SUB-SOVEREIGN

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CREDIT OPINION
15 December 2021

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Riverside Group (United Kingdom)

Update following downgrade to A2 stable

RATINGS

Riverside Group

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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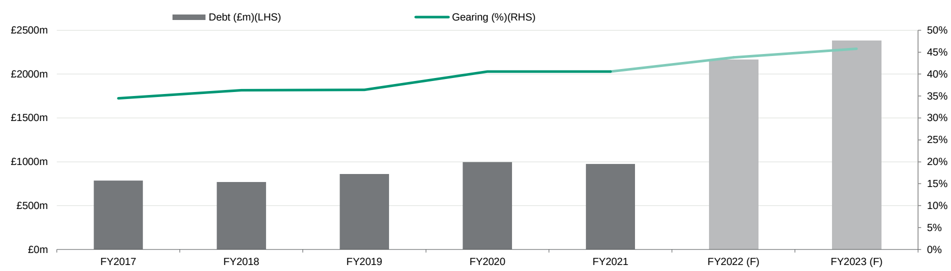
Summary

The credit profile of Riverside Group (Riverside, A2 stable) reflects its significant market position, its stronger debt metrics than peers, solid liquidity, weaker operating performance and increased risk appetite. The rating also incorporates a strong likelihood that the government of the United Kingdom (UK, Aa3 stable) would intervene if the group were to face liquidity distress. The group is aiming to leverage its larger capacity, following its merger with One Housing Group (OHG) in December 2021, using a growth strategy partially funded by market sales.

Exhibit 1
Riverside will maintain strong debt metrics despite the jump in aggregate debt following the merger
Debt (£m)(LSHS), debt to revenue (x)(RHS) and gearing (%)(RHS), FY2017-2023(F)



F: Indicates forecast. Merger impact can be seen from fiscal 2022 onwards.
Source: Riverside, Moody's Investors Service

Credit Strengths

» Stronger debt metrics than peers and solid liquidity

» Large housing association with nationwide operations and strong policies

» 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

Riverside's stable outlook reflects its debt metrics that will remain stronger than peers, balancing the weaker operating performance. Riverside has a track record on driving efficiencies, including on previous mergers, which should ensure a smooth transition of merging the operations of the two entities together. The outlook also reflects the currently supportive operating environment for English housing associations and the strong regulatory framework.

Factors that Could Lead to an Upgrade

An upgrade in the near term is unlikely given the downgrade but upward pressure on Riverside's ratings could result from a sustained improvement in profitability, leading to strengthened interest cover ratios as well as a decrease in risk appetite through a reduced exposure to market sales.

Factors that Could Lead to a Downgrade

Moody's could downgrade Riverside if there is a further deterioration in operating performance and interest cover ratios, through unforeseen cost pressures or a failure to meet market sales targets, and/or a faster pace of borrowing resulting in weaker debt metrics. In addition, a weaker regulatory framework, a dilution of the overall level of support from the UK government, or a downgrade of the UK government rating could exert downward pressure on the ratings.

Key Indicators

Exhibit 2

Riverside

	31-Mar-17	31-Mar-18	31-Mar-19	31-Mar-20	31-Mar-21	31-Mar-22 (F)	31-Mar-23 (F)
Units under management (no.)	52,610	52,942	56,089	58,360	58,671	76,536	77,520
Operating margin, before interest (%)	21.6	23.1	18.5	15.4	19.8	15.8	18.5
Net capital expenditure as % turnover	17.0	24.6	17.4	56.3	13.6	44.0	41.3
Social housing letting interest coverage (x times)	2.0	1.7	1.1	1.1	1.6	0.8	0.9
Cash flow volatility interest coverage (x times)	2.1	2.2	1.3	2.9	2.7	1.3	1.6
Debt to revenues (x times)	2.1	2.2	2.4	2.8	2.6	3.6	3.6
Debt to assets at cost (%)	34.5	36.3	36.4	40.6	40.6	43.8	45.8

F: Forecast. Merged entity from fiscal 2022 onwards, Riverside as standalone entity in prior years.
Source: Riverside, Moody's Investors Service

Detailed Credit Considerations

On 1 December 2021, Moody's downgraded Riverside's rating to A2 from A1. The downgrade reflected the impact of the merger with OHG, a housing association with a weaker credit profile in Moody's view, as well as the increased risk appetite stemming from the ambitious development programme and increased market sales exposure which is expected to result from the joined entity. The merger between Riverside and OHG completed on 1 December 2021.

Riverside's 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 Riverside faced acute liquidity stress.

Baseline Credit Assessment

Stronger debt metrics than peers and solid liquidity

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 and the merger with OHG. The low debt metrics provide the association with financial flexibility, as the balance sheet is capable of supporting additional borrowing if required. Debt to revenues stood at a low 2.6x in fiscal 2021 compared to a rated peer median of 4.3x. Following the integration of OHG into the group (fiscal 2022), it will increase but remains stronger than peers, averaging 3.5x over the next three years.

Debt is increasing to fund growth, but this rise will be relatively manageable due to the size of the new entity. Debt prior to the merger was £975 million at fiscal year end 2021, down from £997 million in fiscal 2020. From fiscal 2022, and with the larger organisation, debt is expected to increase to around £2.1 billion and to grow further to £2.4 billion by fiscal 2024. Despite this, gearing (debt to assets at cost) will remain moderately stronger relative to peers, averaging 45% over the next three years compared to the rated peer median of 48% (fiscal 2021).

Riverside's liquidity position will remain solid. As of June 2021, the group held immediately-available liquidity of £294 million, sufficient to cover 1.8x Riverside's standalone forecasted two-year cash need (Riverside's and OHG's combined available liquidity in fiscal 2021 would cover 1.3x the merged entity's two-year cash need). Over the next three years, we expect liquidity cover to average 1.3x for the merged entity.

Besides, we expect that the group's unencumbered asset position will increase to around £1.2 billion in fiscal 2022 thanks to the addition of OHG's housing stock, enough to cover the £481 million in required debt funding over the next five years.

Large housing association with nationwide operations and strong policies

Riverside will become the UK's fourth largest HA in fiscal 2022 with 76,500 units under management thanks to the addition of OHG. The large size affords the organisation increased political influence and a favourable position when competing for development opportunities with smaller housing associations. This was recently illustrated in September 2021 when Riverside was selected as a strategic partner for Homes England, thereby securing additional funding (£81 million to build 1,530 units) that will limit debt growth going forward, a credit positive. Similarly, OHG and Riverside will both receive grants from the Greater London Authority for their London-based schemes (respectively £42 million and £19 million). The organisation is politically engaged with dedicated public policy staff in order to ensure its views are heard.

The newly merged entity operates nationwide across 179 local authorities (England and Scotland). There was 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. The integration of OHG into the Group, which is predominantly focused in London, is expected to bring in higher average rents and a younger stock profile for Riverside.

In addition to its scale, Riverside's credit quality is supported by its strong policies. As part of the merger, OHG will adopt Riverside's more stringent financial and treasury policies from the outset. We view Riverside's sophisticated and tailored policies, stress-tests and tiered mitigations as stronger compared to peers. In response to the coronavirus pandemic, Riverside identified a number of potential mitigating actions to minimise the impact, including a campaign on rent arrears ('Let's Talk Rent Campaign'), maintaining rent and service charge arrears at 4.4%. The housing association successfully reduced its headline social housing cost per unit to £4,344 from £4,959 the year before. This resulted in a strengthening of the operating margin in fiscal 2021, despite the pandemic.

Riverside's strong financial policies are balanced by the increased risk appetite following the merger. The larger entity will have a more complex group structure than pre-merger, as well as looking to leverage its scale with a more ambitious development programme. We capture this increasing risk in Riverside's baa score for financial management. However the group retains its 'a' score for investment and debt management as it is still able to comfortably meet its funding needs over the next five years, benefitting from low refinancing risk over the near-term and is also underpinned by Riverside's strong treasury policies.

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

Despite the planned and achieved efficiencies, Riverside's operating margin is expected to remain weak relative to peers, a key credit challenge. Riverside's operating margin increased to 20% in fiscal 2021 from 15% in fiscal 2020, compared to a rated peer median of 25%. We expect this metric to remain weak over the next three years, averaging just 18% for the merged entity. Riverside prudently only forecasted savings stemming from the merger from fiscal 2024 onwards, of circa £7.5 million per annum, a level we deem reasonable and prudent.

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 (in average £10 per week below peers as of fiscal 2021, pre-merger) 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 and OHG view care and support as integral to their social mission. Care and support activities tend to display lower margins than social housing lettings due to the labour-intensive nature of the work. We note that Riverside improved its performance on supported housing lettings (representing 29% of turnover in fiscal 2021), decreasing the operating deficit to -6% from -10% the year before, despite the impact of the pandemic. The merger with OHG provides an additional challenge for Riverside going forwards due to OHG's similar exposure and underperformance on its own care business in recent years. OHG also faces high fire safety remedial costs which may add additional downwards pressure on Riverside's margins over the near-term.

The weaker profitability underpins weaker interest cover ratios than peers. The group's social housing lettings interest cover (SHLIC) reached 1.6x in fiscal 2021, from 1.1x in fiscal 2020, the increase driven by the improvement in margins. The group's SHLIC is expected to remain weak at just 0.9x over the next three years, remaining significantly lower than peers (rated peer median of 1.4x in fiscal 2021 and expected at 1.5x over the next three years).

Increase in development risk and weak performance on market sales

In line with peers, Riverside is increasing its development programme and is targeting approximately to build 7,400 new homes between fiscal 2022 and 2026. This is up from its pre-merger target of 6,000, following the grant funding from Homes England and Greater London Authority. From fiscal 2027, 42% more units are targeted for development than compared to Riverside's and OHG's standalone business plans, as Riversides aims to leverage its increased development capacity. We view the group's development risk as manageable given the strong balance sheet, liquidity, and management of Riverside.

The development programme targets an average of 1,300 units per annum, including 36% of social housing, 20% shared ownership and 19% outright sales over the next five years. Net capital expenditure to revenues is expected to increase to an average of 35% over the next three years, up from 14% in fiscal 2021 (for Riverside standalone, or an estimated combined 8%), which is in line with the rated peer median.

Riverside will increase its market sales exposure to high (we define high as 20-30% of turnover) in order to utilise surpluses to fund growth. Market sales, which includes first tranche shared ownership and outright sales, will rise to 20% of turnover over the next five years from 9% in fiscal 2021. Market sales are expected to fund 50% of the 5-year development programme. A failure to meet the targeted amount of market sales could imply faster and higher debt increases than the adequate levels currently projected, which would be credit negative.

Riverside has underperformed on its market sales margins compared to peers, a negative given the upcoming increased exposure. Riverside's margin on market sales was only 1% in fiscal 2021, down from 2% in fiscal 2020, and very weak compared to a rated peer median of 15%. Similarly, OHG have also had very weak performance on its sales over the past three years, having made significant losses. OHG's margin on market sales averaged 6% between fiscal 2019 and 2021. Management is focused on improving profitability of market sales with expected margins of between 11%-17% over the next three years, supported by the current positive market dynamics.

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 material to the group's credit profile. Although the impact of physical climate risks such as water shortages and flood risk are unlikely to be material to HAs' credit profiles as they are managed by government authorities, energy efficiency and decarbonisation more broadly are becoming an increasingly acute priority for HAs with a target of all homes obtaining an energy performance certificate (EPC) of C or above by 2035 in England. We expect this to require material levels of capital expenditure - which would either divert cash flows away from development programmes or increase debt levels. Riverside has included achieving EPC C for all its properties by 2030 in its combined business plan.

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 pandemic as a social risk under our ESG framework given its impact on health and safety. 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 a3 is one notch below the scorecard-suggested BCA of a2 for fiscal 2021 as it reflects the pre-merger position.

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 2021 scorecard (pre-merger)

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%	58,671	a
Factor 3: Financial Performance			
Operating Margin	5%	19.8%	baa
Social Housing Letting Interest Coverage	10%	1.6x	a
Cash-Flow Volatility Interest Coverage	10%	2.7x	a
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	2.6x	a
Debt to Assets	10%	40.6%	ba
Liquidity Coverage	10%	1.8x	a
Factor 5: Management and Governance			
Financial Management	10%	baa	baa
Investment and Debt Management	10%	a	a
Suggested BCA			**a2**

Source: Riverside, Moody's Investors Service

Ratings

Exhibit 5

Category	Moody's Rating
RIVERSIDE GROUP	
Outlook	Stable
Baseline Credit Assessment	a3
Issuer Rating -Dom Curr	A2
RIVERSIDE FINANCE PLC	
Outlook	Stable
Senior Secured -Dom Curr	A2

Source: Moody's Investors Service

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