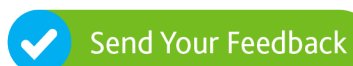


CREDIT OPINION

27 October 2023



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)

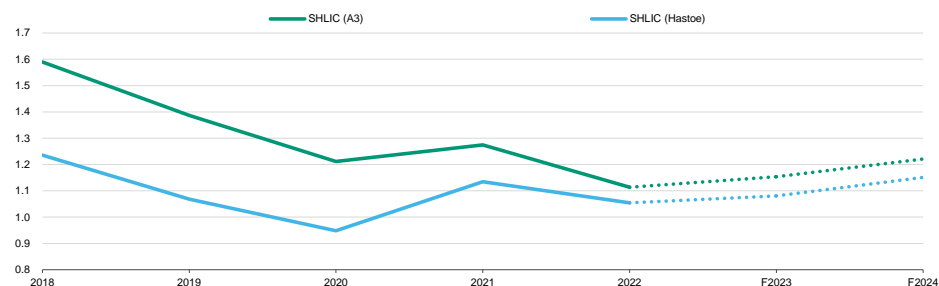
Update following outlook change to stable from negative

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 weaker interest coverage ratios than peers and its high 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: Forecasted on 2022 business plan.

Source: *Hastoe and Moody's Investors Service*

Credit Strengths

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

Credit Challenges

- » Debt levels expected to remain higher than peers
- » High interest costs, resulting in weak interest coverage

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-18	31-Mar-19	31-Mar-20	31-Mar-21	31-Mar-22	31-Mar-23 (F)	31-Mar-24 (F)
Units under management (no.)	7,595	7,630	7,669	7,681	7,737	7,736	7,902
Operating margin, before interest (%)	41.7	37.8	33.6	41.9	37.5	37.5	40.1
Net capital expenditure as % turnover	20.4	21.5	(4.4)	(11.0)	10.5	68.2	63.1
Social housing letting interest coverage (x times)	1.2	1.1	0.9	1.1	1.1	1.1	1.2
Cash flow volatility interest coverage (x times)	1.5	1.3	1.5	1.5	1.7	1.4	1.5
Debt to revenues (x times)	6.5	7.3	6.9	7.3	6.7	6.7	6.5
Debt to assets at cost (%)	53.9	55.9	54.1	53.2	52.8	52.9	54.1

Debt figures exclude bond premium and loan arrangement fees. F: forecasts based on 2022 business plan.

Source: Hastoe and Moody's Investors Service

Detailed Credit Considerations

On 25 October 2023, Moody's changed the outlook to stable from negative and affirmed Hastoe's ratings. The change in outlook followed Moody's change in outlook of the Government of the United Kingdom's Aa3 rating to stable from negative on 20 October 2023.

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 consistently among the strongest ones in our rated portfolio at 38% in fiscal 2022 (A3-rated peer median: 23%). The decrease compared to fiscal 2021 (42%) is mainly due to a catch-up on repair and maintenance, which increased by £1.6 million compared to fiscal 2021, as the previous year was impacted by Covid-19 restrictions.

Operating margin is expected to slightly deteriorate over the next three years, but to remain well above rated peers. HAs in the UK face elevated cost pressures as inflation surged in the UK, reaching 11.1% in the 12 months to October 2022, and we forecast it to remain above the Bank of England's 2% target until the end of 2024, whilst rent increases will be capped at 7% in fiscal 2024. As of September 2022, despite the inflationary pressures, Hastoe reports an operating margin slightly above budget, a credit positive. The HA benefits from delays on its planned works programme (positive variance of £0.4 million) and staff vacancies and reductions in other overheads

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

(positive variance of £0.4 million), despite being affected by increased energy costs (negative variance of £0.1 million) and ongoing delays to schemes under development (negative variance of £0.1 million)

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 been consistently around 40% for the last five years, well above the A3-rated peer median (28% at fiscal 2022).

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

Hastoe had 7,700 units under management as of fiscal 2022, 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 moderate exposure to market sales (outright sales (OS) and first-tranche shared ownership (FTSO)), which we define as in between 5-20% of turnover. Hastoe's market sales will slightly increase to 7% of turnover, from a low 5% of turnover in fiscal 2022. 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 22% over the next 3 years, from 15% in fiscal 2022.

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 (called Lowen Homes until May 2021). The parent has effective control over its 4 subsidiaries (the other 3 are Lowen Homes - dormant, a financing vehicle and a building company - Hastoe Homes Limited) by board appointment. The structure is simpler than most rated peers, a credit strength.

Adequate liquidity

As of September 2022, Hastoe held sufficient cash to cover 11 months of expenses and sufficient liquidity to cover 30 months, a credit positive. Development delays and strategic decisions to reduce development have helped consolidating its liquidity position.

Hastoe's development programme includes 100 units per year, with no committed units after fiscal 2025 as Hastoe operates by rolling three-year forecast. This is a relatively modest development programme (1% of existing units per year), as Hastoe elected to defer or not proceed with some development schemes due to the weakened economic conditions. Besides, the HA experiences delays in line with the sector, which will limit spending for the year.

Two-thirds of developed units will be 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 (£5 million expected to fund the programme) is small 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. The HA also operates on small schemes, which limit concentration risks. 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.

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 to be 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 remain limited, but they will remain higher than peers. Whilst other HAs were increasing their development ambitions, Hastoe's board decided that the HA needed to consolidate its financial position after a period of sustained growth, and thus to limit its development ambitions for the foreseeable future. Given the weakened operating environment and high inflation on development costs, this is a credit positive for the HA. Current delays in the development programme will push back debt increases, allowing for a modest deleveraging.

As of fiscal 2022, Hastoe's gross debt (excluding bond premium) decreased slightly to £226 million (compared to £231 million in fiscal 2021), equivalent to 6.7x revenues. This remains considerably above the A3-rated peer median of 4.3x. Its gearing ratio (debt to assets at cost) stood at 53%, which is also above the A3-rated peer median (51%).

Hastoe's debt structure is simple, with few facilities and counterparties, and conservative with 94% of debt being held at fixed rates in fiscal 2022 with no standalone swaps. As of fiscal 2022, 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.

High interest costs, resulting in weak interest coverage

Despite its high profitability, Hastoe will maintain low interest coverage ratios due to its high indebtedness. Hastoe's social housing letting interest coverage (SHLIC) was at 1.05 in fiscal 2022, slightly below previous year's 1.13x and slightly below A3 rated peers 1.15x. The slight SHLIC decrease is explained by the aforementioned increase in repair and maintenance activity. SHLIC is forecasted to stabilise, averaging 1.1x over the next three years, because of the inflationary pressures.

Similarly, cash flow volatility interest coverage (CVIC) stood at 1.67x in fiscal 2022, slightly below A3 rated peers 1.74x. CVIC is anticipated to decrease, averaging at 1.44x over the next three years as Hastoe prudently forecasts weaker margins on market sales in fiscal 2023.

Hastoe will still remain compliant with its interest coverage covenant (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 165% in fiscal 2027, with a sufficient headroom of 55 percentage points.

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

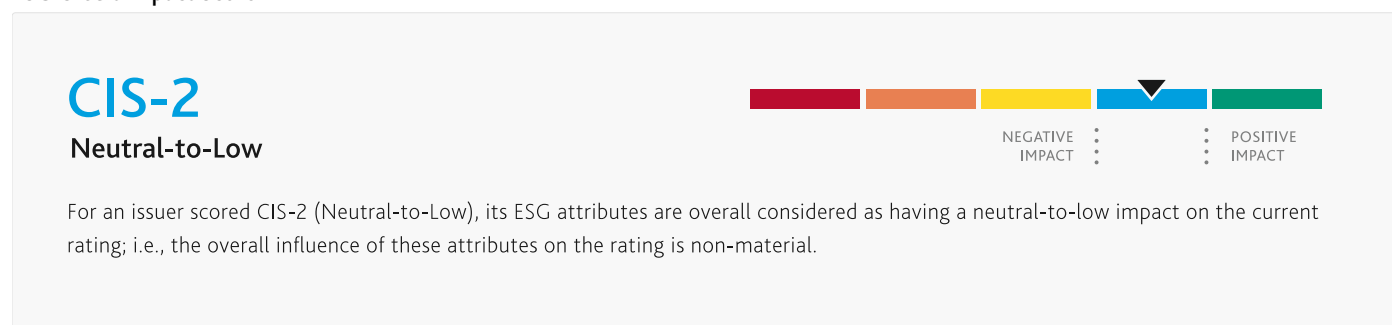
is reliant on HAs agreeing to merge, which could be more challenging in a weakening operating environment. Recent history has shown that the UK government is willing to support the sector, as housing remains a politically and economically sensitive issue. The strong support assumption also factors increasing 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

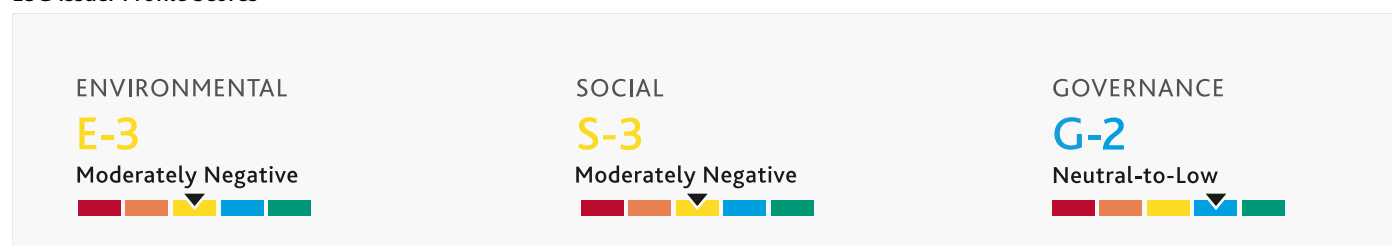


Source: Moody's Investors Service

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 FY2022.

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 2022 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%	7,737	baa
Factor 3: Financial Performance			
Operating Margin	5%	37.5%	aa
Social Housing Letting Interest Coverage	10%	1.1x	baa
Cash-Flow Volatility Interest Coverage	10%	1.7x	baa
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	6.7x	b
Debt to Assets	10%	52.8%	b
Liquidity Coverage	10%	0.8x	baa
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

<u>Category</u>	<u>Moody's Rating</u>
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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