MOODY'S
INVESTORS SERVICE

CREDIT OPINION
26 October 2023

Update

RATINGS

Peabody Trust

Domicile	London, 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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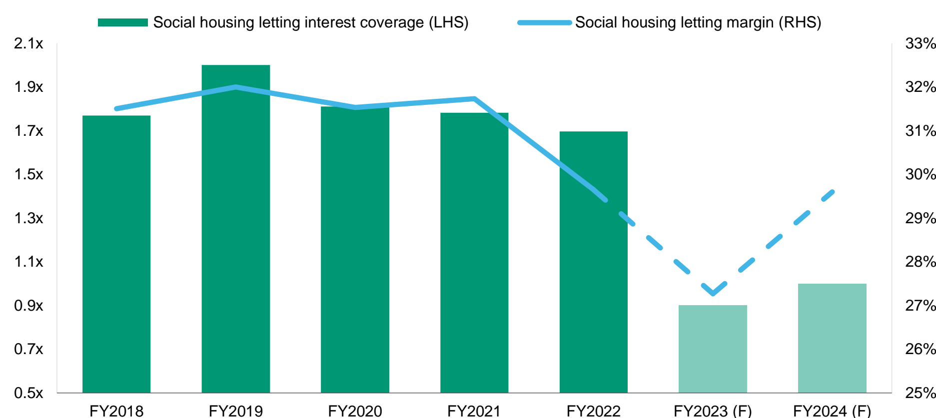
Peabody Trust (United Kingdom)

Update following outlook change to stable from negative

Summary

The credit profile of Peabody Trust (Peabody, A3 stable) reflects the entity's strong balance sheet and modest debt burden, weaker interest coverage going forward and risks from a high exposure to market sales. Peabody 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 Peabody faced acute liquidity stress. Peabody merged with Catalyst Housing Group (Catalyst) in April 2022, making it one of the largest housing associations in England.

Exhibit 1
Peabody's interest coverage is expected to be weaker than historical years
Social housing letting interest coverage and social housing letting margin, fiscals 2018 to 2024



Source: Peabody, Moody's Investors Service

Credit Strengths

» Large housing association with robust debt metrics

» High stock of unencumbered assets and strong liquidity

» Supportive institutional framework in England

Credit Challenges

» Social housing letting interest coverage projected to remain low

» High exposure to market sales expected to continue

Rating Outlook

The stable outlook reflects the expected gradual reduction in inflation and associated cost pressures as well as the proactive actions taken by Peabody 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 more quickly than forecasts, weaker liquidity or a failure to adapt strategies and risk appetite to mitigate against 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

Peabody Trust

	31-Mar-18	31-Mar-19	31-Mar-20	31-Mar-21	31-Mar-22	31-Mar-23 (F)	31-Mar-24 (F)
Units under management (no.)	54,714	55,869	65,588	66,257	66,916	108,427	109,752
Operating margin, before interest (%)	27.9	26.4	23.7	22.9	20.0	20.9	29.1
Net capital expenditure as % turnover	25.6	52.4	39.6	51.0	58.9	49.0	23.9
Social housing letting interest coverage (x times)	1.8	2.0	1.8	1.8	1.7	0.9	1.0
Cash flow volatility interest coverage (x times)	1.7	(1.5)	3.0	(1.3)	(0.5)	1.1	1.4
Debt to revenue (x times)	3.2	3.9	4.2	4.6	4.7	4.8	4.6
Debt to assets at cost (%)	34.9	36.7	39.8	40.6	40.9	45.2	44.9

Source: Peabody, Moody's Investors Service

Detailed Rating Considerations

On 25 October 2023, Moody's changed the outlook to stable from negative and affirmed the ratings for Peabody. The change in outlook followed Moody's change in outlook of the Government of the United Kingdom's Aa3 rating to stable from negative on 20 October 2023.

Peabody's ratings combine (1) its Baseline Credit Assessment (BCA) of baa2 and (2) a strong likelihood of extraordinary support coming from the UK government in the event that Peabody faced acute liquidity stress.

Baseline Credit Assessment

Large housing association with robust debt metrics

Peabody has a history of growing both organically and inorganically, including through the acquisition of Gallions Housing Association in 2014 and the mergers with Family Mosaic in 2017 and with Town and Country Housing in May 2019. In April 2022, Peabody completed a merger with Catalyst, with transfer of engagements planned after one year. The merged entity manages over 100,000 units, making it one of the largest housing associations in the UK. Catalyst, like Peabody, has a footprint in London, as well as around the Home Counties. The substantial size of the merged organisation results in a strong market position, affording it more political influence than smaller peers and bringing a larger balance sheet which provides resilience. We anticipate that the new entity will be able to deliver the planned efficiencies given Peabody's strong track record of growth through mergers.

Peabody's debt metrics have historically been robust. Gearing (debt to assets at cost) was 41% in fiscal 2022, in line with fiscal 2021 and lower than the A3-rated peer median of 50%. Gearing is expected to increase to 45% in fiscal 2023 following the consolidation of Catalyst, which has higher gearing than Peabody (48% in fiscal 2022). However, we expect gearing to decrease from fiscal 2024

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following significant reductions in the group's development programme in response to the weaker operating environment. Gearing will therefore remain low relative to our portfolio of rated housing associations, and well below the A3-rated peer median.

Likewise, we expect Peabody's debt to revenue to improve in the medium term. The metric has weakened in recent years, rising to 4.7x in fiscal 2022 from 3.2x in fiscal 2018, as debt materially increased to fund Peabody's development programme. This is higher than the A3-rated peer median of 4.3x in fiscal 2022. We expect it to peak to 4.8x in fiscal 2023 before falling from fiscal 2024, supported by slower debt growth as a result of a smaller development programme; debt will only moderately increase to £5.1 billion in fiscal 2026 from £5.0 billion in fiscal 2023.

Peabody issued a £350 million sustainability bond in Marc h 2022 and recently completed the extension of a £100 million revolving credit facility expiring in May 2023. The group has limited interest rate risk, with around 80% of debt at fixed rates as of January 2023.

High stock of unencumbered assets and strong liquidity

Peabody has around 25,000 unencumbered properties as of June 2022, giving the organisation plenty of capacity to support its future borrowing needs. The unencumbered assets amount to approximately £4 billion, significantly above the group's net funding needs over the next five years. Additionally, Peabody and Catalyst combined held approximately £539 million in investment properties as of fiscal year end 2022 that could be sold if needed.

The group's liquidity position has strengthened compared to the previous year and is supported by strong liquidity policies. As of September 2022, Peabody's liquidity amounted to £1.7 billion (£114 million in cash and £1.6 billion in undrawn, secured facilities), enough to cover 2.2x the forward-looking two-year cash needs. This is above the A3-rated peer median of 1.5x. Peabody's liquidity policy sets out a requirement to maintain cash and committed facilities to cover 18 months of contracted expenditure, increasing to three years including uncommitted facilities. The liquidity policy mitigates the sales risk associated with the development programme by excluding sales income from the calculation.

Supportive institutional framework in England

The sector's credit quality will continue to benefit from the strong institutional framework governing English housing associations 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 and annual reviews and by undertaking biennial In-Depth Assessments for large and complex housing associations. 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 housing associations remains supportive. Demand for social housing remains very high and the government has committed to increased capital grants on more flexible terms for new social housing. English housing associations retain some expenditure flexibility and have a track record of reducing costs to mitigate lower income.

However, due to presently very high rates of inflation, the government has intervened on social rent policy with a 7% ceiling on social rent increases to be implemented from April 2023 for one year. The ceiling of 7% will likely result in an adverse differential between rental income and cost growth, driving lower margins and interest coverage. The intervention introduces policy volatility to the sector as the ceiling will supersede the allowable increase of consumer price inflation plus 1% under the current rent standard, which is in place until March 2025.

Social housing letting interest coverage projected to remain low

Peabody's social housing letting interest coverage (SHLIC) is expected to remain low over the medium term. SHLIC amounted to 1.7x in fiscal 2022, slightly below 1.8x in fiscal 2021 but above the A3-rated peer median of 1.1x. However, the ratio is expected to weaken significantly to an average of 1.0x over the next three years as a result of a high level of spending on fire safety and improvements to existing stock, the cap on social rent increases set below inflation levels and higher interest costs.

Peabody is presently undergoing initiatives to reduce its costs to help support margins. Some of the cost cutting measures include a new localities model focused on delivering services by local teams and improvements to digital platforms. In addition, the group expects to significantly exceed the efficiency target planned from the merger with Catalyst.

Peabody's cash flow from operations are volatile as a result of its high exposure to market-oriented tenures, reflected in the cash flow volatility interest coverage (CVIC) ratio. Peabody's CVIC was -0.5x in fiscal 2022; despite an increase in operating cash flows, the ratio continued to be negatively impacted by the volatility in market sale receipts over the past three years. We expect CVIC to improve going forward and increase to an average of 1.5x between fiscal 2023 and fiscal 2025, although this is contingent on market sales being realised as planned.

High exposure to market sales expected to continue

Peabody's strategic focus incorporates significant exposure to the cyclical housing market. Market sales as a proportion of total revenue amounted to 23% in fiscal 2022 (16% outright sales and 7% first-tranche shared ownership sales) and is forecasted to remain close to current levels over the next three years. This is credit negative as it exposes the group to the risk of increased volatility in its operating cash flows. In addition, a weakening housing market over the next year may lead to lower market sale receipts, which would result in higher borrowing needs or further reductions in the development programme. However, we note that Peabody reduced its exposure to market sales in the latest business plan and it will remain significantly below previous expectations.

The development pipeline continues to be in line with Peabody's mixed tenure strategy. 48% of developments will be general needs and affordable housing, 34% shared ownership and 18% outright sales. Whilst the development programme continues to have a strong focus on market sales, Peabody has sought to reduce the risk in its sales programme through advance sales and working with the Greater London Authority on obtaining additional grant to convert planned market sale units to social or affordable housing. As part of its newly increased size, Peabody will aim to become a more influential partner with the Greater London Authority and Homes England. In addition, Peabody's development programme is predominantly land led, giving it more control over sites and tenures.

Peabody has entered into a handful of joint venture agreements with commercial land developers in order to mitigate the risk and cost of some market sale schemes. This includes the Thamesmead Waterfront joint venture with Lendlease, with a plan to develop 11,500 homes over 30 years as part of the larger Thamesmead development in southeast London. Including joint ventures, we estimate that market sales will account for around 26% of turnover over the next three years. While there will be an aspect of risk mitigation for joint venture schemes and benefits of leveraging partner expertise, this will also introduce potential risks stemming from the joint venture partners themselves.

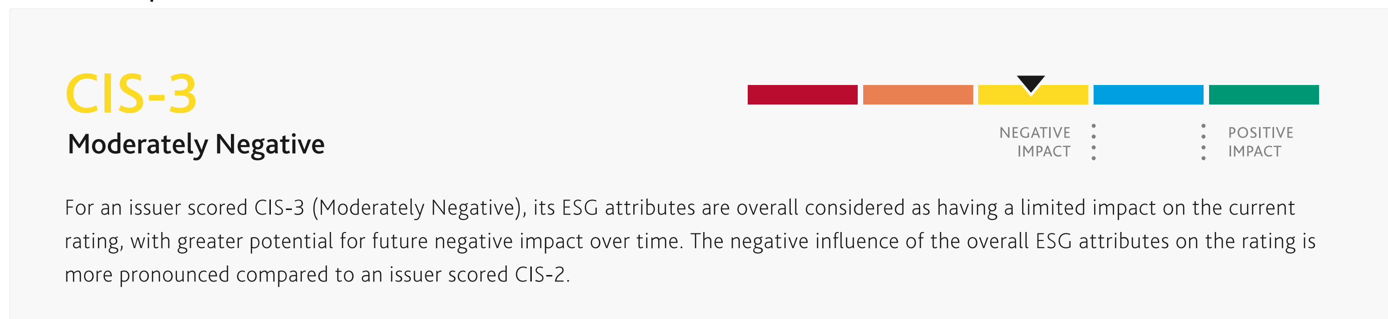
Extraordinary Support Considerations

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 or a transfer of engagements. However, the process can be protracted and is reliant on housing associations 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 increasing exposure to non-core social housing activities in the sector, that add complexity to housing association 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 Peabody and the UK government reflects their strong financial and operational linkages.

ESG considerations

Peabody Trust's ESG Credit Impact Score is Moderately Negative CIS-3

Exhibit 3
ESG Credit Impact Score



Source: Moody's Investors Service

Peabody's **CIS-3** reflects our view that ESG risks have a materially negative impact on its rating. In particular, expenditure requirements related to carbon transition and building and safety will weaken margins and increase financing needs, as well as affordability constraints for low-income tenants, which have led to government-imposed sub-inflationary rent caps.

Exhibit 4
ESG Issuer Profile Scores

Source: Moody's Investors Service

Environmental

Peabody has a 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

Peabody is highly exposed to social risks (**S-4**) through sector-wide legislative requirements to improve the safety of existing housing stock (responsible production risks) for which Peabody has considerable expenditure requirements, which will weigh on its margins and interest coverage over the medium term. Peabody is also affected by 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

Peabody has limited governance risks (**G-2**). Its governance is fit for purpose, with strong financial management policies and processes, detailed reporting and a somewhat more complicated organisational structure due to significant joint ventures, but we consider this mitigated by the group's strong management and governance practices. 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 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.

Exhibit 5

2022 scorecard

Peabody Trust			
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%	66,916	aa
Factor 3: Financial Performance			
Operating Margin	5%	20.0%	baa
Social Housing Letting Interest Coverage	10%	1.7x	a
Cash-Flow Volatility Interest Coverage	10%	-0.5x	b
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	4.7x	ba
Debt to Assets	10%	40.9%	ba
Liquidity Coverage	10%	2.2x	aa
Factor 5: Management and Governance			
Financial Management	10%	baa	baa
Investment and Debt Management	10%	baa	baa
Scorecard - Indicated BCA Outcome			**baa1**
Assigned BCA			**baa2**

Source: Peabody, Moody's Investors Service

Ratings

Exhibit 6

Category	Moody's Rating
PEABODY TRUST	
Outlook	Stable
Baseline Credit Assessment	baa2
Issuer Rating -Dom Curr	A3
PEABODY CAPITAL NO 2 PLC	
Outlook	Stable
Senior Secured -Dom Curr	A3
PEABODY CAPITAL PLC	
Outlook	Stable
Senior Secured -Dom Curr	A3

Source: Moody's Investors Service

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