FitchRatings

RATING ACTION COMMENTARY

Fitch Affirms A2Dominion Housing Group at 'A'; Outlook Stable

Mon 31 Oct, 2022 - 8:06 AM ET

Fitch Ratings - London - 31 Oct 2022: Fitch Ratings has affirmed A2Dominion Housing Group Limited's (A2D) Long-Term Foreign- and Local-Currency Issuer Default Rating (IDR) at 'A' with a Stable Outlook and Short-Term IDR at 'F1+'. A2D's Standalone Credit Profile (SCP) is 'a-'.

A2D's ratings reflect continuing high demand for social and affordable housing across the UK, despite Covid-19 and Brexit. Ongoing cash flow from rented properties supports robust financial performance, alongside considerable grant funding from the Greater London Authority (GLA), within an industry that is tightly regulated by the Regulator of Social Housing (RSH). Diversification into non-core business should allow A2D to maintain sufficient revenues for debt servicing, as well as cross-subsidising its core business.

As one of the largest providers in London, A2D has seen significant exposure to fire-safety costs, which has put pressure on its metrics in the past few years. As remediation works progress, Fitch expects A2D's net adjusted debt/EBITDA to recover to below 12x by financial year ending 31 March 2025 (FY25) in the rating case.

KEY RATING DRIVERS

Status, Ownership and Control:

A2D is a private, not-for-profit, registered provider (RP) of social housing (SH) in the UK, and as such it is not under the ownership of the UK government, due to its structure and status: in strict terms it has no legal owner. We view the regulatory framework for English SH as having a robust legal basis, and the Regulator of Social Housing (RSH) as maintaining sound control and tight monitoring of RPs. The regulator's history of oversight and (non-financial) intervention in (rare) cases of distress is a key factor behind the sector's solidity. In the event of financial distress, we expect a transfer of assets and liabilities to another RP within the sector under the direction of the RSH.

Support Track Record:

Policy influence is moderately supportive of the financial stability of RPs. Regulatory restrictions on government support are unlikely to prevent timely intervention in exceptional circumstances. A2Dominion receives financial support through grants from the GLA for affordable development, as part of its Affordable Development Programme. This is on an ongoing basis to support development, not to finance debt or prevent default.

The regulator assesses governance and financial viability every 18-36 months, depending on an RP's size, to assess the need for intervention. A2D's current regulatory judgement is G1/V2 for governance and viability respectively, the highest possible score for governance and the second highest for viability, reflecting its ambitious development programme.

Socio-Political Implications of Default:

In the unlikely event of financial default, other RPs can act as substitutes with only minor or temporary disruption to the service offered by A2D. A2D's development plan may have to be scaled down to adapt to its new financing capacity, which limits its ability to provide housing in general.

Financial Implications of Default:

Default would have a minimal impact on either the availability or cost of domestic financing of other RPs. Fitch believes that a default would be treated as an isolated case of mismanagement or viability issues and should, therefore, not affect the sector.

Standalone Credit Profile

Revenue Defensibility:

Demand for SH remains strong and any change in the rents that RPs are able to charge would be unlikely to materially affect demand. Nevertheless, our assessment of revenue is somewhat constrained by the lack of control RPs have on rents. The affordable and social revenue stream is highly regulated, with rents in SH reducing by 1% per year between 2016 and 2020. From 1 April 2020, increases to social rent of CPI +1% were put in place for the next five years.

In September 2022 a consultation was announced to cap social and affordable rents temporarily at 3%,5%, or 7% due to high levels of inflation. We have considered this as part of our pricing assessment and believe it to be a variation on existing caps and maintaining revenue at levels sufficient to maintain solvency, in line with our assessment. However, Fitch expects revenue from housing benefits as a percentage of total revenue to eventually fall, due to increased revenue from non-SH activity. RPs have the flexibility to collect enough non-SH revenue to cover all costs.

Operating Risk:

A2D has well-identified cost drivers and low potential volatility in major items. It has material capex in its development plans in the medium term but has flexibility to scale back committed schemes, defer uncommitted schemes as well as switch tenure from sale to market rent. It has a low proportion of staff costs in comparison with peers, equating to less than 20% of operating costs.

A2D owns or manages 74 high-rise buildings, which could be subject to fire safety costs. All have had intrusive fire-safety inspections. Almost all of its mid-rise buildings have been inspected, and inspections continue on its low-rise stock, with all inspections expected to be complete by the end of the financial year ending in March 2023. GBP42 million has been claimed from the government's Building Safety Fund in relation to this, with GBP7.7 million approved and GBP24.5 million pending approval. A2D anticipates costs of around GBP177 million, of which it expects GBP88 million to be recoverable from third parties either through the government's Building Safety Fund or Building Safety Pledge.

A2D will use its stock rationalisation proceeds to reinvest in existing stock and develop new assets, and expects proceeds of around GBP200 million from selling non-core assets. The group can operate within its stressed net debt limits even if these proceeds are delayed.

A2D has already stress-tested and run multi-variable scenarios for its business plan (BP). The scenarios include loan portfolios being repriced at higher lending margins, sales prices falling, delays in sales, inflation, increasing arrears and bad debt as well as political factors such as further rent reductions. To mitigate these effects and to be able to comfortably meet covenants, A2D has put forward corrective measures, including pre-emptive and responsive actions. Fitch will continue to monitor the resilience of A2D and assess its ability to overcome possible further turmoil. We will also closely review the robustness of its stress testing relative to its ratings and assess its flexibility to adapt to new market conditions.

Financial Profile:

We expect A2D's performance to improve, 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 units will be re-invested in the RP to continue to build and provide affordable social units.

A2D is now one of the largest RPs in London and the south-east of England with around 39,000 units. It reported GBP466 million operating revenue in FYE22. EBITDA was GBP116 million (this includes A2D's share of operating profit from joint ventures). Debt at FYE22 remained stable at GBP1.7 billion and is expected to increase slightly to GBP1.9billion by FYE27. Fitch expects net debt/Fitch-calculated EBITDA to remain below 12x from FYE25 onwards. Our rating case forecasts operating revenue (including A2D's share of operating profit from joint ventures) to average around GBP460 million over the five years to FYE27.

A2D has no group covenants. However, there are interest cover and gearing covenants within its two main subsidiaries, A2D Homes and A2D South. These covenants are met within the BP and in the stress- tested BPs, albeit with diminished headroom. Over the last decade, A2D has developed over 7,400 properties, and currently has around 3,300 in its development pipeline. The tenure split is expected to be 25% private sale and 75% affordable rent, private rent, and shared ownership.

A2D is in a strategic partnership with the GLA as part of its 2016-21 Affordable Homes Programme (now extended to 2023). It has secured GBP111.5 million in grant funding, or around GBP112,000 per unit delivered. Of the units, 60% will be for affordable tenures. A2D's profile is supported by high-value assets based in London, with significant sale values, if needed, to maintain operations and repay debt, as well as EBITDA/cash interest coverage above 1.3x across the rating case.

Derivation Summary

The 'a-' SCP is driven by our assessment of 'Stronger' revenue defensibility, operating risk and financial profile, and a comparison with peers in the sector.

We view A2D as a government-related entity (GRE) in the UK, with a score of 12.5 points based on our assessment of government support. This results in a bottom-up approach, with a one-notch uplift to the SCP to arrive at the Long-Term 'A' IDR, reflecting modest links with the government and a robust regulatory environment.

A2D's Short-Term 'F1+' IDR reflects the combination of a 'Stronger' revenue defensibility and a strong liquidity cushion and liquidity coverage ratio.

Short-Term Ratings

A2D's 'F1+' Short-Term IDR is in line with its 'A' IDR and takes into account the neutral liquidity assessment.

Liquidity and Debt Structure

Total drawn debt remained stable in FY22 at just below GBP1.7 billion, out of total debt of GBP2.2 billion. A2D had GBP476 million revolving credit facility (GBP388 million secured undrawn) at 31 March 2022, and the group held GBP97 million in cash.

Issuer Profile

A2D is one of the largest SH RPs in the south of England, with around 39,000 total units. It is a member of the G15 group of London's largest housing associations. A2D operates in London and throughout the south-east of England, with a strong presence in Ealing, Bromley and Oxford through A2Dominion Homes, and in Staines and Winchester through A2Domion South. The group operates across 83 local authorities, of which 10 are key partners.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to negative rating action/downgrade:

A multi-notch downgrade of the sovereign's ratings, deterioration of net debt/EBITDA to above 12x on a sustained basis or an adverse change to our assessment of key rating factors.

Factors that could, individually or collectively, lead to positive rating action/upgrade:

A sustained improvement in net debt/ EBITDA towards 10x in the medium term or a favourable change in our assessment of key rating factors.

ESG Considerations

Unless otherwise disclosed in this section, the highest level of ESG credit relevance is a score of '3'. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity, either due to their nature or the way in which they are being managed by the entity. For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg

PUBLIC RATINGS WITH CREDIT LINKAGE TO OTHER RATINGS

A2D's ratings are currently bottom-up plus 1, capped at the UK sovereign minus 1. This is based on the GRE score of 12.5, and the fact that A2D's SCP is between one and three notches away from the sovereign.

Best/Worst Case Rating Scenario

International scale credit ratings of Sovereigns, Public Finance and Infrastructure issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

References for Substantially Material Source Cited as Key Driver Rating

The principal sources of information used in the analysis are described in the Applicable Criteria.

RATING ACTIONS

ENTITY / DEBT	RATING			PRIOR
A2Dominion Housing Group Limited	LT IDR	A Rating Outlook Stable	Affirmed	A Rating Outlook Stable
	ST IDR	F1+	Affirmed	F1+
	LC LT IDR	A Rating Outlook Stable	Affirmed	A Rating Outlook Stable
	LC ST IDR	F1+	Affirmed	F1+
senior unsecured	LT	A	Affirmed	A

A2D Funding II plc				
senior unsecured	LT	A	Affirmed	A

VIEW ADDITIONAL RATING DETAILS

FITCH RATINGS ANALYSTS

Michael Brooks, ACA
Associate Director
Primary Rating Analyst
+44 20 3530 1409
michael.brooks2@fitchratings.com
Fitch Ratings Ltd
30 North Colonnade, Canary Wharf London E14 5GN

Paul Norris
Director
Secondary Rating Analyst
+61 2 8256 0326
paul.norris@fitchratings.com

Samuel Kwok, CFA, CAIA
Regional Head of APAC IPF, Senior Direct
Committee Chairperson
+852 2263 9961
samuel.kwok@fitchratings.com

MEDIA CONTACTS

Athos Larkou
London
+44 20 3530 1549
athos.larkou@thefitchgroup.com

Additional information is available on www.fitchratings.com

PARTICIPATION STATUS

The rated entity (and/or its agents) or, in the case of structured finance, one or more of the transaction parties participated in the rating process except that the following issuer(s), if any, did not participate in the rating process, or provide additional information, beyond the issuer's available public disclosure.

APPLICABLE CRITERIA

Government-Related Entities Rating Criteria (pub. 30 Sep 2020)

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 01 Sep 2021) (including rating assumption sensitivity)

ADDITIONAL DISCLOSURES

Dodd-Frank Rating Information Disclosure Form

Solicitation Status

Endorsement Policy

ENDORSEMENT STATUS

A2D Funding II plc	UK Issued, EU Endorsed
A2Dominion Housing Group Limited	UK Issued, EU Endorsed

DISCLAIMER & DISCLOSURES

In issuing and maintaining its ratings and in making other reports (including forecast information), Fitch relies on factual information it receives from issuers and underwriters and from other sources Fitch believes to be credible. Fitch conducts a reasonable investigation of the factual information relied upon by it in accordance with its ratings methodology, and obtains reasonable verification of that information from independent sources, to the extent such sources are available for a given security or in a given jurisdiction. The manner of Fitch's factual investigation and the scope of the third-party verification it obtains will vary depending on the nature of the rated security and its issuer, the requirements and practices in the jurisdiction in which the rated security is offered and sold and/or the issuer is located, the availability and nature of relevant public information, access to the management of the issuer and its advisers, the availability of pre-existing third-party verifications such as audit reports, agreed-upon procedures letters, appraisals, actuarial reports, engineering reports, legal opinions and other reports provided by third parties, the availability of independent and competent third- party verification sources with respect to the particular security or in the particular jurisdiction of the issuer, and a variety of other factors. Users of Fitch's ratings and reports should understand that neither an enhanced factual investigation nor any third-party verification can ensure that all of the information Fitch relies on in connection with a rating or a report will be accurate and complete. Ultimately, the issuer and its advisers are responsible for the accuracy of the information they provide to Fitch and to the market in offering documents and other reports. In issuing its ratings and its reports, Fitch must rely on the work of experts, including independent auditors with respect to financial statements and attorneys with respect to legal and tax matters. Further, ratings and forecasts of financial and other information are inherently forward-looking and embody assumptions and predictions about future events that by their nature cannot be verified as facts. As a result, despite any verification of current facts, ratings and forecasts can be affected by future events or conditions that were not anticipated at the time a rating or forecast was issued or affirmed.

The information in this report is provided “as is” without any representation or warranty of any kind, and Fitch does not represent or warrant that the report or any of its contents will meet any of the requirements of a recipient of the report. A Fitch rating is an opinion as to the creditworthiness of a security. This opinion and reports made by Fitch are based on established criteria and methodologies that Fitch is continuously evaluating and updating. Therefore, ratings and reports are the collective work product of Fitch and no individual, or group of individuals, is solely responsible for a rating or a report. The rating does not address the risk of loss due to risks other than credit risk, unless such risk is specifically mentioned. Fitch is not engaged in the offer or sale of any security. All Fitch reports have shared authorship. Individuals identified in a Fitch report were involved in, but are not solely responsible for, the opinions stated therein. The individuals are named for contact purposes only. A report providing a Fitch rating is neither a prospectus nor a substitute for the information assembled, verified and presented to investors by the issuer and its agents in connection with the sale of the securities. Ratings may be changed or withdrawn at any time for any reason in the sole discretion of Fitch. Fitch does not provide investment advice of any sort. Ratings are not a recommendation to buy, sell, or hold any security. Ratings do not comment on the adequacy of market price, the suitability of any security for a particular investor, or the tax-exempt nature or taxability of payments made in respect to any security. Fitch receives fees from issuers, insurers, guarantors, other obligors, and underwriters for rating securities. Such fees generally vary from US$1,000 to US$750,000 (or the applicable currency equivalent) per issue. In certain cases, Fitch will rate all or a number of issues issued by a particular issuer, or insured or guaranteed by a particular insurer or guarantor, for a single annual fee. Such fees are expected to vary from US$10,000 to US$1,500,000 (or the applicable currency equivalent). The assignment, publication, or dissemination of a rating by Fitch shall not constitute a consent by Fitch to use its name as an expert in connection with any registration statement filed under the United States securities laws, the Financial Services and Markets Act of 2000 of the United Kingdom, or the securities laws of any particular jurisdiction. Due to the relative efficiency of electronic publishing and distribution, Fitch research may be available to electronic subscribers up to three days earlier than to print subscribers.

For Australia, New Zealand, Taiwan and South Korea only: Fitch Australia Pty Ltd holds an Australian financial services license (AFS license no. 337123) which authorizes it to provide credit ratings to wholesale clients only. Credit ratings information published by Fitch is not intended to be used by persons who are retail clients within the meaning of the Corporations Act 2001.
Fitch Ratings, Inc. is registered with the U.S. Securities and Exchange Commission as a Nationally Recognized Statistical Rating Organization (the “NRSRO”). While certain of the NRSRO's credit rating subsidiaries are listed on Item 3 of Form NRSRO and as such are authorized to issue credit ratings on behalf of the NRSRO (see https://www.fitchratings.com/site/regulatory), other credit rating subsidiaries are not listed on Form NRSRO (the “non-NRSROs”) and therefore credit ratings issued by those subsidiaries are not issued on behalf of the NRSRO. However, non-NRSRO personnel may participate in determining credit ratings issued by or on behalf of the NRSRO.

READ LESS

SOLICITATION STATUS

The ratings above were solicited and assigned or maintained by Fitch at the request of the rated entity/issuer or a related third party. Any exceptions follow below.

ENDORSEMENT POLICY

Fitch's international credit ratings produced outside the EU or the UK, as the case may be, are endorsed for use by regulated entities within the EU or the UK, respectively, for regulatory purposes, pursuant to the terms of the EU CRA Regulation or the UK Credit Rating Agencies (Amendment etc.) (EU Exit) Regulations 2019, as the case may be. Fitch's approach to endorsement in the EU and the UK can be found on Fitch's Regulatory Affairs page on Fitch's website. The endorsement status of international credit ratings is provided within the entity summary page for each rated entity and in the transaction detail pages for structured finance transactions on the Fitch website. These disclosures are updated on a daily basis.

International Public Finance   Supranationals, Subnationals, and Agencies   Europe

United Kingdom
