

ISSUER IN-DEPTH

June 11, 2015

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RATINGS

Poplar HARCA

LT Issuer Rating - Dom Curr Outlook	A3 Stable
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Poplar HARCA Capital Plc

Senior Secured - Dom Curr	A3
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Source: Moody's

KEY METRICS

	31/3/12	31/3/13	31/3/14
Units Under Management	8,707	8,830	9,059
Operating margin, before interest (%)	12.4	6.8	17.6
Net capital expenditure as % turnover	134.9	61.4	62.9
Social housing letting interest coverage (x times)	1.3	0.9	0.6
Recurrent cash interest coverage (x times)	2.1	1.8	1.0
Debt to revenues (x times)	4.9	4.8	5.1

Excluding one-off breakage costs, the social housing letting interest coverage would have reached 0.9x and the recurrent cash interest coverage 1.6x in FY2014.

Source: Moody's.

Table of Contents

WHY DID THE REGULATOR LOWER POPLAR HARCA'S VIABILITY RATING?	1
POPLAR SEEKS RENT SURCHARGE EXEMPTION	2
WHY IS MOODY'S RATING OF POPLAR HARCA UNCHANGED, DESPITE THE REGULATORY DOWNGRADE?	2
WHAT COULD PROMPT MOODY'S TO RECONSIDER POPLAR'S RATING OR OUTLOOK?	3
MOODY'S RELATED RESEARCH	4

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English Housing Associations

Poplar HARCA's Credit Rating Unaffected by Regulatory Downgrade

On 29 April 2015, the Homes and Communities Agency (HCA), the English Housing Association sector's regulator, cut Poplar HARCA Limited's (Poplar) financial viability rating to V2 from the best possible ranking of V1 (on a scale from V1 to V4). The downgrade reflected the HCA's view that while Poplar's meets viability requirements, its business plan provides minimal headroom against lenders' covenants, and that this will need to be managed to support continued compliance. While the HCA's viability ratings inform Moody's analysis, we follow our own methodology in gauging housing associations' financial position. We maintain Poplar's A3 credit rating and its stable outlook, as its limited covenant headroom compared to rated peers is already captured in our forward-looking assessment. This report aims to address frequently asked questions on how the regulatory downgrade affects our view of Poplar's creditworthiness.

Why did the regulator lower Poplar HARCA's viability rating?

The HCA lowered Poplar's rating following a periodic review of its financial viability, including an evaluation of its business plan. The regulator deemed that Poplar's base case business plan provides limited headroom against lenders' covenants, restricting its ability to manage adverse business scenarios. The HCA also took the view that Poplar will need to obtain an extension of its partial waiver from the sector's rent-setting rules (see highlight box) if the association is to achieve the financial results projected in its business plan.

Poplar seeks rent surcharge exemption

Poplar has applied to the HCA to continue imposing a £2-a-week rental surcharge after the right to do so is withdrawn for the sector as a whole in FY 2016. The surcharge was originally designed to compensate HAs whose rents fall below the targeted level for their area. Poplar has obtained permission to keep applying it in FY 2016, and is waiting for a decision regarding subsequent years. The association has kept the assumption of the +£2 a week increase in its long-term projections.

Not receiving the exemption would have a negative impact on Poplar's capacity to deliver projected results. The association's business plan also indicates that if the exemption is not extended beyond 2016, its already limited interest cover covenant headroom will deteriorate, as shown in Exhibit 1. Stress tests carried out by Poplar show that without mitigating action, the association would breach its interest cover covenant in FY2021, and have very limited headroom in FY2018.

The withdrawal of the £2 weekly surcharge formed part of a wider overhaul of the HA rent-setting regime under which the Consumer Price Index (CPI) measure of inflation replaced the Retail Price Index (RPI) as the benchmark for annual rate increases from April 2015.

What is the likelihood of the regulator lowering Poplar's viability rating further?

A comparison of Poplar's current financial position with the regulator's definition of a V3 viability rating suggests that a further downgrade is unlikely in the short to medium term. Poplar has also agreed with the regulator to identify potential savings that could help it adapt to the new rent-setting regime. This is likely to prevent a further deterioration of its current covenant headroom.

According to the HCA's definition, the regulator applies a V3 rating when "the provider does not meet our viability requirements. There are issues of serious regulatory concern and in agreement with us, the provider is working to improve its position."

A V3 rating generally means that the regulator becomes more directly involved in the association's day-to-day operations in order to help restore it to financial health.

As of 31 May, Poplar was one of just three housing associations within Moody's 44-strong rated portfolio to hold a V2 viability rating from the HCA, with the remainder all ranked at V1.

Why is Moody's rating of Poplar HARCA unchanged, despite the regulatory downgrade?

Poplar currently sits at the low end of the narrow Aa3-A3 range assigned to Moody's-rated English housing associations. Since our assessment is informed by a regular review of multiyear business plans, Poplar's projected proximity to its financial covenants is already incorporated in the rating.

We do not consider it prudent to factor unconfirmed rent increases into the base case business plan. However, we believe Poplar's other business plan assumptions are sensible, and could provide a platform for outperforming projected financial results.

For example, the association's latest business plan from March 2015 conservatively assumes a 3-month London Interbank Offered Rate (LIBOR) of 1.25% in FY2016, rising to 5% by FY2020. This compares with current 3-month LIBOR of around 0.5%, and is broadly in line with the assumptions of Poplar's rated peers. LIBOR influences housing associations' variable debt repayment costs.

Poplar also prudently assumes an above-inflation increase in payroll costs (Consumer Price Index +0.5%), that house prices will increase only in line with CPI, and that voids and bad debts will rise to 2.9% of gross rental income in FY2016 and beyond, up from an average of just 1.4% over FY2010-14.

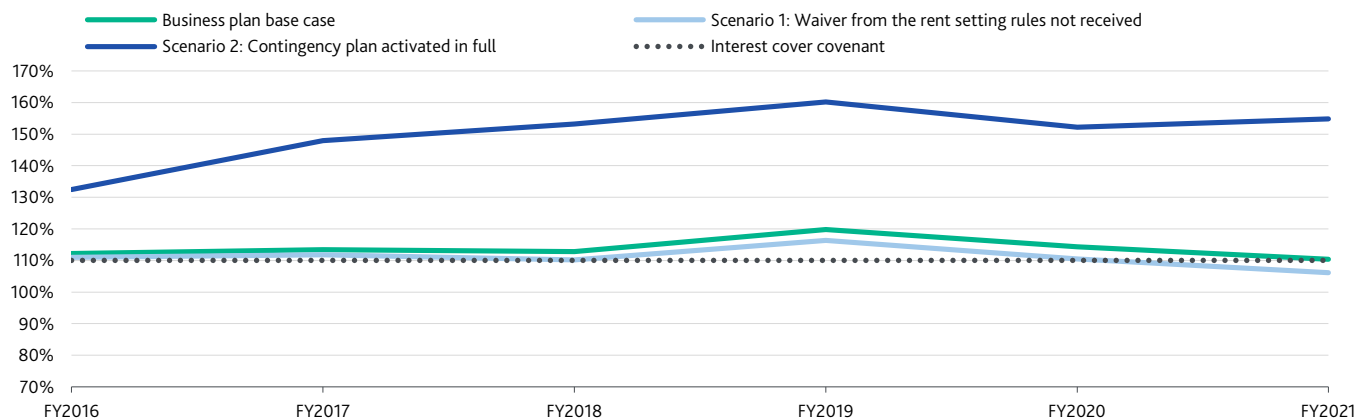
This publication does not announce a credit rating action. For any credit ratings referenced in this publication, please see the ratings tab on the issuer/entity page on www.moodys.com for the most updated credit rating action information and rating history.

Poplar's business plan is also relatively cautious regarding the projected timing of cashflows from market rent and sale activities, with management confirming that targets in the FY2016 budget will be outperformed.

EXHIBIT 1

Forecasted covenant headroom will remain limited even if the rent waiver is received

Interest cover as per Poplar's bank covenants, FY2016-FY2021



Source: Poplar HARCA, Moody's

Poplar is finalising a detailed contingency plan that would generate additional savings of up to £2.8 million in FY 2016, rising to £8.1 million in FY 2020, in case of financial stress. The savings, which are not included in the association's business plan, would be achieved by reducing or deferring expenditure. These additional savings would counterbalance even the worst case scenario built into Poplar's stress tests.

What could prompt Moody's to reconsider Poplar's rating or outlook?

Poplar expects to receive a decision by September 2015 regarding the proposed extension of the rent surcharge beyond FY 2016. Should the extension be refused, we will closely monitor Poplar's ability to cope with the adverse impact this would have on its financial position. Failure to maintain a satisfactory financial performance and covenant compliance could exert downward pressure on its rating. One or a combination of the following developments could also inflict negative pressure on the rating: (1) inability to deliver the improvement in operating margins outlined in the latest business plan; (2) higher-than-projected debt levels, resulting in depletion of unencumbered assets; (3) gradual weakening of interest coverage ratios; (4) erosion of Poplar's currently adequate liquidity position.

Moody's Related Research

Credit Opinion:

- » [Poplar Harca Ltd](#)

Issuer-In-Depth:

- » [English Housing Associations: Circle's A2 Rating Intact Despite Regulatory Downgrade, May 2015 \(1004894\)](#)

Sector Comments:

- » [2014 Results: Operating performance strengthens despite drop in interest coverage, May 2015 \(181194\)](#)
- » [Levelling the Playing Field – Maturing LSVTs match credit strength of traditional HAs, March 2015 \(1003511\)](#)
- » [English Housing Associations: Proposed New Regulatory Framework Keeps Pace with Sector Risks, a Credit Positive, February 2015 \(1002469\)](#)
- » [English Housing Associations: Unexpectedly low inflation limits future rent increases and erodes margins, a credit negative, December 2014 \(1001357\)](#)
- » [English Housing Association's Liquidity Trouble Is Credit Negative for the Sector, October 2014 \(176343\)](#)
- » [English Housing Associations: Welfare reform still a credit risk despite early resilience, September 2014 \(175125\)](#)
- » [English Housing Associations: Financial Disintermediation - A One Way Trip, July 2014 \(173505\)](#)
- » [English Housing Associations: Implementation of "Lessons Learned" from Cosmopolitan Would Be Credit Positive, June 2014 \(172097\)](#)
- » [English Housing Associations: Mergers Promise Credit Gains, but Execution is Risky, March 2014 \(165825\)](#)
- » [FAQ: Variable Rate Debt and Swaps in English Housing Associations, May 2014 \(170744\)](#)
- » [All that glitters is not gold - English Housing Associations and Outright Market Sales, May 2014 \(170865\)](#)
- » [English Housing Associations in FY2013: Resilient Results In A Challenging Operating Environment, February 2014 \(165197\)](#)

Special Comments:

- » [UK Public Sector: Social Investment Provides New Funding Opportunity as Austerity Bites, May 2015 \(180998\)](#)
- » [European Public Sector: Issuers in Core Europe to Increasingly Tap Capital Markets As New Funding Opportunities, May 2015 \(181148\)](#)

Market Outlooks:

- » [2015 Outlook English Housing Associations, December 2014 \(177979\)](#)

Rating Methodology:

- » [English Housing Associations, October 2013 \(156878\)](#)

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