



## Fitch Affirms A2Dominion Housing Group Limited at 'A+'; Outlook Stable

Fitch Ratings - Barcelona - 02 July 2019: Fitch Ratings has affirmed A2Dominion Housing Group Limited's (A2D) Long-Term Foreign- and Local-Currency Issuer Default Ratings (IDR) at 'A+' with Stable Outlooks. Fitch has removed A2D's Short-Term Foreign-Currency IDR of 'F1' from Under Credit Obsevation (UCO) and placed it on Rating Watch Positive (RWP). The GBP1billion EMTN programme long-term rating has been affirmed at 'A+' as has the GBP250million senior unsecured long-term rating. A2D Funding plc and A2D Funding II plc's long-term local currency unsecured bonds have also been affirmed at 'A+'.

### Key Rating Drivers

Fitch believes A2D's performance is strong despite the challenges that have affected the sector over recent years. Continued high demand for social and affordable housing, cost-efficiency measures and diversification into non-core business should allow A2D to maintain revenues sufficient for debt servicing, as well as cross-subsidising the core business.

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 registered providers (RPs) in England. The impact of Brexit on the sector, although still uncertain, appears less evident than on other public finance sectors such as higher education and healthcare, although the possible consequences have been factored into in A2Ds' stress tests. The Regulator of Social Housing continues to provide strong oversight.

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 RP's financial profile assessment. We incorporate public support factors, notably the strong predictability of the RP's cash flow through direct and indirect government funding. Fitch also applies the Government Related Entity Criteria whereby we assess RPs in England as non-credit-linked entities and apply a one-notch uplift to the standalone ratings. This reflects the assessment of strength of linkage and incentive to support factors. As a consequence, RPs' ratings do not automatically move in line with those of the UK sovereign.

#### Standalone Under the Revenue Supported Rating Criteria

##### Revenue Defensibility: Strong

Demand for social housing 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 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. Regarding this aspect of their portfolios, RPs have the flexibility to collect enough revenues to cover all costs.

##### Operating Risk: Strong

A2D has well-identified cost drivers and low potential volatility in major items. A2D has material capex in its development plans in the medium term but has 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.

A2D has factored the Brexit vote and its potential impact on the UK economy, public finances and political continuity into its stress testing. The main implications for the sector will be continued uncertainty and short- to medium-term turbulence in the financial and housing markets.

A2D has already stress tested and run multi-variable scenarios for its business plan. Critical variants include scenarios such as loan portfolios being repriced at higher lending margins, sales prices falling, delays in sales, inflation and 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 the stress testing relative to its ratings, including the impact of the Brexit vote on its business plan (BP), and assess A2D's flexibility to adapt to new market conditions.

#### Financial Profile: Strong

We expect A2D's strong 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 sale units will be re-invested in the RP to continue to build and provide affordable social units. Although the share of sales and non-social housing activity is expected to increase in the medium term to 50% from 30% of total turnover, at least half of the turnover will remain from social housing lettings. Debt will continue to increase to fund capital expenditure on development programmes.

A2D is now one of the largest RPs in London and the south-east of England with just under 38,100 units. It reported GBP301 million turnover in FY18 (last available published data) and an operating surplus of GBP100 million. Debt at FYE18 remained stable at GBP1.5 billion and is expected to increase further to GBP1.8 billion by FYE22. However, in its rating scenario Fitch expects that net debt/Fitch-calculated EBIDTA is likely to remain below 12x on a sustainable level, with the exception of FY19, which is considered a one-off. A2D's BP foresees turnover averaging about GBP410 million over 2019-2023.

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. A2D has developed just under 10,500 units in the past decade and it aims to develop on average 1,200 units a year from 2020. The tenure split is expected to be 20% affordable rent, 20% shared ownership, 20% private rent and 40% private sale.

Under Fitch's Revenue Supported Debt Criteria a combined assessment of Revenue Defensibility as Strong, Operating Risk and Financial Profile as Strong leads to a combined assessment of a standalone rating of 'a' for A2D.

#### Bottom-up Under the GRE Criteria

The assessment under the GRE shows a total scoring of 12.5 points. Under the Strength of Linkage factors, Fitch has assessed status, ownership and control as Strong and Support track record and expectations as Moderate. Under the incentive to support factors, Fitch has assessed the socio-political implications of default as moderate and the financial implications of default as weak.

#### Derivation Summary

With a standalone assessment at 'a' under the Revenue Supported Debt Criteria (up to three notches away from government), and 12.5 points under the GRE Criteria this leads to a bottom up plus one under the Notching Guideline Table.

The short-term ratings have been placed on RWP following the application of Fitch's new Short-Term Criteria. For GREs that are rated on a bottom-up basis under the Revenue Supported Debt Criteria, the higher of the short-term ratings will apply, providing the three factors defined in the Short-Term Ratings

criteria are met (liquidity profile and debt characteristics assessed as 'neutral' and a minimum coverage ratio). Fitch will resolve the RWP within six months.

## RATING SENSITIVITIES

The standalone ratings may be downgraded if there is further pressure on the sector or on A2D as a result of the negative operating environment in the UK.

The ratings may also be downgraded in the event of:

- 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.
- Greater pressure on headroom on existing interest cover and gearing covenants.
- Further reliance on sales receipts than those currently expected.
- Further changes passed by government negatively affecting the revenues of RPs.

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

## RATING ACTIONS

ENTITY/DEBT	RATING	PRIOR
A2Dominion Housing Group Limited	LT IDR A+ ● Affirmed	A+ ●
	ST IDR F1 ◆ Rating Watch On	F1
	LC LT IDR A+ ● Affirmed	A+ ●
senior unsecured	LT A+ Affirmed	A+
A2D Funding plc		
senior unsecured	LT A+ Affirmed	A+
A2D Funding II plc		
senior unsecured	LT A+ Affirmed	A+

Additional information is available on [www.fitchratings.com](http://www.fitchratings.com)

## Applicable Criteria

Government-Related Entities Rating Criteria (pub. 25 Oct 2018)

Public Sector, Revenue-Supported Entities Rating Criteria (pub. 28 May 2019)

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