S&P Global Ratings

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Research Update:

U.K. -Based Housing Association bpha Ltd. 'A+' Rating Affirmed: Outlook Remains Negative

October 26, 2020

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Overview

- We expect housing association bpha Ltd. to continue focusing on the development of affordable housing in the East of England, where the group operates a very strong asset base.
- We forecast that liquidity will remain very strong but that the group's debt metrics will deteriorate over the two-year forecast period, due to increasing investment in existing stock and lower sales receipts as a result of the COVID-19 pandemic, leading to weakening interest coverage.
- We are therefore revising downward our stand-alone credit profile (SACP) for bpha to 'a' from 'a+', and affirming our 'A+' long-term issuer credit rating on the group based on one notch of uplift that we apply to the SACP to reflect government support.
- The negative outlook reflects our view that the group's financial position is becoming increasingly stretched amid economic uncertainty.

Rating Action

On Oct. 26, 2020, S&P Global Ratings affirmed its 'A+' long-term issuer credit rating on U.K.-based social housing association bpha Ltd. The outlook remains negative.

We also affirmed our 'A+' long-term rating on the £350 million senior secured bonds issued by bpha Finance PLC.

Rationale

Bpha's ability to generate most of its income from stable low-income social housing rental activities has supported the group's operations through COVID-19-related headwinds. Delays in development have resulted in bpha slightly re-profiling its sales program by 300 units, until the financial year ending March 31, 2023 (FY2023). This will result in lower sales receipts over the FY2021-FY2023 forecast period. Combined with increasing investment in existing stock, we expect the group's funding needs to rise and debt metrics to deteriorate over FY2021-FY2023.

We have revised downward the SACP (which reflects bpha's intrinsic creditworthiness) to 'a' from 'a+'. This takes into account its weaker credit metrics, with profitability dropping below 40%, adjusted debt to EBITDA of around 17.5x over FY2021-FY2023, and EBITDA interest coverage of about 1.3x over the same period. The 'A+' rating on bpha now incorporates one notch of uplift from the SACP, reflecting our view that there is moderately high likelihood that the entity would receive extraordinary support in case of financial distress. Bpha'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 bpha 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 track record of being willing and able to provide extraordinary support on a timely basis.

Bpha's very strong enterprise profile is underpinned by its high proportion of revenues derived from traditional social housing lettings activities, its dynamic area of operations, and its excellent asset quality. The group operates across the East of England, with core operating areas in Oxfordshire, Bedfordshire, and Cambridgeshire. This region remains one of the most dynamic in the country in terms of economic fundamentals, supported by investment in infrastructure--such as the East-West rail extension--which promotes job creation. The group benefits from stronger operational metrics than peers', with voids accounting for just 1% of rent and service charges over the past two years.

Management has a strong focus on asset quality and environmental policy, having designated "sustainability" as one of its five key principles in its corporate strategy. The group's policies go beyond the government's Decent Homes Standards and look at carbon footprint, energy efficiency for tenants, construction best practices, and value for money. An integral part of bpha's asset strategy is its tower block project; it expects to refurbish 14 tower blocks over the next 10 years to meet its environmental standards. The increased capital investment in existing stock supports the group's excellent asset quality but will also weigh on profitability over the forecast period.

We now expect adjusted EBITDA margins to drop below 40% across the forecast period, driven by three main factors: a small temporary effect from the COVID-19 pandemic, a sustained increase in capitalized repairs, and the addition of lower-margin outright sales into the tenure mix. We forecast revenue from sales activities will average 21% of total revenue over our forecast period, peaking at 26% in FY2023. These activities carry lower margins than the group's traditional lettings tenure for which operating margins stand at around 40%. We expect margins to suffer more pressure in FY2022 and FY2023, years in which we expect higher sales exposure. In addition, we believe a small increase in short-term arrears due to the pandemic will be mostly recoverable, and consider the residual rent losses as a one-off event. We generally see the social housing sector as anti-cyclical, given that during economic downturns demand for these services may increase.

We expect bpha to develop around 1,300 affordable units and about 90 units for outright sale over FY2021-FY2023. We expect 69% of the development will be for affordable lettings, 34% for shared ownership, and 6% for private sale. We view bpha's management as having extensive experience in the social housing sector, with a development strategy aligned to its capabilities, and limited appetite for sales exposure. We do not expect bpha's exposure to sales to exceed one third of revenues.

Ongoing development efforts, combined with higher capital investment in existing assets and lower sales receipts due to the outbreak of COVID-19, will increase the nominal debt burden. We now expect debt to EBITDA to remain 17.5x on average over the forecast period, compared with our previous expectation of below 15x. Interest coverage will also weaken, averaging 1.3x over

FY2021-FY2023. We take into account that income from non-sale traditional activities will just cover interest costs through 2023 (1.1x on average for FY2021-FY2023).

Liquidity

We view liquidity as a rating strength for bpha, underpinned by the group's strong financial policies. The group has established a target of maintaining funding facilities sufficient to cover two years of development expenditure at all times. Our view of its very strong liquidity is supported by a high level of committed undrawn bank facilities and its potential to generate cash consistently in our base case. We estimate sources to cover uses by 2.5x.

Bpha's sources of liquidity are:

- Adjusted internal cash flow generation for the next 12 months of £68 million.
- Cash and liquid investments of £79 million.
- Proceeds from asset sales of £13 million.
- The undrawn part of its contracted and secured bank facilities maturing beyond 12 months, amounting to £215 million.

The company's uses of liquidity are:

- Expected capital expenditures (capex) adjusted for cost of sales and capitalized repairs, amounting to £103 million.
- Interest and principal repayment of £48 million.

We view bpha's access to external liquidity as satisfactory.

Outlook

The negative outlook on bpha reflects our view that the group's financial position is becoming increasingly stretched amid the Brexit and pandemic-related economic uncertainty, and that we could lower the rating if, over the next two years, higher than expected capex or maintenance spend lead to further debt accumulation. This would entail debt to EBITDA exceeding 20x or non-sales interest coverage dropping below 1x. We could also lower the rating on bpha if we lowered the rating on the U.K. government or if we estimated that there was a lower likelihood of the group receiving timely and sufficient extraordinary support from the U.K. government, through the RSH, in the event of financial distress.

A revision of the outlook to stable would depend on the group proving more profitable than our base case, with debt remaining moderate below 15x adjusted EBITDA. Under this scenario, we would expect liquidity to remain strong at above 1.75x.

Key Statistics

Table 1

bpha Ltd. Key Statistics

	--Year ended March 31--				
(Mil. £)	2019a	2020e	2021bc	2022bc	2023bc
Number of units owned or managed	18,721	19,235	19,583	20,005	20,524
Revenue§	124.3	126.0	127.1	136.5	156.1
Share of revenue from sales activities (%)	20.7	18.4	17.5	19.0	25.8
EBITDA§†	57.5	54.8	49.6	51.8	59.7
EBITDA/revenue §†(%)	46.3	43.5	39.0	38.0	38.3
Capital expense†	124.7	85.8	73.3	117.3	92.6
Debt	787.1	855.0	878.5	947.9	969.6
Debt/EBITDA §†(x)	13.7	15.6	17.7	18.3	16.2
Interest expense*	36.9	38.0	38.9	41.0	43.0
EBITDA/interest coverage§†* (x)	1.6	1.4	1.3	1.3	1.4
Cash and liquid assets	26.4	59.8	47.6	43.9	37.3

§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

Table 2

bpha Ltd. Ratings Score Snapshot

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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
- 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

- ESG Industry Report Card: Public And Nonprofit Social Housing Providers Outside The U.S., Aug. 4, 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
- Global Social Housing Ratings Score Snapshot: December 2019, Dec. 2, 2019
- Global Social Housing Risk Indicators: December 2019, Dec. 2, 2019

Ratings List

Ratings Affirmed	
bpha Ltd.	
Issuer Credit Rating	A+/Negative/--
bpha Finance PLC	
Senior Secured	A+