

**UK
Special Report****Social Housing in England:
A Strongly Government-Supported Sector****Analysts**

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Related Research

- *Ratings of Public-Sector Entities (February 2007)*
- *The UK Social Housing Sector - FAQs answered (June 2004)*
- *IDRs and Senior Unsecured Ratings for European Property Companies (May 2006)*

Although this report makes reference to the UK social Housing sector, the rating criteria are specific to English Housing Associations, as Wales, Northern Ireland and Scotland have different regulatory bodies.

Introduction

Housing associations (HAs) in the UK are generally considered private entities in that their ownership is not directly controlled by the state. However, some of these HAs (those which are classified as registered social landlords; RSLs¹) are highly regulated, benefit from recurring publicly supported cash flows (as about 66% of the revenue comes from housing benefit) and receive significant state grants, although it does not contribute to the UK's public sector borrowing requirement. Moreover, HA status has been challenged by a number of legal rulings in recent years. In 2004 the UK government accepted an EU ruling under which HAs were considered public bodies for the purposes of procurement. More recently, the English High Court in *Weaver v. London and Quadrant Housing Trust* (February 2008) ruled that housing associations were public authorities and, as a result, could be subject to judicial review in certain circumstances. The court stated that the HA sector was permeated by state control and state influence with a view to meeting the government's aims for affordable housing.

HAs have provided the vast majority of new social housing in the UK in recent years. They have a strong track record in delivery, working with the for-profit sector and in developing new and innovative services alongside their core activities of social housing management and new provision. Since 1988 HA investment has been funded by a mixture of grant and private borrowing. Capital expenditure funding by the Housing Corporation (HC; the sector regulator in England until December 2008) accounted for 44% of total scheme costs in 2008, with RSLs raising 56% through borrowing and their own surpluses. Lending to HAs totalled about GBP50bn in 2008, GBP34bn drawn in England, 10% of which was in the form of bond debt.

This report studies the public support available for English social housing and the implications for the ratings of social housing providers, as the institutional framework is key for rating these entities. About 2.3 million affordable homes (5% of all UK housing stock), both social rented and intermediate, are owned by RSLs, which raise private finance, which is combined with social housing grants (SHGs) to maintain and develop stock. Until December 2008 the regulator in England was the HC; it approved schemes that met local housing needs at affordable rents and that offered good value for money in terms of the public subsidy required and the quality of homes built. In December 2008 the corporation was split into two governing bodies, the Homes and Communities Agency (HCA) and the Tenant Services Authority (TSA) that are now, respectively, the funding provider for social housing investment and regeneration, and the regulator for social housing functions.

Fitch Ratings will consider individual RSLs as public-sector entities. After a review of the regulations, Fitch is of the opinion that the regulatory framework for RSLs has a robust legal basis, with sound control and tight monitoring. Furthermore, although the UK social housing sector faces more exposure to business risks, with an expansion into non-social housing business and increasing development demand, state involvement is still a strong factor supporting the creditworthiness of the sector. However, overall, the implied regulatory support is quite remote from the sponsor (the UK government) and Fitch will not therefore apply the "top-down" rating approach set out in its criteria (see the related research link above). Instead, to arrive at the senior unsecured rating of the RSL it will use a "bottom-up"

¹ Social housing providers registered with the Housing Corporation (now the TSA)

approach starting from the stand-alone credit profile of the entity and factoring in credit enhancement of two notches to reflect the robustness of the regulatory framework and tight oversight, which would mitigate the likelihood of default. The stand-alone assessment of each RSL will take into account aspects such as demand, operational efficiency, debt dynamics and management.

Overview of the Social Housing Sector in the UK

Differing Legal Status for Social Housing Organisations But All Working for the Same Common Interest

The high-cost housing market and the uneven spread of socio-economic wealth across the country have triggered increased need for social housing in the UK. House prices have doubled in real terms in the last decade. The average house market cost is about GBP210,000, more than 8x the average salary. This has made the building of affordable homes necessary. Although housing governmental bodies have focused on improving the quality of social housing for the young and the elderly since 1997, they are now developing more affordable homes both to rent and to buy, including increasing provision of family housing.

HAs are non-profit-making organisations that provide and manage homes for people who cannot afford to meet their housing needs on the open market - even if they are not buying, private renting could prove too expensive. HAs may be registered charities, industrial and provident societies (a form of legal status), companies registered under the Companies Act, or a combination of these. Some associations obtain funding from private sources such as charitable trusts but most provide housing using public money from local councils or until 2008, in England, from the HC and since then, from the HCA, together with private finance. The regional equivalents of the HC and its successor organisations are the Northern Ireland Housing Executive, The Scottish Housing Regulator and the Welsh Assembly Housing Directorate.

HAs usually provide a “public service”. They are not owned or controlled by external private shareholders, do not issue preference capital/capital that pays interest or dividends, and all their surpluses are reinvested into the entity. They are also legally independent of the UK government.

Most RSLs are HAs, but there are also trusts, co-operatives and companies. RSLs abide by HC (now TSA and HCA) regulations, which makes them eligible to apply for public grants to finance investment for social housing.

From small beginnings at the time of the 1975 Housing Act, HAs have expanded steadily, and more than 1,700 RSLs in England now house nearly 4 million people. The largest 200 RSLs own 90% of the stock. The UK government’s objective in the 1975 Act was to provide an alternative source of low-cost rented property to that provided by local authorities. The HC was established to channel public money to the social housing projects started by registered HAs in England, supervise their performance, and regulate their conduct. HAs’ funding was supplemented by mortgage loans from banks and the then building society sector. By an Act of Parliament in 1988 the sector’s ability to raise finance from the private sector was greatly extended. In 2008, HC grants (social housing grants; SHGs) accounted on average for 44% of total social housing schemes costs. The HA average gearing level is therefore rather moderate, as SHGs accounted for 49% of the consolidated gross book value of traditional RSLs’ assets and debt 34% at end-2007, compared with 53% and 33%, respectively, in 2005. This evolution indicates that the falling grant rate has not increased the level of debt in the balance sheet of traditional RSLs, which are increasingly self-financing their investments through their operating balance. In 2007 RSLs’ overall turnover rose by 9.4%, while operating costs rose more slowly, by 7.8%.

Progressive Decrease in Stock Transfers Since 2003

RSLs play a key role in housing investment in the global UK market. Since the late 1980s almost all new social housing in the UK has been provided by RSLs. The 2004 UK Spending Review introduced a target to supply 75,000 new homes for social rent during FY06-FY08, of which 30,000 would be supplied in the final year. In FY08, 29,370 new homes were provided for social rent, but combined with previous years' building this brought the total built in the period to 77,730.

Large-scale voluntary transfers (LSVTs) are transfers of social housing stock in excess of 500 units from local authorities to newly constituted or existing RSLs. In general, these are block transfers of a large number of properties, usually in their thousands, at a price well below even the existing use value of the unit as social housing stock. There has been a significant reduction in LSVT activity since 2003. This overall decline followed a number of high-profile tenant votes against LSVTs, although it appeared that tenant interest in stock transfers picked up at certain times. At the same time, stakeholder interest in alternative models to outright transfer has increased, including arm's-length management organisations, private-finance initiatives, and prudential borrowing.

Regular and Highly Predictable Cash Flows and State Grants

Rental cash flows from social housing stock are both highly predictable and largely regulated via two major sources: the payment of housing benefit, a public housing subsidy for low-income dwellers (those with an income of less than GBP16,000 per year) and the target rent policy. Housing benefit is a key component of the RSLs' liquidity, ensuring strong secured cash flows, as about 66% of the RSLs' revenue comes from housing benefit.

Housing benefit is usually paid to the landlords, and more exceptionally into the bank account of the tenant, in arrears. This means that it is paid after the rent is due. It can be paid weekly, fortnightly, every four weeks or every month, depending on how frequently the rent is paid. A tenant has the right to be paid fortnightly if the housing benefit is not being paid to the landlord.

HAs can also resort to bank lines to cover temporary liquidity shortfalls and have to respect strict treasury management rules: in 2007 the HC issued Circular 01/07 "Treasury Management by Housing Associations", requiring:

- That HAs must have the skills, knowledge and experience, at both board and officer levels, systems, and access to independent advice necessary to identify and manage the treasury risks to which they are exposed; and
- That they must use derivative instruments solely for the purpose of managing treasury risk.

Rent Convergence: Reducing the Gap Between Houses Rented From RSLs and Those From Councils by 2012

A rents convergence policy has been gradually implemented across England's social housing stock in order to smooth out anomalies in rents between and within RSLs, and between RSLs and local authorities. In April 2002, the government introduced a new policy for social housing rents for all councils and RSLs. The new rent policy changed the way councils and RSLs set their rents and was designed to bring rents into line by 2012. This means that by 2012 similar rents will be charged for similar homes across the country, regardless of whether the landlord is a council or an RSL. Using the formula set out by the government, a "target rent" is calculated for each home, with the aim of keeping rents for social housing below market levels (ie those for private rented homes).

The HC introduced a rent-influencing regime - the means by which the government's policy is to be implemented - in 2001, to become effective on 1 April 2002. On 1 December 2008 the regime was inherited by the TSA. The rent-

influencing regime features a guideline limit for rent increases. The guideline limit for rent increases is the all-items retail price index (RPI) plus 0.5%. The reference point for RPI is the September preceding the start of a given financial year (1 April-31 March). For example, the guideline limit for the year to 31 March 2009 is based on RPI in September 2007. In addition to applying the guideline limit, registered providers can increase rents by up to an additional GBP2 per week in order to converge actual with target rents. The guideline limit is applied to the target rent each year. If actual rents are above target rents, RSLs do not necessarily reduce rents by the stipulated GBP2 of the weekly rent but instead wait for inflation to catch up under the RPI plus 0.5% formula, as long as they can achieve target rents by 2012. Where rent levels are forecast to be adversely affected by rent restructuring, associations have had to address their cost base to ensure any mismatch between revenue growth and cost growth is minimised.

The incidence of units with actual rents above target rents is small in south-east England, but more widespread in the Midlands and north. In the south east this situation is often restricted to types of stock that do not have universal appeal or require significant remedial works. These properties tend to have actual rents above “target rents”, partly as a result of long-term tenants who may be indifferent to rental levels because they are entitled to full housing benefit. These tenants are effectively paying more rent than an RSL could obtain should it try to re-let to a new social housing tenant, until the target rent is achieved by 2012.

There were a limited number of exceptions where the HC allowed rent increases of more than RPI plus 0.5%. These are generally limited to LSVTs where the HC had pre-agreed to permit higher rent increases due to heavier capex requirements to bring ex-local authority stock up to the Decent Homes Standard (which has to be met by 2010). Such rent restructuring is set to continue and is aimed at relating social rents more closely to the types of property on offer and bringing local authority and RSL rents more closely into line over time.

Decent Homes Standard to Affect RSLs' Capex

The UK government believes that everyone should have the opportunity to have a decent home. It aims to make all council and HA housing “decent” (ie it should be “warm, weatherproof and have reasonably modern facilities”) and to improve conditions for vulnerable households, particularly those with children, in privately owned housing. Decent homes are important for the health and well-being of those living in them. In 1997 there were 2.1 million houses owned by local authorities and HA that did not meet the Decent Homes Standard and local authorities had a GB19bn backlog of repairs and improvements. Since 1997, GBP20bn has been invested in making social homes decent for tenants. As a result, according to the government’s English House Condition Survey conducted in 2006 the number of households living in non-decent social homes had fallen by more than 1 million since that date. All RSLs and local authority landlords must try to meet the Decent Homes Standard by 2010. This effectively specifies a certain set of internal and external building and internal fitting-out requirements for social housing units. For example, kitchens should not be more than 20 years old and bathrooms 30 years old. About 11% of HA properties do not yet measure up to the Decent Homes Standard, although this figure is reducing every year.

Even though the Decent Homes Standard is not a statutory requirement for RSLs and local authorities it is at least a minimum “best practice” target to be achieved by 2010. The minimum statutory “good and tenantable condition” measure will continue to be set by section 604 of the Housing Act 1985 for the time being. The proposed Housing Health and Safety Rating System, under a further revision of the Housing Act, would enshrine in law higher standards for certain aspects of housing specification (such as electrics) already addressed by the Decent Homes Standard. This revision to the Act is at the consultation stage with the government and other parties.

Under existing secured financial RSL transactions, properties only need to be in “good and tenable condition”, which meets the minimum standard required to rent or sell the property on the open (private sector) market. However, the Decent Homes Standard may become more relevant if an RSL were to transfer stock to another. This is because the price the other RSL would be prepared to pay for a unit would be net of the future maintenance spending needed to bring the unit up to the Decent Homes Standard. HC (now the TSA) guidelines suggest, however, that Decent Homes Standard regulatory requirements may be waived in certain transfer situations, meaning that a substitute RSL may be prepared to pay a higher price.

Fitch expects 95% of social housing to be made “decent” by end-2010. Fitch considers that many RSLs aspire to exceed the Decent Homes Standard over the long term, but that the Standard has introduced a timing requirement, which may cause some of the smaller, less well-managed RSLs to struggle to meet targets.

For those RSLs that need extra funding to meet the required standard, the government has outlined three options aimed at providing improved performance and services, and ensuring the extra money is spent cost effectively. These options are:

- Setting up an arm’s-length management organisation, ie a company created to manage the homes and make them decent;
- Using the private-finance initiative to encourage extra private sector investment; and
- Transferring all or some of the stock to an RSL.

“Right to Buy” May Continue to Affect RSLs’ Cash-Flow Projections, Albeit on a Smaller Scale

The right-to-buy (RTB) scheme allows qualifying local authority tenants the right to purchase their home, provided they have been living there for at least five years and satisfy other criteria. This right is preserved after transfer to an RSL (known as “preserved right to buy” or in some cases “right to acquire” (RTA), concerning properties built or acquired by housing associations with public funds from 1 April 1997. Historically, completed RTB and RTA transactions have accounted for 2% of RSL social housing portfolios per year. Although RSL forecasts show this rate continuing into the future, there is a general view within the sector that the combination of lower discounts and higher property prices (ie effectively meaning that acquiring tenants have to take out larger mortgages) are likely to restrict RTB/RTA to perhaps no more than 1% of the portfolio per year.

Recent important changes to the RTB scheme include:

- Extension for new tenants of the qualifying period to five from three years;
- Extension of the discount repayment period to five from three years;
- Suspension of the RTB where the landlord intends to demolish buildings; and
- Penalising tenants who enter into agreements to resell after the RTB purchase, giving the landlord a right of first refusal if the dwelling is sold within 10 years of the RTB purchase.

Future Challenges: Diversification and Consolidation

HAs’ non-social housing activities have mainly been in the areas of market renting, properties built for sale, student accommodation, and nursing homes. The overall level of activity, however, is limited. The HC assessed that only about 3% of stock across the sector can be defined as non-social housing; in reality, non-social activities represented 14% of RSLs’ combined turnover in 2007. For some associations, however, the proportion of non-social housing is higher. Some HAs that expand into non-social housing business, such as nursing homes and student

accommodation, may have insufficient expertise to manage the different risks associated with the new business. In some cases, HAs can attract experienced management, which can help offset some of these risks. Some associations have sought to mitigate risks and exposures to specific non-social housing projects by setting up special-purpose companies (SPCs). These companies are legally separate and stand apart from the association. The SPC raises debt in its own name and repays its obligations from the net revenue provided by the particular project; there is no legal recourse to the association. Overall, diversification issues require RSLs' management to become increasingly financially sophisticated so as to meet the growing challenges within the sector.

In addition to the diversification sought by some RSLs, the whole sector is to face other major challenges, notably the need for consolidation. With annual rent increases now restricted to RPI plus 0.5% and in order to meet efficiency targets, it is likely there will be some reshaping of the sector, as some associations seek partnerships and mergers to achieve economies of scale. For those associations with development ambitions, changes in the allocation of development grants are likely to encourage more partnerships and mergers. The number of grant recipients is expected to reduce further in future years. A further catalyst for consolidation is that the minimum HCA development project grant application is now GBP10m, which has already led to RSLs forming loose partnerships in order to bid jointly for government subsidy. Size, however, is not always a guarantee of improved efficiency. Other associations may seek efficiencies on their own through, for example, outsourcing activities.

Lending Market Previously Dominated by A Few Players

The market continues to be dominated by a few lenders, while lending margins tended to decline until 2007. The 10 lenders most active in the sector during the year to 31 March 2007, in terms of total facilities, were, in alphabetical order, Abbey, Barclays Bank, Bradford & Bingley, Britannia, Dexia, HBOS, Lloyds TSB, Nationwide, Royal Bank of Scotland and The Housing Finance Corporation Ltd (THFC). THFC is an independent, specialist, not-for-profit organisation established in 1987 through a joint initiative between the HC, the National Housing Federation and the private sector. It specialises exclusively in raising private sector finance for RSLs. As an independent financing vehicle THFC raises funds by a variety of means including public secured bond issues, private placements and bank loans. By pooling the financial requirements of individual RSLs, it aims to achieve economies of scale for associations while providing a broad-based security portfolio for investors. Up to now, THFC has used a large array of financing instruments including zero coupon, deep-discounted, index-linked, and conventional public debenture stocks, stepped and par coupon private placements, and fixed- and variable-rate bank loans. THFC's loans are fully secured and covenanted to an agreed minimum level, to which THFC is legally bound.

There are no overt signs that the lenders' overall appetite for working with the sector is declining, although the effect of the "credit crunch" of FY08 may have caused some to review the extent of their individual exposures, and there are concerns that some may be looking to improve margins. Margins increased from 20bp before 2007 to about 200bp in 2008. Overall, lenders do not appear to be viewing this market segment less favourably than before, though it is possible, as groups and associations become very large, that they may come up against individual lenders' borrowing limits. It is likely that the larger groups and associations, particularly the ones with significant development programmes, will seek alternative forms of financing such as the capital markets.

Most of the loans are for 25-30 years. To date, banks have been prepared to take on refinancing risk, particularly as property values have been increasing. Recently, however, many bank lending transactions have been refinanced, partly driven by the borrowers' willingness to take advantage of lower interest rates, or to

consolidate their loans. The aggressive lending terms offered by banks reflect the absence of defaults before the Ujima Housing Association case in 2007 (see “Regulator’s Thorough Actions and Protective Role Demonstrated by Ujima Collapse in 2007” below).

Regulation of English Housing Associations: Recently Amended But Still Strict

Fully Reliant on Central Government

The regulator’s history of oversight and financial support in (rare) cases of distress is a key factor behind the sector’s solidity. The HC was the backbone of English social housing regulation until 2008. It was a non-departmental governmental agency, sponsored by the Department for Communities and Local Government. The HC regulated the sector through continual monitoring of performance, and, on behalf of the government, invested grants in the sector.

On 1 December 2008, the HC’s functions were transferred to two new organisations the HCA and the TSA, pursuant to the Housing and Regeneration Act, which became law on 22 July 2008. Among other things, the Act established the HCA. The HCA took over the former investment functions of the HC and will support regeneration and provide decent homes, for example by grant funding social housing and investing in infrastructure. With an investment budget of more than GBP5bn per year, the HCA’s scale and resources mean that it will bring about a radical change in housing supply and enhance people’s quality of life. This will not only entail the delivery of much-needed housing (both affordable and within the private sector) but also the creation and regeneration of sustainable communities within which these homes are built.

Like the HC, the HCA and the TSA will not provide a direct guarantee for HA borrowers. They can, however, use their statutory powers to intervene where there are serious concerns about the performance of an HA. For example, the TSA can place a poorly performing association under supervision, and make statutory appointments to the board. Furthermore, in some extreme cases it can direct an independent statutory inquiry, which could result in an association being required to transfer its assets to another HA in order to protect the interests of tenants and other relevant parties.

Under the Housing and Regeneration Act, tenants will also be given more choice and a voice in how their homes are managed, through the reformation of social housing regulation, giving tenants a stronger say in stock transfer decisions by making a tenant ballot mandatory for stock transfer - but not for other options such as PFI - and giving local authority tenants greater powers over options for the future management and ownership of their homes. Changes will also be made to improve the way that housing services are provided, including creating a level playing field for members of the armed forces applying for local authority housing and changes to improve the way the RTB scheme operates.

Government Support for UK Social Housing Proved to be Strong

Funding for new homes (often termed the SHG) represents a large public investment. In its 2008-2011 Prospectus, the HC claimed that in this period the subsidy would be “at least” GBP8bn. Most of this would go to HAs for use in development projects. Since 2003, in an effort to seek greater value for money, much of the funding by the HC for new housebuilding has been channelled to fewer than 80 “developing housing associations” that have achieved “partner status” through Partner Programme Agreements. However, “partners” often enter into development partnerships with other RSLs, so SHG ultimately flows to a much higher number of these bodies.

In order to achieve its targets of more affordable housing supply and sustainable communities, the government is providing more public funding, but at the same time is seeking significant efficiency savings in the social housing sector. In part, this will come from improved social housing procurement, by introducing new partnering arrangements, and from the realisation of more general efficiencies in the social housing sector. The drive for efficiencies is likely to result in some restructuring of the sector, as a number of associations will increasingly look for partnering arrangements and merger opportunities.

Insolvency Procedures That Protect Lenders and Tenants

If an HA becomes insolvent, the regulator, can:

- Continue to protect the interests of tenants where possible;
- Appoint competent managers trusted by all stakeholders;
- Provide lenders with the ability to realise their security if necessary;
- Maintain the infrastructure of the HA for as long as necessary to perform such tasks as collecting rents carrying out maintenance;
- Provide adequate protection against unsecured creditors or minority secured creditors' action;
- Maximise the prospects of cash being available for as long as possible during the process; and
- Maximise the options for stakeholders if a solution cannot be found that provides for the activities of the association to be transferred to another, along with all liabilities (a "solvent transfer").

The TSA operates under the existing HC regulatory powers. Among its most tangible powers are those of: performing an in-depth audit of the HA, including a financial review, with recommendations and action plan; putting an HA into supervision,

Regulator's Thorough Actions and Protective Role Demonstrated by Ujima Collapse in 2007

The events following the collapse of Ujima Housing Association in December 2007 demonstrated the effectiveness of the regulatory regime governing the English social housing sector and the responsiveness of the HC to financial difficulties at a RSL.

Ujima was founded in 1977 as a black and minority ethnic (BME) HA to tackle the housing problems facing young, black single men and women in London. It operated in London and in the Reading and Slough areas and was one of the largest BME-led RSLs. It had about 4,600 homes, received more than GBP300m of public sector funding and had borrowings of nearly GBP200m. Ujima received GBP13.4m in FY07 and GBP7.3m in FY08 to support new development. However, of the total amount granted to Ujima by HC to finance its new developments, the HC claimed back GBP4m, as Ujima did not achieve the level of performance that the HC expected on its new developments.

Ujima was brought under HC regulatory supervision in October 2007, after which significant mismanagement came to light. It became clear that Ujima was in serious financial difficulty and in December 2007 the HA petitioned the High Court to be wound up, and its secured creditors appointed receivers. Ujima was the first RSL to suffer this fate.

The circumstances underlying Ujima's problems were particular to it and do not reflect the overall financial health of the sector. Its financial difficulties were primarily a result of significantly poor governance and a number of injudicious development schemes. Initially the board's proposal for the association to merge with London & Quadrant Housing Trust was rejected by the members. The directors at Ujima then met with the HC and the secured creditors, after which the HC's power to enforce a 28-day moratorium on secured creditors' action was triggered, which gave it the opportunity to rescue the RSL and protect the interests of tenants and other stakeholders. For the first time, the HC used its powers under section 44 of the 1996 Act to propose the transfer of Ujima's activities to London & Quadrant Housing Trust, which was completed on 16 January 2008.

Ujima's situation clearly demonstrated that HC's moratorium powers worked effectively when needed to minimise risk to tenants and lenders. Despite the effectiveness of the regulatory response, Ujima's case should be seen as a "wake-up call" to many stakeholders in the sector in terms of taking action to prevent such a crisis arising in the first place.

including making statutory appointments to its board; directing a statutory inquiry; appointing a manager to replace staff who have been removed after the conclusion of an inquiry; establishing a 28-day moratorium in response either to a winding-up order or the lenders taking steps to enforce any security over land held by the association; and the extension of the role of the manager to include insolvency (this now means that the TSA could appoint an interim manager at the start of a moratorium).

How Will Fitch Rate English Housing Associations?

Fitch will use its public-sector entity criteria as a methodology basis for the rating of HAs and will apply a “bottom-up” rating approach starting from its “stand-alone” assessment of the HA. However, the agency will add a rating enhancement of two notches to reflect the strong regulatory sector and tight oversight, as per Fitch’s criteria, which has played a part in reducing or mitigating default. Nevertheless, the “stand-alone” assessment will factor into the rating the public function of the HA and its predictable cash flow, with a large part of its revenue coming from the central government by way of housing benefit. It would not, therefore, be appropriate to compare HAs’ debt dynamics and credit matrices with those of commercial/private property companies given the generally not-for-profit nature of their activities, which would make their comparable ratios considerably weaker.

Public Sector Mission Factored into Stand-Alone Assessment of HAs

To assess the stand-alone credit profile of an HA, Fitch will use a blended approach of corporate rating criteria, but will factor into the rating the public nature of HAs’ activities and funding. Key rating factors include those detailed below.

Demand

Demand for social housing is determined by two main variables - the socio-economic profile of the residents where the housing stock is located and the difference between the social housing rent and private rent. The weaker the socio-economic profile and the wider the gap between the social housing rent and private rent the greater the demand for social housing. Demand will also have an influence on the waiting list and rotation of housing stock once vacated. Therefore, if demand is high the level of voids will be minimised. A calculation of voids as a percentage of rent, the level of social rent compared to private rents, and the average re-let times will be useful operational indicators for demand.

Operational

Fitch will look at a number of key operational data ratios to assess the HA’s cash flow predictability and social housing-related activities. The greater the level of income sourced from social housing rent, the more stable the revenue, which will be considered a positive rating factor. In addition, wider operational margins will indicate the HA’s flexibility to invest in capital expenditure. Fitch’s analysis of an HA’s operations begins with an examination of trends in operating revenue and operating expenses. The agency will evaluate the revenue growth trend to determine how much it is driven by volume and business mix.

Therefore, key ratios that Fitch will use will include the percentage of operational revenue from social housing and its stability over time. The greater the proportion of revenue from social housing, the more positive for the rating. It is also important to assess the potential uplift for rent increases. As rental income rises are generally limited to RPI plus 0.5%, the flexibility is wider for HAs with a greater difference between actual rent and target rents (provided the actual rent is lower than the target rent), as they can charge an additional GBP2 per unit per week. Where actual rent is higher than the target rent, the rating impact would be negative, as rent increases are likely to be capped.

Given HAs’ not-for-profit nature, an assessment of efficiency will be important. In its assessment Fitch will include ratios such as management cost per unit and maintenance cost per unit. The lower these are, the less cost pressure an HA will

encounter. In addition, the higher the number of units under management the greater the cost economies of scale and efficiency. Therefore, this ratio is likely to be lower in the larger HAs than in the smaller ones. Pressure on expenditure will also come from capital investment, and it will be important to assess the percentage of units fully compliant with the Decent Homes Standard, as this will give an indication of likely future capital expenditure needs and potential recourse to external financing. Additional Indicators that Fitch will use to assess capital expenditure needs will be committed capital expenditure compared with the properties' portfolio value.

Debt Dynamics

Fitch will also examine the HA's debt position closely in terms of both its total level and its characteristics. The level will be analysed using a variety of ratios, including debt to EBITDA (with and without property disposals), debt to revenue, gearing (debt to reserves and housing grant) and debt to valuation. Debt to property valuation will also be an important ratio. As Fitch stated in its report *The UK Social Housing Sector: FAQs Answered*, published on 10 June 2004 and available at www.fitchratings.com, it considers that the market value subject to tenancies (also known as existing use value were vacant properties to be sold) as the most realistic method of valuation. This is because this valuation, whereby stock is valued subject to tenancy but also assumes that empty properties can be sold at market value, allows the sale of marginal vacated stock that HAs wish to sell at open market rates.

The two main debt coverage ratios that Fitch will consider are the interest cover ratio (before and after property disposals) and the debt payback ratio (measured by debt to EBITDA).

As part of its analysis, the agency asks the HA about its future debt plans and factors any additional debt intake into its projections. The characteristics of the debt are also considered, including the proportion of fixed- and variable-rate debt, and whether the debt takes the form of bond issues, bank loans or other debt instruments, the amortisation schedule and whether it is secured or not.

Management

In Fitch's analysis of HA management, it considers the depth and breadth of the executive team and its experience both with the HA concerned and the social housing industry. The agency also examines the management team's track record, particularly regarding controllable items, together with its forecasting accuracy and financial experience. This includes discovering what and understanding why actions were taken, determining how quick and decisive they were, and how successful they have been.

The final component of Fitch's analysis of operations is future projections. The agency tests the reasonableness of the assumptions used in the projections and modifies them upwards or downwards, if necessary. When appropriate, and if significant changes are forecast to occur with any high degree of likelihood, Fitch gives considerable weight to the projections, as the credit rating expresses an opinion about the HA's ability to service debt.

Expected Ratings for RSLs

From its assessment of the social housing sector and aggregate figures, Fitch expects the ratings of RSLs, taking into account the regulatory framework and public support, to fall into three broad categories. The weaker RSLs are likely to be in the 'BB' rating category (from 'BB-' to 'BB+'), the average ones in the 'BBB' rating category and the stronger ones in the 'A' category. Nevertheless, Fitch would expect that a large proportion of the RSLs to be rated at the high investment grade level and some of the very strong and well established RSLs could obtain ratings in the 'AA' category. However, the ratings would not factor in recovery post default.

Appendix

Largest 50 Groups or HAs (by Total Stock Owned) in March 2008

rank	Group or Housing Association	Housing association name (group member HAs that do not own stock are not shown in the list)	Owned stock* HA total	Group total
1	Sanctuary	Sanctuary	32,853	
		Shaftesbury	7,166	
		Hereward	4,509	
		Beth Johnson	4,032	
		Charter Community	3,587	
		Rochford	1,735	
		Banbury Homes	1,555	
		Kingsmead Homes	774	
		Asra	751	56 962
		2	Guinness Trust	Guinness Trust
		Northern Counties	18,355	
		Hermitage Ha	4,045	
		Midsummer	2,959	
		Midsummer Homes	1,583	
		Gcs	1,139	
		Clapton Community	798	
		Guinness H A L	603	
		Kennet Hs	421	
		Nc Specialised	181	
		Wycombe Friendship	136	51 861
3	London & Quadrant Ht	London & Quadrant Ht	30,409	
		Ujima	4,521	
		L & Q Beacon	4,352	
		L&Q Threshold	4,059	
		L & Q Bexley Homes	3,474	
		Tower	3,364	
		Opus	983	
		Threshold Key Homes	336	
		Lien Viet	105	51 603
		4	Riverside Group	Riverside
		English Churches	12,081	
		Carlisle Hal	6,044	
		Berrybridge	2,827	
		Lee Valley Hal	2,073	
		Bowlee Park Hal	2,030	
		Community Seven	1,106	
		Riverside North	954	
		St Michaels Ht	13	48 609
5	Places For People	Places For People H	42,660	
		Bristol Churches	2,366	
		Places For People Is	1,499	
		Kush	897	47 422
6	Home Group Limited	Home Group Limited	44,554	44 554
7	Affinity Sutton	William Sutton HA	20,310	
		Broomleigh	13,036	
		Downland	10,790	
		Brighton Ht	362	
		Aashyana Hal	24	44 522
8	Circle Anglia	Circle 33	14,667	
		South Anglia	6,647	
		Russet	6,515	
		Wherry	6,033	
		Roddens Ha	3,750	
		Mole Valley Hal	3,516	
		Old Ford	2,598	43 726
9	Wakefield	Wakefield	30,997	30 997
10	Hyde	Hyde	20,950	
		Martlet Homes	5,200	
		Hyde Southbank	2,304	
		Minster General	1,539	
		Hillside	718	30 711
11	Midland Heart	Midland Heart	30,621	30 621
12	Anchor Trust	Anchor Trust	30,544	30 544

Largest 50 Groups or HAs (by Total Stock Owned) in March 2008

rank	Group or Housing Association Name	Housing association name (group member HAs that do not own stock are not shown in the list)	Owned stock*	
			HA total	Group total
13	Metropolitan Ht	Metropolitan Ht	19,388	
		Spirita	6,222	
		Granta Hs	2,186	
		Clapham Park Homes	1,456	
		Hallmark	398	
		Metropolitan Support Trus	144	29 794
14	Gentoo Group Limited	Gentoo Sunderland Ltd	29,621	
		Gentoo Group Limited	32	29 653
15	Amicushorizon	Swale	7,410	
		Slfha	5,676	
		Ten Sixty Six	3,908	
		Amicushorizon	3,650	
		Rother Homes Limited	3,091	
		Southern Horizon	1,112	
		Crystal Palace	225	
		Casa Support Ltd	61	
		Julia Spicer Chy	14	25 147
16	Bromford Hgl	Bromford	12,790	
		Homezone	4,636	
		Fosseway	4,215	
		Bromford Home	1,611	
		Bromford Charitable	615	23 867
17	Orbit Housing Grp	Orbit South Housing	10,824	
		Orbit Ha	10,373	
		Orbit Housing Grp	2,305	23 502
18	Southern Hgl	Southern Hgl	14,541	
		James Butcher	3,542	
		South Wight	3,009	
		Southern Housing H/Own	1,886	22 978
19	Sovereign Hgl	Sovereign	14,432	
		Vale	5,416	
		Twynham	2,374	22 222
20	Bradford Comm Ltd	Bradford Comm Ltd	21,573	21 573
21	Flagship Housing	Peddars Way	8,891	
		Suffolk Heritage	8,331	
22	Walsall Htl	Kings' Forest	3,225	20 447
		Bloxwich Htl	4,768	
		Aldridge & Brownhills	4,368	
		Central Walsall Htl	3,634	
		Willenhall Htl	3,277	
		Darlaston Htl	3,196	19 243
23	Family Mosaic Housing	Family Mosaic Housing	17,266	
		Charlton Triangle	884	
		Landmark	820	18 970
24	Accent Group	Accent Foundation	12,305	
		Accent Nene Ltd	3,202	
		Accent Peerless	3,187	
		Accent Group	52	18 746
25	Peabody Trust	Peabody Trust	16,855	
		Cbha	1,427	18 282
26	Genesis	Paddington Churches	13,060	
		Springboard	4,525	
		George Greens Alms	21	
		Legg Whittuck Chy	8	
		Miss Rutlands	4	
		Loughton Alms	4	17 622
27	Servite	Servite	16,735	16 735
28	White Friars Hg Ltd	White Friars Hg Ltd	16,669	16 669
29	Contour Hsg	Contour	10,968	
		Hyndburn Homes	3,255	
		Peak Valley Ha Ltd	1,386	
		Rivers (Hillock)	891	16 500
30	Harvest Housing	Manchester & Dist	8,359	

Largest 50 Groups or HAs (by Total Stock Owned) in March 2008

rank	Group or Housing Association	Housing association name (group member HAs that do not own stock are not shown in the list)	Owned stock* HA total	Group total
		Derwent And Solway	3,073	
		Moorlands	2,792	
		Frontis Homes	2,165	16 389
31	Devon And Cornwall	Devon & Cornwall	9,087	
		Penwith	3,918	
		Tor Homes	3,307	16 312
32	Vicinity Housing Group	Liverpool Ht	9,659	
		Cobalt Housing	5,579	
		Beechwood	864	16 102
33	Trans-Pennine Housing Ltd	Pennine	12,234	
		Green Vale Homes	3,718	15 952
34	First Wessex	Atlantic	5,674	
		Pavilion	4,990	
		Portsmouth	4,837	
		First Atlantic	262	
		Hewitt Homes	53	15 816
35	Notting Hill	Notting Hill	11,941	
		Notting Hill Ho	3,594	15 535
36	Aster	Sarsen H A Ltd	5,800	
		Testway	5,149	
		Mendip Housing	4,125	
		Ridgeway Community	196	15 270
37	Radian Group Limited	Swaythling	5,923	
		Drum Hal	4,814	
		Windsor & District	3,755	
		Portal Housing	383	
		Longwood Park	337	15 212
38	Liverpool Mutual Hl	Liverpool Mutual Hl	15,045	15 045
39	New Charter Ht	New Charter North	7,631	
		New Charter South	6,737	
		Aksa	640	15 008
40	Spectrum Housing Group Lt	Western Challenge	6,843	
		Signpost	4,662	
		Medina	2,958	
		Signpost Care	461	14 924
41	Network Hgl	Stadium	7,731	
		Riversmead	3,140	
		London Strategic	1,727	
		Community Trust	1,023	
		Willow Housing	744	
		Mitali Ha	51	14 416
42	Catalyst Hgl	Catalyst Communities	9,236	
		Kensington Ht	3,390	
		Fortunegate	1,526	14 152
43	Jephson Homes	Jephson Homes	9,115	
		Jephson	2,740	
		Marches Housing	2,223	14 078
44	Housing 21	Housing 21	13,835	13 835
45	Yorkshire Housing	Yorkshire Housing	9,532	
		Brunel & Family	2,702	
		Craven Housing	1,509	13 743
46	Knowsley Ht	Knowsley Ht	13,740	13 740
47	Arena	Arena	10,533	
		Headrow Limited	1,071	
		Leasowe Community	978	
		Tung Sing	498	
		Arena Options	234	13 314
48	Moat Homes	Moat Homes	12,299	
		Bourne	949	13 248
49	Dominion	Acton	6,915	
		Kelsey	3,564	
		Cherwell Ht	2,062	
		Optimum	354	12 895
50	Helena	Helena	12,880	12 880

Source: Housing Corporation

Trends in the Gross Supply of Affordable Housing by Type of Scheme, England, FY00-FY08

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
Social rent, of which:	27,090	26,810	23,960	22,660	21,670	23,630	24,730	29,370
Housing Corporation (new build)	17,300	17,510	16,590	16,600	16,560	17,400	18,180	21,700
Housing Corporation (acquisitions)	8,840	8,140	6,420	4,290	2,610	2,410	2,360	3,390
Other Housing Corporation schemes ^d					870	920	950	660
Local authorities (new build)	180	60	200	190	100	300	250	310
Section 106 nil grant total (new build) ^c	750	1,070	720	1,580	1,530	2,550	2,750	3,130
Of which, recorded by Housing Corporation only					40	260	290	460
Private finance initiative ^e	20	40	30	0	10	60	240	180
Intermediate affordable housing^b	6,070	6,210	8,970	15,410	15,800	22,350	19,840	24,360
Intermediate rent, of which:				280	1,510	1,680	1,200	1,110
Housing corporation (new build)				260	680	1,370	1,110	1,050
Housing corporation (acquisitions)				30	830	310	90	60
Low cost home ownership, of which:	6,070	6,210	8,970	15,120	14,280	20,680	18,640	23,250
Housing corporation (new build)	2,260	2,040	2,330	3,710	5,570	7,570	9,210	12,040
Housing corporation (acquisitions)	2,380	2,270	4,550	8,850	5,800	7,710	3,050	3,540
Other housing corporation schemes ^d						490	570	130
Section 106 nil grant total (new build) ^c	450	1,060	1,250	1,550	1,900	3,810	4,440	5,090
Of which, recorded by housing corporation only					220	420	640	880
Assisted purchase schemes ^f	990	840	830	1,010	1,020	1,100	1,360	2,460
All affordable^a	33,160	33,020	32,920	38,070	37,470	45,980	44,570	53,730

^a Affordable housing is the sum of social rent, intermediate rent and low-cost home ownership

^b Intermediate affordable housing is the sum of intermediate rent and low-cost home ownership

^c Section 106 nil-grant completions are from the Housing Strategy Statistical Appendix returns and the Housing Corporation Investment Management System (IMS). Some Section 106 nil-grant completions are included in both data sources and have been excluded from one source to exclude double counting. The section 106 nil-grant completions from the IMS are excluded from the Housing Corporation rows to show total section 106 nil-grant completions

^d "Other Housing Corporation schemes" include homeless division, safer communities, recycled capital grant funds, disposal proceeds fund, and remodelled units. The homeless division figures include some refurbishments and new builds, and most figures will be units but a small number of bed spaces are included

^e Private finance initiative figures are mostly new build, but include a small number of acquisitions

^f Assisted-purchase schemes include instances where a dwelling has been purchased through the cash incentive scheme, voluntary purchase grant, right to acquire, social home-buy scheme, first-time buyers' initiative or London-wide initiative scheme. The first-time buyers' initiative and London-wide initiative scheme figures cannot be broken down below national level, so the sum of the regional figures may not equal the England figure

^g The figures have been rounded to the nearest 10, so the totals may not sum due to rounding

Source: Housing Corporation, English Partnerships, local authorities

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