MOODY'S
PUBLIC SECTOR EUROPE

CREDIT OPINION
13 January 2021

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RATINGS

Alliance Homes Group

Domicile	United Kingdom
Long Term Rating	A1
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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Alliance Homes Group

Update to credit analysis

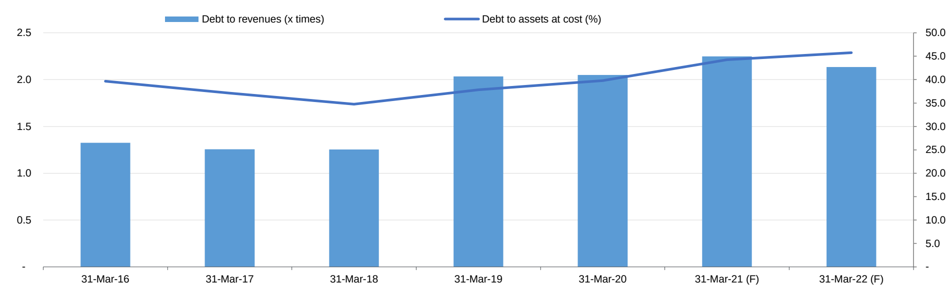
Summary

The credit profile of Alliance Homes Group (Alliance, A1 stable) reflects its strong interest cover ratios, low debt to revenues, straightforward debt profile, and growing risk appetite which will result in increased debt and development risk. Alliance also benefits from the strong regulatory framework governing the English housing association sector and our assessment that there is a strong likelihood the government of the United Kingdom (Aa3 stable) would intervene in the event it faced acute liquidity distress.

Exhibit 1

Gearing will increase to support the group's development programme

Debt to revenues (x times) and gearing (debt to assets at cost, %) FY2016-FY2022



Source: Alliance Financial Statements, Moody's forecasts, F=Forecast

Credit strengths

» Very strong interest cover ratios

» Low debt to revenues, simple debt profile and strong unencumbered assets position

» Strong governance and management with clear strategy

» Supportive institutional framework in England

Credit challenges

» Weak profitability

» Increased debt to support new strategy, higher development risk

Rating outlook

The stable outlook on Alliance reflects our expectation that strategy will remain stable, focused on social housing and communities, with limited diversification. The stable outlook also reflects the stable operating and policy environment for English housing associations.

Factors that could lead to an upgrade

Upwards pressure on Alliance's rating would result from a combination of the following key factors: 1) improved operating margin sustained above 35%, 2) reduced gearing (debt to assets at cost) sustained below 40%, 3) market sales exposure sustained at low levels (<5% of turnover), and/or 4) stronger than projected liquidity, with liquidity coverage remaining above 1.5x.

Factors that could lead to a downgrade

One or a combination of the following key factors would result in downward pressure on Alliance's rating: 1) a deterioration in liquidity beyond levels expected in the business plan, 2) a material increase in borrowing pushing gearing above 50%, 3) increased market sales exposure and/or 4) further scaling up of development risk and capital expenditure. In addition, a weaker regulatory framework or a dilution of overall support for the sector could also exert downward pressure.

Key indicators

Exhibit 2

Alliance Homes Group

	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.)	6,367	6,426	6,488	6,610	6,662	6,679	6,895
Operating margin, before interest (%)	25.9	24.8	20.7	25.3	21.5	22.6	22.2
Net capital expenditure as % turnover	3.6	(1.6)	7.4	23.5	21.0	62.2	30.8
Social housing letting interest coverage (x times)	7.8	8.0	7.1	0.9	2.4	2.2	2.2
Cash flow volatility interest coverage (x times)	8.6	8.4	9.6	1.6	4.9	4.6	5.0
Debt to revenues (x times)	1.3	1.3	1.3	2.0	2.0	2.2	2.1
Debt to assets at cost (%)	39.7	37.1	34.8	37.8	39.8	44.2	45.8

Source: Moody's, Alliance

Detailed credit considerations

The credit profile of Alliance, as expressed in the A1 stable rating, combines (1) a baseline credit assessment (BCA) for the entity of a2 and (2) a strong likelihood of extraordinary support coming from the UK government in the event that the entity faces acute liquidity distress.

Very strong interest cover ratios

Alliance's interest cover ratios are expected to remain strong compared to Moody's rated English housing associations (HAs). After fiscal 2019, when the group's social housing lettings interest cover (SHLIC) dropped to 0.9x due to a one-off breakage cost of £6.9 million, SHLIC improved to 2.4x in fiscal 2020. Even though this is well below historically strong performance of minimum 7x between fiscal 2015-18, the ratio is expected to average 2.5x over the next three years, slightly above the rated peer median of 2.4x (fiscal 2019).

The weakening of the metric is due to Alliance's weakening operating performance and increasing interest cost, which doubled between 2018 and 2020, and will climb further to £3.5m by fiscal 2023. The growing interest costs reflects the group's 2019 decision to materially scale up its development programme and increasing debt to fund growth.

Alliance's cash flow volatility interest cover (CVIC) was at 4.9x for fiscal 2020 and is projected to remain among the strongest of UK-rated peers, averaging 4.3x over the next three years, above rated peer median of 2.5x (fiscal 2019).

Low debt to revenues, simple debt profile and strong unencumbered assets position

Alliance will retain its low debt to revenues ratio despite plans for additional borrowing over the next few years to fund growth. Debt to revenues remained unchanged at 2.0x in fiscal 2020. The ratio is expected to remain stable and among the strongest of UK-rated peers, averaging 2.2x over the next three years.

Alliance refinanced its debt over 2019, replacing a legacy bank loan with a private placement of £90 million and a revolving credit facility (RCF) of £45 million. The key objectives of the refinancing were to obtain additional funding to support its corporate strategy ("Plan A"), which includes an increase in development, to remove restrictions linked to the legacy bank loan, and to release security.

Post refinancing, Alliance has retained its straightforward debt profile, ample covenant headroom, and strong unencumbered assets. Alliance's unencumbered assets position of £182 million as at 30 September 2020 is strong relative to future borrowing needs.

Alliance's balance sheet strength weakened following the increase in debt in fiscal 2019; gearing (debt to assets) reached 40% in fiscal 2020 from 38% the year before, and will weaken further to 46% by fiscal 2022 as the group continues to draw down debt to fund development.

Liquidity coverage further strengthened in fiscal 2020 and reached 1.9x at the end of September 2020 due to £45m of secured, undrawn facilities and a strong cash balance of £34.8m. The ratio is expected to remain stable averaging 1.4x over the next three years. Alliance's liquidity policy calls for cash and facilities to cover 18 months' cash need (net operating cash flow plus committed and Board-approved schemes) in addition to a minimum of £8 million of cash as a Golden Rule.

Strong governance and management with clear strategy

Alliance demonstrates strong governance and management for its size, including a well-defined strategy, strong financial controls and comprehensive risk management. The organisation has undergone a significant transformation over the last couple of years following the appointment of a new CEO and executive team and the adoption of the new corporate plan for 2017-2022, "Plan A". "Plan A" is a departure from previous strategy in that it is more ambitious for delivery of new homes, with a goal of delivering 2,000 new homes in ten years. Despite the increased development, Alliance will retain a focus on providing social housing and improving services for customers.

Alliance has adapted its risk management in light of the increased ambition as part of its revised strategy. The Board adopted financial 'Golden Rules' as part of the new strategy which include internal targets and limits, such as a maximum on outright sales exposure of 25% of turnover and a minimum liquidity balance set in relation to its development cash flow exposure. The combination of a clear five-year strategy and Golden Rules result in a defined decision-making framework and strategic predictability. Moreover, the group has adapted its plans to incorporate pandemic risks, for example by adjusting its macroeconomic and voids and bad debts assumptions.

Risk awareness and management is embedded throughout the organisation and risk reporting is clear and comprehensive. In particular, we note the strength of Alliance's stress test reporting, especially for pandemic-related risks.

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 profitability

Alliance's operating margin is expected to improve but remain weak relative to peers, averaging 22% over the next three years compared to a rated peer median for fiscal 2019 of 24%. The weaker operating margin is driven by less profitable social housing lettings in addition to low margin care and support activities. Profitability on the core social housing lettings business is weaker than peers, with higher costs per unit. Alliance's margin on its social housing lettings is expected to average 22% over the next three years compared to a rated peer median of 26% (fiscal 2019).

In addition to weak margins on the core business, Alliance's care and support activities also weigh on its profitability. Alliance view its care and support activities as a key pillar of its social mission and intend to grow the business going forward to meet local need. Through contracts with local government, Alliance Living Care (ALC) provides support to a wide range of vulnerable people and domiciliary care to older people. In addition to contracts through ALC, Alliance established its Care Academy in order to train carers, which addresses the local carers shortage and meets its strategic objective to help people into employment.

Increased debt to support new strategy, higher development risk

Alliance will increase borrowing over the next few years to fund growth, although we expect debt metrics to remain strong. Debt increased substantially to £90 million in fiscal 2020 from £53 million in 2018. Similar to last year, the majority of the new debt is still held as cash at fiscal year end 2020. Alliance plans to utilise funding for the purchase of a large 127 unit mixed tenure scheme, it partially plans to sell in form of shared ownership from 2022 onwards.

The association will also increase its capital expenditure (capex) compared to historical levels, with capex averaging £20 million per year for the next three years. Net capex to revenues will increase to a three-year forward looking average of 41%, compared to a rated peer median of 15% (fiscal 2019). Funds will be used to build more homes across a number of tenures, with a focus on social housing. Debt will grow at a measured pace over the next three years, reaching a peak of £125 million in fiscal 2023 to fund the "Plan A" strategy.

As part of the 10-year development strategy, the Board has approved a more varied approach to growth, including acquiring land and procuring a construction contractor, building on existing land, and acquiring new homes through S106 partnerships with developers. Previously, growth was centered around S106 purchases. In addition, in response to more generous capital grant, the group has rebalanced its tenure split in favour of more social rented development. Due to uncertainties resulting from coronavirus, all formerly planned outright sales were removed from business plan in 2020. Market sales exposure will be concentrated on shared ownership.

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 Alliance and the UK government reflects their strong financial and operational linkages.

ESG considerations

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

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 Alliance, the materiality of ESG to its credit profile is as follows:

Environmental considerations are not material to HAs' credit profiles. In line with the rest of the UK, the sector's main environmental risk exposures relate to water shortage and flood risk. Flood risk is managed by country and national authorities, and therefore the financial burden of adapting to increased flood risk will not fall on individual housing associations.

Social risks are material to HAs' credit profiles. 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 HAs' credit profiles 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 a2 is the same as the scorecard suggested BCA for FY2020.

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

Alliance Homes Group, 31 March 2020

Alliance Homes Group			
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%	6,662	baa
Factor 3: Financial Performance			
Operating Margin	5%	21.5%	baa
Social Housing Letting Interest Coverage	10%	2.4x	aa
Cash-Flow Volatility Interest Coverage	10%	4.9x	aaa
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	2.0x	a
Debt to Assets	10%	39.8%	baa
Liquidity Coverage	10%	1.9x	a
Factor 5: Management and Governance			
Financial Management	10%	a	a
Investment and Debt Management	10%	a	a
Suggested BCA			**a2**

Source:Moody's, Alliance

Ratings

Exhibit 4

Category	Moody's Rating
ALLIANCE HOMES GROUP	
Outlook	Stable
Issuer Rating -Dom Curr	A1

Source: Moody's Investors Service

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