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CREDIT OPINION
21 June 2019

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RATINGS

LiveWest Homes Limited

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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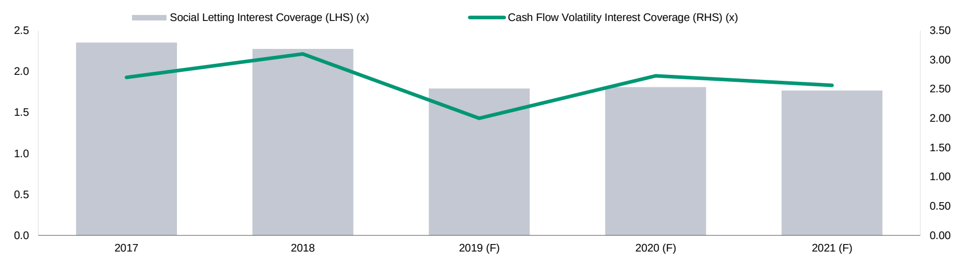
LiveWest Homes Limited (United Kingdom)

Update to credit analysis

Summary

The credit profile of LiveWest Homes Limited (LiveWest), A2 stable) is supported by the housing association's stable operating performance, ample interest coverage, moderate debt metrics compared to peers and a strong likelihood that the UK government (Aa2 stable) would intervene in the event that the association faced acute liquidity stress. LiveWest's A2 rating also incorporates credit challenges represented by a growing exposure to sales, high levels of capital expenditure, as well as integration and implementation risk from the merger of housing associations formerly known as Devon and Cornwall and Knightstone.

Exhibit 1
LiveWest's ample interest coverage metrics support its credit profile
Social housing letting interest coverage (x), Cash flow volatility interest coverage (x), Fiscal 2017-2021(F)



2017 and 2018 are audited financial statements, 2018 is the first full year of merged entity, 2019-2021 are forecasts
Source: LiveWest, Moody's

Credit strengths

» Strong interest coverage expected to continue

» Low level of debt, set to rise moderately to A2-peer median

» Strong regulatory framework

Credit challenges

» Higher net capex, growing proportion of revenues from market sales transactions

» Implementation and strategic risks from merger, but strong financial management

» Operating environment remains challenging but policy is more stable

Rating outlook

The stable outlook on LiveWest reflects our expectation that the housing association's credit metrics will remain in-line with A2 peers, as well as the currently stable operating environment, which is unlikely to undergo further material change in the medium-term, and the stable outlook on the sovereign rating.

Factors that could lead to an upgrade

We would consider upgrading LiveWest's rating if there was a strengthening in operating performance. Maintenance of current strong levels of interest coverage, in contrast to the expected weakening, would also support an upgrade. A reduction of market sales activity to levels sustained below 15% of turnover would also be credit positive.

Factors that could lead to a downgrade

We would consider downgrading LiveWest's rating in the event of a material scaling up of market sale development above currently proposed levels, together with a deterioration in the strong liquidity and unencumbered asset position. Negative pressure would also be exerted on the rating by an increase in debt-to-assets above 50%, or a failure to successfully integrate as part of the merger process.

In addition, a weaker regulatory framework, a dilution of the overall level of support from the UK government or the weakening of the UK's credit profile leading to a sovereign rating downgrade would also be credit negative.

Key indicators

Exhibit 2

LiveWest Homes Limited

	31-Mar-17	31-Mar-18	31-Mar-19*	31-Mar-20*	31-Mar-21*
Units under management (no.)	34,537	35,503	36,209	37,306	38,367
Operating margin, before interest (%)	29.8	26.7	26.6	27.9	29.1
Net capital expenditure as % turnover	36.8	20.4	53.4	46.8	40.3
Social housing letting interest coverage (x times)	2.4	2.3	1.8	1.8	1.8
Cash flow volatility interest coverage (x times)	2.7	3.1	2.0	2.5	2.4
Debt to revenues (x times)	3.3	3.2	3.3	3.5	3.7
Debt to assets at cost (%)	39.6	39.3	40.7	41.9	43.3

2017 and 2018 are audited financial statements, 2018 is the first full year of merged entity, 2019-2021 are forecasts
Source: LiveWest, Moody's

Detailed credit considerations

The credit profile of LiveWest, as represented in an A2 stable issuer rating, combines a baseline credit assessment (BCA) of a3 and a strong likelihood of extraordinary support coming from the national government in the event that the entity faced acute liquidity stress.

Baseline credit assessment

Strong interest coverage expected to continue

LiveWest's forecast interest cover metrics are expected to decline but remain strong relative to rated peers. LiveWest's strong interest cover metrics are upheld by a profitable core business, strong operating cash flows and a moderate debt burden relative to peers.

The social housing letting interest cover (SHLIC) for fiscal 2018 was among the highest of rated peers at 2.3x, compared to an A2-rated peer median of 1.9x. Going forward, the interest cover will weaken due to increased costs associated with full integration of the two previous housing associations, Devon and Cornwall and Knightstone, into one operational organisation as part of a merger completed in March 2018. We expect the SHLIC to average 1.8x over the next three years.

Cash Flow Volatility Interest Coverage (CVIC), which measures net cash interest expense against operating cash flow adjusted for historical volatility, also remained very strong at 3.1x for fiscal 2018 compared with an A2-rated peer median of 2.1x. The CVIC is also expected to decline going forward, averaging 2.3x over the next three years, still a very strong position relative to peers.

Low level of debt, set to rise moderately to A2 peer median

LiveWest's credit profile is further supported by the housing association's relatively low debt level and strong balance sheet. The group is planning on additional borrowing to fund development, with debt increasing from £736 million in fiscal 2018 to £989 million by fiscal 2021, but the increase will be gradual and the group will maintain strong debt metrics aligned to its A2-rated peers.

Gearing (debt to assets at cost) for the group was 39% for fiscal 2018, compared to an A2-rated peer median of 40% and wider Moody's-rated peer median of 49%. Gearing is expected to weaken over the next few years as borrowing increases, rising to 43% by fiscal 2021. Debt to revenues will also weaken from 3.2x in fiscal 2018 to 3.7x by fiscal 2021.

LiveWest's treasury policy with regards to debt is relatively flexible, allowing for between 60%-90% fixed rate (including floating rate debt swapped to fixed), 0-40% variable and index linked at 0-25%. As of March 2019, LiveWest had approximately 80% of debt held at fixed rates.

A significant proportion of this debt is fixed with standalone swaps; the total portfolio has a notional value of £406 million. Mitigating the high standalone swap exposure is LiveWest's ample unencumbered asset position, which can be used to post as collateral in the event of an adverse interest rate movement, and the excess security posted. At March 2019, LiveWest had a negative mark-to-market value net of thresholds of £87 million, which was easily met with allocated security of £129 million, £42 million above the requirement. Additionally, LiveWest's policy for managing mark-to-market risk requires the organisation to ensure sufficient available security (either property or cash) to cover a 50 basis point shift in the interest rate swap curve.

Strong regulatory framework

The sector's credit quality will continue to benefit from the strong regulatory framework and oversight by the Regulator of Social Housing (previously Homes and Communities Agency). The Regulator of Social Housing maintains strong oversight through quarterly returns, long-term business plans, annual reviews, and undertaking In-Depth Assessments of entities where deemed necessary. Additionally, the Regulator of Social Housing has powers to make board member and manager appointments where there has been a breach of Regulatory Standards. From October 2017, The Regulator of Social Housing will charge fees for social housing regulation, as a means of enhancing the independence and maintaining the effectiveness of the regulator.

Higher net capex, growing proportion of revenues from market sales transactions

LiveWest's capital expenditure (capex) is set to rise as the group increases its development. Net capex to revenues was in line with rated peers at 20% in fiscal 2018, but this will increase to 53% in fiscal 2019 and remain between 40% and 50% for the subsequent two years as the housing association develops social rented units, homes for outright sales and shared ownership properties. The capex to revenues going forward will be higher than that of its A2-rated peers who reported a median capex to revenues of 19% in fiscal 2018.

LiveWest's development pipeline targets a total of 6700 units over the next five years. The majority of the development programme is focused on social rent and shared ownership units, but the group is also building homes for outright sales. Revenue from market sales (outright sales and first tranche shared ownership) as a percentage of turnover are projected to increase gradually from 22% in fiscal 2018 to 28% by fiscal 2021. The market sales exposure is partially mitigated by the group's policy to maintain turnover from market sales below 30% of turnover, a credit positive. Compared to the previous year's business plan, the current business plan no longer includes build of market rent units and includes a higher number of shared ownership properties.

We expect profitability to remain strong for market sales given the group's track record and market characteristics in the South West of England. In fiscal 2018, LiveWest achieved a 23% margin for both its first tranche of shared ownership products (FTSO) and on properties developed for outright sale (OS). For fiscal 2019, the group expects full-year market sales volumes to be lower than expected, but profitability will exceed budget with a sales margin of 25% against a forecast of 23%. Looking forward, the business plan assumes achievable sales margins continuing near fiscal 2018 levels of around 17-20% for both OS and FTSO. While LiveWest does have experience in these tenures, and has achieved solid margins on these products in the recent past, increasing exposure to pro-cyclical market sales adds risk to the housing association's credit profile.

A strengthening liquidity position partially mitigates the increased risks taken on by LiveWest, as measured by Moody's liquidity coverage metric, which compares the two-year net-capex requirement with funds available for drawdown within 48 hours. LiveWest's liquidity coverage was aligned with peers at 1.1x as of fiscal year end 2019, and expected to average 1.4x over the next three years.

Furthermore, a sophisticated liquidity policy somewhat mitigates the sales risk associated with the growing development programme. LiveWest's liquidity policy sets out a requirement to maintain sufficient liquidity to cover 24 months of expenditure, plus all committed development spend beyond 24 months, in addition to a further liquidity provision which accounts for sales risk. The additional liquidity buffer is calculated as the cash effect of a six month delay in sales, accompanied by a 15% drop in sales values.

Implementation and strategic risks from merger, but strong financial management

As with any merger, there are implementation risks which could eclipse the benefits of combining two organisations. Company cultures, data, and IT systems may clash and lead to delays and overspend in the integration process. The newly composed Board may decide to pursue a more aggressive development programme.

We feel, in the case of Devon and Cornwall and Knightstone, that these risks are manageable. LiveWest's management has created a realistic timeline for integration, with current performance ahead of the original plan of £12 million of savings to be realised over the next three years. Due to performance being ahead of schedule, management have accelerated the timetable for efficiencies by 12 months and added an additional £5 million of savings to the merger base case, for total savings of £17 million.

The group forecasts a reduction in its management costs per unit as merger efficiencies are realised, an area of focus for management which is monitored as part of KPI reporting. Management cost per unit will decrease from £1,023 in fiscal 2020 to £940 by fiscal 2022.

LiveWest's management team demonstrate strong financial management, which is captured in their 'a' score for financial management. This assessment is based on a number of factors, including its strong decision-making framework (the Internal Financial Framework) which outlines minimum requirements for interest cover, cash, immediate and long-term liquidity, and maximum limits for debt to revenues and market sales exposure. The group also has strong stress testing with quantified mitigating actions. The high financial management score also reflects strong delivery against merger plans to date.

Operating environment remains challenging but policy is more stable

We do not expect additional material adverse policy shifts for the sector and considers the operating environment to be stable in the medium term. Adverse policies announced in the last few years will continue to negatively impact revenues, especially the effects of the 1% annual decrease in social rents (until FY2020) and Universal Credit (a pillar of broader welfare reform measures). However, HAs have demonstrated resilience to adverse policies to date and been proactive to mitigate the impact.

Extraordinary support considerations

The strong level of extraordinary support factored into the rating reflects the wide-ranging powers of redress available to the regulator in cases of financial distress, with the possibility of a facilitated merger or a transfer of engagements. Recent history has shown that the UK government (Aa2 stable) is willing to support the sector, as housing remains a politically and economically sensitive issue. The strong support assumption also factors increasing exposure to non-core social housing activities in the sector, that add complexity to HA operations, and the weakening of the sovereign's financial resilience, making an extraordinary intervention slightly more challenging. In addition, our assessment that there is a very high default dependence between LiveWest and the UK government reflects their strong financial and operational linkages.

Rating methodology and scorecard factors

Output of the baseline credit assessment scorecard

The assigned BCA of a3 is the same as the scorecard suggested BCA.

Exhibit 3
BCA Scorecard - Fiscal 2018

LiveWest Homes Limited			
Baseline Credit Assessment	**Sub-factor Weighting**	**Value**	**Score**
Scorecard			
Factor 1: Institutional Framework			
Operating Environment	10%	a	a
Regulatory Framework	10%	a	a
Factor 2: Market Position			
Units Under Management	10%	35,503	a
Factor 3: Financial Performance			
Operating Margin	5%	26.7%	a
Social Housing Letting Interest Coverage	10%	2.3x	aa
Cash-Flow Volatility Interest Coverage	10%	3.1x	aa
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	3.2x	baa
Debt to Assets	10%	39.3%	baa
Liquidity Coverage	10%	0.8x	baa
Factor 5: Management and Governance			
Financial Management	10%	a	a
Investment and Debt Management	10%	baa	baa
Suggested BCA			**a3**

Source: LiveWest Homes Limited, Moody's

European Social Housing Providers, April 2018 (1113602)

Government Related Issuers, June 2018 (1104983)

Ratings

Exhibit 4

Category	Moody's Rating
LIVEWEST HOMES LIMITED	
Outlook	Stable
Issuer Rating -Dom Curr	A2
LIVEWEST CAPITAL PLC	
Outlook	Stable
Senior Secured -Dom Curr	A2

Source: Moody's Investors Service

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