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PUBLIC SECTOR EUROPE

CREDIT OPINION
21 January 2021

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RATINGS

Riverside 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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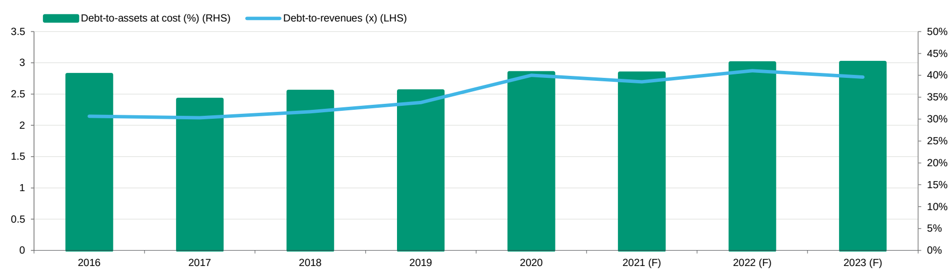
Riverside Group

Update to credit analysis

Summary

The credit profile of Riverside Group (Riverside, A1 stable) reflects its low level of debt, strong liquidity, weak profitability, and a strong likelihood that the government of the United Kingdom (UK, Aa3 stable) would intervene if the group were to face liquidity distress. Riverside is rated at the top of the range of Moody's-rated UK housing associations (HAs) due to its low level of debt, with debt to revenues among the lowest, expected to average 2.8x over the next three years. The group is shifting its strategy toward increased growth partially funded by market sales, but overall exposure will remain moderate.

Exhibit 1
Riverside's debt metrics will remain strong, despite the rise in borrowing
Debt to revenues (x) and Debt to assets at cost (%)



Source: Riverside, Moody's Investors Service

Credit Strengths

» Low debt and strong liquidity

» Large housing association with nationwide operations and strong management

» Supportive institutional framework in England

Credit Challenges

» Lower operating margin and interest cover ratios

» Increase in development risk and weak performance on market sales

Rating Outlook

The stable outlook on Riverside reflects our view that group's credit quality will remain strong, underpinned by its very low debt and strong management, despite a shift in strategy which includes increased development risk.

Factors that Could Lead to an Upgrade

Given that Riverside is currently among the highest rated of its English housing association peers and that it is increasing its development risk and market sales exposure, an upgrade is unlikely. However, we would consider an upgrade if the association were to increase its operating margin to levels sustained above 30%, maintain interest cover ratios above 2.5x, and reduce its market sales exposure to a low level (<5% of revenue).

Factors that Could Lead to a Downgrade

A downgrade to Riverside's rating could result from a further increase in development risk as evidenced by a larger development programme funded by increased market sales activity, underperformance on its market sales activity, or a failure to deliver on planned efficiencies with a corresponding weakening of its operating margin and interest cover ratios. A weaker regulatory framework or a dilution of the overall level of support from the UK could also exert downward pressure on the rating.

Key Indicators

Exhibit 2

Riverside

	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.)	52,945	52,610	52,942	56,089	58,360	58,422	59,201
Operating margin, before interest (%)	20.0	21.6	23.1	18.5	15.4	18.1	20.5
Net capital expenditure as % turnover	22.3	17.0	24.6	17.4	56.3	18.6	38.6
Social housing letting interest coverage (x times)	1.6	2.0	1.7	1.1	1.1	1.1	1.1
Cash flow volatility interest coverage (x times)	1.2	2.1	2.2	1.3	2.9	2.1	2.3
Debt to revenues (x times)	2.1	2.1	2.2	2.4	2.8	2.7	2.9
Debt to assets at cost (%)	40.1	34.5	36.3	36.4	40.6	40.5	42.8

F = Forecast
Source: Riverside, Moody's Investors Service

Detailed Credit Considerations

Riverside's rating combines (1) its baseline credit assessment (BCA) of a2, and (2) a strong likelihood of extraordinary support coming from the UK government in the event that Riverside faced acute liquidity stress.

Baseline Credit Assessment

Low debt and strong liquidity

Riverside will retain a strong balance sheet with low debt, a key credit strength. Riverside's debt to revenues will remain one of the lowest of Moody's-rated peers over the next three years despite an increase in borrowing. The low debt level provides the association with financial flexibility, as the balance sheet is capable of supporting additional borrowing if required. Debt to revenues stood at a low 2.8x in fiscal 2020 compared to a rated peer median of 4.3x (fiscal 2020). It is expected to remain low averaging 2.8x over the next three years.

Debt is increasing to fund growth, but this rise will be relatively modest and manageable. Debt was £997 million at fiscal year end 2020, up from £862m in fiscal 2019, and is expected to grow to approximately £1.2 billion fiscal 2023. Gearing (debt to assets at cost) will increase but remain strong relative to peers, averaging 42% over the next three years compared to the rated peer median of 49% (fiscal 2020).

Riverside's liquidity position will remain strong. As of September 2020, the group held immediately-available liquidity of £267 million, sufficient to cover 1.2x forecasted two-year cash need. The group's treasury policy is robust and requires the group to hold the higher of 1) £100 million or 2) sufficient liquidity to cover the next 18 months net cash requirement. The group's net cash requirement includes all operational and debt-related cash flows. In addition, the group holds unencumbered assets with borrowing capacity of just under £600 million.

Large housing association with nationwide operations and strong management

Riverside is one of the UK's largest housing associations with more than 58,000 homes under management as of fiscal year end 2020. The large size affords the organisation increased political influence and a favourable position when competing for development opportunities with smaller housing associations. The organisation is politically engaged with dedicated public policy staff in order to ensure its views are heard.

Riverside operates nationwide across 152 local authorities. Although the association's operations are spread nationally, there is a concentration of stock in the North of England where social housing rents are much closer to market rents compared to the South of England. Riverside also has a presence in Scotland.

In addition to its scale, Riverside's credit quality is supported by its strong management, which is captured in their 'a' scores for both financial management and investment and debt management. In response to the coronavirus pandemic, Riverside identified a number of potential mitigating actions of different scale and lead times to minimise the impact. This included stopping all non-contracted development as soon as possible and removing all non-compliance maintenance spend. Riverside also undertook conscious cost mitigations during FY2020, such as reducing spend on repairs and maintenance, planned maintenance, major works and discretionary spend in order to continue to meet its Golden Rules. At the start of the pandemic in March, Riverside also drew additional cash as a prudent measure but this has been repaid following the HA seeing no negative impact on its access to funds.

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.

Lower operating margin and interest cover ratios

Riverside's operating margin is expected to remain weak relative to peers despite planned efficiencies, a key credit challenge. Riverside's operating margin fell to 15% in fiscal 2020 compared to a rated peer median of 30%, and down further from 19% in fiscal 2019. However, Riverside's lower operating margin in fiscal 2020 was largely impacted by a reduction in sale of fixed assets and pension exit fees as the Group exited three defined benefit Local Government Pension Schemes. Removing these one-off exit fees, Riverside's operating margin would amount to 19% in FY2020. The group is focused on improving the underlying margin over the medium term, which is expected to reach 23% by fiscal 2024.

Riverside's lower operating margin is a result of both structural and temporary factors. Structural drivers of its lower profitability include its comparatively lower rents and its relatively high proportion of lower margin care and support housing and services. Temporary drivers of the exceptionally low margins in fiscal 2019 and 2020 include spend on its business transformation strategy, poor performance on market sales, and the exit costs from the multi-employer pension schemes.

Many of Riverside's peers have divested away from care and support activities, but Riverside view care and support as integral to its social mission. Care and support tends to be lower margin than social housing lettings due to the labour-intensive nature of the work. Income from supported housing lettings accounted for 30% of Riverside's turnover in fiscal 2020, but had an operating margin of negative 9% compared to 22% for its general needs properties. The negative margin in fiscal 2020 was driven by one-off service charges during the year as the Group targeted ensuring health and safety and compliance requirements are met.

Riverside is actively addressing its low profitability through a transformation programme to change the culture of the business and to improve efficiency, though it expects its operating margin to remain below peers due to the structural drivers. The group is aiming on increasing savings through its new procurement policy and sourcing strategy, in addition to a closure of a number of office sites.

The weaker profitability and one-off costs have led to weaker interest cover ratios in the past two years. The group's social housing lettings interest cover (SHLIC) maintained the same 1.1x in fiscal 2020 as in fiscal 2019. However, cash flow volatility interest cover ratio had a strong increase to 2.9x in fiscal 2020 from 1.3x in fiscal 2019 following a strengthening of operating cash flows. Riverside's SHLIC is below the rated peer median of 1.3x but CVIC signifcantly outperforms the rated peer median of 1.7x. The group's SHLIC is expected to improve modestly in the near term, averaging 1.2x over the next three years but we expect CVIC to continue to remain strong at an average of 2.3x in the same period.

Increase in development risk and weak performance on market sales

In line with many of its rated peers, Riverside is increasing its development programme and is targeting approximately 5400 new homes between fiscal 2021 and 2025. We view the group's development risk as manageable given the strong balance sheet, liquidity, and management of Riverside. In addition, the increased development is part of a broader organisational strategy which includes reducing its cost base and improving efficiency, reviewing its sales strategy, and improving returns on existing stock. The efforts to deliver a stronger existing business will improve the financial resilience of the group, counterbalancing the increased development risk.

The current business plan includes an average of 1,100 homes to be completed per annum across the group, which includes Irvine Housing Association (in Scotland), Prospect (GB) Ltd (residential development), and Compendium Group Limited (joint venture with Lovell Partnerships for large scale urban regeneration). The development programme will consist primarily of general needs housing but also includes new supported housing, shared ownership and outright sales. Net capital expenditure (capex) to revenues stood at 56% in fiscal 2020 but is expected to remain broadly in line with the rated peer median, averaging 24% over the next three years.

Riverside will maintain a moderate exposure to market sales in order to utilise surpluses to fund growth. Market sales, which includes first tranche shared ownership and outright sales, accounted for 9% of turnover in fiscal 2020. Market sales will account for an average of 13% of turnover over the next three years.

Although the group's exposure to market sales will remain moderate, it has underperformed on its market sales compared to peers. Riverside's margin on market sales was only 2% in fiscal 2020, down from 7% in fiscal 2019, and very weak compared to a rated peer median of 26% (fiscal 2020). Management are focused on improving profitability of market sales with expected margins of between 15%-18% over the next three years.

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

ESG considerations

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

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 Riverside, 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 county 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 close to the scorecard-suggested BCA of a3 for fiscal 2020.

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

Riverside's 2020 scorecard

Riverside			
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%	58,360	a
Factor 3: Financial Performance			
Operating Margin	5%	15.4%	baa
Social Housing Letting Interest Coverage	10%	1.1x	baa
Cash-Flow Volatility Interest Coverage	10%	2.9x	a
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	2.8x	a
Debt to Assets	10%	40.6%	ba
Liquidity Coverage	10%	1.2x	a
Factor 5: Management and Governance			
Financial Management	10%	a	a
Investment and Debt Management	10%	a	a
Suggested BCA			**a3**

Source: Moody's Investors Service, Riverside

Ratings

Exhibit 4

Category	Moody's Rating
RIVERSIDE GROUP	
Outlook	Stable
Issuer Rating -Dom Curr	A1
RIVERSIDE FINANCE PLC	
Outlook	Stable
Senior Secured -Dom Curr	A1

Source: Moody's Investors Service

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