MOODY'S
PUBLIC SECTOR EUROPE

CREDIT OPINION
20 November 2017

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RATINGS

Genesis Housing Association

Domicile	United Kingdom
Long Term Rating	Baa2
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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Genesis Housing Association

Update to credit analysis

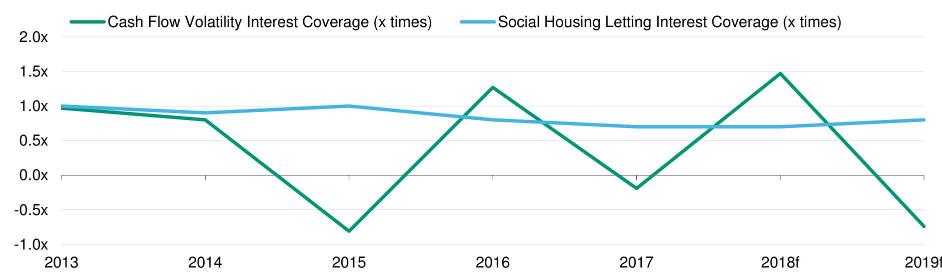
Summary Rating Rationale

The Baa2 issuer and debt ratings assigned to Genesis Housing Association (Genesis) reflect its (1) size as a large housing association operating in areas of high demand, (2) solid liquidity position, (3) weak interest cover ratios and volatile operating cash flows, (4) weak operating margin, and (5) expected increase in market sales activity.

In addition, ratings in the sector benefit 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 Genesis faces acute liquidity stress.

The entity is rated at the bottom of the Moody's-rated English housing associations, whose ratings span from A1 to Baa2. Genesis's relative position reflects its weak profitability and interest cover ratios, high debt burden and forecasted increase in market sales.

Exhibit 1
Genesis's interest cover ratios will remain weak
Cash flow volatility interest cover and social housing letting interest cover, FY2013 - FY2019



Note: FY2018-FY2019 are forecasts.
Source: Genesis, Moody's

Credit Strengths

» Large housing association operating in areas of high demand

» Moderate liquidity and robust stress testing

» Strong regulatory framework

Credit Challenges

» Weak interest cover ratios

» Forecasted increase in market sales exposure

» Relatively high debt burden

» Operating environment remains challenging but policy is more stable

Rating Outlook

The stable outlook on Genesis reflects the currently stable operating environment, which is unlikely to undergo further material change in the medium-term, and the stable outlook on the sovereign rating .

Recent Developments

On September 26th 2017, Genesis's rating was downgraded to Baa2 from Baa1 to reflect the close institutional, operational and financial linkages between the central government and UK housing associations (HAs), and the reduced financial resilience of the sovereign as captured by Moody's recent decision to downgrade the UK's sovereign rating to Aa2 from Aa1. The outlook has been changed to stable from negative to reflect the stable outlook on the sovereign rating, and the HA sector adapting well to a challenging policy environment, which is not expected to undergo further material change in the medium-term.

In July 2017, Genesis's board approved a merger with Notting Hill Housing Association (Notting Hill, A3, stable outlook) to form a new group, NottingHill Genesis. The two organisations share a similar geography and an ambitious growth strategy, but Notting Hill's credit profile is stronger due to the strength of its balance sheet with low gearing (debt to assets at cost), higher operating margin and slightly stronger interest cover ratios compared to Genesis as a standalone entity. The merger is expected to complete by Q1 FY2019. We will formally assess the credit implications of the merger closer to the merger date, once a board-approved merger business plan is in place.

The forecasts referenced in this report are based on Genesis as a standalone entity.

Factors that Could Lead to an Upgrade

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

» A sustained improvement in interest cover ratios

» An increase in operating margin, to levels sustained above 25%

» A reduction debt to revenues

Factors that Could Lead to a Downgrade

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

» A sustained reliance on market sales and/or other high-risk activities to cover interest costs while social housing letting interest coverage ratio structurally remains below 1.0x

» A material increase in debt

» A weakening in liquidity position

» A weaker regulatory framework, a dilution of the overall level of support from the UK government, or UK sovereign downgrade would also exert downward pressure

Key Indicators

Exhibit 2

Genesis Housing Association	31-Mar-13	31-Mar-14	31-Mar-15	31-Mar-16	31-Mar-17	31-Mar-18*	31-Mar-19*
Units under management (no.)	32,925	32,369	31,510	32,319	32,080	31,940	32,359
Operating margin, before interest (%)	20.4	24.4	24.0	19.2	20.0	20.8	19.1
Net capital expenditure as % turnover	16.0	44.8	62.7	-3.4	43.4	21.1	80.5
Social housing letting interest coverage (x times)	1.0	0.9	1.0	0.8	0.7	0.7	0.8
Cash flow volatility interest coverage (x times)	0.0	0.8	-0.8	1.3	-0.2	1.5	-0.7
Debt to revenues (x times)	4.8	5.3	5.3	4.5	5.8	5.0	5.3
Debt to assets at cost (%)	47.2	46.8	53.9	52.3	53.2	50.4	52.8

*FY2017 and FY2018 are forecasted figures. Note that FY2015 and onwards are prepared in FRS102 format while those before were prepared as per the old UK GAAP.

Detailed Rating Considerations

Genesis's Baa2 rating combines (1) a baseline credit assessment (BCA) of ba1 and (2) a strong likelihood of extraordinary support coming from the national government in the event that the entity faced acute liquidity stress.

Baseline Credit Assessment

Large housing association operating in areas of high demand

Genesis's credit quality benefits from its size as a large, London-based social landlord with housing stock under management of approximately 32,000 as of March 2017. Genesis operates across London and South East England in approximately 84 local authorities. Its size comes with enhanced political influence compared to smaller housing associations, which benefits Genesis in negotiations with local authorities as well as in bidding for development opportunities.

The demand for social housing in Genesis's areas of operation is generally high, with social housing rents only 39% of market rents on average. The gap between social and market rent is credit positive as it supports high demand for social housing stock as well as revenue flexibility should the organisation elect to increase its level of affordable rented housing and market rent.

Similar to many of its rated peers, Genesis is planning an increase in the number of new homes it builds. The 2015-2020 Corporate Strategy outlines a target of 5,000 homes built over the period. The current business plan includes 3,600 homes built over the next five years across a range of tenures included affordable rented housing, shared ownership, market rent and outright sales.

In order to fund the growth and minimise the need for additional borrowing, Genesis will average 150 fixed asset sales per year over the next five years as its properties become void. Cash proceeds from fixed asset sales (including disposals and staircasing) will average £100 million per year over the next three years, reducing Genesis's debt requirement. With only 21% of its development programme committed, Genesis has considerable flexibility to scale back or adapt its programme if external conditions deteriorate.

Moderate liquidity and robust stress testing

Genesis maintains a solid liquidity position in addition to an arrangement whereby it can sell units to LINQ, a property-owning vehicle, to generate cash if required. As of September 2017, Genesis held £221 million of immediately-available liquidity, consisting of £20 million of cash and £201 million of secured, available facilities. Together, immediately available liquidity covered 0.8x two years' forward-looking cash need.

Genesis has ample covenant headroom, expected to be maintained. In addition, its stress testing is robust covering numerous downside risks and scenarios including higher cost inflation, higher interest rates, increased bad debts, drops in market sales prices and delays in market sales. Downside risks are tested in isolation and combined scenarios. The most detrimental stress test is the unlikely impact of no market sales, which would result in a covenant breach in FY2022.

Genesis's liquidity policy is strong, calling for sufficient liquidity to cover the next 12 months' net cash requirement (inclusive of all cash inflows and outflows, including principal debt repayments). The policy accounts for entity-specific risks and as such, excludes 50% of property sales income and requires additional liquidity to cover a 50 bps adverse movement in the yield curve negatively affecting its mark-to-market position. In addition, Genesis only commits to development schemes once funding is secured.

Genesis also has access to a property owning vehicle, LINQ, which enables the association to sell assets with relative ease to generate cash if required. The investment vehicle enables suitable units to be sold at a 50-year market rent investment value. The option of selling a large portion of units to LINQ is credit positive as it provides Genesis with financial flexibility and a viable exit strategy if economic circumstances change. Our view is that access to LINQ partially mitigates Genesis's exposure to market sales.

Strong regulatory framework

The sector's credit quality will continue to benefit from the strong regulatory framework and oversight by the Homes and Communities Agency (HCA). The HCA maintains strong oversight through quarterly returns, long-term business plans, annual reviews, and undertaking In-Depth Assessments of entities where deemed necessary. Additionally, the HCA has powers to make board member and manager appointments where there has been a breach of Regulatory Standards . From October 2017, the HCA will charge fees for social housing regulation, as a means of enhancing the independence and maintaining the effectiveness of the regulator.

Weak interest cover ratios

Genesis's interest cover ratios will remain weak relative to peers, a credit negative. Social housing lettings interest cover (SHLIC) was 0.7x in FY2017, down slightly from 0.8x the year before compared to a rated peer median of 1.3x. The SHLIC measures the ability of surpluses from Genesis's low-risk social housing rental business to cover its cash interest expense. Genesis's SHLIC is expected to remain below the rated peer median and below 1.0x over the next three years, averaging 0.8x.

Genesis's cash flow volatility interest cover (CVIC) is also weak relative to peers and expected to remain weak and volatile over the next three years. Genesis's CVIC stood at -0.2x in FY2017, down from 1.3x in FY2016 compared to a rated peer median of 1.7x. The negative CVIC makes Genesis an outlier among rated peers.

The weak CVIC results from volatile cash flows from operations (CFO), which have ranged from £-4.2 million in FY2015 to £182 million in FY2016. The volatile cash flows are caused by cash movements associated with market sales activity, either in the investment phase or as sales receipts are realised. Going forward, CFO will remain volatile, ranging from £16 million in FY2019 to £148 million in FY2018 resulting in CVIC ranging from -0.7x in FY2019 to 1.5x in FY2018.

Moody's acknowledges that a majority of Genesis's development and market sales pipeline is uncommitted and CVIC would improve substantially if the uncommitted pipeline is not initiated.

Forecasted increase in market sales exposure

Genesis is forecasting an increase in market sales activity, a credit negative. Market sales, which include outright sales and first tranche shared ownership, accounted for only 4% of Genesis's FY2017 turnover, down from 23% in FY2016. Market sales turnover is expected to increase substantially over the next three years, reaching 38% of turnover in FY2020, a level deemed high (>20% of turnover) by Moody's. The high level of exposure to market sales activity makes Genesis's cash flows more susceptible to the cyclical property market.

Genesis is an experienced developer with a track record of market sales activity. Its market sales have performed well in the past, with an average margin on market sales over the last three years of 17%. The association expect stronger performance going forward, with an average forecasted margin on market sales of 24% over the next three years. Despite Genesis's experience, the projected margins may be difficult to achieve given weaker economic conditions, with house prices slowing in London.

Genesis's overall profitability is weak relative to peers which negatively impacts its coverage ratios. Its operating margin was 20% in FY2017, 10 percentage points lower than the rated peer median of 30%. The operating margin is expected to remain weak going forward, averaging 21% over the next three years.

Relatively high debt burden

Genesis's debt burden, as measured by debt to revenues, is high compared to rated peers. Debt to revenues was 5.8x in FY2017 compared to a rated peer median of 4.0x, up from 4.5x in FY2016.

Genesis's debt stood at £1.5 billion at year end 2017. The current business plan projects debt growing slowly in the next couple years, reaching £1.6 billion in FY2019. Growth in revenues will outpace growth in debt resulting in an improved debt to revenues position of 5.3x in FY2019, although the debt burden will remain high relative to peers. Genesis's gearing of 53% in FY2017 was also high relative to the rated peer median but is expected to remain stable at that level over the next couple years.

In addition to the high debt burden, Genesis's interest rate exposure is higher than rated peers. As of August 2017, 41% of Genesis's debt was held at floating rates, well above the rated peer median of 17%. The association's LIBOR assumptions are realistic and assume a steady rise in rates from 1.1% in FY2018 to 1.7% in FY2020. If rates increase more quickly than anticipated, there could be downward pressure on already weak interest cover ratios.

As of September 2017, Genesis had a negative mark-to-market position on its standalone swaps of £111 million. However, the risk is mitigated by overcollateralisation of £83 million through a combination of unsecured thresholds, secured property and cash. In addition, as of year end Genesis has sufficient unencumbered assets with an equivalent borrowing value of £402 million.

Operating environment remains challenging but policy is more stable

Moody's does not expect additional material adverse policy shifts for the sector and considers the operating environment to be stable in the medium term. Adverse policies announced in the last few years will continue to negatively impact revenues, especially the effects of the 1% annual decrease in social rents (until FY2020) and Universal Credit (a pillar of broader welfare reform measures). However, HAs have demonstrated resilience to adverse policies to date and been proactive to mitigate the impact. A reduction of capital grant for new social housing over the last five years has led to increased exposure to market sales activity, which has more than doubled since 2012 to reach 17% of turnover for Moody's rated HAs in FY2016. Credit risk association with exposure to market sales is incorporated in BCAs.

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 (Aa2 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 Genesis and the UK government reflects their strong financial and operational linkages.

Rating Methodology

European Social Housing Providers, July 2016 (190944)

Government Related Issuers, August 2017 (1047378)

Ratings

Exhibit 3

Category	Moody's Rating
GENESIS HOUSING ASSOCIATION	
Outlook	Stable
Issuer Rating -Dom Curr	Baa2
GENFINANCE II PLC	
Outlook	Stable
Senior Secured -Dom Curr	Baa2

Source: Moody's Investors Service

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