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PUBLIC SECTOR EUROPE

CREDIT OPINION
23 October 2020

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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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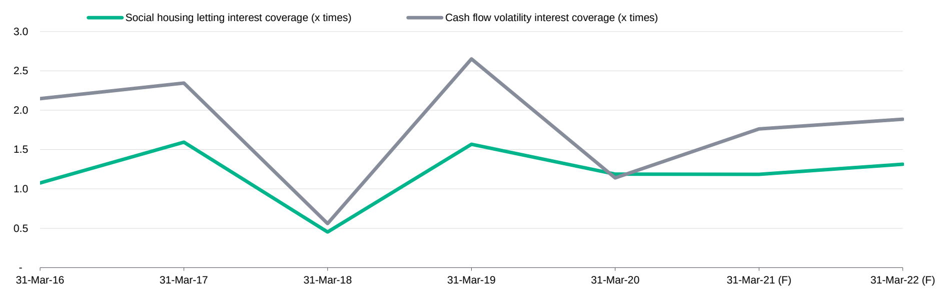
Citizen Housing Group Limited (UK)

Update following affirmation of A2 stable

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 a simplified 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 (Aa3 stable) would intervene in the event that Citizen faced acute liquidity stress.

Exhibit 1
Citizen's interest cover is projected to remain stable



The projections for FY2021-22 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

» 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 our view that Citizen's growth will continue at a measured pace, supporting steady revenue growth and strengthening margins.

Factors that Could Lead to an Upgrade

Upward pressure on Citizen's rating could result from: social housing letting interest coverage (SHLIC) sustained at above 2.0x; sustained improvement in the operating margin to over 35%; or a significant scaling down in the development programme, particularly in the market sales segment.

Factors that Could Lead to a Downgrade

Downward 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 sustained weakening in the operating margin to below 25%; a material weakening in interest coverage; or a material scaling up of the development programme, including more reliance on outright sales, or an inability to adapt strategies and risk appetite to mitigate against weaker economic conditions and operating performance. In addition, a weaker regulatory framework or a dilution of the overall level of support from the UK government could also exert downward pressure on the rating.

Key Indicators

Exhibit 2

Citizen Housing Group Limited

	31-Mar-16	31-Mar-17	31-Mar-18	31-Mar-19	31-Mar-20	31-Mar-21 (F)	31-Mar-22 (F)
Units under management (no.)	28,175	27,883	27,886	27,956	28,132	28,455	29,078
Operating margin, before interest (%)	22.8	29.9	26.4	27.4	21.8	22.5	24.7
Net capital expenditure as % turnover	9.7	1.4	43.2	3.6	29.3	38.1	61.1
Social housing letting interest coverage (x times)	1.1	1.6	0.5	1.6	1.2	1.2	1.3
Cash flow volatility interest coverage (x times)	2.1	2.3	0.6	2.7	1.1	1.8	1.9
Debt to revenues (x times)	3.6	3.6	4.2	4.0	4.0	4.0	3.8
Debt to assets at cost (%)	44.6	43.6	48.4	46.9	47.3	48.3	51.7

The projections for FY2021-22 have been calculated using Citizen's business plan.
Source: Citizen Housing Group Limited, Moody's Investors Service

Detailed Rating Considerations

On 21 October 2020, Moody's affirmed Citizen's rating and stable outlook. The affirmation followed Moody's downgrade of the Government of the United Kingdom's rating to Aa3 from Aa2 and the change in outlook to stable from negative on 16 October 2020.

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

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. This structure has been streamlined and as of 1 Sept 2019, the Group benefits from a simplified organisational structure, improving transparency and oversight of the organisation.

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 rebranding operations of the group's subsidiaries.

Moderate debt burden

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 FYE2020, Citizen's total debt stood at £597 million, equivalent to 4.0x revenues and 47% of assets adjusted at cost. Debt will increase to finance new development plans but we expect debt-to-revenue to remain moderate over the next few years.

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 £92 million at FYE2020. 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 0.5x, down from 1.3x at FYE2019 due to large projected capex in FY2021 and FY2022. In October 2019, Citizen re-opened its 2042 bond issuing a further £100 million, with £135 million proceeds received in October 2020, which will boost liquidity. We anticipate that liquidity coverage will improve as we expect Citizen to replace facilities maturing in 2021 and 2022 and set up new ones to support development plans. We also expect Citizen to adhere to its liquidity guidelines, which 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.

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 (IDAs) for large and complex HAs. In response to the coronavirus pandemic, the regulator adapted some aspects of its oversight temporarily, for example, extending its liquidity monitoring, briefly pausing the programme of IDAs and delaying regulatory submissions to reduce the operational burden on 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 has improved under more supportive policies for social rent increases and capital grant. Following four years of social rent reductions, HAs now 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 3,600 new social homes, with a mix of 73% social rented and 27% shared ownership homes. In addition to this, Citizen plans to increase its outright sale activity, averaging 49 units per year between FY2021-2025. This would be a significant increase from FY2020 when 5 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 3.8% of Citizen's FY2020 turnover, achieving a 23.1% margin, down from 28.6% in FY2019. 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 £27.5 million in FY2021, and rising to £34.4 million in FY2022 (18.1% of turnover). Citizen expects revenue from market sales to supplement revenue from social housing. The increase in market sales, however, exposes the group to increased volatility in its operating cash flows, which is exacerbated by the current volatility in the housing market caused by the coronavirus outbreak and associated economic contraction.

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 FY2020, registering a 21.8% operating margin overall, down from 27.4% in FY2019. We expect operating margins to improve from 2022 as the sector sees the return to CPI +1% annual increases in social housing rents in FY2021. Social housing letting turnover remained broadly stable, increasing slightly to £139.1 million from £138.2 million in FY2020, as the last 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 FY2020, 92% of Citizen's turnover was comprised of social housing lettings and we expect this proportion to remain around 82% on average over the next five years.

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. In FY2020, social housing letting interest cover (SHLIC) fell to 1.2x, down from 1.6x in FY2019, due to a decrease in operating margin on social housing lettings. Unsold and in progress stock weighed on cash flow volatility interest cover (CVIC), which declined to 1.1x in FY20 from 2.7x in FY2019[1]. As debt grows, interest payments are also forecast to increase, meaning SHLIC and CVIC will remain below historic strong levels, with an average of 1.3x and 1.8x, respectively, over the next two years. We however expect both ratios to improve from 2022.

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. 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, 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 particular, the sector is exposed to risks stemming from socially-driven policy agendas affecting social rents, benefits and capital grants in addition to the impact of demographic trends on demand which are captured in our assessment of the operating environment. We view the coronavirus outbreak as a social risk under our ESG framework given its impact on health and safety. Overall, we expect the outbreak to cause ongoing operational disruption for HAs but do not expect a material credit impact as higher arrears and lower market sales receipts will be offset by cash savings from reduced capital spending on development and repairs. HAs are also impacted by customer relations and product quality. The Grenfell fire tragedy in June 2017 has encouraged higher health and safety standards with many HAs planning on increasing spending on the quality of their existing stock.

Governance considerations are also material to Citizen's credit profile and are captured in our assessment of governance and management. In general, housing association governance is strong with multi-year strategies supported by detailed forecasts, conservative liquidity policies, and robust risk management including stress testing.

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 above the scorecard suggested BCA of baa2. We expect liquidity, interest coverage and operating margins to improve from FY2022.

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

Exhibit 3
2020 Scorecard

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%	28,132	a
Factor 3: Financial Performance			
Operating Margin	5%	21.8%	baa
Social Housing Letting Interest Coverage	10%	1.2x	baa
Cash-Flow Volatility Interest Coverage	10%	1.1x	baa
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	4.0x	baa
Debt to Assets	10%	47.3%	ba
Liquidity Coverage	10%	0.5x	baa
Factor 5: Management and Governance			
Financial Management	10%	baa	baa
Investment and Debt Management	10%	baa	baa
Suggested BCA			**baa2**

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

Source: Moody's Investors Service

Endnotes

1 At the end of August 2020, 40% of the unsold stock at FYE20 had been sold.

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