HARDMAN & CO. BESPOKE

MORHOMES 3.4% NOTES 2038/40

Low-risk issuer in a low-risk market

MORhomes (MH) is a pooled borrowing vehicle for housing associations (HAs). It offers its HA borrowers a flexible experience, rapid access to funds and potentially lower-cost funding. To its Social Bond investors, MH offers access to the socially responsible, low-risk HA market. MH's processes, capital structure, borrower selection and alignment of interests all reduce risk further. MH's launch involved many of a competitor's customers, and it has a unique position in the HA middle market. As it grows and matures, we believe it will be increasingly attractive to more borrowers. Its bond spreads have fallen by 29bps (15%) since launch.

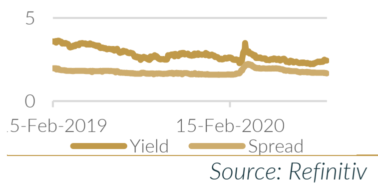
- **HA low-risk:** We are not aware of any capital losses incurred from lending to the large, long-established HA market. MH has i) resilient tenant income, ii) high-quality, conservatively-valued security, iii) government financial support, and iv) regulatory supervision. The COVID-19 crisis has confirmed this resilience.
- **MH-specific risk reduction:** MH has below-sector risk, with i) robust credit risk processes, ii) focused borrower conditions, iii) borrower financial resilience, iv) equity, contingent convertible and senior debt support, v) portfolio diversification, vi) excess, effective security, vii) undrawn £20m liquidity facilities, and viii) growth.
- **Valuation:** As a new issuer, with a modest number of existing borrowers, MH's cost of funds is above its expected, long-term level. Its spreads have already started to tighten (29bps, 15% since launch); and, as the business grows and matures, further tightening, and so capital appreciation, may result.
- **Risks:** For credit risk to be an issue, we believe it requires i) a material change in government policy, ii) customer behaviour to change, and iii) house prices to fall. Most regulatory changes have seen little effect, although the impact of Universal Credit (UC) has yet to be fully felt. Liquidity risk is tightly controlled.
- **Investment summary:** MH is a pooled borrowing vehicle with a unique position in the low-risk HA mid-market. It was established by many of a competitor's borrowers who wanted a more flexible, quick and low-cost service available to more of them. It focuses on the middle market, and with robust credit procedures, significant capital support, borrower alignment of interest and good security, so risk is further reduced in a low-risk market. Growth will deliver economies of scale and reduce interest costs, making MH even more appealing to borrowers.

Financial summary and valuation

Year-end Mar (£000)	2019	2020	2021E	2022E
Total income	114	790	1,155	1,406
Impairments	-54	21	-24	-33
Costs	-940	-974	-1,000	-1,050
Pre-tax profit	-880	-163	131	323
Total loans	259,157	315,636	502,124	753,186
Cash	2,347	1,903	4,750	6,938
Contingent convertible debt	0	3,269	8,002	12,003
NAV	2,501	2,746	3,943	5,711
Cost:income ratio	825%	123%	87%	75%
No. of borrowing entities	11	13	22	30
No. of shareholders	62	62*	64	66
Average loan size	23,560	21,042	22,824	25,106

**two new shareholders offset by two mergers of existing ones; Source: Hardman & Co Research*

Bond yield and spread over gilt (%)



Source: Refinitiv

Market data

EPIC/TKR (LSE)	61DP
Bonds Outstanding (£m)	333.9
Spread over gilt (bp)	170
12-month spread high (bp)	224
12-month spread low (bp)	160
Registration contact for tap issues	Andrew Morton, Deputy CEO & CFO, andrew.morton@morhomes.co.uk

Description

MORhomes (MH) is a pooled borrowing vehicle for the social housing sector. Over 60 major borrowing housing associations came together to set up a PLC, whose public debt is traded on the London Stock Exchange. The International Securities Market (ISM) is designated for professional investors, and the notes are not admitted to the Official List of the Financial Conduct Authority (FCA). MH raises bond market finance, and lends it on to housing associations. The first issue of £250m was completed in Feb'19.

Company information

CEO	Patrick Symington
Deputy CEO & CFO	Andrew Morton
Chairman	Neil Hadden

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Key shareholders

62 Housing Associations (none >5%)

Diary

24 Sep 9.00 am — Webinar – register with as@hardmanandco.com

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Disclaimer: Attention of readers is drawn to important disclaimers printed at the end of this document

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Executive summary

HA is very low-risk market

MH is operating in a low-risk market because i) HAs have sustainable income streams, with benefits being a significant source of tenant income, low rents, meaning there is little downside, low voids and stable asset prices, ii) borrowers are subject to regulatory oversight, iii) the quality of security is high and conservatively valued, and iv) it is a large, well-established market with proven risk management. The first insolvency in more than a century was in 2008 (Ujima) but, even here, we understand there was no loss for lenders. MH's IFRS9 assumptions are 0.03%-0.06% probability of defaults and 20%-45% loss in the event of default. In terms of COVID-19, i) arrears have risen, but only modestly so far, ii) letting activity is well down, so voids have risen, but the forecast ca.1.2% increase in the year is well within the financial capacity of HAs to manage, and iii) valuations have remained relatively stable. We highlight the risk from UC because, unlike other welfare reform changes, it requires a change in customer behaviour, which can be difficult to predict/manage. Other reforms have had a modest impact. MH reports income not directly related to high-impact social activities is at most 17%. These activities generate diversified income, but a different risk profile.

MH has reduced risk further

We believe MH's processes and procedures reduce risk further. We note: i) a good credit management with a balance between quantitative and qualitative measures, independence of review, and ongoing relationship with borrowers; ii) borrower criteria which see it focused in the lower-risk end of that market and with borrowers' interests aligned with MH; iii) borrower resilience above the market average and some important metrics improving June 2020 vs. March 2019; iv) MH's capital structure provides bondholders with massive protection through equity; v) effective security; and vi) underlying diversity by geography, unit sizes, and business models. MH borrowers have a balanced mix of social and non-social housing-related activities.

Yield outlook

MH offers service and product benefits that have a real value to borrowers. Over time, pricing should become increasingly attractive. The current yield reflects a rating that is depressed temporarily by two factors: i) a "start-up" penalty, despite its low-risk business; and ii) while the underlying risk is diverse, lending is somewhat concentrated in 14 borrower entities. As these penalties reduce, the rating should improve, and spreads contract, making MH attractive to a broader range of potential borrowers.

Unique position in market, with many borrowers from a competitor helping establish MH in first place. Flexible and quick service. Over time, pricing should reduce, expanding from current sweet spot in mid-market space, where competition from GBSH and bLEND modest.

MH has three "direct" competitors none of whom focus on its chosen niche. GB Social Housing (GBSH) was established in 2012, has £314m bonds in issue and a S&P rating of A-. The main differences compared with MH are that GBSH focuses on smaller borrowers (many not regulated to MH borrower levels), there is no shareholder alignment with borrowers, it has targeted slower growth and provides less capital support. The Housing Finance Corporation (THFC) was established 31 years ago and, across all its operations, including government guaranteed loans, provides £7bn of finance to 145 HAs. We find it interesting that many of these customers helped establish MH as a competitor to THFC. We believe they were looking for a more flexible service, to avoid the cost and disruption of getting a rating agency review, and lower cost. bLEND, a subsidiary of THFC, is the third pooled borrowing vehicle and it was set up in 2018. It has issued more bonds than MH, is focused on much larger, rated HA and has marginally higher security levels but lower capital support.

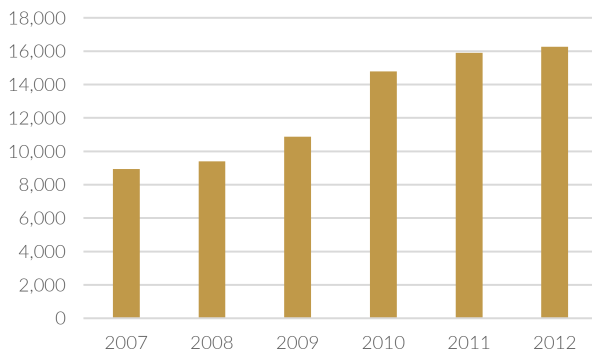
Social Bonds, and so of interest to ESG investors

MH issues are Social Bonds and it publishes reports on its social impact with independent review of its progress. Borrowers are not-for-profit organisations, which plough back any surplus into the community with many incremental social activities. MH voluntarily meets the corporate governance code and has excellent disclosure.

Potential investors should register with company an interest for future tap deals

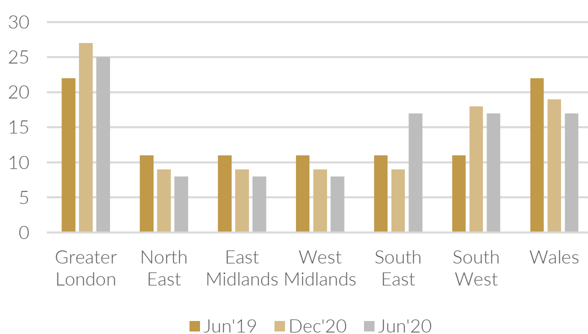
MH bonds have long-term appeal, and trading is unsurprisingly modest. Participating in tap issues is likely to be the most effective way of building a position. Investors wishing to do this should register an interest with Andrew Morton, Deputy CEO & CFO (andrew.morton@morhomes.co.uk).

Melin turnover throughout Global Financial Crisis (£000)



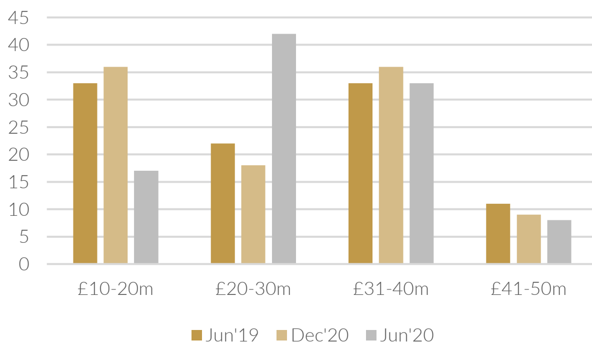
- HAs are low-risk, with resilient income streams (chart shows one of MH's borrowers throughout GFC).
- This reflects tenant income significantly supported by non-cyclical state benefits, low rents, meaning there is little downside, low voids and stable asset prices.
- Historical losses have been minimal – MH's IFRS9 assumptions are 0.03%-0.06% probability of defaults.
- COVID-19 effects so far have been a modest rise in arrears and voids, and stable asset prices – all well within the sector's financial capacity.

Geographical diversity of book (% loans by location of borrowers' head offices)



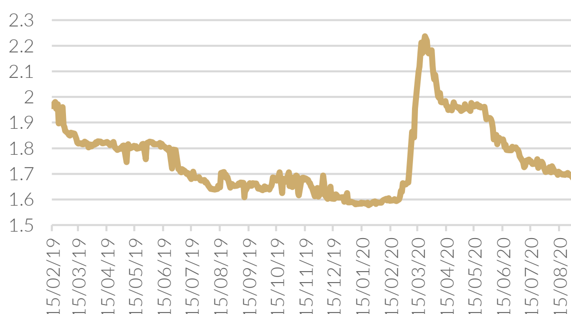
- MH reduces risk further in what is already a low-risk market.
- Credit risk assessment, monitoring and control are structurally robust.
- Borrower criteria reduces risk, and aligns interest with MH. They should show better-than-market resilience.
- Borrowers provide MH with equity and contingent convertible debt (combined 1.65% loans), aligning borrowers' interests with MH. Third-party Second Secured Debt is 3.5%. Our forecast impairment rate is 0.013%.

Percentage of loan portfolio by loan size (%)



- MH has unique sweet spot in HA middle market, driven by flexible and quick service.
- MH's approach should see lower administration costs, especially for middle-market players.
- As MH grows and matures, we expect the spread on its bonds to fall. In addition to service and product competitive advantages, its pricing will then be more attractive to a broader range of potential borrowers.
- Many borrowers of a competitor to MH helped set up MH.

Spreads have been falling since launch



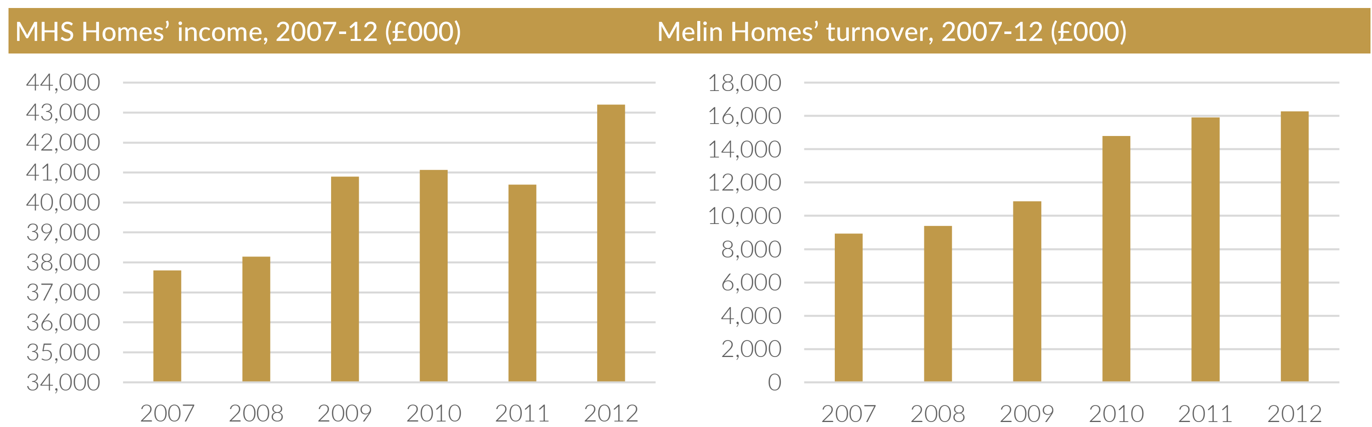
- Despite being effectively quasi-government risk, MH bonds provide investors with a spread premium.
- The spread over the benchmark gilt has fallen by 29bps since launch, having been down 40bps (20%) before a COVID-19 spike.
- Removal of the temporary "start-up" and concentration rating penalties is likely to see further falls.
- Such falls could then see mark-to-market valuation gains.

Source: Company data, Hardman & Co Research

HAs are low-risk

Resilience of HA income

The MH bonds fund back-to-back HA loans. The real risk for MH bondholders is thus to the underlying HA borrowers. MH bondholders can take significant comfort from the fact that HAs have multiple features, meaning that their income is recurring and non-cyclical. By way of example, the charts below shows the growing revenue streams reported by two of MH's borrowers throughout the Global Financial Crisis.



Source: Hardman & Co Research

The key factors driving this resilience are:

Tenant income is low but relatively stable, given significant elements are covered by state benefits. With such support, HA bond risk is, in reality, quasi-gilt risk.

- While HA tenant income is low (e.g. Kent-based MHS Homes' average income is £13,595, well under half the regional average), it is typically much less dependent on earned income and more on benefits. These include housing benefits (57% of social renters were claiming housing benefits in 2018/19 – see section on UC below), but HAs also serve the elderly and sick with their associated benefit income. By way of example, one of MH's borrowers, Local Space, reports that 90% of rental income is guaranteed through one of its local authority partnerships. Accordingly, most HA income may be considered government risk.

Rents unlikely to fall from already low levels

- Rents are well below market levels. For example, registered providers (RP) of social housing report an average weekly rent in London was £123 in 2018-19, with a high of £140 p.w. in Westminster[1] compared with ca.£400 for non-social new tenancies[2]. Across England, the English Housing Survey reported social renters paid £102 p.w. against £200 p.w. for private renters[3]. We note, in the borrower review section below, that such levels are consistent with MH borrowers. From this low starting point, rents are unlikely to fall materially or show the same volatility as private market rates, giving HA a much more predictable income stream.

[1] https://www.gov.uk/government/statistical-data-sets/live-tables-on-rents-lettings-and-tenancies Table 704
[2] https://homelet.co.uk/homelet-rental-index/london
[3] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/898397/2018-19_EHS_Housing_costs_and_affordability.pdf p6

Lower proportion of tenant income spent on rent than non-social housing

- Even though income is low, the lower rents means that social renters are paying somewhat less as a proportion of income than private renters[4] creating less of a potential strain and cause of default.

HAs experienced in managing tenants with financial difficulties

- HAs are well used to managing tenants who are in financial difficulties, ca.80% of whom have no savings[5]. What this means for bondholders is that managing financially stretched tenants is a normal course of business for HAs and they have processes and procedures in place to manage it. It does not come as a shock to the system to have strained tenants. Peabody[6] reported that nearly 70% of its tenants on housing benefits had some form of arrears in spring 2019. For the sector, arears were 4.7% of gross rent in March 2019. Bad debts as a percentage of gross rent were 0.8% in the years to March 2019 and 2018[7].

Low level of voids

- There are few voids with much more demand for HA properties and a strong desire to stay *in situ* due to few alternative accommodation options. Indeed, most voids are short-term or related to property refurbishment, rather than problems finding tenants. In the year to March 2019, the rent loss from voids was just 1.5%[8].

Diversity from number of tenants

- Most HAs have diversity from the number of tenants (we detail in the section below, MH's incremental risk reduction from targeting medium-sized not small HAs).

Stable asset prices driven from stable expected cashflow

- Asset valuations are driven off expected cashflows, which are themselves stable.

Security

High quality of security

The quality of security is hugely important as assets such as cars can mysteriously disappear during the collection process. With MH, security is either property or (on rare occasions) cash.

HAs conservatively value their properties. They assume the property will continue to be social housing and so see a lower capital value than a free-market, vacant possession one.

The affordable housing sector is unique in that it is the only type of property asset to have its own basis of valuation called the "Existing Use Value for Social Housing" (EUV-SH) in addition to consideration of market value with vacant possession (MV-VP) or a market value subject to tenancies (MV-ST). EUV-SH assumes a hypothetical sale to another RP on the strict assumptions that: the stock will continue to be let at affordable rents in perpetuity; will be managed in accordance with the regulator's requirements; and that any void properties will be re-let and not sold with vacant possession. Given these constraints, it typically produces a valuation that is considerably lower than the MV-VP or MV-ST. The difference is greatest in areas of the country with high market values and market rents and smaller in areas of the country with low market values and rents. MH's minimum security cover varies according to which accounting approach is adopted.

For a2dominion (a2d), the March 2019 accounting value, with a significant proportion of the book on EUV-SH, was £3.2bn, against open market value of £9.0bn

The conservative nature of the accounting can be put into perspective, by considering note 27 of London-based a2dominion's 2019 report and accounts. It highlights that, as at 31 March 2019, the accounting value of all completed housing stock, which included a significant proportion on EUV-SH basis, was £3.2bn, compared with an open market value (OMV) of £9.0bn. A full OMV may not be

[4] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/898397/2018-19_EHS_Housing_costs_and_affordability.pdf p6
[5] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/898397/2018-19_EHS_Housing_costs_and_affordability.pdf p4
[6] Source: The Impact of UC- Examining the risk of debt and hardship among social housing residents
[7] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/852013/2019_Global_accounts_of_private_registered_providers.pdf p14
[8] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/852013/2019_Global_accounts_of_private_registered_providers.pdf p14

achievable, given the constraints on liquidation we detail later; however, the fact it is ca.3x higher than the accounting value is noteworthy. Given the reputational damage, we do not believe any HA (or mortgage re-possessor) would be likely to sell tenanted social housing properties and so EUV-SH is a fair measure. However, untenanted properties could be sold at closer to open market values and we understand transfers between HAs have typically been well above EUV-SH, so the cushion to the market value is also relevant.

Government financial support

Grants and guarantees improve creditworthiness of borrowers

In addition to the government support via benefits to tenants, there have been a number of programmes to encourage and support social housing. We expect support, in some form, to continue well beyond the currently announced programmes, which run to 2026/27. For MH, it means that its borrowers have grants/guaranteed lower-cost funding support, making them more creditworthy counterparties.

Grant: Affordable Homes Programme (AHP)

This programme aims to increase the supply of shared ownership and other affordable homes in England. AHP is administered on behalf of the government by Homes England. Providers (including housing associations) are required to bid for grant funding, and then successful bidders enter into delivery agreements with Homes England. The March 2020 Budget announced £9.5bn for an extension of the AHP over five years from 2021-22; so, in total, the programme will allocate £12.2bn of grant funding from 2021-22 to build affordable homes across England. The government has confirmed that as a condition of receiving AHP funding, homes built must have the right to shared ownership attached.

In the table below, we have taken the total grants reported in the annual reports and accounts for each of MH's borrowers and compared it with their total housing assets. In aggregate, they report £2.8bn of grants representing nearly a third of the value of their social housing stock.

Importance of grants to MH's borrowers

	a2d	Aster	EMH	Hafod	Local Space	Melin	MHS	North Devon	pobl	SYHA	Thrive	Wandle	Total
Grants (£m)	1,054	257	231	177	7	140	29	14	320	159	13	390	2,790
% housing assets	40%	16%	29%	55%	1%	56%	6%	9%	35%	51%	7%	46%	31%

Source: Company annual reports, Hardman & Co Research

Affordable Homes Guarantees

The coalition government announced that legislation (The Infrastructure (Financial Assistance) Act 2012) would enable the government to underwrite the debt of HAs and private sector developers. Underwriting HA bonds was aimed at reducing the cost of finance for developing landlords. The programme was ended in March 2016 but the Chancellor's Spring Statement 2019 announced £3bn of further affordable homes guarantees. In July 2020, ARA Venn (website: https://www.ara-venn.com/) was announced as the preferred bidder to be partner to deliver the latest affordable homes guarantee scheme, which is likely to launch towards the end of 2020[9]. The earlier scheme was run by THFC but it has provided support to a number of MH borrowers.

[9] https://www.socialhousing.co.uk/news/news/mhclg-tenders-for-partner-on-potential-6bn-affordable-homes-guarantee-scheme-64319

HAs are regulated

Regulatory oversight is additional independent review of business with associated transparency. Also, it is likely to be positive for a conservative culture.

The importance to MH bondholders of the HA sector being regulated is threefold: i) there is an independent review of the borrowers, over and above that conducted by MH management, its board and the auditors, creating a fourth layer of defence; ii) regular public reporting by the regulator enhances transparency and allows investors to identify and review risk; and iii) although by no means guaranteed, from a cultural point of view, having to meet regulatory requirements is likely to see a more conservative approach to managing the business.

Regulator of Social Housing aims to ensure social housing providers are viable, efficient and well governed

The *Regulator of Social Housing* (RSH) regulates registered providers of social housing (this includes housing associations, local authorities and for-profit providers). Its statutory objectives are set out in the Housing and Regeneration Act 2008 (as amended). Focusing on governance, financial viability and value for money, as well as consumer standards, RSH ensures social housing providers are viable, efficient and well-governed and lay out the framework of engagement in its March 2019 document "Regulating the Standards"[10]. It publishes its regulatory judgments and notices on its website: *https://www.gov.uk/guidance/regulatory-judgements-and-regulatory-notices-a-to-z-list*. It grades providers on governance (G) and viability (V) with a range of outcomes: G1/V1 and G2/V2 compliant, G3/V3 non-compliant and intensive regulatory engagement and G4/V4 non-compliant, serious failures leading to either intensive regulatory engagement or the use of enforcement powers. In the section on borrowers below, we report each of MH's regulatory grading and related comments.

Welsh regulatory powers devolved

The Welsh Government has powers to regulate registered social landlords registered in Wales, which are more commonly known as "housing associations". The Regulation Framework applies to housing associations registered and regulated by the Welsh Ministers under Part 1 of the Housing Act 1996. More details are available at: *https://gov.wales/social-housing-regulation*.

Large, well-established and funded market

HA owns/manages 2.7m homes

The Regulator of Social Housing (English regulator) reports there are now ca.1,400 active providers of social housing of which ca.200 have more than 1,000 homes. In aggregate, they manage/own 2.7m units. The largest 215 contribute to the English regulator's quarterly surveys and annual global accounts reports from which we have extracted the following data.

HA borrowing facilities of £103bn (£81bn drawn). Virtually all saw end-March facilities as sufficient for coming year.

- The sector's total agreed borrowing facilities reached £103bn at the end of the March 2020, £61bn (59%) of which were bank loans and £40bn came from the capital markets. £81.2bn was drawn, leaving undrawn facilities of £21.9bn (the highest amount of available facilities ever reported by the sector). Cash available at March 2020 was also £6.3bn. Forecasts showed this reducing to £4.3bn over the next 12 months as cash reserves are used to fund capital investment. 93% of providers were forecasting that debt facilities at the end of March 2020 would be sufficient for more than 12 months[11].

[10] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/790533/Regulating_the_Standards_-_March_2019.pdf

[11] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/886406/Quarterly_Survey_for_Q4_2019-20.pdf

Quarterly operating surplus approaching £1bn (£3.2bn including asset sales), with interest coverage of 132%, excluding any asset sales.

- The same survey reported an operating surplus in 1Q'20 of £0.9bn before £2.2bn of disposal sales. Interest cover, based on operating cashflows excluding sales, stood at 132% in the quarter to March 2020 (December 2019: 129%). This compared with a forecast of 108% made in December 2019. The higher-than-forecast interest cover resulted from net cashflows from operating activities being £88m (6%) higher than forecast, plus capitalised repairs and maintenance being £95m (14%) below forecast. The latter reflects the sector's ability to manage cashflows as required when there is an uncertain outlook[12].

Most borrowing is fixed. A 2% rise in LIBOR would erode just over 10% of operating surplus.

The regulator reported that 75% of borrowing are at fixed rates of at least one year, reducing the sensitivity to interest rates. An increase in LIBOR of 2% could theoretically increase interest costs by approximately £400m per year against a surplus of £3.5bn in the year to March 2019[13].

No historical losses

No losses to date. When one HA over-expanded, it was rescued by another HA in a process co-ordinated by the regulator.

Neither we, nor Chatham Financial (advisers to the sector for over 30 years), are aware of any capital losses made by lenders to HAs. Recent incidences of near loss can be counted on one hand.

- In December 2007, Ujima, petitioned the Court to wind up and secured creditors appointed receivers, the first registered social landlord to suffer this fate. In 2007, Ujima, became the first housing association of any kind to go insolvent, breaching its lending covenants and triggering a call on security. Ujima had been expanding rapidly with heavy capital expenditure funded mainly by loans, which were meant to be serviced chiefly by rental income and which, in the end, were insufficient to cover capital spending. The Housing Corporation (regulator at the time) took control of Ujima, following acceptance of the Corporation's proposals by creditors, on 16 January 2008, Ujima's assets and liabilities were transferred to another HA, London & Quadrant (L&Q) and lenders did not see any capital loss. The independent *Report of the Ujima Inquiry* made a number of recommendations in July 2008. We believe MH is fully aware of the risk from such over-trading and understand the credit model is designed to monitor and flag this risk.

- In May 2012, the Social Housing Regulator (the Regulator) identified that Cosmopolitan Housing Group (CHG) was experiencing cashflow problems because expected funding for its development programme was not in place. This was the beginning of a crisis that, as it developed, brought the whole Cosmopolitan Group (the Group) to the brink of insolvency. The Group was rescued by the Sanctuary Group (Sanctuary) in March 2013, again protecting lenders from loss. The cause of the crisis was fundamentally the same (weak governance and management, and an over-ambitious development programme which over-stretched their finances), but Cosmopolitan was rescued ahead of insolvency. Again, there was an *independent report* on the lessons to be learned.

- In 2019, a struggling, small Scottish HA (Antonine) narrowly avoided insolvency, after statutory intervention triggered a breach of its loan agreement and it was required to repay its only loan. It only managed 330 homes, thus significantly smaller than anything MH would consider.

[12]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/886406/Quarterly_Survey_for_Q4_2019-20.pdf
[13]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/852013/2019_Global_accounts_of_private_registered_providers.pdf

MH's IFRS9 assumptions are 0.03%-0.06% probability of defaults and 20%-45% loss in the event of default; worst case 0.024%. By way of comparison, Barclays' impairment for unsecured consumer lending is 1,200x this level.

We note that, for its IFRS9 expected loss calculations, MH has used 0.03%-0.06% probability of defaults (PD) and 20%-45% loss given default (LGD) assumptions (the higher loss rate being for unsecured exposures). The worst loss would thus be 0.024%, the best 0.006% and the current stock of provisions is 0.01%. These assumptions are of course audited (KPMG) and from market-wide data bases (S&P (generic rating-driven, i.e. non-HA, PD estimates) and Basel Framework rates (LGD)). To put these exposures into a perspective, Barclays in its recent *interim results* advised impairment coverage ratio for the unsecured consumer lending portfolio increased to 12.0%, nearly 1,200x the level of MH's provisions

COVID-19

Going into COVID-19, sector was well positioned in terms of low voids and arrears

Going into COVID-19, mean current tenant arrears reported in the regulator's quarterly survey reduced to 3.6% in the quarter to March 2020 (December: 3.8%), and median arrears reduced to 3.0% (December: 3.2%), albeit both were up on March 2019 (3.3% and 2.9%, respectively). Median void losses for the year-to-date remained at 1.1% at the end of the quarter (December: 1.1%), while mean void losses remained at 1.6% for the sixth consecutive quarter (the mean average is affected by 12 providers reporting void losses of 5% or more)[14].

Arrears have risen but only modestly so far. Letting activity still well down, so voids have risen, but the forecast is ca.1.2% increase in year and well within financial capacity of HAs to manage.

The July HouseMark COVID-19 impact data[15] shows:

- Arrears increased a further 2.9% in June 2020, a slowing rate of increase (3.3% in May, 10% in April and 5% in March). By the end of the month, average sector arrears stood at 3.47% (May 3.37%, April 3.27%). This data is on a different basis from the arrears quoted above, so it is the trend that is important. We understand, however, there is significant variation within individual landlords and concerns remain of further increases once the government's job retention scheme ends.

Current voids equivalent to 7% of sector's surplus…

- There are now 50,000 properties empty but available to let in the sector (twice as many as HouseMark would expect to see) and equivalent to £5m in lost income for every week these properties are un-tenanted. If sustained for a quarter, this would be £65m, or 7% of the surplus reported to March 2020.

…but unlikely to be sustained for whole quarter, as letting activity has re-started

- Lettings activity is recovering as properties can now be visited. Levels recovered 82% in May compared with the previous month, but still remains at only a third of the level that would normally be expected at this time of year. Without significant focus from landlords to re-start standard void works and let empty homes quickly, in June HouseMark forecasts an average end-of-year void loss position of 2.34%, double the 1.14% they expected without the pandemic.

Number of operational constraints, but financial impact likely to be modest

The government introduced a range of measures to protect tenants through the COVID-19 crisis. Inter-alia these include suspending all possession proceedings until 23 August 2020 and extending notice periods to a minimum of three months between 26 March 2020 and 30 September 2020. We see this action as affecting HA's operationally in that it will be harder to evict problem tenants, but the financial impact of these temporary constraints is unlikely to be material.

Property value: valuers' conclusion in April was "rental income is remarkably robust and any increases in arrears or voids are marginal". No significant reduction in EUV-SH valuations, and MV-T valuations may fall by up to 10%.

Two leading sector valuers, JLL and Savills, in their joint statement on *EUV-SH and MV-T Valuations – Impact of Covid-19 Crisis*, published on 29 April 2020[16], considered the valuation practicalities, the housing market, EUV-SH and MV-T valuations. It was comforting to note that EUV-SH values are expected to hold up

[14] *https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/886406/Quarterly_Survey_for_Q4_2019-20.pdf* p20
[15] *https://www.housemark.co.uk/media/2688/covid-19-impact-monitoring-july-report-2020.pdf*
[16] https://www.housing.org.uk/globalassets/files/resource-files/coronavirus-impact-on-valuations---jll-and-savills-joint-statement.pdf

well on the basis of the balance of reduced income and costs. MV-T values may fall by up to 10%, which is aligned to negative house price growth, but which will vary according to local market conditions. In their conclusions, the valuers noted "rental income is remarkably robust and any increases in arrears or voids are marginal". We understand that MH had all its security revalued as at 31 March and saw almost no change in value, which is consistent with the valuers' statement.

Impact of Universal Credit (UC) unclear

UC has seen arrears rise significantly, but full effect yet to be seen

We highlight the risk from UC because, unlike other welfare reform changes, it requires a change in customer behaviour, which can be difficult to predict and manage. As implemented at the moment there is an increase in arrears (one report indicated 3x the number and much greater severity of arrears once there) and the failure of mitigating policies.

The rollout of UC has been slowed down but the goal is for full implementation by December 2023. On the upside, this allows HAs more time to prepare for the full impact, having seen the effects on the first tranches of their tenants, and also allows more time for further reforms to be introduced to the policy to help mitigate some of the most damaging effects identified to date.

Number of factors drive higher arrears, including lack of financial expertise, higher-priority spend, accidental underpayment and delays in receiving payments

UC recipients are experiencing higher-than-average arrears because i) tenants were not used to paying their rent, as housing benefit had previously been paid to the landlord, ii) tenants encountering any unexpected events have prioritised their rent below that expense, iii) "accidental" underpayment, where people who are unused to being responsible for the payment forget to do so, and iv) there are delays between a tenant's initial UC claim and receipt of their first payment. The Peabody research indicates reducing the time of first payment from six to five weeks reduced the average amount of arrears by between 8% and 13%.

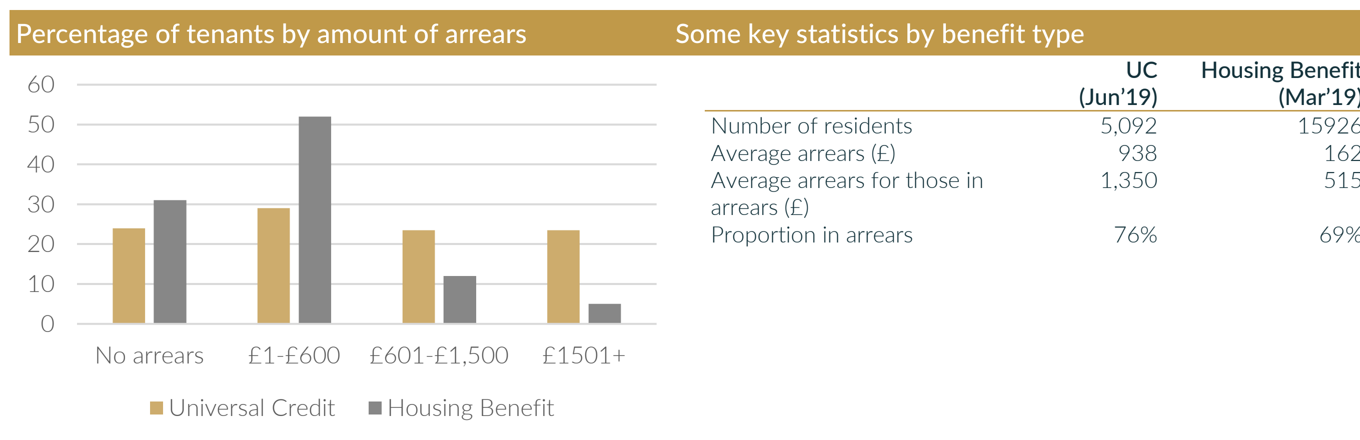
Peabody produced report when about a quarter of its benefit recipient tenants had moved to UC. More serious arrears (over eight weeks) ca.3x the level of other benefit recipients. Alternative payment arrangements fall short of their goals.

In September 2019, Peabody (the national HA) issued a report called *The Impact of UC- Examining the risk of debt and hardship among social housing residents*. At the time, Peabody had just over 5,000 tenants receiving UC. In addition to making a number of observations about the social impact on tenants (e.g. 30% going without essentials), there were a number of key conclusions of the impact on HAs. These include:

- 76% of claimants on UC are behind on their rent payments, with just 24% not in some form of rent arrears.
- About one third of their residents on UC are in arrears of more than eight weeks' rent, which is the amount required for a court to grant a mandatory eviction. They are three times more likely to be in this position than other benefits claimants.
- Despite policy concessions to improve the system, Peabody residents making the transition onto UC still experience spikes of arrears, which remain elevated over the long term.
- Alternative payment arrangements have been put in place to give flexibility to UC claimants who are at "risk of financial harm." The types of alternative payment arrangements include paying housing costs directly to the landlord, increasing the frequency of payments and splitting of monthly payments between partners. There is no significant difference in arrears status between those who had housing paid directly to the landlord and those who did not. This suggests alternative payment arrangements are being introduced too far down the line.

The report gave some interesting comparisons between the 5,000 on UC against the 16,000 who had been on housing benefit (in March 2020). As can be seen in the charts below, there is both a higher propensity to be in arrears, but also the amount of arrears is more serious.

Percentage of tenants by amount of arrears



Some key statistics by benefit type

	UC (Jun'19)	Housing Benefit (Mar'19)
Number of residents	5,092	15926
Average arrears (£)	938	162
Average arrears for those in arrears (£)	1,350	515
Proportion in arrears	76%	69%

Source: MH quarterly presentations, Hardman & Co Research

MH borrowers have range of experiences

We detail in Appendix 1, borrower snapshots, some of the borrower-specific comments on their experience with UC. There is a range of impacts but, from MH's perspective, we characterise the experience of its borrowers as having being broadly consistent with Peabody).

MH uses forecast data submitted to regulator in assessing credit, and this includes borrowers' views of UC impact

We note MH uses the financial forecast data in its credit model (which is based on data submitted by HAs to their regulator) to allow for the potential impact of UC. We believe there is now a sufficient number of borrowers' tenants already on UC for a reasonable view of the financial performance, although there remains some risk from further changes in behaviour.

Impact of other reforms modest

Other reforms saw reduced tenant income, but did not require new behaviour, making the change more manageable

We have highlighted UC because we believe it requires a fundamental change in tenant behaviour. In contrast, the other reforms we detail below have seen the absolute level of tenant income fall, but they have not required a change of behaviour. As a result, their effects have been more predictable and manageable.

Welfare changes include caps, freezes, bedroom tax and rent controls

Other changes in the past 10 years have included benefit caps, benefit freezes, size criteria (also known as the "bedroom tax"), and rent controls (e.g. English HAs had to reduce rents by 1% p.a. 2016-20)[17]. There is some mildly positive news in this area as rents in England can be raised by CPI+1% for the next five years. Welsh HAs had been allowed positive rent increases throughout but, going forward, is now capped at CPI. These changes have all been absorbed by HAs and reflected in the low arrears and voids and £0.9bn surplus in 1Q'20, pre COVID-19.

Voluntary right to buy (RTB) being piloted. HAs will get full value of property (likely to be significantly above EUV-SH shown in accounts). RTB a positive for MH bondholders.

HAs have agreed with the government a voluntary code for the "Right to Buy" based on four key principles: i) tenants would have the right to purchase a home at right-to-buy discounts (maximum discount of £77,900 (£103,900 in London)) subject to government funding for the scheme; ii) Registered Providers will have the final decision about whether to sell an individual property; iii) Registered Providers will receive the full market value of the properties sold, with the value of the discount funded by the government; and iv) nationally, for every home sold under the agreement, a new affordable property would be built, thereby increasing supply. A second pilot scheme is due to conclude shortly, testing the effectiveness of the

[17] https://www4.shu.ac.uk/research/cresr/sites/shu.ac.uk/files/cache-impact-welfare-reforms-housing-associations.pdf

code. We note that the provision that HAs will get the full value of the property is an important issue in limiting any impact on MH. Indeed, as HAs get the full market value of the property, this is likely to be an uplift on the EUV-SH valuations reported in their accounts.

The government has confirmed its intention to publish the Social Housing White Paper before the end of this year. When it does arrive, the sector can still expect enhanced consumer regulation and redress, as well as the need to report on their performance in relation to the customer voice, customer experiences and satisfaction, although the timing and extent of any changes are not yet known. Given current practices, and political realities (what government will want to be seen to attacking HAs), we do not believe that any financial impact will be material.

General building regulations changing post Grenfell. May incur one-off costs for HAs.

We also note the government issued in June 2019 a consultation paper called *Building a safer future: proposals for reform of the building safety regulation system* (April 2020 update available on https://www.gov.uk/government/consultations/building-a-safer-future-proposals-for-reform-of-the-building-safety-regulatory-system/building-a-safer-future-quick-read-guide). Changes in building regulations could affect the procurement, development, construction and management of existing and new build properties and on their valuations for security purposes. Our view is that any changes are likely to increase cost, may lower valuations and require some capital investment. The effect on MH's bondholders is mitigated as MH's credit model requires confirmation that the cost of meeting current and expected future requirements is fully provided for in the future cashflows (this is also a regulatory requirement).

Non-social housing activities

Range of other activities

HAs undertake a number of non-social housing activities, including i) affordable rented homes (typically at 80% of the local market rent, rather than the 50% for social housing), ii) shared ownership homes, iii) supported and specialist housing for, say, the elderly and people who need extra support to live independently, iv) market homes to rent and buy at market rents, with all the proceeds put into building more social and affordable homes or by investing in their local communities, and v) building new homes.

In aggregate, non-social housing letting income about a quarter of turnover, but lower-margin business, so smaller percentage of operating profit

The Regulators of Social Housing's 2019 Global Accounts of private registered providers provides some data on the importance of these activities in terms of turnover and operating profit for the sector. In aggregate, i) around three quarters of turnover comes from social housing lettings, ii) 14% comes from developments for sale (including both outright sales and low-cost home ownership (LCHO) first-tranche sales)) – profits from these sales have been falling (£1.4bn in FY'19, vs. £1.6bn in FY'18), iii) 8% comes from other non-social activity, and iv) 4% comes from non-letting social housing activities. The margin on non-social housing is relatively low, with surplus reported by the top ca.200 HAs of just £0.4bn from these activities in the year to March 2019, against £4.8bn from social housing activities.

While these activities generate diversified income, offer access to alternative finance and can be segregated from MH borrower legal entities, they create a different risk profile, which is likely to be higher than the core HA operations

These activities have a number of consequences for the risk profile of HAs and therefore on MH bondholders.

- On the upside, i) they generate income from diversified sources, ii) by providing such services, the HA can access incremental pools of government money, and iii) most developments are carried out by non-regulated subsidiaries, which are ring-fenced from the entities that are borrowing from MH. Should market conditions deteriorate, the failure of the development bodies may, depending on the exact HA construct, not lead to the failure of the MH borrower.
- On the downside, i) they bias the risk to both income and capital away from quasi-government support and more towards mainstream residential property,

ii) we believe residential property is a low-risk asset class, with both a modest probability of default and good security ensuring modest losses in the event of default, but HA risk is lower, iii) it requires a different, but complementary, skill set to manage such activities – MH notes that by far the biggest such activity is development for sale, either outright or as shared ownership and, where conducted, it is of a scale that may be regarded as a core skill for HAs, and iv) at times of stress, it could divert resources from the core business, albeit carrying some risk.

MORhomes reduces risk further

Summary

All the canons of lending are met by MH

Investors will be aware that we believe the fundamental canons of lending apply to all lenders (see for example p11 of our 2019 report on Debt Investment companies *Diving deep finds you the treasure*). As we detail below, we believe MH is robustly following all of these canons.

CAMPARI and ICE: the canons of lending

Requirement	Hardman & Co comment
Character	We believe most HAs are run by conservative boards who are aiming to provide their socially enriching offering for many years. Several of MH's borrowers have been going for 30, 40 or 50 years. Additionally, the borrowers are regulated, so MH benefits from an independent over-sight and the culture associated with this. MH borrowers have been willing to commit capital to MH and so align their interests.
Ability	We detail in the section below the specific financials and financial ratios of MH's borrowers. We take considerable comfort from this bottom-up review, which confirms MH's own presentations reporting robust financials.
Means	MH bonds are back-to-back lending with interest receipts from borrowers due 10 days before MH pays its interest.
Purpose	There is a clearly-defined, well-established purpose to the borrowing in a proven market.
Amount	The £10m minimum requirement gives MH's borrowers economies of scale and diversification of tenants.
Repayment	MH bonds are back to back lending with loans made to HAs. Interest is received in advance of interest payments due on the bonds.
Interest	The spread of 0.115% reflects the partnership nature of MH with its borrowers and, on our estimates, will achieve profitability for MH once scale is achieved (FY ending March 2022).
Insurance	We detail below MH's approach to ensure it has effective and sufficient security. On average, security held is 136% vs. 105%/115% minimum required. Security is valued on two bases, both of which reflect the implications of being low-rent, social housing giving less downside risk than most property classes.
Commissions	MH reclaims the expenses of bonds issues (in cashflow reported as loan asset re-charge), small charges for standby liquidity agreement, and security fees until security is in place. MH is not looking to charge for extra products.
Extras	MH benefits from each borrower committing both equity and contingent convertible debt (which are low cost to MH but still earn the borrower a positive turn).

Source: Hardman & Co Research

Looking at some of MH's company-specific risk reduction measures in more detail:

Credit risk management

- i) There is a good balance between quantitative and qualitative measures. MH uses five years of historical and five years of planned financial information to assess eight key measures. Risk is then graded with manual oversight, which sets limits at each level and by borrower; ii) Review is independent, with the whole process overseen by a credit committee, including directors and specialists co-opted on it. External reviews are also commissioned on each borrower. iii) Review and relationship management with borrowers is ongoing, including a minimum of quarterly reviews of performance – plus corporate actions, such as mergers, also trigger a review. iv) Extra cash collateral is called if limits likely to be breached. v) Any recovery through administration is likely to be managed, rather than seeing creditors' squabbles. MH's industry contacts may assist this process.

Borrower conditions

- MH borrower criteria see it focused in the lower-risk end of that market. It requires i) 2,000 home minimum, which ensures the borrower has diverse income streams and, at this scale, it is a regulated entity, ii) a minimum £10m borrowing, which again means borrowers are of scale and diversity, iii) a minimum 12 months' liquidity (the current actual average is 25 months), iv) the borrower to have sufficient unencumbered property and provide evidence of this through a due diligence exercise (we detail below how covers vary by valuation approach but, at present, on average, security held is 136%, vs. 105%/115% minimum required), and v) borrowers to align their interests with MH by taking an equity stake (equivalent to 0.5% of loan) and contingent convertible debt (1.15% of the loan).

Borrower financial resilience

- The portfolio has significant borrower diversity by risk, with strong financial and operating metrics that are indicative of financial resilience. In the quarter to June 2020 (i.e. including initial COVID-19 impact), MH borrowers improved margins, increased liquidity, and had interest cover at 165%. One borrower's credit level was reduced in 2Q'20 but that borrower increased liquidity significantly.

Capital support in MH structure

- MH's capital structure provides bondholders with substantial protection against this expected loss and aligns borrowers' interests. Borrowers put up 0.5% of loan as equity and 1.15% in contingent convertible debt. Combined this level is nearly 127x our forecast impairment charge. Additionally, a third party provides senior secured debt equivalent to 3.5% of loans (a further 269x expected loss).

MH approach to security

- MH imposes minimum security cover, which varies by the valuation approach adopted (105% where EUV-SH valuation and 115% if MV-ST) and asset (e.g. 155% has been set for the unusual circumstances when properties such as head offices/commercial property are charged). Borrowers, having proved upfront they have the security available, are currently given up to a year to legally complete the security, although the most recent security documentation has been completed within six months. At least one property must be secured before drawdown, so that MH has a seat at the secured creditor's table. We believe this temporarily increases risk (MH is an unsecured creditor until security is executed), but given all the other risk controls and processes, the inherently low-risk nature of HAs, and the fact that the credit will have very recently been assessed in detail, the exposure is both modest and short-term.

Portfolio diversification

- There is diversity by geography, unit size, business model and commitment to development as well a mid-market presence, which gives borrowers diverse tenant income.

MH borrowers' non-social housing activities

- MH borrowers have a mix of social and non-social housing-related activities with slightly greater-than-average non-social turnover, but this is driven by a couple of specific names, rather than a strategic intent.

Near-term growth outlook

- MH offers service and product benefits that have a real value to borrowers. Over time, pricing should become increasingly attractive. The current yield reflects a rating that is depressed temporarily by two factors: i) a "start-up" penalty, despite its low-risk business; and ii) while the underlying risk is diverse, lending is relatively concentrated in 14 borrowing entities across 12 HAs. As these penalties reduce, the rating should improve, and spreads contract, making MH attractive to a broader range of potential borrowers.

Credit risk management

Assessment

MH uses five years of historical and five years of planned financial information to assess eight key measures. Risk is then graded, with limits at each level and by borrower. External review commissioned. Whole process overseen by Credit Committee with specialists co-opted on it. Even in most extreme stress tests, the bonds are serviced in full and on time.

MH's credit assessment processes are outlined on slides 13-14 of its *January 2020 investor presentation*. The key features are:

- The financial review includes both the past five years of audited accounts and the non-public approved regulatory business plan for the next five years;
- Eight key financial ratios (adjusted EBITDA margin, adjusted EBITDA interest cover, Social Housing, SH EBITDA interest cover, net debt/EBITDA, net debt/voids, net debt per unit, liquidity, and capacity) are considered;
- Applications are then graded into five levels with caps on individual exposures determined by the risk grade (for example, at present, no level 4 application could be more than 6% of issuance, while the better-quality grade 1 cap is

12%)[18]. In addition to individual limits by risk level, there are also portfolio limits (L1 - unlimited, L2 - 60%, L3 - 30%, L4 - 20%)[19]. By way of comparison, Level one is broadly equivalent to Moody's rating A1; Level two is broadly equivalent to Standard and Poors rating A+ and to Moody's A2. Level three is broadly equivalent to Standard and Poors rating A and Moody's A3. Investors will note that MH's biggest loan (£50m) is to Local Space, which has the highest external rating of all its borrowers (AA-).

- An external party independently verifies the information and produces a detailed credit report.
- These quantitative measures are then overseen by a credit committee, which is independent and not under pressure from marketeers to grow the business. The committee includes three independent non-executive directors and two external members (David Carton and Andrew Newberry, see company section below for their biographies) who take a qualitative view on things like quality of management, business mix and the quality and location of the stock. The credit committee can increase the rating by half a notch but reduce it to any level considered appropriate, including declining a proposition that has passed all the other tests.
- Investors will note, from page 15 of the *MTN prospectus*, that MH conducts a number of stress tests. We believe they used severe assumptions (not a bad thing) and note that, even in the most extreme of these scenarios, the bonds (and second secured debt) were expected to be serviced on time and in full. This outturn (4.5% default rate/1.25% of the loan portfolio written off) can be compared with i) the fact that we are not aware of any capital loss from any HA lending to date, and ii) the proportion of loss should fall as new loans diversify the book. In the early stages, the implied 4.5% default rate could be seen by one account failing, but this falls away quickly with book growth.

Monitoring

Minimum quarterly reviews of performance

MH's credit management and monitoring processes are outlined on slides 15-16 of its *January 2020 investor presentation*. Loan limits are regularly monitored i) quarterly against budget and ii) annually (or more often) against the business plan/financial forecasts. Material changes in performance see the lending level raised/lowered, as appropriate, and changes to the lending level alter the borrowers' individual loan limits, restricting future borrowing.

Extra cash collateral if limits likely to be breached

In terms of a historical borrower, which could then breach limits, the borrower must pledge cash against the loan, with the amount of cash reflecting the severity of the fall (one-notch fall six months' interest, two-notch fall 12 months' interest). Should the reduction in the level see the borrower drop into Level five (which would be a "fail" for a new application), it must provide cash equivalent to 18 months' interest, 12 months plus added security cover and actively engage with MH to rectify the situation. The latter, we believe, is probable, as there has been an ongoing close relationship between borrower and lender.

[18] Note that the percentage of issuance is based off of £500m issuance until MH gets to that £500m mark. So, Level 4 is £30m, Level 3 is £40m, Level 2 is £50m and Level 1 is £60m.
[19] Note that these aggregate up, so if there is 0% at Level 4 then we can have 50% at Level 3 (being 30%+20%).

Corporate actions, such as mergers, also trigger review

Monitoring is not just about changes in creditworthiness. In the event of exceeding a credit level caused by a merger, the borrowers will be required to meet the same requirements, plus further penalties where the overall single name exposure limit is exceeded, e.g. for a Level one, if the combined exposure is 13%-15% of MH's issuance, the new borrower has to deposit one year's interest. If the combined entity meant the Level one exposure exceeded 25% (which would require a three-way merger of Level one borrowers, and MH does not at present have any), the new entity would have to at least partially redeem the loan.

Debt recovery

Any administration likely to be managed, rather than seeing creditors' squabbles, and MH industry contacts may assist orderly administration

The new powers in the Housing and Planning Act enable the Secretary of State or the Regulator of Social Housing to apply to the court for a housing administration order, which would appoint a housing administrator in the event of a private RP becoming insolvent. These powers give the Regulator of Social Housing 28 calendar days to assess the problem, develop a plan for the organisations and agree the solution with all creditors. If this is not possible, the creditors would then be able to enforce their security, which would likely result in an unstructured sale of the private registered providers' social housing stock putting tenants' rights around rent rises and other matters at risk. Housing administration has two objectives: i) to replicate normal company administration; and ii) additionally retain the social housing within the regulated sector. We note MH has extensive HA contacts to help ease any sale process and, for MH bondholders, this means any liquidation would be orderly and so likely to achieve better returns.

It should be noted that, legally, should MH enforce its security, it would be a mortgagee in possession and, since lenders are not regulated by HCA, they would not be bound by the same regulatory standards as bind RPs. Similarly, in the great majority of cases (unless there are binding restrictions on title) a purchaser from a mortgagee in possession would similarly not be so restricted and would be able, in principle, to operate the stock in a more commercial manner. In practice, we believe MH will act as if it was a RP as we detail in the section on collection below.

In practice, we understand that external legal advisors would be engaged to assist MH through the regulator-led rescue package (which also, noted above, has to date safeguarded loan debt) all overseen by Credit Committee members who have in-depth credit experience, including collections.

Borrower conditions

We note that, to be MH borrowers, they must:

2,000 home minimum do diverse income streams and regulated

- generally own and operate at least 2,000 homes[20]. This achieves three objectives: i) scale provides diversification of tenants; ii) at this level of properties, the borrower is subject to regulatory detailed oversight; and iii) it reduces the probable impact of HAs being lessors, rather than owners, of property, and we believe owners are lower-risk than lessors.

Minimum £10m borrowing

- in general, be prepared to borrow at least £10m[21]. Again, this introduces the scale benefits.

12 months' liquidity (actual average 25 months)

- have at least 12 months' liquidity available to satisfy in full all of its contracted cashflow requirements during that period. In its June 2020 update, MH advised the actual average available liquidity was 25 months.

[20] Can go down to 1,000 with prior MH Board approval, which is still a level with detailed regulation
[21] Can go down to £5m with prior MH Board approval

Have sufficient unencumbered property (on average, security held is 136%, vs. 105%/115% minimum required).

- own sufficient unencumbered real property to enable it to comply with the asset cover test on or before the required charging date. In its June update, MH advised on average security held is 136% vs. 105%/115% minimum required. The minimum cover itself depends on the valuation approach adopted (105% where EUV-SH valuation and 115% if MV-ST) and asset class (155% where agreed for small amounts of security accepted for office buildings and other commercial properties, based on advice from valuers on a case by case basis).

- have an objective to develop new housing or deliver other assets with high social impact (for example, care homes or extra care accommodation);

Align interests with MH via equity stake (0.5% of loan) and contingent convertible debt (1.15%)

- be willing to align its interest with equity and contingent convertible debt participation. We detail below how this is of value to MH bondholders.

The effect of such borrower restrictions can be seen in disclosure by MH's largest borrower by turnover, a2d. As can be seen in the table below, its rent arrears and re-let periods have shown remarkable consistency and, despite all the pressures from things like rent reduction and UC (see section below), arears to end-March 2019 were 18% lower than in 2012/13.

a2dominion – performance measures

%	2012/13	2013/14	2014/15	2015/16	2016/17	2017/18	2018/19
Rent arrears (general needs homes)	4.04	4.14	3.84	3.70	3.52	3.35	3.32
Re-let turnaround (days)	18	18	18	19	20	19	19

Source: a2dominion Report and Accounts, Hardman & Co Research

Borrower financial resilience

MH disclosure range of operational and financial measures by individual borrowers.

Slides 22-23 of MH's January 2020 investor presentation show the measures it uses. On the six financial measures, there were five different borrowers at most risk, showing a good diversity of risk. Local Space is lowest-risk in three, and it has an S&P rating of AA- Stable (the only UK HA to have such a rating) and a regulatory rating of G1 V1 (2017). Looking at the six operational measures, there were six different borrowers most at risk.

Selected key financials from MH presentation

	a2d	Aster	EMH	Hafod	Local Space	Melin	MHS	North Devon	pobl	SYHA	Wandle	Avg.	Sector
Adj. EBITDA margin	19%	32%	34%	18%	73%	20%	42%	15%	11%	30%	38%	35%	25%
Adj. EBITDA ICR (x)	1.0	2.0	2.0	2.0	2.0	1.9	2.3	1.4	1.1	1.5	1.4	1.7	1.5
Net debt/EBITDA (x)	15.7	8.2	7.8	8.1	12.6	14.7	7.4	16.9	11.4	8.2	11.7	10.4	10.0
Net debt/unit (x)	45.4	28.6	21.1	18.3	120.2	21.3	27.3	25.1	21.5	37.9	28.5	41.3	25.6
Liquidity	2.2%	2.5%	2.5%	1.0%	58.9%	0.9%	1.8%	1.8%	7.6%	3.0%	1.6%	10.0%	
Capacity	32.6%	17.4%	39.2%	27.8%	12.4%	29.90%	9.4%	10.50%	19.9%	41.1%	21.4%	24.2%	
Annual development (no. of units)	900	400	500	370	100	100	70	370	20	125		264	
Satisfaction	81%		81%	90.0%	92%	86%		87%	85%	61%	88%	81%	
Rent arrears	3.32%	2.10%			2%	1.92%		2.06%	2.90%	7.56%	0.70%	3.1%	
Voids	1.3%	0.8%	1.3%	0.6%	1%	1.01%	0.60%	1.93%	0.80%	0.01%	0.83%	0.8%	
New homes	2.8%	4.1%	2.4%	1.6%	9.9%	0.2%	2%	2.7%	1%	2%	2%	3.2%	
Open market sales	30%	21%	3.1%	2.6%	0.0	13%	12%	6%	2%	0%	0%	8.5%	
Cost of funds	4.5%	3.5%	4.8%	4.0%	4.2%	3.08%	4.36%	3.93%	3.55%	4.44%	4.60%	4.2%	

Source: Company annual reports (see glossary for terms), Hardman & Co Research

In the table below, we present the most recent published statutory information on the borrowers. Given that any loss will not be driven by average portfolio measures

but by an individual borrower's finances, we believe that investors should focus on that level of disclosure. While Hafod, Melin and SYHA all have low operating surpluses, when you look at the cash cover it is robust.

Selected key financials

£m	a2d	Aster	EMH	Hafod	Local Space	Melin	MHS	North Devon	pobl	SYHA	Thrive	Wandle	Total
Date of last accounts	Jul'19	Mar'19	Mar'19	Dec'18	Mar'19	Mar'19	Mar'19	Mar'19	Mar'19	Mar'19	Mar'19	Mar'19	
Income	372.2	211.9	103.8	55.4	29.1	24.3	61.4	16.2	134.7	48.7	27.4	68.6	1,154
Cost of sales	-128.4	-36.9	-2.6	0.0	0.0	0.0	-6.0	0.0	0.0	0.0	-1.3	-10.6	-186
Other costs	-190.2	-115.4	-70.2	-47.1	-11.0	-20.6	-29.0	-11.6	-112.0	-42.4	-17.7	-36.4	-704
Operating surplus	53.6	59.6	31.0	8.3	18.2	3.7	26.4	4.6	22.7	6.3	8.4	21.6	264
Asset sale surplus	9.7	17.6	4.0	0.5	0.3	0.0	1.3	0.8	-0.1	1.0	0.6	8.6	44
Op. surplus inc. sales	63.3	77.0	34.9	8.8	15.9	3.7	27.7	5.4	23.0	7.3	9	30.2	306
Interest receivable	7.9	5.0	0.0	0.1	0.0	0.1	0.1	0.0	4.4	0.1	0.2	0.2	18
Interest payable	-59.6	-28.4	-19.1	-4.9	-11.1	-3.0	-10.6	-4.4	-17.3	-5.0	-5.4	-12.5	-181
Post-tax surplus	23.9	55.4	15.7	3.5	4.7	0.7	16.4	1.0	9.1	2.3	3.7	18.8	1,55
													0
Housing fixed assets	2,633	1,586	788	322	480	252	461	157	912	311	182	855	8,939
Investment property	653	17	0	1	1	20	73	2	10	0	9	7	793
Cash	160	132	32	27	10	15	18	3	38	10	35	20	500
Net current assets	315	119	56	26	6	6	14	11	101	-1	34	5	692
Loans/debt > 1 year	1,572	936	127	127	295	94	239	96	438	118	156	301	4,499
Grants	1,054	257	231	177	7	140	29	14	320	159	13	390	2,791
NAV	945	561	176	68	187	16	309	56	255	33	43	126	2,775
Operating cashflow	146.8	151.8	54.6	14.1	17.6	4.1	33.8	1.9	15.3	11.3	13.3	36.2	501
Inv. activity cashflow	-102.6	-181.8	-68.0	-15.8	-77.5	-10.3	-36.9	-3.4	-16.4	-10.6	-31.9	-17.1	-572
Financing cashflow	-10.8	61.0	31.7	3.5	60.9	10.7	12.9	0	16.9	3.2	26.3	-5.5	211
o/w interest paid	-75.1	-34	-18.2	-4.9	-10.8	-2.8	-11.2	-4.4	-18.8	-4.2	-6.1	-13.4	-204
Ratios													
Op. surplus as % of turnover	**14%**	**28%**	**30%**	**15%**	**63%**	**15%**	**43%**	**28%**	**17%**	**13%**	**31%**	**31%**	**23%**
Op. surplus/CF int. paid	**71%**	**175%**	**170%**	**169%**	**169%**	**132%**	**236%**	**105%**	**121%**	**150%**	**138%**	**161%**	**130%**
Op surplus (inc. sales) to CF int. paid	**84%**	**226%**	**192%**	**180%**	**147%**	**132%**	**247%**	**123%**	**122%**	**174%**	**148%**	**225%**	**150%**
Cash to CF interest	**-213%**	**-388%**	**-176%**	**-551%**	**-93%**	**-536%**	**-161%**	**-68%**	**-202%**	**-238%**	**-574%**	**-149%**	**-245%**
Cash to expenses	**50%**	**87%**	**44%**	**57%**	**91%**	**73%**	**51%**	**26%**	**34%**	**24%**	**184%**	**43%**	**56%**
Loans as a % housing assets	**60%**	**59%**	**16%**	**39%**	**61%**	**37%**	**52%**	**61%**	**48%**	**38%**	**86%**	**35%**	**50%**
NAV as a % housing assets	**36%**	**35%**	**22%**	**21%**	**39%**	**6%**	**67%**	**36%**	**28%**	**11%**	**24%**	**15%**	**31%**

Source: Company annual reports, Hardman & Co Research

In quarter to June 2020 (i.e. including initial COVID-19 impact), MH borrowers improved margins, increased liquidity, and had interest cover at 165%. One credit level was reduced in 2Q'20, but that borrower increased liquidity significantly.

In its latest quarterly update (published end-July 2020), management commented that it had now seen returns from all borrowers to end-June, which showed the initial COVID-19 effect and their updated plans to reflect expected impacts. On average, i) adjusted EBITDA margins have improved slightly, ii) there has been a noticeable increase in liquidity, iii) there remains significant capacity in uncharged property stock, and iv) interest cover remains strong, at 165%. We believe this reflects the conservative nature of the borrowers and actions taken such as deferring investment. The interest cover is well above the market level reported in the regulators report to end-March. In the quarter, one Level three borrower was downgraded to Level four. MH commented that the borrower had strengthened liquidity significantly, so it was not an underlying concern. The downgrade was due to the short-term deterioration in some other metrics due. The borrower remains within its (now lower) credit limit.

Capital support in MH structure

MH's capital structure provides bondholders with considerable protection against this expected loss, and aligns borrowers' interests. Borrowers put up 0.5% of loan as equity and 1.15% in contingent convertible debt (CoCo). Combined, nearly 120x expected loss.

MH has both a very low incidence of default (0.03%-0.06% in MH's IFRS9 calculation) and low loss in the event of default (20%-45% in MH's IFRS9 calculation). The implied expected loss on even its riskiest assets is thus 0.024%. In addition to this low-risk book, MH's capital structure provides bondholders with protection against this expected loss with both a financial buffer but also, importantly, by aligning borrower interests with MH.

- Equity. After initial start-up losses (£730k FY'19, £116k FY'20), MH had 31 March 2020 equity of £2.7m, 0.87% of loan assets. Going forward, new borrowers are required to invest the equivalent of 0.5% of their loan in further equity (38x expected loss). Existing shareholders have to top up by the full 0.5%.
- At end-March 2020, there was £3.6m of CoCos, which, for accounting purposes, were split into £344k classified as equity and £3.3m as debt. Going forward, new borrowers contribute 1.15% of their loan (88x expected loss) in new CoCos. For MH, these instruments provide access to equity if required and come at very low costs (5% coupon) for such instruments. The borrower is committing the funds but receives a coupon, which means they make a positive return on the amount invested.

Third-party provides senior secured debt equivalent to 3.5% of loans (269x expected loss)

MH has a cushion of 3.5% of loans (269x expected loss) from a secured second charge debt facility provided currently by a third party. We understand that MH has discussed its growth ambitions and does not foresee any issues with further drawings on this line as more bonds are issued.

MH approach to security

The requirements for security to be provided by borrowers are given on pages 100–104 of the *January 2020 memorandum*. MH identified that a flexible approach to security was important to its customers and so adopted the following procedures:

Minimum security cover varies by valuation approach adopted

- Minimum security cover would depend on the asset type and how it was valued (for example, on the more conservative EUV-SH approach, cover of 105% was acceptable but 115% would be required if the MV-ST approach was adopted). Investors should note that the MV-ST is likely to be materially lower than a simple open market value. Where a different asset is provided as security, the minimum cover is up to 155% (where unusual assets such as head offices / commercial property are taken). Turning it around, this is a 64% maximum loan to value when many commercial property lenders set 70% as their cap.

Borrowers given up to a year to legally complete security, having proved upfront they have the security available. Latest security documentation being completed within six months.

- All borrowers had to prove (and this is verified by due diligence) that they had sufficient unencumbered real-estate security to meet the cover requirement. Critically, though, they would be given time to go through the legal process to formalise the security. Initial loans were given up to two years (100% secured now), while later loans were required to complete the documentation in one year (100% October/November 2019 lending was secured by 1 July 2020). MH has put in place processes to accelerate security pledging and we understand the new loans agreed in April 2020 (£35m) are on course to be charged within six months of drawdown. MH requires at least one property to be secured ahead of drawdown, so that it is technically a secured creditor and so has a seat at that table. There are increasing costs (/penalties) the longer the security is not in place.

Temporarily increases risk, but only marginally, given low risk inherent in HA sector and MH's other procedures to reduce risk further

- Having a period when the documentation is not in place over all the security does leave MH as a partially unsecured creditor and this is reflected in higher impairments provisions from a higher loss in the event of default. We believe this only temporarily and modestly increases risk, as i) the borrower has to prove sufficient uncharged property available to secure the loan before drawdown, ii) all the other risk controls and processes, iii) HAs are inherently low-risk by nature, iv) available security is one of the metrics in the credit model, and v) the fact that the credit will have very recently been assessed in detail.

Processes completed using standardised documents, externally reducing execution risk

The importance of effective execution cannot be understated. By way of example, we highlight s344 p88 of the FCA "the Failure of HBOS PLC A report by the FCA and PRA" (Hardman & Co emphasis), where over half of the security take by HBOS may not have been effective. In MH's case, we note the legal processes are completed externally (and so losses potentially covered by professional indemnity guarantees) with the costs re-charged to borrowers. Documentations has been standardised, again reducing execution risk. It should be noted that MH is only dealing with a small number of borrowers, each of whom can get a bespoke legal coverage.

Detailed valuations by third party

MH shared with us one its 70-page valuation updates provided by Savills. We are very encouraged by the detail to which the update is conducted (see Appendix 4), the fact it is an external party, and we think the fact that MH was willing to share it shows great confidence.

Portfolio diversification

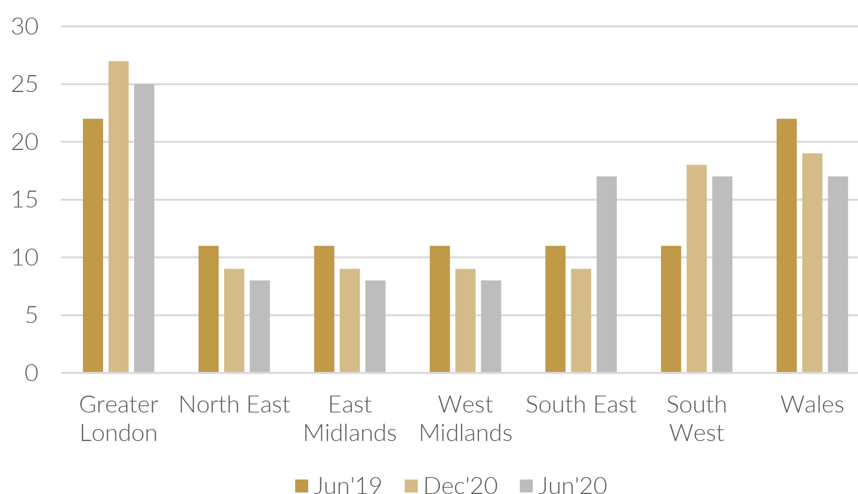
Diversity by geography, unit size, business model and commitment to development

In its June 2020 investor update, MH notes that its 12 borrowing groups (with 14 legal entity borrowers) have diversity by geography, unit size, business model and commitment to development. Six of the borrowing groups had public ratings (all S&P "A" / Fitch A+ or above) and they account for 55% of loans (£192.5m). By MH's own rating levels, 60% of the book (six borrowers) was Level two, 31% (five borrowers) was Level three and 9% Level four (one borrower, £30m).

Broad geographical spread – overweight presently in Wales

The geographical distribution is shown in the table below. Relative to the overall housing market, there is a greater concentration in Wales, but the number of borrowers remains modest at present.

Percentage of borrowers by region (measured by Head Office of borrower)

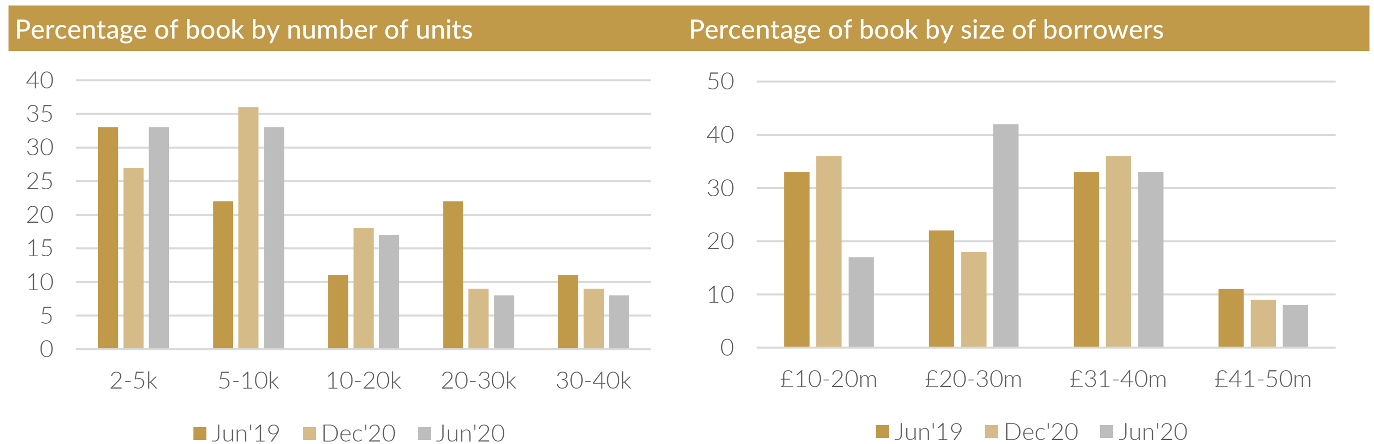


Source: MH quarterly presentations, Hardman & Co Research

Clearly in mid-market

For the reasons outlined above, MH is concentrated in medium-sized HAs, with most of its loans in the £20m-£40m range.

Percentage of book by number of units | Percentage of book by size of borrowers



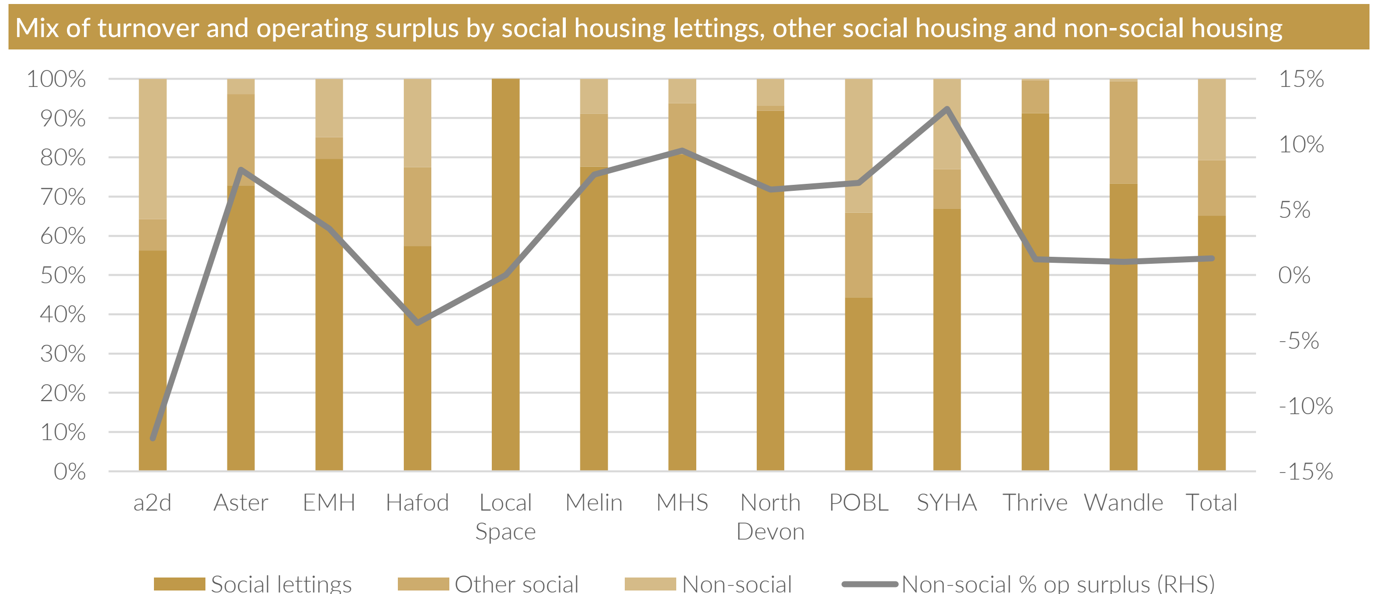
Source: MH quarterly presentations, Hardman & Co Research

MH borrower non-social housing activities

MH borrowers have mix of social and non-social housing-related activities

Readers will by now be aware that we consider the social-housing letting element to be extremely low-, indeed quasi-gilt, risk. We detail in the borrower profile section below the non-social housing activities of each of MH's borrowers, which, we believe, introduce diversity but a different risk sensitivity. Borrowers with a high proportion of non-social housing face a greater exposure to mainstream property prices and/or care-home-related risk. The table below shows the mix of turnover and how much operating profit is generated from these activities.

Mix of turnover and operating surplus by social housing lettings, other social housing and non-social housing



Source: Hardman & Co Research

Slightly greater-than-average non-social turnover but driven by a few specific names

We note that MH borrowers, in aggregate, generate slightly above-average turnover from non-social letting. There is a range of activities with the most notable being development for open market sales (ca.11% of aggregate turnover). As can be seen in the chart above, non-social income is concentrated in a few names with the rest broadly in line with the sector. Taking the individual borrowers with the greatest non-social letting turnover:

- Of particular note is a2d, where development income is a material source of revenue. It has ca.6,700 homes in development, with ca.1,200 delivered p.a.). It also builds high-quality sustainable homes for sale and shared ownership through the FABRICA by a2dominion brand. In 2019, non-social housing accounted for £133m of turnover but delivered an operating loss. It accounts for 57% of MH borrowers' total non-social housing income.
- Hafod – Of its £55m turnover in FY'18, £8m came from residential care homes and £10m from nursing care homes.
- pobl – In addition to 11,073 general need units, pobl provides 3,970 student units, 1,415 additional needs, 469 shared ownership units and 370 care home units.

MH's control of non-social housing income appears very robust. Taking development as the highest-risk category, there are quantitative and qualitative metrics to ensure borrower has skill in this area, detailed oversight, including seeing stress tests, and alternative uses for the property. All these should ensure no borrower becomes a forced seller at distressed prices.

MH is fully aware of the risks in non-social activities. It manages its exposure in a number of ways:

- The credit model and credit process concentrate on this area and have quantitative metrics that exclude sales income. Additionally, there is a "traffic light" system, which identifies risk areas that specifically include open market sales and care and support activities.
- There is an overlay of qualitative review. Only borrowers where MH has confidence in the management and their competency in these areas will pass credit committee. Most HAs run operating surpluses, which are re-invested in new property development, so there is usually a well-established track record of development as a core skill. Clearly, where development makes up a higher proportion of business, the borrower's competency at it gets more attention.
- MH sees the non-public five-year plans and, importantly, the borrowers' stress tests, which show how it would manage a no-sales environment to ensure it has sufficient liquidity to survive such an event. We understand these are similar to/the same as the ones submitted to the regulator.
- While some developments may be speculative, in that there is no buyer ahead of the development, HAs have a natural hedge as any unsold properties can be added to their social housing portfolio and so generate letting income. Even with rents at half market levels, they make a significant contribution to covering any borrowing costs. MH monitors the units of its borrowers, so it would quickly see if there were any potential delays/material increases in voids.
- With robust stress tests, strong liquidity and potential tenant income, unlike many private developers, MH borrowers are not in the position of being forced sellers who have to accept distressed sale prices.

MORhomes' liquidity

Liquidity risk tightly controlled

In the financial section below, we show MH's historical financials and our estimates. Current cash balances represent two years of expenses. We believe the real liquidity risk lies in interest payments. To mitigate this risk, i) we note interest on loans is expected to be received well before interest due on the bonds, ii) we understand there is an undrawn, £20m, two-year-committed funding line, which currently covers around two years of interest on the bonds, and iii) on our 2021 forecasts, cash will be a third of annual interest paid and, as the interest payments are received semi-annually and from multiple borrowers, the risk of MH not having the cash to make interest payments is modest, so we characterise MH's liquidity as very strong.

Near-term growth outlook

MH offers service and product benefits that have a real value to borrowers

MH has ambitious growth plans driven around offering its shareholder borrowers i) a low administration route to capital markets – for example, they do not need to get their own rating, ii) a flexible approach to security – both the nature of the asset and a period to complete documentation, so long as the security is there, iii) an innovative product range, including 11 shareholders having standby liquidity arrangements, and iv) rapid market access to take advantage of specific pricing opportunities. A new relationship director was hired in April 2020 to add further impetus to the growth plans.

So far, 34 shareholders have been through the credit rating process with two graded Level one, 15 graded Level two, 14 graded Level three and three graded Level four. To date, only 12 have drawn down, indicative of a material advanced pipeline.

We do not underestimate the value and importance of service in winning new business. MH developed a "Standby Liquidity Agreement" product, which takes advantage of the speed and efficiency of access to the market that they can offer. MH goes through the credit process and, if approved, for a fixed fee (typically £25k), MH's lawyers will then prepare all the necessary documentation for a borrower to go to the market, and hold it ready to execute on the borrower's instruction. This gives the borrower access to the market with as little as two to four weeks' notice for a fraction of the cost and resources required to access the market through other routes or an undrawn bank facility. MH has approved 11 customers for this product of which four were drawn down as at June 2020.

Over time, we would expect the pricing to also be a competitive advantage

MH bonds offer diversification that only the largest individual borrowers may get close to achieving and, over time, their pricing should reflect this. Management indicates that as a mature business and in normal conditions, they would expect the spread to be well below comparable private placements for most of its potential borrowers. However, at present, this is not the case, and we understand it rates are broadly in line with comparable private placements.

Pricing significantly based on rating, which is depressed TEMPORARILY due to two factors: i) it still attracts a "start-up" penalty, despite its low-risk business; and ii) its book is still relatively concentrated

Bearing in mind the better service noted above, this pricing differential may be a deterrent to potential borrowers and a constraint on near-term growth. It is important that investors understand what is driving the pricing and what may change. We believe a significant factor is the rating. Despite the low-risk market and MH's incremental risk reduction procedures, its S&P bond rating is just A- and has a negative outlook. It is anomalous to have this rating for a pooled borrowing vehicle when, as we have detailed above, each of the individual borrowers has a rating at least as good, if not better. We understand that this is due to two temporary factors.

- S&P ascribes all start-ups an incremental risk weighting given the lack of a proven track record. We concur that in many instances a start-up is an above-average risk but this does not take account of the very low risk that MH operates in and the incremental risk reduction practices it has put in place. We

understand this "penalty" applies for up to four years, i.e. it is likely to be removed in 2022.

- Secondly, the rating reflects the risk that concentrated books are above-average risk compared with diversified ones. Again, as a general rule, this is a view with which we concur, with the caveat of Warren Buffett's 1993 annual letter to shareholders, where he writes: "Portfolio concentration may well decrease risk if it raises, as it should, both the intensity with which an investor thinks about a business and the comfort-level he must feel with its economic characteristics before buying into it." The outlook for the S&P rating was reduced from positive to negative in December 2019 based on "prolonged expansion", i.e. slower-than-anticipated growth, meaning the book was more concentrated than originally expected. While MH's underlying exposure is to many thousand individual tenants, the legal risk is to 14 borrowing entities (in 12 borrowing groups). Assuming MH's current growth plans are delivered, one again may expect the removal of this penalty and again we highlight the illogicality of MH's rating compared with its borrowers who, individually, must be a more concentrated vehicle than MH but have at least as good ratings.

For bondholders, the rating, and consequent pricing has a number of implications:

Spreads should contract as these penalties reduce

- If the business grows successfully, its rating should improve, the spread will continue to fall (it is already down 29bp, 15% since launch) and, *ceteris paribus*, existing bondholders could expect a valuation uplift.

In short term, MH is most likely to be attractive to its smaller shareholder borrowers, but this will change over time

- For some borrowers, the incremental interest costs may be more than outweighed by the cost and disruption of say getting and keeping a rating. *Ceteris paribus*, this means MH has more of a competitive advantage with its smaller targets than the largest ones. As the rating improves, we expect larger HAs will be attracted, thus bringing increased diversity by borrowers and underlying tenants. It is worth noting that MH's minimum number of properties criteria means its borrowers have reached a critical mass and so the size of its borrower does not correlate to its risk grade.

As rating improves, it will look increasingly attractive to the lowest-risk borrowers

- For above-average-risk HAs, the current pricing is likely to still be attractive. At present, half of MH borrowers do not have a rating. This compares with 44% of shareholders assessed for credit. We note that the distribution of approved shareholders by MH's credit levels is also lower risk than the distribution of existing borrowers. Over time, as MH pricing continues to improve, it will look increasingly attractive to the lower-risk borrowers and the MH bondholders risk profile will consequently reduce.

MH has multiple legs to its strategy to better penetrate existing shareholders (market share ca.1% of existing debt) and new borrowers (total number in target space 4x shareholders). It is devoting more resource to sales, innovating on product and service, and broadening awareness of its proposition.

There is an element of virtuous (and vicious) circle here. As the book grows, pricing should fall, making it more attractive to lower-risk, larger borrowers, which in turn fuels more growth. However, to get into this circle, it needs to grow. We understand management's plans in this area include:

- the recent hiring of dedicated sales resource;
- allocation of additional resource to follow up on the 250 HAs on MH's database (i.e. four times the number of existing shareholders), thus aiming to win new potential customers, as well as better penetrate existing ones;
- increasing the number of shareholders assessed for credit, so that any launches can be brought very rapidly to the market, i.e. better penetration of existing "customers";
- increasing contact with intermediaries, such as treasury advisers;

- increasing the penetration of products, such as standby liquidity arrangements, the cost of which is refunded against issue costs if/when they borrow;
- adapting security charging processes, and introduction of "mechanical charging", which can enable borrowers to avoid security fees by getting the legal charges in place upfront if they want (with full due diligence to follow post-completion);
- regular investor engagement with existing and potential investors; and
- an increased market awareness programme through sponsored research to increase demand for issues, which should start the process of narrowing spreads.

Non-credit risks

Regulatory

Unforeseen regulatory changes could affect HAs, but appears unlikely, given social need for housing and practical political considerations

MH's borrowers operate in markets with multiple aspects of regulation and potential political intervention. As noted above, measures like 1% p.a. rent reductions over four years have proved manageable. There is uncertainty though over UC and, in a post-Grenfell environment, the ultimate costs of building regulations remain unknown. However, there is an important practicality to be considered. Social Housing as an industry is an essential service and is more likely to get government support than hindrance. We note the voluntary right to buy has seen HAs compensated at the market value for properties sold.

Liquidity of bonds

Bondholders bought them for long-term quasi-gilt appeal, so trading is limited. Accessing tap issues may be best way to build positions.

We note that while the bonds are quoted on the LSE (ticker 61DP), the trading in is minimal. This is to be expected as there are approximately 10 holders, all of whom are looking to MH bonds for their long-term, quasi-gilt risk profile. Accordingly, new investors are most likely to get liquidity when tap issues are made to fund new loans. Over time, as the book builds, it may be expected that there will be a greater amount of trading, but we believe it should be considered as long-term investment.

Participating in tap issues is likely to be the most effective way of building a position. The arranger of the programme was Barclays with dealers at Barclays, BofA Securities, Citigroup, J.P. Morgan, Morgan Stanley, NatWest Markets, Nomura and Santander. Alternatively, investors should register an interest with Andrew Morton, Deputy CEO & CFO (andrew.morton@morhomes.co.uk).

Investors will note that we believe that the spread on MH bonds primarily reflects the temporary issues around start-up and concentration penalties in its rating. In the section on valuation, we note that MH's spread is 39bps above bLEND's 2047 tranche. Interestingly, bLEND's 2034 smaller (£75m) tranche trades at a broadly similar spread to MH even though it is issued under the same programme as the 2047 bond. We understand that this is due to illiquidity in the bond. As MH grows, any distortion from its limited liquidity should also reduce.

Early repayment of loans

Any loan early repayment would be matched by bond redemption, with borrower liable for cost

MH is issuing long-term bonds; so the early repayment of a loan would potentially leave it earning a negative spread. In the event of any early loan repayments, MH would redeem/repay some bonds back-to-back and the borrowers are specifically liable for the "associated" senior note early redemption premiums.

Comparison with peers

GB Social Housing (GBSH)

GBSH established in 2012. Bonds in issue £314m. Rating S&P A-.

GBSH is the closest direct competitor. It was established in 2012 by the UK asset management division of MBIA Inc, a global insurance company specialising in public/infrastructure finance insurance in Europe (including the UK), US and Australia. Other than a £250k preference shareholding, MBIA now has no connection with the GBSH. GBSH provided an investor update on 1 July 2020 noting the loan book grew had grown £40m since April 2019 and bringing total GBSH bonds in issue to £314m. It made three taps of the 2038 issue (£25m up to £299m) and two taps of the 2047 one (£15m). As with MH, all borrowers are fully regulatory compliant (noting English borrowers with less than 1,000 units are subject to a much lighter regulatory regime – for example, they do not have Governance and Viability ratings (G1, V1, etc). Its S&P rating is A- stable (the same level but a more positive outlook than MH).

Main differences are: 21 borrowers (MH 12 borrowing groups); focus on smaller borrowers; no shareholder alignment with borrowers; slower targeted growth; less capital support to bonds with minimal equity and no CoCo

The main differences from MH are:

- GBSH has a greater focus on smaller associations with 12 of its 21 borrowers having loans under £10m and eight of them having less than 1,000 units. It also has 34% of its book in Scotland. This gives less diversification within each borrower, and we note that a lower regulatory regime in England applies to HAs with less than 1,000 units. GBSH believes that the lower size means that development risk is much reduced compared with larger, more complex RPs and a number of GBSH borrowers take no direct development risk at all.
- GBSH has a charitable purpose and all the shares of GB Social Housing plc are in trust for a designated UK housing charity. This provides a different alignment of interest from MH whose HA borrowers have to be shareholders.
- GBSH's targeted growth appears to be much lower than MH with an upper end target of £100m from up to 15 borrowers. Achieving this target would be an acceleration of new lending on recent levels (£40m in FY'20, £19m FY'19, £28m FY'18).
- Supporting the £314m bonds in issue, its total shareholder funds at end-2019 were £525k (after a loss in the year of £218k). It does not have a CoCo structure, and so provides much less capital support than MH bondholders.
- GBSH has a range of financial covenants depending on security offered (slide 30 of the investor update).

THFC

Established 31 years ago. Across group, £7bn, including AHGS. THFC itself loans £2.8bn.

THFC has a 31-year trading history and claims to have cultivated long-term relationships with the UK government and the European Investment Bank (whose money historically was passed without charging a commercial margin). Its most recent investor presentation was in September 2019. At that time, THFC provided more than £7bn to 165 Housing Association borrower groups throughout the UK. Of this, £3.244bn was through the Affordable Housing Guarantee Scheme. THFC itself had loans outstanding of £2.8bn. The total bonds in issue were £3.7bn (£1.6bn in THFC names, £1.7bn in AHF and £300m via bLEND see below).

Main difference is scale and maturity of the business, and both industry body and regulator are shareholders

- THFC has much greater scale than MH and having been established for so long does not suffer from the rating agency start-up penalty (and with a better rating can thus offer lower-cost funding). Its S&P rating is A. All shareholders of THFC are non-executive directors, except for the Regulator of Social Housing and the

National Housing Federation, who nominate board members. The latter are clearly important shareholders, and all members enter into a declaration of trust in respect of their shares in favour of THFC; however, again, there is less shareholder/borrower alignment than at MH.

THFC borrowers helped set up MH. Main reasons are service, security requirements and cost.

- It is worth considering why HAs, which could potentially access capital markets through an established player like THFC, would then create and support the establishment of a competitor like MH. THFC group loan growth has been anaemic (September 2019 £7.27bn, March 2019 £7.26bn, September 2018 £7.14bn, March 2018 £6.91bn) further evidence that its proposition has been unappealing. The key issues as we see them are:
  - MH offers a better, more flexible service, including i) not requiring security in place on day 1 (enabling the borrower quicker access to market to take advantage of best rates), or ii) considering different property types as security (e.g. shared ownership or HQ buildings), iii) the high level of security required by THFC – its September *investor presentation* noted all loans had cover of at least 150% (on MV-ST basis, MH on this basis 115% minimum), iv) THFC requires extra covenants, e.g. net annual income from the security must always cover interest payable on the loan, and vi) MH offers an innovative product range, such as standby liquidity arrangements.
  - We understand THFC costs are higher than MH.
  - Strategically having a single monopoly provider is rarely advantageous.

bLEND

bLEND subsidiary of THFC, set up in 2018. Issued more bonds than MH but focused on much larger HAs, with ratings and with higher security levels, but much lower capital support to bonds.

bLEND is a 100% subsidiary of THFC, established in 2018, sharing board members, management services (bLEND has no employees) and codes of governance. bLEND provided investors with an update in May 2020 ahead of its tap issue (*https://blendfundingplc.com/investor-update-2020/*). It has a Moody's A2 (stable) rating and post tap has £515m bonds in issue. In comparison with MH:

- All bLEND borrowers must have either a public or a private rating from Moody's. The latter means there is no management meeting but the borrower commits to providing Moody's with whatever information it requires to maintain the rating and this can be operationally demanding.
- bLEND has also committed that it will get written confirmation in advance from Moody's that any new loan agreement will not affect the rating at the time .
- bLEND has higher security requirements: i) asset cover is higher (120% MV-ST, 110% EUV-SH); ii) security is required from day 1; iii) there is a debt service reserve, which requires a dedicated cash reserve held against 12 months interest adversely affecting borrowers' liquidity/cash management.
- bLEND does not have CoCo support and equity just 0.1% of loans.
- bLEND exactly matches loans and bonds (no spread).
- Consequently, bLEND borrowers are larger (loans £25m, 2x £50m, £100m, £110m and £180m, respectively). All its English borrowers are G1/V1 rated.
- In its recent £125m tap (2047 programme) the yield in issue was 1.97%, a spread of 132bps over the benchmark gilt. This reflects its rating (Moody's A2 is equivalent to S&P's A, i.e. one notch better than MH) despite being a start-up. This may be a result of methodological differences (S&P vs. Moody's) or some credit being given for THFC's role.

ESG review

MH issues are Social Bonds and publishes reports on its Social Impact, with independent review of its progress

MH believes that its business model – assisting providers of affordable housing to raise capital – will resonate with investors interested in allocation of capital towards positive social outcomes, and has therefore decided to issue Social Bonds in accordance with the Social Bond Principles 2018. MH's Social Impact report 2019/20 is available on its website at https://morhomes.co.uk/wp-content/uploads/2020/02/MORhomes-Social-Impact-Report-2019.20-2.pdf. This report lists the 66 specific projects to which Social Bond proceeds have been allocated by each of MH's nine initial borrowers (this will increase with additional borrowers). Sustainalytics provided the 15-page second party opinion noting "Sustainalytics is of the opinion that the MORhomes Social Bond Framework is credible and impactful and aligns with the four core components of the Social Bond Principles 2018.". We note that, in March 2020, MH won the Environmental Finance award for the Corporate Social Bond of the year.

Next bonds intended to be Sustainability Bonds

Looking forward, we understand MH has advanced plans to "upgrade" the next bond to a Sustainability Bond, again applying International Capital Market Association (ICMA) principles and with an independent opinion. Sustainability Bonds are bonds where the proceeds will be exclusively applied to finance or re-finance a combination of both Green and Social Projects. More details can be found in this link on the Sustainability Bond Guidelines, which were issued in June 2018.

MH borrowers are outperforming the sector as a whole in terms of operating performance, particularly when it comes to delivering new homes. On average, they built 383 new homes in the financial year to March 2019, versus the sector average of 226. Tenant satisfaction ranges from 81% to 92%, averaging at 85% (slightly above the sector average).

Borrowers not for profit, so plough back surpluses into community. Many incremental social activities.

As the borrowers are working on a not-for-profit basis, they can drive funds back into communities, services and new developments. In addition to managing and maintaining homes and building new ones, their commitment to improving lives runs through their business plans and activities and is visible on their websites. Other social activities carried out by MH's borrowers include i) apprenticeship schemes, free training and job clubs, ii) money management support, iii) health classes, iv) holiday and lunch clubs for children, v) regeneration of existing communities, and vi) local employment initiatives.

Borrowers actively enhancing their environmental footprint

In terms of their environmental impact, most borrowers are setting stretching energy performance targets on new builds, improving energy efficiency in existing stock (by replacing windows, boilers, insulation, etc.), including green spaces for residents and have business models to minimise carbon footprints.

Meeting Corporate Governance Code, even though no obligation to do so. Governance enhanced by good disclosure.

Even though MH is not listed and so has no legal or regulatory obligation to apply any code of corporate governance or practice, the conservative culture of the company is reflected by its high level of corporate transparency. The Board is voluntarily following the provisions of the new UK Corporate Governance Code issued by the Financial Reporting Council on 16 July 2018 (the UKCGC). We note MH's regular reporting in quarterly bulletins, investor presentations posted on the website and engagement of sponsored research as practical examples of good disclosure.

Financials

The key driver to the financials will be growth. As noted above, the HA finance market is huge. Just taking its current shareholders, MH has made loans totalling £0.35bn against borrowing shareholders' debt of £4.6bn. Shareholders who have yet to borrow have further debts of £24.3bn, so MH has only a 1% share of its total shareholder debt. Our model assumes £753m of loans by March 2022, a share of just over 2%. We have assumed a spread of 0.115% against bond costs and impairments of 0.013% (up from the 0.01% cumulative provision to date). With the infrastructure largely built, the incremental expenses from here are modest.

Profit and loss				
Year-end Mar (£000)	**2019**	**2020**	**2021E**	**2022E**
Interest income	1,055	10,410	12,675	19,457
Interest expense	-1,058	-10,052	-12,207	-18,739
Net interest income	**-3**	**358**	**468**	**719**
Other income	117	432	687	687
Total income	**114**	**790**	**1,155**	**1,406**
Impairments	-54	21	-24	-33
Operating expenses	-940	-974	-1,000	-1,050
Pre-tax profit	**-880**	**-163**	**131**	**323**
Tax	150	47	-25	-61
Profit/loss for period	**-730**	**-116**	**106**	**262**

Source: MORhomes, Hardman & Co Research

Balance sheet				
@ 31 Mar (£000)	**2019**	**2020**	**2021E**	**2022E**
Property, plant & equipment	3	3	3	3
Loan assets	258,102	314,301	500,000	750,000
Total non-current assets	**258,105**	**314,304**	**500,003**	**750,003**
Trade and other receivables	281	600	600	600
Cash and cash equivalent	2,347	1,903	4,750	6,938
Loan assets	1,055	1,335	2,124	3,186
Total current assets	**3,683**	**3,838**	**7,474**	**10,724**
Total assets	**261,788**	**318,142**	**507,477**	**760,727**
Trade and other payables	-596	-600	-600	-600
Bond liabilities	-1,029	-1,231	-1,958	-2,937
Total current liabilities	**-1,625**	**-1,831**	**-2,558**	**-3,537**
MT note liabilities	-257,662	-299,353	-476,237	-714,369
Senior secured debt	0	-10,943	-16,737	-25,106
Contingent convertible notes	0	-3,269	-8,002	-12,003
Total non-current liabilities	**-257,662**	**-313,565**	**-500,976**	**-751,478**
Share capital	465	495	514	539
Share premium	1,886	2,159	3,073	4,303
Contingent convertible notes	286	344	502	753
Retained earnings	-136	-252	-146	116
Total equity	**2,501**	**2,746**	**3,943**	**5,711**

Source: MORhomes, Hardman & Co Research

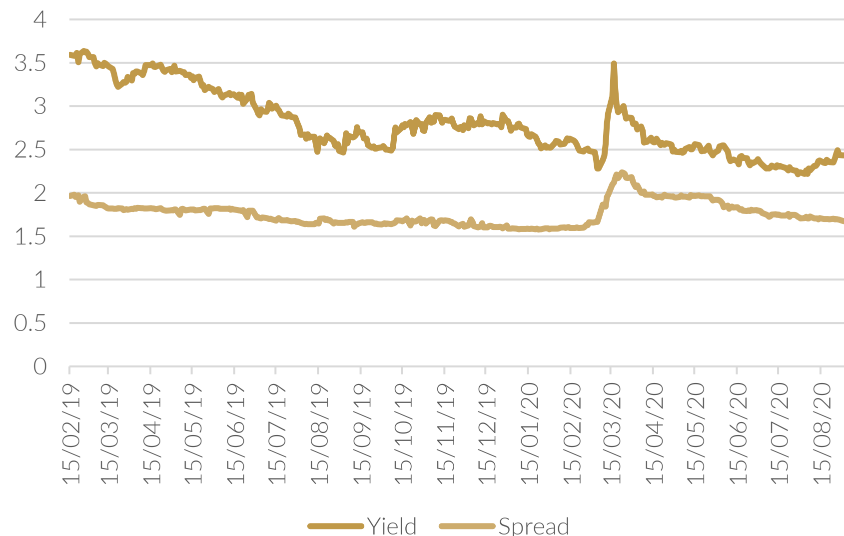
Cashflow				
Year-end Mar (£000)	**2019**	**2020**	**2021E**	**2022E**
Loss before tax	-730	-163	131	323
Depreciation	1	1	1	1
Interest payable	1,058	10,052	12,207	18,739
Interest receivable	-1,055	-10,410	-2,124	-3,186
Gain/loss on disposal of tangible assets	0	1	0	0
Tax credit	-150	-47	25	61
Impairment expenses	54	-21	24	33
Loan asset recharges	-105	508	2,153	2,777
Bond issue and prog. costs	-2,446	-360	-1,769	-2,381
Loan interest received	0	10,129	1,824	2,886
Increase in receivables	-131	-271	0	0
Increase in payables	596	-4	0	0
Net cash used in op. activities	**-2,908**	**9,415**	**12,472**	**19,253**
Interest paid	0	-10,036	-12,207	-18,739
Net cash used in ops.	**-2,908**	**-621**	**265**	**514**
Investing activities				
Fixed asset purchase	-4	-2	-1	-1
Loans advanced	-258,051	-56,660	-186,488	-251,062
Net cash in investing	**-258,055**	**-56,662**	**-186,489**	**-251,063**
Financing				
Proceeds from new shares	2,945	303	932	1,255
Bond proceeds	260,365	56,536	188,138	251,481
Net cash from financing	**263,310**	**56,839**	**189,070**	**252,737**
Total cash movements	2,347	-444	2,847	2,188
Opening cash	**0**	**2,347**	**1,903**	**4,750**
Closing cash	**2,347**	**1,903**	**4,750**	**6,938**

Source: MORhomes, Hardman & Co Research

Valuation

The chart below shows MH's narrowing spread to the benchmark gilt, and the fact that the taps have had no impact on pricing. The spread over the comparable gilt since launch has come down from 196bps to 167bps. Although the nominal spread has fallen, as a multiple at launch, MH bonds earned 2.2x the gilt rate, whereas now it is 3.2x. Given the limited trading, we believe the pricing needs to be treated with a degree of caution.

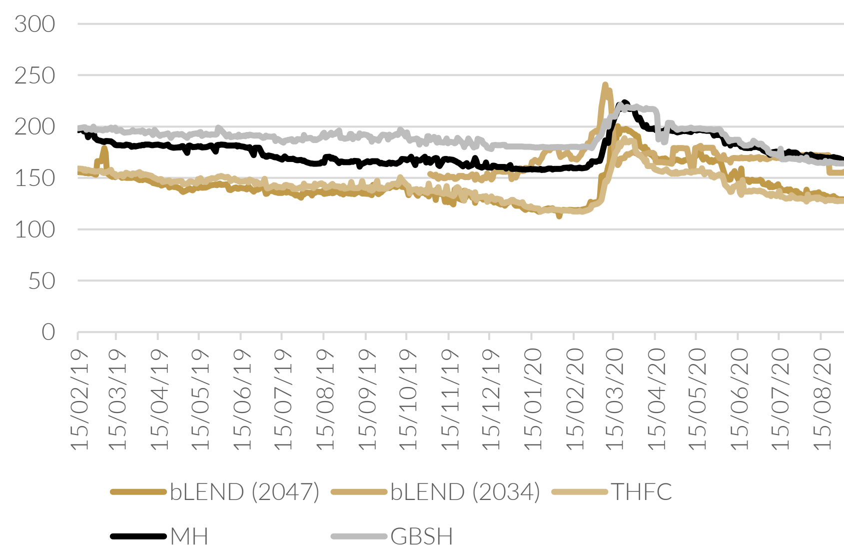
MH's yield and spread over gilt (%)



Source: Refinitiv data accessed 2 September 2020, Hardman & Co Research

The chart below shows MH spread over the benchmark rate relative to peers. As can be seen, MH, the small bLEND 2034 and GBSH are on broadly similar yields, while bLEND 2047 and THFC are 40bps-50bps below MH.

MH's and peers' spread over benchmark rate (bps)



Source: Refinitiv data accessed 2 September 2020, Hardman & Co Research

Appendix 1: borrower snapshots

a2dominion (a2d)

a2dominion South Ltd	
	Comment
Website	*https://www.a2dominiongroup.co.uk/about/at-a-glance*
MH Loan	n/d
Number of homes	38,133 owned and managed
Non-social housing activities	6,701 homes in development (ca.1,200 delivered p.a.). It also builds high-quality sustainable homes for sale and shared ownership through the FABRICA by a2dominion brand. In 2019, non-social housing accounted for £133m of turnover (36%) but delivered an operating loss.
Geographical focus	London (part of the G15, a group of the largest housing providers in London) and southern England. It works with more than 80 local authorities
Rating	Fitch A+, Regulatory judgement G1: V2. "It has an adequately funded business plan, sufficient security and is forecast to continue to meet its financial covenants." "As a consequence of a large and diverse development programme, a2d continues to face a range of risks and a high level of exposure to the private sale market. a2d currently retains capacity to deal with downside risk aimed at ensuring its long-term viability."
Funding	As at July 2019, total loans and borrowings were £1,609m of which £37m were due in one year and £462m within two to five years. £219m were on floating rates. Total bonds in issue £693m, including two Retail Bonds - 2022 (£150m, 4.75% unsecured) and 2026 (£150m 4.5%). It has a 1bn Euro Medium Term note programme – with debut issue of £250m, 12 years at 3.5%. As at 31 March 2019, the group had undrawn loan facilities of £405m (2018: £330m), which carry margins between 0.3% and 1.4%.
Other comments	More than 1,000 staff.

Source: a2dominion, Hardman & Co Research

Aster Group

Aster Communities Ltd + Synergy Housing Ltd	
	Comment
Website	*https://www.aster.co.uk/*
MH loan	£40m borrower in augural launch
Number of homes	30,791
Non-social housing activities	2019 revenue split: i) Aster communities: 73% affordable housing, 20% first tranche sales of shared ownership, 3% care and support; ii) Synergy Housing: 80% affordable housing, 16% first tranche shared ownership, 4% other
Geographical focus	Devon and Cornwall (5%), Dorset (33%), Hampshire (22%), Somerset (16%), and Wiltshire (24%) and starting in West Berkshire, Surrey and Sussex
Rating	A+ (S&P) Regulator: G1/V1 March 2020
Funding	Total loans £961m (£15m in one year, £116m in one to five years). Of the total, £450m own bond capacity £320m had been issued at March 2019 and £20m issued shortly after that. Interest rates in FY'19 ranged from 1.5% to 6.3% for fixed/hedged loans and 0.7% to 1.3% for variable loans. The average cost of funds for fixed rate loans is 3.27% and 4.5% under the guaranteed fixed-rate secured bonds. At 31 March 2019, the group had undrawn loan facilities of £173m (2018: £118m) to finance future operating cashflows and investments.
Other comments	Established in 1990, the group was formed by six large-scale voluntary transfers (LSVTs). Aster Communities: arrears 2.1% end-March 2019, percentage rent lost to vacant possession 0.8%, average days to re-let 17, general needs (30 days' Housing for older people). Synergy very similar statistics: properties include family-sized houses, homes for single people and couples, and accommodation specifically for customers aged 55 and above.

Source: Aster Group, Hardman & Co Research

East Midlands Housing Group t/a EMH group

EMH Housing and Regeneration Ltd	
	Comment
Website	*https://www.emhgroup.org.uk/about-emh-group/*
MH loan	£ 37.5m repayable 2038
Number of homes	20,000
Non-social housing activities	Midlands Rural Housing, emh care (delivers ca.16,000 hours of care and support each week within a supported living, registered care and nursing home environment), and Hello Homes. £15.4m of turnover out of £103.7m
Geographical focus	More than 40 local authority areas across the East Midlands
Rating	Regulatory G1: V1 October 2019
Funding	At March 2019, total loans £433m of which £5m due in one year and £39m in one to five years). Consists of £208m of bank loans, £27m from THFC and £199m in bonds.
Other comments	Bad debts of £588k on net rents of £80m. Total tenant arrears £3.4m current tenants (£1.7m provided for) against annual turnover of £104m.

Source: EMH, Hardman & Co Research

Hendre

Hafod Housing Association Ltd	
	Comment
Website	*https://www.hafod.org.uk and https://www.hendre.org.uk/*
MH Loan	n/d
Number of homes	4,500
Non-social housing activities	Through Hafod Care, Hendre provides care and support services to more than 1,000 people. Social housing letting accounted for £31m, other social housing £11m (of which £8m was residential care homes) and non-social housing £12m (of which £10m was nursing care homes).
Geographical focus	South Wales. Hendre works with nine local authorities
Rating	Regulatory statement https://gov.wales/sites/default/files/publications/2019-12/hendre-regulatory-judgement-2019.pdf.
Funding	As at December 2018, Hendre has housing loans of £129m (£2.5m due within one year, £6.5m due in one to five years). The interest rates are fixed at between 1.2% and 10.3% or vary with market rates.
Other comments	More than 1,400 staff. Hafod is a not-for-profit company established more than 50 years ago.

Source: Hendre, Hardman & Co Research

Local Space

Local Space Ltd	
	Comment
Website	*https://www.localspace.co.uk*
MH loan	£50m
Number of homes	2,660 homes (as of June 2020), the majority of which give homeless people a place to live. The rest of the homes are for keyworkers, most of whom work in the public sector.
Non-social housing activities	£0.1m of £29.2m turnover
Geographical focus	Mainly in the east end of London
Rating	AA- Stable (S&P) (the only UK HAs to have such a rating). G1 V1 (2017)
Funding	Debts included £171m of bank loans, £75m of bonds and £50m to MH. As at March 2019, it has undrawn facilities of £97m with a further £15m awaiting security formalities to complete. £143m was repayable over two to five years.
Other comments	Local Space was created in 2006 by a partnership between the London Borough of Newham and a group of housing professionals. During its growth period from 2016-2021, the group partnered with Newham Council to purchase 800 new homes; the remaining 76 properties will be completed by 2021.

Source: Local Space, Hardman & Co Research

Melin

Melin Homes Ltd	
	Comment
Website	https://www.melinhomes.co.uk/
MH loan	£10m drawn April 2020 + Melin original borrower (amount not disclosed)
Number of homes	4,246 (Nov'19) of which 3,516 general needs, 664 shared ownership and 66 commercial
Non-social housing activities	Of the £25.6m turnover, £19.1m comes from social housing lettings, £3.3m from other social housing activities and £2.2m from non-social housing activities (including £1.2m from care and repair.
Geographical focus	Wales – Blaenau Gwent, Monmouthshire, Newport, Powys, Torfaen
Rating	Governance and viability – standard (Welsh)
Funding	As at March 2019,the debt due in under one year was £10m in over one year, £37m in one to five years. Interest rates on fixed vary from 2.52% to 12.14% with floating at 1.44% to 2.09%.
Other comments	Rent arears at March 2019 1.92%, Void losses 1.01%

Source: Melin, Hardman & Co Research

MHS homes

Heart of Medway Housing Association Ltd	
	Comment
Website	https://www.mhs.org.uk/
MH loan	n/d
Number of homes	More than 10,000
Non-social housing activities	More than 500 homes in development.
Geographical focus	Medway, Maidstone, Gravesham, Dartford and Tonbridge and Malling areas of Kent.
Rating	MHS is unique in being an unregistered HA Group, although it has a not-for-profit constitution similar to regulated HAs. Heart of Medway is a regulated subsidiary, but because it is small it doesn't currently have a regulatory judgment. The decision to lend to HoM was carefully considered by the Credit Committee and specifically approved as an exception by the Board. MH monitors the financial status of both MHS and HoM.
Funding	Total bank loans of £245m include £6m due in one year and £31m due between two and five years. At 31 March 2019, the group had unused facilities of £60m, all of which is charged and available to draw. In addition, it arranged a further private placement of £10m in July 2019. This covered all the group's funding requirements to 2021.
Other comments	64% tenants in receipt of housing benefit, 31% have a long-term health condition, Average household income £13,595 (tenants), household £31,695 for shared ownership. 29% of new lets to previously homeless.

Source: MHS Group, Hardman & Co Research

North Devon Homes

North Devon Homes	
	Comment
Website	https://www.ndh-ltd.co.uk/
MH loan	£12.5m
Number of homes	2,275 (social), 426 (affordable), 511 (older persons), 60 other social housing, 815 other, including 679 garages
Non-social housing activities	Non-social housing related activities contributed £1.1m out of £16.1m turnover in FY'19.
Geographical focus	North Devon
Rating	Regulatory G1: V1 October 2019
Funding	Of the £96m of loans, just £4m were due within two to five years. The weighted average cost of loans was 5.12%.
Other comments	March 2019 arrears were 0.6%, only a small increase on prior year. At that date, 270 tenants transitioned to UC with arrears averaging 2.75% against 0.4% for non-UC customers. Voids were 0.83%. Registered charity with accounts filed at Companies House.

Source: North Devon Homes, Hardman & Co Research

pobl

Charter Housing Association Ltd/Tai Gwalia Cyf	
	Comment
Website	https://www.poblgroup.co.uk/
MH loan	n/d
Number of homes	15,960 homes and manages a further 1,337 properties owned by third-party landlords
Non-social housing activities	1,415 additional needs units, 3,970 student units, 370 care home units. The group provides services to more than 2,500 people, from registered nursing care to drop-in support and advice.
Geographical focus	Across Wales with roughly half in two areas: 4,363 units in Swansea, 4,010 in Newport
Rating	Welsh regulated: Governance – standard, Viability – standard https://gov.wales/sites/default/files/publications/2019-07/pobl-group-regulatory-judgement-2019.pdf
Funding	As at March 2019, pobl had outstanding loans of £463m (total facility of £554m), of which £379m was fixed at interest rates of between 3.2% and 10.9%. £164m was at variable rates between 1.6% and 4.3%. The weighted average cost of debt, inclusive of margins, as at 31 March 2019, was 3.93%. £44m was due in one year, £101m in one to five years and £336m in over five years. Capital markets funding stood at £125m.
Other comments	Rent arrears was 2.06%.

Source: pobl, Hardman & Co Research

SYHA

South Yorkshire Housing Association Ltd	
	Comment
Website	https://www.syha.co.uk/homes/
MH loan	n/d
Number of homes	3,800 social rented homes
Non-social housing activities	Works with more than 1,600 customers in supported housing, ranging from long-term, extra-care to short-term homeless services. Works with more than 7,000 people in its community-based health and wellbeing services, ranging from specialist employment support to social prescribing services. It also provides sales and lettings services via the SYHA Enterprises subsidiary.
Geographical focus	South Yorkshire
Rating	Regulator G1/V2 "It has the financial capacity to deal with a reasonable range of adverse scenarios. In optimising the delivery of its objectives, SYHA is undertaking a material level of low margin supported housing activity, and venturing into market rent financed through a model which introduces fixed, long-term repayment liabilities set against less predictable assumptions on income and costs. These activities, coupled with reducing covenant headroom caused by more prudent wider business plan assumptions, reduce SYHA's capacity and flexibility to cope with downside risk."
Funding	Loans > 1 year £118m (cost 3.66%), Government grants £143m, £5m loans due within one year. Average interest rate 3.66% (2018: 3.52%).
Other comments	Established 1972. Rent arrears end-2019 2.9%, general needs voids 0.8%. In FY'19, SYHA added 0.9% of social housing new supply (49 new homes). In addition, it has added 2% in non-social units (111 homes) through a leasing deal. More than two thirds of rent is received as housing benefit, and many supported housing schemes receive revenue grants from local authorities or health trusts.

Source: SYHA, Hardman & Co Research

Thrive Homes

Thrive Homes	
	Comment
Website	*https://www.thrivehomes.org.uk/*
MH loan	£25m drawn April 2020
Number of homes	5,000 (4,100 low cost rented homes)
Non-social housing activities	Housing for older people £3.4m turnover in FY'19 out of £25.0m, shared ownership £0.5m. Operating surplus £1.1m and £0.3m, respectively, out of £8.1m.
Geographical focus	Hertfordshire, Bedfordshire and Buckinghamshire
Rating	Rating agency: A, Regulatory G1/V1 Nov'19
Funding	£125m bonds, £25m loans repayable at fixed and variable interest rates of between 1.58% and 2.61%. In the year to March 2019, Thrive Homes secured a loan from a Local Authority partner. The loan is at a fixed interest rate of 4.69% and is secured by land owned by Thrive Homes.
Other comments	£107 per week average rent. Void turnaround 23 days. Arrears 2.7% March 2019, up from 2.18% March 2018 with ca.500 customers on UC (prior year 100). The group is seeing arrears for customers in UC generally being more than 10%, although it notes not all UC customers are in arrears and arrears levels drop over time.

Source: Thrive Homes, Hardman & Co Research

Wandle

Wandle Housing Association	
	Comment
Website	*https://www.wandle.com/*
MH loan	£38.6m
Number of homes	More than 7,000
Non-social housing activities	Providers of homes for affordable rent, shared ownership, outright sale, and supported housing. It also has a small portfolio of commercial properties and garages. Of the 7,306 units owned and managed, 161 were supported housing, 60 intermediate rent and key worker, 780 shared ownership, 488 leased units and 5,774 "general needs". Approximately 130 properties have been developed in each of the past three financials years of which about a third have been for London affordable rent and two thirds low-cost ownership.
Geographical focus	Nine south London boroughs with the biggest being Wandsworth (ca.1,800 properties, and Merton, Southwark and Croydon (ca.1,400 each).
Rating	3Q'18 (confirmed in December 2019 review) saw regulator downgrade its governance rating to G2/V2 with a governance focus on improved business planning and stress testing and enhancing risk management in its approach to treasury management. In terms of viability, the focus was on medium-term material refinancing requirements, and the need to maintain covenant compliance with a relatively high dependency on asset sales income concurrent with the need to achieve a relatively high volume of efficiency savings. The treasury strategy requires further development in order to facilitate the refinancing requirements in the medium term. WHA needs to embed recently created financial controls in order to increase its financial resilience and ultimately deliver a significant redevelopment scheme.
Funding	14% debt capital markets, 45% bank 41% revolving credit. Of the £305m of loans, £6m was due in one year and £35m in two to five years.
Other comments	As at March 2019, there were 852 tenants on UC (arrears 9.98% against wider arrears of 7.56%).

Source: Wandle, Hardman & Co Research

Appendix 2: HA history

Housing associations have their roots in early philanthropy and charity, dating back to at least 1235 when an almshouse in Cirencester was established to offer shelter for the seriously ill. The modern housing association movement was born in the late 19th century, when Victorian philanthropists set up charitable housing trusts to help homeless people and alleviate poverty. Many of today's housing associations – such as Peabody, the Guinness Partnership and Octavia – were founded in this period. While in first half of the 20th century, housing association homes made up a relatively small proportion of social housing (large council housebuilding projects), this began to change in the 1960s and 1970s with increased public concern about homelessness.

In 1974, a new Housing Act meant housing associations could receive significant public funding for the first time to build new social homes. By 1980, there were more than 400,000 housing association homes in England. In the late 1980s, many councils transferred their social housing into housing association ownership through large-scale voluntary transfer agreements. HAs were also given new freedoms to borrow private funding to build new homes, topping up the funding they received from the government. They built 419,000 new homes between 1990 and 2010. In 2010, funding for building affordable housing reduced by 60% and funding for new social rented housing was stopped altogether. HAs adapted to this change by generating their own income to build social and affordable rented homes. They developed more homes for sale and market rent and invested the proceeds into building more social homes and into supporting their local communities. They built almost 20k social rented homes between 2015/16 and 2018/19, as well as ca.77k for affordable rent and ca.43k for shared ownership. HAs are not-for-profit organisations providing affordable homes and supporting local communities. Their main activities are:

- Social homes: The most common type of home housing associations provide is social rented and affordable rented housing, which are offered to people on lower incomes at a subsidised rent. Social rented homes are usually rented at about 50% of the average local market rent and affordable rented homes are rented at ca.80% of the local market rent.

- Shared-ownership homes: Shared ownership is a more affordable way to buy a home. The buyer a percentage of the property, between 25% and 75%, and pay a reduced rent on the rest to a housing association. Buying a percentage means a smaller deposit and a smaller mortgage, so it can help the buyer take their first step on the property ladder sooner.

- Supported and specialist housing: Supported and specialist housing helps older people and people who need extra support to live independently. Housing associations are the main provider of supported housing in England, with 300,000 homes for older people and more than 115,000 homes for people who need extra support.

- Market homes to rent and buy: Housing associations also provide quality homes to rent or buy at market rates. They put all the proceeds from the rent and sale of these homes into delivering their social purpose, either by building more social and affordable homes or by investing in their local communities.

- Building new homes: Housing associations build thousands of new homes for communities around the country. In 2018/19, they built more than 45,000 homes, nearly a third of all new homes in England. This includes more than 5,000 homes for social rent, more than 19,000 homes for affordable rent, and more than 14,000 homes for shared ownership. To do this, they invest their own money to top up funding provided by the government. In 2017/18, they invested £10bn on top of £1bn invested by the government.

Appendix 3: company matters

Registration

Company Registered No. 10974098. Registered Address: Future Business Centre, Kings Hedges Rd, Cambridge, CB4 2HY.

Board of Directors

Neil Hadden – Board Chair

Neil Hadden entered the housing sector in 1978 and spent 27 years at the Housing Corporation, which was the industry regulator prior to the Homes and Communities Agency, where he held a number of positions, including serving as Deputy Chief Executive. He moved to Aldwyck Housing Association in 2005 and led the group through significant growth in his role as Chief Executive. He became Genesis's Chief Executive in October 2009. Neil left Genesis in April 2018 upon the merger with Notting Hill.

Malcolm Cooper – Board Member, Senior Ind. Director, Chair New Issues Committee

Malcolm is a finance professional with wide experience in infrastructure, property and construction. He spent more than 15 years as Group Treasurer for National Grid plc. He is a non-executive director at CLS Holdings plc, where he Chairs the Audit Committee and is Senior Independent Director at Morgan Sindall plc, where he Chairs the Audit Committee and the HSE Committee. He is also a member of the Audit Committee of Local Pensions Partnership Ltd and independent non-executive director and chair of the Audit Committee of Southern Water Services Limited.

Ann Santry CBE – Board Member

Ann was the CEO of Sovereign Housing, and previously CEO of the Swaythling Housing Society (now part of the Radian Group), and Development Director at the Guinness Trust. Previously, she was Vice Chair of the National Housing Federation.

Rob Young – Board Member

Rob is a fellow of the CIH, with substantial experience of the housing sector, and former Group Chief Executive of Helena Partnerships and Torus.

Peter Shorthouse – Board Member and Chair of Credit Committee

He is Director of Treasury and Structured Finance at Paragon Banking Group, and has more than 30 years of experience within financial services. Peter previously held roles at SG Warburg and UBS.

Andrew Kitchingman – Board Member and Chair of Audit and Risk Committee

Andrew is Chairman of Mpac Group Board, as of April 2018. He is also a member of MH's Audit and Risk Committee, and a member of the Remuneration and Nomination Committees. He is a non-executive director of Lonpro Holding PLC and Incommunities Group Limited, and is a director of The Cathedral Choir School Ripon Limited. He is a Fellow of the Institute of Chartered Accountants in England and Wales, and formerly worked in corporate finance for a number of firms, including KPMG, Hill Samuel, Albert E Sharp and Brewin Dolphin. Andrew is on the Board of the Andrews Sykes Group PLC as a non-executive Director

Charles Tilley OBE – Board Member and Chair of Nomination and Remuneration Committee

Charles led the CIMA (Chartered Institute of Management Accountants) as Chief Executive from 2001. He achieved 90% membership support to integrate CIMA's activities with those of the American Institute of Certified Professional Accountants in 2016, forming a $300m organisation supporting 600,000 members globally. On formation, he was appointed part-time chairman of the CGMA Research Foundation focused upon the issues critical to the ongoing relevance of the Management Accounting Profession facilitating good governance and decisions. Charles was awarded an OBE for his services to the economy in the New Year's Honours, 2016. He is currently the CEO of the International Integrated Reporting Council.

Executive staff

Patrick Symington – Chief Executive and Board Member

Patrick is a finance professional, originally from the private sector, with long experience in the housing sector as an executive director, NED and consultant. Patrick was most recently Executive Director at First Wessex, responsible for Finance, IT, Governance and Business Transformation. Until recently, he was also a Board Member and Chair of Risk at Stonewater HA.

Andrew Morton – Deputy Chief Executive and Chief Financial Officer

Andrew is a qualified chartered accountant, with more than 25 years' experience in financial services, firstly in practice with one of the Big Firms, followed by a range of different strategic, financial and commercial/business leadership roles with Barclays. More recently, he has been running his own advisory business, alongside a portfolio of Chair and Non-Executive Director roles.

Joseph Carr – Relationship Director

Joseph is well-known in the HA sector from his time as Policy Leader with the National Housing Federation and more recently as a Director with Altair Consultancy Services. He is a chartered accountant, and has a wealth of experience of the HA sector and its financial landscape. He is ideally suited as the main Executive point of contact between MH and its shareholders/borrowers.

Credit Committee additional members

David Carton

David Carton joined Legal & General Investment Management in 1981, and spent 35 years as an equity and credit analyst covering a wide range of companies and sectors, including the Social Housing sector. He was a member of Legal & General Investment Management's credit rating committee for several years up to his retirement in 2016.

Andrew Newberry

Andrew is a fellow of the Institute of Chartered Accountants in England and Wales. He has more than 20 years of experience in housing as a Director of Finance, during which time he helped his group (Radian Housing) grow from 3.5k to over 23k homes. This was achieved through organic growth funded through bank debt and bond issues, and through mergers. Prior to this, he worked in industries including Financial Services, Construction and Property Development, after working for an international firm of chartered accountants in the UK and Africa.

Appendix 4: external valuation

We detail below the contents page from one of the Savills valuations

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2.1. The Properties

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Appendix 5: glossary

Term	Definition
1. Adjusted EBITDA/revenues	a. Adjusted EBITDA – the total operating profits (before fixed asset sales) as taken from the financial statements, adjusted for property depreciation and impairment (add back) and capitalised major repairs (deduct). b. Revenues – the total turnover of the borrower as taken from the financial statements.
2. SH EBITDA/ interest	a. The total EBITDA from social housing activities – usually taken from note to the accounts detailing turnover, operating surplus and business segment but excluding shared ownership first tranche sales. It is the total social housing activities, not just social housing lettings. b. Interest – the total cash interest paid (as taken from the cashflow statement in the financial statements) less the total cash interest received.
3. Adjusted EBITDA (all)/interest	a. Adjusted EBITDA – as calculated in "1" above. The total EBITDA including all activities (social and non-social). b. Interest – the total cash interest paid (as taken from the cashflow statement in the financial statements) less the total cash interest received.
4. Net debt/ EBITDA	a. Net debt – total net debt from the financial statements. The total of short- and long-term outstanding debt less cash holdings (which can be allocated to the borrower's discretion). b. EBITDA – as taken in "1" above but does not include capitalised major repairs.
5. Net debt/(annual voids x OMV values)	a. Net debt – total net debt from the financial statements. The total of short- and long-term outstanding debt less cash holdings (which can be allocated to the borrower's discretion). b. Annual voids – the number of voids that the borrower usually encounters each year for the general needs portfolio. c. OMV values – a calculated estimate of the average open market value of each general needs property in the portfolio.
6. Net debt by total whole units	a. Net debt – total net debt from the financial statements. The total of short- and long-term outstanding debt less cash holdings (which can be allocated to the borrower's discretion). b. Total whole units – the total number of units – amended to exclude car spaces, leaseholds, bed spaces, commercial units and the proportion of shared ownership properties which have been sold (either first tranche or staircasing). c. The committee may wish to take into account those borrowers who have the majority of their stock in Central London, where average cost of a new property will be as high as £200k.
7. Cash & undrawn facilities as % of commitments	a. Cash - cash holdings (which can be allocated to the borrower's discretion). b. Undrawn facilities – total documented facilities less the outstanding drawn balance. c. Commitments – the contracted and committed spend agreed by the board. Commitments can include contracted housing grant receipts but not sales receipts and can be from the annual accounts or calculated by management.
8. Uncharged assets as a % of debt	a. Uncharged assets – those assets which could be charged to an MH loan. Management can determine the valuation methodology (EUV, MVT, etc.) based on the actual pool of uncharged stock and prepare a calculated estimate of its valuation. b. Debt – total net debt from the financial statements. The total of short- and long-term outstanding debt less cash holdings (which can be allocated to the borrower's discretion).

Source: MORhomes, Hardman & Co Research

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