

Research Update:

# U.K.-Based Public Sector Funding Agency MORhomes PLC Ratings Affirmed At 'A-'; Outlook Remains Negative

December 2, 2020

## Overview

- While MORhomes PLC's initial expansion has been markedly slower than expected, it is making progress in building a stronger market share and continues to attract shareholders.
- We now anticipate that MORhomes could take more than three years to substantially diversify its loan portfolio.
- MORhomes' startup status is a constraint for the rating because fewer-than-expected borrowers will further delay the stabilization of its financial profile due to a slower build-up of capital.
- We are affirming our ratings on MORhomes at 'A-/A-2'. The outlook is negative.
- The negative outlook reflects the risk of a downgrade in the next two years if MORhomes fails to sustain a relevant market position against the backdrop of increased competition. We could also lower our ratings if credit quality in the U.K. social housing sector deteriorated significantly.

### PRIMARY CREDIT ANALYST

**Abril A Canizares**  
London  
+ 44 20 7176 0161  
abril.canizares  
@spglobal.com

### SECONDARY CONTACT

**Richard E Kubanik**  
London  
+ 44 (20) 71767031  
richard.kubanik  
@spglobal.com

## Rating Action

On Dec. 2, 2020, S&P Global Ratings affirmed its 'A-' long-term issuer credit rating and 'A-2' short-term rating on U.K. social housing funding agency MORhomes PLC. The outlook is negative.

At the same time, S&P Global Ratings affirmed its 'A-' long-term issue rating on the company's £5 billion EMTN senior secured debt program.

## Outlook

The negative outlook reflects the risk of a downgrade in the next two years if MORhomes fails to sustain a relevant market position against the backdrop of increased competition, following the

rollout of the 2020 Affordable Homes Guarantee Scheme and a higher direct access to capital market from housing associations. We could also lower our ratings if credit quality in the U.K. social housing sector deteriorated significantly following the COVID-19 pandemic, combined with Brexit resulting in meaningfully higher leverage, or if MORhomes experiences losses on its loan portfolio.

We could revise the outlook to stable if faster-than-anticipated business expansion accompanied by robust risk management policies strengthens MORhomes' capitalization, while supporting our view of a stronger enterprise profile.

## **Rationale**

Our rating on MORhomes reflects our view that, albeit markedly more slowly than expected, business is expanding and has reached the level of some of the other bond aggregators in the U.K. MORhomes' original business plan and the earlier revisions were focused on a progress toward significantly lower funding costs and less competition from various sources, neither of which has materialized. The company's new, meaningfully lower targets are more realistic in our view, and a sustained market share is commensurate with the current rating level.

While lending expansion has been slow, there is continued interest in joining MORhomes, and the company has added two new shareholders during the year. However, the negative outlook reflects the risk that higher competition in the market could hamper the progress achieved so far, resulting in a further downward revision of the pipeline.

After the most recent revision on MORhomes' business plan, we now expect that the company's loan book will take longer to diversify significantly in order to consistently achieve S&P Global Ratings' risk-adjusted capital (RAC) ratios of higher than 3% by fiscal year (FY) ending March 31, 2023. As a result, we are weakening our assessment of MORhomes' financial risk profile to moderate. However, the forecast volume of loans will allow MORhomes to be profitable after FY2022.

The rating continues to be constrained by our view that MORhomes will continue operating as a startup-like entity in the next two years.

MORhomes is a public limited company formed in June 2018 to provide borrowing to social housing associations in the U.K., so the ratings reflect our assessment of the low industry risk associated with this sector. We anticipate that the company will be able to mitigate a potential deterioration on its asset quality, as housing associations in the U.K. navigate Brexit-related risks and the pandemic-induced economic contraction. This mainly because of the relative resilience of the U.K. housing sector, the credit risk management that prevents lending to less-creditworthy housing associations, and the different layers of protection in MORhomes such as equity, subordinated debt, and access to standby liquidity facilities.

## **Enterprise risk profile: Slow but steady consolidation of market position while operating in a low-risk industry**

Housing associations in the U.K. join MORhomes as shareholders primarily to get access to funding, a feature we believe is a positive for the enterprise risk, as it will likely foster loyalty. During 2020, membership increased to 62 housing associations.

After beginning operations in 2019 with its inaugural bond, MORhomes on-lent £260 million to nine borrowers, and continued to tap the market increasing its loan portfolio to £313 million as of

end-March 2020, and £408 million as of Oct. 26, 2020. It now has 17 loans across 14 borrower groups. We expect MORhomes' market position will remain relevant and provide about 3% of new annual lending in the sector for the next two years.

However, MORhomes operates in an increasingly competitive environment, and pricing and execution in the social housing sector are imperative. Recently, more housing associations have been able to take advantage of investors' increased appetite to tap the markets at favorable terms through own-name placements. These issuances compete with MORhomes' lending. Increased competition will also come from the implementation of the Affordable Homes Guarantee Scheme 2020 (AHGS 2020), with first issuance expected to be in the second quarter of 2021.

We expect MORhomes' customer base to remain stable and continue expanding. Our view is supported by borrowers joining as shareholders. However, the slower-than-expected expansion means that concentration risk will be material for longer and could potentially affect MORhomes' revenue stability.

MORhomes operates with a small permanent staff and outsources most functions. Nevertheless, the ultimate decision making lies with the board members, who have experience in the housing and banking sectors. We believe this to be a reasonable structure, since MORhomes will engage in a monoline lending operation strategy including standby liquidity agreements. In addition, MORhomes is looking into increasing its product offering by establishing a 30-year tenure bond program.

We consider the U.K. social housing sector as low risk. Our public-sector industry risk and country risk assessment (PICRA) is favorable because of the sector's low industry risk, combined with a wealthy, open, and diversified economy and adequate leverage risk. We believe COVID-19's adverse impact on the sector will be limited, because the sector is anticyclical in nature and has strong oversight from the government via regulators. Social housing providers generally experience an increase in demand for their core services in times of economic hardship, and demand typically remains strong throughout the business cycle. Moreover, social housing is usually a prominent part of most political agendas. We expect the sector will expand borrowing in the next few years as housing associations continue to invest in existing and new stock to satisfy the U.K.'s housing needs.

This low industry risk, combined with strong economic resilience (partially clouded by Brexit negotiations and the pandemic-induced economic recession) and strong financial system risk, results in our assessment of a low-risk PICRA for MORhomes.

We regard the company's management policies and governance standards as adequate. We believe MORhomes will maintain its current risk appetite and not target a significant number of loans to weak borrowers or lower prices significantly to gain business. Following its business pipeline, we expect this forecast loan volume will enable MORhomes to be profitable, and will continue to lack incentives to boost earnings for shareholder distributions.

In our view, MORhomes' setup has adequate controls for management to respond to stakeholders' interests. The executive team has added two new permanent members during the year: a CFO and a relationship manager. While funding policies mitigate the interest rate, currency, and asset-liability mismatches, the company assesses its credit risk policies effectively and closely monitors its lending portfolio's asset quality.

**Financial risk profile: Operations under a match-funding principle and collateralization largely mitigate financial risks, although portfolio concentration has increased risks to capitalization**

The amount of share capital on which MORhomes has started its operations provides a platform for increasing its lending portfolio. However, a prolonged expansion of its lending book has weakened its capital adequacy as the loan book has taken longer to diversify.

As a result, we now forecast that MORhomes' RAC after adjusting for single-name concentration will likely remain significantly below 3% up to FY2023. As of end-FY2020, the RAC after adjustments was 1.5%, which largely reflects a still-limited number of borrowers that spur concentration risks.

We include in MORhomes' total adjusted capital 33% of additional equity from subordinated contingent convertible notes. The convertible notes comply with our requirement to qualify for intermediate equity content. Therefore, the notes have loss-absorption features to enable the company to operate on a going-concern basis. Furthermore, the notes will have maturities larger than the forecast loans in MORhomes' portfolio.

We take a positive view of the robust collateralization that MORhomes will build on the loan portfolio, although securities charges could occur in the event of a delay. Moreover, the company was formed to act as a pass-through vehicle, further neutralizing risks from asset-liability management and limiting its exposure to interest rates movements and currency risks.

The funding and liquidity ratios are supported by the match-funding policy under which MORhomes is set up to operate and ensure that the company will not form significant funding or liquidity gaps. Therefore, we expect the company to maintain adequate funding and liquidity. We forecast its one-year liquidity ratio to be above 1.0x and we do not expect large uncovered needs in the next 12-24 months.

Our funding assessment is neutral, because we do not foresee MORhomes operating with significant funding gaps, and the domestic market is deep.

## Ratings Score Snapshot

Table 1

### MORhomes PLC

Issuer Credit Rating	A-/Negative/A-2
Stand-alone credit profile	a-
Enterprise risk profile	Adequate (3)
PICRA	Low risk (2)
Business position	Weak
Management and governance	Adequate
Financial risk profile	Adequate (3)
Capital adequacy	Moderate
Funding	Neutral
and liquidity	Adequate
Support	--
GRE support	--
Group support	--

GRE--Government-related entity, PICRA--Public-sector industry risk and country risk assessment.

## Key Statistics

Table 2

### MORhomes PLC Key Statistics

Mil. £	-- Year ended March 31--	
	2020	2019
<b>Business position</b>		
Total adjusted assets	318.1	261.8
Gross receivables	315.7	259.2
Growth in loans (%)	21.8	N.M.
Interest revenues	10.4	1.1
Noninterest expenses	1.0	0.9
<b>Capital and risk position</b>		
Total liabilities	312.1	256.6
Total adjusted capital	2.9	2.7
Assets/capital	108.5	95.3
RAC ratio before diversification (%)	22.7	28.7
RAC ratio after diversification (%)	1.5	1.2
Gross nonperforming assets/gross loans	N/A	N/A
Common + preferred dividends/net income (%)	N/A	N/A
<b>Funding &amp; liquidity</b>		
Liquidity ratio with loan disbursement (one year)	N.M.	N.M.
Liquidity ratio without loan disbursement(one year)	N.M.	N.M.
Funding ratio (one year)	N.M.	N.M.

N/A--Not applicable. N.M.--Not Meaningful. RAC--Risk-adjusted capital.

## Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- Criteria | Governments | International Public Finance: Public-Sector Funding Agencies: Methodology And Assumptions, May 22, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011

## Related Research

- Global Social Housing Ratings Score Snapshot: July 2020, July 14, 2020
- Global Social Housing Ratings Risk Indicators: July 2020, July 14, 2020
- U.K. Social Housing Providers Should Remain Largely Resilient To Short-Term Economic Difficulties From COVID-19, April 23, 2020
- COVID-19: Emerging Market Local Governments And Non-Profit Public-Sector Entities Face Rising Financial Strains, April 6, 2020
- Public-Sector Funding Agencies Risk Indicators: May 2019, May 13, 2019
- Assumptions For Liquidity Gap Analysis Under "Public-Sector Funding Agencies: Methodology And Assumptions", May 22, 2018
- Credit FAQ: A Closer Look At The New Public-Sector Funding Agencies Criteria, May 22, 2018

## Ratings List

### Ratings Affirmed

---

#### MORHomes PLC

---

Issuer Credit Rating A-/Negative/A-2

---

Senior Secured A-

---

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at [www.standardandpoors.com](http://www.standardandpoors.com) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at [https://www.standardandpoors.com/en\\_US/web/guest/article/-/view/sourceId/504352](https://www.standardandpoors.com/en_US/web/guest/article/-/view/sourceId/504352) Complete ratings information is available to subscribers of RatingsDirect at [www.capitaliq.com](http://www.capitaliq.com). All ratings affected by this rating action can be found on S&P Global Ratings' public website at [www.standardandpoors.com](http://www.standardandpoors.com). Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.

Copyright © 2020 by Standard & Poor's Financial Services LLC. All rights reserved.

No content (including ratings, credit-related analyses and data, valuations, model, software or other application or output therefrom) or any part thereof (Content) may be modified, reverse engineered, reproduced or distributed in any form by any means, or stored in a database or retrieval system, without the prior written permission of Standard & Poor's Financial Services LLC or its affiliates (collectively, S&P). The Content shall not be used for any unlawful or unauthorized purposes. S&P and any third-party providers, as well as their directors, officers, shareholders, employees or agents (collectively S&P Parties) do not guarantee the accuracy, completeness, timeliness or availability of the Content. S&P Parties are not responsible for any errors or omissions (negligent or otherwise), regardless of the cause, for the results obtained from the use of the Content, or for the security or maintenance of any data input by the user. The Content is provided on an "as is" basis. S&P PARTIES DISCLAIM ANY AND ALL EXPRESS OR IMPLIED WARRANTIES, INCLUDING, BUT NOT LIMITED TO, ANY WARRANTIES OF MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE, FREEDOM FROM BUGS, SOFTWARE ERRORS OR DEFECTS, THAT THE CONTENT'S FUNCTIONING WILL BE UNINTERRUPTED OR THAT THE CONTENT WILL OPERATE WITH ANY SOFTWARE OR HARDWARE CONFIGURATION. In no event shall S&P Parties be liable to any party for any direct, indirect, incidental, exemplary, compensatory, punitive, special or consequential damages, costs, expenses, legal fees, or losses (including, without limitation, lost income or lost profits and opportunity costs or losses caused by negligence) in connection with any use of the Content even if advised of the possibility of such damages.

Credit-related and other analyses, including ratings, and statements in the Content are statements of opinion as of the date they are expressed and not statements of fact. S&P's opinions, analyses and rating acknowledgment decisions (described below) are not recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security. S&P assumes no obligation to update the Content following publication in any form or format. The Content should not be relied on and is not a substitute for the skill, judgment and experience of the user, its management, employees, advisors and/or clients when making investment and other business decisions. S&P does not act as a fiduciary or an investment advisor except where registered as such. While S&P has obtained information from sources it believes to be reliable, S&P does not perform an audit and undertakes no duty of due diligence or independent verification of any information it receives. Rating-related publications may be published for a variety of reasons that are not necessarily dependent on action by rating committees, including, but not limited to, the publication of a periodic update on a credit rating and related analyses.

To the extent that regulatory authorities allow a rating agency to acknowledge in one jurisdiction a rating issued in another jurisdiction for certain regulatory purposes, S&P reserves the right to assign, withdraw or suspend such acknowledgment at any time and in its sole discretion. S&P Parties disclaim any duty whatsoever arising out of the assignment, withdrawal or suspension of an acknowledgment as well as any liability for any damage alleged to have been suffered on account thereof.

S&P keeps certain activities of its business units separate from each other in order to preserve the independence and objectivity of their respective activities. As a result, certain business units of S&P may have information that is not available to other S&P business units. S&P has established policies and procedures to maintain the confidentiality of certain non-public information received in connection with each analytical process.

S&P may receive compensation for its ratings and certain analyses, normally from issuers or underwriters of securities or from obligors. S&P reserves the right to disseminate its opinions and analyses. S&P's public ratings and analyses are made available on its Web sites, [www.standardandpoors.com](http://www.standardandpoors.com) (free of charge), and [www.ratingsdirect.com](http://www.ratingsdirect.com) (subscription), and may be distributed through other means, including via S&P publications and third-party redistributors. Additional information about our ratings fees is available at [www.standardandpoors.com/usratingsfees](http://www.standardandpoors.com/usratingsfees).

STANDARD & POOR'S, S&P and RATINGSDIRECT are registered trademarks of Standard & Poor's Financial Services LLC.