S&P Global Ratings

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Research Update:

U.K.-Based Social Housing Provider Hyde Housing Association Affirmed At 'A'; Outlook Stable

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Overview

- We estimate that U.K.-based Hyde Housing Association will report weaker-than-anticipated S&P Global Ratings-adjusted EBITDA in the financial years (FY) to March 2020 and 2021, which will weigh on the group's adjusted credit metrics for these two years.
- We consider this deterioration in the debt service coverage ratios to be temporary, as Hyde used higher-than-expected proceeds from the sale of homes in FY2020 to fund nonrecurring investments in preparation for the effect of the COVID-19 pandemic in FY2021.
- We are therefore affirming our 'A' long-term rating on Hyde.
- The stable outlook indicates that we expect Hyde's adjusted EBITDA margins will comfortably exceed 20% through FY2023, and that the debt service coverage ratios will materially strengthen from the current weak position.

Rating Action

On July 24, 2020, S&P Global Ratings affirmed its 'A' long-term issuer credit rating on U.K. social housing provider Hyde Housing Association. The outlook is stable.

We also affirmed our 'A' issue rating on Hyde's £250 million senior secured bond and on the £400 million senior secured bond issued by Martlet Homes Ltd., because we consider this finance vehicle to be a core subsidiary of Hyde.

Rationale

One or more of the credit ratings referenced within this article was assigned 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 "Criteria | Governments | General: 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 revenue 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 "Criteria | Corporates | Industrials: Key Credit Factors For The Homebuilder And Real Estate Developer Industry" 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.

We affirmed the ratings because we anticipate that the weakening of Hyde's adjusted EBITDA over FY2020 and FY2021 is likely to be temporary. As costs return to a more normal level from FY2022, we forecast that adjusted EBITDA will be higher and adjusted EBITDA margins stronger. In our view, management's proactive steps will result in further debt reduction and lower interest costs, resulting in stronger credit metrics through our forecast period to March 31, 2023.

As for other English housing associations, we believe there is a moderately high likelihood that Hyde would receive extraordinary support in case of financial distress. This provides a one-notch uplift from the stand-alone credit profile (SACP). Hyde's primary purpose is to provide affordable homes, supporting important policy objectives of the U.K. government. We consider that the Regulator of Social Housing (RSH), a government agency, regulates Hyde to promote a viable, efficient, and well-governed social housing sector, and maintain lender confidence and low funding costs across the sector. It is therefore our view that the RSH would step in to prevent a default in the sector, based on its record of being willing and able to provide extraordinary support on a timely basis.

Significant exposure to sales has resulted in less stable revenue at Hyde compared with more traditional housing associations. For example, market sales in FY2019 created a spike in revenue, so that Hyde was unable to sustain its revenue at the same level in FY2020. Hyde also generated less rent in FY2020 as it continued its stock rationalization program. In FY2021, we anticipate revenue will remain weak, as rental income was hit during the lockdown imposed to curb the spread of COVID-19, increasing arrears. We forecast that gross arrears, including former tenant arrears, will reach 8%, which we associate with weaker asset quality.

We understand that Hyde generated a higher level of income than we had forecasted in FY2020 from the sale of more than 900 existing homes to other housing associations and local authorities. Hyde used these proceeds to invest in its information technology and data systems, increase investments in fire safety-related work, and cover other costs, in anticipation of a potential impact from the COVID-19 pandemic.

We exclude proceeds from fixed-asset sales in our adjusted EBITDA, because we consider this to be asset management, rather than a core activity for a social housing provider. Therefore, we estimate that the extra costs would have lowered the group's adjusted EBITDA to less than £70 million in FY2020, from more than £120 million in FY2019. This weighs on the group's adjusted EBITDA margins, which we estimate would have declined to less than 20% in FY2020, from 28% in FY2019. For FY2021, we forecast that the adjusted EBITDA could edge up to about £80 million, before recovering to over £100 million in FY2022 and FY2023.

As much of the costs in FY2020 are nonrecurring, we consider the weakening of the adjusted EBITDA margins to be temporary. Our forecast suggests that margins will revert to a solid 24%-26% over the next two-to-three years. EBITDA margins are supported by higher rent revenue from April 1, 2020, when rents increased by consumer price index (CPI) plus 1%, and the completion of fire safety work ahead of its peers.

We understand that, due to the phasing of its development program, Hyde developed fewer homes in FY2020, when it completed 687 homes, including its share of joint venture development, compared with more than 1,000 new homes the year before.

Our forecast suggests that Hyde will not develop more than 900 units a year over the next two-to-three years, of which about a third would be for outright sale. We forecast that Hyde will spend about £220 million annually on the development of rental units and homes for sale, mostly funded with internally generated cash flows, including the proceeds from asset sales and grant funding. As a result, the overall debt level will be contained.

Hyde has taken steps to lower the group's debt and funding costs--in absolute terms, its debt has steadily decreased since a major refinancing exercise in FY2018. Interest costs have also fallen after the group refinanced expensive legacy debt. We expect the group to maintain its prudent approach to debt management, leading to a £200 million reduction in nominal debt by the end of FY2022, from £1.65 billion in FY2018. Over the same period, we estimate that annual interest expenses decreased by about £20 million.

Although Hyde's adjusted debt and interest cover ratios are under pressure this year, due to the lower adjusted EBITDA, we forecast a steady strengthening through the forecast period.

Hyde's stock rationalization program is consistent with its focus on its existing core areas of operation in London and southeast England. Annual population growth in these regions has fallen to national levels, according to the latest data from the Office for National Statistics, at around 0.5%. The difference between Hyde's average social and affordable rent has consistently been below 50% of the market rent. The growing population and much lower rent support demand prospects for Hyde's homes, in our view; its void levels are low, at less than 0.5%.

Liquidity

We consider Hyde's liquidity position to be very strong, thanks to its high levels of cash, large undrawn credit facilities, and satisfactory access to capital markets. In our base case, we estimate that sources of cash will cover uses by more than 3x over the next 12 months.

Sources of liquidity include:

- Cash of about £150 million;
- Cash flow from operations of about £200 million;
- Available funds under undrawn committed facilities expiring beyond 12 months of £550 million; and
- Grants and proceeds from fixed-asset sales exceeding £150 million.

Uses of liquidity include:

- Capital expenditure (capex) including development spending on homes for sale exceeding £190 million; and
- Debt service (including interest costs) of about £85 million.

Outlook

The stable outlook indicates that we expect Hyde's adjusted EBITDA margins will comfortably exceed 20% through FY2023, and that the debt service coverage ratios will materially strengthen from the current weak position.

Downside scenario

We could lower the rating if Hyde's financial performance comes under pressure, for instance, from a protracted negative impact of the COVID-19 pandemic and Brexit on the U.K. economy. Pressure on the ratings could also emerge if Hyde increases its dependence on less stable sources of revenue, such as development for sale, or if management fails to take proactive steps to strengthen its debt metric.

Upside scenario

An upgrade would depend on Hyde further reducing its exposure to market-related activities, or on a sustained improvement in its financial performance, supporting a solid strengthening of the group's debt metrics.

Key Statistics

Table 1

Hyde Housing Association Key Statistics

	--Year ended March 31--				
Mil. £	**2019a**	**2020e**	**2021bc**	**2022bc**	**2023bc**
Number of units owned or managed	48,796	48,287	48,470	48,607	48,800
Revenue*	438.4	351.9	344.1	421.6	440.3
Share of revenue from sales activities (%)	39.0	27.1	28.0	36.7	37.4
EBITDA*§	122.3	67.0	80.5	106.8	114.3
EBITDA/revenue *§(%)	27.9	19.0	23.4	25.3	26.0
Capital expense§	98.2	179.8	175.5	226.2	252.5
Debt	1,597.9	1,510.2	1,503.2	1,453.2	1,353.2
Debt/EBITDA *§(x)	13.1	22.5	18.7	13.6	11.8
Interest expense†	81.1	73.0	68.7	63.9	59.1
EBITDA/interest coverage*§† (x)	1.5	0.9	1.2	1.7	1.9
Cash and liquid assets	111.2	150.0	141.8	155.8	171.0

*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.

Ratings Score Snapshot

Table 2

Hyde Housing Association Ratings Score Snapshot

Key rating factors	Scores
Industry Risk	3
Economic fundamentals and market dependencies	2

Table 2

Hyde Housing Association Ratings Score Snapshot (cont.)

Key rating factors	Scores
Strategy and management	3
Asset quality and operational performance	2
Enterprise profile	3
Financial performance	5
Debt profile	3
Liquidity	2
Financial policies	2
Financial profile	3

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: Group Rating Methodology, July 1, 2019
- 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: 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 Ratings Score Snapshot: July 2020, July 14, 2020
- Global Social Housing Ratings Risk Indicators: July 2020, July 14, 2020
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, April 24, 2020
- U.K. Social Housing Providers Should Remain Largely Resilient To Short-Term Economic Difficulties From COVID-19, April 23, 2020
- COVID-19: Emerging Market Local Governments And Non-Profit Public-Sector Entities Face Rising Financial Strains, April 6, 2020
- U.K. Social Housing Ratings History: February 2020, March 3, 2020
- Why Most Rated U.K. Social Housing Providers Are At Home In The 'A' Category, Dec. 3, 2019

- Credit FAQ: How S&P Global Ratings Assesses Industry Risk For English Social Housing Providers, Aug. 6, 2018

Ratings List

Ratings Affirmed	
Hyde Housing Association Ltd	
Issuer Credit Rating	A/Stable/--
Senior Secured	A
Martlet Homes Ltd.	
Senior Secured	A