FitchRatings

RATING ACTION COMMENTARY

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

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Fitch Ratings - London - 26 Oct 2023: Fitch Ratings has affirmed A2Dominion Housing Group Limited's (A2D) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDRs) at 'A' with a Stable Outlook and Short-Term IDR at 'F1+'.

The affirmation reflects Fitch's expectation that the credit profile will remain strong enough over the five-year forecast period to support the ratings, and that a single-notch downgrade of the UK sovereign IDR (AA-/Negative) would not automatically result in a downgrade of A2D's IDRs.

Fitch views A2D as a government-related entity (GRE) of the UK. Its rating is driven by its 'a-' Standalone Credit Profile (SCP), reflecting 'Stronger' revenue defensibility, operating risk, and financial profile assessments. Under Fitch's GRE Rating Criteria, A2D has a score of 12.5 points, and is therefore rated on a bottom-up plus-one basis, capped at the sponsor minus one. This leads to the 'A' Long-Term IDR.

KEY RATING DRIVERS

Status, Ownership and Control: 'Strong'

As a private, not-for-profit, registered provider (RP) of social housing (SH) in the UK, A2D is not government-owned and it has no legal owner. It operates in a robust regulatory framework. The UK Regulator of Social Housing's (RSH) record of monitoring and intervention in rare cases of distress is a key feature of the sector. In the event of financial distress, Fitch expects a transfer of assets and liabilities to another RP under the direction of the RSH.

Support Track Record: 'Moderate'

Policy influence is moderately supportive of RPs' financial stability. Regulatory restrictions on government support are unlikely to prevent timely intervention in exceptional circumstances. The RSH does not provide a direct guarantee for RP borrowers, and the government does not own the entities, but the regulator can use its statutory powers to intervene when there are serious concerns about an RP's performance. Fitch believes that RPs with difficulties would be forced to merge with larger or financially stronger entities, as has happened in a handful of cases in the past decade.

Socio-Political Implications of Default: 'Moderate'

If A2D was in financial default, which Fitch views as unlikely, other RPs could act as substitutes with only minor or temporary disruption to A2D's services.

Financial Implications of Default: 'Weaker'

Default would have only a minimal impact on the availability and cost of domestic financing for other RPs, given the number of borrowers in the market and their relative sizes.

Standalone Credit Profile

Fitch assesses A2D's SCP at 'a-', which reflects a 'Stronger' assessment of revenue defensibility and operating risk. It also reflects a leverage ratio (net adjusted debt/EBITDA) that Fitch expects to improve below 12x from the financial year ending 31 March 2025 (FY25) under its rating-case scenario, in line with some of its Fitch-rated peers with a 'a-' SCP.

Revenue Defensibility 'Stronger'

This assessment is based on 'Stronger' demand and pricing characteristics. Demand in the UK for SH remains high, and any change in the rents that providers charge is unlikely to materially affect demand. The UK government sets the threshold for annual social rent increases via the Rent Standard, but A2D has flexibility over pricing for its non-social lettings activity, which it uses to cross-subsidise the core business. Fitch believes the regulatory framework aims to maintain sector solvency.

Operating Risk 'Stronger'

Operating risk covers operating costs, resource management, and capital planning. A2D has well-identified cost drivers and low potential volatility in major items. Its business plan includes GBP177 million for fire safety (of which GBP88 million will be recoverable), and GBP91 million on its sustainability programme. It has no material supply constraints on labour or resources. A2D has material capex in its medium-term development plans but has flexibility to scale back committed schemes, defer uncommitted ones, and to switch tenure from sale to market rent or affordable rent, supported by grant funding.

Financial Profile 'Stronger'

The financial profile is assessed at 'Stronger' due to comparison with peers with the same SCP.

Under its rating case, Fitch expects A2D's turnover to average GBP350 million in FY24-FY28, with EBITDA averaging GBP103 million a year. Debt at end-FY23 was at GBP1.581 billion and is expected to gradually decline over the rating case to reach GBP1.230 billion by end-FY28. Despite the envisaged material capex plan, including a large reinvestment plan, we expect net adjusted debt to EBIDTA to remain high in FY24 before falling below 12x between FY25-FY28 from the current 20x.

The improved performance will be substantially helped by the impact of disposing of all private rental stock over three years, which has received board approval as A2D wants to disinvest from this sector, as well as a pilot phase of the stock rationalisation programme. This results in no additional borrowing requirements until FY29, leading to a lowering of net debt/EBITDA, and reflected in the Stable Outlook.

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.

Fitch views A2D as a UK GRE, 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 from the SCP to the Long-Term 'A' IDR, reflecting modest links with the government and a robust regulatory environment.

Short-Term Ratings

A2D's Short-Term 'F1+' IDR is the higher of two options mapping to a 'A' Long-Term IDR, reflecting the combination of 'Stronger' revenue defensibility and strong liquidity cushion and coverage ratios.

Debt Ratings

Fitch rates A2D's senior secured and unsecured debt issuances, which are unconditional, unsubordinated, and rank pari-passu with all other debt in the group, in line with the 'A' IDR.

Liquidity and Debt Structure

The economic environment changed rapidly in 2022, with market volatility and rising inflation contributing to higher interest rates and gilt yields, wider spreads on public bonds, and a slowdown in bond issuance. However, the issuance that did take place in the SH sector was over-subscribed, highlighting investor demand.

On average, 41% of funding for A2D's new units is external (loans), 39% is from surpluses, and 20% is from government grants. A2D's debt is similar to sector peers, spread across bonds, a revolving credit facility, and term loans, with limited near-term maturity. At 31 March 2023, drawn debt totalled nearly GBP1.58 billion, of a total GBP2.2 billion, and 41% of this was bank loans, with margins ranging from 0.325% to 5.97% (fixed). The weighted average cost of funds on group debt was 4.33%. A2D had a GBP512 million revolving credit facility (GBP386 million secured undrawn) at 31 March 2023, and the group held GBP37 million in cash.

Issuer Profile

A2D is one of the largest RPs of SH in the south of England, with about 39,000 units. It is a member of the G15 group of London's largest housing associations.

RATING SENSITIVITIES

Factors that Could, Individually or Collectively, Lead to Negative Rating Action/Downgrade

Inability to maintain net debt/EBITDA below 12x on a sustained basis, a multi-notch downgrade of the sovereign's ratings, 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 below 10x in Fitch's rating case or a favourable change in our assessment of key rating factors.

ESG Considerations

The highest level of ESG credit relevance is a score of '3', unless otherwise disclosed in this section. A score of '3' 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. Fitch's ESG Relevance Scores are not inputs in the rating process; they are an observation on the relevance and materiality of ESG factors in the rating decision. For more information on Fitch's ESG Relevance Scores, visit https://www.fitchratings.com/topics/esg/products#esg-relevance-scores.

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

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APPLICABLE CRITERIA

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

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 27 Apr 2023) (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

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