

CREDIT OPINION

6 January 2021

✓ 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.

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Hastoe Housing Association

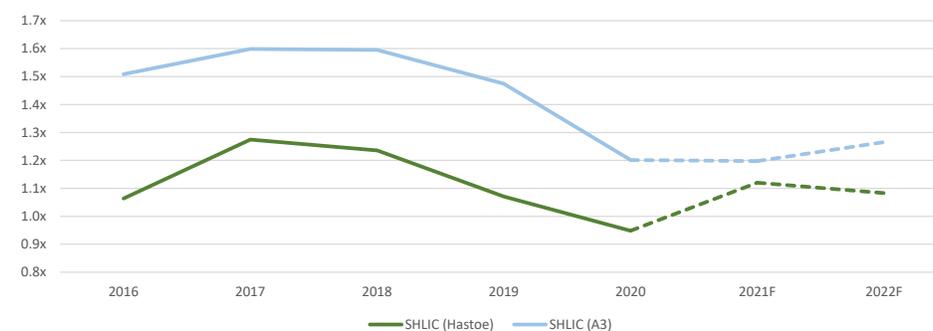
Update to credit analysis

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 and high but moderating debt levels. 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 moderate as a result of a ramped-down development programme, but remain higher than peers
- » Weak social housing interest coverage

Rating Outlook

The stable outlook on Hastoe reflects its stable financial performance and debt levels.

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 could also exert downward pressure on the rating.

Key Indicators

Exhibit 2

Hastoe Housing Association							
	31-Mar-16	31-Mar-17	31-Mar-18	31-Mar-19	31-Mar-20	31-Mar-21 (F)	31-Mar-22 (F)
Units under management (no.)	7,390	7,220	7,595	7,630	7,669	7,707	7,842
Operating margin, before interest (%)	38.1	43.2	41.7	37.8	33.6	41.4	37.4
Net capital expenditure as % turnover	24.1	7.6	20.4	21.5	(4.4)	55.5	50.2
Social housing letting interest coverage (x times)	1.1	1.3	1.2	1.1	0.9	1.1	1.1
Cash flow volatility interest coverage (x times)	1.5	1.7	1.5	1.3	1.5	1.1	1.3
Debt to revenues (x times)	6.7	6.6	6.5	7.7	7.2	7.1	6.6
Debt to assets at cost (%)	55.8	54.6	53.7	57.0	55.2	53.8	54.4

FY2021 and FY2022 are forecasts

Source: *Hastoe Financial Statements, 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 margins

Hastoe's operating margin remained amongst the strongest in its rated peer group at 34% at FYE2020 (FY2020 A3 peer median: 26%), despite a decrease compared to historical levels of an average of 40% over FY2017 to FY2020. The decline is due to the inclusion of a provision related to fire safety works, lower margins on property sales and increased costs of routine maintenance.

Hastoe's operating margin is expected to remain solid in the coming years, projected to reach 41% in FY2021 and 37% in FY2022, well above the expected peer median of 28% and 27%, respectively. Hastoe's strong margins reflect the fact that around half of its stock is less than twenty years old and therefore has lower maintenance requirements, in addition to 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 been consistently above 40% for the last five years, dropping to 39% in FY2020 but still remaining well above the peer median. The fall in social housing lettings interest margin mostly reflects a £0.9 million provision relating to fire safety remedial works, and a lower surplus on market sales.

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

Hastoe had 7,670 units under management as of FY2020, 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 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 and demand is high.

Hastoe continues to have a moderate exposure to market sales (including outright sales and first-tranche shared ownership(FTSO)), which accounted for 10% of turnover in FY2020. From FY2021 onwards, Hastoe will have very minimal exposure to outright sales, which are expected to represent just 2% of total turnover in this year. Its margin on market sales has been volatile in recent years, ranging from 33% in FY2018 to 15% in FY2020, reflecting some volatility in the housing market. Hastoe's Board made the strategic decision to reduce its exposure to market sales due to the slowdown in the housing market and sold a land holding during the year to reduce its risk, in addition to converting another land holding to an affordable scheme.

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 moderate as a result of a ramped-down development programme, but remain higher than peers

As of FYE2020, Hastoe's gross debt decreased slightly to £240 million (compared to £246 million in FY2019), equivalent to 7.2x revenues and 55% of assets at cost. The decrease in debt reflects its negative net capex level in FY2020, at -4%. Its development programme delivered fewer units than expected in FY2020 - 82 units vs. 140 planned. The shortfall reflects delayed handovers, and the sale of the site that was originally expected to be developed.

Hastoe's development programme includes 295 units to FY2023, which is a relatively modest development programme, reflected in low net capex of 44% over FY2021 to FY2023. 70% of the new units will be affordable rented housing, 30% FTSO and very small numbers of outright sales on individual schemes will also be included.

The programme is expected to be financed by a combination of 47% debt funding, 23% through grants, 20% through cash and 10% through sales proceeds. Any under-performance in the sales programme would therefore be likely to have an impact on debt levels. However, sales risk (£8.2 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 specialized in delivering detached and semi-detached houses, which tend to report lower price volatility when compared to flat sales.

Hastoe's debt to revenues level of 7.2x is considerably above the 4.6x median debt-to-revenue level of Hastoe's A3 peer group. However, as the development programme is quite moderate, its debt to revenues metric is expected to decrease to 6.6x by FY2022, although this will continue remain well above the A3 peer median.

Hastoe's debt structure is conservative with 96% of debt being held at fixed rates in 2020 with no standalone swaps. As of FYE2020, 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 2020, immediately available liquidity totaled £56.8 million (£19.3 million cash holdings and £37.5 million of undrawn secured loan facilities). This current liquidity level fully covers Hastoe's estimated two-year-cash-net-capital needs (£29 million), with Hastoe's liquidity metric at 1.5x at 31st March 2020.

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.

Weak social housing interest coverage

At 0.9x in FY2020, Hastoe's social housing letting interest coverage was below its A3 peers (median of 1.2x), and is forecasted to remain low at 1.1x over FY2021-23. This mainly reflects increased fire safety compliance costs and its high debt levels. 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 160% in FY2021, with a headroom of 50 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 the same as the scorecard suggested BCA of baa2 for FY2020.

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

Exhibit 3

31 March 2020

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%	7,669	baa
Factor 3: Financial Performance			
Operating Margin	5%	33.6%	a
Social Housing Letting Interest Coverage	10%	0.9x	ba
Cash-Flow Volatility Interest Coverage	10%	1.5x	baa
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	7.2x	b
Debt to Assets	10%	55.2%	b
Liquidity Coverage	10%	1.5x	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 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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