MOODY'S
PUBLIC SECTOR EUROPE

CREDIT OPINION
23 October 2020

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RATINGS

Poplar HARCA

Domicile	United Kingdom
Long Term Rating	Baa1
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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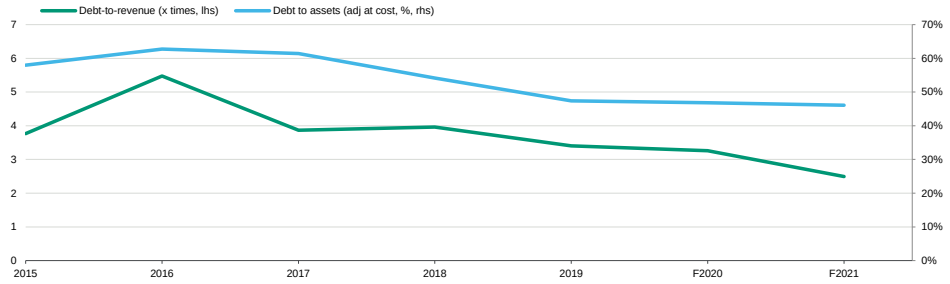
Poplar HARCA (United Kingdom)

Update following affirmation of Baa1 stable

Summary

The credit profile of Poplar HARCA Ltd (Poplar, Baa1 stable) reflects its strengthened governance and management, strong liquidity, and improving debt metrics. The rating also reflects its weak operating performance, low social housing lettings interest cover, and high level of exposure to market sales through joint ventures. In addition, the rating benefits the strong regulatory framework governing English housing associations and our assessment that there is a strong likelihood that the government of the United Kingdom (UK, Aa3 stable) would intervene in the event that Poplar faced acute liquidity stress.

Exhibit 1
Debt to revenues and gearing will continue to improve
Debt to revenues and gearing (debt to assets at cost), fiscal 2015-2021



The projections for FY2020-21 have been calculated using Poplar's 2019 business plan.
Source: Poplar HARCA, Moody's Investors Service

Credit strengths

» Improved financial management embedded in the organisation, higher covenant headroom

» Very strong liquidity, stable debt and improving debt metrics

» Supportive institutional framework in England

Credit challenges

» Weak operating performance and low interest cover ratios

» High exposure to market sales through joint ventures, reduced surplus forecasts

Rating outlook

The stable outlook on Poplar balances its weaker operating performance and significant market sales exposure with its strengthening balance sheet, improved governance and management and very strong liquidity.

Factors that could lead to an upgrade

An upgrade to Poplar's rating could result from an operating margin sustained near 30% leading to higher surpluses and interest cover ratios, further strengthening in governance and management evidenced by more conservative financial policies, and a material reduction in market sales exposure leading to more stable cash flows.

Factors that could lead to a downgrade

Given Poplar's very weak performance on the core social housing business, a further deterioration of profitability could exert negative pressure on the rating in addition to a material increase in borrowing or weaker liquidity to mitigate volatile market sales cash flows. Lastly, a weaker regulatory framework or a dilution of overall level of support from the UK government could exert negative pressure on the rating.

Key indicators

Poplar HARCA	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.)	8,757	9,141	8,903	9,382	9,485	9,940	10,096
Operating margin, before interest (%)	21.7	18.5	24.3	25.0	31.3	14.6	12.3
Net capital expenditure as % turnover	15.2	18.6	14.1	16.0	11.8	38.3	8.1
Social housing letting interest coverage (x times)	0.9	1.0	0.8	1.0	0.6	0.5	0.5
Cash flow volatility interest coverage (x times)	0.9	1.5	1.5	1.3	2.0	0.8	1.4
Debt to revenues (x times)	3.8	5.5	3.9	4.0	3.4	3.3	2.5
Debt to assets at cost (%)	57.9	62.8	61.4	54.2	47.4	46.8	46.1

The projections for FY2020-21 have been calculated using Poplar's 2019 business plan.
Source: Moody's Investors Service, Poplar HARCA

Detailed credit considerations

On 21 October 2020, Moody's affirmed Poplar'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.

The credit profile of Poplar HARCA, as expressed in the Baa1 stable rating combines (1) its baseline credit assessment (BCA) of baa3, and (2) strong likelihood of extraordinary support coming from the UK government in the event that Poplar faced acute liquidity distress.

Baseline credit assessment

Improved financial management embedded in the organisation, higher covenant headroom

Poplar's governance and management have improved over the last couple years resulting in an enhanced focus on financial resilience. Implemented in fiscal 2017, its defined Financial Control Framework has been embedded and outlines targets for interest cover (as defined by its covenant), debt level, exposure to market sales and liquidity. While some of the target levels are not as conservative as peers (for example, market sales <50% of turnover), the commitment to operate within defined risk parameters is credit positive.

Poplar's governance and financial viability have improved from a low point of minimal covenant headroom in fiscal 2015, when the business plan projected the group's interest cover covenant to be as low as 1.12x against a 1.1x covenant. In the 2019 business plan[1], the group forecasts its covenant interest cover ratio to remain above 1.35x (as outlined in the Financial Control Framework) against

a covenant of 1.1x. In addition, the organisation has a track record of outperforming budgets. In fiscal 2019, Poplar's profitability was higher than forecasted and debt was lower.

The 2019 business plan was put through stress test scenarios specifically tailored for Poplar's risk profile, including a 33% drop in house prices, a 12-month delay in shared ownership sales, and no profits from its outright sales which shows the association retaining headroom to its interest cover covenant, albeit limited, especially in fiscal 2021. The business plan also includes credible mitigating actions to restore financial viability.

In addition to the Financial Control Framework, the organisation has implemented its Resourcing the Vision strategy, which outlines five objectives for improving its financial position, including ongoing efficiency savings and disposing of uneconomic properties. The group has reduced budgeted costs, however, we note there was a material increase in costs on its social housing in fiscal 2019 so effective cost control remains a challenge.

Very strong liquidity, stable debt and improving debt metrics

Poplar is expected to maintain very strong liquidity which partially mitigates risks associated with its high market sales exposure and associated cash flow volatility. As of September 2019, Poplar held £74 million of immediately-available liquidity. The liquidity position is expected to remain strong relative to Poplar's forward-looking cash need with liquidity coverage remaining near 3.0x over the next two years. Forecasted liquidity coverage is among the highest of rated housing associations.

Poplar's liquidity policy is in line with peers and calls for sufficient liquidity to cover 18 months' cash flow including all contracted commitments and loan repayments. As of September 2019, the value of Poplar's unencumbered assets which could be used to source additional liquidity is £96 million, a strong increase compared to £53 million three years ago (on Existing Use Value for Social Housing basis). In October 2020, Poplar reopened its 2043 bond, issuing a further £110 million, a portion of which was retained.

In its 2019 business plan, Poplar's debt was expected to remain stable over the next three years. Debt (inclusive of finance lease) stood at £272 million in fiscal 2019, to remain near £270 million over the medium term as the association had no plans for additional borrowing. While debt will remain stable, Poplar's turnover and reserves are expected to grow resulting in strengthened debt metrics, according to its 2019 business plan. Gearing will continue its downward trend reaching 45% by fiscal 2022, down from a peak of 63% in fiscal 2016 and 47% in fiscal 2019. The historically high gearing is partially attributable to the organisation's history as a Large Scale Voluntary Transfer (LSVT) housing association.

Debt to revenues was strong in fiscal 2019 at 3.4x compared to a rated peer median of 4.1x (fiscal 2019) and is expected to strengthen further reaching a low of 2.5x in fiscal 2021, although this performance is contingent on market sales receipts being realised as planned. However, debt to revenues is expected to remain strong relative to peers irrespective of market sales receipts.

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 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.

Weak operating performance and low interest cover ratios

Poplar's operating margin is expected to remain below rated peer medians, a key credit challenge. The ratio stood at 31% in fiscal 2019 boosted by a one-off overage receipt of £14.3 million but is expected to deteriorate from fiscal 2020, averaging 16% over the next three years compared to a rated peer median of 29% (fiscal 2019).

Poplar's weak operating margin is primarily driven by weak performance on its core social housing lettings, for which the group reported an operating margin of 17% in fiscal 2019 compared to a rated peer median of 34% (fiscal 2019). Profitability on the core business is expected to remain very weak compared to peers, averaging 15% over the next three years. The low margin on social housing is due to higher management, maintenance and major repairs expense compared to peers. The group's social housing cost per unit increased by 23% to £4,873 in fiscal 2019, up from £3,955 the year before. The drivers for the increase during the year were higher spend on fire and electrical safety and the reinstatement of an in-house police team.

A combination of higher costs, disposing of uneconomic social housing, and voids as a result of regeneration has diminished surpluses and interest cover ratios. The group's surplus from social housing lettings dropped to £8 million in fiscal 2019 from £13 million the year before. Poplar's social housing lettings interest cover (SHLIC) ratio was the weakest among rated peers at 0.6x in fiscal 2019 and is expected to remain near 0.5x over the next three years.

An additional driver of the reducing surpluses from social housing lettings is the group's strategy to convert general needs units to a Local Housing Allowance (LHA) tenure after refurbishment for which the group can charge higher rents. Poplar obtained regulator consent to convert some of its social housing and plans to convert 300 units over five years. While the LHA tenure has similar characteristics as other SHL tenures, it doesn't not meet Moody's strict definition of SHL and we do not include it in our SHLIC ratio. The metric would not be significantly improved if it were included. However, we do recognise the turnover is relatively predictable and stable, being funded by the local authority.

Poplar's cash flow volatility interest cover (CVIC) ratio was strong at 2.1x in fiscal 2019 compared to the rated peer median of 1.6x. However, due to weakened profitability on the core business and volatile market sales cash flows, the metric is expected to weaken going forward, with a low of 0.8x expected in fiscal 2020 before recovering to 1.4x in fiscal 2021.

High exposure to market sales in joint ventures, reduced surplus forecasts

Poplar has a high exposure to market sales over the next two years concentrated in two key regeneration projects, which constrains its credit quality. Mitigating the high exposure are Poplar's strong liquidity, targeted stress testing, and political support for the regeneration schemes.

As of December 2019, Poplar had £12 million of investment in two 50% owned joint ventures formed with different developers for key regeneration projects. Aberfeldy New Village LLP was set up with development company Eco World to undertake a large regeneration of the Aberfeldy Estate, with delivery of around 1,200 new housing units over 10 years. Phase 3 of 6 is currently on site and will deliver 344 units. As of September 2019, Phase 3A which includes 82 private sales was completed, with 95% of sales completed, exchanged or reserved and only four unsold units available. Phase 3B started on site in August 2019. As of December 2019, off-plan sales had been progressing well, with 31 of 180 homes for sale exchanged.

Works on the other JV, Balfron Tower Developments LLP, started in 2017 with and initial investment of over £8 million. The Balfron Tower is a historically significant building built in 1967, with Grade II listed status for its brutalist architecture. The project will preserve and restore approximately 150 flats for private sale, which are expected to be delivered in 2021. Costs had increased on Balfron Tower which will negatively impact the overall profitability of the project, although the group is still forecasting a small surplus on the project.

Although it is contained within the JVs, the resulting large exposure to market sales makes Poplar vulnerable to the cyclicality of the housing market. This is particularly the case because open market sales will average 28% of turnover over the next three years and peak at 44% of turnover in fiscal 2021 with the completion of the Balfron Tower, according to its 2019 business plan.

Despite the mitigations put in place by Poplar, this remains a key risk for the association. We note that projections on sales margins are below historical performance, appear prudent and have been stress tested. The JVs are structured in phases that Poplar can delay,

and the association developed a robust mitigation plan in case of underperformance or delayed profits, but these actions could only partially smooth the impact of underperforming or delayed market sales on cash flows.

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 (HA) and the UK government reflects their strong financial and operational linkages.

ESG considerations

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

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

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

Social considerations are material to Poplar'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 material to Poplar's credit profile. Poplar's management and governance has strengthened of late as outlined in the main body of the report. English housing associations also benefit from a strong regulatory framework and close oversight by the Regulator of Social Housing, as detailed within the main body of this report.

Further details are provided in the "Baseline credit assessment" 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 is baa3 compared to the scorecard-suggested BCA of baa2 for FY2019. An expected drop in SHLIC and rising exposure to market sales underpin the one-notch difference.

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

2019 Scorecard

Poplar HARCA			
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%	9,485	baa
Factor 3: Financial Performance			
Operating Margin	5%	31.3%	a
Social Housing Letting Interest Coverage	10%	0.6x	b
Cash-Flow Volatility Interest Coverage	10%	2.0x	a
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	3.4x	baa
Debt to Assets	10%	47.4%	ba
Liquidity Coverage	10%	1.8x	a
Factor 5: Management and Governance			
Financial Management	10%	ba	ba
Investment and Debt Management	10%	ba	ba
Suggested BCA			**baa2**

Source: Moody's Investors Service, Poplar HARCA

Ratings

Exhibit 4

Category	Moody's Rating
POPLAR HARCA	
Outlook	Stable
Issuer Rating -Dom Curr	Baa1
POPLAR HARCA CAPITAL PLC	
Outlook	Stable
Senior Secured -Dom Curr	Baa1

Source: Moody's Investors Service

Endnotes

1 All projections presented in this document are based on the 2019 business plan.

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