Research Update:

U.K. Housing Provider Metropolitan Thames Valley Housing 'A-' Rating Affirmed; Outlook Stable

December 18, 2020

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Overview

- We expect U.K. housing provider Metropolitan Thames Valley Housing (MTVH) to curtail its ambitious development plan, but that development-for-sale activities--including joint ventures--will still account for one third of total revenues.
- In addition, we believe that ongoing increasing investment in its asset base, combined with our view of the effect of the COVID-19 pandemic on rental revenues, will put more pressure on the group's margins than we had previously expected, and will keep debt high at above 20x EBITDA across the forecast period.
- We are therefore revising downward our assessment of MTVH's stand-alone credit profile to 'bbb' from 'bbb+', and at the same time affirming our 'A-' long-term issuer credit rating on MTVH, now incorporating two notches of uplift for our view of a moderately high likelihood of extraordinary support from the U.K. government.
- The stable outlook reflects our view that MTVH's core lettings business will support future EBITDA growth in line with the rent settlement, and that non-sales EBITDA interest coverage will recover above 1x.

Rating Action

On Dec. 18, 2020, S&P Global Ratings affirmed its 'A-' long-term issuer credit rating on U.K.-based housing provider Metropolitan Thames Valley Housing (MTVH). The outlook is stable.

We also affirmed our 'A-' long-term issuer credit rating on Metropolitan Housing Trust Ltd., a core subsidiary of MTVH.

At the same time, we affirmed our long-term issue rating on Metropolitan Funding PLC's £250 million senior secured bond at 'A-'. Metropolitan Funding PLC was set up for the sole purpose of issuing bonds and lending the proceeds to the group, and we view it as a core subsidiary of MTVH.

Rationale

We assigned one or more of the credit ratings mentioned in this article by deviating from S&P Global Ratings' published criteria. We think that significant exposure to sales activities limits visibility and predictability of future earnings in a way not typically seen with a traditional housing association providing mainly social rent properties. In our view, exposure to sales activities will also reduce the ability to withstand external risks. We therefore deviate from our "Methodology For Rating Public And Nonprofit Social Housing Providers," published on Dec. 17, 2014, when assessing the industry risk for housing associations that generate more than one third of their revenues from market sales. We do this by blending S&P Global Ratings' industry risk assessment for social housing providers (2), and that for homebuilders and real estate developers (4) in line with our "Key Credit Factors For The Homebuilder And Real Estate Developer Industry," criteria published on Feb. 3, 2014. For more information see "Credit FAQ: How S&P Global Ratings Assesses Industry Risk For English Social Housing Providers," published on Aug. 6, 2018.

Our lower assessment of MTVH's intrinsic credit quality reflects our expectation that the group's debt will remain high at above 20x over our forecast period, from this financial year ending March 31, 2021 (FY2021) until FY2023. We expect S&P Global Ratings-adjusted group interest coverage will average just 1.1x over our rating horizon. Pressure on debt metrics will be mainly driven by higher investment in the group's stock than we previously forecast, which will increase the group's cost base, pressuring profitability.

The 'A-' rating on MTVH now incorporates two notches of uplift from the stand-alone credit profile, reflecting our view that there is moderately high likelihood that the entity would receive extraordinary government support in case of financial distress. MTVH's primary purpose is to provide affordable homes, supporting important policy objectives of the U.K. government. We consider that the Regulator of Social Housing (RSH), a government agency, regulates MTVH to promote a viable, efficient, and well-governed social-housing sector, and maintain lender confidence and low funding costs across the sector. It is therefore our view that the RSH would step in to prevent a default in the sector, based on its track record of being willing and able to provide extraordinary support on a timely basis.

Following the completion of the merger between Thames Valley Housing and Metropolitan Housing Trust, the combined group has a significant geographic footprint in the U.K., with a large stock of more than 58,000 units. MTVH mainly focuses its operations and development on London, which benefits from stronger economic conditions than the national average. However, it also has large concentrations in the South East, East Midlands, and the East of England. The group benefits from strong demand for its units, demonstrated by low void levels of about 1%. MTVH is characterized by extremely strong asset quality, supported by its relatively young portfolio with an average age of around 33 years. All units comply with the Decent Homes Standard, and we expect the group's investment in its stock will continue to support asset quality and enable MTVH to respond to future consumer and environmental regulation. Gross arrears remain higher than those of peers nationwide but are in line with MTVH's rated peers operating in London. We anticipate they will remain elevated over the forecast period, impacted both temporarily by the effect of the COVID-19 pandemic on tenants' ability to pay rent, but also over the medium term by the continued rollout of Universal Credit.

Compared with last year, the group has curtailed its development ambitions but kept a similar sales appetite, with more than one third of revenues expected to come from development-for-sale activities (including joint ventures [JVs]). In line with our last base case, the group aims to keep its exposure to sales activities (including JVs) below 40% of total revenues but will now deliver most of its outright sales pipeline through JVs. Under its updated development plan, MTVH aims to deliver around 5,900 units over the next five years, down from 6,700 units in last year's business plan. We expect lower debt accumulation over the forecast period as a result of lower capital expenditure (capex) needs. We believe management is highly skilled and can deliver this development plan, although we continue to believe it is ambitious at a time of heightened economic uncertainty, and that the group's exposure to sales activities brings earnings volatility.

MTVH has reined in its development ambitions to redeploy capital toward improving the quality of the existing asset base, especially regarding the group's Safer Buildings program, and increasing energy efficiency across its units. We expect capitalized repairs to increase over the forecast horizon more quickly than we previously anticipated. These increased investment efforts are in line with sector trends and show management's commitment to carbon neutrality. The total cost impact linked to fire safety works and decarbonization targets is still unclear, as it will depend on the outcome of asset surveys and on any new regulation regarding building safety risk and improved home standards.

We expect subdued financial performance for MTVH compared with our last base case, driven by these investments and the temporary effect of the COVID-19 outbreak on rental revenues. Under our base case, we project that adjusted EBITDA margins will remain below 25% over FY2021-FY2023, but that they will strengthen from FY2020 levels as the supportive consumer price index +1% rent settlement benefits the group's rental activities.

We expect MTVH's debt sustainability metrics will deteriorate over our forecast period, as lower debt accumulation than previously expected will not fully mitigate subdued performance. We now forecast that adjusted debt to EBITDA will remain above 20x, averaging 23x from FY2021 to FY2023, and that interest coverage will remain fairly weak, averaging just 1.1x. The group's high tolerance for debt to EBITDA compared with peers constrains our assessment of its financial policies. We take into consideration that, in our base case in FY2020, income from non-sale activities only covered 90% of the group's interest costs. We expect management's decision to reduce development ambitions and the subsequent effect on borrowing needs, combined with the supportive rental settlement, will enable the group to entirely cover interest costs from its traditional lettings business from FY2022.

Liquidity

We now view MTVH's liquidity as strong. We expect sources of liquidity for the group to exceed planned uses by around 1.65x over the next 12 months, mainly supported by its very large undrawn bank facilities. We do not include MTVH's £150 million of outstanding undrawn funding obtained under the Bank of England's Covid Corporate Financing Facility, as we view commercial paper to be short-term, and not akin to a committed facility expiring beyond 12 months.

We expect liquidity sources will comprise:

- Internally generated cash flow of close to £177 million;
- Current cash and liquid investments of £39 million;
- Proceeds from asset sales of about £82 million;
- The undrawn, available portion of committed facilities of just above £639 million; and
- Government grants of close to £10 million.

We forecast uses of liquidity will comprise:

- Expected adjusted capex of about £275 million; and

- Interest and principal payable of close to £299 million.

We view MTVH's access to external liquidity as satisfactory given its ready and diverse access to bank funding but limited track record of issuance in the capital markets.

Outlook

The stable outlook reflects our expectation that MTVH's core social housing lettings business will support future EBITDA growth, as the group increases rents in line with the rent settlement. We also expect that MTVH will successfully manage to improve non-sales EBITDA interest coverage to remain structurally above 1x from FY2022. It also reflects our view that MTVH will continue to benefit from a moderately high likelihood of support from the U.K. government.

Downside scenario

We could lower the ratings on MTVH if we observed a deterioration of its financial performance whereby EBITDA margins declined below 20%, combined with non-sales interest coverage staying below 1x. This could occur if the group's investment in its asset base puts more pressure on margins than we expect and could lead us to take a negative view on the group's financial policies. We could also lower the rating if we downgraded the U.K. government or if we estimated that there was a lower likelihood of the group receiving timely and sufficient extraordinary support from the U.K. government, through the RSH, in the event of financial distress.

Upside scenario

We could raise the rating if we observed a reduction in sales appetite to remain structurally below one third of total revenues including JVs. Under such a scenario, we would expect MTVH's liquidity to recover to a very strong position, and that group interest coverage will strengthen to stand above 1.25x.

Key Statistics

Table 1

Metropolitan Thames Valley Housing Selected Financial Indicators

	--Year ended March 31--				
(Mil. £)	**2019a**	**2020a**	**2021e**	**2022bc**	**2023bc**
Number of units owned or managed	57,043	57,836	58,431	59,528	60,301
Revenue§	400.5	454.5	425.1	442.4	420.2
Share of revenue from sales activities (%)	20.3	28.2	21.4	19.8	12.1
EBITDA§†	102.6	93.4	92.8	98.6	101.8
EBITDA/revenue §†(%)	25.6	20.5	21.8	22.3	24.2
Capital expense†	222.1	158.7	251.0	287.0	364.0
Debt	1,924.0	1,935.2	2,090.5	2,204.3	2,348.9
Debt/EBITDA §†(x)	18.8	20.7	22.5	22.4	23.1

Table 1

Metropolitan Thames Valley Housing Selected Financial Indicators (cont.)

	--Year ended March 31--				
(Mil. £)	2019a	2020a	2021e	2022bc	2023bc
Interest expense*	81.5	84.6	86.7	88.6	91.5
EBITDA/interest coverage§†* (x)	1.3	1.1	1.1	1.1	1.1
Cash and liquid assets	223.0	105.5	192.9	196.7	106.5

§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.

Ratings Score Snapshot

Table 2

Metropolitan Thames Valley Housing

Industry Risk	3
Economic fundamentals and market dependencies	2
Strategy and management	3
Asset quality and operational performance	1
Enterprise profile	3
Financial performance	5
Debt profile	5
Liquidity	3
Financial policies	3
Financial profile	4

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: Group Rating Methodology, July 1, 2019
- 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
- Criteria | Corporates | Industrials: Key Credit Factors For The Homebuilder And Real Estate Developer Industry, Feb. 3, 2014
- General Criteria: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

Related Research

- Global Social Housing Ratings Risk Indicators: December 2020, Dec. 10, 2020
- Global Social Housing Ratings Score Snapshot: December 2020, Dec. 10, 2020,
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, Oct. 23, 2020, Aug. 4, 2020
- U.K. Social Housing Providers Should Remain Largely Resilient To Short-Term Economic Difficulties From COVID-19, April 23, 2020
- U.K. Social Housing Ratings History: February 2020, March 3, 2020, Dec. 3, 2019

Ratings List

Ratings Affirmed	
Metropolitan Housing Trust Ltd.	
Issuer Credit Rating	A-/Stable/--
Metropolitan Funding PLC	
Senior Secured	A-
Metropolitan Thames Valley	
Issuer Credit Rating	**A-/Stable/--**