FitchRatings

Correct: Fitch Assigns Hyde Housing Association 'A+' IDRs; Outlook Stable

Fitch Ratings-Frankfurt/London-27 March 2019: This replaces the rating action commentary published on 12 March 2019 to correct the collateral type of the local currency senior bond issued by Hyde to secured.

Fitch Ratings has assigned Hyde Housing Association (Hyde) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) of 'A+'. The Outlooks are Stable. Fitch Ratings has also assigned 'A+' Long Term ratings to the local-currency senior secured bond issued by Hyde (the parent company of the Hyde Group) and to the local currency senior secured bond issued by its subsidiary Martlet Homes Limited. A full list of rating actions is below.

Hyde's ratings reflect high and sustained demand for social housing in London and the south-east of England, where Hyde mainly operates, and continued cash flow from its core social rental business. The ratings also factor in Hyde's secured cash flow from public funds and the tight control and the regulation provided by the Regulator of Social Housing (RSH).

At 31 March 2018, Hyde owned or managed nearly 50,000 housing units, ranking it among the largest registered providers (RP) in England. The ratings factor in Hyde's moderate debt level with stable debt metrics and improved liquidity due to its recent deleveraging. We expect net debt to Fitch-calculated EBITDA to remain stable within the next five years, despite the ambitious development programme target of 1,500 housing units per year. The ratings further reflect the one-notch uplift Fitch applies to Hyde's standalone credit profile, driven by the application of the Government Related Entities (GRE) Criteria.

The Stable Outlooks reflect Fitch's view that Hyde will continue to demonstrate robust performance, despite the weakened operating environment and increased challenges faced by RPs in England. The impact of Brexit on the sector, although still uncertain, appears less evident than on other public finance sectors, such as higher education and healthcare, although the possible consequences have been factored into Hyde's stress tests. The RSH continues to provide strong oversight.

KEY RATING DRIVERS
Fitch rates English RPs under its Revenue-Supported Rating Criteria and takes into account such factors as revenue defensibility, operating risk and the RPs' financial profile assessment. We incorporate public support factors, notably the strong predictability of the RPs' cash flow through direct and indirect government funding. Fitch also applies its GRE Criteria, whereby we assess RPs in England as non-credit-linked entities and we uplift its standalone credit profile by one notch. This reflects our assessment of strength of linkage and incentive to support factors. As a consequence, RPs' ratings do not automatically move in line with those of the UK sovereign

The following rating factors are reflected in Hyde's standalone 'A' credit profile:

Revenue Defensibility: Strong

Fitch assesses Revenue Defensibility, which covers demand and pricing, overall as strong. Demand for social housing remains strong and any change in the rents that RPs are able to charge would be unlikely to materially affect demand. The supportive regulatory regime aims to maintain compensation for services at a level consistently supporting solvency for not-for-profit of an essential public service. For the core business part of operations RPs' have limited revenue flexibility, as the UK government determines social housing rent rises. Since April 2016 rents have been reduced by 1% per year and then on 4 October 2017, it was announced that rents would return to the consumer price index (CPI) plus 1% for the five years from 1 April 2020. However, due to the increasing share of revenue from non-social housing activity, RPs have been gaining more flexibility to collect enough revenue to cover all costs.

Operating Risk: Strong

Operating Risk covers operating costs and we have assessed resource management as strong overall. Hyde has well-identified cost drivers and low potential volatility in major items. Hyde envisages material capex in its medium term development plan but has the flexibility to slow down committed schemes, delay uncommitted schemes as well as switch tenure from sale to market rent as it operates in high demand areas. Additionally, in the event of financial stress, Hyde can curtail some discretionary expenditure or spending on non-essential major works and improvements. Less than GBP500 million of development capex is contractually committed within the next five years, and this includes affordable social housing units.

Regarding resource management risk, there are unlikely to be supply constraints for labour or resources. Hyde has factored into its stress testing the Brexit vote and its potential impact on the UK economy, public finances and political continuity. The main implications for the sector will be continued uncertainty and short- to medium-term turbulence in the financial and housing markets, which may lead RPs to further delay any planned bond issuances, and put pressure on refinancing. Nevertheless, in 2017 Hyde's subsidiary Martlet Homes Limited successfully raised a GBP400 million secured bond issue with a coupon rate of 3%, leaving GBP 500 million of undrawn liquidity headroom and GBP 1.4 billion of unencumbered property collateral.

Hyde has stress tested and run multi-variable scenarios for its business plan. In general, throughout the stress-tested business plan interest cover and gearing covenants are met without the need to scale back any development spending, albeit with decreased but sufficient headroom. Fitch will continue to monitor Hyde's resilience and assess its ability to overcome possible further turmoil. We will also closely review the robustness of the stress testing relative to its ratings, including the impact of Brexit on its business plan, and assess Hyde's flexibility to adapt to market conditions.

Financial Profile: Strong

Fitch believes Hyde's performance is robust despite the challenges that have affected the sector over recent years. Continued high demand for social and affordable housing, cost-efficiency measures and extensive diversification into non-core business should allow Hyde to maintain sufficient revenue to service debts and cross-subsidise its core business.

We expect Hyde's robust performance to continue, aided by a mixed tenure development plan that aims to deliver housing for sale as well as affordable housing and market rent properties. Profits from the sale of private sale units will be re-invested in the RP to continue to build and provide affordable social units. The share of non-social housing activity is expected to peak in FY20 at 43% from 30% in FY18 of total turnover, but in the medium term 67% of turnover on average will continue to come from social housing lettings. Hyde has fully funded its development capex for the next five years.

In 2018 Hyde signed joint venture contracts to deliver 3,350 homes, including some for affordable rent and shared ownership and for outright sales. Hyde developed 1,285 units in FY18 (up from 465 housing units in FY17) and it aims to develop up to a total of 1,500 units per year over the next five years. Over the next five years, the tenure split is expected to be 26% general needs and affordable rental tenure rent, 26% shared ownership, 6% private rent (for onward sale to an investor) and 43% private sale.

Fitch applies a conservative approach in its rating case scenario and expects Hyde's turnover to average about GBP470 million in 2019-2023 with the operating surplus averaging a high of GBP150 million a year. Despite the material capex plan envisaged, we expect net debt to Fitch-calculated EBIDTA to remain around 9x, in line with 'A' category peers.

In FY18 Hyde reported an adjusted turnover of GBP405.8 million turnover (FY17: GBP 404.4 million), when including the surplus on asset disposals at GBP 66.2 million, which has been recurring since 2016, with an operating surplus of GBP 161 million. Debt at FY18 was at GBP1.65 billion (FY17: GBP1.37 billion).

Under Fitch's GRE criteria status, we assess ownership and control factor as Strong. We assess support track record and expectations factor as Moderate, the socio-political implications of default as Moderate and the financial implications of default as Weak. This gives a total score of 12.5, leading to a bottom up + 1 under the Notching Guideline Table.

RATING SENSITIVITIES
The standalone credit profile could be downgraded if there is further pressure on the sector or on Hyde as a result of the negative operating environment in the UK.

The ratings could be downgraded if Hyde's net debt/EBITDA ratio sustainably weakens, along with the weaker illiquidity, revenue defensibility or operating risks.

We could upgrade Hyde if the net direct risk to Fitch- calculated EBIDTA declines towards 8x on a sustained basis.

On 21 February Fitch placed the UK's Long-Term Foreign-and Local-Currency IDRs (AA) on Rating Watch Negative. RPs' ratings do not automatically move in line with those of the UK sovereign. However, in the event of further downgrade Fitch may re-assess the impact of the weakened operating environment on the standalone credit profile of the RPs.

FULL LIST OF RATING ACTIONS
Long-Term Foreign- and Local- Currency IDRs assigned at 'A+'; Outlook Stable
Short-Term Foreign- and Local-Currency IDRs assigned at 'F1'
Long-term rating of the local currency senior secured bond issued by Hyde Housing Association and Long-term rating of the local currency senior secured bond issued by Martlet Homes Limited assigned at 'A+'.

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Summary of Data Adjustments: Turnover of Hyde is adjusted by the recurring nature of asset disposals since 2016, which is also reflected in the issuer's operating surplus.
Interest receivables /payables on the I&E are adjusted by the fair gain/ losses resulting from derivatives, where the latter are classified as non-operating revenue/ expenditure.

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Additional information is available on www.fitchratings.com
Applicable Criteria
Government-Related Entities Rating Criteria (pub. 25 Oct 2018)
Rating Criteria for Public-Sector, Revenue-Supported Debt (pub. 26 Feb 2018)

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