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Research Update:

U.K.-Based Social Housing Association Bromford Housing Group Assigned 'A+' Rating; Outlook Negative

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Overview

- Bromford Housing Group Ltd. is a U.K.-registered social landlord operating in the West-Midlands of England.
- A historically low operational cost base, a high quality of stock, and a focus on traditional activities has resulted in strong EBITDA margins over the past two years.
- However, we expect the increase in market-related activities in Bromford's development plan to put pressure on profitability and increase revenue volatility.
- We are assigning our 'A+' long-term issuer credit rating to Bromford.
- The negative outlook reflects the outlook on the U.K. This is because if we were to lower our U.K. sovereign rating, we would no longer factor one notch of uplift for government support into our rating on Bromford.

Rating Action

On April 18, 2018, S&P Global Ratings assigned its 'A+' long-term issuer credit rating to U.K.-based registered social landlord Bromford Housing Group Ltd. The outlook is negative.

Rationale

The 'A+' rating on Bromford reflects its strong enterprise and financial profile, which results in a stand-alone credit profile (SACP) of 'a'. The SACP benefits from one notch of uplift due to our opinion that there is a moderately high likelihood of extraordinary support from the U.K. government, if needed.

The enterprise profile is buttressed by high demand for Bromford's services. The housing association also enjoys the low industry risk associated with the social housing sector, given its anti-cyclical nature, high barriers to entry, and strong government oversight from the U.K.'s Regulator of Social Housing. This results in lower industry risk than other sectors such as the property development industry. The sector also benefits from strong demand across all areas of the U.K.

Bromford predominantly operates in the West Midlands. The Midlands exhibits strong demand for general-needs rent but also for non-traditional tenure types such as shared ownership properties. House prices are lower than in London and the south east, and demand for shared ownership is strong. We anticipate that this high demand will drive up house prices faster than in other regions across the south of England, and as a result, many housing associations operating in this area are adjusting development plans to incorporate shared-ownership units.

Bromford's development plan contains a substantial increase in shared ownership units, and the association is planning on introducing some outright sales in financial years (FY) 2019 and 2020. By FY2020, Bromford expects 24% of revenues to stem from market-related activities, of which 10% from outright sales. In our view, this erodes the revenue predictability that Bromford has historically enjoyed. It also exposes the association to price fluctuations and consumer confidence, which are associated with these activities.

However, we take a positive view of the group's decision to also include a large proportion of socially rented units. Bromford plans to add over 500 units annually for social rent over the same period, which will see their total stock reach around 32,000 by FY2020. The group's asset base is 100% compliant with the Decent Homes Standard and has an average age of 31 years. From an operational perspective, Bromford has modest arrears of 3.4%, which has the potential to rise as the rollout of the Universal Credit benefits system continues. This risk is mitigated by Bromford's status as a trusted partner of the Department for Work and Pensions (DWP), which enables it to request that housing benefit be paid directly to the landlord as rent in cases of potential arrears.

We understand that Bromford is in advanced talks to merge with Merlin Housing Society. The merger, which is due to complete on July 2, 2018, is an opportunity for Bromford to consolidate its operations in other local authorities within the West Midlands. The organizations are similar in culture, with both opting to focus on traditional social housing activities, and we therefore do not expect a shift in strategy should the merger complete successfully. Our base case currently assesses Bromford as a stand-alone entity, but we do not at this time expect the merger to have a material impact on the rating on Bromford.

Thanks to stable revenues and a low operational cost base, Bromford recorded very strong S&P Global Ratings-adjusted EBITDA margins of above 40% in both FY2016 and FY2017. However, we anticipate pressure on profitability going forward from the lower quality of earnings associated with the aforementioned increase in market-related activities. We forecast margins to fall to around 37% by FY2020.

Bromford's debt position is modest, with a debt stock of £569 million as of March 31, 2017. This results in S&P Global Ratings-adjusted debt-to-EBITDA of around 8x for FY2016 and FY2017, which is lower than the average 13x-15x we tend to observe in the sector. However, we anticipate that Bromford will secure funding for the capital expenditure program, and therefore forecast debt to peak in FY2019 with debt-to-EBITDA reaching 11.3x, before declining slightly in FY2020. We expect interest coverage to remain robust, with EBITDA covering interest payments by 2.4x over our five-year base case.

Liquidity

We expect Bromford's liquidity position to be solid over the next 12 months, supported by strong cash flows from operations and sufficient undrawn committed facilities. We expect capital expenditure to be the group's primary use of funding over this period.

In our base case over the next 12 months, we estimate sources of liquidity of around £337 million will cover uses of around £208 million by 1.6x.

Source of liquidity include:

- £72 million expected from cash flow from operations;
- £111 million cash and liquid investments;
- £22 million from asset sales; and
- £131 million of committed undrawn facilities.

Uses of liquidity include:

- £153 million of expected capital expenditure; and
- £54 million of interest and principal repayments.

Outlook

The negative outlook on Bromford reflects the outlook on the U.K. We could lower the rating on Bromford if we lowered our sovereign credit rating on the U.K. We could revise the outlook to stable in the next two years if we took the same action on the sovereign, with Bromford performing in line with our base-case scenario.

Table 1

Bromford Housing Group Limited Key Statistics

	--Year Ended 31-Mar--				
(Mil. £)	**2016a**	**2017a**	**2018bc**	**2019bc**	**2020bc**
Number of units owned or managed	29,110	29,510	30,437	31,258	32,001
Vacancy rates (% of rent net of identifiable service charge)	0.8%	0.7%	N.A.	N.A.	N.A.
Arrears (% of rent net of identifiable service charge)*	2.8%	3.4%	N.A.	N.A.	N.A.
Revenue§	165.4	162.4	181.2	190.5	205.0
Share of revenue from non-traditional activities (%)	8.9%	9.5%	17.6%	20.0%	24.4%
EBITDA¶	73.0	67.9	72.6	73.0	77.2
EBITDA/revenue (%)	44.1%	41.8%	40.1%	38.3%	37.7%
Interest expense	26.9	26.8	27.3	32.5	36.8
Debt/EBITDA (x)	8.1	8.4	8.2	11.3	10.6
EBITDA/Interest coverage† (x)	2.7	2.5	2.7	2.2	2.1
Capital expense	50.8	63.6	87.1	164.7	160.3
Debt	588.4	568.5	596.2	826.9	815.3
Housing properties (according to balance sheet valuation)	1569.9	1604.6	1657.5	1727.8	1865.3
Loan to value of properties (%)	37.5%	35.4%	36.0%	47.9%	43.7%
Cash and liquid assets	74.1	35.5	47.3	201.2	114.3

*Rent and service charge arrears. §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

Table 2

Bromford Housing Group Limited Ratings Score Snapshot	
Industry risk	2
Economic fundamentals and market dependencies	4
Strategy and management	3
Asset quality and operational performance	1
Enterprise profile	3
Financial performance	4
Debt profile	3
Liquidity	3
Financial policies	2
Financial profile	3

S&P Global Ratings' analysis of social housing providers' creditworthiness rests on our scoring of eight key rating factors: (i) industry risk; (ii) economic fundamentals and market dependencies; (iii) strategy and management; (iv) asset quality; (v) financial performance; (vi) debt profile; (vii) liquidity; and (viii) financial policies. Each of the factors is assessed on a continuum spanning from 1 (strongest) to 6 (weakest). S&P Global Ratings' "Methodology For Rating Public And Nonprofit Social Housing Providers," published Dec. 17, 2014, and "Rating Government-Related Entities: Methodology And Assumptions," published March 25, 2015, detail how we derive and combine the scores, and then determine each social housing provider's stand-alone credit profile and the issuer credit rating. In accordance with S&P Global Ratings'public and nonprofit social housing providers methodology, a change in score does not in all cases lead to a change in the rating, nor is a change in the rating necessarily predicated on changes in one or more of the scores. In determining the final rating, the committee can make use of the flexibility afforded by paragraphs 12-17 of "Methodology For Rating Public And Nonprofit Social Housing Providers."

Related Criteria And Research

Related Criteria

- General Criteria: Rating Government-Related Entities: Methodology And Assumptions - March 25, 2015
- Criteria - Governments - General: Methodology For Rating Public And Nonprofit Social Housing Providers - December 17, 2014
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating - October 01, 2010
- General Criteria: Use Of CreditWatch And Outlooks - September 14, 2009

Related Research

- U.K. Social Housing Providers To Borrow £12 Billion Of New Debt By 2020, Total Debt To Reach £89 Billion - March 07, 2018
- New Rent Policy Brings Relief, But No Big Boost To The Credit Standing Of U.K. Housing Associations - Jan. 31, 2018. To access the article click this link: https://www.capitaliq.com/CIQDotNet/CreditResearch/viewPDF.aspx?pdfId=32157&from=Research
- U.K. Social Housing Scenario Analysis: What Could Happen To Ratings In A Market Downturn? - Sept. 25, 2017. To access the article click this link: https://www.capitaliq.com/CIQDotNet/CreditResearch/viewPDF.aspx?pdfId=28976&from=Research

Ratings List

Bromford Housing Group Limited	
Issuer Credit Rating	
Foreign and Local Currency	A+/Negative/--