

CREDIT OPINION

8 February 2018

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RATINGS

The Guinness Partnership Ltd.

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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The Guinness Partnership Ltd. (United Kingdom)

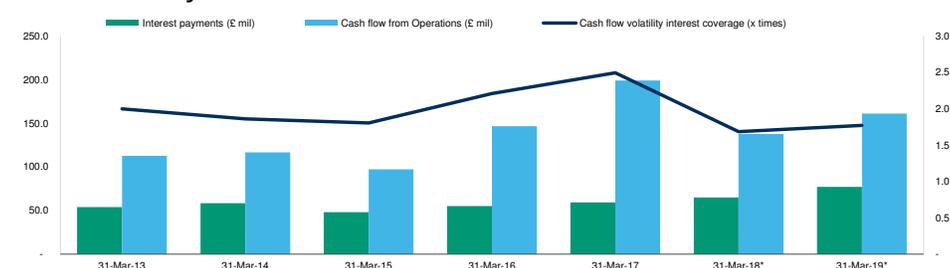
Update to credit analysis

Summary

The A2 issuer rating assigned to [The Guinness Partnership \(A2 stable\)](#) balances the housing association's history of improving operating margins, robust social housing lettings interest cover and low debt burden, with risks stemming from a projected increase in market sales. Guinness' 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 \(Aa2 stable\)](#) would intervene in the event that Guinness faced acute liquidity stress. Guinness is rated at the upper end of Moody's-rated English housing associations, whose ratings span from A1 to Baa2.

Exhibit 1

Guinness' market sales strategy boosts cash flow, but renders it more volatile, weakening the cash flow volatility interest cover metric



Note: FY2015 and FY2016 have been restated in FRS102 format. FY2017-FY2018 are forecasts

Source: Guinness Partnership and Moody's

Credit strengths

- » Modest debt level and strong liquidity position
- » Strong social housing letting interest coverage supported by improved operating margin
- » Strong regulatory framework

Credit challenges

- » Increasing exposure to sales
- » Operating environment remains challenging but policy is more stable

Rating outlook

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

Factors that could lead to an upgrade

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

1. strengthened Social Housing Letting Interest Cover (SHLIC) to a level structurally at or above 1.8x;
2. operating margins which consistently exceed 30%;
3. reduced volatility in operating cash flow, supporting Cash Volatility Interest Cover (CVIC) remaining at or above 2.2x.

Factors that could lead to a downgrade

Negative pressure would result from one or more of the following:

1. substantial volatility in operating cash flow, leading to a weakening of the CVIC;
2. SHLIC falling consistently below 1.5x;
3. liquidity coverage falling below 1.25x.

Key indicators

Guinness Partnership							
	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.)	59,180	58,650	60,216	60,671	66,684	67,281	67,711
Operating margin, before interest (%)	27.0	27.4	27.5	29.1	30.3	30.0	28.2
Net capital expenditure as % turnover	6.3	27.6	28.5	10.2	(11.7)	23.8	15.4
Social housing letting interest coverage (x times)	1.6	1.5	2.1	1.9	2.0	1.4	1.2
Cash flow volatility interest coverage (x times)	2.0	1.9	1.8	2.2	2.5	1.6	1.7
Debt to revenues (x times)	3.5	3.4	3.0	2.6	2.9	3.5	3.0
Debt to assets at cost (%)	35.5	33.8	37.8	37.5	38.8	36.5	37.1

FY2018 and FY2019 are forecasted figures
Source: Guinness Partnership and Moody's

Detailed credit considerations

Guinness' A2 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 the entity faces acute liquidity stress.

Baseline credit assessment

Modest debt level and strong liquidity position

As of the end of FY2017, Guinness' total debt stood at £1.27 billion, equivalent to 2.9x revenues, or 38.8% of assets-at-cost, one of the lowest debt burdens amongst Moody's rated housing associations. The debt-to-revenues and debt-to-assets metrics in FY2017 was weakened slightly as a result of increased debt, needed to fulfill the new development plan. The merger with Wulvern in January 2017 also added £150 million of debt to the organization's balance sheet. Regardless of these additional liabilities, Guinness' debt metrics were strong compared to the medians of A2 rated peers in FY2017, which stood at 3.5x and 44% for debt-to-revenues and debt-to-assets at cost, respectively.

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.moody's.com for the most updated credit rating action information and rating history.

Estimates for FY2018 show debt-to-revenues deteriorating somewhat to the peer median of 3.5x, as Guinness' revenues - in particular for non-social housing activities - decline compared to FY2017. However, we estimate Guinness' gearing ratio in FYE2018 to remain stable at 38.5% debt-to-assets at cost.

Guinness' liquidity position remains strong, supported by robust treasury policies which require available liquid funds to meet cash requirements for the next eighteen months. Furthermore, committed loan facilities must be in place for all contracted, approved, and pipeline commitments, in addition to a contingency of £25 million. As of September 2017, Guinness' immediately available liquidity consisted of £58.7 million in cash and £415.6 million of undrawn secured loan facilities, equivalent to around 110% of FY2017 turnover. Guinness' liquidity coverage metric for FY2017, at 3.2x, is well above the Moody's-rated peer median of 1.5x in FY2017.

Strong social housing letting interest coverage supported by improved operating margin

Guinness maintained its strong Social Housing Letting Interest Cover (SHLIC) in FY2017 at 2.0x, remaining above the A2-peer median of 1.8x. The strength of Guinness' SHLIC is supported by the housing association's improved operating margin which registered 30% (FY2013-FY2016 average: 28%), slightly below the A2 peer median of 32% in FY2017.

However, as the rent cut squeezes social housing letting margins and income from social housing letting stagnates, the SHLIC will decline from this strong position, to an estimated 1.4x and 1.2x in FY2018 and FY2019, respectively. Looking further ahead, we expect interest costs to rise as Guinness takes on additional debt, and social housing letting revenues are not projected to keep pace, depressing the SHLIC to around 1.1x in FY2020.

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. Since October 2017, the HCA has charged fees for social housing regulation, as a means of enhancing the independence and maintaining the effectiveness of the regulator.

Increased exposure to sales

Guinness has historically had a high share of low-risk social housing letting revenue, averaging 90% from FY2011-FY2015. However, in FY2017 the share fell to 72% as the housing association increased its development for sale, subsequently increasing the entity's exposure to potentially volatile market forces. Outright sales of £87.5 million were 20% of total revenues and first-tranche shared ownership sales (FTSO) made up a further 2% of revenues. In FY2018, revenues from total sales should decrease to just under £30 million, however, the current the business plan calls for an increase to £115 million in FY2019.

Commercial activities are conducted in development subsidiaries for tax efficiency purposes and surpluses are gift-aided to the main group. The gift-aided surpluses support Guinness' social housing function. With 42% of the total units in the FY2018-FY2022 development plan destined for outright sale, and a further 32% for shared ownership, moving forward, Guinness is more exposed to cyclical market risk than in its relatively conservative past.

While social housing letting will remain Guinness' main source of income, increased revenues from sales will be reflected in the organisation's credit metrics. Cash flow from operations will become more volatile, and the CVIC will deteriorate from FY2018 onwards. While Guinness' CVIC remained strong in FY2017, registering 2.5x, above the A2 peer median of 2.1x in the same time-period, a projected drop in the CFO in FY2018 will push the CVIC down to 1.6x.

Liquidity coverage will, likewise, deteriorate as net capex rises to 24% of turnover in FY2018. Looking forward, Guinness' liquidity cover metric, which measures forecast year-end liquidity against the following two years' net capex spend, will weaken progressively from an estimated 3.2x in FY2017 to a projected 2.3x in FY2018.

Guinness' management are currently reviewing the organisation's strategy in relation to sales and market activity. We will continue to monitor changes in strategy as reflected in Guinness' business plans and their potential impact on these credit metrics.

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 15% of turnover for Moody's rated HAs in FY2017. 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 Guinness Partnership 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 4

Category	Moody's Rating
THE GUINNESS PARTNERSHIP LTD.	
Outlook	Stable
Issuer Rating -Dom Curr	A2
Senior Secured -Dom Curr	A2

Source: Moody's Investors Service

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