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Research Update:

U.K.-Based Housing Association bpha Ltd. 'A+' Rating Affirmed; Outlook Remains Negative

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Overview

- We expect housing association bpha Ltd. to continue focusing on the development of affordable housing in the South East of the U.K., a dynamic region where strong demand for bpha's units underpins its high operating margins.
- The group has improved its liquidity position, which supports the group's strong financial profile.
- We are therefore affirming our 'A+' long-term issuer credit rating on bpha.
- The negative outlook reflects the risk that, over the next two years, bpha's exposure to market-related revenues could increase beyond our base case, which would put pressure on operating margins and debt metrics.

Rating Action

On Oct. 16, 2019, S&P Global Ratings affirmed its 'A+' long-term issuer credit rating on U.K.-based social housing association bpha Ltd. (bpha). The outlook remains negative.

Rationale

We continue to assess bpha as having a very strong enterprise profile, underpinned by its high proportion of revenues derived from traditional social housing lettings activities, its dynamic area of operations, and its excellent asset quality.

The group operates across the South East of England, with core operating areas in Oxfordshire, Bedfordshire, and Cambridgeshire. This region remains one of the most dynamic regions of England in terms of economic fundamentals such as population growth, the ratio of social rent to market rent, and house price growth. The strong demand for social housing in its area of operation supports the group's strong operational metrics compared to peers and high operating margins from traditional lettings activities.

Management has a strong focus on asset quality, having established its own "Homes Standards" for its housing stock. These standards go beyond the government's Decent Homes Standards and look at environmental policies, energy efficiency, construction best practices, and value for money. An integral part of bpha's asset strategy is their tower block regeneration project. The group aims to refurbish 14 tower blocks over the next 10 years with an expected investment of £65 million to enable these buildings to meet the group's environmental standards, become energy efficient, and have lower ongoing maintenance costs.

We expect that the group will develop around 1,800 affordable units and about 80 units for outright sale over the financial years (FY) 2020-2022. We expect that 59% of the development will be for affordable lettings, 37% for shared ownership, and 4% for private sale. We view bpha's management as having extensive experience in the social housing sector, with a development strategy that is aligned to its capabilities. The group has recently appointed a new chief financial officer, Julian Pearce, with both private sector and public sector experience. We expect bpha will deliver this development plan, and maintain operations focused on affordable housing.

We forecast bpha will increase its exposure to market-related activities to an average of 27% over our forecast period FY2020-FY2022, peaking at 29% in FY2021, from 21% in FY2019. Beyond FY2021, we expect that bpha will taper its development for sales program and sales exposure will decline. We do not expect bpha's exposure to sales to exceed one-third of revenues.

These development-for-sale activities carry higher volatility and lower margins than traditional social housing lettings (we expect operating margins of around 20% for outright sales compared to 40% on the traditional lettings business), and we forecast that they will weaken the group's operating margins. Combined with higher capitalized repairs linked to the group's increased investment efforts in its existing stock, we expect that adjusted margins will average 41% over our forecast period FY2020-2022 compared to 46% in FY2019. Should sales prices were lower than our baseline, margins could fall below 40%.

We forecast that bpha will increase its debt burden by around £150 million over FY2020-FY2022, a change from our previous expectation that the group would deleverage. Higher capital expenditures of around £300 million and debt repayment of around £30 million over the next three years will require the group to draw from its large available undrawn revolving credit facilities or issue its retained bond. However, we expect management to maintain a moderate debt burden below 15x EBITDA and interest coverage above 1.5x.

The 'A+' rating on bpha is at the same level as its stand-alone credit profile. 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, but this currently provides no uplift for the rating. 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 view liquidity as a rating strength for bpha, underpinned by the group's strong financial policies. Bpha has established a target of maintaining at all times funding facilities sufficient to cover two years of development expenditure. Our view of its very strong liquidity is supported by a high level of committed undrawn bank facilities, the secured part of its retained bond, and its potential to generate cash consistently in our base case. We estimate sources to cover uses by 2.38x.

Bpha's sources of liquidity are:

- Adjusted EBITDA for next 12 months of £59 million.
- Cash and liquid investments of £8 million.
- Proceeds from asset sales of £18 million.
- The undrawn part of its contracted and secured bank facilities maturing beyond 12 months, amounting to £189 million.
- The secured part of its retained bond standing at £27 million.

The company's uses of liquidity are:

- Expected capital expenditures adjusted for cost of sales and capitalized repairs, amounting to £80 million.
- Interest and principal repayment of £47 million.

We view bpha's access to external liquidity as satisfactory.

Outlook

The negative outlook on bpha reflects the risk that, over the next 12 months, rising exposure to sales revenue and market uncertainties could put pressure on bpha's financial risk profile. We could lower the rating on bpha if the group's financial performance and debt metrics deteriorate materially and if we lower the sovereign ratings on the U.K. due to a disruptive exit from the European Union.

We could revise the outlook to stable if market risks subside or if we observe a track record of management maintaining a moderate debt level and strong financial performance despite market risk.

Key Statistics

Table 1

bpha Ltd. Key Statistics

	--Year ended March 31--				
(Mil. £)	**2018a**	**2019e**	**2020bc**	**2021bc**	**2022bc**
Number of units owned or managed	18,253	18,721	19,367	19,847	20,340
Vacancy rates (%)*	1.6	0.9	N.A.	N.A.	N.A.
Arrears (%)*	4.3	4.7	N.A.	N.A.	N.A.
Revenue§	117.1	124.3	133.6	151.3	156.3
Share of revenue from nontraditional activities (%)	18.2	20.7	24.2	29.3	27.5
EBITDA§†	60.3	57.5	56.6	60.2	63.2
EBITDA/revenue §†(%)	51.5	46.3	42.4	39.8	40.5
Interest expense**	34.1	36.9	38.6	40.6	42.5
Debt/EBITDA §†(x)	12.3	13.6	14.6	14.4	14.3
EBITDA/interest coverage§†** (x)	1.8	1.6	1.5	1.5	1.5

Table 1

bpha Ltd. Key Statistics (cont.)

	--Year ended March 31--				
(Mil. £)	2018a	2019e	2020bc	2021bc	2022bc
Capital expense†	80.8	124.7	83.6	80.8	84.4
Debt	738.9	781.5	826.5	866.4	906.2
Housing properties (according to balance sheet valuation)	1,075.9	1,170.6	N.A.	N.A.	N.A.
Loan to value of properties (%)	68.7	66.8	N.A.	N.A.	N.A.
Cash and liquid assets	30.1	26.4	31.7	35.8	33.5

*Rent and service charge. §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

bpha Ltd. Ratings Score Snapshot

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Note: 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 "Key Credit Factors For The Homebuilder And Real Estate Developer Industry."

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- 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

Ratings List

Ratings Affirmed	
bpha Ltd.	
Issuer Credit Rating	A+/Negative/--
bpha Finance PLC	
Senior Secured	A+

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.