S&P Global
Ratings

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Research Update:

U.K. Social Housing Provider Hyde Housing Association Upgraded To 'A+'; Outlook Stable

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Overview

- Long-term presale arrangements with institutional investors will reduce U.K.-based Hyde Housing Association Ltd.'s (Hyde's) direct exposure to market volatility, in our view.
- We expect that the recent refinancing of relatively expensive debt following a £400 million bond issuance in 2020 will result in stronger debt service coverage.
- We therefore raised our long-term issuer credit rating on Hyde to 'A+' from 'A'. The outlook is stable.

Rating Action

On July 22, 2021, S&P Global Ratings raised its long-term issuer credit rating on U.K. social housing provider Hyde to 'A+' from 'A'. The outlook is stable.

We also raised our issue rating to 'A+' from 'A' on Hyde's £650 million senior secured bonds and on the £400 million senior secured bond issued by Martlet Homes Ltd., because we consider this entity to be a core subsidiary of Hyde.

Outlook

The stable outlook reflects our view that Hyde's reduced sales risk and still-solid operating performance in the main area of operations offsets pressure on S&P Global Ratings-adjusted EBITDA margins.

Downside scenario

We could lower the rating if management's strategy shifts to debt-funded development of homes for outright sale, indicating a higher-than-anticipated appetite for risk exposure. We think this could reduce the group's profitability and weigh on its debt service coverage. We could also lower the rating if we assessed the likelihood of support from the government to have weakened.

Upside scenario

An upgrade would depend on Hyde's financial performance strengthening significantly, with the adjusted EBITDA margins exceeding 30% on a sustained basis. At the same time, we would expect to see a further improvement of the group's credit metrics, with debt to nonsales EBITDA approaching 15x, and nonsales EBITDA interest exceeding 1.75x on a sustained basis.

Rationale

The upgrade reflects our view that long-term presale arrangements with institutional investors will reduce Hyde's direct exposure to sales risk. In our view, this would reduce any potential volatility stemming from sales activities and would provide a more stable and predictable income stream for Hyde. We also expect that recent refinancing of relatively expensive debt, following a £400 million bond issuance in August 2020, will result in stronger debt service coverage than we had previously assumed. In our view, these are positive steps taken by the management of Hyde to reduce risk in the business and strengthen the group's credit metrics on a sustained basis.

Hyde has entered into a pre-sale arrangement with M&G Investments (M&G) which means that M&G's Shared Ownership Fund, a registered for-profit social housing provider, would acquire newly developed shared ownership units from Hyde at a predetermined price, for subsequent sale on the open market. We consider that this transfers the sales risk to M&G and as such we exclude these sales when we assess Hyde's overall risk exposure to sales income. We understand that Hyde, in order to bring in institutional capital to support the funding and development of homes, is looking at other models, including mixed tenures. While we expect that Hyde's sales risk would decrease on a sustained basis over time, it is our view that Hyde still takes on the construction risk once the development of a scheme has started, including the risk that cost overruns reduce margins on the presold units, or that the sales income from M&G would be delayed if Hyde's completion and handover of the units are delayed for any reason.

In our view, the group's risk management has strengthened, given the steps taken to reduce risk across the business. We also consider the recent refinancing of expensive legacy debt to be a positive step, as it would lower the group's interest costs. Hyde used proceeds from the £400 million bond issued in August 2020 (of which £50 million was retained for later issuance), at a coupon of 1.75%, to repay more than £215 million of debt carrying interest at about 8%. We see Hyde's liquidity position as excellent, providing further evidence of the prefunding of development projects. However, it is our view that the departure of the group's CEO on July 1, 2021, adds some uncertainty as to the longer-term management and strategic direction of the group.

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 Regulator for Social Housing (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 providers in England can develop homes for outright sale, using the proceeds as an alternative funding source, however, we think that this exposes them to risks and potential volatility compared with providers in other regions. Providers in England are also subject to negative intervention from the U.K. government in the form of constraints on rent setting or additional spending responsibilities, without adequate additional funding. In our view, this weighs on the regulatory framework assessment.

We understand that Hyde's stock rationalization program has largely completed, in line with its focus on its existing core areas of operation in London and southeast England, but that void disposals will continue. We think that in combination with increasing investments in Hyde's existing stock, this could strengthen the group's asset quality. Furthermore, the difference between Hyde's average social and affordable rent has consistently been below 50% of market rent, which supports demand prospects for Hyde's homes. This is also evidenced by Hyde's low void levels, which at less than 0.5% are below the average for the sector.

Given the investment in existing stock to meet enhanced building and fire safety standards, as well as making the stock more energy efficient, we forecast that Hyde's adjusted EBITDA margins will weaken through fiscal year (FY) ending March 31, 2024, to just above 20%, from an estimated 28% in FY2021. Built into our forecast is also the forward sales program with institutional investors such as M&G, which comes at lower margins, thereby also weighing on the group's wider margins. At the same time, we anticipate that the group's interest costs will decrease, which--if supported by solid EBITDA through the forecast three-year period--should result in a solid strengthening of the group's interest coverage. We project that Hyde's adjusted nonsales EBITDA interest cover has strengthened significantly, and expect it to remain at about 1.6x through the forecast period, with the debt to nonsales EBITDA relatively stable at about 18x.

We believe there is a moderately high likelihood that Hyde would receive extraordinary support from the government via the RSH in case of financial distress. This provides a one-notch uplift from the stand-alone credit profile (SACP). As one of the key goals of the RSH is to maintain lender confidence and low funding costs across the sector, we believe the RSH is likely to step in to try to prevent a default in the sector. The RSH has a record of mediating mergers or arranging liquidity support from other registered providers in cases of financial distress, and we think this would apply to Hyde.

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 3.5x over the next 12 months.

Sources of liquidity include:

- Cash of more than £160 million;
- Cash flow from operations adjusted for noncash cost of sales of about £180 million;
- Available funds under undrawn committed facilities expiring beyond 12 months of £680 million; and
- Grants and proceeds from fixed-asset sales exceeding £100 million.

Uses of liquidity include:

- Capital expenditure including development spending on homes for sale exceeding £220 million; and
- Debt service (including interest costs) of close to £90 million.

Key Statistics

Table 1

Hyde Housing Association Ltd.--Key Statistics

	--Year ended March 31--				
Mil. £	2020a	2021e	2022bc	2023bc	2024bc
Number of units owned or managed	48,287	48,702	48,925	46,734	47,504
Adjusted operating revenue	352.0	353.4	357.3	405.8	504.6
Adjusted EBITDA	62.9	98.3	102.6	95.9	102.6
Nonsales adjusted EBITDA	54.3	85.0	91.5	86.1	86.1
Capital expense	178.1	120.0	218.3	240.1	301.9
Debt	1,523.8	1,598.7	1,587.5	1,560.6	1,519.4
Interest expense	73.2	61.7	54.7	54.1	52.9
Adjusted EBITDA/Adjusted operating revenue (%)	17.9	27.8	28.7	23.6	20.3
Debt/Nonsales adjusted EBITDA (x)	28.1	18.8	17.3	18.1	17.7
Nonsales adjusted EBITDA/interest coverage(x)	0.74	1.38	1.67	1.59	1.63

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 Ltd.--Ratings Score Snapshot

	Assessment
Enterprise risk profile	2
Industry risk	2
Regulatory framework	3
Market dependencies	1
Management and governance	2
Financial risk profile	3
Financial performance	4
Debt profile	4
Liquidity	1

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

- 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

- Global Regulatory Framework Report Card For Public And Nonprofit Social Housing Providers Published, June 8, 2021
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, April 23, 2021
- Building Up Debt: U.K. Social Housing Sector Braces Itself For Borrowing, March 16, 2021
- Global Social Housing Ratings Score Snapshot: December 2020, Dec. 10, 2020
- Global Social Housing Ratings Risk Indicators: December 2020, Dec. 10, 2020
- Outlook 2021: Strong Liquidity Should Help Social Housing Providers Remain Resilient, Dec. 8, 2020
- ESG Industry Report Card: Public And Nonprofit Social Housing Providers Outside The U.S., Aug. 4, 2020

Ratings List

Upgraded

	To	From
Hyde Housing Association Ltd		
Issuer Credit Rating	A+/Stable/--	A/Stable/--
Hyde Housing Association Ltd		
Senior Secured	A+	A
Martlet Homes Ltd.		
Senior Secured	A+	A