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Research Update:

DRAFT: U.K.-Based Housing Solutions Ratings Affirmed At 'A+'; Outlook Stable

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Overview

- U.K. social housing provider Housing Solutions has persistently high EBITDA margins, a strong liquidity position, and exceptional asset quality.
- We believe Housing Solutions will be able to manage its exposure to market-related activities by effectively monitoring risks.
- We are therefore affirming our 'A+' long-term issuer credit rating on Housing Solutions.
- The stable outlook reflects our view that Housing Solutions' financial performance and debt will remain relatively stable over the next two years.

Rating Action

On March 28, 2019, S&P Global Ratings affirmed its 'A+' long-term issuer credit rating on U.K.-based social housing provider Housing Solutions Ltd. The outlook remains stable.

Rationale

The rating is supported by Housing Solutions' strong financial management that upholds its strong financial performance and liquidity position. The company's debt position, in conjunction with market-related activities, remains a rating constraint, but we expect management to successfully maintain sound performance and contain risks.

Housing Solutions is located in a dynamic region in the South East of England (Windsor and Maidenhead), and its strategy is to continue expanding in this area. Population growth in the South East is projected to be slightly below 1% over the next few years, according to the U.K. Office for National Statistics. Housing Solutions currently owns and manages about 5,700 properties--nearly 80% of which are dedicated to general needs, and affordable, supported housing. We continue to expect that the share of revenue coming from shared-ownership first-tranche sales will be above 15% in individual years.

The company's business profile remains robust because its housing stock is young, located in areas with attractive demand dynamics, and in relatively good condition. We continue to see the global social housing sector as low risk, typically characterized by low volatility through business cycles.

Nontraditional activities, such as shared-ownership first-tranche sales, will likely decrease on average, but be volatile over our forecast horizon through fiscal 2021 (year ending March 31). We understand the volatility in development comes from having the development program focused on allotment under section 6 (s.106) of the Town and Country Planning Act 1990 (as amended), which overall is positive for Housing Solutions as it mitigates development risk.

As a result of the rent cuts from welfare reforms, Housing Solutions wrote down its property values by more than 10% in 2017. This led to an increase in the loan-to-value (LTV) ratio, which have since recovered. Management has taken a number of actions to offset the impact of the rent cuts on its general lettings, for instance deferring nonessential maintenance, and has been successful in achieving cost savings. We also note that vacancy rates are minimal at 1.3%, and we expect both vacancy rates and voids to remain stable.

We expect rising maintenance costs in the coming years will cause EBITDA margins to fall below 50%. From 2021, we believe rents may rise again, which should help the company finance some of the increase in maintenance and maintain its strong financial profile.

We expect Housing Solutions to complete development of about 140 properties in fiscal 2019, and to complete a further 90 by fiscal 2020. That said, we believe the company's development activities pose low risk, since the majority is through s.106 allotment. Housing Solutions has not expressed any interest in developing units for sale on the open market.

We expect Housing Solutions' total debt, which sat at about £300 million the end of fiscal 2018, to remain around current levels through fiscal 2021, due to the company using its large cash holdings to fund amortization and capital expenditure. The debt largely comprises bank loans and private placements, with relatively long tenors and low refinancing risk (the first major repayment is in 2034 when the private placement comes due). Slightly less than 80% of debt is at a fixed rate, which limits Housing Solutions' exposure to interest rates. Despite stable debt position, we continue to view Housing Solutions' high leverage as a rating constraint as--although the debt to EBITDA of about 13x is lower than the 15x in 2016--the EBITDA interest coverage is below 2x.

The 'A+' rating on Housing Solutions is derived from its stand-alone credit profile (SACP), which we assess at 'a+'. In our opinion, there is a moderately high likelihood that the U.K. government--working through the social housing regulator, Homes England--would provide timely and sufficient extraordinary support to Housing Solutions in the event of financial distress, which is neutral for the rating.

Liquidity

We forecast Housing Solutions to have a very healthy liquidity position over the coming 12 months, during which sources of cash will exceed uses by 2x. Housing Solutions' liquidity is buoyed by the expanded £50 million revolving credit facility, which is contractually committed but undrawn. Furthermore, Housing Solutions holds significant cash and equivalent balances of about £40 million.

Over the coming years, we expect cash to decrease because Housing Solutions will use it to fund its development program. We expect capital expenditure will amount to £30 million over the next 12 months, and we expect debt service to cost about £21 million. However, we anticipate management will remain prudent with regard to liquidity and retain a strong liquidity position even with lower cash holdings.

Outlook

The stable outlook reflects our view that Housing Solutions will successfully deliver on its developments plan in a way that keep financial performance and debt burden stable.

We could consider a negative rating action if we were to observe a sharp deterioration of Housing Solutions' liquidity, while management failed to act to uphold a strong position. We could also lower the rating if Housing Solutions were to enter into open-market-sales or heavily increase its exposure to shared ownership, which could lead us to take a more negative view of management's risk tolerance.

We could raise the rating on Housing Solutions if we observe a significant strengthening of the financial profile. For instance, as a result of a more conservative financial policy and supported by deleveraging, such that debt to EBITDA fell below 10x, combined with a corresponding improvement in the interest coverage ratio, while decreasing exposure to market-related activities.

Table 1

Housing Solutions Ltd. Key Statistics

	--Year ended March 31--				
(Mil. £)	**2017a**	**2018e**	**2019bc**	**2020bc**	**2021bc**
Number of unites owned or managed	5,438	5,636	5,778	5,868	5,983
Vacancy rates (% of rent net of identifiable service charge)	1.2	1.3	N.A.	N.A.	N.A.
Arrears (% of rent net of identifiable service charge)*	3.7	4.7	N.A.	N.A.	N.A.
Revenue§	46.0	43.2	44.7	44.1	48.4
Share of revenue from nontraditional activities (%)	24.7	18.2	19.3	17.2	21.2

Table 1

Housing Solutions Ltd. Key Statistics (cont.)

	--Year ended March 31--				
(Mil. £)	**2017a**	**2018e**	**2019bc**	**2020bc**	**2021bc**
EBITDA†	24.7	23.5	21.6	20.3	22.6
EBITDA/revenue (%)	53.7	54.4	48.3	46.1	46.7
Interest expense	13.1	14.9	13.9	13.6	13.7
Debt/EBITDA (x)	12.5	12.7	13.4	14.4	13.0
EBITDA/interest coverage‡ (x)	1.9	1.6	1.6	1.5	1.7
Capital expense†	18.0	17.2	24.8	16.8	20.0
Debt	307.7	299.2	290.6	293.1	294.6
Housing properties (according to balance sheet valuation)	430.9	457.4	472.5	482.3	495.4
Loan to value of properties (%)	71.4	65.4	61.5	60.8	59.5
Cash and liquid assets	67.1	57.8	42.7	41.5	38.4

*Rent and service charge arrears. §Adjusted for grant amortization. †Adjusted for capitalized repairs. ‡Including capitalized interest. a--Actual. e--Estimate. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. N.A.--Not available.

Table 2

Housing Solutions Ltd. Rating Score Snapshot

Industry risk	2
Economic fundamentals and market dependencies	3
Strategy and management	2
Asset quality and operational performance	1
Enterprise profile	2
Financial performance	3
Debt profile	3
Liquidity	2
Financial policies	2
Financial profile	3

S&P Global Ratings bases its ratings on non-profit social housing providers on the eight main rating factors listed in the table above. S&P Global Ratings' "Methodology For Rating Public And Nonprofit Social Housing Providers," published on Dec. 17, 2014, summarizes how the eight factors are combined to derive each social housing provider's stand-alone credit profile and issuer credit rating. For social housing providers generating more than a third of its consolidated revenues from open market sales, we also refer to the "Key Credit Factors For The Homebuilder And Real Estate Developer Industry."

Related Criteria

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Governments | General: Methodology For Rating Public And Nonprofit Social Housing Providers, Dec. 17, 2014
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.