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CREDIT OPINION
16 January 2019

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RATINGS

Walsall Housing Group Ltd

Domicile	United Kingdom
Long Term Rating	A3
Type	LT Issuer Rating - Dom 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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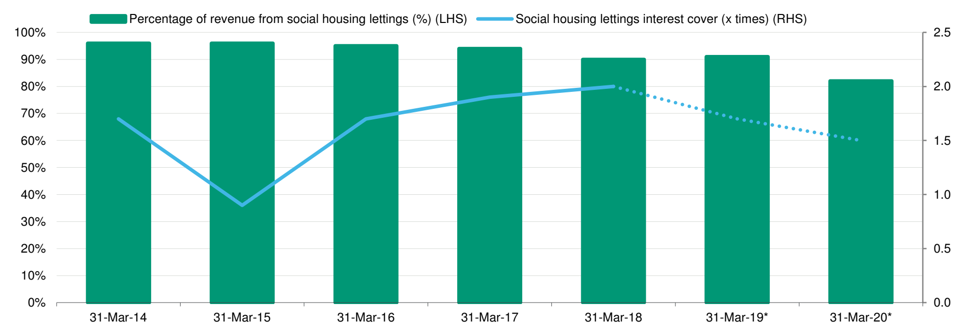
Walsall Housing Group Ltd (United Kingdom)

Update to credit analysis

Summary

The credit profile of Walsall Housing Group, "Walsall" (A3 stable) reflects its low-risk business model focused on social housing lettings and strong operating performance, as well as its high level of indebtedness and moderate development ambition. The sector benefits from the strong regulatory framework governing English housing associations and our assessment that there is a strong likelihood that the UK government (Aa2 stable) would intervene in the event that Walsall faced acute liquidity stress.

Exhibit 1
Social housing lettings remain a high percentage of revenues despite some diversification, reflected in strong social housing lettings interest coverage



FY2019 and FY2020 are projections, the fall in FY2015 relates to one-off breakage costs.
Source: Moody's Investors Service, Walsall Housing Group financial statements

Credit Strengths

» Concentration on low-risk social housing lettings

» Solid operating performance and interest coverage ratios

» Strong financial management policies

» Strong regulatory framework and stable operating environment

Credit Challenges

» Moderate development ambition

» High level of indebtedness, mitigated by substantial liquidity

Rating Outlook

The stable outlook on Walsall Housing Group reflects its stable financial performance and debt metrics, a stable operating environment which is unlikely to undergo further material change in the medium-term and the stable outlook on the sovereign rating.

Factors that Could Lead to an Upgrade

Moody's would consider upgrading the rating if: (1) operating margins are sustained at levels above 30% (2) debt metrics improve with gearing sustained at levels below 55% and (3) interest coverage ratios are sustained at levels above 1.5x for social housing lettings interest coverage (SHLIC) and 2.0x for cash flow volatility interest coverage (CVIC).

Factors that Could Lead to a Downgrade

Negative pressure on the rating could result from one or a combination of the following: (1) a weakening in financial performance metrics, including SHLIC or CVIC at levels close to or below 1x, (2) a ramp-up in risk appetite, including higher exposure to market sales than currently projected (3) an increase in indebtedness, including gearing sustained at levels above 70%. In addition, a weaker regulatory framework, a dilution of the overall level of support from the UK government or a downgrade of the UK sovereign rating could exert downward pressure on the rating.

Key Indicators

Exhibit 2

Walsall Housing Group

	31-Mar-14	31-Mar-15	31-Mar-16	31-Mar-17	31-Mar-18	31-Mar-19*	31-Mar-20*
Units under management (no.)	19,281	19,253	20,020	20,289	20,644	20,751	21,405
Operating margin, before interest (%)	20	23	32	35	35	32	29
Net capital expenditure as % turnover	22	16	27	29	16	60	42
Social housing letting interest coverage (x times)	1.7	0.9	1.7	1.9	2.0	1.7	1.5
Cash flow volatility interest cover (x times)	2.2	1.3	1.9	2.3	2.2	1.8	2.2
Debt to revenues (x times)	2.6	4.0	3.8	3.5	3.8	3.8	3.4
Debt to assets at cost (%)	79	85	84	79	67	67	66

FY2019 and FY2020 are forecasted figures
Source: Moody's Investors Service, Walsall Housing Group financial statements

Detailed Credit Considerations

The credit profile of Walsall, as expressed in an A3 stable rating, combines (1) a baseline credit assessment (BCA) of baa1 and (2) a strong likelihood of extraordinary support coming from the national government in the event that the entity faced acute liquidity stress.

Baseline Credit Assessment

Sustained concentration on low-risk social housing lettings, with limited plans to diversify

Social housing lettings constituted 90% of turnover in FY2018, a small drop from 94% in FY2017, but still above Moody's A3-rated peer median of 84% in FY2018. Social housing lettings are expected to decline to 82% of turnover in FY2020, reflecting Walsall's diversification into market sales, primarily shared ownership. This represents a moderate level of exposure in Moody's perspective, and we consider that Walsall's diversification is well-managed, with a risk averse approach to both market sales and outright sales exposure being maintained by the Board.

Solid operating performance and interest coverage ratios

Walsall's operating performance has been a key focus of management since the end of its transfer obligation in FY2013. FY2018 saw the highest operating surplus of £37.4 million, a 9% increase from the previous year, which will be reinvested into building homes and maintenance. The operating margin was 35% in FY2018, stable compared to the FY2017 level. Margins are expected to remain close to 30% to FY2022, in line with A3-rated peers.

Walsall's social housing lettings interest coverage (SHLIC) is expected to remain above the median of its A3-rated peers for the next few years. SHLIC continued to perform strongly at 2.0x in FY2018 (1.9x in FY2017) compared to an A3-rated peer median of 1.5x in FY2018. We expect the ratio to remain strong, averaging 1.6x over the next three years.

Walsall's ability to cover net cash interest expenses from cash flow from operations is also very strong. Cash flow volatility interest cover (CVIC) will remain solid and continue to outperform peers. Walsall's CVIC was 2.2x in FY2018 (2.3x in FY2017), above the Moody's-rated peer median of 1.7x in FY2018. CVIC is expected to remain above that of peers, averaging 2.1x over the next three years, reflecting its stable operating cash flows derived from low-risk social housing lettings.

Strong financial management policies

Walsall exhibits strong financial management. In order to ensure the association has sufficient financial resilience, management have financial Golden Rules in place: 1) a minimum of £7.5 million headroom on its interest cover covenant, 2) a minimum of £20 million held in cash and undrawn facilities, and 3) unencumbered and headroom security assets at a minimum of 10% of total charged housing assets security. The golden rules were further strengthened in FY2017 to account for the emerging sales risk: 4) liquidity must meet 18 months cash need, with a review at 24 months, 5) sales turnover is capped at 20% of turnover net of sales, 6) open market sales exposure commitments capped at £10 million, and 7) net development costs are capped at 75% of turnover.

Those rules are broader and tend to be more stringent when compared to peers. The Walsall management team is long-tenured, skilled and experienced, with a strong track record in executing plans. Multi-variant stress testing provides assurance of financial viability under a range of adverse scenarios. In particular, management has planned for mitigation measures to be put in place in the event of a no-deal or bad Brexit scenario, including strengthening liquidity rules, increasing availability of revolving credit facilities, and reducing market sales exposure.

Strong regulatory framework and stable operating environment

The sector's credit quality will continue to benefit from the strong regulatory framework and oversight by the Regulator of Social Housing. The regulator maintains strong oversight through quarterly returns, long-term business plans, annual reviews, and undertaking In-Depth Assessments of entities where deemed necessary. Additionally, the regulator has powers to make board member and manager appointments where there has been a breach of Regulatory Standards. Since October 2017, the regulator has charged fees for social housing regulation, as a means of enhancing the independence and maintaining the effectiveness of the regulator.

Moody's does not expect additional material adverse policy shifts for the sector and considers the operating environment to be stable in the medium term. Adverse policies announced in the last few years will continue to negatively impact revenues, especially the effects of the 1% annual decrease in social rents (until FY2020) and Universal Credit (a pillar of broader welfare reform measures).

However, HAs have demonstrated resilience to adverse policies to date and been proactive to mitigate the impact. A reduction of capital grant for new social housing over the last five years has led to increased exposure to market sales activity, which has more than doubled since 2012 to reach 17% of turnover for Moody's rated HAs in FY2018.

Moderate development ambition

Walsall intends to retain its conservative business model with moderate exposure to market sales. Its five-year development programme includes £200 million investment to build 2,185 units with 517 of these planned to be shared ownership tenure and 200 for outright sales. Only 25% of the development spend in the business plan is committed, leaving considerable flexibility to slow the programme in the event of financial strain. Its development strategy is moving away from being focused on the purchase of s106 properties from other developers and towards a land-led strategy, which will enable Walsall to be more strategic about where it develops, and holds the advantage of attracting capital grants.

Walsall has been building a solid track record in market sales. Shared-ownership schemes delivered margins of 32% on average over the last three years. Market sales are expected to peak at 13% of revenues in FY2020, a moderate exposure. Its outright sales development programme is intended to be developed in a joint venture with a commercial partner with significant sales experience in the West Midlands. Development remains focused in Walsall and the surrounding area.

High level of indebtedness, mitigated by substantial liquidity

Walsall has a relatively weak balance sheet with a high level of debt, mainly as a result of its large-scale voluntary transfer (LSVT) origins. In FY2018 Walsall's gross debt exceeded £400 million, up from £350 million in FY2017. We expect Walsall's debt to decline moderately as the association plans to use its accumulated cash and immediately available facilities to finance development.

Walsall's gearing (debt to assets) is expected to remain very high relative to its A3-rated peers and constrains its credit profile. Although gearing has improved from 90% in FY2012 to 67% in FY2018, it remains significantly higher than the median for A3-rated peers of 54%. Gearing is expected to improve slightly over the next three years averaging 65% but will continue to remain above A3-rated peers. However, debt to revenues in FY2018 of 3.8x (FY2017: 3.5x) was below the FY2018 median for A3-rated peers of 4.2x and is expected to average 3.4x over the next three years, below the expected average peer median of 4.2x over the same time period.

Conversely, as a credit strength, Walsall has low interest rate and refinancing risk. Following the bond issuance in FY2014, 100% of its drawn debt is fixed. Refinancing risk is low, with only 12% of its debt due for repayment in the next five years. Walsall's unencumbered assets position has improved in the year as properties appreciated, new homes were completed and security was released from over-collateralised loans. The borrowing value of unencumbered assets was £223 million as of October 2018.

Walsall's elevated risk profile associated with high debt is partially mitigated by its ample cash balance, which stood at £137 million in October 2018. Walsall has immediately available liquidity sufficient to cover 1.5x its two year cash needs. The cash balance will gradually reduce as it is used to fund the development programme, but will remain above £20 million as required by its Golden Rules and will be accompanied by a £50 million RCF.

Extraordinary Support Considerations

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 (Aa2 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 Walsall and the UK government reflects their strong financial and operational linkages.

Rating Methodologies and Scorecard Factors

The assigned BCA of baa1 is the same as the scorecard-suggested BCA.

The methodologies used in this rating were the European Social Housing Providers rating methodology, published in April 2018, and the Government-Related Issuers rating methodology, published in June 2018.

Exhibit 3

Walsall Housing Group			
Baseline Credit Assessment	**Sub-factor Weighting**	**Value**	**Score**
Scorecard			
Factor 1: Institutional Framework			
Operating Environment	10%	a	a
Regulatory Framework	10%	a	a
Factor 2: Market Position			
Units Under Management	10%	20,644	a
Factor 3: Financial Performance			
Operating Margin	5%	35.4%	aa
Social Housing Letting Interest Coverage	10%	2.0x	a
Cash-Flow Volatility Interest Coverage	10%	2.2x	a
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	3.8x	baa
Debt to Assets	10%	67.3%	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			**baa1**

Source: Moody's Investors Service, Walsall financial statements

Ratings

Exhibit 4

Category	Moody's Rating
WALSALL HOUSING GROUP LTD	
Outlook	Stable
Issuer Rating -Dom Curr	A3
WHG TREASURY PLC	
Outlook	Stable
Senior Secured -Dom Curr	A3

Source: Moody's Investors Service

REPORT NUMBER 1157256

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