14 May 2020 | Affirmation

Fitch Affirms 2 English Social Housing Registered Providers; Outlooks Negative

Fitch Ratings-Barcelona-14 May 2020:

Fitch Ratings has revised Origin Housing Limited's Outlook to Negative from Stable, while affirming the entity's Long-Term Issuer Default Ratings (IDR) at 'A'. It has also affirmed Great Places Housing Group's Long-Term IDR at 'A+', also with a Negative Outlook. A full list of rating actions is below.

Fitch rates social housing registered providers (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 (GRE) Criteria under which we assess RPs in England as non-credit linked entities and apply a single-notch uplift to their 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.

The recent outbreak of coronavirus and related government containment measures worldwide create an uncertain environment for RPs in the near term. While material changes in revenue and cost profiles are occurring across GREs in the UK and are likely to continue in the coming weeks and months as economic activity suffers and government restrictions are maintained. Fitch's ratings are forward-looking in nature, and Fitch will monitor developments in the social housing sector as a result of the virus outbreak in terms of their severity and duration, and incorporate revised base and rating case qualitative and quantitative inputs based on expectations for future performance and assessment of key risks.

Fitch does not see any immediate rating impact on RPs of social housing, which are less affected by the coronavirus than other Fitch-rated sectors. An increase in arrears may arise in the short-term, as a consequence of tenants losing their jobs. However, the overall impact is lessened for RPs because a significant proportion of rental income within social lettings is funded by benefit payments that will continue.

Key Rating Drivers

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 is unlikely to materially affect demand. Nevertheless, the assessment of revenue is somewhat constrained by the lack of control RPs have on rents. A supportive regulatory regime aims to maintain compensation for services at a level that will consistently support the solvency of an essential public service. However, Fitch expects revenue from housing benefits as a percentage of total revenues to eventually fall, due to increased revenues from non-social housing activity to finance development plans to compensate for rent cuts and reduced grants. In this respect, RPs have the independent ability and full flexibility to collect sufficient revenues to cover all costs.

Operating Risk: 'Strong'

The sector has well-identified cost drivers and low potential volatility in major items. RPs have material capex in their development plans in the medium-term but have flexibility 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 on labour or resources.

RPs have fared well in light of the coronavirus outbreak as they were well-prepared ahead of uncertainties around Brexit. RPs may need to delay development programmes, affecting their cash flow, and postpone funding due to market uncertainty. Isolation measures have already affected the UK property market (decline in home viewings; people reconsidering plans to buy or sell.) The construction industry has said that building companies face widespread insolvencies - affecting RPs - without government action. However, RPs have some near-term flexibility and they will likely boost their liquidity positions as an additional buffer.

RPs have put forward corrective measures, including pre-emptive and responsive actions. Fitch will continue to monitor the resilience of RPs and assess their ability to overcome possible further turmoil. We will also closely review the robustness of the stress testing of RPs relative to their ratings, including the impact of coronavirus on their business plan, and we will assess 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 units will be re-invested 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 development programmes.

Great Places manages just under 19,500 units in northern England and the Midlands. The group reported turnover of GBP109 million in financial year to March 2019 and an operating surplus of GBP36 million. A transfer of engagements (or merger) was completed with Equity Housing Group on 1 April 2020. Great Places will subsequently own or manage over 24,000 homes across the North West and South Yorkshire (geographically compatible and within a similar area), with turnover in excess of GBP150 million, housing assets of over GBP1.5 billion and more than 700 staff.

Debt fell to GBP543 million at FYE20 and is forecast to rise to about GBP650 million over the next five years as per the 2019 business plan. Total turnover is forecast to continue rising to just over GBP156 million in FY24 and operating surplus to just under GBP50 million. Net adjusted debt/EBITDA was 9x at FYE19 and Fitch expect this to remain below 9x in its rating case over the next five years. Great Places has developed about 5,500 units over the last decade and, as part of the Equity merger, has committed to building 11,000 homes over a 10-year period from April 2020.

Origin manages just under 7,000 properties in North London and Hertfordshire. The group reported turnover of GBP56 million in financial year to March 2019 and an operating surplus of GBP12 million. Debt rose to GBP381 million at FYE20 and according to its 2019 business plan is forecast to peak at GBP420 million in FY23. Origin has golden rules in place such that it will have at least GBP10 million headroom over the tightest gearing covenant for the next year and GBP20 million thereafter.

The group's development target has risen to 1,090 units over five years and a quarter of units have now been completed with an expected tenure split of 48% for general needs, 5% for intermediate rent, 27% for shared ownership, 5% for open market and 15% though JVs. Net adjusted debt/EBITDA was 14x at FYE19 but Fitch expects this to rise significantly in its rating case over the next five years. Due to this the Outlook has been revised to Negative until Fitch reviews developments over the short term.

Fitch will re-assess any changes in development pipelines resulting from the coronavirus outbreak, and assess whether this may lead to changes in the RPs' standalone assessments.

Under the Revenue-Supported Debt Criteria a combined 'Strong' assessment of revenue defensibility operating risk and financial profile leads to a combined assessment of a standalone rating of 'a' for Great Places and 'a-' for Origin.

Bottom-up Under GRE Criteria

Our assessment under the GRE Criteria shows a total score of 12.5 points each for Great Places and Origin. Under the strength-of-linkage factors, Fitch assesses status, ownership and control as 'Strong' and support track record and expectations as 'Moderate'. Under the incentive-to-support factors, Fitch assesses 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 and four notches away from the UK sovereign's 'AA-'/Negative/'F1+' ratings, respectively), and 12.5 points under the GRE Criteria this leads to a bottom-up plus one rating under the Notching Guideline Table. Great Places' rating is capped at the sovereign's rating minus 1. As such its Outlook reflects that of the sovereign.

RATING SENSITIVITIES

Factors that could, individually or collectively, lead to positive rating action/upgrade:

-Increased volatility in operating revenue as a result of higher exposure to development activities and a significant increase in gearing and net adjusted debt/ EBITDA ratios on a sustained basis.

-A downgrade of the UK sovereign would lead to a downgrade of Great Places, which is now capped at government minus 1.

Factors that could, individually or collectively, lead to negative rating action/downgrade:

-The IDRs could be upgraded if the net adjusted debt/EBIDTA improves on a sustained basis.

Best/Worst Case Rating Scenario

International scale credit ratings of Public Finance issuers have a best-case rating upgrade scenario (defined as the 99th percentile of rating transitions, measured in a positive direction) of three notches over a three-year rating horizon; and a worst-case rating downgrade scenario (defined as the 99th percentile of rating transitions, measured in a negative direction) of three notches over three years. The complete span of best- and worst-case scenario credit ratings for all rating categories ranges from 'AAA' to 'D'. Best- and worst-case scenario credit ratings are based on historical performance. For more information about the methodology used to determine sector-specific best- and worst-case scenario credit ratings, visit https://www.fitchratings.com/site/re/10111579.

REFERENCES FOR SUBSTANTIALLY MATERIAL SOURCE CITED AS KEY DRIVER OF RATING

The principal sources of information used in the analysis are described in the Applicable Criteria.

ESG Considerations

The highest level of ESG credit relevance, if present, is a score of 3. This means ESG issues are credit-neutral or have only a minimal credit impact on the entity(ies), either due to their nature or to the way in which they are being managed by the entity(ies). For more information on Fitch's ESG Relevance Scores, visit www.fitchratings.com/esg.

Great Places Housing Group Limited; Long Term Issuer Default Rating; Affirmed; A+; RO:Neg
----; Short Term Issuer Default Rating; Affirmed; F1+
----; Local Currency Long Term Issuer Default Rating; Affirmed; A+; RO:Neg
----senior secured; Long Term Rating; Affirmed; A+
Origin Housing Limited; Long Term Issuer Default Rating; Affirmed; A; RO:Neg
----; Short Term Issuer Default Rating; Affirmed; F1+
----; Local Currency Long Term Issuer Default Rating; Affirmed; A; RO:Neg

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Additional information is available on www.fitchratings.com

Applicable Criteria

Government-Related Entities Rating Criteria (pub. 13 Nov 2019)
Public Sector, Revenue-Supported Entities Rating Criteria (pub. 27 Mar 2020) (including rating assumption sensitivity)

Additional Disclosures

Dodd-Frank Rating Information Disclosure Form
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