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CREDIT OPINION
25 October 2021

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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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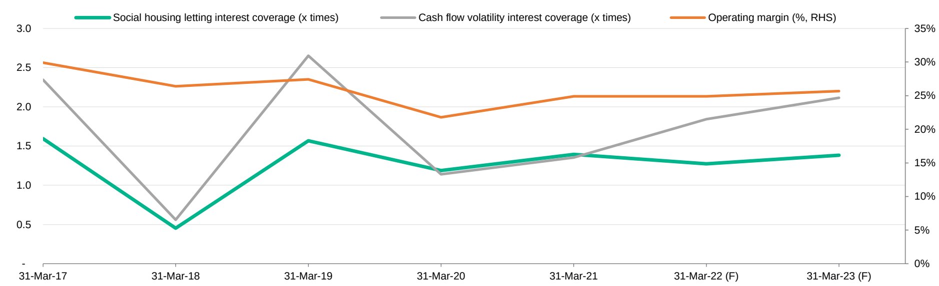
# Citizen Housing Group Limited (UK)

Update 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 as well as moderate but improving operating margins. 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 and operating margin are projected to slowly improve**




The projections for FY2022-23 have been calculated using Citizen's business plan.
*Source: Citizen Housing Group Limited, Moody's Investors Service*

## Credit Strengths

» Medium-sized association with a high proportion of turnover derived from low-risk social housing letting

» Moderate debt burden

» Supportive institutional framework in England

## Credit Challenges

» Projected increases in outright sales, albeit from a relatively low base

» Moderate, but improving, operating margins

## 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%; as well as 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; structural decline in efficiency, leading to a sustained weakening in the operating margin to below 25%; a material weakening in interest coverage; forecast sales not materialising, impacting debt-to-revenue and cash-flow volatility interest coverage (CVIC); 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-17 | 31-Mar-18 | 31-Mar-19 | 31-Mar-20 | 31-Mar-21 | 31-Mar-22 (F) | 31-Mar-23 (F) |
|---|---|---|---|---|---|---|---|
| Units under management (no.) | 27,883 | 27,886 | 27,956 | 28,132 | 28,452 | 29,105 | 29,811 |
| Operating margin, before interest (%) | 29.9 | 26.4 | 27.4 | 21.8 | 24.9 | 24.9 | 25.7 |
| Net capital expenditure as % turnover | 1.4 | 43.2 | 3.6 | 29.3 | 22.9 | 55.1 | 38.0 |
| Social housing letting interest coverage (x times) | 1.6 | 0.5 | 1.6 | 1.2 | 1.4 | 1.3 | 1.4 |
| Cash flow volatility interest coverage (x times) | 2.3 | 0.6 | 2.7 | 1.1 | 1.4 | 1.8 | 2.1 |
| Debt to revenues (x times) | 3.6 | 4.2 | 4.0 | 4.0 | 4.2 | 3.7 | 3.5 |
| Debt to assets at cost (%) | 43.6 | 48.4 | 46.9 | 47.3 | 48.0 | 49.7 | 51.3 |

The projections for FY2022-23 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

**Medium-sized association with a high proportion of turnover derived from low-risk social housing letting**

Citizen benefits from stability of revenue due to a high proportion of turnover coming from low-risk social housing letting. In FY2021, 85% of turnover was comprised of social housing lettings, slightly down from around 90% on average over the previous five years. We expect this proportion to rise above 85% over the medium term after dipping to 74% over FY2023-24 (see *Projected increases in outright sales, albeit from a relatively low base*).

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. Citizen's structure has simplified since the mergers, improving oversight of the organisation.

**Moderate debt burden**

Citizen's gearing and debt burden increased after it re-opened its 2042 bond in October 2019 issuing a further £100 million, with £135 million proceeds received in October 2020. At FYE2021, Citizen's total debt stood at £717 million, equivalent to 4.2x revenues and 48% of assets adjusted at cost, up from 4.0x and 47% at FYE2020. To finance new development plans, we expect debt will increase, with gearing increasing to 51% at FYE2023. Debt-to-revenue is expected to be volatile in the next few years as a result of a lumpy sales profile: it is forecast to fall to 3.6x on average over the next three years, before rising above 4x over the medium term, although this profile is contingent on market sales receipts being realised as planned.

Citizen's available liquidity, represented by cash, short-term investments and undrawn secured facilities, stood at £195 million at FYE2021. 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), was 1.1x, up from 0.7x at FYE2020 as a result of the bond proceeds received in October 2020. We anticipate that liquidity coverage will remain above 1x as we expect Citizen to replace facilities maturing in 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 18 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. 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 3,100 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 102 units[1] per year between FY2022-2024 before reducing below 50 on average over the following two years. This would be a significant increase from FY2021 when 27 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, reached £20 million, accounting for 11.9% of Citizen's FY2021 turnover, up from 3.9% in FY2020, and achieving a 23.9% margin. Citizen's revenue from market activities had been a small proportion of the total over the previous 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 continue to increase, to £29.6 million in FY2022, peaking at £50 million on average over FY2023-24 or 23% of turnover, before returning to an average of 11% of turnover over the following two years. 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. Citizen's development, however, tends to be of smaller scale and only around a quarter of planned units is committed.

**Moderate, but improving, operating margins**

Citizen's operating margin improved in FY2021, to 24.9% after dipping to 21.8% in FY2020, and will improve slowly over the next three years, reaching 25.8% on average. This is driven by stronger margins on social housing lettings as a result of rents having returned to CPI +1% annual increases. In addition, margins are supported by Citizen facing lower spending pressures related to fire safety and energy efficiency than peers. However, the higher outright and first tranche shared ownership sales volumes over 2022-24 are weighing on operating margin, as these tend to carry lower margins than social housing lettings; business plan assumptions for these are also below historically achieved margins.

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 FY2021, social housing letting interest cover (SHLIC) reached 1.4x, up from 1.2x in FY2020, and will continue to improve slowly over the medium term as margins on social housing lettings strengthen. Cash flow volatility interest cover (CVIC), grew to 1.4x in FY2021 from 1.1x in FY2020 as market sales revenue increased, and will also continue to rise over the next three years, averaging 2.1x over the period as a result of stronger margins on social housing letting and higher market sales revenue, although this is contingent on market sales receipts being realised as planned.

### 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 (Aa3 stable) 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. The sector is facing decarbonisation pressures to improve energy efficiency of its stock; however, Citizen is well positioned with 83% of its housing stock at or above EPC C as of September 2021.

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 affected 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 close 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 February 2020.

Exhibit 3
2021 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% | 28,452 | a |
| **Factor 3: Financial Performance** | | | |
| Operating Margin | 5% | 24.9% | baa |
| Social Housing Letting Interest Coverage | 10% | 1.4x | baa |
| Cash-Flow Volatility Interest Coverage | 10% | 1.4x | baa |
| **Factor 4: Debt and Liquidity** | | | |
| Debt to Revenue | 5% | 4.2x | ba |
| Debt to Assets | 10% | 48.0% | ba |
| Liquidity Coverage | 10% | 1.1x | a |
| **Factor 5: Management and Governance** | | | |
| Financial Management | 10% | baa | baa |
| Investment and Debt Management | 10% | baa | baa |
| **Suggested BCA** | | | **baa1** |

*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 Including joint ventures.

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