of baa2 for FY2019.

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

31 March 2019

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%	7,630	baa
Factor 3: Financial Performance			
Operating Margin	5%	37.8%	aa
Social Housing Letting Interest Coverage	10%	1.1x	baa
Cash-Flow Volatility Interest Coverage	10%	1.3x	baa
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	7.3x	b
Debt to Assets	10%	55.0%	b
Liquidity Coverage	10%	2.4x	aa
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 4

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

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