

Research Update:

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

December 1, 2021

## Overview

- MORhomes continues consolidating its business position, attracting new shareholders and expanding its product offering; this supports our view that it will maintain its market share despite high competition.
- In our view, risk management policies provide certainty that MORhomes financial risk profile will remain adequate, and we expect its borrowers' creditworthiness will be upheld amid the aftermath of Brexit and the pandemic-induced economic contraction.
- As a result, we revised our outlook on MORhomes to stable from negative and affirmed our 'A-/A-2' long- and short-term issuer credit ratings on the company.

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## Rating Action

On Dec. 1, 2021, S&P Global Ratings revised its outlook on U.K. social housing funding agency MORhomes PLC to stable from negative and affirmed its 'A-' long-term issuer credit rating and 'A-2' short-term rating on the company.

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

## Outlook

The stable outlook indicates that we expect MORhomes to continue strengthening its business operations. In addition, we expect the company to maintain its adequate financial risk profile because we anticipate its risk management policies will not change.

## Upside scenario

We could raise the rating if MORhomes sustains higher-than-anticipated loan growth, which would be a key indicator of its business' maturity. This would, in turn, result in a large diversification of its borrowing base and a consequent strengthening of its risk-adjusted capital (RAC) after adjustments, and higher certainty about the effectiveness of the company's strategy and business model sustainability.

## Downside scenario

We could lower our ratings if the credit quality of the U.K. social housing sector deteriorated materially, or if MORhomes experiences losses on its loan portfolio. We could also lower the ratings if the appetite for the company's business offering weakens.

## Rationale

The outlook revision reflects our view that MORhomes will continue strengthening its business operations and its borrowers will maintain solid credit quality. Our view is supported by maintained growth in the company's shareholders base, new product offering, and a longer track record of consolidating operations.

We see positively that MORhomes continues adding shareholders having expanded its members base to 66 from 60 when it started operations. While the company's targets had been more ambitious, the revision to its business plan is more realistic in our view and a sustained market share is commensurate with the rating.

We continue to adjust the rating down because of our view that MORhomes will continue operating as a startup-like entity in the next 12-18 months.

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. In our view, risk management policies provide certainty that the company will mitigate a potential deterioration on its asset quality as housing associations in the U.K. navigate risks related to the aftermath of Brexit and the pandemic-related contraction. This is mainly because of the relative resilience of the housing sector in the U.K., 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 its business position in a highly competitive market whilst 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 provides stickiness to its customer base. During the year, membership increased to 66 housing associations from the original 60.

As of November 2021, the company increased its loan book to £492 million after beginning operations in February 2019 with its inaugural bond of £250 million. It now has 20 loans across 19 U.K.-based housing associations.

We expect MORhomes' market position will remain relevant and provide about 3% of new annual lending in the sector for the next two years despite operating in an increasingly competitive environment. Recently, more housing associations have taken advantage of an increased appetite from investors to tap the markets at favorable terms through own-name placements, and we expect competition will increase once the Affordable Homes Guarantee Scheme 2020, managed through ARA Venn, starts operations

However, we expect MORhomes' shareholder and borrower base to continue expanding, which we expect will provide greater diversification and stability of its revenue base; the prolonged business expansion remains a constraint.

The company 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 in the banking sector. We believe this structure is reasonable, because MORhomes will engage in a monoline lending operation strategy including standby liquidity agreements. Also, the company has expanded its product offering by launching a 30-year sustainability bond. In addition, management continues focusing on its alignment towards environmental, social, and governance principles and launched its Sustainable Bond Framework in February.

We consider the U.K. social housing sector as low risk as reflected in our public-sector industry risk and country risk assessment (PICRA) assessment. Our PICRA, which remains low, considers that leverage has increased the risk to the U.K. social housing sector. Offsetting this, the sector benefits from low cyclicality, high barriers to entry, and strong government oversight via regulators. As a result, the pandemic has so far only had a limited effect on the sector. Our PICRA also considers the wealthy, open, and diversified U.K. economy, and that the government's furlough scheme supported strong rent collection through the pandemic.

We regard MORhomes' management policies and governance standards as adequate. We believe it will maintain its risk appetite and not target a significant number of loans to weak borrowers or lower prices significantly to gain business. Following the business pipeline, the forecast loan volume will enable the company to be profitable and has no incentives to boost earnings for shareholder distributions.

In our view, MORhomes' setup has adequate controls for management to respond to investors' and shareholders' interests. While funding policies mitigate the interest rate, currency, and asset-liability mismatches, the company assesses its credit risk policies effectively and monitors closely the asset quality of its lending portfolio.

### **Financial risk profile: Operations under a match-funding principle and collateralization largely mitigate financial risks, although borrower concentration continues weighing on the capital position**

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

We forecast that MORhomes' RAC after adjusting for single name concentration will likely remain below 3% up to fiscal 2023. As of fiscal year-end 2021 (March 31), the RAC after adjustments was a very weak 2.2%, 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 requirements to qualify for intermediate equity content. Therefore, the notes have loss-absorption features that enable the company to operate as a going concern. Furthermore, the notes will have maturities of more than 20 years (larger than the forecast loans in its portfolio).

We take a positive view of the robust collateralization MORhomes builds on the loan portfolio, although property securities charges could happen with a delay. Moreover, the company was formed to act as a pass-through vehicle, further neutralizing risks from asset-liability management and 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 MORhomes to maintain adequate funding and liquidity. We forecast its one-year liquidity ratio to be above 1.0x and do not expect large uncovered needs in the next 12-24 months.

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

Table 1

### MORhomes PLC Key Statistics

Mil. £	--Year ended March 31--		
	2021	2020	2019
<b>Business position</b>			
Total adjusted assets	477.7	318.1	261.8
Gross receivables	474.2	315.7	259.2
Growth in loans (%)	50.2	21.8	N.M.
Interest revenues	13.5	10.4	1.1
Noninterest expenses	1.0	1.0	0.9
<b>Capital and risk position</b>			
Total liabilities	469.0	312.1	256.6
Total adjusted capital	4.3	2.9	2.7
Assets/capital	111.1	108.5	95.3
RAC ratio before diversification (%)	23.1	22.7	28.7
RAC ratio after diversification (%)	2.2	1.5	1.2
Gross nonperforming assets/gross loans	N/A	N/A	N/A
Common + preferred dividends/net income (%)	N/A	N/A	N/A
<b>Funding and liquidity</b>			
Liquidity ratio with loan disbursement (one year)	N.M.	N.M.	N.M.
Liquidity ratio without loan disbursement(one year)	N.M.	N.M.	N.M.
Funding ratio (one year)	N.M.	N.M.	N.M.

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

## Ratings Score Snapshot

Table 2

### MORhomes PLC--Ratings Score Snapshot

<b>Issuer Credit Rating</b>	A-/Stable/--
Senior secured debt	A-
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 and liquidity	Neutral
Support	0
GRE support	0
Group support	0

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

## Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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

- The Green Agenda Is Taking Root In Global Social Housing Providers' Investment Plans, Nov. 23, 2021
- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers Published, June 8, 2021
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, April 23, 2021

- Building Up Debt: U.K. Social Housing Sector Braces Itself For Borrowing, March 16, 2021
- Global Social Housing Ratings Score Snapshot: December 2020, Dec. 10, 2020
- Global Social Housing Ratings Risk Indicators: December 2020, Dec. 10, 2020
- Outlook 2021: Strong Liquidity Should Help Social Housing Providers Remain Resilient, Dec. 8, 2020

## Ratings List

### Ratings Affirmed

#### MORHomes PLC

Senior Secured	A-
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### Ratings Affirmed; Outlook Action

To	From
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#### MORHomes PLC

Issuer Credit Rating	A-/Stable/A-2	A-/Negative/A-2
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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.

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