MOODY'S
PUBLIC SECTOR EUROPE

Rating Action: Moody's downgrades 54 UK sub-sovereign issuers and changes outlook to stable; universities and two local authorities retain negative outlook. Affirms University of Cambridge's Aaa rating with stable outlook.

Global Credit Research - 26 Sep 2017

London, 26 September 2017 -- Moody's Public Sector Europe (MPSE) has today taken rating actions on 55 UK sub-sovereign entities (and associated 34 SPVs) covering the following sectors: (1) local authorities; (2) Transport for London; (3) universities; (4) housing associations; and (5) PRS Finance plc. The actions follow the recent downgrade of the UK's government bond rating to Aa2 with a stable outlook from Aa1 with a negative outlook: http://www.moodys.com/viewresearchdoc.aspx?docid=PR_372649 .

Moody's has downgraded the ratings of 54 entities and has affirmed the Aaa rating with a stable outlook for the University of Cambridge. The outlooks for seven universities and two local authorities are retained as negative, and the outlooks for housing associations and Transport for London are changed to stable from negative. A full list of affected Credit Ratings can be seen via the following link:

Please click on this link http://www.moodys.com/viewresearchdoc.aspx?docid=PBC_197362 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and identifies each affected issuer.

RATINGS RATIONALE

Please click on this link http://www.moodys.com/viewresearchdoc.aspx?docid=PBC_197362 for the List of Affected Credit Ratings. This list is an integral part of this Press Release and provides, for each of the credit ratings covered, Moody's disclosures on the following items:

* Principal Methodologies

OVERALL RATIONALE FOR DOWNGRADE OF 54 UK SUB-SOVEREIGNS

The downgrade of the ratings of 54 UK sub-sovereign issuers and associated SPVs reflects the close economic, financial and institutional linkages between the sovereign and sub-sovereign sectors. The rating for the University of Cambridge has been affirmed due to its exceptional market position, diversified revenue sources, and low debt relative to peers.

Moody's believes that the UK government's decision to leave the EU Single Market and customs union as of 29 March 2019 will be negative for the country's medium-term economic growth prospects. Aside from the direct impact on the UK's credit profile, the loss of economic strength will further exacerbate the evident pressures on fiscal consolidation. The UK's weaker economic outlook has direct implications for UK sub-sovereign budgets through potential slowing or declining central government transfers, which make up a significant share of their revenue.

The UK national government retains a high degree of control over the sub-sovereign sector via legislation and the different regulatory frameworks in place. The ability of central government to provide timely and forward-looking policy direction for public sector entities may be compromised as the sovereign's institutional capacity is dominated by dealing with the implications of the UK's departure from the EU.

Sector-specific rationales for (1) local authorities; (2) Transport for London; (3) universities; (4) housing associations; and (5) PRS Finance plc are provided below.

1) RATIONALE FOR ONE NOTCH DOWNGRADE ON LOCAL AUTHORITIES

The one notch downgrade reflects the close institutional links between the local authority sector and the sovereign, as well as the sector's continued high dependence on government transfers. Should there be further pressure on UK government finances, Moody's expects that these would continue to be passed on to local authorities. Furthermore, slower economic growth would impose downward pressure on business rates, which are now partially retained by local authorities, as well as own-source revenues.

RATIONALE FOR TWO NOTCH DOWNGRADE ON WARRINGTON BOROUGH COUNCIL

The two notch downgrade of Warrington Borough Council (Warrington) from Aa2 to A1 reflects (1) the pressures discussed above for all UK local authorities, and (2) the relative position of Warrington compared to other rated local authorities in terms of risk appetite and projected increased debt burden. Warrington's capital investment programme demonstrates a higher risk appetite relative to peers. In addition to traditional town centre infrastructure improvements, the programme includes investing in a new "challenger" bank, launching a Housing Company, and on-lending to housing associations, introducing riskier elements to the local authority's credit profile. Warrington plans to fund this capital programme mainly through debt, which would lead to a projected quadrupling of debt to revenues over the next three years, from 103% in 2016 to a forecast 436% in 2019.

RATIONALE FOR CHANGING OUTLOOK TO STABLE FROM NEGATIVE ON CORNWALL COUNCIL, ABERDEEN CITY COUNCIL AND GUILDFORD BOROUGH COUNCIL

The change in outlooks for Cornwall Council (Cornwall), Aberdeen City Council (Aberdeen) and Guildford Borough Council (Guildford) to stable reflects the stable outlook on the UK sovereign. Furthermore, while funding uncertainties remain, the stable outlook is supported by the proven abilities of these local authorities to absorb the funding cuts imposed thus far by the central government.

RATIONALE FOR RETAINING NEGATIVE OUTLOOK ON LANCASHIRE COUNTY COUNCIL AND WARRINGTON BOROUGH COUNCIL

The negative outlook for Lancashire County Council (Lancashire) reflects uncertainties regarding the local authority's savings plan. A plan to prevent the council from running out of non-earmarked reserves within the next two years has not yet been agreed. The negative outlook for Warrington reflects increasing contingent liabilities linked to the capital and treasury investment programme.

WHAT COULD MOVE THE RATINGS UP/DOWN

Upward pressure would be exerted from a significant strengthening in financial performance and a material decline in debt. Given that Cornwall and Guildford are rated on a par with the UK sovereign rating, an upgrade of the sovereign rating would be a necessary, but not sufficient, pre-condition to an upgrade of Cornwall and Guildford. For Lancashire, given the negative outlook, a rating upgrade is unlikely, however a credible plan to return the local authority to fiscal sustainability would support the return of the rating outlook to stable. For Warrington, given the negative outlook, a rating upgrade is unlikely, however a material increase in reserves or a limitation of the scope of contingent liabilities would exert stabilising pressure on the outlook.

Downward pressure would arise from any further deterioration of the creditworthiness of the UK sovereign, or demonstrated further weakening of the links between the central and local governments, a lack of credible budgeting to prevent depletion of local government reserves and/or a significant worsening of debt metrics, either due to ambitious capital programmes or repeated large operating deficits. For Warrington, downward pressure could also arise from the materialisation of contingent liabilities, depletion of reserves, or a failure of expected income from investments to accrue.

2) RATIONALE FOR THE DOWNGRADE AND STABLE OUTLOOK ON TRANSPORT FOR LONDON (TfL)

The downgrade of the rating of Transport for London (TfL) to Aa3 from Aa2 reflects the close institutional, operational and financial linkages with the sovereign. A significant proportion of TfL's income comes through locally raised business rates paid by the Greater London Authority. These transfers may be negatively impacted by a weakening economy.

The stable outlook on TfL's rating reflects the stable outlook on the UK sovereign and Moody's view that TfL will be able to absorb potential negative implications of Brexit including diminishing funding from the EU and slower growth in ridership reflecting slower growth in London's population. TfL's P-1 short term rating was affirmed.

WHAT COULD MOVE THE RATINGS UP/DOWN

Upward pressure on the rating could result from the following: a significant and sustained improvement in TfL's financial position, including outperformance in fare revenues, and/or a substantial decrease in its debt burden resulting in lower interest payments. Furthermore, materially improved revenue and spending flexibility or an upgrade of the UK sovereign rating could also put upward pressure on the rating.

Downward pressure could result from TfL's underperformance in meeting operational or financial goals, specifically if fare revenue growth is materially slower than projected, new revenue sources fail to contribute to the revenue gap or planned expenditure savings do not materialise. Further, if the UK government were to signal a clear dilution of its support for TfL's capital plan or the UK sovereign rating were to be downgraded, this would also put downward pressure on the rating given the strong linkages in funding and support from the sovereign.

3) RATIONALE FOR THE DOWNGRADE AND NEGATIVE OUTLOOKS ON UNIVERSITIES

The downgrade of final ratings and the maintained negative outlooks on seven rated UK universities reflect the close institutional and financial linkages with the UK as well as Brexit-specific sector risks. Central government funding, though in decline in the last five years, still accounts for a significant proportion of income for UK universities. Lower economic growth could put pressure on public finances, resulting in lower transfers to universities for both teaching and research which could impact competitiveness.

In addition to potential knock-on effects of a weaker UK economy and stagnant domestic demand, rated universities are likely to be negatively impacted by Brexit-specific risks, including: fewer international students in the UK, loss of European research funding, and fewer EU students and staff. Of these, the implications of fewer international students would have the most significant credit impact. The majority of rated universities have increased their borrowing to fund capital projects in the last couple of years, with an expectation that growth in tuition fees from both domestic and international students would offset increased interest expense. Given the current climate of weakened student demand and increased competition, Moody's expectation is that some universities will be unable to realise their revenue targets.

The loss of EU research funding, students and staff will have less of a direct financial impact, but may erode competitiveness and market position in an increasingly competitive and global market.

RATIONALE FOR AFFIRMING THE UNIVERSITY OF CAMBRIDGE'S Aaa RATING AND STABLE OUTLOOK

The affirmation of the University of Cambridge's Aaa rating with a stable outlook reflects its extraordinary market position as an established global leader in the higher education sector, its superior financial resilience relative to peers, and proactive response to mitigating Brexit-specific risks. Moreover, Cambridge does not seek to materially increase its current number of students (c20,000) so its forecasted financial position is not as dependent on growing its student numbers for domestic or international students, as is the case for other rated universities.

Cambridge is less susceptible to adverse movements in government support than other universities due to its diverse revenues, substantial endowment, and low level of debt. The maximum single revenue contribution for Cambridge is 26% compared to a median of 46% for UK-rated universities. Moreover, Cambridge is less indebted than its peers, with debt to revenues of 21% compared to a median of 45% for rated universities. Its cash and investments stood at a very strong GBP3.3 billion at FYE2016. Finally, Cambridge can raise funds more easily than its peers due to its exceptional reputation, government relationships, and alumni.

Additionally, Cambridge is undertaking a proactive response to Brexit risks. The university is actively seeking research funding outside of EU sources, including plans to increase funds from research councils, industry, trusts and foundations, in addition to plans to increase engagement with the corporate sector.

WHAT COULD MOVE THE RATINGS UP/DOWN FOR RATED UNIVERSITIES, EXCLUDING THE UNIVERSITY OF CAMBRIDGE

Whilst unlikely in the near-term, an improvement in the UK government's credit profile, as reflected by an upgrade of the sovereign, would exert upward pressure on universities' ratings. The ratings could also face upward pressure if they were to significantly improve their performance and market positions in the face of increased competition in the sector through improving enrolment trends, substantial increases in research funding, or growing endowments.

A further weakening of the UK government's credit profile, as reflected by a downgrade of the sovereign rating, would likely translate into a downgrade of the universities' ratings. In addition, an inability to realise targets for international or domestic student growth, reductions in government funding for the sector, a weaker regulatory framework or an adverse change in assumption for government support would all result in negative pressure being exerted on the universities' credit profiles.

WHAT COULD MOVE THE RATING DOWN FOR UNIVERSITY OF CAMBRIDGE

Whilst considered unlikely in the near-term, a sustained deterioration in the value of its endowment funds, a weakening in its ability to attract research funding or top students and staff, or a significant increase in borrowing that outpaces revenue growth could exert downward pressure on the rating.

4) RATIONALE FOR THE DOWNGRADE AND STABLE OUTLOOKS ON HOUSING ASSOCIATIONS

The one notch downgrade of ratings for the 40 UK housing associations (HAs) and the associated 34 SPVs (see list of affected entities) reflects the close institutional, operational and financial linkages between HAs and the UK sovereign.

The stable outlooks on 40 HAs and associated 34 SPVs reflect the stable outlook on the sovereign rating. Moody's expects the median operating margin to remain stable near 30% over the next two years, and median social housing letting interest cover to remain around 1.4x. HAs have adapted well to a challenging policy environment, which is unlikely to undergo further material change in the medium-term. Additionally, oversight in the sector remains strong, with the regulator (the Homes and Communities Agency) effectively monitoring risk through quarterly reporting and in-depth assessments. In addition, it has the ability to intervene in the management of a HA in financial distress.

The Baseline Credit Assessments (BCAs) of the 40 HAs are maintained (with the exception of Notting Hill Housing Group) as sector-wide risks and issuer specific risks are reflected in the idiosyncratic assessments of our rated HA entities. Declining government transfers and capital funding have led to increases in market sales exposure in the sector, however the level of exposure varied from 0% - 42% in FY2016 across our rated HAs and is incorporated in their given idiosyncratic BCA rating.

Places for People Homes Limited and Places for People Capital Markets PLC's short-term ratings were downgraded to (P)P-2 from (P)P-1. The methodology used to assess Places for People Homes Limited's BACKED Senior Secured debt was Rating Transactions Based on the Credit Substitution Approach: Letter of Credit-backed, Insured and Guaranteed Debts, published in May 2017, which differed from the principal methodologies used to assess the issuer (Places for People Homes Limited). The relevant methodologies used for the affected Credit Ratings are listed in the FROM TO list, which can be accessed by the link provided.

RATIONALE FOR LOWERING BCA AND DOWNGRADING FINAL RATING BY ONE NOTCH FOR NOTTING HILL HOUSING GROUP

We have lowered the BCA of Notting Hill Housing Group (Notting Hill) by one notch to baa2 from baa1 and downgraded the final rating to A3 from A2, and have changed the outlook to stable from negative. The lowering of the BCA reflects a weakened financial management score, driven by a lack of adherence to its treasury policy sustained for several months. The downgrade of the final rating reflects the sector-wide impact of a weaker sovereign rating.

Notting Hill's treasury policy, revised in March 2016, calls for sufficient liquidity to cover all committed development, or, if higher due to aspirational development, 18 months' projected cash flow. Due to a combination of funding not materialising as planned and deferring of funding due to its merger discussions with Genesis Housing Association, the current position stands at 15 months. While Moody's expects the policy breach to be resolved in the coming months, given the association's profile as a significant developer with a sustained high exposure to market sales activity, a lack of adherence to the policy negatively impacts its credit profile. Once funding is obtained, Notting Hill's liquidity coverage ratio is expected to recover to 1.3x in line with a rated peer median of 1.4x.

WHAT COULD MOVE THE RATINGS UP/DOWN

Strengthening credit metrics of standalone BCAs, which may include reducing exposure to market activity, decreasing debt levels and strengthening governance, could put upward pressure on individual ratings.

Downward ratings pressure on HAs would be prompted by a further weakening of the UK government's credit profile, as reflected by another downgrade of the sovereign rating. Additionally, any sector or issuer-specific risks would place downward pressure on the ratings.

5) RATIONALE FOR THE DOWNGRADE OF THE RATING OF PRS FINANCE PLC

The downgrade to (P)Aa2 from (P)Aa1 for the senior secured debt rating assigned to the PRS Finance Guaranteed Secured Bond Programme reflects the downgrade of the sovereign rating, as the rating is based solely on the unconditional and irrevocable guarantee provided by the DCLG. As such, any movement in the UK sovereign rating will affect PRS Finance's rating.

WHAT COULD CHANGE THE RATING UP/DOWN

The guaranteed senior debt rating is linked to that of the UK. Any change in the rating of the UK would be expected to translate into a rating change on the bonds.

PUBLICATION OF RATING ACTIONS ON LOCAL AUTHORITIES

The downgrade of the UK's sovereign rating prompted the publication of this credit rating action on Cornwall Council, Guildford Borough Council, Lancashire County Council, Aberdeen City Council and Warrington Borough Council on a date that deviates from the previously scheduled release date in the sovereign release calendar, published on www.moodys.com.

The specific economic indicators, as required by EU regulation, are not available for these entities. The following national economic indicators are relevant to the sovereign rating, which was used as an input to this credit rating action.

Sovereign Issuer: United Kingdom, Government of

GDP per capita (PPP basis, US$): 42,481 (2016 Actual) (also known as Per Capita Income)

Real GDP growth (% change): 1.8% (2016 Actual) (also known as GDP Growth)

Inflation Rate (CPI, % change Dec/Dec): 1.6% (2016 Actual)

Gen. Gov. Financial Balance/GDP: -3% (2016 Actual) (also known as Fiscal Balance)

Current Account Balance/GDP: -4.4% (2016 Actual) (also known as External Balance)

External debt/GDP: [not available]

Level of economic development: Very High level of economic resilience

Default history: No default events (on bonds or loans) have been recorded since 1983.

On 21 September 2017, a rating committee was called to discuss the ratings of Cornwall Council, Guildford Borough Council, Lancashire County Council, Aberdeen City Council and Warrington Borough Council. The main points raised during the discussion were: The issuers' fiscal or financial strength, including their debt profile, has materially decreased. The systemic risk in which the issuers operate has materially increased.

The weighting of all rating factors is described in the methodology used in this credit rating action, if applicable.

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rating. For further information please see the ratings tab on the issuer/entity page for the respective issuer on www.moodys.com.

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Regulatory disclosures contained in this press release apply to the credit rating and, if applicable, the related rating outlook or rating review.

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