CREDIT OPINION
1 February 2024

Update

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RATINGS

Saxon Weald

Domicile	United Kingdom
Long Term Rating	A3
Type	LT Issuer Rating - Dom Curr
Outlook	Stable

Please see the ratings section at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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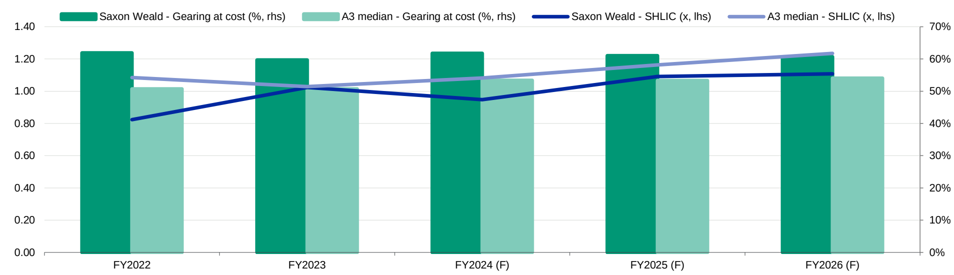
Saxon Weald (United Kingdom)

Update to credit analysis

Summary

The credit profile of Saxon Weald (A3 stable) reflects its low risk business model, focused on social housing lettings, its strong liquidity position and robust operating performance balanced against its relatively high level of indebtedness and low interest coverage ratios. Additionally, the credit profile benefits from our assumption of a strong likelihood that the government of the United Kingdom (UK, Aa3 stable) would act in a timely manner to prevent a default.

Exhibit 1
Debt and interest coverage metrics will remain weaker than rating peers



(F) indicates forecast years.
Source: Saxon Weald and Moody's Investors Service

Credit strengths

» Low risk appetite, including low exposure to market sales

» Simple debt structure and strong liquidity

» Supportive institutional framework in England

Credit challenges

» Weakened margins due to increased spend on existing stock

» Weaker debt metrics than peers

Rating outlook

The stable outlook reflects the expected gradual reduction in inflation and associated cost pressures as well as the proactive actions taken by Saxon Weald to mitigate the adverse effects of the weaker operating environment, thereby limiting development risk.

Factors that could lead to an upgrade

Upward pressure on the ratings could result from a significant improvement in operating performance, a material reduction in debt or a significant increase in government support for the sector, especially significantly higher levels of capital grants.

Factors that could lead to a downgrade

Downward pressure on the ratings could result from a prolonged weakening in operating performance, debt growing faster than expected, weaker liquidity or a failure to adapt strategies and risk appetite to mitigate weaker economic conditions. Lower government support for the sector or a dilution of the regulatory framework could also lead to downward pressure on the ratings.

Key indicators

Exhibit 2

Saxon Weald

	31-Mar-19	31-Mar-20	31-Mar-21	31-Mar-22	31-Mar-23	31-Mar-24 (F)	31-Mar-25 (F)
Units under management (no.)	6,579	6,707	6,669	6,741	6,809	7,035	7,068
Operating margin, before interest (%)	36.2	34.4	33.3	26.5	22.3	26.8	29.7
Net capital expenditure as % turnover	17.5	(0.3)	12.8	39.3	34.0	18.4	20.9
Social housing letting interest coverage (x times)	1.1	1.1	1.0	0.8	1.0	0.9	1.1
Cash flow volatility interest coverage (x times)	1.9	2.0	1.4	1.3	1.6	1.4	1.4
Debt to revenues (x times)	4.9	4.8	5.1	5.4	5.3	5.3	4.9
Debt to assets at cost (%)	65.4	62.2	62.2	61.9	59.7	61.7	61.0

(F) indicates forecast years
Source: Saxon Weald and Moody's Investors Service

Detailed credit considerations

The credit profile of Saxon Weald, as expressed in its A3 stable rating, combines a Baseline Credit Assessment (BCA) of baa2, and a strong likelihood of extraordinary support that the UK government would act in a timely manner to prevent a default.

Baseline Credit Assessment

Low risk appetite, including low exposure to market sales

Saxon Weald has a very simple group structure, enabling good oversight and risk controls. The group comprises the registered provider and two fully owned subsidiaries: Saxon Weald Capital plc (A3 stable), a financing special purpose vehicle, and Weald Property Development Limited, which is dormant.

Saxon Weald manages around 6,800 homes across the South of England. The group has a low risk appetite and focuses predominantly on low risk social housing lettings. Its exposure to market sales is low with just 5% of turnover from first tranche shared ownership in fiscal 2023 and no exposure to outright sales, limiting its vulnerability to the current weakening in the housing market. Its historical performance on shared ownership is strong, with an average margin of 23% achieved between fiscal 2019 to fiscal 2023.

A high proportion of revenue derived from social housing generates stable and predictable operating cash flows. This stability is highlighted by the solid performance of Saxon Weald's cash flow volatility interest cover (CVIC), which stood at 1.6x in fiscal 2023. Its CVIC will average 1.5x over the next three years, in line with the median for A3-rated peers.

Saxon Weald has significantly scaled back its development plan in response to the deterioration in the macroeconomic environment, including high cost inflation and elevated interest rates. It cut its development plan by almost half and now plans to deliver 393 units over the next five years, mostly for social rent (66%) and shared ownership (32%). This will result in a gradual improvement in its debt metrics.

Simple debt structure and strong liquidity

Saxon Weald has a simple debt structure with no exposure to variable rate debt and no derivatives. It also has no refinancing risk in the next five years. The group has sufficient covenant headroom with more than 140 basis points of headroom above its tightest interest cover covenant in fiscal 2023 and 21 percentage points above its tightest gearing covenant.

Saxon Weald's liquidity position is solid, amounting to £83 million as of FYE 2023. This is sufficient to cover 3.6x projected net cash requirement over the next two years, above the A3 peer median of 1.2x. As such, Saxon Weald has no need for further borrowing for a number of years.

Supportive institutional framework in England

The sector's credit quality benefits from the strong institutional framework governing English housing associations (HAs) reflected in an Operating Environment score of "a3" and a Regulatory Framework score of "a1". These scores are assigned at a national level and reflect the following credit considerations:

The regulator maintains strong oversight through quarterly returns, long-term business plans, annual reviews, and by undertaking biennial In-Depth Assessments (IDAs) for large and complex HAs. The regulator has a strong track record of intervention in cases of mismanagement or financial stress with powers to provide financial assistance and/or make manager appointments where there has been a breach of regulatory standards.

The operating environment for English HAs remains supportive. Demand for social housing remains very high and the government has committed to increased capital grant on more flexible terms for new social housing. English HAs retain some expenditure flexibility and have a track record of reducing costs to mitigate lower income.

However, due to very high rates of inflation in 2022, the government introduced a 7% ceiling on social rent increases from April 2023 for one year. The ceiling resulted in an adverse differential between rental income and cost growth, which we expect will drive lower margins and interest coverage across the sector in fiscal 2024. The UK government has confirmed that English HAs will be able to return to rent increases of consumer price inflation (CPI) plus 1% in fiscal 2025, which will be favourable, considering the recent reduction in inflation.

Weakened margin due to increased spending on existing stock

Saxon Weald's margin has deteriorated by 10 percentage points over the past three years, due to increased expenditure on its housing stock, which was exacerbated by inflation and issues with contractors. However, due to its strong starting point, its operating margin remains slightly stronger than peers, standing at 22% in fiscal 2023 compared to the 20% median of A3-rated peers.

We expect that its operating margin will improve gradually from fiscal 2025, underpinned by a return to CPI-linked rent increases and moderating cost inflation. However, Saxon Weald's small size limits the expenditure flexibility it can exercise. Although it has cut its development programme, significant operating efficiencies will be challenging to achieve.

Margins will also remain constrained by sustained spending on its existing stock. In particular, Saxon Weald faces high retrofitting needs to meet energy efficiency standards. As of fiscal 2023, only 53% of its social housing stock was at EPC-C compared to 75% for the median of rated UK HAs.

Weak debt and interest coverage metrics

Saxon Weald's debt metrics are weaker than peers largely due to its legacy as a large scale voluntary transfer (LSVT) HA. As of FYE 2023, its total outstanding debt was £265 million, equivalent to 5.3x revenue (A3 peer median: 4.4x) and 60% of its assets (A3 peer median: 51%).

The group anticipates its debt to remain stable in the next five years following the scaling back of its development plan, which will primarily be funded by fixed asset disposals and shared ownership sales receipts. As a result, its debt metrics will gradually strengthen but still remain weaker than rating peers.

Saxon Weald's interest coverage ratio is weaker than peers due to its high indebtedness and associated high interest costs. Its social housing lettings interest coverage (SHLIC) stood at 1.0x in fiscal 2023 and 0.7x when excluding a one-off £4.8 million loan breakage receipt. Saxon Weald used some of its available liquidity to buy back £20 million of its outstanding bond, which will reduce its interest charge by around £1.1 million annually. That said, its SHLIC will remain tight at around 1.0x over the next three years, meaning that Saxon Weald will rely on shared ownership sales to provide sufficient cash to meet its covenants.

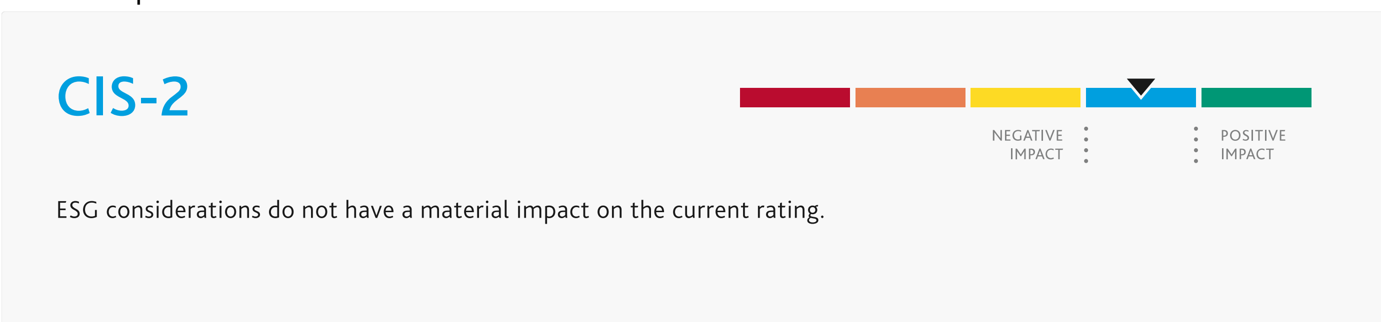
Extraordinary support considerations

The strong level of extraordinary support factored into the rating reflects the wide-ranging powers available to the regulator in cases of financial distress, with the possibility of a facilitated merger. However, the process can be protracted and is reliant on HAs agreeing to merge, which could be more challenging in a weakening operating environment. Recent history has shown that the UK government is willing to support the sector, as housing remains a politically and economically sensitive issue. The strong support assumption also factors the increased exposure to non-core social housing activities in the sector, that add complexity to HA operations. In addition, our assessment that there is a very high default dependence between Saxon and the UK government reflects their strong financial and operational linkages.

ESG considerations

Saxon Weald's ESG credit impact score is CIS-2

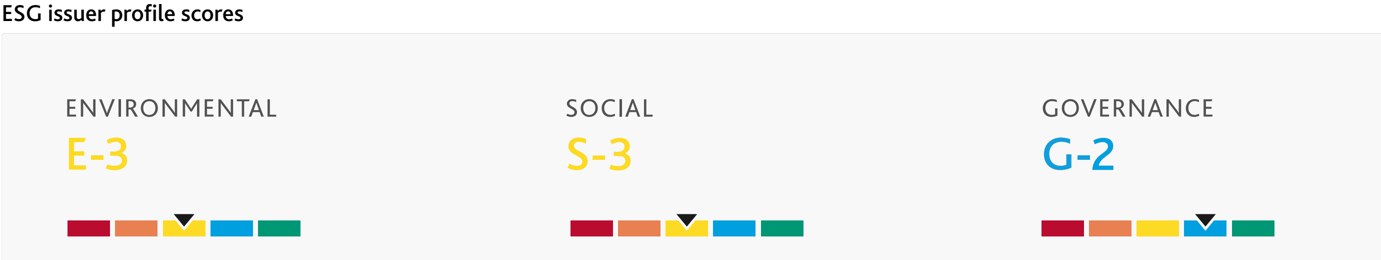
Exhibit 3
ESG credit impact score



Source: Moody's Investors Service

Saxon Weald's **CIS-2** reflects that ESG risks have a limited impact on its rating. Although Saxon Weald has a material level of carbon transition risk, due to a large proportion of its stock requiring retrofit, as well as significant social risks - in line with the rest of the sector - its governance and management is strong and offsets some of these risks. In addition, the supportive regulatory framework for the sector also mitigates ESG risks.

Exhibit 4
ESG issuer profile scores



Source: Moody's Investors Service

Environmental

Saxon Weald has material exposure to environmental risks (**E-3**) relating to a significant proportion of its stock requiring retrofit to meet energy efficiency standards by 2035 (carbon transition risks), leading to increased expenditure.

Social

Saxon Weald has material exposure to social risks (**S-3**) through sector-wide legislative requirements to improve the safety of existing housing stock (responsible production risks) which weighs on expenditure and operating margins, and the impacts of cost of living or affordability pressures on social tenants (demographic and societal trends) which led to the UK government capping social rent increases below inflation in fiscal 2024 in England, which will also have a negative impact on margins.

Governance

Saxon Weald has limited governance risks (**G-2**). Its governance is fit for purpose, with strong financial management policies and processes, detailed reporting and a simple organisational structure. The regulatory framework also supports good governance in the sector.

ESG Issuer Profile Scores and Credit Impact Scores for the rated entity/transaction are available on Moodys.com. In order to view the latest scores, please click here to go to the landing page for the entity/transaction on MDC and view the ESG Scores section.

Rating methodology and scorecard factors

The assigned BCA of "baa2" is one notch below the scorecard-indicated BCA outcome in fiscal 2023.

The rating methodologies used in this rating were European Social Housing Providers, published in April 2018, and Government Related Issuers, published in January 2024.

Exhibit 5
Saxon Weald's 2023 scorecard

Saxon Weald			
Baseline Credit Assessment	**Sub-factor Weighting**	**Value**	**Score**
Factor 1: Institutional Framework			
Operating Environment	10%	a	a
Regulatory Framework	10%	a	a
Factor 2: Market Position			
Units Under Management	10%	6,809	baa
Factor 3: Financial Performance			
Operating Margin	5%	22.3%	baa
Social Housing Letting Interest Coverage *	10%	1.0x	baa
Cash-Flow Volatility Interest Coverage	10%	1.6x	baa
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	5.3x	b
Debt to Assets	10%	59.7%	b
Liquidity Coverage	10%	3.6x	aa
Factor 5: Management and Governance			
Financial Management	10%	a	a
Investment and Debt Management	10%	baa	baa
Scorecard - Indicated BCA Outcome			**baa1**
Assigned BCA			**baa2**

* Includes a £4.8 million loan breakage receipt; excluding this one-off revenue, the social housing letting interest coverage would be at 0.7x
Source: Saxon Weald and Moody's Investors Service

Ratings

Exhibit 6

Category	Moody's Rating
SAXON WEALD	
Outlook	Stable
Baseline Credit Assessment	baa2
Issuer Rating -Dom Curr	A3
SAXON WEALD CAPITAL PLC	
Outlook	Stable
Senior Secured -Dom Curr	A3

Source: Moody's Investors Service

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