MOODY'S INVESTORS SERVICE

CREDIT OPINION
2 February 2023

Update

Send Your Feedback

RATINGS

Paragon Asra Housing Ltd

Domicile	United Kingdom
Long Term Rating	A3
Type	LT Issuer Rating - Dom Curr
Outlook	Negative

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

Maylis Chapellier +44.20.7772.1429
Analyst
maylis.chapellier@moodys.com

Laura Balkarova +44.20.7772.5629
Associate Analyst
laura.balkarova@moodys.com

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

CLIENT SERVICES

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

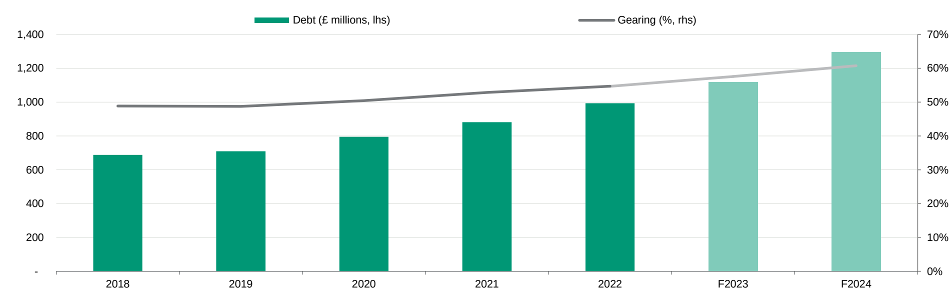
Paragon Asra Housing Ltd (United Kingdom)

Update following affirmation of A3 negative

Summary

The credit profile of Paragon Asra Housing Ltd (PA Housing, A3 negative) reflects its strong liquidity and strong financial management. It also reflects the weakened operating performance, induced by fire safety costs, and the increase in debt, both weighting negatively on interest coverage ratios. PA Housing also benefits from the strong regulatory framework governing English housing associations (HAs), and our assessment that there is a strong likelihood that the government of the United Kingdom (UK, Aa3 negative) would intervene in the event that PA Housing faces acute liquidity stress.

Exhibit 1
PA Housing will increase its debt to fund its development programme, worsening its debt metrics



(F): Forecast.
Source: PA Housing and Moody's Investors Service

Credit strengths

» Solid liquidity to be maintained because of its robust treasury policies

» Comprehensive growth strategy supported by external grant funding from key partners

» Supportive institutional framework

Credit challenges

» Debt to increase, weighing negatively on debt and interest cover ratios

» Weakened operating performance

Rating outlook

The negative outlook reflects the high exposure to weaker economic and financial conditions in the UK. A 7% ceiling on social rent increases in England combined with high cost inflation and sizeable levels of mandatory expenses (quality, fire and building safety, decarbonisation) will weigh on operating margins over the next 12 to 18 months. This could be worsened by additional below-inflation caps on social rent increases. At the same time, higher interest rates and tightening financing conditions will further weaken interest coverage ratios. Further declines in home prices and sale volumes in the UK could affect HAs' profitability and surpluses from market sales and further weaken their credit profile.

Factors that could lead to an upgrade

A rating upgrade is unlikely due to the negative outlook. The negative outlook could be changed to stable if PA Housing is able to maintain relatively stable financial metrics over the medium term. This could be driven by operating performance improving more than anticipated, including the ability to contain cost pressures, and reductions in development plans leading to lower debt levels than anticipated.

Factors that could lead to a downgrade

PA Housing's rating could be downgraded as a result of one or a combination of the following: failure to adapt strategies to mitigate against weaker economic conditions; a further weakening in operating margins and interest coverage ratios; increases in debt beyond levels that are currently anticipated; significant deterioration in liquidity; significant scaling up in market sales exposure or material deterioration in market sales performance; or any weakening of the regulatory framework or dilution of the overall level of support from the UK government. A downgrade of the UK sovereign rating would also place downward pressure on PA Housing's rating.

Key indicators

Exhibit 2

PA Housing	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.)	22,676	22,220	21,901	22,312	22,591	23,300	23,800
Operating margin, before interest (%)	34.6	33.8	26.2	23.2	23.0	19.6	20.9
Net capital expenditure as % turnover	10.4	18.6	76.1	66.3	80.2	67.5	83.0
Social housing letting interest coverage (x times)	1.4	1.5	1.2	1.3	1.1	0.8	0.7
Cash flow volatility interest coverage (x times)	1.3	1.7	0.4	1.2	1.1	1.2	1.3
Debt to revenues (x times)	4.2	4.4	5.3	5.6	5.9	5.8	5.9
Debt to assets at cost (%)	48.8	48.7	50.5	52.9	54.7	57.6	60.7

(F): Forecast.
Source: PA Housing and Moody's Investors Service

Detailed credit considerations

On 30 January 2023, we affirmed PA Housing's ratings of A3 and maintained the negative outlook. At the same time, we downgraded PA Housing's baseline credit assessment (BCA) to baa2 from baa1, reflecting the weakened operating performance due to the fire/building safety spend and the worsening debt metrics due to high development ambitions.

PA Housing's A3 rating combines its Baseline Credit Assessment (BCA) of baa2 and a strong likelihood of extraordinary support from the UK government in the event that PA Housing faces acute liquidity stress.

Baseline Credit Assessment

Solid liquidity to be maintained because of robust treasury policies

PA Housing has a robust liquidity policy, mitigating treasury risk. Golden rules adopted by the board state that the group will hold sufficient cash and liquid resources to cover at least the next 18 months' forecast net cash requirement excluding 50% of market sales proceeds, mitigating market sales exposure risk.

Its liquidity coverage ratio was strong at 1.1x as of December 2022, with £23 million in cash and £306 million in secured undrawn facilities with 8 revolving credit facilities. PA Housing also benefits from a strong unencumbered assets position, which supports additional borrowing capacity of £512 million, which compares well with funding needs.

The treasury policy also includes a specific mark-to-market policy requiring a separate liquidity buffer covering an adverse movement of interest rates of 50 basis points. PA Housing inherited Asra's large swap portfolio, giving a total standalone notional value of £160 million and a negative mark-to-market value of £1 million, as of September 2022. This mark-to-market exposure is covered using a combination of property and cash security, amounting to £35 million as of September 2022, reducing the impact of potential margin calls.

PA Housing's solid liquidity position has enabled the HA to acquire stock from other HAs, 163 units in fiscal 2022 and 412 units in fiscal 2023. The acquisitions will increase PA Housing's turnover and can allow the HA to benefit from economies of scale as the stock is located in areas where the HA has a significant concentration of units.

Comprehensive growth strategy supported by external grant funding from key partners

PA Housing's five-year development programme includes 3,652 units (fiscal 2023-27), and is supported by grants the HA secured through strategic partnerships. PA Housing has been granted £182 million by the Greater London Authority (GLA) to deliver 1,455 units in London over fiscal 2021-26. PA Housing was also granted £89 million by Homes England to build 1,400 units over fiscal 2021-26 (through a partnership with another HA (Accent, unrated) and two other delivery partners).

Whilst it is positive for the HA to receive those grants as it will reduce future debt funding and gearing levels, to maintain an ambitious development programme in the current weakened operating environment is credit negative as it creates risks. Risks include contractor failure, further costs increases which would lead to more debt funding, labour and material shortages leading to delays, housing market downturn or volatility that would impact shared ownership. As a mitigant, we note that PA Housing works on small sites, 20-100 units per site, which reduces concentration risk.

PA Housing's development plan is split between social rent (58% of units) and first tranche shared ownership (FTSO). PA Housing does not want to develop outright sales schemes because of the higher risks involved and the lack of grants available, another mitigant.

In addition to its development programme, PA Housing will dedicate £8 million of capital spending over the next five years on retrofitting and energy efficiency works. PA Housing established its Sustainable Finance Framework, which promotes retrofitting and energy efficiencies work, and spending on new social housing properties that achieve an Energy Performance Rating of “A” or “B”.

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.

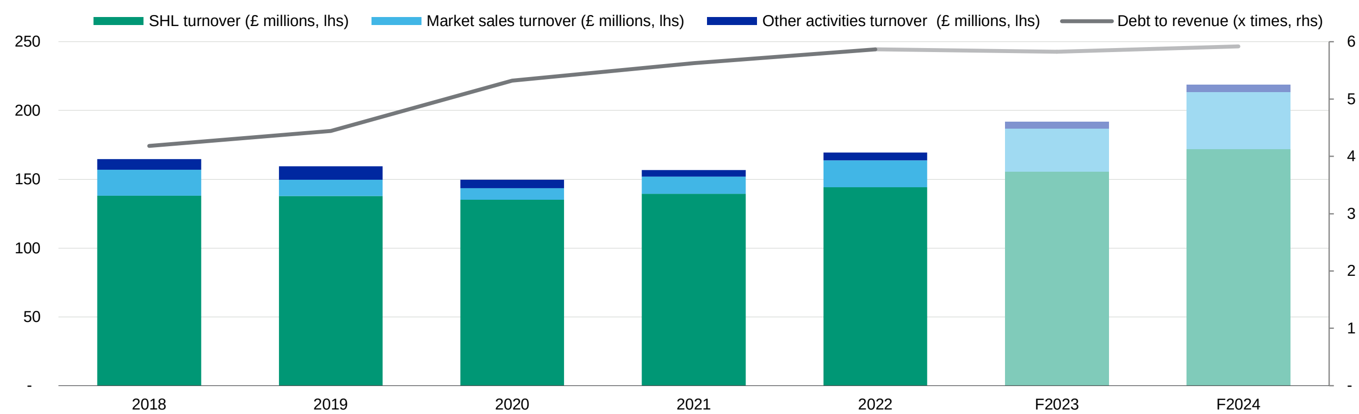
Debt to increase, weighing negatively on debt and interest cover ratios

PA Housing plans to materially increase its debt to fund its development programme. Gross debt is planned to increase to £1,469 million by fiscal 2025 from £994 million in fiscal 2022, weighing on the HA's debt metrics. The future increase in debt depends on the pace of the development programme, which has been slower than expected over the past three years.

PA Housing's metrics have already weakened as the HA steadily grew its debt by nearly £100 million per year over the past three years. Debt/revenue was at 5.9x in fiscal 2022, up from 5.6x in fiscal 2021, comparing negatively with the A3-rated peer median of 4.3x. Gearing (debt/assets at cost) also weakened to 55% in fiscal 2022, up from 53% in the previous year, comparing negatively with the A3-rated peer median of 50%. Gearing is anticipated to worsen to 63% by fiscal 2025, well above that of peers, a credit negative. Debt/revenue could remain stable over the next three years but 1/ this is contingent on additional market sales revenue (see Exhibit 3) and 2/ this would still remain high compared to peers.

Exhibit 3

Expected stabilisation in debt/revenue is contingent on additional market sales revenue



(F): Forecast.

Source: PA Housing and Moody's Investors Service

In line with the debt increase, net interest costs are likely to increase to £56 million by fiscal 2025 from £30 million in fiscal 2022. PA Housing already has interest cover ratios weaker than peers, because of its high debt burden and weakened operating performance (see paragraph below). PA Housing's social housing letting interest coverage (SHLIC) was slightly below the A3 peer median in fiscal 2022 (1.06x compared to 1.1x), while its cash flow volatility interest coverage (CVIC) was lower than the A3 peer median (1.1x compared to 1.7x). Both are expected to remain below peers, and will be negatively impacted by the inflationary pressures.

Weakened operating performance

PA Housing's operating margin remained stable at a low 23% in fiscal 2022, compared with historical margins of 32%-35% between fiscal 2017 and fiscal 2019. PA Housing's low margin is explained by increased maintenance spending related to fire and building safety. Excluding these costs, which are also excluded from covenant ratios, the margin would have been 27%, compared to 25% the year before. Fire and building safety costs represented £7 million of operating costs with £3 million on fire remediation works and £4 million of waking watch and fire safety cover costs.

PA Housing's operating margin is projected to remain lower than peers in the next three years because of the continued impact of fire safety costs, as the work continues on its 5 high-rise blocks (one completed in fiscal 2022). The HA hopes to recover up to £34 million through the Building Safety Fund and thanks to negotiations with the original house builder contractors to share the burden.

The HA maintains an internal target of 30% of operating margin on social housing lettings, demonstrating its commitment to operating efficiency. It anticipates to reach it from fiscal 2027. PA Housing anticipates to complete most of the fire safety work by fiscal 2025, allowing its operating margin to start recovering. The full recovery is delayed by inflationary pressures, which negatively impact PA Housing's results, including high and increased utility costs and repair and maintenance costs. In line with the sector, the HA's results will be further constrained by the 7% rent cap ceiling.

On the other hand, margins on market sales remained stronger than peers, at 30% in fiscal 2022, even though delayed handovers due to the pandemic limited the growth of this activity. The increased exposure to market sales (to an average of 20% of turnover over the next three years, from 12% in fiscal 2022) is risk as Moody's views a housing market downturn over the next two years likely. A failure to meet the targeted amount of market sales could imply faster and higher debt increases than the levels currently projected, which would be credit negative. PA Housing monitors market sales risk and continuously stress-tests this risk, with mitigating actions in place in case of shortfall. The HA delimited its maximum sales exposure to 25% of turnover, and its board is considering a long-term target of 20%, which if implemented will reduce its exposure to risk.

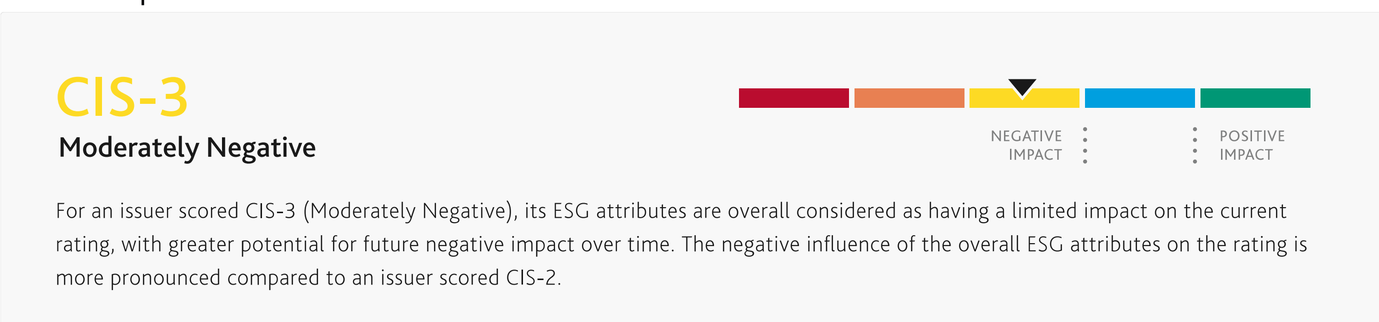
Extraordinary support considerations

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 PA Housing and the UK government reflects their strong financial and operational linkages.

ESG considerations

Paragon Asra Housing Ltd's ESG Credit Impact Score is Moderately Negative CIS-3

Exhibit 4
ESG Credit Impact Score



Source: Moody's Investors Service

PA Housing's CIS is moderately negative reflecting moderate exposure to environmental risks, high exposure to social risks, low-neutral governance profile, as well as a supportive regulatory framework and support from the UK government.

Exhibit 5
ESG Issuer Profile Scores

Source: Moody's Investors Service

Environmental

Its overall E issuer profile score is moderate (**E-3**), reflecting moderately negative exposure to environmental risks, primarily due to carbon transition risk from the legislative requirement for English housing associations to improve the energy efficiency of their existing housing stock by 2035, leading to increased expenditure. We consider that PA Housing has a material exposure to this risk due to a significant proportion of its stock requiring retrofit.

Social

We assess its S issuer profile score as highly negative (**S-4**), reflecting high exposure to risks from responsible production and demographic and societal trends. Responsible production risks include the legislative requirement to improve the safety of its existing housing stock which will increase expenditure over the medium term. This is requiring significant expenditure for PA Housing. Demographic and societal trends risks reflect the vulnerability of the sector to tenant affordability challenges and government policy which controls rent setting in England and Wales. The government's recent intervention on social rent policy with a ceiling on social rent increases introduces policy volatility to the sector and will have a negative impact on financial performance.

Governance

We assess its G issuer profile score as neutral to low (**G-2**). Governance in the sector is generally fit for purpose, with good oversight of business risks, strong financial planning and risk management processes, detailed reporting and simple organisational structures. 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 BCA of baa2 is in line with scorecard-indicated BCA of baa2.

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

Exhibit 6
Fiscal 2022 scorecard

Paragon ASRA			
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%	22,591	a
Factor 3: Financial Performance			
Operating Margin	5%	23.0%	baa
Social Housing Letting Interest Coverage	10%	1.1x	baa
Cash-Flow Volatility Interest Coverage	10%	1.1x	baa
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	5.9x	b
Debt to Assets	10%	54.7%	b
Liquidity Coverage	10%	1.1x	a
Factor 5: Management and Governance			
Financial Management	10%	baa	baa
Investment and Debt Management	10%	baa	baa
Scorecard - Indicated BCA Outcome			**baa2**
Assigned BCA			**baa2**

Source: PA Housing and Moody's Investors Service

Ratings

Exhibit 7

Category	Moody's Rating
PARAGON ASRA HOUSING LTD	
Outlook	Negative
Baseline Credit Assessment	baa2
Issuer Rating -Dom Curr	A3
PARAGON TREASURY PLC	
Outlook	Negative
Senior Secured -Dom Curr	A3

Source: Moody's Investors Service

REPORT NUMBER 1349404

CLIENT SERVICES

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

Moody's
INVESTORS SERVICE