S&P Global Ratings

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Research Update:

U.K. Social Housing Association Housing & Care 21 Outlook To Negative On Planned Sales Increase; 'A+' Rating Affirmed

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Overview

- English housing association Housing & Care 21 (H&C) continues to benefit from strong demand for its extra care and retirement properties. The overall strategy of the association remains a rating strength, in our view, with management focused on specializing in the extra care market.
- However, H&C's exposure to care services results in low margins, and a forecast increase in sales has the potential to erode its financial profile.
- We are therefore revising the outlook on H&C to negative from stable. We are affirming the issuer credit rating on the housing association at 'A+'.
- The negative outlook reflects our view that we could lower the ratings on H&C over the next 24 months if it were to increase its exposure to first-tranche and outright sales, such that revenue from these activities made up 15% of the association's overall turnover.

Rating Action

On July 11, 2018, S&P Global Ratings revised its outlook on English social housing provider Housing & Care 21 (H&C) to negative from stable. At the same time, we affirmed the issuer credit rating on H&C at 'A+'.

We also affirmed our 'A+' issue rating on H&C's £250 million 3.288% senior secured bond due 2049.

Rationale

We continue to view H&C's enterprise profile as very strong, supported by low industry risk, high demand for its stock, and a solid strategy. The outlook revision reflects our view that H&C's financial profile is at risk of deteriorating over the next two-to-three years, predominantly due to a planned increase in first-tranche and outright sales. Sales expose housing associations to volatility and tend to return a lower quality of earnings compared to traditional rental revenue. Therefore, we believe an increase in sales could put further pressure on H&C's margins, which are already lower than traditional housing associations due to their exposure to care-related

services. Nevertheless, we currently still assess H&C's stand-alone credit profile at 'a+'.

In our view, H&C's industry carries low risk due to its anticyclical nature, high demand, and strong oversight from the government via the Regulator of Social Housing. For H&C in particular, its focus on tenants above the legal retirement age of 65, in a country with an ageing population, bodes well for demand. The group continues to operate nationally, where social rents are on average below 70% of market rents, and annual population growth is around 2% for over-65s.

Operationally, H&C has worked to reduce void levels for extra care and retirement tenures over the past year. In the financial year (FY) ending March 31, 2018, voids for retirement properties reduced to 1% of H&C's rent plus service and utility charge income, with extra care voids reduced to 2%. H&C remains committed to developing retirement and extra care tenured units in order to facilitate growth and remain a leading provider of affordable and contemporary retirement housing in England. However, the specialist nature of these tenure types means development tends to be more technical than that of traditional general-needs homes, which require no adaptations. This is the main reason for the delays H&C has experienced in its development pipeline. These delays led the group to push its target of delivering around 2,300 units by FY2021 back to FY2022. Although we do not view such a change as favorable, we consider that the revised plan is more positive than the housing association stretching itself beyond its capabilities to deliver an unchanged target.

We continue to view H&C's strategy as a risk-averse one that remains focused on the tenure types the association specializes in. In addition, the experienced management team remains a credit-positive factor for the group, in our view.

Although we consider H&C's business profile to be a major rating strength, we view the decision to have 50% of the development plan comprise shared ownership and outright sales as a source of pressure on the rating. We view the first-tranche sales associated with a shared-ownership property as subject to the same characteristics as sales to the open market. We believe they are a revenue source that can bring volatility and is linked to consumer confidence. H&C forecasts the development of around 325 shared ownership and 175 outright sales in FY2021, which we anticipate will generate one-fifth of the group's revenue in that year. We also forecast an increase in the volatility of the earnings of H&C between FY2019 and FY2021 due to the speed at which development is expected to increase for tenures with a sale aspect. H&C plans to develop 91 shared ownership units in FY2019, 226 units in FY2020, and 325 units in FY2021. This will result in total revenues increasing by 10% in FY2020 and 14% in FY2021.

Sales return a lower quality of earnings than traditional lettings, which constrains H&C's already low margins. We forecast H&C's five-year S&P Global Ratings-adjusted EBITDA margin (excluding amortized government grants and

capitalized repairs from reported EBITDA), to average just over 20% in our base-case scenario. H&C's capitalized repairs have been around £30 million over the last three years, but we expect them to drop to around £20 million after FY2021, when H&C completes its five-year investment program. On completion of this investment phase, we forecast that adjusted EBITDA margins will improve to structurally above 20%.

H&C's successful bond issuance in FY2018 resulted in debt peaking at £626 million at year end. Upon issuing the bond, H&C repaid early the £50 million facility it had with RBS and terminated the £70 million revolver it had with Barclays. We expect the remainder of the proceeds to fund the group's development aspirations throughout our base case. With amortization, we expect debt to drop to £583 million in FY2020 before increasing again to £605 million if the group wishes to maintain the £100 million of available facilities it has built into its business plan. Adjusted-debt to EBITDA peaked at 18x in FY2018, in line with the bond issuance, which is high compared with the levels of around 13x-15x that we normally observe in the sector. However, we forecast an improvement in this metric as H&C repays debt and improves EBITDA to around 12x in FY2021. We anticipate that H&C's five-year average coverage of interest payments from group-level EBITDA will be 1.7x under our base case.

Liquidity

We continue to view H&C's liquidity position as strong, supported largely by the bond issuance last year. Funding sources at present total £315 million and we expect them to cover uses of £98 million over the next 12 months by 3.22x.

We expect H&C's extremely strong liquidity position to diminish somewhat over our base case as it draws on bond proceeds to cover an increase in capex. Nevertheless, we expect H&C to retain a very strong liquidity position with its policy to ensure £100 million of headroom in liquidity facilities at all times.

Source of liquidity include:

- Adjusted EBITDA as a cash flow proxy of £37 million;
- Cash and liquid investments of £239 million;
- Undrawn committed bank facilities of £25 million; and
- Government grants of £13 million.

Uses of liquidity include:

- Expected adjusted capital expenditure of £52 million; and
- Interest and principal payable of £45 million.

Outlook

The negative outlook reflects our view that we could lower the ratings on H&C over the next 24 months if it were to increase exposure to first-tranche and

outright sales, such that revenue from these activities accounted for over 15% of total revenues. This would lead us to consider that the group's strategy had changed slightly to one where revenues from sales activity are more common.

We could revise the outlook on H&C over the next 24 months if its exposure to sales activities and the related volatility dissipated, with the association performing in line with our base case.

Key Statistics

Housing & Care 21 Selected Financial Indicators

	--Year ended March 31--				
(Mil. £)	**2017a**	**2018e**	**2019bc**	**2020bc**	**2021bc**
Number of unites owned or managed	19,589.0	20,188.0	20,279.0	20,683.9	21,278.6
Vacancy rates (% of rent net of identifiable service charge)	2.9	2.0	N.A.	N.A.	N.A.
Arrears (% of rent net of identifiable service charge)*	1.0	0.9	N.A.	N.A.	N.A.
Revenue§	177.5	178.5	187.5	205.9	234.9
Share of revenue from nontraditional activities (%)	81.0	81.0	78.0	72.0	66.0
EBITDA†	40.1	34.6	35.9	37.9	51.1
EBITDA/revenue (%)	22.6	19.4	19.1	18.4	21.8
Interest expense	21.9	24.4	25.1	24.2	25.2
Debt/EBITDA (x)	11.5	18.1	17.0	15.4	11.8
EBITDA/interest coverage** (x)	1.8	1.4	1.4	1.6	2.0
Capital expense	13.7	29.0	40.6	88.0	86.5
Debt	462.9	625.8	608.2	582.9	605.5
Housing properties (according to balance sheet valuation)	1,091.3	1,117.4	1,161.5	1,253.6	1,340.0
Loan to value of properties (%)	42.4	56.0	52.4	46.5	45.2
Cash and liquid assets	69.5	238.8	197.3	99.7	63.2

*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

Housing & Care 21 Ratings Score Snapshot	
Industry risk	2
Economic fundamentals and market dependencies	2
Strategy and management	2
Asset quality and operational performance	2
Enterprise profile	2
Financial performance	5
Debt profile	3
Liquidity	2

Housing & Care 21 Ratings Score Snapshot (cont.)	
Financial policies	2
Financial profile	3

S&P Global Ratings' analysis of social housing providers' creditworthiness rests on our scoring of eight key rating factors: (i) industry risk; (ii) economic fundamentals and market dependencies; (iii) strategy and management; (iv) asset quality; (v) financial performance; (vi) debt profile; (vii) liquidity; and (viii) financial policies. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Methodology For Rating Public And Nonprofit Social Housing Providers," published Dec. 17, 2014, and "Rating Government-Related Entities: Methodology And Assumptions," published March 25, 2015, detail how we derive and combine the scores, and then determine each social housing provider's stand-alone credit profile and the issuer credit rating. In accordance with S&P Global Ratings'public and nonprofit social housing providers methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating, the committee can make use of the flexibility afforded by paragraphs 12-17 of "Methodology For Rating Public And Nonprofit Social Housing Providers."

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

Related Research

- Ratings On The United Kingdom Affirmed At 'AA/A-1+'; Outlook Remains Negative, April 27, 2018
- U.K. Social Housing Providers To Borrow £12 Billion Of New Debt By 2020, Total Debt to Reach £89 Billion, March 7, 2018
- New Rent Policy Brings Relief, But No Big Boost To The Credit Standing Of U.K. Housing Associations, Jan. 31, 2018
- Global Social Housing Risk Indicators: January 2018, Jan. 30, 2018
- U.K. Social Housing Scenario Analysis: What Could Happen To Ratings In A Market Downturn?, Sept. 25, 2017

Ratings List

Ratings Affirmed; CreditWatch/Outlook Action

	To	From
Housing & Care 21		
Issuer Credit Rating	A+/Negative/--	A+/Stable/--
Senior Secured	A+	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.

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