Research Update:

# Outlook On U.K. Social Housing Provider Bromford Housing Group Revised To Negative From Stable; 'A+' Rating Affirmed

**January 22, 2021**

PRIMARY CREDIT ANALYST

**Celia Franch Lopez**
London
+ 44 20 7176 0100
celia.franch_lopez
@spglobal.com

SECONDARY CONTACT

**Christopher Mathews**
London
+ 44 20 7176 7115
christopher.mathews
@spglobal.com

## Overview

- Our view of Bromford's creditworthiness is supported by its continued focus on traditional affordable tenures, very strong liquidity, and robust operational metrics.
- We now expect that increasing investment in existing stock to meet energy-efficiency and carbon-neutrality targets will keep adjusted EBITDA margins structurally below 30%.
- We are therefore revising our outlook on Bromford Housing Group to negative from stable and affirming our 'A+' long-term issuer credit rating.
- The negative outlook reflects that higher-than-anticipated expenditure for Bromford's existing asset base, combined with higher debt intake for development capital expenditure (capex), could pressure its debt metrics more than we currently estimate.

## Rating Action

On Jan. 22, 2021, S&P Global Ratings revised to negative from stable its outlook on U.K.-based social housing provider Bromford Housing Group Ltd. (Bromford). At the same time, we affirmed our 'A+' long-term issuer credit rating on Bromford.

We also affirmed our 'A+' long-term issue ratings on the £300 million and £250 million senior secured bonds issued by Bromford.

## Rationale

The outlook revision reflects the deterioration in the group's adjusted EBITDA margins, which, combined with its increasing debt burden, could put more pressure on its debt than we currently forecast. The deterioration in profitability is being driven by higher capitalized repairs in its existing homes, to meet future energy efficiency targets, and weaker inflation and economic conditions as a result of COVID-19 that we expect will affect both rental revenue growth and margins on development-for-sale activities. Despite pressuring profitability, we view its increasing investments in stock as supporting its excellent asset quality. Bromford's stock complies 100% with the Decent Homes Standard, and its future energy efficiency targets are part of its wider environmental, social, and governance (ESG) framework. These targets are not only embedded in its business plan, but are also the key metrics referenced in one of Bromford's sustainability-linked facilities.

As with other English housing associations, we believe there is a moderately high likelihood that Bromford would receive extraordinary support from the government in case of financial distress. As such, we apply one notch of uplift to the stand-alone credit profile to derive the long-term issuer credit rating. Bromford's primary purpose is to provide affordable homes, supporting important policy objectives of the U.K. government. We consider that the Regulator of Social Housing (RSH), a government agency, regulates Bromford to promote a viable, efficient, and well-governed social housing sector, and maintain lender confidence and low funding costs across the sector. It is therefore our view that the RSH would step in to prevent a default in the sector, based on its record of being willing and able to provide extraordinary support on a timely basis.

The affirmation reflects our expectation that Bromford will adhere to its strategy and focus on the delivery of 12,000 new homes by 2029 as part of its "New Homes Plan". The group's development ambitions remain in line with last year's and aligned well with management's capabilities, with only a minor re-profiling of units in the current fiscal year due to COVID-19-related delays. Bromford's very robust liquidity and treasury policies, and strategic partnership with Homes England, support these efforts--as seen in the group securing funding well in advance of development delivery. Bromford is targeting its development efforts within its existing core geographies in the Midlands and Southwest, while rationalizing stock in areas of lower concentration. We note consistency in the breakdown between tenures of the development plan: we forecast that, similarly to last year, social and affordable rental tenures will represent 58% of total development, with shared ownership first tranche sales at around 30% and outright sales at 13%. Although sales account for a significant portion of the development plan, the group has a golden rule stipulating that it will derive no more than 30% of its total revenues from sales-related activities. We do not expect Bromford will breach this internal rule; we forecast sales revenue as a percentage of total revenue will peak at 24% in financial year 2023 (FY2023; ending March 31, 2023).

Bromford benefits from strong demand for its properties, evidenced by very strong operational metrics and long waiting lists in its core geographies. Voids have remained low at 0.9% on average over the last three years and gross arrears were 4.3% at end-FY2020, which is stronger than for most local peers. We do not expect arrears will increase on a sustained basis because of COVID-19 given that Bromford's income collection team is offering support to vulnerable tenants as they transition to Universal Credit. However, economic conditions in its areas of operations are weaker than in other U.K. regions. Long-term population growth of 0.6%, combined with average social housing rents in the Midlands and Southwest of 66% of market rents, constrain our view of economic conditions. Peers in the Southeast and London benefit from larger discounts between social and market rents.

Our base case is now that adjusted EBITDA margins will remain structurally below 30%, constrained by increasing investments in existing stock, lower inflation, weaker economic conditions, and a significant share of lower-margin development-for-sale activities. A limited ability to deliver repairs and maintenance expenditure due to pandemic constraints will lead to temporarily higher margins in FY2021.

We forecast that interest coverage will remain very solid, but that debt to adjusted EBITDA will deteriorate to structurally above 15x. Higher leverage will stem from worsening profitability combined with an increase in nominal debt. However, the group's robust treasury policy will continue to support its interest coverage. Bromford carried out significant treasury operations during 2020, securing £190 million of deferred funding with very low yields, refinancing legacy debt, and restructuring some of its revolving credit facilities (RCFs). Through these funding agreements, it has lowered its overall cost of debt and ensured that, despite a nominal increase in the debt burden, group interest coverage will remain very solid at 1.7x on average in FY2021-FY2023. If we looked at interest cover from social housing revenues alone, Bromford would still cover interest expenses by more than 1.5x over the forecast period, which reflects its traditional nature and strong core operating margins.

### Liquidity

We view Bromford's liquidity position as very strong on the back of its continued treasury activities since the merger: the issuance of two public bonds, three private placements, and the restructuring of its RCFs. Through these funding agreements, the group has secured facilities in advance of the delivery of its ambitious development plan. Over the next 12 months, we estimate sources of liquidity will cover uses by 2.9x, supported by the group's comprehensive liquidity policies and golden rules. We view its access to external liquidity as satisfactory; Bromford has tapped the public debt capital markets twice since the merger and holds facilities across a range of national and international lenders.

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

- £109 million from cash flow from operations;
- £197 million cash and liquid investments;
- £30 million from asset sales;
- £538 million of committed undrawn facilities; and
- £22 million of grant funding.

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

- £236 million of expected capex; and
- £75 million of interest and principal repayments.

## Outlook

The negative outlook reflects our view that higher-than-anticipated expenditure on its stock, combined with increased debt for development capex, could pressure the group's debt metrics more than we currently estimate.

### Downside scenario

We could lower the rating on Bromford if further pressure on profitability or increased development efforts increased its debt to adjusted EBITDA to or above 20x. This could also lead us to revise downward our view of the group's financial policies. We could also lower the rating if we observed a material deterioration in the liquidity position. In addition, we could lower the rating if we thought that the likelihood of timely extraordinary support from the U.K. government had decreased.

### Upside scenario

Alternatively, we could revise the outlook to stable if the group performs in line with our base case while keeping exposure to sales activities limited to below one-third of total revenues.

## Key Statistics

Table 1

### Bromford Housing Group Key Statistics

| | --Year ended March 31-- | | | | |
|---|---|---|---|---|---|
| (Mil. £) | 2019a | 2020a | 2021e | 2022bc | 2023bc |
| Number of units owned or managed | 43,674 | 44,480 | 44,990 | 45,840 | 47,163 |
| Revenue§ | 251.9 | 266.0 | 254.1 | 273.5 | 317.8 |
| Share of revenue from sales activities (%) | 21.0 | 18.2 | 11.7 | 15.6 | 23.7 |
| EBITDA§† | 75.3 | 76.0 | 81.9 | 74.5 | 79.6 |
| EBITDA/revenue §†(%) | 29.9 | 28.6 | 32.2 | 27.2 | 25.1 |
| Capital expense† | 167.2 | 152.5 | 183.3 | 253.3 | 297.5 |
| Debt | 1,186.6 | 1,239.7 | 1,257.9 | 1,425.7 | 1,539.8 |
| Debt/EBITDA §†(x) | 15.8 | 16.3 | 15.4 | 19.1 | 19.3 |
| Interest expense* | 42.1 | 44.0 | 43.6 | 45.7 | 49.3 |
| EBITDA/interest coverage§†* (x) | 1.8 | 1.7 | 1.9 | 1.6 | 1.6 |
| Cash and liquid assets | 232.1 | 195.1 | 127.0 | 148.8 | 104.5 |

§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.

## Ratings Score Snapshot

Table 2

### Bromford Housing Group

| | |
|---|---|
| Industry Risk | 2 |
| Economic fundamentals and market dependencies | 4 |
| Strategy and management | 3 |
| Asset quality and operational performance | 1 |
| Enterprise profile | 3 |
| Financial performance | 5 |
| Debt profile | 3 |
| Liquidity | 2 |
| Financial policies | 2 |
| Financial profile | 3 |

Table 2

### Bromford Housing Group (cont.)

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: Principles Of Credit Ratings, Feb. 16, 2011
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010

## Related Research

- Global Social Housing Ratings Risk Indicators: December 2020, Dec. 10, 2020
- Global Social Housing Ratings Score Snapshot: December 2020, Dec. 10, 2020
- Outlook 2021: Strong Liquidity Should Help Social Housing Providers Remain Resilient, Dec. 8, 2020
- United Kingdom 'AA/A-1+' Ratings Affirmed; Outlook Stable, Oct. 23, 2020
- ESG Industry Report Card: Public And Nonprofit Social Housing Providers Outside The U.S., Aug. 4, 2020
- U.K. Social Housing Providers Should Remain Largely Resilient To Short-Term Economic Difficulties From COVID-19, April 23, 2020
- U.K. Social Housing Ratings History: February 2020, March 3, 2020
- Why Most Rated U.K. Social Housing Providers Are At Home In The 'A' Category, Dec. 3, 2019

## Ratings List

**Ratings Affirmed; Outlook Action**

| | To | From |
|---|---|---|
| **Bromford Housing Group Ltd.** | | |
| Issuer Credit Rating | A+/Negative/-- | A+/Stable/-- |
| Senior Secured | A+ | |

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors,