

CREDIT OPINION

27 January 2020

 Rate this Research

RATINGS

The Guinness Partnership Ltd.

Domicile	United Kingdom
Long Term Rating	A2
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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The Guinness Partnership Ltd. (United Kingdom)

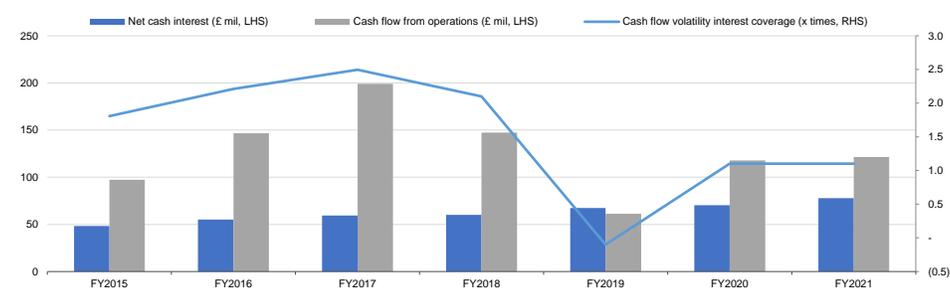
Update to credit analysis

Summary

The A2 issuer rating assigned to [The Guinness Partnership](#) (Guinness, A2 stable) balances the housing association's low debt burden and adequate liquidity position, with risks stemming from a projected increase in market sales and a deterioration in operating performance. Guinness's A2 rating also benefits from the strong regulatory framework governing English housing associations and our assessment that there is a strong likelihood that the [UK government](#) (Aa2 negative) would intervene in the event that Guinness faced acute liquidity stress.

Exhibit 1

Guinness' market sales strategy boosts cash flow, but renders it more volatile, weakening the cash flow volatility interest coverage metric



Source: Guinness Partnership and Moody's

Credit strengths

- » Large housing association with operations spread nationally
- » Strong balance sheet and healthy unencumbered assets position
- » Supportive institutional framework in England

Credit challenges

- » Deterioration in operating performance and interest cover
- » Growing development and market sales risk, albeit reduced from previous year

Rating outlook

The stable outlook on Guinness reflects our view that its deterioration in operating performance and consequent impact on interest cover ratios is balanced by the organisation's large size and resilient balance sheet.

Factors that could lead to an upgrade

Positive pressure on the rating could result from a combination of the following key factors: 1) strengthened Social Housing Letting Interest Cover (SHLIC) to a level structurally at or above 2.0x, 2) operating margins which consistently exceed 30%, and/or 3) reduced volatility in operating cash flow, supporting Cash Volatility Interest Cover (CVIC) remaining at or above 2.2x.

Factors that could lead to a downgrade

One or a combination of the following key factors would result in downward pressure on the rating: 1) interest coverage metrics being sustained below 1.2x, 2) operating margin remaining consistently below 25%, and/or 3) liquidity coverage falling below 1.0x. In addition, a weaker regulatory framework or a dilution of support for the sector could also exert negative pressure on the rating.

Key indicators

Exhibit 2

Guinness Partnership							
	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.)	60,216	60,671	65,363	65,538	63,857	64,573	66,279
Operating margin, before interest (%)	27.5	29.1	30.3	28.6	23.8	25.1	24.3
Net capital expenditure as % turnover	28.5	10.2	(11.7)	2.0	4.4	(0.6)	(7.5)
Social housing letting interest coverage (x times)	2.1	1.9	2.0	1.9	1.4	1.2	1.2
Cash flow volatility interest coverage (x times)	1.8	2.2	2.5	2.1	(0.1)	1.1	1.1
Debt to revenues (x times)	3.0	2.6	2.7	3.1	3.5	3.8	3.9
Debt to assets at cost (%)	37.8	37.5	36.6	35.8	36.4	39.5	42.6

*Fiscal 2020 and fiscal 2021 are forecast figures based off Guinness' latest business plan
Source: Guinness Partnership and Moody's

Detailed credit considerations

Guinness' A2 rating combines (1) its baseline credit assessment (BCA) of a3 and (2) a strong likelihood of extraordinary support coming from the UK government in the event that the entity faces acute liquidity stress.

Baseline credit assessment

Large housing association with operations spread nationally

Guinness is a large and influential housing association, with diverse operations. As at fiscal year end 2019, the group owned and managed around 64,000 homes across 150 local authorities. The group's large size and strength of its balance sheet provide financial resilience and opportunities to leverage economies of scale compared to its smaller rated peers.

The group's geographic spread partially mitigates demand risk. Guinness has homes nationally, with its largest proportion in the north of England. Areas which have the highest number of homes are Cheshire East, London, Milton Keynes and Manchester.

The group's strategy is to rationalise some of its stock to improve efficiency of service delivery. In fiscal 2019, Guinness disposed of 1,800 homes to other housing associations.

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.moody's.com for the most updated credit rating action information and rating history.

Strong balance sheet and healthy unencumbered assets position

Guinness's balance sheet will remain strong relative to peers, with low debt supporting strong debt metrics. As of the end of fiscal 2019, Guinness's total debt stood at £1.25 billion, equivalent to 3.5x revenues, or 36% of assets at cost, one of the lowest debt burdens amongst Moody's rated housing associations. The group's debt metrics compared favorably to the medians of its A2-rated peers, which stood at 4.0x and 46% for debt to revenues and debt to assets at cost, respectively.

Over the next five years, Guinness plans to gradually take on approximately £500 million in additional debt which will push the debt to assets ratio to just over 40%. We expect Guinness to retain comparatively strong debt metrics relative to peers despite the planned increase in debt.

Guinness' liquidity position remains adequate, supported by robust treasury policies which require available liquid funds to meet cash requirements for the next eighteen months. Furthermore, committed loan facilities must be in place for all contracted, approved, and pipeline commitments, in addition to a contingency of £25 million. As of November 2019, Guinness's immediately available liquidity consisted of £56.3 million in cash and £414.3 million of undrawn secured loan facilities, equating to a liquidity coverage of 2.5x.

Refinancing risk is moderate, with around 60% of Guinness' outstanding debt maturing in five years or more. Interest rate risk is relatively low, as 76% of Guinness' outstanding debt is fixed rate. Planned borrowing is more than covered by currently available unencumbered assets of around £1.0 billion.

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.

Deterioration in operating performance and interest cover

Guinness reported a marked deterioration in its operating performance in fiscal 2019 which resulted in a material deterioration in interest cover ratios. Profitability and interest covers are expected to remain below peer medians over the next few years. The weaker operating performance is a departure from historical performance; the group's above average interest cover ratios had hitherto been a credit strength compared with peers.

The group's operating margin was 24% in fiscal 2019 compared to an A2-rated peer median (fiscal 2019) of 29%. The lower operating margin was driven by the continued 1% reduction in social rents and higher investment in repairs. Going forward, the group has prioritised higher investment in existing stock to improve safety and sustainability which will continue to depress profitability. The operating margin will remain near 25% over the next three years compared to a five-year historical average of 28%.

The most significant fall in fiscal 2019 was the group's cash flow volatility interest cover (CVIC) which fell to -0.12x from 2.0x in fiscal 2018. The negative ratio was driven by a material increase in stock of £132 million in the year as the group ramps up its market sales combined with higher cash interest expense of £67 million from £60 million in fiscal 2018. The CVIC is expected to recover over the next few years, averaging 1.2x.

The reduced surpluses also impacted the group's social housing letting interest cover (SHLIC) interest cover which also declined to 1.4x in fiscal 2019 from 1.9x the year before. The 2019 position is below the A2-rated peer median (fiscal 2019) of 1.6x. The SHLIC is expected to remain just below 2019 levels for the medium term.

Growing development and market sales risk, albeit reduced from the previous year

Guinness will increase its investment in new and existing homes over the next few years, although the group has reduced its growth aspirations in the last year in response to weaker external economic conditions and an internal strategic shift to prioritise investment in safety and sustainability of existing homes.

The draft business plan for 2020/21 incorporates lower development targets and a material reduction in future market sales exposure compared to the previous year's business plan, both credit positive. The group's focus for the next five years will be the delivery of 5,055 homes as agreed under grant programmes with Homes England and the Greater London Authority.

The group has significantly reduced its planned market sales exposure by reducing outright sales to only those which are currently contractually committed. The reduction is in response to Board concerns about the viability of the cross-subsidy model given current property market trends. Management incorporation of economic risk, resulting in lower exposure is credit positive.

Although Guinness has reduced its exposure to outright sales, overall turnover from market sales is expected to increase over the next few years driven by growing income from first tranche shared ownership sales and outright sales from committed development schemes. Market sales will grow from a low exposure of 4% in fiscal 2019 to 29% by fiscal 2023, a level we consider high. Although growth is still expected over the next few years, the level is significantly reduced from the peak of 56% in the previous business plan.

Guinness' strong liquidity coverage - standing at 2.5x for fiscal 2019 - somewhat mitigates the risk stemming from higher levels of capital expenditure and development. Guinness' performance on this metric, which measures forecast year-end liquidity against the following two years' net capex spend, is more than comfortable, and remains above the A2 peer median of 1.3x

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 negative) 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 Guinness Partnership and the UK government reflects their strong financial and operational linkages.

ESG Considerations

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

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 Guinness, the materiality of ESG to its credit profile is as follows:

Environmental risks are not material to Guinness's credit profile. Social rented homes in the UK are generally more energy efficient than privately rented and owner-occupied homes. Additionally, housing associations continue to invest in new stock and improving the energy efficiency of existing stock. In line with the rest of the UK, Guinness's main environmental risk exposures relate to water shortage and flood risk. Flood risk is managed by country and national authorities, and therefore the burden of adapting to increased flood risk will not fall on Guinness.

Social considerations are material to Guinness'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. 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 Guinness's credit profile. Guinness'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 "Detailed credit considerations" 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 BCA of a3 is near to the scorecard suggested BCA of baa1.

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

Exhibit 3

Guinness Partnership

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%	63,857	aa
Factor 3: Financial Performance			
Operating Margin	5%	23.8%	baa
Social Housing Letting Interest Coverage	10%	1.4x	baa
Cash-Flow Volatility Interest Coverage	10%	-0.1x	b
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	3.5x	baa
Debt to Assets	10%	36.4%	baa
Liquidity Coverage	10%	2.5x	aa
Factor 5: Management and Governance			
Financial Management	10%	baa	baa
Investment and Debt Management	10%	baa	baa
Suggested BCA			baa1

Source: Guinness Partnership and Moody's

Ratings

Exhibit 4

<u>Category</u>	<u>Moody's Rating</u>
THE GUINNESS PARTNERSHIP LTD.	
Outlook	Stable
Issuer Rating -Dom Curr	A2
Senior Secured -Dom Curr	A2

Source: Moody's Investors Service

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