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Research Update:

U.K.-Based Social Housing Association Housing & Care 21 Rated 'A+'; Outlook Stable

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Overview

- Housing & Care 21 (HC) is an England-based registered provider that provides housing and care services to older people of modest means.
- We view HC's enterprise profile as its rating strength, supported by England's aging populating. We view its financial profile as strong, with a very robust liquidity position, and despite low operating margins.
- We are therefore assigning our 'A+' issuer credit rating to HC.
- The stable outlook reflects our view that HC will maintain very strong economic fundamentals amid only-modest exposure to market-related activities.

Rating Action

On Oct. 25, 2017, S&P Global Ratings assigned its 'A+' long-term issuer credit rating to the U.K. social housing provider Housing & Care 21 (HC). The outlook is stable. We also assigned our 'A+' issue rating to HC's proposed benchmark senior secured bond issuance.

Rationale

HC's very strong enterprise profile is its key rating strength. It reflects solid economic fundamentals due to HC's older tenant base and strong market position. We see HC's financial profile as strong, underpinned by our expectation of its very robust liquidity position following the bond issuance. This is despite HC's low operating margins, compared with the rest of the U.K. social housing industry, which stem from its focus on retirement housing and extra care lettings. Our rating is at the same level as HC's stand-alone credit profile (SACP), which we assess at 'a+'.

In our view, the retirement and extra care segments carry low risk globally given their low cyclicality, high demand, and government support. Specifically we foresee ongoing strong demand for such housing for older people in England (the average age bracket of HC's tenants is 75-80). HC operates across England where social rents account for less than 70% of relevant market rents and the annual population growth for the over-55s is 1.9%, which supports strong demand for HC's services.

We also view HC's asset quality as extremely strong with a comparatively young portfolio (below 30 years) enhanced by management's willingness to keep a sound level of maintenance on units and associated equipment. Despite higher vacancies compared to the 2015-2017 sector average--notable due to high void levels in new units in financial year (FY) 2016 when HC delivered more than 1,000 units--we expect voids to decrease to around 2%-3% of HC's rental plus service and utility charge income over our forecast period.

HC's exposure to non-traditional activities (non-social lettings) weighs on the ratings, in our view. This portion accounts for over 25% of its revenues (31% as of end of FY2017), and encompasses care services, shared ownership first-tranche sales, and outright sales. We believe these activities carry more risk and volatility compared to traditional social lettings. We expect sales activity will increase, but only gradually and not until 2019-2020, and therefore HC's exposure to this segment continues to weigh on our assessment of its enterprise profile. As HC has low operating margins relative to other social housing operators, it has increased its market-related activity to offset welfare reforms and the lack of grants, as well as to fund its development plan.

Overall, we believe that HC's strategy aligns with the market conditions in which it operates and we view positively that management is addressing the negative impact of welfare reforms. We view HC's overall financial management as well-balanced, supported by a stable and experienced senior management team. We also note HC's long-term planning and debt management policy: its proposed bond issuance will enable it to cover its funding needs through to 2020; we also acknowledge the efforts HC has made to reduce its cost base over the last few years.

We anticipate that HC's performance will stabilize despite constraints on revenue growth stemming from the local housing allowance (LHA) cap likely to be implemented from 2019. The new LHA will limit the housing benefit allowance at the same level as the current LHA for household size, and we estimate that due to HC's provision of care services there could be a risk of funding shortfall. In line with HC's risk management policy, we expect it would mitigate the LHA cap risk by stopping its Shared Ownership and Affordable Housing Programme (SOAHP) if it had to. Currently, HC forecasts the development of 2,310 properties by 2021 (predominately extra care and some retirement homes).

In our view, HC has a strong financial profile characterized by very strong liquidity and moderate debt levels. We see HC's financial performance as weaker than peers due to its historically low operating margins; its adjusted EBITDA margins were below 20% of revenues in both FY2016 and FY2017. That said, our base case is that HC's adjusted EBITDA margins will improve structurally to reach about 22% in 2018-2020, primarily due to it reducing its care services (this year HC decided to sell its home care operations and has transferred around 30,000 hours of care services to a different provider) and due to already-implemented cost efficiencies. HC's focus on supported housing means that it is exposed to the lower margins inherent in these care facilities compared to peers who focus on general social housing.

We expect debt-to-EBITDA to peak at 17x in FY2018 following the bond issuance before returning to the FY2017 level of 12x-13x in FY2020. The proceeds from the bond issuance will be used to subsidize HC's development program amid a lack of government grants and low operating margins. In the meantime, we expect HC to maintain sound adjusted EBITDA/interest coverage of around 1.7x over our forecast period.

In our view there is a moderately high likelihood of extraordinary government support for HC. This reflects its important role vis-à-vis the U.K. government's policy of delivering affordable supported housing. At the same time, we see a strong link with the government given its direct regulatory oversight and track record of timely support. Nevertheless, our assessment that HC benefits from a moderately high likelihood of extraordinary support from the U.K. government is currently neutral for the rating.

Liquidity

We see HC's liquidity as very strong. Projected sources of about £465 million for the next 12 months are 2.5x uses of about £185 million.

Sources of cash mainly include cash and liquid investments of about £325 million, about £80 million of committed undrawn facilities, and close to £60 million in cash from continuing operations over the next 12 months. We expect the bond issuance will allow HC to cover its funding needs over the forecast period.

Debt service is one of the major uses of cash over the next 12 months, along with capital expenditure. We envisage £110 million will be used to service bank debt, including a £50 million voluntary repayment of a facility, and about £75 million for investment costs.

We view HC's access to external liquidity as satisfactory by international standards, given its ready access to bank funding but no track-record of issuance on the capital markets so far.

Outlook

The stable outlook reflects our view that HC will maintain very strong economic fundamentals amid only-modest exposure to market-related activities.

Downside scenario

We could lower the rating on HC if we saw a deterioration in its financial performance with adjusted EBITDA margins falling structurally below 20% between FY2018 and FY2020. Weaker financial performance coupled with an increased exposure to high-risk non-traditional activities, such as outright sales, could deteriorate the quality of earnings and expose HC more to the volatility that is associated with market-related revenue streams.

Upside scenario

We could raise our rating on HC if we saw a significant improvement in its financial performance and quality of earnings, such that EBITDA improved structurally above 30% and if, at the same time, we saw a marked improvement in its internal liquidity position to above 3x.

Table 1

Housing & Care 21

	Year ended March 31				
Balance Sheet Date Year	**2016a**	**2017a**	**2018bc**	**2019bc**	**2020bc**
('000 £)					
Number of units	19,539	19,589	20,282	20,511	21,333
Vacancy rates (% of rent net of identifiable service charge + service and utility charge)	4.8	2.8	N.A.	N.A.	N.A.
Arrears (% of rent net of identifiable service charge + service and utility charge)*	2.0	1.9	N.A.	N.A.	N.A.
Revenue§	219.6	202.0	176.2	189.5	224.4
Share of revenue from non-traditional activities (%)	38.8	31.2	18.8	24.0	33.3
Operating expense (before D&A)	160.6	136.9	116.3	122.3	150.8
EBITDA¶	37.2	39.7	37.8	43.2	45.2
EBITDA/revenue (%)	16.9	19.7	21.5	22.8	20.1
Interest expense	22.4	21.9	24.3	25.9	24.8
Debt/EBITDA (x)	12.7	11.7	16.5	14.1	12.8
EBITDA/interest coverage (x)†	1.7	1.8	1.6	1.7	1.8
Capital expense	60.9	41.3	70.6	113.9	134.9
Debt	471.9	462.9	624.2	608.2	577.0
Housing properties (according to balance sheet valuation)	1,091.6	1,091.3	1,126.6	1,203.3	1,296.0
Loan to value of properties (%)	43.2	42.4	55.4	50.5	44.5
Cash and liquid assets	49.4	69.5	222.1	159.3	66.8

*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

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

- U.K. Social Housing Scenario Analysis: What Could Happen To Ratings In A Market Downturn? – September 25, 2017
- Global Social Housing Risk Indicators – June 9, 2017
- Ratings On the United Kingdom Affirmed At 'AA/A-1+'; Outlook Remains Negative, April 28, 2017
- High Demand For U.K. Social Housing Will Push Sector's Debt Above £80 Billion In FY2019, March 20, 2017

Ratings List

New Rating; CreditWatch/Outlook Action

Housing & Care 21	
Issuer Credit Rating	A+/Stable/--

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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 the 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.