S&P Global
Ratings

RatingsDirect®

Research Update:

U.K. Housing Provider Thames Valley Housing Association Rated 'A-' After Completed Amalgamation; Outlook Stable

Primary Credit Analyst:
Jean-Baptiste Legrand, London (44) 20-7176-3609; jb.legrand@spglobal.com

Secondary Contact:
Karin Erlander, London (44) 20-7176-3584; karin.erlander@spglobal.com

Research Contributor:
Celia Franch Lopez, London + 44 20 7176 0100; celia.franch_lopez@spglobal.com

Table Of Contents

Research Update:

U.K. Housing Provider Thames Valley Housing Association Rated 'A-' After Completed Amalgamation; Outlook Stable

Overview

- U.K.-based housing associations Metropolitan Housing Group and Thames Valley have amalgamated under ultimate parent Thames Valley Housing Association (TVHA). We are therefore discontinuing our ratings on Metropolitan Housing Group.
- Our view of TVHA's creditworthiness balances its solid liquidity, and the strong demand for its social housing, against a projected increase in its exposure to development-for-sale activities. This will expose the group to risks of earnings volatility and lower operating margins.
- We also factor in the moderately high likelihood that the U.K. government will provide extraordinary support to TVHA if needed.
- We are assigning our 'A-' long-term issuer credit rating to THVA.
- The stable outlook reflects our view that the strong underlying social housing business will continue to mitigate risks from increased sales exposure, and that TVHA will benefit from a moderately high likelihood of support from the U.K. government.

Rating Action

On Dec. 19, 2018, S&P Global Ratings assigned its 'A-' long-term issuer credit rating to U.K.-based housing provider Thames Valley Housing Association (TVHA). The outlook is stable.

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 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 Thames Valley Housing Association.

Finally, we discontinued our 'A-' rating on Metropolitan Housing Trust.

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.

Thames Valley's creditworthiness benefits, in our view, from a moderately high likelihood of extraordinary support from the U.K. government, through the Regulator of Social Housing, in the event of financial distress. The 'A-' rating on TVHA is therefore one notch higher than its stand-alone credit profile. Our view of a moderately high likelihood of extraordinary government support is based on Thames Valley's important role for the U.K. government and its public policy mandate. It is also based on Thames Valley's strong link with the U.K. government, demonstrated by the government's track record of providing credit support in certain circumstances.

The rating also reflects our base-case expectation that TVHA will carry out a significant sales program, such that first-tranche shared-ownership sales and outright sales will structurally account for more than one-third of the group's revenues. We believe that the group's higher exposure to more volatile business will stretch its financial risk position as it exposes it to cyclical and more volatile income sources. We recognize that this is a structural trend in the industry to mitigate a reduction in government grant funding by cross-subsidizing social housing development with revenues from market-related activities. That said, we think the industry risk for English social housing entities such as TVHA, which are relying ever-increasingly on sales activities, has heightened.

Although the group remains a non-profit provider of social housing, market sales now form a solid core business and we expect that their share of the group's total revenues will increase over our forecast period. The development plan for the newly amalgamated entity aims to deliver 7,700 units over the next five years (excluding development through joint ventures), of which 47% are for shared ownership sales, 39% for social housing rental tenures, and the remaining 14% for outright sale. Although we think that management--which combines talent from Metropolitan and Thames Valley--is highly skilled and has the capabilities to grow at such a scale, we consider that the overall program is ambitious. We think it will expose the business to more cyclical risk from the housing market and consequently we have factored some slippage and sales delays into our base case compared to management estimates.

The company is able to sustain a strong enterprise profile thanks to the stability and high demand observed for its traditional social housing activities. It has a significant geographic footprint in the U.K with a large asset base of more than 50,000 social housing units. The main focus of operations and development is London, but there are large concentrations in East Midlands, East Anglia, and the South East. The London area benefits from stronger population growth than the national average along with higher market rent than social and affordable rent, but the group's economic fundamentals are weighed down by its activities in other geographic locations. The group has managed to reduce vacancies as of financial year 2018 ending (March 30) 2018 to below 0.8%, which we view as a positive, but we note that gross arrears are higher than most of its peers.

We foresee the group's financial performance weakening compared to performance observed based on pro forma consolidated accounts of Metropolitan Housing Group and Thames Valley for FY2017 and FY2018. This reflects likely higher maintenance costs and capitalized repairs in the next two years related to fire safety investments, combined with the increasing role of development-for-sale and ongoing negative effects of rental cuts. While TVHA's social housing lettings business has strong operating margins of about 37%, we forecast TVHA's adjusted EBITDA margin will fall below 30% and average around 26% of revenues over 2019-2021. The sharp decrease in margins expected at the end of the 2019 financial year is due to a significant temporary increase in planned maintenance and repair works, but we expect adjusted margins to dilute structurally to below 30% as TVHA increases its lower-margin development-for-sale activities. While the increase in repairs affects financial performance, we view positively increases in maintenance because this will maintain the high quality of the asset base. Currently it has an average age of 32 years and is 100% compliant with the Decent Homes Standard.

Lower anticipated margins, along with a nominal debt increase to fund development activities, will worsen TVHA's debt burden. We forecast an increase to about £2.2 billion in nominal debt, from £1.7 billion, in our base case. This reflects our expectations that the entity will draw on its existing facilities and retained bond to finance parts of its capital program, with capital expenditure (capex) also being funded through sales receipts. We expect debt to EBITDA to average about 17x in 2019-2021, up from 14x at the end of the 2018 financial year, as margins come under pressure and the group increases its borrowings.

Our assessment of TVHA's financial policies is constrained by its higher tolerance to leverage than peers. Also, we factor in that income from social housing lettings just covers interest costs through 2021 (1x on average for 2019-2021). We view positively, however, that the group has limited exposure to interest-rate fluctuations.

Liquidity

We consider TVHA's liquidity position to be very strong. We expect sources of liquidity for the group to exceed planned uses by 2x over the next 12 months, mainly driven by its very large undrawn bank facilities and its retained corporate bond.

This very solid coverage incorporates about £437 million of committed and secured undrawn short-term facilities, £100 million from its retained corporate bond issuance, about £121 million of cash flow from operations (before interest), £114 million of cash, and about £111 million of proceeds from asset sales.

These liquid assets are set to be used to finance TVHA's large capital development program, with more than £272 million of capex related to fixed assets, close to £134 million of interest and principal payments due over the next 12 months, and £41 million in grants to be repaid to GLA related to past land acquisitions and ongoing repayments of expired grants.

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

Outlook

The stable outlook reflects our view that the strong underlying social housing business will continue to mitigate risks from increased sales exposure, and that TVHA will continue to benefit from a moderately high likelihood of support from the U.K. government.

We could lower the ratings on TVHA if we observed a deterioration of its liquidity and debt profile beyond our current expectations. This could occur if the group's development for sale activities over the next few years put further pressure on its liquidity position or funding needs, compared with our base-case projection, because of a severe housing market correction for example. We could also lower the ratings if we revised down our assessment of the likelihood of support that TVHA receives from the U.K. government through the Regulator of Social Housing.

We could raise the rating if we observed an improvement in financial performance with adjusted EBITDA margins structurally above 30% of revenues, along with contained exposure to sales activity at current levels. Under such a scenario, we would expect TVHA to maintain its very strong liquidity position and balanced debt profile.

Key Metrics

Table 1

Thames Valley Housing Association					
	--Year ended March 31--				
(Mil. £)	**2017a**	**2018e**	**2019bc**	**2020bc**	**2021bc**
Number of unites owned or managed	48,875.0	49,624.0	50,641.0	51,465.6	52,926.9

Table 1

Thames Valley Housing Association (cont.)					
	--Year ended March 31--				
(Mil. £)	**2017a**	**2018e**	**2019bc**	**2020bc**	**2021bc**
Vacancy rates (% of rent net of identifiable service charge)	1.1	0.8	N.A.	N.A.	N.A.
Arrears (% of rent net of identifiable service charge)*	9.1	9.7	N.A.	N.A.	N.A.
Revenue§	370.0	409.3	442.8	487.6	428.2
Share of revenue from nontraditional activities (%)	15.6	23.2	28.2	33.4	20.7
EBITDA†	128.7	125.6	102.7	129.9	125.1
EBITDA/revenue (%)	34.8	30.7	23.2	26.7	29.2
Interest expense	80.8	80.2	86.7	87.8	97.8
Debt/EBITDA (x)	12.8	13.8	17.6	15.4	18.0
EBITDA/interest coverage** (x)	1.6	1.6	1.2	1.5	1.3
Capital expense†	201.4	205.0	264.4	251.4	368.0
Debt	1,642.6	1,728.6	1,809.7	2,004.2	2,255.3
Housing properties (according to balance sheet valuation)	4,009.8	4,194.2	4,422.0	4,631.0	4,979.5
Loan to value of properties (%)	41.0	41.2	40.9	43.3	45.3
Cash and liquid assets	202.4	158.5	29.7	53.5	13.3

*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.

Ratings Score Snapshot

Table 2

Thames Valley Housing Association	
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	3
Liquidity	2
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: 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: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- Global Social Housing Risk Indicators: December 2018, Dec. 3, 2018
- Scenario Analysis: U.K. Social Housing Association Ratings Under A No-Deal Brexit, Dec. 3, 2018
- Global Social Housing Ratings Score Snapshot: December 2018, Nov. 29, 2018
- Countdown to Brexit: No Deal Moving Into Sight, Oct. 30, 2018
- Credit FAQ: How S&P Global Ratings Assesses Industry Risk For English Social Housing Providers, Aug. 6, 2018

Ratings List

New Rating		
Metropolitan Thames Valley		
Issuer Credit Rating	A-/Stable/--	
Not Rated Action		
	To	From
Metropolitan Housing Trust Ltd.		
Issuer Credit Rating	NR/--	A-/Stable/--
Ratings Affirmed		
Metropolitan Funding PLC		
Senior Secured	A-	

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.