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Research Update:

The Housing Finance Corporation Ltd. 'A+/A-1' Ratings Affirmed; Outlook Stable

Primary Credit Analyst:
Liesl Saldanha, London (44) 20-7176-3571;liesl_saldanha@standardandpoors.com

Secondary Credit Analysts:
Richard Sugden, London (44) 20-7176-7124;richard_sugden@standardandpoors.com
Giles Edwards, London (44) 20-7176-7014;giles_edwards@standardandpoors.com

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Rationale

On Dec. 23, 2008, Standard & Poor's Ratings Services affirmed its 'A+/A-1' corporate credit ratings on The Housing Finance Corporation Ltd. and subsidiary undertakings (together; THFC). The outlook remains stable. At the same time, it affirmed its 'AA-' rated bonds issued by T.H.F.C. (Funding No. 1) PLC.

The affirmation reflects THFC's franchise in the social housing sector, its adequate risk profile, satisfactory earnings prospects, and ongoing strong government support for the sector. These strengths counterbalance the potential challenges posed by the weakening outlook for the social housing sector, and the low interest rate environment, which will likely reduce THFC's investment income. THFC's modest liquid financial resources also constrain the ratings.

THFC's ability to meet its financial obligations is mainly dependent on its receipts from its underlying borrowers. While the social housing sector faces increased challenges with higher funding costs and reduced income from property sales, we expect THFC to continue to closely monitor the health of its borrowers. The system of government support and the regulatory framework continues to be proactive in preventing cash defaults by housing associations. In the event of a default, the robust collateralization of THFC's loans, which averages over 250% across the portfolio when calculated on a market value subject to tenancy basis, provides an indication of support in a recovery scenario. Our rating on THFC factors in no direct external support for THFC itself.

THFC's thin capitalization, and resultant modest liquid financial resources, is a key weakness that constrains the rating. As of March 31, 2008, the capital base of £7.6 million provided support to a balance sheet worth £1.8 billion. In addition, THFC's relatively narrow line of lending business presents single-industry risk, which is compounded by increasing borrower concentration risk. Loans to the top 10 borrowers account for about 35% of the loan book.

In recent years, THFC's competitive position in the funding market has been relatively weak, given its rather narrow product profile and more conservative lending criteria, when compared with some of its competitors. As a result, THFC has had modest success with new bond issues and funding mandates. However, the rising costs and scarcity of bank funding may lead more associations to tap bond markets via THFC. THFC has also developed a useful relationship with the European Investment Bank which, we expect, will help to underpin lending volumes in the coming year.

THFC is a small organization, leaving it somewhat vulnerable to staff turnover and key personnel risk. Although the business model is quite scalable, we consider that THFC has limited flexibility to adjust costs in the

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event that new business volumes fall materially.

As THFC lends on substantially the same terms at which it borrows, structural interest rate risk is minimal. However, the low interest rate environment will likely lead to lower investment income and net income for THFC in the medium term. While we expect profitability to remain satisfactory, lower earnings will prevent a material strengthening of reserves.

Outlook

The stable outlook reflects the support that the U.K government provides to the social housing sector, the quality and the diversity of THFC's loan portfolio and its prudent lending policies.

The rating will come under pressure if the reserves are eroded substantially or if in our opinion there is a significant change in government policy resulting in reduced support for this sector. In the short to medium term, key personnel risk and THFC's modest liquid financial resources are likely to cap the rating at its present level.

Ratings List

Ratings affirmed

The Housing Finance Corporation Ltd.	
Corporate credit rating	A+/Stable/A-1
T.H.F.C. (Funding No. 1) PLC	
Secured debt	AA-

Additional Contacts:
International Public Finance Ratings Europe;PublicFinanceEurope@standardandpoors.com
Financial Institutions Ratings Europe;FIG_Europe@standardandpoors.com

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