Research Update:

U.K.-Based Public Sector Funding Agency MORHomes PLC 'A-/A-2' Ratings Affirmed; Outlook Stable

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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, MORHomes' robust liquidity position and prudent risk management policies provide certainty that the company's financial risk profile will remain adequate, and we do not expect its borrowers' creditworthiness to deteriorate.
- We affirmed our 'A-/A-2' long- and short-term issuer credit ratings on the company.
- The outlook remains stable, reflecting our expectation that MORHomes will continue strengthening its business operations despite the challenging environment.

Rating Action

On Dec. 16, 2022, S&P Global Ratings affirmed its 'A-/A-2' long- and short-term issuer credit ratings on MORHomes PLC. The outlook remains stable.

At the same time, we affirmed our '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 despite the challenging environment. In addition, we expect the company to maintain its adequate financial risk profile thanks to its prudent risk management policies.

Downside scenario

We could lower our ratings if the credit quality of the U.K. social housing sector deteriorated materially, beyond our current expectations, and if MORHomes experienced losses on its loan portfolio.

Upside scenario

We could raise the rating if MORHomes substantially increased its market share and became profitable. 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.

Rationale

We base the 'A-' issuer credit rating on MORHomes' adequate enterprise profile and adequate financial profile.

The affirmation reflects our view that MORHomes will continue strengthening its business operations and its borrowers will maintain solid credit quality.

Our assessment of the low industry risk associated with social housing sector supports the ratings on MORHomes. In our view, risk management policies provide certainty that the company will mitigate a potential deterioration of its asset quality as housing associations in the U.K. navigate risks related to the elevated inflation and the rent cap introduction. We also think the company's asset-liability matching principle and the £10 million untapped liquidity facility support the company's robust funding and liquidity profile. The still-modest market share of MORHomes and concentrated loan portfolio constrain the ratings.

Enterprise risk profile: Slow but steady consolidation of its business position in a highly competitive market 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 think provides stickiness to its customer base.

During the fiscal year ended March 31, 2022 (fiscal 2022), the company continued to grow the business with another £65 million of lending to four new borrowers, resulting in a total of £522.4 million on-lent. Between April and September, MORHomes disbursed another £20 million, achieving a £542 million loan portfolio despite market turbulence. The portfolio now comprises 23 loans provided to 22 separate borrowers.

In light of elevated inflation in the U.K., the rent cap introduction, and the cost of borrowing increase, MORHomes revised its business plan and now expects to disburse £100 million per year (a 50% reduction). Although we think this target will be difficult to achieve in fiscal 2023, we expect MORHomes' market position will remain relevant and provide about 2%-3% of new annual lending in the sector for the next two years despite operating in a highly competitive environment.

We expect MORHomes' borrower base to continue expanding, which will provide greater diversification and stability to its revenue base. The prolonged business expansion remains a constraint.

MORHomes has been on the market for more than four years, so we consider its business to be relatively mature, and we no longer view the company as a startup-like entity.

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. 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 COVID-19 pandemic.

We regard MORHomes' management policies and governance standards as adequate. We think 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 should enable the company to be profitable and it has no incentives to boost earnings for shareholder distributions. 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 banking sectors. We think this structure is reasonable because MORHomes will engage in a monoline lending operation strategy including standby liquidity agreements. In our view, MORHomes' setup has adequate controls for management to respond to investors' and shareholders' interests. Although funding policies mitigate the interest rate, currency, and asset-liability mismatches, the company assesses its credit risk policies effectively and closely monitors the asset quality of its lending portfolio.

Financial risk profile: Operations under a match-funding principle and robust liquidity support the assessment, 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.

As at March 31, 2022 MORHomes' RAC after adjusting for single-name concentration remained very low at 2.5%, roughly comparable with 2.2% as of year-end fiscal 2021. This largely reflects a still-limited number of borrowers, which spurs concentration risks.

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 matched funding vehicle, further neutralizing risks from asset-liability management and its exposure to interest rates movements and currency risks.

We also include in MORHomes' total adjusted capital 33% of additional equity from its 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.

MORHomes' match-funding policy, which ensures that the company will not form significant funding or liquidity gaps, supports the company's funding and liquidity ratios.

We revisited our approach of MORHomes' liquidity assessment. We switched to a cash flow basis, which we think is a more accurate approach when it comes to entities with extremely long-term liabilities, like MORHomes. With the new approach, the liquidity ratios are sustainably above 1x (the one-year ratio equals 1.44x). We therefore revised the company's liquidity assessment to strong from adequate. The liquidity ratios benefit from the £10 million of undrawn liquidity facilities.

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

Key Statistics

Table 1

MORHomes PLC Key Statistics

	--Year ended March 31--			
Mil. £	**2022**	**2021**	**2020**	**2019**
Business position				
Total adjusted assets	542.2	477.7	318.1	261.8
Gross receivables	539.0	474.2	315.7	259.2
Growth in loans (%)	13.7	50.2	21.8	N.M.
Interest income	16.5	13.5	10.4	1.1
Noninterest expenses	1.1	1.0	1.0	0.9
Capital and risk position				
Total liabilities	532.7	469.0	312.1	256.6
Total adjusted capital	4.5	4.3	2.9	2.7
Assets/capital	120.5	111.1	108.5	95.3
RAC ratio before diversification (%)	21.5	23.1	22.7	28.7
RAC ratio after diversification (%)	2.5	2.2	1.5	1.2
Funding and liquidity*				
Liquidity ratio with loan disbursement (one year)	1.4	N.M.	N.M.	N.M.
Liquidity ratio without loan disbursement(one year)	1.4	N.M.	N.M.	N.M.
Funding ratio (one year)	1.8	N.M.	N.M.	N.M.

*As at Sept. 30, 2022. N.M.--Not meaningful. RAC--Risk-adjusted capital.

Ratings Score Snapshot

Table 2

MORHomes PLC--Ratings Score Snapshot

Issuer Credit Rating	**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

Table 2

MORHomes PLC--Ratings Score Snapshot (cont.)

Issuer Credit Rating	A-/Stable/--
Financial risk profile	Adequate (3)
Capital adequacy	Moderate
Funding	Neutral
and liquidity	Strong
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: Hybrid Capital: Methodology And Assumptions, March 2, 2022
- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- 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

- Banking Industry Country Risk Assessment: United Kingdom, Dec. 12, 2022
- Non-U.S. Social Housing Sector Outlook 2023: The Most Negative Bias Since 2018 Implies Significant Pressure On Ratings, Dec. 1, 2022
- Cap On Rent Increases Is Consistent With Our Base Case For English Social Housing Providers, Nov. 17, 2022
- United Kingdom Outlook Revised To Negative On Rising Fiscal Risks; 'AA/A-1+' Ratings Affirmed, Sept. 30, 2022
- Rated U.K. Social Housing Providers' Creditworthiness Could Suffer If The Gap Between Rent And Cost Increases Persists, Aug. 1, 2022

Ratings List

Ratings Affirmed	
MORHomes PLC	
Issuer Credit Rating	A-/Stable/A-2
Senior Secured	A-