MOODY'S
PUBLIC SECTOR EUROPE

CREDIT OPINION
24 February 2021

Rate this Research

**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

**Sam McDonald** +44.20.7772.1401
*Associate Analyst*
sam.mcdonald@moodys.com

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




# Longhurst Group Ltd

Update to credit analysis

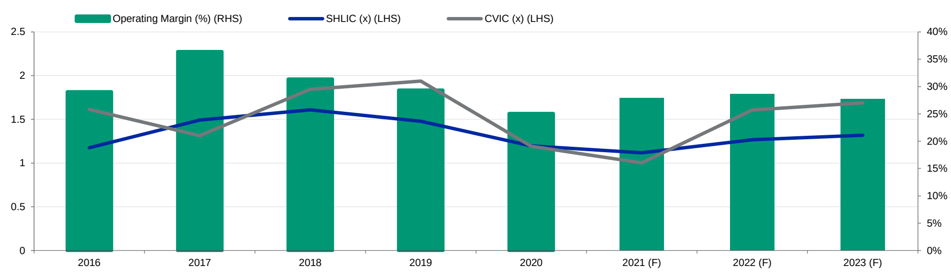
## Summary


The credit profile of Longhurst Group Ltd. (Longhurst, A3 stable) reflects its strong operating margins, ample liquidity, and sufficient interest coverage ratios, which balance weakening debt metrics driven by the housing association's (HA's) growth plans. Longhurst benefits from the strong regulatory framework governing English HAs and our assessment of a strong likelihood that the government of the United Kingdom (UK, Aa3 stable) would intervene in the event that Longhurst faced acute liquidity stress.


Exhibit 1

**Operating margins and interest covers take a modest dip in fiscal years 2020 and 2021 but are expected to return to historically strong levels**

**Operating margin in percent (RHS), social housing interest cover (x) (LHS) and cash flow volatility interest cover (x) (LHS)**




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

## 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 falling, but expected to remain 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 above 35%; (2) maintaining social housing letting interest coverage to above 1.5x; (3) reducing planned borrowing such that debt to assets is sustained below 50%

## 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

Exhibit 2

Longhurst Group

| | 31-Mar-16 | 31-Mar-17 | 31-Mar-18 | 31-Mar-19 | 31-Mar-20 | 31-Mar-21 (F) | 31-Mar-22 (F) |
|---|---|---|---|---|---|---|---|
| Units under management (no.) | 18,737 | 19,164 | 22,422 | 23,155 | 23,462 | 23,833 | 24,519 |
| Operating margin, before interest (%) | 29.0 | 36.4 | 31.4 | 29.3 | 25.1 | 27.9 | 28.6 |
| Net capital expenditure as % turnover | 13.9 | 25.4 | 18.1 | 14.6 | 30.4 | 33.6 | 47.2 |
| Social housing letting interest coverage (x times) | 1.2 | 1.5 | 1.6 | 1.5 | 1.2 | 1.1 | 1.3 |
| Cash flow volatility interest coverage (x times) | 1.6 | 1.3 | 1.8 | 1.9 | 1.2 | 1.0 | 1.6 |
| Debt to revenues (x times) | 4.3 | 4.2 | 3.7 | 3.5 | 4.6 | 4.5 | 4.3 |
| Debt to assets at cost (%) | 62.2 | 60.0 | 57.7 | 57.5 | 57.4 | 55.7 | 57.8 |

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

## Detailed Rating Considerations

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 UK government in the event that the entity faced acute liquidity stress.

### Baseline Credit Assessment

**Strong operating margins and sufficient interest cover ratios**

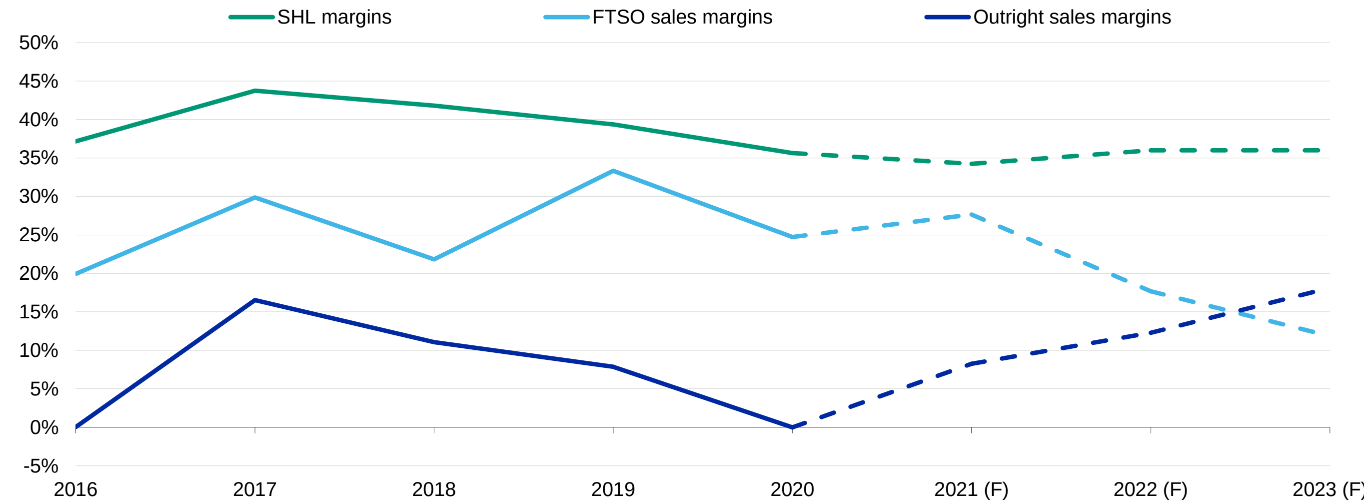
Longhurst has a strong record of operating margin performance, averaging 32% over the past four years. This is despite the adverse operating environment resulting from the rent cut policy which negatively affected the wider HA sector. Longhurst's operating margins have been supported by the high margins delivered through its social housing letting (SHL) business, averaging 40% since fiscal 2017. The HA's overall operating margin dipped slightly in fiscal year 2020 (fiscal 2020) to 25%, from 29% in fiscal 2019. This was largely driven by one-off exit costs from the Local Government Pension Scheme, increased maintenance and repair spend, and land impairment. Overall operating margins were also dampened due to the HA's moderate exposure to market sales through the Group's joint venture, Evera, which generated lower margins than the HA's core social housing letting operations (see Exhibit 3).

We expect Longhurst's margins to recover closer to its historic levels, averaging 29% over the next four years, which is stronger than the A3-rated peer median of 26% in fiscal 2020. According to the HA's business plan, Longhurst is targeting management cost savings of £0.3 million per annum from changes in future working habits, such as strategic reductions in travel expenses, supporting Longhurst's strong SHL margin forecasts.

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 weakened moderately in fiscal 2020 and are expected to remain below in fiscal 2021 compared to historically strong levels. This is due expected reductions in market sales income and increasing interest costs. The HA's Cash Flow Volatility Interest Coverage (CVIC), which reflects how effectively an HA can cover net cash interest expense based on cash flow from operations (CFO), adjusted by their historical volatility, decreased to 1.2x in fiscal 2020, below the A3 rated median of 1.7x. This was driven by a decline in Longhurst's CFO in fiscal 2020 lowering to £48 million from £69 million in the previous year, as Longhurst completed a programme of outright sales in fiscal 2019. The HA plans to lower its exposure to market sales in subsequent years (see: Market sales exposure falling, but expected to remain 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. However, Longhurst's CVIC is forecasted to be in line with its historic levels from fiscal 2022, increasing to 1.6x and reaching 1.7x in fiscal 2023.

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 moderately to 1.2x in fiscal 2020 (in line with the A3 rated peer median), from 1.5x in fiscal 2019, as SHL surplus modestly fell to £37 million from £40 million in fiscal 2019. We expect SHLIC to stabilise at 1.3x from fiscal 2022. The dip in both interest covers in fiscal 2020 were also driven by the HA's increase in interest payment obligations, following the HA's £100 million bond sale in March 2020 (see: Increase in forecast borrowing weakens debt metrics relative to peers).

### Ample liquidity cover against planned development programme

As at September 2020, Longhurst held ample immediately available liquidity to cover its two-year net capital funding requirement. This metric strengthened in fiscal 2020 to 1.8x from 1.4x in fiscal 2019, as the HA's two-year net capital funding requirement declined to £126 million in fiscal 2020, from £142 million in fiscal 2019. In fiscal 2021, Longhurst's liquidity cover metric is expected to remain stable at 1.7x; reflecting a planned increase in the HA's immediately available liquidity from agreed facilities to counter a planned net capital funding requirement totaling £174 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 £120 million of borrowing capacity as at Septmeber 2020, 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 (IDAs) for large and complex HAs. In response to the pandemic, the regulator adapted some aspects of its oversight temporarily, for example, extending its liquidity monitoring, briefly pausing the programme of IDAs and delaying regulatory submissions to reduce the operational burden on 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 has improved under more supportive policies for social rent increases and capital grant. Following four years of social rent reductions, HAs now 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.

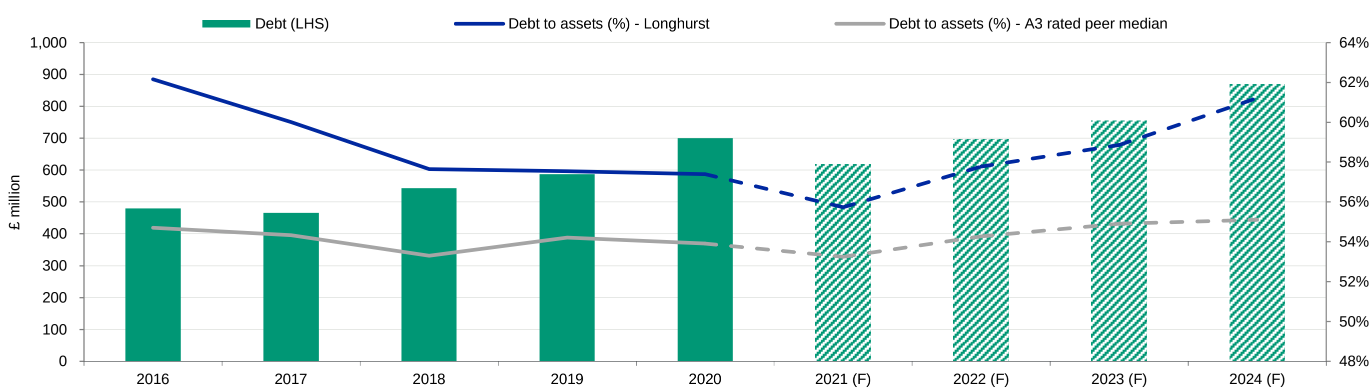
Counterbalancing the improvements, we expect policy to drive increased borrowing and development risk in the sector as it responds to the government's objective to deliver a significant increase in the construction of new homes.

### Increase in forecast borrowing weakens debt metrics relative to peers

Over the next five years, Longhurst aspires to deliver an average of 760 units per year, growing its units under management by 13% to 26,400 by fiscal 2025. The HA will require approximately £200 million in funding over this period, which is expected to weaken its debt metrics relative to peers in forthcoming years.

In fiscal 2020, Longhurst's debt to revenue was at 4.6x, up from 3.5x in fiscal 2019, driven largely by the HA's bond sale at fiscal year end 2020 and a dip in market sales revenues in the year. Debt is expected to grow at a CAGR of 5% by fiscal 2025, but debt to revenues are expected to remain largely stable, averaging 4.4x in this period. 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 2020, the HA's gearing stood at 57%, compared to an A3 rated peer median of 54%, and is set to reach 60% in forthcoming years (see Exhibit 4).

Exhibit 4
**Longhurst's rise in borrowing is expected to lead to a weakening in gearing relative to peers**
**Forecasted debt against debt to assets (%)**




Note: (F) indicates forecast
*Source: Longhurst, Moody's Investors Service*

While Longhurst's growing debt stock will weaken debt metrics, we note that 93% of the HA's drawn debt matures in more than five years as at September 2020, 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 87% fixed as at September 2020). As at September 2020, Longhurst's swap portfolio had a negative mark-to-market exposure of £25 million, which was sufficiently covered by the HA's unsecured asset threshold of £10 million, as well as property and cash totaling £15 million, which is line with Longhurst's treasury policy to adequately cover mark-to-market liabilities.

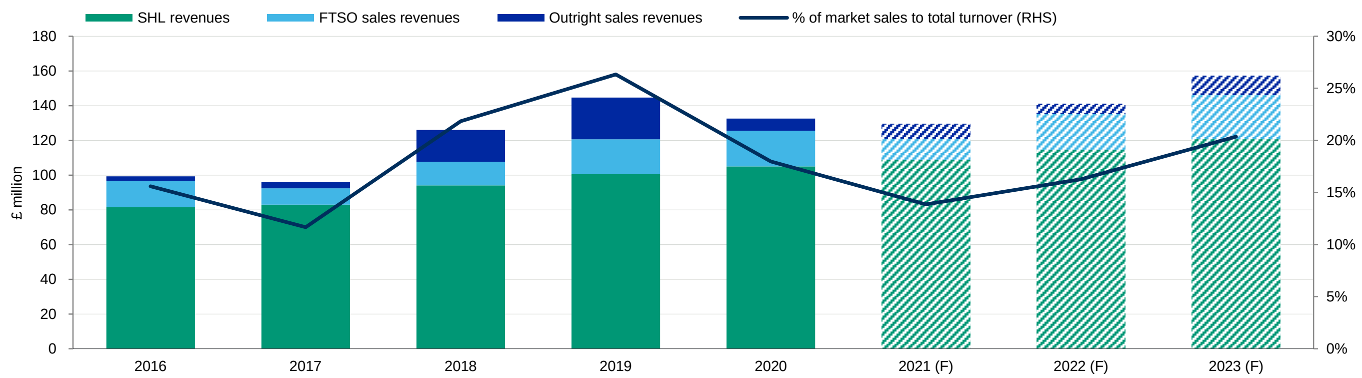
**Market sales exposure falling but expected to remain moderate**

Longhurst's exposure to market sales, measured as the proportion of revenues derived from FTSO sales and outright sales to total turnover, steadily increased between fiscal 2017 and 2019 as the HA has diversified its income stream to account for reductions in capital grants and the rent cut policy in previous years. Market sales exposure declined in fiscal 2020 to 18%, from a historic high of 26% in fiscal 2019 following the completion of its outright sales programme. We expect total sales as a proportion of turnover to average a moderate 17% over the next three fiscal years[1] and will be driven by development of FTSO sales (see Exhibit 5).

Exhibit 5

**Longhurst's exposure to market sales is expected to remain moderate over the next three fiscal years**

**Main revenues sources (LHS) compared to market sales exposure (RHS)**




Note: (F) indicates forecast

*Source: Longhurst Group, Moody's Investors Service*

Longhurst's market sales exposure has resulted in volatile CFO, which almost doubled to £69 million in fiscal 2019, from £36 million in fiscal 2017, but has subsequently declined by 30% in fiscal 2020 to £48 million. It has also had a dampening effect on operating margins, as outright sales margins averaged 12% between fiscal 2017 and 2019 and delivered a 0% margin in fiscal 2020. Lower than expected revenues from outright sales were a primary driver for the dip in Longhurst's turnover in fiscal 2020.

Longhurst's current five-year development programme (fiscal 2021 - fiscal 2025), aims to deliver 3,800 units, consisting of a tenure mix of 53% affordable rent, 35% shared ownership sales, and 7% for outright sales. 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 2020, approximately 57% of Longhurst's programme is committed, which allows the HA some flexibility in delaying or scaling down their development should markets change adversely.

### 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 HAs' credit profiles. In line with the rest of the UK, the sector's main environmental risk exposures relate to water shortage 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 individual housing associations.

Social risks are material to HAs' credit profiles. In particular, the sector is exposed to risks stemming from socially-driven policy agendas affecting social rents, benefits and capital grants in addition to the impact of demographic trends on demand which are captured in our assessment of the operating environment. We view the coronavirus outbreak as a social risk under our ESG framework given its impact on health and safety. Overall, we expect the outbreak to cause ongoing operational disruption for HAs but do not expect a material credit impact as higher arrears and lower market sales receipts will be offset by cash savings from reduced capital spending on development and repairs. HAs are also impacted by customer relations and product quality. The Grenfell fire tragedy in June 2017 has encouraged higher health and safety standards with many HAs planning on increasing spending on the quality of their existing stock.

Governance considerations are also material to HAs' credit profiles and are captured in our assessment of governance and management. In general, housing association governance is strong with multi-year strategies supported by detailed forecasts, conservative liquidity policies, and robust risk management including stress testing.

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 February 2020.

Exhibit 6

**Longhurst's 2020 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% | 23,462 | a |
| **Factor 3: Financial Performance** | | | |
| Operating Margin | 5% | 25.1% | a |
| Social Housing Letting Interest Coverage | 10% | 1.2x | baa |
| Cash-Flow Volatility Interest Coverage | 10% | 1.2x | baa |
| **Factor 4: Debt and Liquidity** | | | |
| Debt to Revenue | 5% | 4.6x | ba |
| Debt to Assets | 10% | 57.4% | b |
| Liquidity Coverage | 10% | 1.8x | a |
| **Factor 5: Management and Governance** | | | |
| Financial Management | 10% | baa | baa |
| Investment and Debt Management | 10% | baa | baa |
| **Suggested BCA** | | | **baa1** |

*Sources: Longhurst, Moody's*

## 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%.

REPORT NUMBER 1262304

### CLIENT SERVICES

| | |
|---|---|
| Americas | 1-212-553-1653 |
| Asia Pacific | 852-3551-3077 |
| Japan | 81-3-5408-4100 |
| EMEA | 44-20-7772-5454 |

MOODY'S PUBLIC SECTOR EUROPE