MOODY'S
PUBLIC SECTOR EUROPE

CREDIT OPINION
16 January 2020

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RATINGS

Longhurst 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.

Contacts

Edward Demetry +44.20.7772.1720
Analyst
edward.demetry@moodys.com

Sebastien Hay +34.91.768.8222
Senior Vice President/Manager
sebastien.hay@moodys.com

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Americas	1-212-553-1653
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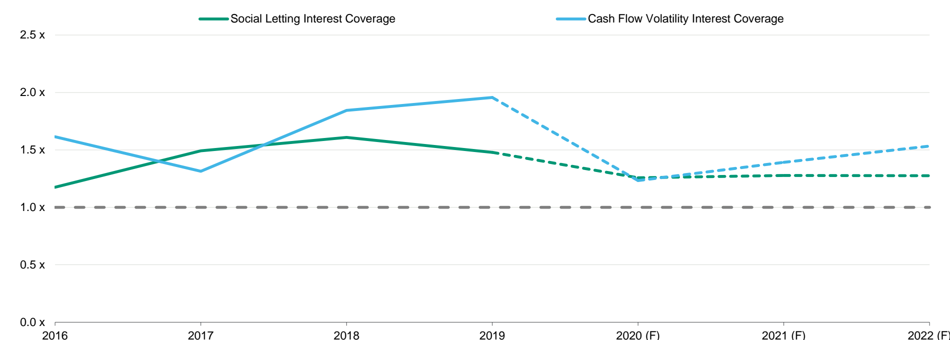
Longhurst Group Ltd

Update following credit analysis

Summary

The credit profile of Longhurst Group Ltd. ("Longhurst") (A3, stable) reflects its strong operating margins, ample liquidity, and sufficient interest coverage ratios against growing interest costs, which balance weakening debt metrics driven by increasing growth aspirations. Longhurst benefits from the strong regulatory framework governing English housing associations (HAs) and our assessment of a strong likelihood that the UK government ("UK") (Aa2, negative) would intervene in the event that Longhurst faced acute liquidity stress.

Exhibit 1
Social housing letting surplus and cash flow from operations continue to be sufficient to cover rising interest costs
Interest cover from social housing letting surplus and cash flow from operations



Note: (F) indicates forecasts
Source: Longhurst Group and Moody's Investors Services

Credit strengths

» Strong operating margins and sufficient interest cover ratios

» Ample liquidity cover against planned development programme

» Supportive institutional framework in England

Credit challenges

» Increase in forecast borrowing weakens debt metrics relative to peers

» Market sales exposure remains high, although expected to moderate

Rating Outlook

The stable outlook on Longhurst reflects the currently stable operating environment, which is unlikely to undergo further material change in the medium-term.

Factors that Could Lead to an Upgrade

Positive pressure on Longhurst's rating could result from one or a combination of the following: (1) sustaining operating margins of above 35%; (2) maintaining social housing letting interest coverage to above 1.5x; (3) sustained debt to revenue ratio of under below 4x

Factors that Could Lead to a Downgrade

Negative pressure could be exerted on Longhurst's rating by one or a combination of following: (1) weaker social housing letting interest coverage falling below 1x; (2) substantially increasing projected debt beyond business plan forecasts, exceeding 5x revenues; (3) material deterioration of the liquidity position. In addition, a weaker regulatory framework or a dilution of the overall level of support from the UK could also exert downward pressure on the rating.

Key Indicators

Longhurst Group	31-Mar-15	31-Mar-16	31-Mar-17	31-Mar-18	31-Mar-19	31-Mar-20 (F)	31-Mar-21 (F)
Units under management (no.)	18,424	18,737	19,164	22,422	23,155	23,399	23,991
Operating margin, before interest (%)	30.2	29.0	36.4	31.4	29.3	30.2	29.1
Net capital expenditure as % turnover	34.4	13.9	25.4	18.1	14.1	53.2	41.0
Social housing letting interest coverage (x times)	1.4	1.2	1.5	1.6	1.5	1.3	1.3
Cash flow volatility interest coverage (x times)	1.7	1.6	1.3	1.8	2.0	1.2	1.4
Debt to revenues (x times)	4.4	4.3	4.2	3.7	3.5	4.3	4.4
Debt to assets at cost (%)	62.2	62.2	60.0	57.7	57.5	59.4	58.9

Note: (F) indicates forecasts
Source: Longhurst Group and Moody's Investors Service

Detailed Rating Considerations

On 13 November 2019, Moody's affirmed Longhurst's long-term credit rating. The affirmation followed Moody's change in the UK's outlook to negative from stable, Aa2 rating affirmed, on 8 November 2019. The credit profile of Longhurst, as expressed in an A3 stable rating, reflects a baseline credit assessment (BCA) of baa1 and a strong likelihood of extraordinary support coming from the national government in the event that the entity faced acute liquidity stress.

Baseline Credit Assessment

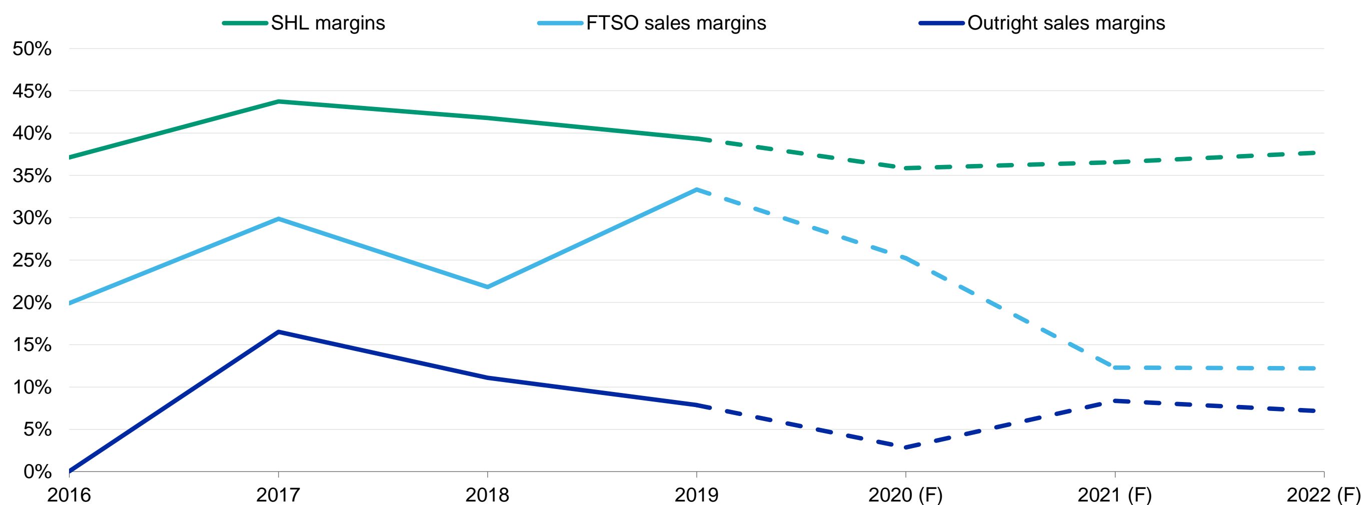
Strong operating margins and sufficient interest cover ratios

Longhurst continued to record a strong operating margin in fiscal year 2019 (fiscal 2019) at 29%. The HA's operating performance have remained strong, averaging 32% since fiscal 2017, despite the adverse operating environment resulting from the rent cut policy which negatively affected the wider HA sector. Longhurst's operating margins have been bolstered by the high margins delivered through its social housing letting (SHL) business, averaging 42% since fiscal 2017 (see Exhibit 3). Additionally, the HA has been able to deliver efficiency savings by successfully managing to keep arrears low through its income management system during a period of welfare reform, and by simplifying its organisational structure over the last two years, which enables Longhurst to be agile in managing the operations of the group. Longhurst's business plan forecasts the HA will maintain an average operating margin of 30% up to fiscal 2022, in line with A3 rated peers.

This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

Exhibit 3

Longhurst's operating margins are supported by strong performance from core SHL business
Operating margins from SHL, first tranche shared ownership (FTSO) sales, and outright sales



NOte: (F) indicates forecast
Source: Longhurst Group and Moody's Investors Service

Longhurst's interest cover ratios were strong in fiscal 2019. The HA's Cash Flow Volatility Interest Coverage (CVIC), which reflects how effectively a HA can cover net cash interest expense based on cash flow from operations (CFO), adjusted by their historical volatility, rose to 2x, in line with the A3 rated median of 1.9x. The strength of this metric reflects the continued growth in Longhurst's CFO, growing by 27% in fiscal 2019 to £69 million, while interest costs grew by 9% to £27 million. The HA's social housing letting interest cover ratio (SHLIC), which measures SHL surplus in the year over interest payments and indicates a HA's ability to meet debt service out of low risk social housing lettings proceeds, declined marginally to 1.5x in fiscal 2019, from 1.6x in fiscal 2018, as SHL surplus remained stable in the year at £40 million. This metric similarly remained in line with the A3 rated peer median of 1.5x.

In fiscal 2020, we note that both CVIC and SHLIC are forecast to decline to 1.2x and 1.3x respectively, with CVIC strengthening to reach 1.5x by fiscal 2022 and SHLIC maintaining at 1.3x over the following three years (see Exhibit 1). The dip in interest cover ratios in fiscal 2020 is driven the HA's planned increase in interest payment obligations, which are set to grow by a compounded annual growth rate of 10% up to fiscal 2022, resulting from an increase in planned borrowing during this period (see: Increase in forecast borrowing weakens debt metrics relative to peers). Additionally, in fiscal 2020 CFO is forecast to reduce to £48 million from £69 million in fiscal 2019, as Longhurst completes a programme of outright sales in fiscal 2019 and plans to lower its exposure to market sales in subsequent years (see: Market sales exposure remains high, although expected to moderate). The reduction in CFO reflects the volatile nature of income generated from market sales, which can have an adverse impact on the CVIC metric.

Ample liquidity cover against planned development programme

As at October 2019, Longhurst held ample immediately available liquidity to cover its two-year net capital funding requirement. This metric had declined however to 1.0x in fiscal 2019 from 1.7x in fiscal 2018, as the HA's two-year net capital funding requirement grew to £142 million in fiscal 2019, from £101 million in fiscal 2018, in parallel to the HA using its cash to fund development as planned. In fiscal 2020, Longhurst's liquidity cover metric is expected to strengthen to 1.4x; reflecting a planned increase in the HA's immediately available liquidity from agreed facilities to counter a planned net capital funding requirement totaling £158 million over the subsequent two years.

Longhurst's liquidity position is supported by its treasury policy, which stipulates that the group will maintain sufficient financing to meet obligations contractually committed within a period of eighteen months. As such, we expect that management would ensure that financing is in place when Longhurst's capital expenditure targets become contractual commitments. Moreover, Longhurst's liquidity position is supplemented by a pool of unencumbered assets that are sufficient to support an additional £47 million of borrowing capacity as at October 2019, based on an EUV valuation.

Supportive institutional framework in England

The sector's credit quality will continue to benefit from the strong regulatory framework governing English HAs. The regulator maintains strong oversight through quarterly returns, long-term business plans, annual reviews, and by undertaking biennial In-Depth Assessments for large and complex HAs. Additionally, 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.

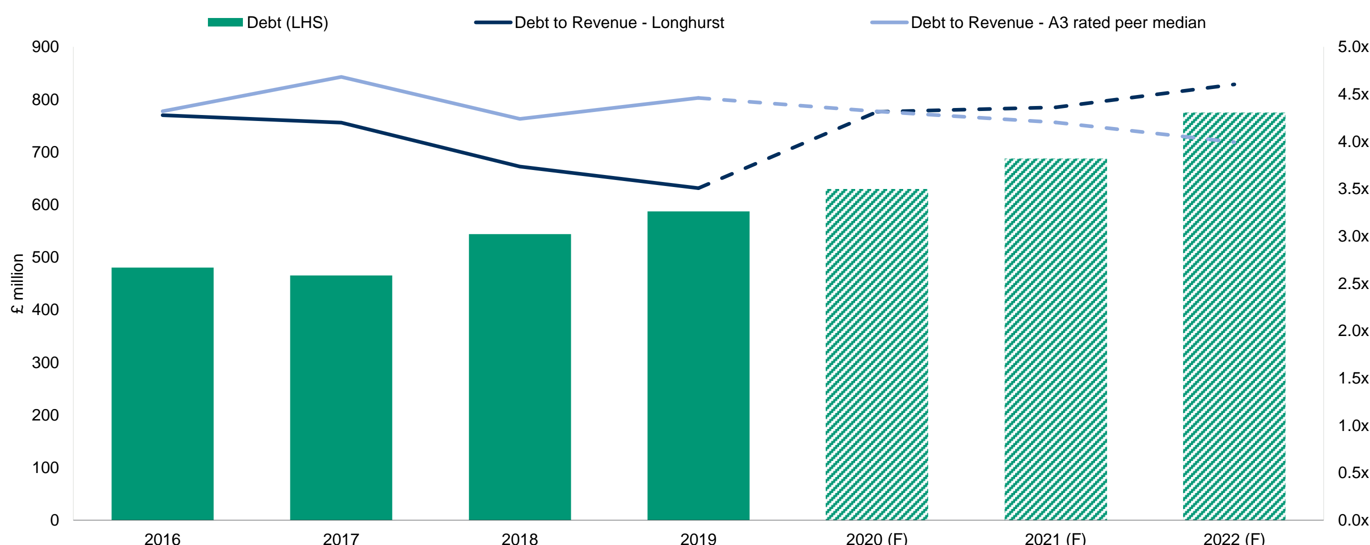
The operating environment for English HAs has improved under more supportive policies for social rent increases and capital grant. Following four years of social rent reductions, HAs will benefit from a return to inflation-linked rent increases from April 2020 for five years. In addition, the government has committed to increased capital grant on more flexible terms for new social housing. Counterbalancing the improvements, we expect policy to drive increased borrowing and development risk in the sector as it responds to the government's objective to deliver a significant increase in the construction of new homes.

Increase in forecast borrowing weakens debt metrics relative to peers

Over the next five years, Longhurst aspires to deliver an average of 730 units per year, growing its units under management by 13% to 26,000 by fiscal 2024, which is expected to require approximately £277 million in debt funding over the same period. As such, Longhurst's business plan outlines a planned increase in debt which would weaken its debt metrics relative to peers in forthcoming years.

In fiscal 2019, Longhurst's debt to revenue was at 3.5x, which was stronger than the A3 rated peer median of 4.5x in the year, and represented a continuation in this metric's strengthening since fiscal 2015. In the medium term, debt is expected to grow at an annual rate of 10% per year, to £775 million by fiscal 2022, from £587 million in fiscal 2019. In parallel to this planned increase in borrowing, turnover is expected to initially dip in fiscal 2020 to £146 million, from £167 million in fiscal 2019, following the completion of a programme of market sales (see: Market sales exposure remains high, although expected to moderate), and subsequently grow at a slower rate than debt up to fiscal 2022 (see Exhibit 4). Additionally, Longhurst's gearing metric, measured as debt to assets at cost, has historically been weaker than rated peers due largely to its LSVT legacy. In fiscal 2019, the HA's gearing stood at 58%, compared to an A3 rated peer median of 51%, and is set to stay stable at around 60% in forthcoming years.

Exhibit 4
Increase in planned borrowing will weaken debt metrics relative to peers, after period of strengthening
Forecast debt levels against debt to revenue metrics for Longhurst and A3 rated peer median



Note: (F) indicates forecast
Source: Longhurst Group and Moody's Investors Service

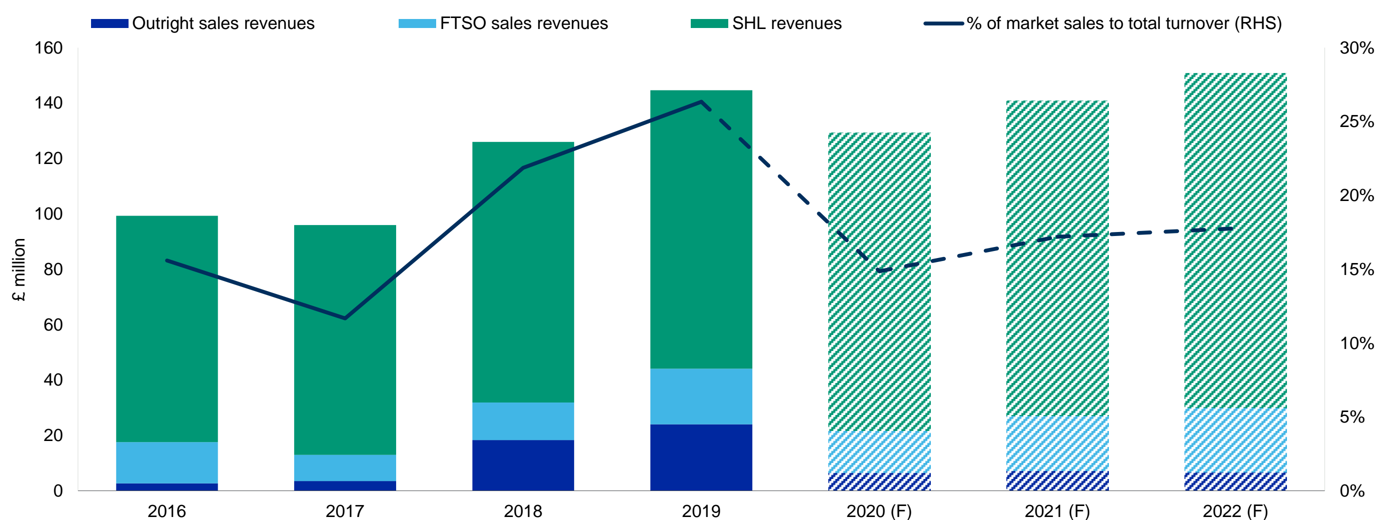
While Longhurst's growing debt stock does pose credit risk, we note that approximately 91% of the HA's drawn debt matures in more than five years as at October 2019, which reduces refinancing risk, and that Longhurst ensures a minimum of 70% of loans are at fixed rate, thereby controlling the exposure to interest rate risk (Longhurst's debt was circa 83% fixed as at October 2019). Longhurst's treasury policy stipulates that adequate collateral must be available to cover mark-to-market liabilities that may arise from adverse change in prevailing market interest rates. As at October 2019, Longhurst's swap portfolio had a negative mark-to-market exposure of £24 million, which was sufficiently covered by the HA's unsecured asset threshold of £10 million, as well as property and cash totaling £14 million, and £35 million in ring-fenced charged security.

Market sales exposure remains high, although expected to moderate

Longhurst's exposure to market sales, measured as the proportion of revenues derived from FTSO sales and outright sales to total turnover, has steadily increased since fiscal 2017 as the HA has diversified its income stream to account for reductions in capital grants and the rent cut policy in previous years. In fiscal 2019, the contribution of total market sales to turnover was 26%; the highest it has been since it was 15% in fiscal 2016. This level of exposure to the cyclical housing market is considered to be high[1] and encompasses market risk to Longhurst's credit profile. Longhurst's growing market sales exposure has resulted in volatile CFO, which almost doubled to £69 million in fiscal 2019, from £36 million in fiscal 2017, but is expected to reduce by 30% in fiscal 2020, and has had a dampening effect on operating margins. The expected volatility in CFO and the drag in operating margins have been largely driven by Longhurst's outright sales programme, which delivered margins averaging 12% since fiscal 2017 and are expected to generate £7 million in revenue in fiscal 2020 after generating over £24 million in fiscal 2019, up from £4 million in fiscal 2017; this volatility is the primary drive for the forecast dip in Longhurst's turnover in fiscal 2020.

We note Longhurst's total market sales exposure is forecast to drop to 15% in fiscal 2020 and is expected to stay moderate in subsequent years. The scaling down in market sales exposure will be driven by a shift away from the outright sales tenure, which is set to contribute 4% to turnover in fiscal 2020, from 14% in fiscal 2019, while FTSO sales exposure is set to remain relatively stable (see Exhibit 5). As aforementioned, Longhurst intends to deliver approximately 3,600 units in its current five-year development programme (fiscal 2020 - fiscal 2024), which consists of an approximate tenure mix of 54% affordable rent, 36% shared ownership sales and 4% for outright sale. Development for outright sale will continue to be delivered through Keystone (Longhurst's subsidiary that focuses on market sales units) from land opportunities and with joint venture partnerships. As at October 2019, approximately 25% of Longhurst's programme is committed, which allows the HA flexibility in delaying or scaling down their development should markets change adversely.

Exhibit 5
Moderating market sales exposure will reduce turnover in fiscal 2020, but will lower market risk in future years
Main sources of revenue and market sales exposure



Note: (F) indicates forecast
Source: Longhurst Group and Moody's Investors Service

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 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 Longhurst and the UK government reflects their strong financial and operational linkages.

ESG Considerations

How environmental, social and governance risks inform our credit analysis of Longhurst

Moody's takes account of the impact of environmental (E), social (S) and governance (G) factors when assessing sub-sovereign issuers' economic and financial strength. In the case of Longhurst, the materiality of ESG to its credit profile is as follows:

Environmental considerations are not material to Longhurst's credit profile. In line with the rest of the UK, its main environmental risk exposures relate to water shortages and flood risk. Flood risk is managed by county and national authorities, and therefore the financial burden of adapting to increased flood risk will not fall on the issuer.

Social considerations are material to Longhurst's credit profile, in line with the rest of the English housing association sector. In particular, the sector is exposed to risks from socially-driven policy agendas, and is also affected by the impact of demographic trends and customer relations on demand. Socially-driven policy agendas can be credit positive or credit negative for the sector. The broad political support for social housing in the UK is reflected in our analysis of the operating environment in the main body of this report.

On the other hand, central government's policy to increase affordability for low-income social housing tenants led to a sector-wide rent cut initiated in FY2017 which was credit negative for the sector. Customer relations and product quality can also have an impact on housing associations. Longhurst is currently undertaking internal analysis to assess the shifting demographics of its customer base to determine how best to provide its services related to social care. The Grenfell fire tragedy in June 2017 has encouraged higher health and safety standards and led many housing associations to increase spending on the quality of their existing stock.

Governance considerations are material to Longhurst's credit profile. Longhurst's management and governance is strong, with policies and practices that are well aligned to its business plan and development strategy. English housing associations also benefit from a strong regulatory framework and close oversight by the Regulator of Social Housing, as detailed within the main body of this report.

Further details are provided in the "Baseline credit assessment" section above. Our approach to ESG is explained in our cross-sector methodology General Principles for Assessing ESG Risks.

Rating Methodology and Scorecard Factors

The assigned Baseline Credit Assessment (BCA) of baa1 is aligned with the scorecard suggested BCA.

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

Longhurst Group - 2019 BCA scorecard

Longhurst Group			
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%	23,155	a
Factor 3: Financial Performance			
Operating Margin	5%	29.3%	a
Social Housing Letting Interest Coverage	10%	1.5x	baa
Cash-Flow Volatility Interest Coverage	10%	2.0x	baa
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	3.5x	baa
Debt to Assets	10%	57.5%	b
Liquidity Coverage	10%	1.0x	baa
Factor 5: Management and Governance			
Financial Management	10%	baa	baa
Investment and Debt Management	10%	baa	baa
Suggested BCA			**baa1**

Source: Longhurst Group and Moody's Investors Service

Ratings

Exhibit 7

Category	Moody's Rating
LONGHURST GROUP LTD	
Outlook	Stable
Issuer Rating -Dom Curr	A3
LIBRA (LONGHURST GROUP) TREASURY NO 2 PLC	
Outlook	Stable
Senior Secured -Dom Curr	A3
LIBRA (LONGHURST GROUP) TREASURY PLC	
Outlook	Stable
Senior Secured -Dom Curr	A3

Source: Moody's Investors Service

Endnotes

1 Market sales exposure is considered high where market sales generate over 20% of turnover; moderate where market sales generate between 5%-20% of turnover; and low where the contribution is less than 5%.

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