

CREDIT OPINION

18 November 2019

 Rate this Research

RATINGS

Bromford Housing Group Limited

Domicile	United Kingdom
Long Term Rating	A2
Type	LT Issuer Rating - Dom Curr
Outlook	Stable

Please see the [ratings section](#) at the end of this report for more information. The ratings and outlook shown reflect information as of the publication date.

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Bromford Housing Group Limited (United Kingdom)

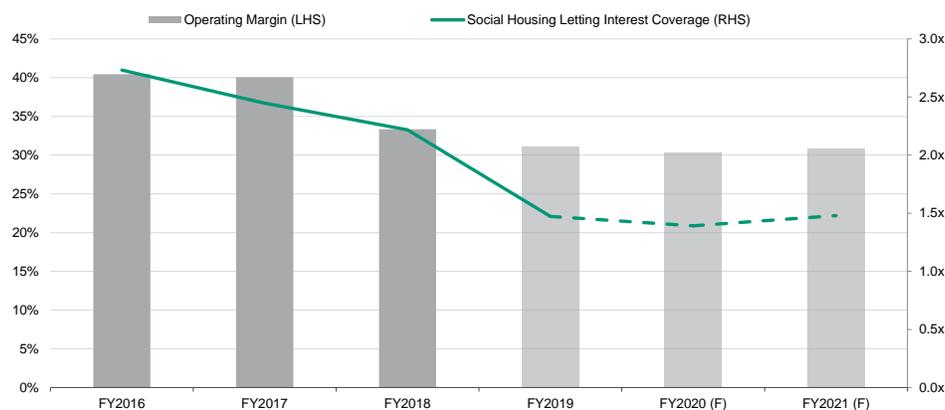
Update following rating affirmation

Summary

[Bromford Housing Group's](#) (Bromford A2 stable) credit profile reflects weakening debt metrics, operating margin, and interest coverage, balanced against ample liquidity, strong market position, strong regulatory framework, and our assumption of a strong likelihood that the [United Kingdom Government](#) (UK, Aa2 negative) would intervene in the event of acute liquidity stress.

Exhibit 1

Bromford's profitability and interest cover continue their decline but stabilise beyond FY2019 Operating margin and social housing letting interest cover (SHLIC)



Bromford standalone financials for FY2016-18; the merged entity's board-approved business plan for FY2019-21
 Source: Moody's Investors Service, Bromford

Credit strengths

- » Ample liquidity cover and additional borrowing capacity
- » A strong market position and renewed focus on core business following mergers
- » Supportive institutional framework in England

Credit challenges

- » Increased debt levels and financing costs weaken key metrics
- » Weaker operating margins and high exposure to market sales

Rating outlook

Bromford's current stable outlook reflects an expectation that Bromford is well positioned in the A2 rating category in the medium term, based on our assessment of the current business plan.

Factors that could lead to an upgrade

A combination of the following could have positive rating implications: 1) operating margins returning to historic levels at or above 40%; 2) SHLIC is enhanced and maintained to 2x or above; 3) debt to revenue reducing to 3.5x.

Factors that could lead to a downgrade

Negative pressure could be exerted on the rating by one or a combination of the following: 1) SHLIC weakening materially to close to 1x; 2) increasing the proportion of revenues sourced from market sales activity, above currently planned levels; 3) growing debt above currently planned levels, with debt to revenue held at or above 4.5x; 4) weaker regulatory framework or a dilution of the overall level of support from the UK could also exert downward pressure on the rating.

Key indicators

Exhibit 2

Bromford Housing Group

	31-Mar-15	31-Mar-16	31-Mar-17	31-Mar-18	31-Mar-19 (F)	31-Mar-20 (F)	31-Mar-21 (F)
Units under management (no.)	28,753	29,110	29,510	30,096	42,735	43,155	44,387
Operating margin, before interest (%)	39.9	40.5	40.0	33.3	31.2	30.4	30.8
Net capital expenditure as % turnover	3.4	1.0	10.9	34.9	86.6	35.8	61.8
Social housing letting interest coverage (x times)	2.3	2.7	2.4	2.2	1.5	1.4	1.5
Cash flow volatility interest coverage (x times)	2.6	3.3	3.1	2.4	2.0	1.9	2.1
Debt to revenues (x times)	3.4	3.4	3.4	3.6	4.3	4.3	3.9
Debt to assets at cost (%)	36.8	35.3	35.2	36.1	43.8	42.0	44.0

F : forecast

Source: Moody's Investors Service, Bromford

Detailed credit considerations

On 13 November 2019, [Moody's affirmed Bromford's long-term credit rating](#). The affirmation followed [Moody's change in the Government of UK's outlook to negative from stable, Aa2 rating affirmed, on 8 November 2019](#).

The credit profile of Bromford, as expressed in its A2 stable rating, combines (1) its current Baseline Credit Assessment (BCA) of a3, and (2) a strong likelihood of extraordinary support from the UK government in the event that Bromford faces acute liquidity stress.

Baseline credit assessment

Ample liquidity cover and additional borrowing capacity

A key credit strength for Bromford is its liquidity cover metric, measured as cash on hand and immediately available secured facilities against two years of projected net cash need, and the additional borrowing capacity it can secure through its unencumbered asset position. As at 31st March 2019, Bromford had sufficient available liquidity to cover 1.9x of its net two year spending requirements, and this metric is set to remain strong at 1.85x in FY2020. Bromford's ample liquidity cover is a pertinent factor in its credit quality as it counterbalances the high level of forecast capital expenditure in the forthcoming years related to Bromford's development programme, as well as the front loading of 1,400 units the HA must deliver by FY2024 through its Strategic Partnership with Homes England.

Bromford enhanced its unencumbered asset position as a result of its merger with Merlin Housing Society (Merlin) and Severn Vale Housing (SVH), growing it to over 7,000 units valued at approximately £411 million on a EUV basis, from £183 million in FY2018. Bromford is able to further enhance its unencumbered asset position by valuing a portion of these units on a MSVT basis. While Bromford has around £355 million in undrawn facilities to use against the £350 million of debt required for its development plan in the next four years, its unencumbered assets provide an additional and abounding source for future funding.

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Bromford maintains strong management practices and well-documented procedures, and places high importance on the liquidity of its funds, which is reflected in its strong liquidity coverage. The housing association's (HA's) treasury policy stipulates the need to keep on-hand facilities covering 18 months of expected committed and uncommitted spending, as well as an additional £25 million facility for contingency, and sufficient liquidity to cover a 20% slippage in forecast sales income. Additionally the policy also states that Bromford should maintain a minimum cash balance of £25 million, £10 million of which must be available same day, and maintain an additional £15 million buffer above its net mark-to-market position on callable stand-alone swaps. Bromford has also established eight new golden rules (see "A strong market position and renewed focus on core business following mergers"), one of which is to have a minimum of £100 million worth of unencumbered assets that are ready to charge to ensure liquidity is available for the HA.

A strong market position and renewed focus on core business following mergers

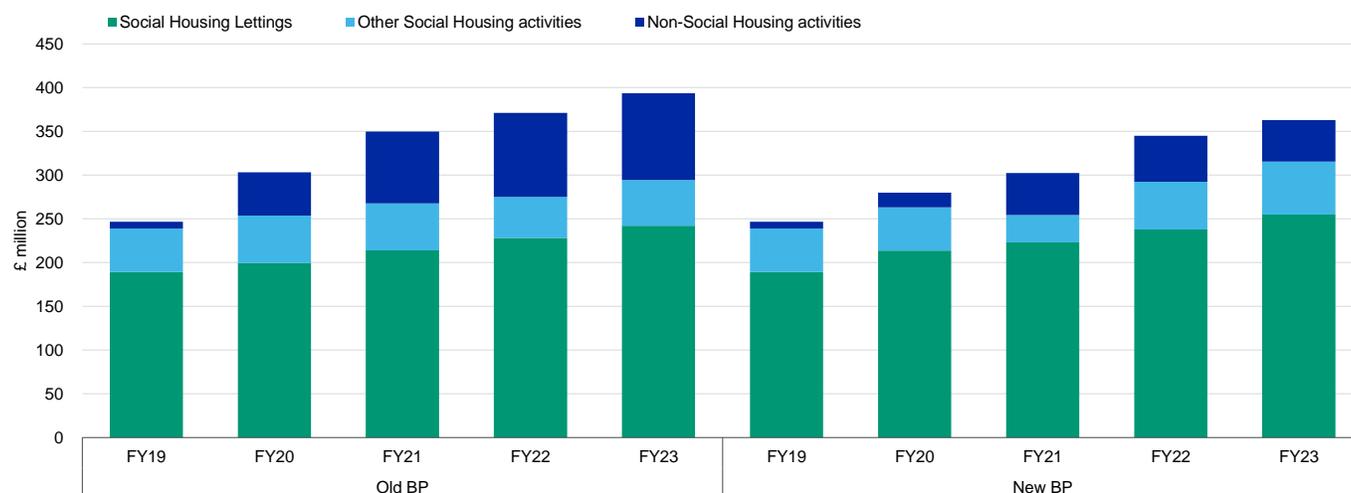
Following the mergers with Merlin and SVH in FY2019, Bromford grew its units under management by 44%, to over 42,700 from 30,000. The growth in housing stock establishes Bromford as one of the largest HAs within the regions it operates, namely the Midlands and the West of England. We find that Bromford's current scale enables the HA to carry influence in negotiations with other key market players and provide input to local and national policy. Moreover, 50% of Bromford's stock is located in four areas: Lichfield, Cotswold, Tewkesbury, and South Gloucestershire, wherein Bromford manages between 65% - 79% of the social and affordable homes, further strengthening the HA's influence in these specific areas. Bromford plans to rationalise its housing stock by disposing of units in areas where it has less presence, which would result in a reduction of 1.8% of stock and focus Bromford's scope to 40 areas from 51. The rationalisation plan is set to generate approximately £46 million in income over the coming years.

After completing the transitional period of implementing the mergers with Merlin and SVH, Bromford revisited its business plan in January 2019 and scaled back its development programme to a targeted 13,100 by FY2028 from approximately 14,100. Additionally, the HA reduced its planned exposure to market sales activity, as it was able to secure £66 million in capital grant funding through a Strategic Partnership with Homes England to deliver 1,400 affordable and intermediate homes by FY2024. While Bromford's forecast proportion of markets sales receipts to total turnover is still considered to be high, it is now set to peak at 29% in FY2022, from a previous peak of 37% in FY2021. Both the reduction in development ambition and the exposure to market sales activity are considered to be credit positive. Exhibit 3 below shows the extent to which non-social housing activities (which includes outright sales) have reduced in their contribution to total revenues in Bromford's updated business plan.

Exhibit 3

Bromford's updated revenue forecasts are slightly lower, but more of its revenue is now coming from less risky tenures

Forecast revenue by tenure; previous business plan against updated business plan



Source: Moody's Investors Service, Bromford

While we note that forecast revenues are expected to be 9% lower per year on average over the next four years, a larger proportion of Bromford's revenues will be sourced from less risky tenures. Bromford's eight new golden rules have been established as a means of

exercising financial discipline and refocusing on what it deems to be its core business; social and affordable housing provision. As such, current forecasts show that no less than 70% of revenues will come from social housing letting in future years, which is in line with Bromford's new golden rules, and is a change from the previous business plan that had this metric set to reach 60%.

Supportive institutional framework in England

The sector's credit quality will continue to benefit from the strong regulatory framework governing English HAs. The regulator maintains strong oversight through quarterly returns, long-term business plans, annual reviews, and by undertaking biennial In-Depth Assessments for large and complex HAs. Additionally, the regulator has a strong track record of intervention in cases of mismanagement or financial stress with powers to provide financial assistance and/or make manager appointments where there has been a breach of regulatory standards.

The operating environment for English HAs has improved under more supportive policies for social rent increases and capital grant. Following four years of social rent reductions, HAs will benefit from a return to inflation-linked rent increases from April 2020 for five years. In addition, the government has committed to increased capital grant on more flexible terms for new social housing. Counterbalancing the improvements, we expect policy to drive increased borrowing and development risk in the sector as it responds to the government's objective to deliver a significant increase in the construction of new homes.

Increased debt levels and financing costs weaken key metrics

Bromford's bond issuance of £300 million in May 2018, the amalgamation with Merlin, and its plan to gradually increase debt levels will weaken its debt metrics and interest cover ratios in the forthcoming years. Bromford's total debt in FY2019 is expected to be approximately £1.06 billion, resulting in the HA's debt to revenue metric rising to 4.3x from 3.6x. The HA's business plan continues its previous trajectory of gradually increasing borrowing over the next four years to fund its development programme, reaching an anticipated £1.27 billion in FY2021. Forecast revenues are expected to offset the increase in debt, thereby stabilising Bromford's debt to revenue metric at 4.3x in FY2020 before lowering to 3.9x in FY2021, as the growth rate of revenues surpasses the growth of borrowing.

Similarly Bromford's gearing, measured as debt to assets at cost, is set to increase to 44% in FY2019 from 36% in FY2018. Gearing is expected to stay stable over the next four years as Bromford's asset wealth is forecast to grow in line with its debt accumulation. The weakening of both these debt metrics places Bromford in line with its A2-rated peers.

Bromford's increased indebtedness raised interest costs to an anticipated £44 million in FY2019, from £28 million in FY2018, and these costs are expected to gradually grow in line with its debt level. The rise in financing costs has lowered the HA's interest cover ratios, with SHLIC and cash flow volatility interest cover (CVIC) expected to shift down to 1.5x and 1.97x in FY2019, from previously strong levels averaging 2.5x and 3.0x, respectively since FY2016. Both interest coverages are forecast to remain stable in future years, and are aligned with A2 rated peers.

Bromford's refinancing risk has grown in FY2019 to 30% of drawn debt being due in five years, from 5% in FY2018. However, this level still adheres to the HA's treasury policy of having a maximum of 35% of debt due with five years. We consider interest rate risk to be low as a total of 6% of Bromford's drawn debt is subject to variable rates, given Bromford's swap portfolio, which is at a notional value of £86 million, is 100% swapped to fixed rate. Bromford's management continues to take advantage of low values of options and buying out of cancellable swaps, and maintain sufficient security (£36.9 million of security charged against a negative mark-to-market position of £25.9 million as of 31st March 2019) ready to meet margin calls.

Weaker operating margins and high exposure to market sales

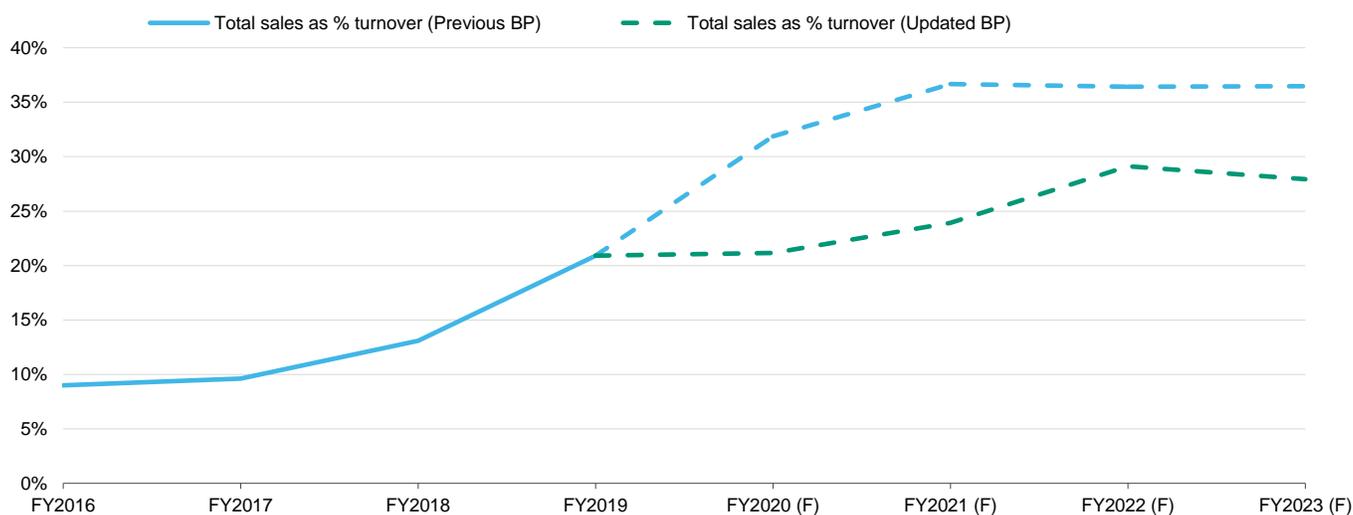
Bromford's financial performance in FY2019 is expected to marginally weaken to 31% from 33% in the previous year. While this operating margin was above the A2 rated peer median of 28% for the year, it remains significantly lower than Bromford's previous average of 40%, achieved between FY2015-2017. The drivers for Bromford's reducing operating margins continue to be the ongoing rent cut regime which has hindered social housing letting revenue growth since FY2016, but is set to be reversed in FY2020. Additionally, Bromford's margins continue to face a growing cost base related to Bromford's expansion of its Neighbourhood Coaching programme (a tenants service programme which will increase in scope following the expansion of Bromford's units under management), increased investment in the "ProgrammeOne" IT enhancement to upgrade Bromford's previous systems and consolidate

Merlin and SVH's packages, as well as lower forecast margins related to market sales activity. These investments are planned to realise about £28 million by FY2023, enhance customer satisfaction and lower voids. Operating margins are forecast to stabilise at around 31%, before increasing to 33% in FY2023. Although this margin is lower than historical levels, it remains largely in line with the trend in our rated portfolio.

The weakening in Bromford's operating profitability is also driven by incremental increases in market sales activity, which have lower margins. Bromford has historically generated a large share of its revenue from core social housing letting, averaging 85% between FY2015-2017. However, social housing letting as a percentage of revenue is projected to decline for Bromford to 73% by FY2021, from 77% in FY2019, as the HA continues a sales programme to cross-subsidise social housing provision. We note that Bromford's planned market sales exposure has reduced since the 2018 business plan (Exhibit 4) and that golden rules have been set to ensure that social housing letting revenues contribute a minimum of 70% to turnover (see "A strong market position and renewed focus on core business following mergers"). However we expect revenue from market sales activity (consisting of first tranche shared ownership and outright sales) to remain high, at above 20%, and introduce credit risk given the susceptibility these tenures have to market forces and the increased volatility in cash flow compared to more stable and predictable revenue from social housing letting.

Exhibit 4

Market sales exposure lowered in updated business plan, but still remains high Total sales as a proportion of turnover, previous and updated business plans



Source: Moody's Investors Service, Bromford

Extraordinary support considerations

The strong extraordinary support factored into the rating reflects the wide-ranging powers of redressal available to the regulator in the event of financial distress, with the possibility of a facilitated merger or a transfer of engagements. Recent history has shown that the UK government is willing to support the sector, as housing remains a politically and economically sensitive issue. The strong support assumption also factors in (1) the increasing exposure to non-core social housing activities in the sector, which adds complexity to HA operations, and (2) the weakening of the sovereign's financial resilience, making an extraordinary intervention slightly more difficult. In addition, our assessment that there is a very high default dependence between Bromford and the UK government reflects their strong financial and operational links.

ESG Considerations

How environmental, social and governance risks inform our credit analysis of Bromford

Moody's takes account of the impact of environmental (E), social (S) and governance (G) factors when assessing sub-sovereign issuers' economic and financial strength. In the case of Bromford, the materiality of ESG to its credit profile is as follows:

Environmental considerations are not material to Bromford's credit profile. In line with the rest of the UK, its main environmental risk exposures relate to water shortages and flood risk. Flood risk is managed by county and national authorities, and therefore the financial burden of adapting to increased flood risk will not fall on the issuer.

Social considerations are material to Bromford's credit profile, in line with the rest of the English housing association sector. In particular, the sector is exposed to risks from socially-driven policy agendas, and is also affected by the impact of demographic trends and customer relations on demand. Socially-driven policy agendas can be credit positive or credit negative for the sector. The broad political support for social housing in the UK is reflected in our analysis of the operating environment in the main body of this report.

On the other hand, central government's policy to increase affordability for low-income social housing tenants led to a sector-wide rent cut initiated in FY2017 which was credit negative for the sector. Customer relations and product quality can also have an impact on housing associations. The Grenfell fire tragedy in June 2017 has encouraged higher health and safety standards and led many housing associations to increase spending on the quality of their existing stock.

Governance considerations are material to Bromford's credit profile. Bromford's management and governance is strong, with policies and practices that are well aligned to its business plan and development strategy. English housing associations also benefit from a strong regulatory framework and close oversight by the Regulator of Social Housing, as detailed within the main body of this report.

Further details are provided in the "Baseline credit assessment" section above. Our approach to ESG is explained in our cross-sector methodology [General Principles for Assessing ESG Risks](#).

Rating methodology and scorecard factors

The assigned BCA of a3 is aligned with the scorecard-suggested BCA.

The methodologies used in this rating are [European Social Housing Providers](#), published April 2018 and [Government Related Issuers](#), published in June 2018.

Exhibit 5

Bromford 2018 scorecard

Bromford Housing Group

Baseline Credit Assessment	Sub-factor Weighting	Value	Score
Factor 1: Institutional Framework			
Operating Environment	10%	a	a
Regulatory Framework	10%	a	a
Factor 2: Market Position			
Units Under Management	10%	30,096	a
Factor 3: Financial Performance			
Operating Margin	5%	33.3%	a
Social Housing Letting Interest Coverage	10%	2.2x	aa
Cash-Flow Volatility Interest Coverage	10%	2.4x	a
Factor 4: Debt and Liquidity			
Debt to Revenue	5%	3.6x	baa
Debt to Assets	10%	36.1%	baa
Liquidity Coverage	10%	1.4x	a
Factor 5: Management and Governance			
Financial Management	10%	baa	baa
Investment and Debt Management	10%	baa	baa
Suggested BCA			a3

Source: Moody's Investors Service, Bromford

Ratings

Exhibit 6

Category	Moody's Rating
BROMFORD HOUSING GROUP LIMITED	
Outlook	Stable
Issuer Rating -Dom Curr	A2

Source: Moody's Investors Service

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