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CREDIT OPINION

19 December 2024

Update

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RATINGS

Midland Heart

Domicile	United Kingdom
Long Term Rating	A1
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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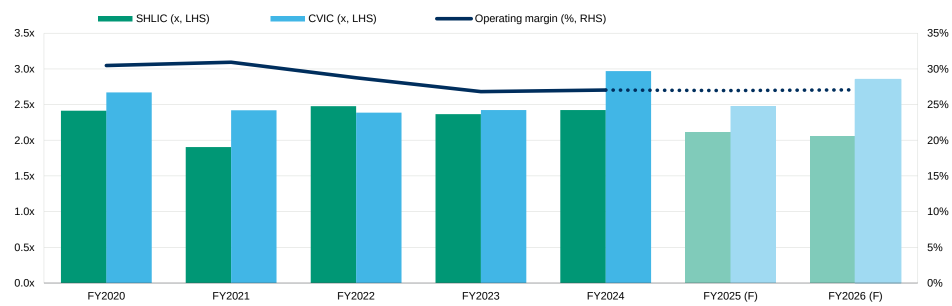
Midland Heart (United Kingdom)

Update to credit analysis

Summary

The credit profile of Midland Heart (A1 stable) reflects its stable strategy and financial metrics, low debt and strong operating performance and interest coverage ratios. Midland Heart 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 (UK, Aa3 stable) would act in a timely manner to prevent a default.

Exhibit 1
Midland Heart's interest coverage and margins are expected to remain strong
Social housing lettings interest cover (x, LHS), cash flow volatility interest cover (x, LHS), operating margin (%, RHS)



F: Forecast
Source: Midland Heart and Moody's Ratings

Credit strengths

- Strong financial management, with a focus on low-risk social housing activities
- Healthy financial performance, with strong interest coverage and operating margin
- Low debt metrics, forecast to remain aligned with that of highest-rated peer group
- Supportive institutional framework in England

Credit challenges

- Reduced but material swap portfolio, mitigated by the strength of its treasury policy

Rating outlook

The stable outlook reflects Midland Heart's stable operating performance, with strong interest covers and operating margins, and sound debt metrics and liquidity.

Factors that could lead to an upgrade

Upward pressure on the ratings could result from a significant improvement in operating performance beyond current expectations, a material reduction in debt or a significant increase in government support for the sector.

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, and weaker liquidity. 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

Midland Heart

	31-Mar-20	31-Mar-21	31-Mar-22	31-Mar-23	31-Mar-24	31-Mar-25 (F)	31-Mar-26 (F)
Units under management (no.)	33,169	33,324	33,877	34,362	34,966	35,668	36,140
Operating margin, before interest (%)	30.5	30.9	28.8	26.8	27.0	27.0	27.1
Net capital expenditure as % turnover	20.8	25.1	45.9	32.7	40.1	28.8	20.6
Social housing letting interest coverage (x times)	2.4	1.9	2.5	2.4	2.4	2.1	2.1
Cash flow volatility interest coverage (x times)	2.7	2.4	2.4	2.4	3.0	2.5	2.9
Debt to revenues (x times)	2.6	2.9	3.1	2.9	2.7	2.8	2.8
Debt to assets at cost (%)	29.2	29.8	29.7	29.6	30.9	31.9	32.7

F: Forecast
Source: Midland Heart and Moody's Ratings

Detailed credit considerations

Midland Heart's credit profile, as expressed in an A1 stable rating combines (1) its baseline credit assessment (BCA) of a2, and (2) a strong likelihood that the UK government would act in a timely manner to prevent a default.

Baseline credit assessment

Strong financial management, with a focus on low-risk social housing activities

Midland Heart exhibits strong financial management, with a modest risk appetite and a focus on low-risk social housing lettings (SHL) which accounted for 90% of turnover in fiscal 2024 compared to a rated peer median of 80%. The focus on traditional social housing will continue with an average of 91% of income from SHL over the next three years. For fiscal 2024, other income sources included a small percentage of first-tranche shared ownership (FTSO) sales at 6%, and a small amount of income from market rent and care activities.

Midland Heart's development programme is also focused on social housing. The group intends to develop around 2,669 units over the next five years, with a tenure mix of: affordable rent (57%) shared ownership (26%) and general needs (17%).

The group's credit profile also benefits from its strong governance and management as evidenced by its strategic predictability and very stable financial metrics. In addition, financial management is governed by three golden rules, which have been unchanged and consistently adhered to for many years, underpinning a clear risk framework for the group. Golden rules include (1) gearing maintained below 70%, (2) interest cover above 150%, and (3) a minimum of 18 months of forecast cash requirements, net of development sales. In November 2023, Midland Heart retained its G1/V1 rating by the regulator.

Healthy financial performance, with strong interest coverage and operating margin

We expect that Midland Heart will continue to maintain strong and stable financial performance. The group's operating margin was 27% in fiscal 2024 compared to a rated peer median of 21%. Profitability is expected to remain strong over the next three years with operating margins averaging 27%, supported by management's commitment to efficiency and prudent planning.

In line with other rated HAs, Midland Heart's social housing letting (SHL) operating margin has fallen over the last five years, largely driven by the rent cut, but remains strong. SHL operating margin was 28% in fiscal 2024 compared to a rated peer median of 23%, down from 34% five years earlier. The SHL margin is projected to remain stable at around 28% over the next three years, providing the foundation for the strong overall group profitability.

The group will also maintain strong interest cover ratios. Midland Heart's social housing letting interest cover (SHLIC) stood at 2.4x and cash flow volatility interest cover (CVIC) stood at 3.0x in fiscal 2024. Midland Heart's SHLIC will average 2.0x over the next three year, down from 2.4x in fiscal 2024, as interest cost increase with higher debt levels, but will remain stronger than the peer median of 1.2x over the next three years.

Low debt metrics, forecast to remain aligned with that of highest-rated peer group

Midland Heart's moderate development programme combined with its track record of high profitability has resulted in strong debt metrics which we expect to continue despite a planned increase in debt to fund development.

The group's debt stood at £635 million in fiscal 2024 and is expected to increase to £990 million by fiscal 2027. Midland Heart sold £75 million in retained bonds in February 2022, with a further £75 million available to be drawn at a later date. Despite the increase, gearing (debt to assets) and debt to revenues will remain strong. Gearing stood at 31% in fiscal 2024, well below the rated peer median of 49% (fiscal 2024), and is expected to marginally increase to 33% by fiscal 2027. Debt to revenues will also remain robust, averaging 3.1x over the next three years compared to a rated peer median of 4.4x (fiscal 2024).

Supportive institutional framework in England

The sector's credit quality will continue to benefit 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 housing associations remains supportive. Demand for social housing is very high and English housing associations retain some expenditure flexibility, with a track record of controlling costs to mitigate lower income. The UK government confirmed that for fiscal 2026, rent increases within the English sector will be pegged at the September Consumer Price Index (CPI) plus 1%. A consultation is currently ongoing to extend the policy to at least fiscal 2031, which would provide more certainty to the sector.

Reduced but material standalone swap portfolio, mitigated by the strength of its treasury policy

Midland Heart's interest rate risk is aligned with peers but it has a material exposure to standalone swaps, exposing it to liquidity risks associated with collateral posting. The group has security pledged against its swap positions, which covered a negative mark to market position of £14 million in March 2024. The association's treasury policy requires Midland Heart to have sufficient security charges to cover a 50 basis point decline in interest rates, reflecting strong debt management.

We see Midland Heart's liquidity policy as a strength of the organisation and a supporting factor in its high investment and debt management score. The policy outlines that cash flow should be managed such that sufficient liquidity is always available to cover 18 months' cash flow, including all committed developments but excluding any development sales income. This policy effectively eliminates the entity's dependence on sales proceeds in managing liquidity, a credit positive.

As of March 2024, immediately available liquidity totaled about £295 million, consisting of immediately available undrawn facilities of £256 million and £39 million of cash and cash equivalents. At fiscal year end 2024, Midland Heart's liquidity coverage was a strong

2.3x of the HA's net cash requirements over the next two years. Moreover, the group will retain a strong level of unencumbered assets which stood at £472 million (MVT basis) at March 2024.

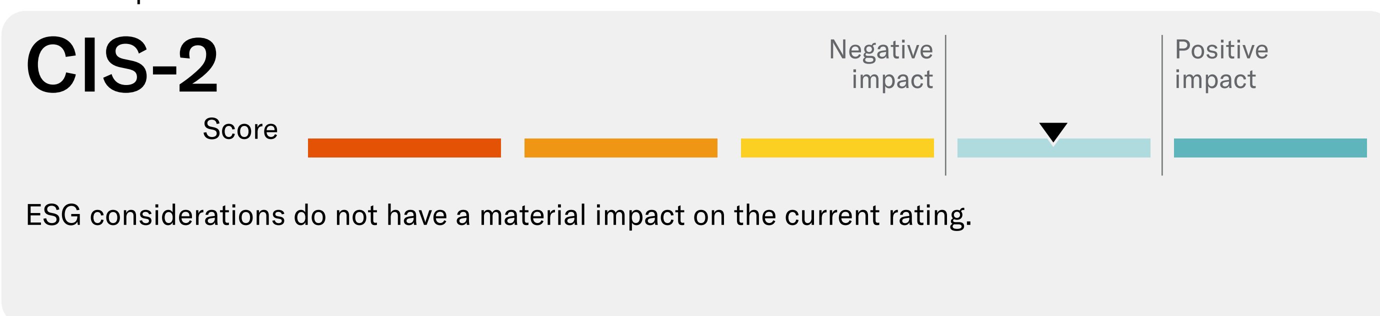
Extraordinary support considerations

The strong level of extraordinary support factored into the ratings reflects our view of the UK government's support for the housing association sector due to its political, economic and social importance. Extraordinary support for the sector is predominantly exercised through sector regulators whose wide-ranging powers in cases of financial distress include facilitating mergers. However, this process can be protracted and is reliant on housing associations agreeing to merge, which is more challenging in a weakened operating environment, with high expenditure pressures and high borrowing costs. In addition, our assessment that there is a very high default dependence between Midland Heart and the UK government reflects their strong financial and operational linkages.

ESG considerations

Midland Heart's ESG credit impact score is CIS-2

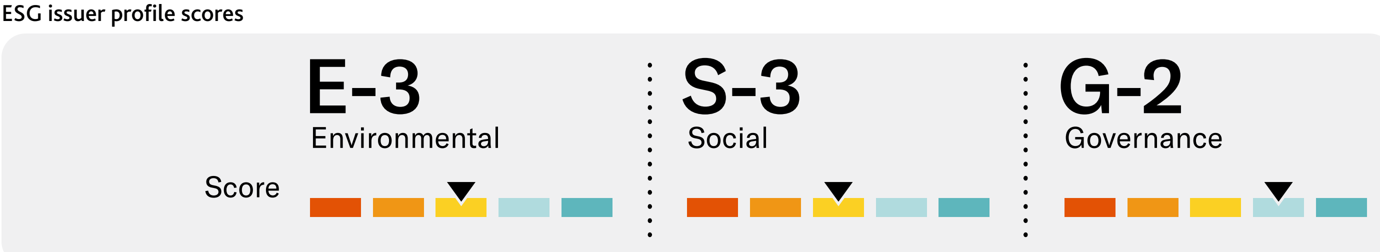
Exhibit 3
ESG credit impact score



Source: Moody's Ratings

Midland Heart's **CIS-2** indicates that ESG risks have a limited impact on its rating. Midland Heart has limited exposure to carbon transition risks as the majority of its stock already meets energy efficiency requirements, and although social risks are prevalent we consider that it has the ability to effectively mitigate them through its strong governance and management practices. We also consider that the supportive regulatory framework for the sector offsets some ESG risks.

Exhibit 4
ESG issuer profile scores



Source: Moody's Ratings

Environmental

Midland Heart's exposure to environmental risks (**E-3**) relates to its material exposure to carbon transition risks as a relatively high proportion of its stock requires retrofit to meet EPC-C standards by 2035. This will increase capital expenditure over this time period, although we expect that this will be manageable due to its strong financial management practices.

Social

Midland Heart 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

Midland Heart 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 a2 is one-notch lower than the scorecard-indicated BCA outcome of a1 for fiscal 2024.

The methodologies used in this rating are the European Social Housing Providers, published in July 2024, and Government-Related Issuers, published in January 2024.

Exhibit 5

Midland Heart's 2024 scorecard

Midland Heart			
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%	34,966	a
Factor 3: Financial Performance			
Operating Margin	5%	27.0%	a
Social Housing Letting Interest Coverage	10%	2.4x	aa
Cash-Flow Volatility Interest Coverage	10%	3.0x	a
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	2.7x	a
Debt to Assets	10%	30.9%	baa
Liquidity Coverage	10%	2.3x	aa
Factor 5: Management and Governance			
Financial Management	10%	a	a
Investment and Debt Management	10%	a	a
Scorecard - Indicated BCA Outcome			**a1**
Assigned BCA			**a2**

Source: Moody's Ratings

Ratings

Exhibit 6

Category	Moody's Rating
MIDLAND HEART	
Outlook	Stable
Baseline Credit Assessment	a2
Issuer Rating -Dom Curr	A1
MIDLAND HEART CAPITAL PLC	
Outlook	Stable
Senior Secured -Dom Curr	A1

Source: Moody's Ratings

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