

## **FITCH AFFIRMS 3 ENGLISH SOCIAL HOUSING REGISTERED PROVIDERS; OUTLOOKS STABLE**

Fitch Ratings-Barcelona/London-07 July 2017: Fitch Ratings has affirmed A2Dominion Housing Group and Great Places Housing Association's Long-Term Issuer Default Ratings (IDR) at 'A+' and Origin Housing Limited's Long-Term IDR at 'A'. The Outlooks are Stable. A full list of rating actions is below.

Fitch believes the three registered providers (RPs) are still showing strong performance despite the challenges that have affected the sector over the last few years. Continued high demand for social and affordable housing, implemented cost-efficiency measures and diversification into non-core business, should allow the RPs to maintain adequate revenues sufficient for debt servicing, as well as cross-subsidising the core business. Additionally, the reduced development plans are likely to limit debt growth pressure.

The Stable Outlooks reflect Fitch's view that developments will not have a material negative impact on the sector despite the weakened operating environment and increased challenges faced by RPs in England. The possible impact of Brexit on the sector, although still uncertain, appears less evident than on other public finance sectors, such as higher education or healthcare, although the possible consequences have already been factored into in RPs' stress tests. At the same time, the Homes and Communities Agency continues its strong oversight.

### **KEY RATING DRIVERS**

Fitch rates social housing RPs in England under its Revenue Supported Rating Criteria and takes into account factors such as revenue defensibility, operating risk and the RPs' financial profile assessment. We also incorporate public support factors, notably the strong predictability of the RPs' cash flow through direct and indirect government funding. Fitch also applies the Public Sector Entity Criteria whereby RPs in England are assessed as non-credit linked entities and a one-notch uplift is applied to the standalone ratings. This reflects the assessment of substitution of services by other RPs, ratings relative to the indirect sponsor, borrowing options, moral hazard and strong regulatory oversight and likelihood of extraordinary support from the government, although this is not certain. As a consequence of this approach, RPs' ratings do not automatically move in line with those of the UK sovereign.

#### **Revenue Defensibility: Strong/Midrange**

Demand for social housing remains strong across the country and any change in the rents that RPs are able to charge would be unlikely to materially affect demand. Nevertheless, assessment of revenue is constrained by the lack of control RPs have on rents. The supportive regulatory regime aims to maintain compensation for services at a level consistently supporting solvency for not-for-profit of an essential public service. However, Fitch expects the revenue from housing benefits as a percentage of total revenues to eventually fall, due to the increased revenues from non-social housing activity in order to finance development plans to compensate for rent cuts and reduced grants.

#### **Operating Risk: Strong**

The sector has well-identified cost drivers and low potential volatility in major items. The RPs have material capex on their development plans in the medium term but have opportunities to slow down committed schemes, defer uncommitted schemes as well as switch tenure from sale to market rent.

Regarding resource management risk, there are unlikely to be supply constraints for labour or resources. The RPs have factored the Brexit vote and its potential impact on the UK economy, public finances and political continuity into their stress testing. The implications for the sector will primarily be continued uncertainty and short to medium-term turbulence in the financial and housing markets, which may lead RPs to further delay any planned bond issuances, and put pressure on refinancing. Nevertheless, during FY17, A2Dominion established a GBP1 billion EMTN programme and issued GBP250 million 3.5% unsecured 12-year bonds, the group's lowest coupon to date. Origin also took advantage of rates to obtain GBP30 million new funding at 3.07% for 15 years through a private placement.

The RPs have already stress tested and ran multi-variable scenarios for their Business Plans (BPs). Critical variants include loan portfolios being repriced at higher lending margins, sales prices falling, delays in sales, inflation and increasing arrears and bad debt and political factors including further rent reductions. To mitigate these effects and to be able to comfortably meet covenants, the RPs have put forward corrective measures, including pre-emptive and responsive actions. Fitch will continue to monitor the resilience of the RPs and assess their ability to overcome possible further turmoil. We will also closely review the robustness of the stress testing of the RPs relative to their ratings, including the impact of the Brexit vote on their BPs, and we will assess the flexibility the rated RPs have to adapt to new market conditions and funding options.

#### Financial Profile: Stronger/Midrange

All three RPs have maintained a strong performance and we expect performance will improve, aided by continued but conservative development plans. Profits from the sale of private sale units will be re-invested in the RPs in order to continue to build and provide affordable social units. Over half and up to 80% of total turnover continues to come from social housing lettings, despite increases in sale and other non-social housing activity. Debt will continue to increase to fund capital expenditure on development programmes.

A2Dominion is now one of the largest RPs in London and the south-east of England with over 36,500 units. It reported GBP378 million turnover in FY16 and an operating surplus of GBP113 million. Debt at FYE17 rose to GBP1.56 billion and is expected to be GBP1.59 billion in FY22. Turnover is forecast to rise to GBP547 million in FY22 with the operating surplus at GBP142 million in the same year. The tightest interest cover covenant of 1.1x as well as the tightest gearing covenant of 65% are met across the BP and stress tests by all subsidiaries, albeit with diminished headroom. A2D has developed just under 10,500 units in the last decade and its strategy for 2015-2020 is to develop a further 4,500-6,000 units. The tenure split is expected to be 20% affordable rent, 20% shared ownership, 20% private rent and 40% private sale, although this is currently under review.

Great Places now manages just under 19,000 units in northern England and the Midlands. The group reported turnover of over GBP100 million in FY16 and an operating surplus of GBP28 million. Debt rose to GBP545 million at FYE17 and is forecast to peak at GBP584 million in FY19 over the next 5 years. Total turnover is forecast to rise to GBP124 million in FY22 and operating surplus to GBP36 million in the same year. The operating margin is expected to range between 30-34%, interest cover is expected to remain well above the golden rule level of 140% and gearing is not expected to approach the golden rule limit of 55%. Great Places has developed about 5,500 units over the last decade and hopes to develop about 400 units per year over the next five years.

Origin now manages just under 6,600 properties in North London and Hertfordshire. The group reported turnover of GBP75 million in FY16 and an operating surplus of GBP15 million. Debt rose to GBP308 million at FYE17 and is forecast to peak at GBP425 million in FY19. The operating surplus is forecast to peak at GBP37 million in FY22. Origin has golden rules in place such that for gearing, it will have at least GBP10 million headroom over the tightest gearing covenant for the next year and GBP20 million thereafter. For interest cover it will have headroom at least to the

tightest interest cover plus 10%. The group developed just under 600 units over four years to FY17 and aims to develop just over 1,000 new homes by 2022 with an expected tenure split of 37% for social rent, 25% for shared ownership, 9% for market rent and 29% for private sale.

#### RATING SENSITIVITIES

The standalone ratings may be downgraded if there is further pressure on the sector or on individual RPs as a result of the negative operating environment in the UK.

The ratings may also be downgraded in the event of:

- Greater pressure on headroom on existing interest cover and gearing covenants.
- Further reliance on sales receipts than those currently expected.
- Increased volatility in operating revenue as a result of higher exposure to development activities and a significant increase in gearing and net debt/EBITDA ratios.
- Further changes passed by government negatively affecting the revenues of RPs.

The Outlook on the UK sovereign is Negative and in the event of further downgrade Fitch may reassess the impact that the sovereign credit metrics weakening would have on the RPs' standalone credit profiles, notching uplift and ratings relativity.

The rating actions are as follows:

#### A2Dominion Housing Group Limited:

Long-Term Foreign- and Local-Currency IDRs affirmed at 'A+'; Outlooks Stable

Short-Term IDR affirmed at 'F1'

GBP1billion EMTN programme long-term rating affirmed at 'A+'

GBP250million senior unsecured long-term rating affirmed at 'A+'

A2D Funding plc and A2D Funding II plc's long-term local currency unsecured bonds affirmed at 'A+'

#### Great Places Housing Association Limited:

Long-Term Foreign- and Local-Currency IDRs affirmed at 'A+'; Outlooks Stable

Short-Term IDR affirmed at 'F1'

Long-term local currency secured bonds affirmed at 'A+'

#### Origin Housing Limited:

Long-Term Foreign- and Local-Currency IDRs affirmed at 'A+'; Outlooks Stable

Short-Term IDR affirmed at 'F1'

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### Applicable Criteria

Rating Criteria for Public Sector Revenue-Supported Debt (pub. 05 Jun 2017)

<https://www.fitchratings.com/site/re/898969>

Rating of Public-Sector Entities – Outside the United States (pub. 22 Feb 2016)

<https://www.fitchratings.com/site/re/877128>

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