

CREDIT OPINION

28 October 2019



RATINGS

Citizen Housing Group Limited

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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Citizen Housing Group Limited

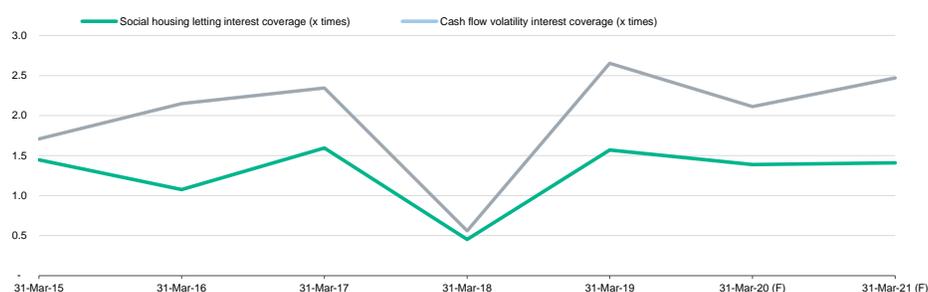
Update to credit analysis

Summary

The credit profile of [Citizen Housing Group Limited](#) (Citizen, A2 stable) reflects the high proportion of turnover coming from low-risk social-housing lettings, moderate debt levels and recent improvements to governance and management structure. It also incorporates a projected increase in market sale activity. The 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 \(Aa2 stable\)](#) would intervene in the event that Citizen faced acute liquidity stress. In September 2019, Citizen Housing Group was renamed following amalgamation of WM Housing Group and subsidiaries.

Exhibit 1

Citizen's strong interest coverage ratios continue post the refinancing exercise in FY2018



The projections for FY2020-21 have been calculated using Citizen's business plan.
 Source: Citizen Housing Group Limited, Moody's Investors Service

Credit Strengths

- » Management and governance reforms strengthen oversight
- » Moderate debt burden, liquidity and debt management improved by refinancing
- » Supportive institutional framework in England

Credit Challenges

- » Projected increases in outright sales, albeit from a relatively low base
- » Moderate operating margins but limited revenue volatility due to a high proportion of turnover derived from low-risk social housing lettings

Rating Outlook

The stable outlook reflects both the stable operating environment, which is unlikely to undergo further material change in the medium-term, as well our assumption that if Citizen adheres to its current business plan, metrics will remain in line with A2 peers.

Factors that Could Lead to an Upgrade

Positive pressure on the rating could result from one or a combination of the following:

- » Social housing letting interest coverage (SHLIC) sustained at above 2.0x;
- » Sustained improvement in the operating margin to over 35%;
- » Material scaling down in development programme, particularly in the market sales segment

Factors that Could Lead to a Downgrade

Negative pressure could be exerted on the rating by one or a combination of following:

- » Significant increase in debt beyond that approved in the business plan;
- » Structural decline in efficiency, leading to a weakening in the operating margin to below 25%;
- » Material scaling up of the development programme, above currently proposed levels, including more reliance on outright sales

A weaker regulatory framework, dilution of the overall level of support from the UK government or a downgrade of the UK sovereign rating could also exert downward pressure on the rating.

Key Indicators

Exhibit 2

Citizen Housing Group Limited							
	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.)	27,945	28,175	27,883	27,886	27,956	28,054	28,337
Operating margin, before interest (%)	28.5	22.8	29.9	26.4	27.4	24.7	25.5
Net capital expenditure as % turnover	13.3	9.7	1.4	43.2	3.6	34.3	21.4
Social housing letting interest coverage (x times)	1.4	1.1	1.6	0.5	1.6	1.4	1.4
Cash flow volatility interest coverage (x times)	1.7	2.1	2.3	0.6	2.7	2.1	2.5
Debt to revenues (x times)	3.9	3.6	3.6	4.2	4.0	3.8	3.3
Debt to assets at cost (%)	45.4	44.6	43.6	48.4	46.9	48.3	48.5

The projections for FY2020-21 have been calculated using Citizen's business plan.

Source: Citizen Housing Group Limited, Moody's Investors Service

Detailed Rating Considerations

Citizen's 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 Citizen faced acute liquidity stress.

Baseline Credit Assessment

Management and governance reforms strengthen oversight

In early 2019, following consultation and approval from stakeholders and tenants, the group structure was further amalgamated. The organization's registered providers; Family Housing Association (Birmingham) Limited, Optima Community Association Limited, West Mercia Homes Limited, Whitefriars Housing Group Limited and WM Housing Group Limited ceased to exist as separate legal entities, and from 1 September 2019 came together as Citizen Housing Group Limited. These changes have reduced complexity and strengthened oversight at Citizen, a credit positive development.

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Citizen grew from 6,000 units in FY2008 to around 28,000 units today through a series of mergers, including 17,000 unit Whitefriars Housing Group and 2,000 unit Optima Community Association, both of which were large scale voluntary transfers (LSVT) providers. The acquisition of 2,500 unit Family Housing Association helped Citizen consolidate its footprint in Birmingham. Family also brought its own in-house repairs and ground maintenance team to the Group. While this growth multiplied turnover, the mergers resulted in a relatively complex governance structure, with multiple boards, and two separate executive directors overseeing the operations of the Group's subsidiaries.

Over the past two years, Citizen has been successful in streamlining procedures and processes, and in 2018 moved all Registered Providers within the group (other than Optima) to a single, coterminous board. Optima retained its own Subsidiary Board, but delegated many of its powers to the Parent board. Furthermore, Citizen restructured the executive management team, tasking a Chief Operating Officer at the group level to replace the executive directors who oversaw operations of the group's subsidiaries.

Moderate debt burden, liquidity and debt management improved by refinancing

In October 2017, Citizen issued a 31-year £280 million bullet bond in order to refinance about a third of the loan portfolio, with additional funds used to supplement liquidity in the group. The bond issuance increased Citizen's gearing and debt burden, and at FYE2019, Citizen's total debt stood at £617 million, equivalent to 4.0x revenues and 47% of assets adjusted at cost. These metrics are in line with the A2 rated peer medians of 4.1x and 46%, respectively.

In parallel to the refinancing exercise, Citizen moved most of the group's debt from the subsidiary level to a group treasury vehicle. This allows the group to more efficiently manage its debt burden, as a raft of different loan covenants within each subsidiary were replaced by group level interest coverage and net debt per unit covenants. Both covenants are forecast to be comfortably met, even in the tightest year. The refinancing, and renegotiation of terms for the majority of the remaining non-refinanced debt, has removed the remaining LSVT-type restrictions which Citizen had inherited through its process of growth through acquisition.

Citizen's available liquidity, represented by cash, short-term investments and undrawn secured facilities, stood at £147 million at FYE2019. At this level of liquidity, our estimated liquidity cover ratio for Citizen, which takes immediately available liquidity and divides it by the next two years cash need (net capex), is 1.6x, a strong level of cover. Citizen's liquidity guidelines stipulate that immediately available liquidity should be sufficient to cover six-month cash requirements, rising to 12 months for total liquidity, including lending facilities still requiring property collateral for draw-down. The guidelines are both comfortably met. Citizen had planned to run down its liquidity over the coming years to fund its development programme, however in October 2019, Citizen re-opened its 2042 bond issuing a further £100 million, with proceeds expected in October 2020. While this will increase Citizen's debt somewhat, it will boost Citizen's liquidity and debt levels are expected to remain in line with A2 peers.

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.

Projected increases in outright sales, albeit from a low base

Over the next five years, Citizen plans to develop around 2,700 new social homes, with a mix of approximately three-quarter social rented and one-quarter shared ownership homes. In addition to this, Citizen plans to increase its outright sale activity, averaging 90 units per year between FY2021-2024. This would be a significant increase from FY2019 when 26 units were sold. Whilst not large as a proportion of Citizen's total size, this represents a step change in terms of operational challenges for the primarily traditional housing association.

Total sales, comprised of both outright and first tranche shared ownership sales, accounted for 5.9% of Citizen's FY2019 turnover, achieving a 28.6% margin, up from 22.5% in FY2018. Citizen's revenue from market activities has been a small proportion of the total over the last five years, contributing £4-£9 million of revenue per year. Going forward, Citizen is projecting that outright sales and first tranche shared ownership receipts will increase to £19.1 million in FY2020, and rising to £35.3 million in FY2021 (19.2% of turnover). Citizen expects revenue from market sales to offset somewhat the effects of the continued loss of revenue from the rent cut, which will continue until FY2021. We see the projected increase of market sales revenue as a credit challenge for the housing association, as market sales revenues are more volatile and generally pro-cyclical when compared to Citizen's core social rented business.

Moderate operating margins but limited revenue volatility due to a high proportion of turnover derived from low-risk social housing lettings

Citizen performed moderately in FY2019, registering a 27.4% operating margin overall which is slightly up from the FY2018 figure of 26.4%. Social housing letting turnover remained broadly stable, decreasing slightly from £140.0 million to £138.2 million, as the penultimate year of the rent cut continued to impact revenues. Citizen, however, benefits from stability of revenue due to a high proportion of turnover coming from social housing lettings. In FY2019, 90% of Citizen's turnover was comprised of social housing lettings, firmly above the 76% FY2019 median for Moody's-rated peers.

Citizen's interest coverage metrics took a one-off hit in FY2018 due to the £67.9 million breakage costs incurred as part of the refinancing exercise. This was an exceptional cost and the metrics have now returned to historic strong levels, with social housing letting interest cover (SHLIC) at 1.6x and cash flow volatility interest cover (CVIC) at 2.7x for FY2019. Social housing letting surpluses are set to increase from £37.2 million in FY2019 to £44.0 million by FY2022, as Citizen builds more units for social rent and the sector sees the return to CPI +1% annual increases in social housing rents. However, interest payments are also forecast to increase during this same period, meaning SHLIC will average 1.5x over the next three years (excluding the recent bond reopening) - slightly above the Moody's-rated peers median of 1.4x. The limited revenue volatility associated with traditional social housing letting will benefit Citizen and the CVIC metric, which is expected to remain above 2.0x going forward.

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

ESG Considerations

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

Moody's takes into account environmental (E), social (S) and governance (G) factors when assessing sub-sovereign issuers' economic and financial strength. In the case of Citizen, the materiality of ESG to the credit profile is as follows:

Environmental risks are not material to Citizen's credit profile. In line with the rest of the UK, its main environmental risk exposures relate to water shortage and flood risk. Flood risk is managed by county and national authorities, and therefore the burden of adapting to increased flood risk will not fall on Citizen.

Social risks are material to Citizen's credit profile, in line with the rest of the UK housing association sector. In particular, the sector is exposed to risks stemming 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 positive or negative for the sector. The broad political support for social housing is captured in our analysis of the operating environment. On the other hand, central government's policy to increase the affordability of rents for low-income social housing tenants led to four years of sector-wide rent cuts from fiscal 2017 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 also material to Citizen's credit profile. Citizen's governance and management are strong, underpinned by a broadly stable strategy and solid financial reporting. English housing associations also benefit from a strong regulatory framework and close oversight by the Regulator of Social Housing, as detailed in 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 the same as 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 June 2018.

Exhibit 3

Citizen Housing Group Limited			
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%	27,956	a
Factor 3: Financial Performance			
Operating Margin	5%	27.4%	a
Social Housing Letting Interest Coverage	10%	1.6x	a
Cash-Flow Volatility Interest Coverage	10%	2.7x	a
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	4.0x	ba
Debt to Assets	10%	46.9%	ba
Liquidity Coverage	10%	1.6x	a
Factor 5: Management and Governance			
Financial Management	10%	baa	baa
Investment and Debt Management	10%	baa	baa
Suggested BCA			a3

Source: Citizen Housing Group, Moody's Investors Service

Ratings

Exhibit 4

Category	Moody's Rating
CITIZEN HOUSING GROUP LIMITED	
Outlook	Stable
Issuer Rating -Dom Curr	A2
CITIZEN TREASURY PLC	
Outlook	Stable
Senior Secured -Dom Curr	A2
CITIZEN TREASURY 2 PLC	
Outlook	Stable
Senior Secured -Dom Curr	A2

Source: Moody's Investors Service

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