Research Update:

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

December 16, 2021

Overview

- U.K.-based housing association Metropolitan Thames Valley Housing (MTVH) will continue investing in new homes as well as in its existing stock.
- We think this will result in MTVH's debt burden remaining elevated over the next three years.
- We expect gradually improving nonsales EBITDA and solid liquidity will counterbalance the risks associated with the group's development-for-sale activities.
- We affirmed our 'A-' long-term issuer credit rating on MTVH. The outlook is stable.

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Rating Action

On Dec. 16, 2021, S&P Global Ratings affirmed its 'A-' long-term issuer credit rating on MTVH. The outlook is stable.

We also affirmed our 'A-' long-term issuer credit rating on Metropolitan Housing Trust Ltd. (MHT), which we consider a core subsidiary of MTVH, since it owns and manages the majority of the group's rental units and shared ownership sales. We also affirmed our 'A-' rating on MHT's £2 billion senior secured and unsecured medium term notes program and the £250 million senior secured bond.

At the same time, we affirmed our 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 as well.

Outlook

The stable outlook reflects our expectation that MTVH will gradually increase its nonsales EBITDA, despite increasing operating costs and debt-financed development efforts, such that interest coverage will remain above 1x on a sustained basis. 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 the group's strategy led to a deterioration of its financial indicators, for example due to additional cost pressures and investment in existing properties, or lower margins on sales activities. Under this scenario, we think EBITDA margins would decline below 20%, combined with nonsales interest coverage falling below 1x, on a sustained basis.

We could also lower the rating 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 Regulator for Social Housing (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 revenue, including joint ventures (JVs). Under such a scenario, we would expect MTVH's profitability and interest cover to improve.

Rationale

The affirmation reflects our view on MTVH's main operations in the countercyclical social housing sector and strong demand for its services. We think these elements should counterbalance the risks associated with its development-for-sales activities. The group has slightly reduced its risk appetite, although we still expect sales exposure, including developments in JVs, to remain above one-third of total revenue. Under our base case, we continue to attribute the elevated debt metrics to increased investments in existing homes, which weighs on the group's S&P Global Ratings-adjusted EBITDA, as well as debt funding of the development of new homes.

We believe there is a moderately high likelihood that MTVH would receive timely extraordinary support from the UK government in case of financial distress. This provides two notches of uplift from the stand-alone credit profile, which we assess at 'bbb'. As one of the key goals of the RSH is to maintain lender confidence and low funding costs across the sector, we believe it is likely that the RSH would step in to try and prevent a default in the sector. We base this view on previous records of the RSH mediating mergers or arranging liquidity support from other registered providers in cases of financial distress and think this would also apply to MTVH.

We assess the regulatory framework under which registered providers of social housing in England operate as strong, underpinned by their public policy mandate to provide affordable homes. We also consider that the sector benefits from solid ongoing oversight by the RSH. These strengths are offset in our view by the relatively low levels of grant funding that the providers in England receive for the development of affordable homes. We consider that the providers in England have the ability to develop homes for outright sale, using the proceeds as an alternative funding source. However, we think this exposes them to risks and potential volatility compared with providers in other regions. Providers in England are also subjected to negative intervention from the U.K. government in the form of constraints of rent setting or additional spending responsibilities, without adequate additional funding. This weighs on our view of the regulatory framework assessment.

MTVH's affordability levels in its main area of operations and large stock further underpin our view of its creditworthiness. 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 about 58,000 units. MTVH mainly focuses its operations 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. On average, we assume that the group's social and affordable rent levels stand at about 50% of market rents. This supports the strong demand for MTVH's units, as also demonstrated by slightly lower-than-market void levels, averaging about 1.3% of rent receivable and service charges in the past three years.

In our view, MTVH still has material exposure to market sales risk, including units developed for sale through the group's JVs. We understand MTVH will conduct the majority of its open market sales through such partnerships, although we consider that revenue stemming from the first-tranche sales of shared ownership units and outright sales, including market sales coming from the group's JVs, will remain above one third of total revenue.

We think MTVH's management is skilled and can deliver on its plans and work toward identified operational and financial targets. That said, we still think the group's development plan is ambitious and its exposure to sales activities brings earnings volatility. In the past, 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 it to continue doing so, should costs on existing properties be significantly higher than currently anticipated, to ensure its financial sustainability.

We expect EBITDA margins to remain relatively stable at just under 25% on average over our three-year forecast horizon. We forecast that increased investments in existing properties will somewhat offset the benefit from annual rent increase of the consumer price index plus 1%. We expect the temporary effect of the COVID-19 outbreak on rental revenue, following the end of temporary support schemes for tenants by the U.K government, will also affect this year's performance. A gradually increasing share of low-margin sales activities at the group level should also squeeze margins in the final year of the forecast, although we still expect the group's EBITDA margin to remain above 20% on a sustained basis.

We also consider that debt will remain a key source of financing for MTVH's development activities, even if proceeds from the group's sale of fixed assets and grant funding from Homes England and the Greater London Authority would fund part of the development of affordable rent units. Over the next three years, we expect MTVH's debt to nonsales EBITDA to remain above 20x, and that interest coverage will average just above 1x.

Liquidity

We view MTVH's liquidity as very strong. We expect sources of liquidity for the group to exceed planned uses by about 1.9x over the next 12 months, mainly supported by its very large undrawn bank facilities. 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.

We expect liquidity sources will comprise:

- Cash flow from operations, adding back noncash cost of sales, of close to £125 million;
- Current cash and liquid investments of £55 million;
- Proceeds from asset sales of about £95 million;
- The undrawn, available portion of committed facilities of close to £670 million; and
- Other inflows, including government grants receipts, dividends from--and return of investments in--JVs, of about £105 million.

We forecast uses of liquidity will comprise:

- Expected adjusted capex of about £310 million;
- Interest and principal payable of close to £140 million; and
- Other outflows, including grant repayment and investments in JVs and associates of close to £120 million.

Key Statistics

Table 1

Metropolitan Thames Valley Housing--Key Statistics

	--Year ended March 31 --				
Mil. £	**2020a**	**2021a**	**2022bc**	**2023bc**	**2024bc**
Number of units owned or managed	57,836	58,063	58,020	57,556	58,218
Adjusted operating revenue	454.5	439.6	384.5	381.8	513.3
Adjusted EBITDA	93.4	104.5	88.9	89.9	109.3
Non-sales adjusted EBITDA	76.5	92.6	81.2	86.4	92.6
Capital expense	158.7	113.9	252.9	341.8	467.2
Debt	1,935.8	1,965.2	2,035.8	2,206.4	2,405.8
Interest expense	86.7	82.9	80.0	83.2	87.9
Adjusted EBITDA/Adjusted operating revenue (%)	20.5	23.8	23.1	23.6	21.3
Debt/Non-sales adjusted EBITDA (x)	25.3	21.2	25.1	25.5	26.0
Non-sales adjusted EBITDA/interest coverage(x)	0.9	1.1	1.0	1.0	1.1

a--Actual. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario.

Ratings Score Snapshot

Table 2

Metropolitan Thames Valley Housing--Ratings Score Snapshot

	Assessment
Enterprise risk profile	3
Industry risk	3
Regulatory framework	3
Market dependencies	1
Management and Governance	3
Financial risk profile	4
Financial performance	4
Debt profile	5

Table 2

Metropolitan Thames Valley Housing--Ratings Score Snapshot (cont.)

	Assessment
Liquidity	2

S&P Global Ratings bases its ratings on non-profit social housing providers on the seven main rating factors listed in the table above. S&P Global Ratings' "Methodology For Rating Public And Nonprofit Social Housing Providers," published on June 1, 2021, summarizes how the seven factors are combined to derive each social housing provider's stand-alone credit profile and issuer credit rating.

Related Criteria

- General Criteria: Environmental, Social, And Governance Principles In Credit Ratings, Oct. 10, 2021
- Criteria | Governments | General: Methodology For Rating Public And Nonprofit Social Housing Providers, June 1, 2021
- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- 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

- Social Housing Outlook 2022: Green Agenda Takes Root In Investment Plans, Nov. 23, 2021
- How U.K. Public Finance Sectors Fare Under Latest Spending Review, Nov. 11, 2021
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, Oct. 22, 2021
- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers Published, June 8, 2021
- Building Up Debt: U.K. Social Housing Sector Braces Itself For Borrowing, March 16, 2021
- ESG Industry Report Card: Public And Nonprofit Social Housing Providers Outside The U.S., Aug. 4, 2020

Ratings List

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

Ratings Affirmed	
Metropolitan Housing Trust Ltd.	
Senior Secured	A-