Research Update:

U.K.-Based Social Housing Provider Bromford Housing Group Ltd. 'A+' Rating Affirmed; Outlook Negative

April 26, 2019

Overview

- Following mergers with Merlin and Severn Vale, we expect Bromford Housing Group Ltd. (Bromford) to focus on delivering about 13,500 homes over the next 10 years.
- Bromford's liquidity position has strengthened on the back of its first bond issuance and a subsequent private placement.
- We are affirming our 'A+' long-term issuer credit rating on Bromford.
- The negative outlook reflects our view that we could lower our rating on Bromford if we were to lower the U.K. sovereign rating or if we were to revise downward our view of U.K. government support.

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Rating Action

On April 26, 2019, S&P Global Ratings affirmed its 'A+' long-term issuer credit rating on U.K.-based social housing provider Bromford Housing Group (Bromford, the group). The outlook remains negative.

At the same time, we affirmed our 'A+' long-term issue rating on the £300 million senior secured bond issued by Bromford.

Rationale

The 'A+' rating is supported by our view of Bromford's strong financial profile following the completion of mergers with Merlin Housing House Society in July 2018 and Severn Vale Housing Association in January 2019. The combined entity has improved its liquidity position over the past 12 months, supported by a £300 million bond and a £100 million private placement. These facilities have strengthened the group's financial profile as it begins its plan to deliver about 13,500 units by the financial year ending March 31, 2029 (FY2029).

The 'A+' rating incorporates one notch of uplift from its stand-alone credit profile (SACP) because we think there is a moderately high likelihood of extraordinary support from the U.K. government, if needed.

Bromford's recent mergers have broadened its geographical footprint from the Midlands to the southwest of England and increased its portfolio size to 42,375 units under management as of FY2019. All of Bromford's stock currently meets the Decent Homes Standard, and the group has committed £350 million of capital maintenance over the next five years to ensure a high level of asset quality.

Robert Nettleton, who was previously Merlin's chief executive officer (CEO), has taken charge as Bromford's CEO, as agreed when initial merger talks between Bromford and Merlin began. The rest of the executive management team comprises legacy Bromford and Merlin employees. In FY2019, Bromford became a strategic partner with Homes England, which will result in the group receiving about £66 million. This grant funding will enable Bromford to develop about 1,400 homes by March 2023. Due to the uncertainty as to when Bromford will draw the grant, we have excluded it from our assessment of liquidity.

Bromford aims to develop about 13,500 homes over the next 10 years. As a consequence of securing grants, we expect more than 50% of the plan will be for social and affordable rent, 30% for shared ownership, and 15% for open market sale. Although sales account for 45% of the development plan, Bromford has a golden rule stipulating that it will derive no more than 30% of total revenues from sales-related activities.

Despite this golden rule, we still expect a slight deterioration in financial performance over our base case, which sales will exacerbate. The forecast increase in sales exposure, along with a planned increase in capitalized repairs, will reduce adjusted EBITDA margins over our base case. In our adjusted EBITDA, we have removed amortized government grants and capitalized repairs because we think the former is a noncash item and the latter is an operating cost. We therefore expect adjusted EBITDA margins to fall to about 33% between FY2020 and FY2022, from 37% in FY2018.

Consolidation of Merlin and Severn Vale's debt, combined with Bromford's recent £300 million bond issuance, resulted in total debt outstanding of £1.1 billion at year-end FY2019, higher than the £0.6 billion Bromford recorded before the partnerships' completion. We forecast debt to increase further throughout our base case, supported by Bromford drawing on the £100 million private placement in FY2020, peaking at £1.35 billion in FY2022. An increase in debt, combined with an erosion in adjusted EBITDA, will result in debt to EBITDA increasing to a peak of 15x in FY2021 from 10x in FY2018, before settling at about 13x in FY2022. We observe a similar trend in EBITDA to interest cover, falling to about 1.8x in FY2022 from a high of 2.3x in FY2018, albeit remaining at a sound level in comparison to sector peers. We also expect Bromford to comfortably cover interest from social housing-generated EBITDA by 1.6x over our five-year base case.

Liquidity

We view Bromford's liquidity position as exceptional on the back of a £300 million bond issuance completed in April 2018 and a £100 million private placement, due to be drawn in May 2019. Bromford inherited about £290 million of facilities from Merlin and subsequently restructured them into new revolving credit facilities. This also strengthened the group's liquidity position.

Over the next 12 months, we estimate sources of liquidity will cover uses by 3.6x. We think Bromford will retain strong liquidity coverage of more than 3x, which is supported by the group's liquidity policies and golden rules.

We expect sources of liquidity over the next 12 months will include:

- £84 million from cash flow from operations;
- £293 million cash and liquid investments;
- £12 million from asset sales; and
- £340 million of committed undrawn facilities.

We expect uses of liquidity over the same period will include:

- £131 million of expected capital expenditure; and
- £69 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.

Downside scenario

We could also lower the rating on Bromford if we thought the likelihood of timely extraordinary support from the U.K. government to the group had decreased.

Upside scenario

Alternatively, we could revise the outlook to stable if we revised the outlook on the U.K. to stable, with Bromford performing in line with our base case.

Table 1

Bromford Housing Group Ltd. Key Statistics

	--Year ended March 31--				
(Mil. £)	**2018a***	**2019e§**	**2020bc**	**2021bc**	**2022bc**
Number of units owned or managed	33,131	47,842	48,360	48,945	49,943
Vacancy rates (%)†	0.8	N.A.	N.A.	N.A.	N.A.
Arrears (%)†	3.5	N.A.	N.A.	N.A.	N.A.
Revenue‡	169.5	252.1	257.3	270.5	305.4
Share of revenue from nontraditional activities (%)	16.4	26.2	21.6	22.4	27.1
EBITDA‡**	62.7	87.4	83.8	85.1	104.3
EBITDA/revenue (%)‡**	37.0	34.7	32.6	31.5	34.1
Interest expense§§	26.9	45.4	52.5	55.9	59.1
Debt/EBITDA (x)‡**	9.9	12.9	14.4	15.0	12.9
EBITDA/interest coverage (x)‡**§§	2.3	1.9	1.6	1.5	1.8
Capital expense**	92.7	140.0	130.9	101.1	143.7
Debt	621.8	1,124.5	1,207.3	1,278.6	1,349.4

Table 1

Bromford Housing Group Ltd. Key Statistics (cont.)

	--Year ended March 31--				
(Mil. £)	2018a*	2019e§	2020bc	2021bc	2022bc
Housing properties (according to balance sheet valuation)	2,018.6	N.A.	N.A.	N.A.	N.A.
Loan to value of properties (%)	30.8	N.A.	N.A.	N.A.	N.A.
Cash and liquid assets	52.9	261.1	258.6	269.1	247.1

*FY2018 reflects Bromford as a standalone entity pre-merger. §FY2019 includes 12 months of Bromford and Merlin and three months of Severn Vale. †Rent and service charge. ‡Adjusted for grant amortization. **Adjusted for capitalized repairs. §§Including capitalized interest. a--Actual. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. e--Estimate. N.A.--Not available.

Ratings Score Snapshot

Table 2

Bromford Housing Group Ltd. Ratings Score Snapshot

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Strategy and management	3
Asset quality and operational performance	1
Enterprise profile	**3**
Financial performance	4
Debt profile	3
Liquidity	1
Financial policies	2
Financial profile	**3**

S&P Global Ratings bases its ratings on non-profit social housing providers on the eight main rating factors listed in the table above. S&P Global Ratings' "Methodology For Rating Public And Nonprofit Social Housing Providers," published on Dec. 17, 2014, summarizes how the eight factors are combined to derive each social housing provider's stand-alone credit profile and issuer credit rating. For social housing providers generating more than a third of its consolidated revenues from open market sales, we also refer to the "Key Credit Factors For The Homebuilder And Real Estate Developer Industry."

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, Dec. 17, 2014
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- A Push For New Homes Means U.K. Social Housing Providers Will Borrow £17 Billion Of New Debt By 2021, March 19, 2019
- U.K. Social Housing Association Ratings Under A No-Deal Brexit, Dec. 3, 2018
- Global Social Housing Risk Indicators: December 2018, Dec. 3, 2018

Ratings List

Ratings Affirmed	
Bromford Housing Group Ltd.	
Issuer Credit Rating	A+/Negative/--
Senior Secured	A+