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Housing Associations – United Kingdom

2021 Outlook

Research Publication

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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 flows

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 historic 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 is 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 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

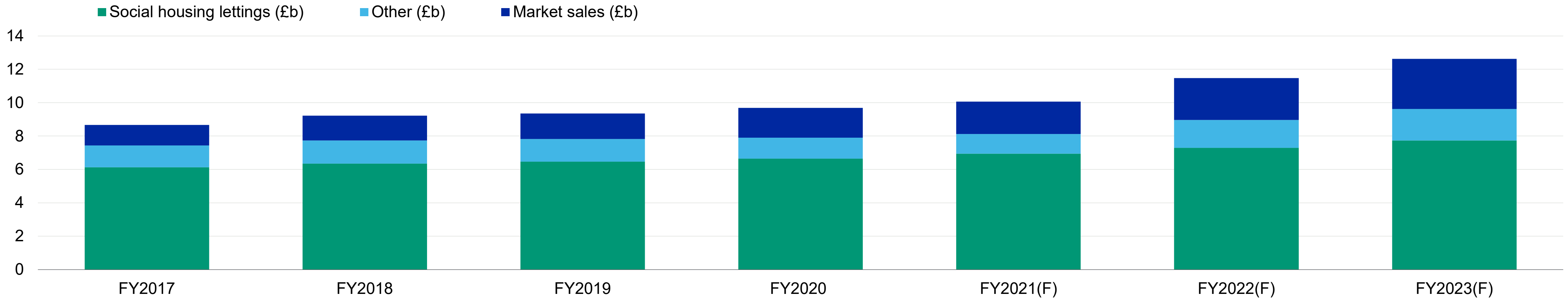
- Higher turnover growth and reduced expenses leading to higher surpluses and interest cover ratios.
- Moderated risk appetite, slower debt growth and lower capital spending.
- Higher government support, especially larger capital grants for new homes.

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 for social housing will drive turnover growth

- Turnover will continue to grow, driven by inflation-linked social rent income, but at a slower pace than pre-pandemic forecasts. Demand for social housing will rise amid increasing unemployment due to the effects of the coronavirus shock.
- Housing market volatility, especially lower transaction volumes, will lead to reduced market sales income in fiscal 2021 compared to pre-pandemic forecasts. From 2022, however, a recovery in volumes and property prices will support market sales income.
- Rising unemployment will drive higher arrears and bad debts, but proactive management and government support will limit the impact.

Turnover will continue to grow steadily over the next two years



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

Inflation-linked rent increases will support stable profitability

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

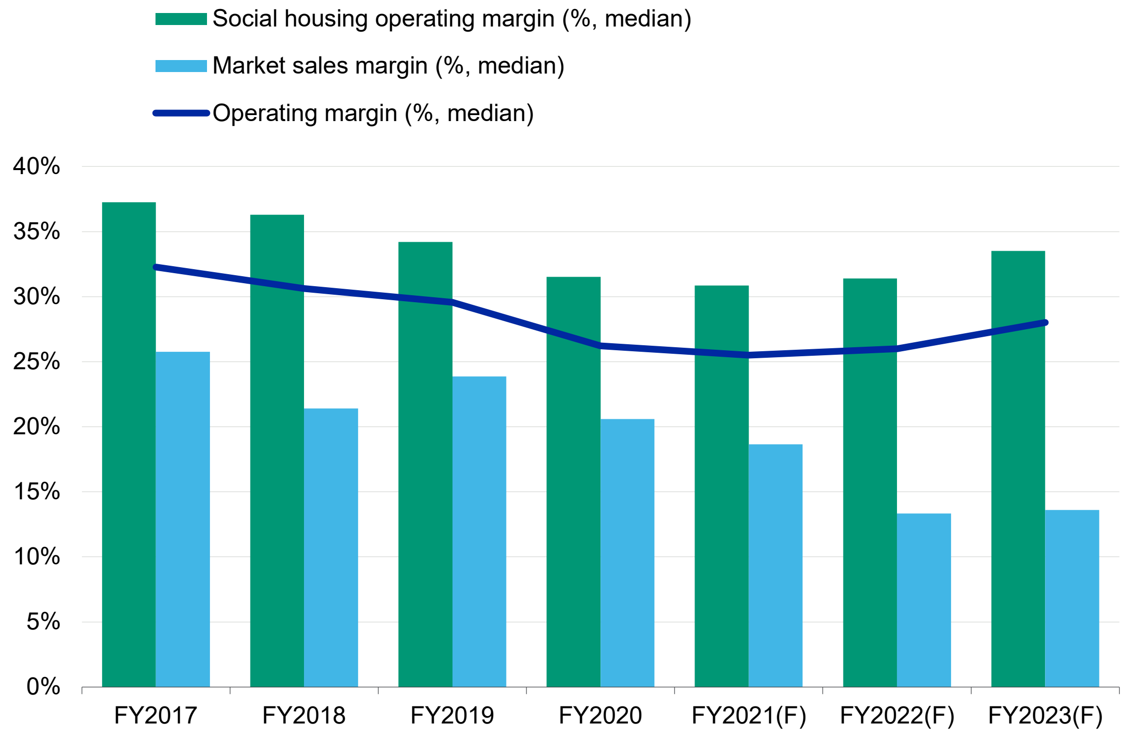
Operating margins will remain stable, albeit low, compared to historic levels

» 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 coronavirus-driven economic recession 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

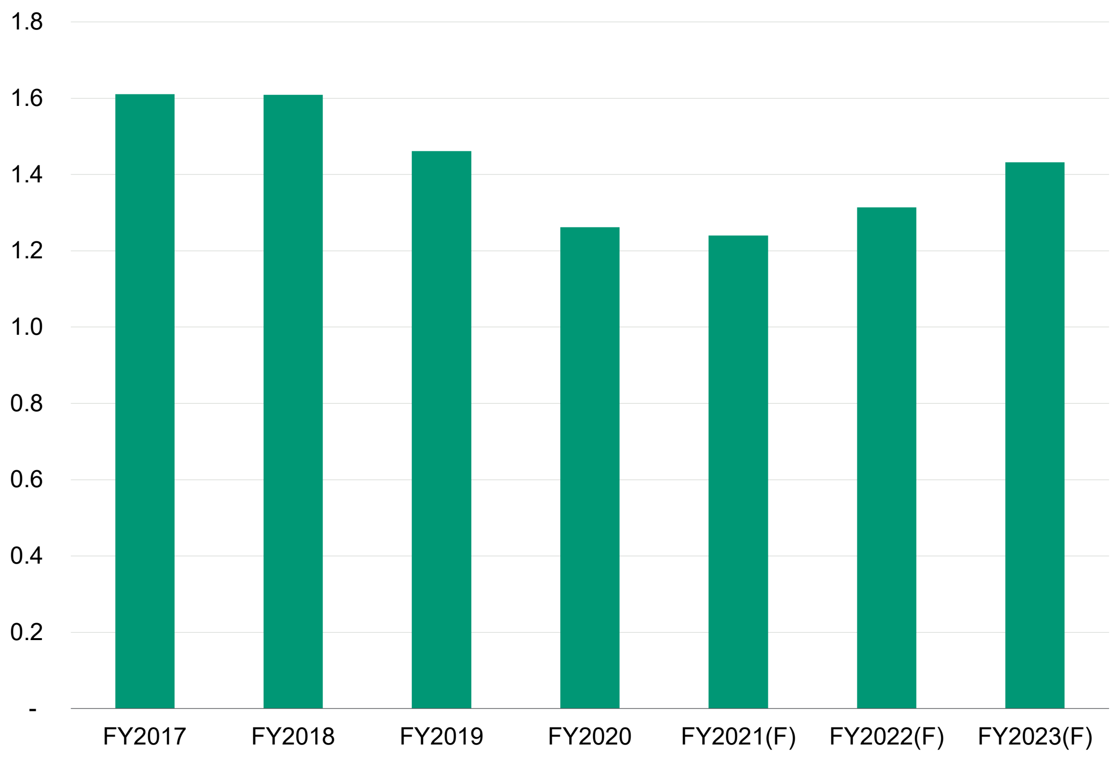


Note: F=Forecast.
Source: Moody's Investors Service

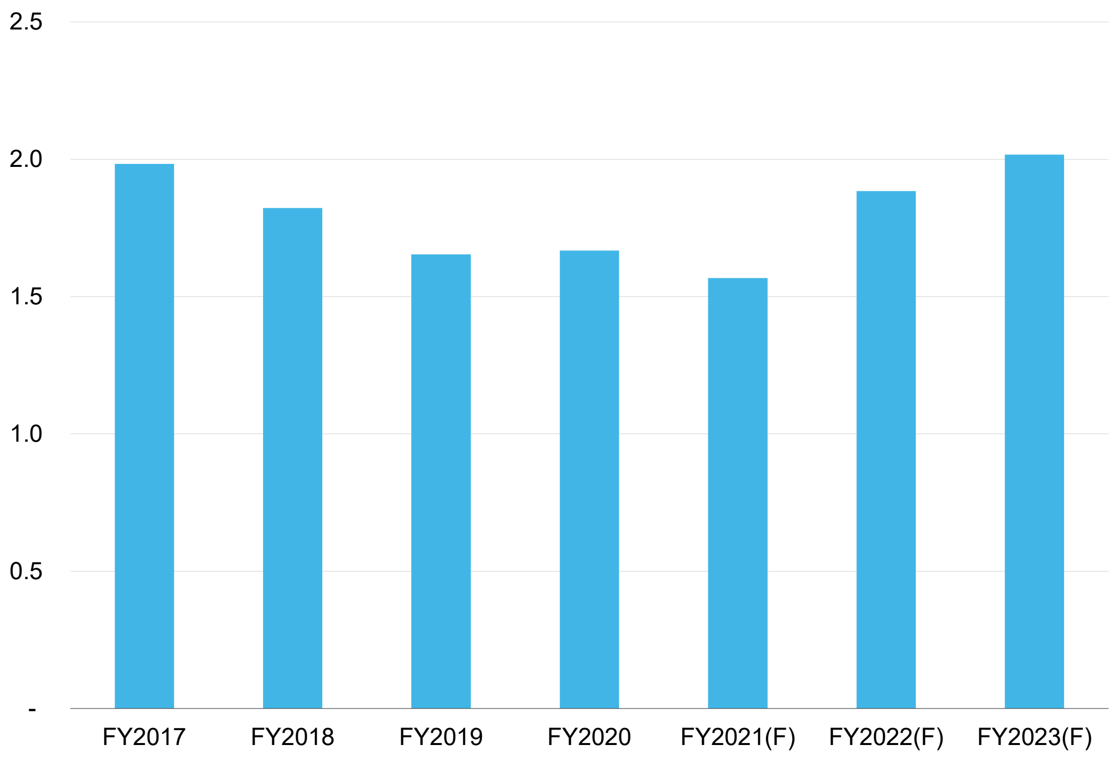
Strong social housing demand and low rates drive stable interest cover

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

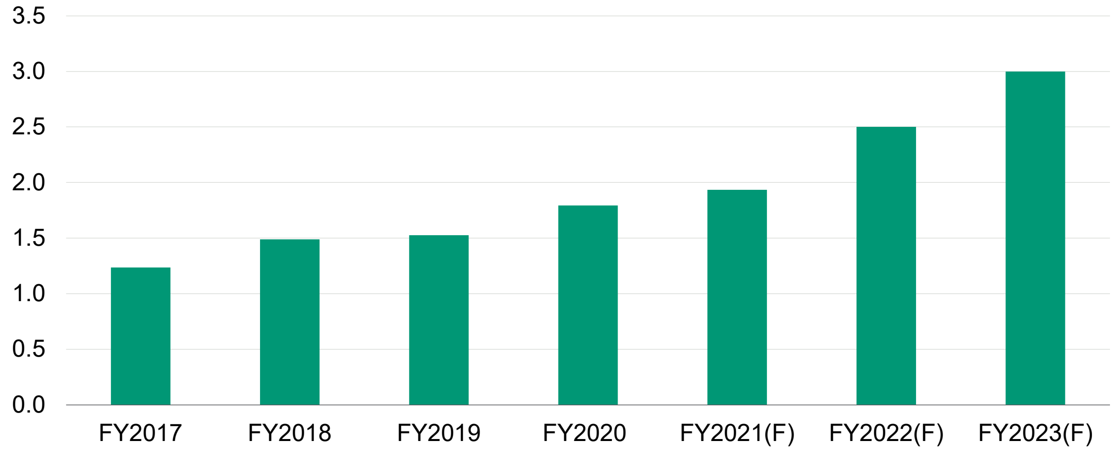


Note: F=forecast.
Source: Moody's Investors Service

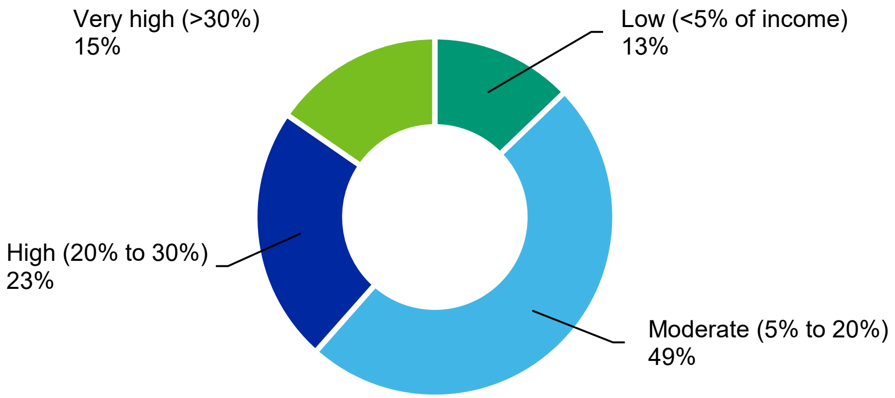
Market sales income will continue to rise but exposure varies

- The majority of rated 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 forecast fiscal 2022 position.
Source: Moody's Investors Service

Debt-financed development plans will continue, but at a slower pace

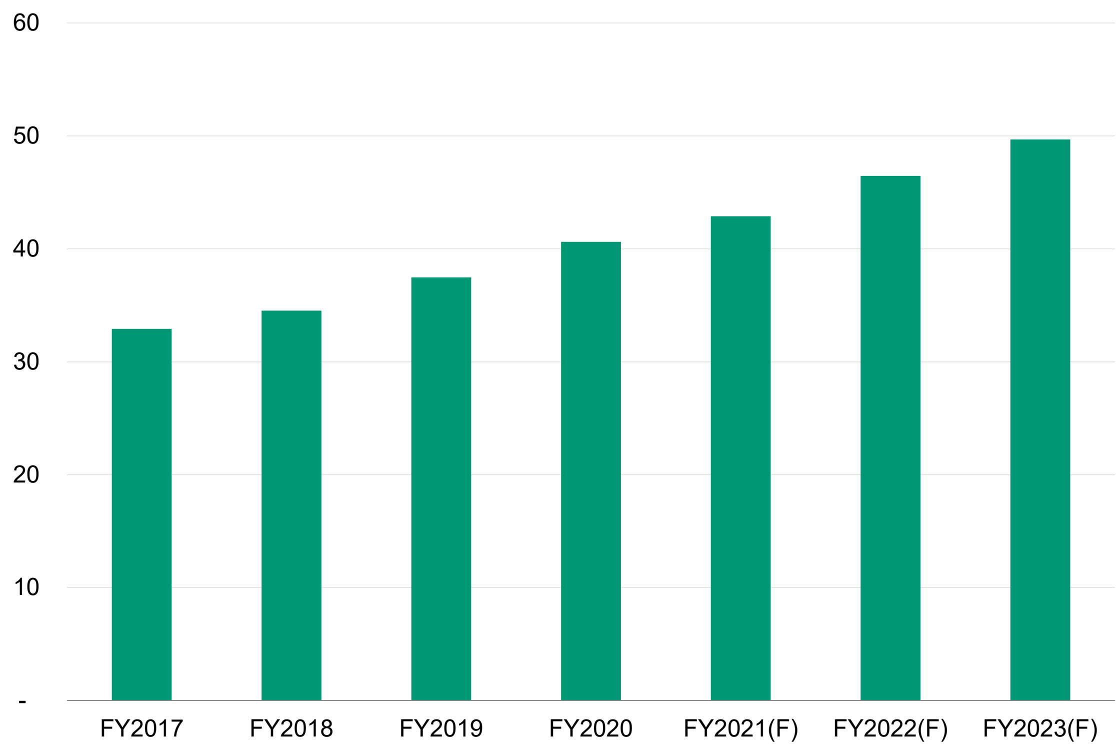
Debt will rise to fund the construction of new homes, albeit at a slower pace than pre-pandemic forecasts

» Borrowing by rated HAs will continue to rise, reaching £46 billion by fiscal 2022, up from £41 billion in fiscal 2020.

» Lockdowns to curb the spread of the coronavirus resulted in delays to construction as well as repairs and maintenance spending. They subsequently led to reduced funding requirements compared to pre-pandemic forecasts.

» Although capital spending and construction have resumed, the lockdown-driven delays will result in a lower pace of debt growth compared to pre-pandemic forecasts.

Debt will continue to rise but at a slower pace

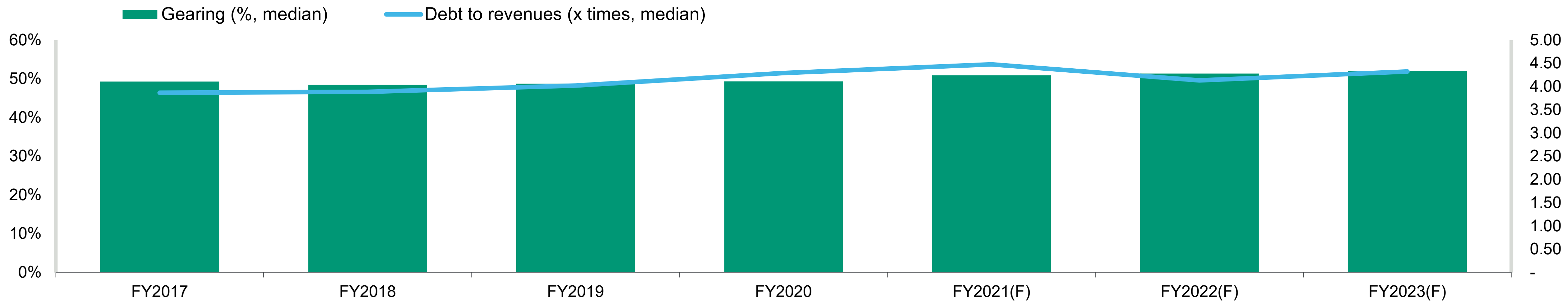


Note: F=Forecast.
Source: Moody's Investors Service

Debt metrics will remain stable

- Despite an increase in debt, gearing (debt to assets ratio) 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 nearly 50%, despite the increase in borrowing



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

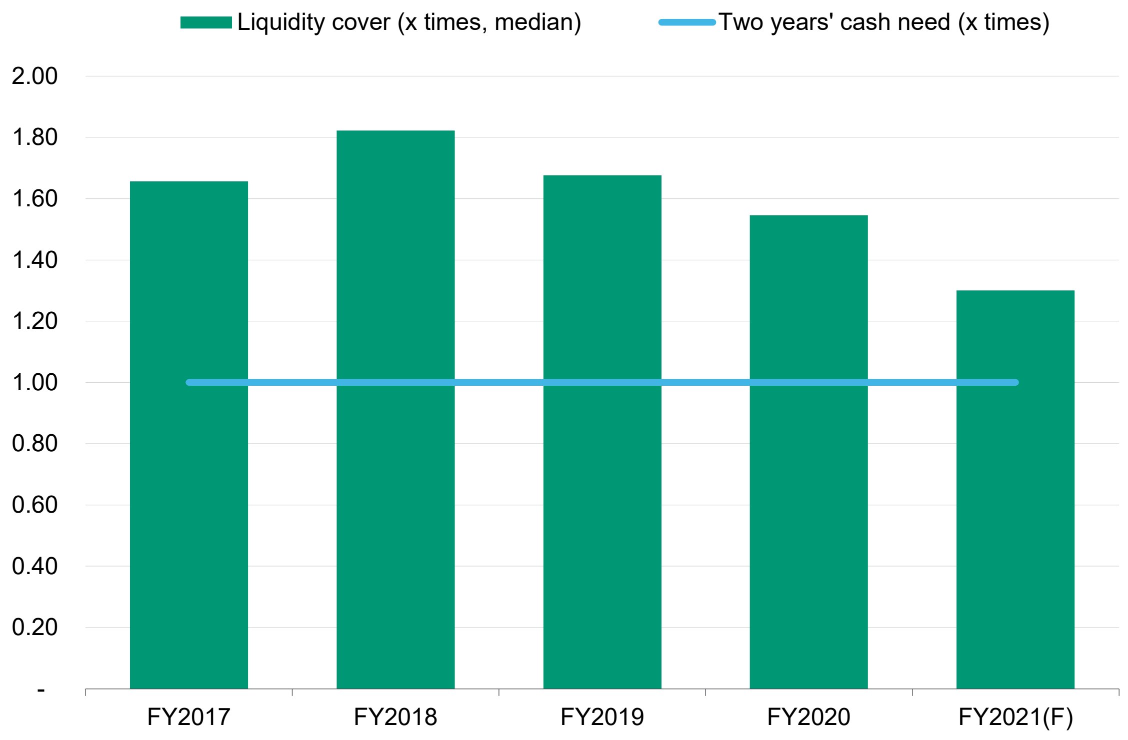
Conservative management will preserve strong, albeit declining, liquidity

Liquidity cover will decline but remain robust

Management is focusing on liquidity and implementing conservative treasury policies.

- Treasury policies outline a minimum liquidity level for housing associations, with most requiring at least 18 months' worth of liquidity.
- Although higher forecast capital spending will drive a lower liquidity coverage ratio, it will remain strong with enough liquidity to 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



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

Moody's related publications

Issuer research

» Sovereign Housing Association: Update to credit analysis, December 2020
» B3 Living Limited (United Kingdom): Update to credit analysis, December 2020
» Together Housing Group (United Kingdom): Update to credit analysis, November 2020
» Yorkshire Housing Limited: Update following affirmation of A3 stable, November 2020
» Bromford Housing Group Limited (UK): Update to credit analysis, November 2020
» LiveWest Homes Limited (United Kingdom): Update following affirmation of A2 stable, November 2020
» The Guinness Partnership Ltd. (UK): Update following affirmation of A2 stable, October 2020
» Sanctuary Housing Association (UK): Update following affirmation of A2 stable, October 2020
» Southern Housing Group Limited (UK): Update following affirmation of A3 stable, October 2020
» Notting Hill Genesis (United Kingdom): Update following affirmation of Baa1 stable debt ratings, October 2020
» L&Q Group (United Kingdom): Update following affirmation of A3 stable, October 2020
» Radius Housing Association Limited (UK): Update following affirmation of A1 stable, October 2020

Sector research

» Housing Associations – United Kingdom: Spending flexibility and liquidity mitigate weaker market sales in 2020-21, July 2020
» Housing Associations – United Kingdom: Coronavirus effects will be mitigated by strong liquidity and reduced maintenance and capital spending, April 2020

Methodologies

» European Social Housing Providers, July 2016