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CREDIT OPINION
27 October 2023

Update

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RATINGS

Paragon Asra Housing 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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Paragon Asra Housing Ltd (United Kingdom)

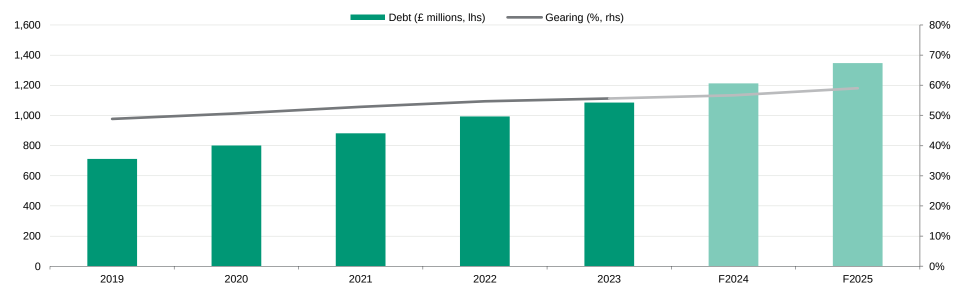
Update following outlook change to stable from negative

Summary

The credit profile of Paragon Asra Housing Ltd (PA Housing, A3 stable) reflects its strong liquidity and its recent focus on efficiency and risk reduction. It also reflects the weakened operating performance, induced by fire safety costs, and the increase in debt, both weighting negatively on interest coverage ratios. PA Housing also benefits from the strong regulatory framework governing English housing associations (HAs), and our assessment that there is a strong likelihood that the government of the United Kingdom (UK, Aa3 stable) would intervene in the event that PA Housing faces acute liquidity stress.

Exhibit 1

Gearing will continue to increase, to fund PA Housing's development programme, although at a lower speed than before due to the reduction in development targets



F: Forecast.
Source: PA Housing and Moody's Investors Service

Credit strengths

» Solid liquidity to be maintained because of its robust treasury policies

» Reduced development ambitions, supported by external grant funding

» Supportive institutional framework

Credit challenges

» Debt to increase, weighing negatively on debt and interest cover ratios

» Weakened operating performance

Rating outlook

The stable outlook reflects the expected gradual reduction in inflation and associated cost pressures as well as the proactive actions taken by PA Housing to mitigate the adverse effects of the weaker operating environment, thereby limiting development risk.

Factors that could lead to an upgrade

Upward pressure on PA Housing's ratings could result from a significant improvement in operating performance, 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 PA Housing's ratings could result from a prolonged weakening in operating performance, increased development ambitions, 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

PA Housing

	31-Mar-19	31-Mar-20	31-Mar-21	31-Mar-22	31-Mar-23	31-Mar-24 (F)	31-Mar-25 (F)
Units under management (no.)	22,220	21,901	22,312	22,591	23,467	23,858	24,676
Operating margin, before interest (%)	33.8	26.2	23.2	23.0	18.7	25.0	25.4
Net capital expenditure as % turnover	18.6	76.1	66.3	80.2	62.7	61.8	65.3
Social housing letting interest coverage (x times)	1.5	1.2	1.3	1.1	0.9	0.9	0.9
Cash flow volatility interest coverage (x times)	1.7	0.4	1.2	1.1	1.9	0.7	1.2
Debt to revenues (x times)	4.5	5.4	5.6	5.9	6.0	5.9	5.8
Debt to assets at cost (%)	48.9	50.6	52.9	54.7	55.8	56.7	59.0

F: Forecast.
Source: PA Housing and Moody's Investors Service

Detailed credit considerations

On 25 October 2023, Moody's changed the outlook to stable from negative and affirmed PA Housing'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.

PA Housing's A3 stable rating combines (1) its Baseline Credit Assessment (BCA) of baa2 and (2) a strong likelihood of extraordinary support from the UK government in the event that PA Housing faces acute liquidity stress.

Baseline Credit Assessment

Solid liquidity to be maintained because of robust treasury policies

PA Housing has a robust liquidity policy, mitigating treasury risk. Golden rules state that the group will hold sufficient cash and liquid resources to cover at least the next 18 months' forecast net cash requirement excluding 50% of market sales proceeds, mitigating market sales exposure risk.

Its liquidity coverage ratio was strong at 1.0x as of August 2023, with £17 million in cash and £250 million in secured undrawn facilities. PA Housing also benefits from a strong unencumbered assets position, which supports additional borrowing capacity of £455 million, which combined with its undrawn and charged position, compares well with funding needs. Besides, PA Housing's existing debt facilities report a lot of excess security, which is likely to be used should PA Housing choose to increase facilities with existing lenders instead of new ones.

The treasury policy also includes a specific mark-to-market policy requiring a separate liquidity buffer covering an adverse movement of interest rates of 50 basis points. PA Housing inherited Asra's large swap portfolio, giving a total standalone notional value of £260 million and a negative mark-to-market value of £3 million, as of August 2023. This mark-to-market exposure is covered by properties (valued at £34 million), reducing the impact of potential margin calls.

Reduced development ambitions, supported by external grant funding

PA Housing's five-year development programme includes 3,503 units (fiscal 2024-28), and is supported by grants it secured through strategic partnerships. PA Housing has been granted £182 million by the Greater London Authority (GLA) to deliver 999 units (revised down from 1,455) in London over fiscal 2021-26. PA Housing was also granted £89 million by Homes England to build 686 units (revised down from 1,400) over fiscal 2021-26.

Those grants will reduce future debt funding and limit the increase in gearing levels, a positive. PA Housing reduced its overall development target to 5,000 units from 6,000 by 2030. Of those, 3,000 units are either completed or in construction at time of publication. The reduction in development is a mitigant to the weakened operating environment with added risks including contractor failure, further costs increases which would lead to more debt funding, labour shortages leading to delays, housing market downturn or volatility that would impact shared ownership. PA Housing is currently dealing with two contractor failures impacting two schemes, creating delays and increased costs.

Along with other changes in its operating model, PA Housing is reviewing its development strategy, to reduce risk. PA Housing is aiming to work with bigger contractors with larger sites to reduce the risk of contractor failure. Moving to larger sites will also allow them to reduce management costs per unit. Importantly, PA Housing has reduced its shared ownership pipeline, including with its strategic partnerships, with 63% of units to be developed for social or affordable rent, the rest for shared ownership. PA Housing does not want to develop outright sales schemes because of the higher risks involved and the lack of grants available, another mitigant.

In addition to its development programme, PA Housing will dedicate £38 million of capital spending over the next five years on retrofitting and energy efficiency works. PA Housing established its Sustainable Finance Framework, which promotes retrofitting and energy efficiencies work, and spending on new social housing properties that achieve an Energy Performance Rating of “A” or “B”.

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 to increase, weighing negatively on debt and interest cover ratios

PA Housing plans to materially increase its debt to fund its development programme. Gross debt is planned to increase to £1.4 billion by fiscal 2026 from £1.1 billion in fiscal 2023, weighing on the PA Housing's debt metrics. The future increase in debt depends on the pace of the development programme, which has been slower than expected over the past three years.

PA Housing's metrics have already weakened as the group steadily grew its debt by nearly £100 million per year over the past three years. Debt/revenue was at 6.0x in fiscal 2023, up from 5.9x in fiscal 2022, comparing negatively with the A3-rated peer median of 4.4x. Gearing (debt/assets at cost) also weakened to 56%, up from 55% in the previous year, comparing negatively with the A3-rated peer median of 50%. Gearing is anticipated to worsen to 60% by fiscal 2026, well above that of peers, a credit negative. Debt/revenue could slowly decrease over the next three years if targeted levels of income are achieved, but this would still remain high compared to peers.

In line with the debt increase, net interest costs are likely to increase to £53 million by fiscal 2026 from £34 million in fiscal 2022, which will weigh on PA Housing's interest cover ratios. PA Housing's social housing letting interest coverage (SHLIC) was slightly below the A3 peer median in fiscal 2023 (0.9x compared to 1.0x), while its cash flow volatility interest coverage (CVIC) was higher than the A3 peer median (1.9x compared to 1.6x). Both will be negatively impacted by the increased debt burden and rising interest expenses.

Weakened operating performance

PA Housing's operating margin decreased to 19% in fiscal 2023, compared with historical margins of 32%-35% between fiscal 2017 and fiscal 2019. PA Housing's lower margin is explained by increased maintenance spending related to fire and building safety. Fire and building safety costs represented £5.5 million of operating costs with £0.3 million on fire remediation works and £5.2 million of waking watch and fire safety cover costs. Excluding these costs, which are also excluded from covenant ratios, the operating margin would have been 22%, compared to 27% the year before (excluding safety costs). In fiscal 2023, the operating margin was also hit by the higher utility prices, which tripled, and higher maintenance costs, although PA Housing managed those through reprioritisation.

PA Housing maintains an internal target of 30% of operating margin on social housing lettings, demonstrating its commitment to operating efficiency. PA Housing is working to reduce its cost base, through a restructuring plan in fiscal 2024, reducing its office use, efficiency improvements around re-let times, building its in-house recruitment and maintenance teams. PA Housing anticipates to reach its target from fiscal 2027. The group projects to finish most of the fire safety works by fiscal 2026, allowing its operating margin to start recovering. The full recovery is delayed by inflationary pressures, which negatively impact PA Housing's results, including high and increased utility costs and repair and maintenance costs. In line with the sector, PA Housing's results will be further constrained by the 7% rent cap ceiling.

On the other hand, margins on market sales remained stronger than peers, at 23% in fiscal 2023, even if decreased from the previous years, at 30%. The slightly increased exposure to market sales (to 15% of turnover in fiscal 2026, from 12% in fiscal 2023) is a credit risk as Moody's views a housing market downturn over the next two years as likely. PA Housing monitors market sales risk and continuously stress-tests this risk, with mitigating actions in place in case of shortfall. PA Housing delimited its maximum sales exposure to 25% of turnover, and its board is considering a long-term target of 15%, which if implemented will reduce its exposure to risk.

Extraordinary support considerations

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 PA Housing and the UK government reflects their strong financial and operational linkages.

ESG considerations

Paragon Asra Housing Ltd's ESG Credit Impact Score is Moderately Negative CIS-3

Exhibit 3
ESG Credit Impact Score

CIS-3
Moderately Negative

NEGATIVE IMPACT POSITIVE IMPACT

For an issuer scored CIS-3 (Moderately Negative), its ESG attributes are overall considered as having a limited impact on the current rating, with greater potential for future negative impact over time. The negative influence of the overall ESG attributes on the rating is more pronounced compared to an issuer scored CIS-2.

Source: Moody's Investors Service

PA Housing's **CIS-3** reflects our view that ESG risks have a materially negative impact on its rating. In particular, expenditure requirements related to the carbon transition and building safety will weaken margins and increase financing needs, as well as affordability constraints for low-income tenants which have led to government-imposed sub-inflationary rent caps.

Exhibit 4
ESG Issuer Profile Scores

ENVIRONMENTAL	SOCIAL	GOVERNANCE
E-3	**S-4**	**G-2**
Moderately Negative	Highly Negative	Neutral-to-Low

Source: Moody's Investors Service

Environmental

PA Housing has a material exposure to environmental risks (**E-3**) relating to a significant proportion of its stock (26% as of fiscal 2023) requiring retrofit to meet energy efficiency standards by 2035 (carbon transition risks), leading to increased expenditure.

Social

PA Housing is highly exposed to social risks (**S-4**) through sector-wide legislative requirements to improve the safety of existing housing stock (responsible production risks) for which PA Housing has considerable expenditure requirements which will weigh on its margins and interest coverage over the medium term. PA Housing is also affected by 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

PA Housing 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 in line with scorecard-indicated BCA of baa2.

The methodologies used in this rating were European Social Housing Providers, published in April 2018, and the Government-Related Issuers Methodology, published in February 2020.

Exhibit 5
Fiscal 2023 scorecard

Paragon ASRA			
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%	23,467	a
Factor 3: Financial Performance			
Operating Margin	5%	18.7%	baa
Social Housing Letting Interest Coverage	10%	0.9x	b
Cash-Flow Volatility Interest Coverage	10%	1.9x	baa
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	6.0x	b
Debt to Assets	10%	55.8%	b
Liquidity Coverage	10%	1.0x	a
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: PA Housing and Moody's Investors Service

Ratings

Exhibit 6

Category	Moody's Rating
PARAGON ASRA HOUSING LTD	
Outlook	Stable
Baseline Credit Assessment	baa2
Issuer Rating -Dom Curr	A3
PARAGON TREASURY PLC	
Outlook	Stable
Senior Secured -Dom Curr	A3

Source: Moody's Investors Service

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