UK Housing association sector outlooks

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Summary

Our 2021 outlook for UK housing associations (HAs) is stable, balancing high social housing demand, strong liquidity and a supportive policy environment, against a volatile property market.

1 **High demand will support turnover and cash flow**

High demand for social housing and inflation-linked social rent increases will support turnover growth, strong operating cash flows and interest coverage. However, coronavirus-driven unemployment may drive higher arrears and bad debts.

2 **Exposures to a volatile market vary**

HAs with higher income from market sales are more exposed to a housing market downturn, which would lead to lower operating cash flows, surpluses and potential impairments.

3 **Capital spending delays will slow debt growth**

Although capital spending on new and existing homes has now resumed, delays as a result of lockdowns will lead to slower debt growth, supporting stable debt metrics.

4 **Conservative management to preserve strong liquidity**

Capital spending delays, conservative treasury policies and favourable market conditions will support continued high liquidity. Demand for social housing debt remains strong and interest rates are at historical lows.

5 **Stable and supportive policy environment**

Multi-year funding agreements for social rent increases and capital grants* enable HAs to create long-term plans. Above-inflation social rent increases will support strong operating cash flows.

*Note: Funding agreements pertain to England only. Social rent and capital grant funding is slightly different in devolved nations including Wales and Northern Ireland, but are also stable and supportive.

2021 UK housing associations – stable

Our 2021 outlook for UK HAs is stable, balancing high social housing demand, strong liquidity and a supportive policy environment, against a volatile housing market.

Negative

What could change the outlook to negative

- A material increase in development programmes, driving higher debt and capital spending, and lower interest cover ratios.
- Weaker liquidity, which would constrain resilience to weaker economic conditions.
- Significantly lower market sales receipts for HAs with high market sales exposure, negatively affecting profitability and interest cover ratios.
- Reduction in government support, either through lower social rent increases, a material reduction in benefits, or lower capital grants.

Stable

Drivers of the stable outlook

- High demand for social housing will support stable operating cash flows and interest cover ratios.
- A volatile housing market; HAs most exposed will record lower income and potential impairments.
- Delays to capital spending will drive slower debt growth; debt metrics will remain stable.
- Proactive management and favourable market conditions will support high liquidity and a lower cost of capital.
- Stable and supportive policy environment, including inflation-linked social rent increases from fiscal 2021 and capital grants as part the 2021-26 Affordable Homes Programme.

Positive

What could change the outlook to positive

- Higher turnover growth and reduced expenses leading to higher surpluses and interest cover ratios.
- Moderated risk appetite, slower debt growth and lower capital spending.
- Higher government support, especially larger capital grants for new homes.

Industry outlooks reflect our view of fundamental business conditions for an industry over the next 12-18 months. Since outlooks represent our forward-looking view on business conditions that factor into our ratings, a negative (positive) outlook suggests that negative (positive) rating actions are more likely on average. However, the industry outlook does not represent a sum of upgrades, downgrades or ratings under review, or an average of the rating outlooks of issuers in the industry, but rather our assessment of the main direction of business fundamentals within the overall industry.

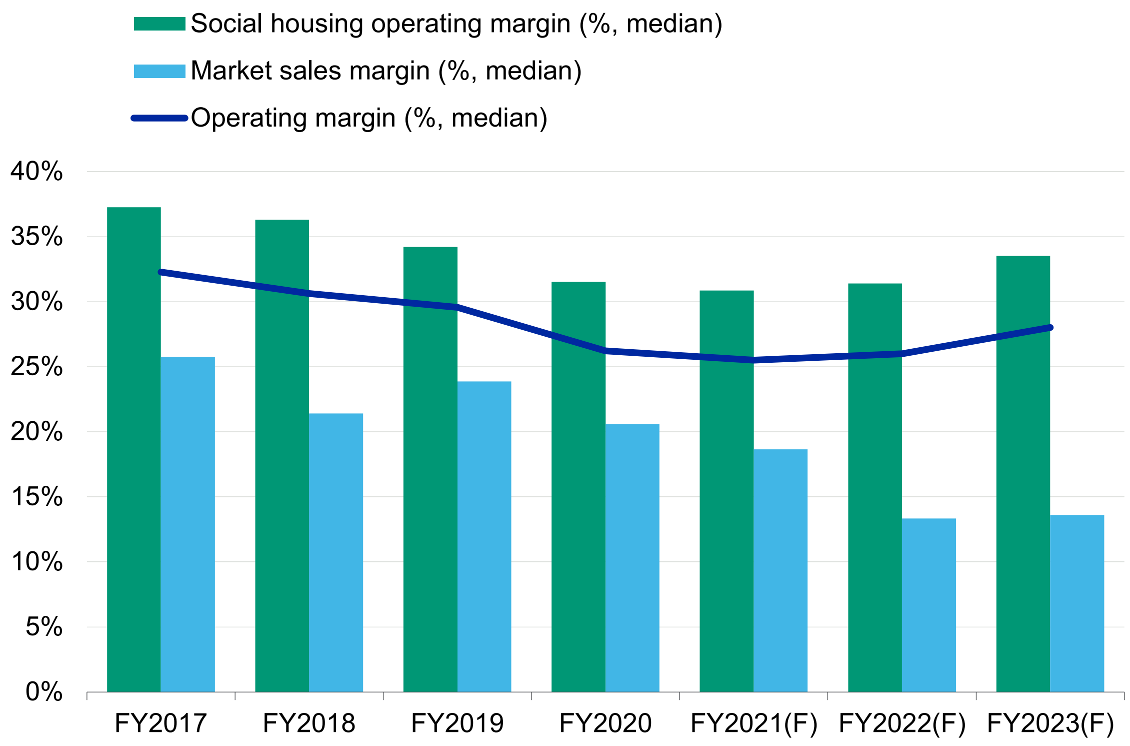
High demand and inflation-linked rent increases support profitability

Profitability will remain stable despite weaker profits from market sales and higher building safety expenses.

Operating margins will remain stable, albeit low, compared to historic levels

- Turnover will continue to grow, driven by inflation-linked social rent income, and high demand for social housing amid increasing unemployment due to the effects of the coronavirus shock.
- Inflation-linked social rent increases will support social housing margins.
- Rising building and fire safety expenses, as well as works to improve energy efficiency, will constrain increases in social housing lettings margins.
- The economic recession resulting from the coronavirus shock will negatively impact house prices. We expect margins on market sales to fall to a five-year low of 13% in fiscal 2022.

Market sales margins will fall, while overall operating margins stabilise

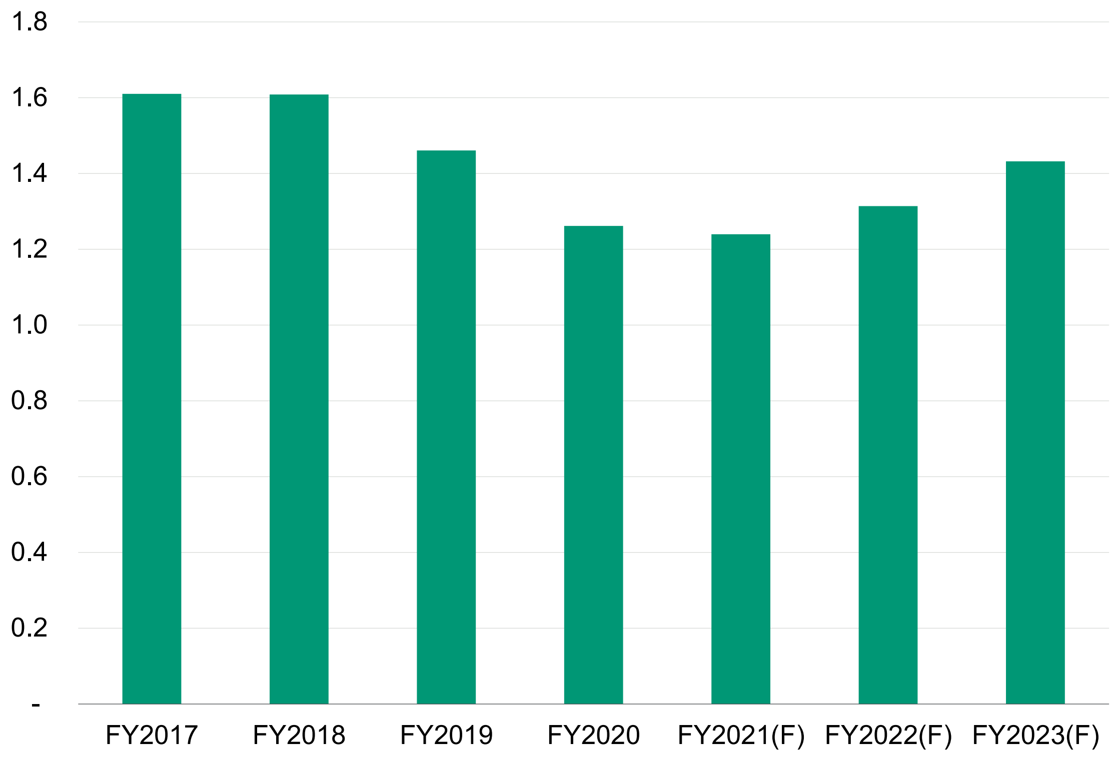


Note: F=Forecast.
Source: Moody's Investors Service

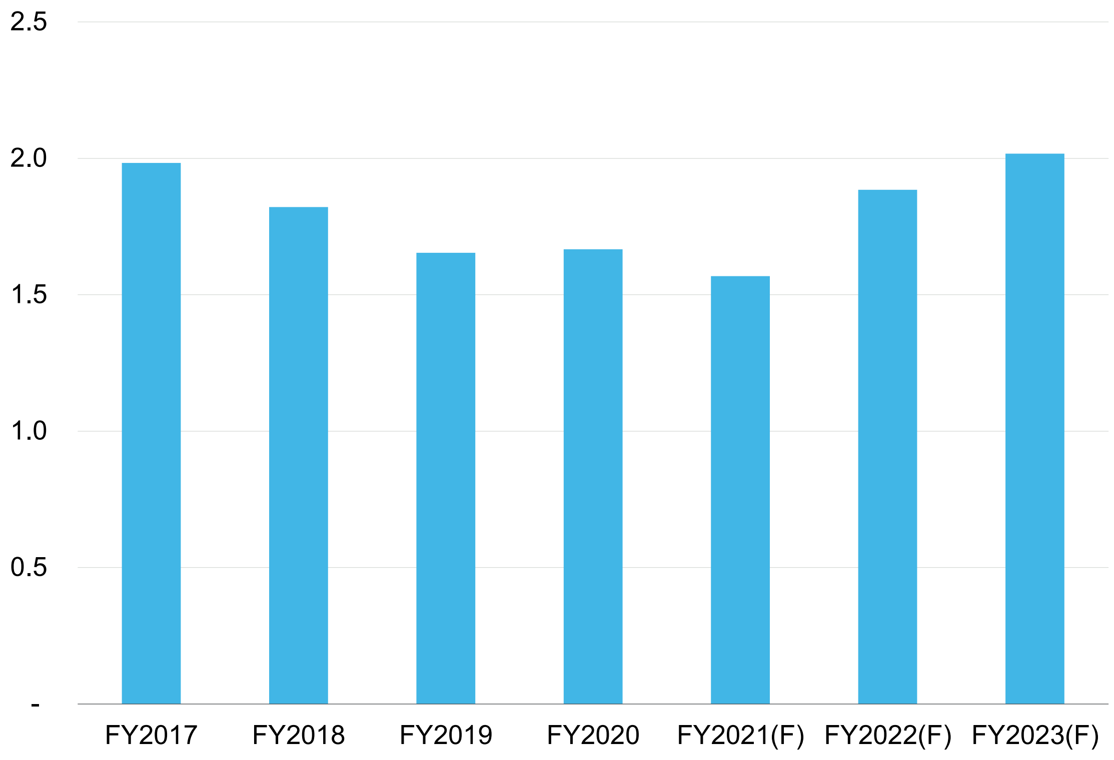
Strong social housing demand and low rates drive stable interest cover

Steady surpluses from social housing lettings, robust profitability and lower-than-expected interest rates on new borrowing will support stable interest cover ratios.

Social housing lettings interest cover will remain stable at around 1.3x



Cash flow volatility interest cover will improve over the next two years

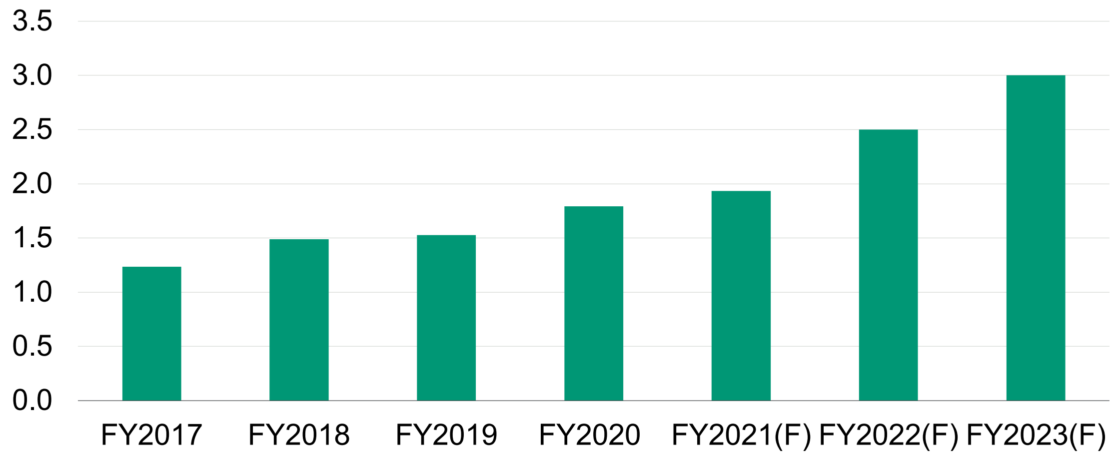


Note: F=forecast.
Source: Moody's Investors Service

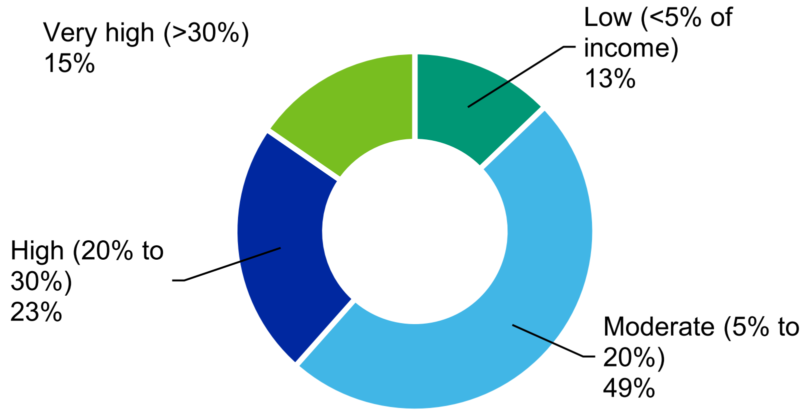
Market sales income will continue to rise but exposure varies

- The majority of rated housing associations (HAs) will continue to use profits from market sales to partially fund their social housing development.
- Housing market volatility and construction delays will lead to lower market sales income for fiscal 2021 compared with pre-pandemic forecasts, which will, in turn, reduce surpluses and operating cash flows.
- HAs' exposure to market sales varies significantly – approximately 50% of rated HAs maintain a moderate exposure at 5%-20% of income.

Market sales income will continue to rise



Around 50% of rated HAs will have a moderate exposure to market sales

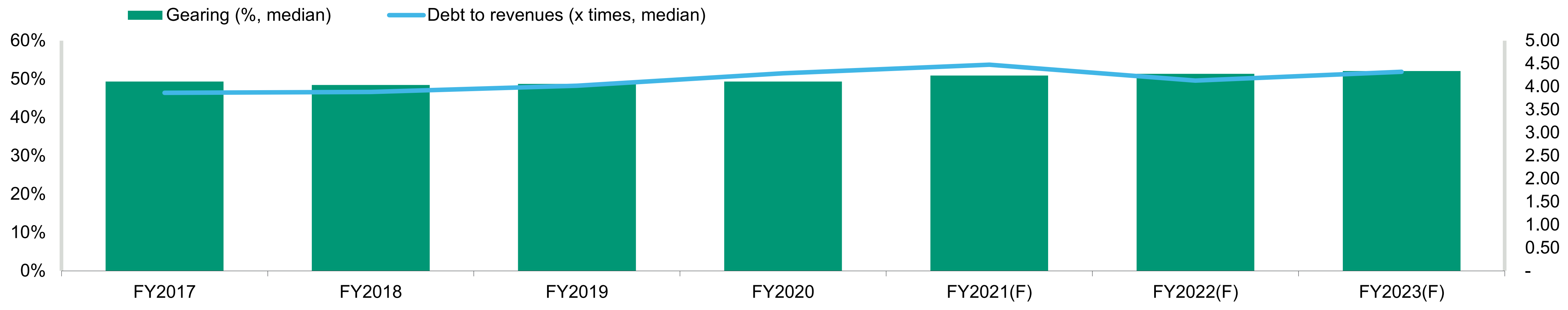


Note: F=Forecast. Individual exposure to market sales is based on forecasted fiscal 2022 position.
Source: Moody's Investors Service

Stable debt metrics, with debt-financed development continuing at slower pace

- Borrowing by rated HAs will continue to rise, reaching £46 billion by fiscal 2022, up from £41 billion in fiscal 2020. Lockdowns resulted in delays to construction and repairs and maintenance spending, reducing funding requirements compared to pre-pandemic forecasts.
- Despite an increase in debt, gearing (debt to assets at cost) will remain broadly stable, at nearly 50% over the next two years.
- We expect funding market conditions to remain favourable, with strong access to capital markets and bank lending, as well as historically low interest rates.

Gearing will remain stable at near 50%, despite the increase in borrowing



Note: F=Forecast.
Source: Moody’s Investors Service

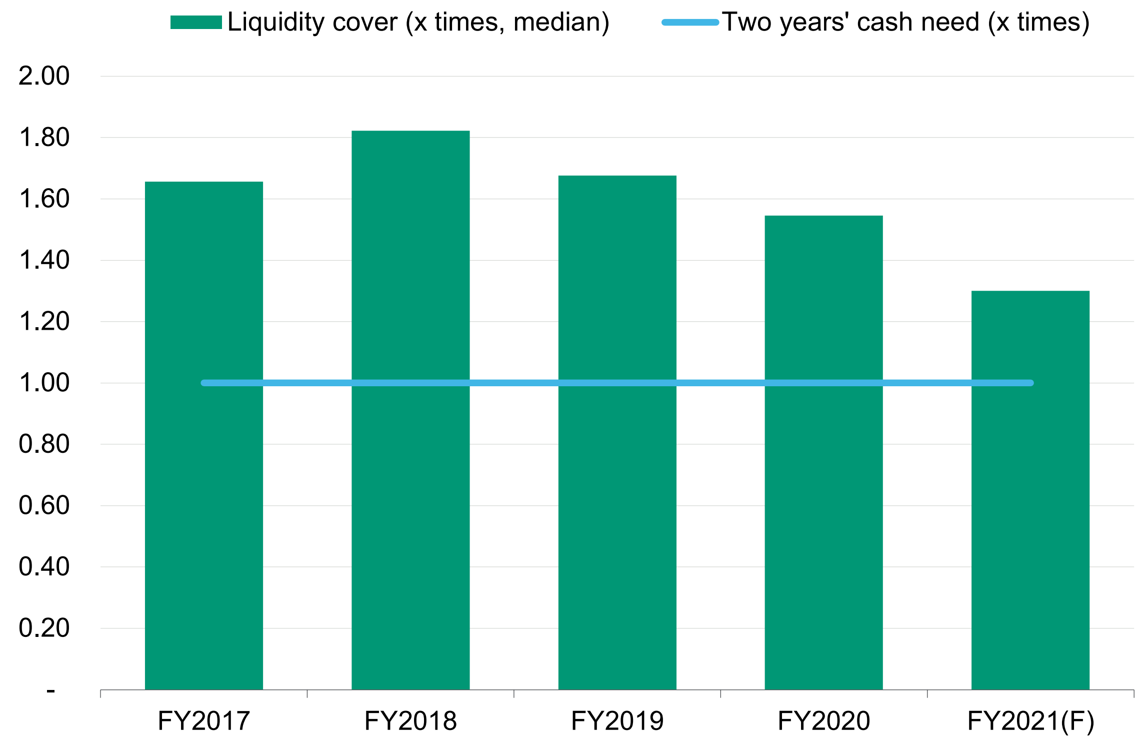
Conservative management will preserve strong, albeit declining, liquidity

Liquidity cover will decline but remain robust

Management is focusing on liquidity, and implementing conservative treasury policies.

- Treasury policies outline a minimum liquidity for housing associations, with most requiring at least 18 months' liquidity.
- Although higher forecast capital spending will drive a lower liquidity cover ratio, it will remain strong – liquidity will cover more than two years' forward-looking cash needs.
- For HAs with high market sales exposure, robust liquidity provides resilience amid housing market volatility and less predictable market sales income.

Most rated HAs have liquidity to cover more than two years' cash needs



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Source: Moody's Investors Service

Questions?

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ESG Scoring

Jennifer Wong, Vice President - Senior Credit Officer, Moody's Investor Services

Four components to MIS integration of ESG

New ESG scores will assist in transparently and systematically demonstrating the impact of ESG on credit ratings

Credit Ratings & Research

How is ESG integrated into credit ratings?

ESG factors taken into consideration for all credit ratings. Greater transparency in PRs and Credit opinions. Credit Impact Score (CIS) is an output of the rating process that indicates the extent, if any, to which ESG factors impact the rating of an issuer or transaction.

ESG Classification

What is ESG?

Our classification reports describe how we define and categorize E, S and G considerations that are material to credit quality. New environmental classification sharpens focus on physical climate risks.

ESG Scores

How is a specific issuer exposed to ESG risks/benefits?

Issuer Profile Scores (IPS) are issuer-specific scores that assess an entity's exposure to the categories of risks in the ESG classification from a credit perspective. IPSs, where available, are inputs to credit ratings.

Heat Maps

Is ESG material to credit quality?

Heat maps provide relative ranking of various sectors along the E and S classification of risks.

ESG Classification system incorporates credit relevant considerations

Our assessment of ESG risks is framed by the classification

Environmental

- Physical climate risks
- Carbon transition
- Water management
- Waste and pollution
- Natural capital

Social

Private sector	Public sector
Customer relations	Access to basic services
Demographic and societal trends	Demographics
Human capital	Education
Health and safety	Health and safety
Responsible production	Housing
	Labor and income

Governance

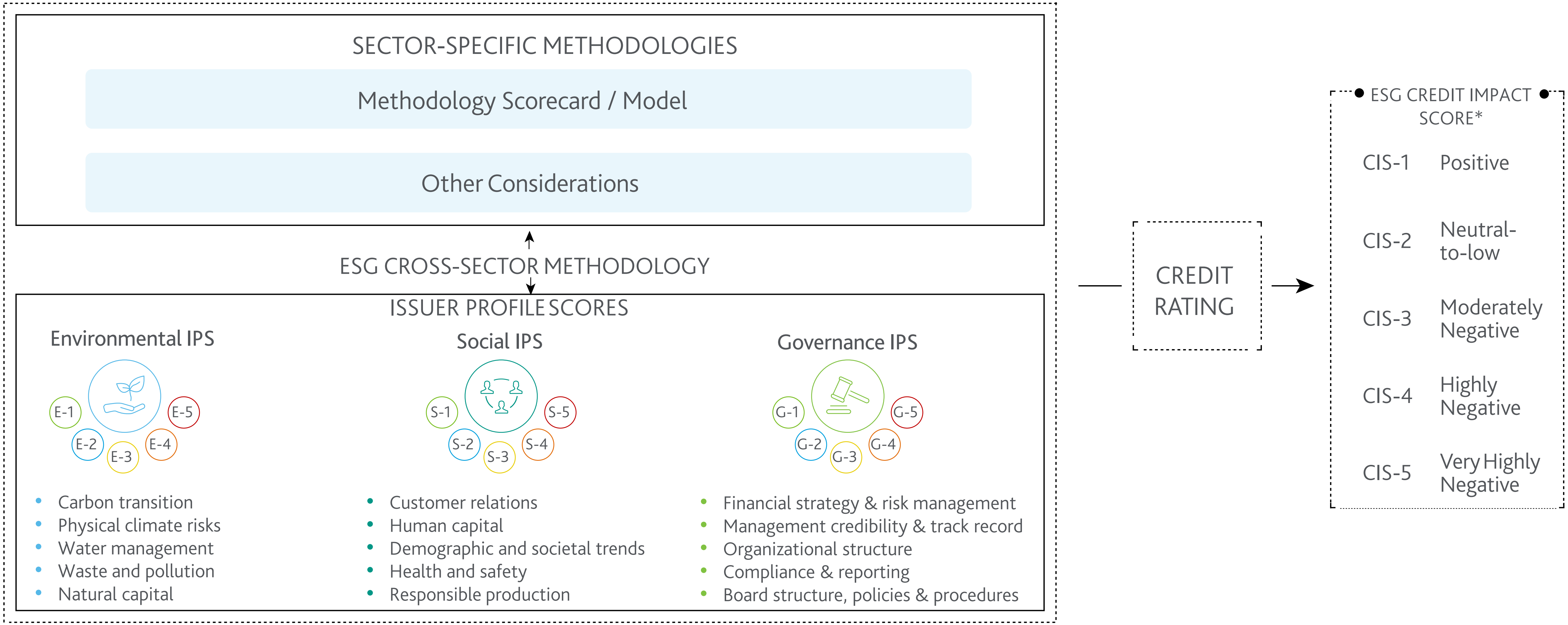
Private sector	Public sector
Financial strategy & risk management	Institutional structure
Management credibility & track record	Policy credibility and effectiveness
Organizational structure	Budget management
Board structure, policies & procedures	Transparency and disclosure
Compliance & reporting	

Environmental classification updated 14 December 2020

Source: Moody's Investors Service

ESG Integration into credit analysis

Our rating analysis considers all material credit considerations, including ESG



The ESG credit impact score (CIS) is an output of the rating process that more transparently communicates the impact of ESG considerations on the credit rating of an issuer or transaction.

IPS and CIS assessed on a five-point scale

IPS and CIS scoring scale and definitions

5	4	3	2	1
Very Highly Negative	Highly Negative	Moderately Negative	Neutral-to-Low	Positive

Example: United Kingdom's "Neutral to Low" CIS in Credit Opinion

The UK's ESG Credit Impact Score is neutral to low (CIS-2), reflecting low exposure to environmental and social risks and, like many other advanced economies, very strong governance profile and in general capacity to respond to shocks.

Environmental The UK's overall E issuer profile score is neutral to low (E-2), reflecting low exposure to environmental risks across most categories.

Social We assess its S issuer profile score as neutral to low (S-2), reflecting low exposure to social risks over most categories. The only category that entails moderately negative risk is demographics: demographic change in the form of relatively fast aging of the population poses long-term fiscal sustainability challenges to the UK. Health care in particular will become an increasingly important source of fiscal risk in the absence of reforms. The UK's labour and income score reflects the country's very flexible labour market as well as rising income and wealth inequalities, which have had political and policy ramifications.

Governance The UK's very strong institutions and governance profile support its rating and this is captured by a positive G issuer profile score (G-1). The UK scores very highly on institutional factors, as captured in the Worldwide Governance Indicators, reflecting strong policy effectiveness and rule of law. Coupled with high wealth levels and moderate government financial strength this supports a high degree of resilience.

Source: Credit Opinion

Note: The "Sector median" above refers to the median IPS or CIS score in the sector, and not the heat map score

Questions?

Investor & analyst panel discussion

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