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CREDIT OPINION
30 October 2023

Update

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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.

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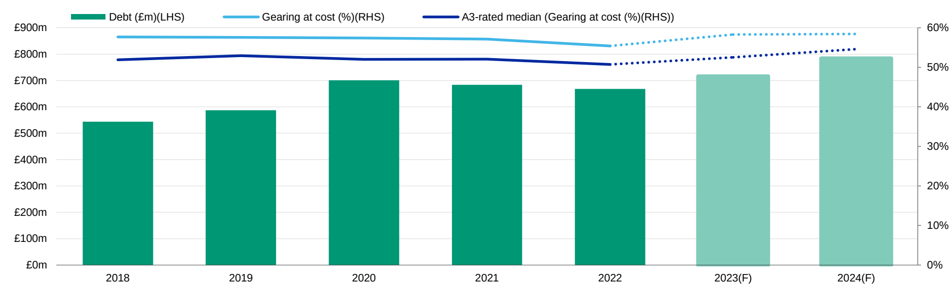
Longhurst Group Ltd (United Kingdom)

Update following outlook change to stable from negative

Summary

The credit profile of Longhurst Group Limited (Longhurst, A3 stable) reflects its moderate risk appetite, good performance on social housing operations and relatively weak debt metrics. Longhurst benefits from the strong regulatory framework governing English housing associations (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
Longhurst will maintain weak gearing as debt increases



F: Indicates forecast
Source: Longhurst, Moody's Investors Service

Credit strengths

» Simple group structure and moderate risk appetite

» Good performance on social housing business, although some deterioration in recent years

» Supportive institutional framework in England

Credit challenges

» Weakened operating margin and interest coverage due to reduction in margins on market sales and care and supported housing business

» Weak debt metrics, gearing expected to weaken further

Rating Outlook

The stable outlook reflects the expected gradual reduction in inflation and associated cost pressures as well as the proactive actions taken by the issuer to mitigate the adverse effects of the weaker operating environment.

Factors that Could Lead to an Upgrade

Upward pressure on the 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.

Factors that Could Lead to a Downgrade

Downward pressure on the ratings could result from a prolonged weakening in operating performance, debt growing more quickly than forecasts, weaker liquidity or a failure to adapt strategies and risk appetite to mitigate weaker economic conditions. Lower government support for the sector or a dilution of the regulatory framework could also lead to downward pressure on the rating.

Key Indicators

Exhibit 2

Longhurst Group Ltd	31-Mar-18	31-Mar-19	31-Mar-20	31-Mar-21	31-Mar-22	31-Mar-23 (F)	31-Mar-24 (F)
Units under management (no.)	22,422	23,155	23,462	23,658	24,149	24,979	25,669
Operating margin, before interest (%)	31.4	29.3	25.1	23.5	23.8	26.4	28.6
Net capital expenditure as % turnover	18.1	14.6	30.4	19.7	17.7	65.6	44.2
Social housing letting interest coverage (x times)	1.6	1.5	1.2	1.1	1.2	1.2	1.4
Cash flow volatility interest coverage (x times)	1.8	1.9	1.2	1.5	1.5	1.2	1.7
Debt to revenues (x times)	3.7	3.5	4.6	4.5	4.3	4.6	4.3
Debt to assets at cost (%)	57.7	57.5	57.4	57.1	55.4	58.3	58.4

F: Indicates forecast
Source: Longhurst, Moody's Investors Service

Detailed Rating Considerations

On 25 October 2023, Moody's changed the outlook to stable from negative and affirmed Longhurst's baa1 BCA and A3 issuer rating. 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.

Longhurst's A3 rating combines: (1) Baseline Credit Assessment (BCA) of baa1 and a strong likelihood of extraordinary support coming from the UK government in the event that Longhurst faced acute liquidity stress.

Baseline Credit Assessment

Simple group structure and moderate risk appetite

Longhurst Group Limited is the Registered Provider and the parent of the Group, with around 24,000 homes managed in the Midlands and East of England. It also has four subsidiaries - Keystone Developments which is responsible for market sales development, two financing special purpose vehicles (SPVs) which have issued bonds and on-lent proceeds to group members and Teetotal Homes which is a registered charity. Longhurst has been involved in a cross-sector joint venture, with a 25% equity holding in Evera Homes which was set up to develop outright sales, however members have agreed that there will be no activity undertaken under Evera over the medium term. Another JV with Countryside Properties is also likely to remain inactive.

Longhurst's development programme includes spending of £699 million (including committed and uncommitted schemes) to build 3,395 units over the next five years. 60% of the total programme will be on social rent tenures including 1,338 for affordable housing units and 551 for general needs, and the remainder predominantly on shared ownership units. Longhurst successfully bid with Nottingham Community Housing Association (NCHA) for £230 million in grant funding from the Homes England's Affordable Homes

Programme 2021-26, allowing 16% of total development to be funded by capital grant receipts. Longhurst's exposure to market sales is forecast to remain moderate over fiscal 2023-2025, accounting for 14% of turnover on average over this period, limiting the impact of a housing market downturn. Moody's forecasts UK house prices to decline by 5% in 2023 and 2024.

Good performance on social housing business, although some deterioration in recent years

Longhurst's social housing lettings margin has shown some deterioriation in recent years - with the margin decreasing from 42% in fiscal 2018 to 32% in fiscal 2022, however this still remains above the A3 peer median of 28%. The falling margin over this period is due to the sector-wide rent cut from fiscal 2017 to fiscal 2020, as well as idiosyncratic challenges including increasing management and maintenance costs. The former relates to challenges in achieving efficiencies from the merger and consolidation of the group structure in 2019. The latter relates to increased costs of repairs and maintenance, resulting from labour shortages in its repairs service. Longhurst's social housing cost per unit is high compared to the sector median, at £4,200 vs. £3,680, based on the 2021 value for money metrics published by the Regulator of Social Housing[1]. The back-log in repairs has also led to a lag in being able to re-let properties, although void losses still remained low in aggregate at £2.8 million in 2022, around 1.8% of total turnover in the year. It will intensify efforts to clear the back-log in fiscal 2023 and 2024, with new repairs contractors now in place. We expect the margin on social housing lettings to remain above peers, however it is likely to remain somewhat depressed over the next 2-3 years due to the rent cap and high cost inflation.

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.

Weakened operating margin and interest coverage due to reduction in margins on market sales and care and supported housing business

Longhurst's operating margin has weakened since fiscal 2018, driven largely by the pressures highlighted above - from 31% to 24% in fiscal 2022, although this is still above the A3 peer median of 23% in the same year. Longhurst expects its margin to remain below 30% until fiscal 2025 which we consider is likely, considering its challenges related to management and maintenance costs, as well as underperformance in its care and supported housing business. The latter reported an operating loss of 17% in fiscal 2022, due to high levels of voids as a result of lower referrals by local authorities, a pandemic-related trend. However, as this part of the business only accounts for around 8% of turnover this limits the impact on its overall operating margin. In contrast, its margins on first tranche shared ownership sales are strong at 22% in fiscal 2022, and are expected to remain decent as demand for this product remains more resilient than that for outright sales.

Social housing lettings interest coverage (SHLIC) has been modest over the last three years at an average of 1.2x, although - as with the operating margin - this remains slightly above the A3 peer median of 1.1x in fiscal 2022. Longhurst's SHLIC is forecast to marginally improve over the next three fiscal years, averaging 1.4x, higher than the expected A3-rated peer median of 1.2x over the same period.This results from the anticipated growth in Longhurst's social rented units over the medium-term, which typically records strong operating margins as detailed above.

Weak debt metrics, gearing expected to weaken further

Longhurst's total debt is rising, due to its development programme being 52% debt-funded, in addition to major repairs work estimated at £120 million over the next 5 years, including its projections on decarbonisation spend. As at 31 September 2022, total debt was £718 million, but will reach £838 million by fiscal 2025. 95% of Longhurst's debt was held at fixed rates (including hedges), above the 70% fixed rate minimum level stated in its treasury policy. Longhurst's debt profile includes a moderate level of refinancing risk, with 13% of drawn debt due within the next five years.

Longhurst's debt to revenue metric decreased slightly to 4.3x in fiscal 2022 from 4.5x in fiscal 2021 and remains in line with the median of its A3 rated peers, which stood at 4.3x in fiscal 2022. Longhurst expects its debt to revenues metric to weaken to 4.5x over the next three years as its debt levels increase over the medium-term. Debt to assets remains higher than peers at 55% in fiscal 2022 compared to the A3-rated peer median of 51% in the same fiscal year. This is a result of its legacy as a large scale voluntary transfer organisation (LSVT) and we expect this metric to weaken again, reaching 58% by fiscal 2024 due to its rising debt levels.

Longhurst's liquidity position is expected to be decent over the next three years, averaging 1.0x over that period.As of 30th September 2022, its cash and immediately available liquidity totaled £155 million. Longhurst's liquidity position is supported by its treasury policy, which stipulates that the group will maintain sufficient financing to meet obligations contractually committed over a period of eighteen months, which is in line with the sector. As such, we expect that management would ensure that financing is in place when Longhurst's capital expenditure targets become contractual commitments. Longhurst's liquidity position is supplemented by a pool of unencumbered assets that are sufficient to support an additional £260 million of borrowing capacity as of September 2022, based on EUV valuations, which compares favourably to its funding need of £130 million, based on its business plan.

Its interest cover covenant headroom is relatively tight per Moody's assessment, at around 40 basis points for its tightest covenant based on EBITDA-MRI in fiscal 2023. However, Longhurst is in discussion with lenders to carve out works in association with its Social Housing Decarbonisation Fund bid if successful.

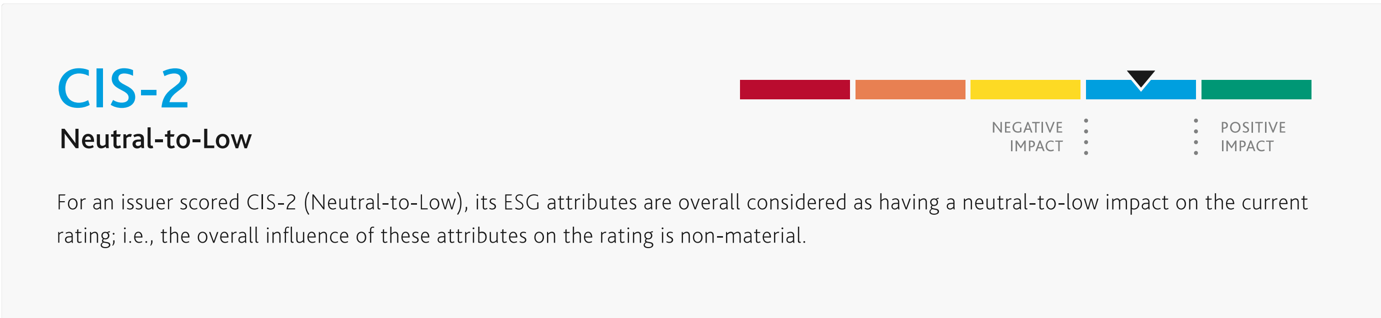
Extraordinary Support Considerations

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

ESG considerations

Longhurst Group Ltd's ESG Credit Impact Score is Neutral-to-Low CIS-2

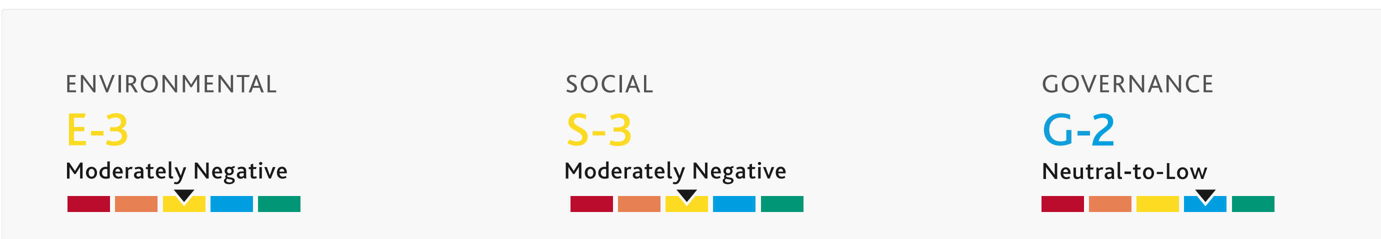
Exhibit 3
ESG Credit Impact Score



Source: Moody's Investors Service

Longhurst's **CIS-2** reflects that ESG risks have a limited impact on its rating. Longhurst has low exposure to carbon transition risks as the majority of its stock already meets energy efficiency requirements, and, although social risks are prevalent, we consider that it has the ability to effectively mitigate them through its strong governance and management practices. We also consider that the supportive regulatory framework for the sector offsets some ESG risks.

Exhibit 4
ESG Issuer Profile Scores



Source: Moody's Investors Service

Environmental

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

Social

Longhurst has material exposure to social risks (**S-3**) through sector-wide legislative requirements to improve the safety of existing housing stock (responsible production risks) which weighs on expenditure and operating margins, and the impacts of 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

Longhurst 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 Baseline Credit Assessment (BCA) of baa1 is the same as the scorecard-indicated outcome.

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

Exhibit 5

Longhurst's 2022 scorecard

Longhurst Group Ltd

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%	24,149	a
Factor 3: Financial Performance			
Operating Margin	5%	23.8%	baa
Social Housing Letting Interest Coverage	10%	1.2x	baa
Cash-Flow Volatility Interest Coverage	10%	1.5x	baa
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	4.3x	ba
Debt to Assets	10%	55.4%	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			**baa1**
Assigned BCA			**baa1**

Source: Longhurst, Moody's Investors Service

Ratings

Exhibit 6

Category	Moody's Rating
LONGHURST GROUP LTD	
Outlook	Stable
Baseline Credit Assessment	baa1
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 https://www.gov.uk/government/collections/value-for-money-guidance-and-reports

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