FitchRatings

Fitch Affirms 2 English Social Housing Registered Providers; Outlooks Stable

Fitch Ratings-Barcelona/London-15 May 2019: Fitch Ratings has affirmed Great Places Housing Group's Long-Term Issuer Default Ratings (IDR) at 'A+' and Origin Housing Limited's Long-Term IDR at 'A'. The Outlooks are Stable. The Short Term ratings have been placed on Rating Watch Positive (RWP). Fitch has assessed Great Places Housing Group's Standalone credit profile (SCP) at 'a' and Origin Housing Limited's SCP at 'a-'. A full list of rating actions is below.

Fitch believes the two 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 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 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 or healthcare, although the possible consequences have already been factored into in RPs' stress tests. At the same time, the Regulator for Social Housing 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 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 of this approach, 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 across the country and any change in the rents that RPs are able to charge would be unlikely to materially affect demand. Nevertheless, the 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 in order to finance development plans to compensate for rent cuts and reduced grants. Regarding this aspect of their portfolios, RPs have the independent ability and full flexibility to collect revenues sufficient to cover all costs.

Operating Risk: Strong
The sector has well-identified cost drivers and low potential volatility in major items. The RPs have material capex in 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.

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 RPs' flexibility to adapt to new market conditions.

Financial Profile: Strong
Both RPs have maintained a strong performance, which we expect will improve, aided by continued but conservative development plans. Profits from the sale of private sale units will be re-invested in the RPs to continue to build and provide affordable social units. For both entities about 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.

Great Places manages just under 19,500 units in northern England and the Midlands. The group reported turnover of GBP101 million in FY18 and an operating surplus of GBP33 million. Debt rose to GBP558 million at FYE18 and is forecast to continue rising to about GBP650 million over the next five years as per the 2018 BP. Total turnover is forecast to continue rising to just under GBP140 million in FY23 and operating surplus to just under GBP50 million. The operating margin is expected to hover around 30%, 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%. Net debt/EBITDA is at 9x at FYE18 and Fitch does not expect this to rise above 10x in its rating case over the next five years, based on the 2018 BP. Great Places has developed about 5,500 units over the last decade and intends/plans to develop at a similar scale.

Origin manages just under 6,700 properties in North London and Hertfordshire. The group reported turnover of GBP50 million in FY18 and an operating surplus of GBP17 million. Debt rose to GBP327 million at FYE18 and according to its 2018 BP is forecast to peak at GBP420 million in FY21. The operating surplus is forecast to peak at GBP27 million in FY22. Origin has golden rules in place so 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%. Net debt/EBITDA is at 14x at FYE18 but Fitch expects this to remain under 12x on a sustainable level in its rating case over the next five years, based on the 2018 BP. The group developed just under 600 units over the four years to FY17 and aims to develop just over 1,000 new homes by 2022 with an expected tenure split of 38% for social rent, 37% for shared ownership, 5% for market rent, 10% for private sale and 10% though JVs. Origin is likely however to re-assess the tenure split in its 2019 BP.

Fitch will re-assess any changes in development pipelines resulting from the 2019 BPs expected to be finalised by end June, and assess whether this may lead to any changes in the RPs standalone assessments.

Under the 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 Great Places and 'a-' for Origin.

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' for Great Places and 'a-' for Origin under the Revenue Supported Debt Criteria (up to three notches away from government and four notches away from government respectively), 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 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 sustainable threshold of net debt/EBITDA ratio of above 12x under Fitch's rating case.
- 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 downgrade Fitch may re-assess 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:
Great Places Housing Group Limited:
Long-Term Foreign- and Local-Currency IDRs affirmed at 'A+'; Outlooks Stable
Short-Term IDR of 'F1' placed on RWP
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 of 'F1' placed on RWP

Contact:
Primary Analyst
Ines Callahan
Director
+34 93 467 87 45
Fitch Ratings Espana S.A.U.
Av. Diagonal 601
08028 Barcelona

Secondary Analyst
Maurycy Michalski
Director
+48 22 330 67 01

Committee Chairperson

Vladimir Redkin
Senior Director
+7 495 956 2405

Media Relations: Athos Larkou, London, Tel: +44 20 3530 1549, Email: athos.larkou@thefitchgroup.com

Additional information is available on www.fitchratings.com
Applicable Criteria
Government-Related Entities Rating Criteria (pub. 29 Mar 2019)
Rating Criteria for Public-Sector, Revenue-Supported Debt (pub. 26 Feb 2018)
Short-Term Ratings Criteria (pub. 02 May 2019)

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