

CREDIT OPINION

17 January 2022

 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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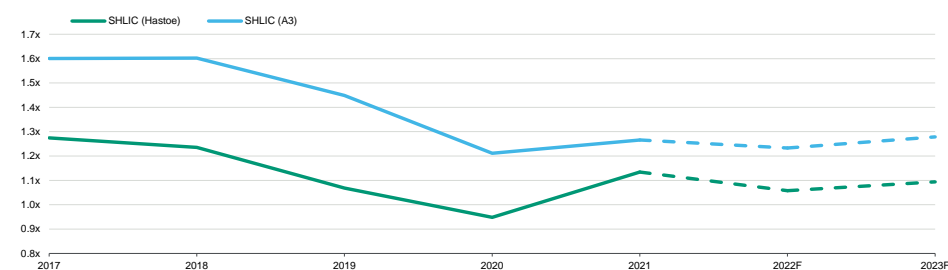
Update to credit analysis

Summary

The credit profile of [Hastoe Housing Association](#) (Hastoe, A3 stable) reflects its solid operating margins, simple structure and strong market position, counterbalanced by its 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, because of its high indebtedness



F: forecast.

Source: *Hastoe and 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, but remain higher than peers
- » High interest costs, resulting in weak 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 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

Hastoe Housing Association							
	31-Mar-17	31-Mar-18	31-Mar-19	31-Mar-20	31-Mar-21	31-Mar-22 (F)	31-Mar-23 (F)
Units under management (no.)	7,220	7,595	7,630	7,669	7,681	7,726	7,839
Operating margin, before interest (%)	43.2	41.7	37.8	33.6	41.9	37.6	38.7
Net capital expenditure as % turnover	7.6	20.4	21.5	(4.4)	(8.7)	47.1	62.7
Social housing letting interest coverage (x times)	1.3	1.2	1.1	0.9	1.1	1.1	1.1
Cash flow volatility interest coverage (x times)	1.7	1.5	1.3	1.5	1.5	1.4	1.5
Debt to revenues (x times)	6.5	6.5	7.3	6.9	7.3	6.7	7.0
Debt to assets at cost (%)	54.3	53.9	55.9	54.1	53.2	53.2	54.4

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 margins

Hastoe's operating margin is among the strongest ones in our rated portfolio at 42% in fiscal 2021 (A3 peer median: 25%). The improvement compared to fiscal 2020 (34%) is mainly due to increased rent incomes and lower maintenance costs.

Operating margin is expected to slightly deteriorate over the next three years, averaging at 38% over fiscal 2022-24, which will still be well above rated peers. Backlog on maintenance, as a consequence of the pandemic, was caught up by mid fiscal 2022, however some fire safety compliance works (for which a provision of £3.9 million has been built) are still outstanding and will weight negatively on margins. Besides, further costs are anticipated to arise from retrofitting, a further negative impact on its operating margin. Hastoe is better placed than rated peers regarding decarbonization with 82% of its properties already achieved an energy performance contract (EPC) rating of minimum 'C', one of the highest shares among rated HAs. Hastoe is furthermore considering divesting from its four urban blocks over 18 meters, which should limit its decarbonization and fire and building safety costs.

Hastoe's strong margins reflect its lower maintenance requirements, with around half of its stock built within the last twenty years. Hastoe also benefits from the rural nature of its portfolio which carries the advantage of lower management costs. This is

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demonstrated in its continued strong margin on its social housing letting business, which has been consistently above 40% for the last five years, (except for fiscal 2020 at 39%), well above the peer median (31.4% at fiscal 2021).

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

Hastoe had 7,681 units under management as of fiscal 2021, 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.

Although the market sales reduced in fiscal 2021 due to the pandemic, Hastoe will maintain a moderate exposure to market sales (including outright sales and first-tranche shared ownership (FTSO)), which we define as in between 5-20% of turnover. Hastoe's Board made the strategic decision in 2019 to reduce its exposure to market sales due to the slowdown in the housing market and sold one of its two open market led sites in fiscal 2020 to reduce its exposure, in addition to converting the other one to an affordable scheme.

Hastoe's market sales will increase to 8% of turnover, from a low 2% of turnover in fiscal 2021. Hastoe anticipates its market sales margin to average 20% over the next 3 years, from 22% in fiscal 2021. We will monitor its margin as it has been volatile in recent years, decreasing to 15% in fiscal 2020.

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, its open market sales development are carried out by Sustainable Homes Limited (called Lowen Homes until May 2021). The parent has effective control over all subsidiaries (4 including Lowen Homes, a dormant company, a financing vehicle 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 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, but remain higher than peers

As of fiscal 2021, Hastoe's gross debt (excluding bond premium) decreased slightly to £231 million (compared to £236 million in fiscal 2020), equivalent to 7.3x revenues considerably above the 4.5x median debt-to-revenue level of Hastoe's A3 peer group. Its gearing ratio (debt to assets at cost) is in line with the A3 peer median of 53%.

We anticipate Hastoe's debt metrics to moderate as debt growth will remain limited. The HA's development programme is expected to be financed by a combination of debt funding (36%), cash and asset disposal (28%), grants (22%) and sales (13%). Thanks to the diverse funding sources, Haste's debt will only increase by 12% in between 2021-24, while revenues are anticipated to grow by 26%.

Consequently, its debt to revenues metric is expected to decrease to 6.5x by fiscal 2024, a positive, although this will continue remain well above the A3 peer median.

Hastoe's development programme includes 337 units to fiscal 2024, as Hastoe operates by rolling three-year forecast. This is a relatively modest development programme (4% of existing units), but higher than what was achieved in previous years. The HA plans to build around 100 units per year, compared to the 48 units built in fiscal 2020 (only 20 units were completed in fiscal 2021 due to the pandemic). The increased ambition will be reflected in an increase of net capital spending, averaging 44% over fiscal 2022-24, compared to an average of 7% over the past five years.

69% of the new units will be affordable rented housing and 31% will be dedicated for shared ownership. A very small number of outright sales (5 units per year) on individual schemes will also be included. Any underperformance 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) is 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. 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.

Hastoe's debt structure is simple, with few facilities and counterparties, and conservative with 97% of debt being held at fixed rates in fiscal 2021 with no standalone swaps. As of fiscal 2021, 93% of Hastoe's outstanding debt was due after five years, limiting its immediate refinancing risk. Its amortization profile however peaks in 2042, when its bullet bond of £150 million matures.

As of March 2021, immediately available liquidity totaled £41.9 million (£4.4 million of cash holdings and £38 million of undrawn secured loan facilities). This liquidity level fully covers Hastoe's estimated two-year-cash-net-capital needs (£39 million), with Hastoe's liquidity metric at 1.1x in fiscal 2021. The HA also has access to an additional £7.7 million, which we did not include in immediate liquidity because of the three-month notice period, but we note that it would increase the liquidity coverage ratio to 1.3x.

High interest costs, resulting in weak interest coverage

Hastoe's social housing letting interest coverage (SHLIC) was at 1.1x in fiscal 2021, above previous year's 0.9x but remaining below its A3 peers (median of 1.3x). The improvement in social housing lettings margin is due to the increased revenue from social housing lettings, and due to delayed maintenance costs. The low interest coverage ratio despite Hastoe's high profitability is a reflection of its high indebtedness.

SHLIC is forecasted to stabilise, averaging 1.1x over the next three years, as increased fire safety compliance costs outweigh increased income from rent increases. 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 FY2022, with a headroom of 50 percentage points. Although the headroom is lower than peers, 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 Riverside, the materiality of ESG to its credit profile is as follows:

Environmental considerations are material to the group's credit profile. Although the impact of physical climate risks such as water shortages and flood risk are unlikely to be material to HAS' credit profiles as they are managed by government authorities, energy efficiency and decarbonisation more broadly are becoming an increasingly acute priority for HAS with a target of all homes obtaining an energy performance certificate (EPC) of C or above by 2035 in England. We expect this to require material levels of capital expenditure - which would either divert cash flows away from development programmes or increase debt levels. Hastoe is currently estimating the costs of achieving EPC C for all its properties by 2030. Although the HA is late compared to peers, an estimated 82% of its stock has already an EPC rating of minimum C, a better position than peers. Hastoe will also launch in fiscal 2022 its own Hastoe New-Build Standard to ensure it delivers energy-efficient homes that meet UK targets for carbon reduction.

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 pandemic as a social risk under our ESG framework given its impact on health and safety. 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 "Detailed credit considerations" 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 FY2021.

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 2021

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%	7,681	baa
Factor 3: Financial Performance			
Operating Margin	5%	41.9%	aa
Social Housing Letting Interest Coverage	10%	1.1x	baa
Cash-Flow Volatility Interest Coverage	10%	1.5x	baa
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	7.3x	b
Debt to Assets	10%	53.2%	b
Liquidity Coverage	10%	1.1x	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 and 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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