MOODY'S
PUBLIC SECTOR EUROPE

CREDIT OPINION
6 January 2021

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RATINGS

Paragon Asra Housing Ltd

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.

Contacts

Zoe Jankel +44.20.7772.1031
VP-Senior Analyst
zoe.jankel@moodys.com

Csaba Szontagh +44.20.7772.8738
Associate Analyst
csaba.szontagh@moodys.com

Sebastien Hay +34.91.768.8222
Senior Vice President/Manager
sebastien.hay@moodys.com

CLIENT SERVICES

Americas	1-212-553-1653
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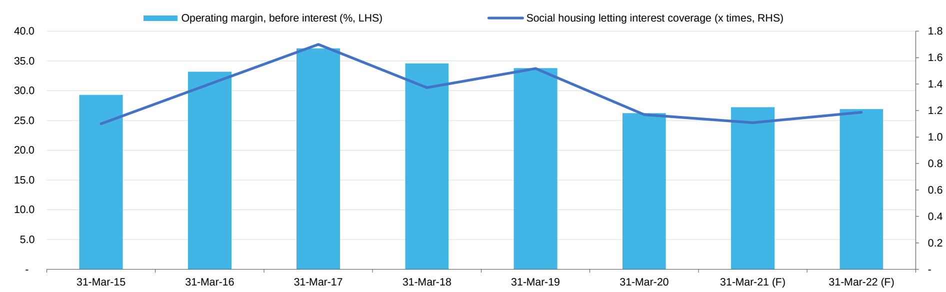
Paragon Asra Housing Ltd

Update to credit analysis

Summary

The credit profile of Paragon Asra (A3 stable) reflects its solid operating performance, simple governance structure and strong financial management, and continued moderate exposure to market sales. Paragon Asra also benefits from the strong regulatory framework governing English housing associations, and our assessment that there is a strong likelihood that the Government of the United Kingdom (Aa3 stable) would intervene in the event that Paragon Asra faced acute liquidity stress.

Exhibit 1
Paragon Asra retains strong profitability, but social housing letting interest coverage is weakening
Social housing letting interest coverage and operating margin



(F): Forecast
Note: Paragon until 2017, Paragon Asra thereafter
Source: Issuer, Moody's

Credit strengths

» Weakened but still solid operating performance

» Stable debt metrics, with strong liquidity

» Supportive institutional framework

Credit challenges

» Moderate exposure to market sales, predominantly shared ownership

» Weakened social housing letting interest coverage

Rating outlook

The stable outlook on Paragon Asra's rating reflects its stable debt and financial metrics, in addition to the supportive institutional framework for the sector.

Factors that could lead to an upgrade

Factors that could lead to an upgrade include strengthened interest coverage metrics to levels sustained above 2.0x, and a significant reduction in debt levels and gearing.

Factors that could lead to a downgrade

Factors that could lead to a downgrade include a material scaling up of the development programme, a material weakening in operating performance with interest coverage metrics falling below 1.0x, a deterioration of its strong unencumbered assets position and/or a scaling up of debt beyond that currently anticipated. In addition, a weaker regulatory framework or a dilution of the overall level of support from the UK government could also exert downward pressure on the rating.

Key indicators

Exhibit 2

Paragon until 2017, Paragon ASRA thereafter

	31-Mar-16	31-Mar-17	31-Mar-18	31-Mar-19	31-Mar-20	31-Mar-21 (F)	31-Mar-22 (F)
Units under management (no.)	10,699	22,708	22,676	22,220	21,901	22,848	23,195
Operating margin, before interest (%)	33.2	31.9	34.6	33.8	26.2	27.2	26.9
Net capital expenditure as % turnover	71.7	7.9	10.4	18.6	76.1	63.6	43.5
Social housing letting interest coverage (x times)	1.4	1.3	1.4	1.5	1.2	1.1	1.2
Cash flow volatility interest coverage (x times)	1.8	2.1	1.3	1.7	0.4	1.3	1.5
Debt to revenues (x times)	5.1	4.5	4.2	4.4	5.3	5.0	4.9
Debt to assets at cost (%)	71.1	49.3	48.8	48.7	50.5	52.7	54.2

(F): Forecast
Source: Issuer, Moody's

Detailed credit considerations

Paragon Asra's rating combines (1) its baseline credit assessment (BCA) of baa1 and (2) a strong likelihood of extraordinary support coming from the UK government in the event that Paragon Asra faces acute liquidity stress.

Baseline credit assessment

Weakened but still solid operating performance

Paragon Asra's operating margin decreased to 26% in FY2020 compared to historical margins of 32-35% between FY2017-19. The decrease is due to a £10 million reduction in turnover caused by lower first tranche shared ownership (FTSO) sales than expected and lower social rent due to the last year of the rent cut. The margin was also affected by a 20% increase in maintenance and fire-safety costs. However, despite the weakened performance, Paragon Asra's operating margin remains in line with expected A3 rated peer median of 26%. Despite fewer sales of FTSO tenures than expected in FY2020, due to delayed handovers, margins remained strong on this activity - Paragon Asra delivered a margin of 42% on FTSO in FY2020.

Its operating margin is projected to stabilize at 27% in FY2021-22, mainly due to continued increased costs on building safety and maintenance. This trend can be seen in the margin on social housing lettings which has decreased from an average of 33% from FY2017 to FY2019, to an expected average of 26% from FY2020 to FY2022.

Cash flow volatility interest coverage (CVIC) was at 0.36x in FY2020, well below the expected A3 rated peer median of 1.63x. The low level is due the weaker cash performance in FY2020 - cash flow from operations decreased to £29 million in FY2020 from £60.4

million in FY2019. This is primarily driven by the lower FTSO sales in FY2020 due to delayed handovers on a number of sites. We expect CVIC to improve to above 1 in FY2021 as construction completes on these sites. CVIC is projected to strengthen in the coming years and reach 1.94x by FY2023 (expected peer median 1.9x).

Solid liquidity, but debt metrics set to weaken

Paragon Asra has a robust liquidity policy, mitigating treasury risk. It includes high general liquidity requirements and is adapted to the association's specific risk profile and is stress tested on a regular basis. Golden rules adopted by the Board state that the group will hold sufficient cash and liquid resources to cover at least the next 18 months' forecast net cash requirement excluding 50% of sales proceeds, mitigating sales exposure risk. The treasury policy also includes a specific mark to market policy requiring a separate liquidity buffer covering an adverse movement of interest rates of 50 basis points. Paragon Asra executed a bond tap of £25 million from its original 2015 bond issue in October 2019. Its liquidity metric was at 1.34x in FY2020 with £39.6 million in cash and £160 million in secured undrawn facilities. Paragon Asra also benefits from a strong unencumbered assets position which supports additional borrowing capacity of £590 million and is currently reviewing its security position to further improve its borrowing capacity as between FY2022-25 c£400 million of its bank facilities will mature.

Paragon Asra inherited Asra's large swap portfolio, giving a total stand alone notional value of £160 million and a negative mark to market value of £68 million, as of October 2020. This mark to market exposure is covered using a combination of property and cash security, reducing the impact of margin calls.

Both debt metrics are expected to weaken, as debt increases to fund its development programme. At FYE2020, gross debt was £775 million and this is planned to increase to £1,140 million by FY2024 - an increase of 47%. The current debt to revenue metric of 5.3x is expected strengthen to 4.9x by 2023, before the expanding development programme will require further funding. Debt to assets was at 50% at FYE2020 and is expected to worsen to 58% over the same period. Both metrics depend on the pace of the development programme which has been slower than expected over the past two years.

Its development programme includes 3,000 units from FY2021 to FY2025 and is concentrated on affordable and social rent (55% of units) and shared ownership (45% of units) with very few outright sales. Paragon has made the strategic choice to not develop outright sales schemes due to the higher risks involved and this is supported by higher grant rates for social housing in their grant programmes with both the Greater London Authority and Homes England.

Supportive institutional framework

The sector's credit quality will continue to benefit from the strong regulatory framework governing English HAs. 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. In response to the pandemic, the regulator adapted some aspects of its oversight temporarily, for example, extending its liquidity monitoring, briefly pausing the programme of IDAs and delaying regulatory submissions to reduce the operational burden on 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 has improved under more supportive policies for social rent increases and capital grant. Following four years of social rent reductions, HAs now benefit from a return to inflation-linked rent increases from April 2020 for five years. In addition, the government has committed to increased capital grant on more flexible terms for new social housing.

Counterbalancing the improvements, we expect policy to drive increased borrowing and development risk in the sector as it responds to the government's objective to deliver a significant increase in the construction of new homes.

Moderate exposure to market sales but all shared ownership

Paragon Asra's market sales activity will remain moderate and focused on shared ownership, a product for which it has a strong track record. Paragon Asra's total revenues equalled £149 million in FY2020 and comprised primarily of social housing lettings revenue, which accounted for 90% of revenues in FY2020. Market sales activity accounted for 6% of revenues for Paragon Asra in FY2020. By FY2023, this is expected to increase to 24%, a high level of exposure. Turnover from FTSO sales is projected to increase in the business plan, with a peak of £55 million of turnover in FY2024. This increase is fairly ambitious, however uncertainties in sales risk are monitored, continuously stress-tested and mitigating actions are in place in case of shortfall.

Weakened social housing letting interest coverage, driven mostly by the increase in debt

Paragon Asra's social housing letting interest coverage (SHLIC) was 1.2x in FY2020, in line with the A3 peer median of 1.2x. This metric is 0.3x below last year's figure and is due to weaker operating performance. The metric is expected to further weaken to 1.1x in FY2021, before returning to an improving path from FY2022. The reduction reflects the projected increase in debt, and tighter margin on social housing lettings due to increased building safety and maintenance costs. Interest costs are expected to peak at £40 million by 2024 from £29.7 million at FYE2020.

Extraordinary support considerations

The strong level of extraordinary support factored into the rating reflects the wide-ranging powers of redress available to the regulator in cases of financial distress, with the possibility of a facilitated merger or a transfer of engagements. 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 increasing exposure to non-core social housing activities in the sector, that add complexity to HA operations, and the weakening of the sovereign's financial resilience, making an extraordinary intervention slightly more challenging. In addition, our assessment that there is a very high default dependence between Paragon Asra and the UK government reflects their strong financial and operational linkages.

ESG considerations

How environmental, social and governance risks inform our credit analysis of Paragon Asra

Moody's takes account of the impact of environmental (E), social (S) and governance (G) factors when assessing sub-sovereign issuers' economic and financial strength. In the case of Paragon Asra, the materiality of ESG to its credit profile is as follows:

Environmental considerations are not material to HAs' credit profiles. In line with the rest of the UK, the sector's main environmental risk exposures relate to water shortage and flood risk. Flood risk is managed by country and national authorities, and therefore the financial burden of adapting to increased flood risk will not fall on individual housing associations.

Social risks are material to HAs' credit profiles. In particular, the sector is exposed to risks stemming from socially-driven policy agendas affecting social rents, benefits and capital grants in addition to the impact of demographic trends on demand which are captured in our assessment of the operating environment. We view the coronavirus outbreak as a social risk under our ESG framework given its impact on health and safety. Overall, we expect the outbreak to cause ongoing operational disruption for HAs but do not expect a material credit impact as higher arrears and lower market sales receipts will be offset by cash savings from reduced capital spending on development and repairs. HAs are also impacted by customer relations and product quality. The Grenfell fire tragedy in June 2017 has encouraged higher health and safety standards with many HAs planning on increasing spending on the quality of their existing stock.

Governance considerations are also material to HAs' credit profiles and are captured in our assessment of governance and management. In general, housing association governance is strong with multi-year strategies supported by detailed forecasts, conservative liquidity policies, and robust risk management including stress testing.

Further details are provided in the "Baseline credit assessment" section above. Our approach to ESG is explained in our cross-sector methodology General Principles for Assessing ESG Risks.

Rating methodology and scorecard factors

The assigned BCA of baa1 is the close to the scorecard indicated BCA. The methodologies used in this rating were European Social Housing Providers, published in April 2018 and Government Related Issuers, published in February 2020.

31 March 2020

Exhibit 3

Paragon ASRA			
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%	21,901	a
Factor 3: Financial Performance			
Operating Margin	5%	26.2%	a
Social Housing Letting Interest Coverage	10%	1.2x	baa
Cash-Flow Volatility Interest Coverage	10%	0.4x	b
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	5.3x	b
Debt to Assets	10%	50.5%	b
Liquidity Coverage	10%	1.3x	a
Factor 5: Management and Governance			
Financial Management	10%	baa	baa
Investment and Debt Management	10%	baa	baa
Suggested BCA			**baa2**

Source: Issuer, Moody's

Ratings

Exhibit 4

Category	Moody's Rating
PARAGON ASRA HOUSING LTD	
Outlook	Stable
Issuer Rating -Dom Curr	A3
PARAGON TREASURY PLC	
Outlook	Stable
Senior Secured -Dom Curr	A3

Source: Moody's Investors Service

REPORT NUMBER 1252549

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