MOODY'S
PUBLIC SECTOR EUROPE

Rating Action: Moody's affirms Genesis Housing Association rating at Baa1 with a negative outlook after assessing their latest standalone business plan

Global Credit Research - 20 Dec 2016

London, 20 December 2016 -- Moody's Public Sector Europe, ("MPSE") has today affirmed Genesis Housing Association's (GEN) long term issuer rating at Baa1. Concurrently, Moody's has affirmed the debt rating on the GBP250 million senior secured bond issued under GenFinance II Plc at Baa1. The outlook on all ratings remains negative.

RATINGS RATIONALE

Genesis Housing Association (GEN) was expected to officially merge with Thames Valley Housing Association Limited (TVHA) in July 2016. However, on 23 August 2016, GEN announced that its merger with TVHA was canceled citing "differences in style and approach". Despite the failed merger, today's rating affirmation reflects our assessment that GEN as a standalone business will continue to operate with many of the same credit challenges as under the proposed merger structure.

GEN's cash interest cover is forecasted to be amongst the lowest in Moody's rated portfolio averaging 0.6x over the next three years. Consequently, GEN will rely on either debt or reserves to cover net cash interest due. In addition, social housing letting interest cover is expected to remain below one over the next five years, below the Moody's-rated portfolio median of 1.3x, indicating a structural reliance on non-social housing income to cover interest expense. Net capital expenditure is also expected to peak at 122% of revenues in FY2018, far above GEN's standalone past five-year average of 35%.

GEN's business model shows a continued structural reliance on non-social activity and any underperformance in market sales activity would exert additional rating pressure. Moody's notes that GEN has generated sales margins of 11% over the past three years on a standalone basis but GEN ambitiously expects to generate sales margins of 28% over the next five years. While Moody's acknowledges that there is flexibility to scale down their development pipeline, as the majority of sites are not committed, management does not appear likely to reduce their growth agenda. On the contrary, Moody's expects GEN to maintain a long term growth focus and remain "merger ready" as they aim to fulfill their ambition to develop more units.

The rating also factors the combined entity's strong balance sheet, operations in London where demand for social housing is currently high as well as moderate liquidity which is further supported by access to an investment fund (LINQ) that is seen as a de-risking mechanism providing a possibility of a liquidity injection if house prices fall significantly.

The ratings in the social housing sector continue to benefit from (1) the strong regulatory framework; (2) revenue stability provided by government subsidies (housing benefit), although this may come under renewed pressure from pressures on public finances; and (3) our assessment that there is a strong likelihood that the UK government (Aa1 negative) would intervene in the event that GEN faced acute liquidity stress.

As per the application of Moody's Joint Default Analysis methodology for government-related issuers, GEN's baseline credit assessment (BCA) has been set at ba1. The final rating of Baa1 incorporates the uplift provided by Moody's assessment of a strong likelihood of support from the UK government.

RATIONALE FOR NEGATIVE OUTLOOK

The outlook on GEN's rating is negative reflecting the sector wide risks on the housing association (HA) sector following the UK vote to leave the European Union (EU). Pressures on public finances stemming from weaker GDP growth could result in further policies restricting HA revenues. Additionally, volatility and/or slower house price growth could negatively impact GEN, as it maintains a high exposure to market sales.

WHAT COULD CHANGE THE RATING -- UP

Given the negative outlook, an upgrade is unlikely at this stage. However, one or a combination of the following could have positive rating implications: (1) a social-housing-letting interest coverage structurally exceeding 1.2x; (2) a reduction in market sales activity with a corresponding moderation in capital expenditure; (3) reducing cash flow volatility.

WHAT COULD CHANGE THE RATING -- DOWN

Negative pressure could be exerted on the rating by one or a combination of following: (1) sustained reliance on sales and/or other high-risk activities to cover interest costs while social housing letting interest coverage ratio structurally remains below 0.8x; (2) planned sales not performing according to budget leading to a deterioration of GEN's already low operating margins. In addition, a weaker regulatory framework, a dilution of the overall level of support from the UK government or a downgrade of the UK sovereign rating would also exert downward pressure on the rating.

The methodologies used in these ratings were European Social Housing Providers published in July 2016, and Government-Related Issuers published in October 2014. Please see the Rating Methodologies page on www.moodys.com for a copy of these methodologies.

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