UK Social Housing Providers Rating Methodology

Sovereign and Public Sector

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1. Introduction

This document presents our methodology for assigning short-term and long-term credit ratings to regulated non-profit social housing providers in the United Kingdom and their debt obligations[1]. Our dedicated approach for rating UK social housing providers highlights the importance of the policy and regulatory frameworks under which the providers operate. The approach also focuses on the resulting country-specific strategic orientations, reliance on debt funding and debt management practices.

1.1 Scope of the methodology

This methodology is applicable to regulated, non-profit social housing providers in the UK. Scope defines a non-profit social housing provider as a registered entity that has the primary objective of providing low-cost rental and/or home ownership accommodation to ensure that housing is made available to people whose needs are not adequately served by the commercial housing market.

Private for-profit companies that undertake some provisioning of social housing or assume some responsibilities as part of a local, regional or the national government are assessed via Scope's Rating Methodology for European Real Estate Corporates, potentially in conjunction with Scope's Rating Methodology for Government-Related Entities.

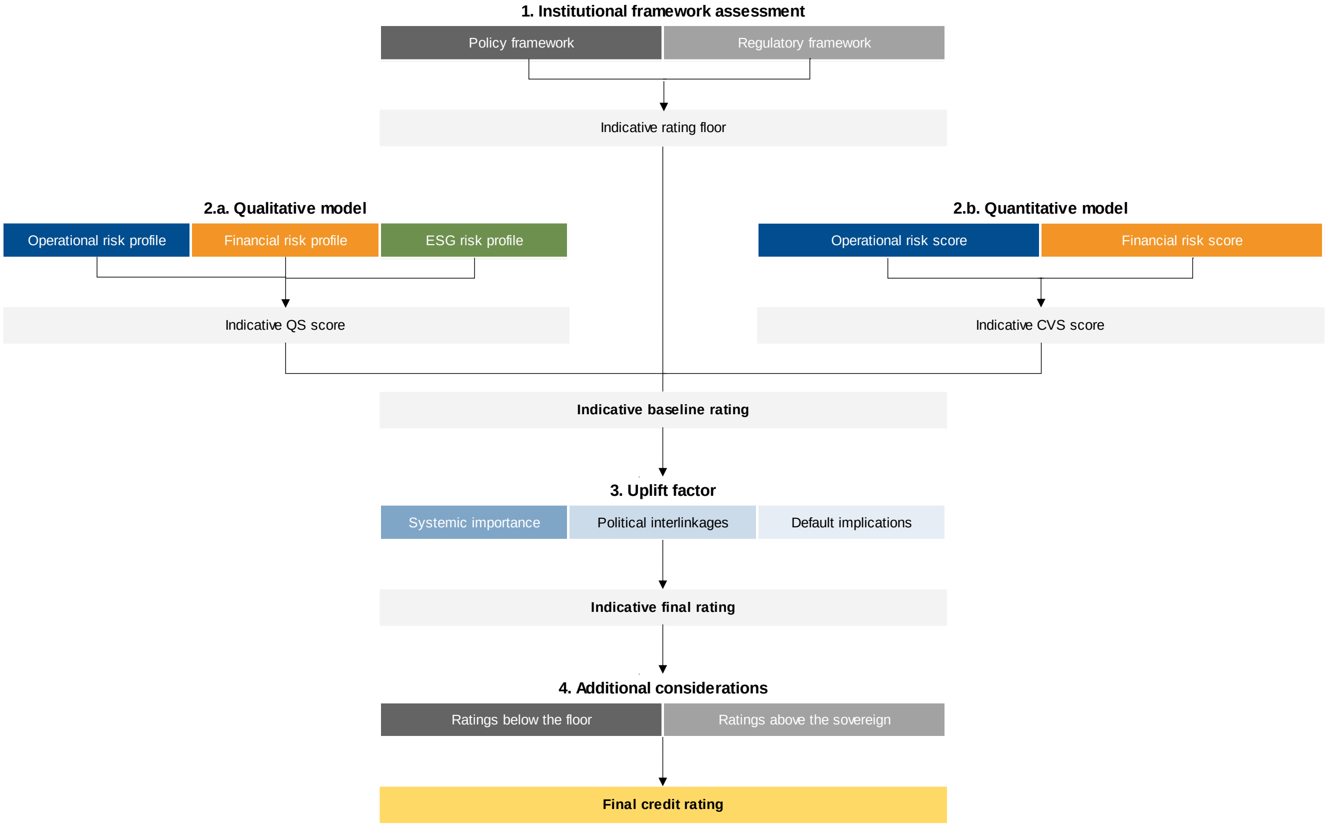
Scope's definition of default is applicable to UK social housing providers.

1.2 Summary of Scope's UK social housing approach

Our approach to rating non-profit social housing providers in the UK is split into four fundamental steps. As the first step, we assess the supportiveness of the policy and regulatory frameworks under which social housing providers operate, recognising that both can evolve with time. This determines an indicative rating floor, which can differ across the four countries in the UK given that housing is a devolved function. The second step, which includes a dual quantitative-qualitative analysis of a non-profit social housing provider's stand-alone credit profile, results in an indicative baseline rating. The third step is an uplift factor, which accounts for the UK sovereign's capacity and willingness to provide a credit uplift to individual providers in order to derive the final credit rating. The last step considers additional factors such as those that could adjust the credit rating lower should a provider face acute distress as well as exceptional conditions under which a select provider could be rated above the UK sovereign.

[1] In case a UK social housing provider issues an instrument that is not a senior unsecured debt obligation, this would be assessed on a case-by-case basis.

Figure 1. Overview of Scope's UK social housing approach



Source: Scope Ratings GmbH.

Step 1: Institutional framework assessment

In this first stage of the analysis, we capture systemic factors and determine an indicative rating floor by assessing the supportiveness of the domestic policy and regulatory frameworks. Details are provided in Chapter 2.

Step 2: Indicative baseline rating

We determine the indicative stand-alone credit profile of a provider, based on quantitative and qualitative analyses of its operational risk and financial risk profiles, while ESG risks are captured only via a qualitative evaluation. This risk assessment combined with the outcome of the institutional framework assessment, results in an indicative baseline rating. Details are provided in Chapter 3.

Step 3: Uplift factor

We determine the final indicative rating via a third step that assesses the sovereign's ability and willingness to provide exceptional support to prevent default of an individual provider. Details are provided in Chapter 4.

Step 4: Additional considerations

We determine the final credit rating after a fourth step that includes the consideration of any downward adjustments, including under the indicative ratings floor in exceptional circumstances and any required downward adjustments for providers that are rated above the UK sovereign after Step 3. Details are summarised in Chapter 5.

2. Institutional framework assessment

2.1 Overview

Our analysis of a non-profit social housing provider's creditworthiness starts with an assessment of systemic factors that capture the supportiveness of the institutional framework, resulting in an indicative rating floor. This recognises:

- Firstly, a mature and stable system, with gradual implementation of reforms and strong stakeholder engagement provides visibility on the evolution of providers' revenue sources and facilitates long-term planning, supporting creditworthiness.
- Secondly, the regulatory framework drives the overall level of risk and the quality of governance in the domestic social housing sector. In addition, effective regulatory interventions can help avoid cases of severe provider distress. These elements have a substantial impact on the likelihood of default across the domestic social housing sector.
- Thirdly, government social housing policies and support schemes are important to providers' strategic direction and long-term viability of business models, affecting their operational performance and reliance on debt financing.

We assess the degree to which the policy and regulatory frameworks for the UK social housing sector support the credit profiles of social housing providers through qualitative assessments as outlined in the following sections. The supportiveness of the institutional framework can vary over time, which can have an impact on the outlook for the credit quality across the domestic social housing sector. Typically, very supportive institutional frameworks with stable and predictable policies, robust government support mechanisms as well as strong, effective and pro-active regulatory frameworks lead to stronger credit profiles in the domestic social housing sector, support lender confidence and low funding costs across the sector, thereby acting as a de-facto floor for the ratings.

2.2 Qualitative scorecard (QS1)

We apply a Qualitative Scorecard (QS1) in which our analysis of the institutional framework under which social housing providers operate is structured around five components: i) the stability, predictability and transparency of the institutional framework; ii) the strategic importance of social housing as a policy area; iii) government support schemes; iv) the strength of regulatory standards and oversight; and v) the regulator's intervention powers and track record.

For each category, assessments are made on a five-point scale. We use a scoring system assigning 1 to 'no support', 25 to 'some support', 50 to 'strong support', 75 to 'very strong support' and 100 to 'exceptional support'. The institutional framework score, ranging from a maximum of 100 to a minimum of 1, is calculated as a simple average of these assessments which determines the overall level of support and the indicative ratings floor. For example, the highest possible institutional framework score of 100 is achieved if the framework is assessed as exceptionally supportive across all categories, whereas the lowest possible score of 1 is equivalent to an assessment of 'no support' across all categories.

The rationales that underpin each assessment, including quantitative metrics that support the analysis are detailed in the qualitative assessment tables for every analytical component as presented in the following sections. A simple average of the assessments results in an institutional framework score which is then used to determine the indicative rating floor for the regulated sector. Details on mapping to the indicative rating floor are provided in Chapter 2.3.

Figure 2. The institutional framework scorecard (QS1)

			Assessments				
Risk pillar	Analytical component	Weight	No support (1)	Some support (25)	Strong support (50)	Very strong support (75)	Exceptional support (100)
Overall institutional framework	Stability, predictability and transparency of the framework	20%	○	○	○	○	○
Regulatory framework	Strength of regulatory standards and oversight	20%	○	○	○	○	○
	Intervention powers and track record	20%	○	○	○	○	○
Social housing policy framework	Strategic importance of social housing as a policy area	20%	○	○	○	○	○
	Government support schemes	20%	○	○	○	○	○
	Institutional framework score		*1-100*				

Source: Scope Ratings GmbH

We use quantitative metrics to underpin our assessments[2]. However, institutional frameworks and rules are typically complex and cannot be easily captured on a purely quantitative basis. Thus, our assessments are qualitative but underpinned by quantifiable metrics to determine the indicative rating floor for the sector.

2.2.1 Overall institutional framework

➢ **Stability, predictability and transparency of the framework**

This assessment addresses the stability of as well as the predictability and transparency of changes in the institutional framework, which have a material impact on providers' long-term visibility for strategic decision making. We examine factors such as the frequency and extent of reforms affecting the operating environment for social housing providers including rent regulations, changes in welfare policies and revisions to the regulatory framework, and their impact on the operating environment. When changes to the framework are made, we examine the predictability of such reforms as well as the extent to which providers were included in the decision-making process and given appropriate advance notice to minimise disruption to their operations.

Assessment	No support (1)	Some support (25)	Strong support (50)	Very strong support (75)	Exceptional support (100)
Rationale	Evolving policy framework. Frequent changes to social housing policies and regulatory framework made with little advance notice. Limited engagement with providers.	Broadly stable policy and regulatory frameworks. Frequent changes to social housing policies but communicated to providers in advance. Occasional engagement with providers on selected topics.	Broadly stable policy and regulatory frameworks. Changes to social housing policies communicated well in advance. Frequent government engagement with providers on most topics.	Mature and stable framework. Occasional and predictable changes to social housing policies, gradually implemented to minimise the adverse impact on providers. Frequent government engagement with providers on a broad range of topics.	Very mature, well-balanced and stable framework, ensuring long-term visibility for providers. Continuous government engagement with providers on all relevant topics.

Source: Scope Ratings GmbH

2.2.2 Regulatory framework

➢ **Strength of regulatory standards and oversight**

This assessment examines the strength and breadth of the regulatory framework for social housing providers. This is vital for determining the level of risk that individual providers can engage in. Strong regulatory oversight, with comprehensive regulatory standards and robust ongoing monitoring of providers' financial reports, strategic plans and governance, support the resilience of the sector overall.

Assessment	No support (1)	Some support (25)	Strong support (50)	Very strong support (75)	Exceptional support (100)
Rationale	Limited to no regulatory oversight.	Limited scope of regulatory standards and/or oversight. Occasional review of financials in selected cases.	Strong regulatory oversight and standards, covering key aspects of social housing activities. Timely, mandatory audits of financial statements by regulator.	Very strong oversight. Regulatory standards are comprehensive and effective at reducing risks of mismanagement. Quarterly and in-depth review of financial reports, strategic plans and stress testing.	Exceptional oversight. Regulatory standards are comprehensive, strict and effective at ensuring strong financial management and governance. Quantitative borrowing limits and strict debt management regulation. Quarterly and in-depth review of financial reports, strategic plans and robust stress testing analysis.

Source: Scope Ratings GmbH

[2] The quantitative metrics provided in the qualitative assessment tables in this methodology serve as a guide only and therefore do not automatically determine the analyst's qualitative assessments.

➢ **Intervention powers and track record**

When regulatory standards are not adhered to and the provider is unable or unwilling to implement necessary remedial measures, the regulator's ability to step in can be critical to avoiding the financial distress of social housing providers. This assessment accounts for the regulator's ability to intervene in cases of distress or mismanagement by examining the regulator's statutory and enforcement powers as well as its record of interventions. More pro-active regulators with a strong track record of early and effective interventions can greatly reduce the risks of serious distress in the sector.

Assessment	No support (1)	Some support (25)	Strong support (50)	Very strong support (75)	Exceptional support (100)
Rationale	No intervention powers. No track record of regulatory intervention.	Regulator able to intervene in select cases as a last resort. Record of regulatory intervention to support distressed providers.	Regulator able to intervene in cases of mismanagement with a broad range of powers. Good record of regulatory intervention to support providers facing distress.	Pro-active regulator that intervenes early to address mismanagement with comprehensive statutory powers. Strong record of effective regulatory intervention that avoids significant distress for providers.	Pro-active regulator that intervenes early to eliminate mismanagement risks with highly comprehensive and extremely effective powers. Strong record of effective regulatory intervention, including via extraordinary financial support, with no instances of providers entering heightened distress.

Source: Scope Ratings GmbH

2.2.3 Policy framework

➢ **Strategic importance of social housing as a policy area**

With this assessment, we capture the importance of social housing policy for the national government. The more social housing is considered a critical policy area within the government's agenda, the more we can expect to see governmental ongoing support for social housing providers. Ambitious (absent) targets for delivering net additions to the social housing stock generally reflect the strong (limited) importance of social housing as a policy area. We also look at housing availability and affordability conditions in the country as they can underpin rising political and popular support for the sector. This assessment considers how these challenges translate to or are expected to translate into political support for social housing which can provide an indication of future trends in social housing policies. However, countries can face no immediate housing pressures due to the critical historical importance of the sector and strong historical support for social housing. Such frameworks are viewed as very supportive.

Supporting indicators we consider when making this assessment include: the share of social housing dwellings in the total stock; and the housing cost overburden rate.

Assessment	No support (1)	Some support (25)	Strong support (50)	Very strong support (75)	Exceptional support (100)
Rationale	Social housing is and/or has been of limited importance to the government. No targets or commitments to increase the housing stock have been outlined. The country faces no immediate pressures on housing affordability and/or shows limited political support for the sector.	Social housing is and/or has been of some importance to the government. Political commitments to increase the housing stock have been made but without specific targets. The country faces some housing affordability challenges and/or shows some political support for the sector.	Social housing is and/or has been an important policy area for the government. Specified targets to increase the housing stock have been set. The country faces housing affordability challenges and/or shows strong political support for the sector	Social housing is and/or has been a very important policy area for the government. Ambitious targets to increase the housing stock have been set. The country faces significant housing affordability challenges which are prominent in the domestic policy debate and/or has been effectively addressing such challenges thanks to very strong historical support.	Social housing is and/or has been a critical policy area for the government. Very ambitious targets to increase the housing stock have been defined and matched with tangible policies. The country faces acute housing affordability pressures which are considered a high policy priority and/or has effectively addressed such challenges due to the critical importance of the sector and exceptionally strong historical support

Source: Scope Ratings GmbH

Governmental support schemes

This assessment captures the degree to which the government is providing ongoing financial support to the social housing sector to ensure viability of providers' business models and capacity to continue delivery of affordable housing. Direct support can take the form of capital grants or liability guarantees while indirect support can be channelled through housing benefits. We also assess the extent to which the availability of support for social housing is stable and predictable. The higher (lower) the share of development costs that are covered by government capital grants, the more (less) supportive the institutional framework is. Similarly, stable government funding, as opposed to declining or unpredictable funding flows, provides a more supportive operating framework for UK social housing providers.

Supporting indicators we consider when making this assessment include: the share of social housing capital expenditure that is covered by government grants; and the share of public expenditure on housing.

Assessment	No support (1)	Some support (25)	Strong support (50)	Very strong support (75)	Exceptional support (100)
Rationale	Little to no direct governmental capital support and/or indirect support is provided to social housing providers. Funding for the housing sector is under pressure.	Some direct capital and/or indirect support is provided by the government. Funding for housing is inadequate.	Government capital grants cover a material share of social housing development costs and/or indirect support is strong. Funding for housing is adequate and generally stable.	Government capital support is very strong and covers a high share of social housing development costs. Additional indirect support via housing benefits and guarantees is provided. Funding for housing is stable and predictable.	Government capital support is very strong and covers most of social housing development costs. Additional indirect support via generous housing benefits, which are directly paid to providers, and extensive guarantees are provided. Funding support is very stable and predictable.

Source: Scope Ratings GmbH

2.3 Indicative rating floor

Our analysis of the degree to which the domestic policy and regulatory frameworks underpin the credit profile of social housing providers defines an indicative rating floor for the indicative baseline ratings. While we do not incorporate the UK's sovereign rating in this analytical step, we recognise that any changes to the sovereign's creditworthiness can have knock-on effects on the institutional framework by, for instance, affecting funding schemes for social housing providers or impacting the regulator's administrative capacity to effectively monitor the sector. This indicative rating floor reflects our view that the credit quality of domestic social housing providers cannot usually fall below a given level unless exceptional weaknesses for a given provider have been identified, as detailed in Chapter 5.1.

To derive the indicative rating floor, we map the score from the institutional framework scorecard (QS1) to the table as presented below. A high (low) system score results in a high (low) indicative rating floor. The highest achievable indicative rating floor, corresponding to an exceptionally mature, supportive and predictable framework, is BBB-.

Figure 3. Mapping the institutional framework score to indicative rating floors

Framework score	0 ≤ x < 10	10 ≤ x < 20	20 ≤ x < 30	30 ≤ x < 40	40 ≤ x < 50	50 ≤ x < 60	60 ≤ x < 70	70 ≤ x < 80	80 ≤ x < 90	90 ≤ x < 100	x = 100
Indicative rating floor	No floor	c	cc	ccc	b-	b	b+	bb-	bb	bb+	bbb-

Source: Scope Ratings GmbH.

3. Stand-alone credit profile

3.1 Overview

In this second stage in the analysis, we assess the stand-alone credit profiles of UK social housing providers, which are intertwined with the domestic institutional framework. Our qualitative and quantitative assessments are structured around three key risk pillars: i) the operational risk profile; ii) the financial risk profile; and iii) the ESG risk profile. We apply a 50% weighting to the CVS and QS2. We assess the ESG Risk Profile through the QS2 only[3].

- **The Qualitative Scorecard (QS2)**

We apply a Qualitative Scorecard (QS2), which includes nine forward-looking assessments, capturing factors that cannot be adequately entirely captured on a quantitative basis. The qualitative analysis results in an indicative QS2 score (ranging from 1 to 100) whereby a high (low) score is associated with a strong (weak) credit profile. Details on the QS2 are provided in Chapter 3.2.

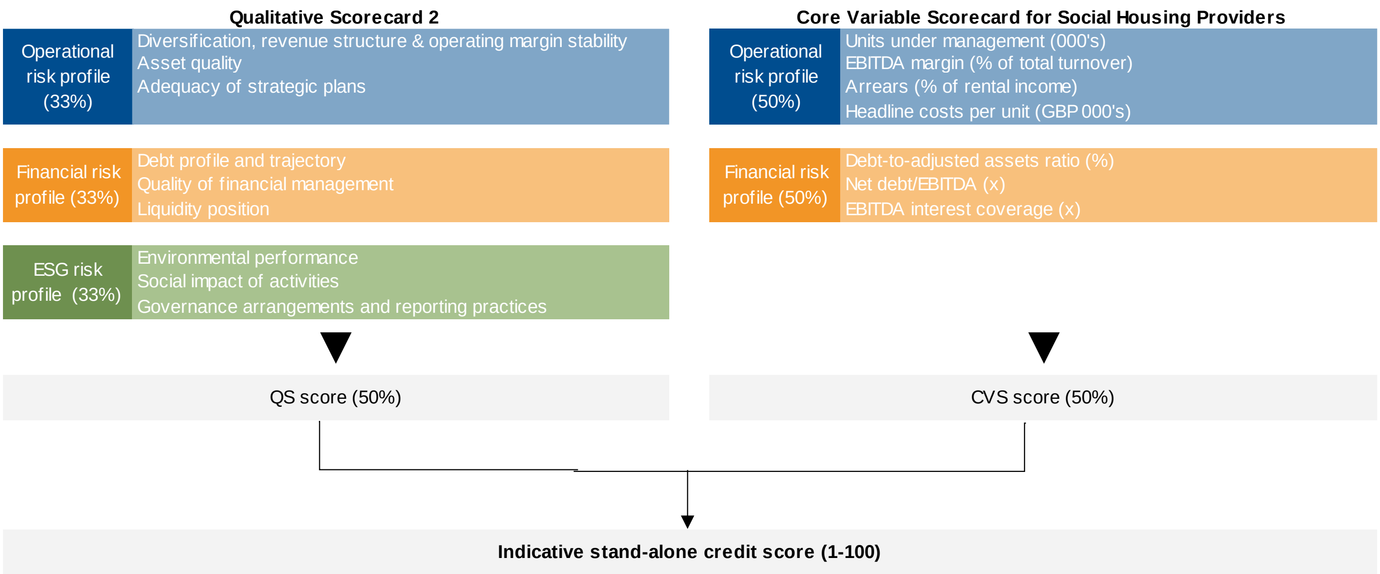
- **The Core Variable Scorecard for Social Housing Providers (CVS)**

We also apply a Core Variable Scorecard for Social Housing Providers (CVS) to quantitatively assess the operational and financial risk profiles of a social housing provider. It includes seven key credit metrics, which are assessed by conducting a relative comparison of the provider with peer providers in the domestic social housing sector (see Chapter 3.3.3.). This CVS analysis results in an indicative CVS score (ranging from 1 to 100) whereby a high (low) score is associated with a strong (weak) indicative credit profile. Details on the CVS are provided in Chapter 3.3.

- **Indicative baseline rating**

We apply a 50% weighting to both scorecards to obtain a stand-alone credit score which is mapped to an indicative baseline rating. Details on this step are provided under Chapter 3.4.

Figure 4. Overview stand-alone credit profile assessment



Source: Scope Ratings GmbH

3.2 Qualitative scorecard (QS2)

The Qualitative Scorecard 2 (QS2) is structured along three risk pillars: i) the operational risk profile; ii) the financial risk profile; and iii) ESG risk profile. In total, there are nine forward-looking analytical components to evaluate risks. This complements the quantitative assessments of the CVS, which is based on historical data and is therefore backwards looking.

[3] We exclude ESG from our quantitative model because standardised and publicly available ESG data for the UK social housing sector is lacking. Note that work to produce such data is ongoing and the inclusion of ESG metrics in the CVS is expected once they become publicly available.

This QS2 assessments are conducted on a three-point scale comprising of ‘weak’, ’neutral’ and ‘strong’. The rationales underpinning each assessment, including quantitative metrics are detailed in the qualitative assessment tables for each analytical component as presented in the following sections. These tables outline the characteristics which underpin each assessment per analytical component. Some providers’ characteristics may deviate from the rationales presented in these tables. In this case the analysis will use appropriate assessments in line with the drivers and risk assessment levels presented below.

Figure 5. The Qualitative Scorecard 2 (QS2)

Risk pillar	Analytical component	Weights	Assessments: Weak (1)	Neutral (50)	Strong (100)
Operational risk profile 33%	Diversification, revenue structure & operating margin stability	11%	○	○	○
	Asset quality	11%	○	○	○
	Adequacy of strategic plans	11%	○	○	○
Financial risk profile 33%	Debt profile & trajectory	11%	○	○	○
	Quality of financial management	11%	○	○	○
	Liquidity position and financial resilience	11%	○	○	○
ESG risk profile 33%	Environmental performance	11%	○	○	○
	Social impact of activities	11%	○	○	○
	Governance arrangements and reporting processes	11%	○	○	○
	QS score		*1-100*		

Source: Scope Ratings GmbH

3.2.1 Operational risk profile assessment (33%)

➢ **Diversification, revenue structure and operating margin stability (11%)**

Revenue streams, diversification and the historical stability of its operating margins provide critical insight into a provider’s ability to withstand adverse shocks. Large providers with broad geographical footprints and diversified property portfolios typically benefit from steadier and more predictable cash flows. Conversely, limited diversification, a strong reliance on volatile revenue streams such as market sales and a history of unstable cash flows reduce the certainty regarding a provider’s ability to service its debt.

Supporting indicators we consider when making this assessment include: EBITDA margins, the share of market sales in total turnover, and the share of social housing letting in total turnover.

Assessment	Weak (1)	Neutral (50)	Strong (100)
Rationale	Limited diversification. Small size limits scope of activities. Very high reliance on market sales or other volatile revenue streams. Historically high volatility in operating margins.	Adequate tenant and property diversification. Some reliance on market sales or other volatile revenue streams. Broadly stable operating margins historically.	Strong diversification across tenants, properties and geographies. Very large size limiting sensitivity to shocks. Limited reliance on market sales or other volatile revenue streams. Historically very stable operating margins.

Source: Scope Ratings GmbH

➢ **Asset quality (11%)**

Asset quality is a good indication of future maintenance costs and the stability of rental income. High quality assets also tend to have higher marketability than lower quality ones at time of sale. We include an assessment of a provider's assets in terms of economic age, length of tenor, turnover and occupancy rates. Asset quality can determine the strength and stability of a providers operating cash flows and asset values across the economic cycle.

Supporting indicators we consider when making this assessment include: occupancy rates, weighted average tenor of existing lease contracts, the average economic age of the portfolio and tenant turnover rates.

Assessment	Weak (1)	Neutral (50)	Strong (100)
Rationale	Weak asset quality. High vacancy and turnover rates indicating operating inefficiencies. Older housing stock in subpar physical condition and associated risk of increased maintenance costs. Shorter lease tenors leading to limited visibility on future cash flows.	Adequate asset quality. Some vacancies, albeit manageable. Moderate turnover in tenants. Average age of stock in line with market standards. Medium to long lease tenors providing some visibility over future cash flows.	Strong asset quality. Very low vacancy, turnover and arrears reflecting strong property management. Assets are in very good physical condition. Very long lease tenors translating into highly predictable cash flows

Source: Scope Ratings GmbH

➢ **Adequacy of strategic plans (11%)**

A provider's ability to formulate and implement a coherent strategic plan is a key determinant of its long-term credit quality. Our assessment examines the provider's strategic objectives, the objectives' credibility and adequacy in view of regulatory requirements, government policy objectives as well as developments in the operating environment. This assessment includes analysis of the timing and deliverability of efficiency savings as well as the track record of implementation vis-à-vis previous plans.

Assessment	Weak (1)	Neutral (50)	Strong (100)
Rationale	Business plans lacking clear strategic and operational goals. Little to no tracking of progress; policies and procedures inconsistent with plans. Weak or no track record of implementation leading to credibility concerns.	Business plans defined with clear strategic and operational goals. Performance metrics to track progress have been identified and are adequate. Good track record of implementation.	Very well-defined business plans with credible strategic and operational goals that have been effectively communicated to stakeholders. Coherent key performance metrics subject to effective monitoring. Very successful implementation of previous plans.

Source: Scope Ratings GmbH

3.2.2 Financial risk profile assessments (33%)

➢ **Debt profile and trajectory (11%)**

A provider's ability to cover recurring financing costs and repay debt can be substantially impacted by the quality of its debt profile. This component assesses the interest rate, currency and maturity structure of the provider's debt including contingent risks and liability support mechanisms. Here, we also account for long-term trends in leverage with a forward-looking assessment.

Supporting indicators we consider when making this assessment include: the loan-to-value and net debt-to-EBIITDA ratios, the share of unhedged floating rate and foreign currency debt, the share of short-term debt, and the weighted average residual maturity of debt.

Assessment	Weak (1)	Neutral (50)	Strong (100)
Rationale	Weak and/or deteriorating leverage and debt affordability metrics. Debt profile is risky with high exposure to interest rate and/or foreign currency risks. Unfavourable maturity structure and debt repayment schedules leading to heightened financing risks.	Adequate and/or stable leverage and debt affordability metrics. Debt profile with some interest-rate and/or foreign-currency risks. Adequate maturity structure and debt repayment schedules with manageable refinancing risks.	Low and/or strongly improving leverage and debt affordability metrics. Strong debt profile with limited interest rate and/or foreign currency risks. Effective hedging strategies are in place. Favourable maturity structure and debt repayment schedules limiting refinancing risks.

Source: Scope Ratings GmbH

➢ **Quality of financial management (11%)**

Management strategies around financial risk, debt and liquidity are essential to credit quality as they directly affect debt levels, liquidity position and overall financial resilience in the long term. This component assesses the riskiness of the provider's financial strategies, including impact on financing risk as well as degree of vulnerability to interest rate and foreign exchange changes, the nature and complexity of hedging strategies as well as the quality of longer-term planning, risk management policies and internal stress testing.

Supporting indicators we consider when making this assessment include: the regulator's financial viability grade or other similar metrics

Assessment	Weak (1)	Neutral (50)	Strong (100)
Rationale	Heavy reliance on borrowing to fund maturing debt and capital expenditures. Debt and financial management is aggressive and/or lacks effective and transparent policies. Financial forecasts lacking sufficient credibility. Missing or incomplete internal stress testing.	Some reliance on borrowing to fund maturing debt and capital expenditures. Adequate debt and financial management which gives clear guidelines, aligned with regulatory standards. Credible financial forecasts with an appropriate time horizon. Internal stress tests conducted.	Limited reliance on borrowing to fund maturing debt and capital expenditures. Very conservative debt and financial management with detailed and well-designed policies. Internal debt limits exist and are abided by. Prudent financial forecasts with a long time horizon that identify potential risks well in advance. Regular stress testing across a wide range of adverse scenarios.

Source: Scope Ratings GmbH

- **Liquidity position (11%)**

The liquidity position is important in assessing a provider's ability to service debt on time and in full and provides insights into the provider's resilience to financial shocks. We consider average cash buffers, minimum cash reserves, committed bank credit lines, access to debt capital markets. Our assessment of resilience to shocks considers elements such as the impact on liquidity of a temporary loss of access to external funding lines. Adequate access to liquidity is especially important for more capital-intensive social housing providers.

Supporting indicators we consider when making this assessment include: the internal and external liquidity coverage ratios.

Assessment	Weak (1)	Neutral (50)	Strong (100)
Rationale	Liquidity management lacking clear guidelines and/or failing to ensure adequate internal liquidity coverage. No or limited access to external liquidity. High dependence on a single backup facility for upcoming liquidity need.	Appropriate liquidity management with internal sources of cash covering all short-term debt maturities. Access to external liquidity with a relatively diversified pool of lenders.	Prudent liquidity management practices leading to highly comfortable cash buffers covering multiple years of debt service. Very strong access to external liquidity via capital market access and/or a highly diversified pool of lenders. Provision of detailed documentation on the sources of liquidity risk and expectations regarding liquidity fluctuation under a stressed scenario. Policies on liquidity management and the limitation of related risks exist. Proven resilience of strong market access over time.

Source: Scope Ratings GmbH

3.2.3 ESG risk profile assessments (33%)

ESG considerations are material to social housing providers' risk profiles and are captured in our assessment of the institutional framework (Chapter 2), and via the uplift factor (Chapter 4). In addition, governance considerations are captured in our assessment of quality of financial management (Chapter 3.2.2) and the adequacy of a provider's strategic plans (Chapter 3.2.1).The ESG risks captured in this section reflect factors which are relevant for the stand-alone credit profile of providers and are not already captured in other sections of the methodology.

- **Environmental performance (11%)**

Governments are increasingly focusing on environmental standards and benchmarks, with more scrutiny of energy efficiency and the environmental impact of buildings. Providers managing properties displaying poor environmental profiles and low energy efficiency could face relatively high transition risks, given the costs of aligning portfolios with government standards. In contrast, more proactive providers as it relates to environmental standards could benefit from favourable regulatory treatment. Providers that fail to ensure adequate energy efficiency could face regulatory pressure, including the need to invest heavily to meet market standards and reputational risk. This component examines the environmental impact of a provider's letting and development activities and analyses the policies and practices implemented to monitor and improve environmental performance.

Supporting indicators we consider when making this assessment include: the weighted average energy efficiency ratings and environmental impact ratings.

Assessment	Weak (1)	Neutral (50)	Strong (100)
Rationale	Lack of adequate monitoring of the environmental impact of activities. Few if any policies implemented that materially mitigate the environmental impact of activities. Property portfolio's energy efficiency and environmental impact ratings below market standards.	Adequate monitoring of the environmental impact of activities. Steps taken to mitigate the environmental impact of activities. Property portfolio's energy efficiency and environmental impact ratings in line with market standards.	Very robust monitoring of the environmental impact of activities. Environmental considerations at the core of decision-making processes and coherent plans to limit the environmental impact of activities with tangible results. Property portfolio's energy efficiency and environmental impact ratings outperform market standards.

Source: Scope Ratings GmbH

- **Social impact of activities (11%)**

Social housing providers' core mission is to address housing affordability and availability challenges. It is also critical that the development and letting of affordable homes does not coincide with deteriorating safety and quality due to lack of investment in existing properties. Increasing political and regulatory pressures to empower residents are additional socially relevant considerations. Providers with material shortcomings in social responsibility could face regulatory action, reputational costs and lower public-sector support for their activities. This component assesses providers' social performance in terms of delivery of new social housing and addressing affordability challenges in their local markets, while accounting for regional differences in demand for their services. It also considers to degree to which providers' properties meet national safety and quality standards as well as how well providers foster resident empowerment, transparency and community outreach.

Supporting indicators we consider when making this assessment include: new social supply delivered relative to the total stock, the share of homes with compliant fire and gas safety assessments; and the share of homes meeting national quality standards.

Assessment	Weak (1)	Neutral (50)	Strong (100)
Rationale	Lack of adequate monitoring of social impact of activities. Limited progress in delivering new affordable homes. Few or no policies to improve resident satisfaction and/or empowerment. Shortcomings in the security, quality and affordability of homes.	Adequate monitoring of social impact of activities. Substantial progress in delivering new affordable homes. Coherent policies in place to improve residents' satisfaction and/or empowerment. Security, quality and affordability of homes in line with market standards.	Very robust monitoring of social impact of activities is in place. Provider is a critical contributor to the development of affordable homes in its area(s) of operations. Provider has taken ambitious steps to ensure strong resident voice and satisfaction with tangible results. Security, quality and affordability of homes outperform market standards.

Source: Scope Ratings GmbH

- **Governance arrangements and reporting practices (11%)**

The strength of a provider's governance and a high quality of internal and external reporting processes support transparency and accountability as well as limit risk. We also assess the degree to which key personnel have adequate expertise and experience to effectively manage the organisation. The governance assessment is supported by considering the track record of providers' compliance with regulatory standards including consideration of publicly available governance grades from the respective regulator.

Supporting indicators we consider when making this assessment include: the regulator's governance grade or similar governance metrics.

Assessment	Weak (1)	Neutral (50)	Strong (100)
Rationale	Lack of a clearly defined code of governance. Governing board has limited oversight over operational developments, leading to potential organisational risk. Limited internal and external reporting. Shortcomings in governance. Key personnel lack the adequate expertise and experience to effectively manage the organisation.	Clearly defined code of governance. Governing board has oversight over key aspects of operations. Good internal and external reporting practices with essential information disclosed to key stakeholders. Key personnel have adequate expertise and experience to effectively manage the organisation.	Robust governance systems and structures. Governing board exercises strong oversight and actively manages organisational risk. Highly transparent and effective reporting and disclosure practices on all important aspects of activities. Key personnel have extensive expertise and experience as well as a proven capacity to effectively manage the organisation.

Source: Scope Ratings GmbH

3.2.4 Scorecard calculation

The QS2 uses a scoring system with 1 point for an assessment of 'weak', 50 for a 'neutral' and 100 for a 'strong'. To determine the overall QS2 score, the assessment scores are weighted according to the scheme as summarised in **Figure 5**, resulting in a range from a maximum evaluation of 100 to a minimum evaluation of 1. For example, the highest (lowest) possible individual QS2 credit score of 100 (1) is achieved if the nine qualitative factors are assessed as 'strong' ('weak') across all categories.

3.3 Core Variable Scorecard for Social Housing Providers

We conduct the quantitative assessment of a provider's stand-alone credit profile by benchmarking the provider's performance across key credit metrics against that of peers operating under the same institutional framework. By comparing individual performance with those of other national peers, we acknowledge the high degree of interaction between the institutional framework and key credit metrics. This approach ensures that the ratios selected are more meaningful than applying absolute thresholds and allows us to make a comparative analysis across providers and across time, which is essential for consistency.

The CVS assessment covers two main risk pillars: i) the operational risk profile; and ii) the financial risk profile. The CVS acts primarily as a scoring tool that results in an indicative CVS score ranging from 1 (worst) to 100 (best). The lack of social housing provider defaults prevents us from adequately performing a statistical analysis of the probability of default. Therefore, the CVS serves as an analytical tool for assessing a provider's relative strengths and weaknesses by benchmarking select core quantitative metrics against the relevant performance of national peers, allowing us to identify positive and negative outliers and meaningful differences between the strongest and weakest entities.

3.3.1 Operational risk profile credit metrics (50%)

Figure 6. Four key credit metrics under the operational risk profile

Risk pillar	Key credit metrics	Weights
Operational risk profile (50%)	Units under management (000's)	12.5%
	EBITDA margin (% of total turnover)	12.5%
	Arrears (% of rental income)	12.5%
	Headline costs per unit (GBP 000's)	12.5%

Source: Scope Ratings GmbH

➢ **Units under management (12.5%)**

This is a measure of the breadth and scope of operations of a provider and its relevance in the market. It captures a provider's market strength and ability to benefit from economies of scale. A large size often goes hand in hand with strong diversification, heightened resilience to shocks as well as more sophisticated management and operational policies.

➢ **EBITDA margin (12.5%)**

The EBITDA margin is an essential metric for the comparison of relative profitability of providers operating in the same sector and reporting under the same accounting principles. Additionally, it indicates a provider's financial strength and ability to generate cash from operating activities. Large EBITDA margins underpin a provider's capacity to generate sufficient cash flow to develop affordable housing, invest in existing stock and meet financial obligations.

➢ **Headline social housing costs per unit (12.5%)**

Headline social housing costs per unit captures a provider's cost efficiency relative to its social housing rental base. Low costs per unit reflect a more efficient cost base and can support profitability.

➢ **Arrears (12.5%)**

Current tenant arrears as a percentage of rental income is a key performance indicator in assessing the efficiency of lettings and rent collection. High arrears are typically associated with poor rent collection, operating inefficiencies and low tenant quality. It can also reflect weaker tenant satisfaction and poor service quality.

3.3.2 Financial risk profile credit metrics (50%)

The following weights are assigned to the three main metrics based on our analytical judgment of their relative importance in assessing a given provider's individual credit profile:

Figure 7. Three key credit metrics under the financial risk profile

Risk pillar	Key credit metrics	Weights
Financial risk profile (50%)	Debt-to-adjusted assets ratio (%)	25.0%
	EBITDA interest coverage (x)	15.0%
	Net debt/EBITDA (x)	10.0%

Source: Scope Ratings GmbH

➢ **Debt-to-adjusted assets (25%)**

The debt-to-assets ratio is an essential indicator of a provider's borrowing capacity. The ratio measures the proportion of assets (excluding cash and cash equivalents) that are being financed with debt. A high debt-to-assets ratio implies greater indebtedness, more limited financing flexibility and higher sensitivity to financial shocks while a low ratio supports a provider's access to finance under more favourable terms.

➢ **EBITDA interest coverage (15%)**

EBITDA interest coverage is an important measurement of a provider's financial position and ability to cover interest-related expenses using pre-tax income. The analysis of EBITDA interest coverage ratios over time illustrates a provider's financial capacity to meet its interest payment obligations. High EBITDA interest coverage ratios imply strong ability to meet interest expenses.

➢ **Net debt/EBITDA ratio (10%)**

The net debt/EBITDA ratio is a proxy of financial leverage that takes into account a provider's ability to decrease debt over time. The ratio measures a provider's debt payment obligations with its ordinary, unleveraged and untaxed cash flow generation. A higher net debt/EBITDA ratio indicates that a provider needs more time to repay its debt with operations at the current level.

3.3.3 Scorecard calculation

When calculating the CVS score, we use a minimum-maximum algorithm to determine a score for each of the seven key credit metrics. Scores range from 1 (worst) to 100 (best). We calculate the minimum and maximum for each credit metric and place providers within this defined range.

Providers with the strongest results for each credit metric receive the highest score and those with the weakest results receive the lowest score. In this case, a higher score corresponds to a stronger result. Conversely, if a lower score corresponds to a stronger result, we use the following formula to derive the score on a variable:

$$1 + 99 \times [\,|(X - MAX)|\,/\,(MAX - MIN)]$$ [4]

We use statistical analysis to exclude outliers (statistical noise) at either end of the distribution. This is conducted based on the median absolute deviation[5] which adds (subtracts) the median of the absolute difference between each observation and the median of the full sample multiplied by a constant to (from) the median of the sample. The scores for each metric are aggregated into a CVS score using the weights as summarised in **Figures 6** and **7**.

[4] For example, if the MAX (MIN) of a hypothetical variable is identified as being the value 1 (-10), the score of a variable with a value of 0.3 would be derived using the following calculation: $1 + 99 \times [\,|(X - MIN)|\,/\,(MAX - MIN)]$ or $1 + 99 \times [\,|(0.3 - -10)|\,/\,(1 - -10)] = 93.7$

[5] See 'Leys, C. et al. 2013. 'Detecting outliers: Do not use standard deviation around the mean, use absolute deviation around the median'

The CVS combines historical and current financial data. The CVS is therefore updated and monitored continuously. We use publicly available financial data. For most indicators, we calculate a three-year weighted average of the latest available data, by assigning a higher weight to the most recent year. For the others, we use the most recent data point (see Chapter 7.2). A case study illustrating how we determine the CVS score in a hypothetical example is presented in Chapter 7.1.

3.4 Indicative baseline rating

We apply a 50% weighting to both scorecards. We use a scoring system from 1 to 100 which results in a QS2 score and a CVS score. The two scores result in an indicative stand-alone credit score which is calculated as a simple average of the two. We map the score derived by the application of the scorecard to an indicative baseline rating, as depicted in **Figure 8** below. This mapping also accounts for the indicative rating floor as determined in the institutional framework assessment (QS1), reflecting our view that there is a high level of interaction between the institutional framework overall and the credit quality of individual providers.

Figure 8. Interaction between the indicative rating floor and mapping table for indicative baseline ratings

		Rating floors										
Framework score		0-10	10-20	20-30	30-40	40-50	50-60	60-70	70-80	80-90	90-100	100
Indicative floor		No floor	c	cc	ccc	b-	b	b+	bb-	bb	bb+	bbb-
Indicative baseline ratings	Default	0										
	c	5	0									
	cc	10	5	0								
	ccc	15	11	5	0							
	b-	20	16	11	6	0						
	b	25	21	17	12	6	0					
	b+	30	26	22	18	13	7	0				
	bb-	35	32	28	24	19	13	7	0			
	bb	40	37	33	29	25	20	14	8	0		
	bb+	45	42	39	35	31	27	21	15	8	0	
	bbb-	50	47	44	41	38	33	29	23	17	9	0
	bbb	55	53	50	47	44	40	36	31	25	18	10
	bbb+	60	58	56	53	50	47	43	38	33	27	20
	a-	65	63	61	59	56	53	50	46	42	36	30
	a	70	68	67	65	63	60	57	54	50	45	40
	a+	75	74	72	71	69	67	64	62	58	55	50
	aa-	80	79	78	76	75	73	71	69	67	64	60
	aa	85	84	83	82	81	80	79	77	75	73	70
	aa+	90	89	89	88	88	87	86	85	83	82	80
	aaa	95	95	94	94	94	93	93	92	92	91	90

Source: Scope Ratings GmbH

4. Uplift factor

4.1 Overview

In this third step in the analysis, we assess the government's capacity and willingness to provide exceptional support to a particular social housing provider. The application of this uplift factor can lead to an upward adjustment of the provider's indicative baseline rating by up to three notches. The extent of this upward notching is based on our assessment of: i) the government's 'capacity to provide a credit uplift'; and ii) the government's 'willingness to provide support'. An assessment of the government's willingness to provide extraordinary support, completed on a three-point scale of 'high', 'medium' and 'limited', is combined with the government's capacity to provide a credit uplift and mapped to an indicative ratings uplift.

4.2 Sovereign capacity to provide a credit uplift

Our assessment of a government's capacity to provide a credit uplift to a social housing provider is informed by the rating-differential between the UK sovereign rating and the provider's indicative baseline ratings. The higher (lower) this differential, the higher (lower) the capacity of a government to provide uplift to the creditworthiness of a given social housing provider. In cases where the social housing provider's baseline credit quality is equal to or above that of the sovereign, the capacity to provide support is assessed as 'limited', allowing for, in principle, an uplift only under extraordinary circumstances.

4.3 Sovereign willingness to provide exceptional support

Our assessment of the government's willingness to provide exceptional support is defined as the likelihood of such an action on a timely basis to prevent default of an individual provider. This assessment rests on i) the systemic importance of the provider to the government; ii) political interlinkages with local, regional and national governments iii) the implications the default of a provider or a disruption of in a provider's services might have. The more (less) systemic the provider and the higher (lower) the potential costs of its default for the government, the higher (lower) we assess the government's willingness to provide support to the provider.

This risk assessment is conducted on a three-point scale comprising of 'high', 'medium' and 'limited'. The rationales underpinning each assessment, including quantitative metrics are detailed in the qualitative assessment tables in the following sections.

- **Systemic importance to the government (33%)**

We view a provider's systemic importance as critical for determining the likelihood of exceptional support. We assess the systemic importance of a provider in view of its size, the number of tenants it houses, and the scale of contributions that the provider makes to the development of social housing, supporting important policy priorities of the UK government. We also assess local market dynamics and consider the presence of alternative social housing providers of similar services. We note that the systemic importance of a provider might vary over time.

Supporting indicators we consider when making this assessment include: the number of tenants and new supply delivered.

Assessment	Limited (1)	Medium (50)	High (100)
Rationale	Small size; limited contributions to new social housing supply locally. Multiple alternative providers in regional markets with similar services. Limited importance to national government.	Moderate size and contributions to new social housing supply in its areas of operations. Few alternatives providing similar services. Medium importance to the national government.	Large size and substantial contributions to increasing national social housing stocks. Very difficult to replace provider; few alternatives exist. High systemic Importance to government.

Source: Scope Ratings GmbH

- **Political interlinkages (33%)**

Social housing providers can have strong multilateral and/or bilateral relationships with local, regional as well as national governments through informal arrangements or through formal ones such as partnerships. Providers which benefit from extensive and publicised relationships with local, regional or national governments are more likely to benefit from exceptional support. Such support could prevent the substantial political and/or reputational costs of default for the government. We also include an assessment of any public declarations favouring support for a provider.

Assessment	Limited (1)	Medium (50)	High (100)
Rationale	Little to no direct links with local and regional governments. No public governmental declarations favouring support.	Informal and formal relationships with local, regional and/or national governments. Instances of public declarations in favour of support.	Extensive and widely acknowledged informal and formal relationships with local, regional and/or national governments. Participation in joint projects or partnerships with explicit government backing. Public declarations explicitly speaking to government support.

Source: Scope Ratings GmbH

- **Default implications (33%)**

We view a provider's socio-economic and financial default implications for the government as another critical determinant of the likelihood of exceptional support. The greater the impact of a hypothetical default on local/regional communities as well as on local/regional economies the greater the likelihood of exceptional support. We also consider the knock-on effects for financial and funding positions of other social housing providers. In addition, a default scenario could entail significant financial costs for the government; this can be the case, for example, if the government has issued explicit government guarantees.

Assessment	Limited (1)	Medium (50)	High (100)
Rationale	A default would have a minimal impact on local communities and economies. No material impact from a default on government finances is expected.	A default would have some adverse repercussions for local and/or regional communities and economies. Other social housing providers may face some albeit manageable turmoil.	A default would pose substantial adverse effects for local and/or regional communities and economy. The financial stability of the entire social housing sector would be materially impacted. Government finances could deteriorate substantively as a result.

Source: Scope Ratings GmbH

4.4 Scorecard calculation

The assessment for the government's willingness to provide support uses a scoring system assigning 1 point for an assessment of 'limited', 50 for a 'medium' and 100 for a 'high' assessment. To determine the overall willingness to provide exceptional support score, a simple average of these three qualitative assessments is calculated, resulting in a range from a maximum of 100 to a minimum of 1. For example, the highest (lowest) possible willingness to provide support score of 100 (1) is achieved if the three qualitative factors are assessed as 'high' ('limited') across all categories. In determining the uplift factor (QS3), we map the government's capacity to provide a credit uplift with the government's willingness to provide support score as shown below:

Figure 9. Uplift factor scorecard (QS3)

	Capacity to provide a credit uplift - Rating differential		
Willingness to support - Score	≥ 4 notches	3 notches	≤ 2 notches
High (score > 75)	≤ +3 notches	+2 notches	+1 notch
Medium (25 ≤ score ≤ 75)	≤ +2 notches	+1 notch	+1 notch
Low (score < 25)	≤ +1 notch	0 notches	0 notches

Source: Scope Ratings GmbH

5. Additional considerations

As a final step in our rating process, we account for additional considerations which are not fully captured in the previous sections. The final ratings are derived once the following additional considerations have been assessed:

5.1 Additional downward adjustments and ratings below the indicative rating floor

Our ratings approach indicatively limits the rating levels of a social housing provider on the lower end via the institutional framework assessment, which determines an indicative rating floor. This indicative rating floor reflects our view that a minimum degree of support exists for social housing providers in the UK. However, under exceptional circumstances, we may apply additional downward adjustments and adjust the credit rating below an indicative rating floor in deriving the final rating assignment.

This will be driven by, but not restricted to: i) an exceptionally weak liquidity position with no credible alternatives to access funding combined with an exceptionally unattractive portfolio of assets reducing the willingness of other providers to acquire the entity; ii) sizeable, growing and/or extremely risky contingent liabilities; iii) severe shortcomings in governance and/or financial management, leading to an exceptionally weak stand-alone credit profile; iv) direct conflicts with the government and/or regulatory authorities, and/or violation of regulatory standards and agreed principles, thus casting doubt on the authorities' willingness to provide support under worst-case scenarios; and/or v) a recent history of default/debt restructuring.

5.2 Adjustments if the baseline rating is above that of the sovereign and criteria to be rated above the sovereign

Our indicative baseline ratings are not automatically capped at the sovereign rating. We recognise that the credit quality of social housing providers is intertwined with that of supporting governments given the typically central role that the government plays in underpinning the long-term viability of the entire social housing sector. In addition, social housing providers' activities are usually limited to the domestic market, increasing their exposure to any deterioration in sovereign creditworthiness. As a result, if the indicative baseline rating of a provider is higher than that of the sovereign, we would only allow the final rating of the provider to pierce that of the sovereign under exceptional circumstances that would need to be justified on a case-by-case basis. Otherwise, the rating of the provider would be adjusted downward to match that of the UK sovereign.

To justify a rating above the that of the UK sovereign, the provider must be exceptionally resilient to sovereign default-related shocks, reflected in: i) an exceptionally strong stand-alone credit profile relative to peers even under a scenario of substantial deterioration in revenues and asset valuations; ii) very comfortable ring-fenced internal cash buffers that cover multiple years of debt servicing requirements even after assuming haircuts to the liquidity held at domestic banks and in marketable securities and/or equities; iii) an ability to withstand a severe decline in property prices; and iv) little to no foreign currency and/or external debt exposures.

6. Accounting for group structures

Some social housing providers are organised into housing groups. When assigning ratings to such providers, we assess the stand-alone credit profile of an entity while accounting for the formal and informal relationships that exist across the group. Our analysis of group structures includes the assessment of the strategic importance of individual group entities as it concerns the parent company's financial health. We also consider the extent of a parent's support to its subsidiary, including explicit guarantees or letters of credit. More implicit forms of parent commitment could be provided by name equality, the use of the same banks, or even common treasury operations.

In cases where the relationship between the subsidiary and the parent or group is sufficiently strong, we could align the rating analysis of the subsidiary with that of the group. This can be the case when we have sufficient confidence that additional financial resources can be allocated by the parent company to cover liquidity gaps within the group in a timely way. Similarly, a comprehensive overview of the overall group-level credit quality allows us to account for risks and exposures across the entire group including potential contingent liability risk arising from the financial difficulty of a single group entity.

7. Appendixes

7.1 Case study: Stylised social housing provider rating[6]

➢ **Step 1: Institutional framework assessment**

Figure 10. Application of QS1

Risk pillar	Analytical component	Weight	Assessment	Score
Overall institutional framework	Stability, predictability and transparency of the framework	20%	Some support	25
Social housing policy framework	Strategic importance of social housing as a policy area	20%	Strong support	50
	Government support schemes	20%	Very strong support	75
Regulatory framework	Strength of regulatory standards and oversight	20%	Strong support	50
	Intervention powers and track record	20%	Some support	25

Institutional framework score	45

Framework score	0 ≤ x < 10	10 ≤ x < 20	20 ≤ x < 30	30 ≤ x < 40	40 ≤ x < 50	50 ≤ x < 60	60 ≤ x < 70	70 ≤ x < 80	80 ≤ x < 90	90 ≤ x <	x= 100
Indicative rating floor	No floor	c	cc	ccc	**b-**	b	b+	bb-	bb	bb+	bbb-

As a first step, we assess the supportiveness of the domestic institutional framework, as detailed in Chapter 2.2. The outcome is used to determine the indicative rating floor for social housing providers operating in a hypothetical framework. The institutional framework score resulting from the assessments is 45 out of 100, resulting in an indicative rating floor of b-.

[6] This hypothetical case study does not reflect Scope's view of the UK's institutional framework or the fundamentals for any specific social housing provider. It is presented here purely for illustrative purposes.

➢ **Step 2: Stand-alone credit profile and indicative baseline rating**

Figure 11. Application of the QS2

Risk pillar	Qualitative criteria	Weights	QS score
Operational risk profile (33%)	Diversification, revenue structure & operating margin stability	11.1%	100
	Asset quality	11.1%	50
	Adequacy of strategic plans	11.1%	50
Financial risk profile (33%)	Debt profile and trajectory	11.1%	1
	Quality of financial management	11.1%	50
	Liquidity position	11.1%	100
ESG risk profile (33%)	Environmental performance	11.1%	50
	Social impact of activities	11.1%	100
	Governance arrangements & reporting practices	11.1%	50

QS score	***61***

Figure 12. Application of the CVS

Risk pillar	Quantitative metrics	Weights	CVS score
Operational risk profile (50%)	Units under management	12.5%	82.3
	EBITDA margin	12.5%	59.9
	Arrears	12.5%	44.0
	Headline costs	12.5%	68.8
Financial risk profile (50%)	Debt-to-assets ratio	25.0%	53.9
	EBITDA interest cover	15.0%	46.4
	Net debt/EBITDA ratio	10.0%	10.9

Operational risk score	*31.9*
Financial risk score	*21.5*
CVS score	***53***

The qualitative assessments are combined using a weighted average as presented in Chapter 3.2, resulting in a QS score of 61. The quantitatively derived CVS score is 53 using a weighted average as presented in Chapter 3.3. The CVS and QS scores are combined using a simple average, resulting in a stand-alone credit score of 57. The indicative baseline rating is obtained by mapping the stand-alone credit score to the indicative rating floor (per QS1) using the table presented in Chapter 3.4, resulting an indicative baseline rating of a-.

Figure 13. Deriving the indicative baseline rating of the provider

		Rating floors										
	Framework score	0-10	10-20	20-30	30-40	40-50	50-60	60-70	70-80	80-90	90-100	100
	Indicative floor	No floor	c	cc	ccc	**b-**	b	b+	bb-	bb	bb+	bbb-
Indicative baseline ratings	Default	0										
	c	5	0									
	cc	10	5	0								
	ccc	15	11	5	0							
	b-	20	16	11	6	0						
	b	25	21	17	12	6	0					
	b+	30	26	22	18	13	7	0				
	bb-	35	32	28	24	19	13	7	0			
	bb	40	37	33	29	25	20	14	8	0		
	bb+	45	42	39	35	31	27	21	15	8	0	
	bbb-	50	47	44	41	38	33	29	23	17	9	0
	bbb	55	53	50	47	44	40	36	31	25	18	10
	bbb+	60	58	56	53	50	47	43	38	33	27	20
	a-	[illegible] Indicative baseline rating	[illegible]	[illegible]	[illegible]	**56**	53	50	46	42	36	30
	a	70	68	67	65	63	60	57	54	50	45	40
	a+	75	74	72	71	69	67	64	62	58	55	50
	aa-	80	79	78	76	75	73	71	69	67	64	60
	aa	85	84	83	82	81	80	79	77	75	73	70
	aa+	90	89	89	88	88	87	86	85	83	82	80
	aaa	95	95	94	94	94	93	93	92	92	91	90

Step 3: Uplift factor

We assess the government's capacity to provide a credit uplift by calculating the rating differential between the provider's indicative baseline rating (a-) and the sovereign rating (for this hypothetical example, AA-), which is equal to three notches. We also assess the willingness to support by analysing the provider's systemic importance (in this example: 'medium'), political interlinkages ('limited') and socio-economic and financial default implications ('medium'), which results in a probability of support score of 34. We map results of the rating differential to the willingness to support score, resulting in an upward notching of one notch.

Figure 14. Application of QS3

	Capacity to provide a credit uplift - Rating differential		
Willingness to support - Score	≥ 4 notches	**3 notches**	≤ 2 notches
High (score > 75)	≤ +3 notches	+2 notches	+1 notch
Medium (25 ≤ score ≤ 75)	≤ +2 notches	**+1 notch**	+1 notch
Low (score < 25)	≤ +1 notch	0 notches	0 notches

Step 4: Additional considerations

As a final step, we capture any additional considerations as outlined in Chapter 5. In this example, we assume that such exceptional considerations do not apply for this provider and make no added adjustments. As such, the final rating for this hypothetical social housing provider is A.

7.2 Key credit metrics used in the Core Variable Scorecard

Variable	Description	CVS calculation
Operational risk profile		
Units under management ('000s)	Total number of social and non-social housing units owned or managed by the provider	Latest data point; application of a natural logarithmic function
EBITDA margin (%)*	[EBITDA = (operating surplus/deficit - gain/loss on disposal of fixed assets - amortised government grant + interest receivable + total depreciation charge)] / turnover	Three-year weighted average; application of a linear function
Headline social costs per unit (GBP '000s)*	(Operating expenditure for social housing letting + operating expenditure for social housing services + major repairs expenditure + lease costs + capitalised major repairs expenditure + other costs for social housing activities) / total social housing units owned or managed	Three-year weighted average; application of a linear function
Arrears (%)	Current tenant arrears / rental income	Three-year weighted average; application of a linear function
Financial risk profile		
Debt-to-assets (%)	(Short-term debt + long-term debt - cash and cash equivalents) / (total assets - cash and cash equivalents)	Three-year weighted average; application of a linear function
Net debt/EBITDA (x)	(Short-term debt + long-term debt - cash and cash equivalents + amounts owned to group undertakings + finance lease obligations) / (EBITDA)	Three-year weighted average; application of a linear function
EBITDA interest cover (x)*	EBITDA / (interest capitalised + interest payable)	Three-year weighted average; application of a natural logarithmic function

* Adapted from the Regulator of Social Housing's Value for Money Metrics

7.3 Relationship between long-term and short-term ratings

Scope's Rating Definitions apply to UK social housing providers and their long-term and short-term debt obligations.

See Scope's Rating Definitions for more information on long-term and short-term rating scales. The long-term issuer rating is a measure of a provider's fundamental credit quality, which also includes consideration of short-term risks related to the liquidity position and funding flexibility. Short-term ratings are correlated with the long-term ratings but also include a strong emphasis on risks and considerations related to liquidity aspects, including an assessment of available cash, reserves in form of liquid assets, access to external short-term liquidity and flexibility in borrowing.

Our evaluation of short-term credit quality is typically highly correlated with our qualitative assessment of a provider's liquidity position (see Chapter 3.2.2.). In cases where two short-term ratings can be derived from the long-term rating, the higher short-term rating of the two would be selected when our assessment of the provider's liquidity position is either "strong" or "neutral". Conversely, if our assessment of the liquidity position is "weak", we would assign the lower of the two short-term ratings.

7.4 Sources of information

We conduct our analysis based on UK government policy and regulatory documents in addition to economic, fiscal and financial data produced by national authorities. Sources for our analysis of individual providers include annual reports, financial statements and investor relations presentations, in addition to internal documents and/or data provided by the issuer.

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