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Research Update:

U.K. Social Housing Provider bpha 'A+' Rating Affirmed; Outlook Revised To Negative On Increasing Market Exposure

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Overview

- We project that U.K.-based bpha Ltd. will increase its exposure to market-related activities over the coming three years, although not exceeding one-third of revenues.
- We view these activities, such as shared ownership sales and outright sales, as higher risk than traditional social housing activities, leading to less predictable revenues.
- We are therefore revising our outlook on bpha to negative and affirming our 'A+' rating.
- The increasing proportion of nontraditional revenues, in combination with a government-imposed rent cut until 2020, is leading to weaker interest and debt coverage for the social housing activities, although we think coverage could improve again in 2020 when the rent cut disappears.

Rating Action

On Oct. 4, 2018, S&P Global Ratings revised its outlook on U.K.-based social housing provider bpha Ltd. to negative from stable. At the same time, we affirmed our 'A+' long-term issuer credit rating on bpha.

We also affirmed our 'A+' long-term rating on the £200 million senior secured bonds issued by bpha Finance PLC.

Rationale

The negative outlook reflects our view that bpha is likely to increase its exposure to market-related activities over the next three years. However, currently we don't expect these activities will account for more than one-third of revenues over the coming two years.

The increase in revenues from market-related activities reflects a broader sector-wide shift, which includes more outright sales and shared ownership first-tranche sales. Unlike traditional rental activities, these expose housing associations to the cyclicality of the residential property development sector and potentially more volatile revenues, which reduces the visibility and predictability of future earnings compared with a traditional social housing association providing mainly social rent properties. In addition, the growth of this sector is less predictable than social housing, given the significantly higher level of competition.

We project that bpha's revenues from shared ownership first-tranche sales and outright sales are rising, given bpha's current development program. Our view is that consumer confidence, disposable income, employment levels, and growth, as well as interest rates and the availability of mortgage loans, ultimately drive demand for properties for sale, which heightens revenue and earnings volatility. Additionally, high variability in numbers of sales and property valuations, as manifested by recent fluctuations in U.K. housing prices, render social housing groups vulnerable to business cycle blips.

We continue to think that bpha benefits from strong economic fundamentals and excellent asset quality. Its properties are located in the rapidly growing Oxford-Cambridge corridor close to London, where population growth is more than 1.1%--higher than average for the U.K. In combination with relatively low rents for its social and affordable housing properties compared with market rents, this ensures solid demand for its properties. We also factor into our assessment of bpha's high asset quality the very low average age of its properties (around 29 years), and the generally low vacancy rates of less than 2%.

Despite a rising volume of low-margin sales operations, we expect bpha to maintain strong EBITDA margins of 44.5% on average over our forecast horizon, which is high in a peer perspective, and solid EBITDA interest coverage as management continues to work actively to curb cost development. We forecast that the EBITDA should remain sufficient to cover interest payments by 1.8x on average over the next three years. bpha's strong social housing EBITDA will, in our opinion, ensure that social housing lettings cover interest payments by 1.3x over the same period, further supported by the removal of the government-imposed rent cut in 2020, which will allow an increase in social housing rent.

We project moderate debt accumulation over the next two years, such that debt to EBITDA falls back to 11.3x from a peak this year of 13.7x. We project that bpha will be able to fund a large part of the capital expenditure program over the next three years with internally generated cash flows, including proceeds from the sale of new and existing properties. As a result, we project the loan-to-value ratio will strengthen over the coming years to 59% in 2021, from 69% in 2018. bpha plans to deliver 3,000 new homes between 2018 and 2022. Under our base case, bpha will build 1,744 new homes over the next three years, the vast majority of which will be affordable rent and shared ownership, with a small number of outright sales.

In our opinion, there is a moderately high likelihood that the U.K. government--working through the Regulator of Social Housing--would provide timely and sufficient extraordinary support to bpha in the event of financial distress. This is a neutral factor for the ratings. We base our view of the likelihood of extraordinary government support on our assessment of bpha's important role for the U.K. government, its public policy mandate, and its strong link with the U.K. government, demonstrated by the government's track record of providing strong credit support in certain circumstances.

Liquidity

We consider bpha's liquidity position to be very strong. In our base case over the next 12 months, we estimate that sources of funds will cover uses by 1.89x.

Sources of liquidity include:

- Cash flows from operations of close to £58 million;
- Cash and cash equivalent of £33 million;
- Proceeds from asset sales of £23 million; and
- Available funds under undrawn committed facilities of close to £155 million.

Uses of liquidity include:

- Capital expenditure of £100 million; and
- Interest and principal repayment of about £42 million.

We continue to assess bpha's access to external liquidity as satisfactory. We believe that bpha will be able to maintain strong headroom under its covenants, and we do not see any risk to its ability to continue to draw on its credit facilities.

Outlook

The negative outlook reflects the risk over the next two years that the proportion of nontraditional revenues could increase beyond our base-case expectation, to the extent that we would no longer assess the industry risk as in line with low-risk core social housing activities. Further downward pressure could come from a weakening in bpha's social housing financial performance and debt profile.

We could revise the outlook back to stable if we observed a leveling out or decline in the proportion of revenues from nontraditional activities to a level structurally below one-third of total revenues, together with stable financial performance and a continued moderate debt level.

Table 1

bpha Ltd. Key Statistics

	--Year ended March 31--				
(Mil. £)	**2017a**	**2018a**	**2019bc**	**2020bc**	**2021bc**
Number of units owned or managed	18,186	18,253	18,861	19,471	19,957

Table 1

bpha Ltd. Key Statistics (cont.)

	--Year ended March 31--				
(Mil. £)	2017a	2018a	2019bc	2020bc	2021bc
Vacancy rates (% of rent net of identifiable service charge)	1.3	1.6	N.A.	N.A.	N.A.
Arrears (% of rent net of identifiable service charge)*	4.1	4.3	N.A.	N.A.	N.A.
Revenue§	122.4	117.3	123.7	145.1	148.0
Share of revenue from nontraditional activities (%)	24.7	19.2	21.4	31.4	28.8
EBITDA†	59.9	60.5	56.5	60.1	68.2
EBITDA/revenue (%)	49.0	51.6	45.7	41.4	46.0
Interest expense	35.9	34.1	34.6	35.1	34.9
Debt/EBITDA (x)	12.5	12.3	13.7	12.8	11.3
EBITDA/interest coverage** (x)	1.7	1.8	1.6	1.7	2.0
Capital expense	70.8	80.8	105.9	93.7	92.4
Debt	751.2	744.1	774.6	771.3	768.8
Housing properties (according to balance sheet valuation)	1,011.6	1,075.9	1,159.0	1,232.4	1,299.0
Loan to value of properties (%)	74.3	69.2	66.8	62.6	59.2
Cash and liquid assets	57.7	30.1	32.7	33.6	23.9

*Rent and service charge arrears. §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.

Table 2

bpha Ltd. Ratings Score Snapshot

Industry risk	2
Economic fundamentals and market dependencies	3
Strategy and management	2
Asset quality and operational performance	1
Enterprise profile	2
Financial performance	3
Debt profile	3
Liquidity	2
Financial policies	2
Financial profile	3

S&P Global Ratings bases its ratings on nonprofit 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 standalone 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: Group Rating Methodology, Nov. 19, 2013
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Ratings List

Ratings Affirmed; Outlook Action

	To	From
bpha Ltd.		
Issuer Credit Rating	A+/Negative/--	A+/Stable/--
bpha Finance PLC		
Senior Secured	A+	A+

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Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column. Alternatively, call one of the following S&P Global Ratings numbers: Client Support Europe (44) 20-7176-7176; London Press Office (44) 20-7176-3605; Paris (33) 1-4420-6708; Frankfurt (49) 69-33-999-225; Stockholm (46) 8-440-5914; or Moscow 7 (495) 783-4009.