

Research Update:

# U.K.-Based Public Sector Funding Agency MORhomes PLC Outlook Revised To Negative; 'A-/A-2' Ratings Affirmed

December 7, 2023

## Overview

- MORhomes PLC's loan portfolio expanded a modest 3.3% in the fiscal year ended March 31, 2023 (fiscal 2023) and there was no new lending between April and November 2023 due to subdued demand from U.K. social housing providers.
- The company posted losses again in fiscal 2023 and, excluding the one-off gain from the loan prepayment in July 2023, the prospects of MORhomes becoming structurally profit-making in the next two fiscal years are uncertain if business volumes remain muted.
- The credit quality of MORhomes' borrowers has deteriorated in line with the U.K. social housing sector, for which we see weakening debt metrics and financial performance.
- We therefore revised the outlook to negative and affirmed our 'A-/A-2' long- and short-term issuer credit ratings on MORhomes.

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## Rating Action

On Dec. 7, 2023, S&P Global Ratings revised the outlook on MORhomes PLC to negative from stable. We also affirmed the 'A-/A-2' long- and short-term issuer credit ratings on the company and our 'A-' long-term issue rating on its £5 billion euro-medium-term note program.

## Outlook

The negative outlook indicates the risks that in the next 12-24 months MORhomes might not see substantial loan portfolio growth, which would prevent the company from becoming profitable.

## Downside scenario

We could lower our ratings if MORhomes fails to materially expand its lending portfolio and if the

business remains loss-making. We could also lower the ratings if our view of the credit quality of its borrowers deteriorates further or if we revise down our U.K. Public-Sector Industry Risk and Country Risk Assessment (PICRA).

## **Upside scenario**

We could revise the outlook back to stable if MORhomes materially increases its market share and strengthens its business position. This might result in the organization breaking even sooner, improved diversification of its borrowing base, and a consequent structural improvement of its risk-adjusted capital (RAC) ratio after adjustments.

## **Rationale**

The outlook revision reflects our view that MORhomes' market share, measured as the company's loan book to the outstanding debt of U.K. social housing providers, could decrease further and it might continue reporting losses in the 12-24 months. As observed in fiscal 2023, MORhomes failed to achieve its growth target, which weighs on its ability to generate profits. The outlook revision also reflects overall pressure we see on the credit quality of MORhomes' borrowers and our U.K. PICRA, which considers that higher leverage has increased risks to the U.K. social housing sector. We believe external factors, such as cost inflation and higher interest rates, could cause additional pressure on housing associations' financial positions.

The rating affirmation indicates the generally still-solid credit quality of MORhomes' borrowers and robust funding and liquidity metrics, thanks to its asset-liability matching principle and the £10 million untapped liquidity facility. The company's still-modest market share and concentrated loan portfolio constrain the ratings.

Our assessment of the low industry risk associated with the U.K. social housing sector supports the ratings on MORhomes. That said, we expect the sector to face increased costs caused by inflation and the need to achieve energy efficiency and fire safety targets. We believe social housing providers' debt burdens will remain elevated and that interest coverage will only marginally strengthen from weak levels. Many providers are scaling back the development of new homes because of cost pressures, delays caused by material or labor constraints, and the continued focus on investments in existing homes. We project the slowdown in the development of new homes will reduce funding needs. We also consider that many providers will continue to dispose of existing homes. This, together with grant funding and the use of cash, will provide funding sources for investments in new and existing homes and further reduce the need for additional debt.

## **Enterprise risk profile: Slow business growth in a highly competitive market while operating in a low-risk industry**

During the fiscal year ended March 31, 2023, MORhomes disbursed only one new loan totaling £20 million, against the company's target of £100 million, with no new lending between April and November 2023. Additionally, one loan--of £30 million to A2Dominion (A2D)--was prepaid in July 2023, decreasing the total loan book to £512.4 million as at Nov. 30, 2023 from £542.4 million as of March 31, 2023. Although we have no specific indication of other potential prepayments, we can't completely rule them out. Notably, one borrower, South Yorkshire Housing Association, was downgraded to noncompliant G3/V3 grades by the regulator.

These developments led us to revise our management and governance assessment on MORhomes, which we now view as moderate from adequate. The company's market of operations remains very competitive and demand from social housing providers is subdued, which is making it increasingly challenging for MORhomes to attract new borrowers. We believe this weighs on the company's strategic positioning. Without loan portfolio growth, MORhomes will likely remain loss-making, excluding the one-off gain it got from the loan prepayment. On a positive note, we believe the company's risk management policies are sophisticated; it assesses credit risk effectively and closely monitors the asset quality of its lending portfolio. MORhomes operates with a small permanent staff and outsources most functions. Nevertheless, ultimate decision-making lies with the board members, who have experience in the housing and banking sectors.

Our U.K. PICRA benefits from low cyclicality, high barriers to entry, and strong government oversight via regulators. The PICRA also considers the wealthy, open, and diversified U.K. economy. Although we believe that higher leverage has increased risks to the U.K. social housing sector, we project debt metrics will improve and we still consider the sector to be low risk, which supports our rating on MORhomes.

### **Financial risk profile: Operations under a match-funding principle and robust liquidity support the assessment, although borrower concentration continues to weigh on the capital position**

The prepayment from A2D had a temporally positive effect on MORhomes' equity in quantitative terms but weighed on its business position. As of July 31, 2023, MORhomes' RAC ratio after adjusting for single-name concentration improved to 3.6% from 2.5% as of year-end fiscal 2022. Still the ratio is low and reflects a limited number of borrowers, which spurs concentration risks. The top-10 loans account for 66% of the loan book.

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 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. With our cash-flow-based approach, MORhomes' liquidity assessment remains strong. Its liquidity ratios are sustainably above 1x, with a one-year ratio of 1.49x, and 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 consider the domestic market deep.

## **Key Statistics**

Table 1

## MORhomes PLC--Key statistics

Mil. £	--Year ended March 31--				
	2023	2022	2021	2020	2019
<b>Business position</b>					
Total adjusted assets	560.2	542.2	477.7	318.1	261.8
Gross receivables	556.7	539	474.2	315.7	259.2
Growth in loans (%)	3.3	13.7	50.2	21.8	N.M.
Interest income	18.4	16.5	13.5	10.4	1.1
Noninterest expenses	1.1	1.1	1	1	0.9
<b>Capital and risk position</b>					
Total liabilities	550.1	532.7	469	312.1	256.6
Total adjusted capital	4.5	4.5	4.3	2.9	2.7
Assets/capital	124.5	120.5	111.1	108.5	95.3
RAC ratio before diversification (%)	30.6*	21.5	23.1	22.7	28.7
RAC ratio after diversification (%)	3.6*	2.5	2.2	1.5	1.2
<b>Funding and liquidity*</b>					
Liquidity ratio with loan disbursement (one year)	1.49*	1.4	N.M.	N.M.	N.M.
Liquidity ratio without loan disbursement(one year)	1.49*	1.4	N.M.	N.M.	N.M.
Funding ratio (one year)	1.73*	1.8	N.M.	N.M.	N.M.

\*As at July 31, 2023. N.M.--Not meaningful. RAC--Risk-adjusted capital.

## Ratings Score Snapshot

Table 2

### MORhomes PLC--Ratings score snapshot

Issuer Credit Rating	A-/Negative/--
Senior secured debt	A-
Stand-alone credit profile	a-
Enterprise risk profile	Adequate (3)
PICRA	Low risk (2)
Business position	Weak
Management and governance	Moderate
Financial risk profile	Adequate (3)
Capital adequacy	Moderate
Funding and liquidity	Neutral
Support	0
GRE support	0

Table 2

**MORhomes PLC--Ratings score snapshot (cont.)**

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**

- Non-U.S. Social Housing Sector Outlook 2024: At A Turning Point?, Nov. 29, 2023
- Non-U.S. Social Housing Providers Ratings Score Snapshot November 2023, Nov. 15, 2023
- Non-U.S. Social Housing Providers Ratings Risk Indicators: November 2023, Nov. 15, 2023
- Regulatory Framework Assessment: Social Housing Providers In The U.K. Benefit From Strong Regulatory Frameworks, Oct. 23, 2023
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, Oct. 20, 2023
- U.K. Social Housing Providers' Credit Headroom Could Tighten If The Operating Environment Deteriorates, Oct. 4, 2023
- U.K. Social Housing Borrowing 2023: On Pause, March 28, 2023

**Ratings List**

**MORhomes PLC**

**Ratings Affirmed; Outlook Action**

	To	From
Issuer Credit Rating	A-/Negative/A-2	A-/Stable/A-2

**Ratings Affirmed**

	To	From
Senior Secured	A-	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.spglobal.com/ratings](http://www.spglobal.com/ratings) for further information. A description of each of S&P Global Ratings' rating categories is contained in "S&P Global Ratings Definitions" at <https://disclosure.spglobal.com/ratings/en/regulatory/article/-/view/sourceid/504352>. Complete ratings information is available to RatingsDirect subscribers 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.spglobal.com/ratings](http://www.spglobal.com/ratings). Alternatively, call S&P Global Ratings' Global Client Support line (44) 20-7176-7176.

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